JOHANNESBURG STOCK EXCHANGE

Quarterly Review of interest rate market

Introduction

Risk aversion hit global markets in Q3/2011, spreading even to emerging markets which had been favoured previously amid lower and riskier returns in the traditional, more developed markets that were struggling to shake off the financial crisis. Fears of a double dip recession emerged, forcing downward revisions to economic growth forecasts globally. At present, a sombre mood continues to permeate financial markets.

In lock-step with these developments, the economic outlook for the domestic economy has deteriorated. This, coupled with exchange rate volatility, inflationary pressures and portfolio capital outflows could cast a shadow of vulnerability on domestic markets in the closing stages of the year.

Notwithstanding global developments in Q3/2011, activity on the primary bond market remained healthy. The nominal value of total bonds listed on the JSE increased by a steady 3.4% q-o-q, on par with the increase recorded the previous quarter. Renewed activity was visible among corporates – predominantly financial sector corporates (excluding banks) and also in the previously depressed special purpose vehicles component.

The secondary bond market recorded increased and record activity during the past quarter, as higher risk aversion affected the appetite for bonds. Non-residents sold off bonds in September, while local asset managers increased their bond holdings marginally. Year-to-date turnover moved up to R16 trillion and looks set to reach a higher level in 2011 than that recorded in 2010.

Economic backdrop

The third quarter of the year proved to be a most eventful one in the life of global financial markets. This is because, as the International Monetary Fund stated in its World Economic Outlook in September, "The global economy is in a dangerous new phase." This factor was indeed responsible for the new wave of uncertainty and volatility that played havoc with financial markets in August and September. In reality, two major factors provided the impetus for the havoc, but one seemingly carried more weight than the other. The first and relatively less significant factor was the escalation observed in the Eurozone debt crisis; the second factor was the deterioration discernable in global economic data, a deterioration suggestive of a possible relapse into economic recession. In particular, data out of the US and Europe during the quarter suggested that economic activity during the remainder of the year would probably be very weak if not negative.

Content highlights:

- **Primary market:** primary market remains active notwithstanding global turmoil

- **Secondary market:** monthly turnover in August sets new record of R2.4 trillion, highest since 2008 crisis

Total listings (at end Q3/2011):

- R1 269 696 million (nominal value outstanding)
- R1 413 604 million (market capitalisation of total outstanding)

Secondary market totals (at end Q3/2011):

- R16 trillion (y-t-d total turnover value)
- 281 778 (y-t-d total number of trades on JSE)
- 6.7 (turnover velocity in cash market)

Author:

Monica Ambrosi
Senior Strategist

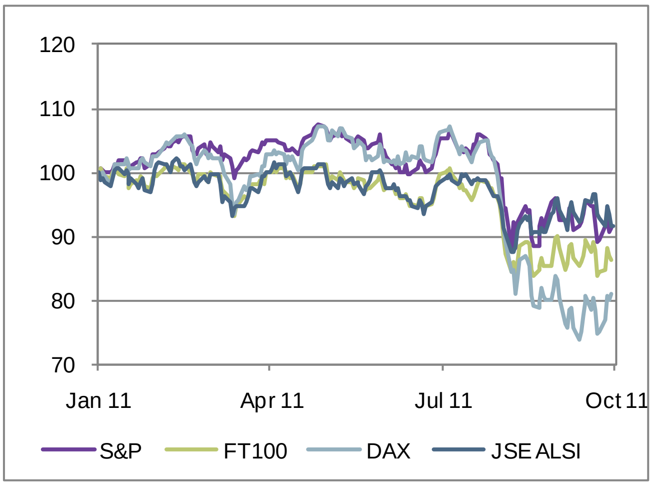
Contact:

For further information please contact Strategy & Legal Counsel:

011 520 7809/7229 or email monicaa@jse.co.za

An additional and not, by any means insignificant factor was the credit rating downgrade of the US's long-term debt by Standard and Poors' (S&P). The credit rating agency downgraded the US from AAA, a rating it had held since 1941, to AA+ with a negative outlook. The downgrade was motivated by the country's rising fiscal deficit and overall debt level and was announced only days after the US President had signed new legislation aimed at reducing the fiscal deficit by $2.1 trillion over the next 10 years. According to S&P, this was too little too late, and an action that followed weeks of political haggling over whether to raise the debt ceiling or not, thus bringing the country on the brink of default.

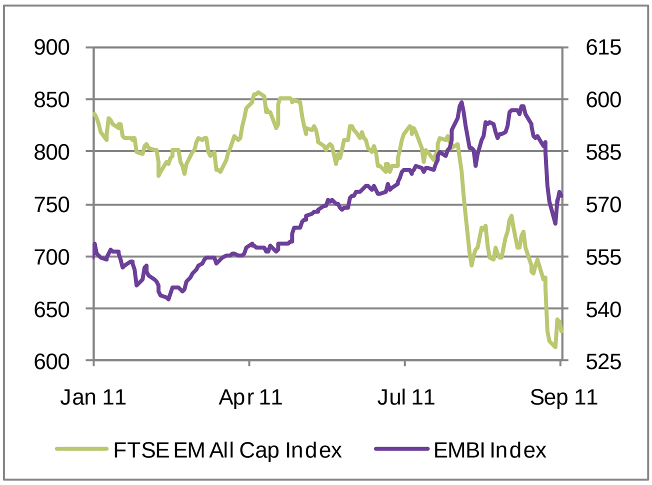
Equity markets' tumble



As these events unfolded and as fears of a double-dip recession (principally driven by a weak US economy) spread, financial markets tumbled. And even though throughout the economic crisis emerging markets had remained bastions of relatively sturdy economic growth, they did not escape this round of risk aversion. Consequently, the domestic equity market followed the global trend of losses, although these were slightly contained relative to the losses observed on other (especially European) equity markets.

The decline registered in equities was so severe and immediate that some European authorities (in Spain, France, Italy and Belgium) implemented a short-selling ban on selected stocks (mostly financial stocks). But this resulted in only a momentary lift in the markets, which otherwise remained volatile and subsequently lost more ground.

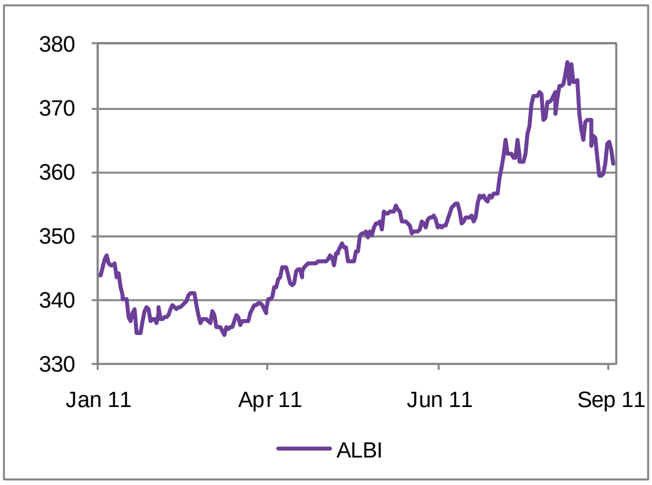
Emerging markets: equity and bond market movements



One could correctly argue that this renewed bout of volatility was no surprise, given the uncertainty reflected in equity markets since the financial crisis. What was surprising, however, was the loss in confidence in emerging markets, which resulted in substantial capital outflows and currency depreciation. All 25 of the largest emerging market currencies dipped against the US dollar in September, many by double digits. For foreign investors invested in local currency bonds, losses were exacerbated.

According to EPFR Global, which tracks movements in global investment funds, emerging markets have suffered the worst run of redemptions in 2011 since at least 2004, and much of this occurred in September alone. Investments have sought out "safer" asset classes, such as developed market bond markets and money market funds. Furthermore, while an exodus from emerging market equity funds had been evident for some time, the same could not be said of emerging market bond funds. The latter have only more recently come under attack.

BEASSA ALBI index



The FTSE emerging market all capitalisation index is a free float market capitalisation weighted index (1986 = 100). It includes constituents from the large, mid and small capitalisation universe of stocks in advanced[1] emerging and secondary emerging markets. When the index movements are compared to the movements in the JP Morgan emerging markets bond index (EMBI+), which is a benchmark measure for the total return performance of international government bonds issued by emerging markets it is notable that both indices converged to follow a negative path over the past two months. Previously, the EMBI+ was clearly on an upward path.

The JSE BEASSA all bond index (ALBI), which tracks the returns of the top 20 listed bonds on the JSE ranked by market capitalisation and liquidity has, in turn mirrored the developments reflected in other emerging bond markets, taking a negative turn after peaking at 377.3 on 6 September 2011.

Amid the latest developments, central banks have yet again emerged as the providers of market liquidity, or as the European Central Bank (ECB**)** President Trichet stated, "...an anchor of stability and confidence". His comments followed the announcement of co-ordinated action between some central banks, among which the ECB, the Bank of England and Switzerland's central bank to provide 3-month US dollar loans to European banks from October to ease a dearth of US dollar funding. The dearth followed the withdrawal of US investors from European markets amid the fiscal debt crisis.

Turning to individual action, the Federal Reserve's second program of quantitative easing (QE2) ended in June and it was suggested in a previous Quarterly Review that more easing might be required. This has indeed materialised, albeit in a less direct form in what has been dubbed "operation twist" but is formally known as the "Maturity Extension Program and Reinvestment Policy". Following its 21 September Federal Open Market Committee meeting, the Federal Reserve Board of Governors announced that the bank will be purchasing $400 billion of Treasury securities with remaining maturities of 6 years to 30 years over coming months (up to the end of June 2012) with the proceeds generated by the sale of an equal amount of Treasury securities with remaining maturities of 3 years or less. In so doing the bank will be altering, that is, extending the maturity structure of its (Treasuries) portfolio while simultaneously influencing long-term interest rates downwards. By swapping short-term securities for long-term securities no additional liquidity is actually provided to the financial system. However, the decline in long-term interest rates should increase the affordability of long-term debt and thereby ease financial market conditions, contributing towards economic recovery. The Fed furthermore committed to maintaining short-term interest rates low until at least mid-2013, thus anchoring market expectations regarding its interest rates policy.

The ECB, which had started a rate tightening cycle earlier this year (there were rate hikes in April and July), was forced to do an about-turn in Q3/2011. The Bank left interest rates on hold at subsequent meetings, admitted that the increases might have to be reversed and was also forced to intervene in sovereign bond markets during the quarter to prevent the collapse of the Italian and Spanish bond markets as a consequence of spiraling borrowing costs, thus extending further liquidity to the financial system. By mid-August 2011, total ECB bond purchases amounted to €110.5 billion (since March 2010). However, it should be noted that the ECB has sterilised some of this liquidity.

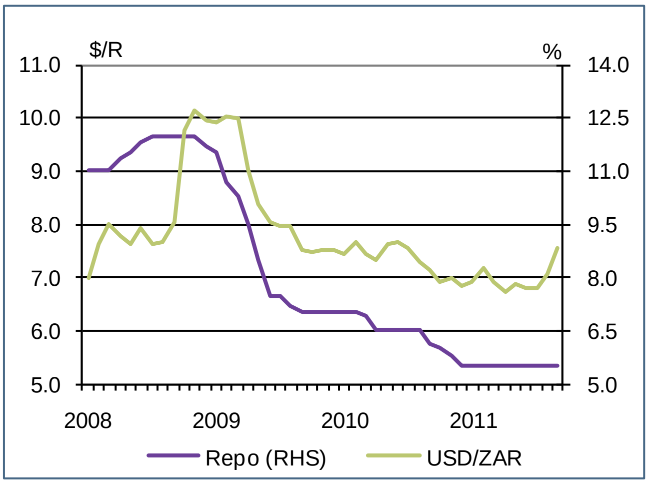
---

[1] *This grouping includes the following countries: South Africa, Brazil, Turkey, Hungary, Poland, Czech Republic, Malaysia, Taiwan and Mexico. Secondary emerging markets include, amongst others, China, Russia, India, Thailand, Indonesia, Colombia, Peru and Egypt.*

The bank's actions have come notwithstanding strong opposition from the German Bundesbank, which fears that such measures will weaken incentives for these rogue countries to ensure sound fiscal finances. Germany has also strongly voiced its opposition to the extension of the bailout powers of the European Financial Stabilisation Facility (EFSF), which to date has assisted Greece, Ireland and Portugal. In particular, the country opposes the issuance of Eurobonds, fearing that there is a lack of appropriate governance and adequate institutions to manage this. Indeed, in the absence of fiscal consolidation in the Eurozone, it is difficult to ensure proper administration of funds thus raised. Germany (as well as the Netherlands) further proposes that it is investors rather than taxpayers that should absorb the losses arising from fiscal ill-discipline. Suggestions that within the second bail-out package agreed to for Greece in July bondholders should take higher hair-cuts or write-downs than those originally envisaged in the event that the country misses any deficit reduction targets, rattled European bond markets in Q3/2011.

Notwithstanding its vociferous reservations, Germany formally voted in favour of measures to bolster the EFSF at the end of September, providing European bond markets with some reprieve. The EFSF will be able to buy bonds and recapitalise banks, if necessary. Nonetheless, differences in opinion across key Eurozone members suggest that the fiscal debt crisis is far from over and that the possibility of sovereign defaults will hang thick in the air for some time. And an early test for the EFSF could come in October, when Greece has to meet its budget deficit targets in order to receive the next tranche of its bailout package amounting to €8 billion (total package of €110 billion).

Exchange rate and repo rate movements



Developments on global financial markets did not leave domestic financial markets unaffected in Q3/2011, as is evidenced by equity and bond market data, as well as the ZAR exchange rate (the ZAR was 18% weaker at the end of September, relative to the end of June, against the US dollar). Contributing towards the weakness of the ZAR were the portfolio capital outflows that followed the onset of risk aversion in both the equity and bond markets. As indicated in the Q2/2011 Quarterly Review, non-residents had become net buyers of domestic bonds in April 2011, following about 5 months during which they had been net sellers. Non-resident net purchases of bonds peaked in May at R13.1 billion for the month, moderating every month thereafter and ultimately turning negative in September. An outflow of R18.3 billion was recorded on the bond market during the month. In the equity market, net sales in September amounted to R7.9 billion, bringing the year-to-date net outflow from this market to R17.2 billion.

Similarly, fears that global economic activity will remain slow and on the brink of another recession in the closing stages of 2011 have filtered through to result in a downward revision to the growth prospects for the domestic economy, which was already suppressed in Q2/2011, following the contraction of the primary (agriculture & mining) and the secondary (manufacturing) sectors.

Data released by the South African Reserve Bank (SARB) show that the domestic economy grew at a rate of 1.3% q-o-q (seasonally adjusted, annualised) in Q2/2011, down from a downwardly revised growth rate of 4.5% in Q1/2011. Forecasts of growth for the year vary in the region of 3% to 3.5%, with previous forecasts higher than 3.5% having been revised lower. The International Monetary Fund (IMF) recently revised its outlook for global economic growth, mostly lowering its projections relative to June 2011. The global economy is expected to grow by 4% this year (previous forecast 4.3%), the US economy by 1.5% (previous forecast 2.5%), advanced economies by 1.6% (previous forecast 2.2%) and emerging markets by 6.4% (previous forecast 6.6%). Clearly the downward revisions are sharper for the US and advanced economies in general. The IMF expects GDP growth of 3.4% for South Africa (previous forecast 3.5%).

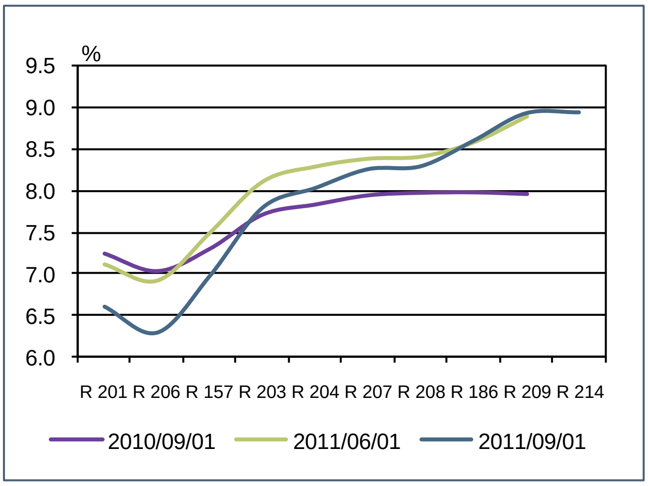
The two principal risk factors to the global growth outlook remain the Eurozone fiscal debt crisis and a deterioration in US economic activity – the same factors that drove financial market developments during Q3/2011, as indicated earlier. A worsening in either of these, or both, would result in a lower growth outcome than that anticipated by the IMF in its September 2011 World Economic Outlook. Other additional and significant risk factors identified by the IMF include, amongst others, vulnerabilities appearing in certain emerging markets (especially overheating of some economies in Asia and South America) and volatility in commodity prices (partly resulting from geopolitical tensions).

The SARB recognised some of these risk factors when it announced its monetary policy decision in September. The bank left the repo rate unchanged at 5.5% and revised its GDP growth forecast downwards while it continued to express some concern over inflationary pressures which have not eased but remain delicately balanced notwithstanding the subdued economic environment. It also highlighted the vulnerability to contagion reflected in emerging markets in recent months. Still, the SARB continued to express a willingness to maintain loose monetary policy amid a low growth environment.

The SARB monetary policy committee will meet once more before the end of the year (in November) and is expected to maintain an unchanged repo rate; however, further and substantial deterioration in the global environment in the closing stages of the year could prompt the bank to cut the repo rate. At present, the likelihood of such an outcome remains below 50% while there is more certainty that interest rates will remain low at least up to the end of Q2/2012. It is also unlikely that ZAR exchange rate weakness, which places upward pressure on inflation when sustained, will force the bank's hand to tighten interest rates, unless it becomes evident that the depreciation is likely to be sustained into the future thus placing the inflation outlook at risk.

The latest developments in financial markets have been reflected in a steeper bond yield curve relative to a year ago. By the end of Q3/2011, the yield curve had shifted lower at the short end, notwithstanding a steady rise in domestic inflation, while substantially higher at the long end. Compared to the previous quarter, the most visible shift occurred at the short end of the curve given that, as outlined above, conditions and subsequently expectations shifted in favour of lower interest rates.

Government yield curve



Other major emerging markets have grappled with similar issues the past few months and some have already moved to prevent a slowdown in economic growth (perhaps somewhat hastily). Notably, the Brazilian central bank cut interest rates by 50 basis points in August, following a 7-month tightening cycle and notwithstanding inflationary pressures. Brazil's interest rates remain high relative to those of other emerging markets, a factor that is believed to be constraining stronger economic growth and contributing towards speculative capital flows.

China's growth figures, although still relatively high are also moderating amid the global turmoil. While it is believed that the country's economy is heading for a soft-landing rather than stalling, data are reflecting the impact of low growth in some of its key trading partners like the US and Europe, with Chinese exports clearly moderating in recent months.

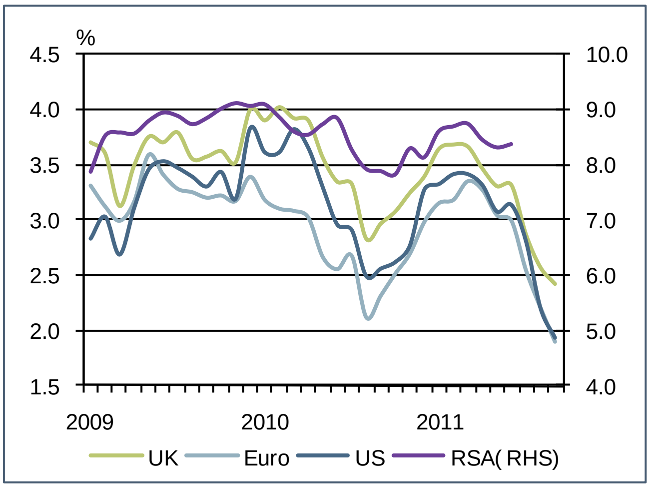
Thus, as we head towards the end of the year, we are unlikely to see a resolution to what are undoubtedly some of the global financial system's most serious and unprecedented problems. As a consequence, economic activity is likely to remain weak and interest rates accommodative. Uncertainty is likely to continue to produce volatility on global financial markets in the months ahead.

Domestically, the focus shifts towards the National Treasury at the beginning of Q4/2011 which, in the fourth week of October will be disclosing its medium-term (the next three fiscal years) budget plans. Demands for increased expenditure have been intensifying on many fronts in the lead-up to the Medium Term Budgetary Policy Statement (MTBPS) and it will be interesting to see the extent to which the fiscal authority will try to accommodate these, especially given the recent signals emanating from the global economic system, without exacerbating taxation pressures or opting for too high and possibly unsustainable debt levels.

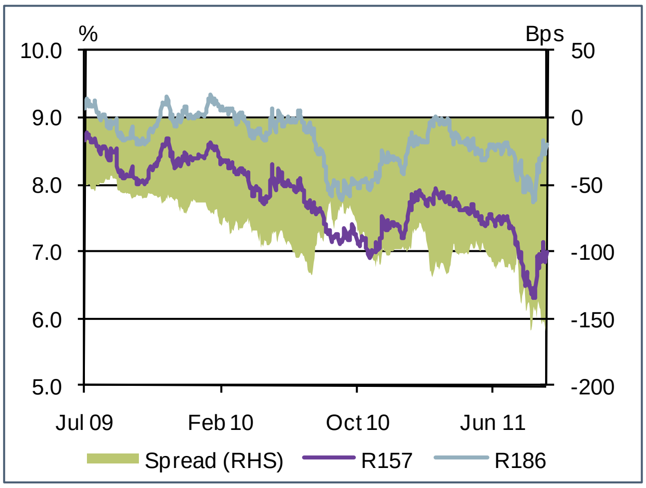
Table 1: Economic indicators as at end of period

Category	Q4/2010	Q1/2011	Q2/2011	Q3/2011
GDP (% q-o-q, saar)	4.5 (R)	4.5 (R)	1.3	-
CPI (% y-o-y)	3.5	4.1	5.0	-
PPI (% y-o-y)	5.8	7.3	7.4	-
USD/ZAR	6.62	6.78	6.78	8.03
JSE ALSI	32 118.9	32 204.1	31 864.5	29 674.2
BEASSA ALBI	343.7	338.4	351.5	361.4
BEASSA ALBI performance (%)*	0.7	-1.5	3.9	2.8
Repo rate (%)	5.5	5.5	5.5	5.5
Prime rate (%)	9.0	9.0	9.0	9.0
** End of relevant quarter relative to end of previous quarter*				

10-year Benchmark yield movements

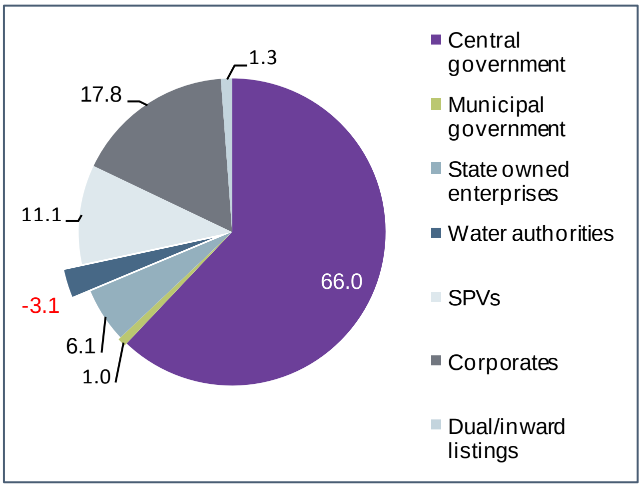


RSA benchmark bonds and spread



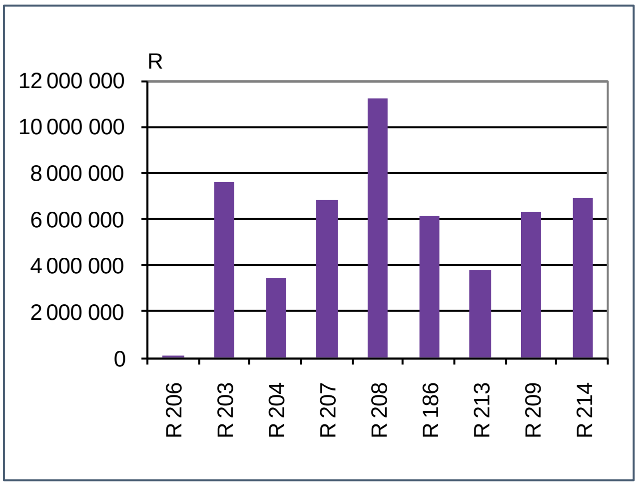
Primary market

Contribution to the change in the nominal value of listings Q3/2011



The primary bond market recorded a slight improvement during Q3/2011 following the moderation registered in Q2/2011. During the quarter, only one sub-category of listings subtracted from the net[2] change in the total nominal value of bonds listed as at the end of the quarter, namely the sub-category for water authorities' listings. The contribution to the net increase in listings in Q3/2011 by both total government and state owned enterprises (SOEs) moderated relative to the previous quarter, while the contribution by total corporates improved. In addition, this improvement was not driven by banks, even though the latter's contribution remained sound. In total, the net nominal value of bond listings on the JSE increased by R42.1 billion in Q3/2011, up from the previous quarter's change of R40.3 billion. Central government accounted for 66% of this change, down from 88% in Q2/2011, while corporates accounted for 17.8%, up from the previous quarter's 13.6%. On a month-to-month basis, the net change in the nominal value listed was strongest in September, although July recorded very similar strength. The weakest month for listings proved to be August, which is not surprising as global events virtually shut down capital markets globally. However, in addition to this, the R155 government bond matured on 31 August 2011. Consequently, notwithstanding a continuation of the weekly government auctions, the net change in the nominal value of central government bonds listed was only R546 million during the month.

Government gross bond issuance across yield curve (Apr 2011 – Aug 2011)

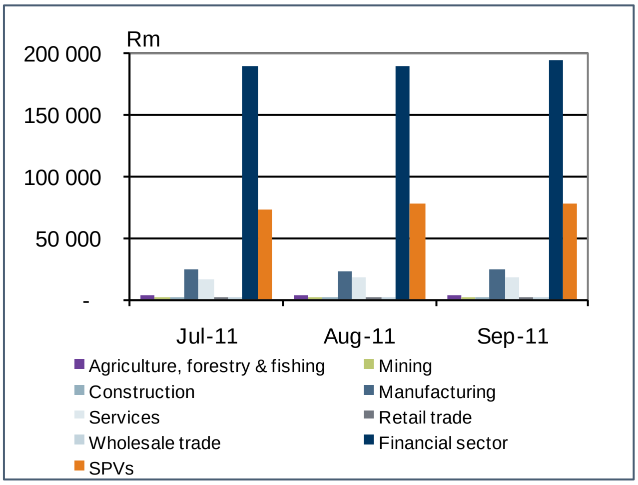


A total of R27.3 billion worth of fixed income paper was placed in the domestic market by government during its weekly auctions in Q3/2011. An additional R8.1 billion was placed via the auctions of inflation-linked bonds. On the fixed income side, gross issuance on a year-to-date basis (that is, fiscal year beginning March 2011 to August 2011) remains concentrated in the R208, maturing in 2021. There continued to be relatively sound appetite for government paper on the domestic market during the quarter, notwithstanding the global turmoil. However, government expressed some concern over the impact of the latter on government bonds, given that Europe holds approximately 35% of RSA debt. Continued risk aversion could push domestic bond yields higher.

Municipal listings, which by the end of Q3/2011 totaled R13.7 billion, recorded a marginal rise relative to Q2/2011 as the City of Johannesburg issued commercial paper (CP) to the value of R401 million.

[2] *Net of redemptions and maturities*

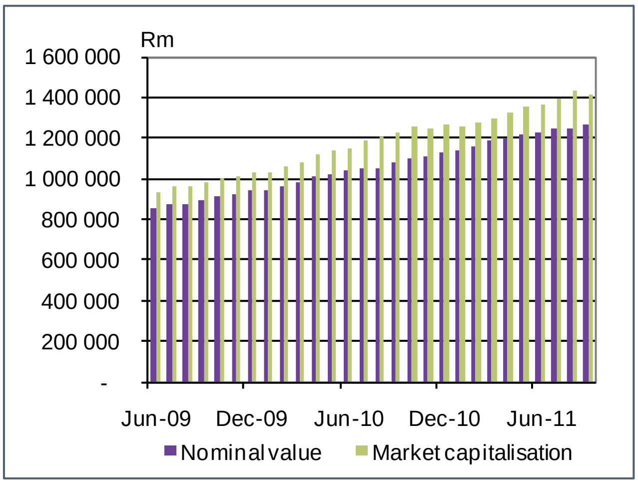
Sectoral breakdown of corporate listings



Net new issuance by total corporates in Q3/2011 amounted to R7.5 billion, while excluding banks it amounted to R4.3 billion. Still, this activity was concentrated in the financial sector. New listings during the quarter among corporates included issuance amounting to R4.9 billion by Toyota Financial Services, issuance by RCS Investment Holdings amounting to R2 billion and issuance by Resilient Property Fund amounting to just over R1 billion. New listings by banks amounted to R6.9 billion in Q3/2011, with the instrument types varying from floating rate notes (FRNs), to vanilla bonds (V), to customised instruments (CI), inflation linked bonds (CPI) and CP. The bulk of issuance, however, was in the form of FRNs (R4.2 billion). Unfortunately, with GDP growth slowing in Q2/2011 and given the negative growth outlook for the global economy for the remainder of the year, corporate listings are unlikely to strengthen further in the closing stages of the year.

July and August were both strong months with respect to the net change in the nominal value of special purpose vehicles (SPVs[3]) listings. In Q3/2011, the net nominal value of SPVs listed on the JSE increased by R4.7 billion, marking the strongest showing for the category since the global financial crisis. A lot of this issuance was in the form of short-dated CP, however, some FRNs were also listed in the vehicle-backed sub-category.

Nominal value of listings vs market capitalisation



New listings by SOEs during Q3/2011 amounted to just over R2 billion, with both Transnet and Denel coming to market albeit with CPs. On a net basis, the nominal value of SOE listings increased by R2.6 billion during the quarter, down from R3.4 billion in Q2/2011. As mentioned in the previous edition of this Review, SOE issuance has played a less prominent role in 2011. Nonetheless, many SOEs continue to tap existing issues regularly.

There has been only a marginal change in the instrument composition of bond listings on the JSE recently. By the end of Q3/2011 vanilla bonds still dominated as the issuance of these instruments continued to rise, but their share of listings had declined from 71% to 70%, with FRNs instead gaining in share (by 1%) to comprise 11% of total. There was a moderate increase in the nominal value of CP instruments listed in September.

As at the end of Q3/2011, the market capitalisation of the bond market was R1 414 billion ($201 084 million), down from R1 433 billion at the end of August, with this loss in value reflecting the impact of global financial market developments. By the end of the quarter there were 1 137 bond listings on the JSE by 112 different

[3] *The JSE's definition of special purpose vehicles encapsulates paper issued with the backing of either a single asset or a pool of assets. Previously, the term securitisations was used, however, this implied only paper backed by a pool of assets.*

issuers. Notwithstanding the volatility in capital markets in recent years, the number of listings has increased and is now higher than it was at the end of 2008.

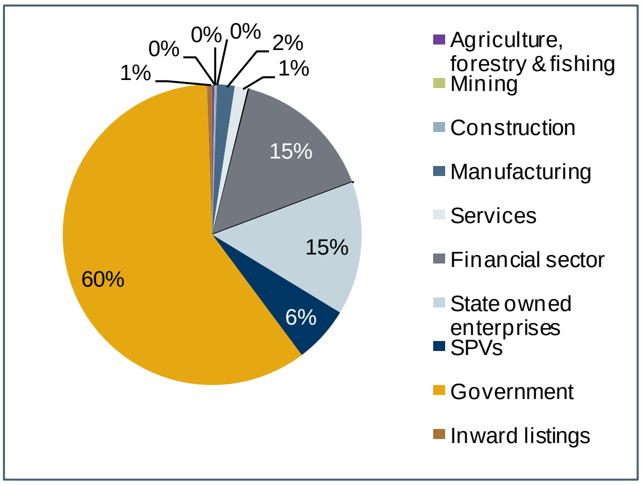
Table 2: Summary of bond listings as at end Q3/2011

Category	Nominal value ($m)	Nominal value (Rm)	Market Cap (Rm)	No of Issues	No of Issuers
Central government	92 583	743 144	847 496	80	2
Municipal government	1 703	13 667	14 832	13	3
State owned enterprises	20 637	165 652	177 123	51	8
Water authorities	2 203	17 687	23 792	11	4
SPVs	9 666	77 587	77 949	307	36
Corporates:	30 490	244 740	264 942	643	55
Of which banks only	21 885	175 670	194 409	503	8
Dual/inward listings	899	7 220	7 470	32	4
Total	**158 182**	**1 269 696**	**1 413 604**	**1 137**	**112**

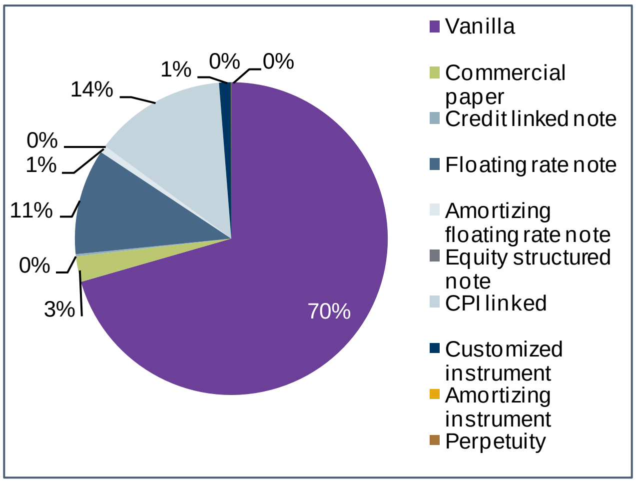
Table 3: Nominal value listed as at end of quarter

Category	Q3/2010	Q4/2010	Q1/2011	Q2/2011
Central government	607 556	644 617	679 845	715 344
Municipal government	14 316	15 018	15 451	13 266
State owned enterprises	148 112	157 416	159 636	163 083
Water authorities	17 395	17 435	18 964	19 007
SPVs	76 051	74 248	74 804	72 910
Total corporates:	207 618	212 389	231 741	237 244
Of which banks only	147 110	149 676	169 138	172 501
Dual/inward listings	6 710	6 765	6 770	6 690
Total	**1 077 758**	**1 127 888**	**1 187 210**	**1 227 544**

Sectoral composition of listings at end Q3/2011

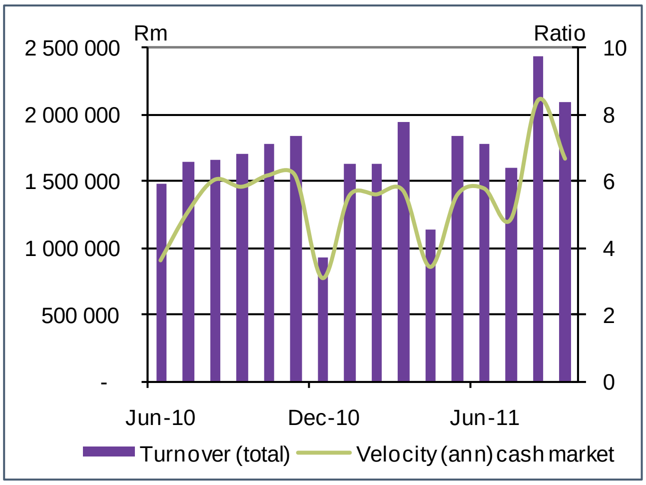


Instrument composition of listings at end Q3/2011



Secondary market

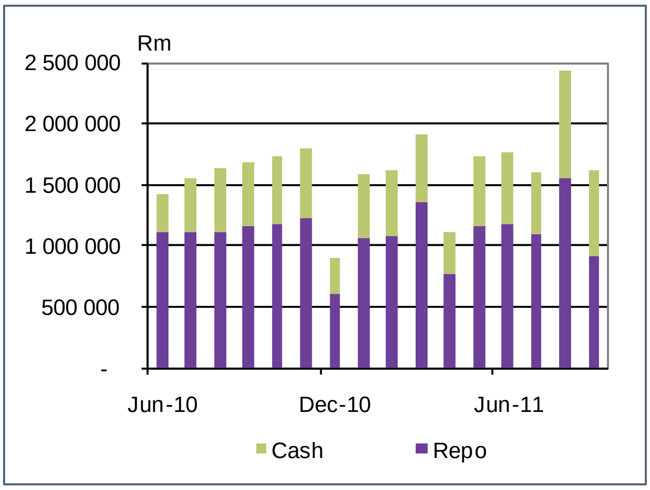
Bond turnover and velocity on the JSE



Trading in bonds on the JSE in August 2011 broke the record set in September 2008, at the height of the financial crisis, after a relatively quiet month of July, during which total turnover moderated to R1.6 trillion. Total nominal turnover in August amounted to R2.4 trillion, while in September 2008 it only breached the R2 trillion level. This highlights the significance of the events that unfolded in Q3/2011 and how severe the uncertainty was that led to what might still turn out to be only short-term portfolio capital flow adjustments.

In September, the nominal value of turnover recorded moderated but remained above R2 trillion. For the quarter as a whole, turnover amounted to R6.1 trillion, raising the year-to-date turnover figure to R16 trillion, close to the total recorded for the full calendar year of 2010 (R16.9 trillion). The highest total turnover recorded in a year was R19.2 trillion and it was recorded in 2008.

Turnover breakdown



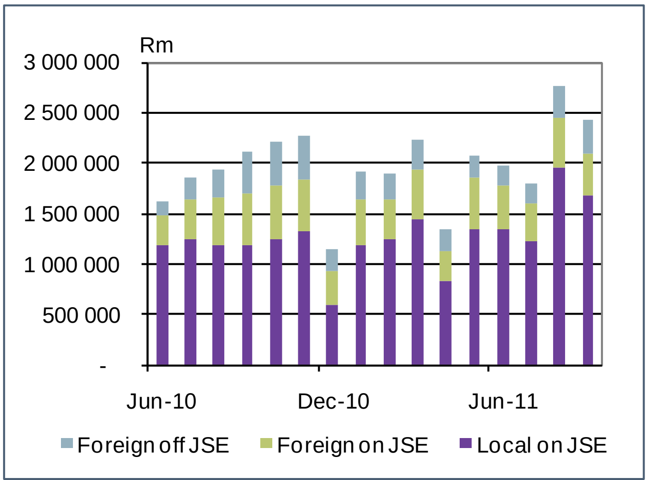
Turnover on the cash bond market continued to advance strongly during Q3/2011. It was highlighted in the Q2/2011 Review that there has been a surge in activity on this market segment this year. In August 2011, turnover on the cash market reached R878 billion, while cumulatively, from January to September, the total turnover recorded on the cash market amounts to R5.2 trillion, which is 52.7% higher relative to the same period a year ago. The hype of activity recorded in August resulted in annualised turnover velocity in cash bonds rising to a record 8.4 before moderating to 6.7 in September 2011. The annualised turnover velocity on the entire bond market reached 23.4 in August 2011.

The increase in bond market activity also resulted in a surge in repo trades during August 2011. Total repo trades during the month peaked at R1.6 trillion before moderating to R1.4 trillion in September 2011. On a year-to-date basis, repo trades have increased by 24.5% y-o-y. It should be noted that a minor reporting change was made by the JSE towards the end of September, which results in the repo trades of members and clients being reported separately henceforth from other member and client trades. This new breakdown can be seen in the graph reflecting turnover on the JSE by trade type.

Heightened trading activity during Q3/2011 resulted in the average turnover per trading day rising on the JSE to a new record high in August 2011. Even though there was only one extra trading day in August relative to July, the average turnover per day in August reached R111.1 billion, up from July's moderate R76.2 billion. In September the average fell to R95.2 billion.

The increase in global risk aversion resulted in capital flight from emerging markets, as outlined earlier in this report. On a net basis, the outflow from the bond market amounted to R18.3 billion in September. In July and August, non-residents had continued to buy RSA bonds on the JSE on a net basis. On a year-to-date basis, the net inflows into the bond market via the JSE amount to R27.5 billion. Notwithstanding the outflows in September, total activity by non-residents on the JSE (that is, sales and purchases combined) only reached R487.7 billion; activity was stronger in March this year at R508.4 billion. It thus remains to be seen whether non-residents will continue to exit the RSA bond market or not; much will depend on a combination of factors, key among which will be global developments and how these shape investor sentiment. However, domestic developments will also play a role, particularly those concerning domestic inflation, the ZAR exchange rate and government's fiscal plans going forward, which will be revealed soon. Thus far in 2011, non-resident activity on the JSE accounts for 24% of the turnover recorded on the Exchange, well off the peak reached in 2006 of 38%. According to National Treasury, as at the end of August this year non-residents held approximately 30% of the stock of RSA government bonds, up from less than 10% a mere five years earlier.

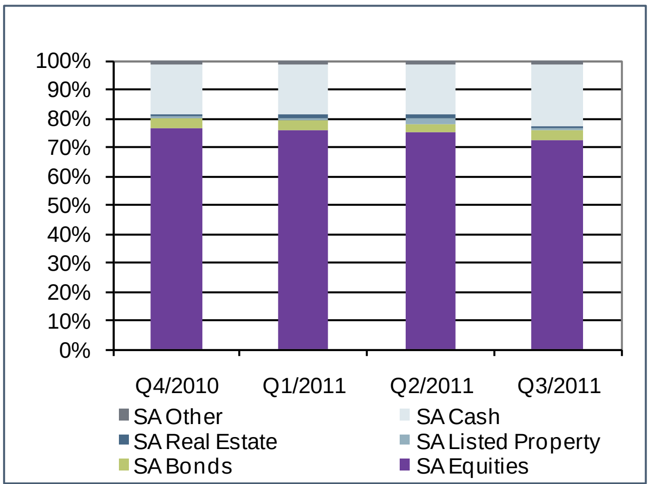
Non-resident interest in South African bonds



Non-residents who traded RSA bonds over the counter (OTC) offshore also upped their overall activity during Q3/2011, according to data provided by Strate. In July 2011, turnover on the OTC market only reached R196.1 billion, but it rose to R329 billion in August 2011 before falling slightly in September to R324.8 billion.

Although non-residents turned bearish on the domestic bond market in the closing stages of Q3/2011, domestic asset managers maintained and indeed increased their appetite for bonds during the quarter, as reflected by the Alexander Forbes asset allocation survey. However, much of this appetite might have been present towards the early part of the quarter. Nonetheless, portfolio allocations towards bonds increased from an average of 14.5% in Q2/2011 to 15.3% in Q3/2011. The shift towards cash holdings was greater during the quarter, possibly a reflection of increased uncertainty; the percentage of cash holdings increased from 15% in Q2/2011 to 18%. The move towards bonds and cash came at the expense of RSA listed equities.

Non-resident interest in South African bonds



The total number of trades recorded in Q3/2011 is 110 893, up from 82 341 in Q2/2011. It is notable that despite the increase in trading activity as reflected in the higher nominal turnover value during the quarter, the average trade size decreased, both relative to Q2/2011 and Q1/2011, a reflection of increased risk aversion.

Concluding remarks

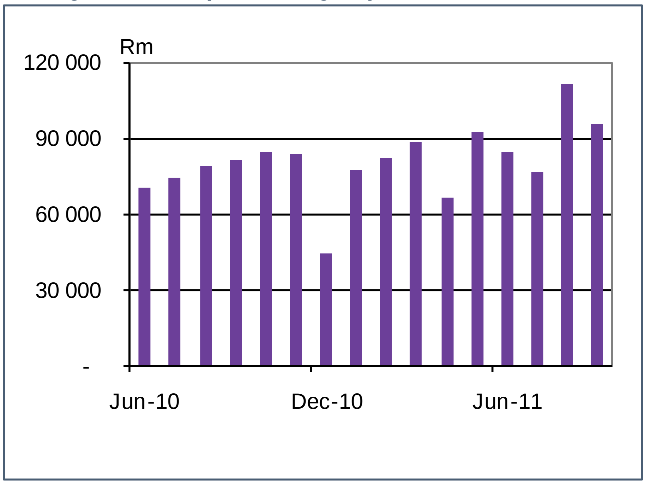
Much has changed in a relatively short space of time, subtracting from the rosy picture envisaged for the bond market at the beginning of Q3/2011. However, this phase of heightened risk aversion could still prove to be temporary or to, at the very least, moderate over the next few months. It is likely that global financial markets will remain on edge in Q4/2011 but that investors will realise the continued relative attractiveness of certain emerging markets and hence return to these, perhaps with a little less conviction than seen previously. Global economic growth will undoubtedly be slow but we do not foresee a double-dip recession scenario.

Domestically, inflationary pressures will remain a concern, particularly if the ZAR exchange rate remains volatile. We suspect, however, that the volatility will abate, inflation will peak but will not run away to unmanageable levels and the SARB will maintain interest rates unchanged at least up to the end of Q2/2012. In this type of climate, the bond market is likely to retain the support of both domestic and non-resident investors, provided that the fiscal situation continues to be managed soundly. Should the MTBPS suggest a shift towards more aggressive borrowing, the situation could deteriorate. There are no signals to suggest this will be the case.

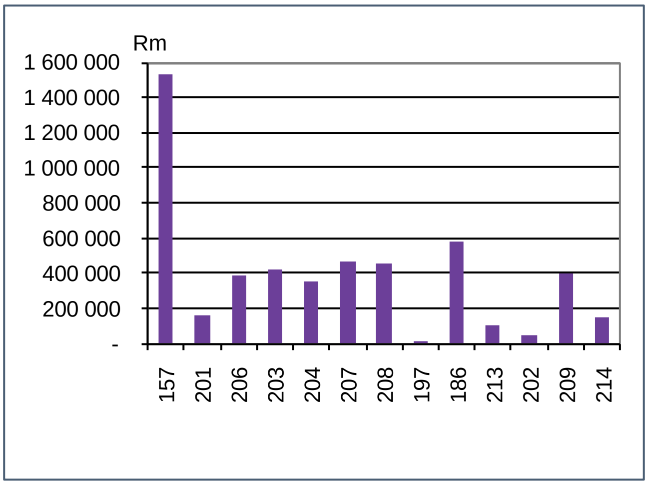
Table 4: Summary of key turnover data

Quarter	Total turnover (Rm)	Total turnover ($m)	No of trades	Ave annualised turnover velocity (on JSE)	Ave annualised turnover velocity (on JSE, cash market only)
Q4/2010	4 555 703	688 173	78 268	16.4	5.2
Q1/2011	5 207 008	767 995	88 544	17.9	5.6
Q2/2011	4 751 914	700 872	82 341	15.6	5.0
Q3/2011	6 138 833	764 792	110 893	19.5	6.7

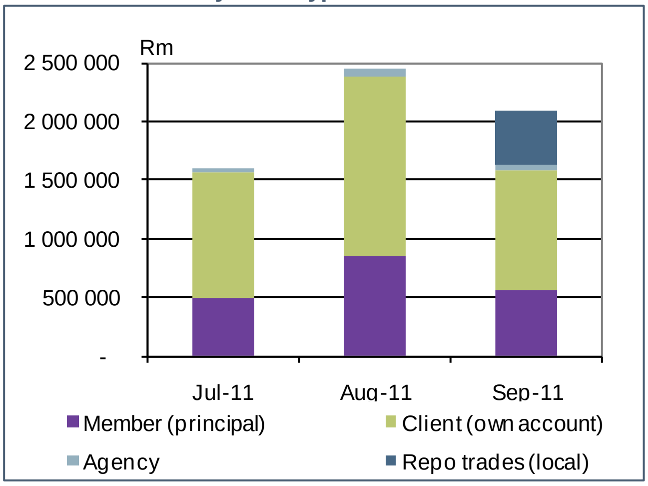
Average turnover per trading day on JSE



Turnover on yield curve in Q3/2011



Turnover on JSE by trade type



Turnover on JSE by transaction type