SOUTH AFRICA | MACROECONOMIC UPDATE | BUDGET ANALYSIS | INSIGHTS

FUNDAMENTALS

SOUTH AFRICA FY26 BUDGET UPDATE

TAKE 2, LOWER VAT RATE HIKE

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IN BRIEF

- South Africa's Finance Minister Enock Godongwana delivered the much-delayed 2025 Budget speech in Parliament on 12 March 2025. At the crux of the budget presentation was the reduction in the proposed VAT rate hike from the initial 2.0% to a revised 0.5% increase in both FY26 and FY27 budget years with effect from 01 May 2025, and 01 April 2026, respectively.

- Despite investor concerns, we think there is a high bar to any pushback of the fiscal framework during the parliamentary approval stage. Section 8 of the Money Bills Amendment Procedure and Related Matters Act (MBARMA) lays out the timeframe for the legislative approval of the fiscal framework.

- The effect of the proposed new taxes will be a cumulative net increase of ZAR 119.0bn in the FY26 – FY28 budget period, lower than the ZAR 182.4bn that had been penciled in the February 2025 budget speech. Alternatives to the proposed 0.5% VAT rise, which targets to raise ZAR 13.5bn in FY26 could have been increases in Personal Income Tax (PIT) and Corporate Income Tax (CIT) which could have been unpalatable, in our view.

- Although fractures have emerged around the tax proposals within the GNU coalition, the budget speech also signalled the ANC's faction warming up to spending reviews to curb wastage and improve efficiency. We think these commitments show some convergence of thoughts around the fiscal framework amongst the GNU coalition partners.

- Refreshingly, the National Treasury published its fiscal anchor discussion document amidst ongoing debate on whether South Africa should formally adopt a fiscal anchor. With the debt expected to stabilize at 76.2% in FY26, we think that the adoption of a formal fiscal rule limit, more so a numerical fiscal (Type III) rule, will better finetune the fiscal framework.

- The National Treasury announced that its maiden infrastructure bond will be issued in FY26 between April 2025 and January 2026 once the appropriate vehicle has been set up. With domestic bond maturities projected at ZAR 303.7bn in FY28, up from ZAR 172.8bn in FY26, the authorities are keen on pursuing switch auctions to manage the gross borrowing requirement in future budget years.

Budget statement delivered but implementation delays in our bear case

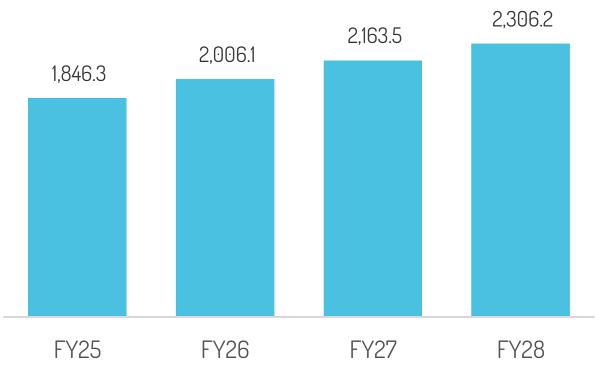
South Africa's Finance Minister Enock Godongwana delivered the much-delayed 2025 Budget speech in Parliament on 12 March, 2025. At the crux of the budget presentation was the reduction in the proposed VAT rate hike from the initial 2.0% to a revised 0.5% increase in both FY26 and FY27 budget years with effect from 01 May 2025, and 01 April 2026, respectively. Even with the presented budget speech showing these concessions, cracks continue to emerge within the Government of National Unity (GNU) coalition partners with sections of the media quoting senior officials of the Democratic Alliance (DA) opposing the tweaked fiscal framework.

Despite investor concerns, we think there is a high bar to any pushback of the fiscal framework during the parliamentary approval stage. Section 8 of the Money Bills Amendment Procedure and Related Matters Act (MBARMA) lays out the timeframe for the legislative approval of the fiscal framework. With no amendment, the Finance Committee is required to table its recommendation report by the end of this month. Any possible amendment to the fiscal framework, more so around the tax proposals, needs to have positive offsets under MBARMA. Assuming a scenario where the Finance Committee approval process prolongs, Section 29 of the Public Finance Management Act (PFMA) has spending limits pending passage of the Appropriations Bill. On the other hand, PFMA assumes tax proposals presented in any budget speech are effective for a period of 12 months, unless reversed by an Act of Parliament. Given the high bar in reversing the contestable proposed VAT hike, we expect a delay in approving the fiscal framework in our bear-case scenario, as opposed to any amendment from the Committee.

Sweet spot with 0.50% VAT hike

The effect of the proposed new taxes will be a cumulative net increase of ZAR 119.0bn in the FY26 – FY28 budget period, lower than the ZAR 182.4bn that had been penciled in the February 2025 budget speech. Alternatives to the proposed 0.5% VAT rise, which targets to raise ZAR 13.5bn in FY26 could have been increases in Personal Income Tax (PIT) and Corporate Income Tax (CIT) which could have been unpalatable, in our view. Despite a ZAR 3.5bn budgetary allocation to the South African Revenue Service (SARS), we think tax administration by itself could have fallen short in plugging the fiscal hole. As offsets to the proposed VAT hikes, the fiscal authorities also announced targeted reliefs to the most vulnerable to cushion them against the adverse effects. Furthermore, consumers were spared an increase in the fuel levy, as has been the case since 2022, with the government foregoing ZAR 4.0bn in revenue collection and a neutral adjustment to other fuel-related levies. Compared to the initial proposed February 2025 budget, the authorities have penciled in lower tax revenue by ZAR 30.0bn.

GROSS TAX REVENUE, ZAR BN'S

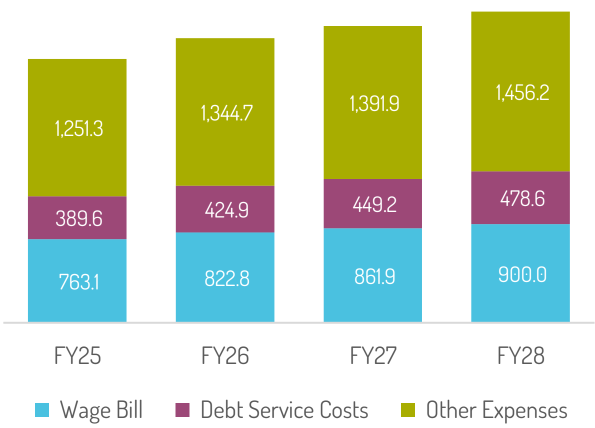


SOURCE: NATIONAL TREASURY, IC INSIGHTS

UAE financing is still on course

Although fractures have emerged around the tax proposals within the GNU coalition, the budget speech also signalled the ANC's faction warming up to spending reviews to curb wastage and improve efficiency. The National Treasury plans to undertake an audit of ghost workers, rationalization of the entire public employment ecosystem using the ongoing labour market reviews and alluded to effecting some changes around the budget process. We think these commitments show some convergence of thoughts around the fiscal framework amongst the GNU coalition partners.

CONSOLIDATED GOVERNMENT SPENDING, ZAR BN'S



SOURCE: NATIONAL TREASURY, IC INSIGHTS

Provisional allocation for frontline workers, infrastructural spending and 2025 public service wage bill will take up 60.5% of the additional spending funded in the FY26-FY28 medium-term period. The COVID-19 Social Relief of Distress (SRD) will have a 1-year extension until March 2026 with a budgetary allocation of ZAR 35.2bn before being phased out from FY27 budget year. The wage bill as a percentage of non-interest spending will steady at 38.4% in FY28 from 38.0% in the current FY25 budget year. The elevated interest rate environment and the weaker ZARUSD exchange rate have ballooned debt service cost from ZAR 389.6bn in FY25 to projected ZAR 424.9bn in FY26. Given these dynamics, the authorities intend to run a fiscal deficit of 4.6% and a primary balance of +0.8% in FY26.

FISCAL DEFICIT-TO-GDP RATIO

SOURCE: NATIONAL TREASURY, IC INSIGHTS

Fiscal anchor on track but we view numerical fiscal rules limit as a more tangible option

Refreshingly, the National Treasury published its fiscal anchor discussion document amidst ongoing debate on whether South Africa should formally adopt a fiscal anchor. The discussion paper weighed on adoption of numerical fiscal rules (Type III), either the debt ratio or deficit ratio or both, and principle or standards-based (Type I) that would allow judgment of fiscal policy sustainability. Given the market access characterization in the IMF/World Bank classification, South Africa's debt sustainability is not accessed as a low-income country which typically would have some debt level thresholds for accessing vulnerabilities. Although the publishing of the fiscal anchor discussion document is a welcome move, it appears that there are open-ended timelines. With the debt expected to stabilize at 76.2% in FY26, we think that the adoption of a formal fiscal rule limit, more so a Type III rule, will better finetune the fiscal framework.

Maiden infrastructure bond to be issued in FY26

Financing to the tune of ZAR 582.0bn will largely be from issuance of long-term domestic debt. The National Treasury announced that its maiden infrastructure bond will be issued in FY26, between April 2025 and January 2026, once the appropriate vehicle has been set up. With domestic bond maturities projected at ZAR 303.7bn in FY28, up from ZAR 172.8bn in FY26, the authorities are keen on pursuing switch auctions to manage the gross borrowing requirement in future budget years. Part of the estimated ZAR 140.4bn cash balance as of end FY25 will be utilized to settle the Eskom debt acquisition of ZAR 40bn. The gradual improvement in Eskom's financial position compared to two years ago implies that the government will realize some cumulative savings of ZAR 24.0bn as compared with the baseline scenario at the onset of the targeted relied to the power utility.

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