

The Budget that never was

Macro implications of the February 2025 Budget

February 2025

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The 19 February 2025 Budget was never tabled, but the embargo on the content of the budget document has been lifted.

- This allows us to model what the impact of the Budget would have been, had it been implemented
- One would expect the biggest macro impact to come from the 2%pt VAT increase, with it being negative for consumption and economic growth.
- But Treasury was careful to build in protection for (lower-income) households:
 - Above-inflation grant increases
 - Zero-rating of more goods
 - Full inflation adjustment of the bottom two personal income tax brackets
 - Extension of fuel levy relief
- Indeed, Treasury's own take was that the additional expenditure that they could now afford on the back of the additional VAT revenue would result in higher consumption over time
- Still, even with cushioning, a VAT hike pushes up inflation which weighs on real consumption and has implications for monetary policy.

The Budget that never was

There was an important tilt in Treasury's approach of fiscal consolidation underpinning the 2025 Budget

- 2024: R15bn worth of tax measures and R80.6bn in expenditure cuts over the medium term
- 2025: R182.4bn of net *new* tax measures over the medium term but *no new* expenditure cuts.
- The additional revenue will allow the National Treasury to ease the spending brakes: the non-budget has consolidated non-interest spending growing by 0.9% on average annually in real terms over the medium term, whereas previously, the plan was for it to contract by 0.5% a year on average.
- This represents a looser fiscal stance, and, while this is being achieved without a meaningful deterioration in the country's debt metrics, a shift in the burden of adjustment. Whereas previously, the brunt of austerity was being felt in frontline government education and health services, it has now moved onto all taxpayers through a higher VAT rate, but especially onto higher income earners through the failure to provide fully for bracket creep for the second year in a row or adjust medical tax credits.

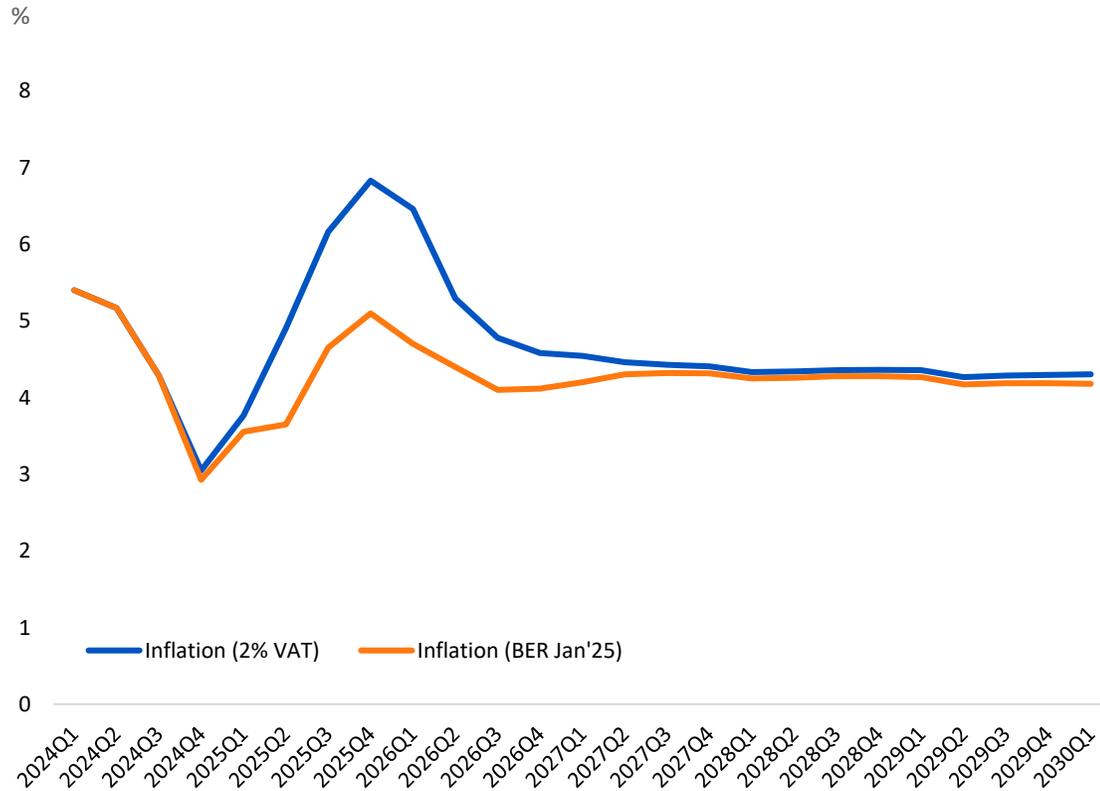
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The VAT hike and additional tax measures would have allowed for an additional R173.3bn in spending over the next three years.

- *If* the government deems all this additional expenditure as necessary, more revenue is needed, and VAT was probably the lesser evil to raise additional revenue (for example, [click here](#) for more on the pros and cons of VAT)
- The question is whether it would have resulted in the revenue Treasury hoped to get from it – Treasury research has shown that, generally, we are at a point where hiking tax rates does not necessarily result in higher tax revenue
- Still, the Treasury expected the VAT increase to bring in around R58 billion additional revenue in 2025/26 and, more importantly, because it is a permanent tax measure, to continue bringing in similar revenue over the medium-term expenditure framework (MTEF)
- This seems optimistic
 - From 2018 (when VAT was increased from 14 to 15% in April), we know that the additional VAT income from the 1%pt increase was marginal

Inflationary impact of a 2% VAT increase

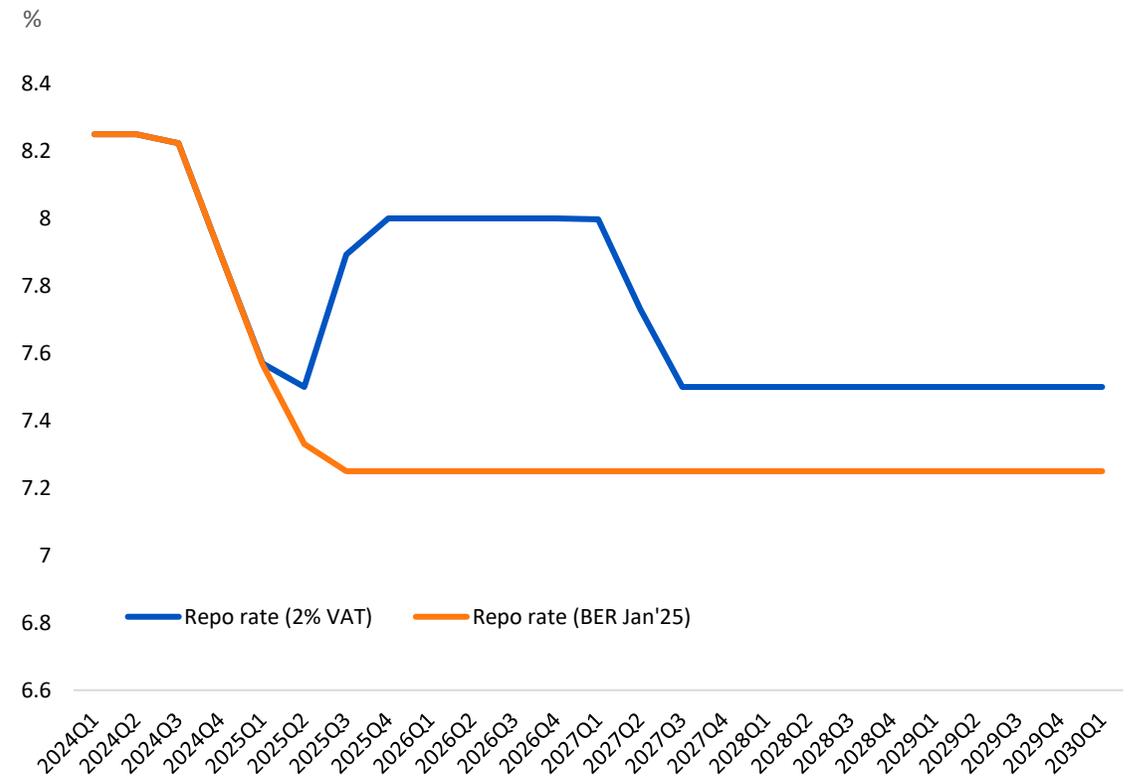
Inflation increases by more than a percentage point.



The impact could be a little less as we could not model the impact of more goods being zero-rated. Zero-rating in itself brings a risk that the unions, for example, could push for more goods to be added to the list.

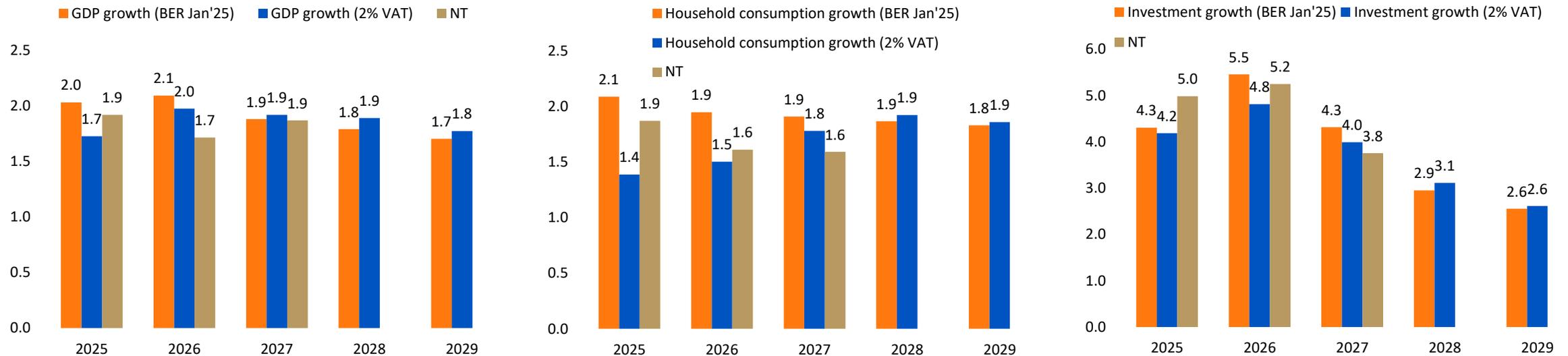
Source: National Treasury, BER

The Taylor rule in our model suggests that the SARB would hold the repo rate steady in March'25 and hike by 50bps later in the year in response to the inflationary VAT hike



What does this mean for growth?

In our model, consumption takes a knock when faced with a VAT increase, which weighs on growth in the near term. The repo rate increase translates weighs on consumption and investment (largely unaffected by the initial VAT shock) over time.



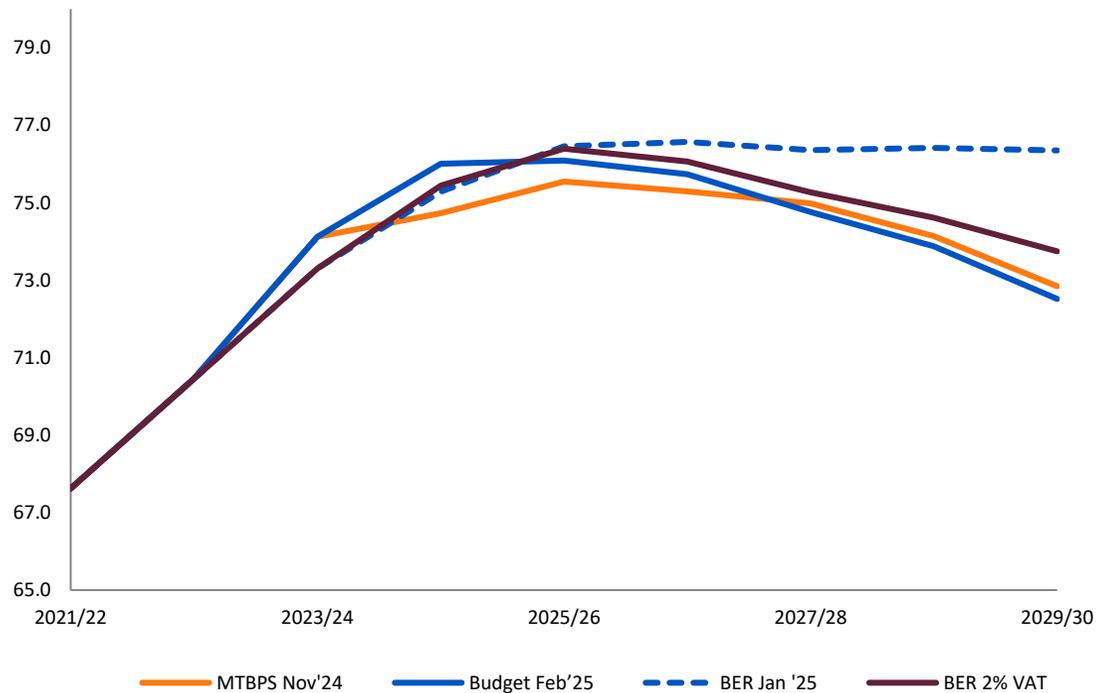
The model merely worked in the numbers from the Budget 2025 as it was (not) presented. We have not made additional tweaks to account for second-round effects. It is also not possible to estimate the impact on business and consumer confidence from the Budget postponement itself.

Source: National Treasury, BER

Fiscal metrics are not much better off under a 2% VAT scenario, given that the additional revenue flows through to higher, additional government expenditure

Debt-to-GDP ratio is still high, but the SRD grant and higher wage bill that is funded via debt in our January baseline (and are not in NT's medium-term figures) can now be funded by tax revenue over time

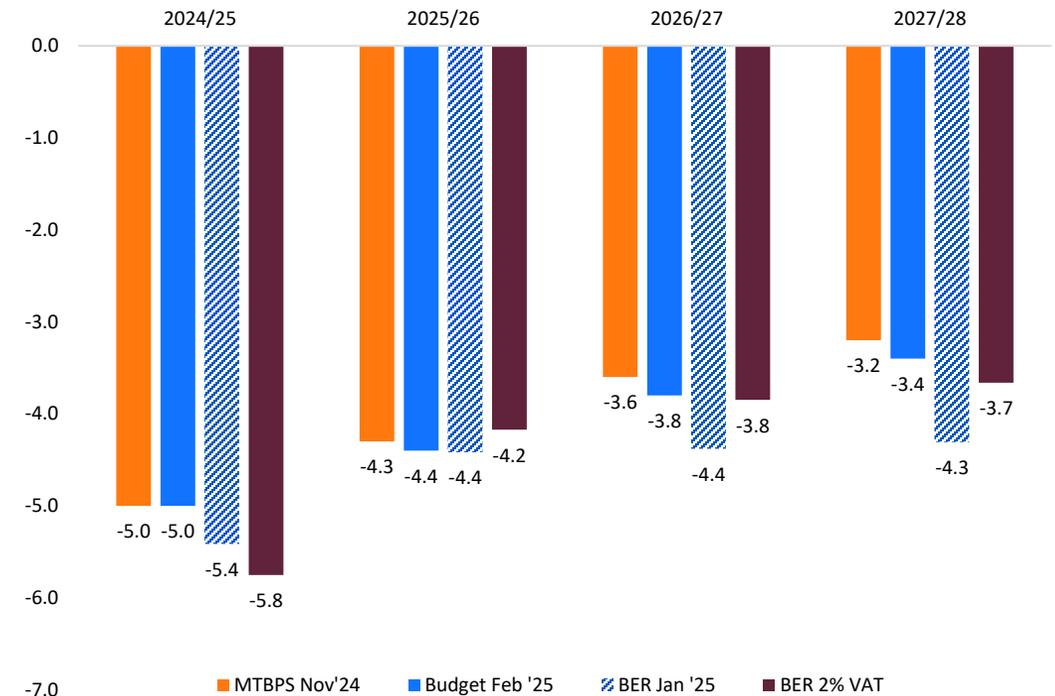
% of GDP



Source: National Treasury, BER

Budget balance remains in deficit

% of GDP



Impact in a nutshell

Our simple model run suggests that:

- Inflation will be higher
- The Taylor Rule suggests that this could lead to higher interest rates
 - This means that investment, initially not directly affected by a VAT hike, also tilts down relative to the baseline
- Real consumption will be lower from the initial VAT impact and higher interest rates
- Ceteris paribus, the impact on real GDP growth will be negative
 - The National Treasury deemed the Budget to support growth over time, despite the tax increases, as the additional expenditure would, for example, lead to job growth
- The improvement in the debt metrics relative to the BER forecast is because some of the additional expenditure we had in our baseline (on the assumption that the government would struggle to stick to inflation-related wages increases and that some form of the SRD would become permanent) can now be funded with VAT revenue rather than by taking on extra debt

The Budget has again brought to the forefront that SA needs a structural reduction in spending

As a share of GDP, government spending has been around 32% of GDP in recent years.

Despite tax rate increases, tax revenue has struggled to get near 28% of GDP over the same period.

- Realistically, this is not a problem that can be fixed before 12 March but does need to be addressed
- For now, if the potential VAT revenue is removed, we need R58bn in either tax increases or expenditure cuts
- There are some quick wins that can be made to help balance the books better by 12 March but to 'find' R60bn will be difficult. Trade-offs need to be made and it will be challenge for all GNU parties to agree on what these trade-offs should be.
 - Examples of quick wins? Without a VAT hike, above-inflation grant increases, zero-rating more goods and the fuel levy relief extension could be scrapped (R6.3bn + R2bn + R4bn = R12.3bn in 2025/26).
- Over the longer term, a [fiscal anchor](#) will help with credibility and accountability

What we really need is economic growth

What role could the Budget, and the government, play in accelerating economic growth?

Enabling structural reform:

- Port and rails – tie financial support to private concessions being achieved (and incentivise Transnet)
- Energy market – publish a roadmap for a competitive electricity market, tie the proposed debt swap for Eskom with the unbundling of the transmission company
- Tariff and trade – enhance competitiveness for SA exports and remove barriers to necessary imports (which SA cannot produce)
- Regulatory and red tape – the World Bank has offered a free regulatory review to streamline bureaucracy and cut unnecessary regulations to encourage entrepreneurship and investment.
- Labour market – more labour market flexibility, reduction of barriers to entry and a more competitive environment
- Public procurement – reform based on transparency, competitive bidding, and value-for-money is needed to eliminate patronage-related premiums
- Equity equivalence - make equity alternatives available in place of ownership requirements (already done in the automotive sector and agreed upon for ICT)

What's next for the BER?

Our next formal forecast update is scheduled for April, but depending on the:

- 2024Q4 GDP figures released on 4 March
 - And the extent of possible revisions to the historical data
- insights from our Business Survey (the RMB/BER BCI for 2025Q1 will be released on 5 March)
- content of the 'new' Budget
 - Scheduled for 12 March, but you never know...
- possible changes to our inflation outlook following the January CPI release (which incorporated updates to the basket and weights)

We might publish an interim forecast update before April, we will keep our clients posted.

THANK YOU.

Shannon Bold

Lisette IJssel de Schepper

✉ sbold@sun.ac.za ; lisette@sun.ac.za

🐦 [@BERcoza](https://twitter.com/BERcoza)

🌐 www.ber.ac.za

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