FUNDAMENTALS

SOUTH AFRICA FY26 BUDGET UPDATE

BUDGET 3.0 EASES CONCERNS

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IN BRIEF

- On 22 May 2025, South Africa's Finance Minister Enock Godongwana delivered the third FY26 Budget Speech. The latest iteration of the medium-term (FY26 - FY28) budget fiscal framework followed the suspension by the High Court of the proposed 0.5% VAT hike from 1 May 2025, and the reversal of this tax proposal by the National Treasury paving way for the budget reading in May 2025.

- The FY26 budget statement was welcomed by markets as it managed to balance the narrowing fiscal space propelled by the revenue hole and fragile macroeconomic backdrop, by lowering the aggregate discretionary spending over the medium-term. In our assessment, this restored the budget credibility and patched the tension that was boiling within the Government of National Unity constituent parties in the previous 2025 budget plans.

- Given the reversal of the proposed 0.5% VAT hike during FY26 budget year, the fiscal authorities also shelved off the widening of the zero-rate VAT regime on select commodities. Furthermore, the National Treasury proposes the first fuel levy increment in three years and effective from 4 June 2025.

- The Budget statement also indicated additional revenue of ZAR 20.0bn to be effective in FY27 budget year. Contingent on the ability of South African Revenue Services (SARS) to generate an annual ZAR 35.0bn from outstanding tax debts, the fiscal authorities will shelve this planned tax raising measures targeted for the next fiscal year.

- The revised budget over the medium term has a lower additional spending of ZAR 180.1bn for FY26 - FY28 period compared to ZAR 232.6bn baked in the March 2025 budget statement, with reduction from ZAR 102.4bn to ZAR 87.3bn in FY26 budget. Provisional allocation for frontline services was reduced by ZAR 10.0bn to ZAR 12.2bn highlighting the need of better accommodating the lower revised budget.

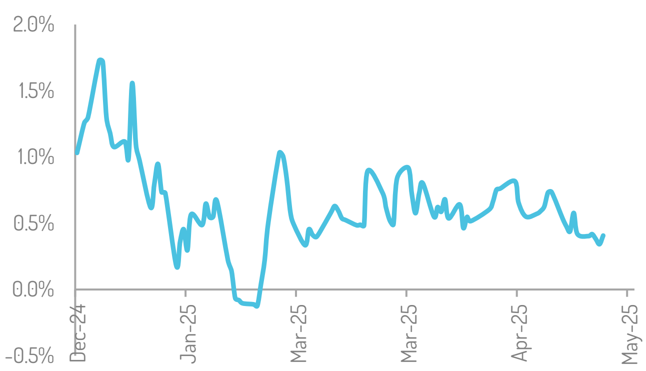
- Gross Financing requirement in FY26 is projected at ZAR 588.3bn from ZAR 398.2bn in FY25, largely on higher domestic long-term bond redemptions and lower Gold and Foreign Exchange Contingency Reserve Account (GFECRA) net settlement.

Third time, a charm

On 22 May 2025, South Africa Finance Minister Enock Godongwana delivered the third FY26 Budget Speech. The latest iteration of the medium-term (FY26 – FY28) budget fiscal framework followed the suspension by the High Court of the proposed 0.5% VAT hike from 1 May 2025, and the reversal of this tax proposal by the National Treasury paving way for the budget reading in May 2025. The downward revision to growth expectations due to negative spillover from external downside risk implies a higher debt stabilization ratio of 77.6% in the latest budget and up from 74.2% in the March 2025 presentation.

The FY26 budget statement was welcomed by markets as it managed to balance the narrowing fiscal space propelled by the revenue hole and fragile macroeconomic backdrop, by lowering the aggregate discretionary spending over the medium-term. In our assessment, this restored the budget credibility and patched the tension that was boiling within the Government of National Unity constituent parties in the previous FY26 budget plans. Given the market-friendly third budget reading and coupled with President Cyril Ramaphosa's visit to the United States to thaw the nascent frosty relationships, the country's risk premium is likely to narrow going forward.

SOUTH AFRICA RISK PREMIUM



SOURCE: BLOOMBERG, IC INSIGHTS

Partly patching the revenue hole

Given the reversal of the proposed 0.5% VAT hike during FY26 budget year, the fiscal authorities also shelved off the widening of the zero-rate VAT regime on select commodities. Furthermore, the National Treasury proposes the first fuel levy increment in three years and effective from 4 June 2025. Specifically, the rate of the specific increase will be ZAR 16cents and ZAR 15cents on petrol and diesel, respectively. On the back of the revised lower average inflation in 2025 – 2026 calendar years from 4.5% to 4.0%, the bracket creep is expected to yield a reduced ZAR 15.5bn in FY26 from the earlier projected ZAR 18.0bn.

FY26 BUDGET TAX PROPOSALS, ZAR MN'S

	Budget 2.0	Budget 3.0
No inflation adj to tax bracket and rebates	18,000.0	15,500.0
No inflation adj to medical tax credits	1,500.0	1,200.0
0.5% increase in VAT	13,500.0	-
Additional zero rating	(2,000.0)	-
No adj to general fuel levy	(4,000.0)	-
Above inflation increase in excise duties on alcohol and tobacco	1,000.0	1,300.0
TOTAL	**28,000.00**	**18,000.00**

SOURCE: THE NATIONAL TREASURY

The Budget statement also indicated additional revenue of ZAR 20.0bn to be effective in FY27 budget year. Contingent on the ability of South African Revenue Services (SARS) to generate an annual ZAR 35.0bn from outstanding tax debts, the fiscal authorities will shelve this planned tax raising measures targeted for the next fiscal year. The fiscal framework has taken a conservative approach by excluding the revenue yield from the tax debts which gives National Treasury freehand with no tax revenue raising in the next fiscal year. Evidently, the National Treasury is cognizant of the maelstrom from any tax revenue raising measure and with possible pushback not only from the Government of National Unity (GNU) constituent parties, but the general public at large.

In this context, there is an ongoing Court case where the Democratic Alliance (DA) and the Economic Freedom Fighters (EFF) seeking constitutionality of Section 7(4) of the VAT Act that grants sweeping powers to the finance minister on the effective date that the proposed VAT tax kicks in. While we await the High Court judgment, we do not anticipate an outright challenge to the effective date of the fuel levy. Despite policy inertia from the finance minister, we observed revenue yields coming from bracket creep that is, no inflation adjustments to tax brackets and rebates, and which has been the case in the previous budget readings suggesting the tight rope of the fiscus. Given the aforementioned strains in adjusting tax revenue and fragile macroeconomic backdrop, the revised budget pencils in a lower revenue potential of ZAR 61.9bn over the medium term.

Lower additional spending baked in Budget 3.0

The revised budget over the medium term has a lower additional spending of ZAR 180.1bn for FY26 – FY28 period compared to ZAR 232.6bn baked in the March 2025 budget presentation, with reduction from ZAR 102.4bn to ZAR 87.3bn in FY26 budget.

Refreshingly, the COVID-19 Social Relief of Distress Grant was retained at ZAR 35.2bn. Provisional allocation for frontline services was reduced by ZAR 10.0bn to ZAR 12.2bn, highlighting the need of better accommodating the lower revised budget. Notably, the authorities have baked in ZAR 1.4bn towards the 2026 local government elections whereas the planned withdrawal of South African National Defense Forces (SANDF) troops from the Democratic Republic of Congo (DRC) has resulted in the reduced budgetary allocation by ZAR 2.0bn over the medium term.

Additional spending for infrastructural projects was scaled down from ZAR 14.1bn to ZAR 7.9bn. With an emphasis on the second phase of Operation Vulindlela, the authorities hinted that there could be the need for financing the projects later in the year. This is potentially an announcement to be made during the 2025 Medium Term Budget Policy Statement (2025 MTBPS) in October. Relatedly, the budget reiterated the issuance of an infrastructure bond in the course of FY26 budget implementation, which we opine is to accelerate the infrastructural development. The scheduled start date of the Public Private Partnership (PPP) Regulations on 1 June 2025 following the gazettement of the amended regulations in February 2025 will also be constructive of the infrastructure sector.

Higher Gross Financing Needs but no tailwind from GFECRA's gold valuation gains

Gross Financing requirement in FY26 is projected at ZAR 588.3bn from ZAR 398.2bn in FY25, largely on higher domestic long-term bond redemptions and lower Gold and Foreign Exchange Contingency Reserve Account (GFECRA) net settlement. Given the 27.9% YTD uptick in gold price this year, there has been expectation amongst market participants that the GFECRA net settlement is likely to be dialed upwards on the underlying commodity's valuation gains. The National Treasury tempered those expectations with a forward guidance of a likely re-adjustment of the GFECRA settlement around the 2025 MTBPS statement after the conclusion of the FY25 financial audit of the South African Reserve Bank (SARB). Should this materialize with some positive bias, FY26 gross financing requirement is likely to narrow and tip the scale towards domestic bond switches to smooth the profile of the short-term maturities.

SOUTH AFRICA MAIN BUDGET FISCAL FRAMEWORK, ZAR BN'S

	BUDGET 2.0			BUDGET 3.0		
	FY26	**FY27**	**FY28**	**FY26**	**FY27**	**FY28**
Gross Revenue	2,006.13	2,163.48	2,306.20	1,985.60	2,141.78	2,286.54
Non-tax revenue	37.88	32.60	32.22	37.36	31.79	31.40
Less: SACU* payments	(73.55)	(77.66)	(91.78)	(73.55)	(78.20)	(88.72)
TOTAL REVENUE [A]	**1,970.46**	**2,118.42**	**2,246.65**	**1,949.41**	**2,095.37**	**2,229.23**
Direct charges (National Revenue Fund)	1,113.33	1,168.52	1,231.50	1,114.81	1,166.35	1,230.40
o/w Debt Service costs	*424.87*	*449.19*	*478.61*	*426.35*	*447.01*	*477.51*
Appropriated by vote	1,168.96	1,174.43	1,215.62	1,172.21	1,170.42	1,211.80
Other expenses	42.06	88.51	95.88	23.71	66.26	73.43
TOTAL EXPENDITURE [B]	**2,324.35**	**2,431.46**	**2,543.00**	**2,310.73**	**2,403.03**	**2,515.63**
Budget Balance [A] - [B]	(353.90)	(313.05)	(296.35)	(361.32)	(307.66)	(286.40)
Redemptions	(172.84)	(152.96)	(303.68)	(171.71)	(151.65)	(301.28)
Eskom debt-relief arrangement	(80.22)	-	-	(80.22)	-	-
GFECRA settlement (net)	25.00	25.00	-	25.00	25.00	-
TOTAL FINANCING	**(581.96)**	**(441.01)**	**(600.03)**	**(588.25)**	**(434.31)**	**(587.67)**

*Southern Africa Customs Union

SOURCE: THE NATIONAL TREASURY, IC INSIGHTS

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