FUNDAMENTALS

SOUTH AFRICA: ESKOM RELIEF PUSHES DEBT STABILIZATION FURTHER

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IN BRIEF

- Finance Minister Enock Godongwana presented the FY24 budget on Wednesday 22 February 2023
- Against the 2022 Medium Term Budget Policy Statement (MTBPS) projections, 2023 growth was revised lower from 1.60% to 0.9%, majorly on the drag of protracted load-shedding. Nonetheless, the National Treasury is more optimistic about the growth prospects compared to the South African Reserve Bank, SARB (2023: 0.3%)
- Debt relief totaling ZAR 254.0bn to Eskom was announced in the budget, comprising of ZAR 184.0bn in loan advances between FY24 – FY26 and ZAR 70.0bn in direct loan takeover in FY26.
- Although the debt relief has resulted in a higher projected positive primary balance from FY24 through FY26, the downside is that debt stabilization is now expected in FY26 (73.6% of GDP).
- Eskom is expected to meet strict conditions but there is less clarity around settlement of the municipalities' arrears (c. ZAR 56.3bn) owed to the state utility company.
- The FY24 budget did not pencil any positive tax adjustments but offered tax relief totaling ZAR 13.0bn. With an expectation of revenue overrun, this implies neutral tax adjustments in FY24.
- Details were light on the status of the three SOEs that received Special Appropriations in FY23, although there is proposed funding to South African Airways and South African Post Office in FY24.

2023 growth slashed on load-shedding

As widely expected, the National Treasury penciled in a more sluggish 2023 growth rate (0.9%) against the projections during the October 2022 Medium Term Budget Policy Statement (MTBPS). Loadshedding – currently at Stage 6[1] for an indefinite period – continues being a major drag to a more durable economic recovery. New investment and business confidence is also likely to be dampened by the slow pace of structural reforms, more so in the energy sector, coupled with the consensus weak global demand. Household consumption in 2023 is expected to grow at 1.0%, constrained by the tight financial conditions to curb the rising inflation. Nonetheless, the National Treasury has maintained the COVID-19 social relief of Distress Grant, to cushion the most vulnerable households. Mr. Godongwana, however struck a more positive tone, about the knock-on positive effects from a China re-opening.

The National Treasury's growth rate is somewhat optimistic compared to South African Reserve Bank (SARB) that has a 0.3% print, as per the January Monetary Policy Committee (MPC) forecast. The point of convergence is on inflation projections; the National Treasury and the SARB project FY24 inflation at 5.3% and 5.4%, respectively. Second-round effects of the global oil price surge and food prices elevated the headline print last year but is expected to taper off slightly this year. However, the 18.7% increase in electricity tariff – approved by the National Energy Regulator of South Africa – and scheduled to take effect at the start of FY24[2], will give inflation some legs. This tees up the odds of a preemptive rate hike in next month's Monetary Policy Committee meeting.

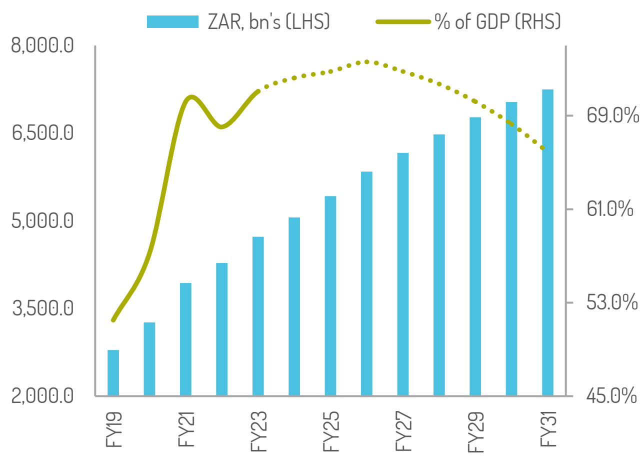
Conditionalities pegged to Eskom debt relief

If there is one thing that united the market ahead of the FY24 budget presentation, undoubtedly, was the confirmation bias around Eskom's debt relief. Mr. Godongwana met market expectations in this point by announcing a ZAR 254.0bn debt relief to Eskom. The government will advance Eskom interest-free subordinated loan totaling ZAR 184.0bn between FY24 – FY26, and ZAR 70.0bn direct loan takeover from FY26. The debt relief comprises of ZAR 168.0bn amortization and ZAR 86.0bn interest costs. With total debt stock estimated at ZAR 423.0bn, the amortization component of the debt relief represents 39.7% of the debt stock. We like the timing of the debt relief, in that the Guarantee Framework Agreement (GFA) that resulted in ZAR 350.0bn of Eskom's debt guaranteed by the government is expiring at the end of FY23.

The debt relief program has resulted in a higher primary surplus (ZAR 65.1bn; 0.9%) of FY24's main budget, above the previous expected ZAR 3.2bn (0.0%) during the tabling of FY23 budget. This primary surplus is expected to be maintained through FY26 (ZAR 138.3bn; 1.7%), as the debt relief transfers the Eskom debt burden from the non-interest expenditure component to debt servicing component. As such, the stock of public debt is expected to stabilize at ZAR 5.84tn (73.6% of GDP) in FY26 from the projected ZAR 5.01tn in FY24 (72.2% of GDP). Actual borrowing requirements totaled ZAR 118bn – 64.1% of the loan advances in FY24 – FY26 – with the remaining ZAR 66bn being a cash transfer (during FY24) as provided in the FY20 budget.

The debt relief has not been a costless exercise as Eskom will be required to adhere to several conditions. Capex for the state utility company will be restricted to transmission and distribution projects. Eskom will not be allowed to carry out any greenfield generation projects in the next three fiscal years. Proceeds from sale of non-core assets – Eskom Finance Company and some assets within the property portfolio – will be used to settle debt service costs during the debt-relief period. Finally, Eskom will not be allowed to raise new debt during the debt relief period. Although the telegraphed 18.7% increase in electricity tariffs will partly restore Eskom's topline, there remains some downside risks on the utility's fiscal position. Municipalities' arrears to Eskom stand at c. ZAR 56.3bn, but the National Treasury did not provide clear way forward to settling these obligations.

GROSS PUBLIC DEBT



SOURCE: THE NATIONAL TREASURY

[1] Eskom to shed off 6,000MW to stabilize its grid

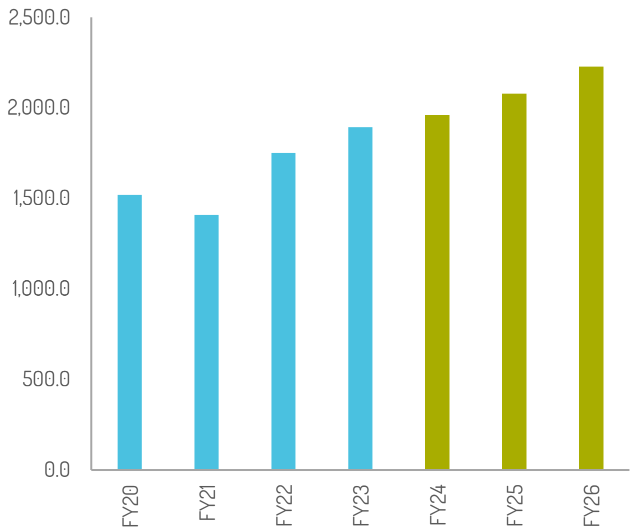
[2] 1 April 2023 – 31 March 2024

Revenue overruns = neutral tax adjustments

The National Treasury expects a positive run rate in FY24, penciling in consolidated budget revenue at ZAR 1.96tn (+ ZAR 66.2bn y/y). The elevated commodity price was a major boon to corporate income tax segment, leading to the revenue overruns in the first nine months of FY23. As has been the norm in the current fiscal year, the finance minister telegraphed that any higher-than-anticipated revenue will be directed to plug the consolidated fiscal deficit (ZAR 283.7bn; -4.0% of GDP).

The FY24 budget took a more cautious approach, with no major adjustments to the tax code. Bar the inflation-adjustments of 4.9% in FY24 on the personal income tax brackets and sin tax (alcohol and tobacco), there was no material upward tax adjustments. The ZAR 1.0bn funding to South Africa Revenue Service (SARS) will assist the government's efforts in tax administration and collection efforts. There was also cheer as the FY24 budget effected an overall ZAR 13.0bn tax relief, mainly within the energy sector: rooftop solar tax incentive for individuals (ZAR 4.0bn), expansion of section 12B – renewable energy incentive (ZAR 5.0bn) and neutral change in the general fuel levy (ZAR 4.0bn). With expectations of revenue overrun spilling into FY24, we do not expect material tax increases during FY24.

REVENUE, ZAR BN'S



SOURCE: THE NATIONAL TREASURY

The status update was light on FY23 Special Appropriations to SOEs

Current payments, inclusive of debt service costs, account for 61.2% of the total ZAR 2.24tn spending requirements in FY24. The COVID-19 social relief of distress grant has been allocated ZAR 36.1bn. Discussions around permanency of this grant, initially to lapse at the end of the current fiscal year but extended to FY24, is still ongoing. The National Treasury remained tight-lipped regarding the ongoing wage negotiations but cautioned against unaffordable public-service wage bill settlements. That notwithstanding, ZAR 15.0bn was allocated in the FY24 budget to fund the carry-through of FY23 public sector wage increase.

Conditional in-year allocations, provided via the Special Appropriations Act (2022) and totaling ZAR 30.0bn, were extended to three SOEs facing financial distress. Denel was allocated ZAR 3.4bn to meet its turnaround plan. Policy inertia around the user-pays principle has hampered South African National Roads Agency Limited (SANRAL) toll portfolio and as such clipped its ability to service its debt obligations. SANRAL was allocated ZAR 23.7bn in the Special Appropriations, while Transnet was allocated ZAR 2.9bn as funding to repair infrastructure damaged by the April 2022 flooding. Details were light as to the progress by the SOEs to meet the set conditions in the FY24 budget. Nonetheless, the FY24 budget has realized ZAR 1.0bn towards South African Airways business rescue program and ZAR 2.4bn for South African Post Office's turnaround plans.

REVISED FY23 AND PROPOSED FY24 BUDGETS, ZAR BN'S

	Revised FY23	Proposed FY24
Taxes on income and profits	989.88	1,021.21
Goods and Services tax	581.87	642.77
Others	120.43	123.48
Gross Tax Revenue	**1,692.18**	**1,787.46**
Non-tax revenue	55.08	51.58
Less: SACU payments	-43.68	-79.81
Main Budget revenue	**1,703.57**	**1,759.23**
Other revenue	189.18	199.68
Consolidated budget revenue	**1,892.75**	**1,958.91**
Current payments	1,299.36	1,355.81
Transfers and subsidies	731.23	767.06
Capital assets payments	91.90	110.67
Financial assets payments	46.31	4.05
Consolidated budget expenditure	**2,168.80**	**2,237.59**
Consolidated budget balance	**-276.05**	**-283.68**

SOURCE: THE NATIONAL TREASURY

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