

Global Credit Crunch: Has South Africa Missed the Opportunity?

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Sources of Funding for Infrastructure Investment in Africa

Traditional Sources:

- **Debt**
 - DFIs (Development Finance Institutions)
 - Commercial Banks (Local & International)
 - Capital Markets (limited in South African context)

- **Equity and Quasi-Equity**
 - Developers
 - Contractors
 - DFIs
 - Local equity partners (limited in South African context)

Sources of Funding for Infrastructure Investment in Africa (contd.)

Recent Additional Sources:

- **Credit enhancement structures / wraps**
 - DFIs (local currency credit enhancements)
 - Development Funds
 - Banks (limited wraps for DCM issues)
 - Political Risk Insurance
- **Equity**
 - Infrastructure private equity funds
 - Commercial appetite increasing
- **Capital Markets**
 - Local currency DCM offerings and appetite increasing
- **Derivatives**
 - Securitisation
 - Swaps

Sources of Funding for Infrastructure Investment in Africa (contd.)

Effects on Southern African funding pre 2007:

- General increase in liquidity across the African spectrum
- Infrastructure linked to resources boom
- International appetite for emerging markets growing as resources boom cycle continued
 - Infrastructure funds (debt & equity)
 - Hedge funds & Institutional investors make an appearance
- African sovereign credit quality improving
- International banks increase African appetite generally
 - access to cheap liquidity
 - risk margin compression and search for yield
 - better international distribution capabilities
- Local funding options increase
 - liquidity
 - tenor
 - pricing

What happened?

- In late 2006, all was well with the markets globally (and in Africa)
 - Rising asset prices (Commodities, Property and Equities in particular)
 - Tightening credit spreads
 - Increasing liquidity globally - emerging markets reaping the benefits
 - Cheap credit available for many classes of borrower
 - Record earnings from financial institutions

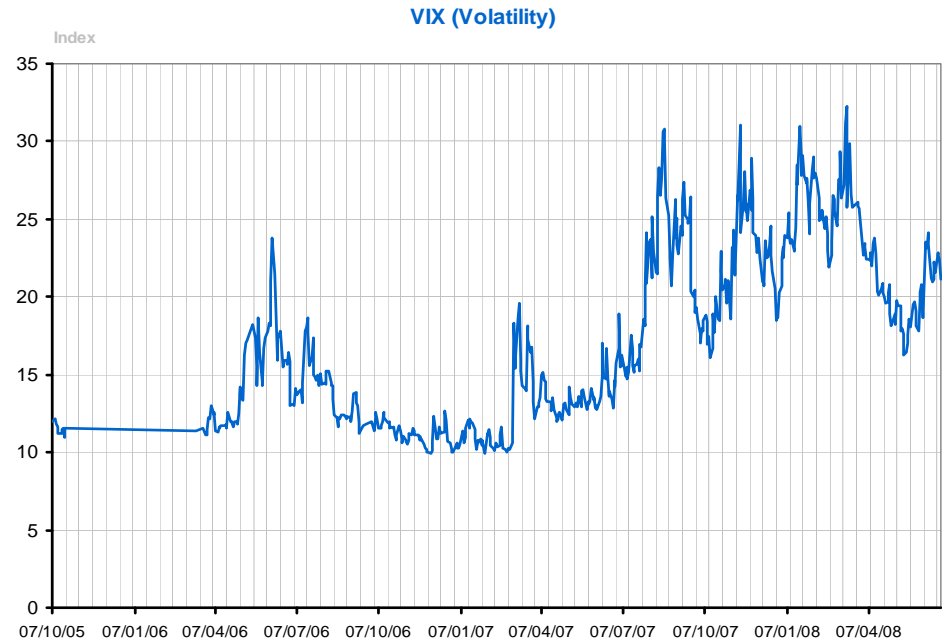
- Sub-prime crisis in US emerges in 2006 and gathers pace in 2007 and further into 2008
 - Global trend emerges in international financial markets leading to:
 - widening of credit spreads
 - rapid decrease in liquidity

How does this impact on South Africa and Southern Africa?

- Not the cause of the problem, but caught in the crossfire
- Funding sources have come under pricing and liquidity pressure
- Extent and duration of the fall-out is still uncertain

Key Features of the Crisis

- Volatilities rise
- Negative sentiment rises
- Liquidity premiums rise
- Asset returns highly correlated
- Flight to quality
- Credit spreads widen
- Hence risk measures increase

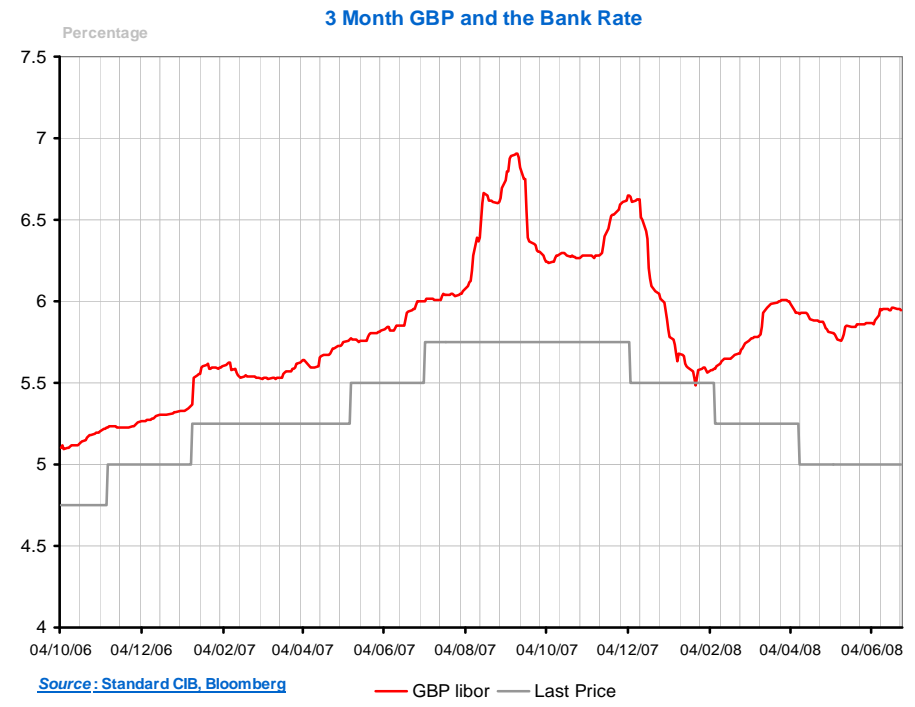


Source: Standard CIB, Bloomberg

VIX: The Chicago Board Options Volatility Index reflects future volatility on the weighted based average of the implied volatilities for a wide range of strikes

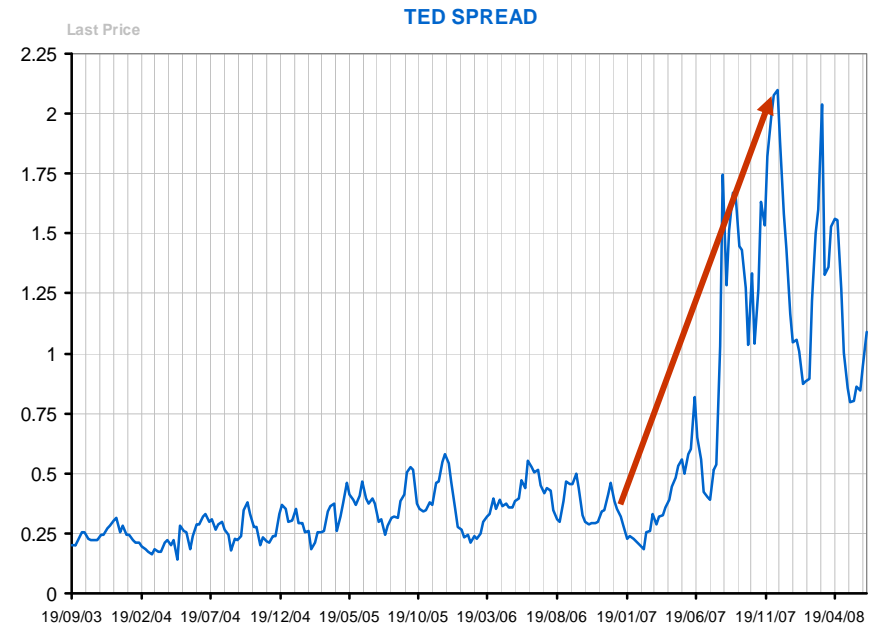
Liquidity constraints

- Dramatic expansion of the 3m swap spread reflecting reluctance of banks to lend to each other
- Central Banks' response was to cut rates
- However Libor is set by the market
 - Decoupling occurs if there is insufficient intermediation vs. the demand for Libor-based funding
- Rates cuts have not necessarily cut banks' cost of funds



The flight to quality in the crunch

- In recent years, there has been a move towards lower-rated and unrated money market, liquidity funds and structured products in order to increase yield
- Liquidity constraints has led to a move towards more traditional financial institutions such as banks and time deposits or at least high rated funds
- As default risk increases, investors will have a preference for safe investments



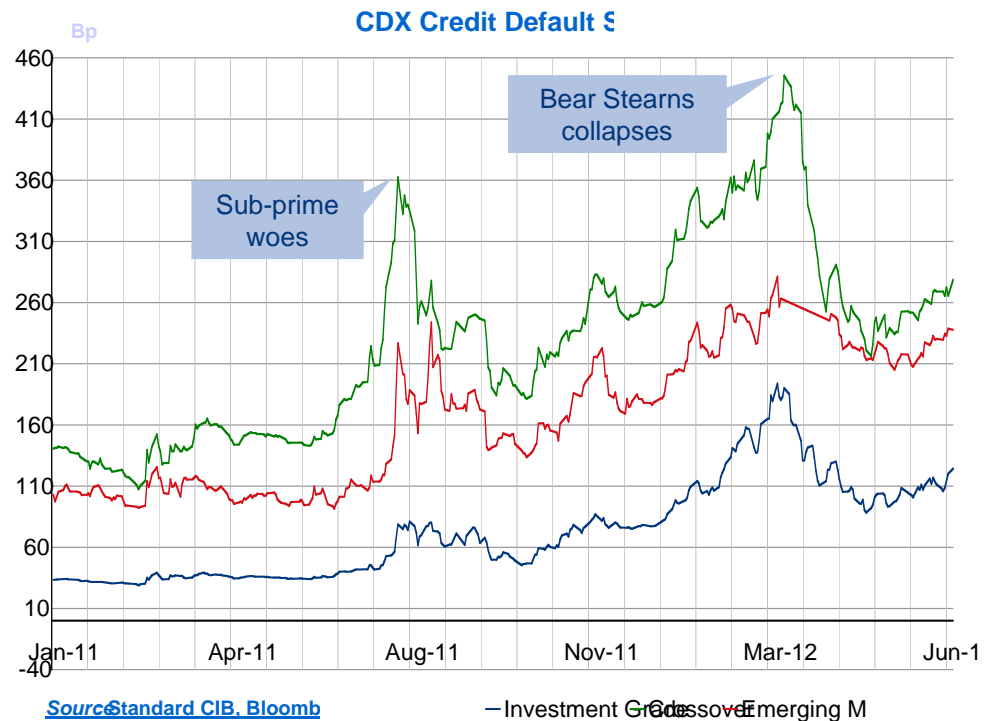
Source : Standard CIB, Bloomberg

The TED Spread is the price difference between three-month futures contracts for U.S. Treasuries and three-month contracts for Eurodollars having identical expiration months. The Ted spread can be used as an indicator of credit risk. This is because U.S. T-bills are considered risk free while the rate associated with the Eurodollar futures is thought to reflect the credit ratings of corporate borrowers. As the Ted spread increases, default risk is considered to be increasing, and investors will have a preference for safe investments. As the spread decreases, the default risk is considered to be decreasing.

Global increase in funding costs

- An increase in funding costs leads to a widening of credit spreads
- The US sub-prime induced credit crunch has led to massive mark-to-market losses at large international banks
- Concerns over where losses may reside has led to a liquidity squeeze and a fundamental deterioration of counterparty credit quality, especially since banks are central to the effective functioning of an economy
- So, worldwide, corporate debt funding costs have risen substantially, due to:
 - Risk aversion
 - Rising capital requirements
 - Increased funding costs
 - Shareholder pressure
- The blow out of CDS spreads reflects higher levels of investor required return

Note: CDX represents a basket of credit derivatives for different segments of debt in North America and emerging markets



Effects on the South African funding market

So what is the impact on funding into South African infrastructure?

- Resource boom seems to be over, as global economic growth slows down considerably
- Need for infrastructure is constantly increasing
- Global financial trends have not been affected many in-country financial markets

But...

- Flight to quality has removed many new participants from this market
 - Hedge funds
 - International banks
 - International DCM
- Pricing has increased
 - Liquidity, particularly for long term debt
 - Credit spreads
- **In summary: Less funds are available and what is available is more expensive and risk averse**

Future outlook

What is the outlook for financing South African infrastructure?

- International uncertainty will have an effect in short to medium term
 - Fewer players looking at emerging markets
 - Increased costs a reflection of global and not local issues
 - Some signs that the fallout has at least stabilised
- Maximisation of local financing options will be key
 - Bringing in the local DCM
 - Narrowing the pricing gap (local vs. international)
- Need to reinforce the perception of quality for South African successes
 - Entice investors back
 - Attract new entrants
- **South Africa and Southern Africa has received only a glancing blow from the global credit crisis, but there is a stumble none-the-less**

Thank You