

# What junk status means for car owners

South Africa has been downgraded to [junk status](#) by Standard & Poor's and Fitch Ratings. As this may not have short-term effects on the average South African, the long-term effects of being downgraded will lead to higher interest rates and will make life a lot more expensive.



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Fernando Pinheiro, joint-MD of [CarZar](#)'s online car-buying tech-startup, believes that it may be a difficult time to have more than one car in a household as the costs to maintain those vehicles are likely to increase due to the current downgrade of the country.

He says that South Africans will be facing a difficult time and can expect to see changes in the financing of cars, petrol prices, as well as insurance costs.

Says Craig Parker, Frost & Sullivan's programme manager for Mobility Africa: "The major effects on the automotive industry in South Africa will be felt through the entire value chain of automotive production. Currently, the local content contribution into final production of OEMs is at 38% and credit downgrades make it increasingly difficult to attract the necessary investment into the country to transform the industry and allow for greater local contribution into the local value chain."

## What junk status means for car financing

One can expect an increase in the risk premium, essentially meaning that lenders will increase interest rates, as a result of a perceived 'greater risk' in default.

Higher interest rates increase the cost of families paying for loans from banks - financing things like home loans and vehicle finance payments.

Standard & Poor's predicted that interest rates would rise, regardless of its downgrade decision. "We think that ongoing tensions and the potential for further event risk could weigh on investor confidence and exchange rates, and potentially drive increases in real interest rates."

If interest rates go up, as S&P expects, the cost of borrowing goes up. It increases your credit card repayments and the amount you need to pay the bank every month, for your short-term loan, or car and home loan.

Pinheiro says he believes that the junk status will impose a 'cascade effect' in the entire financing industry; increasing the interest rates of new contracts and making it more expensive to acquire new vehicles.

"If, in your current financing contract, the interest rates are not fixed (e.g. adjusted according to the base interest rate of the government), you should think about selling your vehicle as soon as possible," says Pinheiro.

## **What junk status means for car insurance**

The downgrade by Standard and Poor's and Fitch Ratings is expected to hit the short-term insurance industry in particular.

"The downgrade will increase the overall cost of foreign capital for South African entities, due to high interest rates and strong devalued currency. Therefore, financial institutions will have to transfer these costs to the market, by increasing the base interest rates."

Junk status will impact the entire auto-trade industry, from spare part costs to insurance premiums of most vehicles, especially the imported ones.

"If your current insurance contract is about to expire, you may see a substantial increase in the monthly premium," says Pinheiro.

According to South African Insurance Association's (SAIA) chief executive, Vivienne Pearson, the cost of motor parts - of which the majority are imported - will increase exponentially, therefore leading to increased repair costs, followed by growing premiums for policyholders.

She says that South African consumers and businesses should prepare themselves for an increase in their car insurance premiums.

"This could expose consumers to financial risks in the event of a loss or damage to assets. Furthermore, motor-body repairers' building industry, and others, will feel the pinch of less work, leading to job losses," says Pearson.

Says Parker: "Automotive manufacturers will also, most likely, have to face higher demands in terms of wage increases, which could lead to a loss of production - as has happened in the past when employers and trade unions cannot agree on an acceptable wage increase. The higher cost of living will impact employees in the local value chain, as well as for OEMs. This will result in a loss of disposable income to employees, due to higher inflation, and their wage rates will need to be adjusted at a higher level to compensate for their loss of relative spending power."

## **What junk status means for investment**

According to Parker, the investment potential of the automotive sector will decline as a result of a less favourable climate in South Africa, where the risk versus reward and return on investment are negatively impacted. Getting foreign Tier 1 and Tier 2 component manufacturers into South Africa to invest in the local automotive value chain will become increasingly difficult.

"Getting these manufacturers to sell equity share, to comply with equity requirements within the procurement stipulations in the value chain, will also be more difficult as uncertainty and a lack of trust in the financial stability of the economy will discourage international investors from allowing local equity partners into their business."

## **What junk status means for petrol**

A weaker rand means that petrol prices are likely to rise. If petrol prices go up, food prices will follow. The raw ingredient of petrol is oil, which is bought in dollars. When the rand weakens, oil prices will therefore rise and so will the price of petrol.

The knock-on effect of a weaker rand is higher transport costs. Higher transport costs affect the price of everything moved by trucks – from food to imported goods, and anything you buy at a shop.

Economist, Dr Azar Jammie, says: "If the rand goes into freefall and reaches R16 or R17 to the dollar, inflation will rise, so will food prices and the petrol price will rise. Households will suffer."

"With the country being downgraded to junk status, owning a car is expected to become more expensive and, depending on the impact of higher costs, more people may decide to sell their vehicles," says Pinheiro.

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