Budget 3.0: a moment of decision 12 May 2025

During the Freedom Day weekend run-up, the Minister of Finance withdrew his proposal to increase the VAT rate. On Freedom Day – Sunday, 27 April – the Cape High Court also issued an order prohibiting the Minister from proceeding with the VAT hike.

The Budget meets a new political reality

The reversal of the VAT increase marks a new experience for South Africans: for the first time, parliament's balance of forces genuinely affects Budget decisions.

In my earlier note on the Budget, I highlighted that the first decision on the Budget, the approval of the **fiscal framework,** was already a 'damn close-run thing'. The majority was only 12 out of 400, but 24 members were absent when the vote was taken.

Since that approval on 2 April, parties that supported the fiscal framework stood back from their decisions. Thus, the Minister could not assume a majority in the remaining three voting rounds. Any case, the High Court ruled the approval of the fiscal framework invalid and set it aside. Hence, the new Budget is now due on 21 May.

How did we get here?

Before and after 1994, South Africa's parliament could approve or reject a Budget, but could not amend it. The 1996 constitution, however, provided that legislation should be passed to allow parliament to amend Budgetary legislation. That enabling Act was passed in 2009, 13 years later. Since the ruling party held an absolute majority in parliament, the practical effect was muted: parliament approved whatever the Minister of Finance proposed.

That changed after last year's election, when the ANC lost its majority. From now on, they will need support from other parties to pass the Budget.

An experience at the dawn of democracy may be useful. In 1993, Derek Keys increased the VAT rate from 10% to 14% in one budget. He did that with the support of all major players in- and outside government. It was an extraordinary political feat. How did he do it? He involved everybody in the budget numbers and asked them what should happen. After these consultations, nobody opposed the 40% increase in VAT. Minister Godongwana missed this simple process trick.

Where do we stand now?

The Minister must now table a new Budget, excluding the VAT increase that had been pencilled in at 0.5% this year and another 0.5% next year. That reduces revenue by **R13.5 billion** for the current fiscal year, and a cumulative **R75 billion** over the medium-term (three years).

The Trump tariffs have made this worse. Global growth is now forecast to be lower and so SA's growth too - about 0.5% lower than the 1.9% on which the Budget was based pre-Trump shenanigans. It will reduce income this year by more than R13,5 billion.

On the expenditure side, the Trump decision to terminate all grants for Aids, health and research will also add more pressure. Health news agency Bhekisisa calculates the lost funding at about R9,5 billion. Add that to the R13,5 billion and lost income and …

A fundamental question

Treasury has already indicated that it will submit a new fiscal framework that retains the goal of 'stabilising SA's debt' - in practical terms, retaining a primary surplus to reduce debt. A primary surplus is simply income more than expenditure before interest payments. It is a precondition to reduce debt and the burden of interest payments. For the year, R71 billion was pencilled in as primary surplus.

The question facing our parliamentarians is whether to work under that constraint, or simply borrow more. We now know the income will be substantially less than envisaged in the first budget. Will the parties now support expenditure cuts? All of them say 'frontline services' must not be cut. What does that nebulous term mean? Does it mean funding for Aids programmes, or appointing more doctors; appoint more teachers but not more doctors?

Equally nebulous is the cry 'Cut corruption!' Sure, but which line items in the Budget authorise corruption? There is a lot of corruption reported in the health sector. Must the health Budget therefore be cut?

A Budget is essentially about the tough choices; nebulous phrases will not help.

The cost of borrowing

Let's take a closer look at the numbers in the tabled Budget. Even with the VAT increase, the Minister of Finance intended to **borrow R394.6 billion** this year. It is more than R1 billion per day – a staggering figure.

An interest rate increase of just 0.01% (one basis point) would increase government interest payments by R39 million annually. That's over R100 000 in extra interest every day of the calendar year.

So, while **0.01% may sound trivial**, it is not. The political fallout around the Budget has already increased the interest payable by some 20 basis points. Yes, the cost of the recent budget fight is an additional R2 million in interest per day! This could have paid for a lot of doctors and teachers.

Why has the kerfuffle around the Budget led to an increase in interest payable? This is where the bond market comes in.

Where politics and economics meet – the bond market

The government borrows money on the **capital market** — colloquially known as the bond market. That is where borrowers and investors meet. The government issues a bond, an 'I-owe-you', in exchange for cash from investors. This exchange happens at weekly bond auctions where the price, or interest rate, is set. That rate is known as the **long rate** – the interest rate payable on long-term debt.

That rate also sets the **cost of capital** in the economy at large. The higher the long rate, the more difficult investment; the lower, the easier investment becomes. The impact goes far beyond governments' interest payments.

Capital markets are vital for all governments. That is how governments finance their deficits. When expenditure exceeds income from taxes (which is virtually all the time), governments turn to the bond market to finance their shortfall.

Political decisions immediately impact bond yields, capital flows and investment. After the formation of the GNU, the long rate declined by more than 80 basis points (or 0.80%) to less than 10.6%. With the Budget turmoil in April, the rate shot up to 11%. (Sure, the Trump tariffs affected this, but part of the spike was certainly local politics.)

Politics fluences what happens in the bond market. It all finds expression in one single number: the long rate. Sensible politics and sound fiscal management are prerequisites for keeping that rate down.

We recently saw the power of the bond market in two remarkable U-turns by Donald Trump. He suspended his infamous 'reciprocal' tariffs for 90 days (except on China) and walked back threats to fire Fed Chairman Jerome Powell. Hence the saying 'TACO – Trump again chickens out' (apology to the FT). In the UK, in 2022, Liz Truss became the shortest-serving prime minister in history (50 days) after she submitted an unfunded Budget to parliament and the bond market revolted. We saw it at work in South Africa, too, when Des van Rooyen was appointed Finance Minister for four days.

In exercising their newfound freedom to amend the Budget, parliamentarians must consider the bond market when deciding on the new fiscal framework.

So What?

- For the first time in South Africa's history, parliament must now decide on the numbers in the Budget and can indeed change them.

- With that power comes the responsibility for the consequences of reckless Budgeting. The recent budget kerfuffles have already cost us more in interest.
- A failure to stabilise debt will push up the long rate and weaken the economy even further. It will undermine the progress made since the GNU was formed.
- Politics and economic meet in the bond market. The will of the people is important. So is long-term fiscal stability. The two must be balanced. It is a moment of decision for the parliamentarians.