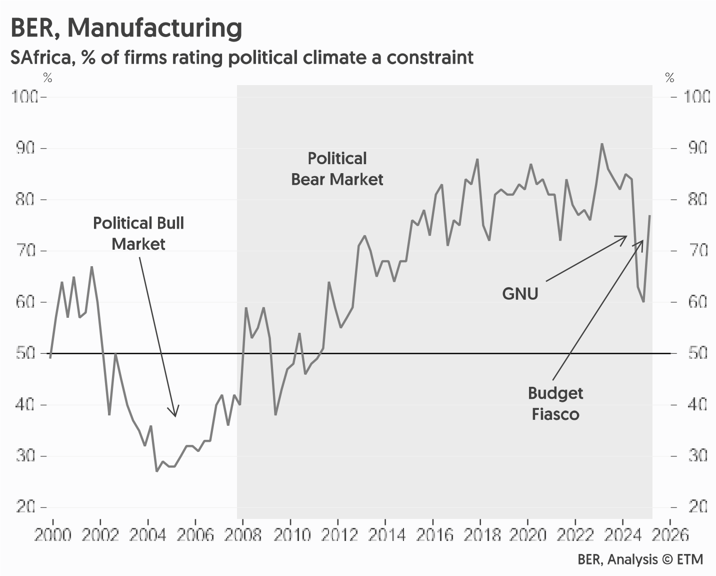
Key points

- The formation of the GNU significantly improved sentiment in South Africa, as evidenced by the BER's manufacturer survey, which showed a sharp decline in political climate constraints through Q3 2024, though sentiment deteriorated in Q1 2025 due to budget postponement and visible GNU divisions.
- The GNU's initial promise of fiscal and economic reforms, supported by initiatives like Operation Vulindlela, boosted investor confidence and bond market performance, but failure to implement reforms risks squandering these gains and sustaining high borrowing costs.
- The ZAR experienced a strong rally in 2024 post-GNU formation, but recent strains in the coalition have made it one of the worst-performing EM currencies in 2025, with market reactions largely tied to GNU stability rather than external factors like US tariff policies.
- South Africa's fiscal challenges, with high budget deficits and debt servicing costs, require deeper structural reforms—such as liberalising energy, streamlining regulations, and enhancing private sector involvement—to drive sustainable economic growth and reverse credit rating declines. This is what the GNU needs to implement.

Baseline view:
While the GNU has provided a boost to investor sentiment and market performance, its long-term success hinges on implementing promised reforms to address South Africa's fiscal and economic challenges. The ZAR's volatility reflects ongoing market concerns about coalition stability, but recent negotiations suggest the GNU may hold, potentially supporting a ZAR recovery if fiscal progress is made. Without sustained reform efforts, particularly in reducing government size and boosting private sector growth, South Africa risks losing the opportunity to achieve a sustainable fiscal trajectory and regain investment-grade status.

GNU optimism, and then the retreat which followed

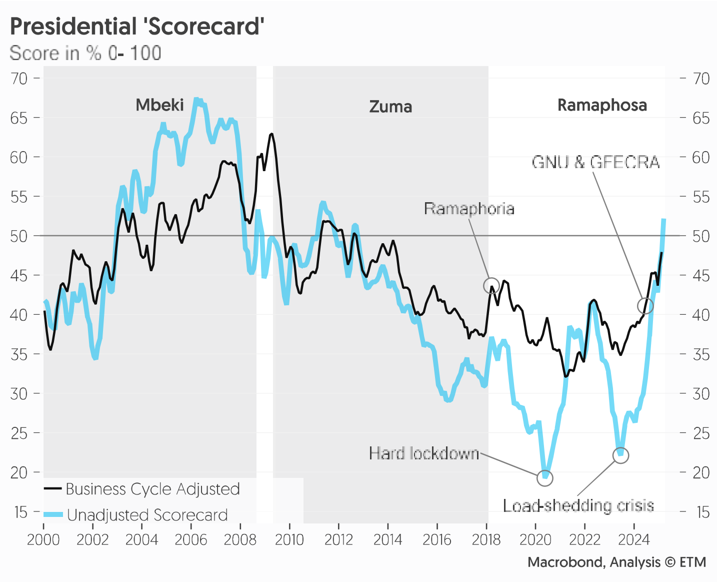


If there was ever any doubt that the formation of the GNU had helped sentiment towards SA, it was made clear in the BER's survey which polled manufacturers to find out what level of constraint the political climate was.

The establishment of the GNU saw sentiment improve dramatically, and that was clearly evident in the way the accompanying chart plunged through Q3. It remained subdued through Q4, but deteriorated sharply when the budget was postponed in Q1. That was the point where it became clear there were major divisions within the GNU that would not be easily overcome. The number of people who saw the political climate as a constraint jumped sharply at the start of the year.

Since then, there has been another vote in parliament on the fiscal framework that proved to be a nail-biter which also highlighted the challenges within the GNU. This data will therefore remain challenging.

GNU scorecard depends on reform implementation



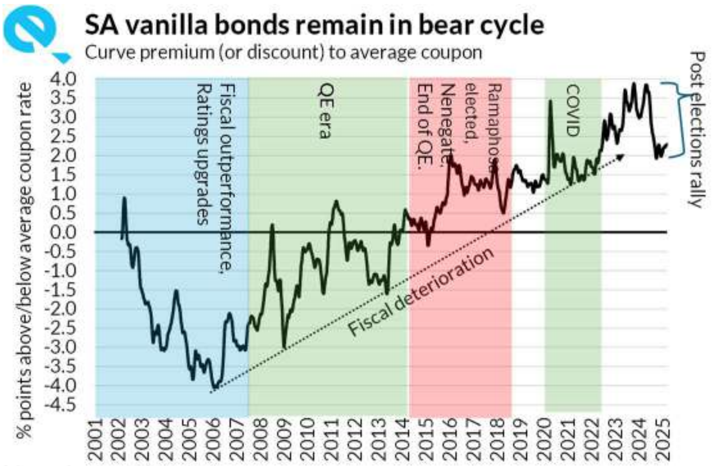
Analysis of ETM's presidential policy scorecard also shows that there was a great recovery in sentiment. The GNU held great promise for some fiscal and economic reforms. With fiscal room running out, the ANC had no choice but to buy time through the use of the GFECRA funds, and to turn more strongly towards the private sector in order to bolster investment and GDP growth.

The expectation of a GNU that held and was able to steer SA onto a more sustainable fiscal path is what investors hoped for. Many of the survey data reflected these hopes, but context is useful. A quick comparison with pre-Zuma times shows that there is still a long way to go. The end of load shedding and the GNU only takes SA so far.

For the improvement in the policy scorecard to be sustained, the government will need to show that it is following through with its promises and finding ways to implement some of the many reforms it has highlighted in the budget.

Operation Vulindlela looks good on paper and makes all the right assertions, but requires regulation that will attract foreign capital to SA, and requires the political resolve to push harder for greater private sector inclusion in SOEs and the network industries that they dominate. Once again, SA is left at the mercy of politicians who are ideologically opposed to shrinking the size of the government, even though historical data shows that growing this burden on the tax base has made matters worse.

Initial GNU benefits could be wasted if key political parties cannot come to an arrangement



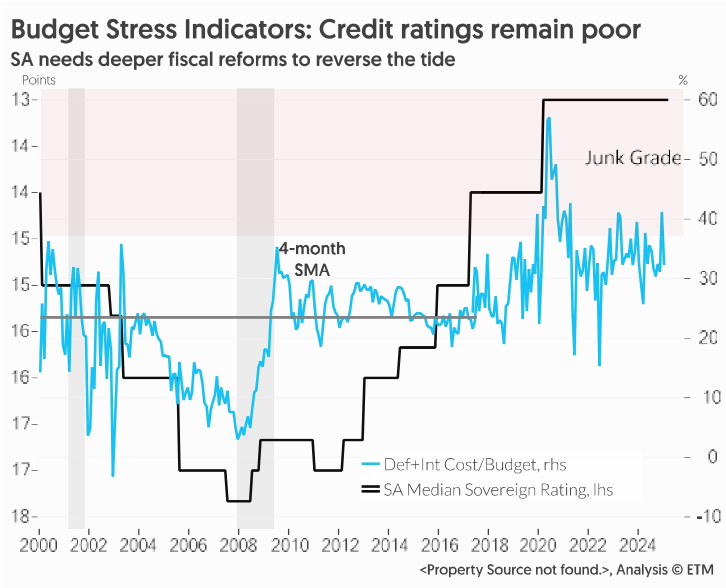
Source: Reuters, ETM Analytics

Focusing on the bond market to gauge how much risk is priced in is also instructive. After the elections and the establishment of the GNU, bonds staged an impressive rally that significantly reduced the premium the government needed to pay to borrow.

Although the government is still issuing bonds at a significant discount with yields above the coupon rate to attract foreign investors, there is still a long way to go before the bond market has normalised the risk it is pricing in.

The initial positive sentiment related to the formation of GNU has dissipated significantly. Unless the GNU can hold together and improve on the fiscal framework to raise the probability of a constructive budget that meaningfully implements a strategy to make SA's fiscal position more sustainable, the government will be forced to continue funding itself at yields that are far too high for comfort. It would be a pity to waste the opportunity of the GNU and not implement reforms. After all, it was Finance Minister Godongwana himself who indicated that he would get SA back into investment grade within two years. That is only possible with a strong shift in political ideology.

Fiscal reforms desperately needed to reverse credit rating



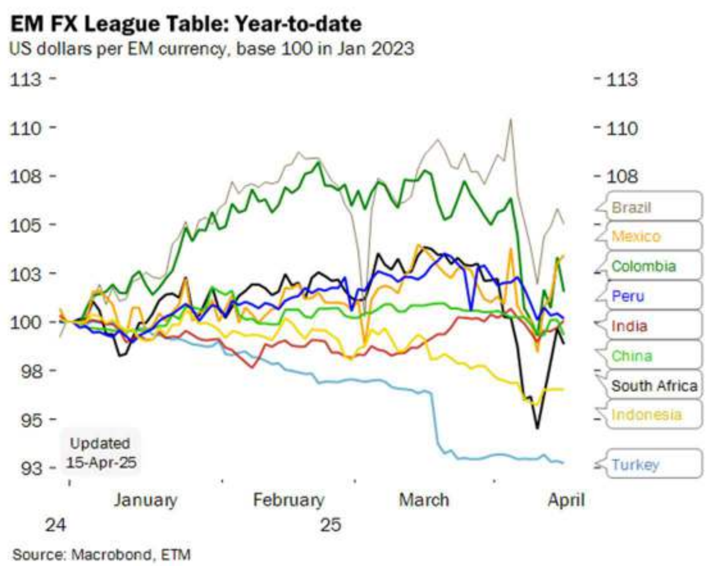
As can be seen in the adjacent chart, the sum of the budget deficit and debt servicing costs as a percentage of revenues (blue line) is much higher than it was prior to the global financial crisis, when SA was running budget surpluses. The increase that followed led to and was caused by a gradual deterioration in SA's credit rating, which is currently two notches below investment grade.

Simply put, the chart reflects relatively high budget stress that was allowed to continue for too long. The government now needs to confront the hard choices head-on by implementing much-needed reforms. This goes beyond just eliminating corruption, scrapping blue-light brigades, and cutting ministerial perks. Although these kinds of reforms would signal positive intent and greater respect for taxpayers, they would do little to dent the deficit. This follows as corruption isn't a budgeted expense, and even if all waste vanished overnight, it wouldn't be enough to close the fiscal gap (although it would undoubtedly help).

Deeper spending cuts are also often proposed, but slashing budgets drastically in one cycle is unrealistic. For instance, multi-year public sector wage agreements, mandatory interest payments, and untouchable social grants limit flexibility. Furthermore, indiscriminate cuts would harm long-term growth by undermining education, infrastructure, and public services without addressing the root issue. With rising debt and stagnant growth, the usual escape routes are gone. All that to say, while cutting (wasteful) expenditure would certainly be a step in the right direction, the more realistic way out is for SA to grow itself out of this crisis.

South Africa can boost economic growth by implementing straightforward reforms that effectively amount to the state getting out of the way of the relatively more productive private sector. Liberalising the energy sector (which is already happening), streamlining business regulations, relaxing labour laws, improving port efficiency through privatisation, and professionalising or automating as much as possible in the public sector would all go a long way in attracting capital that leads to growth. These targeted reforms, building on existing initiatives, could lift GDP growth materially within a few years.

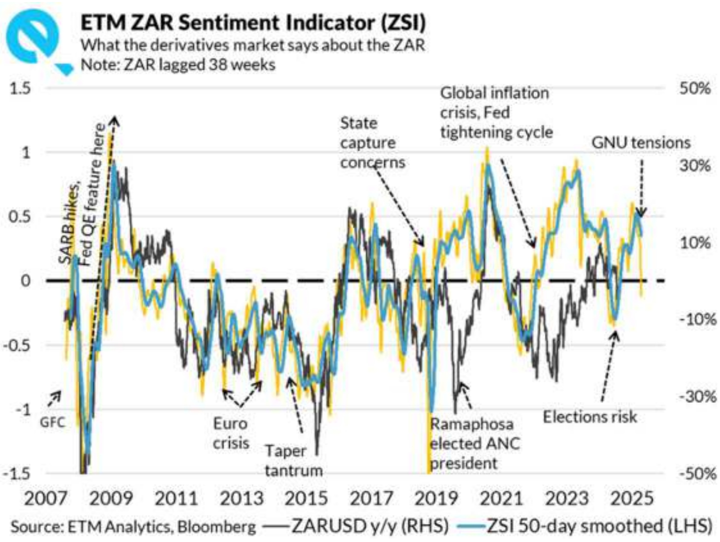
The ZAR's rollercoaster ride



If there was ever any doubt about how much risk the market had priced into the ZAR due to the prospect of the GNU failing, that has been put to rest. The ZAR was among the best-performing EM currencies in 2024 following the formation of the GNU, but is currently among the worst performers so far this year as the coalition has come under strain. However, recent indications that the GNU partners are actively working towards bridging differences concerning the budget impasse suggest that there is still value to the coalition and that it will likely hold after all, with positions seemingly softening all round the longer the discussions and negotiations continue.

Investors now have a very clear indication that the bulk of the sell-off witnessed in April was GNU-related and not a function of the Trump administration's tariff policies. If anything, the tariffs have detracted from the performance of the USD. Therefore, any positive news that the GNU will hold together and that the ANC will reconsider its budget, and the ZAR will extend its rally as it plays catch-up in capitalising on broad-based USD weakness.

GNU concerns to linger



It is, however, worth noting that the risk of a GNU split has not been priced out of the market. The adjacent chart shows that the high-frequency version of ETM's ZAR Sentiment Indicator (yellow line) has dropped sharply in recent weeks. This reflects the increased demand for hedging against ZAR weakness in a six to nine-month window.

The recent budget impasse has clearly raised concerns among investors over the longer-term viability of the GNU, or at least over its ability to navigate the complexities of coalition governance without causing significant hiccups for the ZAR. Although a collapse of the GNU serves no party's interests and appears less likely the longer it stays together, it is a risk that will continue to overshadow the local unit. The April ZAR sell-off holds a valuable lesson: the market is pricing in a lot of optimism that the GNU will succeed.

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