With African roots and a presence in 17 African countries and 33 countries worldwide, Standard Bank has been working with commodities clients since 1994. In 2006, the bank hired Janelle Matharoo as managing director, global head of energy sales & trading, to help grow the business. He talks to *Energy Risk* about the lessons the bank has learnt since the global financial crisis and how the crisis became the catalyst for the acceleration of business initiatives essential to the participants in the energy industry today

BUILDING ON LESSONS LEARNED

Are you concerned about tighter financial regulation and what do you think the impact of it will be both globally and for Africa?

Janelle Matharoo (JM), Managing Director, Global Head of Energy Sales & Trading, Standard Bank: The short answer is yes. We cannot afford to be complacent. The range of stakeholders in how banks are regulated has expanded rapidly and the big unanswered question is: will these diverse groups allow economic sanity to prevail? Will the regulator allow business to run business while it regulates?

The world's individual economies are built for the nation they serve while simultaneously and increasingly operating in a global space. While the national regulator can intervene at one level, the supranational regulator is arguably more relevant. The Europeans are working on such solutions, but how effective this will be is unclear. The uncertainty around the ability to create effective global supranationals is a cause for concern.

Absence of such joined-up regulation may push excessive risk-taking into an unregulated space or reduce risk-taking altogether, thereby reducing liquidity, surely not what is intended in the management of a tight liquidity situation.

One would hope that one of the lessons of the financial crisis would be a move towards a more pre-emptive style where systemic risk caused by situations such as asset price bubbles are managed earlier by controlling the supply of liquidity. The aim should be to align the interests of the consumer and the business and allow free flow of liquidity, avoid the accumulation of risks that threaten the whole system and, in the event that a crisis does occur, understand how to distribute the loss as opposed to just bailouts. It could be argued that there was plenty of evidence that the housing and credit markets were over-inflated before the crash, but regulatory intervention was minimal. Perhaps as a lesson learnt, in China today the government is trying to tackle its own potential housing bubble at a much earlier point. While on its own this early identification and management cannot guarantee what we all want, it is surely preferable to the alternative post-collapse reaction.

When it comes to the impact of new regulation on Africa, most African countries did not suffer a systemic banking crisis although gross domestic product (GDP) did slow to around 1% per annum. Financially, less-developed economies suffered a lag effect as global trade impacted. However, they will continue in deregulation mode and not enter 'tightening-up' mode in the foreseeable future. As a positive by-product of the crisis, is it possible that Africa and other small developing economies have been able to learn the lessons without the actual impacts of the crash? Let's hope so.

Janelle Matharoo

Do you think risk management has kept pace with market developments?

JM: No, and this in no small part contributed to the collapse. But much has been learned.

The fundamentals that drive the price of energy themselves have evolved over the last 25 years. Initially, the energy markets were dominated by the commercial participants. There was mean reversion such that the forward structure was contango and the flat price was low when oversupplied, and in backwardation with a high flat price when supply was tight. Other risks such as funding, credit risk and capital usage were subordinated in importance and invariably underpriced. Oil traders called less often for margin in over-the-counter business, for example. The cost of maintaining liquidity was very poorly understood and, though widely discussed, rarely agreed on.

So what has changed? The correlation between all asset classes has picked up pace over time. The very definition of the fundamentals that determine the energy price have evolved to the point where the price is now dominated by liquidity of money, not supply and demand of the physical. A positive housing-starts data point is likely to be as important as the Department of Energy stock statistics. It is increasingly common now for the flat price to reflect the participation of the 'money' in the market and the supply/demand imbalances to be reflected in the term structure. Hence, oil markets trading higher and increasing in contango, for instance, is no longer uncommon.

The internet revolution and advance of technology have had their impact. Processing power and ease of information flows has lead to significantly more powerful portfolio-style approaches to risk management where funding, credit and capital impacts of a transaction to the whole book are available and, hence, more sophisticated decision-making is possible, though not always evident. Electronic trading has also opened the markets to money managers who are aggressively and programmatically reshaping portfolios. The consequential impacts on price and volatility are significant. The recent absence of money in the markets is evidenced by much reduced volatility.

The tectonic plates have moved and a clear grasp of the new landscape will determine the winners and losers.

What are the major lessons to be learned from the financial crisis?

JM: The key lesson, I believe, is that no risk is too small to be ignored – so start thinking and be prepared.

In 2008, Standard Bank, like many organisations, carefully analysed its risks and assumed the worst for stress scenarios. Many business units were on high alert and perhaps understood their risk portfolios better than at any time in the past. Capital, funding and credit risks were elevated to equals to market risk and structuring of finance became a key differentiator. Although our balance sheet was strong throughout the crisis and was not exposed to some of the dramas that played out, we nevertheless operate in the same regulatory environment so the need to prepare was critical.

Banks' stretched balance sheets were unable to lend to business in emerging economies that were still growing. Smart structuring led Standard Bank to swap balance-sheet exposure into commodity exposures, creating win-win products for clients and ourselves. While this may explain why some banks are keen to get into the physical markets, the crisis merely accelerated our development of these structures and products. It had been our intention since 2006 to serve our clients this way. Standard Bank has managed to effectively broaden its 'originate to distribute' model by virtue of the crisis by finding new routes to connect lenders and borrowers in difficult times and different phases of their growth cycles.

Where are the growth areas for energy and commodities and what role will China play?

JM: Emerging-market demand continues unabated. GDP numbers from China and India – which hold one-third of the world's population – are still enduring. The pivotal question is can they maintain the continuing transition from export-led demand growth to domestically led advancement. A continuation of pre-crisis direction will, to some extent, isolate China from the uncertainties of global economies. However, consumption of commodities and the relative value of the currency will keep them firmly connected. China could yet be derailed by how the present currency wars play out, how they accept the concept of 'universal values' and the impact of that, how their population ages relative to its peers, and so on.

Much of the commodity supply is of course from Africa, and that will be a growing story over the next decade. Standard Bank's presence in Africa and China and extensive capabilities in commodities has meant a growing role in this trend. We're very excited about these developments.

How do you see Africa's contribution to the longer-term supply/demand picture for oil and oil products?

JM: What is often forgotten is that Africa has one billion people. It's increasingly becoming an urbanised society demanding consumer goods. So there's a very early, slow transformation going on there. However, most African economies are young. Corruption is a problem, as is infrastructure. In Nigeria, for example, refined products are imported despite the country being a large crude producer and owning its own refining capacity. Mozambique and Botswana both have huge reserves of coal, but little infrastructure to produce or export it. Unlocking the reserves will require hundreds of billions of dollars of investment. Even South Africa, the most developed African nation, doesn't have effective infrastructure to handle the production and demand for its coal.

With regulation set to tighten in the Organisation for Economic Co-operation and Development region, Africa may become more attractive for investment. Standard Bank's in-country presence has allowed insights that lead to more creative structuring. To a yield hunter from Wall Street with no local presence, getting involved here will be a huge challenge. An understanding of the needs of the influential movers and shakers established over decades creates our unique perspective.

The present global market trends are supportive of Africa's fortunes. There's money building up in Western coffers that will soon be looking for a home. I think the emerging market growth and out-performance is going to be a magnet for a large part of those. So there's likely to be flows into Africa, but not without a shift to smart structuring that builds on the learnings from the recent financial crisis.

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