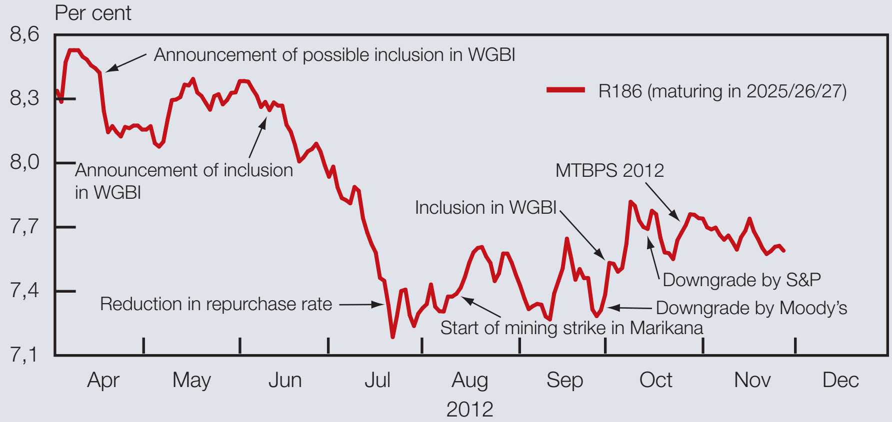
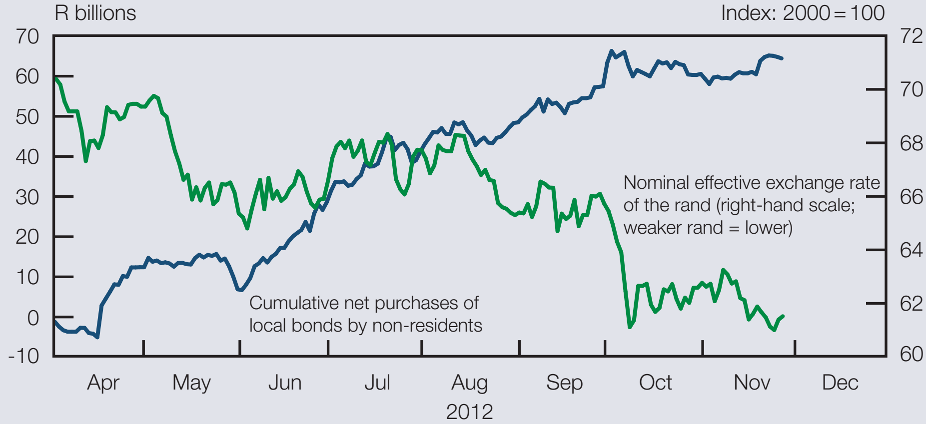
Box 2: Bond yields since the announcement of South Africa's possible WGBI inclusion

The announcement of the possible inclusion of South African government bonds in the Citi World Government Bond Index (WGBI) in April 2012 contributed to higher net purchases of local bonds by non-residents and a decline in bond yields. Thereafter, the inclusion was confirmed in June as the South African bonds had satisfied all three WGBI entry requirements, namely (i) a market capitalisation exceeding US$50 billion, (ii) an adequately strong domestic long-term credit rating, and (iii) the absence of barriers to entry. This, together with the reduction in the repurchase rate in July 2012, the release of lower-than-expected inflation data and strong demand for local bonds by non-residents – due to high levels of global liquidity, seeking higher returns – gave rise to a decline in bond yields.

Government bond yield



Non-residents' transactions in local bonds and the exchange rate



Bond yields came under some upward pressure in August 2012 as the Marikana mining strike started and the exchange value of the rand depreciated. However, as demand surged ahead of the official inclusion of South African bonds in the WGBI, bond yields again fluctuated lower. The total number of countries included in this index reached 23 after the 12 South African government bonds had been included in the WGBI on 1 October 2012. South Africa was the first African country to be included in the WGBI and accounts for 0,45 per cent of the market value of the index.

However, the inclusion of South Africa in the WGBI was overshadowed by the downgrade of the country's sovereign credit rating by Moody's Investors Service, Inc. on 27 September 2012 and by Standard and Poor's (S&P) rating agency on 12 October 2012. Subsequently, bond yields rose moderately in line with higher realised and expected consumer inflation data, the somewhat larger fiscal deficit announced in the *Medium Term Budget Policy Statement 2012*, the weaker exchange value of the rand and moderate net selling of local debt securities by non-residents. Most of the action seems to have been in front-running of the WGBI inclusion, although more lasting benefits should accrue to the South African bond market, for instance, through index-tracking investment funds.