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Impact of the Covid-19 on credit flows

- Lessons from 2008 GFC
- Implications for Recovery from Covid-19

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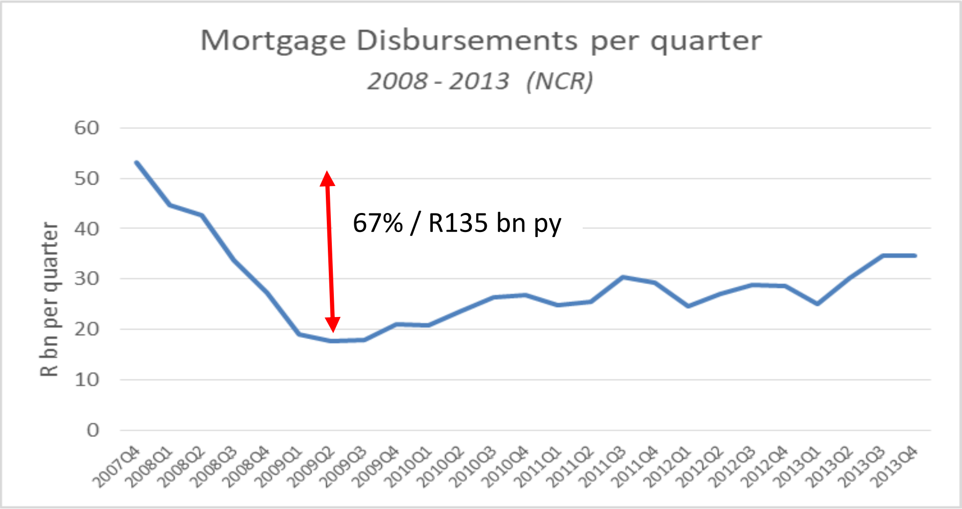
What can we learn from the 2008 Global Financial Crisis ("GFC) ....

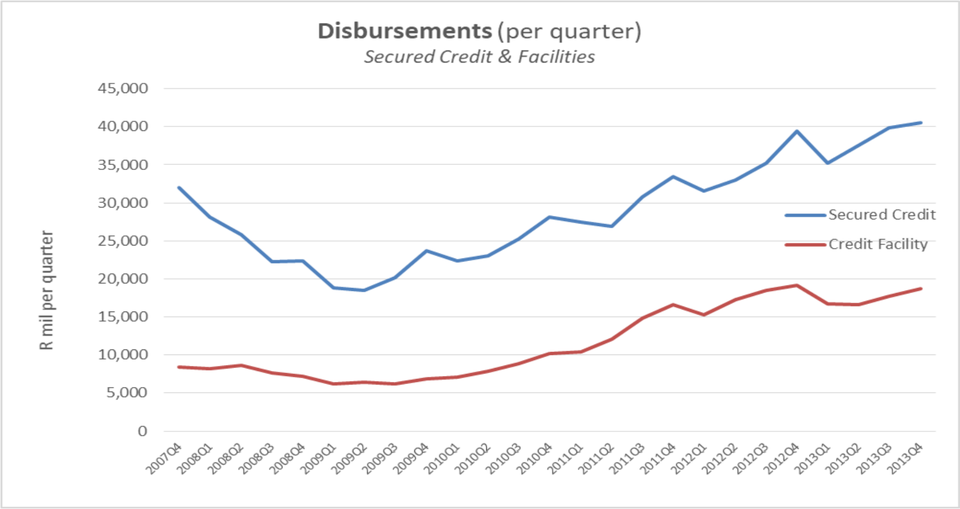
The 2008 GFC was at its heart a banking crisis that had a knock-on impact across the globe. It resulted in a broad economic crisis, which in South Africa led to one million jobs being lost, ***mainly in small enterprises****.*

The COVID-19 pandemic has a direct impact *on all segments of society; and all sectors of business. An incapacity to trade; as well as a direct impact on consumer demand. An economic and social crisis with far-reaching impact across the globe.*

We are still in the pandemic. What should we expect from the recovery phase? What can we learn from the 2008GFC?

2008 GFC: Mortgages & Secured Loans (Cars & Furniture)

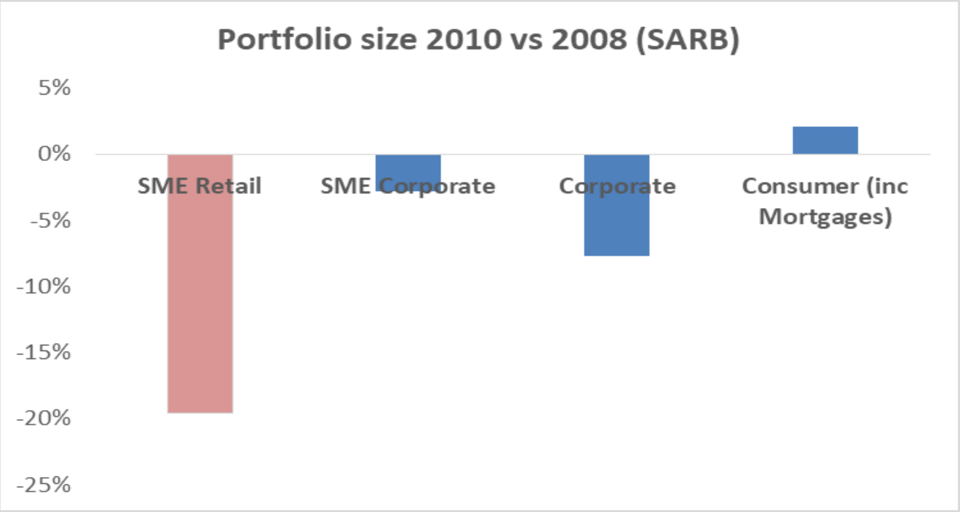


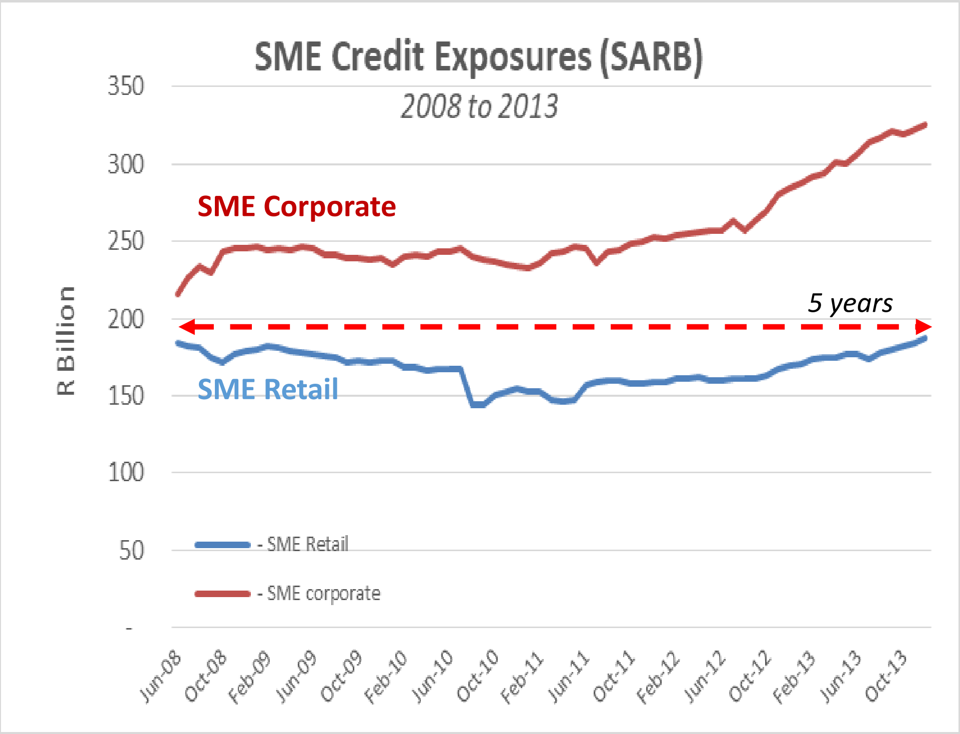


- ❑ **Dramatic decline in mortgage disbursements**. Between 2007Q4 and 2009Q2 the quarterly mortgage disbursements declined by 67% (note difference between trends in disbursements & outstanding balances).
- ❑ The amount of cash going into the economy through mortgage advances had declined by more than R10 bn / month, R135 bn per year from pre-2008 GFC to the trough (2010)

  = reduce housing sales, amounts available for new purchase, for applying in other investments, deploying in businesses = ***massive impact on economic activity***
- ❑ Secured loan disbursements declined by 42% (24% for credit facilities) ~ **decline of > R3bn per month** in money flowing into the economy
- ❑ Reduced flow of money into the economy for **all categories of consumer credit** the was **R93 bn for 2009 and R24bn for 2010** (compared to 2008). From 2011 the overall credit flows recovered, but with a **massive shift away from mortgages** to other consumer credit
- ❑ **WHAT ARE THE IMPLICATIONS FOR SME DEMAND; FOR SME SURVIVAL; FOR EMPLOYMENT IN SMEs?**

So, what about credit to SMEs?





		2019	#
SME Retail:	*Loans < R12.5 mil*	**R235 bn**	300,000+
SME Corporate	*Loans > R12.5 mil* *Buss T/O < R300 mil*	**R377bn**	< 5000

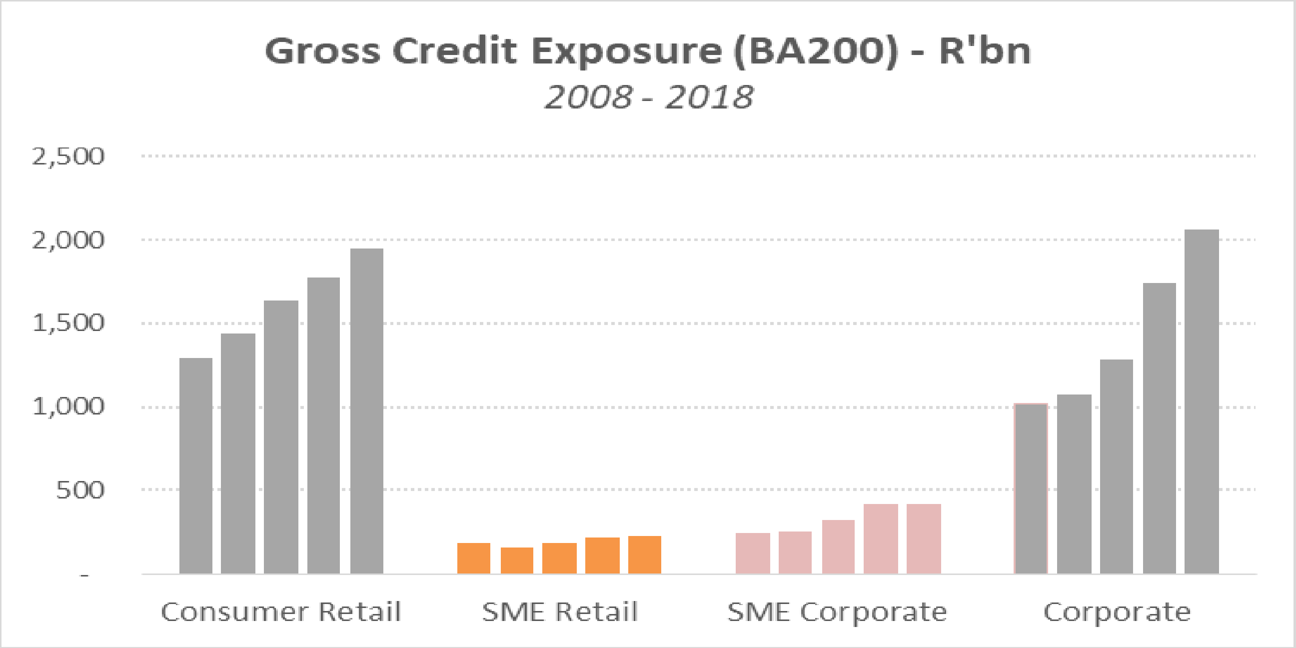
- **Between 2008 and 2010 SME Retail credit exposures had declined by 20%.** Over the same period SME Corporate declined by 3% (Corporate by 8% and Consumer Retail by 2%). The implication is that there was a massive *contraction in credit flows* to the SME Retail sector –contracting an estimated +40% (R40bn+) for the year

- **Only by end 2013** had SME Retail recovered to the 2008 levels. By that time SME Corporate was up 32% (Corporate up by 21% and Consumer credit up 27%

- **Causes**: Banks reduced new lending, cut back on unused facilities, tightened credit criteria, implemented strategies to avoid certain sectors + consumers more cautious

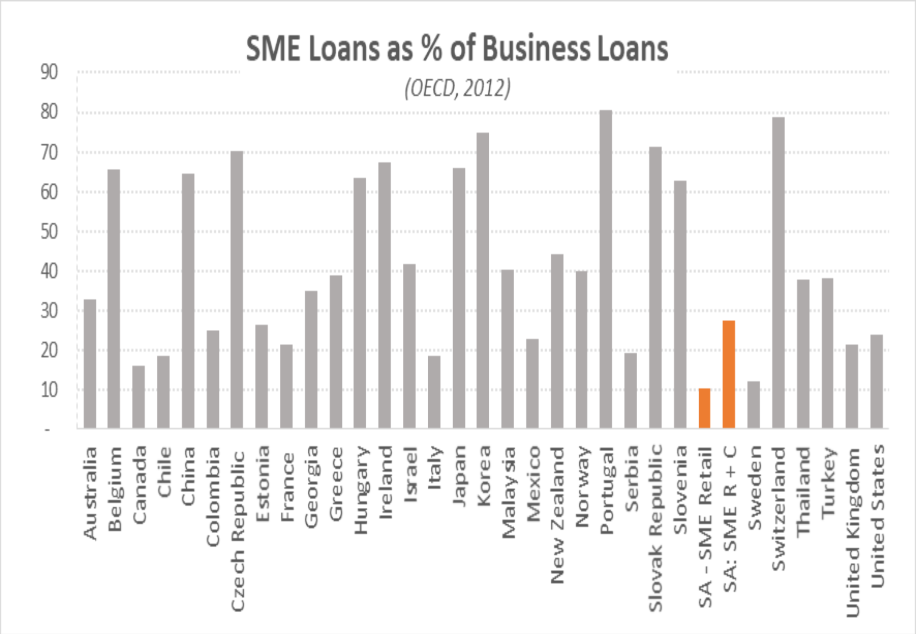
SME Credit

Trend 2008 to 2019



- **2008 GFC affected SME Retail most negatively of any category**. Took longest to recover after 2008. Slowest growth of any category of lending over last decade.
- **80 000 SMEs closed** between 2008 and 2010, only 60 000 new firms emerging by 2016 (TIPS 2017). Bulk of the job losses in the after financial crisis originated in the SME sector = **14% formal SME jobs lost between 2008 and 2010**.
- **We will not turn around the dire (un)employment position without a vibrant SME sector**. Yet a alarming absence of hard stats … lots of waffling around perceptions …

SA compared to international



SME credit in SA small compared to international benchmarks.

A ‘balanced view’

Bankers justifiably concerned with the level of risk in the SME sector as well as having to provide for the losses that will emanate from their current loan portfolio.

- Also impact of external environment on SME survival; impact of electricity disruption on SME; impact of domestic corruption … ***there are many good reasons to avoid SME exposure***

Banks therefore have a strong incentive to reduce credit exposures in order to minimise the risk of future losses.

Unfortunately, this response can become a self-fulfilling prophecy. It will push businesses that are on the margin into bankruptcy. It also means that the stronger businesses, which may see opportunities to expand, for instance by taking over weaker competitors, will also not be able to get finance for such transactions. Even at this early stage there are ample signs of the 2008 cycle being repeated.

Yet, if we all sit back and watch our bonuses and pensions, where will the jobs come from?

What can be done?

- ❑ Much better statistics and monitoring of credit flows to the SME sector (and related stats)
- ❑ A sensible and well managed National SME Guarantee Fund, including non-bank lenders
- ❑ Ramp up the SME support interventions (but the “political leakage” is high)

We have to plan for the next 5 – 10 years, as we move beyond the pandemic … but in a massively distorted environment, with huge interventions by all our trading partners … and a range of negative factors impacting on domestic SMEs

The Covid-19 Guarantee Fund?

It was clearly a failure … but why?

1 – Compare to the significant impact of the leading international guarantee funds

2 – **SA Covid Guarantees ignored international experience**. Terrible design … structured like SOE / Govt guarantee mechanisms, to avoid any claims on guarantees ≈ leave all the risk on banks

3 – **Claim threshold** too high ≈ banks only benefit once losses escalated well beyond the level of "commercial tolerance" ≈ no incentive for increased lending

4 – **Scope** across SME Retail & SME Corporate automatically implied that larger business were primary beneficiaries (lower risk)

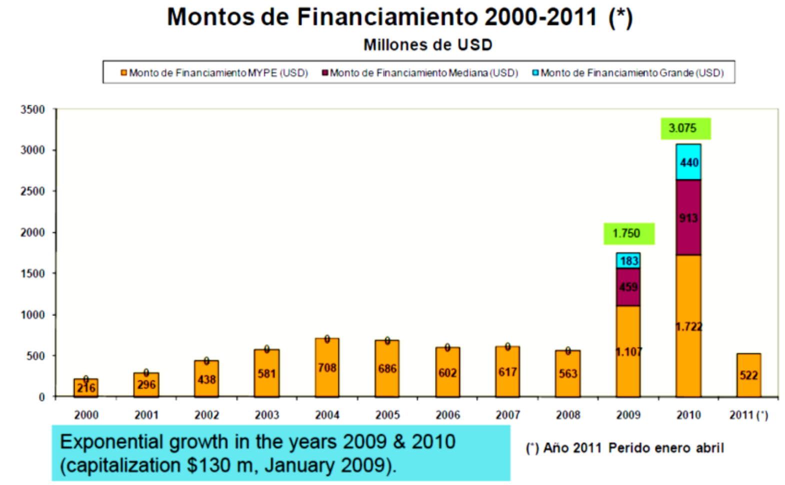
5 – **Entry criteria** excessively strict, excluding businesses that should reasonably have qualifies

6 – **Banks really do not want a guarantee fund**, or external monitoring or scrutiny ≈ maximise scope for deniability and waffle

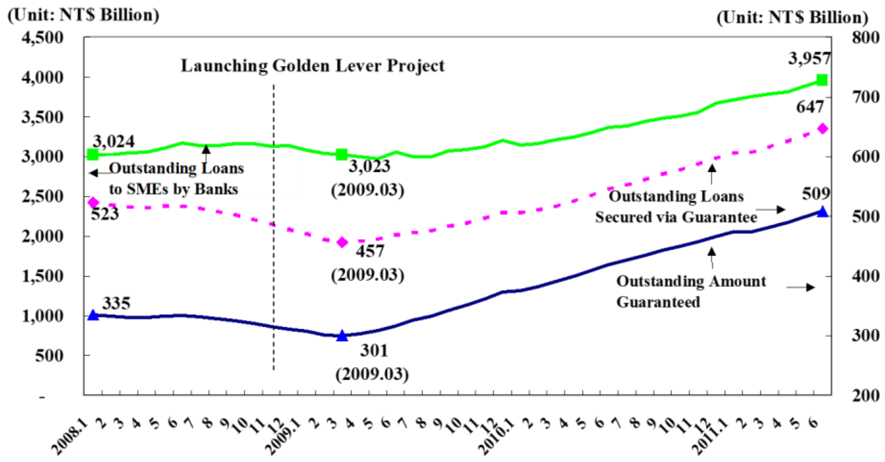
7 – Too early, too impatient: The Guarantee Fund will really be needed when recovery starts, when businesses want to recapitalise / or expand / or take others over … too early to shut it down … *why not "repurpose", to deal with weaknesses?*

So, what do we have: A debate about whether banks already helped everybody that needed help; Or whether businesses are simply cautious and really don't want loans; Or there are just not enough SMEs out there which deserve loans … and these arguments are made **without any basis in hard stats** … an abundance of fiddling while Rome is burning

CHILE



Chile: Portfolio cover, risk based pricing, strong commercial foundation & risk management framework.



Taiwan*: Countercyclical effect after credit contraction, through improved guarantee terms & qualifying criteria*

SME Guarantee Funds

Government Guarantee Funds: Austria, Belgium, Canada, Chile, Colombia, Czech Republic, Denmark, Estonia, Finland, France, Georgia, Greece, Hungary, Ireland, Israel, Italy, Japan, Korea, Malaysia, Mexico, the Netherlands, Norway, Portugal, Russian Federation, Serbia, Slovak Republic, Slovenia, Spain, Switzerland, Thailand, Turkey, United Kingdom, United States …

Thailand	
Portfolio	**$ 12 bn**
# guarantees	**330,617**
Average	$ 37,000

Taiwan	
Portfolio	**$ 24 bn**
# guarantees	**161,370**
Average	$152,651

Malaysia	
Portfolio	**$ 783 mil**
# guarantees	**8,999**
Average	$87,000

Chile	
Portfolio	**$ 505 mil**
# guarantees	**32,165**
Average	$15,700

Bottom line

The lessons from 2008GFC paints provides a warning of the risk that the same pattern could repeat, in much more dramatic fashion, exacerbating the damage to the economy

Is there anything we can do, besides hoping and praying … ?

“The End”