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RSA Bonds: Yes or No?



An essential part of the nation's financial system is the South African bond market. To mobilise savings, manage risk, and set a baseline for interest rates, the bond market is crucial.

In the following article, we will discuss bonds as an investment, the elements affecting the performance of South African bonds, and whether or not these South African bonds are a good investment opportunity or not.

Bonds as an investment

Bonds are a type of financial security that let businesses attract capital from investors. An investor basically lends money to the issuer when they buy a bond. The issuer guarantees that the principal and interest will be repaid at a future date. Governments, businesses, and other organisations frequently issue bonds to fund their operations and investment endeavours.

Some of the benefits of government bonds are that when compared to equities, the risk is typically lower because if the relevant governments do not default on their bonds, interest and principal investments will be returned. Bonds are a great way to diversify. They frequently outperform other asset types when they are performing poorly. Due to the daily buying and selling of bonds on the open market, bonds are liquid, and early redemption is simple.

There are also a few disadvantages we must consider. The 'yield', or the interest paid on bonds, might be quite low. If interest rates increase or inflation expectations increase, bonds may depreciate on the open market. This is because increased inflation or interest rates make bonds' fixed interest payments less alluring. Compared to riskier assets like shares and real estate, long-term returns are often lower. Over time, cash deposits typically outperform bond returns. Bonds may be at risk if the government that issues them experiences a fiscal crisis that casts doubt on the government's ability to honour its debt obligations. The possibility that the state won't be able to compensate you may be low, but it does exist.

South African bonds

Bonds issued by the South African government, state-owned businesses, and companies are debt securities. The South African government issues bonds to pay for infrastructure projects and budget deficits. Bonds are also issued by state-owned businesses like Eskom and Transnet to fund their operations and investment initiatives.

The South African bond market is one of the busiest bond markets in emerging nations. With a wide range of maturities, from short-term Treasury bills to long-term government bonds, the market is deep and liquid and capable of providing many great investment opportunities.

There are many different factors that influence the performance of bonds, and these need to be considered when evaluating them.

Interest rates influence bond performance because the interest rate has an inverse relationship with bond prices. South Africa has a relatively high interest rate of around 7% compared to other countries like the US, whose interest rate floats between 3% and 3.25%. This means South African bonds are advantageous because if your objective is to maximise returns, it is better to buy bonds when interest rates are high since bond yields rise as the interest rate rises.

Political stability is another factor to take into consideration. South Africa is generally politically unstable, and as a result, its credit rating lowers. With a lower credit rating, investors can demand higher compensation for taking on the risk, which in turn leads to higher yields.

Inflation is a bond's arch nemesis. Future cash flows from a bond lose some of their buying power due to inflation. Bonds are typically fixed-rate investments. The return on a bond is decreased in real terms, or when inflation is considered, if inflation is increasing (or prices are rising). The bond's real rate of return can be calculated by taking the interest rate the bond pays and subtracting the current inflation rate. Therefore, the rate of inflation and expected rate of inflation plays a significant role in the pricing of bonds, as investors want to be compensated for this inflation risk.

South Africa's inflation rate has edged closer to 7.1% in March 2023, from 7.0% in February and 6.9% in January. While this is obviously not a good thing, it is not that serious. South Africa has done a decent job of stabilising inflation in recent years, keeping it between 3.2% and 6.3%. It is expected that inflation will cool down in the future as the government aims to achieve its target inflation, which is between 3% and 6%.

In conclusion, the bond market in South Africa is a crucial part of the nation's financial system. Bonds from South Africa give organisations a way to collect money and give investors a chance to get a guaranteed income. Numerous variables, such as interest rates, credit ratings, political stability, and inflation, have an impact on how well South African bonds perform.

South African bonds do have several advantages, such as the high interest rates, low credit rating, and relatively stable inflation. It will not be easy to find all these advantages together in a different country, so South Africa provides a unique investment opportunity, and that's why for us, the answer would be yes.

Investors thinking about purchasing South African bonds should carefully consider these concerns and seek expert guidance.

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