SOUTHERN AFRICA ECONOMIC OUTLOOK 2026

Mobilizing Southern Africa's Development Financing at Scale in a Fragmented World

AFRICAN DEVELOPMENT BANK GROUP

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ACKNOWLEDGEMENTS

The Regional Economic Outlook (REO) 2026 for Southern Africa was prepared in the Vice-Presidency for Economic Governance and Knowledge Management Complex, under the general direction and supervision of Prof. Kevin C. Urama, Chief Economist and Vice-President, with support from Alexandre Kopoin, Special Assistant to the Chief Economist; Adamon Mukasa, Principal Research Economist; and Amah Koffi, Senior Executive Assistant.

Preparation of this report was led by Hervé Lohoues, Officer-in-Charge Director of the Country Economics Department (ECCE), assisted by Linguère Mbaye, Division Manager (ECCE.1), under the coordination of Marcellin Ndong Ntah, Lead Economist (ECCE), Audrey Chouchane, Lead Economist (ECCE) and Richard Doffonsou, Chief Country Economist (ECCE). Tricia Effe Baidoo and Aminata Kouma Moulod, Product Management Specialists (ECCE), managed the REO production cycle. Jeanson Lwenge and Itumeleng Mathlo-Masemola, Research Assistants (ECCE), together with Ziphozethu Dube and Sassire Napo, Data Analysts (ECCE), contributed to the research and data analysis. Eugenia Grant, Kenane Monyela, and Boris Nayalome, Team Assistants (ECCE), provided invaluable administrative and logistical support.

The REO 2026 for Southern Africa was drafted by a Team led by Edward Sennoga, Lead Economist (ECCE) comprising Itumeleng Mathlo-Masemola, Research Assistants (ECCE), as well as Prof. Sessi Tokpavi, Consultant, and Prof. Alain Serge Kpassokro, Consultant; who contributed to background notes on chapters 2 and 3 of the report, respectively. Chisola Sakinyi, Consultant at the Southern Africa Regional Development and Business Delivery Office also provided valuable insights into the report.

The team also wishes to express its gratitude to: (i) the Southern Africa Regional Development and Business Delivery Office (RDGS) regional team, led by Kennedy Mbekeani, Director General, RDGS, and Country Manager for South Africa;(ii) Moono Mupotola, Deputy Director General RDGS; (iii) the Department of Macroeconomic Policy, Forecasting and Research (ECMR), led by Anthony Simpasa (Director); (iv) the Department of Transition States (RDTS), led by Yero Baldeh (Director); and other departments represented in the Bank's Knowledge Management Committee, for their valuable contributions to the preparation of the report.

The Bank would like to thank the regional and country-level authorities for their support during the preparation of the REO 2026, as well as representatives of government institutions, development partners, the private sector, civil society organizations, and other stakeholders for their availability and the quality of the discussions and exchanges during the report's preparation.

The data used in this report were compiled by the Department of Statistics (ECST), led by Samson Babatunde Omotosho, Director, with the participation of Koua Louis Kouakou, Manager of the Economic and Social Statistics Division, and Anouar Chaouch, Senior Statistician.

Peer review comments were received from Paul Mpuga, Division Manager (ECMR); Hammed Amusa, Chief Research Economist (ECMR); Martin Nandelenga, Senior Research Economist (ECMR); Benjamin Camara (KMC); the ECST team and from the Knowledge Management Committee of the Bank. The Report also benefited from the valuable contribution of Léonce Ndikumana, Distinguished Professor of Economics, University of Massachusetts Amherst who served as external reviewer

The cover of the report is based on an original design by Laetitia Yattien-Amiguet and Justin Kabasele of the Bank's External Relations and Communications Department. Copy-editing was carried out by Kobena Hanson while layout and design were undertaken by Creable Media.

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ACRONYMS AND ABBREVIATIONS

AELP	African Exchanges Linkage Project
AEO	Africa Economic Outlook
AfCRA	African Credit Rating Agency
AfDB	African Development Bank
ATAF	African Tax Administration Forum
AUC	African Union Commission
DBSA	Development Bank of Southern Africa
DFI	Development Finance Institution
DRM	Domestic Resource Mobilization
ESG	Environmental, Social, and Governance
EUR	Euro
FATF	Financial Action Task Force
FDI	Foreign Direct Investment
G20	Group of Twenty
GCF	Gross Capital Formation
GDP	Gross Domestic Product
GFI	Global Financial Integrity
IDC	Industrial Development Corporation
IFF	Illicit Financial Flow
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
MDB	Multilateral Development Bank
MSME	Micro, Small, and Medium-sized Enterprises
ODA	Official Development Assistance
OECD	Organization of Economic Co-operation and Development
PAPSS	Pan-African Payment and Settlement System
PDB	Public Development Bank
PFM	Public Finance Management
PIM	Southern African Customs Union
PPP	Public-Private Partnership
SACU	Southern African Customs Union
SADC	Southern Africa Development Community
SDG	Sustainable Development Goal
SME	Small and Medium Size Enterprises
SOE	State-Owned Enterprises
SSA	Sub-Saharan Africa
TFP	Total Factor Productivity
UNECA	United Nations Economic Commission for Africa
US	United States of America
USD	United States Dollar
VAT	Value-Added Tax
WDI	World Development Indicators

EXECUTIVE SUMMARY

Regional Economic Performance and Outlook

Southern Africa's economic recovery remains gradual and uneven, with regional growth projected to increase from 2.1% in 2026 to 2.7% in 2027, supported by stronger household consumption, improved services activity, and a modest cyclical rebound. However, underlying structural constraints including limited economic diversification, weak agricultural productivity, infrastructure deficits, and low domestic resource mobilization continue to constrain long-term growth potential and resilience. This disconnect is reflected in subdued GDP per capita growth and persistent cross-country disparities, highlighting the limited transmission of economic growth into improved living standards. Although inflationary pressures have moderated across much of the region, fiscal deficits, rising public debt burdens, and ongoing external imbalances continue to constrain the policy space and development financing capacity. While the medium-term outlook remains cautiously positive, sustaining stronger and more inclusive growth will require fiscal sustainability to be restored, strengthening macroeconomic stability, enhancing domestic revenue mobilization, improving public expenditure efficiency, and accelerating regional integration to support private investment, productivity growth, and structural transformation.

Mobilizing Southern Africa's Development Financing at Scale in a Fragmented World

Southern Africa's most binding development financing challenge is not simply a shortage of resources, but the limited capacity to mobilize, intermediate, and deploy available capital efficiently at scale in an increasingly fragmented global environment. Investment levels remain persistently below development needs, reflecting weak financial intermediation, inadequate project preparation capacity, and insufficient long-term financing channels. Large pools of domestic savings remain underutilized, while access to affordable external finance has become increasingly constrained by higher borrowing costs, declining concessional flows, and heightened global uncertainty. At the same time, financing gaps are exacerbated by low domestic resource mobilization, capital leakages, and underdeveloped capital markets that limit the conversion of savings into productive investment. Unlocking development financing at scale will therefore require prioritizing a limited set of high-impact levers: strengthening domestic revenue mobilization, deepening regional capital markets, leveraging pension and insurance assets, expanding blended finance mechanisms, and crowding in private investment through improved investment climates and credible policy frameworks. Harnessing the region's abundant natural capital, demographic dividend, and diaspora resources also presents significant opportunities to expand sustainable financing, provided governance, project bankability, and absorptive capacity constraints are addressed.

Strengthening and Consolidating Southern Africa's Financial Systems and Agency in a Changing World

Weaknesses in Southern Africa's financial architecture continue to translate into high costs of capital, limited access to long-term financing, and insufficient credit allocation to productive sectors. Concentrated and unevenly developed financial systems, with shallow capital markets outside a few regional hubs, constrain the ability of financial institutions to support investment, diversification, and private sector development. These domestic vulnerabilities are further amplified by structural weaknesses in the global financial system, including unfavourable sovereign risk perceptions, dependence on foreign currency borrowing, and exposure to volatile global liquidity conditions, which increase financing costs and heighten vulnerability to external shocks. Addressing these challenges requires a comprehensive reform agenda focused on strengthening financial sovereignty, deepening domestic and regional capital markets, and improving financial sector governance and resilience. Priority reforms include expanding local currency financing markets, strengthening regulatory and supervisory frameworks, enhancing the role of institutional investors and development finance institutions, and promoting greater regional financial integration. Improving debt transparency, reducing illicit financial flows, and modernizing financial and customs systems will also be critical to lowering financing costs, improving investor confidence, and strengthening the region's capacity to mobilize long-term development finance in support of sustainable and inclusive growth.

1

ECONOMIC PERFORMANCE AND OUTLOOK

Key Messages

- **Modest and uneven growth, with limited transformation. Southern Africa's growth increased from 2.0% in 2024 to 2.3% in 2025, projected to 2.1% in 2026 amid a fragile recovery, and then strengthen to 2.7% in 2027,** although downside risks from climate shocks, commodity price volatility, and persistent structural constraints remain elevated.
- **Moderating but uneven inflation, with persistent vulnerabilities.** Inflation declined from 26.1% in 2024 to 12.3% in 2025 and is projected to further drop to 8.4% in 2026.
- **Poverty reduction has slowed amid income losses, inflation, and climate shocks,** while persistent inequality, unemployment, and weak service delivery continue to limit welfare gains.
- **Elevated external and domestic risks persist, with significant macroeconomic implications.** Tight global financial conditions may trigger capital outflows and exchange rate depreciation.
- **Sustained, well-sequenced reforms across fiscal, monetary, and structural domains are essential** to restore stability, accelerate diversification, and secure inclusive, resilient long-term growth.

1.1 INTRODUCTION

This chapter presents Southern Africa's recent economic performance and provides updated short to medium-term growth projections over 2026-2027. It discusses the main downside and upside risks to the outlook. It also assesses trends in key macroeconomic indicators, fiscal and monetary policies, inflation dynamics, main drivers of public debt dynamics, and changes in domestic and external financial flows. The chapter provides policy options to foster high and resilient growth, supporting macro-economic stability, economic transformation and dealing with shocks that have continued to buffet Southern Africa's economy.

Southern Africa's growth outlook is shaped by three interrelated tensions that define both the near-term trajectory and longer-term development challenges of the region. A cyclical recovery is emerging alongside weak potential growth, as modest improvements in economic activity reflect post-shock normalisation but remain insufficient to overcome deep structural constraints, including low productivity, limited diversification, infrastructure deficits, and weak investment dynamics. Partial disinflation is occurring alongside persistent macroeconomic vulnerabilities, as easing price pressures in several economies coexist with elevated fiscal deficits, high and rising debt burdens, exchange rate pressures, and constrained monetary policy transmission, all of which continue to undermine macroeconomic stability. Short-term improvements in output and stabilization in selected macroeconomic indicators are also accompanied by elevated structural risks, including commodity dependence, climate variability, geopolitical fragmentation, tightening global financial conditions, and domestic structural bottlenecks. Together, these tensions underscore a recovery process that remains fragile, uneven, and highly exposed to both external shocks and internal constraints.

1.2 GROWTH PERFORMANCE AND PROSPECTS

1.2.1. Forces Shaping Southern Africa's Economic Growth Performance and Outlook

Southern Africa's macroeconomic outlook is increasingly shaped by external shocks and persistent structural constraints, with rising geopolitical tensions amplifying inflationary pressures and fiscal vulnerabilities across the region. Higher oil prices, trade disruptions, and tighter global financial conditions are raising inflation, import costs, and fiscal pressures across most economies, particularly given the region's dependence on imported petroleum products. Vulnerabilities are most acute in import-dependent and fiscally constrained economies such as Madagascar, Malawi, São Tomé and Príncipe, and Zimbabwe while landlocked countries face additional pressures from rising freight and logistics costs. Higher food and fertilizer prices are also expected to intensify food inflation and weaken agricultural productivity. At the same time, domestic challenges including infrastructure bottlenecks, energy shortages, limited fiscal space, and weak diversification continue to constrain growth and policy flexibility. Although Angola may benefit from higher oil export revenues, the broader regional outlook remains highly vulnerable to prolonged geopolitical disruptions, with risks of rising inflation, debt distress, exchange-rate pressures, and macroeconomic instability (Box 1.1).

Box 1.1: Potential impacts of the Middle East conflict on Southern African economies

The escalating conflict in the Middle East is expected to generate adverse macroeconomic spillovers for Southern Africa through higher global oil prices, disruptions to key maritime trade routes, and tighter international financial conditions. Given the region's high dependence on imported petroleum products, these shocks are likely to be transmitted through higher inflation, rising import costs, deteriorating external balances, and increased financing pressures. Sustained increases in oil prices could raise inflation by an estimated 1–3 percentage points and increase import costs by 10–25%, depending on countries' energy intensity and external exposure.

Higher fuel prices are expected to exert broad-based inflationary pressures via higher transportation, food production, and distribution costs. Furthermore, disruptions to global shipping routes could increase freight and insurance costs, raise the cost of imported goods and reduce the competitiveness of exports. The conflict may also weaken global economic activity, dampening demand for the region's commodity exports, while tighter global financial conditions could elevate borrowing costs and refinancing risks, particularly for economies with high debt burdens and limited policy buffers.

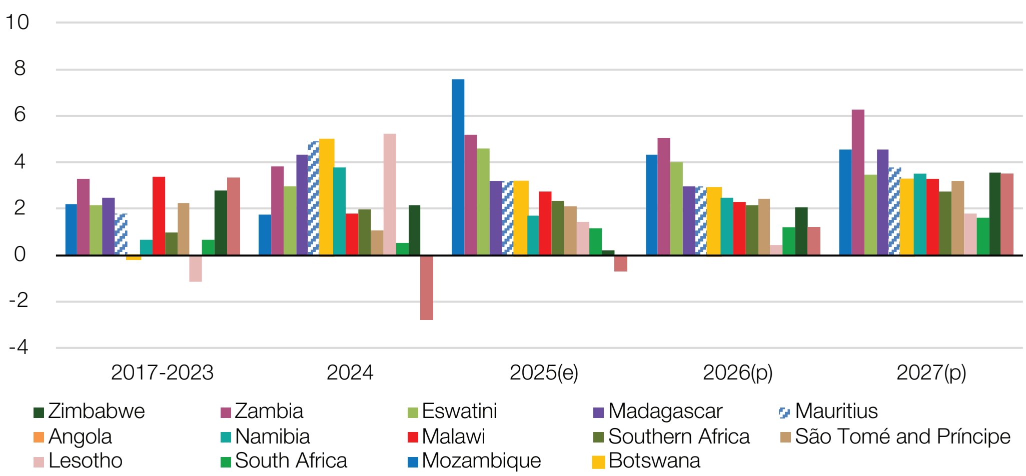
The magnitude of these effects will vary across countries. Oil-exporting economies such as Angola as well as other resource rich countries like South Africa and Zimbabwe (gold) and Zambia (copper) are poised to benefit from increased commodity prices leading to improved fiscal and external balances, although these gains could be partly offset by imported inflation and tighter financing conditions. In contrast, net fuel importers with limited fiscal and external buffers, including Malawi and Mozambique, are likely to face heightened inflationary pressures, widening external imbalances, and increasing debt vulnerabilities. Countries with relatively stronger fiscal positions and external reserves, such as Namibia, could be better placed to absorb external shocks, although higher fuel costs and weaker demand for key exports could still weigh on economic activity. South Africa's more diversified economy and deeper financial markets provide some resilience, but the country remains exposed to inflationary pressures, capital flow volatility, and higher borrowing costs.

Overall, the conflict underscores the importance of strengthening macroeconomic buffers, enhancing energy security, diversifying export structures, and building resilience to external shocks. Accelerating investment in renewable energy, improving fiscal sustainability, and expanding regional trade integration will be critical to mitigating vulnerabilities and safeguarding economic stability across Southern Africa.

1.2.2. Recent Growth Performance

Southern Africa's growth in 2025 reflects a modest cyclical recovery amid persistent structural constraints and uneven country performance. Regional real GDP growth increased from 2.0% in 2024 to 2.3% in 2025, before an anticipated moderation to 2.1% in 2026 and recovering to 2.7% in 2027 (see Figure 1.1). The recovery is supported by stronger performances in Zimbabwe (7.6%), Zambia (5.2%), and Eswatini (4.6%), driven by improved agricultural output, favourable base effects, and relative macroeconomic stabilization. However, the expected moderation in 2026 suggests that these gains remain constrained by structural challenges, including infrastructure gaps, limited diversification, and continued dependence on commodities. The quality of growth remains uneven across the region. While the increase in regional growth may support employment recovery in some countries, much of the expansion is driven by agriculture and extractive industries, which generate limited formal employment and remain vulnerable to external shocks. Growth also appears to be driven more by cyclical recovery than by sustained productive investment. Angola's growth shows a gradual slowdown from 5.0% in 2024 to a projected 2.9% in 2026, highlighting continued dependence on oil sector dynamics and vulnerability to price and production fluctuations. Botswana's economy shows a contraction of 2.8% in 2024 and records a subdued recovery to -0.3% in 2025, the downturn in the global diamond market underscoring the risks associated with commodity dependence. Similarly, Lesotho predicts a sharp slowdown from 5.2% in 2024 to 0.5% in 2026, reflecting its vulnerability to rising trade tensions, including the U.S. reciprocal tariffs, official development assistance (ODA) cuts, weak growth in trading partner countries and the cancellation of the US$300 million Millennium Corporation Challenge compact. Consequently, the region's recent growth recovery has yet to significantly strengthen economic resilience, generate broad-based employment gains, or reduce external vulnerabilities.

Figure 1.1: Real GDP Growth by Country, 2021-2027

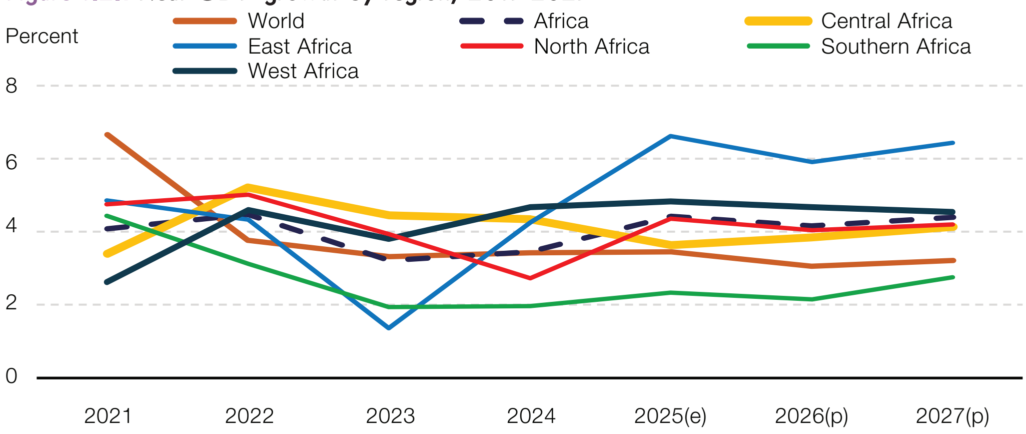


Source: Statistics Department, African Development Bank. Note: e-estimated, p-projected

Southern Africa recorded the most moderate growth performance among Africa's regions, with GDP growth increasing from 2.0% in 2024 to 2.3% in 2025 (see Figure 1.2). Despite this improvement, the region continued to lag behind the continental average, which rose from 3.5% in 2024 to 4.4% in

2025. East Africa remained the fastest-growing region, accelerating from 4.3% in 2024 to 6.6% in 2025, driven by stronger activity in agriculture, services, and investment. West Africa also strengthened, with growth rising from 4.7% in 2024 to around 4.8 % in 2025, supported by oil and gas production, mining, and resilient agriculture. North Africa's growth increased from 2.7% in 2024 to 4.4% in 2025, reflecting recovery in tourism, agriculture, and manufacturing alongside stronger investment activity. Central Africa's growth is estimated at 3.6% in 2025 and projected to grow by 3.8% in 2026, supported by extractive industries, although growth remains vulnerable to fluctuations in global commodity prices. Overall, the growth gap between Southern Africa and the rest of the continent has widened since 2023. While most African regions are projected to sustain growth rates above 4% over the medium term, Southern Africa is expected to remain below both the continental average and the performance of its regional peers.

Figure 1.2.: Real GDP growth by region, 2017-2027

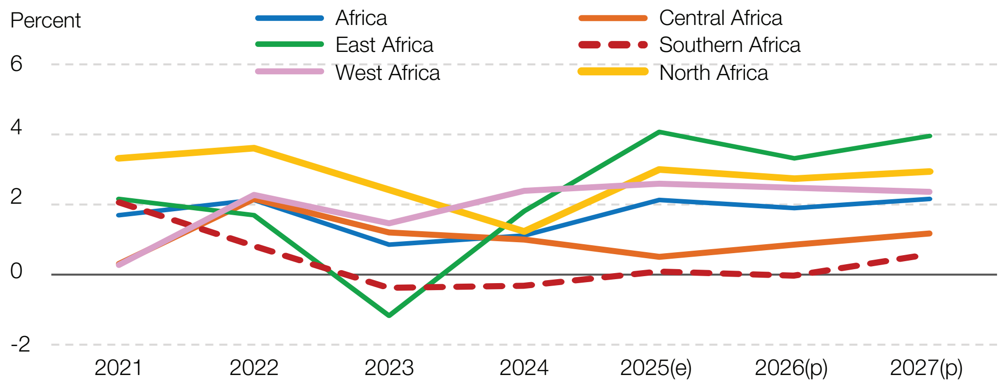


Source: Statistics Department, African Development Bank.
Note: e- estimated, p-projected.

Real GDP Per Capita Growth

Southern Africa's real GDP per capita growth averaged just 0.1% in 2025 (see Figure 1.3), marking a modest recovery from three consecutive years of negative per capita growth. However, gains in real income per person remain limited, constraining poverty reduction and broader socioeconomic development. The region continues to record the lowest real GDP per capita growth among Africa's subregions. It also faces persistently high levels of inequality, although disparities vary considerably across countries. Elevated unemployment, particularly among youth and women, further constrains household incomes and broad-based economic

Figure 1.3.: Real GDP per Capita Growth by Region, 2017-2027

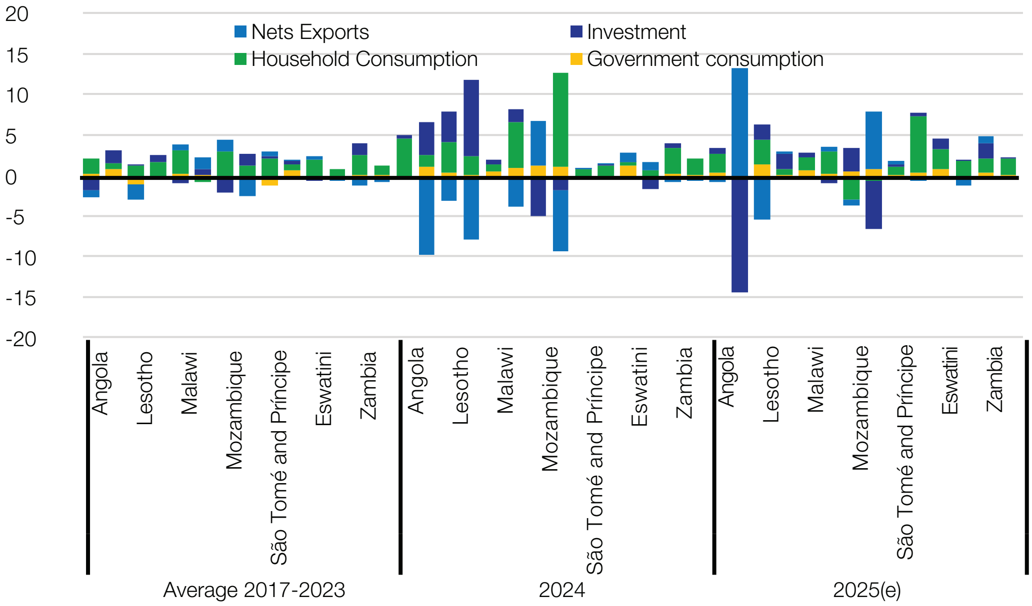


Source: African Development Bank statistics, World Economic Outlook, October 2025, and United Nations Population Division estimates.
Note: e-estimated, p-projected.

1.2.3. Sectoral and Demand-Side Decomposition of Growth

Household consumption remained the dominant driver of demand-side GDP growth in 2025, contributing 2 percentage points (see Figure 1.4). Government consumption added 0.3 percentage points, while investment contributed 0.1 percentage points, reflecting subdued capital formation across much of the region. Net exports impeded real GDP growth, contributing -0.1 percentage points, indicating persistent external sector imbalances and uneven trade performance. At the country level, Zimbabwe (7.6%) and Zambia (5.2%) emerged as the top-performing economies in 2025, with growth in Zimbabwe strongly supported by household consumption, while Zambia's performance was driven by a combination of consumption and investment. In contrast, growth remained negative in Botswana (-0.3%), reflecting a significant contraction in investment alongside sizeable external adjustments. South Africa recorded subdued growth of 1.1%, reflecting modest contributions from both household consumption and investment.

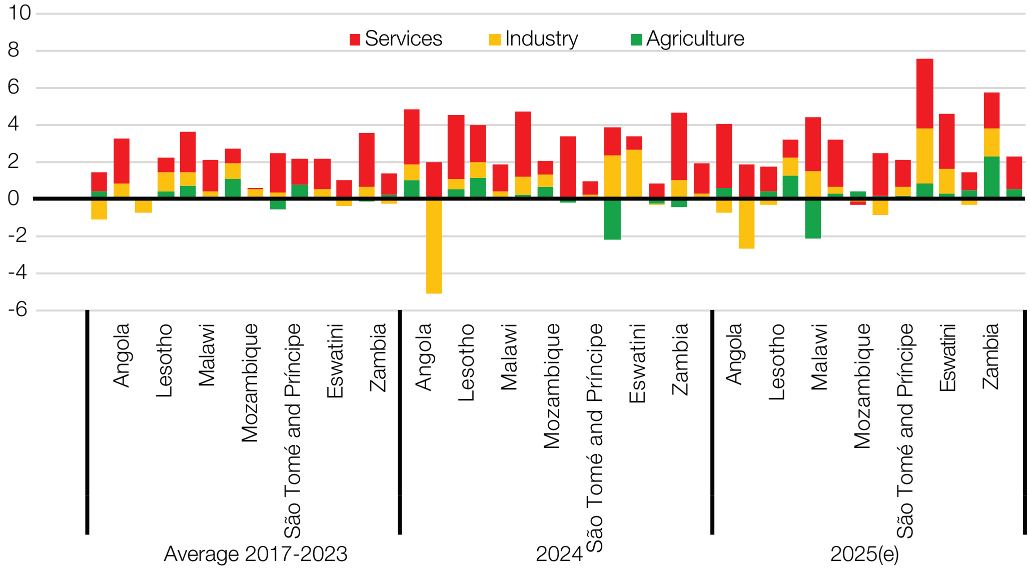
Figure 1.4.: Demand-side decomposition of GDP (at market price) growth (percentage points), 2017-2025



Source: Statistics Department, African Development Bank

Services remained the main driver of GDP growth in 2025 on the supply side, followed by industry and agriculture, reflecting a gradual and uneven pace of structural transformation (see Figure 1.5). The services sector contributed 1.7 percentage points to GDP growth, supported by finance, tourism, telecommunications, and public administration, particularly in more diversified economies such as South Africa and Mauritius. Industry was a drag on growth, contributing -0.1 percentage points, while agriculture contributed 0.5 percentage points, remaining more prominent in less diversified economies such as Malawi and Mozambique, where exposure to climate variability and low productivity persists. Overall, industrial activity remained concentrated (in extractive and resource- based industries, reflecting the region's continued dependence on mining and primary commodity production) and manufacturing depth limited across the region.

Figure 1.5: Sectoral contribution to GDP at basic prices growth (percentage points), 2017-2025



Source: Statistics Department, African Development Bank.
Note e-estimated.

1.2.4. Medium-Term Outlook to Growth

Growth dynamics vary significantly across countries in Southern Africa, reflecting differing economic structures and exposure to global conditions. At the regional level, GDP growth in Southern Africa is projected to improve from 2.1% in 2026 to 2.7% in 2027, supported by easing inflation, and a partial recovery in external demand. Growth in Zambia is projected to strengthen from 5.0% in 2026 to 6.3% in 2027, underpinned by a rebound in copper production and mining-led investment, while growth in Botswana is projected to accelerate from 1.2% in 2026 to 3.5% in 2027, reflecting a gradual recovery in the diamond market and improving external demand conditions. In contrast, South Africa's growth is projected to remain subdued, rising only marginally from 1.2% in 2026 to 1.6% in 2027, constrained by weak investment and energy supply limitations. Similarly, growth in Lesotho is projected to remain weak, improving from 0.5 in 2026 to 1.8% in 2027, weighed down in 2026 by rising trade tensions, including U.S. reciprocal tariffs, reductions in official development assistance (ODA), subdued growth in key trading partners, and the cancellation of the US$300 million Millennium Challenge Corporation compact, all of which continue to constrain external inflows and fiscal space.

1.3 RISKS TO THE OUTLOOK

1.3.1 Downside Risks

Downside risks to Southern Africa's growth outlook remain elevated, reflecting a combination of persistent structural constraints and external vulnerabilities. Low productivity, infrastructure gaps, and governance shortfalls particularly in Lesotho, Madagascar, Malawi, Mozambique, and Zimbabwe, continue to weigh on growth by constraining investment, job creation, and industrial development. Climate shocks, including recurrent droughts in Angola, Malawi, and Mozambique, disrupt agriculture and hydropower, feeding into higher inflation, lower growth, and worsening food insecurity. External pressures further transmit through key macroeconomic channels. Commodity price volatility and higher input costs raise inflation and weaken competitiveness. Tighter global financial conditions increase borrowing costs, constraining public finances and elevating debt risks, especially in Mozambique and Namibia. Exchange rate pressures in commodity exporters such as Angola and Zambia amplify imported inflation and external imbalances. Supply chain disruptions further dampen growth and external resilience. Collectively, these risks reinforce vulnerabilities across inflation, growth, public finances, exchange rates, debt, and food security, underscoring the need for stronger macroeconomic management and resilience-building reforms.

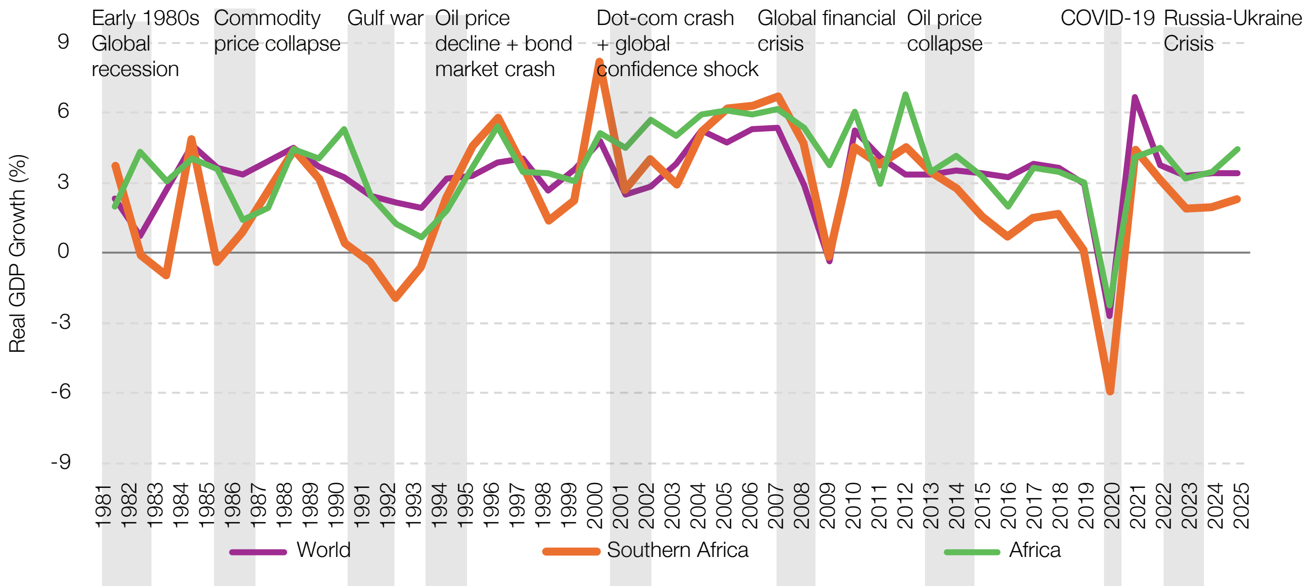
1.3.2 Upside Risks

Despite prevailing uncertainties, Southern Africa holds significant upside potential, supported by favourable commodity market developments, improving external conditions, and ongoing domestic reforms. Higher-than-expected prices for key export commodities such as copper, gold, and lithium will strengthen export earnings, improve fiscal revenues, and ease debt pressures in resource-dependent economies. A faster easing of global inflation and interest rates would support capital inflows, reduce borrowing costs, and stimulate investment and growth. Additional upside could materialize through a stronger recovery in tourism and easing global supply chain constraints, which would reduce production costs, improve trade balances, and support growth and inflation stabilization. Simultaneously, stronger external demand and improved logistics would reinforce export performance and external resilience. To fully capture these gains, countries will need to accelerate energy and infrastructure reforms, deepen diversification, and strengthen the business environment to attract private investment. Regional integration, including through the African Continental Free Trade Area, alongside enhanced climate resilience and expansion of productive capacity, would further support growth, fiscal sustainability, and long-term economic transformation.

1.3.3. Implications of Global Shocks and Geopolitical Fragmentation on Southern Africa's Long-Term Growth

Southern Africa's long-term growth prospects are increasingly shaped by recurrent global shocks and rising geopolitical fragmentation, which heighten external vulnerabilities across the region (see Figure 1.6). Compared with Africa as a whole, Southern Africa has experienced greater growth volatility, reflecting its dependence on primary commodity exports, imported food, agricultural inputs, energy, and external financing. This dependence increases the region's exposure to commodity price volatility, weaker external demand, trade disruptions, and tighter global financial conditions. Under severe geoeconomic fragmentation scenarios, the region could face welfare losses of around 4% of GDP, underscoring the cost of limited economic diversification and high commodity dependence (IMF,2023). During the global financial crisis, growth declined sharply, approaching zero in 2009 as global demand for minerals and metals weakened. Similarly, the COVID-19 pandemic triggered a severe contraction, with the region recording negative growth well below the African average. The ongoing Middle East conflict has further highlighted these structural vulnerabilities (see Box 1.1). Over the long run, repeated exposure to external shocks can discourage private investment, delay infrastructure development, worsen debt vulnerabilities, and divert public resources from productive investment toward crisis response. While growing global demand for critical minerals presents opportunities, realizing these gains will require stronger regional integration, economic diversification, infrastructure development, industrialization, and greater value addition to enhance resilience and support sustainable long-term growth.

Fig 1.6: Global shocks vs. GDP growth (%) in Southern Africa, 1981–2025



Source: Sources: AfDB, Statistics Department and IMF.

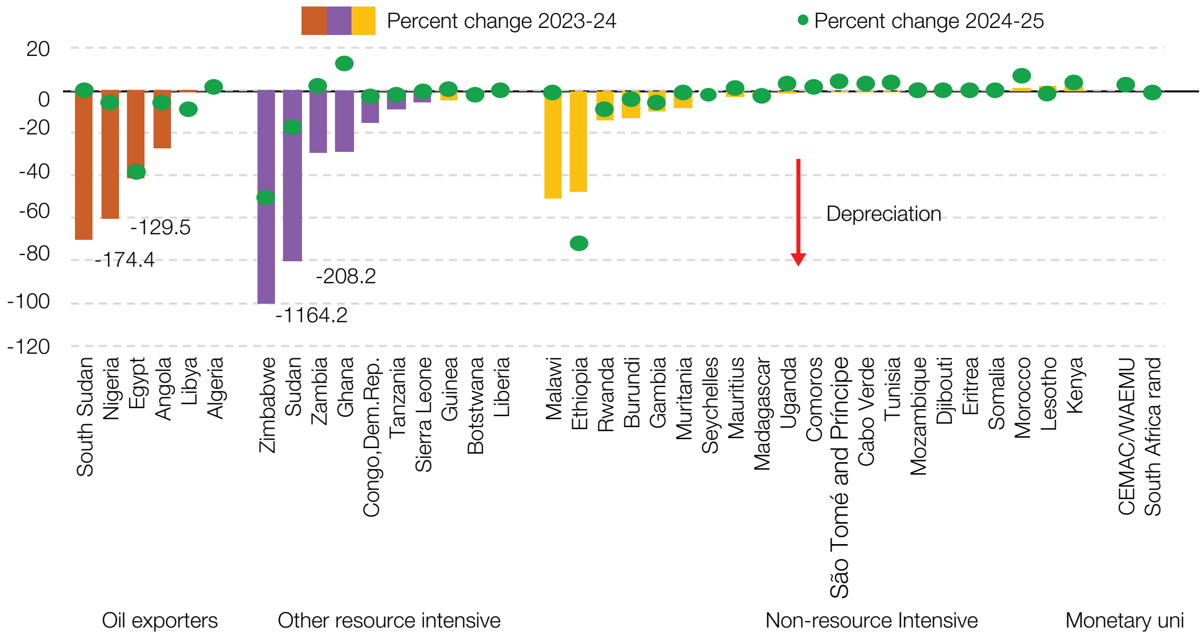
1.4 OTHER MACROECONOMIC DEVELOPMENTS, IMPLICATIONS, AND OUTLOOK

1.4.1 Exchange Rate Developments

The exchange rate developments in Southern Africa between 2023–2024 and 2024–2025 (see Figure 1.7) indicate a broad moderation in currency depreciation pressures, alongside significant cross-country divergence, reflecting differences in nominal adjustment mechanisms, external imbalances, and exchange rate regimes. In 2023–2024, most economies recorded sizeable depreciations against the U.S. dollar, largely driven by persistent current account deficits, limited reserve buffers, and elevated inflation pass-through, which reinforced exchange rate pressures.

Exchange rate pressures eased across most economies in Southern Africa during 2024–2025. Mauritius, Sao Tome and Principe, and Zambia experienced currency appreciations in 2025 while the pace of depreciation slowed in the other Southern African countries. This indicates more contained nominal adjustment pressures amid persistent underlying external constraints affecting currency stability.

Figure 1.7.: Exchange rate changes by country between 2023-2024 and 2024-2025



Source: Statistics Department, African Development Bank

1.4.2 Inflation Dynamics and Monetary Policy Stance

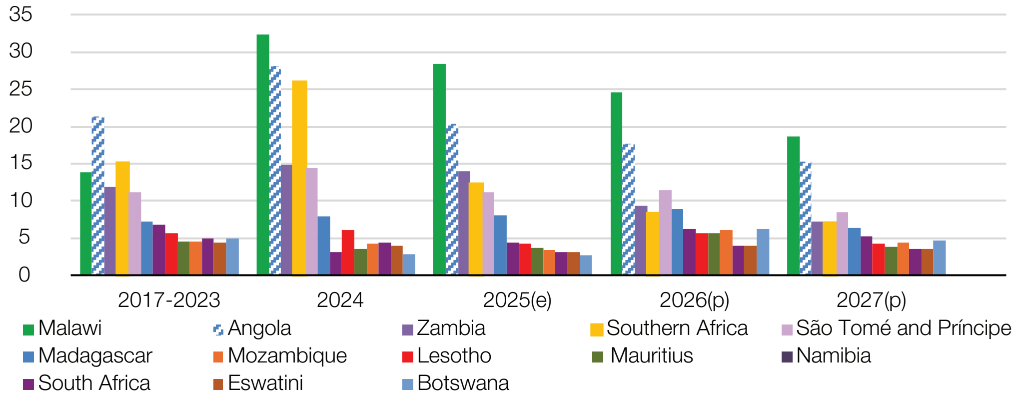
Inflationary pressures in Southern Africa are projected to ease significantly over the medium term, with regional inflation declining from 26.1% in 2024 to 12.3% in 2025, and further to 8.4% in 2026 and 7.1% in 2027 (see Figures 1.8 and 1.9), supported by improved agricultural production, easing food and energy prices, and exchange rate stabilization. Within the Southern Africa region, inflation dynamics remain highly heterogeneous. Countries closely linked to South Africa through the Common Monetary Area generally benefit from lower and more stable inflation, while economies with more flexible exchange rates remain more vulnerable to depreciation-driven price pressures.

Zimbabwe traces a sharp disinflation path, falling from 736.1% in 2024 to 89.0% in 2025 and 10.1% in 2027. Inflation in Malawi and Angola also remained elevated but projected to gradually ease, with inflation in Malawi declining from 32.3% in 2024 to 28.5% in 2025 and 18.7% in 2027, while inflation in Angola is projected to moderate from 28.2% to 20.4% and 15.3% over the same period. Zambia follows a steady disinflation trajectory, with inflation projected to decrease from 14.8% in 2024 to 7.2% in 2027. Inflation in South Africa moderated from 4.4% in 2024 to 3.2% in 2025 and is projected at 3.6%-3.9% during

2026-2027, while inflation in Botswana, Eswatini, Mauritius, and Namibia remains broadly contained, with some temporary increases in 2026.

These differences reflect uneven inflation dynamics: in several economies, uncertainties about high and volatile food prices and exchange rate pass-through sustain inertia, while in others, anchored expectations and more credible monetary frameworks support faster reductions in inflation. Monetary policy transmission remains imperfect across the region, as interest rate changes are often weakened by shallow financial markets, high levels of informality, dollarization in some cases, and weak credit transmission channels, limiting the effectiveness of policy rates in anchoring demand and inflation expectations. In addition, structural constraints continue to shape outcomes, including persistent external vulnerabilities, limited foreign exchange buffers, fiscal pressures that can crowd out monetary tightening, and supply-side bottlenecks in agriculture, energy, and logistics, all of which amplify price volatility. Economies within the Common Monetary Area generally benefit lower and more stable inflation owing to exchange rate stability and the credibility of South Africa's monetary policy framework. By contrast, countries with more flexible exchange rates and greater dependence on imported food, fuel, and intermediate inputs are more exposed to the effects of volatile import costs on domestic prices.

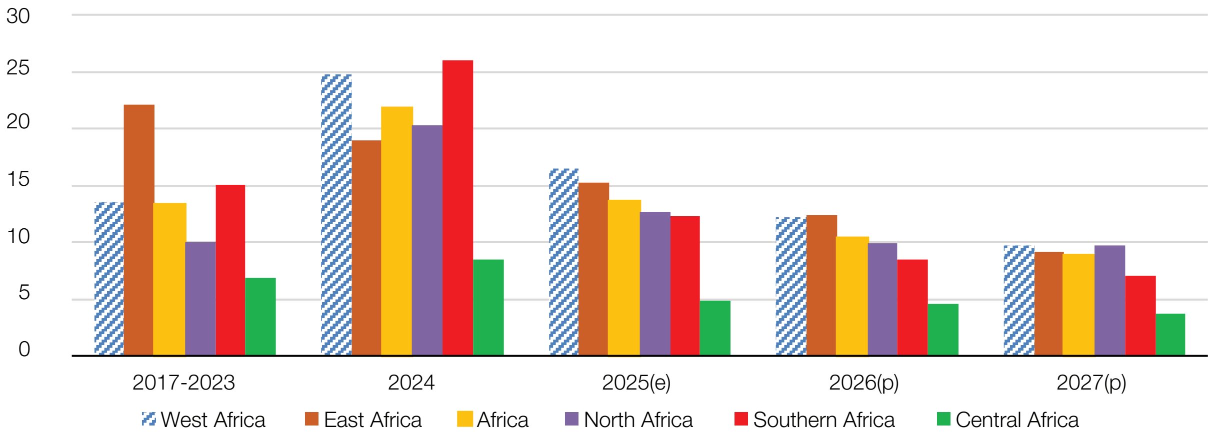
Figure 1.8 Inflation by country, 2017 - 2027 (in %)



Source: Statistics Department, African Development Bank. Note: e-estimated, p-projected.

In comparison to other regions, Southern Africa is projected to experience the most pronounced disinflation. West and East Africa are projected to remain in double-digit inflation in 2026 at 12.2% and 12.4% respectively, before moderating in 2027, while North Africa remains moderately elevated at 9.9% in 2026 and 9.7% in 2027, driven by exchange rate and fiscal pressures. By contrast, Central Africa records the lowest inflation profile after Southern Africa, declining from 4.8% in 2025 to 3.8% in 2027. Overall, Africa's average inflation is projected to fall from 21.8% in 2024 to 8.9% in 2027, indicating broad-based but uneven disinflation.

Figure 1.9: Inflation by Region, 2017 - 2027 (%)



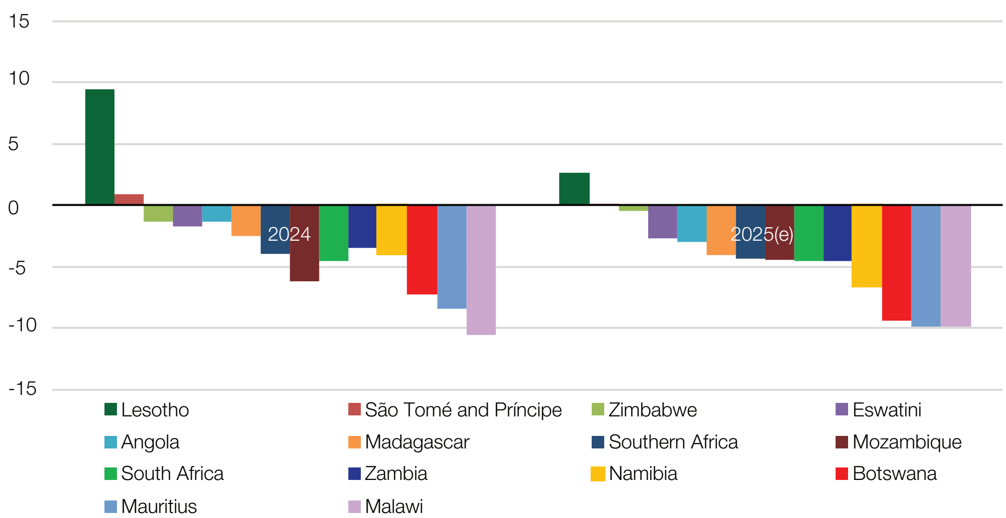
Source: Statistics Department, African Development Bank. Note: e-estimated; p-predicted.

Monetary policy in Southern Africa is guided by the Southern Africa Development Community (SADC) convergence framework, which promotes macroeconomic stability and policy coordination, with the Common Monetary Area (South Africa, Lesotho, Namibia, and Eswatini) representing the most integrated arrangement, where policy is largely anchored by the South African Reserve Bank. While this framework has anchored inflation and supported financial stability, it has also constrained policy autonomy in smaller member states. Across the region, central banks have generally maintained tight monetary stances to contain inflation, although fiscal pressures in several economies have complicated price stability efforts. Exchange rate depreciation continues to contribute to imported inflation, particularly in import-dependent economies, while shallow financial markets and weak credit transmission limit the effectiveness of monetary policy despite gradual financial deepening. Most countries operate within inflation-targeting bands of around 3–6%, while others, including Angola, continue to rely on alternative monetary frameworks.

1.4.3 Fiscal Policy Developments and Implications for Growth

Fiscal positions in Southern Africa are expected to remain in deficit over the medium term, reflecting limited revenue mobilization, rising expenditure pressures, and elevated debt service costs. Southern Africa's average fiscal balance remains in deficit, estimated at 4.4% in 2025, up from 4.0% in 2024 (see Figure 1.10). It is expected to moderate slightly to 4.3 % in 2026, reflecting limited revenue mobilization, rising public spending, and high debt service costs. Fiscal surpluses in Lesotho and São Tomé & Príncipe reflects stronger revenue collection and tighter expenditure control, creating space to maintain priority social and infrastructure spending, while persistent deficits elsewhere constrain public investment, job creation, and long-term growth potential. Across the region, governments face difficult trade-offs between restoring fiscal sustainability, supporting economic recovery, protecting vulnerable populations, and financing critical infrastructure investments. Fiscal adjustment measures increasingly focus on strengthening domestic revenue mobilization, including broadening the tax base and improving tax administration, alongside expenditure rationalization and prioritization of high-impact spending. Efforts to enhance debt sustainability include refinancing costly debt, increasing reliance on concessional financing, and improving debt transparency. In some cases, debt restructuring and reprofiling remain critical to restoring fiscal space and reducing vulnerabilities. However, the pace and composition of fiscal consolidation remain important, as excessive expenditure cuts could undermine social protection, reduce public investment, and weaken growth prospects, while delayed adjustment risks further debt accumulation and rising debt servicing costs.

Figure 1.10: Overall fiscal balance by country in 2024 and 2025

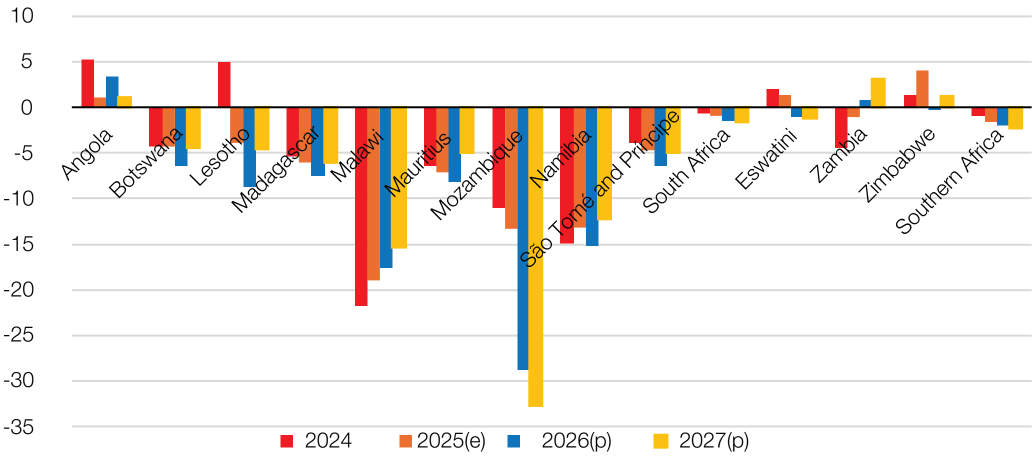


Source: Statistics Department, African Development Bank

1.4.4 External Position and Current Account Balance: Developments, Outlook, and Implications

External positions in Southern Africa are expected to weaken gradually over the medium term, reflecting persistent structural constraints despite intermittent short-term improvements. The regional current account deficit is projected to widen from 1.6% in 2025 to 2.1% in 2026 and 2.2% in 2027 (see Figure 1.11), signalling a gradual erosion of external buffers. External balances vary significantly across countries, reflecting differences in export structures, import dependence, and exposure to commodity price movements. Malawi and Mozambique continue to record high current account deficits, with Malawi's deficit projected to widen from 19.0% in 2025 to 17.5% in 2026 before easing to 15.3% in 2027, with Mozambique's deficit projected to widen from 13.3% in 2025 to 28.8% in 2026 and 32.7% in 2027.Angola, Zambia, and Zimbabwe are projected to post current account surpluses during 2026-2027, supported by strong goods trade and income flows, whereas Eswatini's surplus will change to a deficit during the same period, reflecting the effects of increased import- intensive public investments.

Figure 1.11. Current account balance by country grouping, 2023 –2027

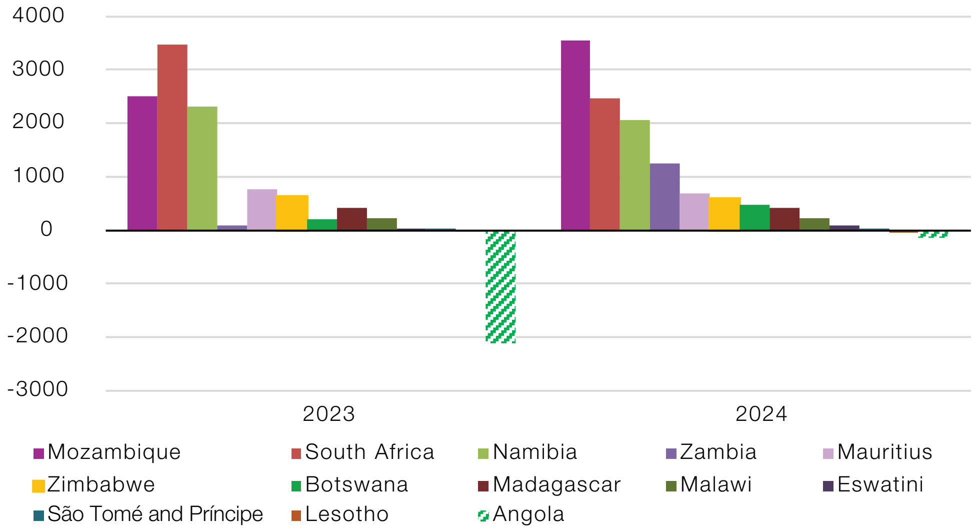


Source: Statistics Department, African Development Bank.

1.4.5 External Financial Flows, Implications and Outlook

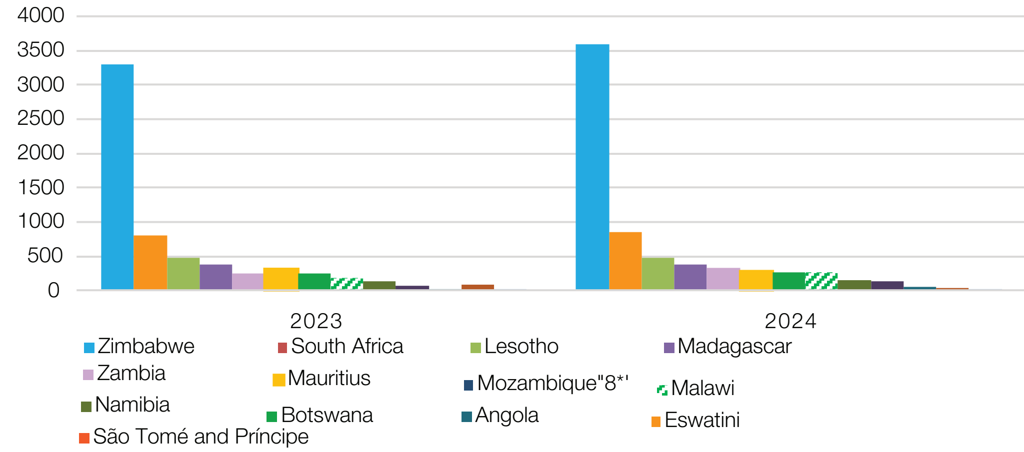
External financial flows remained volatile and uneven in 2025, reflecting a mixed adjustment in external balances across countries amid divergent investment trends, resilient remittance inflows, and persistent disparities in reserve adequacy. Region-wide, current account imbalances were financed through a mix of mechanisms (foreign direct investment [FDI], concessional financing, reserves drawdowns, and remittances) tailored to each country's economic context. FDI inflows to Southern Africa declined sharply from US$43.0 billion in 2021 to US$8.6 billion in 2022 and US$8.5 billion in 2023, before recovering to US$11.6 billion in 2024 (see Figure 1.12). The reductions was driven mainly by a major reduction in inflows to South Africa and continued negative flows in Angola, while Mozambique, Namibia, and Zambia benefited from investment in extractive industries. Remittance inflows in Southern Africa increased steadily from US$4.4 billion in 2014 to US$6.8 billion in 2024 (see Figure 1.13), led by Zimbabwe, with South Africa also recording stable inflows, underscoring its role as a resilient source of external financing. Reserve adequacy remained uneven, with South Africa improving its import cover to 6.3 months in 2025 and Namibia maintaining 3.9 months, while Malawi, Zambia, and Mozambique continued to record weaker buffers, heightening external vulnerability.

Figure 1.12: **FDI Inflows by country, 2016-2024 (millions USD)**



Source: Statistics Department, African Development Bank.

Figure 1.13 **Remittance inflows (US$ million) 2023 - 2024**



Source: Statistics Department, African Development Bank.

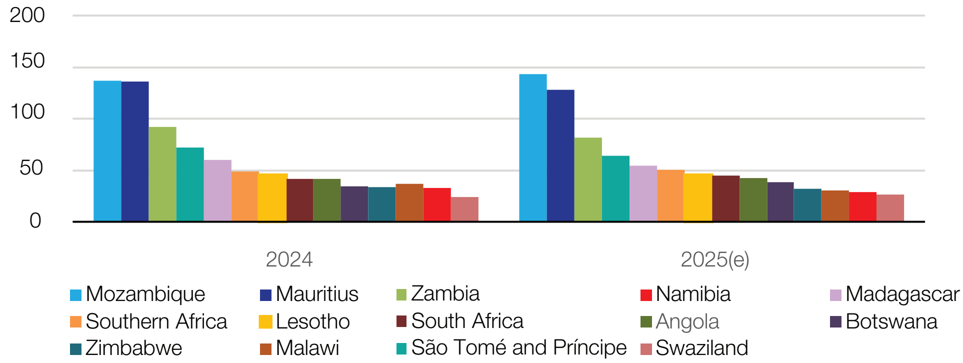
1.4.6 Southern Africa's debt Dynamics and Implications For Development Financing

Southern Africa's public debt remains elevated, increasing from 49.0% of GDP in 2024 to an estimated 50.4% in 2025 (see Figure 1.14), reflecting persistent fiscal deficits, weak revenue mobilization, and rising interest costs. Beyond debt levels, vulnerabilities are shaped by the composition of public debt, with several countries carrying significant external and foreign-currency-denominated obligations that expose them to exchange rate shocks and refinancing risks. Rising borrowing costs and increased debt service obligations continue to constrain fiscal space, limiting governments' ability to finance social spending, public infrastructure, and other growth-enhancing programmes.

At the country level, Mozambique and Mauritius have the highest debt ratios, with Mozambique's debt rising from 136.9% of GDP in 2024 to 143.5% in 2025, while Mauritius' debt dropped from 136.3% to 128.1% over the same period. Zambia shows notable improvement, with its debt-to-GDP ratio easing from 92.7% to 81.8% following ongoing debt restructuring efforts. By contrast, Botswana and Zimbabwe remain relatively low-debt economies, although Botswana's debt rose from 34.7% in 2024 to 38.7% in 2025, while Zimbabwe's decreased from 34.1% to 32.1%.

Fiscal consolidation efforts are ongoing, but constrained fiscal space continues to limit adjustment and heighten debt vulnerabilities. These risks are amplified by weak export performance, external financing pressures, currency depreciation, and slow progress under international debt resolution mechanisms, including the Group of Twenty (G20) Common Framework, under which Zambia remains the only country in the region to have sought restructuring. As a result, debt sustainability challenges increasingly reflect not only the size of debt burdens but also their cost, maturity profile, refinancing requirements, and exposure to exchange rate fluctuations, underscoring the need to strengthen export competitiveness, deepen domestic financing markets, and reduce reliance on import-intensive growth.

Figure 1.14 Total external debt by country, 2024-2025 (% of GDP)



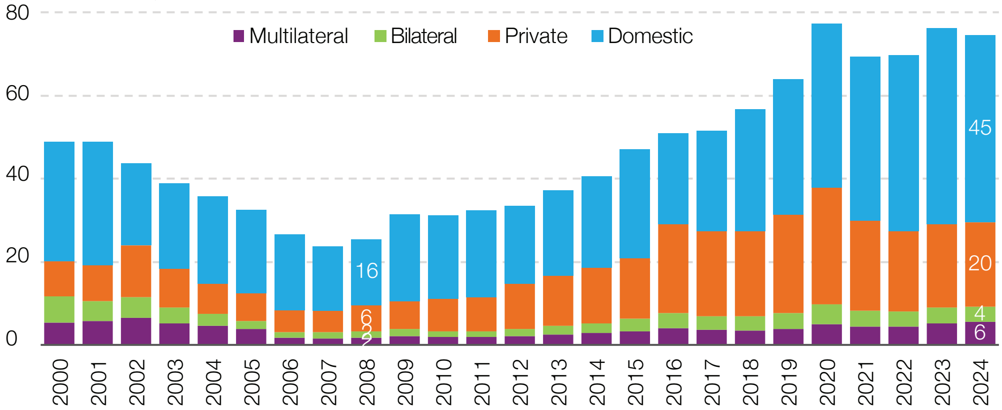
Source: Statistics Department, African Development Bank[1]

The composition of public debt in Southern Africa has shifted away from concessional financing toward domestic and market-based sources (see Figure 1.15a). Domestic debt has emerged as the largest component of public debt, reaching 45% of GDP in 2024, reflecting the region's growing reliance on local financing. While this has expanded governments' financing options, it has also increased debt vulnerabilities, particularly because domestic borrowing is typically concentrated at shorter maturities (see Figure 1.15b). Short-term debt heightens rollover risks by requiring governments to refinance maturing obligations more frequently, often at higher interest rates or under less favourable market conditions. Moreover, domestic borrowing generally carries higher financing costs than concessional loans and, in some cases, even exceeds the cost of Eurobond financing. At the same time, private commercial external debt has become the second-largest source of external financing, increasing from about 6% of GDP in 2008 to around 20% in 2024, reflecting the region's growing dependence on market-based borrowing.

At the country level, the composition of public debt varies considerably across Southern Africa. Domestic debt ranges from 12% of GDP in Angola to 68% in Mauritius, with similarly elevated levels in Malawi (61%) and Zimbabwe (60%), reflecting a stronger reliance on domestic financing in these economies. The composition of gross public debt also differs markedly across countries. Private debt is highest in Angola (35%), followed by Zambia (24%) and South Africa (21%), while Botswana and Lesotho have no private debt. By contrast, Lesotho's gross public debt portfolio is dominated by multilateral creditors, which account for around 35% of its total debt. South Africa stands out with concessional financing accounting for only 2% of its gross public debt, underscoring its heavy reliance on market-based borrowing.

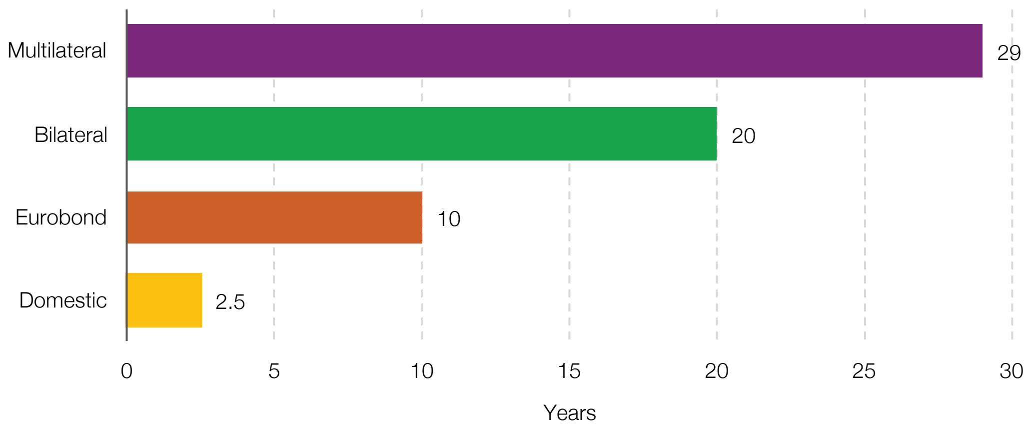
[1] Eswatini total external debt was 23.9% and 26.8%, respectively in 2024 and 2025 (excluded due to visibility of graph).

Figure 1.15 a: **Southern Africa - Gross debt and decomposition by creditor type, 2000-2024 (percent GDP)**



Source: Staff calculations using data from World Bank International Debt Statistics.

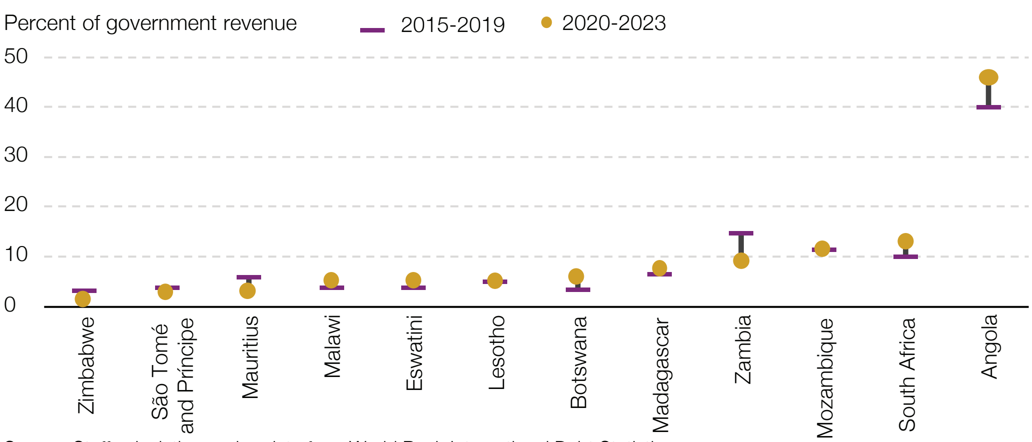
Figure 1.15 b: **Africa - Distribution of debt maturity by instrument, 2015-2024**



Source: Staff calculations using data from World Bank International Debt Statistics.

Debt vulnerabilities remain as the high cost of debt service is crowding out social and development spending across Southern Africa (see Figure 1.16). Angola faces the most fiscal strain, with its debt service consuming over 40% of government revenue. Angola, Botswana, and South Africa experienced notable increases in their debt-service-to-revenue ratios between 2020 - 2023, indicating that a growing share of government revenue is being used to repay debt, constraining the capacity to finance public investment in key infrastructure, social services, and institutional development. Mauritius, Zambia, and Zimbabwe recorded decreases while in Eswatini, Lesotho, Malawi, and Mozambique, debt service obligations remained largely stable but persistent, hovering between 3% and 12% of revenue.

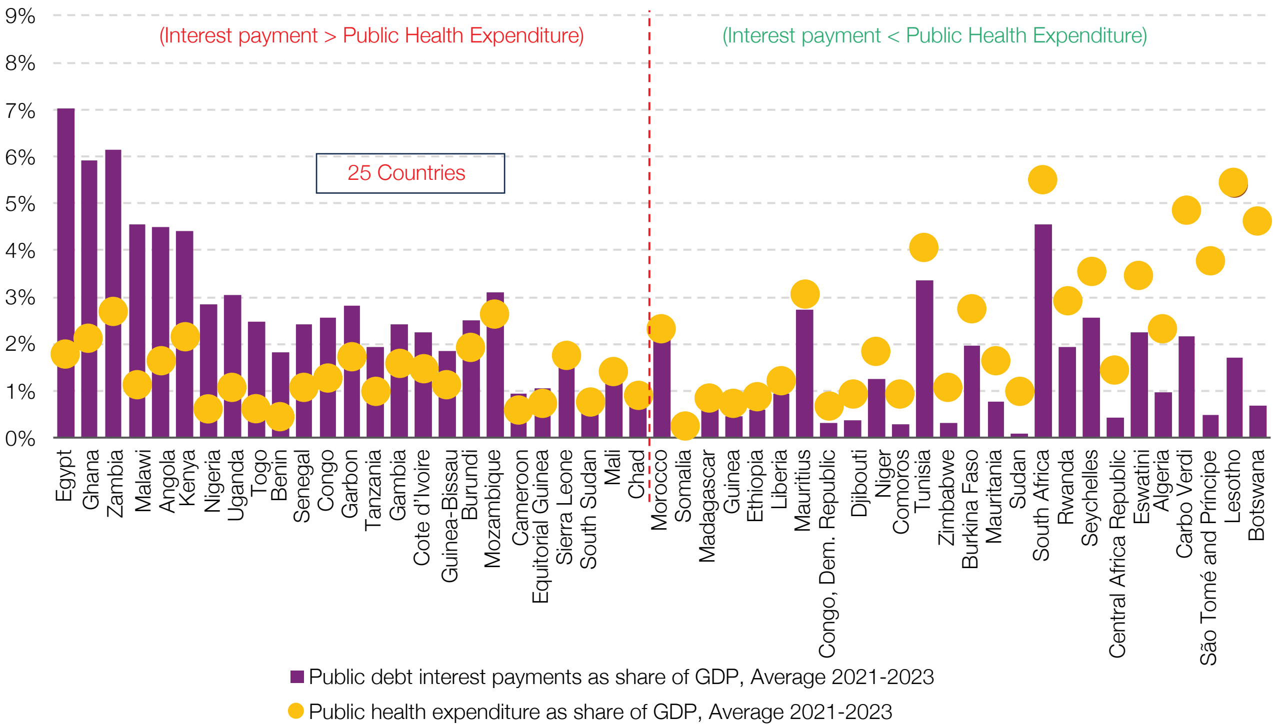
Figure 1.16 **Debt service on external debt in Southern Africa, 2015–23**



Source: Staff calculations using data from World Bank International Debt Statistics

The high debt service costs also have significant implications for health financing across Southern Africa. Figure 1.17 shows the fiscal trade-off between public debt servicing costs and public health expenditure across 25 African countries. Countries with higher interest payments on public debt tend to allocate a smaller share of resources to public health expenditure. In countries such as Angola, Malawi, and Zambia, interest payments exceed public health expenditure, signalling significant fiscal pressure and constrained space for social investment. In contrast, countries including Botswana, Eswatini, Lesotho, Madagascar, São Tomé and Príncipe, South Africa, and Zimbabwe exhibit the opposite pattern, where public health spending exceeds debt servicing costs, suggesting comparatively better fiscal space and a more balanced allocation toward social sectors. Though there are noticeable variations across countries, the overall pattern indicates a negative relationship between debt service burdens and health expenditure.

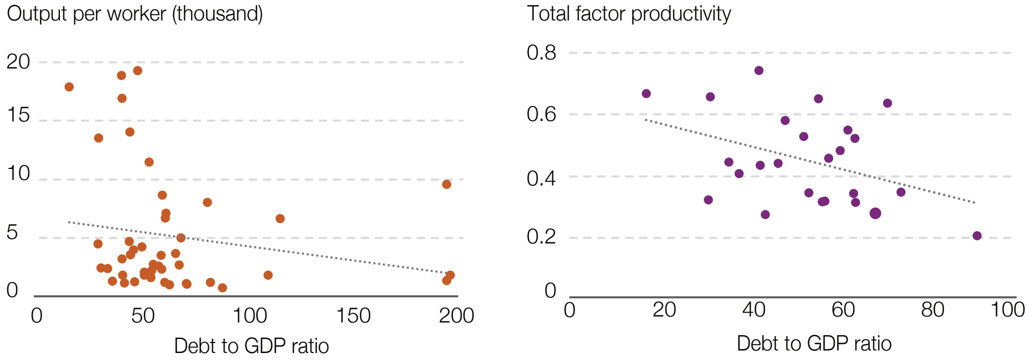
Figure 1.17: Interest payments on public debt and health expenditure, 2021–23



Source: UNCTAD, A World of Debt Database (2025).

Cross-country evidence suggests that higher public debt can hinder productivity in some countries (Figure 1.18). Public debt is negatively correlated with both output per worker and total factor productivity (TFP), suggesting that countries with higher public debt record lower levels of productivity. A 1% increase in public debt leads to a decline in labour productivity and TFP by 4.9% and 4.6%, respectively. This suggests that increasing public debt does not automatically translate into gains in productivity but could hinder economic growth. Several factors explain the negative effect of public debt on productivity in Southern Africa, where countries devote large portions of their budgets to interest payments (see Figure 1.16 and Figure 1.17). Higher public debt can also crowd out private investment by raising the cost of credit and straining the fiscal space, thereby discouraging capital inflow, innovation, and technology adoption. This holds back both labour productivity and TFP.

Figure 1.18: Debt to GDP and productivity relationship in Africa



Source: Staff calculations based on data from Penn World Tables, the International Labour Organization, and World Economic Outlook.

1.5 POLICY RECOMMENDATIONS

1.5.1 Short-term policy recommendations

- **Preserve macroeconomic stability and support the recovery**, by prioritizing coordinated short-term measures focused on stabilization, fiscal prudence, and protecting vulnerable groups in Southern African countries.

- **Maintain monetary and exchange rate stability.** Central banks should anchor inflation expectations through prudent monetary policy, effective liquidity management, and flexible exchange rates that absorb external shocks while preserving macroeconomic stability.

- **Strengthen fiscal resilience.** Governments should improve expenditure efficiency, broaden the tax base, strengthen revenue administration through digitalization, and avoid costly untargeted subsidies. Resource-rich countries should save commodity windfalls in fiscal buffers to enhance resilience.

- **Enhance debt management**. Strengthening debt transparency, monitoring fiscal risks, and improving medium-term debt strategies can help contain refinancing pressures and support debt sustainability.

- **Expand targeted social protection**. Well-targeted cash transfers, food assistance, and temporary support measures should protect vulnerable households from rises in living costs while preserving fiscal sustainability.

- **Support jobs and crisis preparedness.** Targeted support for small and medium-sized enterprises (SMEs) and youth employment, alongside contingency financing mechanisms and emergency support facilities, can strengthen resilience to future shocks.

1.5.2 Medium-term to Long-term Policy Recommendations

To strengthen resilience and support sustainable growth in an increasingly fragmented global environment, Southern African countries should implement structural reforms that enhance productivity, competitiveness, and economic diversification.

- **Strengthen fiscal and external resilience.** Build fiscal and foreign exchange buffers, strengthen medium-term fiscal and debt management frameworks, improve debt transparency, and reduce reliance on external borrowing to safeguard macroeconomic stability and debt sustainability.

- **Enhance energy security and infrastructure.** Scale up investment in renewable energy, regional power pools, transmission networks, and transport corridors to reduce energy shortages, lower production costs, and improve economic competitiveness.

- **Accelerate economic diversification and regional integration.** Promote industrialization, value addition, agro-processing, and services development while leveraging regional integration initiatives to deepen intra-regional trade and strengthen regional value chains.

- **Boost domestic resource mobilization.** Modernize tax administration through digitalization, broaden the tax base, reduce informality, and improve public expenditure efficiency to create fiscal space for development priorities.

- **Reduce import dependence and improve competitiveness.** Expand domestic production capacity, strengthen regional sourcing, improve trade logistics, and invest in digital and transport infrastructure to enhance export competitiveness and resilience to external shocks.

- **Strengthen human capital and institutional capacity.** Invest in education, skills development, healthcare, and governance reforms to improve productivity, enhance public sector effectiveness, and support private-sector-led growth.

- S**cale up climate resilience and the green transition.** Integrate climate adaptation into development planning, expand renewable energy deployment, and strengthen disaster-risk management to reduce vulnerability to climate-related shocks.

- **Enhance regional policy coordination and contingency financing.** Strengthen cooperation on food, energy, and trade security while expanding access to regional financing mechanisms and emergency liquidity facilities to improve resilience against future crises.

2

MOBILIZING CAPITAL AT SCALE FOR ACCELERATED AND RESILIENT GROWTH IN SOUTHERN AFRICA

Key Messages

- **Development financing gaps remain substantial in Southern Africa.** Investment in the region is insufficient to support structural transformation, with gross capital formation (GCF) declining to about 18.6% of GDP in 2025 – well below middle-income benchmarks. Gaps between domestic savings and investment reflect both reliance on external financing and weak intermediation of domestic resources. Combined with tighter global financial conditions and declining concessional flows, this leaves the region facing an estimated annual financing gap of about US$55 billion by 2030.

- **Domestic resource mobilization (DRM) faces structural constraints.** Despite relatively higher tax revenues than the African average, progress has been modest and uneven. Fiscal systems rely heavily on consumption or indirect taxation, while contributions from direct taxation and non-tax revenues remain limited. Weak public financial management (PFM) and persistent illicit financial flows (IFFs) further reduce the effective use of public resources.

- **Several potential sources of development financing remain underutilized.** Southern Africa possesses significant financing sources – including diaspora remittances, institutional investors, capital markets, and natural resources – but their contribution remains uneven and concentrated in a few economies. While remittances are substantial in countries such as Lesotho and Zimbabwe, deeper capital markets and pension assets in Namibia and South Africa highlight the potential role of institutional investors.

- **Addressing these constraints calls for a coherent and integrated policy agenda.** This agenda should prioritize strengthening fiscal capacity and PFM systems, reducing resource leakages, and improving the efficiency and quality of public spending. It also requires investment risks to be lowered through targeted de-risking instruments and scaling the use of blended finance to crowd in private capital, while also expanding access to long-term financing through scaling up public-private partnerships (PPPs) and more effectively mobilizing institutional investors, including pension funds, insurance companies, and sovereign wealth funds. Finally, leveraging digitalization to progressively formalize economic activity will be essential to broaden the tax base, enhance compliance, and reinforce the fiscal social contract, thereby supporting more sustainable and inclusive development financing.

2.1. INTRODUCTION: SOUTHERN AFRICA'S CAPITAL MOBILIZATION CHALLENGE

Southern Africa's development trajectory is shaped not only by its economic potential but also by persistent constraints in mobilizing the financing needed to sustain structural transformation, expand productive capacity, and strengthen resilience to shocks. Across Southern Africa, the gap between available resources and investment needs remains a major impediment to infrastructure development, job creation, human capital formation, and climate adaptation. Recent estimates point to a substantial financing gap, reflecting a growing mismatch between rising investment requirements and limited domestic and external financing capacity. The analysis in this chapter shows that this discrepancy reflects structural constraints in capital mobilization. Investment levels remain relatively low, domestic savings are often insufficient or poorly intermediate, and private sector participation in long-term investment remains limited. These challenges are compounded by shallow financial systems, constrained fiscal space, high borrowing costs, volatile external inflows, and declining concessional finance in a more fragmented global financial environment. The Africa Economic Outlook (AEO) 2026 estimates that lifting Africa's growth from roughly 4% to the 7% a year needed for sustainable and inclusive growth requires a sharp acceleration in capital accumulation: more than doubling the capital stock from about 3.3% today to around 8.7% annually by 2030, a cumulative additional investment effort of approximately $3.5 trillion over 2026–35. Southern Africa, growing at 2.3%, faces the same arithmetic. This chapter therefore examines the region's options for mobilizing capital at scale. It first assesses the scale of Southern Africa's development financing gap. It then examines the key domestic and external constraints to activating capital before exploring alternatives to strengthen DRM and leverage private, regional, and external sources of financing. The recommendations outlined here describe measures to strengthen domestic resource mobilization, improve the efficiency of public financial management, leverage diaspora remittances, harness natural capital, and crowd in private investment. The heightened geopolitical fragmentation, declining external financial flows, and rising public debt vulnerabilities make this agenda urgent.

2.2. QUANTIFYING SOUTHERN AFRICA'S DEVELOPMENT FINANCING NEEDS

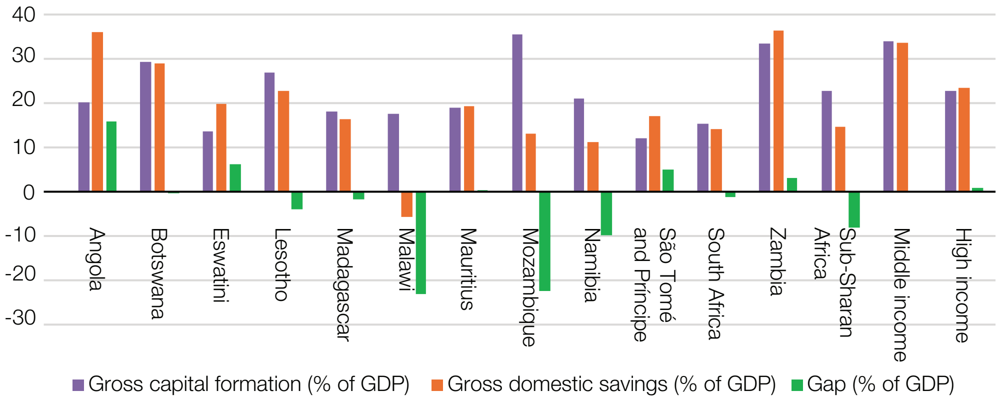
One indication of the financing gap in Southern Africa is the persistently low level of investment. Gross capital formation declined from 22.2% of GDP in 2015–2020 to 18.6% in 2025 (Table 2), remaining below both the sub-Saharan African average and the 30–35% of GDP investment ratios typically associated with sustained structural transformation and rapid economic growth. At these levels, investment is insufficient to generate the capital accumulation required to modernize productive structures, expand manufacturing capacity, upgrade infrastructure, and support technological adoption. As a result, many economies remain dependent on low-productivity activities and commodity exports, limiting their progress toward economic diversification and structural transformation.

Table 2.1: Gross Capital Formationfor Southern African countries (% of GDP)

	2015-2020	2021	2022	2023	2024	2025
Angola	26.4	16.0	14.2	12.3	10.4	10.3
Botswana	27.5	27.4	26.8	30.3	36.2	37.5
Eswatini	13.7	12.4	10.9	10.3	16.4	17.6
Lesotho	26.0	28.5	27.4	27.2	27.1	29.7
Madagascar	16.7	16.4	22.2	19.9	20.7	19.9
Malawi	19.8	16.9	15.9	14.5	14.7	12.2
Mauritius	18.2	19.6	20.4	19.9	21.2	19.2
Mozambique	42.1	40.4	43.2	19.5	17.7	17.9
Namibia	19.1	17.5	20.0	28.0	25.6	25.5
São Tomé and Príncipe	16.2	10.3	8.3	6.2	5.6	5.1
South Africa	16.1	12.8	15.7	15.5	14.1	14.0
Zambia	38.7	31.4	27.0	31.4	23.8	21.3
Zimbabwe	7.8	8.7	7.7	13.1	11.3	11.2
Region average	22.2	19.9	20.0	19.1	18.8	18.6
SSA	23.1	20.6	21.6	22.2	24.1	
Middle-income	33.7	35.1	34.7	33.7	33.4	

Source: African Development Bank (AfDB) Statistics Department.

Figure 2.1: Investments and savings in Southern Africa 2015-2025



Source: AfDB Statistics Department

Cross-country evidence reveals substantial heterogeneity but confirms generally weak investment dynamics. While Botswana and Lesotho have maintained relatively high investment ratios around or above 30% of GDP, most countries in the region record much lower levels. South Africa's investment has remained around 14–16% of GDP, while Eswatini Madagascar, and Malawi remain largely below 20%. In several cases, investment is exceptionally low: São Tomé and Príncipe's investment fell to about 5% of GDP in 2025; Angola's declined from about 26% in 2015–2020 to near 10% in 2025; and Mozambique's fell from above 40% before 2022 to below 18% in 2025 following the completion of major liquefied natural gas-related investments.

Comparing GCF with domestic savings highlights the structural nature of Southern Africa's financing gap. As illustrated in Figure 2.1, in several countries – notably Malawi, Mozambique, and Namibia – investment exceeds domestic savings, implying a reliance on external financing. Conversely, in Angola, Eswatini, and São Tomé and Príncipe, savings significantly exceed investment, pointing to structural inefficiencies in channelling those domestic resources into productive capital formation (AfDB, 2024).

The scale of Southern Africa's financing gap becomes clearer when compared with the investment needed for structural transformation and the sustainable development goals (SDGs). Estimates from the African Economic Outlook 2024 (AfDB, 2024) show large gaps across the region. In Table 2.2, Namibia's annual gap reaches 84% of GDP (US$11.2 billion), while Mozambique and Madagascar face gaps of 38.8% and 40.6% of GDP, respectively. Even higher-saving economies such as Botswana and Angola face shortfalls of US$6.4 billion and US$10.2 billion, respectively. Although smaller in relative terms in South Africa and Mauritius, financing needs remain substantial given their economic size.

Table 2.2: Annual financing gap in Southern Africa by 2030

	Annual financing gap (% of 2024 GDP)	GDP 2024 (USD billion)	Annual financing gap (USD billion)
Namibia	84.1	13.4	11.2
Angola	10.1	101.0	10.2
Mozambique	38.8	22.7	8.8
Madagascar	40.6	17.4	7.1
Botswana	33.0	19.4	6.4
Zimbabwe	13.4	41.5	5.6
South Africa	1.2	401.1	4.8
Zambia	18.3	25.3	4.6
Malawi	29.4	11.3	3.3
Lesotho	37.0	2.3	0.8
Eswatini	14.0	4.9	0.7
Mauritius	1.3	14.9	0.2
São Tomé and Príncipe	2.3	0.8	0.0

Note: AfDB, African Economic Outlook 2024

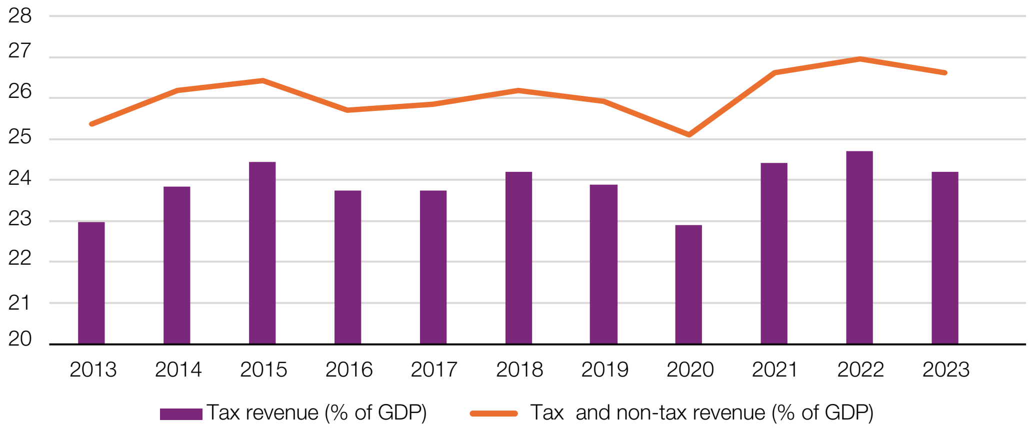
2.3. MOBILIZING FISCAL RESOURCES AT SCALE

Expanding fiscal resources at scale is a critical priority for Southern Africa as countries seek to meet growing development financing needs in an environment of tightening budgets and more limited external financing options. In this context, strengthening DRM, particularly through more effective and diversified taxation, remains the most dependable and sustainable policy lever. A clear assessment of existing tax effort and revenue composition is therefore essential to identify both the potential for revenue enhancement and the structural constraints that continue to limit fiscal capacity.

2.3.1. Tax Capacity Gaps in Southern Africa

DRM in Southern Africa has remained relatively stable but has shown limited structural improvement over the past decade. Figure 2.2 indicates that tax revenues in the region fluctuated within a relatively narrow range, generally between 22 and 25% of GDP. A similar pattern is observed for total revenues including non-tax sources, which remained broadly stable at around 25-27% of GDP[2]. Although revenues recovered after the COVID-19 shock, the overall trend suggests that improvements in DRM have been modest and largely cyclical rather than the result of sustained gains in tax efficiency or structural reforms. Non-tax revenues play only a limited role in the region's overall revenue structure, as suggested by the small gap between tax revenues and total revenues, reflecting the limited scale or volatility of several non-tax revenue streams.[3]

Figure 2.2: Trends in tax and total domestic revenue in Southern Africa 2000-2024



Source: Staff computations based on OECD/African Union Commission (AUC)/African Tax Administration Forum (ATAF) database.

Cross-country comparisons show that Southern Africa generally mobilizes more fiscal revenue than the African average, although untapped potential remains. In Figure 2.3, several countries – including Lesotho, Mauritius, Mozambique, Namibia, and South Africa –record tax-to-GDP ratios near or above 20%, above the African average of about 15%. However, performance remains heterogeneous across the region, and most countries still fall well below the Organization for Economic Co-operation and Development (OECD) average of roughly 33%, highlighting significant scope to strengthen DRM.

[2] Under the Organization of Economic Co-operation and Development (OECD) revenue classification adopted in this analysis, social security contributions are recorded as taxes rather than as non-tax revenues.

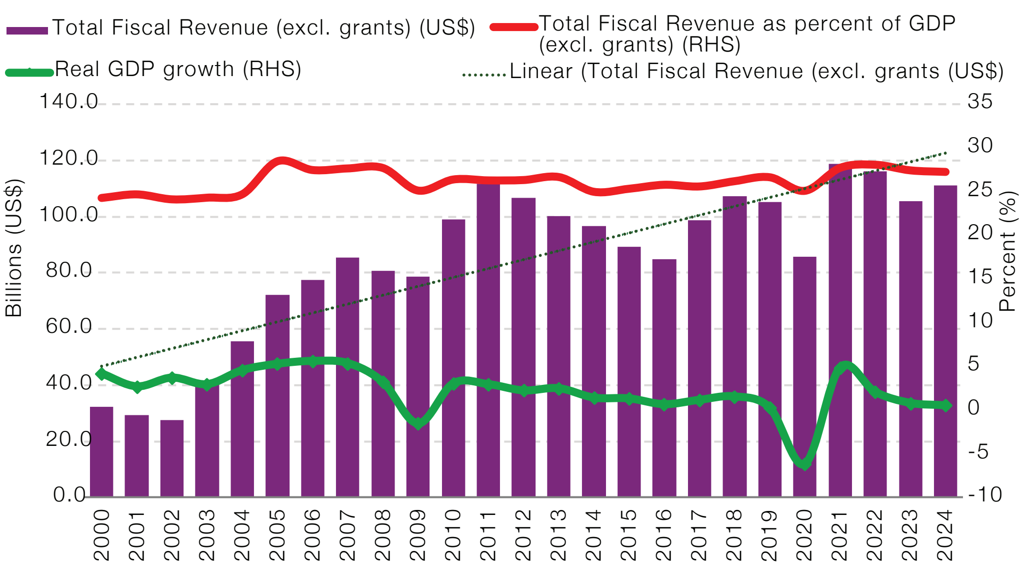
[3] Regional values are GDP-weighted with GDP data from the World Bank's World Development Indicators (WDI) Database.

Figure 2.3: Tax-to-GDP ratios in Southern African countries

Source: Staff computations based on OECD/AUC/ATAF database

Africa's nominal fiscal revenues increased substantially over the past two decades, rising from US$145.5 billion in 2001 to US$589.3 billion in 2022, before declining to US$478.1 billion in 2024. However, this expansion in revenue has been driven largely by favourable commodity price cycles, inflation, and exchange rate movements rather than sustained improvements in tax productivity or domestic revenue mobilization. Consequently, the continent's tax effort has weakened over time, with the average tax-to-GDP ratio falling from 25.6% during 2000–2009 to approximately 16.2% in 2024. This decline reflects persistent structural constraints, including narrow tax bases, widespread tax exemptions, administrative inefficiencies, the underperformance of key tax instruments, and the effects of recurrent global shocks. The recent contraction in nominal fiscal revenues further underscores Africa's continued dependence on volatile commodity-related revenues and trade taxes, which remain highly vulnerable to external shocks, while more stable and broad-based sources of taxation such as personal and corporate income taxes, value-added taxes, and property taxes remain insufficiently developed.

Figure 2.4: Trends in Africa's Total Fiscal Revenue (excluding grants), 2000- 2024

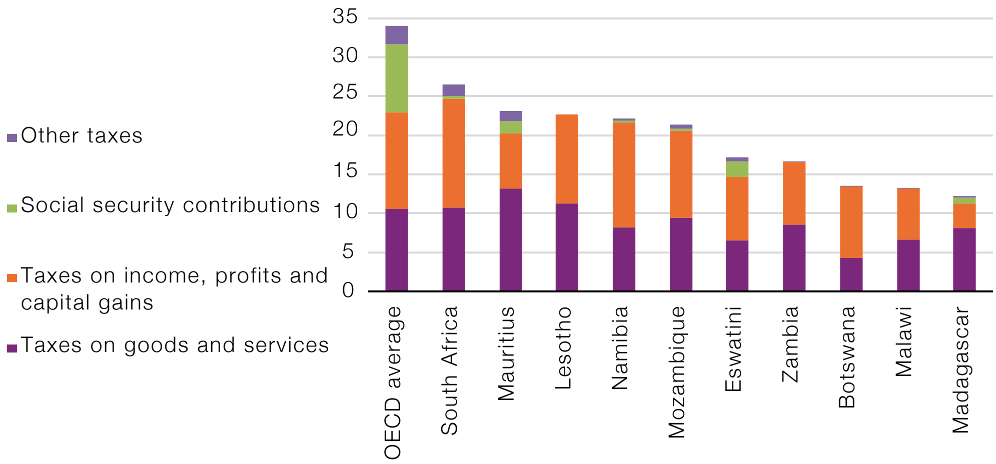


Source: AfDB Statistics Department.

2.3.2. Tax Structure in Southern Africa: Trends, Gaps, And Constraints

A key difference with advanced economies lies in the role of social security contributions in the tax structure (Figure 2.4). These contributions account for about 8.7% of GDP in OECD countries, while they remain extremely limited in Southern Africa, often below 1% of GDP, and even entirely absent in countries such as Botswana, Lesotho, and Malawi. As a result, fiscal revenues in the region rely mainly on taxes on goods and services and taxes on income and profits, while other sources such as payroll and property taxes remain marginal.

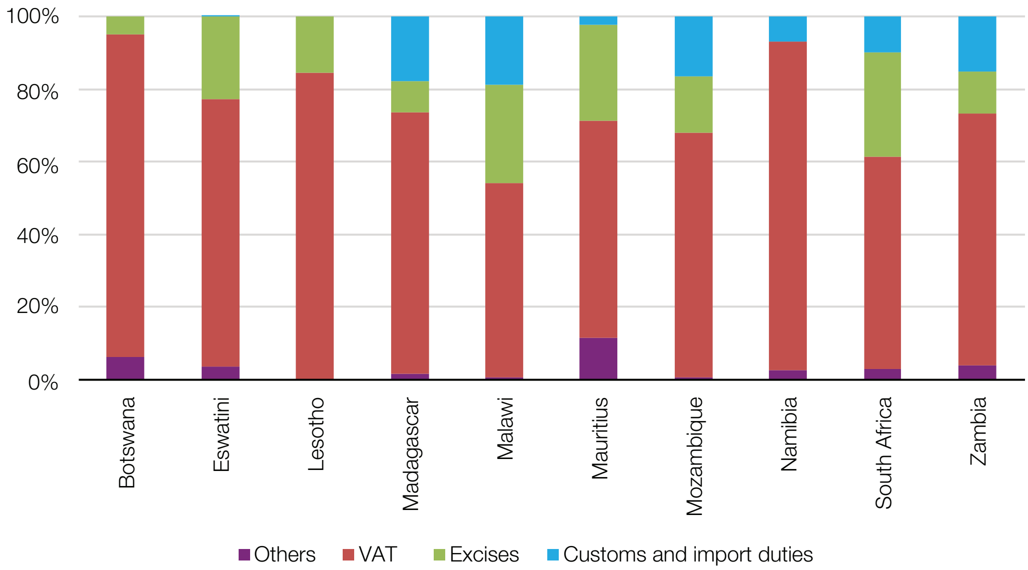
Figure 2.5: Tax structure in Southern African countries, 2023



Source: Staff computations based on OECD/AUC/ATAF database.

The composition of taxes on goods and services confirms the central role of value-added tax (VAT) in revenue mobilization across Southern African economies. VAT is the dominant component of indirect taxation in most countries, often accounting for more than half – and in some cases nearly two-thirds – of total taxes on goods and services (Figure 2.6). This reflects its broad base and relatively easier administration in economies with large informal sectors. While excise duties and customs taxes remain important complementary sources of revenue, the evidence highlights the region's strong reliance on consumption-based taxation, a pattern common across African tax systems (AfDB, 2026).

Figure 2.6: Composition of taxes on goods and services in Southern African countries, 2023

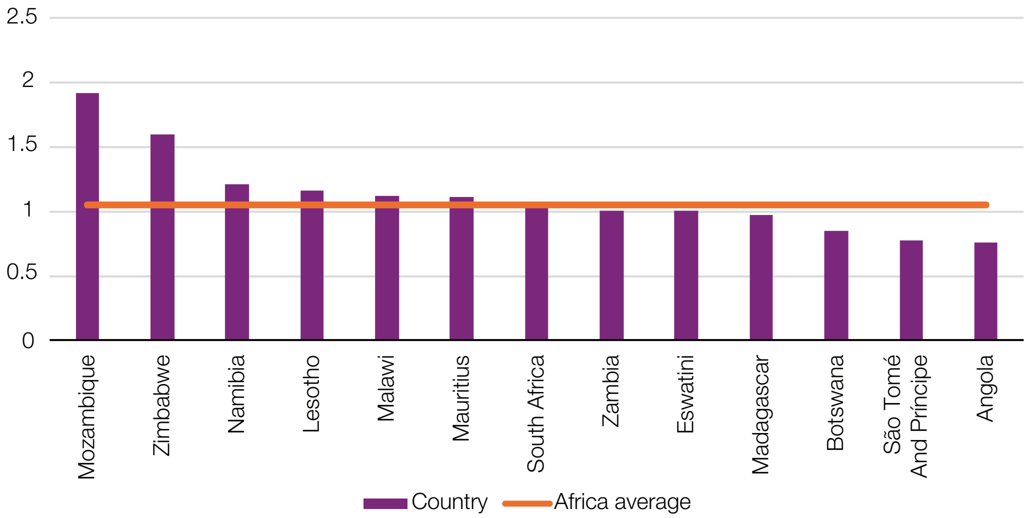


Source: Staff computations based on OECD/AUC/ATAF database.

2.3.3. Tax Efficiency, Buoyancy, and Structural Revenue Gaps in Southern Africa

Tax revenue buoyancy in Southern Africa reflects the heterogeneous responsiveness of revenues to economic growth. In several countries, tax systems generate revenues that expand at least proportionally, and in some cases significantly faster than economic activity (see Figure 2.7). Mozambique stands out with a buoyancy close to 1.9, followed by Zimbabwe at around 1.6, pointing to strong revenue responsiveness and potentially improved tax administration or expanding tax bases. Namibia (1.22), Lesotho (1.16), Malawi (1.12), and Mauritius (1.11) also display buoyancy above unity, suggesting that fiscal systems in these countries are relatively effective at capturing gains from economic growth. By contrast, performance is more subdued in other parts of the region. The African average tax buoyancy of 1.1 serves as a continental benchmark, with values above unity indicating that tax revenues grow faster than economic activity. South Africa, the largest and most diversified economy, records a buoyancy slightly below the continental benchmark (around 1.04), indicating revenues growing broadly in line with GDP but without significant amplification effects. Zambia and Eswatini hover around unity, reflecting proportional responsiveness. More concerning are countries such as Madagascar (0.97), Botswana (0.85), São Tomé and Príncipe (0.77), and Angola (0.76), where buoyancy falls below one, signalling that tax revenues are lagging behind economic growth. This pattern suggests structural inefficiencies in revenue systems and a weak capacity to translate economic expansion into fiscal space.

Figure 2.7: Tax revenue buoyancy in selected Southern African countries



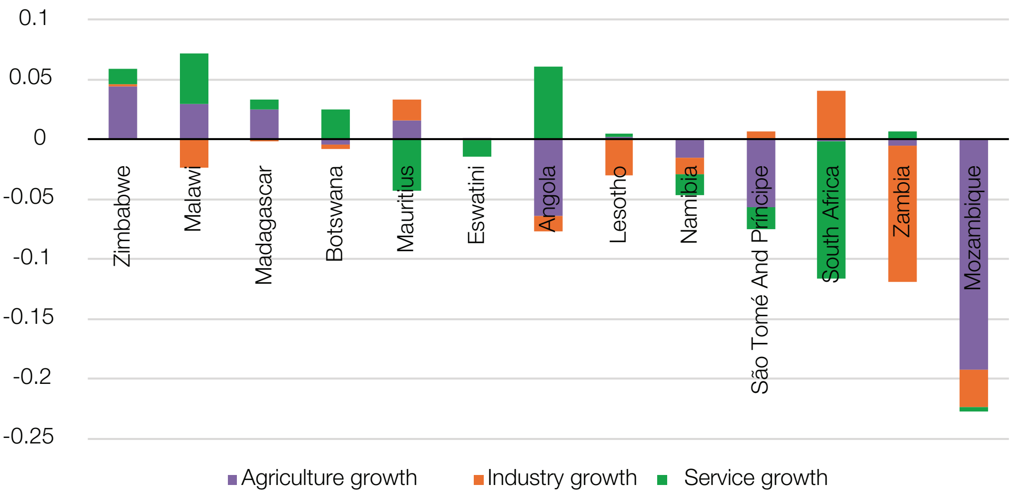
Source: Staff estimation using data from the African Development Statistics

Despite pockets of strong performance, tax systems across the region remain uneven in their capacity to support sustained and predictable revenue mobilization. High buoyancy in some economies may reflect improvements in compliance or favourable economic structures, but it may also be driven by volatile revenue bases, particularly in resource dependent countries. Conversely, low buoyancy highlights persistent structural constraints, including narrow tax bases, heavy reliance on commodity-related revenues, high levels of informality, and administrative inefficiencies.

Sectoral tax buoyancy in Southern Africa highlights a weak and uneven transmission of growth, particularly from services into fiscal revenues. Although economic growth in the region has been primarily driven by the services sector, its contribution to tax buoyancy is highly inconsistent across countries (Figure 2.8). While some economies exhibit a clear positive service contribution, such as Malawi (0.0428), Botswana (0.0246), and Angola (0.0605), others show weak or even negative contributions, including South Africa (-0.115), Mauritius (-0.0431), Namibia (-0.0173), and São Tomé and Príncipe (-0.0184). This suggests that, despite being the main driver of GDP growth, the service sector is not being systematically or effectively captured by tax systems across the region.

Contributions by agriculture and industry remain volatile and generally weak, reflecting structural limitations in tax capture. Agriculture shows positive contributions in some countries – Zimbabwe (0.0439), Malawi (0.029), and Madagascar (0.025) – but turns strongly negative in others, particularly Mozambique (-0.193) and Angola (-0.0643), indicating instability and limited tax capture in largely informal or subsistence-based segments. Industry presents a similarly mixed picture: while it contributes positively in a few cases, such as South Africa (0.04) and Mauritius (0.0177), it is negative in a number of countries, notably in Zambia (-0.114), Lesotho (-0.0298), and Malawi (-0.0237). These patterns reflect both structural weaknesses in industrial tax bases and the prevalence of enclave or incentive-driven sectors.

Figure 2.8: Southern Africa's sectoral tax buoyancy



Source: Staff estimation using data from the African Development Statistics

Mozambique provides an illustration where high aggregate buoyancy coexists with negative sectoral contributions, pointing to measurement and structural issues rather than broad-based tax efficiency. With an overall buoyancy close to 1.9 (Figure 2.7), Mozambique appears to exhibit very strong revenue responsiveness. However, all three sectoral contributions are negative, particularly agriculture (-0.193), but also industry (-0.0304) and services (-0.0042), indicating that sectoral growth has not translated into higher tax revenues. This apparent contradiction suggests that the buoyancy observed is likely driven by non-sectoral factors, such as tax policy changes, improvements in tax administration, one-off revenue measures, or base effects following periods of weak revenue performance. It may also reflect the importance of resource-related revenues or large investment projects, which are weakly captured in standard sectoral growth decomposition but can significantly affect total revenues. More broadly, this pattern highlights a structural disconnect between economic activity and tax collection, suggesting that Mozambique's high buoyancy is not indicative of a well-functioning, growth-responsive tax system, but rather of episodic or externally driven revenue dynamics

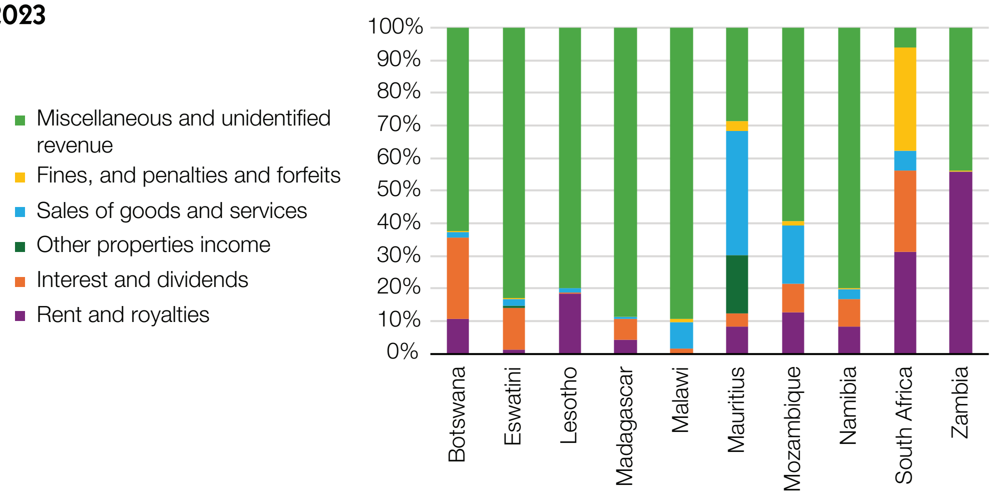
Overall, the disconnect between sectoral growth patterns and tax buoyancy underscores persistent inefficiencies in revenue systems. The fact that the dominant growth sector (services) does not consistently translate into higher tax revenues points to gaps in coverage, compliance, and administration, particularly in informal and fast-growing service activities. At the same time, the volatility observed in agriculture and industry reinforces the limited reliability of these sectors as stable sources of fiscal expansion

2.3.4. Operationalizing Southern Africa's Untapped Revenue Potential

Unlocking Southern Africa's revenue potential thus requires moving from diagnosis to targeted reforms that strengthen efficiency, broaden the tax base, and improve revenue administration. Strengthening DRM will hinge on improving tax efficiency and reducing the structural leakages that limit the responsiveness of revenues to economic activity. In this regard, enhancing VAT compliance, through better enforcement, streamlined refund systems, and reduced exemptions, remains a central priority, given the dominant role of consumption taxes in the region's revenue structure. Strengthening income tax administration, particularly through improved taxpayer registration, audit capacity, and enforcement mechanisms, is also essential to expand direct taxation and enhance equity. Broadening the revenue base will also require greater use of underutilized instruments, including property taxes and selected excises, which remain marginal in most Southern African economies. Expanding social security contributions, currently very limited across the region, could further diversify revenue structures while supporting long-term fiscal sustainability.

In parallel, non-tax revenues offer an additional but underexploited source of financing, although their composition and reliability vary significantly across Southern African countries. A dominant feature across the region is the large share of miscellaneous and unidentified revenues, which accounts for most non-tax revenues in countries such as Botswana, Eswatini, Lesotho, Madagascar, Malawi, Namibia, and Zambia (Figure 2.9). This concentration points to important weaknesses in revenue classification, transparency, and predictability, limiting the ability of governments to manage these flows effectively as part of a coherent fiscal strategy. By contrast, more structured sources of non-tax revenue remain relatively underdeveloped but show potential in specific countries. Rents and royalties play a significant role in resource-rich economies such as Zambia and, to a lesser extent, Lesotho, Mozambique, and South Africa, reflecting the importance of extractive sectors. Interest and dividends, largely linked to state-owned enterprises (SOEs), are more visible in countries like Botswana, Eswatini, and South Africa, although their overall contribution remains modest and often volatile. Sales of goods and services, which reflect cost recovery mechanisms and public service pricing, are particularly important in Mauritius and Mozambique, indicating more advanced efforts to mobilize user-based revenues.

Figure 2.9: Distribution of non-tax revenue sources in selected Southern Africa's countries, 2023



Source: Staff calculations based on data from OECD (2025)

These patterns suggest that strengthening non-tax revenues will require both better governance and improved structuring of revenue sources. Enhancing the performance and transparency of SOEs can increase dividend flows, while improved management of natural resource royalties can stabilize revenues in commodity-dependent economies. At the same time, rationalizing user fees and expanding cost recovery mechanisms, particularly in infrastructure and public services, can provide more predictable income streams. Crucially, reducing reliance on residual and poorly classified revenue categories through improved reporting standards and fiscal transparency will be essential to fully unlock the potential of non-tax revenues as a stable complement to tax-based financing.

Curbing IFFs is also critical to strengthen DRM in Southern Africa. Trade-related leakages and other cross-border financial irregularities continue to erode fiscal resources that could otherwise support public investment and development spending. Estimates from Global Financial Integrity (GFI) indicate that IFFs remain substantial across the region, reflecting persistent vulnerabilities in trade reporting, customs controls, and financial transparency. By weakening the tax base and reducing the resources available for productive investment, these flows constrain governments' capacity to mobilize and deploy domestic revenues effectively (GFI, 2026).

Estimates based on UN Comtrade mirror-trade statistics indicate that trade-related value gaps remain substantial across Southern Africa. Several countries record sizeable cumulative discrepancies between their reported exports and partners' imports over 2013-2022 (Table 2.3). South Africa overwhelmingly dominates the regional pattern, with estimated trade-related value gaps reaching about US$478 billion over the decade. As a share of all Sub-Saharan Africa (SSA), South Africa accounts for 42% of the region's cumulative trade-related IFFs, highlighting the high concentration of leakage among the region's largest commodity exporter (GFI, 2026). Other countries also display significant cumulative gaps, including Zambia (US$35.8 billion), Angola (US$35.4 billion), Mozambique (US$23.3 billion), and Namibia (US$21.3 billion), indicating persistent exposure to trade misinvoicing risks. While smaller economies such as Eswatini, Lesotho, and São Tomé and Príncipe record lower absolute values, the magnitude of these discrepancies can still represent a significant share of their external trade.

Table 2.3: Southern African countries trade-related value gaps (US$millions)

	2013	2022	Total period
Angola	2901	5200	35401
Botswana	1293	2990	17588
Eswatini	610	814	5377
Lesotho	312	511	5107
Madagascar	902	3859	19689
Malawi	686	524	6258
Mauritius	1404	2673	16982
Mozambique	2147	3610	23292
Namibia	1997	2747	21336
São Tomé and Príncipe	17	39	283
South Africa	50865	60062	478082
Zambia	4377	4066	35841
Zimbabwe	2887	2070	16024

Source: GFI (2026).

Reducing IFFs and profit shifting in Southern Africa requires stronger trade oversight, tax administration, and regional cooperation. Key priorities include improving customs valuation procedures and risk-based inspection systems to better detect trade misinvoicing, while strengthening data exchange between customs and tax authorities through integrated information systems.

Expanding capacity to detect abusive transfer pricing is also important to address profit-shifting risks by multinational firms, particularly in resource sectors. Greater transparency – through beneficial ownership registers and participation in international tax information exchange frameworks – can further limit cross-border tax avoidance. Regional cooperation is particularly important within the Southern African Customs Union (SACU), where high volumes of intra-union trade and shared customs revenues require strong coordination of trade monitoring and information-sharing to reduce misreporting risks and protect the regional revenue pool.

Digitalization provides a powerful lever to support all these reforms by improving compliance and reducing administrative inefficiencies. The expansion of e-filing, e-payments, and e-invoicing systems can enhance transparency, limit tax evasion, and strengthen real-time monitoring of transactions. Ultimately, sustained progress in revenue mobilization will depend not only on technical reforms but also on strengthening institutional capacity, improving transparency, and enhancing the quality of public service delivery. Reinforcing the link between taxation and public outcomes will be critical to rebuilding trust and strengthening the fiscal social contract across the region.

2.3.5 Revenue Reforms and Sequencing

Moving from diagnostic assessment to implementation will require carefully sequenced revenue reforms capable of generating early gains while strengthening fiscal institutions over time. In Southern Africa, revenue mobilization reforms face important political, administrative, and economic trade-offs, particularly in economies characterized by high informality, narrow tax bases, commodity dependence, and uneven institutional capacity. A phased approach can therefore help governments build the credibility in reform and strengthen compliance progressively. In the near term, priority measures could focus on improving tax administration and reducing leakages through integrating taxpayer databases, stronger filing and payment enforcement, and tighter management of exemptions. Simplified tax regimes for informal and semi-formal operators could also broaden the tax base while facilitating gradual formalization. Experiences from countries such as Zimbabwe and Namibia show that modernized revenue systems and risk-based audit approaches can contribute to stronger compliance and higher domestic revenue collection (see Box 2.1).

Over the medium term, sustaining revenue performance will depend increasingly on stronger institutions, improved public service delivery, and a more credible fiscal social contract. Broader reforms involving property taxation, reducing exemptions, stronger audit functions, transfer pricing oversight, and integration of tax and customs systems can gradually strengthen fiscal capacity, but their effectiveness ultimately depends on public trust and institutional credibility. In many Southern African countries, taxpayers continue to face forms of "implicit taxation" through the private provision of services such as electricity, water, security, or transport, weakening the incentives for voluntary compliance. Strengthening transparency, accountability, and the visible link between taxation and public services is therefore essential to improve tax morale and reduce evasion. Embedding revenue reforms within medium-term fiscal frameworks and improving the quality of public expenditure can further reinforce reform credibility while supporting more sustainable domestic resource mobilization across the region.

The data illustrate that Africa has recorded strong growth in nominal fiscal revenue, but this has not translated into sustained improvements in revenue mobilization efforts (see Figure 2.4). Despite higher nominal collections, the tax-to-GDP ratio has not kept pace with economic growth. The trend highlights the continent's continued vulnerability to external shocks with revenue declining sharply during the global financial crisis, the 2014–16 commodity downturn, and the COVID-19 pandemic, underscoring a reliance on cyclical and volatile revenue sources rather than broad-based and resilient taxation systems. For Southern Africa, these findings are particularly relevant given the region's exposure to commodity cycles, its relatively high debt burdens, and tightening fiscal space. The pattern suggests that without stronger and more resilient domestic resource mobilization systems, Southern African economies are likely to remain vulnerable to the same revenue volatility observed at the continental level. This reinforces the need for reforms that broaden tax bases, strengthen compliance, and reduce revenue leakages to ensure that economic growth translates more consistently into durable fiscal capacity and development financing. Strengthening the fiscal and social contract between governments and citizens is also critical for improving and sustaining revenue performance. Across many African countries, a significant share of citizens expresses a greater willingness to pay taxes when they observe a clear link between taxation and improved public services.

Box 2.1: Key tax reforms to strengthen domestic resource mobilization in Southern Africa

Southern African countries are implementing a range of tax policy and administration reforms to strengthen domestic resource mobilization, expand fiscal space, and reduce reliance on external financing. A common priority across the region is improving tax efficiency and broadening the revenue base to better capture the benefits of economic growth. Given the dominant role of taxes on goods and services in the region's revenue structure, many countries are focusing on strengthening VAT administration through improved compliance, streamlined refund systems, and the rationalization of exemptions. Efforts are also underway to strengthen income tax administration through improved taxpayer registration, enhanced audit capacity, and stronger enforcement mechanisms aimed at increasing the contribution of direct taxes and improving equity within tax systems.

Several countries are pursuing reforms to address the structural weaknesses that limit revenue mobilization. Despite the growing importance of the services sector in regional economic activity, tax systems often struggle to effectively capture revenues from fast-growing and largely informal service-based activities. To address these gaps, governments are expanding tax coverage, improving compliance among small and medium-sized enterprises, and strengthening mechanisms to integrate informal economic activities into the tax net. At the same time, there is growing recognition of the need to diversify revenue sources through greater use of underutilized instruments such as property taxes, selected excise duties, and social security contributions, which remain relatively limited across much of the region.

Some economies, including Angola, Mozambique, Namibia, and Zambia, are also strengthening the taxation and management of natural resource revenues to improve the collection of royalties and other extractive-sector taxes. In parallel, several countries are reviewing tax expenditures, exemptions, and investment incentives to reduce revenue leakages and enhance the productivity of existing tax systems.

The modernization of tax administration through digital technologies is increasingly supporting these reforms. Countries across the region are expanding e-filing, e-payment, e-invoicing, and digital taxpayer registration systems to improve compliance, reduce administrative costs, and strengthen revenue collection. Digitalization is also enhancing information-sharing between tax and customs authorities, improving risk-based compliance management, and supporting more effective monitoring of economic transactions.

Efforts to curb illicit financial flows, trade mis-invoicing, and profit shifting have also become an important component of domestic resource mobilization strategies. Governments are strengthening customs valuation procedures, improving trade monitoring systems, enhancing transfer pricing oversight, and promoting greater transparency in financial reporting. Increased regional cooperation, particularly within SACU and SADC frameworks, is expected to strengthen information-sharing and reduce cross-border revenue leakages. To sustain revenue gains, countries are embedding tax reforms within broader fiscal consolidation and public financial management strategies while strengthening governance, transparency, and taxpayer trust. These reforms are expected to improve revenue performance, enhance fiscal sustainability, and create greater fiscal space to finance infrastructure development, social services, climate adaptation, and long-term economic transformation across Southern Africa.

2.3.6 Institutional Enablers and Digitalization of Revenue Collection Systems

Strengthening domestic revenue mobilization in Southern Africa will depend increasingly on the quality of institutions and the digital transformation of revenue administration systems. Effective revenue collection requires more than tax policy reforms alone. Sustained progress also depends on capable and autonomous revenue administrations, stronger enforcement mechanisms, transparent legal frameworks, and interoperable public information systems. Across the region, digitalization is becoming a central instrument for broadening the tax base, reducing leakages, and improving compliance. The expansion of e-filing, e-payments, electronic taxpayer registries, and digital customs systems can help reduce administrative discretion, strengthen transparency, and improve real-time monitoring of transactions. Such reforms are particularly important in Southern Africa, where VAT remains the dominant source of tax revenue and where informality, exemptions, and weak compliance continue to limit fiscal performance.

Country experiences across Southern Africa illustrate how digital revenue administration reforms can improve tax compliance, customs efficiency, and fiscal capacity when embedded within broader institutional reforms. In Namibia, the Tax Administration Technical Assistance Project supports the use of advanced data analytics, specialized audits, and institutional capacity-building to strengthen non-mining tax collection. In Zimbabwe, the modernization of tax administration through the integrated tax and revenue management system contributed to stronger compliance, higher taxpayer registration, and increased domestic revenue collection. Moreover, experiences with e-invoicing, digital VAT systems, and customs modernization demonstrate that technology-driven reforms can generate substantial revenue gains when combined with stronger governance, risk-based compliance management, and sustained political commitment. Expanding interoperability between customs systems, tax administrations, national identification systems, and digital payment platforms could therefore significantly bolster revenue collections.

Box 2.2: Key actions and reforms to modernize revenue collection in Southern Africa

Southern African countries are undertaking sustained reforms to modernize tax administration systems, with a strong emphasis on **digitalization, institutional integration, and enforcement capacity** to enhance domestic resource mobilization and fiscal resilience. A central reform trend is the expansion of integrated digital tax platforms and e-filing systems aimed at reducing compliance costs and improving efficiency. South Africa continues to strengthen the South African Revenue Service digital ecosystem, including enhanced e-filing services, automated compliance management systems, and advanced data-matching tools to improve risk-based audits and reduce tax gaps. Botswana has modernized its tax administration through the Botswana Unified Revenue Service's integrated tax administration system, which supports online registration, filing, and payments. Namibia's Inland Revenue Department has similarly expanded e-filing and electronic payment systems, while Zambia has upgraded the Zambia Revenue Authority digital platforms, including electronic invoicing and smart invoicing systems to improve VAT compliance. Zimbabwe's tax authority has advanced fiscalization systems and electronic tax registers to strengthen real-time transaction monitoring, while Malawi's Revenue Authority continues to expand e-tax services and automated customs processing. In Mozambique, the Autoridade Tributária has progressed with electronic tax declaration systems and customs digitalization, and Angola's Administração Geral Tributária has accelerated reforms toward electronic invoicing and integrated taxpayer management platforms.

A second key reform area is the **integration of tax systems with national identification databases, business registries, and financial transaction data** to improve taxpayer segmentation and compliance enforcement. Several countries, including Botswana, South Africa, and Zambia, are increasingly leveraging third-party data sources and data analytics to improve audit selection, identify underreporting, and reduce leakage in VAT and corporate income tax systems. This shift toward data-driven tax administration is also enabling the use of predictive analytics for risk-scoring and compliance monitoring, particularly in larger revenue administrations.

Customs modernization remains a critical pillar of reform across the region. Countries such as Mozambique, Namibia, Zambia, and Zimbabwe are strengthening electronic customs clearance systems, cargo-tracking technologies, and risk-based inspection frameworks to facilitate trade while enhancing border revenue collection. Efforts to modernize customs are being complemented by regional interoperability initiatives aimed at improving cross-border data-sharing and reducing trade-related delays within the Southern African Development Community (SADC) corridor.

These reforms are supported by broader institutional strengthening measures, including improved taxpayer service delivery, streamlined dispute resolution mechanisms, and expanded public financial management linkages. Collectively, these initiatives are transforming Southern African revenue administrations from largely manual and fragmented systems into more integrated, technology-enabled institutions capable of supporting sustained domestic revenue mobilization, improving compliance outcomes, and strengthening long-term fiscal sustainability.

2.3.7 Role of International Cooperation and Development Partners

International cooperation and support from development partners remain important complements to domestic reforms aimed at strengthening revenue mobilization in Southern Africa. Multilateral development banks (MDB), bilateral partners, and international organizations provide financial resources, technical assistance, and institutional support that can help modernize tax administration, strengthen customs systems, improve PFM, and expand fiscal space. International tax cooperation initiatives, including the OECD/G20 Base Erosion and Profit Shifting framework and emerging global minimum tax arrangements, also create opportunities to reduce profit shifting and protect domestic tax bases. However, many Southern African countries continue to face important implementation constraints, including shortages of specialized expertise, limited transfer pricing capacity, weak information systems, and legal and administrative challenges associated with applying increasingly complex international tax standards. Strengthening technical capacity in areas such as treaty negotiation, transfer pricing audits, dispute resolution, and tax data analysis therefore remains critical to improving the effectiveness of international tax cooperation.

Regional cooperation can further strengthen Southern Africa's capacity to combat tax avoidance, improve revenue administration, and increase its influence in international tax governance discussions. Institutions such as the African Tax Administration Forum and regional customs arrangements provide important platforms for information-sharing, technical assistance, and capacity-building on emerging international tax issues. Closer cooperation within regional frameworks, including the SACU and the SADC, can also improve coordination on customs valuation, transfer pricing, trade monitoring, and exchange of tax information, particularly given the importance of intra-regional trade and cross-border investment flows. Aligning external support with country-owned reform strategies and regional priorities will remain essential to ensure that international cooperation contributes effectively to stronger fiscal systems, more sustainable domestic resource mobilization, and greater regional resilience.

2.4. IMPROVING PUBLIC FINANCIAL MANAGEMENT SYSTEMS

Strengthening PFM is essential to support revenue mobilization in Southern Africa. Beyond raising resources, development outcomes depend on how effectively funds are allocated and managed. Expanding fiscal resources at scale is a critical priority for Southern Africa as countries seek to meet growing development financing needs in an environment of tightening budgets and increasingly limited external financing options. In this context, strengthening domestic resource mobilization (DRM) remains the most reliable and sustainable pathway for expanding fiscal space. However, the challenge is not only to raise more revenue, but also to improve the capacity of governments to capture, diversify, secure, and effectively administer public resources. This requires a comprehensive approach spanning tax policy, revenue administration, non-tax revenues, natural resource governance, illicit financial flow mitigation, and broader public financial management (PFM) systems. Despite ongoing reforms, persistent institutional gaps continue to limit spending efficiency and accountability.

2.4.1. Southern Africa's PFM Landscape: Progress Alongside Enduring Institutional Gaps

PFM systems in Southern Africa have undergone significant reforms over the past two decades, with many countries adopting modern legislative frameworks aligned with international standards. Across the region, PFM systems are typically anchored in comprehensive laws, supported by complementary legislation on public debt management and public audit. These frameworks define institutional responsibilities, formalize budget processes, and establish mechanisms for revenue mobilization, expenditure control, and financial reporting. In several countries, treasury functions are clearly structured, and oversight roles are formally assigned to parliaments and supreme audit institutions, reflecting a convergence toward global best practices in fiscal governance.

Despite this progress, the effectiveness of PFM systems remains constrained by persistent implementation gaps and institutional weaknesses. Evidence from Southern African countries indicates that while legal and regulatory frameworks have improved substantially, implementation and enforcement remain uneven, limiting their contribution to fiscal discipline and accountability. Weak enforcement mechanisms, limited institutional capacity, and fragmented coordination across government agencies reduce the effectiveness of budget execution, internal controls, and financial management systems. Moreover, oversight institutions including parliaments and supreme audit institutions often face constraints in ensuring that audit findings and recommendations are effectively implemented, weakening accountability throughout the public financial management cycle (PEFA Secretariat, 2023; IMF, 2023; African Development Bank, 2024).

A key challenge across the region lies in the disconnect between formal PFM frameworks and actual governance outcomes. Even in countries with relatively advanced systems, persistent issues such as irregular expenditure, weak internal controls, and limited fiscal transparency continue to undermine the effectiveness of public financial management. South Africa's experience demonstrates that strong legal and institutional frameworks alone are insufficient to ensure sound PFM outcomes, as institutional capacity constraints, political interference, weak compliance, and inadequate follow-through on audit findings continue to impede effective implementation. These weaknesses contribute to inefficient public spending, poorer service delivery outcomes, and declining public confidence in public institutions (PEFA Secretariat, 2023; IMF, 2023; Auditor-General of South Africa, 2024).

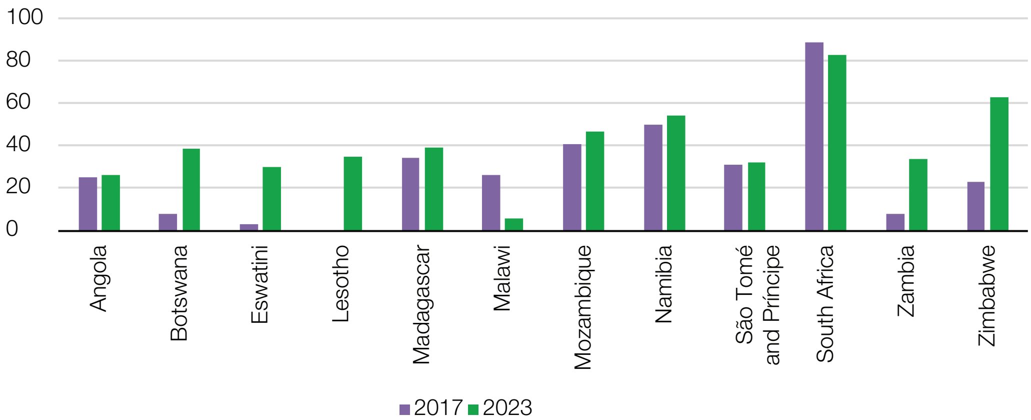
2.4.2. Improvements in Transparency and Fiscal Accountability

These persistent gaps in implementation and institutional effectiveness are closely reflected in the region's transparency and accountability outcomes. In practice, the strength of PFM systems is ultimately revealed not only by their formal design, but by the degree to which they ensure credible, transparent, and accountable management of public resources. Assessing fiscal transparency therefore provides a concrete lens through which to evaluate how far existing frameworks translate into effective governance and public oversight.

Fiscal transparency levels in Southern Africa remain highly uneven across countries, although most have improved over time. South Africa records by far the highest transparency score in the region, followed by Namibia and Mozambique, while most other countries remain below 40 for a score ranging from 0 to 100 (see Figure 2.10). Despite these disparities, transparency indicators increased in most countries between 2017 and 2023 – notably in Botswana, Eswatini, Lesotho, Zambia, and Zimbabwe – with more moderate gains in Angola, Madagascar, Mozambique and Namibia. Only a few exceptions diverge from this trend, particularly Malawi, where transparency declined, and South Africa, which recorded a slight decrease from an already high level. Overall, the pattern suggests gradual improvements in fiscal transparency across the region, consistent with ongoing reforms to strengthen budget reporting and fiscal oversight (IMF, 2022).

These improvements are significant because fiscal transparency is a fundamental component of sound public financial management and effective resource mobilization. Greater transparency enhances the credibility of fiscal policy, strengthens public accountability, and improves the quality of budgetary decision-making by enabling citizens, investors, and oversight institutions to assess how public resources are allocated and used. It also facilitates the identification and management of fiscal risks, including contingent liabilities arising from state-owned enterprises and public-private partnerships. By reducing information asymmetries and policy uncertainty, stronger fiscal transparency can improve investor confidence, support access to financing, and contribute to lower sovereign risk premia.

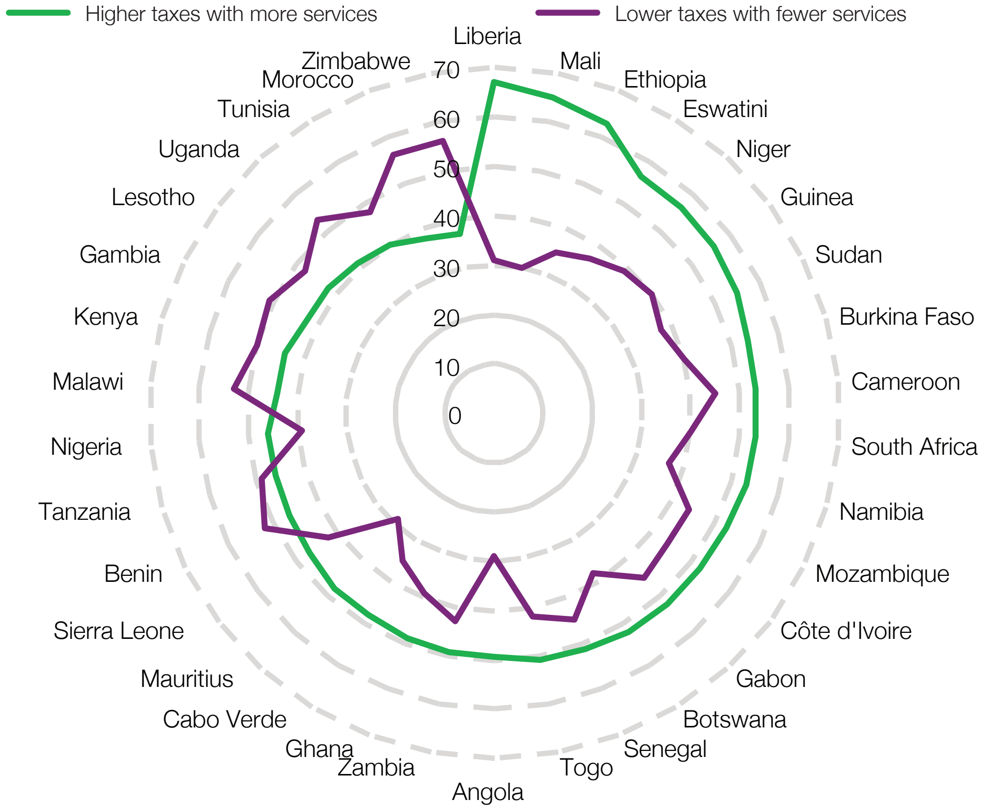
Figure 2.10: Budget transparency score for Southern African countries



Source: Open Budget Survey database, 2023

Implicit taxation shapes the political economy of revenue reform, so a central element of sustaining revenue performance is strengthening the fiscal social contract between governments and citizens through better delivery of social and public services. When taxpayers perceive that they must effectively “pay twice,” once through formal taxes and again through paying for delegitimization and weakening incentives for compliance. Strengthening DRM in such contexts requires linking revenue reforms more explicitly to inclusive and visible improvements in service delivery, helping to restore trust between citizens and public institutions. Where the quid pro quo relationship between taxation and public service delivery is weak, tax morale declines; voluntary compliance erodes, and the effective tax base remains constrained. Across many African countries, a significant share of citizens expresses a greater willingness to pay taxes when they observe a clear link between taxation and improved public services (Figure 2.11). This finding is consistent with a broad empirical literature showing that tax compliance is strongly shaped by perceptions of fiscal reciprocity.

Figure 2.11: Higher taxes with more services vs. lower taxes with fewer services



Source: Staff Calculations using data from the 2022 Afrobarometer surveys

2.4.3. Strengthening Oversight, Audit, PFM Systems, and Public Investment Management

Improving PFM oversight and public investment management (PIM) is essential, not only to enhance spending efficiency in Southern Africa, but also to strengthen the mobilization and effectiveness of development financing. As financing needs increase and access to concessional resources becomes more constrained, development partners, investors, and creditors place growing importance on the quality of PFM systems when assessing countries' capacity to manage public resources effectively. Strong PFM systems therefore play a critical role in attracting financing, improving the use of available resources, and ensuring that development funding translates into tangible economic and social outcomes. Beyond formal institutional frameworks, effective fiscal governance depends on the ability of audit institutions, legislatures, and accountability mechanisms to enforce discipline and ensure that public resources are used as intended. Strengthening external audit functions, parliamentary scrutiny, and public accountability can reinforce fiscal discipline and improve expenditure quality (OECD, 2021). However, in many countries across the region, these mechanisms remain constrained by limited capacity, weak enforcement, and insufficient follow-up on audit findings, reducing their impact on fiscal outcomes.

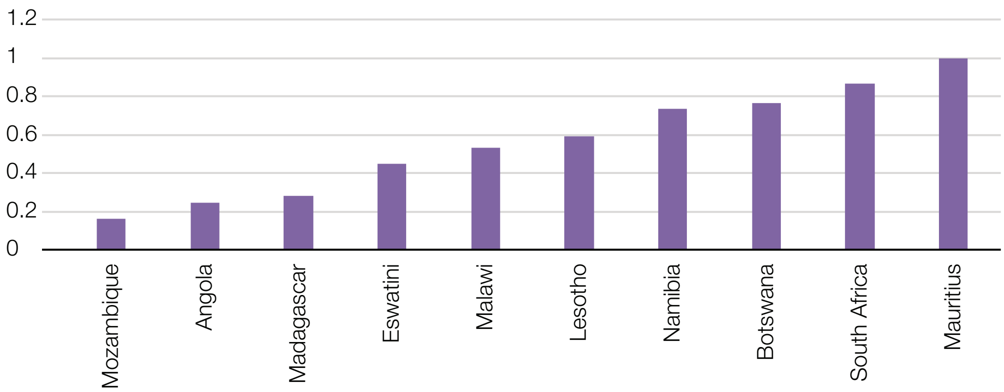
At the same time, improving PIM is critical to raising the efficiency and impact of public spending, particularly in infrastructure. Significant gaps persist between current practices in Southern Africa and international best practices, reflecting weaknesses in project appraisal, selection, execution, and monitoring. Inadequate feasibility analysis, weak prioritization frameworks, and limited ex-post evaluation often result in cost overruns, delays, and suboptimal investment outcomes. These shortcomings weaken the economic returns of public investment, reducing the growth and development benefits generated by scarce fiscal resources and borrowed funds. Strengthening PIM systems, through more rigorous appraisal processes, better project pipelines, and improved monitoring, can substantially enhance infrastructure outcomes and fiscal efficiency (Rajaram et al., 2014).

Sound debt management is also essential to ensure that public financing supports productive investment. In several Southern African countries, rising debt service has increased the share of revenue devoted to interest payments, thereby constraining fiscal space for priority expenditures. Strengthening the link between borrowing decisions, investment planning, and medium-term fiscal frameworks is therefore critical to maintain fiscal sustainability. Weak PFM systems and inefficient public investment management can further undermine budget credibility by contributing to expenditure overruns, project delays, and deviations between planned and actual fiscal outcomes. Lower budget credibility increases perceived fiscal risks among investors and creditors, which can raise sovereign risk premia and increase the cost of financing. Conversely, stronger PFM systems enhance confidence in fiscal management, improve budget predictability, and can contribute to lower borrowing costs and greater access to development financing. This challenge is reflected in the region's low country policy and institutional assessment debt policy rating, with an average of 2.87 in 2024, below both the middle-income average (3.2) and the SSA average (3.08). Zambia's debt default in 2020, following a period of rapid external debt accumulation, illustrates the risks associated with weak debt management and insufficiently anchored fiscal planning. Strengthening debt governance and aligning borrowing with high-quality investment will be key to ensuring that public financing contributes effectively to long-term development outcomes.

2.4.4. Economic Dividends and Fiscal Gains from Closing the Efficiency Gap

Public spending efficiency in Southern Africa is highly heterogeneous, revealing substantial scope for improving the return on public investment. Efficiency scores vary widely across countries, from very low levels in Mozambique (around 0.16) and Angola (0.25) to frontier performance in Mauritius (close to 1.0) and strong outcomes in Botswana and South Africa (Figure 2.12). A middle group, including Eswatini, Lesotho, Malawi, and Namibia, shows moderate efficiency levels, suggesting partial effectiveness in translating public spending into outcomes. This dispersion highlights that while some countries approach best-practice efficiency, a large part of the region continues to experience significant inefficiencies in the use of public resources.

Figure 2.12: **Distribution of Efficiency Scores in Southern Africa**



Source: Staff calculations

Lower-performing countries face structural inefficiencies across the public investment cycle, reducing the impact of spending on growth and development outcomes. In countries such as Angola, Madagascar and

Mozambique, low efficiency scores point to weaknesses in project appraisal, selection, procurement, and execution. These shortcomings often translate into cost overruns, delays, and lower-quality infrastructure, ultimately limiting the productivity of public investment. Weak institutional capacity, fragmented planning frameworks, and limited monitoring and evaluation systems further exacerbate these inefficiencies, reducing the effectiveness of fiscal spending, despite often substantial investment needs.

Closing efficiency gaps offers substantial fiscal and economic dividends by effectively expanding fiscal space without increasing resources. Improving efficiency in lower-performing countries could yield gains equivalent to several percentage points of GDP in additional effective investment, without requiring higher public spending. By reducing leakages, improving project quality, and accelerating implementation, governments can enhance infrastructure outcomes, support private sector development, and strengthen long-term growth prospects. Moreover, higher efficiency increases the credibility of fiscal policy, which can help lower borrowing costs and crowd in private investment.

Policy priorities should therefore focus on strengthening PIM, improving procurement systems, and enhancing accountability mechanisms. Key reforms include institutionalizing rigorous project appraisal and selection processes, developing centralized and transparent project pipelines, strengthening procurement frameworks to reduce delays and corruption risks, and enhancing monitoring and ex-post evaluation systems. Expanding the use of digital tools, such as e-procurement and integrated financial management systems, can further improve transparency and control. At the same time, reinforcing audit institutions and linking investment decisions more closely to medium-term fiscal frameworks will be critical to ensure that public resources are allocated efficiently and aligned with development priorities.

The efficiency of public spending is closely linked to the quality of PFM systems. Weak budget planning, procurement inefficiencies, inadequate project appraisal, and limited monitoring and evaluation reduce the returns on public investment, weaken fiscal credibility, and ultimately increase financing costs. Conversely, stronger PFM systems improve expenditure efficiency, enhance investor confidence, and allow governments to mobilize and deploy development financing more effectively.

2.4.5 Digital Transformation of Public Financial Management Systems

Digitalization provides a key opportunity to modernize PFM systems. The adoption of integrated financial management systems, e-procurement platforms, and digital treasury tools can significantly improve expenditure control, transparency, and real-time monitoring of public finances. These systems reduce information asymmetries, limit opportunities for mismanagement, and strengthen internal controls across the budget cycle (Diamond and Khemani, 2005). Several Southern African countries have initiated digital PFM reforms, notably in systems such as budget management, electronic procurement, and treasury operations. However, the effectiveness of these reforms often remains uneven due to fragmentation, limited interoperability, and capacity constraints, highlighting the need for more integrated and sustained implementation.

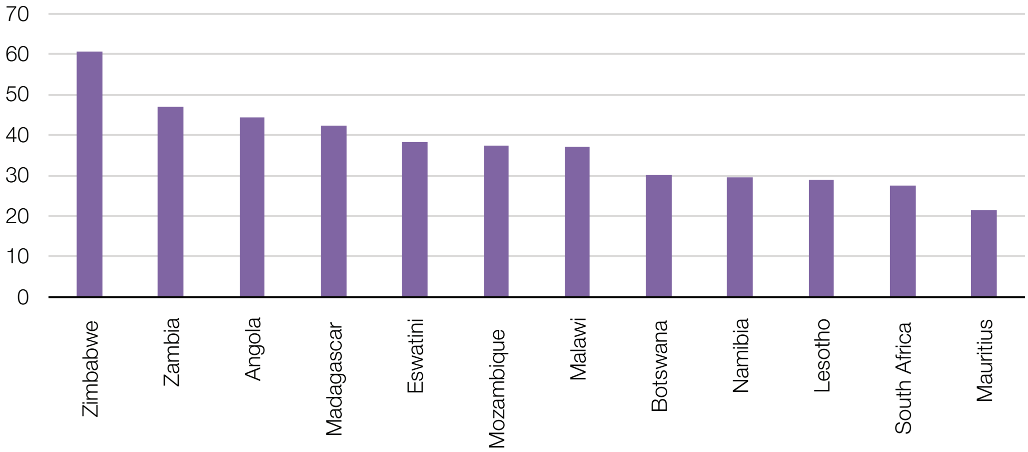
Enhancing digital public finance infrastructure is also key to strengthening fiscal governance by improving accountability and administrative efficiencies, while facilitating better management of public finances. For instance, electronic procurement infrastructure can increase transparency and competition in public contracts, whereas digital human resource systems (payroll and personnel management) have the potential to reduce irregularities in public administration, including the management of the wage bill. Overall, ongoing reforms to strengthen electronic government systems in Southern Africa provide a good foundation for consolidating efficiency gains in fiscal institutions. Nonetheless, it will be critical to address existing variations across countries, for instance in digital infrastructure, technical capacities, and institutional readiness. This calls for continuous investment in digital connectivity, cybersecurity, staff training, and integrated financial and other information systems to maximize benefits from previous and ongoing digital PFM reforms.

2.5 FORMALIZING THE INFORMAL SECTOR

2.5.1. Structural Informality and Relative Positioning in Southern Africa

Informality remains a defining structural feature of Southern African economies, although its scale varies significantly across countries and remains relatively contained compared to the continental average. The contribution of the informal sector to GDP varies widely across the region, from about 60% in Zimbabwe, the highest level not only in the region but across Africa, to around 21% in Mauritius (Figure 2.13). Several countries, including Zambia (about 47%), Angola (44%), and Madagascar (42%), also exhibit high levels of informality, reflecting structural constraints such as limited industrialization, high unemployment, and weak formal sector absorption capacity.

Figure 2.13: Contribution of the informal sector to GDP in Southern Africa, average 2015–2020



Source: Staff calculations using data from Elgin et al. (2021)

A group of Southern African economies stands out for relatively lower levels of informality, indicating stronger formal sector development and institutional capacity. Botswana (around 30%), Namibia (29%), Lesotho (29%), South Africa (27%), and Mauritius (21%) record the lowest informality rates in Africa. This relatively favourable positioning reflects more developed financial systems, higher levels of urbanization, stronger regulatory frameworks, and broader access to formal employment and social protection mechanisms. As a result, Southern Africa as a region performs comparatively well in addressing informality relative to elsewhere on the continent.

2.5.2. Digitalization as a Catalyst for Formalization

Digitalization is emerging as a key lever to accelerate the formalization of economic activity in Southern Africa by reducing compliance costs and improving tax visibility. The expansion of digital tax administration, through e-filing, e-payment systems, and online taxpayer services, has significantly lowered the administrative and transaction burdens associated with entering the formal system. By simplifying registration, declaration, and payment procedures, digital tools make it easier for small and informal businesses to comply with their tax obligations.

Empirical evidence from SSA shows that the digitalization of tax procedures is associated with a measurable decline in the size of the informal sector, with estimates suggesting an average reduction of around 9% in its contribution to GDP (Kogueda Afia et al., 2024). This reflects the ability of digital systems to improve monitoring, reduce opportunities for evasion, and strengthen the link between economic activity and tax collection.

Beyond administrative simplification, digital financial innovations, particularly mobile money, play a transformative role in integrating informal actors into formal economic and fiscal systems. In several Southern African countries, including South Africa and Zambia, tax authorities have introduced the possibility of declaring and paying taxes via mobile platforms, often in partnership with telecom operators. These systems expand access to tax services for firms operating outside traditional banking networks, particularly in rural or underserved areas. More broadly, the experience across Africa suggests that mobile-based tax payments can reduce informality in employment by facilitating compliance, although their impact on informal production remains mixed. Complementary evidence highlights how digital payment ecosystems, such as mobile money in Southern Africa, create transaction records that enhance traceability, thereby gradually integrating informal businesses into the fiscal net (Gwaindepi, 2026).

Digitalization also strengthens enforcement and transparency by improving data availability and enabling more effective monitoring of economic activity. Electronic invoicing, digital registries, and integrated financial management systems allow tax administrations to better track transactions, cross-check information, and detect underreporting. These technologies reduce information asymmetries between taxpayers and authorities, a key driver of informality. They also contribute to reducing corruption and discretionary practices by limiting face-to-face interactions and increasing the transparency of tax processes. In countries such as South Africa, digital reforms have been part of broader efforts to modernize tax administration and enhance compliance, illustrating the potential for technology-driven improvements in fiscal governance.

Nevertheless, digitalization should not be viewed as a substitute for formalization. While digital tools improve traceability, facilitate tax compliance, and generate valuable transaction records, they do not automatically lead to the full formalization of economic activities. Many informal enterprises continue to operate outside regulatory frameworks despite using digital payment systems, particularly where registration costs remain high, regulatory burdens are significant, or the perceived benefits of formalization are limited. In this context, digitalization should be seen as an enabling factor that increases visibility and lowers compliance costs, rather than a standalone solution to informality.

Maximizing the formalization impact of digitalization therefore requires an integrated policy approach combining technology, incentives, and institutional reforms. Expanding digital infrastructure, promoting financial inclusion, and supporting digital literacy are essential to broaden access to digital tax systems. Besides, simplified tax regimes for small businesses, targeted incentives for registration, and stronger enforcement mechanisms can reinforce the incentives to formalize. Ultimately, digitalization offers a powerful but not self-sufficient tool: its effectiveness in reducing informality in Southern Africa depends on its integration into a broader strategy aimed at strengthening state capacity, improving the business environment, and reinforcing the fiscal social contract.

2.5.3. Economic Costs of Informality and the Returns to Formalization

Informality imposes significant macroeconomic and fiscal costs in Southern Africa by simultaneously weakening the four pillars underpinning domestic resource mobilization and

economic transformation: the tax base, financial sector development, productivity, and investment capacity. By operating outside formal regulatory and fiscal systems, informal activities reduce a government's ability to collect taxes, limit the depth and efficiency of financial intermediation, constrain productivity growth, and discourage long-term investment. These effects reinforce one another, creating a self-perpetuating cycle in which weak formalization reduces state capacity and private sector development, thereby limiting the resources available to support structural transformation and inclusive growth.

Beyond fiscal impacts, informality also constrains financial development and productivity growth. Economic activity operating outside formal systems limits the development of financial intermediation, as incomes are not fully captured within banking channels and reliable transaction records are often unavailable. This reduces access to credit, increases borrowing costs, and constrains firm expansion. Evidence shows that higher levels of informality are associated with significantly lower levels of private sector credit and broader financial depth, as well as reduced access to formal financial services (Schneider et al., 2010; Medina and Schneider, 2021). At the firm level, informal enterprises are less likely to access credit, face stricter collateral requirements, and operate at lower productivity levels, reinforcing structural inefficiencies and limiting their contribution to economic growth.

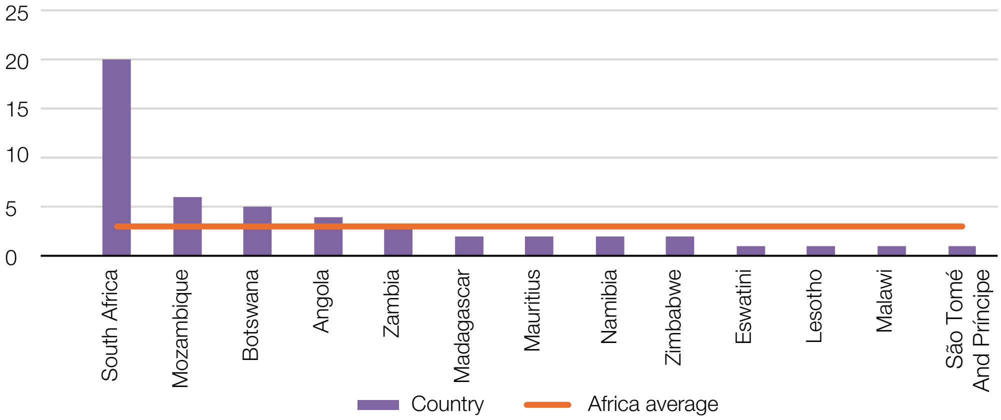
These constraints associated with informality, translate into broader structural challenges, including fragmented labour markets and weaker economic transformation. Informality is typically associated with smaller, less productive firms, limited integration into formal value chains, and reduced incentives for innovation and investment. This fragmentation weakens the effectiveness of macroeconomic policies, reduces the transmission of fiscal and monetary measures, and limits the ability of economies to move toward higher value-added activities. As a result, economies with higher levels of informality tend to experience slower productivity growth and more limited structural transformation over time.

2.6. SCALING UP PUBLIC PRIVATE PARTNERSHIPS

Public-private partnerships (PPPs) are increasingly positioned as a critical instrument to bridge Southern Africa's infrastructure financing gap, yet their scaling remains constrained by structural and institutional bottlenecks. The Southern African region faces a persistent shortfall in public investment capacity, with infrastructure deficits reflecting both fiscal constraints and rising development needs. In this context, PPPs offer a mechanism to mobilize private capital, technical expertise, and operational efficiency in infrastructure delivery. However, evidence from the literature shows that PPPs are not self-scaling mechanisms: their effectiveness depends fundamentally on institutional coherence, regulatory predictability, and the credibility of public counterparts (Sikhosana, 2025). Without these enabling conditions, PPPs risk remaining episodic rather than becoming a systematic financing channel.

The current PPP landscape in Southern Africa is characterized by strong concentration and limited deal flow, underscoring the gap between policy ambition and implementation outcomes. Figure 2.14 illustrates a highly skewed distribution of PPP projects reaching financial closure across countries in 2023-2024, with South Africa, the best performer on the continent, (around 20 projects), followed by a small group of countries such as Botswana and Mozambique, while most countries register only one or two projects. This concentration mirrors broader continental patterns, where a handful of countries account for the majority of PPP activity, reflecting differences in institutional maturity and investment climate (Vallée and Stucchi, 2023). The implication is clear: scaling up PPPs is less about increasing the number of frameworks and more about strengthening the underlying conditions that generate a steady pipeline of bankable projects.

Figure 2.14: Number of PPP projects with financial closure in Southern African countries (2023-2024)



Source: PPI Database

2.6.1 Building credible PPP-enabling frameworks and project preparation ecosystems

A central constraint to scaling PPPs lies in the uneven development of legal and institutional frameworks across the region. While most African countries have adopted PPP legislation, Southern Africa lags in the adoption of specific and robust frameworks, with several countries still lacking dedicated PPP laws or operational units. Even where legal frameworks exist, their effectiveness is often limited by weak enforcement, fragmented governance, and insufficient technical capacity to structure complex contracts (Vallée and Stucchi, 2023). As highlighted in the literature, successful PPP ecosystems, such as those observed in Canada or Germany, rely on standardized procedures, clear risk allocation, and strong institutional oversight, elements that remain unevenly developed in Southern Africa (Sikhosana, 2025). This gap explains why, even where PPP legislation exists, it does not automatically translate into increased project execution or financial closure.

Scaling up PPPs therefore requires a shift from a legalistic approach to a pipeline-driven and institutionally anchored strategy. The evidence suggests that governments must move beyond the mere adoption of PPP frameworks toward building credible project pipelines supported by rigorous project preparation, transparent procurement, and risk-sharing mechanisms aligned with market expectations. Dedicated PPP units strengthened regulatory oversight, and improved coordination across ministries are essential to enhance investor confidence and reduce transaction costs. Regional coordination, particularly through platforms such as the Southern African Development Community (SADC), can help harmonize standards, pool risks, and support cross-border infrastructure projects, thereby increasing scale and attractiveness for investors.

The limited population size of some countries can constrain PPP feasibility by reducing demand volumes, weakening economies of scale, and raising per unit transaction costs, thereby affecting project bankability. In such contexts, small economies may need to pursue cross-border infrastructure initiatives, regional pooling of demand, standardized PPP frameworks, and make targeted use of support to address viability gaps to ensure commercially viable project structures despite their limited domestic market size.

2.6.2 Making marginal projects bankable and connecting them to capital markets

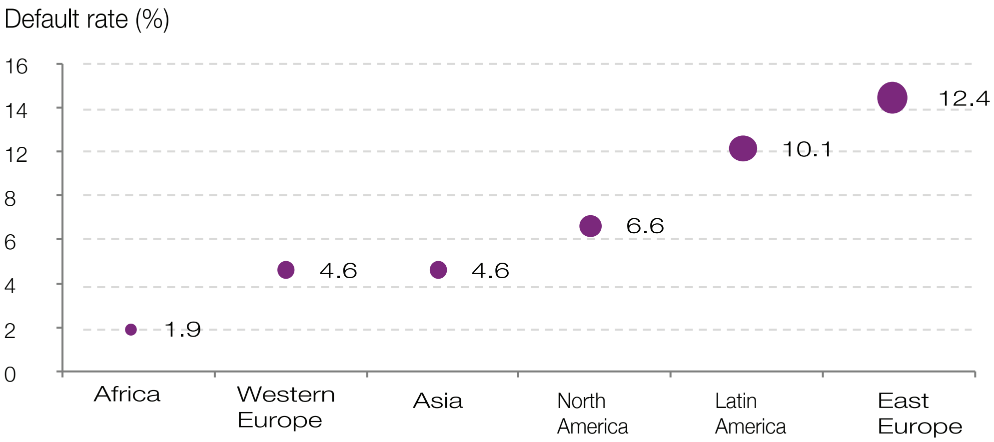
Viability gap support is particularly relevant in Southern Africa because many regional infrastructure projects are economically important but difficult to finance on purely commercial terms. Cross-border power, transport, water, and logistics projects often generate large regional spillovers, but weak cost recovery, affordability constraints, and elevated project risks limit private participation. A Southern Africa PPP agenda therefore needs targeted viability gap mechanisms (capital grants, guarantees, concessional co-financing, or performance-based payments) anchored in competitive procurement and fiscal transparency. This is consistent with the continental logic that viability gap funds should support projects with high economic returns but insufficient financial returns, while avoiding hidden liabilities (AEO, 2026).

Infrastructure asset recycling could help Southern African governments unlock capital from mature public assets while creating a pipeline of investable projects. The region has brownfield assets – ports, toll roads, rail corridors, energy networks, and logistics platforms –that could be concessioned or leased under transparent rules, with proceeds ring-fenced for new infrastructure. This approach is especially relevant where borrowing headroom is limited, because it can mobilize capital without directly increasing public borrowing. For Southern Africa, such mechanisms would require credible asset inventories, independent regulation, clear tariff frameworks, and safeguards to ensure that efficiency gains do not come at the expense of affordability.

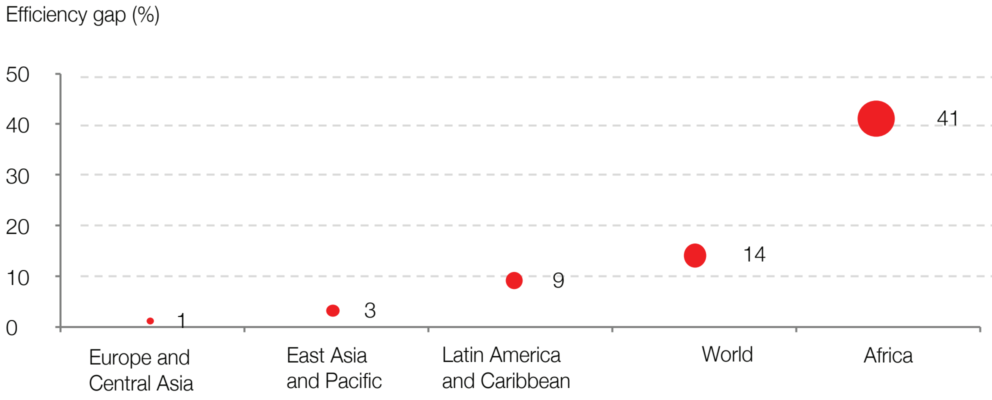
Securitization and capital market instruments can connect Southern Africa's infrastructure assets to its relatively deeper institutional investor base. Botswana, Namibia and South Africa have sizeable pension and insurance sectors, but institutional portfolios remain only partially mobilized for infrastructure. Recent initiatives between the AfDB and the Development Bank of Southern Africa (DBSA) are directly relevant. In 2024, the AfDB, DBSA, and institutional investors signed an agreement to develop a multi-originator synthetic securitization platform aimed at freeing balance sheet capacity and mobilizing investors for infrastructure finance. This fits the widely accepted argument that securitization can transform predictable infrastructure cash flows into tradable instruments, helping commercial banks and Development Finance Institutions (DFIs) to refinance operational assets while offering long-duration products to pension funds and insurers.

Africa's high sovereign borrowing costs coexist with low default rates and persistently high poverty levels (Figure 2.15). Africa's average public investment efficiency score stands at about 59%, implying an efficiency gap of about 41% which means that of $100 spent in public investment, $41 is wasted or does not translate into productive capital. For Southern African countries, closing this gap would be as impactful as significantly increasing infrastructure spending, but without adding to already constrained fiscal burdens. At the same time, Africa's very low infrastructure loan default rate of 1.9%, compared with 12.4% in Eastern Europe and 10.1% in Latin America highlights a disconnect between perceived risk pricing and actual repayment performance. For Southern Africa, this divergence underscores a critical policy lesson that improving public investment efficiency and project quality is likely to yield greater development returns than expanding borrowing, as fiscal space is increasingly constrained and debt

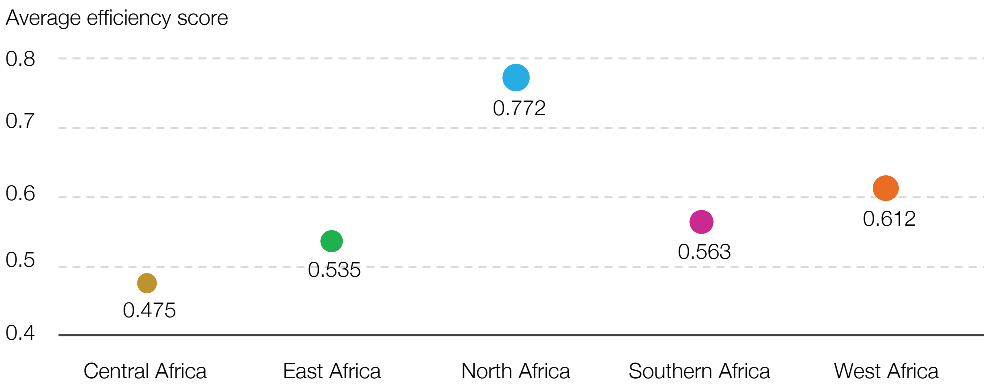
Figure 2.15: Default rates, Efficiency gaps and Credit ratings



Sources: (a) Moody's Analytics, 2020; (b) African Development Bank staff calculations



Sources: (a) Moody's Analytics, 2020; (b) African Development Bank staff calculations



Sources: (a) Moody's Analytics, 2020; (b) African Development Bank staff calculations ; Efficiency gap = 1 - efficiency score

2.6.3 Managing Fiscal Risks and Safeguarding Value for Money

Ensuring that PPPs deliver genuine efficiency gains without undermining fiscal sustainability remains a central challenge for Southern Africa's infrastructure strategy. In the context of tightening fiscal constraints, elevated sovereign risk, and growing debt service burdens, PPP frameworks in the region must carefully balance private sector participation with prudent management of contingent liabilities. Government guarantees, exchange rate protections, minimum revenue clauses, and obligations linked to SOEs can generate substantial long-term fiscal exposure if they are not transparently assessed and integrated into medium-term budget frameworks. At the same time, PPPs should only be pursued where they demonstrably improve project delivery, operational efficiency, or risk allocation, relative to conventional public procurement. This requires rigorous feasibility analysis, transparent and competitive tendering procedures, standardized contract management practices, and stronger institutional oversight capacities. Regional initiatives led by the SADC increasingly emphasize harmonized PPP governance standards and improved project preparation frameworks to strengthen investor confidence while safeguarding public value-for-money objectives.

2.7. MOBILIZING LONG-TERM CAPITAL FROM REGIONAL AND INSTITUTIONAL INVESTORS

The financial landscape of Southern Africa reveals both relatively advanced financial integration and significant structural gaps in the region's capacity to mobilize capital for development. Compared with other African sub-regions, Southern Africa exhibits the highest degree of financial integration, with external assets and liabilities reaching nearly 400% of GDP, far above Central Africa (114%), East Africa (105%), and West Africa (76%). This largely reflects the depth of South Africa's financial markets and the role of Mauritius as a regional financial hub (European Investment Bank, 2022).

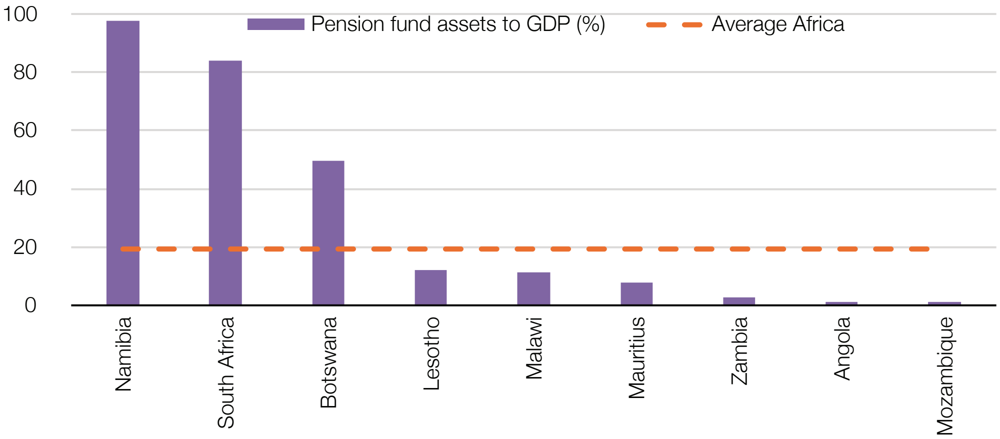
However, this integration is highly concentrated in these two economies, while other countries in the region continue to face shallow capital markets and limited access to long-term finance, restricting the diffusion of financial intermediation across the region. These disparities are reflected in the uneven development of domestic capital markets across Southern Africa. South Africa dominates the region's equity markets, with market capitalization reaching about 246% of GDP in 2024, well above the OECD average of around 154%, while Botswana, Namibia, and Zambia record much lower levels, generally between 15% and 30% of GDP.

The financial landscape of Southern Africa reveals both relatively advanced financial integration and significant structural gaps in the region's capacity to mobilize capital for development. Compared with other African sub-regions, Southern Africa exhibits the highest degree of financial integration, with external assets and liabilities reaching nearly 400% of GDP. However, this integration is highly concentrated in a small number of countries particularly Botswana, Mauritius, Namibia, and South Africa, which account for the bulk of the region's financial assets, institutional investors, and capital market activity. While these countries have developed relatively sophisticated financial ecosystems, many other economies continue to face shallow capital markets and limited access to long-term finance. This uneven distribution constrains the mobilization of regional savings, limits the financing of cross-border infrastructure, and slows progress toward deeper regional economic integration

2.7.1. Pension Funds as Patient Capital: What the Data Implies for Reform

Institutional investors – particularly pension funds – can play an important role in strengthening domestic capital markets in Southern Africa. By mobilizing large pools of long-term savings, these institutions can support the development of domestic capital markets and channel resources toward infrastructure and other productive investments. Their expansion can also strengthen fiscal sustainability by reducing pressure on public borrowing for retirement liabilities, while encouraging labour market formalization through broader participation in pension systems. Through these financial, fiscal, and labour market channels, pension funds can contribute to deeper financial markets and stronger long-term growth (Alonso et al., 2016).

Figure 2.16: Pension fund assets across selected Southern African economies (% of GDP)

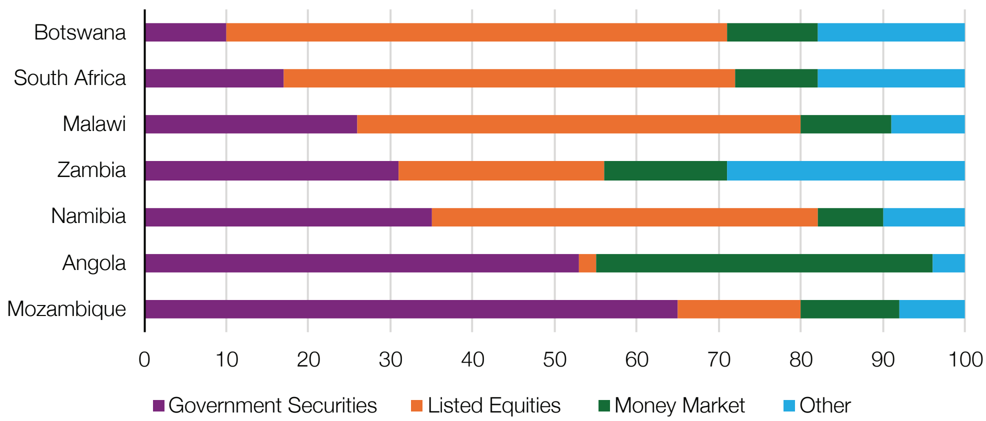


Source: AfDB, African Economic Outlook (AEO), 2026.

The size of pension fund assets in Southern Africa also varies considerably across countries, reflecting different levels of financial development and pension system maturity. Namibia and South Africa exhibit the largest pension sectors in the region, with pension fund assets reaching about 98% and 84% of GDP, respectively, well above the African average of around 19% of GDP (Figure 2.16). Botswana also displays a relatively large pension industry, with assets close to 50% of GDP. By contrast, pension fund assets remain much smaller in other economies, below 15% of GDP. This pattern highlights that, while some countries already possess sizeable pools of long-term capital, others still have limited capacity to mobilize domestic pension savings for investment and financial market development.

However, even where pension assets are relatively large, their contribution to development financing remains constrained by conservative portfolio allocations. As shown in Figure 2.17, pension funds in Southern Africa invest a large share of their portfolios in government securities and money market instruments, reflecting a strong preference for low-risk and liquid assets. This pattern is particularly visible in Angola and Mozambique, where sovereign instruments dominate portfolios, and in Botswana, Malawi, Namibia, and South Africa where substantial holdings of equities complement government debt. By contrast, the category labelled "other" – which includes riskier assets such as corporate securities, real estate, private equity, unlisted equities, and alternative investments – represents only a limited share of portfolios. This allocation structure reduces the capacity of pension funds to channel long-term capital toward infrastructure and productive investment.

Figure 2.17: Pension fund portfolio allocation in selected Southern Africa (% total)



Source: Africa Finance Corporation (2025).

Insurance companies, alongside pension funds, represent another potential source of long-term domestic capital in Southern Africa. However, the development of the insurance sector remains highly uneven across countries. Insurance penetration rates are particularly high in South Africa and Namibia – around 13.4% and 10.4% of GDP respectively – while in most African markets it remains below 2%, highlighting significant disparities in insurance market depth across the region (Signé and Johnson, 2020).

Unlocking the potential of institutional investors and regional capital markets in Southern Africa will require coordinated reforms aimed at expanding the range of long-term investment opportunities and strengthening financial intermediation. Governments can play a key role by deepening domestic capital markets, improving regulatory frameworks for pension and insurance funds, and developing pipelines of bankable infrastructure projects that meet institutional investors' risk-return requirements. Strengthening regional financial integration, through harmonized regulations, cross-listing securities, and regional investment vehicles, would also help pool savings and increase market liquidity. At the same time, policies that promote financial inclusion, expand pension coverage, and support the development of insurance markets can broaden the domestic savings base and enhance the role of institutional investors in financing long-term development.

2.7.2. Leveraging Sovereign Wealth Funds for Development Finance

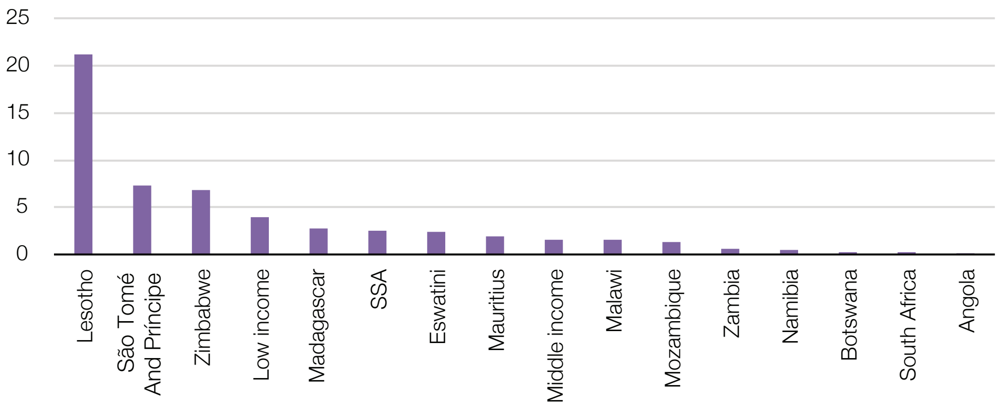
Sovereign wealth funds are emerging as an increasingly important, though still underutilized, instrument for long-term financing in Southern Africa. Across the continent, the number of sovereign wealth funds has expanded rapidly over the past decade, with African funds now managing substantial assets and playing a growing role in domestic investment and fiscal stabilization. In Southern Africa, countries such as Angola, Botswana, and more recently Mozambique and Namibia have established or expanded sovereign wealth funds, often funded by natural resource revenues, with dual objectives of macroeconomic stabilization and intergenerational savings.

For instance, Botswana's long-standing Pula Fund has been used to smooth revenue volatility from diamond exports, while newer initiatives aim to support economic diversification and domestic investment. However, the regional experience also highlights key limitations: many funds remain relatively small, primarily oriented toward stabilization rather than development financing, and often invest a significant share of assets abroad rather than in local economies.

2.8. LEVERAGING DIASPORA CAPITAL

Diaspora remittances represent an important but highly heterogeneous source of external financing across Southern African economies. In a small group of countries, remittances constitute a macroeconomically significant flow. Lesotho stands out as the most remittance-dependent economy in the region (Figure 2.18), with inflows exceeding 20% of GDP. Zimbabwe and São Tomé and Príncipe also record high ratios, where remittances play a substantial stabilization role in supporting household consumption, foreign exchange availability, and external resilience. By contrast, in most other economies including Angola, Botswana, Mozambique, Namibia, South Africa, and Zambia, remittances remain comparatively limited as a share of GDP and therefore play a more marginal macroeconomic role. This divergence highlights a clear duality in the region: in some countries, remittances function as a structural pillar of external financing, while in others they remain largely supplementary.

Figure 2.18: Diaspora remittances in Southern African countries (% of GDP)

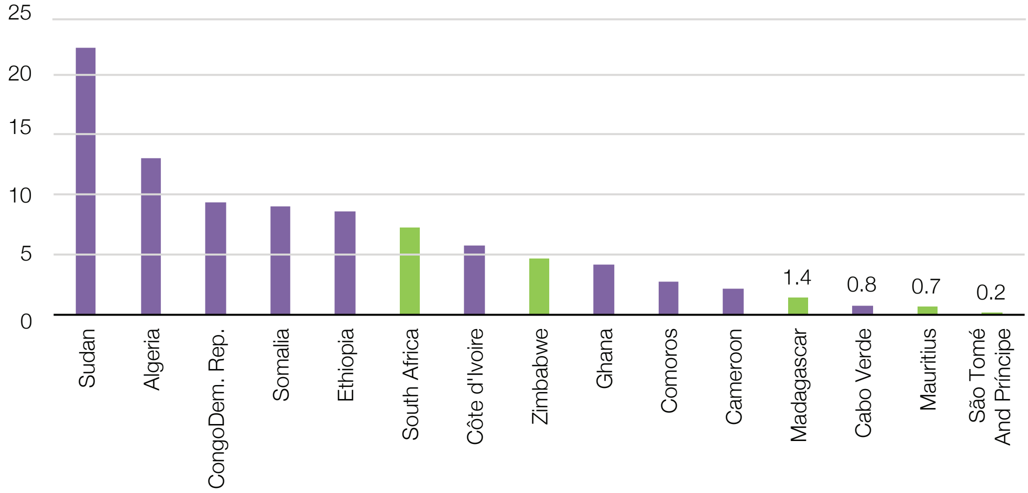


Source: WDI database, World Bank (2024).

Southern African countries are nevertheless disproportionately represented among Africa's economies with significant untapped remittance potential. As shown in Figure 2.19, five of the fifteen countries with the largest estimated untapped potential are located in Southern Africa: Madagascar, Mauritius, São Tomé and Príncipe, South Africa and Zimbabwe accounting for roughly one-third of the group. South Africa alone exhibits the largest estimated untapped annual potential (around US$7.3 billion), followed by Zimbabwe

(US$4.7 billion) and Madagascar (US$1.4 billion). Importantly, the coexistence of high current remittance dependence and large untapped potential in countries such as Zimbabwe and São Tomé and Príncipe suggests that remittance intensity does not necessarily translate into efficient intermediation or full mobilization of diaspora resources for development purposes.

Figure 2.19: Largest untapped remittances potential ($US billion per year) in Africa



Source: AfDB, African Economic Outlook (AEO), 2026

Strengthening institutional frameworks is key to unlocking the development potential of diaspora remittances. Expanding formal transfer channels, reducing transaction costs, and developing instruments such as diaspora bonds or diaspora investment funds can help redirect part of these flows toward productive uses, including entrepreneurship, infrastructure, and financial inclusion. International experience shows that effective diaspora mobilization depends less on the size of migrant communities than on clear and credible policy frameworks. Initiatives such as Nigeria's Nigerians in Diaspora Commission, Kenya's diaspora policy, and Senegal's diaspora investment instruments, alongside emerging efforts in Zimbabwe's diaspora policy and remittance corridor reforms between South Africa and Lesotho, illustrate how dedicated institutions and financial instruments can help channel diaspora savings toward development financing.

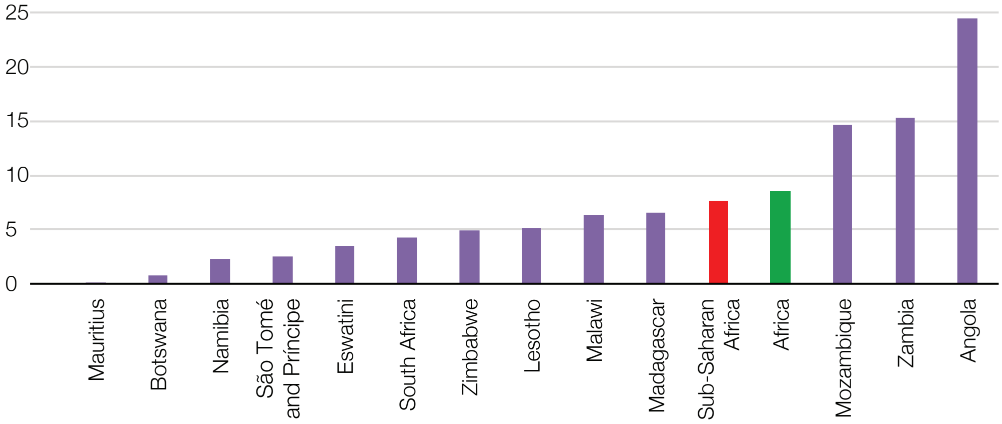
2.9. HARNESSING SOUTHERN AFRICA'S NATURAL RESOURCE ASSETS

Southern Africa's natural capital, especially its renewable energy potential and diverse ecosystems, remains underutilized as a source of development financing. Improved valuation mechanisms, including carbon markets and natural resource accounting, could help unlock additional financing while enhancing resilience to climate and environmental risks in a context of constrained fiscal space.

2.9.1. Moving beyond the extractive model: Scope and distribution of natural resources in Southern Africa

Natural resource dependence remains a defining feature of several Southern African economies, although its intensity varies widely across countries. Natural resource rents range from less than 1 percent of GDP in Mauritius to nearly 25 percent in Angola, revealing high cross-country disparities. Resource dependence is also high in Mozambique and Zambia, where rents exceed 14-15 percent of GDP, while Madagascar, Malawi, Lesotho, and Zimbabwe record more moderate levels between 4 and 7 percent of GDP (Figure 2.20). In contrast, more diversified economies such as South Africa and Mauritius display comparatively lower reliance on resource rents.

Figure 2.20: Natural resource rents (% of GDP) in Southern Africa, SSA and Africa (2015-2021)



Source: WDI database, World Bank

Reducing vulnerability to commodity cycles requires Southern African economies to move beyond development models centered primarily on raw resource extraction. Countries with high dependence on natural resource rents remain significantly exposed to external price volatility and to the structural changes associated with the global energy transition, particularly hydrocarbon exporters such as Angola. Expanding local value addition through downstream processing, mineral transformation industries, and resource-based manufacturing could help retain a larger share of resource wealth domestically while still supporting industrial diversification and employment creation. The experience of Botswana illustrates the potential benefits of leveraging natural resource wealth beyond extraction alone. Through the development of domestic diamond processing and trading activities, combined with relatively prudent management of mineral revenues, Botswana succeeded in transforming diamond resources into broader economic development and public investment. Strengthening linkages between extractive sectors and the wider economy therefore remains essential for improving long-term growth resilience and reducing dependence on commodity exports across the region.

2.9.2 Natural Capital, Economic Performance, and Macroeconomic Sustainability

Integrating natural capital into macroeconomic analysis could significantly improve the assessment of wealth, fiscal sustainability, and long-term productive capacity in Southern Africa. Conventional macroeconomic indicators primarily record the income generated through extraction, trade, and resource conversion, while only weakly reflecting the economic value generated by ecosystem services such as carbon sequestration, watershed protection, biodiversity preservation, and climate resilience. This creates a structural bias in favour of activities that deplete natural assets while undervaluing those that preserve future income-generating capacity. The issue is particularly important in Southern Africa, where forests, river systems, coastal ecosystems, and mineral resources constitute a substantial share of national wealth and support key sectors including agriculture, tourism, mining, fisheries, and hydropower. In countries such as Zambia, Mozambique, and Angola, better integrating natural capital into national accounting frameworks could improve sovereign risk assessments, strengthen debt sustainability analysis, and provide a more comprehensive evaluation of long-term economic resilience. International initiatives led by the World Bank and the United Nations through the System of Environmental-Economic Accounting increasingly encourage countries to incorporate ecosystem assets into macroeconomic statistics and fiscal planning frameworks.

2.9.3 Natural Capital as a Source of Financing

Southern Africa's natural ecosystems could become an increasingly import-

ant source of development financing as global demand for carbon, biodiversity, and nature-based assets expands. The region possesses extensive forests, wetlands, river systems, coastal ecosystems, and biodiversity reserves that generate globally valuable ecosystem services, including carbon sequestration, climate regulation, and marine preservation. Countries such as Zambia, Mozambique, and Madagascar hold substantial potential for carbon credit projects, biodiversity-related financing, and blue economy investment linked to coastal and marine ecosystems. Southern Africa could therefore benefit from the rapid expansion of international markets for high-integrity carbon offsets, biodiversity assets, and nature-based climate solutions. Recent global estimates suggest that Africa could supply a substantial share of worldwide nature-based mitigation potential, particularly through forestry, land restoration, and ecosystem conservation activities. Yet the region continues to capture only a limited portion of global carbon and biodiversity finance because of fragmented project pipelines, high certification costs, and limited integration into international environmental asset markets (Collins et al., 2025).

The monetization of ecosystem services could help diversify Southern Africa's development financing sources while supporting conservation and climate transition investments. Emerging instruments such as carbon credits, blue bonds, biodiversity credits, and ecosystem-linked financial products increasingly transform environmental assets into revenue-generating economic resources. This dynamic is particularly relevant for Southern Africa, where forests, coastal ecosystems, and land restoration projects provide significant opportunities for participation in rapidly expanding environmental asset markets. Sustainable fisheries, marine conservation, reforestation, and biodiversity preservation projects could generate additional external financing flows while strengthening investment in sectors closely linked to natural ecosystems, including tourism, agriculture, and renewable energy.

2.9.4 Governance, Institutions and Macroeconomic Stability

The contribution of natural capital to long-term development in Southern Africa will depend critically on the quality of governance frameworks and their integration into macroeconomic management. Resource-dependent economies in the region remain exposed to commodity price volatility, fiscal instability, and environmental degradation, while weak transparency and limited institutional coordination can reduce the developmental impact of natural resource wealth. Integrating natural capital accounting into budgeting, fiscal planning, and public investment frameworks could improve the management of ecosystem-related revenues and strengthen the consistency between conservation objectives and macroeconomic policies. At the same time, transparent environmental standards, harmonized valuation methodologies, and credible monitoring systems are increasingly important to support participation in carbon and biodiversity markets while improving investor confidence in environmental assets.

2.10. CROWDING IN GLOBAL PRIVATE CAPITAL IN A FRAGMENTED WORLD

Mobilizing private capital in Southern Africa is increasingly influenced by evolving global financial conditions and structural constraints in domestic financial systems. In the context of geopolitical fragmentation, tighter global liquidity, and heightened risk perceptions toward emerging markets, access to international capital has become more selective and volatile. These conditions affect foreign direct investment, portfolio flows, and the availability of long-term project finance. At the same time, stricter regulatory and sustainability standards increasingly shape access to global markets and value chains, requiring credible policy frameworks and stable macroeconomic conditions to attract long-term private investment.
These shifts generate three key implications for Southern Africa. There is upward pressure on the cost of capital, with risk premia increasingly differentiat-

ed across countries based on macroeconomic stability, debt sustainability, and institutional credibility. Capital flows have also become more selective, concentrating on jurisdictions and sectors with predictable policy frameworks, strong governance, and credible risk mitigation instruments. In parallel, investment patterns are shifting toward strategic assets, including transport corridors, critical mineral value chains, and production platforms linked to global supply chain reconfiguration.

2.10.1 Foreign Direct Investment Signals both Southern Africa's Potential and its Fragility

Foreign direct investment dynamics in Southern Africa continue to reflect both renewed investor interest and the region's exposure to concentrated and volatile capital flows. Investment inflows into Southern Africa increased strongly in 2024, supported by large-scale infrastructure, energy, and construction projects (United Nations Conference on Trade and Development, 2025). Countries such as South Africa, Mozambique, and Zambia benefited from rising investor interest linked to mining, renewable energy, logistics, and critical mineral value chains. However, investment inflows remain highly concentrated in a limited number of large projects and extractive activities, making the region vulnerable to commodity price fluctuations, tighter global financial conditions, and shifts in investor sentiment. As a result, headline FDI figures may overstate the strength and stability of the underlying investment pipeline.

These constraints are compounded by the limited depth of domestic financial systems in many Southern African economies. Financial intermediation remains largely bank-dominated, while capital markets and long-term financing instruments are often underdeveloped, limiting the transformation of savings into productive investment. As shown in Table 2.4, credit to the private sector remains low relative to GDP in most countries, reflecting shallow financial markets and limited long-term financing. However, more developed financial systems in countries such as Mauritius and South Africa are an exception, with deeper capital markets and higher levels of credit to the private sector that illustrate the potential role of more diversified financial systems in supporting investment. Mobilizing private capital at scale in Southern Africa will thus require strengthening investment credibility, deeper financial intermediation, and a pipeline of bankable projects.

Table 2.4: Domestic credit to private sector (% GDP) for selected Southern African countries

	2015-2020	2021	2022	2023	2024
Angola	15.6	8.7	6.9	7.6	7.3
Botswana	35.5	34.5	29.9	30.1	32.9
Eswatini	20.9	20.8	21.3	21.3	21.6
Lesotho	20.0	22.3	21.7	24.9	25.6
Madagascar	13.4	17.9	18.6	17.1	16.6
Malawi	7.8	8.2	8.6	7.7	
Mauritius	88.4	85.4	72.4	69.9	69.9
Mozambique	25.8	23.0	20.7	18.5	17.6
São Tomé and Príncipe	26.9	17.7	12.9	7.8	
South Africa	120.5	93.2	91.6	90.4	
High income	**144.5**	**159.6**	**147.9**	**147.9**	**156.0**
Middle income	**103.0**	**117.2**	**124.8**	**130.0**	**134.5**
OECD members	**145.0**	**160.1**	**144.9**	**143.5**	**150.5**

Source: World Development Indicators database, World Bank.

Expanding greenfield investment beyond extractive industries remains critical for strengthening productive diversification and long-term growth resilience in Southern Africa. While large mining and infrastructure projects continue to dominate investment announcements, the developmental impact of FDI depends increasingly on the capacity to attract investments that generate jobs, deepen domestic supplier networks, and support industrial transformation. Greenfield investments in manufacturing, agro-processing, transport services, renewable energy equipment, and regional logistics could help broaden the productive base of Southern African economies while reducing dependence on commodity exports. In the region, growing global demand for critical minerals associated with the energy transition also creates opportunities to move value chains up through local processing and industrial development, rather than relying solely on raw commodity exports. In this context, improving project preparation, infrastructure connectivity, and policy predictability remains essential to convert investment announcements into sustained productive capacity.

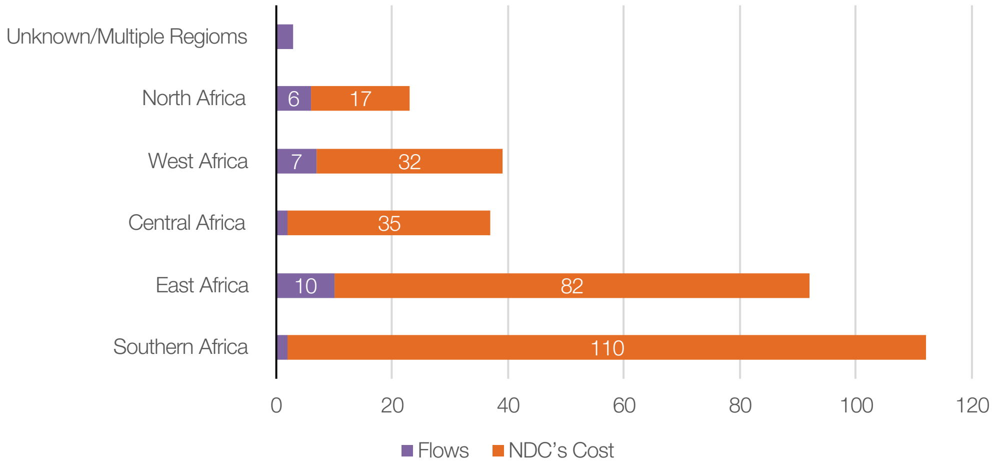
2.10.2 De-risking and Blended Finance: Building Bankable Pipelines

Blended finance and targeted de-risking mechanisms can help reduce the financing constraints that continue to limit private investment in Southern Africa. Many infrastructure, industrial, and productive sector projects remain economically viable over the long term but struggle to attract financing because of elevated borrowing costs, foreign exchange risks, policy uncertainty, and weak project preparation. In this context, blended finance can help narrow the gap between expected project returns and investor risk perceptions by combining concessional resources, guarantees, and risk-sharing instruments with commercial financing. This can improve project bankability, extend financing maturities, and lower the effective cost of capital for strategic investments across sectors such as transport, energy, logistics, manufacturing, and agro-processing.

Building a stronger pipeline of finance-ready projects is equally important for mobilizing larger volumes of private capital in Southern Africa. Stronger project preparation facilities, standardized documentation, and coordinated investment platforms can help reduce transaction costs and transform investment opportunities into investable assets. These mechanisms are also important for attracting long-term institutional investors, including pension funds and insurance companies, by improving risk-adjusted returns and facilitating portfolio diversification beyond traditional bank lending. At the same time, concessional and first-loss instruments should remain targeted and temporary, with clear additionality, to ensure that public resources crowd in rather than displace commercial investment while supporting the development of sustainable domestic capital markets.

Mobilizing Sustainable Finance to Attract Private Investment is Equally Important. Southern Africa faces growing climate vulnerabilities that will require substantial investment in mitigation and adaptation. Although the region accounts for less than 1.5% of global greenhouse gas emissions, it remains highly exposed to the effects of climate change. Increasingly frequent natural disasters have already generated significant human and economic losses across the region, according to the emergency events database (EM-DAT) for 2000-2022. As urbanization, economic activity, and population expand, the exposure of assets and livelihoods to climate-related risks is expected to intensify. Southern Africa's population is projected to grow by more than 60% between 2023 and 2050, increasing demand for energy, infrastructure, and public services. Addressing these needs while reducing vulnerability to climate shocks will require substantial investment in climate mitigation and adaptation, particularly in sectors such as energy, infrastructure, agriculture, and water systems.

Figure 2.21 Climate finance flows and needs in Africa (USD billion, annual average)



Source: Climate Policy Initiative.

Climate investment needs outstrip current financial flows. As illustrated in figure 2.21, Africa's climate investment requirements are estimated at nearly US$276 billion per year by 2030, while existing climate finance represents only a small fraction of this amount. This gap is particularly consequential for Southern Africa, given its high exposure to climate risks and the importance of climate-sensitive sectors such as agriculture, water, and energy. Both public and private climate finance remain well below the levels required to meet countries' nationally determined contributions, highlighting the need to mobilize private capital at scale through blended finance.

2.10.3 External Portfolio Inflows

External portfolio flows in Southern Africa remain highly responsive to changes in political, financial, and macroeconomic risk perceptions. Evidence from South Africa, the largest domestic market in the region, shows that foreign investors rapidly adjust their exposure to domestic equity and bond markets in response to changes in economic conditions, political uncertainty, exchange rate pressures, and sovereign risk perceptions. Episodes of political instability, credit rating downgrades, rising public debt, exchange rate volatility, and electricity shortages have contributed to periods of portfolio outflows and heightened market volatility. At the same time, the region's relatively liquid financial markets and comparatively higher returns continue to attract international investors during periods of improved confidence and favorable global liquidity conditions (Muzindutsi et al., 2025). This dynamic illustrates the strongly cyclical nature of portfolio capital, where external financing conditions can shift rapidly as global investors reassess risk-return trade-offs. Episodes of global monetary tightening or domestic stress are typically associated with abrupt capital outflows, exchange rate depreciation pressures, and heightened volatility in domestic bond and equity markets. Conversely, periods of abundant global liquidity generate rapid inflows, reinforcing the pro-cyclical nature of these flows and amplifying macroeconomic cycles.

The concentration of portfolio investment in a limited number of markets and sectors also increases Southern Africa's exposure to sudden shifts in investor sentiment. In practice, foreign portfolio investment remains heavily concentrated in large and liquid market segments, particularly financial institutions, mining companies, telecommunications, and sovereign bond markets in the region. In South Africa specifically, investors react differently to economic, political, and financial risks, with political and financial instability often exerting the strongest negative impact on foreign portfolio flows. This highlights the importance of macroeconomic stability, credible institutions, predictable regulation, and well-functioning domestic capital markets in sustaining investor confidence. Deepening local currency bond markets, strengthening domestic institutional investors, and improving regional financial integration could help reduce vulnerability to volatile capital reversals while supporting more stable long-term financing conditions across Southern Africa.

2.10.4 Leveraging Fragmentation to Build Strategic Platforms

Global financial fragmentation and the reorganization of supply chains could create new strategic opportunities for Southern Africa to strengthen its role in regional and global production networks. As investors increasingly prioritize supply security, geopolitical alignment, logistical reliability, and regulatory predictability, Southern Africa's abundant critical minerals, transport corridors, energy potential, and relatively developed financial systems position it to attract larger volumes of strategic investment. The growing global demand for minerals, essential to the energy transition, including copper, cobalt, lithium, and platinum-group metals, creates opportunities for Southern Africa to move beyond raw commodity exports toward higher value-added processing and industrial activities. In this context, the quality and integration of investment projects are becoming increasingly important, with investors favouring scalable regional platforms, integrated logistics systems, and predictable cross-border trade frameworks rather than isolated projects.

Regional corridor development could become a central instrument for transforming Southern Africa's fragmented national markets into more integrated investment and production platforms. The region already hosts several strategic transport and logistics corridors connecting inland mining, industrial, and agricultural zones to major ports and export gateways. Corridors such as the North-South Corridor, the Maputo Development Corridor, the Walvis Bay Corridor, and the Beira Corridor increasingly combine investments in railways, ports, roads, border facilities, logistics platforms, and industrial zones to facilitate regional trade and production networks. By improving connectivity between countries such as Angola, Botswana, Mozambique, Namibia, South Africa, Zambia, and Zimbabwe, these corridors can reduce transport and transaction costs while supporting the emergence of regional value chains linked to mining, manufacturing, agro-processing, and energy transition industries. In a fragmented global environment, such integrated corridor systems can strengthen project bankability by creating larger, more predictable trade and investment ecosystems rather than isolated national infrastructure projects.

2.10.5 Strengthening Partnerships to Mobilize Capital, Investment, and Trade

In an increasingly fragmented global environment, Southern Africa will need more diversified and flexible partnership structures to sustain investment, trade, and infrastructure financing. Shifting geopolitical alignments and rising policy uncertainty in advanced economies may increase financing costs and redirect capital toward domestic priorities in partner countries. At the same time, these changes also create opportunities for Southern Africa to broaden its financing relationships across traditional partners, emerging economies, regional institutions, and private investors. The key challenge is therefore not only to attract capital, but to structure partnerships that support domestic industrial development, technology transfer, supplier development, and greater regional value addition.

Co-financing arrangements and regional investment platforms could help Southern Africa mobilize larger volumes of long-term capital, while improving project bankability. Financing structures combining regional DFIs, multilateral lenders, domestic pension funds, export credit agencies, and private investors can help spread risks, reduce borrowing costs, and extend financing maturities for large infrastructure and industrial projects. In parallel, stronger coordination under the SADC and the African Continental Free Trade Area can support more harmonized regulatory frameworks, facilitate cross-border investment, and strengthen the scale and credibility of regional project pipelines. Transparent procurement systems, predictable investment conditions, and effective risk-sharing mechanisms will remain essential to crowd in private capital and improve the long-term developmental impact of external partnerships.

2.11. CONCLUSION AND POLICY RECOMMENDATIONS

The analysis in this chapter shows that Southern Africa's financing constraints arise from the interaction of multiple structural weaknesses, including limited DRM, inefficiencies in public spending, persistent informality, shallow financial systems, and a more restrictive external financing environment. Addressing these challenges requires a coherent and integrated policy agenda focused on strengthening fiscal capacity and PFM systems, reducing resource leakages, improving the efficiency of public spending, mitigating investment risks, expanding access to long-term financing, and leveraging digitalization to progressively formalize economic activity and broaden the tax base.

2.11.1. Strengthening Fiscal Capacity and Reducing Resource Leakages

Policy efforts should prioritize safeguarding fiscal space and strengthening PFM to improve the effectiveness of existing public resources. Immediate actions should focus on strengthening tax administration and improving revenue efficiency rather than increasing statutory tax rates. This includes reducing VAT exemptions, expanding digital tax administration tools, strengthening income tax compliance, and broadening the role of social security contributions, which remain very limited in most countries. At the same time, strengthening PFM systems, particularly in budget execution, expenditure controls, and transparency, is essential to ensure that resources are effectively allocated and utilized. Improving the efficiency of public spending is also critical. Strengthening project appraisal procedures, enhancing procurement oversight, and reinforcing monitoring of SOEs can increase the productivity of public investment without raising debt levels.

Reducing IFFs is also a priority. Strengthening customs valuation procedures, improving coordination between tax and customs administrations, and enhancing enforcement of rules against abusive transfer pricing – particularly in extractive industries – can help protect the tax base. Greater transparency in natural resource management, including clearer licensing processes and disclosure of beneficial ownership, can also help ensure that resource revenues contribute more effectively to development financing.

In parallel, better leveraging remittance inflows offers a high-impact and relatively low-cost policy opportunity. Reducing transaction costs through increased competition, digital payment solutions, and regulatory reforms can immediately raise the net value of transfers. Strengthening financial intermediation and developing diaspora-oriented investment instruments can further help redirect remittances toward productive uses, thereby enhancing their contribution to domestic investment and financial stability.

2.11.2. Mitigating Investment Risks and Expanding Long-Term Financing

Reforms should focus on reducing investment risks and strengthening financial intermediation to mobilize private capital at scale. Enhancing regulatory predictability, strengthening dispute-resolution mechanisms, and clarifying frameworks for PPPs can help reduce investment uncertainty and improve investor confidence. Expanding project preparation capacity and developing transparent pipelines of bankable infrastructure projects are also essential to attract long-term investors.

Mobilizing domestic institutional investors represents another key priority. Gradual regulatory adjustments allowing pension funds and insurance companies to invest a portion of their portfolios in infrastructure, green bonds, and other long-term instruments could significantly expand financing capacity. Risk-mitigation mechanisms through blended finance such as partial guarantees can also help channel long-term savings towards productive investment while maintaining financial stability. At the same time, policies should aim to extend pension participation beyond the formal workforce, notably through digital savings platforms and more accessible retirement products.

2.11.3. Formalizing the Informal Sector through Digitalization

Reducing informality should become a central pillar of Southern Africa's financing strategy. Digitalization offers a scalable pathway to progressively integrate informal firms and workers into formal economic, financial, and fiscal systems. Priority should be given to expanding e-filing, e-payments, e-invoicing, digital business registries, and mobile tax payment systems, while simplifying tax regimes for small businesses to make compliance easier and less costly.

Digital tools should also be linked to broader incentives for formalization. Access to finance, digital transaction histories, social protection, public procurement opportunities, and business development services can encourage informal operators to register and remain within the formal system. This is particularly important because digitalization alone may improve visibility without fully formalizing employment relationships. Sustained progress will therefore require combining technology with institutional reforms, digital literacy, and financial inclusion. By reducing compliance costs, improving traceability, and strengthening trust between citizens and the state, digitalization can help broaden the tax base, deepen financial intermediation, raise productivity, and reinforce the fiscal social contract across Southern Africa.

STRENGTHENING AND CONSOLIDATING SOUTHERN AFRICA'S FINANCIAL SYSTEMS AND AGENCY IN THE CHANGING WORLD

3

Key Messages

- **Unlocking domestic assets for transformation.** The region must move beyond bank primacy to develop its capital markets. Mobilizing long-horizon assets from pension and insurance funds is vital to provide the financing required for the region's structural transformation.
- **Consolidating depth through market integration.** Moving from centralized reliance toward networked regional integration is essential. Linking securities exchanges and harmonizing supervisory standards will create the market size necessary to attract substantial global institutional investment.
- **Reclaiming informational and monetary agency.** Biased global credit ratings systematically inflate borrowing costs across the region. Operationalizing the African Credit Rating Agency and prioritizing local currency debt are critical to end the structural dependency on volatile international capital.
- **Strengthening institutional and regulatory resilience.** Reforming national development banks and exiting global monitoring lists are strategic necessities. Implementing robust governance frameworks and regional supervisory colleges will safeguard stability and enhance the region's collective bargaining power.
- **Leveraging global standing and resource wealth.** South Africa's role in the G20 and BRICS provides a powerful strategic lever for regional advocacy. Capitalizing on vast natural resource wealth will enable member states to overcome structural constraints and secure permanent sovereignty.

3.1 INTRODUCTION

The contrast between emerging global financial realities and the development financing landscape in Southern Africa has reached a critical juncture. While external financial flows including official development assistance and foreign direct investment remain low, the resources required to achieve the African Union's Agenda 2063 have surged significantly. In an era of geopolitical tensions and increasingly inward-looking policies among advanced economies, the region must pivot toward strengthening and leveraging its own domestic financial systems. Achieving this objective requires Southern African nations to prioritize interventions that enhance regional institutional capacity and systems coordination to attract and sustain financing for their unique development needs.

Southern Africa is a region of profound socioeconomic diversity that currently faces deep structural bottlenecks within its financial architecture. The regional landscape encompasses high-income hubs like Botswana and Mauritius alongside fragile and low-income economies, yet the financial system remains primarily bank-led and fragmented. This architecture is characterized by a centralized reliance on South Africa's sophisticated banking and equity markets, creating a systemic vulnerability where economic shifts in the regional core transmit quickly to neighbouring states. Furthermore, the lack of deep capital markets and a heavy dependency on foreign currency debt systematically constrain fiscal space, preventing the region from mobilizing capital at the scale and cost required for its structural transformation.

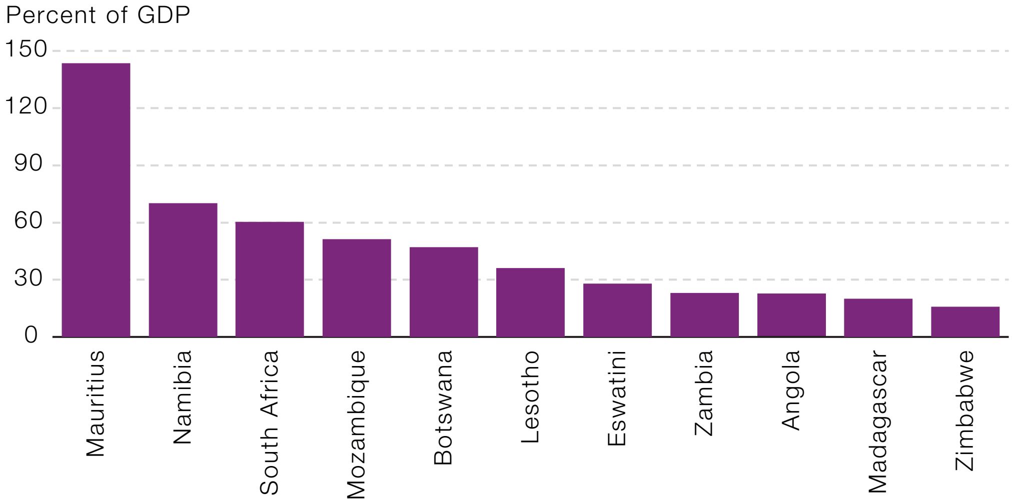
This report utilizes a strategic framework focused on strengthening and consolidating regional financial systems to enhance Southern Africa's collective financial agency. Financial agency alludes to the capacity of the region's nations to exert meaningful influence over the size, structure, and cost of their financing needs. By identifying key structural and policy bottlenecks, such as the sovereign bank nexus and market shallowness, the analysis maps a path toward building a deep and efficient financial ecosystem. The ultimate objective is to unify fragmented institutions into an agile, integrated network capable of mobilizing domestic savings and institutional assets. Strengthening these homegrown gatekeepers is an essential prerequisite for Southern Africa to transition from being a rule-taker to a rule-maker, securing the financial sovereignty needed to fund its own sustainable development.

3.2 STRENGTHENING SOUTHERN AFRICA'S FINANCIAL SYSTEM: ADDRESSING BOTTLENECKS AND EXPANDING REACH AND IMPACT

3.2.1 Current State of the Southern African Financial System

Southern Africa's banking sector possesses substantial financial assets, yet their distribution and impact on regional development remains deeply uneven. As illustrated in Figure 3.1, bank deposits as a percentage of GDP in 2021 reached 143.5% in Mauritius and 70.1% in Namibia, reflecting significant institutional depth. In contrast, several economies continue to face challenges in deposit mobilization, with ratios as low as 15.9% in Zimbabwe and 20.1% in Madagascar. Despite these large pools of liquidity in certain hubs, the regional financial system is often unable to provide the long-term capital required for structural transformation. Much of the bank lending remains concentrated in short-term and low-risk asset classes, illustrating a failure to effectively intermediate domestic resources into productive investment.

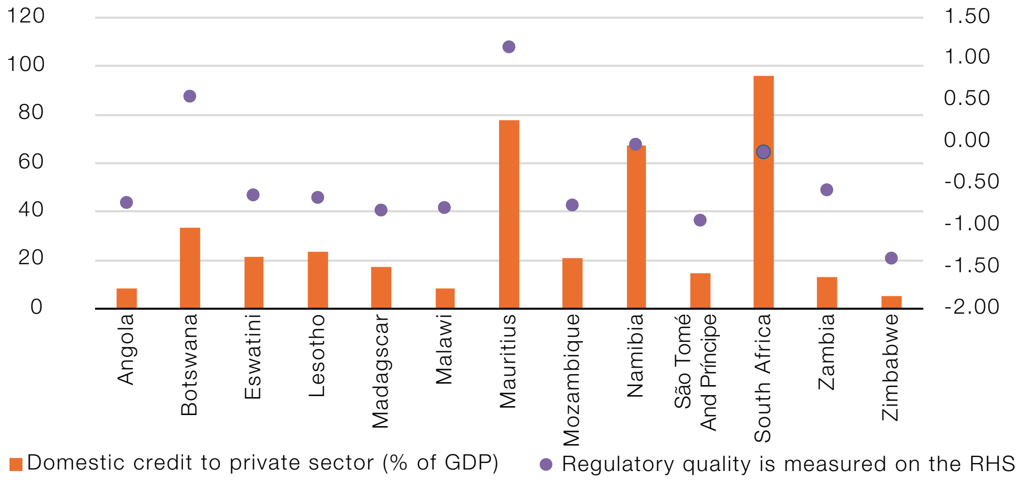
Figure 3.1: Bank deposits as percent of GDP, 2021



Source: World Bank Global Financial Development Database.

The strength of the regulatory environment is a primary determinant of the depth of private sector credit across the region, with higher regulatory quality reflecting stronger contract enforcement, more effective collateral recovery mechanisms, and greater predictability in dispute resolution, all of which reduce perceived lending risk and support deeper financial intermediation. Data in Figure 3.2 demonstrates that economies with higher regulatory quality tend to exhibit much deeper credit markets. Mauritius and South Africa, with regulatory scores of 1.14 and -0.12 respectively, enjoy domestic credit to the private sector at 77.62% and 96.05% of GDP. Botswana, despite a relatively strong regulatory score, records comparatively lower credit to the private sector, highlighting that sound institutions alone are not sufficient where the domestic investment opportunity set is narrow, the economy is resource concentrated, and banks tend to channel liquidity toward low-risk sovereign assets rather than private enterprise. By contrast, countries facing institutional weaknesses and political uncertainty, such as Zimbabwe (-1.40) and Angola (-0.72), see credit supply constrained to single digits. Weak collateral enforcement and slow judicial processes in these jurisdictions increase credit risk, encouraging banks to adopt conservative lending practices and prioritize high-yield government securities over private enterprise, thereby limiting private sector access to finance and constraining investment.

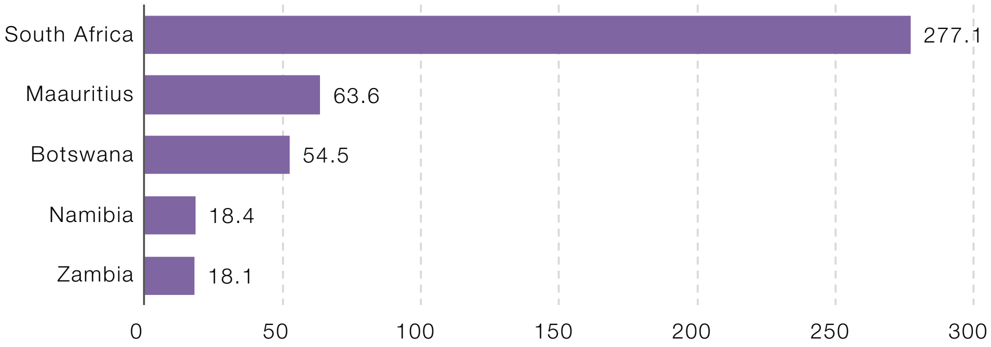
Figure 3.2: **Regulatory quality and domestic credit to the private sector, 2020–2024 (average)**



Source: African Development Bank staff computation based on World Development Indicators
Note: Regulatory quality is measured on the RHS

Capital markets in Southern Africa are characterized by high geographic concentration and significant shallowness outside of the regional hub. While the Johannesburg Stock Exchange is one of the most sophisticated markets globally with a market capitalization of 277.1% of GDP, other regional exchanges remain nascent. As shown in Figure 3.3, market capitalization-to-GDP ratios are as low as 18.1% in Zambia and 18.4% in Namibia. These shallow markets are highly sensitive to external shocks and macroeconomic instability. For instance, extreme inflation volatility, such as the 667% rate observed in Zimbabwe in 2023, undermines long-term contracting and distorts asset valuations, discouraging both domestic and foreign institutional investors from participating in the regional financial architecture.

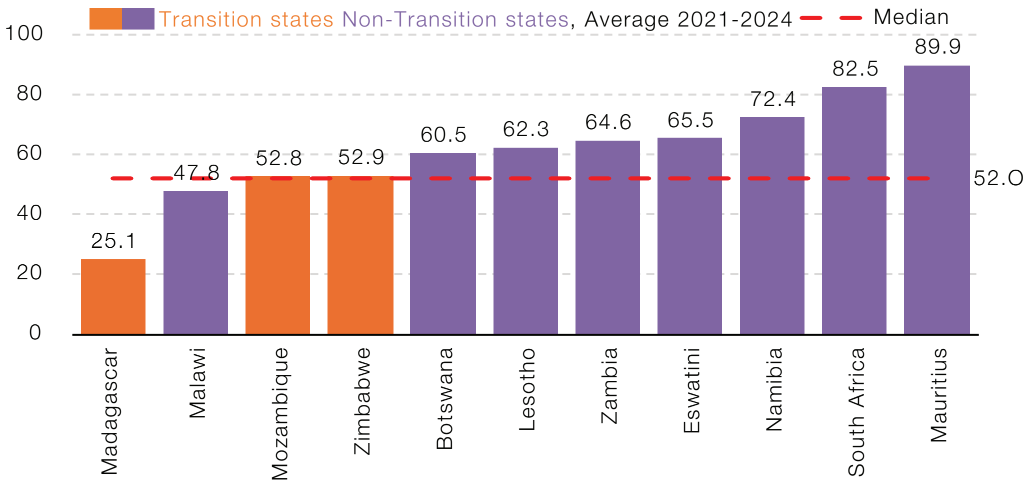
Figure 3.3: Stock market capitalization (percent of GDP), 2020–24 (average)



Source: African Development Bank staff computation based on Source: World Bank WDI (2025).Development Indicators

Progress in financial inclusion remains defined by a stark divergence between stable economies and those facing situations of fragility. Figure 3.4 indicates that non-transition states like Mauritius (89.9%) and South Africa (82.5%) have achieved high levels of account ownership, yet inclusion drops significantly in transition states like Madagascar (25.1%). This limited inclusion deprives financial institutions of a diversified demand base and stable domestic deposits. Fragility, marked by weak governance and limited administrative capacity, acts as a primary barrier to deep financial intermediation. Reclaiming financial agency requires the region to bridge these inequality gaps by addressing the structural bottlenecks that keep nearly half of the adult population outside the formal system.

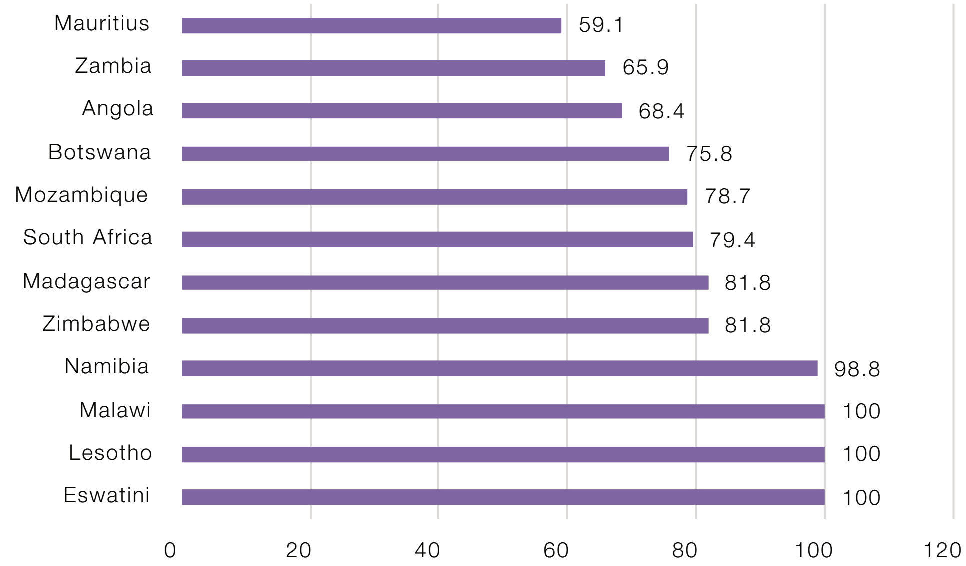
Figure 3.4: State fragility and financial inclusion in Southern Africa, 2021-2024 (average)



Source: African Development Bank staff computation using WDI data
Note: Financial inclusion is measured as the percent of the population ages 15+ owning an account at a financial institution or with a mobile-money-service provider..

Market concentration and poor asset quality further elevate the cost of capital and restrict credit flow to the productive sectors. Figure 3.5 reveals that banking concentration is exceptionally high, with the top three banks controlling almost all assets in Lesotho and 98.8% in Namibia. In Lesotho, the fact that the top three banks account for essentially the entire banking system reflects an extremely oligopolistic market structure, where a very small number of institutions dominate financial intermediation. Similarly, in Namibia, the near-total share of assets held by the largest banks indicates that market power is heavily concentrated, even if additional smaller institutions exist. This oligopolistic structure limits competition and innovation, often resulting in elevated lending margins.

Figure 3.5: Banking asset concentration (asset share of top 3 banks), 2021 or latest



Source: World Bank, Global Financial Development Database (GFDD)

Furthermore, while most nations maintain non-performing loan ratios near the 5% threshold, outliers like Angola (14.1%) and Mozambique (9.2%) face persistent credit risks. These risks, combined with high overhead costs and fiscal dominance, result in wide interest rate spreads, creating a massive finance gap for small business that reaches 49% of GDP in Eswatini (Table 3.1), thereby hindering the region's overall transformation.

Table 3.1: The micro, small and medium-sized enterprise (MSME) financing gap (2024)

	MSME Unconstrained (% of total)	MSME Constrained (% of total)	MSME Finance Gap (% of GDP)
Eswatini	52	48	49
Botswana	75	25	31
Zimbabwe	30	70	26
Madagascar	57	43	24
Mauritius	84	16	23
South Africa	88	12	14
Mozambique	49	51	14
Namibia	70	30	12
Angola	52	48	11
Malawi	34	66	8
Lesotho	67	33	7
Zambia	42	58	3

Source: SME Finance Forum.
Note: "Unconstrained" means financially unconstrained MSMEs; and "Constrained" refers to financially constrained MSMEs

3.2.2 Broadening the catchment area: Expanding the financial sector's reach and impact

Well-governed Southern African national development banks are critical for closing the credit gap in underserved sectors. As detailed in Table 3.2, the region possesses a diverse network of 29 specialized institutions, including the Development Bank of Southern Africa (DBSA) and the Industrial Development Corporation (IDC). These entities are primary vehicles for "institutional agency," capable of bridging the financing gaps left by commercial banks in areas such as SME support and infrastructure. The DBSA serves as a regional benchmark, having successfully transitioned toward a wholesale financing model that leverages public capital to attract external institutional partners. By March 2025, the DBSA provided US$5.6 billion in total infrastructure support, of which US$1.4 billion was catalysed from private partners. Strengthening the governance of these banks is essential to ensure they move from reliance on government budgets toward market-based funding that supports structural transformation.

Table 3.2: Public development banks (PDBs) and DFIs in Southern Africa (2024)

Country	PDB & DFI Name	Level of Ownership	Official
Angola	Development Bank of Angola	NATIONAL	FLEX
Botswana	Botswana Development Corporation	NATIONAL	MSME
	Citizen Entrepreneurial Development Agency	NATIONAL	MSME
	National Development Bank	NATIONAL	FLEX
Eswatini	Eswatini Development Finance Corporation	NATIONAL	MSME
	Eswatini National Industrial Development Company	NATIONAL	MSME
	The Industrial Development Company of Eswatini	NATIONAL	MSME
Lesotho	Lesotho National Development Corporation	NATIONAL	FLEX
Malawi	Export Development Fund	NATIONAL	EXIM
Mauritius	Development Bank of Mauritius	NATIONAL	MSME
Namibia	Development Bank of Namibia	NATIONAL	FLEX
	Agricultural Bank of Namibia	NATIONAL	AGRI
	Environmental Investment Fund of Namibia	NATIONAL	FLEX
South Africa	Industrial Development Corporation	NATIONAL	FLEX
	Development Bank of Southern Africa	NATIONAL	FLEX
	Land and Agricultural Development Bank of South Africa	NATIONAL	AGRI
	Small Enterprise Finance Agency	NATIONAL	MSME
	Ithala Development Finance Corporation	SUBNATIONAL	MSME
	National Housing Finance Corporation	NATIONAL	HOUS
	National Empowerment Fund	NATIONAL	FLEX
Zambia	Zambian Investment Holding	NATIONAL	INFRA
	Industrial Development Corporation Zambia	NATIONAL	FLEX
	Citizen Empowerment Commission	NATIONAL	FLEX
	Development Bank of Zambia	NATIONAL	FLEX
Zimbabwe	Agricultural Bank of Zimbabwe	NATIONAL	AGRI
	Industrial Development Corporation of Zimbabwe Limited.	NATIONAL	INFRA
	Infrastructure Development Bank of Zimbabwe	NATIONAL	INFRA
	Small & Medium Enterprises Development Corporation	NATIONAL	MSME
	Zimbabwe Women's Microfinance Bank	NATIONAL	MSME

Source: INSE, Peking University, PDBs & DFIs Database, 2025.
\Note: official mandate: FLEX: general development; AGRI: rural and agricultural development; LOCAL: local government; MSME: micro, small and medium-sized enterprises.

Unleashing Southern Africa's institutional assets in pension and sovereign wealth funds can provide the patient capital needed for long-term growth. Regional assets under management are significant, with nations like South Africa, Namibia, and Botswana maintaining some of the continent's largest pools of domestic capital (see Box 3.1). If regional authorities strategically reorient even 5% of these assets toward infrastructure and the private sector, it will mobilize billions in long-term capital, sufficient to lengthen yield curves and improve price discovery. Recent reforms have introduced greater operational autonomy and professional boards for these funds, yet a shift from conservative "buy-and-hold" practices toward structured domestic intermediation remains necessary. Rebalancing these portfolios will allow the region to fund high-impact projects while protecting the long-term returns required for retirees.

Box 3.1: Institutional design and outcomes in selected Southern African countries

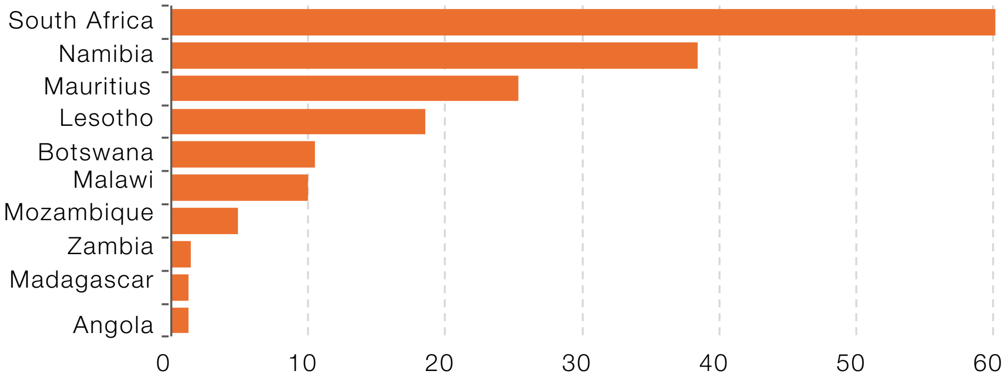
The Development Bank of Southern Africa (DBSA) demonstrates the strategic advantage of transitioning toward a wholesale financing model to leverage private capital. Given its robust global credit standing, the DBSA has successfully pivoted from direct lending to acting as a primary orchestrator of infrastructure finance. By March 2025, the bank provided a total of US$5.6 billion in infrastructure support, of which US$1.4 billion was directly catalysed from external private and institutional partners (DBSA, 2024). This approach allows the DBSA to leverage every unit of public capital into multiple units of external financing, effectively maximizing the region's fiscal space. At the subnational level, the bank's specialized municipal portfolio accounts for 28% of its total credit exposure, successfully unlocking US$159.2 million for under-resourced local governments, thereby strengthening the regional financial architecture from the ground up.
The Industrial Development Corporation (IDC) serves as a benchmark for financial re-engineering to support structural transformation and the green energy transition. As a primary driver of industrialization, the IDC has implemented innovative funding structures to de-risk high-impact sectors such as green hydrogen and value-added mining. By utilizing its substantial balance sheet to provide subordinated debt and equity for "first-mover" projects, the IDC ensures that Southern African enterprises can compete in the global shift toward decarbonization. This strategy has resulted in a resilient credit profile, with a positive outlook (BB+) rating from S&P Global Ratings, proving that national development banks can maintain financial sustainability while fulfilling complex developmental mandates (OECD, 2025).

Strengthening the collective power of Southern African DFIs through the SADC DFI Network is essential to transform isolated national pools of capital into a unified regional engine. Currently, the region's effectiveness is often limited by institutional silos. By coordinating through the SADC DFI resource centre, national institutions are increasingly standardizing their risk management frameworks and project preparation templates. This regional synergy is vital for the development of "Sovereign Plus" projects—long-term infrastructure that serves multiple nations but requires the combined technical and financial weight of several DFIs to reach bankability. This collaborative model reduces the region's dependency on volatile external flows and secures long-term economic sovereignty by recycling SADC's domestic savings within the region.

Bridging the gap between regional hubs and underserved frontiers through a coordinated DFI network is the cornerstone of Southern Africa's financial stability. These high-performing institutions prove that when DFIs embrace wholesale orchestration and market-based discipline, they can effectively insulate regional development from the volatility of global interest rate cycles. By extending the technical depth of the DBSA and IDC into the SADC's more fragile markets, the region ensures that financial agency is not restricted to the core but encompasses the productive capacity of the entire population. Strengthening this networked stability model provides the necessary foundation for Southern Africa to attract global institutional capital on terms that reflect its vast resource wealth and institutional maturity.

Leveraging the potential of the regional insurance industry is essential for deepening financial markets and maturity transformation. As illustrated in Figure 3.6, the depth of the insurance market in Southern Africa is the highest on the continent, with South Africa (60.1%) and Namibia (38.4%) serving as dominant benchmarks. This stands in sharp contrast to other regional economies like Angola and Madagascar, where insurance assets represent only 1.3% of GDP. Expanding and integrating these fragmented markets can strengthen insurers' balance sheets and enhance the mobilization of long-term savings. By translating premium inflows into bonds and equities, the insurance sector can provide the stable capital needed to support productivity-enhancing risk-taking, provided that robust risk management frameworks are in place to ensure solvency.

Figure 3.6: Insurance company assets, percent of GDP (2020 or latest)



Source: Swiss Re Institute (2026).

Southern African central banks play a vital role in safeguarding macro-financial stability while enabling inclusive financial penetration. Central banks in the region have taken the lead in establishing interoperable payment platforms and introducing regulatory sandboxes to test fintech innovations under controlled conditions. These instruments are vital for balancing inclusion objectives with prudential safeguards, ensuring that digital growth is accompanied by consumer protection. Furthermore, the scale of central bank assets in the region determines the available policy space for market stabilization. Larger asset positions, such as those held by the South African Reserve Bank, enhance the ability to provide liquidity support and credibly enforce supervisory standards, reducing the reliance on external anchors during periods of stress.

Expanding Shariah-compliant instruments offers Southern Africa a strategic pathway to diversify its developmental funding sources. While Islamic finance remains concentrated in a few markets, several regional nations have begun introducing legislation and supervisory guidelines to operationalize this segment. Expanding the availability of Shariah-compliant savings, credit, and microfinance products can bring households and SMEs that avoid interest-based finance into the formal system. This shift widens the regional deposit base and promotes financial inclusion. Additionally, the asset-backed nature of Islamic finance makes it well-suited for mobilizing long-term capital for major development projects, including those targeted at infrastructure and climate action.

Scaling climate finance through innovative mechanisms is a strategic necessity for Southern Africa's green energy transition. Current climate finance flows meet only about 23% of the estimated annual funding required for regional goals, highlighting a significant investment gap. The development of climate-related asset classes, such as green and social bonds, allows the region to de-risk projects traditionally perceived as too high-risk for private capital. Regional leaders like South Africa and Mauritius have already made progress, with the region mobilizing a cumulative US$5,175 million through green bond issuances. Strengthening national green-bond guidelines and monitoring frameworks will further signal viable investment opportunities to global Environmental, Social, and Governance (ESG) and impact investors, helping to close the financing deficit.

Southern Africa's rapid urbanization presents a major opportunity to utilize real estate as a catalyst for market deepening. With regional cities expanding at double the global average rate, the demand for housing and modern infrastructure is generating property yields of 8–12%, which exceed those in many developed markets. By transforming illiquid land and unregistered property into bankable collateral, the region can expand access to finance for households and SMEs. Success in this sector depends on the digitalization of land registries and the creation of real estate-backed financial products, such as real estate investment trusts. These instruments allow long-term institutional investors to match their liability structures with long-duration assets, funding urban development while deepening local debt markets.

Lessons from international private capital markets can help Southern Africa build transparency and credibility in domestic financial systems. Accessing global markets provides the region with benchmarks on pricing and market discipline. While the region's reliance on foreign-currency debt, notably Eurobonds, has exposed structural vulnerabilities to global shocks, it has also provided critical funding for development. Market access resumed in 2024–2025 for issuers like South Africa and Angola, yet borrowing costs remain high. The key is to use international lessons to improve market infrastructure, including credit rating systems and legal enforcement. Recalibrating the role of international capital to complement rather than substitute for domestic markets is essential for maintaining sustainable financing and long-term economic sovereignty.

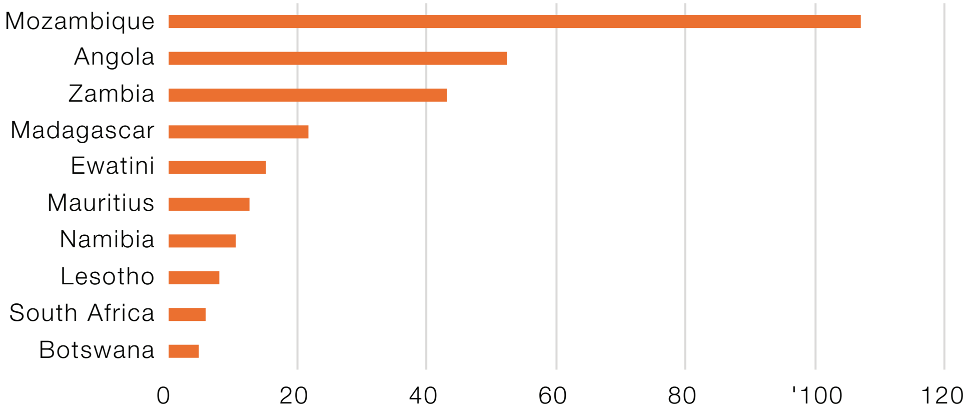
3.3 CONSOLIDATING SOUTHERN AFRICA'S FINANCIAL SYSTEM: THE CASE FOR A COHESIVE AND INTEGRATED FINANCIAL ARCHITECTURE

3.3.1 Southern Africa's Financial System Integration

Regional equity markets in Southern Africa remain dispersed and fragmented, with activity heavily concentrated in a single dominant hub. The Johannesburg Stock Exchange accounts for approximately 60% of regional market capitalization. Despite initiatives such as the African Exchanges Linkage Project (AELP), integration remains limited, leaving exchanges in Botswana, Namibia, and Zambia relatively shallow and only weakly connected to regional liquidity pools. This fragmentation constrains market depth, weakens price discovery, and increases transaction costs. Greater consolidation would yield significant efficiency gains, including deeper liquidity through pooled capital, improved risk-sharing via broader investor diversification, lower transaction costs, and enhanced price discovery, thereby strengthening the region's attractiveness to long-term institutional investors. However, progress toward integration remains constrained by regulatory heterogeneity, uneven institutional capacity, and political economy considerations associated with South Africa's dominant position in regional financial markets, which collectively continue to impede the development of a fully integrated capital market.

Disparities in bank liquidity-to-asset ratios underscore the structural fragmentation of the regional banking architecture. As detailed in figure 3.7, there are sharp differences in banks' liquidity positions across the region, reflecting varying market sizes and regulatory impediments. While hubs like Botswana (4.8%) and South Africa (5.8%) maintain highly efficient liquidity ratios, indicative of deep credit intermediation, others exhibit extreme levels of surplus liquidity. Mozambique, for instance, shows a ratio of 107.0%, while Angola stands at 52.4%. These high ratios are often symptomatic of a risky operating environment where macroeconomic volatility incentivizes banks to adopt precautionary hoarding behaviour rather than expanding cross-border lending. Although regional banking consolidation could improve liquidity allocation, lower country risk premia, and expand cross-border credit to support regional value chains, progress remains constrained by divergent supervisory regimes, uneven regulatory capacity, and ring-fenced national banking systems shaped by sovereignty concerns. Pan-African banks headquartered in South Africa partially mitigate fragmentation by providing cross-border lending, trade finance, and payments services, yet their dominance also reinforces asymmetric integration and reliance on external decision centres. Similarly, fragmented payment and monetary systems continue to raise transaction costs and limit financial integration, as a significant share of intra-regional transactions is still routed through extra-regional correspondent banking networks despite emerging initiatives such as the Pan-African Payment and Settlement System (PAPSS). While deeper integration would enhance efficiency through lower transaction costs, faster settlement, and improved competitiveness, it remains constrained by differences in monetary frameworks, exchange rate regimes, and limited interoperability of digital financial infrastructure.

Figure 3.7: Ratio of bank liquidity to bank assets (%), 2024



Pan-African banking groups headquartered in South Africa act as a strategic bridge for financial integration across the region. The steady penetration of groups such as Standard Bank, the United Bank of Africa, and the ABSA Group is contributing to improved competition and financial inclusion. These institutions combine large balance sheets with managerial expertise and extensive cross-border networks to expand trade finance and credit to the private sector. By leveraging their regional footprint, these pan-African banks help to reduce the reliance on fragmented and externally intermediated financing channels, effectively strengthening regional financial intermediation and value chain development.

Fragmented cross-border payment and monetary systems continue to impede financial transactions and trade within Southern Africa. Despite the potential of the Pan-African Payment and Settlement System (PAPSS), the regional architecture is still hindered by a multiplicity of currencies and regulatory frameworks. Nearly half of intra-regional payments are currently routed through correspondent banks outside the continent using foreign anchor currencies. This fragmentation results in high transaction costs and counterparty risks, underscoring the need for a coordinated and interoperable regional payment infrastructure to redirect capital toward the private sector and improve market access.

3.3.2 Policy Pathways to Consolidate Southern Africa's Financial System

Establishing a coordinated and interoperable Southern African financial architecture is essential for facilitating efficient regional liquidity circulation. Consolidating the regional financial system requires an integrated framework that aligns national infrastructures with cross-border platforms to facilitate greater collaboration. At the core of this effort is the need to develop interoperable payment and settlement systems, such as the SADC Integrated Regional Electronic Settlement System and the Pan-African Payment and Settlement System (PAPSS), facilitate seamless cross-border transactions. By reducing current fragmentation, the thirteen Southern African nations can generate scale economies, improve cross-border risk oversight, and ensure that domestic resources are effectively funnelled into productive regional investments.

Harmonizing banking supervision and prudential standards across the region will reduce regulatory arbitrage and enhance cross-border stability. Achieving an integrated financial system requires the gradual convergence of regulatory frameworks governing capital adequacy, liquidity management, and crisis response. Existing sub-regional arrangements provide institutional laboratories for this coordination, yet regional alignment is necessary to establish a functional "regional banking passport." Implementing structured information-sharing platforms and supervisory colleges, particularly for South African-headquartered groups will improve risk transparency and reduce compliance friction, allowing regional banks to expand their footprints with greater safety and confidence.

Leveraging established sub-regional monetary unions, such as the Common Monetary Area, provides a pragmatic laboratory for broader regional integration. These platforms already embody advanced forms of financial coordination, including shared central banking frameworks and harmonized prudential regulations. Utilizing these established systems as transitional anchors would allow the region to build on tested institutional arrangements rather than purely aspirational frameworks. A forward-looking strategy involves establishing cross-regional equivalence frameworks that harmonize core standards while respecting the diverse institutional identities of member states, ultimately translating regional progress into continent-wide compatibility.

Consolidating regional stock markets and risk assessment frameworks is a prerequisite for attracting large-scale global institutional investment. Rather than pursuing immediate wholesale mergers, the region should adopt a layered integration model that harmonizes listing standards, disclosure rules, and investor protection frameworks. Initiatives like the African Exchanges Linkage Project (AELP) are vital for concentrating liquidity and improving price discovery across Southern African bourses. Simultaneously, the operationalization of the African Credit Rating Agency (AfCRA) offers an opportunity to diversify analytical perspectives and reduce the informational asymmetries that currently lead to the subjective mispricing of regional risk.

Building a robust regional financial safety net is critical to protect Southern African sovereigns from balance of payments crises and global volatility. Consolidating the financial system requires a mechanism capable of absorbing shocks arising from tightening global financial conditions. Strengthening regional financing and stability arrangements, in coordination with the proposed African Financing Stability Mechanism, offers an essential layer of protection. These pools of shared resources provide an efficient and cost-effective way for countries to insure against crises without the heavy conditionality often attached to external anchors, thereby embedding crisis response capacity within the region's evolving financial framework.

Creating a functionally coordinated ecosystem between regional development financial institutions will optimize capital allocation for high-impact projects. Regional integration must move beyond institutional coexistence toward a subsidiarity-based architecture where multilateral development banks, such as the AfDB, channel lending through national and regional DFIs. Under this model, national institutions originate and structure projects close to the ground, while regional entities provide risk-sharing and technical oversight. Properly sequenced, this layered architecture would transform fragmented financial ecosystems into a unified engine capable of recycling regional savings within Southern Africa.

Strengthening sovereign risk governance across Southern Africa is vital for mitigating macro-financial pressures and enhancing market credibility. Consolidating the financial system requires better coordination of existing public debt management frameworks, monetary authorities, and fiscal oversight institutions. Institutional reforms aimed at improving debt transparency and fiscal-monetary alignment will help integrate financial governance into a more coherent system that supports cross-border financial activity. By stabilizing sovereign balance sheets and improving debt composition, the region can enhance the reliability of its financial instruments and support a more predictable environment for long-term investment and intermediation.

3.4 TOWARDS FINANCIAL AGENCY AND SOVEREIGNTY

3.4.1 Imperatives of Southern Africa's Financial Agency

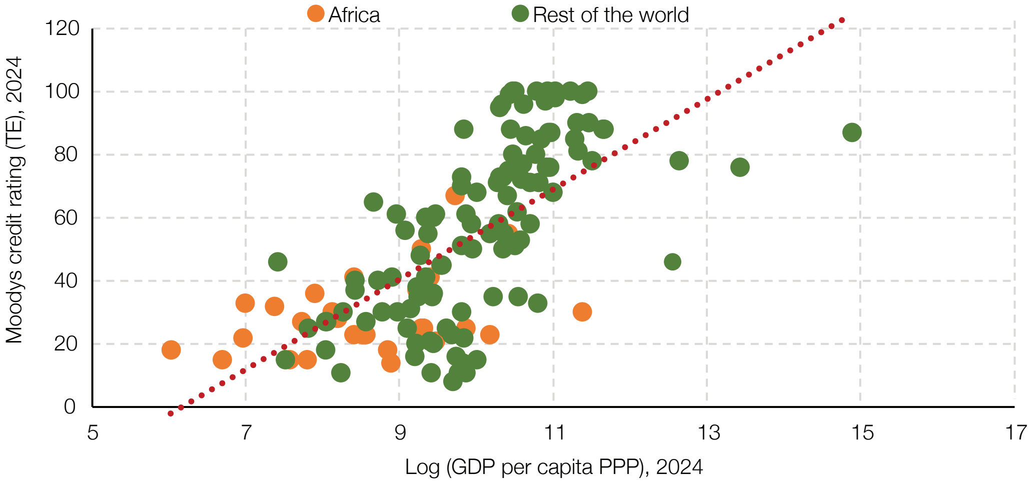
Reclaiming Southern Africa's financial agency requires a fundamental shift toward influencing the fundamental terms of regional and global financing. Financial agency refers to the capacity of the region's nations, individually and collectively, to exert meaningful influence on the size, structure, and cost of their financing needs. Achieving this goes beyond simply improving access to capital; it entails a coherent package of institutional and market-building reforms that allow Southern African countries to exercise greater control over how their risks are assessed and priced. Reshaping the institutional architecture is essential to move from a position of "rule-taking" to one of "rule-making," ensuring that the regional financial system is fit-for-purpose and capable of advancing sustainable development through greater economic sovereignty.

Strengthening local technical expertise in debt management and sovereign liability structuring is vital for Southern African sovereigns to project their institutional weight. Currently, many regional bond issuances and Eurobond roadshows are predominantly arranged by non-African financial institutions, which limits domestic participation in negotiating pricing conditions and structuring terms. Evidence from the Absa Africa Financial Markets Index consistently indicates that countries with stronger fiscal and monetary frameworks such as Botswana and Mauritius exhibit deeper and more liquid financial markets. Expanding the role of regional banks beyond co-arrangers into lead management positions would enhance local ownership of financing processes and strengthen the region's bargaining power in global capital markets.

Correcting the systematic mispricing of regional risk is a strategic priority for securing Southern Africa's informational sovereignty. The prevailing methodologies used to assess sovereign risk often fail to reflect the unique macroeconomic realities of the region, leading to unjustified risk premia that inflate borrowing costs. By the end of 2025, only Botswana and Mauritius held investment-grade ratings, while the region's primary hub, South Africa, remained at speculative grade. The creation of the African Credit Rating Agency (AfCRA) represents an important step toward addressing concerns about potential biases and methodological limitations in sovereign credit assessments of African economies. By providing independent, context-specific credit analysis, AfCRA could help improve the accuracy of risk pricing, strengthen investor confidence, and reduce borrowing costs for countries with stronger fundamentals, which is associated with higher GDP per capita (Figure 3.8).

Adherence to international regulatory codes and the successful exit from global monitoring lists serve as critical validations of Southern Africa's financial agency. The impact of being placed on the Financial Action Task Force (FATF) "grey list" demonstrates the power of global incentive-compatible action; as of early 2026, the presence of Angola, Mozambique, and Namibia, on this list continues to inflate transaction costs and trigger de-risking by international banks. Conversely, the successful removal of Botswana, Mauritius, South Africa, and Zimbabwe from the list proves that agency can be reclaimed through high-level political commitment and targeted legislative reforms. Aligning with international prudential measures, such as the Basel Committee guidance on systemically important banks, further enhances supervisory effectiveness and improves the credibility of the regional financial architecture on the world

Figure 3.8 Credit risk ratings



Source: Staff calculations using data from World Bank International Debt Statistics 2025.

3.4.2 Institutional Structures for a Resurgent and Impactful Financial Sector

Adopting risk-weighted supervisory models in Southern Africa is essential for identifying systemically important institutions and ensuring long-term financial stability. While South Africa hosts the region's only globally systemically important banks, other nations are increasingly identifying domestically systemically important banks to establish resolution regimes that minimize contagion risks. Several countries, including Malawi and South Africa, have undertaken significant steps to comply with Basel III requirements, such as formulating and publishing advanced regulatory codes. As evidenced by the 2008-09 financial crisis, a rules-based approach to management depends heavily on the quality of data. Enhancing data integrity through modernized collection methods is a strategic priority to ensure that regional supervisory ambition aligns with institutional and balance sheet realities.

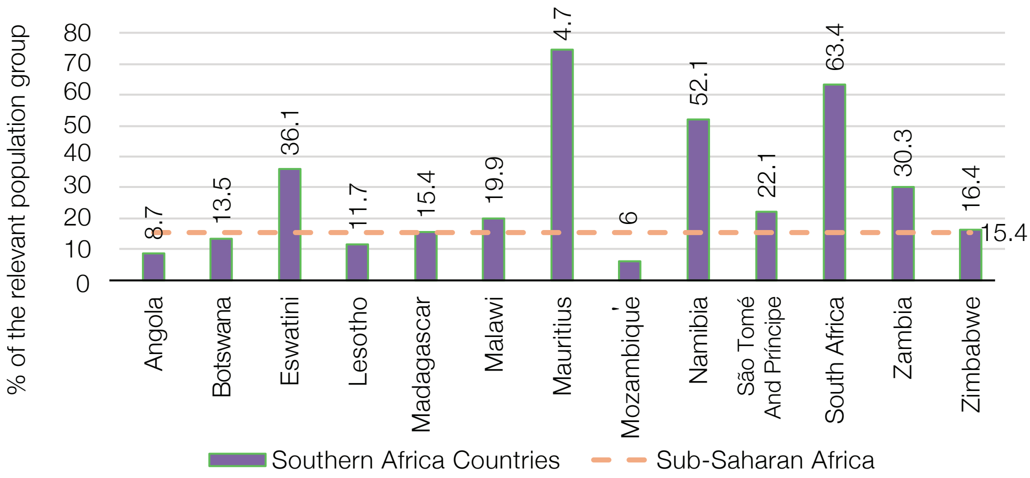
Institutionalizing regulatory sandboxes and cybersecurity protocols is vital for managing the rapid expansion of digital finance and non-bank financial institutions. The liberalization of the regional financial environment has led to a proliferation of new products, including mobile lending and fintech solutions, which often emerge ahead of appropriate legislation. Although non-bank financial institutions have witnessed faster growth than the banking sector in several Southern African nations, they are often not yet exposed to the same rigorous supervisory regimes as traditional banks. To stay ahead of cybersecurity threats and protect payment systems, regional central banks are increasingly utilizing virtual "regulatory sandboxes" to test fintech innovations under controlled conditions. Strengthening human and technical capacities in these areas is required to ensure that digital technology enhances the financial sector without compromising systemic integrity.

Bridging the informational gap through modernized credit infrastructure will allow Southern Africa to extend financial agency to the majority of its population. One of the important obstacles to financial inclusion remains the low capacity for contract enforcement and the lack of verifiable collateral. While credit reference bureaus have been introduced across the region to eliminate information asymmetries, their impact remains modest because they are often not linked to national population or address registries. To become effective, these bureaus must be integrated with digital identity platforms to better monitor borrower behaviour. Furthermore, strengthening digital collateral registries and streamlining procedures for registering and enforcing collateral would help reduce borrowing costs and expand access to credit.

Expanding social protection coverage is a fundamental institutional requirement for building a resilient and inclu-

sive regional financial architecture. As illustrated in Figure 3.9, Southern Africa exhibits a profound disparity in effective social protection coverage, which acts as an automatic economic stabilizer during periods of volatility. While Mauritius (74.7%), South Africa (63.4%), and Namibia (52.1%) have achieved coverage levels significantly above the Sub-Saharan African average of 15.4%, others remain deeply underserved, with Mozambique and Angola standing at just 6% and 8.7%, respectively. These gaps highlight a governance deficit that limits the state's capacity to build human capital. Reforming these institutions to prioritize member benefits and introducing micro-pension systems for the informal sector is a strategic necessity to transform social security into a powerful tool for domestic resource mobilization and long-term economic sovereignty.

Figure 3.9: Social protection effective coverage, 2023 or latest available (% of relevant population)



Source: ILO, World Social Protection Data Dashbords

3.5 CONCLUSION AND POLICY RECOMMENDATIONS

Southern Africa stands at a decisive structural turning point where the consolidation of its financial systems represents the only viable pathway toward long-term economic transformation. Reclaiming financial agency requires a fundamental shift from a model of external dependency and centralization toward the strategic mobilization of domestic institutional assets and deeper regional integration. By modernizing legal foundations, harmonizing regulatory standards, and building local institutional gatekeepers, the region can transform its fragmented markets into a resilient architecture capable of funding its own development. Beyond these technical reforms, the strategic spillover effects arising from South Africa's unique status as the continent's representative in the G20 and BRICS, coupled with the region's vast endowment of natural resources, provide a powerful lever to overcome the diverse structural constraints currently facing individual member states and secure long-term economic sovereignty.

In the short term, the immediate priority involves strengthening the foundation of the regional architecture through enhanced transparency and regulatory convergence. Angola, Mozambique, and Namibia must prioritize the execution of their Anti-Money Laundering and Countering the Financing of Terrorism action plans to exit the FATF grey list and restore international correspondent banking confidence. Simultaneously, governments should simplify sovereign bond issuance frameworks to align with advanced economy medians, establishing the liquid benchmarks necessary for the accurate pricing of private sector debt. Regulators must also implement mandatory ESG disclosure rules and synchronize social protection registries with digital identification platforms to improve fiscal credibility and attract global impact investors. Establishing unified digital collateral registries during this phase will further reduce the high recovery risk that currently limits credit access for small and medium enterprises across the regional architecture.

In the medium term, efforts must focus on building market depth and reorienting long-term institutional capital toward productive investment. Governments should modernize pension and insurance investment guidelines to allow a higher allocation toward domestic private equity and infrastructure funds, moving away from a total reliance on government securities. The operationalization of the African Credit Rating Agency would help to provide data-driven risk assessments that reflect regional realities and counter global rating bias. Incentivizing national development banks to issue local currency bonds will further ensure a steady pipeline of bankable deals while reducing fiscal volatility. Furthermore, leveraging successful subnational models and formalizing micro-pension frameworks will diversify the domestic capital pool and end the systemic crowding out of the private sector, ensuring that financial agency encompasses the bulk of the population.

In the long term, achieving full financial sovereignty requires the completion of a unified regional capital market and the total elimination of structural currency dependencies. The thirteen Southern African nations must finalize the interlinking of all securities exchanges through the AELP framework to create the market size necessary for large-scale global institutional investment. Achieving a complete transition to local currency financing for infrastructure and climate projects will protect the regional architecture from global interest rate volatility and the structural mismatch of foreign currency debt. As the system matures, the region should establish a joint financial stability fund in coordination with the African Financing Stability Mechanism to serve as a liquidity backstop against systemic shocks. By leading the advocacy for the reform of the global financial architecture and aligning all development cooperation with the New African Financial Architecture for Development, Southern Africa can achieve permanent financial self-sufficiency and take full control of its economic future.

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