M&G Investments

M&G Insights

MTBPS Review: Bond market was priced for worse

November 2023

Bulent Badsha
Portfolio Manager at M&G Investments

It is rather unfortunate that fiscal policy in South Africa only gets attention twice a year -- around the time of the Budget Review and the Medium-Term Budget Policy Statement (MTBPS) -- as it has such profound implications for the bond market in particular and the country at large. Nevertheless, we hope to share some highlights we have gleaned from the 2023 MTBPS release covering the macroeconomic forecasts, budget balance, financing, and risk backdrop. We also provide some colour on the market reaction to the announcement, which was made during a very busy period in the global market calendar (on the same day as the US Federal Reserve's FOMC meeting and just ahead of the US Non-Farm Payroll data, the most important monthly indicator globally.

Deteriorating macro forecasts

The macroeconomic projections contained in the MTBPS were updated and now show slower economic growth both for this calendar year and over the medium term when compared to those in the February Budget Review. This was no surprise, as the original projections were widely viewed as being too optimistic. By way of comparison, the updated GDP growth projections remain higher than the South African Reserve Bank's (SARB's) over the entire forecast horizon. As is always the case, the CPI inflation projection shows a return to the targeted rate of 4.5% at the end of the forecast horizon, like the SARB.

The projections made in the main budget framework all showed a deterioration when compared to those made earlier in the year, with lower revenue, high expenditure and wider budget deficits expected for the current as well as future fiscal years. The substantial increase in debt service costs to 22.1% of the main budget revenue (more than R1 in every R5 spent) remains a concerning feature of government finances, particularly as they are expected to have nearly doubled by FY2026/27 from what was spent in FY2020/21. The medium-term projections, as is now customary, show a narrowing in the budget deficit going forward to below 4% (3.7%) in the outer year, albeit from a worse starting point and the inclusion of an additional year.

The financing implication of this is that the gross borrowing requirement has ballooned, and will average a staggering R553.7 billion over the medium term. As a result, the outlook for the ratio of gross debt-to-GDP has also deteriorated, with a meaningful increase from the projections at the time of the February Budget Review. The peak in FY2025/26 has shifter higher to 77.7% as compared to 73.6% before.

Reasonable and credible?

As with any projection, it's the risks that surround them that are of more importance, and here there are a litany, including macroeconomic factors, civil service wage increases, market funding conditions, local government, state-owned enterprises bailouts and government grants. The question for the bond market is whether the projections are reasonable. Unfortunately, the credibility of National Treasury has eroded over time and, like the budget balance, stands in deficit. Regaining credibility will take time and requires a concerted effort with the expected introduction of fiscal anchors in next year's Budget -- something we will be monitoring.

Relief rally helped by US Fed decision

The narrow short-term focus of the bond market going into the MTBPS release was over the risk of an increase in bond issuance. This risk was embedded to some extent in yields, but it was not possible to gauge to what extent with any precision. Market positioning was also light, considering the anxiety in the build-up to the announcement. The National Treasury took the highly unusual step of communicating to the market two hours before the release of the MTBPS that weekly issuance will remain unchanged, and this drove a material positive turnaround in the bond market before the actual release. These gains were followed through after the release, as the rand exchange rate strengthened and the sovereign risk premium narrowed. Interestingly, the rally in nominal bond yields was largely a parallel move across all maturities and thereby had no meaningful effect on the shape of the yield curve.

The market's dovish interpretation of the US Federal Reserve's FOMC decision not to hike and its press conference later that evening also supported global bond markets and weakened the US dollar. Emerging market currencies like the rand and risk assets such as SA government bonds benefitted on Thursday, including the SA inflation-linked bond market. Bonds initially underperformed interest rate swaps (IRS) after the MTBPS, but outperformed after the FOMC decision.

Considering the fiscal issues, the South African government yield curve is one of the steepest in the world. Bond valuations domestically screen cheap across most metrics, but it is always prudent to consider the risks. As a house we are currently positioned overweight SA government bonds from both an asset allocation and interest rate risk (duration) perspective, as they offer higher prospective real returns than cash. However, we remain active in our positioning as this is in the best interests of our clients.

ENDS

Disclaimer.

This document is for information purposes only and is not an offer to or solicitation for investors to invest in any of the capabilities or products offered by MandG Investment Managers (Pty) Ltd [M&G Investment Managers] (Registration no. 2013/051515/07) and MandG Investments (Namibia) (Pty) Ltd (Registration no. 1996/85) [M&G Namibia] or any of their associates, being MandG Investments Unit Trusts South Africa (RF) Ltd (Registration no 1999/005242/06) and MandG Investments Unit Trusts (Namibia) Ltd Registration no. 2007/609. M&G Investment Managers is an authorised discretionary financial services provider by the Financial Sector Conduct Authority of South Africa [FSP45199] in terms of the Financial Advisory and Intermediary Services Act, and has it's registered offices at 5th Floor Protea Place, 30 Dreyer Street, Claremont, 7708. M&G Namibia is an approved person in terms of section 4 of Stock Exchanges Control Act and has it's registered offices at 6 Feld Street, Windhoek, Namibia. Information given in this document has been obtained from, or based upon sources believed to be from an accurate and timely source but M& Investment Managers and M&G Namibia make no representations or warranty, express or implied, with respect to the correctness, accuracy or completeness of the information and opinions. This information is not intended to constitute a basis for any specific investment decision. Investors are advised to familiarise themselves with the unique risks pertaining to their investment choices. Investors should seek the advice of a properly qualified financial consultant/adviser before investing. The value of an investment will fluctuate and past performance is not necessarily an indication of future returns.