The immediate financial market reaction to Brexit was negative

- Markets were pricing in “remain” vote
- The pound and euro have weakened
  - Concerns about further break up in Europe
  - Questions as to how the BoE will respond
- Expectations of weaker growth, lower risk appetite and central bank support to markets has resulted in bond yields in developed economies falling

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<tbody>
<tr>
<td>US dollars per British Pound</td>
<td>1.4686</td>
<td>1.4807</td>
<td>1.3528</td>
<td>1.3635</td>
<td>-7.9% Pound weakness - percentage change</td>
</tr>
<tr>
<td>SA rands per British Pound</td>
<td>21.545</td>
<td>21.419</td>
<td>20.955</td>
<td>20.293</td>
<td>-5.3% Pound weakness - percentage change</td>
</tr>
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<td>US dollars per Euro</td>
<td>1.1283</td>
<td>1.1351</td>
<td>1.0998</td>
<td>1.1117</td>
<td>-2.1% Euro weakness - percentage change</td>
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<td>UK 10 year bond yields</td>
<td>1.308</td>
<td>1.36</td>
<td>1.017</td>
<td>1.1</td>
<td>-0.26 Percentage point drop in UK yields</td>
</tr>
<tr>
<td>US 10 year bond yields</td>
<td>1.7042</td>
<td>1.7181</td>
<td>1.4851</td>
<td>1.565</td>
<td>-0.15 Percentage point drop in US yields</td>
</tr>
<tr>
<td>German 10 year bond yields</td>
<td>0.067</td>
<td>0.076</td>
<td>-0.1089</td>
<td>-0.064</td>
<td>-0.14 Percentage point drop in German yields</td>
</tr>
</tbody>
</table>

Source: Bloomberg

UK Treasury estimates “Brexit” could lower the UK’s GDP level by between 3.8 per cent and 7.5 per cent
- ‘financial conditions effect’ on financial market volatility
- ‘uncertainty effect’ on investment, trade
- ‘transition effect’ as UK becomes less open to trade & investment
Emerging markets suffered too

- Risk appetite worsened
  - EM bond spreads have widened
  - EM currencies have weakened
- Safe haven assets like gold, dollar have strengthened
- Other commodities and EM assets have declined as fears of weaker growth have affected valuations

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<td>1267.63</td>
<td>1262.97</td>
<td>1330.05</td>
<td>1313.55</td>
<td>4.0% Gold strength - percentage change</td>
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<tr>
<td>Oil price (US$ per barrel)</td>
<td>50.33</td>
<td>50.14</td>
<td>47.98</td>
<td>48.56</td>
<td>-3.2% Oil weakness - percentage change</td>
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<td>SA 5 year CDS</td>
<td>2.88</td>
<td>2.8</td>
<td>3.03</td>
<td>2.93</td>
<td>0.13 Percentage point rise in SA CDS</td>
</tr>
<tr>
<td>Brazil 5 year CDS</td>
<td>3.23</td>
<td>3.23</td>
<td>3.31</td>
<td>3.35</td>
<td>0.12 Percentage point rise in Brazil CDS</td>
</tr>
<tr>
<td>Turkey 5 year CDS</td>
<td>2.47</td>
<td>2.4</td>
<td>2.61</td>
<td>2.59</td>
<td>0.19 Percentage point rise in Turkey CDS</td>
</tr>
</tbody>
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Source: Bloomberg
But since then, markets have calmed substantially

- Both in developed and developing financial markets

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<td>-0.2%</td>
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<td>1.7181</td>
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<td>1.54</td>
<td>-0.02</td>
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<td><strong>German 10 year bond yields</strong></td>
<td>0.067</td>
<td>0.076</td>
<td>-0.064</td>
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<td>50.14</td>
<td>48.56</td>
<td>43.62</td>
<td>-10.2%</td>
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</table>
Thanks to supportive policy responses

- Expectations are that there will be sufficient support from central banks
  - BoE expected to cut by 0.25% points today (99.8% expectation)
    - And there is an 25 per cent probability that rates will be zero by December
  - The ECB expected to remain on hold, but ready to act
    - Probability of a cut in August is about 25%, rising to 40% by December
  - There has been a sharp downward revision to Fed rate hike expectations
    - On 3\textsuperscript{rd} August, 39% probability of rate hike by December 2016 (59% on 3\textsuperscript{rd} June)

- And the UK government has hinted that it may have to use stimulus to support the economy
  - Total public borrowing in 2015/16 £75 bn (4 per cent GDP).
  - Due to fall to £55.5 bn 2016/17 and £38.8 bn 2017/18
  - But some forecast may rise as much as £65 billion based on past studies
Confidence measures have broadly fallen

The National Institute of Economic and Social Research says growth has 50/50 chance of technical recession
The CBI survey of SME manufacturers says business optimism has fallen at its fastest rate since January 2009 and are scaling back investment plans – although production and employment is higher, and higher export projections
The Markit/CIPS manufacturing purchasing managers' index suggested that activity among UK manufacturers in July had shrunk at its fastest pace for three years
The truth is there is still huge uncertainty

- Will it actually happen?
  - May has told the House of Lords they must respect the referendum results
  - But Labour will consider 2nd referendum on EU membership, LibDems will fight the next general election on a manifesto promising to take the UK back into the bloc

- When will Article 50 deals be triggered?
  - May has said this will happen early next year
  - Sky Bet seems to think that “early 2017” is about Q2
  - Concerns about EU 21 January 2019 budgeting cycle

- Nature of deals
  - May not keen for off-the-shelf negotiations – but unclear if this will be extended to other countries – could mean significantly protracted discussions
  - Biggest countries likely to support a deals
  - But EU need to incentivise people to remain..
    - New negotiator from European Commission a sign?
  - Liam Fox: UK might leave the EU customs union to facilitate trade deals with other countries
  - EU officials: UK should not expect Brexit to happen before at least 2020

July 1 to September 20 2016 — 33/1
October 1 to December 31 2016 — 9/1
January 1 to March 31 2017 — 9/4
April 1 to June 30 2017 — 3/1
July 1 to September 30 2017 — 7/1
2018 or later or not at all — 6/4
The impact of Brexit

<table>
<thead>
<tr>
<th>Primary channel</th>
<th>ST (0 – 6 months)</th>
<th>MT (6 – 18m)</th>
<th>LT (18+ months)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial markets</td>
<td>GDP impact of financial market moves – primarily confidence, investment</td>
<td>GDP impact as switch in trade agreements</td>
<td></td>
</tr>
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</table>

**Global impact**

- UK, EU asset prices fall
- Volatility increases – esp. for those with close links to UK
- Commodity prices fall
- ECB, BoE, Fed stimulus
- UK GDP 1.5 percentage points lower than baseline by 2018
- EU GDP around 1 per cent lower by 2018 (OECD)
- UK growth
- Lowest impact on those who have been able to re-negotiate positions

**SA Policy implications**

- Issuance costs increase
- Risk of unfulfilled auctions
- Risk to bank financing
- Gold, oil vs export metals
- Lower SA growth
- Lower confidence
- Heightened risk of ratings downgrade
- EU-EPA and preferential trade affected
- UK investment treaties

^ Two thirds of shock due to financial market shocks; the remaining third due to feedback effect of weaker EU growth
* OECD assumes relatively high financial shocks to EU from Brexit (between 20 and 50% of size of UK shock)

Source: dti, SARB
SA’s links with the UK are substantial

<table>
<thead>
<tr>
<th>Trade</th>
<th>Investment</th>
<th>Tourism</th>
</tr>
</thead>
<tbody>
<tr>
<td>• 6th largest trading partner</td>
<td>• UK accounts R1.8 trillion of SA’s R4.9 trillion foreign investment stock in 2014 (37%).</td>
<td>• Around 17% of overseas tourists from UK</td>
</tr>
<tr>
<td>• In 2015, SA exported R41.6 billion worth of products into the UK and imported R35 billion with a R6.6 billion trade balance in favour of SA</td>
<td>• 42% portfolio investment (mostly equities)</td>
<td></td>
</tr>
<tr>
<td>• UK makes up about 4% total exports</td>
<td>• 40% direct investment</td>
<td></td>
</tr>
<tr>
<td>• 43% in platinum</td>
<td>• 18% “other” investment (mostly deposits to SA banks)</td>
<td></td>
</tr>
<tr>
<td>• 8% commercial cars</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• 4% each for centrifuges and passenger cars</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• 4% each for wine, grapes, citrus, deciduous fruits</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: dti, SARB
Brexit raises deep socio economic and political concerns

KEY TRENDS HIGHLIGHTED BY BREXIT

• Rise of far-right, anti-immigration, anti-establishment politicians, anti-globalisation sentiment
  – Is a new type of globalisation required?
  – Do Africa and Asia have to re-think their economic growth models?

• Deglobalisation
  – Banking sector requires controls on international flows for stability

• Secular stagnation likely to be compounded
  – Uncertainty, changes to trade patterns

• Could affect global composition of power

IMPLICATIONS FOR SA

• Could reduce momentum in terms of local politics and will to reform

• Could build up momentum domestically for xenophobia, radical domestic politics

• Potential to re-position SA as a high-yield investment in world of global uncertainty

• Banking system needs to be able to manage the flow of capital to ensure stability

• Need to expand relationships with more open export partners

In SSA there is still a strong need for integration. Do we need to reconsider?
South Africa’s strategy to manage impact of Brexit

• Minimise potential impact of financial instability on South Africa
  – Manage risks to fiscal framework and the concomitant risks to debt issuance

• Monitor financial market conditions and impact on stability
  – SARB and National Treasury constantly monitor

• Trade agreements, investment treaty – monitor the shifts in UK negotiating strategy.
  – dti managing process

• Continue to pursue growth strategy
  – South Africa needs to generate internal sources of growth
  – Increased coordination between government and business
    • Sector interventions on agriculture and tourism
    • SME fund
    • SOC reforms

• Continue to position South Africa as strong, profitable investment destination
  – Brexit highlights concerns of secular stagnation, deglobalisation, particularly in older economies
What does longer term impact mean for SA?

TRADE AGREEMENTS

• Timing of exit from existing agreements will depend on date at which Article 50 is triggered
• UK could switch to European Free Trade Association (EFTA)
  – Could happen quite quickly since a lot of overlap with existing agreements
  – Would need to have agreement on basic agricultural products, as currently negotiated on case-by-case basis.
  – Would also need to consider negotiating additional market access for some agricultural products agreed to under EU-SADC EPA which are not part of the EFTA.
• UK could prefer to negotiate bilaterals
  – Likely to entail protracted negotiation process

INVESTMENT AGREEMENTS

• Investment promotion and protection act will cover UK investors

TOURISM / VISA AGREEMENTS

• Already separate systems, so impact likely to be limited

Critical to negotiate trade & investment treaties sooner rather than later
• SA is largest African trading partner
• But Africa is a very small part of the UK trade
• QUESTIONS?
ANNEX
Financial markets - Developed market reactions to Brexit

Intraday trading in UK, US bonds

- UK 10 year bond
- US 10 year bond

Confirmation of results

Intraday trading in pound

- Pound weakness

Confirmation of results

Source: Bloomberg
Financial markets - Commodity market reactions to Brexit

Intraday trading in Gold

Intraday trading in oil

Source: Bloomberg
Financial markets - EM market reactions

**Intraday trading in SA 10 year bonds**

**Intraday trading in Rand**

*Source: Bloomberg*
Inward investment from the UK

- The UK is the largest investor in SA, accounting for 37% of total foreign investment stock in SA in 2014. Held R1.8 trillion of SA’s R4.9 trillion foreign investment stock.
- However, its share has gradually declined over the years due to faster investment growth from other regions (Asia, Asia, Americas).
- Portfolio investment (mostly equities) makes up 42% of total UK investment in SA while direct investment accounts for 40% and “other” investment the remaining 18%.

SA investment to UK

- The UK is the largest recipient of SA’s investment, accounting for 29% SA’s total outward investment stock in 2014. Holds R1.2 trillion of SA’s R4.3 trillion outward investment stock.
- Nonetheless, SA’s increased investment in Asia and the rest of the African continent has seen UK’s share of total outward investment decline from around 45% in 2000.
- SA’s investments are mainly in portfolio investments (60%), while direct investment and other investment account for 14% and 26%, respectively.
Stock of investment between SA and UK

**Foreign investment from UK**

**SA investment to UK**

Source: SARB
• While the UK is no longer top recipient of South African exports it remains a top 10 export destination
• 8 export products comprise 72.8% of SA’s total exports to the UK
Regarding total trade (i.e. both imports and exports), the UK ranked 6th largest trading partner.

In 2015, SA exported R41.6 billion worth of products into the UK and imported R35 billion with a R6.6 billion trade balance in favour of SA.

Sources: Quantec, National Treasury calculations