Covid-19 briefing call

A long path ahead

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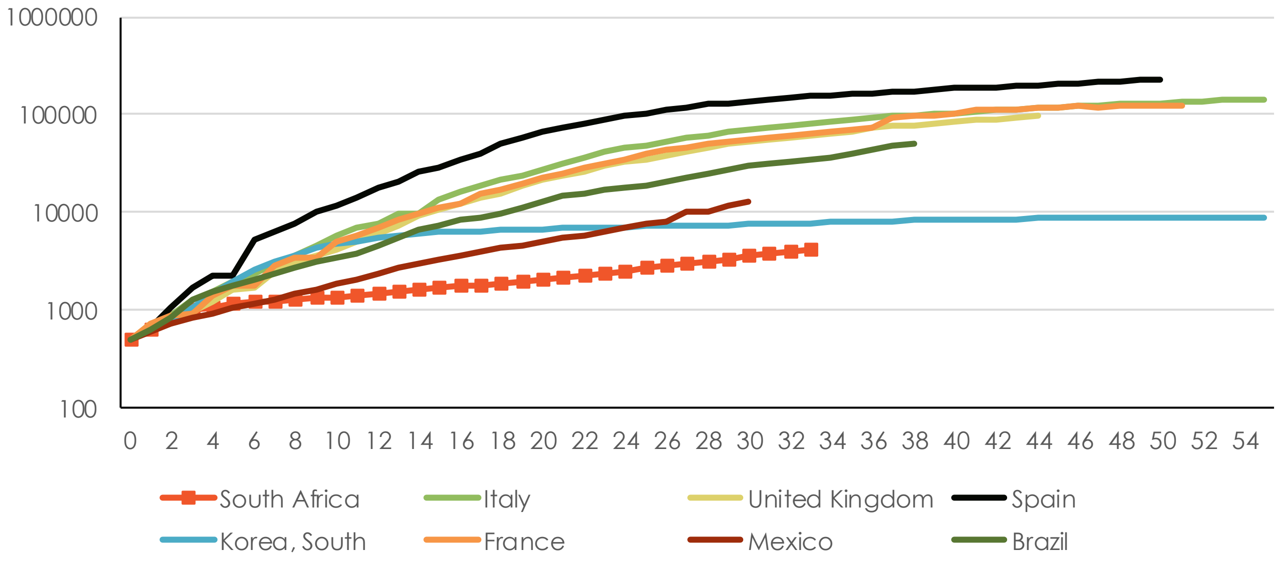
Researching Capital Markets and Financial Services

Macro and fiscal impacts

Consensus still grossly underestimates the length or severity of the path ahead

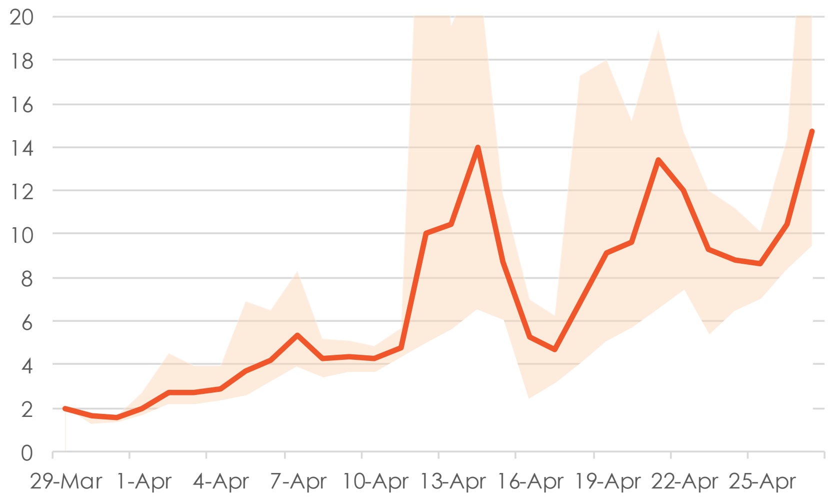
South Africa's experience

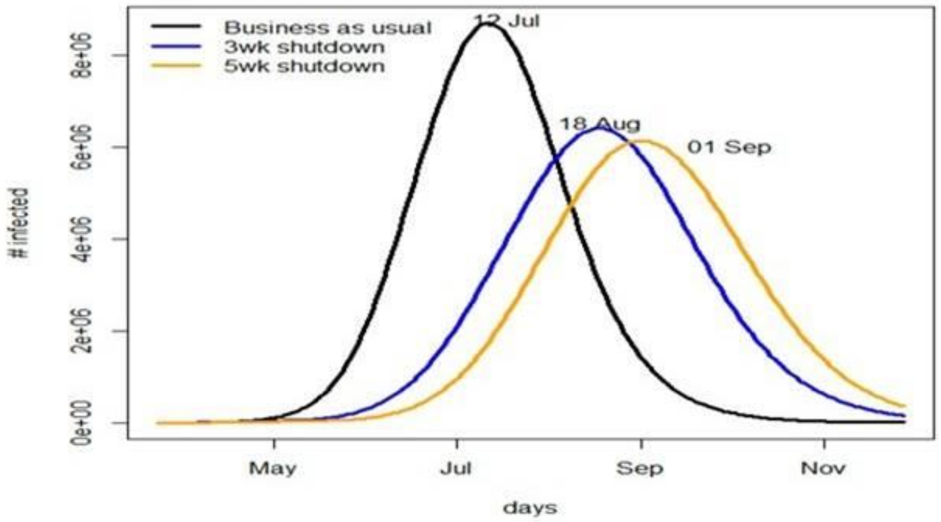
- Exponential curve started through March – imported cases
- Sharp adjustment around start of lockdown on 26th March likely due to Disaster declaration on 15th March
  - Social distancing and sharp drop in tourism arrivals and restaurant and bars open before lockdown
- Lockdown on 26th March occurred without adequate economic package
  - Only approximately 1.5%GDP of which maybe only 0.5% GDP actually deployed on time.



South Africa's experience

- Significant ramp up in community testing – now 10k tests per day conducted
- Significant lumpiness in data – however death rate doubling time (days) increasing.
- Problem is winter is coming, reduction in respiratory health, seasonal flu.
  - DoH planning for early September peak – very different profile to Europe given seasons.
  - Coastal, higher humidity areas likely more affected
  - But also risks to population dense areas.
  - Long way to go – key ramp up time July and August





Growth impact

Start year 2020 GDP growth

1.2%

Post Q4 data and loadshedding

0.1%

Disaster declared, border closure

-2.3%

Lockdown (3weeks), w/ stimulus and rates

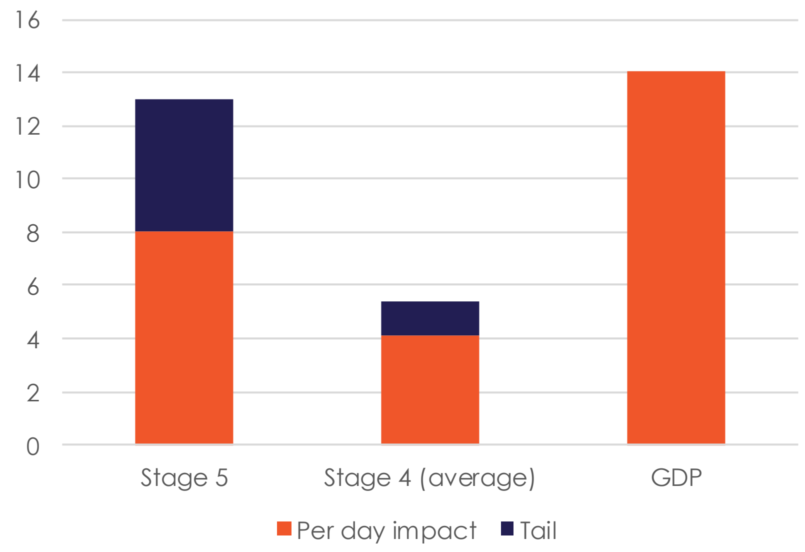
-6.8%

Lockdown extension

-9.7%

Flexible lockdown till September

-16.4%



Estimate 1.7mn jobs will be lost

Add in ZAR500bn stimulus

-10.6%

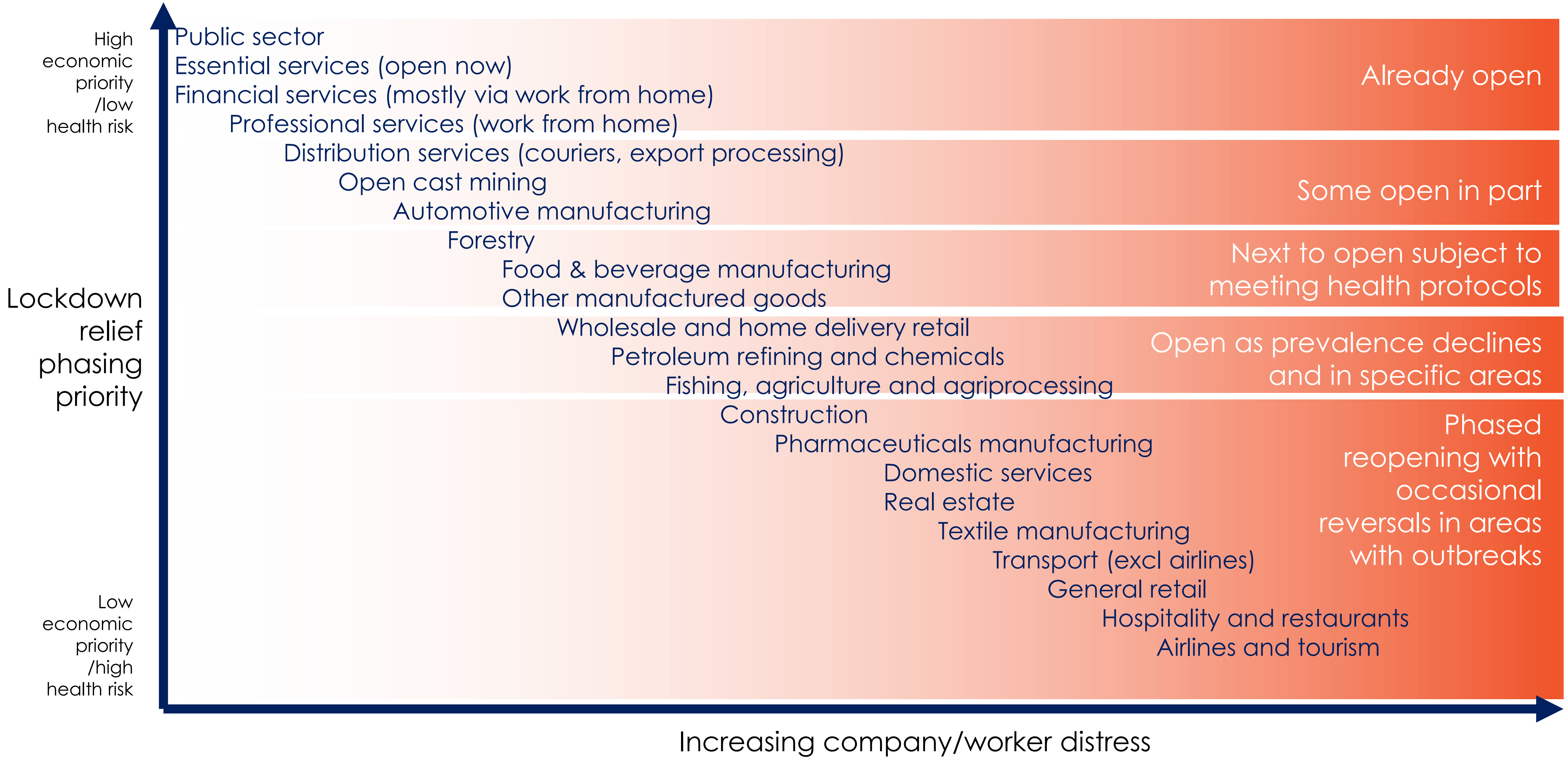
Stimulus problems

- Initial Pretoria response was to treat this as ‘large but normal shock’
- SARB ‘got it’ first – rate cuts and then under pressure banking regulatory easing
  - Bank capital and liquidity changes are **not** ZAR300bn stimulus being marketed
  - Accommodation for 90% of losses expected, not stimulus
  - Expect SARB to cut another 50bp in May, risk of more.
- NT found itself institutionally ill at ease within wider government in stimulus discussions

- Securocrats and microeconomic fiddlers clearly in majority
- Some institutional missteps made around timing of stimulus inputs into cabinet and decision making
- Believe cabinet worked backwards, chose 10%GDP stimulus = ZAR500bn

- Stimulus now being placed into growing hole with next stages of lockdown through to peak

Multistage lockdown to come



Stimulus problems

- Questions over implementability of ZAR500bn stimulus
- No firm ideas on jobs support
- Will final design of bank lending support target right segments?
- Unemployment insurance lite to take significant time to implement on any scale
- Offset by ZAR130bn of reprioritisation – likely from infrastructure
- Revenue measures uncertain (holiday vs relief)
- Overall impact is 6pp on to GDP but possibly spread over time.

Item	Amount ZARbn	Share of GDP %	Multiplier x	Impact ppGDP
Loans	200.0	3.9	1.3	5.1
Health	20.0	0.4	1.2	0.5
Grants	50.0	1.0	0.5	0.5
Unemployment benefit	10.2	0.2	0.5	0.1
Food parcels	0.1	0.0	1.0	0.0
SMME	2.0	0.0	0.7	0.0
Revenue measures	70.0	1.4	0.6	0.8
Jobs	100.0	1.9	0.5	1.0
Municipalities	20.0	0.4	0.8	0.3
Other	27.7	0.5	1.0	0.5
Reprioritisation	-130.0	-2.5	1.1	-2.8
Average/Total			**0.8**	**6.0**

Fiscal risks

- Deficit expected to be around -17.7%GDP
- Everyone forgetting underlying revenue shock from weak growth – ZAR230bn
- Long tail impact from corporate losses rolled over into future years
- ‘Temporary measures’ like grant step up and unemployment impossible to end?
    - How can you have cliff edge risks in November?
- Also cliff edge risks in 6m on guaranteed lending interest payments for SMMEs.
- UIF support pay-outs not timely – long tail
- Step up in debt service costs
- **Risk we get stuck around 10%+ deficits in future years**
    - <u>Worry far more about fiscal risk next year than this year given IFI funding now.</u>
    - Fiscal rule needed to strap government to the mast.
    - Mindset change to CREATE fiscal space
    - Have an emergency budget to anchor credibility

Funding at the cliff edge

- Need to fund the ZAR170bn of stimulus (assuming revenue measures permanent) plus ZAR230bn of revenue underperformance, plus ZAR816bn of redemptions (inc t-bills)
  - Total funding need including February budget is ZAR1.396tr
- Total market (and cash) funding of ZAR952bn
  - Budget assumed 13% step up in SAGB issuance.
  - We assume maximum the market can take with SARB not shifting from ‘not-QE’ is 25% step up
  - T-bill step up already occurred
  - Use ZAR86bn cash (current stock ZAR236bn)
- Some UIF funding via bond buying (conflicts with other commitments?) – ZAR75bn?
- Covid-19 bond of ZAR100bn?
- **ZAR269bn remaining to be funded…….**

IFIs to the rescue

- **ZAR269bn remaining to be funded…….**
- Step up SAGB issuance more (another ZAR50bn or so – up to total increase of 35%?)
- Use sterilisation deposits of ZAR57bn.
- **IFIs required!! – total USD10.7bn / ZAR200bn**
- NT strategy – ‘for now’ ZAR95bn – not conditionality
  - USD4.2bn IMF RFI
  - USD55mn WB health
  - USD1bn NDB health facility
- Still not enough…..
- ‘Later’ – ZAR105bn
  - USD3bn NDB CRA (contingent reserve account)
  - USD2-3bn WB and AfDB etc

The long term problem

- **SA fiscal can only be saved with nominal growth**
- Investors and markets will give **no benefit of the doubt** on structural reforms occurring.
  - Doesn't mean no reforms will happen, but they will occur too slowly to reach lift-off velocity from a lower base.
  - Two-steps-forwards three-steps-back problem.
  - Can show some precommitment now?
- If no nominal growth in future years then only three options:
  - IMF SBA with conditionality – SA strapped to the mast.
    - USD 50bn+
    - Deeply challenging to see politically – time consuming process of social compacting to death
    - IMF SBA required for another NDB CRA USD7bn.
  - Or, SARB 'real-QE' to absorb approximately ZAR250bn of debt per year
    - Hard to see current SARB leadership accepting without an SBA
  - Or, China bilateral loan
    - Non-economic conditionality likely deeply challenging

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Zoom in on the banking sector

Bank performance outlook

- New provisions in terms of IFRS 9 will hit income statement
- Decline in business volumes will hit revenue
- SARB measures are accommodative, not stimulatory

Covid-19 impact on banks			
Model results	**Baseline**	**Positive**	**Negative**
Total cost to banks ('000)	R 120,737,725	R 61,857,162	R 279,758,437
Total cost as % of equity	23.97%	12.28%	55.54%
Cost as % of latest year profit	142.16%	72.83%	329.40%
Ave total capital adequacy before	16.44%	16.44%	16.44%
Ave total capital adequacy after	12.50%	14.42%	7.31%
Inputs:			
Forebearance holiday period (days)	90	90	180
Prime interest rate	8.75%	8.00%	8.75%
Forbearance percentage tolerance (ave % of book)	5.00%	2.00%	10.00%
Capital cost premium from lost liquidity (basis points per montl	1	0.5	1.5
New provisions to be raised in status quo outlook (% of book)	2.00%	1.50%	3.00%
New provisions on forborne book (% of forborne book)	20.00%	5.00%	30.00%
Non-interest revenue shrinkage	10.00%	5.00%	30.00%
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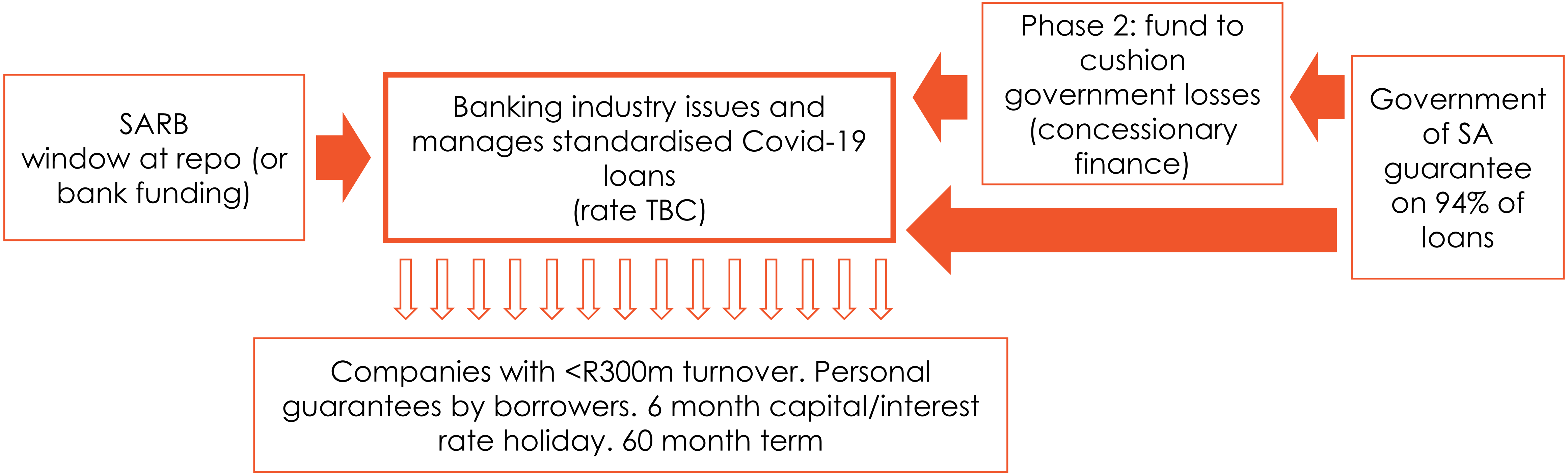
Bank guarantee scheme

- Headline: R200bn scheme. Initially full NT guarantee, with a fund coming in later
- Final details are still being hashed out between lawyers for banks, NT and SARB
- In our view, unlikely any bank will be ready with product by end of this week



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Effectiveness not guaranteed

- Several foreign schemes fell far short of targeted lending amounts
- At 4% of GDP, SA target is quite high
- May have to be tweaking: personal guarantees have been disincentive elsewhere

Success: Swiss Scheme	**Failure: UK Scheme**
Loans of up to R9.6m, 0% interest, 100% guaranteed by state.	Loans to t/over <£45m. Rates variable – many <1%.
Companies "self declare" they are losing money due to crisis	Company viability assessed by lender. Initially, if deemed viable without the loan, not eligible.
	Government requirement for personal guarantees (later removed for <£250k)
	Cashflow forecasts must be provided. Viability has to be assessed. Affordability assessment. 17 assessment steps.
Within a week R273bn lent to 76,000	With a month, R64bn lent to 16,600 (40% of applications)

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Key issues for the future

How do we avoid a permanently smaller economy, with a permanent step up in employment and a permanently narrower fiscal revenue base

Problems for the future

Is nominal GDP growth >8.0% possible?
- (real growth per capita >2.0%?)
- How do we avoid permanent losses of output

Will the SARB step up to 'Real-QE' before or after an IMF SBA?

How much long term control does the President have? Especially over structural reforms.
- Do the securocrats and microeconomic fiddlers maintain control?

How are cliff edge situations dealt with?
- Benefits/Unemployment grant
- Tax holidays
- 6m interest free on lending scheme

Are mistakes on next steps of lockdown (complexity) addressed or not?

How does the economy adapt in the long term to rising inequality and very unequal outcomes?
- What happens if there isn't a vaccine or anti-body test?
- Economic nationalism

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