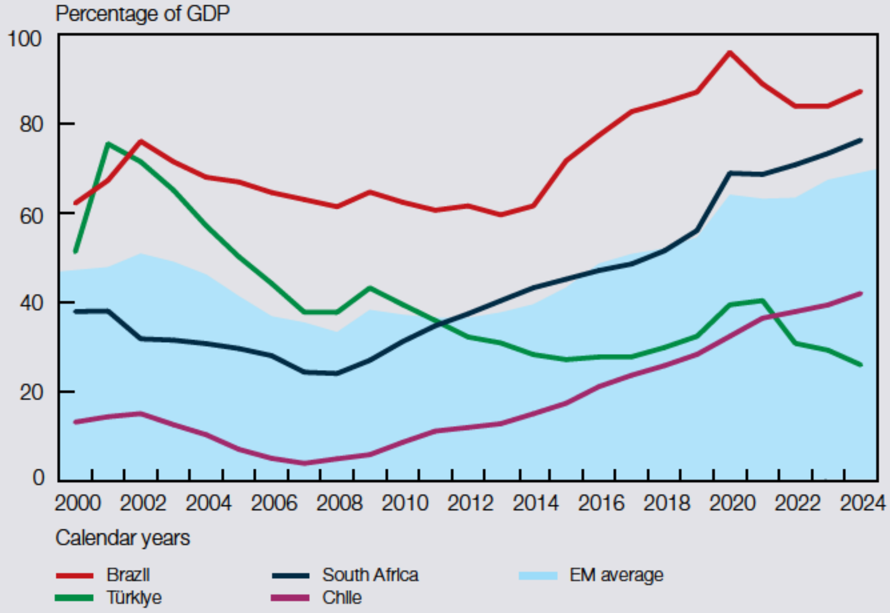
Box 3 The growing impact of debt-service cost on public finances

Since the 2008–09 global financial crisis, South Africa's national government gross loan debt[1] has steadily increased, resulting in persistent growth in interest payments on this debt (debt-service cost). As a ratio of nominal gross domestic product (GDP), South Africa's gross loan debt has been rising faster than the average ratio in other emerging market (EM) countries, with South Africa's debt-to-GDP ratio surpassing the average for EMs since 2020.

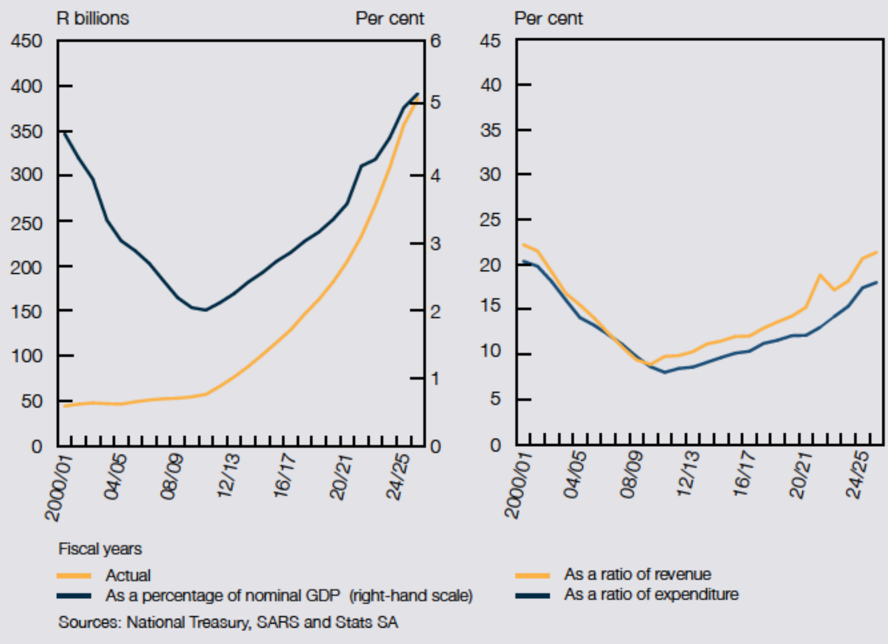
Gross loan debt in selected emerging markets



Source: IMF

South Africa's annual debt-service cost increased gradually from R46.3 billion in fiscal 2000/01 to R54.3 billion in fiscal 2008/09. Subsequently, the cost of servicing debt increased at an annual average rate of about 13.1%, reaching R385.6 billion in fiscal 2024/25. The increase reflected the combined impact of rising debt levels and elevated borrowing costs, both of which present significant constraints for fiscal sustainability. Higher debt-service cost has also contributed to larger budget deficits, increasing the risk of falling into a debt trap.

South Africa's national government debt-service cost



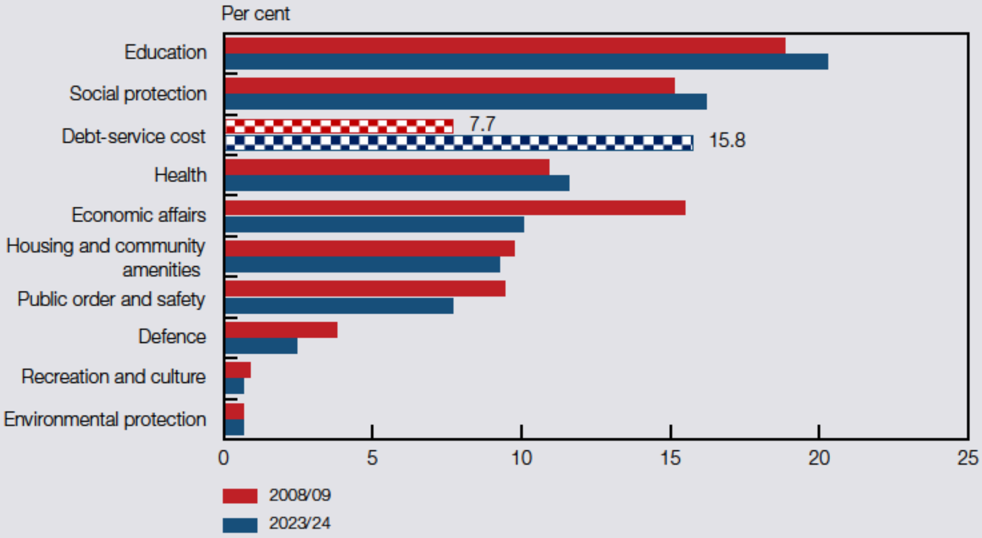
Sources: National Treasury, SARS and Stats SA

1 This debt is managed by National Treasury in accordance with the Public Finance Management Act 1 of 1999.

After reaching a low of 8.9% in fiscal 2008/09, debt-service cost as a ratio of national government's main budget revenue increased notably and is projected to peak at 21.9% in fiscal 2025/26,[2] underscoring the persistent fiscal pressure posed by the rising stock of debt and high financing costs. Expressed as a ratio of national government expenditure, debt-service cost increased from a low of 8.6% in fiscal 2008/09 and is projected to reach 18.4% in fiscal 2025/26. This reflects a greater allocation of resources towards servicing debt, crowding out expenditure for essential priorities such as infrastructure investment, social services and economic development initiatives.

Since fiscal 2008/09, debt-service cost as a share of total consolidated government spending has more than doubled, exerting mounting pressure on the fiscus and crowding out critical developmental priorities as envisioned in the *National Development Plan 2030*.[3] These include social expenditure aimed at reducing poverty and improving the standard of living for all South Africans.

Share of total consolidated general government spending by function



Source: National Treasury

As more resources were allocated to interest payments, the share of spending on infrastructure, education, health and economic development reforms has declined over time, undermining government's goal of building a more resilient and inclusive economy. In addition, the escalating cost of servicing debt has necessitated running a primary surplus[4] during the past two fiscal years. Although this is required to curb the growth in government debt, it is also associated with a slowdown in essential public services spending – a practice commonly referred to as 'austerity'.

In 2024, 75.2% of South Africa's national government domestic marketable debt was held domestically, on average, much higher than the average holding of 59.8% in 2018, indicative of foreign investors reducing their exposure to South African government bonds. This trend underscores foreign investors' perception of increased risk associated with South Africa's capital markets, which has contributed to a waning appetite for government bonds. Although government bonds are generally regarded as fairly low-risk assets, market pricing reflects perceptions of risk around a country's fiscal trajectory. Combined with low economic growth, which constrains growth in government revenue, high bond yields make it difficult to stabilise debt without running primary surpluses, which, in turn, constrains non-interest expenditure. South African government bond yields are higher than the average for EMs, indicating that investors demand higher compensation for lending to the South African government. In general, these yields fluctuate according to investor perceptions of EMs as well as South Africa's macroeconomic fundamentals and fiscal sustainability imperatives.

Although government has limited influence over bond yields, it is able, through credible public finance management and demonstrated resilience to economic shocks, to manage the perceptions of risk related to the fiscal framework. Since South Africa's downgrade to non-investment grade status in 2020, the country's fiscal risk profile has remained subject to scrutiny and uncertainty.

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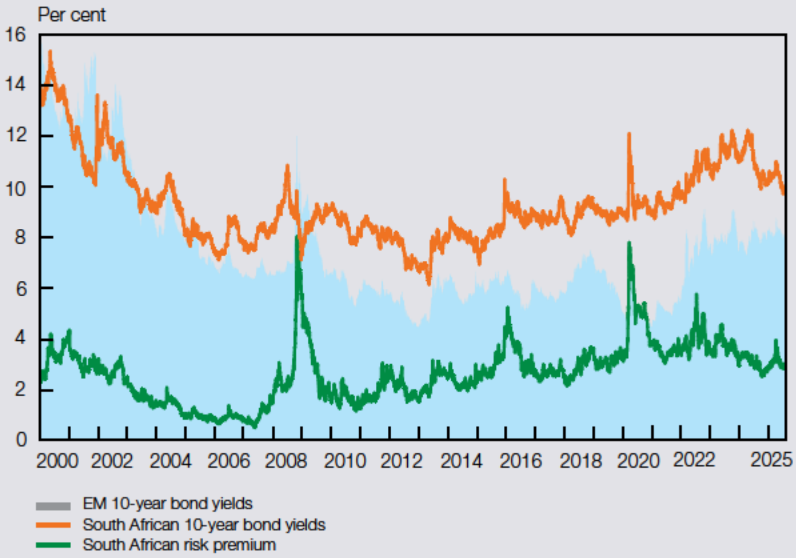
2 According to the *2025 Budget Overview*, available at https://www.treasury.gov.za/documents/National%20Budget/2025May/.

3 See *National Development Plan 2030: Our Future – Make it Work*, available at https://www.gov.za/sites/default/files/gcis_document/201409/ndp-2030-our-future-make-it-workr.pdf.

4 A primary surplus is recorded when national government revenue exceeds non-interest expenditure.

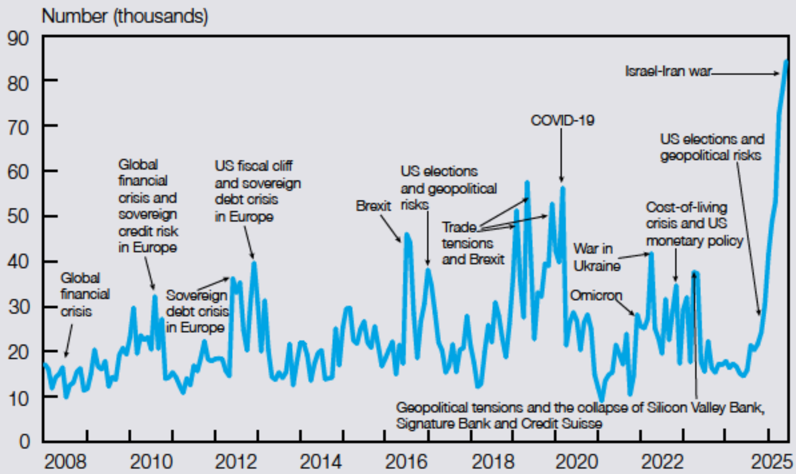
Government bond yields and South African risk premium



Sources: Bloomberg and Haver

In recent years, global financial conditions have been subjected to several shocks, as depicted by the World Uncertainty Index.[5] During this period, South African bond yields have largely risen more than those in other EMs, primarily due to the country's growing debt levels and elevated debt-service cost, along with stagnant economic growth due to the slow implementation of reforms.

World Uncertanity Index



Source: Economist Intelligence Unit

The *2025 Budget Overview* envisioned that national government debt would be stabilised at a revised peak of 77.4% of GDP in fiscal 2025/26 and then reduced to 67.8% of GDP by fiscal 2032/33, reflecting government's commitment to restoring fiscal sustainability. To support this, National Treasury intends to implement fiscal rules, both numerical and procedural, based on recommendations from the International Monetary Fund.[6] The proposed reforms are intended to enhance transparency and improve fiscal policy credibility in support of macroeconomic stability. These fiscal rules are envisioned to be binding through legislation in order to reinforce confidence in South Africa's fiscal framework by ensuring a disciplined budget management process and a sustainable debt trajectory. Coupled with the adoption of fiscal rules, the momentum in the implementation of structural reforms seen over the past two years bodes well for South Africa's goal of inclusive growth and stability in the fiscal framework.

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5 The World Uncertainty Index (WUI) is compiled by counting the number of times the word 'uncertain' (or its variants) is used in the Economist Intelligence Unit's country reports. The WUI is then rescaled by multiplying it by 1 000. A higher number means higher uncertainty, and vice versa.

6 See National Treasury's *Fiscal Anchors Discussion Document*, available at https://www.treasury.gov.za/documents/National%20Budget/2025May/review/Fiscal%20anchors%20discussion%20document.pdf.