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South Africa: Towards a Change of Course?

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Abstract: South Africa's economic activity continues to face numerous structural challenges, including the inefficiency of state-owned enterprises, insufficient investment, corruption, and limited financial inclusion. Against this backdrop, economic growth, although slightly accelerating in 2025, has struggled to exceed 1%. However, the macroeconomic framework has recently strengthened as a result of ongoing reforms, and investor confidence has improved, notably following the country's removal from the Financial Action Task Force (FATF) grey list and the revision of the inflation target, which have further enhanced the credibility of monetary policy. The banking sector remains profitable, liquid, and well capitalized. In 2020, the Presidency and the National Treasury launched an initiative (Operation Vulindlela) aimed at modernizing and transforming the electricity, water, transport, and digital communications sectors. In the electricity sector, significant reforms have led to a substantial improvement in energy supply over the past two years. Public finances remain constrained by a large public sector wage bill, substantial debt-servicing costs, and continued support for state-owned enterprises. As a result, the public debt-to-GDP ratio has tripled since the 2008 global financial crisis. The fiscal situation could improve over the medium term as government reforms seek to enhance the efficiency of public expenditure, with a primary surplus potentially being achieved as early as 2026. Consequently, the increase in the public debt ratio is expected to slow over the coming years. However, the crisis in the Middle East could undermine these efforts and weigh on public finances, external accounts, inflation, and ultimately economic growth.

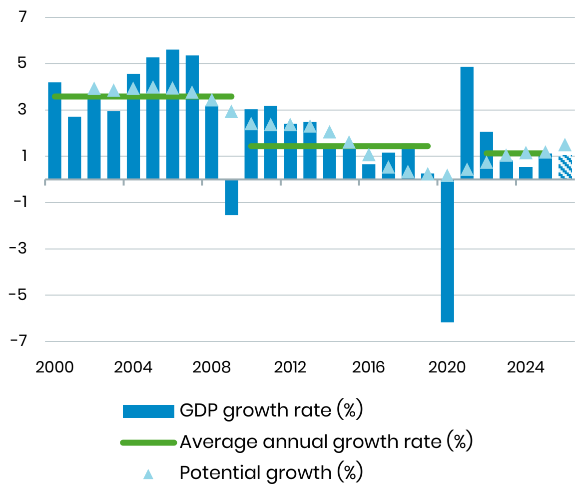
Thematic area: macroeconomics
Geographical area: South Africa

1. Modest and insufficiently inclusive growth facing the Middle East crisis

Economic activity continues to face numerous challenges

The South African economy has slowed markedly since the end of the commodity supercycle in 2014 and was among the economies most severely affected by the COVID-19 crisis. Following the recession of 2020 (-6.2%), the economy rebounded strongly in 2021 (4.9%), reflecting the resilience of its economic fundamentals. Since then, however, growth has steadily decelerated, reaching 0.5% in 2024. Economic activity has been constrained by high inflation, the continuation of load shedding, and the global economic slowdown. Political uncertainty has also weighed on investment decisions and dampened economic growth. Economic activity recovered modestly to 1.1% in 2025, supported by robust private consumption, underpinned by lower inflation and interest rates, as well as rising real wages. Net exports, however, weighed on growth: export volumes declined more sharply than import volumes owing to tariffs imposed on certain exports to the United States—vehicle exports were particularly affected—and continued uncertainty surrounding trade policy. South Africa's external accounts remain structurally fragile and highly exposed to fluctuations in mineral prices, as mineral products account for approximately 50% of total exports. The current account, which has been in deficit again since 2022, recorded a deficit of 0.5% of GDP in 2025, compared with 0.7% in 2024. It is expected to widen gradually (to 0.9% of GDP in 2026) and reach around 2% of GDP over the medium term, as import growth driven by domestic demand outpaces export growth.

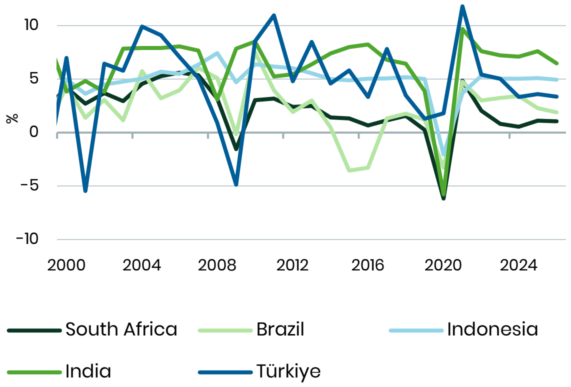
Figure 1 – Growth has been on a long-term downward trend



Source: IMF (WEO, Article IV), World Bank, OECD, AFD calculations.

Significant structural constraints continue to weigh on economic growth, including low productivity in the manufacturing sector, the energy crisis, the inefficiency of state-owned enterprises, limited financial inclusion, and weaknesses in the education system. Chronic under-investment in infrastructure—including energy, rail, and port infrastructure—has undermined the country's competitiveness. Private investment has declined and remains low (below 12% of GDP in 2025, compared with an average of 30% across upper-middle-income countries [UMICs]), while public investment also remains subdued (2.5% of GDP in 2025, excluding state-owned enterprises). Limited financial inclusion constrains small and medium-sized enterprises (SMEs) by restricting their access to credit, while several key sectors—including energy, transportation, and telecommunications—continue to suffer from weak competition. The business environment is adversely affected by institutional constraints (bureaucracy, administrative burdens, and weak governance), unpredictable public policies, the poor performance of state-owned enterprises operating in strategic sectors of the economy, and high levels of crime. In 2024, South Africa ranked 82nd out of 180 countries in Transparency International's Corruption Perceptions Index. Governance and corruption issues are particularly acute at the municipal level. The country is also held back by shortcomings in its education system. Relative to its income level, South Africa performs particularly poorly in terms of educational attainment: in 2024, 43% of individuals aged 25-34 had not completed upper secondary education. Only 1% of young adults held a master's degree, a share unchanged since 2019, reflecting very limited access to postgraduate education. Together, these structural constraints limit potential growth, estimated at 1.2% in 2025 (OECD) and 1.5% in 2026 (IMF, January 2026).

Figure 2 – Growth remains weak compared with other emerging economies



Source: IMF (WEO).

The government's reform program (Operation Vulindlela) recorded encouraging progress in 2025, particularly through improvements in Eskom's financial position and the commissioning of new power generation capacity. The country's infrastructure has suffered from decades of underinvestment by the public sector. In 2025, the government launched the second phase of Operation Vulindlela, focusing on reforms in electricity, local government, digital transformation, visa policy, spatial inequality, water, and logistics. South Africa's electricity system relies primarily on the state-owned utility Eskom, whose financial position remains deeply concerning. The company's governance has been severely undermined by the legacy of state capture, while its coal-fired power plants are aging. The electricity sector, which has been in crisis for several years, forced Eskom to implement prolonged scheduled power outages (load shedding), although the situation has improved recently. Over the past two years, the frequency of load shedding has declined substantially, partly owing to the return to service of several generating units at the Kusile coal-fired power station and the expansion of photovoltaic generation. Nevertheless, electricity supply is expected to remain constrained throughout 2026, with the possibility of renewed load shedding that could have a significant impact on economic activity, particularly for smaller firms that lack viable alternative power supply options. Eskom's reform program includes the establishment of a competitive electricity market that would allow firms and households to choose their electricity supplier rather than relying exclusively on the state-owned utility. In addition, the government plans to unbundle Eskom into three separate entities responsible for generation, transmission, and distribution. Generation and transmission are currently carried out by Eskom, while distribution is shared between Eskom and municipalities. However, this restructuring plan remains controversial and is unlikely to be fully implemented for several years.

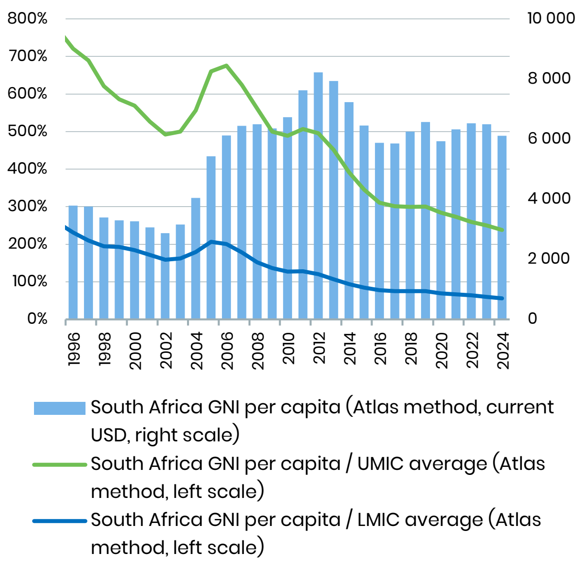
The war in the Middle East and the resulting increase in oil prices have had a direct impact on both inflation and economic growth. South Africa is a net oil importer: petroleum products accounted for 18% of total imports in 2025, equivalent to

4.5% of GDP. In 2025, the country's main suppliers were Oman (18%), Saudi Arabia (13.5%), India (12%), and the United Arab Emirates (11%). Producing only 0.3% of its domestic oil consumption, South Africa imports primarily refined petroleum products. Although oil plays only a limited role in electricity generation (3.5% of electricity production, compared with 82% generated from coal), it is essential for transportation (which accounts for 60% of oil consumption) and industry (6.4%). During the first five months of 2026, retail gasoline prices increased by 30%, while diesel prices rose by 70%. Higher oil prices have had a particularly strong impact on the transportation sector—which accounts for more than 15% of household expenditure—as well as on agriculture, where rising production costs have been passed on to food prices. The IMF revised its 2026 growth forecast downward to only 1.0% (compared with 1.2% before the onset of the crisis) and projects average growth of 1.6% over the 2025–2030 period (April 2026 WEO).

Growth remains insufficiently inclusive and generates too few jobs

Although substantial progress has been made since the end of apartheid, economic growth has been neither strong enough nor sufficiently inclusive to reduce inequality, poverty, and unemployment. Because economic growth has remained below population growth, South Africa has experienced a gradual divergence from other UMICs since 2010. Moreover, since 2020, gross national income (GNI) per capita has stagnated below USD 7,000. While poverty has declined over the past two decades, progress has been slow. The national poverty rate (based on a threshold of ZAR 1,300 per month) fell from 57.5% (approximately 27.3 million people) in 2006 to 37.9% (approximately 23.2 million people) in 2023. Among the Black population, however, the poverty rate reached 43.8%, well above the national average. Based on the international poverty line of USD 6.85 per day, the poverty rate stood at 63.5% in 2025 and affected 49.1% of children. According to UNICEF (2024), 23% of children still experience severe food poverty.

Figure 3 – Per capita income is no longer increasing



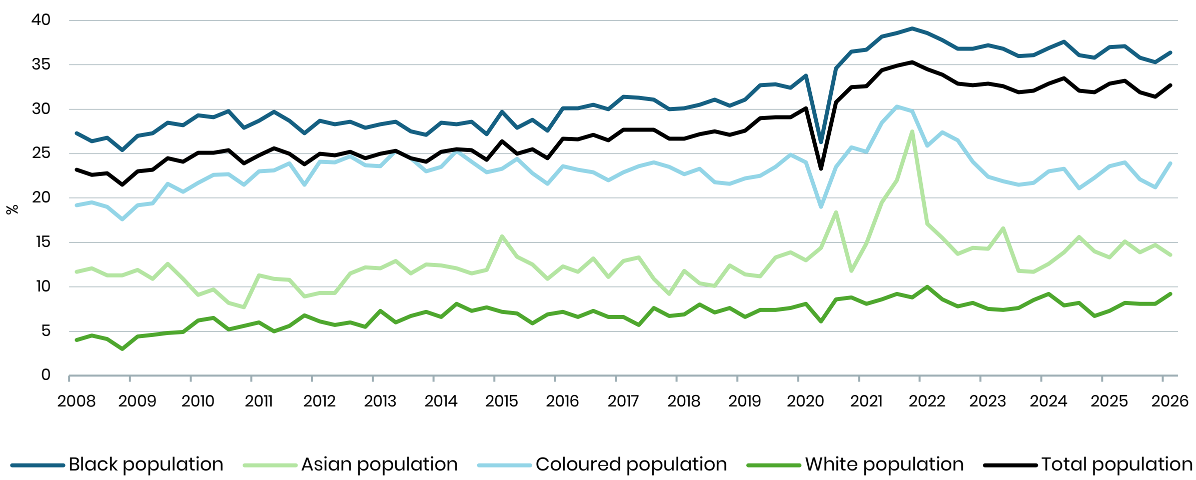
Source: World Bank, AFD calculations.

South Africa remains one of the most unequal countries in the world. According to the latest World Bank data, the country's Gini coefficient stood at 54.1 in 2022, the third highest globally. Although the legislation underpinning apartheid was repealed in 1994, the social and economic consequences of this discriminatory system continue to persist. Race remains the single most important driver of inequality, and its contribution has increased over time. In 2018, race accounted for nearly 41% of overall inequality, compared with 37.5% in 2008 (World Bank 2022), outweighing the contribution of factors such as geographic location, educational attainment, labor market outcomes, and demographic characteristics.

South Africa is facing one of the most severe unemployment crises in the world. The unemployment rate reached 31.4% in the fourth quarter of 2025, an increase of five percentage points over the past decade. This national average conceals substantial disparities across population groups. Young people (57% among those aged 15-24), women (34.5%), and the Black population (35%, or 3.6 percentage points above the national average) are disproportionately affected. By contrast, unemployment among the White population, while having increased slightly, remains the lowest at 8.1% (an increase of 1.5 percentage points over the past decade). These labor market disparities reflect profound inequalities in educational attainment as well as the spatial fragmentation inherited from apartheid. In 2019, tertiary education enrollment stood at only 14.2% among the Black population, compared with nearly 50% among the White population. Despite high levels of inequality and poverty, social protests have remained relatively limited. Crime, however, has reached record levels and continues to impose a heavy burden on the economy, with the World Bank estimating its economic cost at up to 4% of GDP in 2023.

South Africa's tax and social protection systems are relatively redistributive but still leave room for improvement. Personal income tax (PIT) accounted for approximately 40% of total tax revenue in 2025, with the highest income deciles contributing the largest share. Value-added tax (VAT) generated around one-quarter of tax revenues, while several basic goods remain exempt in order to limit its impact on low-income households. South Africa operates one of the most extensive social protection systems among comparable countries, including the *Child Support Grant, Social Relief of Distress Grant, Old Age Grant, and Disability Grant*. These programs represent 3.5% of GDP, cover nearly 86% of households in the lowest income quintile, and account for approximately 70% of their total household income. Nevertheless, nearly 20% of social benefits accrue to households in the two highest income quintiles, while eligibility thresholds remain relatively generous despite the modest average benefit amounts (IMF 2026, Article IV). Furthermore, in 2023, White South Africans were seven times more likely than Black South Africans to be covered by a health insurance scheme.

Figure 4 – Unemployment remains high and has followed an upward trend



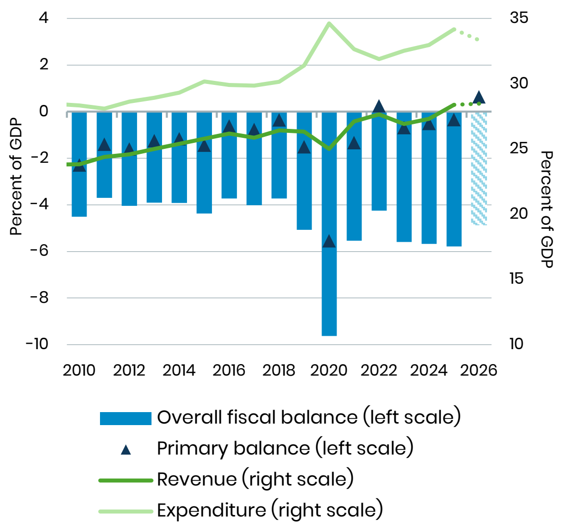
Source: Stats SA, AFD calculations.

2. Encouraging prospects for public finances

Improving the efficiency of public spending

Between 2021 and 2025, against a backdrop of weak economic growth, the fiscal deficit averaged more than 5.5% of GDP (5.8% of GDP in FY25/26).[1] Government revenue amounts to approximately one-quarter of GDP and consists almost exclusively of tax revenue, while non-tax revenue—including royalties on oil and mineral resources and mining lease payments—accounts for less than 1% of total revenue. **Government expenditure exceeds one-third of GDP, and there remains considerable scope for improving spending efficiency.** Nearly one-half of the budget is transferred to subnational governments, whose effectiveness remains limited because of governance and capacity constraints: approximately 40% is allocated to provincial governments and around 10% to municipalities. South Africa's public finances have deteriorated significantly over the past 15 years owing to (i) weak economic growth; (ii) a sharp increase in the public sector wage bill and social transfers; (iii) financial difficulties affecting several state-owned enterprises (SOEs), including Eskom, Transnet,[2] and South African Airways; and (iv) rising debt-servicing costs. Given the government's limited scope to increase the tax burden, the National Treasury (NT) aims to improve the efficiency of public expenditure. To this end, it plans to better target social transfers, conduct an audit to identify fraud within the public sector workforce, encourage the early retirement of civil servants, strengthen municipal capacity, and reduce both debt-servicing costs and transfers to state-owned enterprises.

Figure 5 – Revenue, expenditure, primary balance, and overall fiscal balance



Source: IMF (WEO), AFD calculations.

In 2022, under the first phase of Operation Vulindlela, the authorities announced a debt relief package for Eskom. Between 2022 and 2027, the government will have extended loans totaling ZAR 230 billion (approximately 3% of GDP) to enable the company to repay its debt. In 2024, the South African Reserve Bank (SARB) and the National Treasury (NT) reached an agreement allowing part of the resources accumulated in the Gold and Foreign Exchange Contingency Reserve Account (GEFCRA)—which is established and managed by the SARB on behalf of the Treasury—to be transferred gradually to the government.[3] These transfers are intended to help finance Eskom's debt relief package and the fiscal deficit while maintaining a level of reserves considered prudent for financial stability. In 2025, Eskom recorded its first profit in eight years and is therefore

[1] Fiscal years run from April 1 to March 31.

[2] Transnet SOC Limited ("Transnet") is South Africa's state-owned freight transport and logistics company.

[3] The GEFCRA records valuation gains and losses arising from fluctuations in the exchange rate and in the value of the gold and foreign exchange reserves held by the South African Reserve Bank.

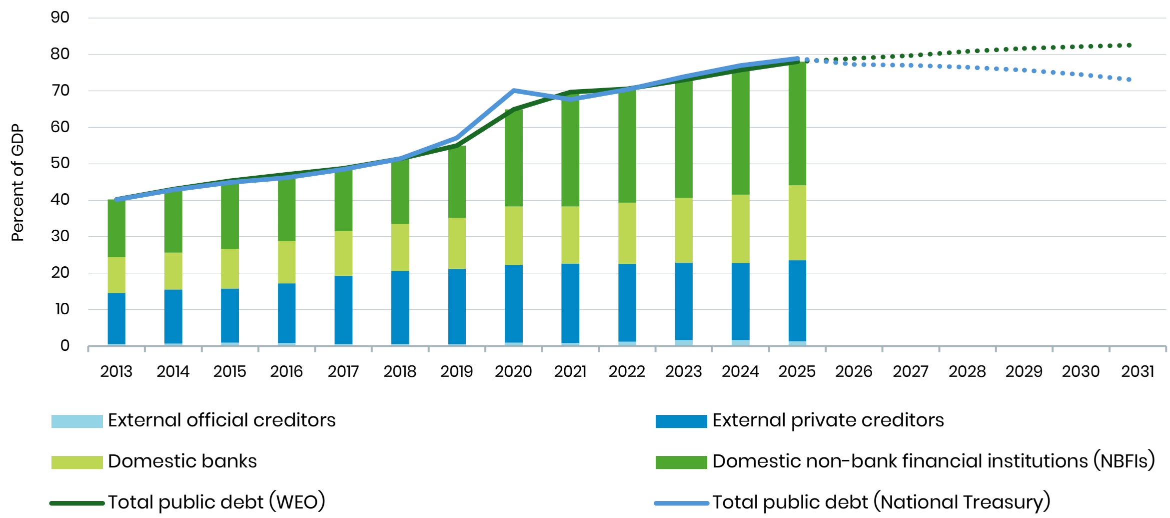
expected to require less financial support in the future, thereby reducing contingent liabilities. Nevertheless, municipal arrears owed to Eskom continue to pose significant risks to the utility's recovery and remain a major threat to its financial sustainability. The National Treasury estimates these arrears at ZAR 110.5 billion in 2026 (approximately 1.5% of GDP). Reforms targeting Transnet, the state-owned rail and port operator, are also underway.

A slowdown in debt accumulation

As a result of persistent primary deficits, weak economic growth, and rising interest payments, the public debt-to-GDP ratio has tripled since the 2008 global financial crisis, increasing by 50 percentage points. Public debt reached 78.6% of GDP at end-2025. This figure does not include the debt of state-owned enterprises, which continues to pose significant contingent liability risks. Total contingent liabilities were estimated at 14% of GDP at end-March 2026, of which 10% was related to SOE debt and 4% to independent power producers. Eskom accounted for 73.6% of the government's total guaranteed exposure, while Transnet represented 17.3%. However, the government's exposure to Eskom has declined as the debt relief program has been implemented (see above).

Despite weak economic growth, the tightening of fiscal policy is expected to generate primary fiscal surpluses from 2026 onward (0.6% of GDP). These surpluses would nevertheless remain insufficient to reverse the upward debt trajectory. According to the IMF, a primary surplus of approximately 3% of GDP would be required to reduce public debt to around 70% of GDP by FY33/34, in line with the authorities' objective. The IMF nonetheless projects a slowdown in debt accumulation, with the debt-to-GDP ratio reaching approximately 82% by 2030. **The conflict in the Middle East could undermine these projections.** In order to cushion the impact of higher fuel prices on households while limiting inflationary pressures, the Ministry of Finance reduced fuel taxes between April and July 2026. The estimated fiscal cost amounts to ZAR 17.2 billion in forgone tax revenue, equivalent to 0.8% of total budget revenue.

Figure 6 – Public debt trajectory and composition



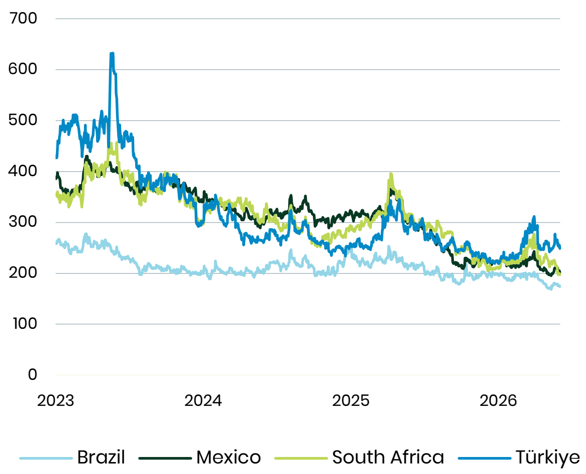
Source: IMF, National Treasury, AFD calculations.

Strengthening investor confidence

The IMF (February 2026) assesses South Africa's overall risk of debt distress as moderate, while the composition of public debt remains favorable. Approximately 89% of public debt is issued on the domestic market, limiting the country's exposure to volatility in global financial markets. In FY25/26, domestic government bonds were held by foreign investors (25% of total domestic debt, down from 41% in 2017), pension funds (22.5%), monetary institutions (20.2%), insurance companies (7.5%), and other non-bank financial institutions (NBFIs) (24.8%). Debt denominated in foreign currency accounted for only around 10% of GDP in FY25/26. In early December 2025, the National Treasury issued two Eurobonds totaling USD 3.5 billion on international capital markets. The borrowing costs obtained were more favorable than those achieved during the previous Eurobond issuance in November 2024 (6.25% versus 7.1% for the 12-year bond, and 7.375% versus 7.95% for the 30-year bond). This development is consistent with the decline in sovereign spreads observed at end-2025 (to 212 basis points, their lowest level since 2014), bringing South Africa broadly in line with other emerging market economies such as Türkiye and Mexico. As a consequence of the conflict in the Middle East, sovereign financing conditions are nevertheless expected to deteriorate over the medium term, at least to the extent of the increase in European and U.S. interest rates. Finally, in 2025, South Africa raised USD 2.6 billion (compared with USD 1.6 billion in 2024) from bilateral development finance institutions (AFD and KfW) and multilateral development banks (the World Bank and the African Development Bank), providing stable, longer-term financing on favorable terms.

The country's reform efforts have been positively received by the major credit rating agencies. After nearly two decades without an upgrade from Moody's, Fitch, or S&P, S&P upgraded South Africa's sovereign credit rating in November 2025, followed by Fitch in June 2026. Moody's, for its part, revised its outlook from stable to positive in May 2026. South Africa's removal from the FATF grey list in November 2025 also sent a positive signal to investors.

Figure 7 – Sovereign spreads: trends and international comparison



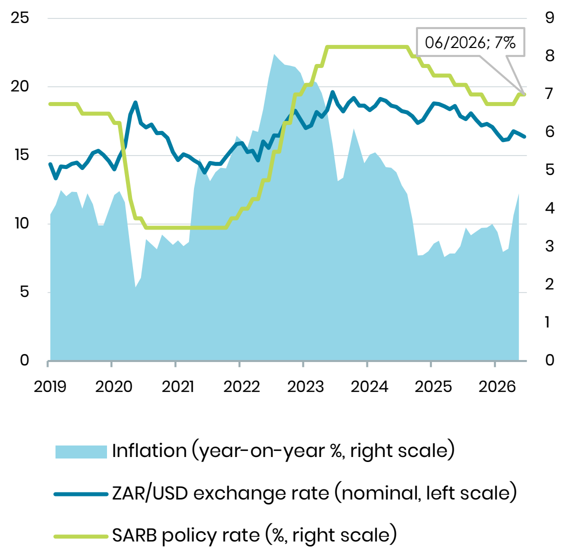
Source: J.P. Morgan.

3. A strengthened monetary policy framework and a sound financial sector

Strengthening the monetary policy framework

The South African Reserve Bank is independent and enjoys a high degree of credibility. In response to the COVID-19 crisis, the SARB implemented measures to increase liquidity in financial markets. However, as inflationary pressures intensified, it shifted back to a restrictive monetary policy stance at the end of 2021 in order to bring inflation back within its target range (3–6%). The SARB raised its policy rate several times between late 2021 and mid-2024, bringing it to 8.25%. In September 2024, it initiated a monetary easing cycle: the policy rate was reduced in several successsive steps (a cumulative 150 bps) and has stood at 6.75% since November 2025. Inflation has consequently declined gradually, from 7.0% in 2022 to 6.1% in 2023, 4.4% in 2024, and 3.2% in 2025. Inflationary pressures—particularly those associated with the depreciation of the rand—have continued to ease, although the ZAR/USD exchange rate remains sensitive to international developments, including announcements by President Trump. The SARB remains firmly committed to maintaining low and stable inflation. For 25 years, South Africa operated under an inflation target range of 3–6%. In November 2025, this framework was revised to a point target of 3%, with a tolerance band of ±1 percentage point. On 29 May 2026, the SARB revised its 2026 inflation forecast upward to 4.4%, compared with an initial projection of 3.7%. As a result, the SARB increased its policy rate by 25 bps, to 7.0%. The Bank justified this tightening by the growing inflationary risks associated with an escalation of tensions in the Middle East and an El Niño episode affecting agricultural production.

Figure 8 – Inflation, policy rate, and exchange rate

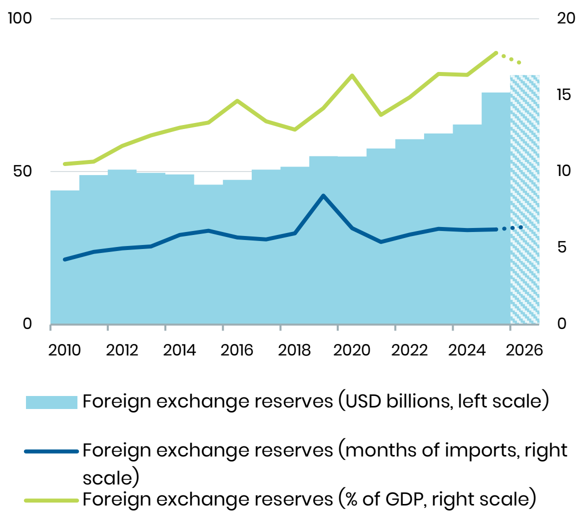


Source: Statistics South Africa, BIS, AFD calculations.

In November 2025, South Africa was removed from the FATF grey list, on which it had been placed since 2023, following significant improvements by the SARB to the country's anti-money laundering and counter-terrorist financing framework.

South Africa has operated a floating exchange rate regime since the gradual dismantling of exchange controls and more administratively managed exchange rate arrangements during the 1990s. The SARB does not intervene in the foreign exchange market, contributing to the observed volatility of the rand (which depreciated by 6% in March 2026), while allowing the floating exchange rate regime to absorb external shocks. The rand remains vulnerable to both domestic and external uncertainty and continues to be highly sensitive to political developments and changes in U.S. monetary policy.

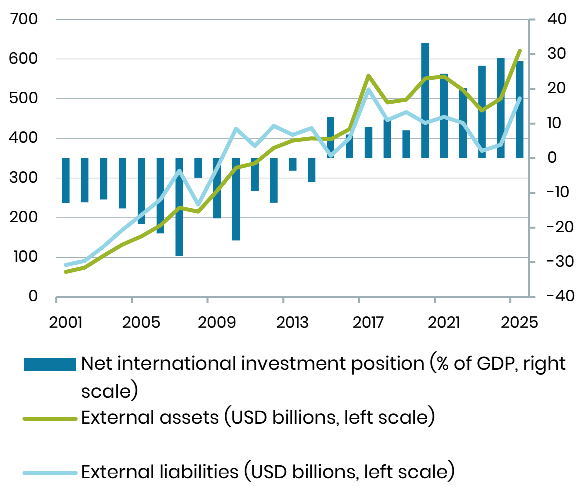
Figure 9 – Foreign exchange reserves



Source: IMF, AFD calculations.

Foreign exchange reserves remain adequate, exceeding six months of imports since 2023 (equivalent to 99% of the IMF's Assessing Reserve Adequacy (ARA) metric at end-2025, compared with 89% at end-2022). Gross international reserves have increased, reflecting valuation gains on the SARB's gold portfolio, while the net international investment position (NIIP) has remained positive despite substantial gross external liabilities.

Figure 10 – Net international investment position



Source: IMF, AFD calculations.

Since 2015, South Africa's net international investment position has remained positive and is estimated at 28% of GDP at end-2025. It is nevertheless expected to moderate over the medium term as the current account deficit widens.

A highly developed and resilient financial sector that is providing progressively less financing to the economy

South Africa's financial sector is highly developed, with total assets amounting to approximately 300% of GDP. It comprises public financial institutions (17% of total assets), banks (29%), the central bank (5%), and NBFIs (49%). The banking sector consists of 28 institutions, including 11 subsidiaries or branches of foreign banks (September 2024). In addition, there are four mutual banks, 28 cooperative financial institutions (banks and other cooperative institutions), 146 insurance companies, nine reinsurance companies, and seven financial market infrastructures. The South African banking sector is highly concentrated, with six institutions accounting for approximately 90% of total banking assets: Standard Bank, FirstRand, Absa Bank, Nedbank, Investec, and Capitec. The banking and insurance sectors remain well capitalized, profitable, and liquid, with liquidity coverage ratios (LCRs) well above 100%. The low ratio of nonperforming loans (NPLs) points to limited credit risk. Overall, banking sector performance indicators remain robust and appear to have been largely unaffected by the deterioration in the macroeconomic environment.

Table 1 – Banking sector indicators

	2015	2021	2022	2023	2024	2025	Q1-2026
Capital adequacy							
Regulatory capital to risk-weighted assets	14.2	18.1	17.5	17.4	17.2	17.9	17.9
Profitability							
Return on assets (ROA)	1.5	1.4	1.5	1.1	1.2	1.2	1.2
Return on equity (ROE)	20.6	13.2	13.5	14.6	15.8	15.8	15.7
Asset quality							
Nonperforming loan (NPL) ratio	3.1	4.5	4.1	4.7	4.5	5.2	n.d.

Source: SARB, IMF (Article IV).

Credit to the private sector amounted to 75% of GDP in mid-2025, continuing the downward trend observed since 2020. One of the financial sector's main weaknesses remains the limited financing available to SMEs, despite their essential role in job creation. This appears to reflect, among other factors, the banking sector's relatively conservative lending practices, limited financial literacy among small business owners, and the crowding-out effect associated with sovereign borrowing. Banks have become increasingly exposed to sovereign risk, with government-related exposures rising to 15.9% of total assets in 2025, compared with less than 5% in 2006. Improving access to finance—particularly for SMEs—will be critical to supporting credit growth and strengthening economic growth.

NBFIs: a significant component of the financial sector

With assets amounting to nearly 200% of GDP at end-2024, South Africa's NBFI sector is the largest among the G20+ emerging market economies. In absolute terms (USD 0.75 trillion), however, it is only slightly above the group's median (USD 0.6 trillion).

The NBFI sector provides substantial benefits by mobilizing long-term savings, deepening capital markets, and promoting financial inclusion. At the same time, its size, interconnectedness, exposure to sovereign risk, and broader exposure to domestic and global risks also create vulnerabilities. The activities of banks and NBFIs indicate that the two sectors are closely interconnected. Banks are heavily exposed to NBFIs through wholesale funding, which accounted for nearly 35% of banking sector assets at end-2022—one of the highest shares worldwide. The NBFI-sovereign nexus further reinforces the interconnectedness of the financial system. Although NBFIs hold approximately 53% of central government domestic bonds—one of the highest shares among emerging market economies—public sector assets in the broad sense account for only 13.7% of total NBFI assets, a relatively modest proportion compared with peer countries.

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List of acronyms and abbreviations

AFD	*Agence française de développement*
ARA	Assessing Reserve Adequacy
BP	basis points
FAFT	Financial Action Task Force
GDP	Gross domestic product
GEFCRA	Gold and Foreign Exchange Contingency Reserve Account
GNI	Gross national income
IMF	International Monetary Fund
KfW	*Kreditanstalt für Wiederaufbau*
NBFI	Non-Bank Financial Institution
NIIP	Net International Investment Position
NPL	Nonperforming loan
NT	National Treasury
OECD	Organisation for Economic Co-operation and Development
PIT	Personal income tax
ROA	Return on assets
ROE	Return on Equity
SARB	South African Reserve Bank
SME	Small and medium-sized enterprise
SOE	State-owned enterprise
STATSA	Statistics South Africa
UMIC	Upper-middle-income country
UNICEF	United Nations International Children’s Emergency Fund
VAT	Value-added tax
WEO	World Economic Outlook

List of figures and tables

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