SOUTH AFRICA

ON A BUMPY ROAD

In South Africa, the coalition government formed in June 2024 is overcoming its strong internal divisions one way or another. After three months of stormy negotiations, the final version of the 2025/2026 Budget, presented to Parliament at the end of May, was recently approved by all coalition parties. This is a necessary condition for regaining investor confidence, but it is not enough. The government will also have to ease diplomatic tensions with the United States. Without a significant rebound in investment, economic growth is likely to remain weak over the next three years, contributing to the fragility of public finances.

ECONOMIC GROWTH: MORE OBSTACLES THAN ADVANCES?

In Q1 2025, economic growth measured over four quarters stagnated at 0.6%. Despite the daily power cuts that had disrupted the whole country ending in March 2024, activity has not rebounded, mainly because of the persistence of logistical bottlenecks. On the demand side, real GDP growth was dragged down by a further contraction in gross fixed capital formation (-3.9%), after two years of timid rebounds. Uncertainty, caused by the election period and then by the formation of a coalition government, prompted investors to adopt a wait-and-see approach. At just 14% of GDP on average over the last five years, the rate of investment is structurally low. It will take many years for it to rebound to a sufficient level to address the infrastructure deficit and restore medium-term economic growth potential.

Economic growth is therefore unlikely to exceed 2% per annum between 2025 and 2027. The outlook is particularly gloomy for 2025, with growth expected to be just 1%. It will be driven mainly by growth in household consumption (1% in 2024). Inflationary pressures have eased: in April 2025, the year-on-year rise in the consumer price index was 2.8%, below the lower limit of the inflation target of the central bank (South African Reserve Bank, SARB). After opting for a pause in its monetary easing cycle in March 2025, the SARB cut its key rate again on 29 May, to 7.25%. On the other hand, net exports will make a negative contribution to growth. Exports are likely to suffer due to US trade tariffs and, in particular, the end of the AGOA, which gave many South African goods preferential access to the US market. Total investment should rebound slightly, supported by local political momentum but dragged down by the highly uncertain international environment.

The cyclical obstacles should not, however, mask the positive results of the structural reforms carried out by the government since October 2020 under the name 'Operation Vulindlela' (OV). In addition to the end of daily power cuts, the increased involvement of the private sector in the management of port and rail infrastructure has halted the operational decline of these sectors. In May 2025, the government launched the second phase of the OV, which will run until 2029. It aims to remedy the chronic underinvestment by municipalities in essential public services. The growing involvement of the private sector in these areas will be key to kick-starting the long-awaited investment momentum.

FORECASTS

	2022	2023	2024	2025e	2026e
Real GDP growth, %	1.9	0.7	0.6	1.0	1.8
Inflation, CPI, year average, %	6.9	5.9	4.4	3.2	3.7
Fiscal balance / GDP, % (1)	-4.6	-4.6	-4.5	-4.9	-4.5
Public debt / GDP, % (1)	70.5	74.1	77.0	79.2	79.6
Current account balance / GDP, %	-0.4	-1.6	-0.6	-1.4	-2.4
External debt / GDP, %	41.4	41.1	41.0	40.9	40.7
Forex reserves, USD bn	59.7	61.7	64.8	66.3	68.2
Forex reserves, in months of imports	5.6	6.0	6.5	6.4	6.4

TABLE 1

(1) Fiscal year from April 1st of year N to March 31st of year N+1
e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

SOUTH AFRICA: FINANCIAL ACCOUNT

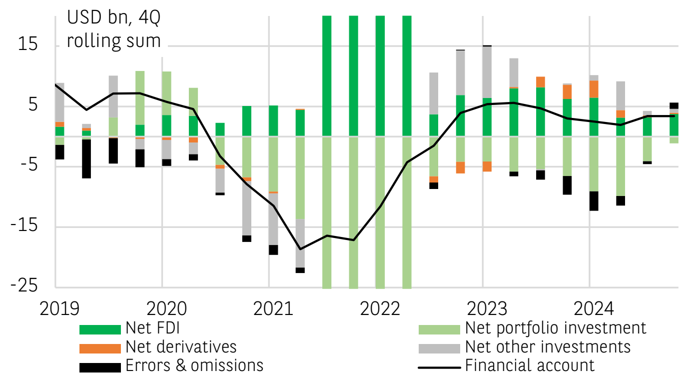

CHART 1

SOURCE: IMF

PUBLIC FINANCES: THE GNU WITHSTANDS THE BUDGETARY TEST

The public finance situation is mixed. For the fiscal year (FY) ending 31 March 2025, the government generated a primary fiscal surplus for the second year running (0.7% of GDP, i.e. +0.3pp compared with the previous FY). However, despite the reduction in the SARB's policy rate over the period, interest payments on public debt continued to rise, reaching 5.2% of GDP, or 21% of government revenue. The risk premium on Treasury bonds suffered in particular due to the high level of political uncertainty. Since June 2024, the ANC, which has lost its absolute majority in Parliament, has had to share power by forming a coalition government made up of ten heterogeneous parties. Ideological differences between the ANC and the other parties on issues such as education, the expropriation law and black empowerment have repeatedly threatened the stability of the coalition.

The disagreements came to a head in April 2025 with the negotiations on the 2025/2026 Budget. Normally, the budget is approved without debate thanks to the ANC's absolute majority in Parliament. This time, it has taken three months and three different versions of the Budget for the ten parties in the GNU to reach agreement. In particular, the ANC had wanted to increase the VAT rate from 15% to 17% in order to finance new spending, but many parties were opposed. In the end, the ANC had to give in. As a result, in the latest version of the Budget presented to Parliament on 21 May, the VAT rate remains unchanged and spending has been revised downwards.

Fiscal consolidation is likely to continue. Passing the budgetary test is an important guarantee of stability for the coalition in power which could help to reduce the risk premium on sovereign bonds in the coming months. The 2025/2026 Budget forecasts a fall in the deficit from 4.6% of GDP for the current year (which began on 1 April) to 3.7% of GDP for the following year and 3.2% for 2027/2028. However, the risk of fiscal slippage persists. The government has made no financial provision in the event that the Social Relief of Distress allowance is extended beyond March 2026. This allowance, which was created during the pandemic, has been renewed every year. With the official unemployment rate still very high (32.9% in Q1 2025), it is difficult for the government to do without this allowance, which costs public finances about 0.4% of GDP each year.

Despite fiscal consolidation efforts, public debt is set to continue rising, approaching 80% of GDP in 2026/2027. In order to stabilise the debt-to-GDP ratio in the medium term, it remains crucial to raise economic growth above 2% per year.

EXTERNAL ACCOUNTS: RISKS TO WATCH

In 2025, the current account deficit should widen moderately to 1.4% of GDP. The volume of imports should accelerate slightly in line with economic activity, while domestic logistical constraints and the rise in US tariffs will weigh on exports. On a positive note, the terms of trade should be favourable: they will be supported by the fall in the import price of oil and by the significant rise in the export price of gold (between 2 January 2025 and 27 May, the price of an ounce of gold in USD rose by 27%). However, there are still risks of deterioration in the financial account. In 2024, net foreign direct investment fell to 0.9% of GDP (compared to 1.6% in 2023). Given the high level of global uncertainty, foreign investors are likely to maintain a wait-and-see attitude again this year. On a positive note, the resolution of the budget impasse at the end of May and the stabilisation of the GNU could lead to renewed confidence in the domestic environment, and net portfolio investment flows could swing back into positive territory for the first time since Q2 2020 (Graph 1). However, they will remain highly vulnerable to strong diplomatic tensions with the United States.

US TARIFFS: HOW TO AVOID THE WORST?

Donald Trump's return to the White House has rekindled long-standing diplomatic tensions between South Africa and the United States. The average tariff on South African imports has risen from just 0.3% in 2024 to 8.8% at present. This rate could rise to 18.4% if the United States finally decides to apply the 30% tariff, as announced on Liberation Day on 2 April (the rate is currently 10% for a period of 90 days from 9 April). In addition to economic sanctions, some members of the government could receive individual diplomatic sanctions for their relations with Russia, Iran and Hamas.

The South African government has taken the threat of US sanctions seriously and has responded proactively. On 21 May, President Ramaphosa met his US counterpart at the White House to reaffirm the importance of the bilateral relationship. The meeting was an opportunity to present a first version of a bilateral trade and investment agreement.

SOUTH AFRICA: EXPORTS TO THE US BY SECTOR, 2023

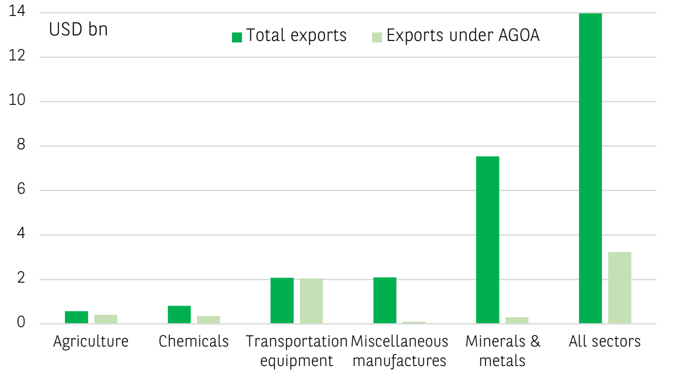

CHART 2

SOURCE: AGOA.INFO

The US administration took a very positive view of several of the proposals, including those to import liquefied natural gas (LNG) and to encourage US companies to invest in mining exploration. South Africa exports to the United States twelve types of minerals described as 'critical' by the US administration and the country is the main supplier of nine of them.

However, a trade agreement will not be enough to put an end to all the tensions, many of which stem from the country's political non-alignment. The main stumbling blocks with the United States are therefore likely to persist (South Africa's complaint against Israel to the International Court of Justice, joint military exercises with Russia and China, rumours of expropriation of Afrikaners). Indeed, even within a coalition government, it is unlikely that the ANC would renounce its historic relations with the countries of the Global South in order to satisfy the United States. Further episodes of tension can therefore be expected in the coming months. For the time being, the impact of the tariffs on South African exports should be limited. Total exports to the United States amounted to 3.6% of GDP in 2024, but minerals (exempt from customs duties) accounted for almost half of this figure. In addition, agricultural exports, which were notable beneficiaries of the AGOA, could be redirected to Southern Africa, which regularly faces droughts and food shortages. On the other hand, the automotive sector (4% of GDP) appears highly vulnerable (Graph 2). It could, however, benefit from the potential opening up of the Chinese market: China announced today that it plans to lift tariffs on all African imports. In addition, in the medium and long term, the sector could benefit from the African Continental Free Trade Area (AfCFTA). Despite its slow roll-out, this could become a vehicle for diversifying the country's trade links: South Africa, as the continent's leading industrial power, would have a comparative advantage to put forward.

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