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Why election outcomes have such a bearing on the *bond market*

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Why do we care about politics?

Sometimes it's tempting to bury our heads in the sand and not get caught up in all the media hype of what is going on at government level. Truly caring about this causes more stress than is good for us and can result in many a spoiled braai. Our influence on political outcomes is mostly limited to exercising our democratic privilege by showing up and voting. *So why worry?*

Wednesday, 29 May 2024 was a significant day for South Africa. For most of the year up until this date, the bond market was on tenterhooks, fearing the worst political outcome for capital markets: a radical, left-leaning coalition necessitated by the ANC losing the majority vote for the first time since 1994. This uncertainty saw bond yields at the highest levels in their history – the 10-year bond hit 12.5% – with much volatility thrown in. It's in times like these that investors are required to remain calm and rational, look through the noise and hype, and understand that the market can often be pricing in a far more disastrous outcome than is likely or even possible. This is not easy. For the last 10 years, we have had one extreme political event after the next – all of which have had a significant impact on the bond market and the emotions of South Africans. From Nenegate to Ramaphoria, Russiagate to Eskom and Transet failures... we have seen it all. Forgive us if we are all suffering from a bit of post-traumatic stress.

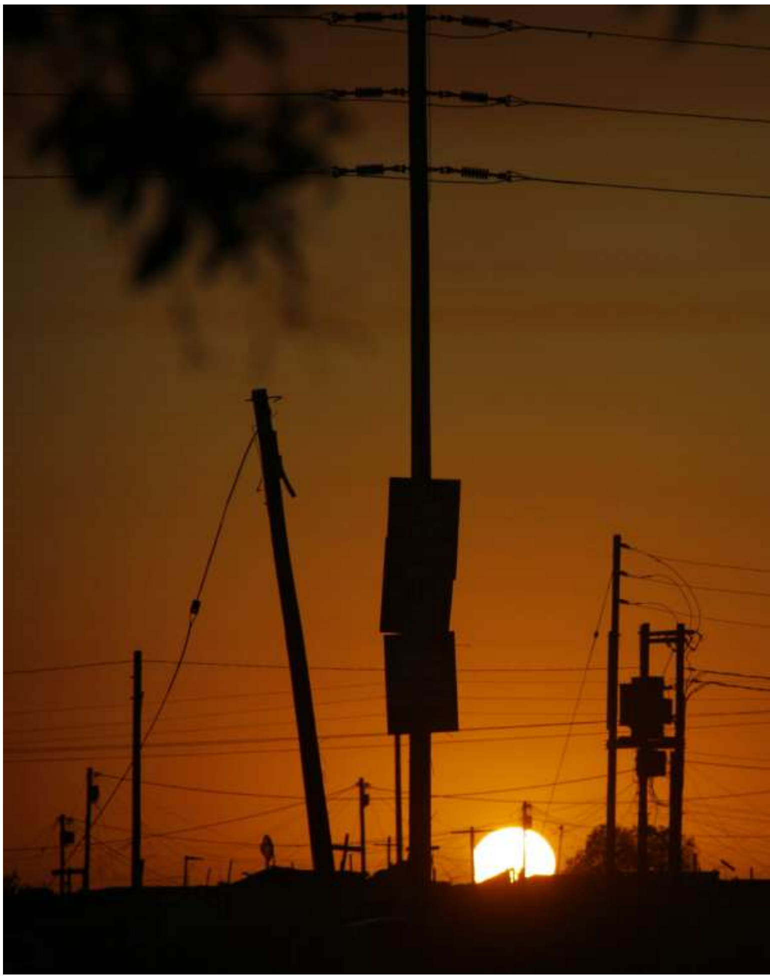
Why does the **bond market** care so much about political outcomes?

Political outcomes have a significant hand in determining economic outcomes, and economic outcomes define the bond market. For example, if the ANC had formed a radical populous coalition we might have seen a change in our finance minister. This could have led to a change in Treasury policy and a move away from debt consolidation and responsible budgeting. It could also have seen government finances slowly deteriorate into a state of over-indebtedness and, heaven forbid, eventual default. Other policies that were being touted by various radical political parties included nationalising the South African Reserve Bank and doing away with inflation targeting, which would have risked the possibility of hyperinflation. These fiscal and monetary outcomes were what the bond market was dreading leading up to the elections. Just like an equity market dreads the irresponsible financial management of companies, the bond market dreads the irresponsible financial management of a country.

A better-than-expected outcome **improves our outlook**

What actually transpired in the political arena was very much 'unicorns and rainbows' compared to what the bond market was fearing. The Government of National Unity and policy certainty has seen yields on the longer end of the curve fall by over 1%. To put this in perspective, the positive performance for the bond market in June was one of the best months on record. The rand has appreciated significantly, and the market is now finally pricing in decent interest rate cuts. While this outcome was a huge relief for many, our base case was for a more moderate outcome than what was being priced in. With the benefit of hindsight, we can now see how far the market had moved into extreme territory in times of heightened sensitivity and emotion. The market is prone to overestimating perceived risk. While it's not always easy, we are pleased to say that we managed to keep our wits about us and kept buying bonds as yields climbed higher. It usually pays off to be calm and rational, when others are fearing the worst outcome.

It is also a great relief to say that the outlook for bonds is one of policy certainty. There will always be things that are uncertain, like inflation, currency movements, global interest rates and geopolitical developments. But these are the normal things we should be analysing day to day. It is a relief to not be concerned with radical changes to policy and to finally say that we are on the road to reform. There is a lot to be done to fix this country and implementation will always be key, but we are now on better footing to get a real growth uplift, which will continue to be very positive for bonds.



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