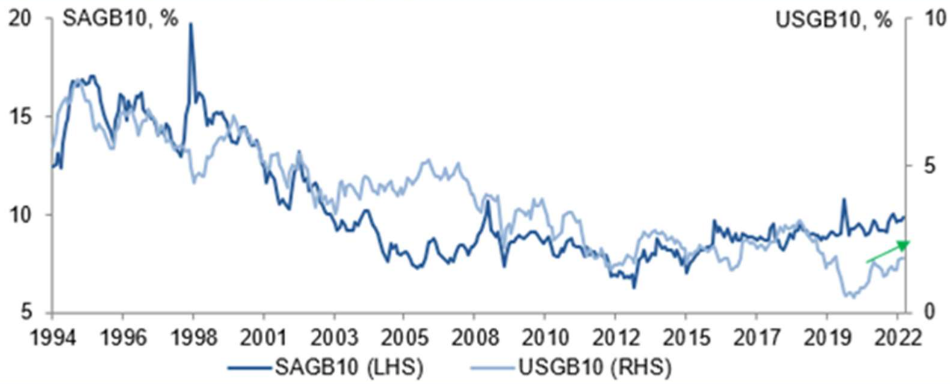
Thursday 3 March 2022

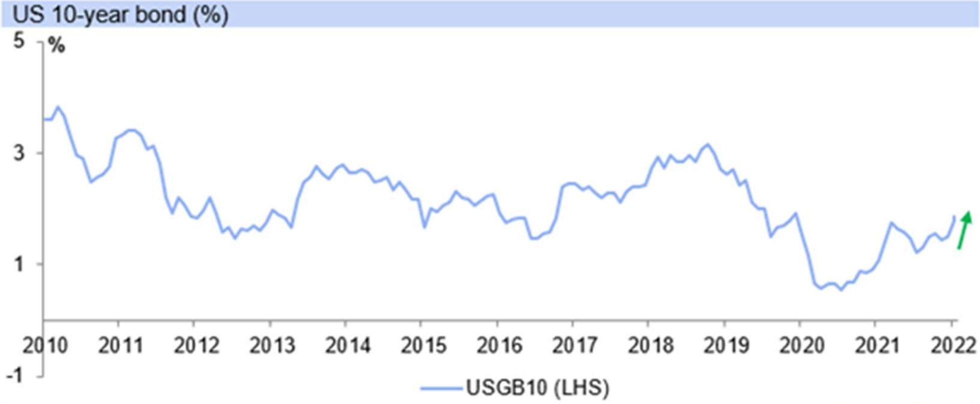
SA bond note: Powell confirms that the Fed funds target rate will be hiked at the FOMC meeting on 16th March, and US treasury yields have climbed

SA 10-year bond vs US 10-year bond



Source: Iress

US 10-year bond (%)



Source: Iress

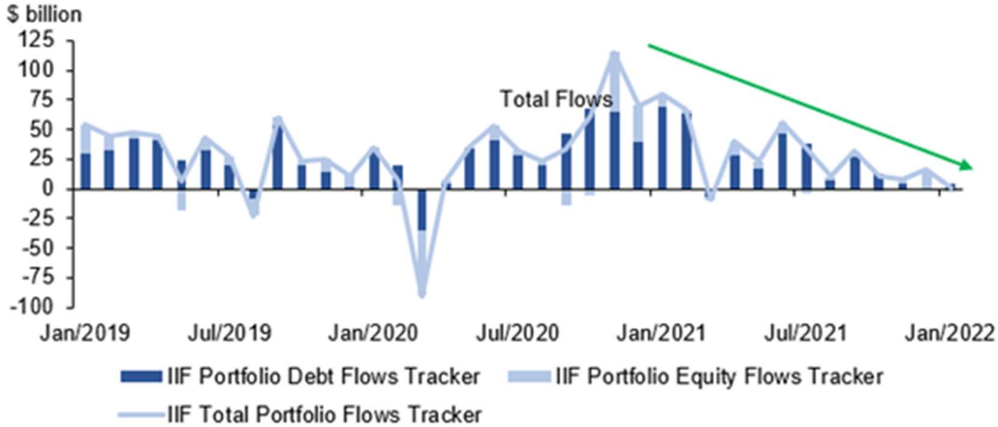
USDZAR vs US 10-year bond (%)

Source: Iress

- The US is widely expected to deliver a 25bp hike in its Fed funds target rate in March, confirmed by Fed Chair Jerome Powell's speech yesterday, stating "we expect it will be appropriate to raise the target range for the federal funds rate at our meeting later this month".
- Adding "we are attentive to the risks of potential further upward pressure on inflation expectations and inflation itself from a number of factors. We will use our policy tools as appropriate to prevent higher inflation from becoming entrenched."
- Powell's "Semiannual Monetary Policy Report to the Congress" speech addressed "Russia's attack on Ukraine" and highlighted that "(t)he implications for the U.S. economy are highly uncertain, and we will be monitoring the situation closely."
- The Russian/Ukraine war is not expected to derail the planned normalisation of US monetary policy currently, with Powell also confirming that the FOMC will reduce the size of the Fed's balance sheet after it has begun hiking rates, and has phased out QE.
- However, he added "(t)he near-term effects on the U.S. economy of the invasion of Ukraine, the ongoing war, the sanctions, and of events to come, remain highly uncertain. Making appropriate monetary policy in this environment … (means w)e will need to be nimble."
- President Biden's recent State of the Union Address (SOUA) also highlighted strong inflation concerns, stating "(i)nflation is robbing … (Americans) of the gains they might otherwise feel", "(t)hat's why my top priority is getting prices under control".
- The US ten-year treasury yield climbed 17bp on the news, and the implied fed funds futures rates strengthened to fully factoring in a 25bp lift at the March FOMC meeting, after the market rate view had seen some recent weakening as the Russian-Ukraine war intensified.
- US inflation climbed to a heady 9.7% y/y for PPI for the month of January (from 9.1% y/y), and 7.5% y/y for CPI (previously 7.3% y/y), with the US breakeven rate reaching 2.73% from 2.36% in January, spurred higher also by the inflation releases.
- The obdurately high inflation in the US has clearly created concerns that the pressures would become broad based, embedding into price systems. Today the US ten year yield rose further, to 1.87% (from 1.52% yesterday, 1.34% on Tuesday) as markets price in further hikes.

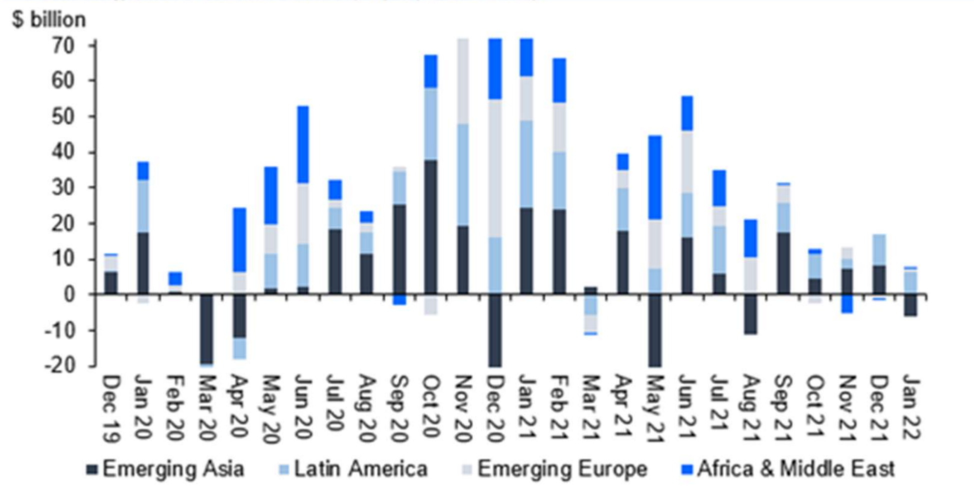
Please scroll down to the second section below

Total portfolio debt flows into Emerging Markets



Source: IIF

Total Regional Portfolio Flows (Equity and Debt)



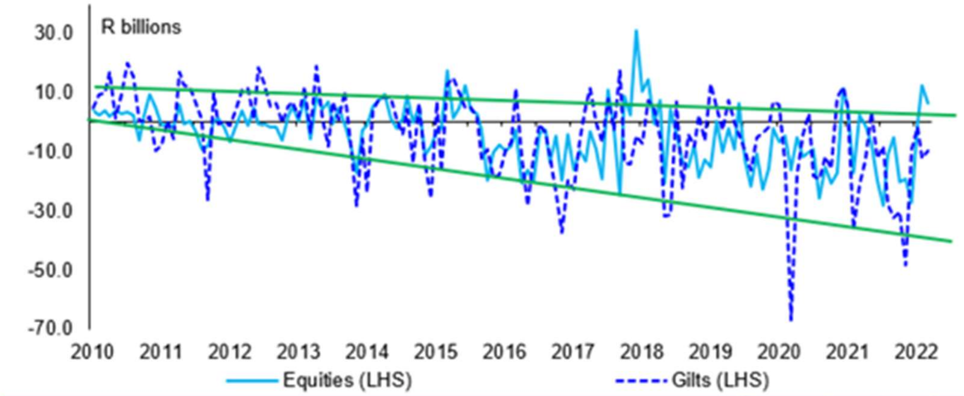
Source: IIF

Non-Resident Portfolio Flows to EM

Source: IIF

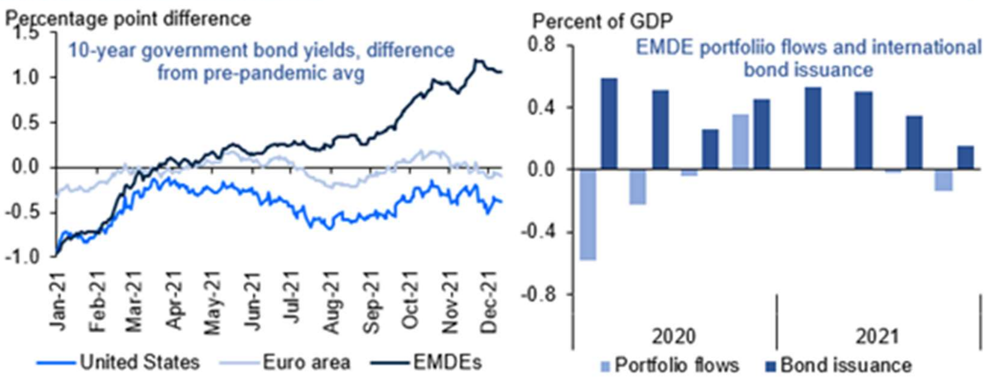
- Embedded (or second round) high inflationary pressures also increase the risk of financial market instability, currency volatility and higher longer-term borrowing costs. For the US ten-year treasury, the CPI inflation print of 7.5% y/y equates to a real yield of -5.6%.
- This is also up from the real yield for the US ten-year treasury in January, of 5.2% (with the CPI inflation print then at 7.0% y/y). The US consequently has remained quite likely to hike its base rate by 25bp in March, and is set to deliver this in near on a couple of weeks' time.
- US inflation is still expected to moderate sharply from Q2.21, ending that quarter closer to 4.0% y/y, with the end of Q3.22 near 3.0% and Q4.22 closing closer to 2.0%. US policy makers are acting to contain any second round inflation effects, and SA is likely to follow.
- SA's ten-year generic government bond yield, at 9.88% yesterday, is well up on a month ago of 9.58%, driven by higher US yields, with noticeable risk aversion in markets on the Russian/Ukraine war, but risk-off has also subsided somewhat today from yesterday's lift.
- This has translated into a degree of market volatility, but for bond markets their directional trend is being driven by the United States' very clearly communicated path of monetary policy normalisation, which remains on track from its January FOMC meeting communications.
- President Biden has also been clear that the US is "inflicting pain on Russia and supporting the people of Ukraine. Together with our allies –we are right now enforcing powerful economic sanctions. We are cutting off Russia's largest banks from the international financial system."
- "Preventing Russia's central bank from defending the Russian Ruble making Putin's $630 Billion "war fund" worthless. We are choking off Russia's access to technology that will sap its economic strength and weaken its military for years to come."
- Financial markets have taken comfort from the Fed's stable hand, and the US and NATO's concerted efforts to not exacerbate, but instead provide quelling actions on the Russian invasion of the Ukraine, taking care not to cause it to spread into a multi-country conflict.
- The rand has subsided today, to R15.26/USD, as financial markets are soothed by the lack of support for a severe multi-country conflict (WWIII) in response to the Russian invasion, but also that allied Western countries are making progress in assisting the demise of the conflict.

Non-resident portfolio net purchases (+)/ sales (-) vs USD/ZAR (monthly averages)



Source: Iress, Investec

10-year government bond yields, difference from pre-pandemic avg and EMDE portfolio flows and international bond issuance



Source: World Bank, Global Economic Prospects Jan 2022

Note: LH chart - EMDEs = emerging market and developing economies. Figure shows the difference in nominal yields on 10-year government bonds from December 2019 averages (5.7 percent for EMDEs, 1.9 percent for the United States, and -0.3 for the euro area). EMDEs calculated as the average yield for 18 EMDEs, excluding Turkey. Last observation is December 13, 2021. RH chart - chart shows cumulative quarterly portfolio inflows and bond issuance. Sample includes 14 EMDEs. Last observation is December 15, 2021.

Extreme up case Forecasts	2020	2021	2022	2023	2024	2025	2026
SA rand bond (year-end: %)	10.10	10.00	9.50	9.40	8.90	8.80	8.90
SA rand bond (average: %)	10.12	9.81	9.55	9.50	9.02	8.87	8.82

Up case Forecasts	2020	2021	2022	2023	2024	2025	2026
SA rand bond (year-end: %)	10.10	10.00	9.80	9.60	9.40	9.30	9.30
SA rand bond (average: %)	10.12	9.81	9.75	9.73	9.48	9.30	9.28

Expected case Forecasts	2020	2021	2022	2023	2024	2025	2026
SA rand bond (year-end: %)	10.10	10.00	10.10	9.90	9.60	9.60	9.50
SA rand bond (average: %)	10.12	9.81	10.18	9.98	9.75	9.55	9.58

Lite down case Forecasts	2020	2021	2022	2023	2024	2025	2026
SA rand bond (year-end: %)	10.10	10.00	11.00	10.80	10.70	10.50	10.40
SA rand bond (average: %)	10.12	9.81	11.10	10.90	10.76	10.60	10.43

Severe down case Forecasts	2020	2021	2022	2023	2024	2025	2026
SA rand bond (year-end: %)	10.10	10.00	11.70	12.00	11.90	11.90	12.00
SA rand bond (average: %)	10.12	9.81	11.43	11.80	11.98	11.86	11.96

Source: All forecast yields are of bonds traded on the stock exchange - Gov. bonds - Nominal yields: 10 years and over (Unit: % (Monthly average bond yield); Source: SARB QB (S-31) - June 2021 No. 300)