Heightened risk aversion results in quality spread compression and shorter-dated issuance
Author: Sithembiso Garane, Head: Listed Credit @ Futuregrowth
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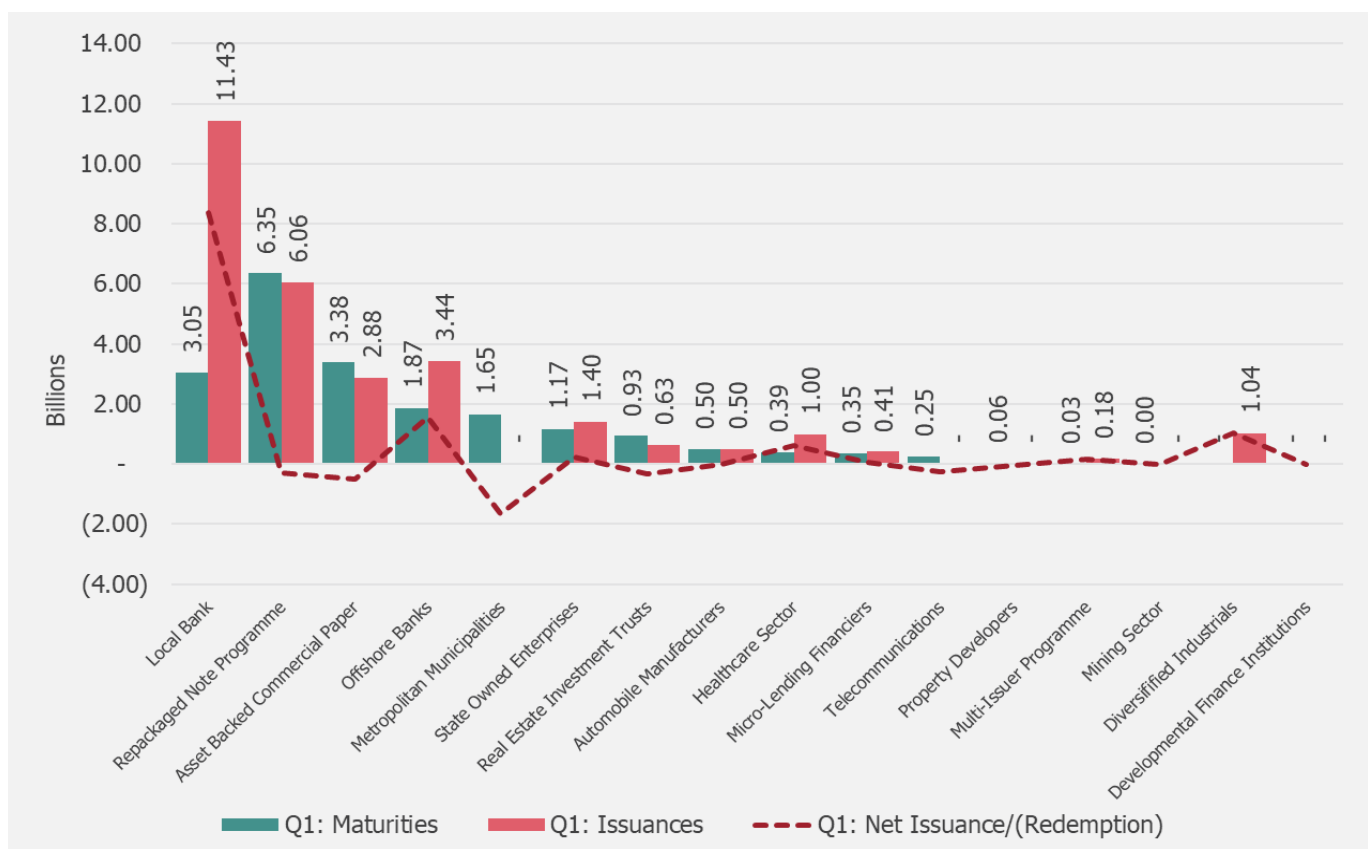
Overview of the listed credit market: Continued investor flight to high quality issuance
The first quarter of 2021 saw credit primary market issuance increase from R27.5 billion in the fourth quarter of 2020 to R28.9 billion (R34 billion including bank structured notes). This was also well in excess of the expected maturities as at December 2020 of R19.9 billion. At face value, the total issuance in comparison to projected refinancing requirement (maturities) for the quarter may possibly mislead market observers to conclude that credit market buoyancy is returning. However, at a closer look, there is an apparent skew of issuance across sectors and maturity buckets, which shows that the market is still biased toward high quality sectors and counterparties, and shorter-term exposure.

Figure 1: Listed credit market activity



Source: JSE, Futuregrowth

The sub-sovereign sector metros and SOEs indicate that debt capital market (DCM) refinancing activity has been stunted. The sector registered a net redemption of R1.42 billion for the quarter with only Transnet managing to remain active in commercial paper issuance. This may be due to a general migration to bank funding or possibly a Land Bank contagion effect after the bank's continuing default. Another trend worth observing is the surge in bank structured notes (mainly credit-linked notes). This is the continuation of a trend that began with COVID-19, where banks are continuing to de-risk their balance sheets by selling down some credit exposure to the market. Of the R22.6 billion bank issuance, structured notes account for R8.6 billion, taking the bank credit issuance for the first quarter of 2021 to R11.4 billion (*see Figure 1*).

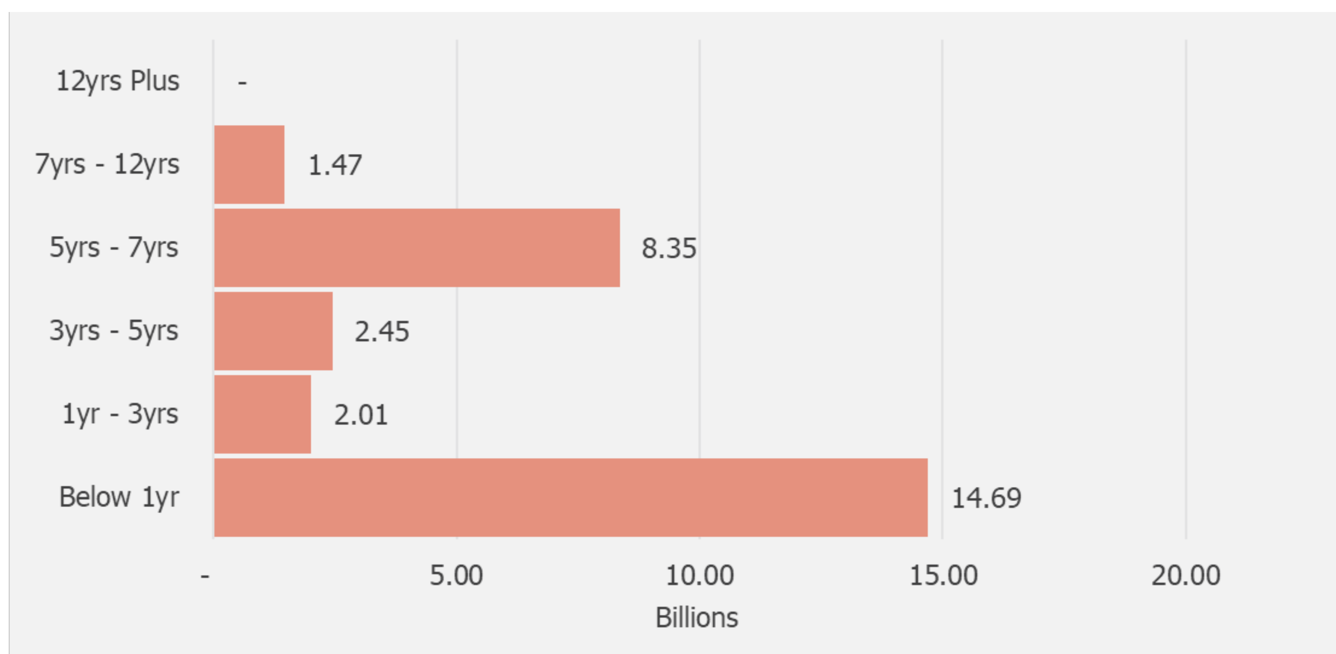
Our firm view is that the credit market is still characterised by high levels of credit risk and continued investor flight to high quality issuance, causing a skewed excess demand in high quality sectors. Consequently, high quality counterparties have traded at compressed spreads – mainly as a result of overall risk aversion.

Primary market: Due to the lack of demand, credit spreads are projected to widen for this sector

The banking, industrial and healthcare sectors had net issuances in the first quarter of 2021, with R11.4 billion, R1.04 billion and R1 billion new instruments, respectively. These three sectors were beneficiaries of the above-mentioned investor flight to quality. The excess refinancing activity amounted to R8.38 billion for banks and R0.61 billion for healthcare. There were no maturities for industrials in the quarter.

The sub-sovereign sector had R2.8 billion of maturities (R1.65 billion in Metros and R1.2 billion in SOEs) and only managed to refinance R1.4 billion with short-term paper. DENEL, City of Joburg, Ekhuruleni Metro and Umgeni Water Board all had maturities in the quarter, but no refinance activity in the DCM. These notes are likely to have been refinanced through bank funding. The sub-sovereign trade has predictably been affected by the Land Bank default and this is projected to continue until confidence is restored in the sector. Due to the lack of demand, credit spreads are projected to widen for this sector.

Figure 2: Credit issuance by maturity bucket for the first quarter of 2021



Source: JSE, Futuregrowth

The majority of the issuances in the quarter was under one year. All issuances above 5 years came from the banking sector, and only R140 000 from a multi-issuer programme. The short-term bias in issuances is one of the manifestations of the heightened risk aversion, and as a result longer-dated issuance spreads should be wide.

Secondary market: Largest spread widening came from sub-sovereign longer-dated instruments

There were 275 listed instruments with spread movements during the quarter: 193 with spread compression (see Table 1); and 82 widening (see Table 2). The average spread compression was 32

basis points (bps), largely in the shorter-term maturity bucket. The sectors that showed the biggest compression were banks, insurance, REITs, industrials and autos (Merc and Toyota). The securitisation sector compression was due to two SA Homeloans instruments (Amber House and Thek14), presumably due to pull to par effect as their maturities roll down to money market instruments (with 13 month and less maturities).

Table 1: Listed instruments - spread compression

Num. bonds tightening					
Term bucket	**Corporates**	**Structured Fin.**	**Financials**	**Sub-sovereign**	**Total**
Below 1yr	21.00	4.00	20.00	2.00	**47.00**
1yr - 3yrs	36.00	6.00	37.00	6.00	**85.00**
3yrs - 5yrs	9.00	0.00	29.00	4.00	**42.00**
5yrs - 7yrs	1.00	0.00	9.00	1.00	**11.00**
7yrs - 12yrs	0.00	0.00	3.00	3.00	**6.00**
12yrs Plus	0.00	0.00	0.00	2.00	**2.00**
	67.00	**10.00**	**98.00**	**18.00**	**193.00**

Average spread tightening					
Term bucket	**Corporates**	**Structured Fin.**	**Financials**	**Sub-sovereign**	**Total**
Below 1yr	-34.65	-108.50	-36.31	-25.50	**-41.25**
1yr - 3yrs	-31.37	-21.17	-28.68	-3.08	**-27.48**
3yrs - 5yrs	-18.51	0.00	-56.03	-11.38	**-43.74**
5yrs - 7yrs	-5.00	0.00	-15.39	-5.00	**-13.50**
7yrs - 12yrs	0.00	0.00	-1.33	-2.50	**-1.92**
12yrs Plus	0.00	0.00	0.00	-5.50	**-5.50**
	-30.28	**-56.10**	**-36.28**	**-7.69**	**-32.55**

Source: JSE, Futuregrowth

Of the 82 listed instruments that widened, most were in the financial 1-year to 3-year bucket. However, the largest spread widening came from sub-sovereign longer-dated instruments: ACSA (AIRL01) had the largest spread increase from 143bps/R210 in Q4:2020 to 310bps/R210 in Q1:2021. Other SOE spread spikes came from DBSA (DV29), Eskom (EL28), Transnet (TN23) and IDC (IDCG06 and IDCG15).

Table 2: Listed instruments - spread widening

Num. bonds widening					
Term bucket	**Corporates**	**Structured Fin.**	**Financials**	**Sub-sovereign**	**Total**
Below 1yr	4.00	0.00	10.00	0.00	**14.00**
1yr - 3yrs	8.00	1.00	18.00	2.00	**29.00**
3yrs - 5yrs	3.00	1.00	13.00	1.00	**18.00**
5yrs - 7yrs	1.00	0.00	8.00	0.00	**9.00**
7yrs - 12yrs	0.00	0.00	7.00	3.00	**10.00**
12yrs Plus	0.00	0.00	2.00	0.00	**2.00**
	16.00	**2.00**	**58.00**	**6.00**	**82.00**

Average spread widening					
Term bucket	**Corporates**	**Structured Fin.**	**Financials**	**Sub-sovereign**	**Total**
Below 1yr	4.60	0.00	17.67	0.00	**13.94**
1yr - 3yrs	8.15	30.00	9.32	1.50	**9.17**
3yrs - 5yrs	13.00	4.00	10.42	5.00	**10.19**
5yrs - 7yrs	10.00	0.00	25.31	0.00	**23.61**
7yrs - 12yrs	0.00	0.00	22.61	61.67	**34.33**
12yrs Plus	0.00	0.00	32.00	0.00	**32.00**
	8.29	**17.00**	**15.60**	**32.17**	**15.42**

Source: JSE, Futuregrowth

Sector focus: Financials - seen as less risky than other sectors
Banks and insurers continued to attract interest, with oversubscribed auctions in the primary market and compression in the secondary market. This is despite increased credit risk with increasing credit loss ratios and nonperforming loans evident in bank financial results. However, both banks and insurers remain sufficiently capitalised with large liquidity buffers – and the financial sector is seen as less risky than other sectors.

Banks issued sub-debt during the quarter, seeking to pre-finance some maturities later on in the year. Nedbank issued an AT1, clearing at 467bps/Jibar (which compressed few weeks later to 425bps/Jibar). ABSA auctioned senior notes across the term structures, garnering massive support. Here, clearing spreads were: 3-year (110bps/Jibar), 5-year (124bps/Jibar), 7-year (149bps/Jibar) and 10-year (157bps/Jibar). MMI issued two 7-year notes, a floater and fixed note, clearing at 194bps/Jibar and 115bps/R186, respectively. Standard Bank (R1.8 billion) and Investec (R450m) also issued AT1 instruments; the latter clearing at 423bps/Jibar, while the former was a private placement at 480bps/Jibar.

Other sectors
The table below shows the counterparties in the other sectors that had credit placements.

Counterparty	Term	Clearing spread
Fortress	1yr	140bps/Jibar
Emira	1yr	160bps/Jibar
Barloworld	1yr & 3yr	105bps & 169bps/Jibar
Investec Property Fund	3m	55bps/Jibar
Leshego	3m	450bps/Jibar
Accelerate property	2yr	290bps/Jibar
Merc Benz	3yr	98bps/Jibar
Netcare	2yr	175bps/Jibar

Credit rating migration
As the COVID-19 impact on corporate balance sheets becomes evident, adverse rating actions are expected.

To this extent, in the previous quarter two DCM issuers, Transnet and Hospitality Property Fund, received rating downgrades, and Moody's Land Bank grading was withdrawn:
- Transnet's global scale rating (GSR) was downgraded by one notch to BB-, taking the SOE to a notch below the current country ceiling of BB. This is the second GSR downgrade for Transnet in as many years. The 2020 downgrade was off the back of the sovereign downgrade, and may affect

Transnet's cost of offshore funding as it uses the Fitch GSR to raise euro and/or US dollar debt. The national scale rating from Moody's remains unchanged.

- The Hospitality Property Fund downgrade does not come as a surprise after the severe strain that the tourism and travel industry has faced and continues to face. The fund remains at investment grade at BBB-, after the single notch downgrade.
- Land Bank's rating was withdrawn by Moody's, with the main downgrade trigger the time it is taking to cure the bank's ongoing default. It is expected that the new notes, to be issued after implementation of the liability solution, will not be officially rated.

Other ratings changes also took place:

- Merc-Benz SA (Fitch) and Netcare (GCR) were both affirmed at AAA and AA-, respectively.
- New ratings were assigned: Momentum Life with a AA- rating; and Accelerate with a single instrument rating (APF15) of A.

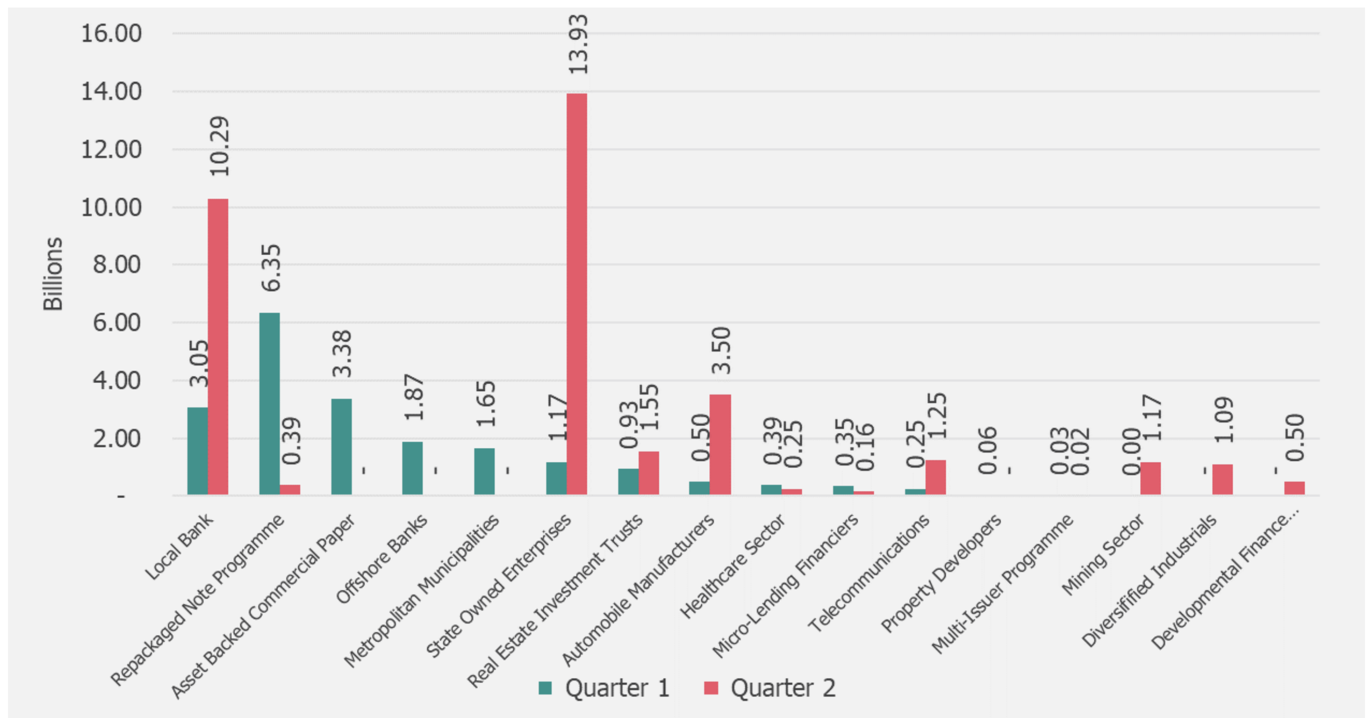
Company	CRA	Rating scale	Rating action	New rating	Old rating
Netcare Limited	GCR	National	Rating affirmed	AA-(za)/A1+(za)	AA-(za)/A1+(za)
Hospitality Property Fund Limited	GCR	National	LT downgraded, ST affirmed	BBB-(za)/A3(za)	BBB(za)/A3(za)
Momentum Metropolitan Life Ltd	Moody's	National	Rating assigned (Sub-debt)	Ba3(hyb)/Aa3.za(hyb)	-
Accelerate Property Fund Limited	GCR	National	Rating assigned (APF15)	A(za)(EL)	-
Transnet SOC Limited	Fitch	Global	Rating downgraded	BB-	BB
Mercedes-Benz South Africa Limited	Fitch	National	Rating affirmed	AAA(zaf)/F1+(zaf)	AAA(zaf)/F1+(zaf)
	Fitch	Global	Rating affirmed	BBB+/F1	BBB+/F1
Landbank SOC Limited	Moody's	National	Rating withdrawn	-	B

Source: SBR, GCR, Moodys, Futuregrowth

Credit market forward view: Fair value may be a myth at the moment

The skewed demand dynamics have certainly benefited banks and insurers and other high-quality liquid asset issuers. This trend is expected to continue until the return of predictability and certainty in economic activity. The SOE second quarter 2021 refinance requirement is the highest, with approximately R16.5 billion of maturities. The Trans-Caledon Tunnel Authority constitutes the majority of this amount, with a R9.5 billion (WSP5) redemption in May 2021. Other sizable maturities are the Development Bank of Southern Africa (DV21 and DVFB21) and Rand Water (RW21) with R1.4 billion and R1.6 billion, respectively. The banks have partially pre-financed the second quarter maturities (R10 billion) and we expect spreads to continue to compress in this sector. The Auto refinance requirement is R3.5 billion and that of REITs R1.15 billion (see figure 3 below).

Figure 3: Credit maturities for the first quarter of 2021



We expect sub sovereigns to migrate to bank funding as the Land Bank saga prevails. The banks have partially pre-financed some of their second quarter maturities, and we expect prefunding to be the norm for banks as they seek to manage refinance risk. The market is likely to be dislocated for some time and, as a result, fair value in the credit market may be a myth at the moment.

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