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FIXED INCOME QUARTERLY COMMENTARY
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What's behind the bond market rally
- and how are we thinking about it?

The South African bond market has been a star performer in recent years, returning 17.2% in 2024 and a stellar 22% in 2025. These are unusual and outsized returns. So, what has been driving this rally?

To understand this large market re-rating, it is useful to understand that there are three distinct structural reforms that have been playing out in the South African landscape:

1 The rollout and slow-building momentum of South Africa's structural growth reform agenda

Reform initiatives have thus far been focused on energy, logistics, water infrastructure, and visa reform. They have shown some notable successes, the most visible of which is the long absence of loadshedding in our daily lives. Structural reforms are, by their nature, slow moving and take time to become visible in printed economic growth numbers. However, it has been clear that we are moving in the right direction, with Operation Vulindlela partnering with the private sector to lift the country's economic growth rate.

This is a long journey, and we'll know we're arriving at the podium once we achieve annual economic growth rates of above 2% - currently expected by economists by around 2027 or 2028.

2 The adoption of a preferred 3% inflation target by the South African Reserve Bank (SARB), which was officially endorsed by National Treasury (NT) at the Medium Term Budget Policy Statement

The new 3% target is a full 1.5% below the previous target of 4.5% and, if achieved, implies a significant lowering of the risk premium fixed-rate bond investors would require as compensation for future inflation. With a credible central bank and political will via NT to commit to this new target, this should result in a structural and permanent lowering of this risk premium in future.

The lower target has also opened the door to lower interest rates over time, with the SARB moving their projected long-term interest rate lower in their forecasts if they are successful in achieving their new target. The SARB's current repo rate is 6.75% but its long-term forecast is as low as 5.5%. Lower interest rates are generally supportive of fixed-rate bond yields, so this has been another factor behind the bond market rally.

The success metric that will prove that this structural change has matured will be when actual inflation, as well as inflation expected by price setters in the economy (or 'inflation expectations'), have become embedded at or near the 3% target.

3 The improvement in South Africa's fiscal outlook, or the balance sheet health of government

After years of fiscal deterioration, the government has recently exercised impressive fiscal restraint by raising more revenue than it spends (calculated before including payment of interest costs) – i.e., a primary surplus. As a result, NT expects South Africa's debt/GDP ratio to peak in the coming year, before gliding down in the years thereafter. This picture of improving debt health is currently quite rare, and contrary to the global trend (especially among large developed country peers).

Lower inflation will help to improve the fiscal outlook even further, as all sources of funding used by government would benefit directly or indirectly from a lower realised inflation rate over time.

The test for whether we are indeed delivering on fiscal consolidation will be if the peak in our debt/GDP ratio is indeed achieved this fiscal year, as currently forecast by NT. Credit rating upgrades will also follow in time as these ratios improve.

These structural forces have positively impacted the valuations of all local fixed income securities we include in our portfolios. However, while showing great initial promise, successful delivery in all three areas will take time to be evident. We therefore still require some risk premium as compensation while we wait. We continue to seek out areas across the market where this risk premium remains attractive, while being cognisant that reforms may take longer than hoped to play out, and that South Africa always remains susceptible to global volatility.