Digital Stock

Turning up the heat

Standard Bank has won Risk South Africa*'s 2007 rankings overall, in the face of tough competition and solid derivatives growth. While this trend looks set to continue, there are some concerns on the horizon.*
By ***Mark Pengelly****, with research by* ***Xiao-Long Chen***

Standard Bank has topped the 2007 *Risk South Africa* rankings, taking first place overall for the third year running. It won with a 16.3% share of the vote, down slightly on 2006 when it received 19.6%. The bank also took first place overall in interest rates and currencies, with 19.6% and 17.5% of the vote – again, down from the 22.9% and 24.1% it managed in 2006. In equities, the bank was leapfrogged by Absa Capital, slipping from second place in 2006 to third place this year, with its share of the vote dropping from 13.9% to 10.8%. But, despite increasingly heated competition, Standard Bank has once again made itself the firm to beat.

"We've seen enormous growth in our customer base, as well as the use of alternative solutions this year," says Andre van der Merwe, head of currency options and foreign exchange structuring at Standard Bank in Johannesburg.

In the face of tougher competition, the bank put in a solid performance, rarely slipping below third place for any of the individual categories in which it was nominated. It won first place for best risk management advisory, rand interest rate swaps, rand and US dollar interest rate exotics, US dollar repos, US dollar/rand cross-currency swaps, South African over-the-counter single-stock options, warrants and South African single-name credit default swaps (CDSs). The bank also won joint first in US dollar interest rate swaps.

Meanwhile, it garnered second place in rand and US dollar interest rate options, rand repos, rand and US dollar forward-rate agreements, US dollar/rand currency options and

South African equity index options. It also came third in metals, international OTC single-stock options and joint third in dollar/rand currency forwards, while finishing fourth in structured products.

Standard Bank and the rest of South Africa's financial institutions have experienced several years of strong economic growth. Real gross domestic product grew by 5% in 2006, and continued to grow at an annualised rate of 4.7% and 4.5% for the first and second quarters of 2007, respectively. Cash markets and equities in particular have thrived in this environment. From the beginning of the year to July 23, the FTSE/JSE Shareholder Weighted All-Share Index rose 16.8% to 6158.43. This bull run – which started in 2005 – has made South Africa's economy look attractive to all kinds of domestic and foreign investors, including private equity firms, which have helped fuel a recent boom in leveraged buyouts throughout the country (see *Riding the M&A wave*, pages 27–29).

Global uncertainty

South Africa has not been immune to the problems that have plagued the global financial markets in recent months. A dip in investor sentiment, fanned by problems in the US subprime mortgage market, caused an uptick in volatility in cash equities from July onward. The FTSE/JSE Shareholder Weighted All-Share Index fell 12.5% between July 23 and August 17, to 5388.55, before rising again by 12.9% to reach 6083 by October 1.

The fallout, sparked by rising delinquencies in US subprime mortgage loans, has made life difficult for South African institutions tapping international markets for funding. But, elsewhere, its impact on the country's financial markets has been relatively muted. "It's still business as usual for a lot of institutions here," remarks Andrew Selby, Johannesburg-based head of sales at Absa Capital.

Despite upheavals in international markets, the rand remained less skittish in 2007 than it has been over the past few years. The country's currency has not broken outside a trading range of R6.73–7.50 to the dollar this year, versus R5.96–7.88 during 2006. Given global uncertainty, the stability of the rand against other emerging market currencies is testament to the country's strong fundamentals, suggests Selby: "People are actually differentiating in currencies at the moment and there's still a very good story in South Africa."

For corporate clients, the low volatility of the rand has offered assistance to those looking to hedge their foreign currency-denominated exposures by reducing implied volatilities and therefore the price of options. It seems many of South Africa's companies are taking advantage of this: van der Merwe of Standard Bank says they have become increasingly willing to consider more complex products involving optionality to offset their foreign exchange risk.

"Typically, they'd be looking at more sophisticated products now, as opposed to vanilla commoditised hedging like spot and forward cover," he comments. These more sophisticated products include collars, binary options and participation options.

Meanwhile, Absa Capital has steadily risen over the past two years to run Standard Bank to its closest-ever finish in this year's *Risk South Africa* survey. Since Barclays Bank took a majority stake in the firm in 2005, it has undergone sweeping internal changes, helping to boost its standing in successive *Risk South Africa* polls. Having shot from fourth to second place overall with 12.5% of the vote in 2006, the consolidated group is now breathing down Standard Bank's neck, in second place overall with 13.1%.

Standard Bank's Johannesburg headquarters

"Our goal this year was to pull up in rates and equities, both of which we have done," says Selby of Absa Capital. While the bank did not top any of the three product categories overall, its performance was extremely consistent: it took second place overall in interest rates (with 15.3% of the vote), currencies (17.1%) and equities (15.4%).

All in all, the bank managed first place in US dollar interest rate options, US dollar forward-rate agreements, US dollar/rand currency forwards and exotic equity options; while achieving joint first place in US dollar interest rate swaps and international equity index options. It also placed second in risk management advisory, US dollar/rand cross-currency swaps, international OTC single-stock options and metals; while coming third in rand interest rate swaps and options, rand and US dollar repos, US dollar/rand currency options, South African OTC single-stock options, warrants and exchange-traded funds (ETFs).

One of the main concerns for South Africa's economy is inflation. At 6.3% during August, South Africa's main year-on-year inflation rate still exceeds the South African Reserve Bank's target range of 3–6%. This has heightened expectations of an interest rate rise, leading many domestic participants to hedge

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> Andrew Selby, Absa Capital

their exposures. But bankers remain divided on the issue of a rate hike. Johan Roos, head of interest rate derivatives trading and co-head of interest rate swaps at Standard Bank in Johannesburg, says this is continuing to make life interesting within the financial community. "There are differing views in the market and that's great, because when you have differing views you're going to get different trading styles and different positions amongst the banks," he says.

Even against a bullish economic outlook, South African investors are still conservative in their investment decisions by international standards. Demand for government bonds remains high, even though the government plans to scale back the size of its domestic debt. Public debt redemptions of R9 billion ($1.3 billion) are anticipated in the fiscal year 2007/8, with just R1 billion of new issuance planned over the next three years.

"We've seen a lack of supply in the market for government bonds, while there's still the same amount of flows from institutions that have to buy assets. So, they've been receiving back-end swaps and we've seen the curve invert massively," says Roos at Standard Bank. Indeed, the 10-year versus 30-year interest rate swap spread was at -70 basis points on February 15 and had widened to -120bp by October 2, according to Standard Bank. Similarly, the five-year versus 10-year swap spread also went from being flat on February 15 to touching -60bp by October 2. Asset swap spreads have also been pushed to historical highs.

This inversion may be a boon to the business of local banks, says Roos: "It's hard to believe that the curve can invert even more, but with a lack of supply you'd expect more institutions would move into the derivatives market and demand back-end swaps."

Infrastructure spending

But, with gargantuan infrastructure spending planned by South Africa's parastatals prior to the 2010 Fifa World Cup, a lack of underlying debt supply may be short-lived. Johannesburg-based electricity generator Eskom, for example, plans to raise R100 billion in debt over the next five years at home and abroad, while transport and logistics firm Transnet, also based in Johannesburg, recently announced spending commitments totalling R78 billion. In addition to perhaps easing the inversion of the swap curve, such issues will provide plenty of business for South Africa's dealers. "The vast amounts of cash that will be needed means there are going to be myriad different sources that will be tapped and a lot of risk management around that," proclaims Selby at Absa Capital.

Climbing up a position to third place overall in this year's poll is Nedbank, with 9.2% of the overall vote. It placed third overall in interest rates and currencies, with 10.8% and 12.2% of the vote, respectively, while finishing fifth overall in equities with 8.2%. The bank's best result was first place in rand repos, while it also gained second-place rankings in exotic equity options, warrants, ETFs, structured products and South African single-name CDSs. It won third place in US dollar interest rate swaps and options, rand interest rate exotics, rand and US dollar forward rate agreements, and US dollar/rand cross-currency swaps; and joint third place in both US dollar interest rate exotics and US dollar/rand currency forwards.

Nedbank has profited in this years' survey at the expense of Rand Merchant Bank (RMB), which dropped to fourth place overall and saw its share of the vote diminish two percentage points from 2006, to 8.7%. In all, RMB has fallen two places since *Risk South Africa*'s first industry survey in 2005, when it achieved second place overall. Since 2006, the bank has also fallen by one position in currencies overall and two in interest rate swaps. In both, it saw its share of the vote decline: from 12.8% to 10.6% in currencies, and from 17.1% to 8.1% in interest rates. But it retained more first-place rankings than Nedbank, winning the rand interest rate options and forward rate agreements, US dollar/rand currency options and metals categories. RMB garnered second place for rand interest rate swaps and US dollar/rand currency forwards, while finishing third in risk management advisory and South African single-name CDSs.

Meanwhile, Icap scores the highest of the interdealer brokerages featured in this year's poll, winning seven individual categories out of 17.

The nimbleness of the big four local banks, along with the strong relationships fostered by their retail arms, can make South Africa challenging territory for foreign interlopers. However, Deutsche Bank finishes fifth overall in this year's survey, triumphing over other international banks in South Africa with 8.2% of the vote. Deutsche's best showing was in equities, where it won first place overall. Although down a touch on 2006, when it received 21.4% of the vote in equities, its ranking remained strong with a formidable 20.8%. Its closest competitor in the asset class, Absa Capital, trails it by over five percentage points.

Deutsche Bank's head of equities in South Africa, Max Koep, attributes the dealer's success to its international capabilities in prime brokerage, derivatives and ETFs, combined with its local franchise.

Many new entrants have sought to take advantage of the country's booming stocks in the past few years, including a burgeoning hedge fund industry. However, some investors are starting to put on protection strategies, says Koep: "While the market still appears bullish over the long-term, there is some concern around current valuations."

Future directions

Aside from inflation and some concerns about future direction of the stock market, there are other uncertainties. For instance, the ruling African National Congress picks its next president in December – and whoever wins the post is a dead cert for the country's presidency in 2009. This could create jitters in the financial markets. Poorly performing US subprime mortgages, which have so far left South Africa relatively unscathed, may also have a broader effect on the country's financial markets. "I'm afraid that, if the subprime issue is worse than expected, that is the kind of thing that will hurt our market place because emerging markets will get knocked as an asset class," says Koep.

Another development that could have reverberations in the South African market is the full implementation of Basel II, which is scheduled for January 2008. However, most of the country's banks are already operating as if the regulation were already fully implemented, says Selby. "I don't think you can discount everything about how the market's going to react when a new regulation's coming in, but most of the local banks have been operating as if they were under Basel II."

Some of the country's hedge funds are known to have been caught out by this year's market moves. Given that, Roos of Standard Bank thinks institutional clients might enter a period of risk aversion. "I think we might have a period of people battening down the hatches and trying to contain their trading profits rather than putting huge trades on the book," he says.

Not all dealers agree with this, but there is one thing they all observe: that derivatives are playing a increasingly important role in the country's financial sector. Koep at Deutsche Bank notes that five years ago, it was uncommon for an asset manager to be literate in derivatives. Now, the expectation is that they would know and understand derivatives. Whether any of the concerns on the horizon are realised, this greater derivatives know-how is only likely to increase. Bearing that in mind, Standard Bank might be well advised to brace itself for yet more intense competition in 2008. ■

How the survey was conducted

The survey was completed by 108 dealers, brokers, corporates and asset managers in South Africa. Participants were asked to vote for their top derivatives dealers in order of preference in derivatives categories in which they had traded over the course of the year.

The survey covered 24 categories, divided into interest rate, currency, equity, credit, commodity, structured products and risk advisory. The votes were weighted with three points for a first place, two points for second and one for third. Only categories receiving a sufficient number of votes are included in the final poll results.

Overall top 10 banks

2007	2006	Bank	%
1	1	Standard Bank	16.3
2	2	Absa Capital	13.1
3	4	Nedbank	9.2
4	3	Rand Merchant Bank	8.7
5	5	Deutsche Bank	8.2
6	6	JP Morgan	6.4
7	7	Investec	6.0
8	–	Société Générale	5.5
9	9	Goldman Sachs	4.6
10	10	UBS	4.2

INTEREST RATES OVERALL

2007	2006	Banks	%
1	1	Standard Bank	19.6
2	4	Absa Capital	15.3
3	3	Nedbank	10.8
4	2	Rand Merchant Bank	8.1
5		Deutsche Bank	7.2

CURRENCY OVERALL

2007	2006	Banks	%
1	1	Standard Bank	17.5
2	2	Absa Capital	17.1
3	5	Nedbank	12.2
4	3	Rand Merchant Bank	10.6
5		Investec	6.8

EQUITY OVERALL

2007	2006	Banks	%
1	1	Deutsche Bank	20.8
2	4	Absa Capital	15.4
3	2	Standard Bank	10.8
4	3	JP Morgan	8.7
5	5	Nedbank	8.2

RISK MANAGEMENT ADVISORY

18 banks cited

2007	2006	Banks	%
1	1	Standard Bank	21.3
2	3	Absa Capital	19.4
3	2	Rand Merchant Bank	17.1
4	4	Nedbank	9.5
5		Deutsche Bank	6.6

INTEREST RATES

INTEREST RATE SWAPS
Rand
15 banks cited

2007	2006	Banks	%
1	1	Standard Bank	25.4
2	2	Rand Merchant Bank	17.4
3		Absa Capital	16.7
4	4=	Nedbank	9.4
5		Deutsche Bank	8
Top broker		Tradition	

INTEREST RATE SWAPS
US dollar
13 banks cited

2007	2006	Banks	%
1=	2	Absa Capital	18.1
1=	1	Standard Bank	18.1
3		Nedbank	13.2
4	5	JP Morgan	10.3
5		Deutsche Bank	8.6
Top broker		Icap	

INTEREST RATE OPTIONS
Rand
14 banks cited

2007	2006	Banks	%
1	1	Rand Merchant Bank	20.3
2	2	Standard Bank	17.3
3	5	Absa Capital	16.3
4	3	Nedbank	10.6
5	4	Deutsche Bank	8.2
Top broker		Cadiz Holdings	

INTEREST RATE OPTIONS
US dollar
16 banks cited

2007	2006	Banks	%
1	5	Absa Capital	24.6
2	2	Standard Bank	22.8
3		Nedbank	13.5
4=		Citi	8.8
4=	1	JP Morgan	8.8
Top broker		Icap	

INTEREST RATE EXOTICS
Rand
14 banks cited

2007	2006	Banks	%
1	1	Standard Bank	25.5
2	4	Deutsche Bank	21.5
3	5	Nedbank	18.6
4	2	Rand Merchant Bank	10.6
5		Absa Capital	8.5
Top broker		Icap	

INTEREST RATE EXOTICS
US dollar
16 banks cited

2007	2006	Banks	%
1	n/a	Standard Bank	21.3
2		Goldman Sachs	18.2
3=		Deutsche Bank	15.2
3=		Nedbank	15.2
5		Absa Capital	9.1
Top broker		Icap	

REPURCHASE AGREEMENTS
Rand
15 banks cited

2007	2006	Banks	%
1	2	Nedbank	19.8
2	3	Standard Bank	17.8
3	5	Absa Capital	16.4
4	4	Deutsche Bank	13.7
5	1	Rand Merchant Bank	12.5
Top broker		Icap	

REPURCHASE AGREEMENTS
US dollar
17 banks cited

2007	2006	Banks	%
1	n/a	Standard Bank	21.1
2		JP Morgan	18.7
3		Absa Capital	15.6
4		Nedbank	12.5
5		Goldman Sachs	9.4
Top broker		Icap	

FORWARD-RATE AGREEMENTS
Rand
14 banks cited

2007	2006	Banks	%
1	1	Rand Merchant Bank	21.9
2	2	Standard Bank	20.8
3	3	Nedbank	17.8
4	4	Deutsche Bank	8.8
5		Absa Capital	7.7
Top broker		Tradition	

FORWARD-RATE AGREEMENTS
US dollar
16 banks cited

2007	2006	Banks	%
1	n/a	Absa Capital	21.3
2		Standard Bank	20.8
3		Nedbank	15.3
4		JP Morgan	10.5
5		Deutsche Bank	7.5
Top broker		Icap	

CURRENCY PRODUCTS

CROSS-CURRENCY SWAPS

US dollar/Rand — 14 banks cited

2007	2006	Banks	%
1	1	Standard Bank	19.8
2	2	Absa Capital	16.6
3	5	Nedbank	12.4
4	3	JP Morgan	11.2
5	3	Rand Merchant Bank	5.6
Top broker		Tullett Prebon	

CURRENCY FORWARDS

US dollar/Rand — 13 banks cited

2007	2006	Banks	%
1	1	Absa Capital	16.2
2	3	Rand Merchant Bank	14.8
3=	4=	Nedbank	10.9
3=	2	Standard Bank	10.9
5		Investec	8.4
Top broker		Tullett Prebon	

CURRENCY OPTIONS

US dollar/Rand — 13 banks cited

2007	2006	Banks	%
1	3	Rand Merchant Bank	18.7
2	1	Standard Bank	17.1
3	2	Absa Capital	11.4
4		Nedbank	8.6
5	5	Investec	6.7
Top broker		Icap	

Risk South Africa Rankings 2007

EQUITY PRODUCTS

SOUTH AFRICAN OTC SINGLE-STOCK OPTIONS

11 banks cited

2007	2006	Banks	%
1	1	Standard Bank	22.4
2	2	Deutsche Bank	19.8
3	5	Absa Capital	13.8
4		JP Morgan	12.1
5	4	Nedbank	7.7
Top broker		Peregrine Holdings	

EXOTIC EQUITY OPTIONS

10 banks cited

2007	2006	Banks	%
1	3	Absa Capital	17.9
2	5	Nedbank	13.5
3	1	Deutsche Bank	12.3
4	2	JP Morgan	11.2
5		Investec	10.1
Top broker		Cadiz Holdings	

INTERNATIONAL OTC SINGLE-STOCK OPTIONS

10 banks cited

2007	2006	Banks	%
1	1	Deutsche Bank	22.9
2		Absa Capital	14.9
3	4	Standard Bank	13.5
4	2	JP Morgan	10.8
5		Nedbank	8.1
Top broker		Peregrine Holdings	

WARRANTS

10 banks cited

2007	2006	Banks	%
1	1	Standard Bank	18.6
2	4	Nedbank	16.2
3	3	Absa Capital	13.5
4	2	Investec	12.2
5	5	Deutsche Bank	10.8

SOUTH AFRICAN EQUITY INDEX OPTIONS

12 banks cited

2007	2006	Banks	%
1	1	JP Morgan	17.3
2	2	Standard Bank	16.5
3	4	Deutsche Bank	15.5
4=	5	Absa Capital	13.2
4=	3	Nedbank	13.2
Top broker		Peregrine Holdings	

EXCHANGE-TRADED FUNDS

12 banks cited

2007	2006	Banks	%
1	1	Deutsche Bank	22.9
2	3=	Nedbank	18.1
3	2	Absa Capital	13.5
4=		Credit Suisse	5.8
4=	5	Investec	5.8

INTERNATIONAL EQUITY INDEX OPTIONS

11 banks cited

2007	2006	Banks	%
1=	4	Absa Capital	18.1
1=	1	Deutsche Bank	18.1
3	2	JP Morgan	16.4
4		Société Générale	14.5
5	3	UBS	7.3
Top broker		Peregrine Holdings	

STRUCTURED PRODUCTS

12 banks cited

2007	2006	Banks	%
1	n/a	Société Générale	16.7
2		Nedbank	15.3
3		Deutsche Bank	11.1
4		Standard Bank	8.3
5		Absa Capital	6.9

CREDIT PRODUCTS

SOUTH AFRICAN SINGLE-NAME CDSs

12 banks cited

2007	2006	Banks	%
1	1	Standard Bank	19.3
2	2	Nedbank	18.4
3	3	Rand Merchant Bank	13.2
4	5	Investec	10.5
5	4	Absa Capital	7.8

METALS

9 banks cited

2007	2006	Banks	%
1	1	Rand Merchant Bank	30.9
2	2	Absa Capital	24.9
3	3	Standard Bank	21.4
4		UBS	14.3
5		Société Générale	7.1