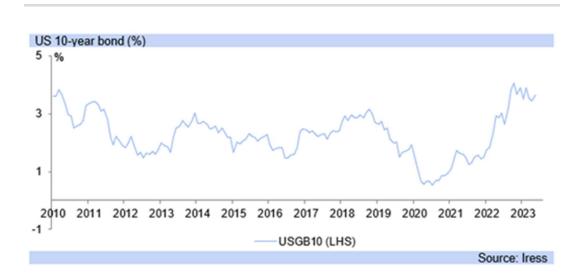
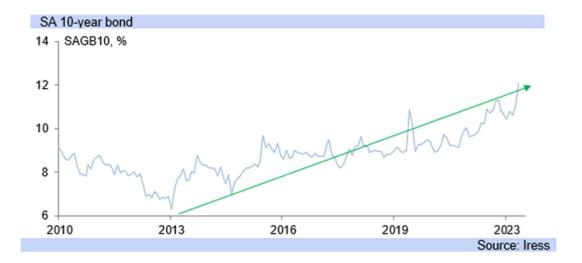




SA Bond note: yields rise as SA's health of state finances expected to deteriorate

Friday 2 June 2023



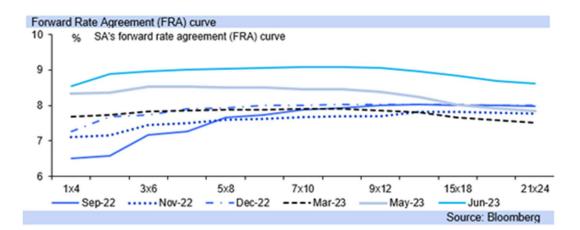


- South Africa has seen a marked deterioration in its bond yields, with the benchmark ten year government bonds seeing well over a 2.0% yield elevation since January this year, as risks are seen as skewed heavily to the downside for South Africa.
- The Reserve Bank (SARB) has warned of increased risks to financial stability, noting "capital outflows and declining market depth and liquidity" with "foreign participation in South African government bonds to 25% from 42% in the last five years".
- This is "further exacerbated by growing fiscal risk, weak demand for new issuances of SAGBs by nonresident investors and South Africa's idiosyncratic risk factors (e.g. high levels of load-shedding and the greylisting by the FATF)."
- "The steepening of the SAGB curve reflects investor concerns about fiscal risks ... from above-inflation wage settlements, weakening domestic growth prospects, lower revenues due to lower commodity prices and export volumes, and contingent liabilities in the form of implicit and explicit guarantees for SOEs."
- "(N)et redemptions of marketable government debt (both foreign currency and ZARdenominated) are estimated at around R1.7 trillion over the next seven years. This highlights the elevated refinancing risk faced by the government ... as maturing government debt may possibly have to be refinanced at higher interest rates."
- High levels of electricity load shedding have decimated the economic growth outlook for this year, and so have weakened the fiscal revenue collection potential of the country, which has also negatively affected sentiment in the bond market.
- Foreign demand has weakened for new issuance of state debt, lifting yields as well, with non-residents dumping -R20.3bn worth of their SA bond holdings already so far this year, after selling -R19.6bn for the whole of 2022, both on a net of sales basis.
- The SARB adds, "South Africa's non-aligned stance in the war between Russia and Ukraine is increasingly being questioned, which may pose a future threat to the

participation of South African financial institutions in the global financial system and increases the likelihood of secondary sanctions being imposed on South Africa".

 In contrast foreigners only sold -R0.1bn worth of SA bonds (all net of purchases) in 2021, after purchasing R76.7bn in 2019. The advent of the Russian /Ukraine war in February 2022 has seen increased polarisation of geo-politics, with international financial market players displaying increased risk aversion towards SA.

Forecasts	Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24		
Repo Rate (year-end: %)	7.75	8.25	8.25	8.25	8.00	7.50	7.50	7.00		
Prime Overdraft Rate (year-end: %)	11.25	11.75	11.75	11.75	11.50	11.00	11.00	10.50		
						Source: Iress, Investec				



Please scroll down to the second section below

- For South Africa's financial markets, economic activity and investor sentiment, the South African government is seen to be increasingly playing with fire (see yesterday's economic note of 1st June 2023) in its still close relationships with Russia, while the Western world has taken a strong stance against Russia due to the Ukraine war.
- Negative international financial market sentiment increases towards SA as it shows ongoing alliances with Russia by allowing Russian ships to dock at SA ports, conducts naval exercises with Russian and Chinese fleets and sends delagtions of South African government officials to Russia.
- The rand is the third worst performing EM (emerging market) currency against the US dollar out of a basket of twenty-two monitored by Bloomberg, weaker by -20.8% y/y, after the Turkish lira and Argentina peso.

- The SAGB has reached 12.06% this year, a massive deterioration in yield since near half that in 2013 when SA's ten year benchmark yield neared 6.0% y/y, reflecting high prices and demand versus the opposite for SA government debt to date.
- The SARB notes "(t)he proportion of SAGBs held by local investors increased to 75% in February 2023, compared to 58% in April 2018. This is a significant structural shift, especially considering the significant increase in government bonds issued during this period. It raises concerns about the capacity of South African investors to continue absorbing new issuances of SAGBs in future".
- "As local participants increasingly step in to absorb the declining appetite for new SAGB issuances by non-residents, this raises financial stability concerns regarding market liquidity, increased volatility and higher domestic government bond yields."
- "South Africa's non-investment grade status and recent greylisting by the FATF could contribute to nonresident sell-offs from local markets, with non-resident investor behaviour becoming increasingly speculative in relation to South African assets."
- We have raised the yield in our bond forecast to represent the deteriorating fiscal and economic situation SA faces, which has seen the country fall into the lite down case for this year, increasing the chance of credit rating downgrades.
- We have raised the yield forecasts, as well as weakened the rand for the lite down and severe down cases as the expected case moved into lite down case territory this year ment, with geo political choices made by our state at risk of driving even further deterioration in these metrics.

Extreme up case Forecasts	2021	2022	2023	2024	2025	2026	2027
SA rand bond (year-end: %)	10.00	11.45	9.30	9.20	9.10	9.00	8.90
SA rand bond (average: %)	9.82	10.81	10.08	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	10.10	9.70	9.50	9.50	9.40
SA rand bond (average: %)	9.82	10.81	10.63	9.85	9.56	9.55	9.43
Expected case Forecasts	2021	2022	2023	2024	2025	2026	2027
SA rand bond (year-end: %)	10.00	11.45	11.50	11.00	10.10	10.00	9.90
SA rand bond (average: %)	9.82	10.81	11.58	10.65	10.25	10.00	9.93
Lite down case Forecasts	2021	2022	2023	2024	2025	2026	2027
SA rand bond (year-end: %)	10.00	11.45	12.50	12.00	11.00	10.80	10.80
SA rand bond (average: %)	9.82	10.81	12.00	11.80	11.18	10.88	10.88
Severe down case Forecasts	2021	2022	2023	2024	2025	2026	2027
SA rand bond (year-end: %)	10.00	11.45	13.00	14.00	13.50	13.00	12.60
SA rand bond (average: %)	9.82	10.81	13.50	14.10	13.40	12.55	12.58
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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)

		Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
ctreme	USD/Rand (average)	17.76	17.60	16.50	15.50	15.00	14.60	14.50	14.40
p case	Repo rate (end rate)	7.75	7.50	7.25	7.00	6.50	6.50	6.25	6.00
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case		Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
6	USD/Rand (average)	17.76	18.20	17.40	17.00	16.90	17.10	16.90	16.60
	Repo rate (end rate) Economic growth lifts towa	7.75	7.75	7.75	7.50	7.00	7.00	6.75	6.50
	compensation. Low domes inflation on increased pri borrowings. Substantial tr measures to alleviate clima	vatisation. ansition to ate change in	Credit rati renewable mpact on (e energy economy.	des on fi away fror Grey liste	iscal cons n fossil fu d for less	solidation, uel usage than eigh	marked , compre teen mon	by lower ehensive oths.
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e	Repo rate (end rate)	7.75	8.25	8.25	8.25	8.00	7.50	7.50	7.00
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