



The structural shift occurring in the local bond market

Bonds have continued their rally throughout this quarter, with the 10-year yield ending the quarter at around 9.15% – its lowest level since the post-COVID period from 2021. But the South African bond market has not been alone.

Emerging market sovereign bonds like those of Turkey, Mexico and Brazil also produced stellar returns for the quarter, and year to date. Local government bonds have delivered a total return of 13.62% in 2025 thus far, compared to government bond returns of 19%, 15% and 15% in Turkey, Mexico and Brazil, respectively. This kind of performance in emerging markets is unusual, and it begs the question: “Is there too much good news priced in, or are there structural reasons that mean lower yields are here to stay?”

Is the U.S. still *risk free*?

The base rate on which we have traditionally based our bond valuations is the 10-year US treasury yield, deemed to be the ‘risk-free rate’. This is because U.S. treasuries are issued by the federal government, which has long been considered the most creditworthy borrower in the world. The likelihood of the U.S. government defaulting on its debt is extremely low due to its ability to raise funds through taxation and, if necessary, to print money.

However, the U.S. government (along with those in other developed markets) is in a precarious debt position and now has debt levels in excess of 130% when measured against GDP. This may have been palatable if the U.S. economy was growing fast and inflation was low, as it would be easy for the country to grow itself out of debt. However, due to the current administration’s questionable and erratic policy decision-making, investors are concerned about

economic imbalances. These are causing uncertainty, and fears about inflation and low economic growth. Recent attacks by the administration on the Federal Reserve, coupled with growing debt levels, mean that the lines between fiscal and monetary policy are blurring. As pressure on the Fed grows to cut interest rates, the U.S. yield curve is steepening. In other words, while shorter-dated U.S. treasuries are pricing in the anticipated rate cuts, longer-dated treasuries aren’t. This is because the market doesn’t believe that inflation can be contained in an environment where the Fed’s independence is compromised. A steeper yield curve means more pressure on already high debt servicing costs, and a decline in creditworthiness.

Could this be the beginning of the end of the U.S. as a ‘risk-free’ economy?

South African monetary policy is on the *right* track

In contrast to U.S. concerns, the South African central bank continues to enhance the credibility of its monetary policy framework. During the quarter, it became clear that the SARB is lowering its preferred inflation target from 4.5% to 3%; a shift in policy stance that reflects that headline inflation has finally receded to the bottom of the current target band.

Several factors have driven this shift: a stronger rand, lower oil prices, contained food price inflation, and subdued domestic demand. What better time than now to pursue a disinflation strategy? By lowering the target to 3%, the SARB will lower inflation expectations and enhance the credibility of its monetary policy framework. It also doesn't seem like there is much resistance to this change from government, and it is expected that Finance Minister Enoch Godogwana will announce this change in the Medium Term Budget Policy Statement in November. The SARB's independence is fully intact, and all credit is due to them.

Although a lower level of inflation will incur a short-term growth sacrifice (due to the SARB having to keep interest rates higher for longer), it will ultimately lead to a lower cost of capital and lower debt servicing costs. In the long term, this will enhance South Africa's creditworthiness – an improvement already reflected in our sovereign credit spread, which narrowed significantly over the last quarter.



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Foreigners come *flooding* back

The trajectory of the U.S. and of U.S. monetary policy is pivotal for emerging markets – and for the direction of foreign capital flows. At the September Federal Open Market Committee meeting, the Fed delivered a 25bps interest rate cut as 'cushioning' for the labour market. While it became evident that views were extremely divergent among committee members, future projections for rate cuts were ultimately moderated extensively. This has spurred foreign investors to return to emerging markets, where yields on offer remain more attractive.

In South Africa, foreigners have not been meaningful buyers of our debt in recent years, especially since COVID. Elevated budget deficits have largely been funded by domestic investors and local banks, with foreign investors representing a far smaller portion of our market, reducing to around 25% of outstanding bonds. The recent reengagement of foreigners in our market has therefore become the major factor in supporting the recent decline in bond yields.

Evidence of *structural* shifts

Are the recent developments in the U.S. and South Africa evidence of real, structural changes in these economies?

Structural changes are fundamental changes that can have lasting effects. The change to the inflation target in South Africa is a policy change that will ultimately affect inflation expectations and lower the cost of capital. This will have lasting positive impacts on our economy, as it will bring down the cost of debt, encourage growth in the medium- to longer-term and lead to a much better fiscal position.

The U.S. is also experiencing policy shifts. However, these are clouding the GDP growth outlook, raising fears over inflation and causing uncertainty. Whether this is a structural change remains to be seen, and will continue to play out over the medium term.

As a South African, it does feel good to be experiencing some policy tailwinds for once. Long may it last!