Viewpoint: Not quite the decisive fiscal pivot needed

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Key points

- The Budget 2026 delivered gradual consolidation (deficit narrowing to 4.0%, debt projected to peak), supporting bonds and the rand, but progress is cautious rather than decisive. Expenditure growth remains firmly higher than could be considered conservative, the fiscal anchor lacks teeth, and credibility still depends on consistent execution.
- Stronger fundamentals reduce ZAR tail risk, yet much of the improvement appears priced in; with growth still sub-2% and reliance on commodity-based revenue high, the ZAR looks somewhat more vulnerable to external shocks or policy disappointment despite a firmer fiscal footing.

BASELINE VIEW: Improved fiscal fundamentals, deficit narrowing, debt peaking, anchored inflation, and lower issuance pressure reduce structural downside risk and support the currency on dips. However, sub-2% growth, persistent real expenditure growth, and an elevated debt ratio limit sustained appreciation, while much of the fiscal improvement is already priced in. External sensitivity remains high, with reliance on commodity export revenue leaving the rand exposed. Key risks to look for include oil shocks, gold pullbacks, or rising US real yields. Overall, the ZAR is structurally more stable, but upside from current levels is limited.

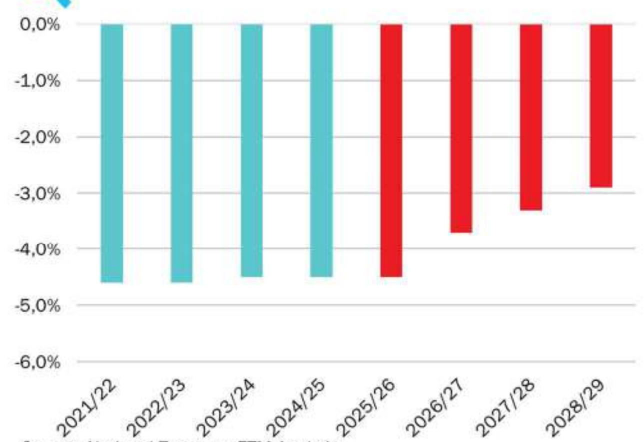
Budget Snapshot

Budget forecasts over time

Key fiscal metrics	2024 MTBPS		2025 Budget (3.0)		2025 MTBPS		2026 Budget	
	2024/25	2025/26	2025/26	2026/27	2025/26	2026/27	2026/27	2027/28
Real GDP	1,1%	1,7%	1,4%	1,6%	1,2%	1,5%	1,6%	1,8%
Consolidated budget balance	-5,0%	-4,3%	-4,8%	-3,8%	-4,5%	-3,6%	-4,0%	-3,5%
Gross loan debt/GDP	74,1%	74,7%	77,4%	77,2%	77,9%	77,7%	78,9%	77,3%
Debt-service costs/GDP	5,2%	5,2%	5,4%	5,4%	5,4%	5,3%	5,3%	5,2%
Borrowing needs (ZAR, bn)	424,7	602,7	588,3	434,3	568,2	377,8	380,0	568,7

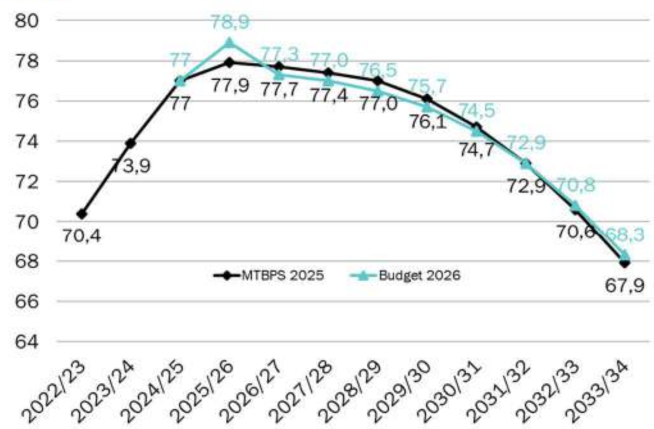
Source: National Treasury, ETM Analytics

Budget deficit (%/GDP) expected to narrow



Source: National Treasury, ETM Analytics

Debt trajectory forecast to compress next year



Gradual progress, but risks remain

South Africa's 2026 Budget initially appears to reinforce the stabilisation narrative that has supported the rand and domestic bonds in recent months. Under NT projections, the deficit narrows, debt-to-GDP peaks, inflation is contained, and no broad-based tax hikes are introduced. Yet beneath the headline improvement lie several numbers that should temper enthusiasm and ultimately complicate the bullish fiscal story.

The budget confirms incremental consolidation, but it also raises legitimate questions about the depth and durability of that commitment, particularly if commodity export revenues come under pressure.

The consolidated budget deficit is projected at 4.5% of GDP in the current fiscal year, declining only to 4.0% in FY2026/27. While this represents progress, the reduction is more modest than the structural risks demand. Given stronger tax collections, elevated commodity prices and lower interest costs, a sharper drop would have signalled stronger fiscal intent. The removal of previously mooted tax increases, while politically welcome, may have limited the pace of deficit reduction.

To understand whether this is a temporary pause or a deeper structural compromise, closer inspection of expenditure line items is required. For now, the consolidation trajectory is more customary than decisive.

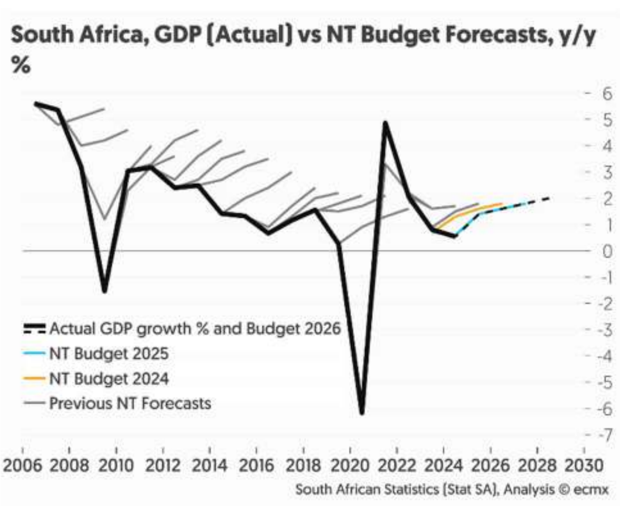
Debt dynamics are equally mixed. Gross debt-to-GDP is projected to rise above expectations before stabilising and edging lower. The repeated upward revisions to the debt ratio year after year have conditioned markets to treat stabilisation forecasts with scepticism.

While the budget projects a peak and gradual decline, the starting level is elevated, and the margin for error remains thin. The key question for investors is whether this government is genuinely serious about sustained fiscal consolidation or whether stabilisation is contingent on favourable macro conditions. Until debt ratios clearly decline over multiple reporting cycles, headlines reporting turnaround remain hype.

The proposed fiscal anchor adds little immediate reassurance. A "principles-based" fiscal anchor, to be formalised only at the upcoming MTBPS, lacks operational detail and binding constraints. This functions more as a signalling device than a policy rule. In the absence of a hard debt ceiling or expenditure cap, the fiscal framework remains exposed to political and economic pressures.

For markets, anchors matter only insofar as they are enforceable and credible. At present, this proposal feels aspirational rather than reformative.

There are several constructive elements as well. Projected declines in net borrowing requirements and an increase in redemptions over the medium term are supportive for bonds. If realised, they would reduce issuance pressure and reinforce the downward trend in debt-service costs.

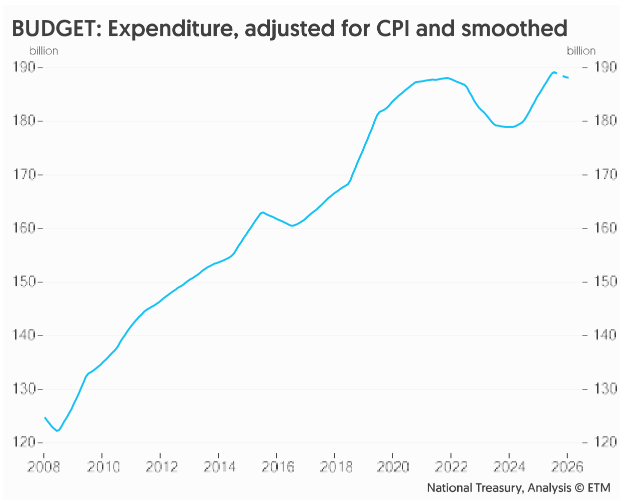


However, these remain forecasts. Their credibility depends on the deficit narrowing as projected and on debt stabilising despite NT's spending aspirations. The fact that the 2026/2028 debt-to-GDP forecast has jumped by a percentage point more than expected in the MTBPS reinforces the point.

Another concern lies further out in the fiscal horizon. Despite improved tax collections, higher commodity prices and lower interest rates, later budget deficits remain sizeable.

This implies that expenditure growth is still planned at a time when revenues are ultimately fragile. Investors need clarity on where this upward spending adjustment represents permanent commitments. If windfall revenues are being structurally embedded into expenditure baselines, the fiscal consolidation narrative weakens.

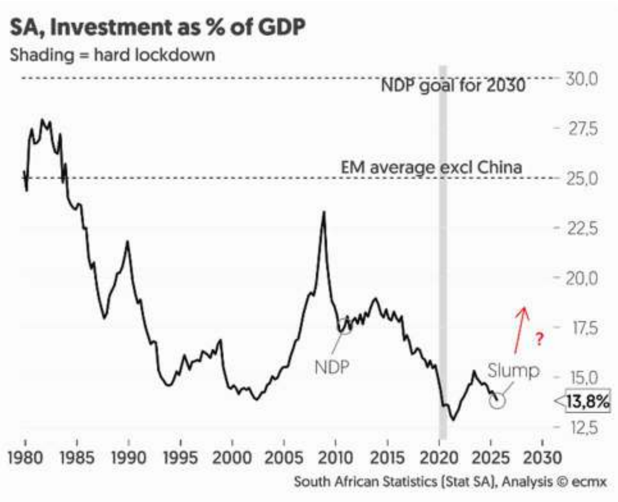
The commitment to spend R1.07 trillion on infrastructure is, in principle, positive. Yet evidence from gross fixed capital formation data suggests that delivery has consistently lagged ambition and is often subject to cost overrun.



No major headline on infrastructure bonds accompanied this commitment, which is disappointing given that project-linked bonds might have been well received in the current yield environment.

Without tangible implementation mechanisms or clear funding structures, the infrastructure push remains aspirational. Operation Vulindlela continues to be framed as the reform vehicle, but its traction must be measured in outcomes rather than announcements.

Growth projections also underwhelm. Real GDP growth has been revised up modestly to 1.6% in 2026 and 1.8% in 2027, but these levels remain insufficient to materially accelerate debt reduction or meaningfully expand the tax base. For a country with unemployment and structural constraints, growth below 2% does little to transform fiscal arithmetic. It stabilises the outlook but does not adequately address core points of fragility.

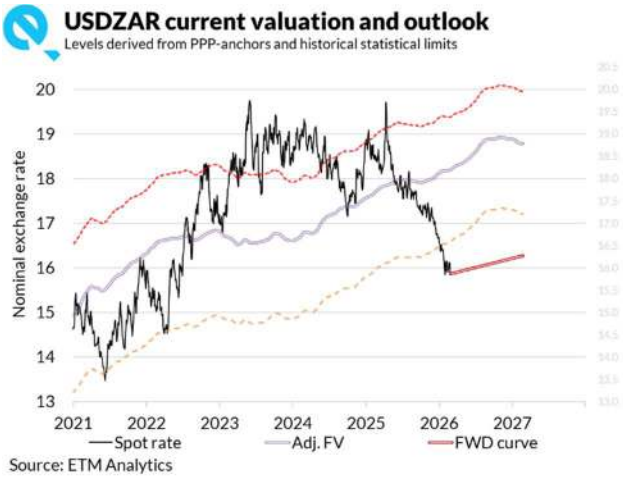


The expenditure trajectory remains bold. Consolidated government expenditure is projected to rise from R2.58 trillion in FY2025/26 to R2.89 trillion over three years, representing approximately 12% growth. This implies expenditure growth above inflation and raises questions about the anchoring of fiscal discipline. If spending expands in real terms while growth remains modest, the margin for sustained consolidation narrows.

Budget forecasts represent incremental progress rather than a decisive fiscal pivot. The deficit narrows, debt stabilises, and borrowing costs improve, which supports the rand and bond market narrative. Yet the improvement relies partly on cyclical support and cautious forecasting. The fiscal anchor lacks immediacy, expenditure growth remains robust, and debt starts from a higher base than anticipated. For investors, this is a budget that reduces tail risk but does not eliminate it. With the budget ultimately constructive but vague, credibility will ultimately be earned through consistent execution rather than forward projections.

Component	Structural?	Comment
Declining deficit (5.1% in 2021/22 → ~4.0% in 2026/27)	YES — but shallow	Improvement exists, but given commodity tailwinds and lower rates, a sharper decline should have been achievable.
Primary surplus rising (~0.7% → ~2.3% of GDP)	YES	This is the strongest structural anchor. However, it assumes no spending slippage and sustained revenue strength.
Revenue overshoot (FY2025/26)	MIXED	VAT base looks healthier (structural). CIT boost heavily commodity- and finance-cycle driven. Not bankable long term.
Commodity price assumptions (gold US$4,529)	NO	A gift from global markets, not policy. If gold retraces, this fiscal comfort evaporates quickly.
Interest savings (R21bn over MTEF)	CONDITIONAL	Lower yields reflect market optimism. If credibility wobbles, these "savings" reverse.
R20bn tax increase withdrawal	STRUCTURAL (policy shift)	Politically welcome, fiscally dilutive. Slows consolidation when conditions were ideal to accelerate it.
GFECRA transfers	NO	One-off accounting support. Improves optics; does not strengthen recurring fiscal capacity.
Consolidated expenditure growth (R2.58trn → R2.89trn, +12% over 3 years)	WEAK DISCIPLINE	Real spending rising above inflation undermines the consolidation narrative. Hard to call this austerity.
Debt/GDP revised higher before stabilising	CONDITIONAL	The "peak" keeps drifting upward before peaking. Markets have seen this movie before.
Fiscal anchor ("principles-based")	NOT CREDIBLE YET	Without numeric targets or enforcement, it is guidance, not constraint. MTBPS will determine seriousness.
Net borrowing requirement decline	FORECAST-DEPENDENT	Looks good on paper, but relies on flawless execution and cooperative markets.
Infrastructure commitment (R1.07trn)	ASPIRATIONAL	No infrastructure bond headline, no clear funding architecture. Delivery track record remains thin.

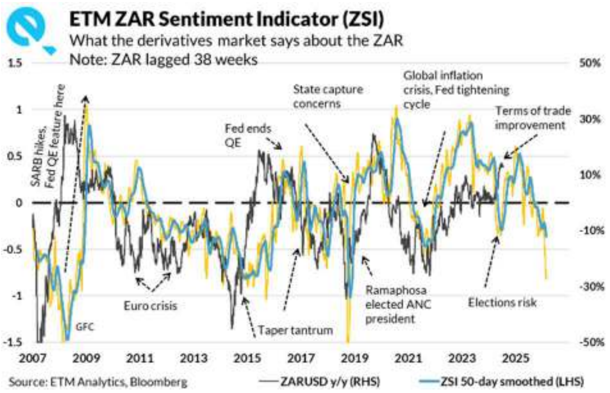
ZAR implications given ZSI deterioration



South Africa's 2026 Budget lands at a time when the rand is trading at its strongest valuation in several years. The domestic backdrop has clearly improved enough to generate some bullish headlines.

The consolidated deficit narrows, debt is projected to peak but edge lower, inflation is anchored, and borrowing costs are lower. The sovereign risk premium has compressed, and lower inflation differentials should support the currency. Structurally, that is a meaningful shift.

However, the pace of consolidation is incremental rather than transformative. A move from a 4.5% to 4.0% deficit is progress, but given high commodity prices and lower interest costs, it is not a dramatic tightening. Growth forecasts of 1.6% in 2026 and 1.8% in 2027 stabilise the macro picture but do not generate a powerful structural growth narrative.



The fiscal story reduces downside risk, but it does not create a new growth engine. Commodities remain central. Gold above US$4,500 per ounce supports exports and fiscal revenues, cushioning the current account and reinforcing rand resilience. Yet this reliance cuts both ways. A meaningful pullback in gold or a spike in oil prices would quickly weaken both fiscal arithmetic and currency support.

The improvement in South Africa's domestic fundamentals reduces vulnerability but does not eliminate external sensitivity. The more pressing topic at this juncture is the ZAR's valuation. On several metrics, the rand is at its best levels in years amid portfolio inflows and commodity revenues. But some might argue that much of the fiscal improvement has now been priced in, leaving an obvious pain trade.

When currencies trade at extended valuations, marginal good news struggles to push them higher, while negative surprises can trigger sharp corrections. This asymmetry is increasingly visible in options markets, where risk reversals have widened. Note that the 1-year 25-delta risk reversal is testing its highest levels since 2022, suggesting investors are pricing in the risk that the ZAR weakens. Investors are paying up for downside protection, signalling that hedging against depreciation risk is becoming more common.

Potential catalysts for such a move are clear. A stronger US dollar, higher global real yields, an oil shock, or disappointment in the forthcoming fiscal anchor details could all reintroduce volatility. SOE-related contingent liabilities remain an underlying risk. None of these drivers would require domestic collapse or failure; they would emerge amid a shift in global portfolio allocations or policy expectations.

In short, the rand stands on firmer fiscal ground than in recent years. Debt stabilisation and improved credibility justify a lower long-term depreciation bias. But at current levels, the risk-reward balance is less compelling for fresh longs. The macro foundation is stronger yet positioning and valuation suggest heightened risk towards a reversal. With the ZAR arguably at or even above PPP fair value, the next significant move may well test the currency's strength rather than extend it.

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