Development of the South African Local Currency Bond Market

G-24 Technical Group Meeting

Washington DC

21 and 22 March 2013

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Overview

- Some Information on SA LCBM
- Some History on the SA Bond Market
- Role of the SARB in the Development of the SA Bond Market
- Benefits To SA of Having a LCBM
- Challenges

Introduction: Some Data (Slide 1)

Primary Government Bond Market	
Net Amount of Capital Raised (after repayments of redemptions)	
Year	Amount
2005	R24 billion
2010	R139 billion
2011	R160 billion
2012	R189 billion
Private sector issues	
2011	R39 billion (21% of total)
2012	R87 billion (31% of total)

- Total outstanding nominal value of debt securities listed was R1.7 trillion at end January 2013.
- September 2011: over 1000 instruments listed for 112 issuers
- SOEs Major Participants --Almost half of total issues 2006--2009.

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Introduction: Some Data (Slide 2)

Annual nominal turnover of bonds listed on JSE	
Year	Amount
1995	R2 trillion
2008	R19 trillion
2009	R13 trillion
2010	R17 trillion
2011	R21 trillion
2012	R25 trillion

- Average daily trades increased from R91 billion in 2011 t0 R101 billion in 2012 and were R90 billion in first 2 months of 2013

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Introduction: Some Data (Slide 3)

Non-resident purchases of bonds	
Year	Amount
2011	R42 billion
2012	R89 billion
First 2 months of 2013	R8 billion

- Non resident participation in the bond market: 10% in 2001-2003; 20% in 2006; 12 and 14% between 2008 and 2011
- Recently Affected by factors like:
  -- Citibank World Government Bond Index (2012), and
  -- sovereign rating downgrade: Fitch: from BBB+ to BBB with stable outlook, S&P from A- to BBB with negative outlook and Moody's from A3 to Baa1.
- Return on the All-Bond Index was 9% in 2011 and 16% in 2012.

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Introduction: Some Data (Slide 4)

National Treasury Introduces New Instruments:

- 2000: Inflation-linked bonds (ILBs)
- 2001: Separate Trading of Registered Interest and Principal (Strips)
- 2004: Retail savings bonds

Corporate Market "Expansion"

- 70% of corporate bonds are "plain vanilla"
- Banking sector == about 70% of corporate issuances
- Helped by credit ratings for corporate issuers
- Instruments include:
  - short term notes
  - asset backed securities issued through SPVs.

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Some History: Infancy and First Steps

- **Late 1970s and First Half of 1980s: Infancy"**
  - Market : government and parastatal debt
  - Limited Transparency:No benchmark bonds or market rates
  - Purpose: government spending and open-market operations

- **Second Half off 1980s First Steps Forward**
  - Bond Market Association (BMA)
  - 1989: Development of Yield Curve- eventually up to 30 years
  - Improving coordination of monetary and fiscal policy

Some History: 1990s: “Growing Up”

- **Building a More Transparent Market**
  - Early1990s: SARB conducts regular auctions on behalf of the government.
  - National Treasury (NT) provides market more information:
    - the extent of the borrowing requirement,
    - auction dates,
    - maturity structures and
    - new instruments
- **1996 BMA → BESA**

Some History: 2000s: Maturity

- Promoting the Markets
  - 2000: BESA and the Actuarial Society of South Africa (ASSA) launched three total return indices
    - **the Government Bonds Index** (“Govi”)
    - **the Other Bonds Index** (“Othi”)
    - the All Bond Index (Albi”)
  - Later Other indices created including:
    - The Composite Inflation-Linked Index (“CILI”)
    - South African Hedge Fund Index
    - Credit Fixed, Credit Floating and Credit Composite Index
- **June 2009, BESA becomes a wholly-owned subsidiary of the JSE**

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Role of The SARB (Slide 1)

- **Founding Member of the BMA**
- **Market Maker:**
  - 1990: Introduces two-way prices for some bonds
  - At its peak, SARB represented about 30% of total bond turnover in the secondary market
  - SARB maintains government bond market, even in adverse market conditions,
  - the Bank was active trader of bond derivatives

Role of The SARB (Slide 2)

- **Promotion of Secondary Market:**
  - 1998: Works with NT to develop a panel of 12 Primary Dealers (PDs).
  - Selection criteria include:
    - Capacity to deal with risks associated with market making.
    - Capacity to comply with
      - institutional requirements,
      - capital requirements,
      - auction procedures,
      - participation on secondary market activity, and
      - surveillance procedures
  - Reduces its involvement in secondary market

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Role of The SARB (Slide 3)

- **SARB's Role Today**:
  - – conducts weekly auctions of on behalf of the NT
  - – Supervises PDs compliance with primary dealer rules– as agent for NT
  - – works with the NT on debt management issues
  - – Chairs the Financial Markets Liaison Group
  - – Manages money-market liquidity through repo transactions against eligible liquid assets

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Benefits of a LCBM for South Africa

- Expanded financing options for both public and private sector
- Increased range of savings instruments– e.g. retail bond
- Promotes modernization and efficiency of financial system
- Facilitates implementation of monetary policy
- Signaling to Government and SARB
- Improve government capacity to respond to shocks
- Promotes integration into global financial system

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Challenges

- Development of Market Infrastructure
- Managing non-resident bond investors
  - Confidence (CRAs, Response to Events)
  - Competition from other Countries
- International Standards Designed for Advanced Economy Markets
  - – e.g. OTC Derivative, CCP
- Developing Corporate Bond Market
- Regulators Keeping Up with Financial Innovation

Challenges (Slide 2)

- Appropriate Role of Central Bank (v NT):
  - Role in development of financial markets:
    - Participant/facilitator
    - Risk of distorting market
    - Nature of Market
      - Money market v. bonds
      - Public v private sector
  - Role in maturing market

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