M&G Investments

M&G Insights

Budget 2024 Preview: Trust issues

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In managing the **M&G Enhanced Income Fund**, we take great effort to understand the evolving local economic landscape, with a particular focus on both monetary and fiscal policy. Unlike domestic monetary policy, which gets the market attention at least six times a year for each meeting of the Monetary Policy Committee (MPC), fiscal policy only really garners market focus twice a year, at the time of the National Budget in February and the Medium Term Budget Policy Statement (MTBPS) in October/November. While MPC meetings can cause the local fixed income market to become nervous a week before the time, the two fiscal events of the year see the market become anxious a month beforehand.

The National Budget on Wednesday, 21 February 2024 will be delivered only a few months ahead of the upcoming general election, where the ruling party is widely expected to lose its majority in parliament for the first time since the advent of democracy 30 years ago. While the first half of this 30-year period was characterised by fiscal responsibility, the second half has seen fiscal profligacy. This shift in policymaking from prudent to populist has had such grave consequences that the fiscal metrics of the country are now in a worse position than 30 years ago, and led to the downgrading of South Africa's sovereign credit rating to "junk".

Track records trump forecasts

At its very essence, the National Budget is composed of assumptions and forecasts for the economy and the fiscus. As any forecaster of economic data will confirm, it is not whether their forecasts will be right or wrong, but rather by how much they will be wrong. The one lever that the National Treasury does have at its disposal to influence the fiscal outcome is tax proposals, which is one of the more certain policies in the document. However, the National Budget is not only the work of the National Treasury -- Cabinet has input and must agree to it as well, which brings in the political influence.

Policymakers do have the power to control the narrative at these events; however, it's important that investors judge them not on their words, but rather on the results of their actions. Here, the evidence has been damning, with the market having become accustomed to fiscal disappointments. Budgets delivered to much fanfare over the past 15 years are almost always revised adversely at the subsequent update, where a new set of downwardly revised figures are expected to be trusted. With confidence eroded, a trust deficit has developed, and it will be difficult journey to earn it back.

The moribund state of the economy that has endured since the bursting of the 2000s commodity price bubble and the Global Financial Crisis (GFC) has played a strong part in our fiscal malaise, but so too has the reluctance to adjust expenditure in the face of anaemic growth. The domino-like collapse of State-Owned Companies has not helped the cause, either.

How to create a rally

On 21 February, the bond market's focus, as always, will be on debt issuance, which is a function of the overall Budget deficit. The past few years, the steepness of the nominal bond curve (with longer-term borrowing requiring much higher interest rates than short-term debt) has seen the National Treasury become creative with other funding sources to divert funding away from fixed-rate bonds. As a sign of the desperation facing the Finance Ministry, the Gold and Foreign Exchange Contingency Reserve Account (GFECRA) is now widely expected to be tapped to free up cash resources, hopefully only to pay down government debt. While this does come at a cost, it should help to alleviate the pressure on the bond curve arising from switch auctions.

Monthly data indicate that the already downwardly revised budget figures from November's MTBPS for the current fiscal year are unlikely to be met. With all this being said, the market has shown a tendency to discount an overly pessimistic scenario going into National Budgets/MTBPS, and with expectations already downtrodden due to prior warnings from the Finance Minister, a low bar has been set for another rally in bonds post the announcement.

Based on the above, although we at M&G Investments do take note of certain numbers in the National Budget to get an indication of the health of the fiscus and general bond market issuance trends going forward, we are always sceptical of forecasts of any kind, and rather rely on market valuations in determining how we construct and manage our client portfolios.

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