Market Update Thursday, 21 February 2019

South Africa pledges $5 bln Eskom bailout as budget creaks - Reuters News

South Africa will bail out state utility Eskom with 69 billion rand ($4.9 billion) over three years, the centerpiece of a budget that exposed the limited room President Cyril Ramaphosa has to fix the economy ahead of an election in May.

Ramaphosa, who is fighting rifts within his own party before the parliamentary election, has made reforming Eskom one of his top priorities as its 420 billion rand debt pile poses a direct threat to Africa's most developed economy. Analysts said the financial support would give the ailing power firm several years to implement a restructuring plan which will see it split into separate entities for generation, transmission and distribution.

But it still leaves Eskom, which last week subjected South Africa to the worst series of power cuts in several years, facing an uncertain future with unsustainable debts, crippling costs and stagnant sales. "The money for Eskom is insufficient given the length of time over which the Eskom reorganisation will occur and the practical and political pitfalls that are ahead," said Peter Attard Montalto, head of capital markets research at Intellidex. Those pitfalls include major job cuts, an option that was unlikely to be implemented before the election amid fierce opposition from leftist sections of the ruling African National Congress (ANC) and powerful trade unions.

The ANC is expected to win the election, but only a handsome victory would give Ramaphosa the mandate to push through painful reforms that are opposed by those within the governing party still loyal to his scandal-plagued predecessor Jacob Zuma.

In his maiden budget speech, Finance Minister Tito Mboweni told parliament the emergency funds for Eskom would be financed through reprioritised spending and increased borrowing, but he rejected Eskom's request that the state take on 100 billion rand of its debt. "Pouring money directly into Eskom in its current form is like pouring water into a sieve," Mboweni said. "I want to make it clear: the national government is not taking on Eskom's debt."

He raised the possibility of selling off more than 100 parastatals, often cited as a risk to the public purse. "Isn't it about time the country asks the question: do we still need these enterprises?" Mboweni asked.

The rand and benchmark 2026 government bond initially fell as the budget forecast wider deficits, rising debt and slower economic growth, before later strengthening as it became clear the state would not carry Eskom's debt.

Eskom's 2023 and 2025 dollar bonds, also strengthened.

Barely enough

But rising government debt levels in a low growth environment will remain a concern for ratings agencies. "South Africa's budget highlights the government's limited fiscal flexibility. The budget shows a further erosion in fiscal strength," Moody's, the last of the top three agencies to have South Africa at investment grade, said of the budget.

Moody's is due to announce a ratings decision at the end of March.

Eskom Chairman Jabu Mabuza said Wednesday's support would cover two-thirds of the company's annual debt-servicing needs. "It is never going to be enough, but it is what can be found in the circumstances," Mabuza told CNBC Africa. "We need to put more pressure on our operational costs." He said the utility hoped the energy regulator would agree to the large tariff hikes Eskom had requested when it announces a decision around mid-March. The regulator has in the past tended to approve smaller increases that Eskom has asked for.

Some business leaders wanted more detail on how Eskom's debt mountain would be reduced over the longer term. Eskom received a 60 billion rand bailout in 2008 via a loan which was later converted into equity. The government later sold state assets to give it another 23 billion rand. "We were hoping that the government was going to look at debt and take some of the burden off the utility, but unfortunately that didn't materialise," said Tanya Cohen, chief executive of Business Unity South Africa.

Eskom's turned off the lights across swathes of the country last week due to plant-related problems, diesel shortages and planned maintenance. The outages exposed the risks to the economy from Eskom's virtual monopoly and the failure of successive governments to take on labour unions and factions in the ANC who consider any form of privatisation as a red line.

The finance ministry said on Wednesday that strategic equity partners would be invited to provide capital and strengthen oversight in a new Eskom transmission subsidiary.

The budget predicted gross domestic product growth of 1.5 percent in 2019, down from a 1.7 percent forecast in October. The budget deficit is seen narrowing to 4.0 percent in the 2021/22 fiscal year from 4.5 percent in 2019/20. The finance ministry also raised the expenditure ceiling by 16 billion rand over three years to find money for Eskom.

Source: Thomson Reuters

Domestic Markets

South Africa's rand was largely flat in afternoon dealings on Wednesday, recouping the bulk of losses suffered after finance minister Tito Mboweni presented the annual national budget. After an initial negative reaction to the budget the currency settled down as traders assessed its impact on South Africa's sovereign credit ratings.

The rand was 0.6 percent weaker at 13.9600 per dollar by 0552 GMT, having earlier touched a low of 14.3700. "It was a tough budget, but the right things have been said by the finance minister which may be enough to avoid a credit ratings downgrade," said Jan Sluis-Cremer, forex trader at Rand Marchant Bank in Johannesburg.

Mboweni unveiled a $5 billion injection over coming years into cash-strapped utility Eskom in his maiden budget that also forecast wider deficits, rising debt and slower economic growth. Government bonds were slightly firmer, with the yield on the benchmark government paper due in 2026 easing 0.3 basis points to 8.840 percent.

On the bourse stocks hardly reacted to the budget as most heavily weighted companies earn more of their income abroad than at home. The benchmark JSE Top-40 index ended 0.9 percent higher 49,405 and the broader All-share index rose by the same margin to 55,691.

Source: Thomson Reuters

Global Markets

An index of stocks across the globe hit a more than four-month high on Wednesday on hopes for progress in trade talks between the United States and China, and a supportive backdrop from major central banks also helped push risk assets higher.

Crude prices rose to their 2019 highs helped by output cuts from top producers as well as U.S. sanctions on OPEC members Iran and Venezuela.

Stocks started with a rally in Asia that pushed the MSCI world equity index to its highest since October after U.S. President Donald Trump said negotiations with China were going well and suggested he was open to extending the deadline to complete them beyond March 1. Many had feared U.S. tariffs on $200 billion worth of Chinese imports would rise to 25 percent from 10 percent if no trade deal was reached by then.

European stock indexes also strengthened, with a region-wide index at a four-month high. On Wall Street, stocks wobbled before ending higher after Federal Reserve policymakers signaled they will soon lay out a plan to manage the bank's $4 trillion balance sheet, but policymakers are still debating how long their newly adopted "patient" stance on U.S. rates policy will last.

The tone of the Fed meeting "was decidedly noncommittal, and the minutes recreated this noncommittal message in more detail," said Jefferies analysts led by Ward McCarthy in a note. "The FOMC is on track to curtail the normalization of the balance sheet without providing any solid reasoning for doing so."

The Dow Jones Industrial Average rose 63.12 points, or 0.24 percent, to 25,954.44, the S&P 500 gained 4.94 points, or 0.18 percent, to 2,784.7 and the Nasdaq Composite added 2.30 points, or 0.03 percent, to 7,489.07. The pan-European STOXX 600 index rose 0.67 percent and MSCI's gauge of stocks across the globe gained 0.47 percent.

Emerging market stocks rose 1.19 percent. MSCI's broadest index of Asia-Pacific shares outside Japan closed 1.13 percent higher. Hong Kong's Hang Seng gained 1 percent to close at the highest level since August.

While hopes for a trade deal between the world's two largest economies are seen as the primary driver for world stocks, dovish central bank messages from the United States to Asia and the ECB are also playing a part.

On currency markets, the dollar index rose 0.04 percent, with the euro down 0.02 percent to $1.1338 while sterling was last trading at $1.3047, down 0.11 percent on the day. The Japanese yen weakened 0.20 percent versus the greenback at 110.87 per dollar after Japan recorded its biggest annual drop in exports in January for more than two years, and on recent dovish Bank of Japan signals. The offshore yuan rose 0.4 percent against the dollar after touching a three-week high of 6.7067.

U.S. oil prices rose above $57 per barrel for the first time in three months supported by OPEC-led supply cuts and U.S. sanctions on Iran and Venezuela, but soaring U.S. production and expectations of an economic slowdown kept the market wobbly. U.S. crude rose 1.47 percent to $57.28 per barrel and Brent was last at $67.14, up 1.04 percent on the day.

U.S. Treasury yields ticked up after the Fed minutes showed committee members were undecided on whether to hike interest rates again this year. Benchmark 10-year notes last fell 1/32 in price to yield 2.6483 percent, from 2.645 percent late on Tuesday. The 30-year bond last fell 7/32 in price to yield 2.9984 percent, from 2.988 percent late on Tuesday.

Source: Thomson Reuters

> Ideas shape the course of history.
>
> **John Maynard Keynes**

Chart of the Day - RSA Budget and fiscal policy II

The Minister of Finance (MoF), Tito Mboweni, presented the SA Budget yesterday. We call it as follows:

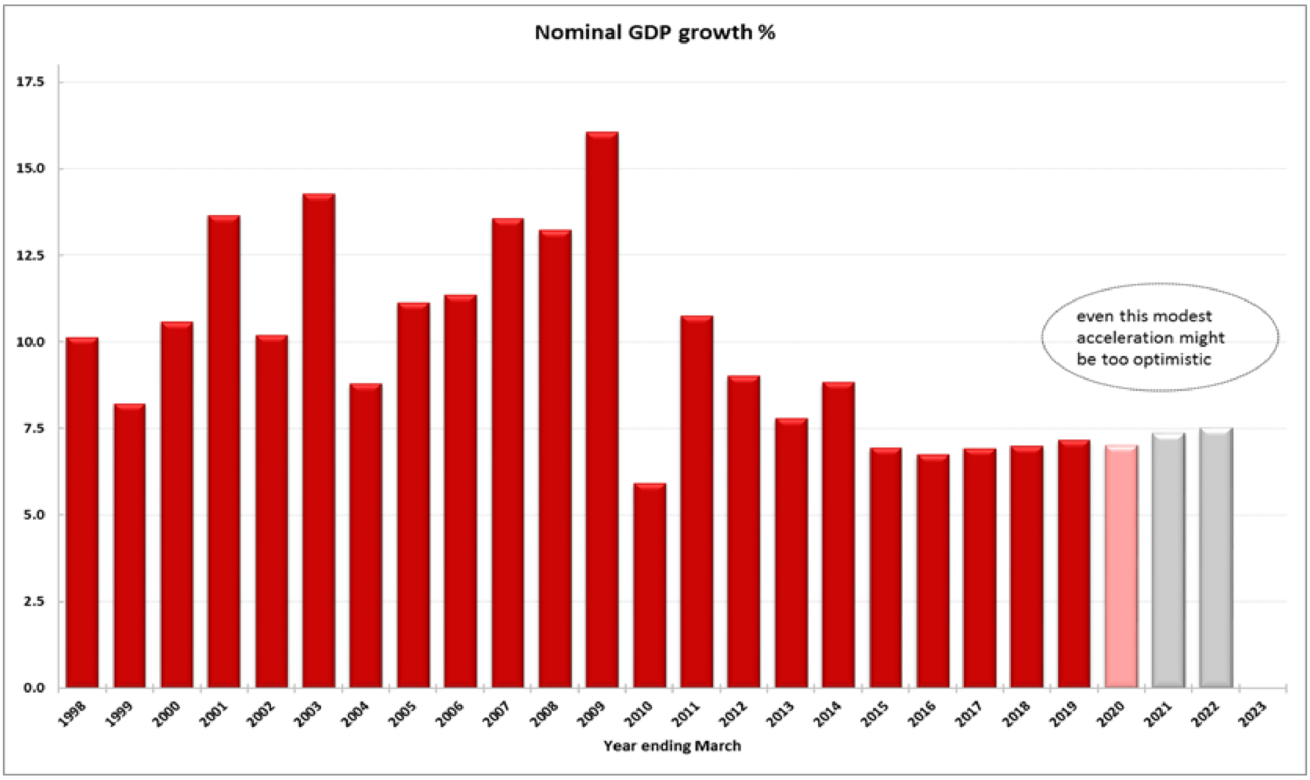
"6 x Prescripts
5 x Tasks
4 x Shifts
3 x Scriptures
2 x Key Quotes
1 x Problem Child"

Key features:

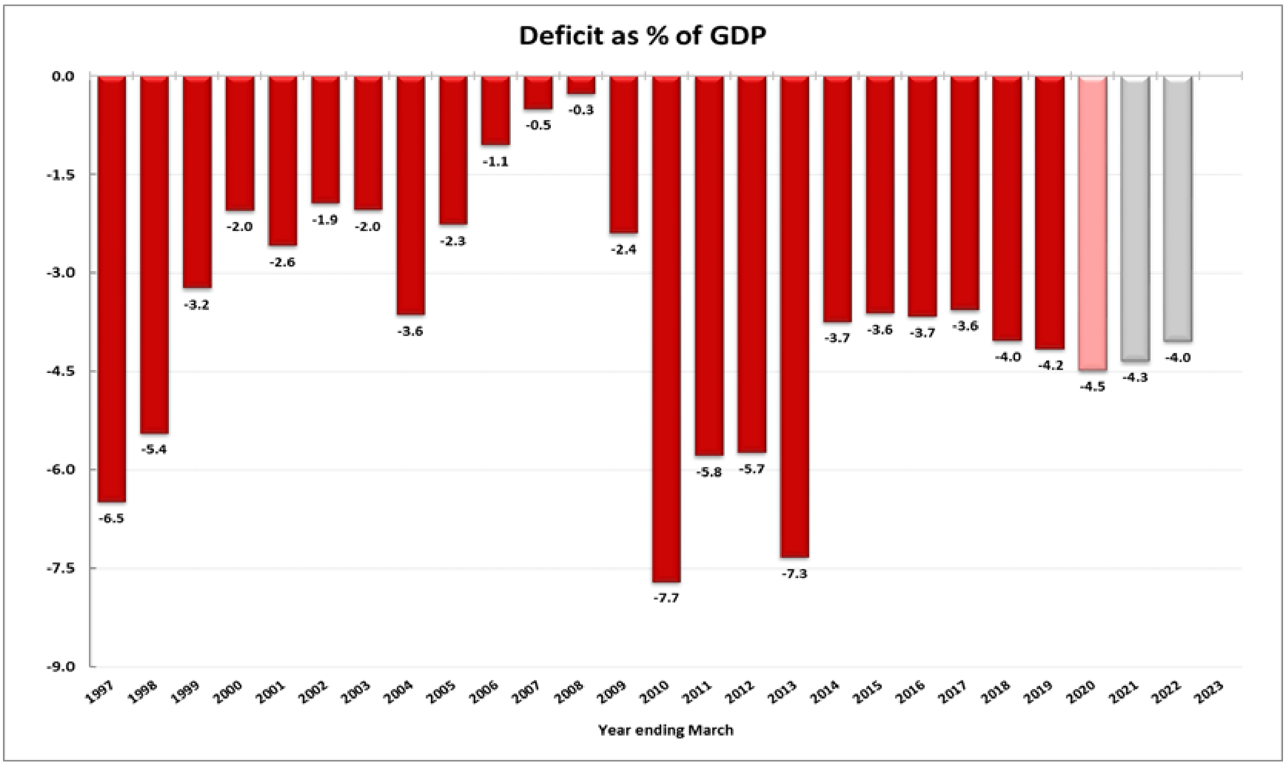
- Eskom will get R23bn p.a. over the course of three years. So, it is as we expected - only some immediate liquidity support.
- The deficit-to-GDP ratio is slipping. It is worse than previously budgeted and will remain at 4% plus.
- Total revenue is under pressure. There are no tax rate changes. Growth in revenue will come from fiscal drag, sin taxes and an increase in the fuel levy.
- Expenditure growth can only be "managed lower" over time. Key here will be the wage bill. We will have to wait and see whether Mboweni can succeed in controlling it.
- The debt-to-GDP ratio will keep rising and may stabilise only in four to five years. The 50% target for net debt has been abandoned. Gross debt will reach for 60% and adding guarantees and contingencies, it will run at 75% plus.

RSA Budget outlook	2016/17	2017/18	Revised 2018/19	2018/19		Budget 2019/20		Medium Term Expenditure Framework 2020/21		2021/22	
	Outcome	Outcome	Outcome	Budget	What if	Budget	What if	Budget	What if	Budget	What if
Total Revenue	1,285,943	1,353,509	1,455,217	1,490,716	1,465,850	1,583,811	1,571,634	1,696,382	1,681,649	1,836,598	1,799,364
% ch	*5.8*	*5.3*	*7.5*	*10.1*	*8.3*	*8.8*	8.0	*7.1*	7.0	*8.3*	7.0
% of GDP	*29.1*	*28.7*	*28.8*	*29.7*	*29.3*	*29.3*	*29.3*	*29.2*	*29.3*	*29.4*	*29.3*
Revenue growth largely due to fiscal drag, hike in fuel levy by 30c per litre and sin taxes											
Total Expenditure	1,442,981	1,543,807	1,665,425	1,671,190	1,675,031	1,826,553	1,826,971	1,948,946	1,954,859	2,089,014	2,101,474
% ch	*5.6*	*7.0*	*7.9*	*8.3*	*8.5*	*9.7*	9.7	*6.7*	7.0	*7.2*	7.5
% of GDP	*32.7*	*32.7*	*32.9*	*33.3*	*33.5*	*33.7*	*34.1*	*33.5*	*34.1*	*33.4*	*34.2*
Expenditure growth to be managed down in the outer years. "Wage bill is unsustainable" (!)											
Deficit	(157,038)	(190,298)	(210,208)	(180,474)	(209,180)	(242,742)	(255,337)	(252,564)	(273,210)	(252,416)	(302,109)
% of GDP	*-3.6*	*-4.0*	*-4.2*	*-3.6*	*-4.2*	*-4.5*	*-4.8*	*-4.3*	*-4.8*	*-4.0*	*-4.9*
feared fiscal slippage is taking place. It was bugeted to slip below 4% over time. However, one senses it will not be achieved and will rather go the other way. Gross funding = 6.2% of GD											
Net Loan Debt	2,008,274	2,260,367	2,522,064	2,526,537	2,469,547	2,829,004	2,777,401	3,147,271	3,050,611	3,471,285	3,352,721
% ch	*11.3*	*12.6*	*11.6*	*11.8*	*9.3*	*12.2*	*10.1*	*11.3*	*9.8*	*10.3*	*9.9*
% of GDP	*45.5*	*47.9*	*49.9*	*50.3*	*49.3*	*52.3*	*51.8*	*54.1*	*53.2*	*55.5*	*54.6*
Guarantees & conting's	881,997	935,634	1,140,234	1,034,996	1,034,996	1,206,574	1,206,574	1,271,813	1,271,813	1,338,194	1,338,194
% of GDP	*20.0*	*19.8*	*22.5*	*20.6*	*20.7*	*22.3*	*22.5*	*21.9*	*22.2*	*21.4*	*21.8*
Total Debt incl G's & C's	2,890,271	3,196,001	3,662,298	3,561,533	3,504,543	4,035,578	3,983,975	4,419,084	4,322,424	4,809,479	4,690,915
% of GDP	*65.5*	*67.7*	*72.4*	*70.9*	*70.0*	*74.5*	*74.3*	*76.0*	*75.3*	*77.0*	*76.4*
One senses capitulation. The target of a net debt-to-GDP ratio of 50% is no more. Adding G&C's results in 75% plus. These ratios will not stabilise soon.											
Nominal GDP	4,412,749	4,720,955	5,059,106	5,025,379	5,004,212	5,413,825	5,362,652	5,812,415	5,738,038	6,249,070	6,139,701
% ch	*6.9*	*7.0*	*7.2*	*6.4*	*6.0*	*7.0*	6.0	*7.4*	7.0	*7.5*	7.0
NT's growth outlook is more realistic for the current year, but too optimistic in the outer years. This is a harbinger of further slippage.											
Inflation			*5.5*				*4.5*		*5.0*		*5.5*
Real GDP			*1.5*				*1.5*		*2.0*		*3.0*
Nominal GDP			*7.0*				*6.0*		*7.0*		*8.5*

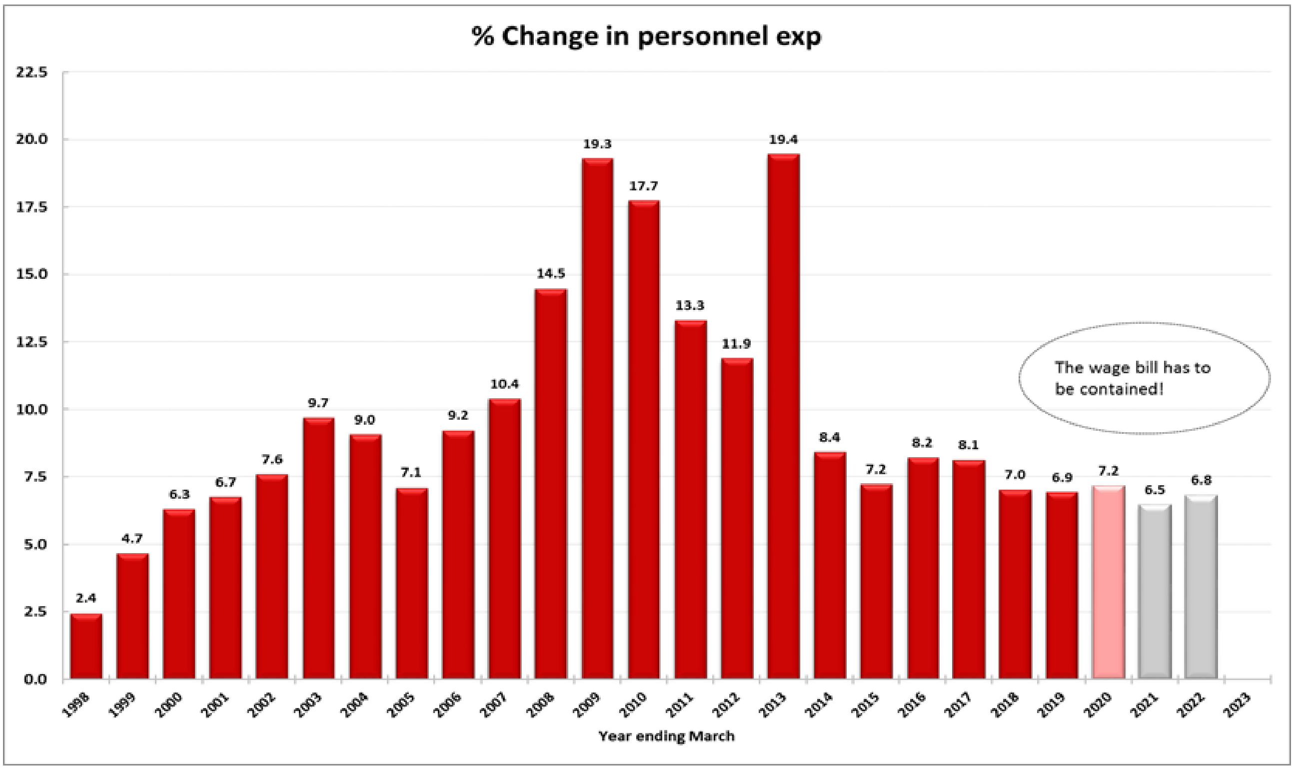
Assumptions about nominal GDP growth have been moderated. It is critically important therein that it is the denominator in the fiscal ratios that credit rating agencies gauge in their assessments of a nation's creditworthiness. Furthermore, expectations of Revenue levels and growth rests on expectations of nominal GDP growth. With inflation expectations decreasing (the number for January is 4%) and real growth elusive, nominal GDP cannot be expected to growth much above 6.5% p.a. SA National Treasury (NT) has been overoptimistic on this up to now. Their latest forecast is for 7% to 7.5% (see table).



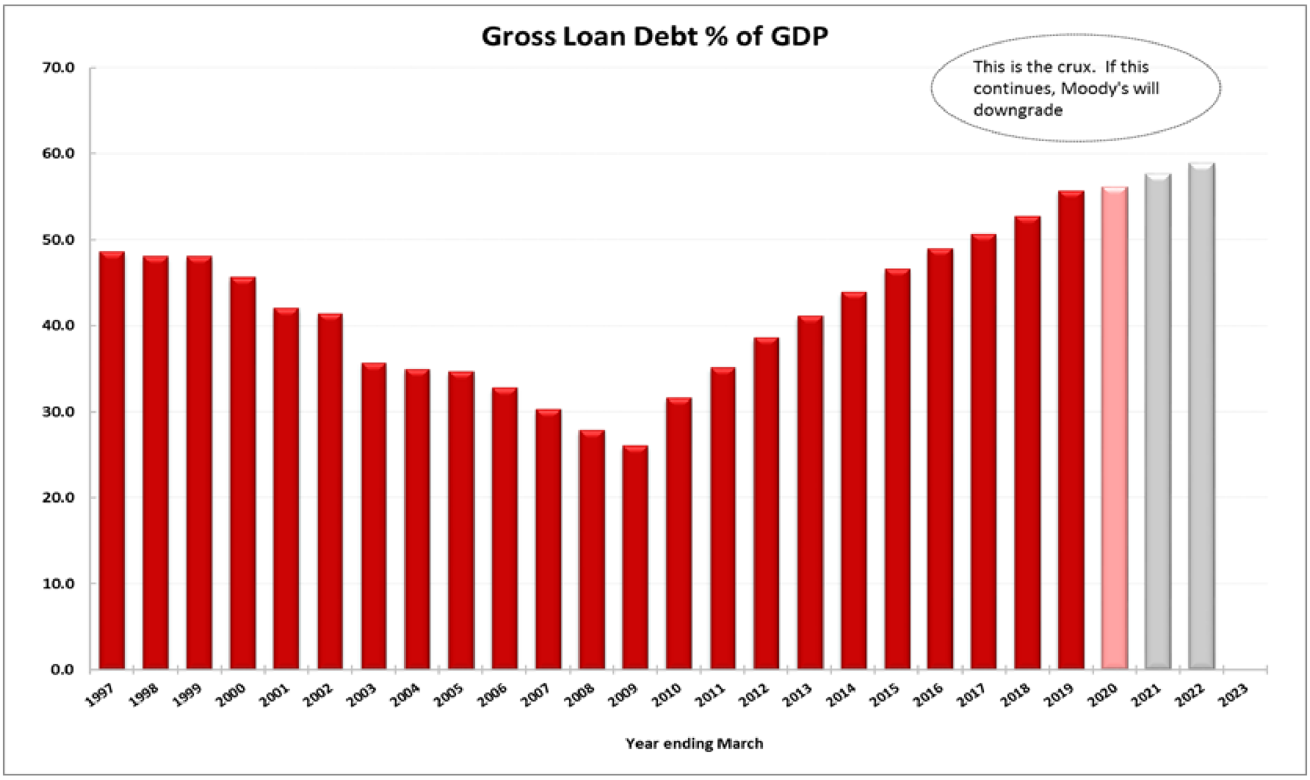
The deficit is likely to remain at 4% plus to GDP. The chart below shows where the psychologically important and fundamentally more healthy 3% ratio lies versus what has been and will likely be achieved. The Deficit at R242bn is larger than expected and by the end of this Medium Term Expenditure period it would have been 13 years since it's been below 3%. No wonder that the fiscal picture has deteriorated so much.



Key statement from the MoF: "The wage bill is unsustainable"!



This means that the debt-to-GDP ratio will not stabilise, but rise, which is a key factor in the credit rating that SA is accorded. The ratio is in the mid-fifties as a % of GDP, closing in on 60%. Adding Guarantees and Contingencies (Eskom et.al.) raises this ratio to the mid-seventies!



One senses a capitulation from the MoF, therein that the ratios of the deficit and debt to GDP that are needed for an investment grade rating is no more. However, it is not a doomsday scenario. The reactions of the currency and of bond yields are muted and can be seen as a "confirmation" of bad news scenario. They are already trading at *de facto* non-investment grade levels.

Market Overview

MARKET INDICATORS				21 February 2019	
Money Market		Last close	Difference	Prev close	Current Spot
3 months	⇨	6.84	0.000	6.84	6.77
6 months	⇨	7.65	0.000	7.65	7.63
9 months	⇨	8.07	0.000	8.07	8.06
12 months	⇨	8.30	0.000	8.30	8.29
Bonds		Last close	Difference	Prev close	Current Spot
GC21 (BMK: R208)	⇩	8.17	-0.070	8.24	8.13
GC24 (BMK: R186)	⇩	9.74	-0.035	9.77	9.81
GC27 (BMK: R186)	⇩	9.94	-0.035	9.98	10.04
GC30 (BMK: R2030)	⇩	10.74	-0.035	10.78	10.71
GI22 (BMK: NCPI)	⇨	4.82	0.000	4.82	4.82
GI25 (BMK: NCPI)	⇨	5.17	0.000	5.17	5.17
GI29 (BMK: NCPI)	⇨	5.85	0.000	5.85	5.85
Commodities		Last close	Change	Prev close	Current Spot
Gold	⇩	1,338	-0.20%	1,341	1,339
Platinum	⇧	823	0.61%	818	821
Brent Crude	⇧	67.1	0.95%	66.5	67.2
Main Indices		Last close	Change	Prev close	Current Spot
NSX (Delayed)	⇧	1,342	0.69%	1,332	1,341
JSE All Share	⇧	55,692	0.90%	55,195	55,807
SP500	⇧	2,785	0.18%	2,780	2,785
FTSE 100	⇧	7,229	0.69%	7,179	7,229
Hangseng	⇧	28,514	1.01%	28,228	28,618
DAX	⇧	11,402	0.82%	11,309	11,402
JSE Sectors		Last close	Change	Prev close	Current Spot
Financials	⇧	16,869	0.64%	16,762	17,046
Resources	⇧	45,903	1.32%	45,306	46,083
Industrials	⇧	66,346	0.92%	65,740	66,208
Forex		Last close	Change	Prev close	Current Spot
N$/US dollar	⇩	14.02	-0.18%	14.04	13.96
N$/Pound	⇩	18.29	-0.28%	18.34	18.19
N$/Euro	⇩	15.89	-0.22%	15.92	15.82
US dollar/ Euro	⇩	1.134	-0.04%	1.13	1.134
		Namibia		RSA	
Economic data		Latest	Previous	Latest	Previous
Inflation	⇩	4.7	5.1	4.0	4.5
Prime Rate	⇨	10.50	10.50	10.25	10.25
Central Bank Rate	⇨	6.75	6.75	6.75	6.75

Notes to the table:

- The money market rates are TB rates
- “BMK” = Benchmark
- “NCPI” = Namibian inflation rate
- “Difference” = change in basis points
- Current spot = value at the time of writing

Source: Bloomberg

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