NATIONAL TREASURY
REPUBLIC OF SOUTH AFRICA
Tel: 012 315 5610 **Fax:** 012 326 7552

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WIDENING OF THE PRIMARY DEALERS BID-OFFER SPREAD

PRESS RELEASE

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1. Paragraph 24 of the Code of Conduct for Primary Dealers makes a provision for a maximum bid-offer spread that applies to prices quoted between Primary Dealers or by Primary Dealers to other market participants. The maximum spread is currently 5 basis points in R10m for liquid bonds and 5 basis points in R5m for the less liquid bonds.

2. The Primary Dealers (PDs) have requested that the maximum bid/offer spread obligation be lifted since the consequence of a predetermined maximum spread is that during times of abnormal market volatility or low liquidity, the PD system does not perform optimally. According to the PDs, in times of volatility, transactions are based on an artificial constraint due to the maximum spread.

3. In an attempt to eliminate the above mentioned problem, and according to the Primary Dealers, to align the South African domestic capital market with the best practices followed in most major international markets, a request was made that the maximum bid/offer spread obligation be lifted. The Primary Dealers stated that the domestic capital market has now reached a level of development and maturity to allow a progression towards the standard practice in more developed economies.

4. The proposal by the Primary Dealers was discussed by the Public Debt Committee which is made of the SARB's and National Treasury's Officials. A Task Team was established to undertake research regarding this issue.

5. The Task Team studied 12 countries, in both the developed and developing capital markets, and the findings were:

   – Except the USA Treasury due to its liquidity, very large total debt outstanding and large number of market participants, all debt offices oblige (or recommend) PDs to a maximum bid/offer spread
   – The bid/offer spread changes from time to time
   – The maximum spread widens as maturity lengthens
   – The minimum nominal amount decreases as maturity lengthens
   – The more liquid the bond is, the tighter is the bid-offer spread obligation/recommendation.

6. The National Treasury has made the following recommendations:

- The maximum bid/offer read obligation be not lifted
- The maximum bid/offer spread be different at different maturity areas of the curve
- The minimum nominal amount be different at different maturities
- The current 5 basis points in minimum amount of R10 million nominal will remain for the short to medium term bonds R150 (2004/05/06), R194 (2007/08/09) and R153 (2010/11/12)
- A maximum of 10 basis points in minimum amount of R10 million nominal for the long-term R157 bond
- A maximum of 15 basis points in minimum amount of R5 million nominal for the ultra long-term R186 bond
- With illiquid bonds almost gone due to the National Treasury's debt consolidation programme, PDs are not obliged to quote a two-way price for non-benchmark bonds. The PDs will quote a two-way price for the R150, R194, R153, R157 and R186. Regarding the R150, an announcement will be made on when will the PDs be requested to quote a two-way price on the split R150 (R006, R151 and R152).

7. Noting the liquidity of the government bonds across the yield curve in which the R150 and the R153 contribute about 70%, the National Treasury is comfortable about widening the bid/offer spreads of the R157 and R186.

8. Considering the level of sophistication of the domestic capital market, it is doubtful that any primary dealer will widen its bid/offer spread in a stable environment since investors will use other market makers. In fact, while the maximum bid/offer spread is currently 5 basis points, in a stable environment, Primary Dealers tend to quote 1-3 basis points spread.

9. The National Treasury will monitor the performance of PDs and reserves the right to move back to the original position if necessary. The National Treasury will compile a first Report on 31 October 2002 (after 3 months) to ascertain the performance of PDs in this new market environment.

10. The widening of the Primary Dealers bid/offer spread obligation on selected bonds will be effective from **1 August 2002**.

For further information contact:

Mr Phakamani Hadebe
Chief Director: Liability Management
Phone: (012) 315 5486
E-mail:phakamani.hadebe@treasury.gov.za