Investec


SA Bond note: investor sentiment strengthens towards South Africa

Thursday 29 August 2024

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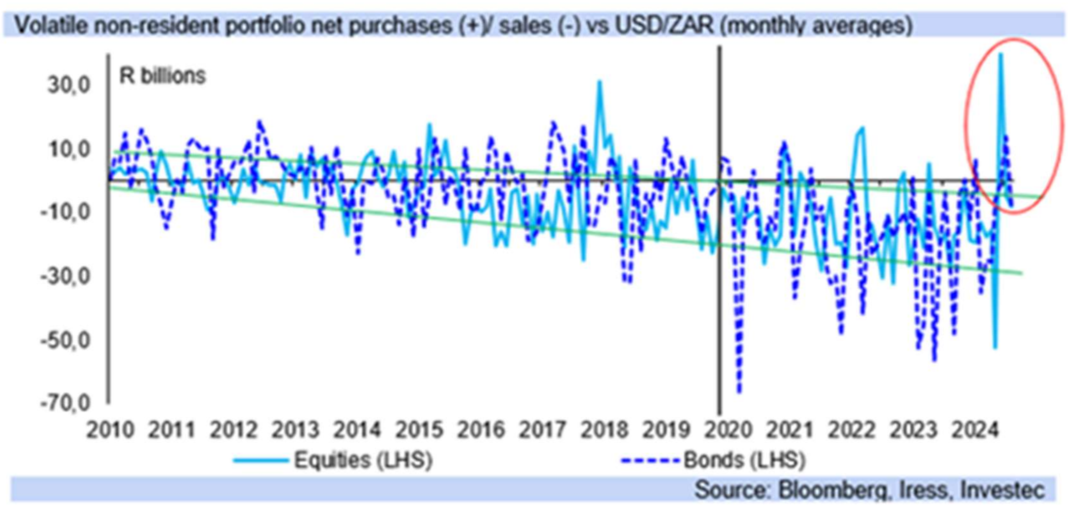

New bond tables August 2024

| Extreme up case Forecasts | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 |
|---|---|---|---|---|---|---|---|
| SA rand bond (year-end: %) | 11.90 | 10.20 | 9.30 | 9.00 | 8.90 | 8.60 | 8.40 |
| SA rand bond (average: %) | 11.63 | 11.00 | 9.70 | 9.20 | 8.80 | 8.70 | 8.50 |

| Up case Forecasts | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 |
|---|---|---|---|---|---|---|---|
| SA rand bond (year-end: %) | 11.90 | 10.60 | 10.00 | 9.70 | 9.50 | 9.00 | 8.90 |
| SA rand bond (average: %) | 11.63 | 11.20 | 10.30 | 9.90 | 9.60 | 9.30 | 9.00 |

| Expected case Forecasts | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 |
|---|---|---|---|---|---|---|---|
| SA rand bond (year-end: %) | 11.90 | 10.90 | 10.60 | 10.20 | 10.00 | 9.80 | 9.70 |
| SA rand bond (average: %) | 11.63 | 11.40 | 10.80 | 10.40 | 10.20 | 10.00 | 9.80 |

| Lite down case Forecasts | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 |
|---|---|---|---|---|---|---|---|
| SA rand bond (year-end: %) | 11.90 | 12.10 | 11.90 | 11.80 | 11.60 | 11.40 | 11.10 |
| SA rand bond (average: %) | 11.63 | 11.90 | 12.0 | 11.90 | 11.70 | 11.50 | 11.20 |

| Severe down case Forecasts | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 |
|---|---|---|---|---|---|---|---|
| SA rand bond (year-end: %) | 11.90 | 12.90 | 12.80 | 12.60 | 12.40 | 12.30 | 12.10 |
| SA rand bond (average: %) | 11.63 | 12.23 | 12.90 | 12.75 | 12.48 | 12.35 | 12.15 |

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))

SA 10-year bond


Source: Iress

- South Africa's ten-year benchmark government bond yield has dropped to below 10.40% (and the rand to below R17.70/USD) from above 12.00% in April, as positive investor sentiment towards South Africa persists, particularly from foreign investors.

- To date this year, foreigners made R9.3bn in net purchases of South African bonds, with R5.2bn of this having occurred in H2.24 to date, and further foreign buying anticipated in the remainder of the year on the positive investment climate for SA.

- This stems from further disinflation (falling inflation) in South Africa, renewed focus on fiscal consolidation on the formation of the GNU (or seventh dispensation in government) post the national elections and approaching SA interest rate cut cycle.

- In addition, the strengthening economic growth cycle of the next five years (see Economic growth note: substantial jump in upside potential, 26th July, and Macro-economic Outlook, 1st July, contact details below) have spurred investment appetite.

- Economic growth of close to 1.0% y/y this year (with Q1.24 contracting by -0.1% qqsa as loadshedding still persisted, but GDP expansion from Q2.24 forecast on a halt to load shedding) is expected for South Africa approaching 2% y/y next year

- South Africa continues to work on removing the impediments to a stronger economic growth environment, most tangibly so far is the halt in loadshedding, with investors believing the change in government will lift the potential for stronger growth.

- In addition, the downside risk has meaningfully reduced as fiscal consolidation is a fundamental tenet of the newly established Government of National Unity (GNU) in South Africa, with the risk of a shift to the left and fiscal deterioration avoided.

- Finance Minister Godongwana highlighted last month a very firm stance on fiscal restraint and consolidation, which has since been unanimously accepted by Cabinet, along with the macroeconomic strategy to prioritise rapid economic growth.

- Globally, bond yields have tended to moderate too as Central Banks approach interest rate cutting cycles (particularly the US), if not having already dipped their toes in the water (ECB), supportive of bond market strength.

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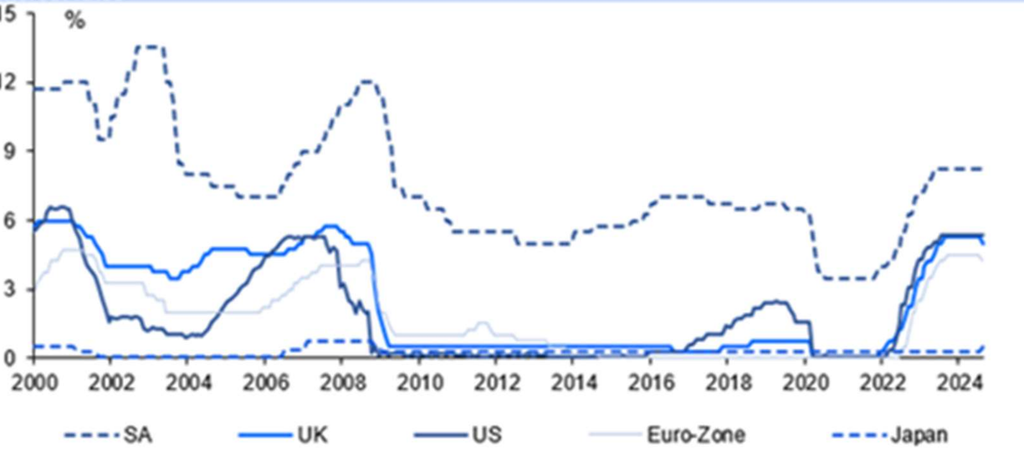
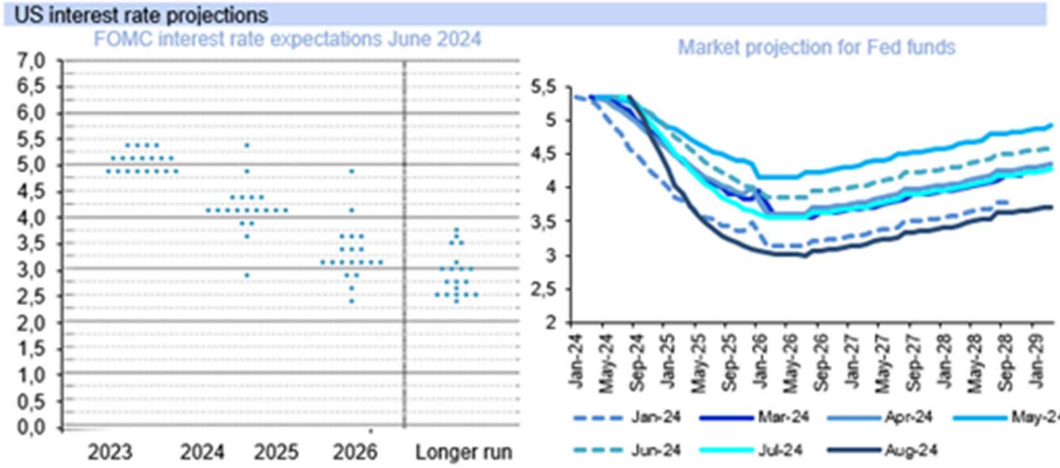
Interest rates



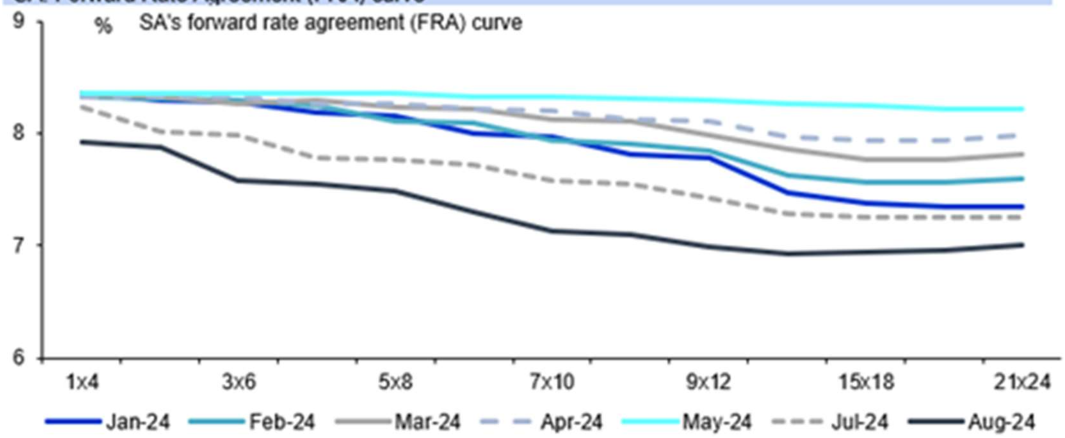

Source: Iress

US interest rate projections




Source: FOMC, Bloomberg

SA: Forward Rate Agreement (FRA) curve




Source: Bloomberg

- Central Banks are not expected to rush into very rapid interest rate cutting cycles universally, with the ECB already having paused after its first cut in June (and only cut so far this year), with the FOMC expected to only cut by -25bp in September.

- That is, a large, sudden drop in the US's fed funds rate (of -50bp) is not expected at the upcoming FOMC meeting, on 18th September, and instead a gradual lowering of US interest rates is expected, in increments of -25bp moves.

- The US's implicit inflation target, of 2.0% y/y for the core PCE deflator, has not been achieved as yet, although the US monetary policy authority has evinced greater confidence that it is on track to do so, and that upside risks have diminished.

- Financial markets continue to price in -25bp cuts at the next two FOMC meetings, September, and November, but currently have an additional 50bp cut priced in by the December FOMC meeting, which is likely too rapid for the Fed's gradualism.

- The yield on the ten-year US treasury is at 3.83% from over 4.00% at the start of the year, pulled down by lower US inflation and the approaching US interest rate cutting cycle, flattening the US's yield curve somewhat as well.

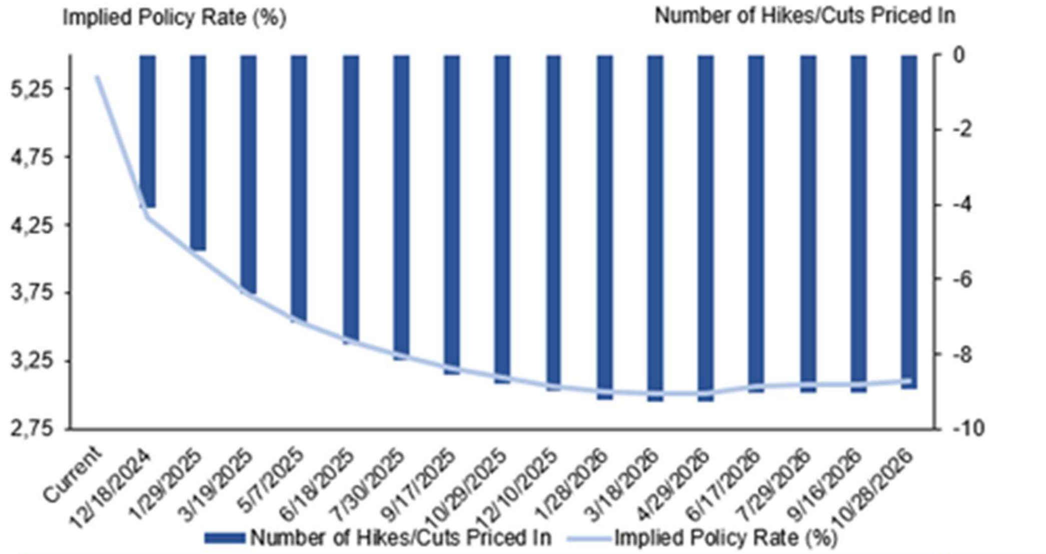
- The rand has benefited from positive sentiment in global financial markets, as risk aversion has diminished, reaching R17.65/USD this week, and gaining particularly from foreign inflows into South Africa's portfolio assets.

- However, SA bond yields are still elevated above those of many EM (Emerging Market) countries, causing South Africa to experience higher borrowing costs as the country's debt ratios, and so the cost of debt, are elevated.

- In February, the Budget projected a stabilisation of the borrowing trajectory at 75.3% of GDP next year but it is a figure above the Emerging Market country average of about 60% of GDP, and interest payments consequently are a drain on finances.

- Lower borrowing ratios to GDP are needed to see further structural strength in South Africa's bond market, although expenditure pressure weighs on the fiscus, including above inflation civil service wage increases to the detriment of state finances.

Implied overnight rate and number of us hikes/cuts



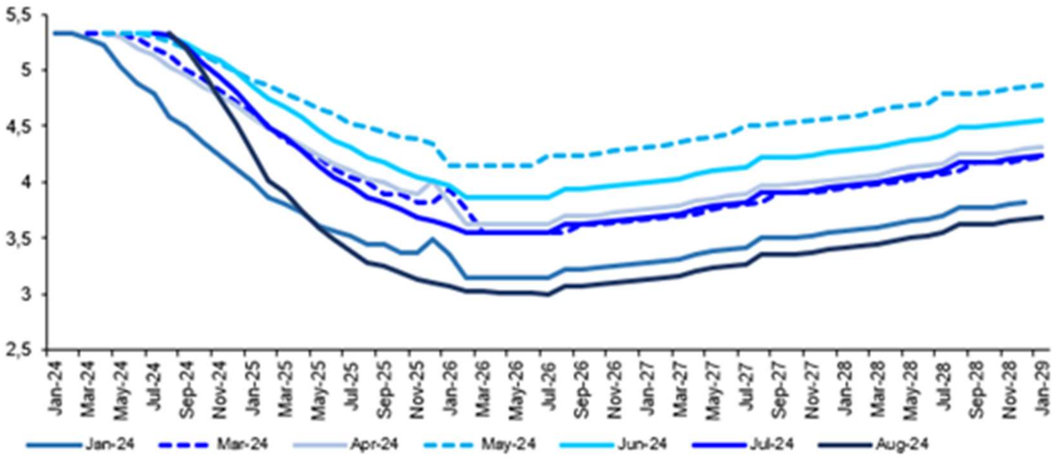

Source: Bloomberg

Fed Fund Futures implied rates – 8 August 2024

| Meeting | #Hikes/Cuts | % Hike/Cut | Implied Rate∆ | Implied Rate | A.R.M |
|---|---|---|---|---|---|
| 09/18/2024 | -1.354 | -135.4% | -0.338 | 4.990 | 0.250 |
| 11/07/2024 | -2.675 | -132.2% | -0.669 | 4.660 | 0.250 |
| 12/18/2024 | -4.086 | -141.0% | -1.021 | 4.307 | 0.250 |
| 01/29/2025 | -5.245 | -115.9% | -1.311 | 4.017 | 0.250 |
| 03/19/2025 | -6.373 | -112.8% | -1.593 | 3.735 | 0.250 |
| 05/07/2025 | -7.140 | -76.7% | -1.785 | 3.544 | 0.250 |
| 06/18/2025 | -7.727 | -58.7% | -1.932 | 3.397 | 0.250 |
| 07/30/2025 | -8.185 | -45.8% | -2.046 | 3.283 | 0.250 |
| 09/17/2025 | -8.530 | -34.5% | -2.133 | 3.196 | 0.250 |
| 10/29/2025 | -8.775 | -24.5% | -2.194 | 3.135 | 0.250 |
| 12/10/2025 | -8.995 | -22.0% | -2.249 | 3.080 | 0.250 |
| 01/28/2026 | -9.215 | -17.8% | -2.304 | 3.025 | 0.250 |
| 03/18/2026 | -9.286 | -7.1% | -2.321 | 3.007 | 0.250 |
| 04/29/2026 | -9.275 | +1.1% | -2.319 | 3.010 | 0.250 |
| 06/17/2026 | -9.038 | +23.7% | -2.260 | 3.069 | 0.250 |
| 07/29/2026 | -9.015 | +2.3% | -2.254 | 3.075 | 0.250 |
| 09/16/2026 | -9.009 | +0.6% | -2.252 | 3.076 | 0.250 |
| 10/28/2026 | -8.915 | +9.4% | -2.229 | 3.100 | 0.250 |

Source: Bloomberg

US interest rate projections




Source: FOMC, Bloomberg