Budget Preview

ECONOMICS | South Africa

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Better revenue growth reduces the budget shortfall in FY2024/25

- Macroeconomic assumptions: The National Treasury will likely reduce its 2024 forecast for real GDP growth to reflect the impact of the sharp contraction in agriculture in Q3. The outlook appears more encouraging as the economy benefits from favourable weather, steadier electricity supply, subdued inflation, modestly lower interest rates, and reasonable global demand. However, downside risks to domestic growth are still elevated primarily due to the looming threat of an escalating trade war between the US and its trading partners. We forecast real GDP growth to average 1.6% a year between 2025 and 2027, which aligns with Treasury's 1.8% forecast in the 2024 Medium-Term Budget Policy Statement (MTBPS).
- Revenue: Gross tax collections for fiscal year (FY) 2024/25 will slightly exceed the MTBPS estimate but remain below the 2024 Budget projection by more than R20 billion. Personal taxes have increased sharply, boosted by the two-pot retirement fund withdrawals. At the same time, company taxes will likely beat October's projections. However, VAT growth will probably fall short of the MTBPS's estimate, contained by the faster-than-expected deceleration in inflation. Over the next three years, faster economic growth and rebounding tax buoyancy will boost tax collections but will still be well below the trajectory set out in February 2024.
- Expenditure: Non-interest expenditure rose by less than 3% in the first nine months of FY2024/25, running well below last year's Budget and MTBPS targets. Debt service costs increased less than projected, while Treasury seems to have absorbed the higher wage bill within the original allocations. Although encouraging, the higher-than-budgeted public sector wage settlement will exert upward pressure on expenditure over the Medium-Term Expenditure Framework (MTEF-2025/26 to 2027/28).
- Budget balance: We expect the consolidated budget deficit to narrow slightly to 4.4% of GDP in FY2024/25 from 4.5% in FY2023/24, beating the 5% reflected in MTBPS. The deficit will narrow over the MTEF, driven by stronger revenue growth as nominal GDP increases. Encouragingly, the primary surplus will increase over the period.
- Debt metrics: The public debt ratio will rise over the next two fiscal years before slowly starting to ease.
- Policy announcements: We expect some clarity on the review of the inflation target, while a fiscal rule will not be announced.

Table 1: Consolidated Budget framework

	2023/24	2024/25		2025/26		2026/27		2027/28	
	Feb-24	Oct-24	Feb-25	Oct-24	Feb-25	Oct-24	Feb-25	Oct-24	Feb-25
Revenue (Rbn)	1 941.4	2 021.5	2 053.4	2 166.6	2 176.0	2 314.3	2 316.8	2 472.4	2 472.4
%growth	2.4	4.1	5.8	7.2	6.0	6.8	6.5	6.7	6.7
%of GDP	27.4	27.4	27.8	27.7	27.8	27.8	27.9	28.0	28.0
Expenditure (R bn)	2 258.8	2 395.0	2 376.3	2 510.3	2 514.1	2 624.4	2 627.2	2 767.1	2 745.4
%growth	5.5	6.0	5.2	4.8	5.8	4.5	4.5	5.4	4.5
%of GDP	31.8	32.4	32.2	32.1	32.1	31.5	31.6	31.4	31.1
Consolidated Budget Balance (R bn)	-317.4	-373.5	-322.8	-343.7	-338.1	-310.1	-310.5	-295.3	-273.1
%of GDP	-4.5	-5.0	-4.4	-4.3	-4.3	-3.6	-3.7	-3.2	-3.1
Debt Service Costs (R bn)	356.1	388.9	383.9	419.1	396.1	445.7	422.7	475.7	447.4
%of GDP	5.1	5.1	5.2	5.2	5.1	5.2	5.1	5.2	5.1
Primary Balance	33.2	33.2	61.1	75.3	58.1	120.6	112.3	166.7	174.3
%of GDP	0.5	0.4	0.8	0.9	0.7	1.4	1.3	1.8	2.0
Gross debt-to-GDP ratio (%)*	*74.1*	*74.7*	*76.5*	*75.5*	*77.9*	*75.3*	*77.0*	*75.0*	*75.7*
Nominal GDP (billion)	*7 094.8*	*7 524.1*	*7 383.1*	*8 014.4*	*7 820.6*	*8 532.2*	*8 318.6*	*9 091.9*	*8 820.2*

Source: MTBPS 2024 and Nedbank Group Economic Unit. Oct-24 shows MTBPS 2024 figures, Feb-25 is our Budget 2025 forecasts

The macroeconomic backdrop

The Finance Minister will table the 2025 Budget Speech against a better macroeconomic environment than a year ago. The government of national unity (GNU) is still intact, and a broad economic policy consensus prevails despite disagreements on basic education and land redistribution policies. Power outages have been reduced significantly, while efforts to improve the efficiency of the rail and port systems are ongoing.

Although the economy remained relatively weak last year, there were pockets of improvement. Services benefitted from robust activity in hospitality and financial services. In Q3, dry weather conditions and the lingering effects of animal diseases hurt agriculture. The return of good rains will lift the harvest in 2025, positively contributing to real GDP growth. Mining and manufacturing have shown signs of stabilisation and will benefit from more reliable power supply, easing logistical bottlenecks, and steady global growth.

Reasonable wage increases and the rapid deceleration in inflation over the final quarter of last year lifted consumers' real disposable incomes. Lower interest rates and withdrawals under the two-pot retirement system gave an additional boost to consumer demand. Although business sentiment has improved substantially, signs of a sustainable pick-up in private-sector fixed investment are still absent. The improving growth outlook will help to mobilise business investment beyond the usual replacement spending. In the State of the Nation Address, President Cyril Ramaphosa stressed that the government will prioritise municipalities to ensure they improve their public service delivery. This, together with a more stable grid and the promised improvement of Transnet's operational efficiency, should establish a more positive domestic macroeconomic environment.

We forecast real GDP to rise above 1% from 2025, buoyed by moderate gains in output and demand. National Treasury is likely to lower its 2024 real GDP growth forecast to account for the Q3 shock from agriculture. However, we still expect Treasury to reflect a recovery of more than 1% between 2025 and 2027.

Table 2: Forecasts of key macroeconomic variables

Indicators (calendar years)	Actuals	Forecasts			
% change	**2023**	**2024**	**2025**	**2026**	**2027**
Final household consumption	0.7	1.2	2.0	1.6	1.8
Gross fixed-capital formation	3.9	-3.8	1.3	2.3	2.9
Gross domestic expenditure	0.8	0.7	0.9	0.9	0.9
Exports	3.7	-4.2	1.2	4.0	3.4
Imports	3.9	-6.0	2.3	3.1	4.1
Real GDP growth	0.7	0.5	1.4	1.8	1.6
CPI inflation	5.9	4.4*	4.0	4.6	4.6
Current account balance (% of GDP)	-1.6	-1.3	-1.7	-1.8	-1.8

Source: Nedbank Group Economic Unit, *actual

The fiscal framework

The improved macroeconomic conditions have lifted consumer incomes and extended a slight boost to corporate profitability, supporting tax collections. We, therefore, expect gross tax revenue to be marginally better than the MTBPS's estimate but still well below the Budget projection.

Gross tax collections have been boosted by firm growth in personal taxes as non-regular pay remained strong, while there was also a boost from the higher-than-projected two-pot withdrawals. Company taxes will likely exceed October's estimate, albeit slightly, while the dip in the fuel levy will offset higher VAT collections. Over the MTEF, we expect the normalisation of the fuel levy to be a positive contributor. Non-interest expenditure rose by less than 3% in the fiscal year to date (FYTD) (April — December 2024), while debt service costs rose by less than 6%. As a result, aggregate expenditure growth amounted to 3.1%, well below the 6% projected in the MTBPS.

We expect a lower budget deficit in FY2024/25, at 4.4% of GDP, which compares favourably with the 5% estimated in the MTBPS and is a slight improvement from 4.5% in FY2023/24. Over the MTEF, we forecast the deficit to drop to 3.1% by

FY2027/28, a trajectory similar to the MTBPS. The primary budget surplus will widen over the period, enabling the National Treasury to reduce its new borrowing. The public sector wage poses a risk to the outlook, with unions reluctant to enter into multi-year agreements that would make the trajectory of the wage bill more certain.

We estimate a slower increase in nominal GDP compared with the MTBPS. As a result, we expect the debt-to-GDP ratio to remain sticky around 76% over the MTEF. Despite the lower nominal GDP, we forecast tax growth to be higher as the tax buoyancy ratio stabilises around 1.1.

We do not expect any new policy announcements. Media reports indicate that the Medium-Term Development Programme (MTDP), which will set an economic growth target of 3% per annum, will not include a fiscal rule. This contradicts the National Treasury's announcement in the MTBPS that it was undertaking technical work on an anchor to guide changes in expenditure. The Treasury will likely give an update on the process to review the inflation target. At January's Monetary Policy Committee meeting, Reserve Bank Governor Kganyago announced that a conference on the inflation targeting framework will be held in March, a clear indication that the public consultation phase of the process is due to commence. In recent years, the Governor has argued to revise the inflation target to 3% from the current 4.5%.

Revenue

The improved macroeconomic environment has boosted consumer incomes and supported corporate profitability, albeit slightly. However, indirect taxes have fallen short of Treasury's projections, undermined by a slump in electrical machinery imports for power generation and lower fuel consumption.

Gross tax revenue was up 5% in the FYTD, below Treasury's projected 5.7% in the MTBPS. We estimate that total tax revenue will rise by 5.8% in FY2024/25, exceeding the MTBPS by R1.1 billion, reducing the shortfall over the Budget projection to R21.2 billion. Over the MTEF period, we estimate a shortfall of R50 billion relative to February's projection, which is much lower than the R63.6 billion shortfall in the MTBPS.

Table 3: Monthly cumulative tax revenue growth

Tax type, (yoy% change)	Apr-24	May-24	Jun-24	Jul-24	Aug-24	Sep-24	Oct-24	Nov-24	Dec-24
Taxes on income and profits	11.4	11.1	5.1	6.6	7.1	8.3	8.4	9.6	7.9
Personal income tax	*15.0*	*12.7*	*11.8*	*12.6*	*11.7*	*11.9*	*12.9*	*13.3*	*13.2*
Taxes on corporate income	*-18.0*	*-0.8*	*-5.5*	*-4.5*	*-1.2*	*1.9*	*-0.6*	*1.3*	*-1.2*
Taxes on goods and services	47.8	-0.9	0.1	-2.6	-1.3	-0.5	-0.9	-0.1	-0.4
Value-added tax	*-11.2*	*-2.2*	*0.4*	*-2.8*	*-0.7*	*0.1*	*0.6*	*1.6*	*1.3*
Import VAT	*8.7*	*0.5*	*-5.2*	*-5.6*	*-4.8*	*-4.5*	*-3.6*	*-2.3*	*-2.3*
Fuel levy	*15.1*	*5.7*	*-2.1*	*-1.3*	*-2.7*	*-3.9*	*-5.1*	*-7.2*	*-9.1*
Gross tax revenue	5.6	6.3	3.4	3.1	4.0	5.0	5.0	6.0	5.0

Source: National Treasury, Nedbank calculations

Personal income taxes (PAYE) are rising ahead of the National Treasury's estimates in the Budget and MTBPS. FYTD collections are up by 13.2%, equivalent to 71.6% of the October estimate, pointing to a slight outperformance for the FY. In addition to strong growth in non-regular pay, the higher-than-projected withdrawals under the two-pot retirement system have also contributed. The South African Revenue Service (SARS) announced on 31 January that R43.42 billion had been withdrawn since the introduction of the system in September 2024. Given the minimum marginal tax rate of 18%, the additional tax receipts amount to around R8 billion. We assume an average tax rate of 20% and withdrawals totalling R46 billion by the end of February 2025, with a tax haul of about R9 billion for FY2024/25. In FY2025/26 and FY206/27, we assume an average of R5 billion per year. We estimate FY2024/25 PAYE to be R1.7 billion above the MTBPS estimate, translating to growth of 12.8% for the whole year.

Corporate taxes were down by 1.2% FYTD in December. Tax payments by companies always rise sharply as the end of the tax year approaches, so there is a good chance that total collections for FY2024/25 will be higher than the R314 billion estimated in October. We project corporate taxes will be R600 million and R12.3 billion, higher than the October and February 2024 estimates.

The other major taxes have been mixed. Value-added tax (VAT) has risen slower than the 3.6% estimated in the MTBPS and will be the main detractor from the expected overall tax take. Although festive season spending picked up, the low levels at the start of the FY will keep the growth rate for the year below 2%. The contraction in import VAT has moderated, but we still expect total collections to be down by 2% in FY2024/25. The fuel levy was down by 9.1% yoy in the first nine months, broadly in line with the 10% drop estimated in the MTBPS.

We do not anticipate any significant new revenue measures. Personal tax brackets are again likely to be left unchanged, considering the subdued inflation rate.

Medical aid tax credits could also be unchanged as the government prepares to introduce the National Health Insurance Scheme (NHI). Reports suggest the NHI legislation will be amended to make provisions for the continued existence of medical aid schemes alongside NHI, implying the withdrawal of tax credits in the future.

The fuel levy has not been adjusted since April 2022, so we expect an inflation-related hike in FY2025/26. Considering the end of load-shedding and the relief it has brought to business operational costs, the levy could be increased by more than inflation.

The excise duties on alcohol and tobacco products will rise by the usual above-inflation adjustments.

Expenditure

The expenditure trends have been encouraging. Debt service costs have risen at a slower rate than National Treasury's forecasts, reflecting the benefit of lower interest rates and the utilisation of the Gold and Foreign Exchange Contingency Reserves (GFECRA) account to limit new borrowing. The wage bill has also been largely contained. This trend, however, is unlikely to be maintained over the MTEF, with spending growth raised by higher wage increases and the expected increase in social spending.

Non-interest expenditure growth has been contained in FY2024/25. It rose by only 2.6% YTD, well below the estimated 4.3% in the MTBPS and the 6.3% recorded in the first nine months of FY2023/24. The lower figure indicates that Treasury has restricted the increase in the public sector wage bill to around 4.5% in FY2024/25, in line with the March 2023 wage settlement. It also suggests that the departments broadly followed Treasury's directive to absorb the additional wage payments within the baseline budgets allocated in FY2023/24. However, the wage bill will rise faster than was reflected in the Budget over the next three years. We assume an increase of 5.5% for the FY2025/26 as some public sector unions have already accepted the government's 5.5% offer, which is less than our assumption of 6.5% in February 2024. Departments will probably be unable to restrict their wage bills further as savings from controls on new hirings will be limited. In FY2026/27 and FY2027/28, we assume an increase of 6% a year as labour unions will still push for above-inflation increases.

Debt service costs have risen by 5.8% YTD in FY2024/25, below Treasury's estimate of 7.3% and the 9.2% of Budget and MTBPS. As a result, we estimate a rise of 5.7% in FY2024/25. Therefore, the interest payments-to-revenue ratio will be slightly lower but still close to 20% over the MTEF.

The expenditure allocation by functions will likely align with the priorities set out in the Budget and the MTBPS. Economic services, dominated by public infrastructure spending, is unlikely to receive higher allocations. In the SONA, President Cyril Ramaphosa stressed that R940 billion would be spent on infrastructure over the MTEF period, which aligns with previous figures. We expect the government to expand public infrastructure expenditure by crowding in private sector capital and expertise, with the details to be provided by the respective departments' appropriations.

Although National Treasury remains committed to restricting new bailouts for the large state-owned enterprises (SOEs), we expect a comprehensive package for Transnet. In November 2023, Treasury extended a R47 billion guarantee facility to Transnet to improve its borrowing profile. However, it has emerged that the utility needs capital injections and debt relief as it tackles the inefficient rail system and strives to improve the operational efficiency of the national ports in partnership with international operators. We expect a package similar to that extended to Eskom, comprised of capital transfers and the fiscus taking over some of the SOE's debt. No major bailouts are likely for the South African Post Office and the South African Broadcasting Corporation.

Budget metrics

For FY2024/25, we forecast the budget deficit at 4.4%, lower than the MTBPS's 5% projection and slightly lower than 4.5% in FY2023/24. Our calculations put the deficit at 3.1% by the end of the MTEF.

We project the gross debt-to-GDP ratio to be higher over the MTEF, primarily due to our lower nominal GDP estimates. Per our forecasts, the ratio peaks at 77.9% in FY2025/26. A faster rise in real GDP as local consumption and investment expand could dampen the debt ratio.

Financing the budget deficit

The National Treasury will take advantage of the more favourable domestic and global financing conditions to extend the maturity profile of the national debt stock. We expect foreign borrowing to increase slightly relative to the Budget plans.

Treasury will continue to utilise the Gold and Foreign Exchange Contingency Reserves (GFECRA) as laid out in February 2024. However, we do not expect the withdrawals to be expanded over the MTEF.

We still expect steady demand for government bonds, with the proportion of foreign investors willing to hold South African public debt stabilising at around 26%.

Conclusion

This year's budget will likely reflect continued progress towards fiscal consolidation and reiterate the government's commitment to structural reforms. We expect a slightly faster pace of deficit reduction as tax revenue benefits from faster economic growth and continued expenditure restraint. Although the debt burden will likely be higher than National Treasury projected, it will stabilise within the next three years. The risk to the fiscal outlook still resides on the upside, with the main threat stemming from higher-than-expected wage settlements and potentially more SOE bailouts.

GROUP ECONOMIC UNIT

Isaac Matshego	+27 10 238 8358	isaacmat@nedbank.co.za
Johannes Khosa	+27 10 234 8359	johanneskh@nedbank.co.za
Nicky Weimar	+27 10 234 8357	nickywe@nedbank.co.za

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