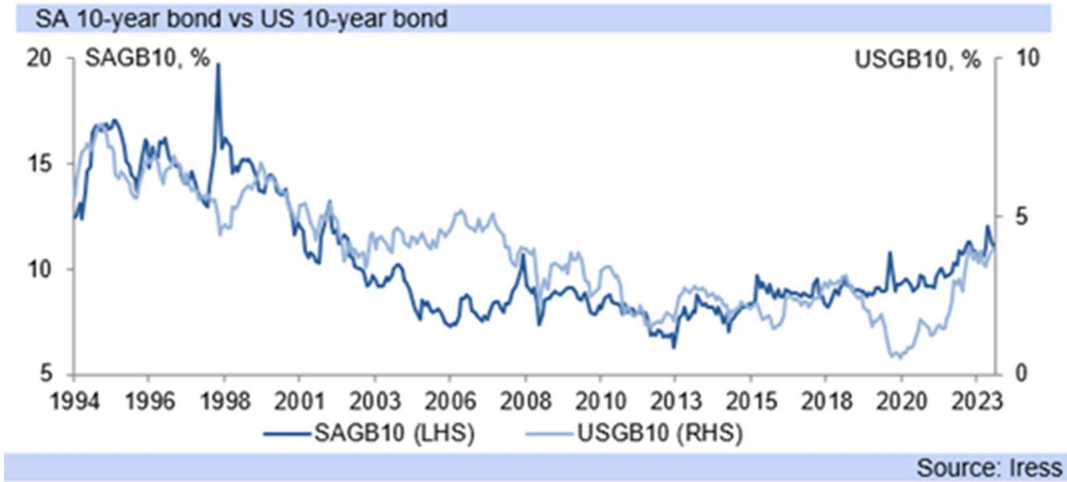
Investec

SA Bond note: foreign appetite for SA bonds grows on global financial market risk-on sentiment

Tuesday 1 August 2023

SA 10-year bond

Source: Iress



- South African bonds have seen a further, modest recovery in yields, with the ten year benchmark yield reaching 11.10%, after some volatility in July when the yield reached 11.69%, while June started off at 11.99%.
- Foreign investors have been net purchasers of SA government bonds in both June R14.5bn and July R11.4bn, after net selling of -R10.41bn in May, and indeed have been net purchasers for four months out of seven this year so far.
- Overall non-residents have been net buyers of government bonds this year, at R7.5bn (settled trade data from Bloomberg, JSE), but with volatility month to month, and SA's ten year yield is still 39bp higher than the start of the year.
- Markets have been constantly recalibrating interest rate expectations this year, leading the volatility, along with uncertainty about global growth outcomes, and concerns are still apparent on inflation for a number of advanced economies.
- The tightening in monetary conditions is unlikely to see release this year, with inflation still sticky for most advanced economies, and markets wary, with some appetite for risk assets (risk-on) but not a full-scale shift away from risk aversion yet.
- In particular, the slow descent (stickiness) of core inflation creates a risk for inflation expectations, which have tended to the optimistic side in markets recently. This, along with incoming economic growth data, leaves room for some volatility.
- In South Africa, concerns over slowing growth on the electricity crisis reduced economic growth expectations and so had negatively impacted expectations as well over the revenue collection potential of government.
- SA is seeing its revenue collection, at R406bn for the year to date below that of last year for the same period of R424bn, while expenditure has not been curtailed, at R453bn for the year to date well above the R412bn of the same period last year.

- The risk of a deterioration in state finances persists, even with a possible marginal upwards revision for GDP growth this year, from 0.2% y/y to 0.3% y/y or even 0.4% y/y. The state is not trimming expenditure and increased bond issuance is a risk.

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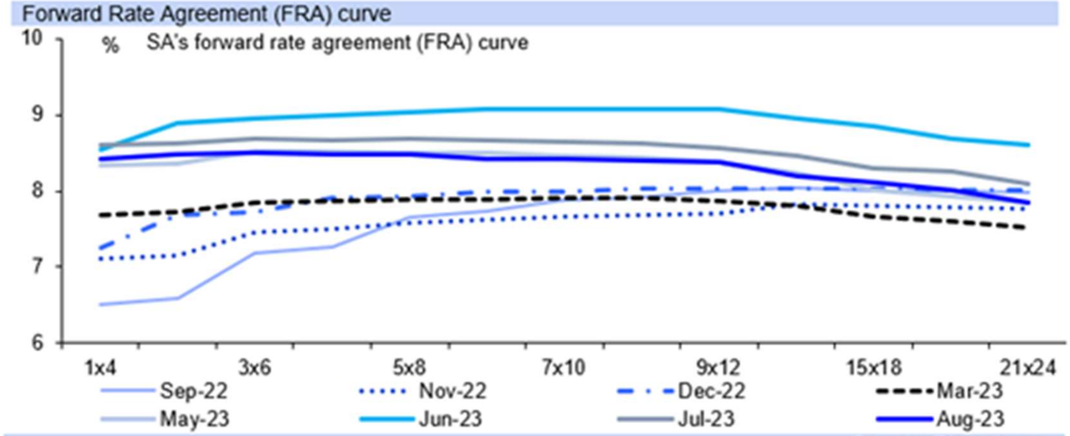
Forward Rate Agreement (FRA) curve



Source: Bloomberg

Extreme up case Forecasts	2021	2022	2023	2024	2025	2026	2027
SA rand bond (year-end: %)	10.00	11.45	10.00	9.20	9.10	9.00	8.90
SA rand bond (average: %)	9.82	10.81	10.89	9.35	9.13	8.98	8.93

Up case Forecasts	2021	2022	2023	2024	2025	2026	2027
SA rand bond (year-end: %)	10.00	11.45	10.70	9.90	9.70	9.70	9.60
SA rand bond (average: %)	9.82	10.81	11.21	10.13	9.76	9.75	9.63

Expected case Forecasts	2021	2022	2023	2024	2025	2026	2027
SA rand bond (year-end: %)	10.00	11.45	11.50	11.00	10.50	10.30	10.00
SA rand bond (average: %)	9.82	10.81	11.58	11.15	10.65	10.40	10.13

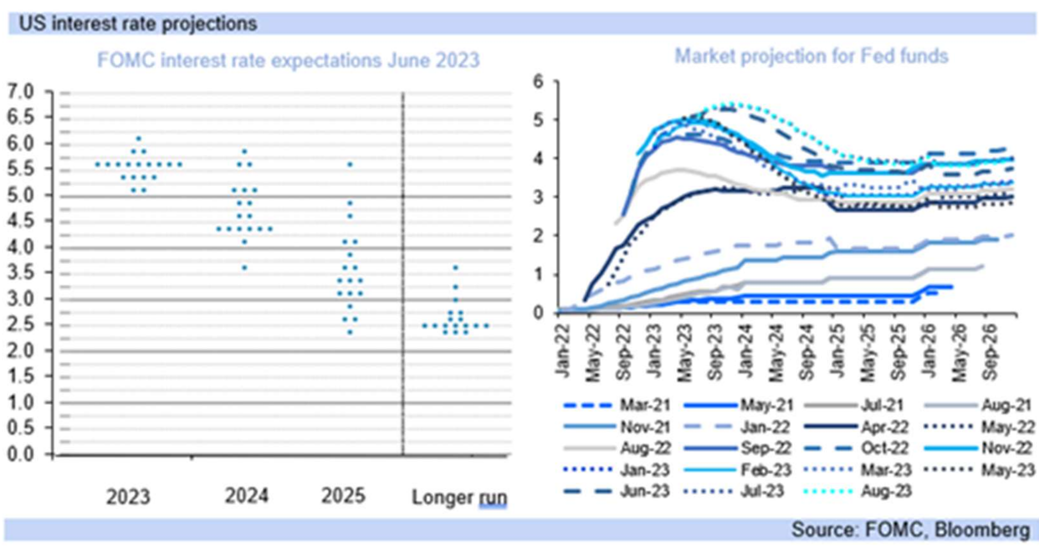
Lite down case Forecasts	2021	2022	2023	2024	2025	2026	2027
SA rand bond (year-end: %)	10.00	11.45	12.50	11.70	11.50	11.20	11.00
SA rand bond (average: %)	9.82	10.81	11.94	11.98	11.55	11.30	11.08

Severe down case Forecasts	2021	2022	2023	2024	2025	2026	2027
SA rand bond (year-end: %)	10.00	11.45	13.00	12.90	12.70	12.30	12.00
SA rand bond (average: %)	9.82	10.81	12.21	12.93	12.80	12.53	12.03

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)

- The difference between a GDP growth outcome of 0.2% y/y or 0.4% y/y (partly as load shedding has proved less severe in winter so far and businesses resilient) is not one which is likely to provide a substantial boost to state revenues.
- The small main budget surplus in June this year, of R36.5bn is less than in June 2022 of R73.8bn, but worryingly the budget deficit to date this year is at -R47.3bn, versus last year's -R12.0bn for the same period (first quarter of the fiscal year).
- SA's projected budget deficit for the current fiscal year, 2023/24, is projected at -R284bn, versus 2022/23's -R276bn, with some worsening in the deficit factored in, but the latest actual figures signal the potential for a worse outcome.
- These concerns are underpinning the elevation in bond yields in SA, with SA's the benchmark yield a year ago at 10.71%. However, some counteraction has occurred lately with global financial markets seeing an end to the US rate hike cycle.

- Two years ago, SA’s benchmark ten year bond yield was at 9.20%, but drifted up to 9.65% by the end 2021, and then by the end of Q1.22 rose to 9.86%, before leaping above 10.00% as the global interest rate hike cycle got underway in earnest.
- Higher interest rates led to upwards pressure on bond yields, both in SA and globally, with SA’s first interest rate hike in its current cycle in November 2021, of 25bp, followed by two more in Q1.22, then a move to larger hikes from Q2.22.
- Markets are factoring in no more hikes in the rate cycles both in the US and in SA, which has only provided some small lowering in government bond yields in South Africa, as markets remain worried over the sustainability of SA’s state finances.
- With the 2022 commodity boom over, and market players unsure of whether a soft landing for the global economy, or a recession will transpire (and poor data incoming from China), commodity prices are modest, unsupportive of a boost to the fiscus.
- A revenue underrun remains the risk for this year, and indeed the future with the unstainable NHI planned and emigration of high income earners typically escalating to OECD and other countries in the face of adverse state legislation to their standard of living.



Fed Fund Futures implied rates – 1 August 2023					
Meeting	#Hikes/Cuts	% Hike/Cut	Implied Rate△	Implied Rate	A.R.M
07/26/2023	+0.190	+19.0%	+0.047	5.374	0.250
09/20/2023	+0.371	+18.1%	+0.093	5.419	0.250
11/01/2023	+0.197	-17.5%	+0.049	5.375	0.250
12/13/2023	-0.095	-29.2%	-0.024	5.302	0.250
01/31/2024	-0.575	-48.0%	-.144	5.183	0.250
03/20/2024	-1.154	-57.9%	-0.288	5.038	0.250
05/01/2024	-1.869	-71.5%	-0.467	-4.859	0.250
06/12/2024	-2.565	-69.6%	-0.641	4.685	0.250
07/31/2024	-3.382	-81.8%	-0.846	4.481	0.250
09/18/2024	-4.184	-80.1%	-1.046	4.280	0.250
11/07/2024	-4.734	-55.0%	-1.183	4.143	0.250
					Source: Bloomberg