## Foreign lenders like SA debt

In April, the South African government **borrowed money** on the international markets — for the first time since September 2019. The country meets most of its **debt financing needs** on domestic markets, but international bond markets give some insight into how South African risk is **perceived abroad.** This is especially interesting after Fitch and Moody's both upgraded their outlook on South Africa's foreign currency debt from negative to stable, the former in December and the latter in April.

The current successful bond issue was for a total of **$3 billion worth of debt,** issued as 10-year and 30-year bonds. On the 10-year bond, the coupon rate was 5.85%, while the spread over the U.S. Treasury equivalent was 309 basis points — slightly lower than the 313-point spread in September 2019, before Moody's downgraded **South Africa's debt** to junk status.

This is an indication that **South African risk** on the 10-year time horizon is perceived not to have increased relative to the risk-free rate on the equivalent U.S. Treasury. However, on the 30-year bond, the coupon rate was 7.3% — while the spread was 447 points compared to 358 in 2019 — a significant rise, possibly reflecting a heightened **risk perception** over the longer term.

## Reinsurer rerates SA risk

Lloyd's of London has increased its **reinsurance premiums** to the South African Special Risk Insurance Association (Sasria) by more than 1 000%. The reinsurer believes that a repeat of the July 2021 unrest cannot be ruled out in the next two to three years, given South Africa's persistently **high poverty and unemployment** — a call with which we agree.

In a briefing to a Parliamentary Committee, Mpumi Tyikwe — Chief Executive of Sasria — said that the insurer could not find **alternative reinsurance** on better terms than Lloyd's. Sasria had, therefore, reduced the level of reinsurance from Lloyd's, was seeking a further capital injection from the government, and had restricted cover for all clients to R500 million per entity, while recognising that this was probably not enough.

The risk of doing business in South Africa appears to be rising. The **July 2021 rioting and looting** cost about R34 billion, according to Sasria. The most recent shock — **the flooding in KwaZulu-Natal** — claimed more than 440 lives and caused damage of around R12 billion to infrastructure, according to KwaZulu-Natal Premier, Sihle Zikalala. In the Eastern Cape town of Kirkwood, preliminary assessments indicate that the **damage caused by protesters** last week amounts to around R170 million.

The **cauldron of risk factors** includes increasing anti-foreigner rhetoric from parties including ActionSA and others, declining state capacity across multiple dimensions, rising logistical challenges, increasing security risks and the impact of severe weather events. It paints a picture of an **increasingly challenging and costly** business environment. When businesses pass on the costs of addressing and mitigating those risks to consumers, this creates additional **inflationary pressure on prices.**

## Losing control of the capital

A story from South Africa's capital city of Pretoria illustrates the **declining capacity of the state.** The Portfolio Committee on Defence and Military Veterans (PCDMV) visited the military's Special Forces School in Murrayhill and there, Committee members heard that **the school faced challenges** including the encroachment of civilians who built houses close to its perimeter fences; water outages as water pipes were being damaged; and power blackouts because locals were stealing the copper cables.

The school said that the Department of Public Works and Infrastructure had **stopped repairing damaged infrastructure** and the Committee recommended that the school drill a borehole to secure its water supply and install solar panels to ensure it had electricity. In other words, a military facility in the nation's capital was advised to go off-grid because **the state could not supply** services reliably. What holds true for state entities applies doubly to private companies and citizens.

## SA's inflation outlook

South Africa's **Producer Price Index** rose by 11.9% year-on-year in March, the fastest rate of increase since 2013. The rise is consistent with similar increases observed in other markets: the U.S. recorded 11.2%, China 8.3% and the Eurozone 31.4%. Among BRICS countries, the rates were 14.6% in India, 20.1% in Brazil and 26.7% in Russia. The increases reflect high **demand meeting constrained supply**, as war continues between Russia and Ukraine, and China continues to pursue its zero-Covid policy with strict lockdowns that are **severely restricting economic output,** as well as the movement of goods in and out of the country.

Rising producer prices are a **lead indicator** for rising consumer prices, raising the risk of continuing high inflation across global markets as well as in South Africa. The South African Reserve Bank, which **raised the repo rate** by 25 basis points in each of its last three Monetary Policy Committee meetings, is expected to raise the rate further at its May meeting, with **markets pricing** in a 50-basis point increase at that meeting.

## Blip or start of recession?

There are early signs that the U.S. economy may be slowing. The **S&P 500 stock market index is down** 13.3% in the first 82 trading days of 2022, its third worst start to a year in history. Meanwhile, the U.S. Commerce Department has reported that the country's **GDP declined** by 1.4% in Q1 2022. This is the first time that the economy has shrunk since the early days of the Covid-19 pandemic. It comes as inflation is running at 8.5% — a 40-year high — with four in five Americans citing **concerns over rising prices** for everyday purchases. The risk of stagflation, which we flagged in earlier editions of the *Risk Alert,* appears to be growing.

Rising prices caused by a **combination of factors** including the Russian invasion of Ukraine, increasing oil prices, global supply chain stickiness, and over two years of large government monetary stimulus packages, are a concern for U.S. central bankers and consumers. In a move that will **impact negatively on the Rand,** and to try to keep a handle on rising inflation, we expect the U.S. Federal Reserve to enact a series of rate hikes throughout this year. Rate increases will **depress economic activity,** adding to the possibility of a recession. However, the labour market remains strong and consumer sentiment improved slightly to 65.2 points in April compared to 59.4 in March, offering **a counterweight** to factors favouring contraction.

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