Potential impact of SA credit ratings' downgrades to sub-investment levels on the economy and the CTFL industries:

A scenario

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Introduction

SA credit ratings downgraded to sub-investment levels: Introduction

- **Credit rating:** *"Credit rating is a process of assessing and scoring the creditworthiness of would-be borrowers, on a standardized basis, to help lenders to decide who to lend to, and on what terms."* (Willis Towers Watson).
- **Sovereign rating:** Credit rating agencies also provide ratings for bonds issued by governments, assessing the relative likelihood that they will honour/default on their obligations.
- **Notations:** Each credit rating agency has developed its own standard notation for rating borrowers:
  - **S&P**, **Fitch** and **GCR** have similar notations: their "**investment grade**" ratings range from AAA to BBB- ; while ratings of BB+ and below are "**sub-investment grade**", also known as "**junk**".
  - **Moody's** investment grade scale ranges from Aaa to Baa3; with its sub-investment or "junk" ratings raging from Ba1 to C.
- **Upgrades / downgrades:** The rating agencies review the ratings they assign to borrowers over time, moving them up ("upgrading") or down ("downgrading') their scales.

Principal international rating agencies:

S&P Global Ratings

Moody's Investors Service

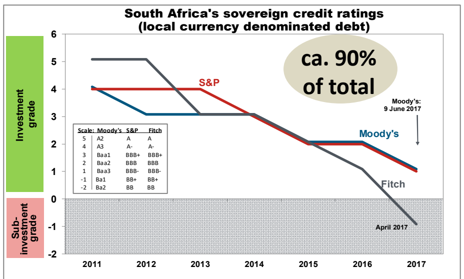
FitchRatings

Local rating agency competing in Southern Africa:

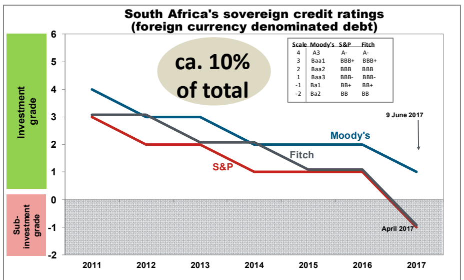
GCR Global Credit Rating Co.

SA credit ratings downgraded to sub-investment levels: Introduction (continued)

- SA's sovereign credit ratings have been gradually lowered over time, with the main rating agencies expressing concerns over: very subdued economic growth; weakening fiscal metrics, rising contingent liabilities of government; political uncertainty, policy consistency, structural reform; strength and independence of key institutions, SOE governance.
- In 2011, SA's credit ratings were still comfortably in investment grade territory with respect to both local- and foreign currency denominated debt, but downgrades ensued in subsequent years:
  - In April 2017, S&P and Fitch lowered their ratings for SA's foreign currency denominated debt to sub-investment. Fitch also lowered its rating for local currency denominated debt to "junk".
  - Moody's followed later and, in June 2017, also lowered its ratings for both the local- and foreign currency denominated debt by 1 notch, although still investment grade.



Source: IDC, compiled from Countryeconomy data



Source: IDC, compiled from countryeconomy data

SA credit ratings downgraded to sub-investment levels: Introduction (continued)

- Investment managers take credit ratings into consideration, among other factors, when deciding whether to lend to a would-be borrower.
- Important to note from experiences of other economies that faced sovereign downgrades to sub-investment levels:
  1. Markets anticipate such moves to a significant extent, for market players can monitor, in real time, the developments that ultimately underpin them;
  2. A sub-investment or "junk" rating does not imply a total loss of investor appetite for the bonds issued by the respective country;
  3. Bonds and currencies can rally thereafter, especially if conditions in international markets are favourable (e.g. yield-seeking flows to emerging markets, as has been the case for some time);
  4. Future downgrades to lower sub-investment categories can be avoided;
  5. A return to investment grade is possible, subject to addressing most/some of the key factors that contributed to the downgrade.
- Having said this, downgrades to "junk" status do affect negatively an economy's performance through various transmission mechanisms.

Dominant global rating agencies:

S&P Global Ratings

Moody's Investors Service

FitchRatings

Local rating agency competing in Southern Africa:

GCR Global Credit Rating Co. Local Expertise • Global Presence

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SA credit ratings downgraded to sub-investment levels: Scenario assumptions and outcomes

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SA credit ratings downgraded to sub-investment levels: Scenario assumptions

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- Downgrades to sub-investment levels have different implications, depending on whether referring to local or foreign currency denominated debt:
  - Around 90% of SA's total government debt is local currency denominated, while foreign currency bonds account for about 10%.
  - Approximately 36% of SA's local currency government bonds is held by foreigners;
  - Hence, the assumed timing of the respective downgrades per agency and per category of debt is important.
- Thus far, **only Fitch has placed SA's local currency rating at sub-investment level**, with limited impact on capital flows, SA debt pricing and the Rand. However, the adverse effects would be magnified if other rating agencies follow suit.
- The following **assumptions** were made in undertaking the **Downgrade Scenario** analysis:
  - **Moody's** downgrades (on 24 Nov. 2017) both SA's local currency denominated debt and SA's foreign currency denominated debt by 1 notch to sub-investment levels (i.e. from Baa3 to Ba1);
  - **S&P** downgrades (also on 24 Nov. 2017) SA's local currency denominated debt by 1 notch to a sub-investment level (i.e. from BBB- to BB+), and will also lower its rating for SA's foreign currency denominated debt (already sub-investment at BB+) by 1 further notch to BB;

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SA credit ratings downgraded to sub-investment levels: Scenario assumptions (continued)

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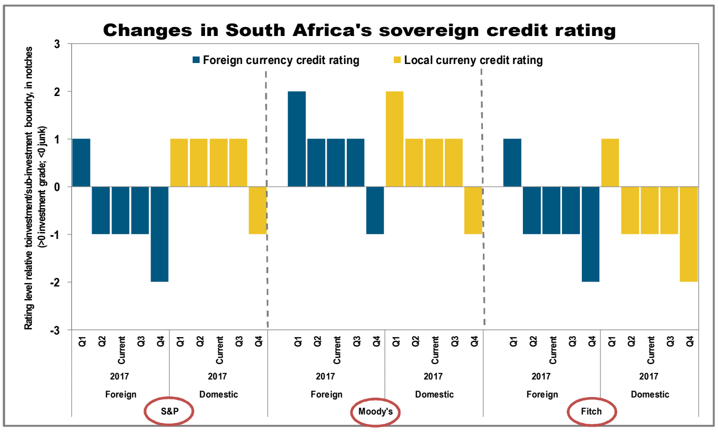
- Although **Fitch** does not have scheduled dates for announcements of its future reviews of SA ratings, these were assumed to occur towards end-November. It is assumed it will lower its ratings (both already sub-investment, at BB+) of SA's local currency denominated debt and SA's foreign currency denominated debt by 1 further notch within the sub-investment category to BB.



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SA credit ratings downgraded to sub-investment levels: Scenario assumptions (continued)

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- Further credit rating downgrades into sub-investment territory, especially if also including local currency denominated debt, would have serious implications for the SA economy:
  - Substantial capital outflows as index-tracking funds would be forced to sell their holdings, affecting the Rand exchange rate and the Balance of Payments.
  - SA's exclusion from key global bond indices, such as the Citibank World Government Bond Index and the Barclays Global Aggregate would be particularly impactful.
  - Hard to assess the extent of index tracking in the global bond market, with estimates of "forced selling" ranging from R85 billion to R130 billion.

Breakdown of the primary global bond indices

Index		SA Weight	Weight value	Estimated outflows	Exclusion criteria
Citi WGB Index	WGBI	0.41%	R127bn	R85bn	BB+ (S&P) and Ba1 (Moody's) for LC rating
JP Morgan Index	GBI-EM GD IG	15%	USD1.5bn	USD1.5bn – USD2.5bn of Euro bonds	BB+/Ba1 for LC rating by one of the three rating agencies
	EMBIG	3.5% - 5.35%	USD1.9bn		BB+/Ba1 for FC rating by one of the three rating agencies
Bloomberg-Barclays	Global aggregate		USD4.6bn	USD4.6bn	BB+/Ba1 for LC rating by the middle rating agency

Source: Adapted from Stanlib

* LC = Local currency denominated debt
** FC = Foreign currency denominated debt

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SA credit ratings downgraded to sub-investment levels: Economic prospects would deteriorate

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- The SA economy would record a **significantly worse performance** under a **Downgrade scenario** when compared to our Base case projections:
  - The cost of debt would thus rise, not only for government, but also for the business sector and households. SA access to credit in global markets would become more challenging, as reflected by higher premiums.
  - A weaker Rand would bring forth inflationary pressures. The Monetary Policy Committee would be forced to raise interest rates to contain such pressures and anchor inflation expectations. A higher interest environment would affect growth.
  - Importantly, business and investor confidence would be dealt a severe blow, impacting negatively on production activity and investment spending and, as a result, on employment levels.
  - Consumer confidence would also be adversely affected, resulting in subdued growth in household expenditure.
  - Lower domestic demand, particularly by households and the business sector will exert further downward pressure on a poorly performing SA economy.
  - Weaker economic growth will affect tax revenue collections by government, constraining its capital as well as operational expenditure, potentially affecting its procurement from and support measures provided to the business sector.

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SA credit ratings downgraded to sub-investment levels: Economic prospects would deteriorate (continued)

- **SA's poor are likely to be the most affected** by the socio-economic developments anticipated in a Downgrade scenario. Households are likely to be affected by:
  - Higher cost of living (transportation costs, food prices, etc.);
  - Increased cost of debt (higher interest rates);
  - Difficult access to credit;
  - Possible increase to taxes (especially indirect taxes);
  - Possible loss of employment and, for those currently without a job, weaker employment prospects;
  - Lower salary adjustments in real terms;
  - If unable to access or accommodate additional debt, households may be forced to sell some of their assets in order to make ends meet;
  - Potential cut-backs in governmental social benefit programmes (education, health, social grants, EPWPs) due to fiscal constraints; and, among others, by
  - Socio-economic related challenges in their environment (e.g. higher incidence of crime, social unrest).

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SA credit ratings downgraded to sub-investment levels: Scenario assumptions

- **Macroeconomic Model** assumptions under the **Downgrade scenario***:
  - Substantial **capital outflows** to adversely affect the Rand.
  - **Rand-USD exchange** rate assumed to depreciate by about 20% compared to Q2 2017 actual levels and to average R15.74 per USD in Q1 2018 (R13.34 per USD in the Base case), with a gradual appreciation thereafter.
  - The Rand is, however, assumed to remain **slightly weaker relative to the Base case** throughout the entire outlook period.
  - A higher inflation outcome would prompt a **more aggressive monetary policy stance**, with the repo rate projected to be hiked by 50 bps as from Q1 2018 relative to the Base case, whilst the **real repo rate** (i.e. after inflation adjustment) remains higher than in the Base case.
  - Business and investor confidence also assumed to be negatively affected due to further downgrades, with the assumption of a **drop in real fixed investment spending** in 2018, followed by a modest recovery in subsequent years.

* International experiences analysed: Hungary, Brazil, Russia

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SA credit ratings downgraded to sub-investment levels: Scenario assumptions

Sectoral Forecasting Model assumptions:

- **Final demand drivers** (e.g. consumer spending, government expenditure, fixed investment, exports) are calculated for each individual sector (46 sectors) as per the **Base case**, based on the macroeconomic forecasts.
- These demand drivers, along with a **sectoral regression analysis,** determine the outcomes for each individual economic variable, such as GDP, employment, exports and imports for the **Base case** at a 46-sector level.
- For the **Downgrade scenario**, a new set of **macroeconomic forecasts** (e.g. lower consumer spending and fixed investment) provide a change in the respective demand drivers at sectoral level, which result in a **new set of forecasts for each of the individual sectors** as per the sectoral model (46 sectors).

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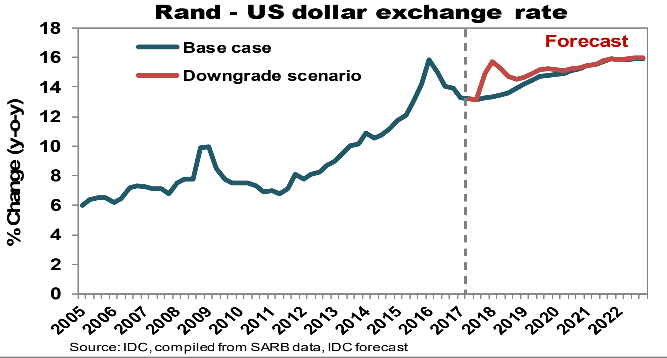
SA credit ratings downgraded to sub-investment levels: Macroeconomic outcomes - Exchange rates

- Following the downgrade of SA's sovereign credit rating by S&P and Fitch in early April 2017, the Rand came under pressure due to market uncertainty and renewed risk aversion.
- Although the Rand has strengthened to some extent since then, it is expected to remain under pressure and show increased volatility in the months ahead.
- Moreover, periods of heightened political tension, especially in the run-up to and during the ANC's elective conference in December 2017, could exert renewed pressures on the Rand.



Source: IDC, compiled from SARB data, IDC forecast

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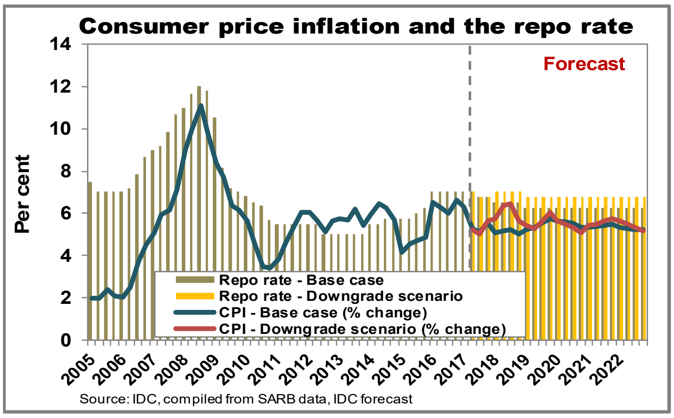
SA credit ratings downgraded to sub-investment levels: Macroeconomic outcomes - Inflation and Repo rate

- A weaker Rand will result in higher domestic inflation, which is expected to peak at 6.5% in Q3 2018, with a declining trend thereafter.
- In order to anchor inflationary expectations and arrest price pressures, the MPC is anticipated to follow a more aggressive monetary policy stance, raising the repo rate again to 7.0% in Q1 2018, with a higher real repo rate than under the Base case forecast.



Source: IDC, compiled from SARB data, IDC forecast

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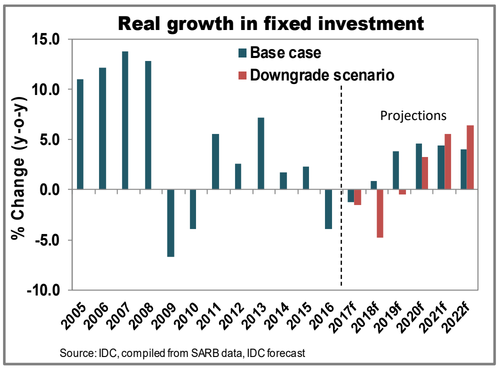
SA credit ratings downgraded to sub-investment levels: Macroeconomic outcomes - Fixed investment

- A worsening operating environment (uncertainty, weakening demand, rising inflation & interest rates etc.) will lead to lower business confidence, impacting negatively on private sector investment.
- General government may be forced to reduce capex due to fiscal constraints (lower tax collections, higher debt servicing costs). This will affect …
  - Roll-out of economic and social infrastructure;
  - Procurement spend, impacting on private sector production and investment activity.
- SOE investment activity would also be lower than planned due to:
  - Difficulty in raising new debt, govt. constraints in providing guarantees;
  - Higher cost of capital;
  - Weaker demand conditions.



Source: IDC, compiled from SARB data, IDC forecast

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SA credit ratings downgraded to sub-investment levels: Macroeconomic outcomes - Household spending

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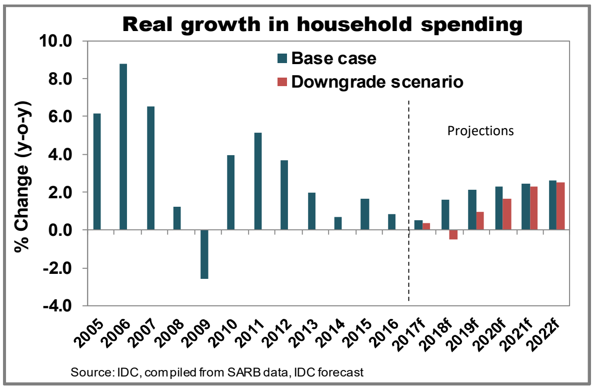
- Consumer confidence, which is already at low levels, will be dealt a further blow as economic conditions deteriorate, retrenchments increase and less new jobs are created.
- Interest rate sensitive spending items, such as motor vehicles and furniture, are likely to be the most affected by cut-backs in household expenditure, whilst spending on semi-durable items, including CTFL-related items, is also likely to be negatively impacted.



Source: IDC, compiled from SARB data, IDC forecast

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SA credit ratings downgraded to sub-investment levels: Macroeconomic outcomes – Government balance

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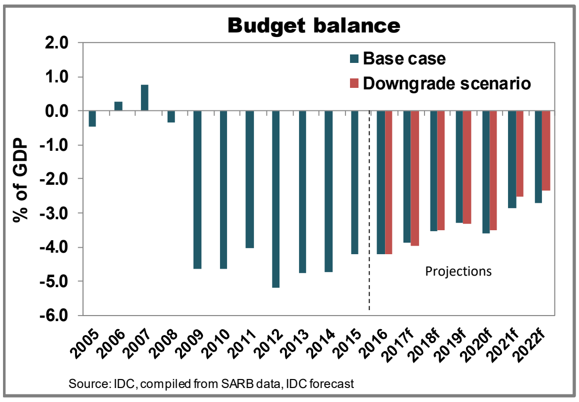
- Facing a tighter fiscal space, government will have to reign in its expenditure (capex and opex) as it proceeds with its fiscal consolidation efforts and to keep its debt at manageable levels.
- The budget balance may improve marginally under a Downgrade scenario.



Source: IDC, compiled from SARB data, IDC forecast

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SA credit ratings downgraded to sub-investment levels: Macroeconomic outcomes - Balance of payments

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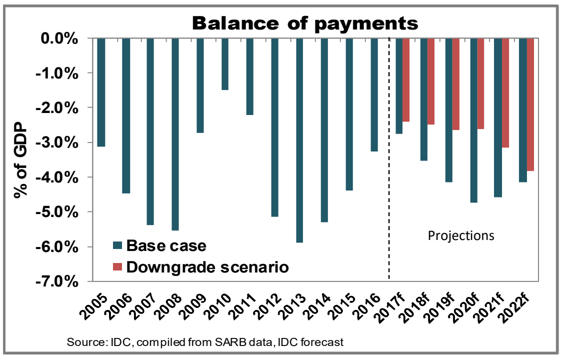
- Underpinned by a depreciation of the Rand, exports are expected to grow at a faster pace relative to projections under the Base case.
- Import demand will be adversely affected by a weaker Rand, by lower levels of economic activity and generally lower spending propensity. A weaker currency should also bring along opportunities for import replacement.
- The deficit on the current account of the balance of payments is thus expected to narrow for most of the outlook period.



SA credit ratings downgraded to sub-investment levels: Macroeconomic outcomes – Overall economic growth

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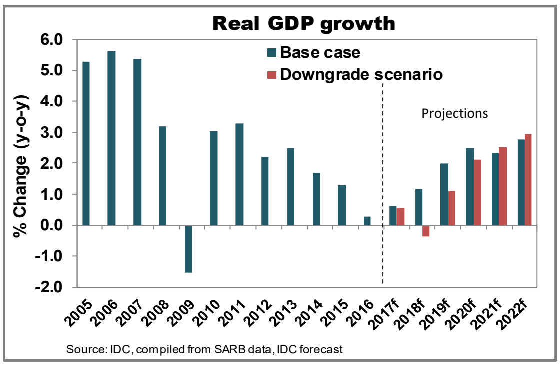
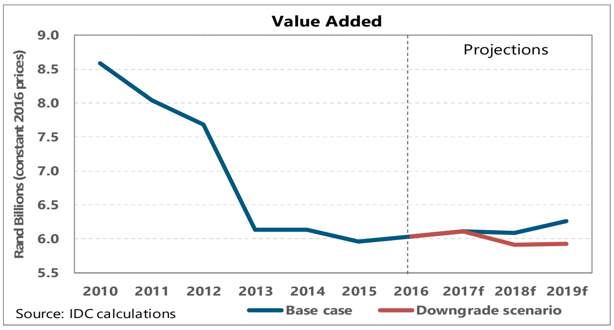
- Having just experienced the worst growth performance since the 2009 recession (only 0.3% growth in 2016), the economy will be negatively affected by further ratings' downgrades and the consequential ripple effects.
- The recovery anticipated in the Base case would be reversed in a Downgrade scenario:
  - SA economy would possibly post 0.5% growth in 2017; but
  - A recession (-0.4% GDP growth) is likely to ensue in 2018; with
  - A very gradual economic recovery thereafter.



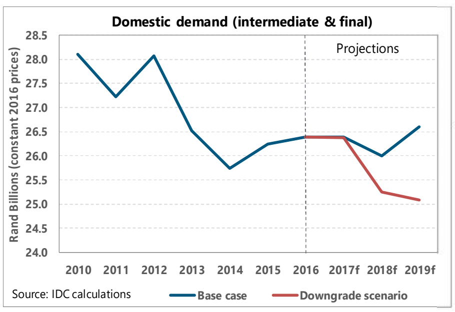
SA credit ratings downgraded to sub-investment levels: CTFL outcomes - **Textiles industry**

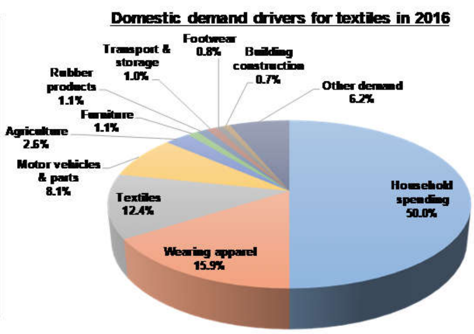
- The textiles industry has taken severe strain in recent years, with **output** having exhibited a sharply declining trend earlier in the decade. More recently, production has been more stable in relative terms.
- By 2016, **value added** was 30% lower than in 2010 (in real terms).
- Weak growth prospects are forecast for the sector as business conditions remain largely unfavourable, especially over the short-term.
- A worsening performance under a Downgrade scenario could result in **value added** being more than 5% lower than under the Base Case by 2019.



SA credit ratings downgraded to sub-investment levels: CTFL outcomes - **Textiles industry** (continued)

- Worsening domestic conditions under a Downgrade scenario are set to affect overall industry **demand**, which accounts for a substantial portion of the textile sector's output.
- Industry demand is dominated by clothing sector. Motor vehicles also a key user of textiles.
- Textile **production** to be adversely impacted by reduced household spending, while government may be forced to cut back on spending, including on designated products.
- Weaker investment activity could affect demand for speciality textiles used in the building and construction sector, whilst subdued growth prospects for the mining sector would add to the industry's woes.





__Note__: Domestic demand = Output - exports

Source: IDC, compiled from SARS data

SA credit ratings downgraded to sub-investment levels: CTFL outcomes - **Textiles industry** (continued)

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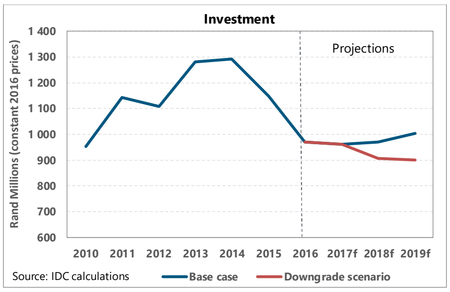

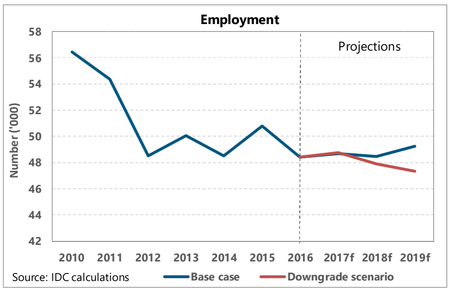

- **Investment spending** is expected to remain under pressure due to weaker demand conditions, especially in light of the spare production capacity.
- 74% of all textiles industry respondents to the BER's Q2 2017 survey indicated that **output levels** were below capacity.
- Higher interest rates under a Downgrade scenario are set to affect investment decisions, with **operating costs rising** in an increasingly uncertain environment.
- Governmental **support measures** to enhance the competitiveness of domestic manufacturing could also be affected due to fiscal constraints.
- Having experienced falling **employment** in recent years, further job losses may occur under a Downgrade scenario.
- By 2019, the textiles industry could employ ca. 2 000 fewer people than under the Base Case.

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SA credit ratings downgraded to sub-investment levels: CTFL outcomes - **Textiles industry** (continued)

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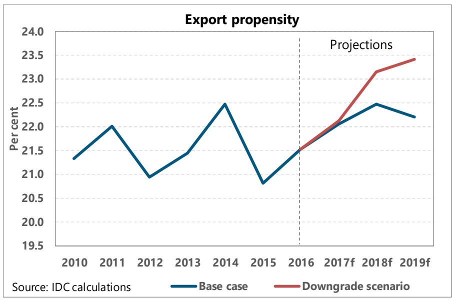
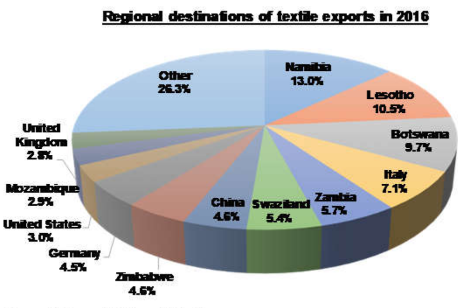
- **Export market opportunities** should be explored in light of the weak domestic demand conditions facing the textiles industry.
- A weaker Rand, alongside stronger global demand and continued support to the industry's competitiveness should permit higher **export growth** in the Downgrade scenario.
- **Exports are highly concentrated** from a regional perspective though, as 60% of all textile exports in 2016 were destined to other African countries, mainly to SACU members (38% of the export basket).The EU was the destination for a further 22% of SA's textile exports, with economic growth in that regional bloc set to gain momentum.





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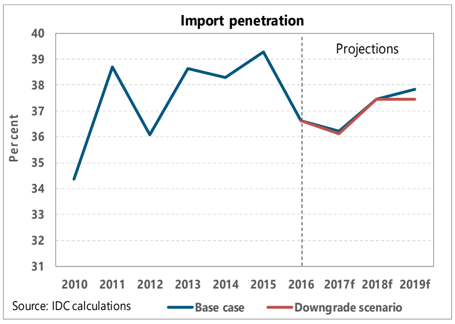
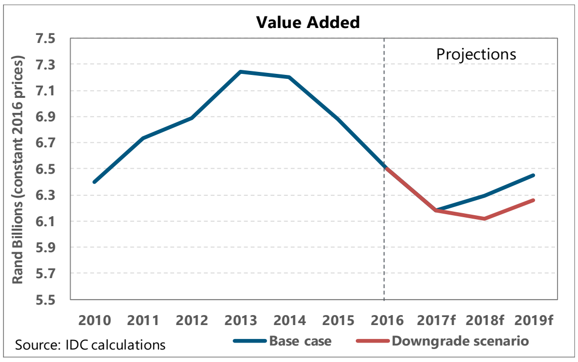
SA credit ratings downgraded to sub-investment levels: CTFL outcomes - **Textiles industry** (continued)

- Worsening domestic economic conditions and a weaker Rand are likely to impact adversely on **imports**.
- A weaker Rand could potentially also provide room for **import replacement**.
- The import penetration ratio is thus expected to fall marginally under the Downgrade scenario.
- From an operational perspective, intermediate imports (i.e. raw materials and other inputs used in the production process) account for roughly 23% of all **intermediate input costs**.
- The Rand's significant depreciation in a Downgrade scenario, especially in 2018, will raise **operating costs**, affecting domestic demand adversely and **reducing price competitiveness** in global markets.



SA credit ratings downgraded to sub-investment levels: CTFL outcomes - **Clothing industry**

- **Output levels** in the clothing industry fell in 2016 as well as in H1 of 2017.
- The industry's **value added** has declined continuously since the 2013 peak, due largely to deteriorating conditions domestically.
- Although the medium-term outlook is expected to show a slight improvement under the Base case, the **operating environment** is anticipated to remain challenging over the short-term, with the situation aggravated under a Downgrade scenario.



SA credit ratings downgraded to sub-investment levels: CTFL outcomes - **Clothing industry** (continued)

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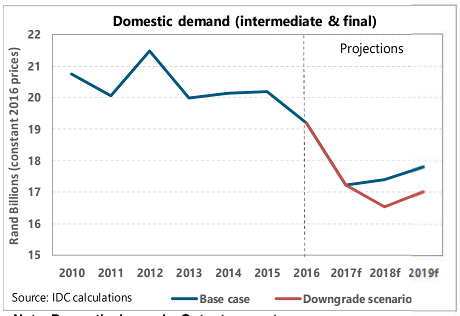
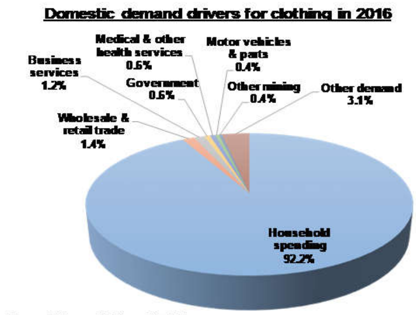
- The clothing industry's substantial **reliance on household spending** does not bode well for its production activity under the Downgrade scenario, since the consumer environment is forecast to worsen considerably.
- The increased **integration** of domestic clothing manufacturers in the **retail supply chain** results in demand being more correlated to domestic consumer spending.
- **Higher interest rates** will adversely affect consumers' demand for new credit, forcing them to cut back on interest rate sensitive items, including clothing. Under the Downgrade scenario, **household spending on semi-durable items** is set to decline in 2017 and 2018, with a modest recovery possibly ensuing in 2019.



Note: Domestic demand = Output - exports



SA credit ratings downgraded to sub-investment levels: CTFL outcomes - **Clothing industry** (continued)

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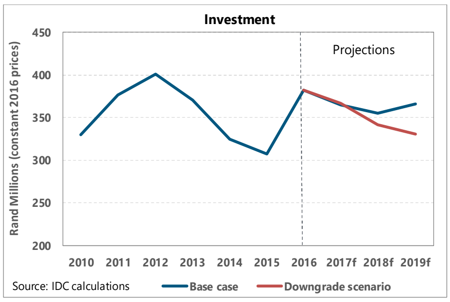
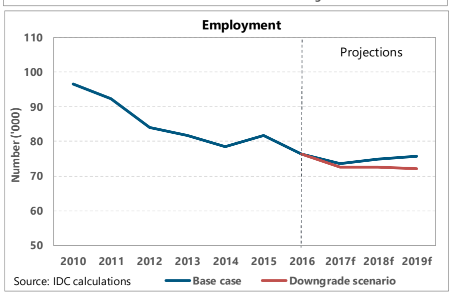
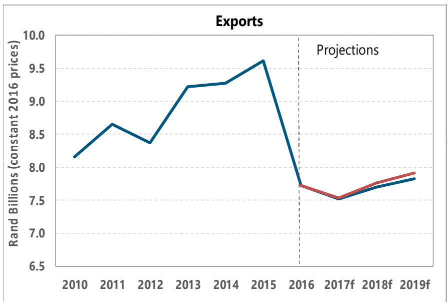




- A difficult operating and trading environment will have a negative impact on **investment spending** in the clothing industry.
- Clothing manufacturers have indicated that investment in plant and equipment will decline quite sharply over the next 12 months (BER Manufacturing survey).
- Fixed investment outlays are anticipated to be much worse under the Downgrade scenario, delaying the industry's recovery.
- The clothing industry has witnessed a strong declining trend in **employment for** many years, largely due to fierce competition from foreign producers and operational challenges.
- More **job losses** are expected under a Downgrade scenario as domestic demand conditions deteriorate.

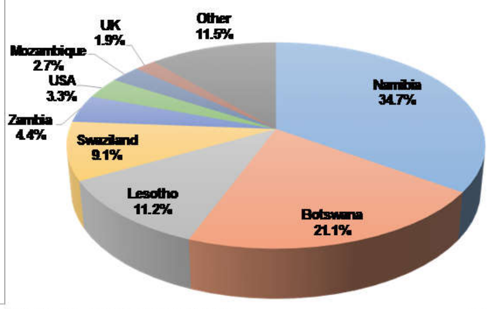
SA credit ratings downgraded to sub-investment levels: CTFL outcomes - **Clothing industry** (continued)

- Clothing **exports** are mostly destined to SA's neighbours (approximately 76% of all clothing exports in 2016 were sold in the BLNS countries.
- The industry's export markets should thus be diversified further, so as to reduce its reliance on a few countries.
- A **weaker Rand** should provide some support for an improved export performance, but a concerted effort would be required to raise the industry's **export propensity**, particularly since domestic consumption is expected to weaken under the Downgrade scenario.



Source: IDC calculations

Regional destinations of clothing exports in 2016



Source: IDC, compiled from SARS data

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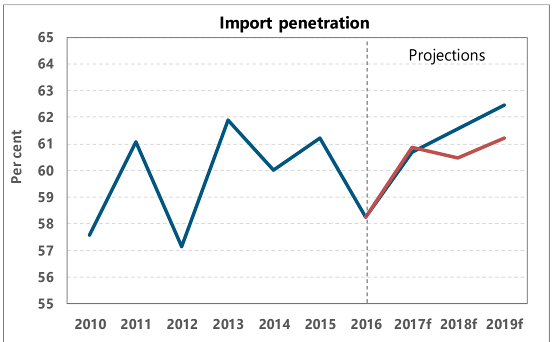
SA credit ratings downgraded to sub-investment levels: CTFL outcomes - **Clothing industry** (continued)

- Reduced domestic demand and the rising cost of imports on the back of a weaker Rand are expected to result in a decline in clothing **imports** under the Downgrade scenario.
- The implementation of the **fast-fashion model** in SA could also contribute to lower import demand.
- The weaker currency should provide opportunities for **import replacement** if competitiveness gains are achieved and sustained.



Source: IDC calculations

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SA credit ratings downgraded to sub-investment levels: CTFL outcomes – **Footwear industry**

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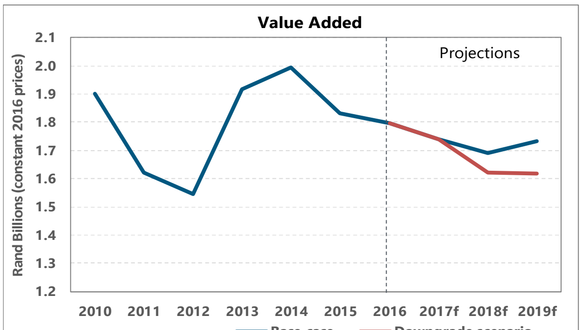
- Footwear **production volumes** have been on a gradual declining trend in recent years, with H1 2017 having recorded a further drop in output.
- The industry's output fell by 8.5% between 2010 and 2016, but is expected to recover to some extent under the Base case, specifically towards the latter part of the forecast period.
- In the more adverse environment prevailing under the Downgrade scenario, however, **production and value added** are likely to remain constrained.



Source: IDC calculations

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SA credit ratings downgraded to sub-investment levels: CTFL outcomes – **Footwear industry** (continued)

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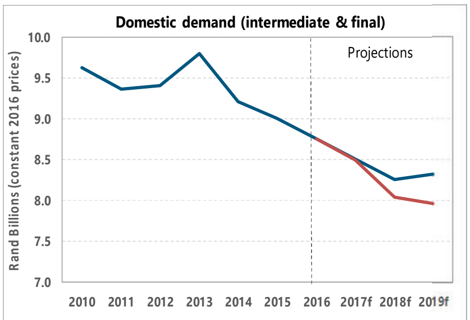
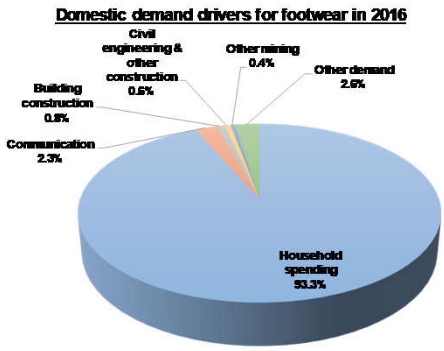
- The footwear industry's **production activity** is largely driven by household spending. Accordingly, a Downgrade scenario will impact it adversely, as consumers will cut back on spending on semi-durable items.
- Corporate demand would also be expected to come under pressure due to cost reduction efforts and potentially lower employment, which would point to reduced demand for items such as safety shoes (e.g. in construction, mining and various manufacturing industries).



Source: IDC calculations

Note: Domestic demand = Output - exports



Source: IDC, compiled from SARS data

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SA credit ratings downgraded to sub-investment levels: CTFL outcomes – **Footwear industry** (continued)

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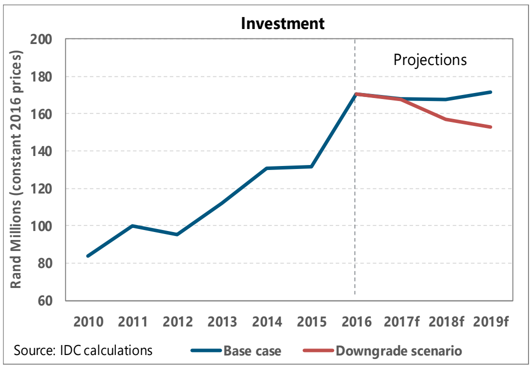
- **Investment spending** in the footwear industry has been on an upward trend for a number of years.
- Fixed investment activity is expected to stabilise under the Base case and could in fact decline in the adverse economic environment characterising the Downgrade scenario, for demand would come under pressure and operating costs rise, affecting the domestic industry's competitiveness.



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SA credit ratings downgraded to sub-investment levels: CTFL outcomes – **Footwear industry** (continued)

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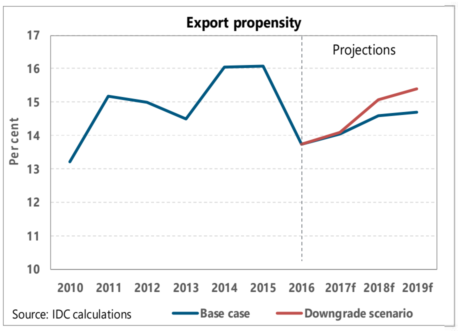
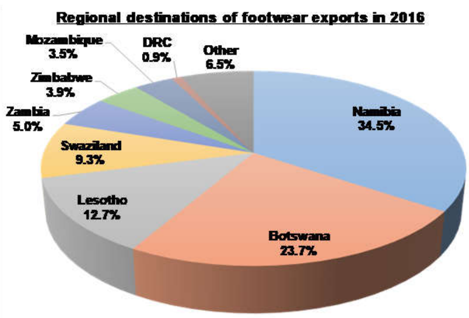
- **Exports** are mainly destined to other SACU members, which accounted for 80% of all footwear exports in 2016. Including other African countries, this figure rises to 97%.
- The footwear industry is forecast to benefit from improving demand conditions in global markets, mainly other African markets, both under the Base case and in the Downgrade scenario.
- Thus, with its output on the decline due to reduced domestic demand, the industry's **export propensity** is projected to rise over the outlook period under the Downgrade scenario.





Source: IDC, compiled from SARS data

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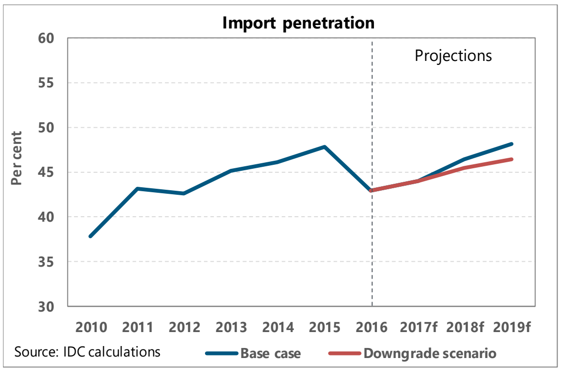
SA credit ratings downgraded to sub-investment levels: CTFL outcomes – **Footwear industry** (continued)

- With domestic demand deteriorating under the Downgrade scenario, **imports** are expected to be lower than under the Base case.
- Demand for both locally manufactured footwear as well as for **imported products** will be adversely affected, with the weaker Rand also contributing to the lower demand for imports.
- Consequently, the **import penetration** ratio is likely to decline under a Downgrade scenario.



Source: IDC calculations

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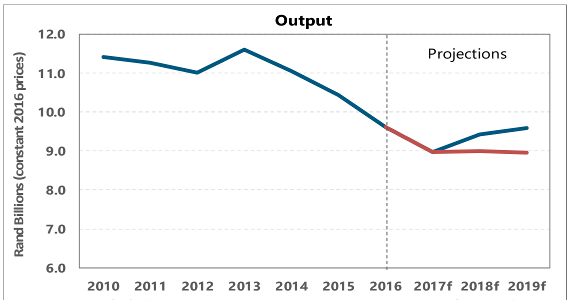
SA credit ratings downgraded to sub-investment levels: CTFL outcomes – **Leather industry**

- The leather and leather products industry has been recording lower **output** levels in an increasingly difficult operating environment. **Production volumes** fell by 6.5%, year-on-year, in H1 2017.
- Overall output is expected to recover in the Base case, especially on the back of improving **global demand**. Domestically, consumer demand is also set to improve, with a gradual recovery in the automotive industry expected to benefit the demand for leather.
- However, should the economic environment deteriorate, as anticipated under a Downgrade scenario, domestic demand would come under renewed pressure and impact on **production activity**.



Source: IDC calculations

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SA credit ratings downgraded to sub-investment levels: CTFL outcomes – **Leather industry** (continued)

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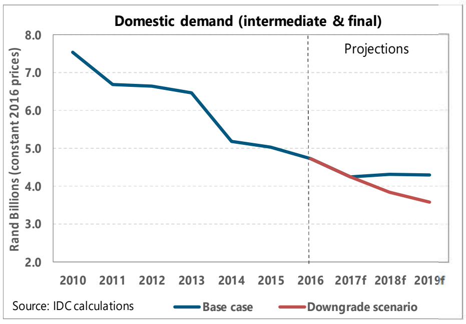
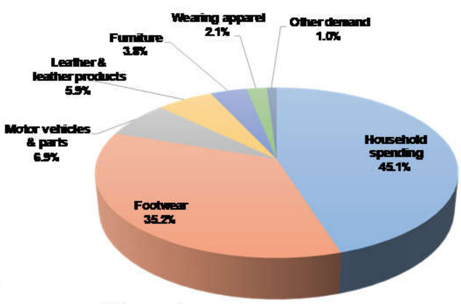
- Both **global demand and domestic demand** are key drivers of the industry's production activities.
- Worsening economic conditions domestically in recent years were reflected in weakening consumer as well as industry demand. A challenging environment in the domestic automotive industry, for example, is likely to have affected the demand for leather.
- Although more stable domestic demand conditions are anticipated in the Base case, the downward trend would most likely continue under the Downgrade scenario.



Note: Domestic demand = Output - exports

Domestic demand drivers for leather products in 2016



Source: IDC, compiled from SARS data

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SA credit ratings downgraded to sub-investment levels: CTFL outcomes – **Leather industry** (continued)

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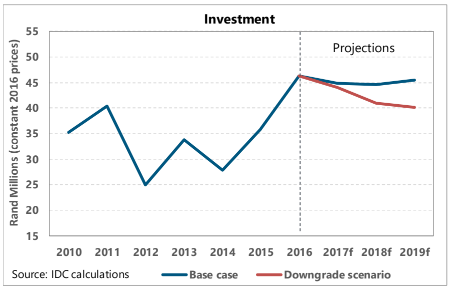

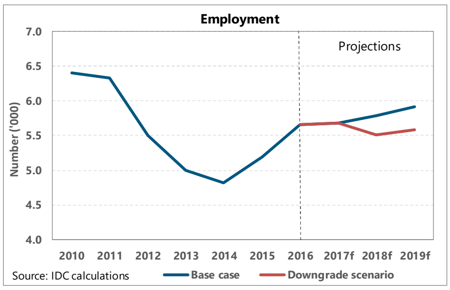

- After having experienced a steep rise in **investment activity** over the past 2 years, capital spending is expected to either stabilise or even decline slightly over the next few years.
- Fixed investment spending in the leather industry would most probably decline under a Downgrade scenario as the economic climate worsens.
- Weakening demand locally, surplus production capacity, and higher cost of credit are not likely to justify additional investment expenditure.
- The sector managed to expand its **employment** on the back of increased investment in recent years.
- However, under a Downgrade scenario some **employment losses** would be expected as production comes under pressure.

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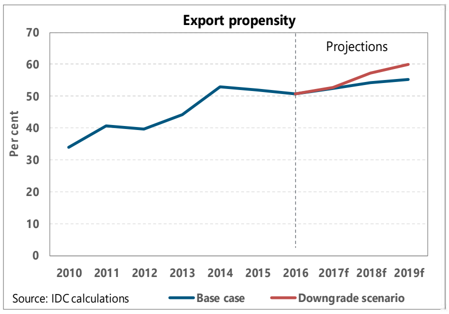
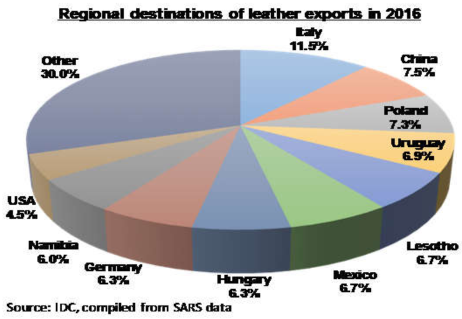
SA credit ratings downgraded to sub-investment levels: CTFL outcomes – **Leather industry** (continued)

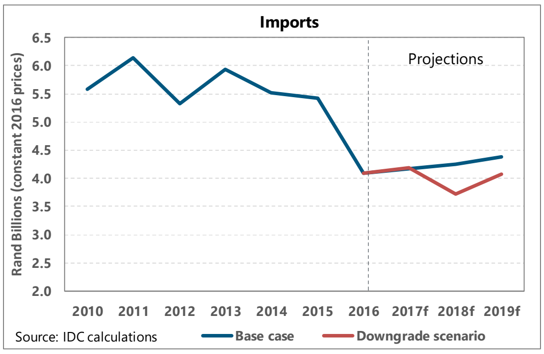
- The leather industry has the **highest export propensity** of all CTFL sectors, with slightly more than 50% of its products destined for global markets.
- Its global reach is diverse, with export markets across the globe.
- With economic conditions improving globally, including in many external markets for SA's leather & leather products, the industry stands to benefit from higher export demand.
- Its **export propensity** is set to rise under the Downgrade scenario, as export demand increases relative to domestic demand, also assisted by a weaker currency.





SA credit ratings downgraded to sub-investment levels: CTFL outcomes – **Leather industry** (continued)

- Under a Downgrade scenario, demand for **imported leather & leather products** is set to remain constrained by challenging domestic economic conditions.
- This will be underpinned by lower household demand, as well as by difficult operating conditions in key industry segments served by the leather industry.
- **Rising cost of imports** on the back of a substantially weaker Rand, especially in 2018, will adversely affect imports under the Downgrade scenario.



Concluding remarks

Concluding remarks

- Further downgrades of SA's sovereign credit ratings to sub-investment levels would have negative implications for the economy, including the CTFL industries.
- In the face of weakening economic conditions domestically, it would be critical for the CTFL industries to focus on building lean and agile operations that are able to compete more effectively, both in local and global markets:
  - Improve efficiencies and raise productivity;
  - Focus on skills development, up-skill and multi-skill to retain jobs;
  - Consider ways to contain operational costs, streamline business processes;
  - Invest in technology, equipment, R&D, innovation;
  - Focus on customer service as a differentiating factor from competitors;
  - Enhance and focus marketing efforts, including export market development;
  - Identify niche market gaps, opportunities for import replacement;

Concluding remarks (continued)

- Integrate effectively within value chains, contributing to their overall development and competitiveness;
- Ensure that individual companies and clusters of companies become significantly more efficient and collaborative;
- Communicate the steps that are being taken to sustain and stabilise the business to the various stakeholders (employees, shareholders, customers, financiers etc.).

• Continued public sector support to CTFL industries is also crucial, including:

- Funding assistance aimed at improving the competitiveness and long-term sustainability of players, and to stabilise employment;
- Tightening control of imports, especially illegal imports, ensuring consistent and effective enforcement of customs regulations;
- Enforcing and monitoring localisation directives, especially product designations; and, among others,
- Pursuing initiatives aimed at strengthening value chains, all the way to their retail and export servicing segments.

Thank you