

LISTED CREDIT MARKET QUARTERLY REPORT AS AT 31 MARCH 2022

Credit diversification remains a pipedream

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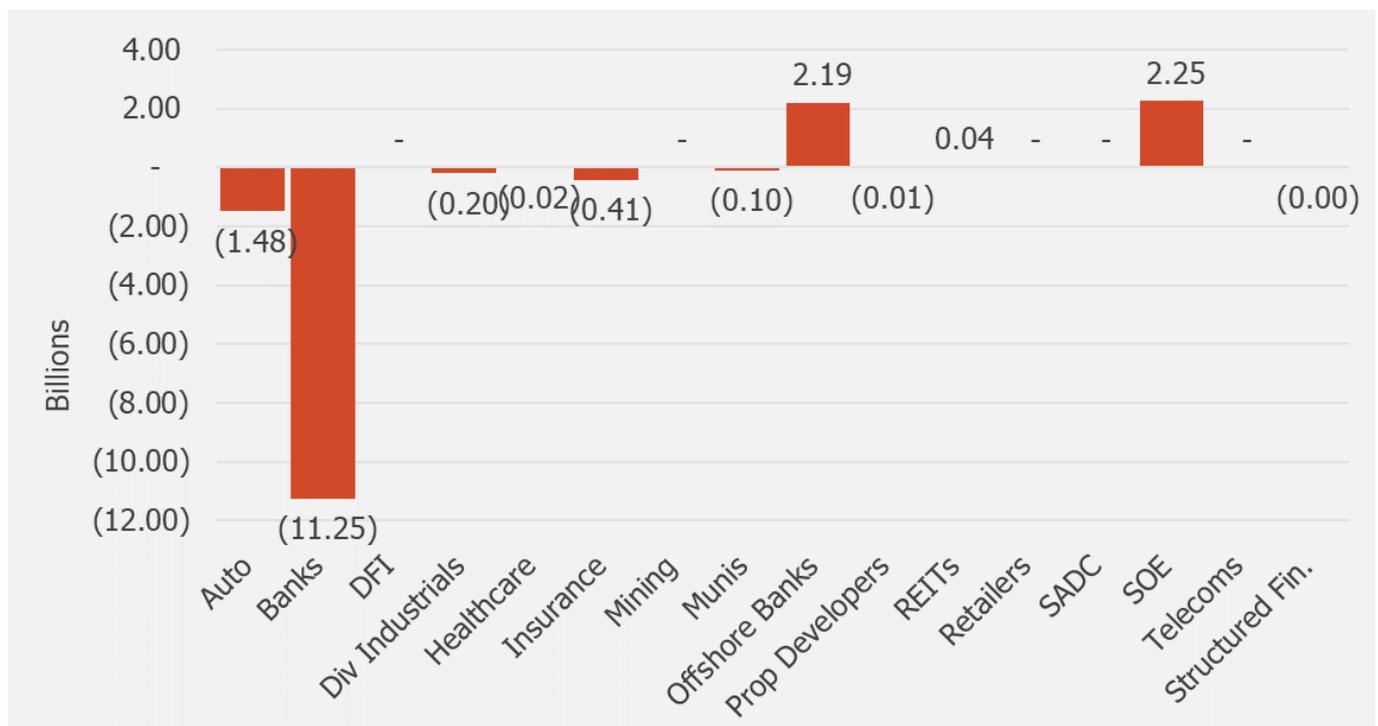
Published: May 2022

OVERVIEW

The prefunding activity in the last quarter of 2021 contributed to a lower R57 billion gross issuance in the first quarter of this year. Gross redemptions came in at R66 billion, which meant there were net redemptions of R9.2 billion, predominantly attributable to the banking sector's R11.5 billion quarterly net redemption. State Owned Enterprises (SOEs) experienced their largest gross issuance since the initial Covid lockdown - R10.3 billion, of which R5.7 billion were Eskom's government-guaranteed Tap issuances.

With the persistent decline in corporate issuances and the dominance of a few sectors, sectoral diversification has become a great challenge for investors in the credit market. The South African market remains highly concentrated when looking at the potential to diversify at a counterparty level. Thus investors' quest to achieve optimal diversification is currently severely constrained.

Figure 1: Net issuance/redemption



Source: JSE, Futuregrowth

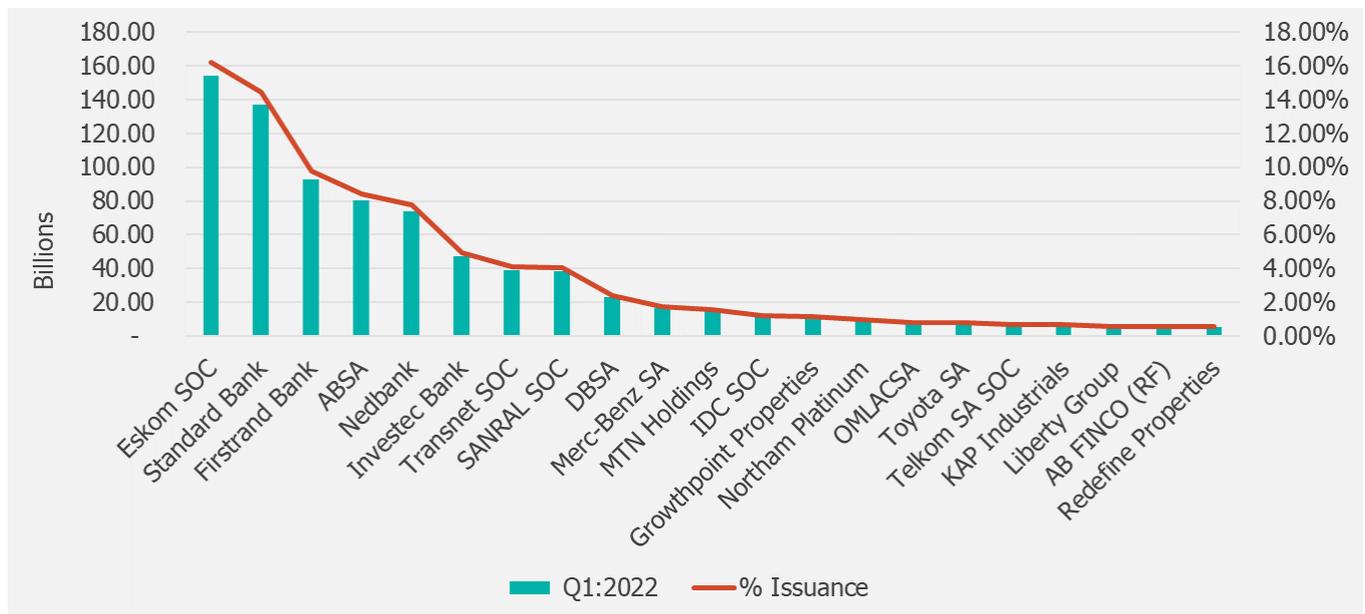
Modern finance's foundational principles highlight that diversification is critical in risk optimisation because of the asymmetric correlation of assets in a diversified portfolio. Investment risk tends to be correlated within a sector and during macro-level events. Numerous equity market studies have highlighted that diversification disappears when needed most because the correlation between stock market prices is higher on the downside. In credit markets, the probability of default, loss given default and migration risk contribute to multi-faceted credit risk. Thus, even at the counterparty level, diversification is still viewed as a prudent way to mitigate risks. However, our domestic credit market's current excessive market concentration stands in the way of attaining the desired diversification.

MARKET CONCENTRATION

The first quarter of 2022 saw the size of the total credit market decline marginally to R948 billion from R958 billion. The sectoral contribution was concentrated around Banks and Sub-sovereigns, cumulatively accounting for 76% of the market. At an issuer level, the market concentration was no better. The top 20 individual issuers contributed 83% to the market's outstanding bonds. Note that bank issuance (between group and bank) has been aggregated.

Eskom has been the largest issuer due to its government-guaranteed programme and thus accounts for 16% of the market. Outside the dominant sectors, property funds, diversified industrials, automotive and mining sectors have some representation in the Top 20. However, the large degree of market concentration around a few sectors and counterparties is significantly hampering our efforts to achieve optimal diversification.

Figure 2: Top 20 credit issuers



Source: JSE, Futuregrowth

The total listed corporate outstanding debt (excl. Banks, Sub-sovereign & Securitisation) is ~R160 billion, cumulatively equal to Eskom's outstanding debt. Generally, issuers rely less on debt capital markets, with the proportion of funding in the capital market roughly ranging between 15% - 30% of total interest-bearing debt.

Capital markets funding comes with higher refinancing risk, and local issuers still prefer to rely on stable bank funding. Although stable, bank funding is usually more expensive (at least for the high-quality issuers), and as a result, the issuers often have a balancing act to navigate between relying on low-cost funding and/or accessing stable funding. Over the past year, the US credit market had burgeoned, in part due to the high yield credit market doubling its size from FY2019 levels. The local market tends to shrink when credit risk is elevated, as below Investment Grade issuers find it hard to place debt in the market.

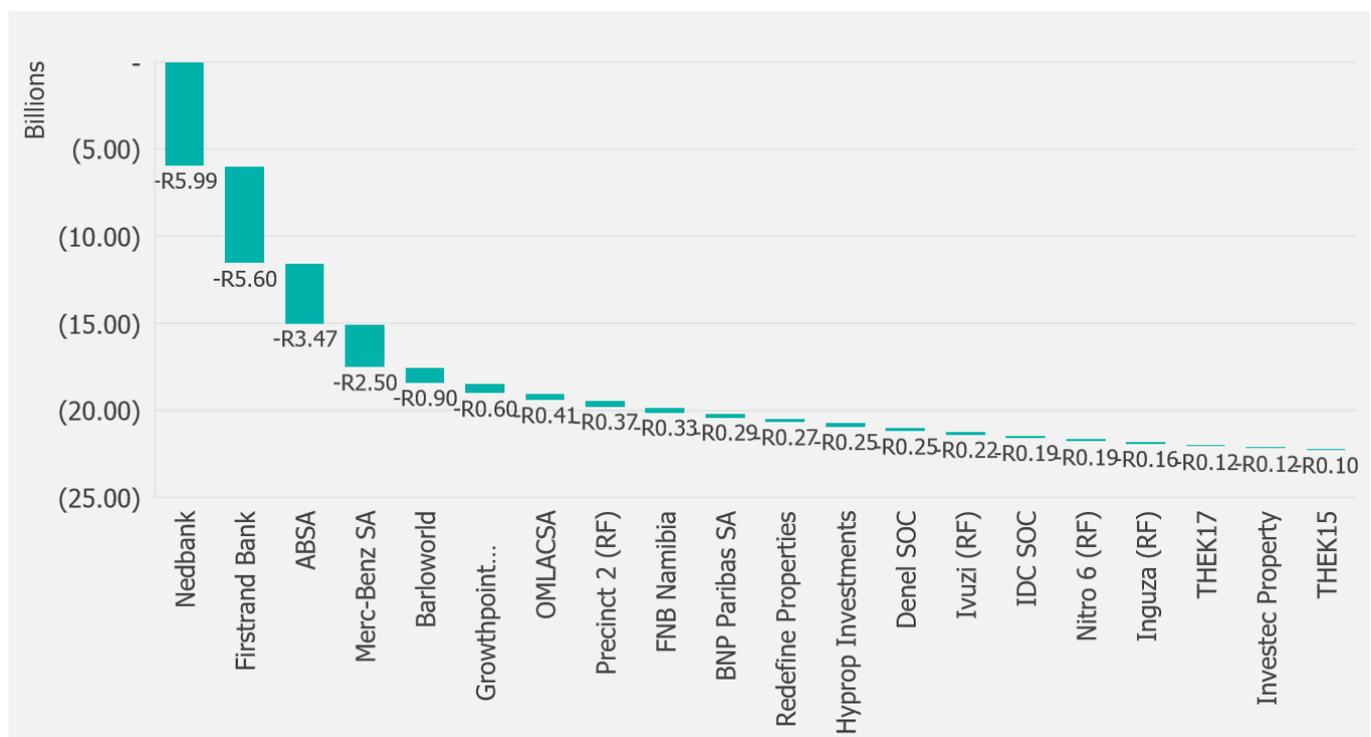
PRIMARY MARKET ACTIVITY

The market's net redemption position was largely due to the decline in gross bank issuance to R29 billion from R41 billion in the previous quarter. The banks were mainly quiet due to reduced activity in structured bank products.

The automotive sector redeemed a net R1.48 billion, with Mercedes Benz opting not to refinance R2.5 billion while Toyota was a net issuer of R1.02 billion.

Offshore banks, REITs and SOEs (Eskom, Transnet and the DBSA) were net issuers of R1.9 billion, R40 million and R2.5 billion, respectively. Of the R29 billion banking issuance, R18 billion was bank credit, namely senior unsecured paper of R17 billion and Tier 2 paper of R1.1 billion. The remainder comprised bank structured products. The sector saw African Bank come back to the market with a R600 million issuance across 3.25-year and 5.25-year senior paper at 259 basis points (bps) above three-month Jibar (3m Jibar) and 300bps/3m Jibar, respectively. Investec issued a 5.5-year Tier 2 note (R1.1 billion) at 220bps/3m Jibar. The market's sweet spot remains in the 3- to 5- year and 5- to 7-year buckets, collectively contributing R24 billion to the quarter's issuance. The 12-year+ bucket was dominated by Eskom tap issuance (EL36 and EL037) and Transnet's new TN34 issuance.

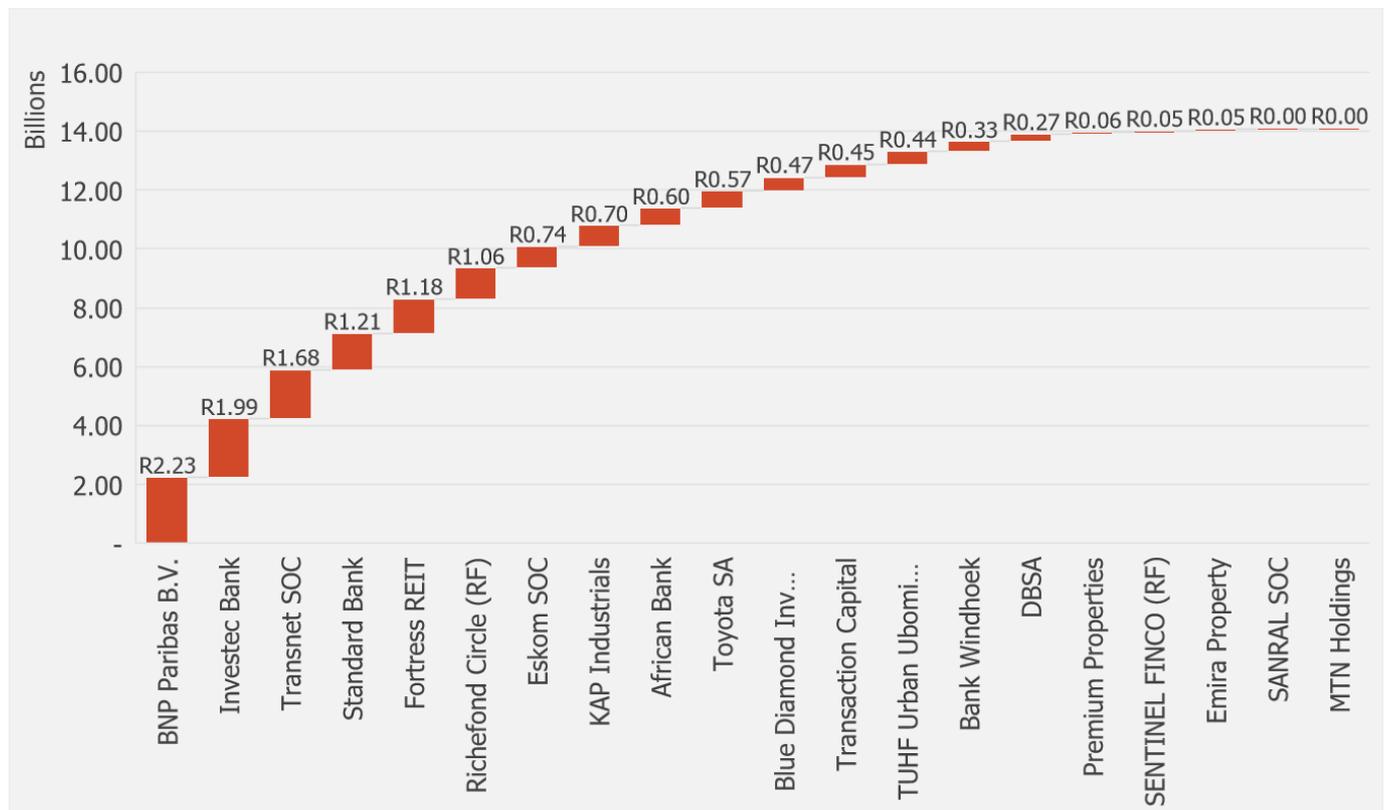
Figure 3: Top 20 quarterly net redeemers



Source: JSE, Futuregrowth

Most of the quarterly net redeemers were banks, which tapered their structured credit. The top 20 net redeemers accounted for 95.63% of the market, amounting to R23.3 billion. Merc-Benz's R2.5 billion bond was not refinanced, and the company is expected to tap the market later in the year. Other net redeemers were insignificant and included property counterparties, Growthpoint, Redefine and Hyprop Investments.

Figure 4: Top 20 quarterly net issuers



Source: JSE, Futuregrowth

The top 20 net issuers, which raised R14.1 billion, comprised 100% of the market net issuance. The SOE trade was conducted mainly by Transnet, Eskom and DBSA. The market also saw new issuers come to the market, namely securitisation issuers, Richefond & Sentinel Finco, and a corporate issuance in Transaction Capital. We expect market issuance to pick up markedly in the second quarter of the year.

Issuance in the first quarter is generally less buoyant. But on a year-on-year basis, the size of issuances is around R15 billion higher, which should augur well for the year ahead. The government's state of disaster has been lifted, and economic activity will likely accelerate, further boosting the credit market.

SECONDARY MARKET

The total number of listed credit instruments experiencing spread movement increased to 323 in the first quarter from 296 in the previous quarter. There was spread compression in 252 bonds during the quarter (200 in Q4:2021), and spreads widened in 71 bonds (96 in Q4:2021). The secondary market tightening came mostly from SOEs and short term roll downs. Banks and fixed-rate sub-sovereigns were subject to widening spreads.

Despite the slight widening in primary market issuance spreads in line with the interest rate cycle, the secondary market still shows compression momentum. This is largely a result of the ongoing "post-covid" normalisation in spreads.

Figure 5: Spread movement

Num. Bonds Spread Movement					
Term Bucket	Corporates	Structured Fin.	Financials	Sub-sovereign	Total
Below 1yr	23.00	6.00	33.00	5.00	67.00
1yr - 3yrs	52.00	4.00	80.00	14.00	150.00
3yrs - 5yrs	10.00	1.00	52.00	5.00	68.00
5yrs - 7yrs	3.00	0.00	14.00	5.00	22.00
7yrs - 12yrs	0.00	0.00	10.00	3.00	13.00
12yrs Plus	0.00	0.00	1.00	2.00	3.00
	88.00	11.00	190.00	34.00	323.00

Ave. Spread Movement					
Term Bucket	Corporates	Structured Fin.	Financials	Sub-sovereign	Total
Below 1yr	-21.90	-123.00	-48.20	-24.40	-43.26
1yr - 3yrs	-11.26	-17.00	-10.25	8.16	-9.06
3yrs - 5yrs	-8.20	-8.00	-13.93	0.90	-11.91
5yrs - 7yrs	-8.67	0.00	2.45	4.50	1.40
7yrs - 12yrs	0.00	0.00	23.35	-15.33	14.42
12yrs Plus	0.00	0.00	51.00	-16.00	6.33
Grand	-13.60	-74.00	-14.82	-1.73	-15.04

Num. Bonds Tightening					
Term Bucket	Corporates	Structured Fin.	Financials	Sub-sovereign	Total
Below 1yr	22.00	5.00	30.00	5.00	62.00
1yr - 3yrs	48.00	4.00	57.00	11.00	120.00
3yrs - 5yrs	9.00	1.00	40.00	4.00	54.00
5yrs - 7yrs	3.00	0.00	6.00	2.00	11.00
7yrs - 12yrs	0.00	0.00	1.00	3.00	4.00
12yrs Plus	0.00	0.00	0.00	1.00	1.00
	82.00	10.00	134.00	26.00	252.00

Num. Bonds Widening					
Term Bucket	Corporates	Structured Fin.	Financials	Sub-sovereign	Total
Below 1yr	1.00	1.00	3.00	0.00	5.00
1yr - 3yrs	4.00	0.00	23.00	3.00	30.00
3yrs - 5yrs	1.00	0.00	12.00	1.00	14.00
5yrs - 7yrs	0.00	0.00	8.00	3.00	11.00
7yrs - 12yrs	0.00	0.00	9.00	0.00	9.00
12yrs Plus	0.00	0.00	1.00	1.00	2.00
	6.00	1.00	56.00	8.00	71.00

Ave. Spread Tightening					
Term Bucket	Corporates	Structured Fin.	Financials	Sub-sovereign	Total
Below 1yr	-23.35	-156.00	-53.92	-24.40	-48.92
1yr - 3yrs	-12.67	-17.00	-19.17	-9.61	-15.62
3yrs - 5yrs	-9.56	-8.00	-22.13	-6.63	-18.62
5yrs - 7yrs	-8.67	0.00	-8.08	-3.25	-7.36
7yrs - 12yrs	0.00	0.00	-15.50	-15.33	-15.38
12yrs Plus	0.00	0.00	0.00	-35.00	-35.00
	-15.04	-85.60	-27.31	-13.14	-24.17

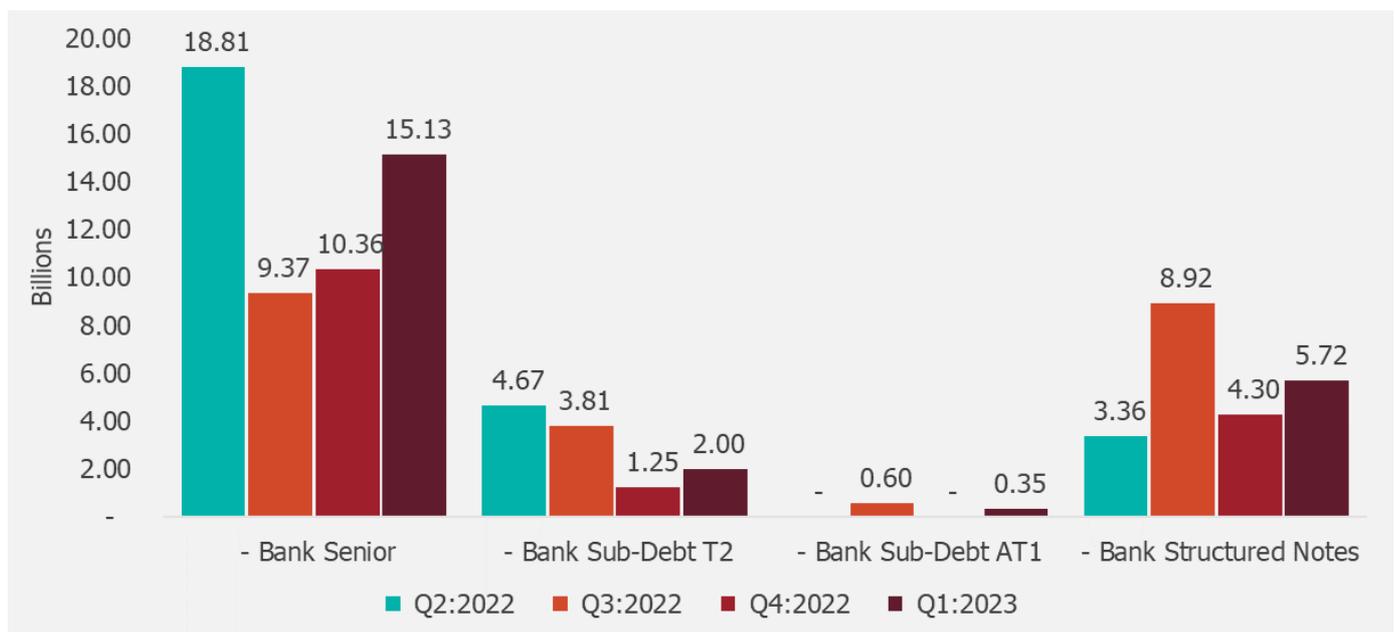
Ave. Spread Widening					
Term Bucket	Corporates	Structured Fin.	Financials	Sub-sovereign	Total
Below 1yr	10.00	42.00	9.00	0.00	15.25
1yr - 3yrs	5.63	0.00	11.84	73.33	17.16
3yrs - 5yrs	4.00	0.00	13.39	31.00	13.98
5yrs - 7yrs	0.00	0.00	10.34	9.67	10.16
7yrs - 12yrs	0.00	0.00	27.67	0.00	27.67
12yrs Plus	0.00	0.00	51.00	3.00	27.00
	6.08	42.00	15.05	35.38	16.90

Source: JSE, Futuregrowth

BANK MATURITY PROFILE

The banking sector has an R98 billion refinancing requirement in the year ahead. The expected refinancing requirement for the first quarter of 2022 is around R15 billion due to the previous quarter's R14.8 billion pre-funding. There is no additional Tier 1 capital refinance obligation during Quarter 1:2022; however, we do expect the second-quarter refinancing requirement to be executed in quarter one, as has become the norm for the sector. The senior unsecured maturities of bank credit include uncertificated notes issued as part of the banks' structured note programmes. Of ABSA's R37 billion paper, R13.4 billion will be maturing in Quarter 1:2022, the largest in the sector.

Figure 6: Bank debt maturities - by Instrument type (Next 12 months)



Source: JSE, Futuregrowth

CREDIT MARKET OUTLOOK

We expect R46 billion to mature during the next quarter, R26 billion of which will be bank issuance. The sub-sovereign sector does not have much redemption activity coming up in the quarter, but the market does expect issuance activity. We also expect increased prefunding from sectors that are more inclined to hedge their liabilities as the interest rate hiking cycle moves into full swing.

The diversified industrials have been de-gearing for the better part of the covid period. We expect this sector to ramp up operational activity and thus gear up again. Our projection for the quarter ahead is that some SOEs will likely return to market (albeit at elevated spreads). These include the IDC, DBSA, Transnet, SANRAL, TCTA and Eskom. All these counterparties have expressed interest in reentering the capital markets this year. Bank credit will remain stifled by the First Loss Absorbing Capital (FLAC) uncertainty, with banks continuing to issue short-term senior notes until there is clarity on FLAC.

The structured finance sector maturities are primarily made up of the conduit (short-term) maturities, and a small amount of Bayport, Amber House and TransSec paper is maturing.

Figure 7: Maturity schedule

Sector	Q2:2022	Q3:2022	Q4:2022	Q1:2023	Grand Total	REDEMPTION Q4:2021
Auto	1,694,000,000.00	2,500,000,000.00	1,250,000,000.00	4,000,000,000.00	9,444,000,000.00	(2,915,000,000.00)
Banks	26,836,901,616.64	24,197,619,275.00	15,914,900,000.00	23,205,672,558.00	90,155,093,449.64	(40,904,811,273.00)
DFI	-	-	-	-	-	-
Div Industrials	3,489,000,000.00	2,176,000,000.00	3,120,000,000.00	400,000,000.00	9,185,000,000.00	(898,100,000.00)
Healthcare	500,000,000.00	500,000,000.00	-	1,572,000,000.00	2,572,000,000.00	(823,000,000.00)
Insurance	1,000,000,000.00	1,548,000,000.00	2,000,000,000.00	900,000,000.00	5,448,000,000.00	(409,000,000.00)
Mining	1,693,185,996.00	-	-	-	1,693,185,996.00	-
Munis	-	-	-	-	-	(101,666,667.00)
Offshore Banks	4,030,000,000.00	60,000,000.00	-	60,000,000.00	4,150,000,000.00	(2,167,000,000.00)
Prop Developers	-	-	-	40,000,000.00	40,000,000.00	(10,000,000.00)
REITs	600,000,000.00	1,083,000,000.00	3,087,000,000.00	2,054,000,000.00	6,824,000,000.00	(2,640,000,000.00)
Retailers	-	-	-	800,000,000.00	800,000,000.00	-
SADC	-	-	1,560,000,000.00	-	1,560,000,000.00	-
SOE	70,000,000.00	4,361,000,000.00	5,827,000,000.00	31,383,314,561.00	41,641,314,561.00	(8,053,619,907.00)
Telecoms	793,000,000.00	2,015,000,000.00	529,000,000.00	-	3,337,000,000.00	-
Structured Fin.	6,267,752,697.00	4,809,284,660.24	4,529,534,432.00	1,001,500,000.00	16,608,071,789.24	(7,774,449,783.60)
	46,973,840,309.64	43,249,903,935.24	37,817,434,432.00	65,416,487,119.00	193,457,665,795.88	(66,696,647,630.60)

Source: JSE, Futuregrowth

The credit market is likely to hit the R1 trillion mark before the end of this year. Although we expect banks to be circumspect in their market activity, other sectors are expected to return to the market and contribute to the net expected annual net issuance position. Market concentration was exacerbated by covid, and although it is a generic local market structure, we don't see much of a decline in concentration (at least in the short run) as more issuers come to capital markets.

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