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OVERVIEW

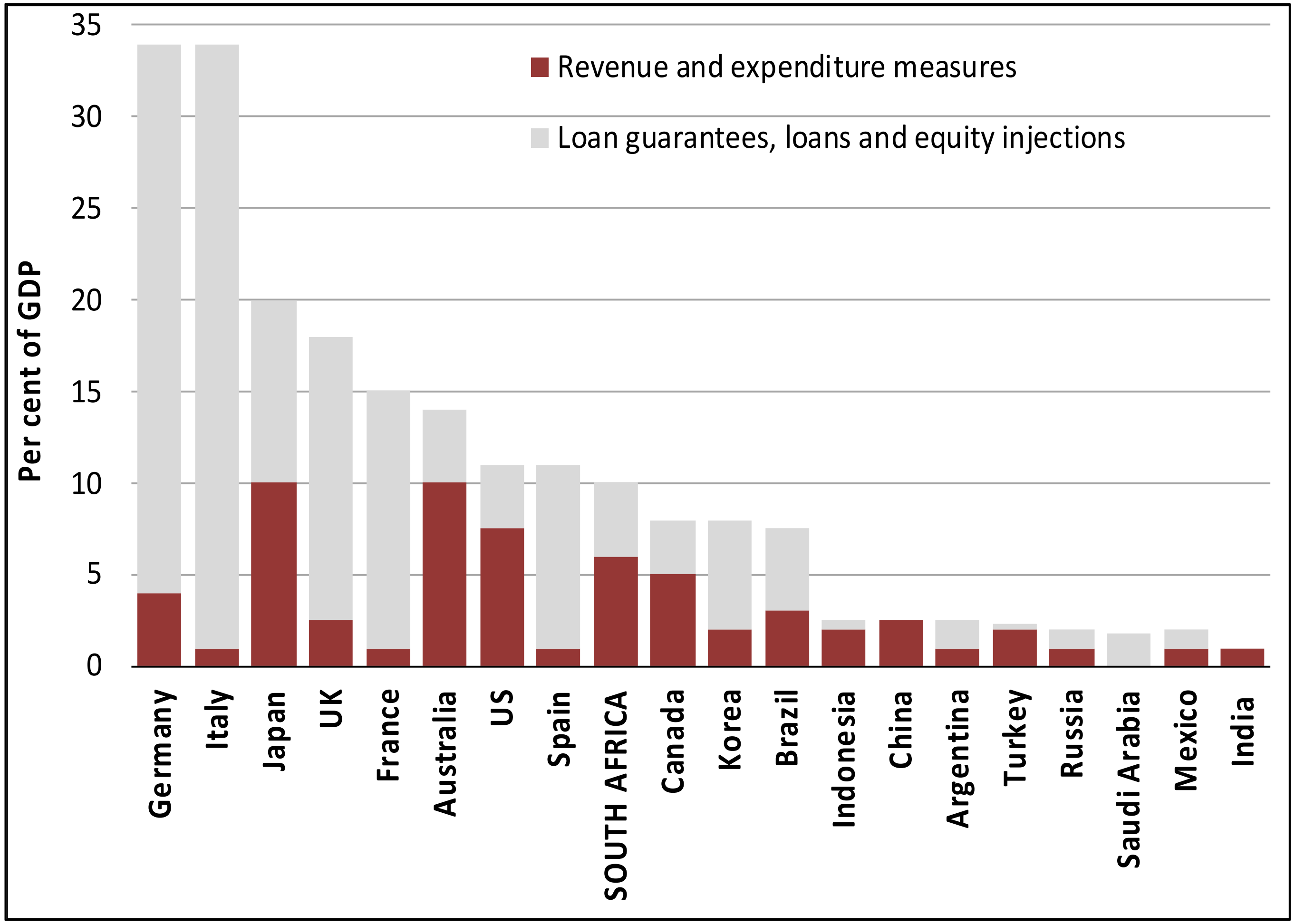
- This special adjustments budget has a dual purpose:
  - It reports on the COVID-19 fiscal measures, and the resulting adjustments to the division of revenue and departmental allocations
  - It also sets out government's commitment to strengthen the public finances, and to position the economy for faster and inclusive growth
- Government has responded to the COVID-19 pandemic with large-scale economic relief measures. Support is targeted at the most vulnerable South Africans. These steps will also build the capacity of the public health system to respond to the pandemic.
- The National Treasury expects the economy to contract by 7.2 per cent in 2020. Households and firms are grappling with the combined effects of economic restrictions and the continued spread of the virus.
- The public finances, which had reached an unsustainable position before the pandemic, are now dangerously overstretched. Without urgent action in the 2021 budget process, a debt crisis will follow.
- This special adjustments budget is a bridge to the October 2020 Medium Term Budget Policy Statement. Over the next several months, government will prepare a set of far-reaching reforms. Determined implementation of these measures will stabilise public debt, contain the budget deficit, and fully restore economic activity to build confidence, increase investment and promote job creation.

KEY POINTS ON ECONOMIC INTERVENTIONS RE: COVID-19

- Overall intervention is among the largest in the developing world
- Monetary Policy:
  - SARB cut interest rates by 250 bps – the median among emerging market countries is 100bps
  - Liquidity programme helped lower the 10yr bond yield from a high of 12.4% to 9%
- Fiscal Policy:
  - Mildly expansionary before the pandemic
  - Cyclically-adjusted primary balance in 2020/21 indicates South Africa's fiscal stance is more expansionary than many peer EM countries
  - The broad fiscal package amounts to more than 10% of GDP
- Rebuilding Policy buffers
  - Pre-crisis fiscal position: poor capacity to respond to crises. The fiscus is now dangerously unprepared for another shock nor supporting public investment
  - Buffers can be rebuilt by immediately targeting a primary surplus in the next few years

ANNOUNCED FISCAL PACKAGE IS LARGER THAN IN OTHER DEVELOPING COUNTRIES IN THE GROUP OF 20

Comparison of economic support announced by G20 governments



THE ECONOMIC ENVIRONMENT HAS WORSENED SINCE BUDGET 2020

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Global conditions have deteriorated significantly, with a global recession in 2020 now inevitable

- Risks around COVID-19 pandemic continue to play out, weighing on economic activity and sentiment
- High frequency activity data points to economic impact being far worse than the global financial crisis

Domestically, growth in Q4 2019 came out much worse than expected (at -1.4 per cent quarter-on-quarter seasonally adjusted annualised rate), bringing 2019 growth to 0.2 per cent

Growth was negatively affected by declines across the primary, secondary and tertiary sectors.

- Electricity constraints intensified in Q4 2019 and Q1 2020, weighing on production and sentiment even before COVID-19. Electricity production (distributed) fell to its lowest level in March 2020 since September 2003.
- High frequency data now showing a contraction in Q1 2020 is likely. March is expected to weigh strongly on the first quarter outcome as COVID-19 restrictions intensified both globally and domestically.
- Leading and sentiment indicators clearly point to significant declines in economic activity from April, and a slight recovery in activity in May – however indications are that demand remains very weak.

Inflationary pressure remains muted in the short term owing to weak domestic demand and lower oil prices

Risks to the global and domestic environment remain biased strongly to the downside

  - Potential for further shut downs in response to infections
  - Longer term ramifications for employment, investment and structure of trade
  - Existing risks to trade tensions, dispersion heightened by pandemic

HOW HAS THE FISCAL SITUATION CHANGED SINCE THE 2020 BUDGET?

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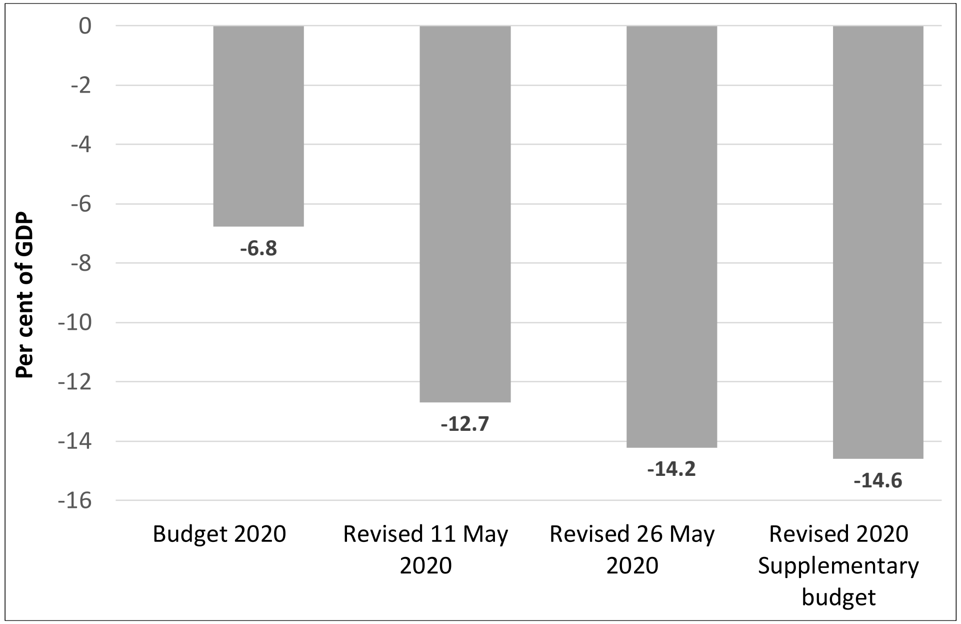
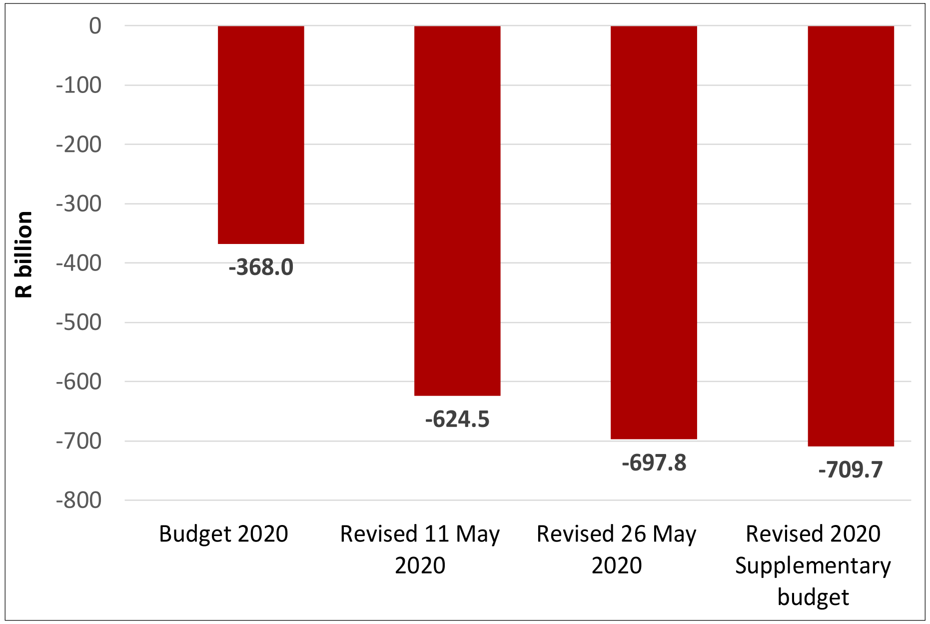
Main budget deficit (percent of GDP), 2020/21



Main budget deficit (R billion), 2020/21



- The 2020/21 fiscal position, and the financing requirements, are markedly changed
- The public finances, which had reached an unsustainable position before the pandemic, are now dangerously overstretched.
- Without urgent action in the 2021 budget process, a debt crisis will follow.

THE GAP BETWEEN REVENUE AND EXPENDITURE IS EXPECTED TO WIDEN

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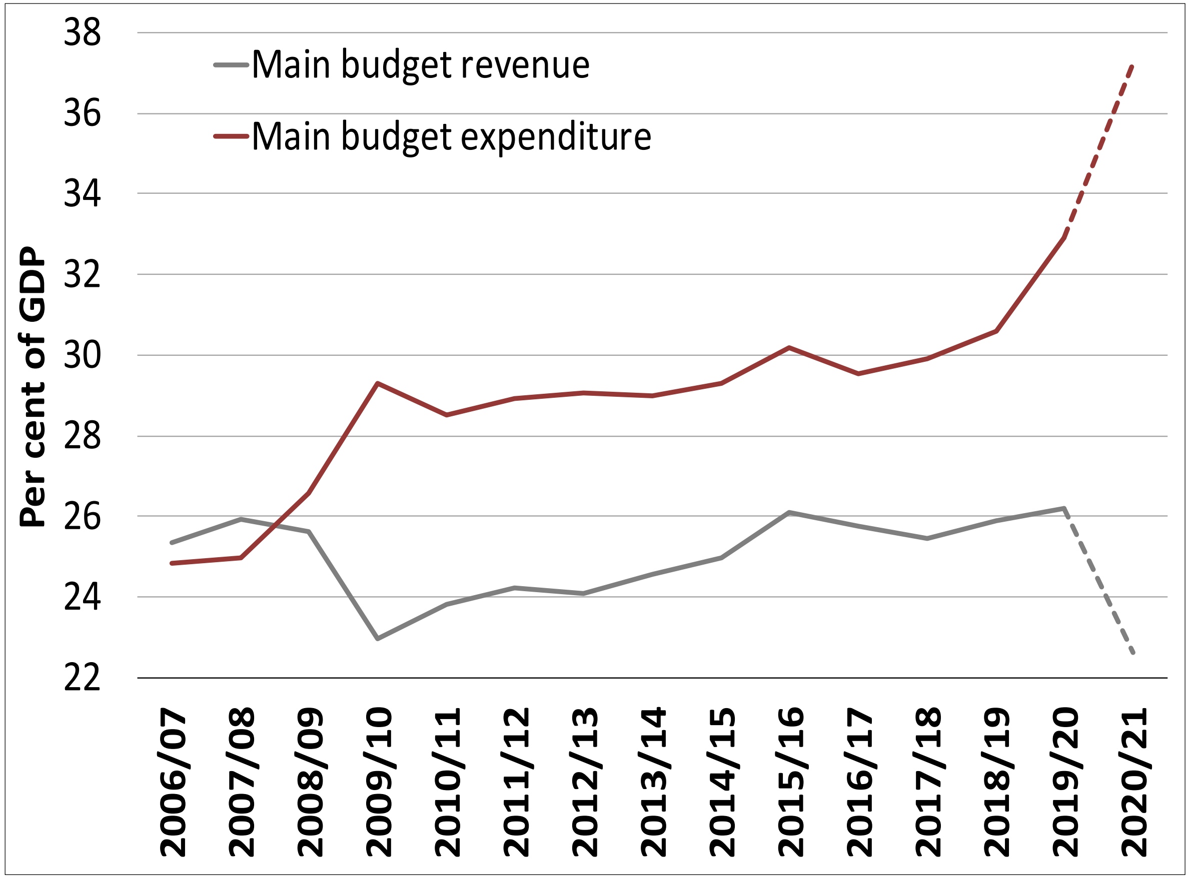
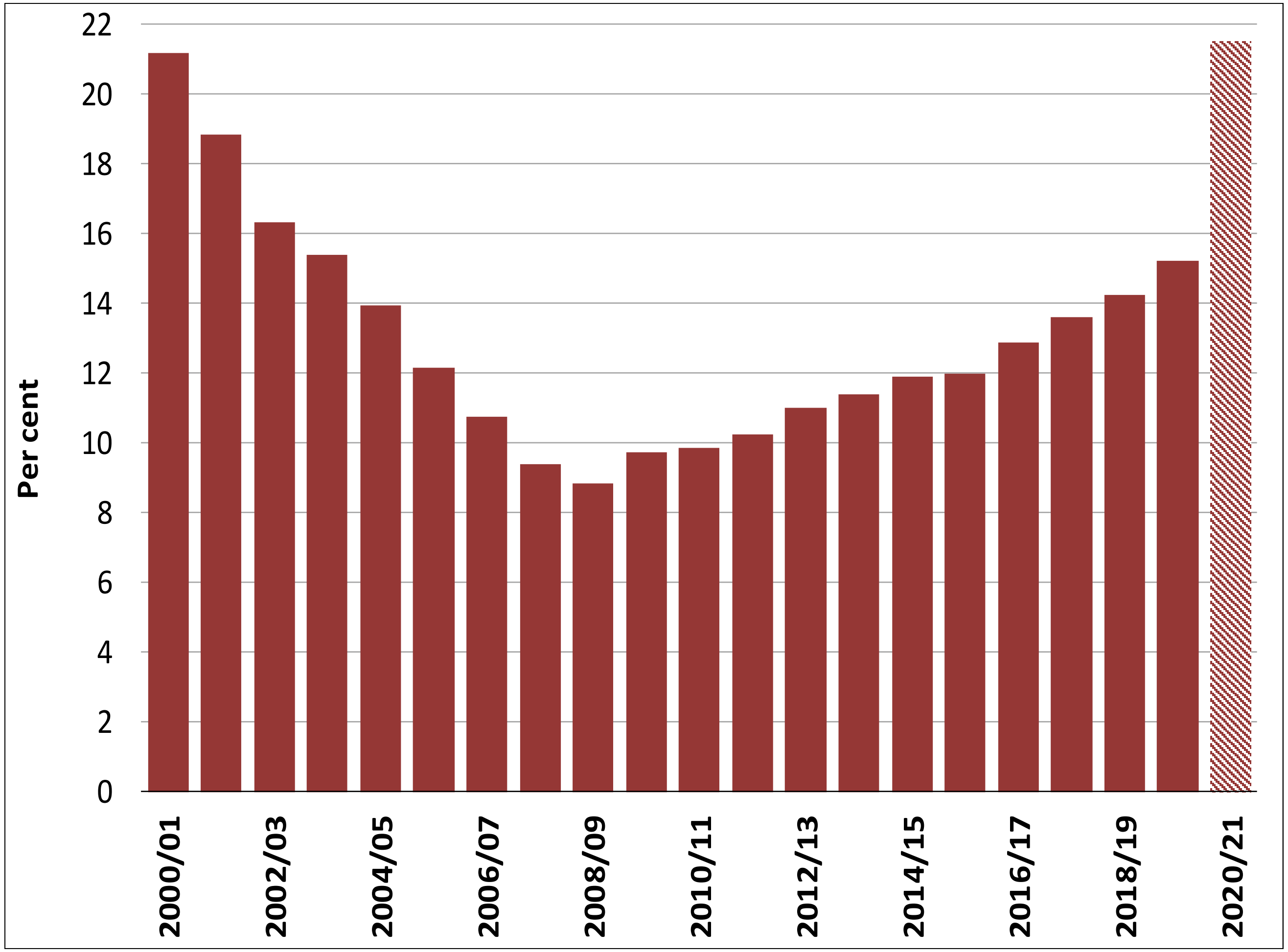
Main budget revenue and expenditure



- The COVID-19 pandemic erupted when South Africa was already in a weak fiscal position
- In recent months, fiscal deterioration has accelerated
- In 2020/21, significant tax revenue underperformance is expected, and expenditure will increase as government reprioritises and allocates funds to contain COVID-19.
- The main budget deficit and gross borrowing requirement will increase sharply

DEBT-SERVICE COSTS TAKE AN INCREASED SHARE OF MAIN BUDGET REVENUE

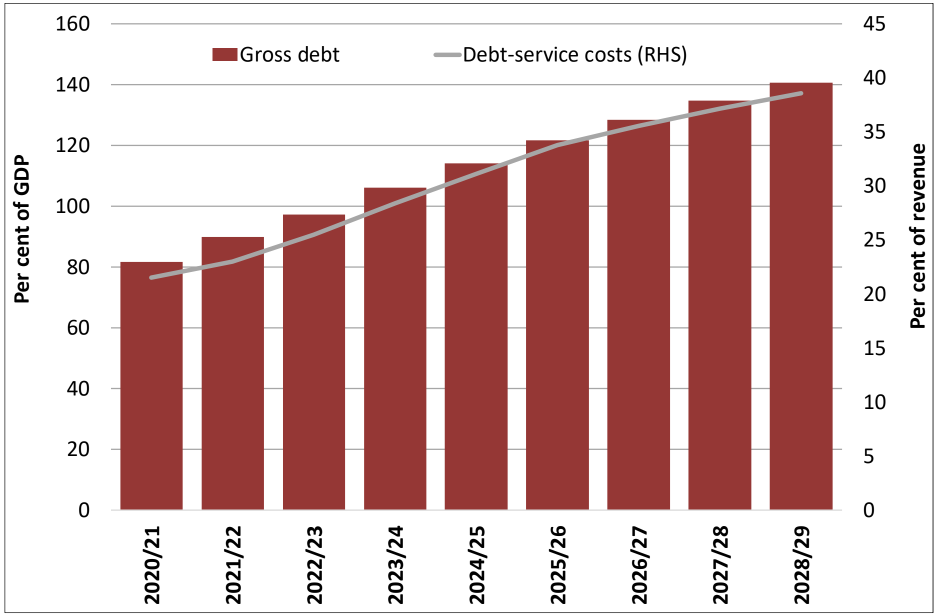
Debt-service costs as a proportion of main budget revenue



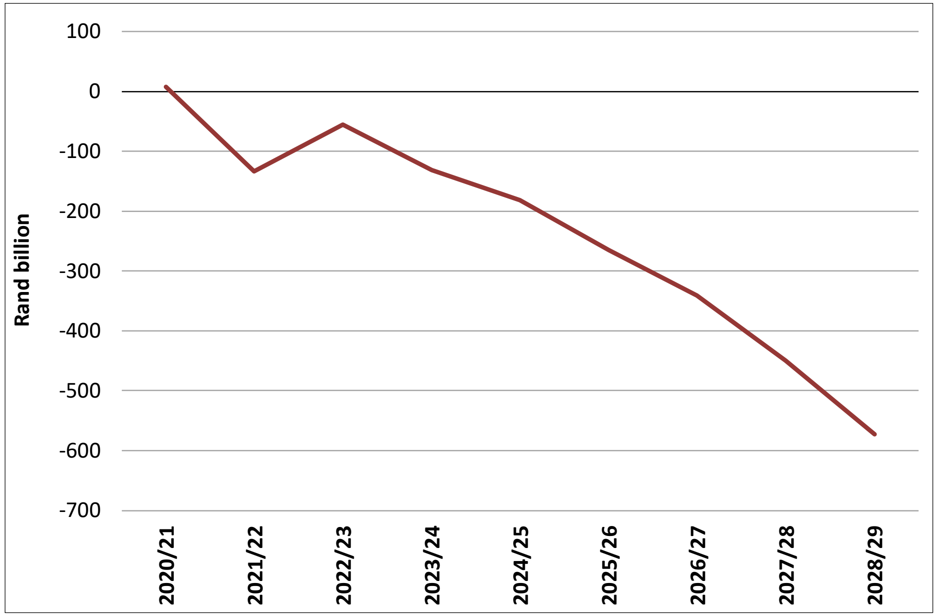
- Gross national debt is now expected to reach 81.8 per cent of GDP in 2020/21 compared to the 2020 Budget estimate of 65.6 per cent of GDP
- Rising public debt means that an ever-increasing share of tax revenue is transferred to bondholders

A DEBT CRISIS CAN HAVE LONG RUN IMPLICATIONS – CONSERVATIVE ANALYSIS

Debt dynamics



Loss of nominal GDP



- Failure to arrest the debt trajectory will see debt-service costs consume around 31% of main budget revenue by 2024/25
- The stock of debt crosses the 100% mark in 2023/24, reaching 140% in 2028/29
- Deficits remain elevated at around 12% of GDP for a long-time, severely constraining domestic saving and investment
- A fiscal crisis could deduct more than R2 trillion from GDP over the next decade

A PHASED APPROACH TO MANAGING THE PANDEMIC

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- Government is responding to the pandemic in a phased manner:
  - Phase 1 is to **preserve** the economy through a set of immediate, targeted and temporary responses.
  - Phase 2 is a plan to **recover** from the immediate effects of the crisis by supporting investment and employment.
  - Phase 3 is a **pivot** to position the economy for the faster growth needed to restore the country's long-term prosperity.
- The COVID-19 fiscal package identifies R500 billion in economic relief.
  - It includes R190 billion in main budget spending – of which R145 billion is allocated immediately – to protect lives and support livelihoods, R70 billion in tax policy measures and a R200 billion loan guarantee scheme to support short-term economic activity.
- The Reserve Bank has reduced interest rates and provided additional support to the bond market, financial-sector regulations have been eased to support the flow of credit to households and businesses, and commercial banks have introduced temporary payment holidays.
- To date, more than 18 million South Africans have received temporary COVID-19 grants, which – along with other interventions for vulnerable households – will cost about R41 billion

A PHASED APPROACH TO MANAGING THE PANDEMIC (CONTINUED)

- In its first few weeks of operation, the COVID-19 loan guarantee scheme had provided small businesses with over R10 billion worth of loans.
- As of mid-June, the Unemployment Insurance Fund had provided R23 billion in COVID-19 relief to over 4.7 million workers.
- To the greatest extent possible, the balance sheets and operational capacity of the broader public sector have been adjusted to form part of the national response.
    - These include state-owned companies, the social security funds and public entities such as the National Health Laboratory Service and the South African Social Security Agency.
- The National Treasury and the Reserve Bank have coordinated fiscal and monetary policy responses.

Government has strengthened its working partnership with the private sector in response to the national emergency.

The private health sector has made valuable contributions, providing critical care beds at a favourable rate and complementing efforts to ramp up testing.

- The Solidarity Fund, a private-sector initiative, has augmented government's efforts to procure medical and personal protective equipment.
- To support economic relief efforts, nearly R12 billion in debt relief has been extended to over 124 000 small and medium-sized enterprises by the banking sector.

ADDITIONS TO SPENDING FOR THE FISCAL RESPONSE TO THE PANDEMIC

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Table 2.1 Main budget non-interest expenditure increases

R million	2020/21
Support to vulnerable households for 6 months	40 891
Health	21 544
Support to municipalities	20 034
Other frontline services	13 623
Basic and higher education	12 541
Small and informal business support, and job creation and protection	6 061
Support to public entities	5 964
Other COVID-19 interventions	1 766
Allocated for COVID-19 fiscal relief package	**122 425**
Land Bank equity investment	3 000
Provisional allocations for COVID-19 fiscal relief	19 575
Total	**145 000**

Source: National Treasury

- The COVID-19 fiscal relief measures are temporary and provide support where it is needed most.
- Funding has been secured by shifting resources from existing programmes and drawing down surplus funds from institutions such as the Unemployment Insurance Fund

- Government aims to spend these funds efficiently and effectively, avoiding waste.
- Budget allocations across national, provincial and local government fund R145 billion of government's response.

A PHASED APPROACH TO MANAGING THE PANDEMIC (CONTINUED)

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- Commercial banks have also granted 90-day payment holidays to more than 2 million clients for relief totalling R16.5 billion to date.
- Initiatives such as the Sukuma Relief Programme and the South African Future Trust are providing interest-free loans and grants to small and medium-sized firms.
- In the context of a sharp economic downturn in developing countries, international finance institutions have announced a range of support mechanisms
- Government intends to borrow US$7 billion from multilateral finance institutions for its pandemic response. This includes a US$1 billion loan which was recently approved by the New Development Bank.
- As a member of the International Monetary Fund (IMF), South Africa intends to borrow US$4.2 billion through the IMF's rapid financing instrument, which is a low-interest emergency facility.

YEAR-TO-DATE MONTHLY REVENUE COLLECTIONS SIGNIFICANTLY WEAKER

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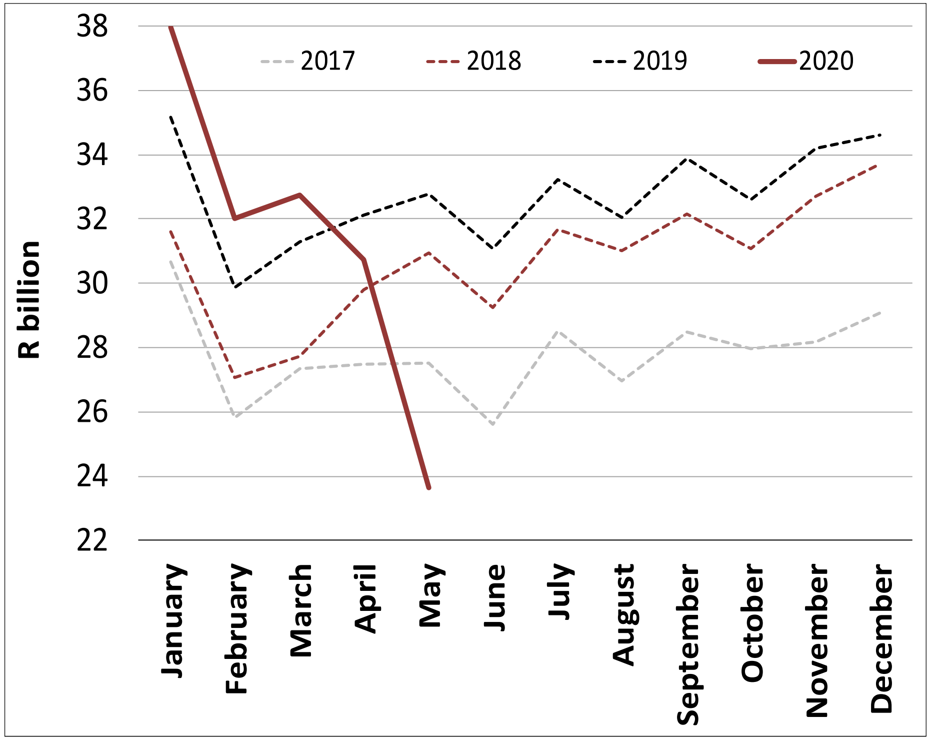
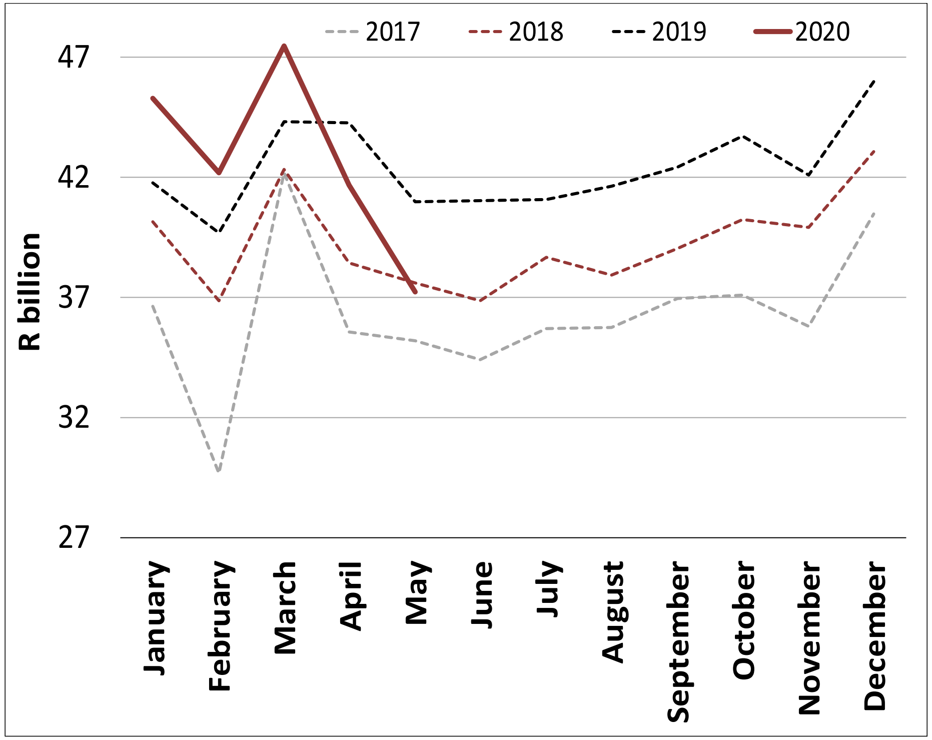
Domestic value-added tax collections



Pay-as-you-earn collections



TAX REVENUE SHORTFALL OF R304.1 BILLION IN 2020/21

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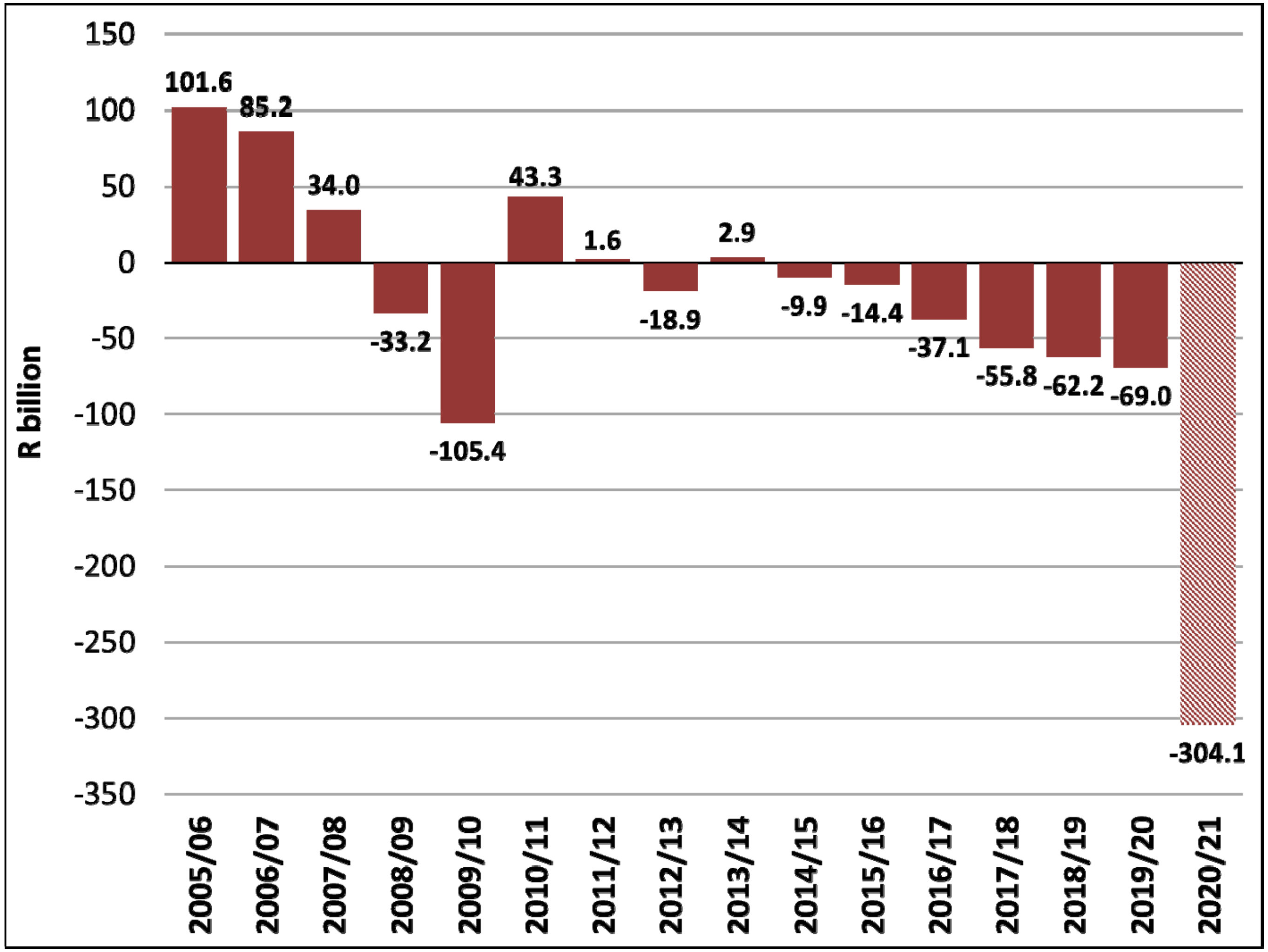
In-year revenue compared with Budget forecasts (2020/21 prices)



- COVID-19 fallout leads to unprecedented drop in in-year revenue estimates compared to prior Budget
- Expect temporary shrinkage in tax base as businesses close and jobs are lost
- Revenue shortfalls include tax relief measures amounting to R26 billion in foregone revenue
- Improved tax collection and administration will be key to achieving fiscal stabilisation

TAX-TO-GDP EXPECTED TO BE WORSE THAN GLOBAL FINANCIAL CRISIS

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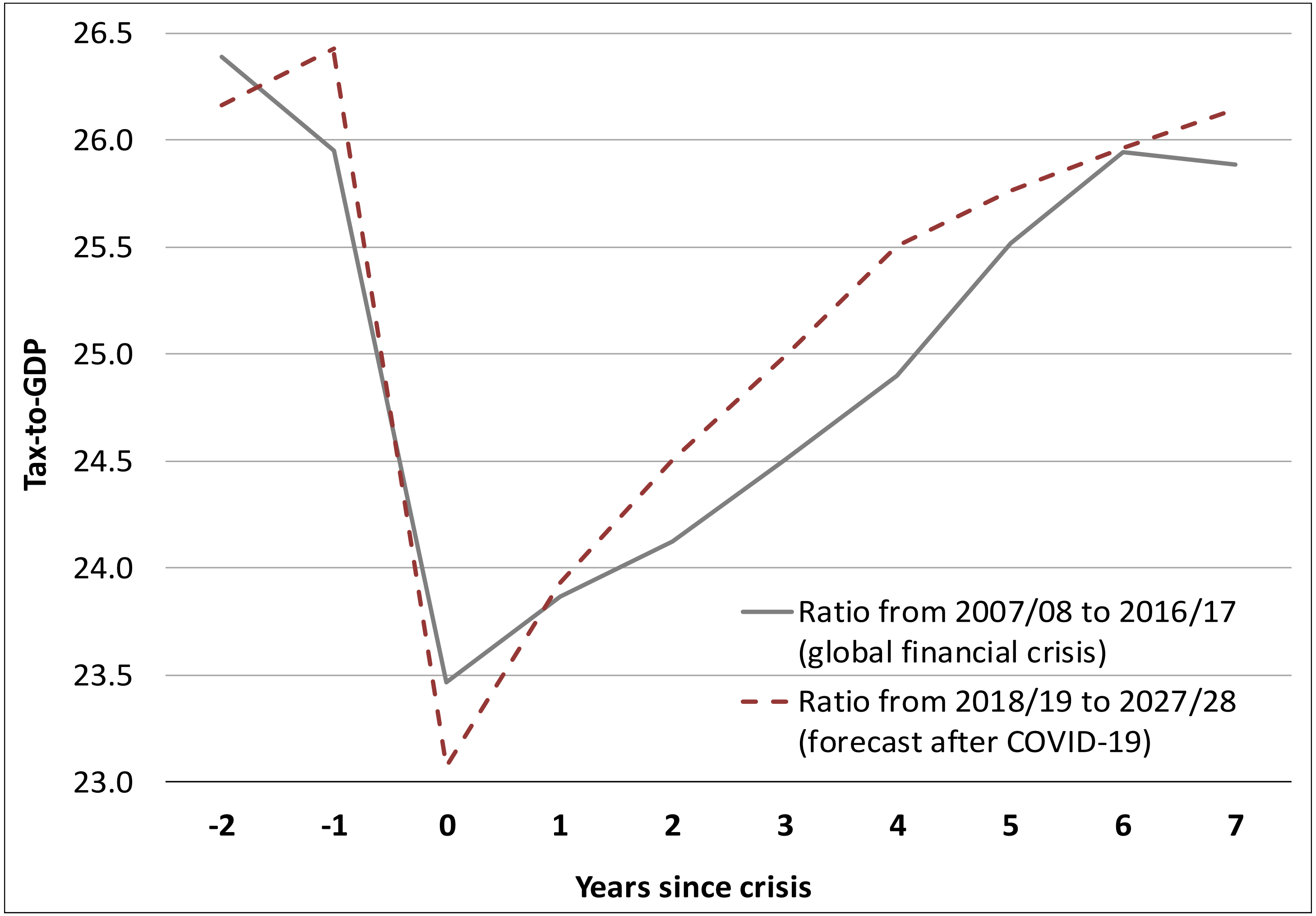
Tax-to-GDP after crisis



- Tax-to-GDP expected to be worse than global financial crisis; but should recover along with economy and further tax measures

IN-YEAR SPENDING ADJUSTMENTS

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Table 2.2 Revisions to main budget non-interest expenditure

R million	2020/21
Main budget non-interest expenditure (2020 Budget Review)	**1 536 724**
Proposed upward expenditure adjustments	**145 000**
Proposed downward expenditure adjustments	**-100 885**
National departments' baseline suspensions	-54 403
Repurposing of provincial equitable share	-20 000
Provincial conditional grant suspensions	-13 848
Local government conditional grant suspensions	-12 633
Other adjustments	**-8 109**
National Revenue Fund payments	13
Downward revisions to skills development levy	-2 122
Lower skills development levy due to 4-month holiday	-6 000
Revised non-interest expenditure	**1 572 730**
Change in non-interest expenditure from 2020 Budget	36 006

Source: National Treasury

- Main budget non-interest spending has increased by a net R36 billion in the current year.
- This amount consists of R145 billion added to spending for the fiscal response to the pandemic. This amount is partially offset by R109 billion from the items shown in Table 2.2.

UPDATED FISCAL FRAMEWORK FOR 2020/21

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Table 2.3 Main budget framework

R billion/percentage of GDP	2019/20 Preliminary	2020/21 Budget 2020	2020/21 Revised
Main budget revenue	**1 345.3**	**1 398.0**	**1 099.5**
	26.2%	*25.8%*	*22.6%*
Main budget expenditure	**1 690.6**	**1 766.0**	**1 809.2**
	32.9%	*32.5%*	*37.2%*
Non-interest expenditure	1 485.8	1 536.7	1 572.7
	28.9%	*28.3%*	*32.4%*
Debt-service costs	204.8	229.3	236.4
	4.0%	*4.2%*	*4.9%*
Main budget balance	**-345.3**	**-368.0**	**-709.7**
	-6.7%	*-6.8%*	*-14.6%*
Primary balance	**-140.5**	**-138.7**	**-473.2**
	-2.7%	*-2.6%*	*-9.7%*

Source: National Treasury

- Main budget revenue is projected to decline as a share of GDP from 26.2 per cent in 2019/20 to 22.6 per cent in 2020/21
- Main budget expenditure is projected to increase to 37.2 per cent of GDP in 2020/21, reflecting support provided to state-owned companies in the 2020 Budget, COVID-19 spending and higher debt-service costs.

REVISIONS TO MAIN BUDGET SPENDING PLANS FOR 2020/21

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Table 2.4 Major revisions to non-interest spending plans

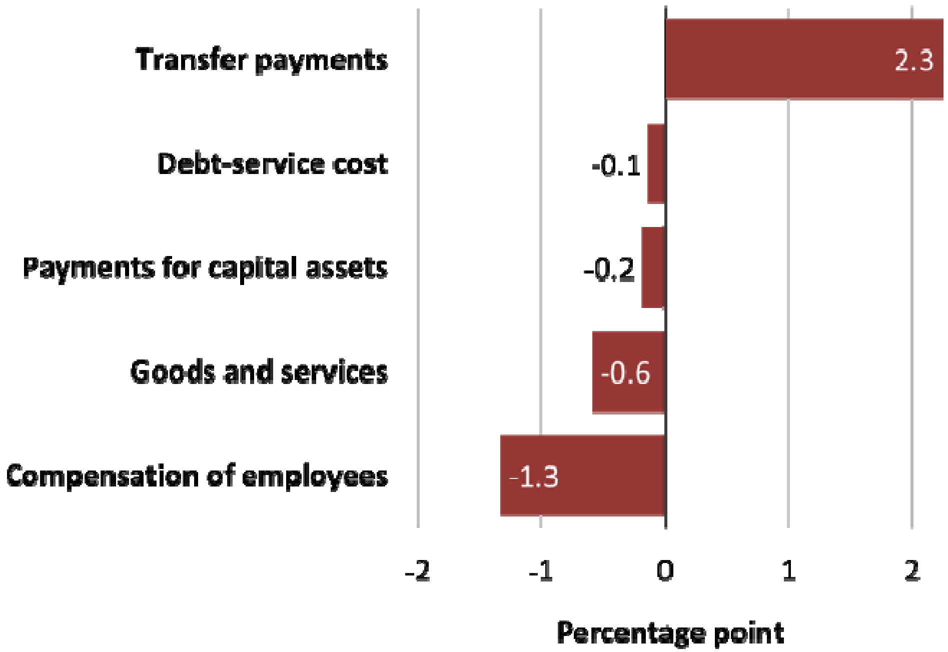
R million	Budget 2020	Reductions	Allocations	Other adjustments	Revised
General public services[1]	618 840	-24 310	25 055	13	619 599
Economic development	88 381	-12 145	4 649	–	80 886
Learning and culture	151 543	-15 617	10 560	-8 122	138 364
Health	55 516	-2 631	5 544	–	58 430
Peace and security	207 006	-4 185	10 170	–	212 991
Community development	219 727	-26 322	28 430	–	221 835
Social development[2]	198 497	-15 675	41 016	–	223 837
Provisional allocations: COVID-19 package	–	–	19 575	–	19 575
Provisional allocations not assigned to votes	-7 786	–	–	–	-7 786
Contingency reserve	5 000	–	–	–	5 000
Total	**1 536 724**	**-100 885**	**145 000**	**-8 109**	**1 572 731**

1. Includes the provincial equitable share that funds a range of functions including health and basic education
2. Includes Department of Women, Youth and Persons with Disabilities
Source: National Treasury

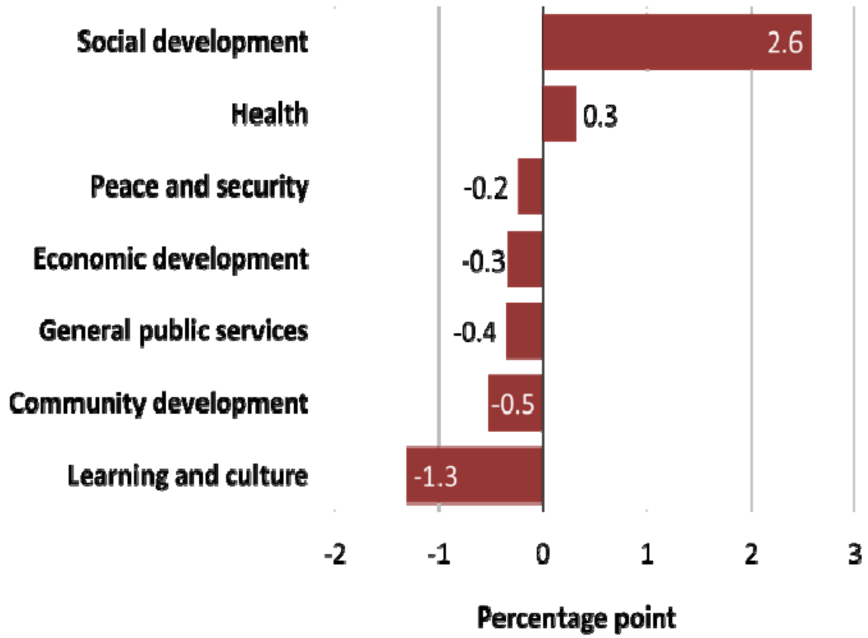
- Spending was adjusted by removing funds underspent due to delays caused by the lockdown from the baselines of affected departments; suspending allocations for capital and other departmental projects that could be delayed or rescheduled to 2021/22 or later; suspending allocations to programmes with a history of poor performance and/or slow spending and redirecting funds towards the COVID-19 response within functions, or towards government's fiscal relief package.

CONSOLIDATED BUDGET SPENDING AND DEFICIT FOR 2020/21

Change in share of expenditure by economic classification, 2020/21*



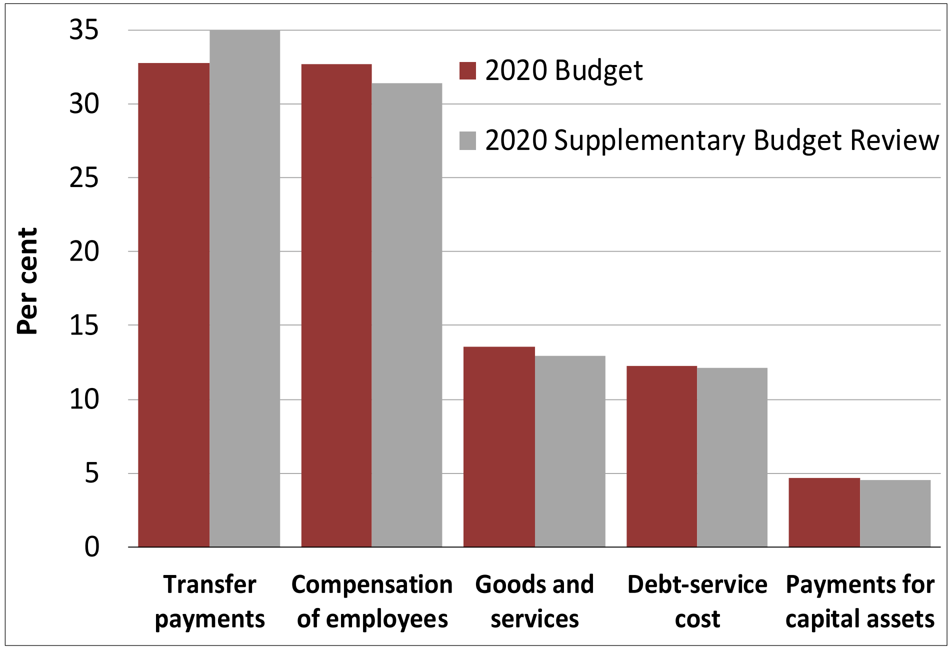
Change in share of expenditure by function, 2020/21*



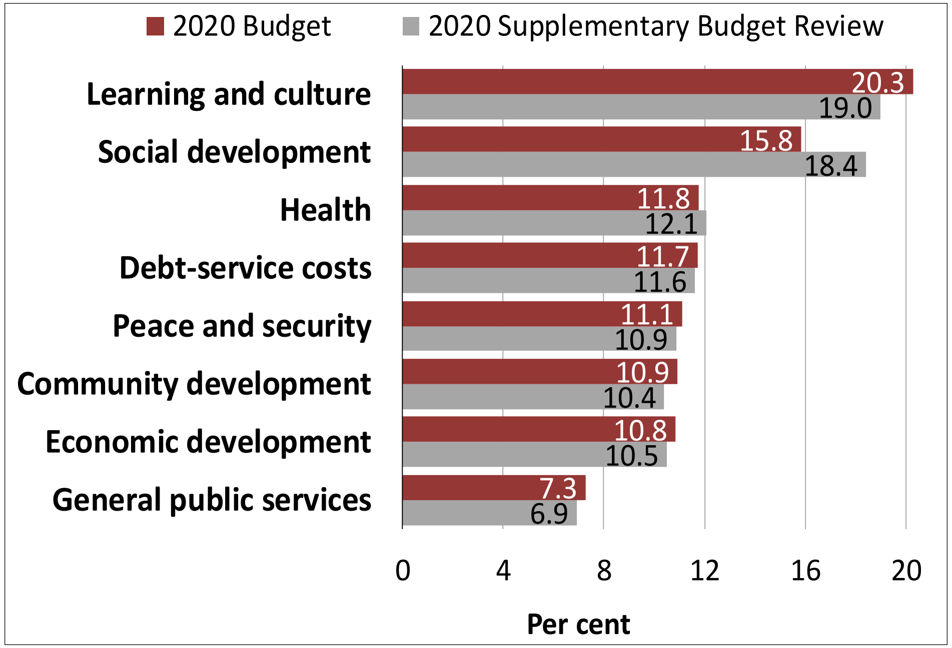
- In the current year, R40 billion will be drawn down from social security funds' cash surpluses to provide wage support to vulnerable employees due to the pandemic.
- Consolidated spending for 2020/21 has been revised from R1.95 trillion in 2020 Budget to R2.04 trillion, mainly due to additional funding of R145 billion allocated for government's COVID-19 response.
- The consolidated budget deficit more than doubles to a projected 15.7 per cent of GDP in 2020/21

CONSOLIDATED BUDGET SPENDING PLANS FOR 2020/21

Share of consolidated expenditure by economic classification, 2020/21



Share of consolidated expenditure by function, 2020/21



- The allocations increase spending on transfers to almost 35 per cent of total expenditure, while the share of all other components declines.
- Debt-service costs are now the fourth-largest spending item, similar in size to what government spends on health services.

CHANGES TO THE DIVISION OF REVENUE

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Table 2.9 Division of revenue framework

R billion	2019/20 Revised	Budget 2020	2020/21 Revised	% change
Division of available funds				
National departments[1]	**749.4**	**757.7**	**790.3**	**4.3%**
Provinces	**613.1**	**649.3**	**645.3**	**-0.6%**
Equitable share	505.6	538.5	538.5	–
Conditional grants	107.6	110.8	106.8	-3.6%
Local government	**123.3**	**132.5**	**139.9**	**5.6%**
Equitable share	65.6	74.7	85.7	14.7%
Conditional grants	44.5	43.8	40.2	-8.2%
General fuel levy sharing with metros	13.2	14.0	14.0	–
Provisional allocation not assigned to votes[2]	–	-7.8	-7.8	–
Contingency reserve	–	5.0	5.0	–
Non-interest expenditure	**1 485.8**	**1 536.7**	**1 572.7**	**2.3%**
Debt-service costs	204.8	229.3	236.4	3.1%
Main budget expenditure	**1 690.6**	**1 766.0**	**1 809.2**	**2.4%**
Percentage shares				
National departments	*50.4%*	*49.2%*	*50.1%*	
Provinces	*41.3%*	*42.2%*	*41.0%*	
Local government	*8.3%*	*8.6%*	*8.9%*	

1. Includes provisional allocation for the COVID-19 relief package

2. Includes proposed compensation reductions, support to Eskom, amounts for Budget Facility for Infrastructure projects and other provisional allocations

Source: National Treasury

AN ACTIVE, INTEGRATED APPROACH TO THE ECONOMY AND FISCUS NEEDED

- **Need active set of fiscal and economic reforms to raise confidence and growth**
  - Fiscal restraint mitigates borrowing cost increases, raises confidence
  - SOC reform allows network industry reform, raises competition and lowers cost of living and doing business
  - Economic reforms need to support investment and employment, raise productivity and competitiveness, and lower cost of living and doing business
- **Economic reforms take time to impact on growth outlook – hence the need to implement now**
  - Government envisages reforms to finalise electricity determinations, unbundling Eskom and other steps to open up energy markets, modernise ports and rail infrastructure, and license spectrum
  - Reforms captured in Economic Transformation, Inclusive Growth, and Competitiveness: Towards an Economic Strategy for South Africa also included supporting labour intensive sectors, regional trade, SME finance
- **Additional reforms to support increased savings, investment and employment will be required to help speed the recovery from the COVID-19 shock**

Active scenario outlook

Percentage change	2010-2018[1]	2019	2020	2021	2022
Real GDP growth	1.9	0.2	-7.2	2.6	1.5
GDP inflation	5.7	4.0	4.0	3.9	4.4
GDP at current prices (R billion)	3 811.9	5 077.6	4 900.2	5 227.9	5 536.1
CPI inflation	5.3	4.1	3.0	3.9	4.3

1. Average growth rates
Sources: National Treasury, Reserve Bank and Statistics South Africa

MEDIUM-TERM FISCAL POSITION

- Beyond 2020/21, government has considered two scenarios:
  - A passive approach, in which South Africa continues on its current trajectory and debt spirals out of control; and
  - An active scenario, in which major reforms and fiscal consolidation are implemented rapidly to stabilise debt in 2023/24.
- Cabinet has adopted the active approach. It has endorsed the target of a primary surplus by 2023/24, meaning revenue will exceed non-interest expenditure.
- This will require spending reductions and revenue adjustments amounting to approximately R250 billion over the next two years. Specifically, the active scenario assumes:
  - Tax increases of R5 billion in 2021/22, R10 billion in 2022/23, R10 billion in 2023/24 and R15 billion in 2024/25.
  - Spending reductions amounting to about R230 billion are required in 2021/22 and 2022/23, followed by further reductions in 2023/24.
- These measures require difficult choices that will affect the economy and distribution of public resources. The 2020 MTBPS will set out these proposals in detail.
- These measures are in addition to proposed medium-term reductions of R160.2 billion to the public-service wage bill set out in the 2020 Budget, which are yet to be finalised.
- To promote fiscal consolidation, preparation of the 2021 MTEF will be informed by the results of forthcoming public expenditure reviews. Government’s consultations on the MTEF will also be guided by the principles of zero-based budgeting.

ACTIVE SCENARIO FISCAL POSITION

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Table 4.1 Active scenario medium-term budget balances

R billion/percentage of GDP	2020/21 Revised	2021/22 Medium-term estimates	2022/23
Main budget revenue	**1 099.5**	**1 268.2**	**1 378.8**
	22.6%	*23.8%*	*24.5%*
Main budget expenditure	**1 809.2**	**1 763.8**	**1 809.3**
	37.2%	*33.1%*	*32.2%*
Non-interest expenditure	1 572.7	1 500.6	1 508.2
	32.4%	*28.2%*	*26.8%*
Debt-service costs	236.4	263.1	301.1
	4.9%	*4.9%*	*5.4%*
Main budget balance	**-709.7**	**-495.6**	**-430.5**
	-14.6%	*-9.3%*	*-7.7%*
Primary balance	**-473.2**	**-232.4**	**-129.5**
	-9.7%	*-4.4%*	*-2.3%*

Source: National Treasury

- The main budget balance and the primary balance will narrow over the medium term in order to stabilise debt in 2023/24

CONSOLIDATED BUDGET BALANCES

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Table 4.2 Consolidated budget balances

R billion	2019/20	2020/21	2021/22	2022/23
Main budget	-345.3	-709.7	-495.6	-430.5
Social security funds	-3.3	-49.1	-1.0	-2.4
Provinces	5.5	-2.6	0.6	1.9
Public entities	13.4	-0.3	5.5	9.5
RDP Fund[1]	-0.6	-0.1	-0.1	-0.0
Consolidated budget balance	**-330.3**	**-761.7**	**-490.6**	**-421.5**

1. Reconstruction and Development Programme Fund

Source: National Treasury

- In 2020/21 the consolidated budget deficit will be revised from 6.8 per cent of GDP projected in the 2020 Budget to 15.7 per cent of GDP
- Public entities, social security funds and provinces are projected to have a combined cash surplus in both 2021/22 and 2022/23.

DEBT OUTLOOK SCENARIOS

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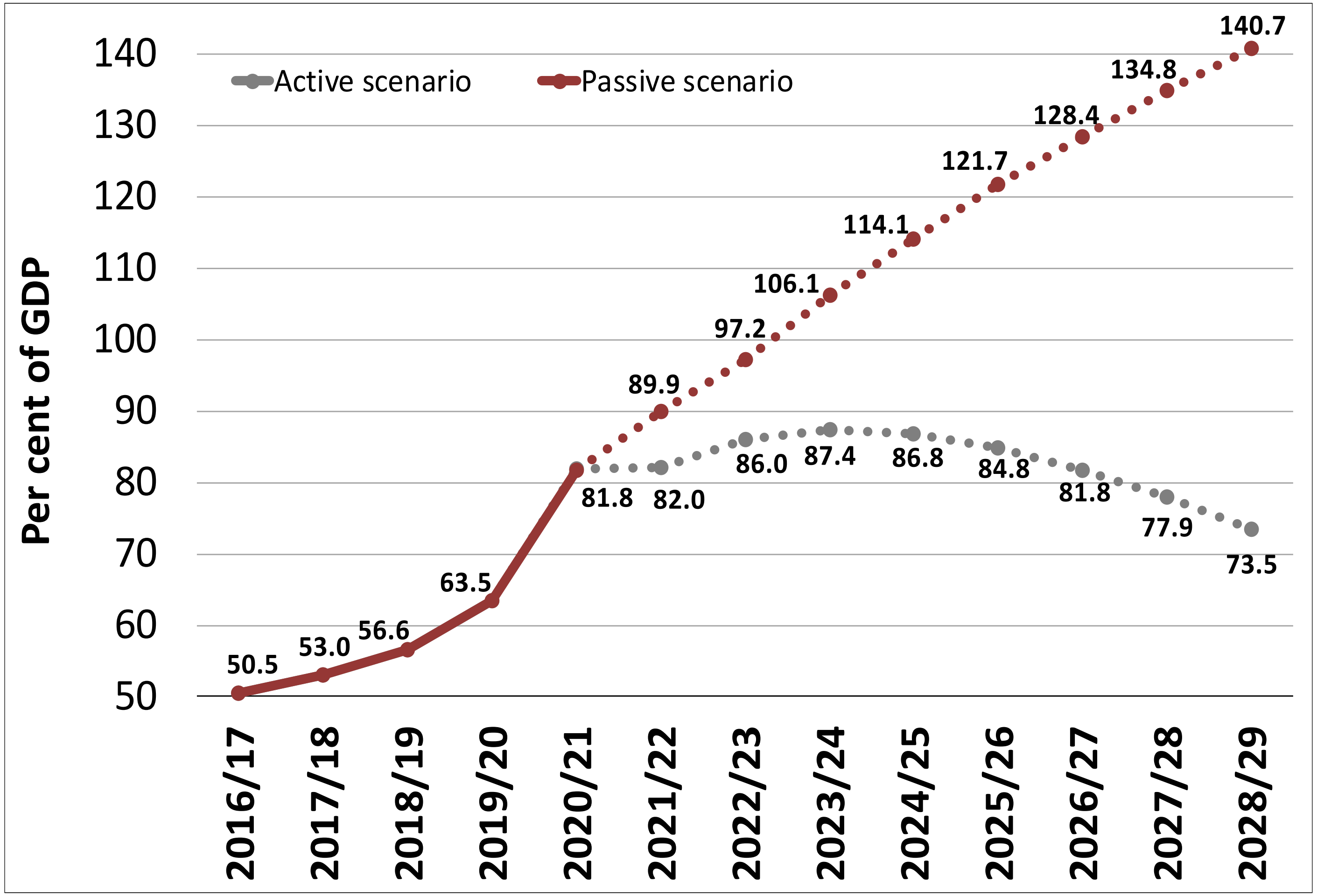

- In the active scenario, debt stabilises at 87.4 per cent of GDP in 2023/24

FINANCING THE GROSS BORROWING REQUIREMENT

- Since February 2020, the gross borrowing requirement for 2020/21 has increased by R344.2 billion to R776.9 billion. Government has revised its financing strategy to minimise the effect of this deteriorating financial position on its stock of debt and on debt-service costs.
- The domestic capital market is under pressure. To moderate its domestic borrowing, government will draw down sterilisation deposits. It will also source funding from international finance institutions
- Existing foreign cash deposits will be used to finance foreign currency commitments. The proceeds from international loans will be converted into rands to partially finance domestic commitments.

Table 4.3 National government gross borrowing requirement and financing

	2019/20	2020/21		2021/22	2022/23
R billion	Preliminary	Budget	Revised	Medium-term estimates	
Gross borrowing					
Main budget balance	**-345.3**	**-368.0**	**-709.7**	**-495.6**	**-430.5**
Redemptions	**-70.7**	**-64.7**	**-67.2**	**-64.9**	**-150.0**
Domestic long-term loans	-19.4	-52.5	-52.5	-60.5	-134.2
Foreign loans	-51.2	-12.2	-14.7	-4.4	-15.8
Total	**-416.0**	**-432.7**	**-776.9**	**-560.5**	**-580.5**
Financing					
Domestic short-term loans (net)	36.1	48.0	146.0	56.0	64.0
Domestic long-term loans	305.4	337.7	462.5	388.4	451.4
Foreign loans	76.1	29.3	125.2	31.9	63.2
Change in cash and other balances[1]	-1.6	17.7	43.2	84.2	1.9
Total	**416.0**	**432.7**	**776.9**	**560.5**	**580.5**

1. A positive value indicates that cash is used to finance part of the borrowing requirement

Source: National Treasury

STATE-OWNED COMPANIES

- The financial performance of state-owned companies, which has placed considerable pressure on the public finances for several years, is likely to deteriorate in 2020/21.
- The pandemic and associated economic restrictions are expected to reduce revenues for entities such as the Airports Company South Africa, Eskom and the South African National Roads Agency Limited.
- Global market volatility may further limit the ability of state-owned companies to borrow in capital markets and service their debt obligations.
- The COVID-19 pandemic underlines the urgent need for broad-based reforms at state-owned companies so that they can become efficient and financially sustainable.
- These reforms include rationalisation (reducing the number of and merging some state-owned companies, and incorporating certain functions into government), equity partnerships, and stronger policy certainty and implementation.
- Planned transfers from the fiscus will be strictly conditional on improving their balance sheets.
- The special adjustments budget includes an additional allocation of R3 billion to recapitalise the Land Bank in the current year
- No other in-year spending adjustments are proposed for state-owned companies.

THANK YOU