

Bond market pushes back on lower rates

Markets. |

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The recent behaviour of Uganda's bond market suggested a gentle easing in interest rates.

With inflation subdued below the five percent policy benchmark and political pressures fading, yields appeared to be moving lower, in line with the preferences of Bank of Uganda.

That alignment is beginning to fray. In the secondary market, the benchmark 10-year government bond is now trading at about 15.5 percent, up from 14.5 percent at the February auction.

The 20-year has edged closer to 16 percent, well above its recent primary market levels. These are consistent, and in fixed income, consistency tends to matter more than magnitude.

Yields rarely move higher without cause.

From premium to pressure

The February auction offers a clear snapshot of where the market stood.

The 10-year bond cleared at a yield of 14.5 percent, even as it carried a coupon of 16.25 percent. That difference mattered. It meant the bond was offering an income stream above prevailing market rates.

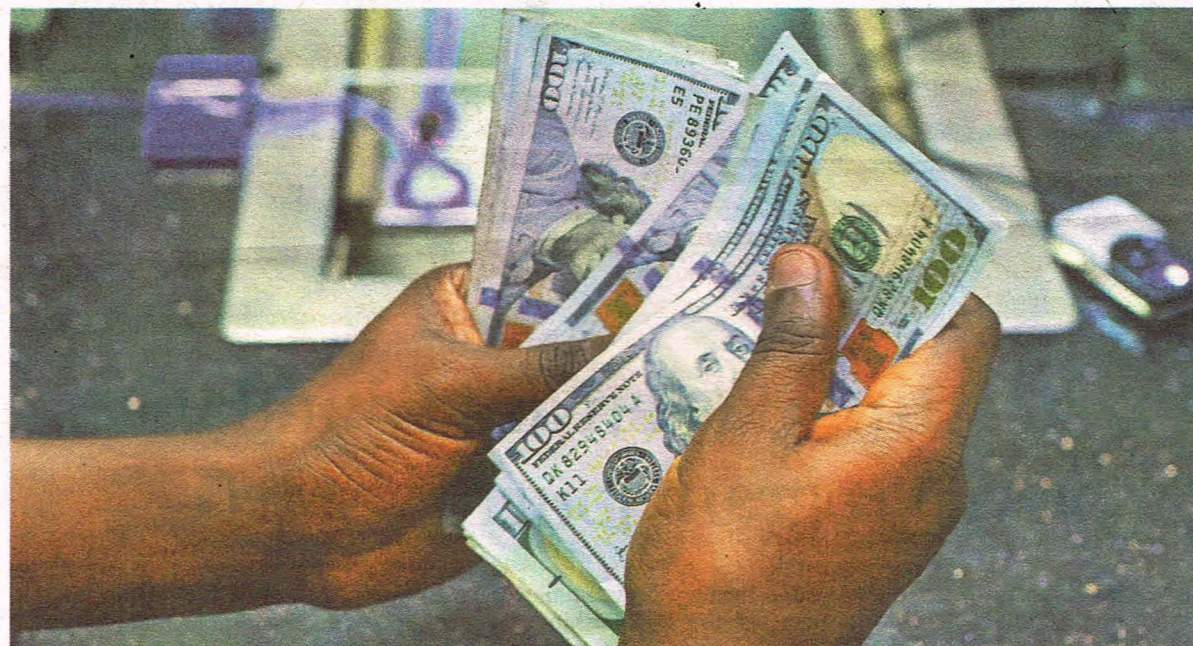
Investors competed for it. Demand tightened, prices were pushed higher, and the bond was issued at a premium of about 13 percent. In effect, investors paid more upfront to secure that higher stream of income over time.

But such pricing rests on an assumption that yields will remain stable, or fall further.

Once that expectation begins to shift, the logic starts to unwind. The premium compresses, pricing adjusts, and the market begins to recalibrate. That recalibration is now underway.

The signal

Currently, that same 10-year bond is trading closer to 15.5 percent, while the



A man counts dollars. By the time bonds return to auction, much of the repricing has already happened. PHOTO/MICHAEL KAKUMIRIZI

20-year has moved to around 16 percent. What has changed is not just the level of yields, but the expectations behind them.

Investors are no longer pricing bonds on the assumption that rates will keep drifting lower. Instead, they are beginning to factor in a different possibility that yields may rise, or at least stay higher for longer.

That shift is significant because the secondary market is where views are formed and tested in real time. It is not reactive; it leads. By the time bonds return to auction, much of the repricing has already happened.

And at the moment, that repricing points in one direction. Investors want to be paid more.

Why?

There is no single cause. What is emerging is the result of several pressures interacting at once.

Start with the external environment. A month into the Iran conflict, global

Interest rates

15.5%

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16%

The 20-year bond has edged closer to 16 percent, well above its recent primary market levels

capital has turned more cautious. Frontier markets like Uganda do not need direct exposure to feel the effect.

When investors reassess risk globally, they adjust pricing broadly, and that adjustment often comes through higher required yields.

Then there is the domestic picture. Government financing needs have not eased. The state remains a steady presence in the market, competing for available liquidity.

That persistent demand for funds places a floor under interest rates, as investors price in the expectation of continued supply.

The third factor is that liquidity has become more selective. Capital is still available, but it is being deployed with greater care. And when money becomes more discerning, it rarely moves cheaply.

Taken together, these forces are not dramatic on their own. But in combination, they point in a direction of upward pressure on yields.

Where this gets tested

The April 15 auction will reveal how far the current one has already gone.

When the Bank of Uganda returns with reopened three-year, 10-year and 20-year bonds, it will be meeting a mar-

ket that has already adjusted its expectations.

For the 10-year bond, yields are likely to come in between 15 percent and 16 percent. That still sits below the 16.25 percent coupon, so the bond should continue to price at a premium.

But that premium will be thinner than before, reflecting a narrowing gap between what the bond pays and what the market now requires.

The 20-year bond sits on a different edge. With a coupon of about 15 percent and secondary market yields already around 16 percent, it is moving closer to a point where the premium disappears altogether. Depending on how the auction clears, pricing could settle near par, or slip into a discount.

It is a small shift in mechanics, but an important one in meaning, reflecting that the market is moving from pricing driven by excess demand to pricing shaped by balance.

Policy versus market

The Bank of Uganda has been working to guide interest rates lower, to support economic conditions and partly to manage the government's cost of borrowing. That effort has relied not just on policy signals, but on market cooperation.

As secondary market yields rise, the Central Bank faces a narrowing set of choices. It can accept higher yields, allowing borrowing costs to adjust upward in line with market conditions.

Or it can reject higher bids at auction, limiting supply in an effort to contain rates. But rejecting bids does not eliminate demand for higher returns. It only postpones it. And the longer that gap persists, the more pressure builds in the system.

For investors, this is no longer a market moving neatly in one direction.

The earlier phase, when falling yields lifted bond prices and made allocation decisions relatively straightforward, is giving way to something more contested. Timing matters more. So do expectations.