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Budget to reveal a tougher year for consumers with significant tax hikes

Cape Town, 16 February 2016: With all eyes on Minister Pravin Gordhan as he prepares for his Budget Speech later this month, one thing that is certain is that 2016 is going to be a tough year for South African consumers. This is according to Old Mutual Investment Group Senior Economist, Johann Els, who says that a looming ratings downgrade, the falling rand and rising inflation means that Treasury will have to hike taxes even more significantly this year than in the previous few years, and much of this burden will land on consumers' shoulders.

To prevent a downgrade to SA's debt, Government will need to make some difficult decisions that will reduce the budget deficit faster than the targets set in the Medium-term Budget in October 2015, says Els.

"Most of the deficit reduction will likely come from tax hikes since reducing Government's expenditure ceiling significantly seems challenging right now," he explains. The easy wins for Treasury will come from consumer tax increases, where high income earners will likely be targeted. The top marginal tax rate could be lifted further from 41% to 42% or 43%, earning government between R2 billion and R4 billion per annum extra. Other possible changes could include raising the effective rate for Capital Gains Tax – an increase from 13.3% to 20% will net R3 billion – or an increase in dividend tax – an increase in the rate from 15% to 20% could net an extra R7 billion.

Els adds that in order to spread the tax burden more widely across all consumers Treasury's revenue increase options might also include a VAT hike of 1% and/or a big fuel levy increase. "The most positive message the Minister could send would be a VAT hike, although the probability of this is less than 50% given that we're currently in an election cycle. However, Gordhan's newfound position of power after his reappointment as Minister of Finance late last year could mean that he has the means to persuade Government on this. A VAT hike would almost certainly stabilise the rand and satisfy the ratings agencies enough to avoid the looming threat of a downgrade of SA to junk status – at least in the short term," he says.

Els says that the Ministry's other tax options include an increase in property tax, inheritance tax and the much-talked about wealth tax, which all remain uncertain for the moment. "While painful for the consumer, across-the-board tax hikes or tighter fiscal policy would take some of the pressure off the SA Reserve Bank increasing interest rates further," he explains.

According to Els, significant tax hikes will certainly hurt the economy and keep downward pressure on growth this year. "We expect growth at around 1% in 2016, but could avert a recession if there are no further negative impacts from the rest of the world, local strikes or a further slump in agricultural production.

Although consumers are in for a bumpy year, he believes that SA isn't facing a deep consumer spending recession and the biggest threat to consumers will be food inflation. "In fact, the situation consumers are facing this year is not as bad as what we saw in 2008 and 2009," he explains. "Interest rates and inflation rises over 2016 and 2017 will be more subdued than in 2008 and 2009 and job losses will likely be a lot lower than the 860 000 local jobs lost during the 2008/2009 global and local recession."

Looking at Government's expenditure framework, Els says that the Minister will be forced to accommodate extra expenditure like the R6.8 billion university funding and an estimated R5 billion of drought relief within their existing spending ceiling. "This means that expenditure cuts will need to come from elsewhere, which is not going to be easy for Treasury," says Els. "We could see a hiring freeze in the public sector, but are unlikely to see any salary cuts."

However, Els believes that working in the Minister's favour is the fact that spending control so far has been good, with Treasury staying within their existing expenditure ceiling. "Minister Nene's last Budget hasn't left Pravin Gordhan with much room to manoeuvre, so he ultimately needs to start from scratch if he's going to implement an effective and tougher Budget this year, which will take the pressure off of the SARB and keep junk status ratings at bay for the country."

Caption: Johann Els, Old Mutual Investment Group Senior Economist

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