FACT SHEET

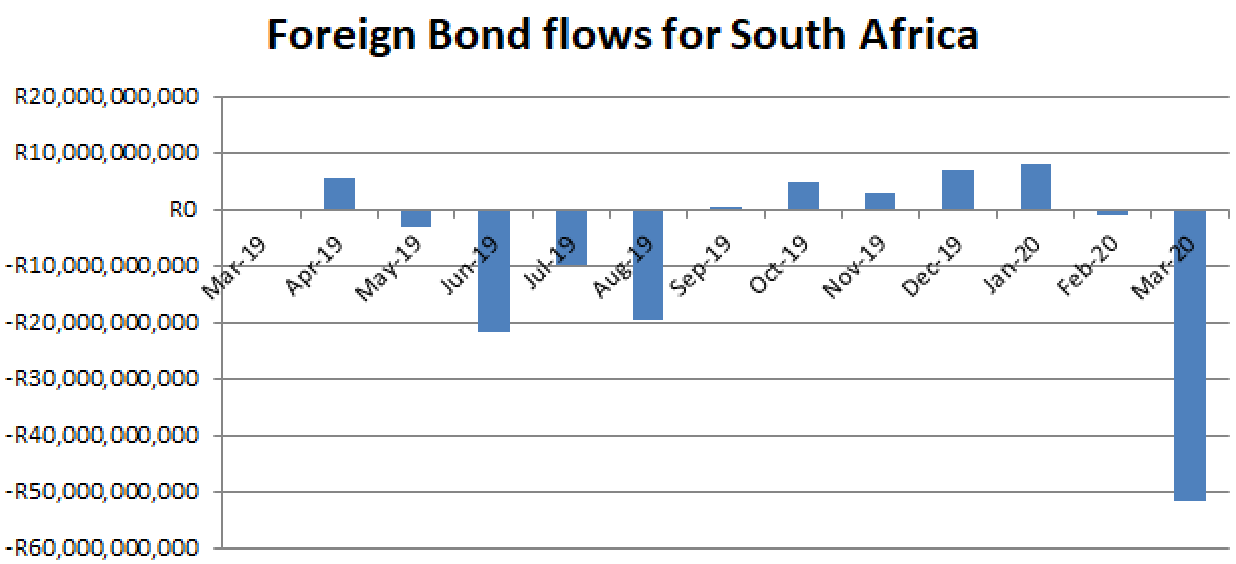
MARKET IMPACT OF LATEST CREDIT RATINGS DOWNGRADE

CASH AND LIQUIDITY FACT SHEET

INTRODUCTION

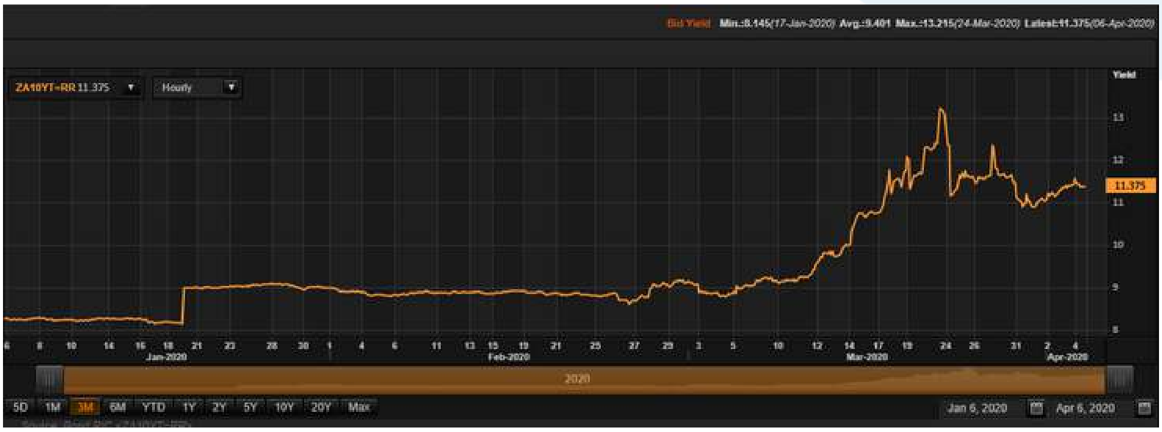
Amidst the current Coronavirus pandemic that has swept through the market, which has caused a bit of market panic, to say the least, but in all the headline of the virus, another major event occurred which will have far-reaching effects in the market. We are of course talking about the credit rating downgrade by Moody's, where South Africa's credit rating has been downgraded to below sub-investment grade, or "junk", by all three major credit rating agencies.

As we are all aware one of the major effects of this is that South Africa will be taken out of the WIGB bond index and that a significant bond outflow will happen in the South African bond market. However, instead of a major sell-off all at one, news came across the wire that passive funds will only be allowed to sell out of the WIGB at the end of April. This will act as a shock absorber and the knee jerk reaction will be softened a little. We have seen from the chart below that there have been significant outflows out of the bond market by foreigners in March already. Some R51bio or $3bio has already left our shores. With the potential outflow being in the region of $10bio, we can perhaps say that a 30% rebalancing has already taken place.



HOW WILL THIS IMPACT SOUTH AFRICA?

With the Sovereign credit rating being downgraded to sub-investment grade, the cost of borrowing of the South African government will become more expensive. The below chart illustrates the market reaction to the downgrade as the benchmark R2030 government 10-year bond reached 13.20% in the wake of the downgrade.



Sovereign credit risk, which is reflected in sovereign credit ratings, represents the likelihood that a government might be unable, or unwilling, to meet its debt obligations in the future. Several key factors come into play in deciding how risky it might be to invest in a particular country or region. They include its debt service ratio, growth in its domestic money supply, its import ratio, and the variance of its export revenue.

We can see from the above that this places extra pressure on a Government that is already under strain and furthermore is not welcome news for an economy which cannot bear a lot more hurdles in the way. However, in the midst of all the drama, there are a few shining lights. One of them is the strength of the local banks in terms of capitalisation and overall financial soundness.

The events of the last couple of weeks have placed certain question on the financial system with liquidity being one of the major issues being addressed. The major concern is whether there will be enough liquidity in the system that banks can service their clients in times where the economy is facing a severe crisis.

The short answer to this is yes, and quite a resounding one at that. After the financial crisis, the Basel banking standards were introduced, these were brought in in order for banks to ensure that they are not on the short end of the stick should a crisis occur in the future. The latest iteration of the Basel frameworks is Basel III which has significantly increased the capital holdings that a Bank needs to have. All the South African banks adhere to this which is a boon in a time of crisis.

Furthermore, the South African Reserve Bank, stated that they will launch their own QE programme in order to stimulate liquidity in South Africa in the short term, which is another indication the liquidity in South Africa will be managed by the banks and that there are measures in place that business could operate as close to “normal” in these trying times.