

Trading Perspectives

Focus on: South Africa

June 2017



In this publication

- Foreword
- South Africa market environment
- Approach to insurance capacity
- In practice
- References & key contacts

Foreword

South Africa remains a dual economy with high inequality rates. Ten percent of the population earn around 55% of all income, compared to approximately 30% in advanced economies.

The African National Congress (ANC) has been driving the policy agenda since 1994 and the current administration is faced with significant challenges to accelerate progress and build a more inclusive society.

The South Africa government vision and priorities are outlined in the 2030 National Development Plan (NDP) which highlights key strategic goals around doubling the GDP by 2030, eliminating poverty, and reducing inequality.

To achieve these objectives, the NDP lists several critical factors for successful implementation, including i) focused leadership for policy consistency, ii) ownership of the plan by all formations of society, and iii) strong institutional capacity at technical and managerial levels. The plan also provides considerations around government spending efficiencies and clear responsibility and accountability at every government level.

Despite the overall efforts, South Africa is currently experiencing difficult political and economic conditions, with a direct impact on the financial and trading performance of businesses. The South African economy has officially just moved into technical recession; and as a result ratings agency Moody's downgraded the South Africa's credit rating in June 2017; it was kept at investment grade with a negative outlook.

The South Africa credit insurance market is estimated to represent around USD 90 million in premium. We are seeing banks driving the use of credit insurance where the coverage is utilized as collateral for credit facilities.

Although new entrants (Euler Hermes in May 2015, Hollard in January 2017) have contributed to create a positive environment for our clients, the adverse macro-economic challenges have also adversely affected insurance capacity in certain industries and for certain large debtors. A thoughtful and structured approach is paramount to optimizing coverage and risk acceptance from the insurance market.

Your Aon Credit Team

South Africa economic overview

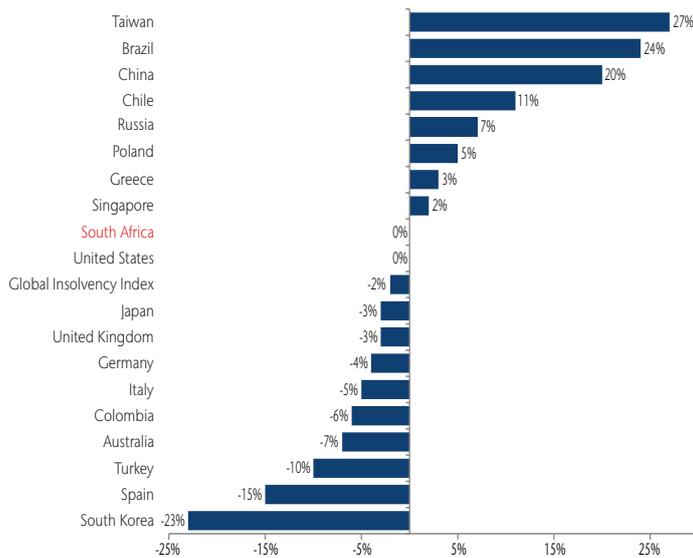
A poor performance in the mining and manufacturing sectors caused GDP to contract 0.3% in Q4 2016 and overall South Africa's economy grew just 0.7% in the full year 2016, which represented the weakest pace of growth in seven years. The economy has been consistently falling behind the government's growth targets, which is having serious implications for business and consumer confidence. 2017 was expected to see a moderate GDP increase, but has officially just moved into technical recession after its GDP declined 0.7% during the first quarter of 2017.

Lifting barriers to competition and favouring the development of SMEs could boost productivity, employment and living standards.

| | Economic growth (% GDP) | Public debt (% GDP) |
|---------|-------------------------|---------------------|
| 2015 | 1.3 | 50 |
| 2016(e) | 0.7 | 51.7 |
| 2017(f) | 1 | 53 |

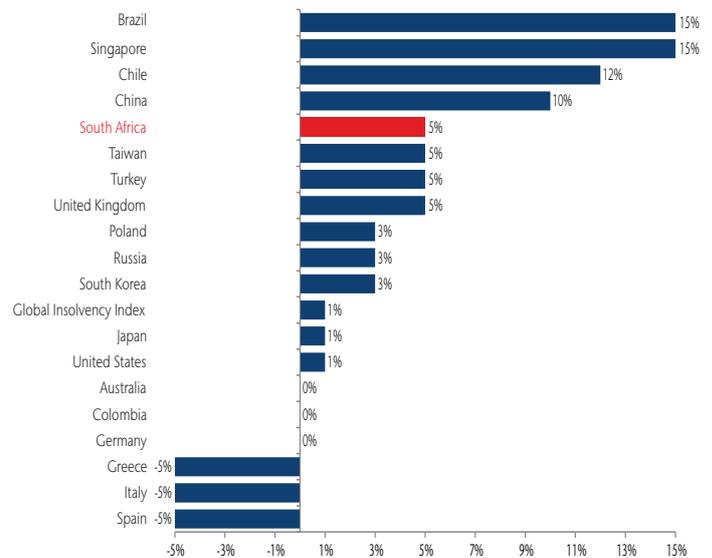
Source: Euler Hermes

Business insolvency variations 2016 vs 2015 (Estimated)



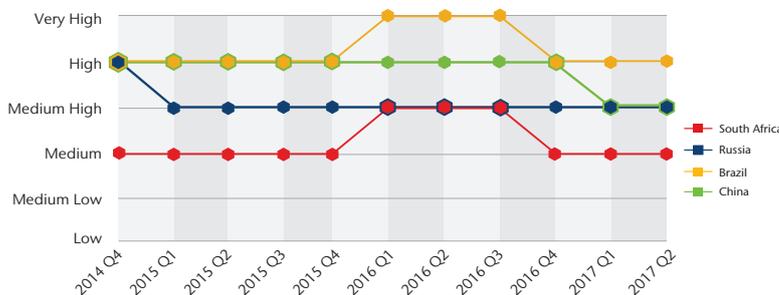
Source: Euler Hermes

Business insolvency variations 2017 vs 2016 (Expected)



In the first quarter of 2017, both the secondary and tertiary sectors recorded negative growth rates. The trade and manufacturing industries were the major heavyweights that stifled production, with trade falling by 5.9% and manufacturing by 3.7%. On the positive side, the agriculture and mining industries contributed positively to growth, but not enough to avoid the recession.

Risk of doing business



Source: Aon Political Risk Analytics

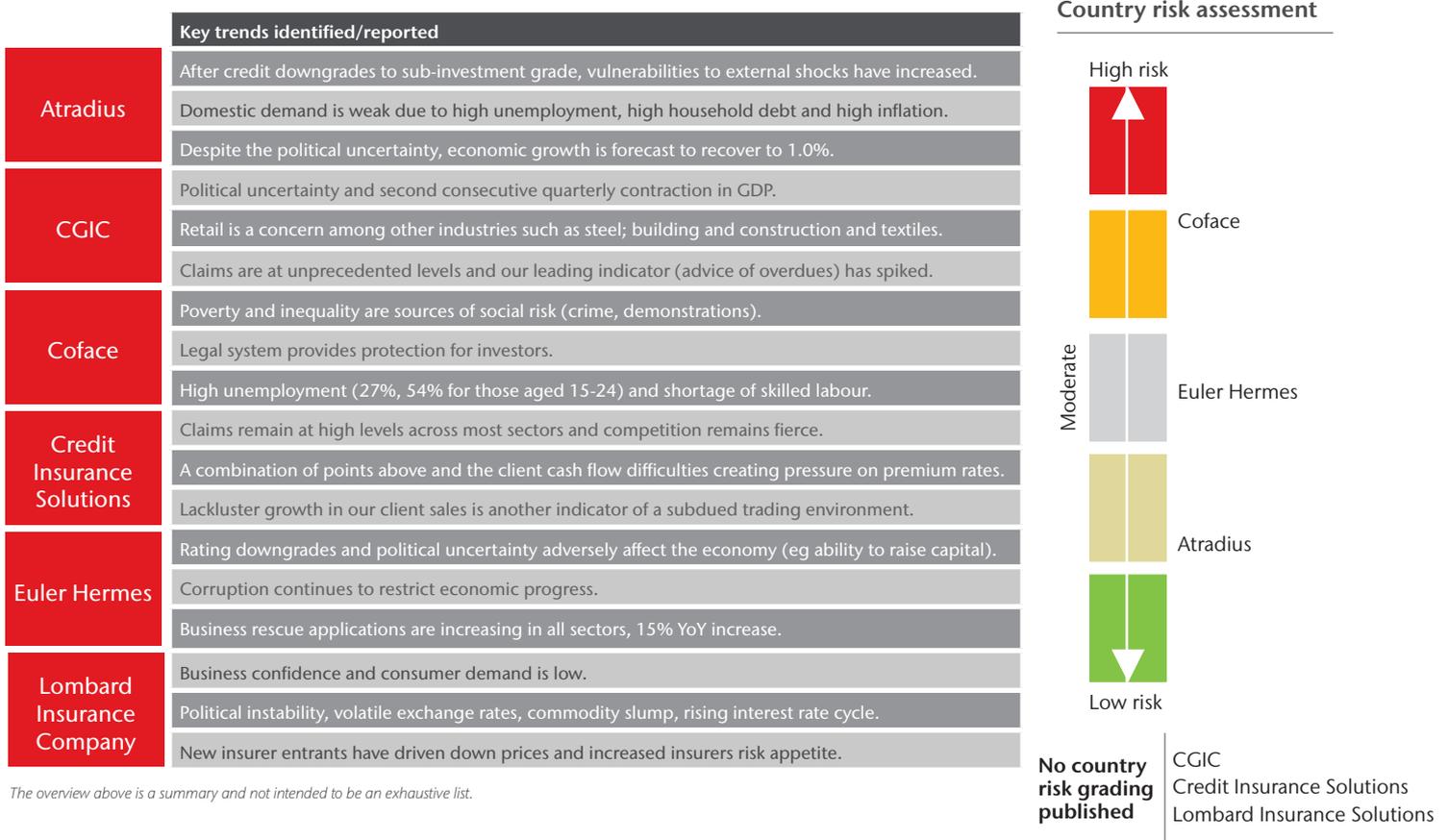
The risk of doing business in South Africa has been oscillating between Medium and Medium High over the last 6 quarters. Typically slightly lower risk than BRIC countries.

Fiscal measures continue to be aimed at striking a balance between debt sustainability and achieving an economic recovery. If economic growth projections are further revised downward, additional measures such as lower increases in public sector wage rates and a moderate increase in consumption taxes would be needed to help ensure debt ratio stability.

Insurer perspectives

The insurers' overall country analysis consistently underpins their specific client decisions around credit limits. It is therefore critical to monitor insurer's assessment of the overall business environment, in order to pro-actively address current and future credit capacity challenges in South Africa.

Insurers are reporting that the South African macro-economic developments shown below influence their local business strategy.



South Africa market in focus

Economic growth trends

The South African economy has officially just moved into technical recession after its GDP declined 0.7% during the first quarter of 2017 after contracting by 0.3% in the fourth quarter of 2016. Economic activity contracted over a wide range of sectors, including construction, manufacturing and transport. Only mining and agriculture made a positive contribution to growth. All other sectors contracted. Monetary and fiscal policies are constrained by the need to keep inflation and the rising public debt in check and there is an overall need to reinvigorate policies to allow greater entry by new firms into key service and product markets.

Government actions and financials

The government has demonstrated a commitment to curb spending. A consolidation plan is being implemented to limit deficit and stabilise public debt.

The high level of unemployment calls for bold structural reforms to boost the economy and job creation. Different areas of the economy are still subject to high barriers of entry or limited competition. Increasing market competition in network industries and lowering restrictions and licensing costs in service sectors could create entrepreneurial opportunities and therefore employment. Developing entrepreneurship through better training, vocational education and access to finance is key to reduce the high structural unemployment level.

The Minister of Finance has intimated an intent to nationalise mines, banks and financial institutions. This would increase the overall risk to doing business.

Fiscal reform

Due to the continued increase of government debt and higher borrowing rates in the context of persistent low growth, South Africa has limited fiscal space. The government remains under pressure to stick to its consolidation path and improve the effectiveness of spending and investments.

Inflation is expected to decline slowly in 2017. Ongoing food price inflation, and its knock-on effects on manufactured food prices, is pushing up inflation, despite lower than expected increases in administered prices. As inflation falls to be within the target band, it could make way to ease monetary policy while remaining vigilant on the evolution of food and oil prices. The dissipation of political uncertainties will play a key role in bringing back confidence and therefore strengthening investment and consumption.

Credit rating and inflation

The South Africa credit rating was cut to “junk” in April 2017 by two major ratings agencies which cited political uncertainty after President Jacob Zuma discharged his finance minister.

However, according to the South Africa central bank governor, the issues raised by the ratings agencies can be addressed, and the central bank will continue to focus on its mandate to lower inflation to within its target range of 3-6% to help the government achieve inclusive growth.

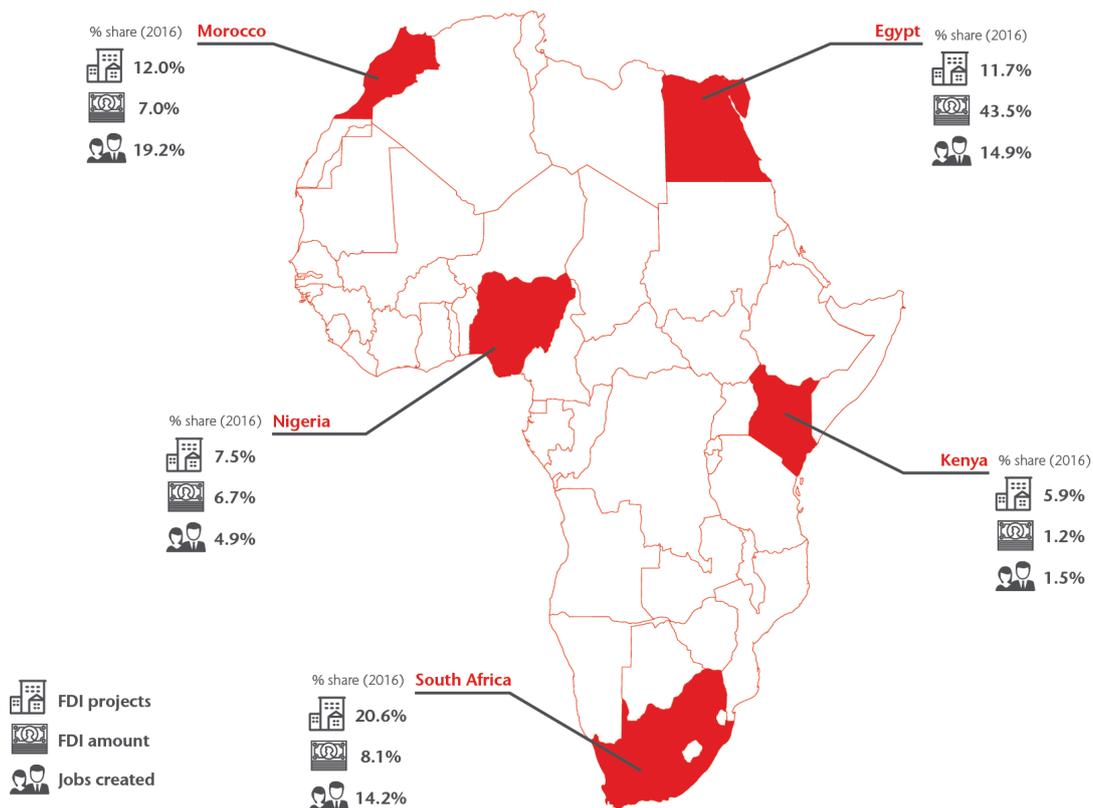
Investment

To foster economic growth and job creation, the cost of crucial inputs for businesses and of services for workers such as electrical power, telecommunications, and transportation would need to be reduced.

South Africa remains the leading foreign direct investment (FDI) destination in Africa, with a 6.9% increase in FDI projects in 2016, according to financial services advisory firm EY’s ‘Africa Attractiveness’ report.

Despite its recent credit ratings downgrades, and political risks, South Africa has also climbed back into the 2017 A.T. Kearney Foreign Direct Investment (FDI) Confidence Index.

South Africa has a mixed outlook with respect to attracting FDI in the coming years. On one hand, South Africa faces challenges related to governance, exchange rate volatility, and decreased trust in political leaders. On the other hand, the country has opportunities to capitalize on its improving economy and regional role.



Source: Engineering News

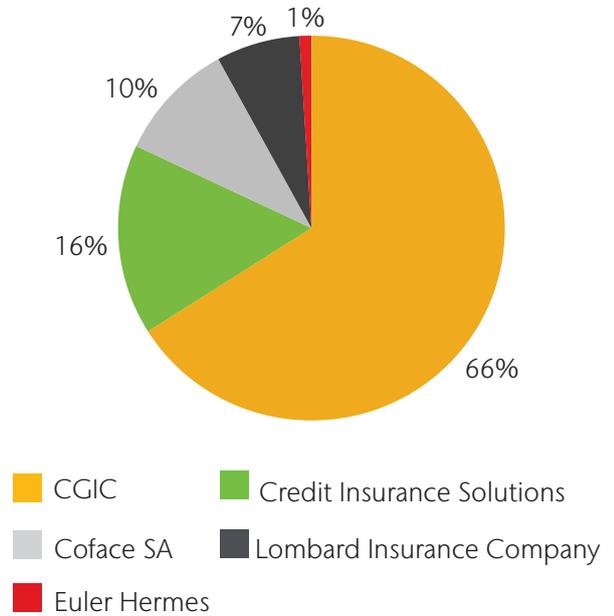
Credit insurance capacity

Impact on insurer behaviours

The combined analysis of South Africa's overall economic condition and the counterparty risks enables us to anticipate the need for new innovative solutions to be developed and delivered for our clients.

| Sector | Risk appetite |
|------------------------|---------------|
| Agriculture | Low |
| Automotive | Average |
| Chemicals | High |
| Construction | Low |
| Construction materials | Low |
| Consumer durables | Low |
| Electronics | High |
| Financial services | Average |
| Food | High |
| Engineering | Low |
| Metals | Low |
| Oil / gas | Average |
| Paper | Average |
| Services | Average |
| Steel | Low |
| Textiles | Low |

South Africa insurer market share



These are estimates based on Aon's market knowledge. No formal publications available.

Market trends overview

Although new entrants (Euler Hermes in May 2015, Hollard in January 2017) have contributed to create a positive environment for our clients, the (recent) adverse macro-economic challenges have adversely affected insurance capacity in certain industries and for certain large debtors.

Atradius owns 25% equity stake in CGIC.

Loss ratio

Some insurer loss ratios have risen to over 70% in the last financial year due to a high volume of claims.

Pricing

Insurer rates have stabilised overall and we have seen premium rate increases in certain specific industries such as steel, building and construction.

From our team on the ground



Key contacts
 Maria J Teixeira
 maria.teixeira@aon.co.za
 +27.11.944.7815

Reinette Cromhout
 reinette.cromhout@aon.co.za
 +27.11.944.7981

Broking strategy

Aon adapts its broking strategy to ensure we are able to support clients in two key areas; claims and risk acceptance levels. In respect of the latter, it is essential that we are able to support our clients in ensuring that insurers do not take a broad-brush to risk assessment but evaluate each risk on its own merits. Aon's risk analysts in conjunction with the broking team distinguish between strong/weak sectors as well as sound/vulnerable buyers' risks.

Placement > cover optimisation

Cover optimisation



Optimise cover with existing carrier

- Establish criteria for current decision
- Review trading patterns and future requirements (average vs. peak exposure)
- Market benchmarking
- Aon's risk analysis/data sources
- Escalate to global insurer via the central strategic teams

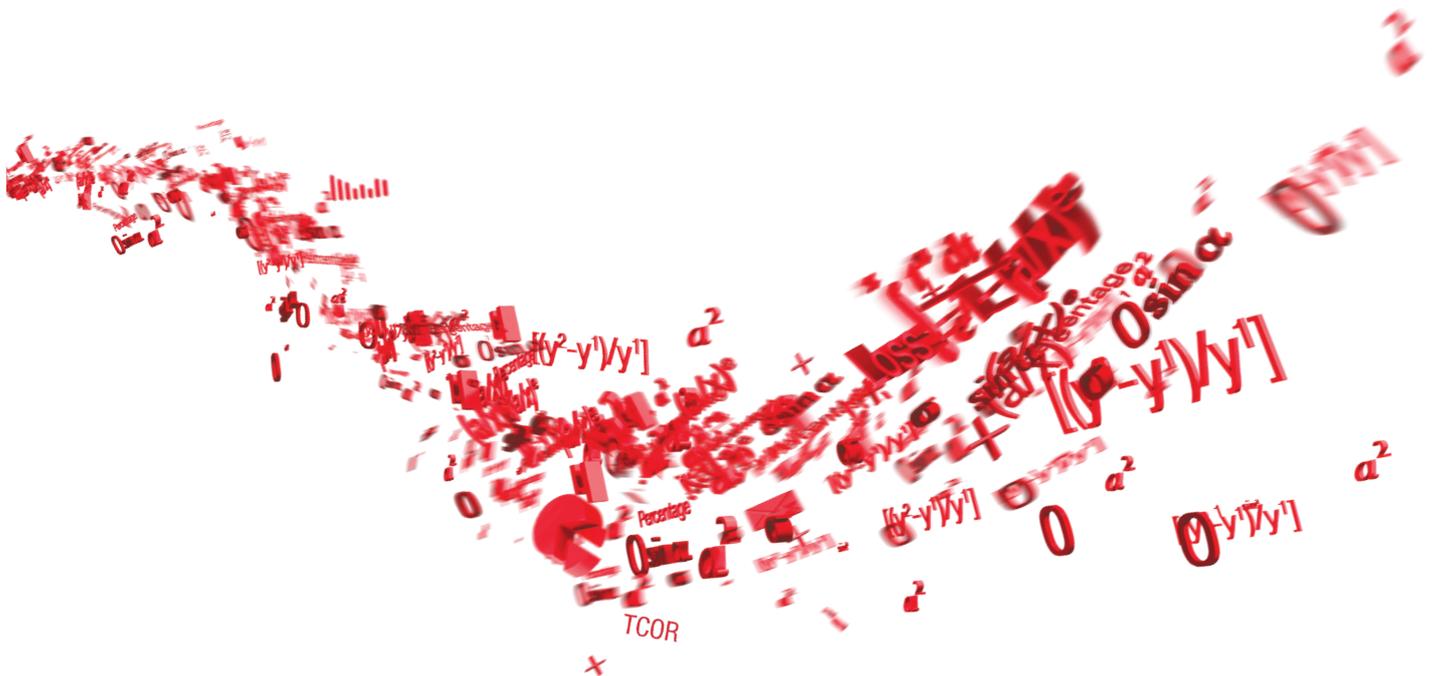
Provide additional capacity

- Bespoke excess lines or syndication
- Capital markets (including surety solutions)
- Market benchmarking
- Additional specialist insurer (typically with regional expertise or national interest)
- Facultative reinsurance solutions

Managed uninsured exposures

- Monitoring of key buyers and continuous review with insurers
- Use diagnostic team to highlight changes in risk rating and country risk
- Risk profiler reports to ensure you can make informed commercial decisions on your customers

Our cover optimisation methodology outlined above helps us achieve increased coverage for our clients, whether that be from the primary insurer or from alternative solutions.



In practice

Over the years during which Aon has been operating and designing credit solutions in the South African market, we have been approached to implement South African domestic whole turnover credit insurance policies as well as various syndicated single risk programs for domestic and export shipments.

Below are three case studies relating to credit insurance solutions arranged by Aon teams.



Flexible use of credit limits

Insured: Multinational producer of electronic consumer goods

Obligors: Domestic and exports

Sum insured: USD 532,000,000

- Aon negotiated a comprehensive insurance coverage at a competitive premium rate to the satisfaction of our client.
- Our team implemented a flexible policy whereby our client is granted overall credit limits on debtors and is then free to allocate across their service centres based on their ongoing/ changing needs.



Covering credit limit gaps

Insured: Construction multinational

Obligors: Whole turnover credit insurance policy and single risk

Sum insured: USD 170,000,000

- Our multinational client has significant operations in South Africa and our local team focuses on strong client service requirements around limits and claims, under the global programme.
- Aon complements the whole turnover policy coverage with single risk policies on specific debtors, utilising a separate insurer.



Optimal local solution

Insured: Large local retailer and wholesaler

Obligors: Domestic and exports

Sum insured: USD 31,000,000

- Aon demonstrated superior value to our new large local retail/wholesale client during a comprehensive tender involving 6 other brokers.
- Our team coordinates the insurance policies to help ensure appropriate domestic and export sales insurance coverage is in place at all times.

References

<http://www.coface.com/News-Publications/Publications/Country-risk-assessment-map-1st-quarter-2017>

<http://www.coface.com/Economic-Studies-and-Country-Risks/South-Africa>

<https://group.atradius.com/publications/trading-briefs/risk-map.html>

<https://atradius.nl/rapport/global-economic-outlook-may-2017.html>

<http://www.eulerhermes.com/economic-research/blog/EconomicPublications/insolvencies-the-tip-of-the-iceberg-economic-outlook-dec16.pdf>

<https://www.riskmaps.aon.co.uk/home>

http://www.engineeringnews.co.za/article/south-africa-remains-largest-fdi-hub-in-africa-report-2017-05-03/rep_id:4136

<https://businesstech.co.za/news/business/170937/south-africa-ranked-among-top-countries-for-foreign-direct-investment/>

<http://www.sundayworld.co.za/news/2017/05/05/..south-africa-can-avert-further-downgrades-central-bank-governor>

<http://www.ey.com/za/en/issues/business-environment/ey-africa-attractiveness-overview-page>

<http://www.statssa.gov.za/>

<https://www.bloomberg.com/news/articles/2017-06-06/south-africa-sees-second-recession-in-8-years-as-economy-shrinks>

Aon is not responsible for the content of the websites listed above.

Key contacts

Pieter Van Ede

Head of Global Clients
Aon Credit International
t + (1) 303 782 3345
m + (1) 303 597 6081
pieter.van.ede@aon.com

Maria J Teixeira

Head of Trade Credit, Surety &
Political Risk
Aon South Africa
t +55 11 20 3058 4452
m +55 11 964 520 196
maria.teixeria@aon.co.za

Mark Powell

Risk Analysis
Aon Credit International UK
t +44 (0) 1495 225 294
m +44 (0) 7714 923 460
mark.s.powell@aon.co.uk

Nicolas Carreño

Head of Strategic Planning
Aon Credit International EMEA
t +44 (0) 20 7086 2208
m +44 (0) 780 369 5361
nicolas.carreno@aon.com

About Aon

Aon plc (NYSE:AON) is a leading global professional services firm providing a broad range of risk, retirement and health solutions. Our 50,000 colleagues in 120 countries empower results for clients by using proprietary data and analytics to deliver insights that reduce volatility and improve performance.

FPref: ACI20170613

Aon UK Limited is authorised and regulated by the Financial Conduct Authority.

© Aon UK Limited 2017. All rights reserved.

The information contained herein and the statements expressed are of a general nature and are not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information and use sources we consider reliable, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future.

No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

Aon UK Limited is authorised and regulated by the Financial Conduct Authority. For more details, please visit aon.co.uk/professionalservices

aon.co.uk

Risk. Reinsurance. Human Resources.

