Rand Note

23rd September 2019

Rand runs back towards R15.00/USD, eyeing downside risks of US rate cut cycle halt, rising middle east tensions, Brexit and slower global growth, while SA fundamentals remain weak

Economic Scenarios: - note change in probabilities

Extreme Up case 1%

	Q1.19	Q2.19	Q3.19	Q4.19	Q1.20	Q2.20	Q3.20	Q4.20
Rand/USD (average)	14.01	14.38	11.50	10.30	9.50	8.60	7.90	7.60
Repo rate (end rate)	6.75	6.75	6.00	6.00	5.75	5.75	5.50	5.50

Fast, sustainable economic growth of 5-7% y/y. Change in political will with growth creating economic reforms that structurally lift private sector investor confidence and fixed investment. Global growth boom (including commodities). Trump protectionism removed. SA export and domestic growth boom lifts employment and incomes, poverty eventually eliminated. Property rights strengthened, individuals obtain title deeds in EWC without disruption to economy. Fiscal consolidation, credit rating upgrades to A grade.

Up case 10%

	Q1.19	Q2.19	Q3.19	Q4.19	Q1.20	Q2.20	Q3.20	Q4.20
Rand/USD (average)	14.01	14.38	13.00	11.50	10.00	9.95	9.90	9.70
Repo rate (end rate)	6.75	6.75	6.25	6.25	6.25	6.00	6.00	6.00

Persistent growth of 3–5%, higher probability of extreme up case. Better governance, growth creating reforms (structural constraints are overcome), greater socio-economic stability, strengthening in property rights, individuals obtain title deeds in EWC without disruption to economy and can leverage and obtain credit. High business confidence and fixed investment growth, substantial FDI inflows, fiscal consolidation. Strong global growth and commodity cycle, 'trade war' subsides. Stabilisation of credit ratings, with ultimately credit rating upgrades.

Base case 45%

	Q1.19	Q2.19	Q3.19	Q4.19	Q1.20	Q2.20	Q3.20	Q4.20
Rand/USD (average)	14.01	14.38	14.30	13.90	13.40	13.70	13.90	13.30
Repo rate (end rate)	6.75	6.75	6.50	6.50	6.50	6.50	6.50	6.50

Annual growth rate of close to 2.0% y/y reached by 2020, 3.0% y/y by 2024. Higher confidence and investment levels than past decade. Rand structurally stronger nears PPP by 2021. SA retains one investment grade (Moody's) rating on its local currency long-term sovereign debt in 2019. Sedate global monetary policy normalisation – avoid severe global risk-off environment, neutral to global risk-on. Modestly strengthening global demand. Limited impact of EWC/expropriation without compensation (to abandoned and unused land of government and agricultural sector – individuals are new owners and receive title deeds).

Lite (domestic) Down case 35%

	Q1.19	Q2.19	Q3.19	Q4.19	Q1.20	Q2.20	Q3.20	Q4.20
Rand/USD (average)	14.01	14.38	15.50	17.00	16.50	15.50	15.15	14.90
Repo rate (end rate)	6.75	6.75	7.50	8.50	7.50	7.50	7.50	7.25

Business confidence remains depressed, marked rand weakness, significant load shedding and weak investment growth. SA sub-investment grade Moody's rating but substantial repair avoids further marked downgrades. SA experiences a V shaped, credit rating downgrade related, recession. However, modestly strengthening global demand and elevated commodity prices help lessen the longer-term impact of domestic disturbances. Sedate global monetary policy normalisation occurs – a severe global risk-off environment is avoided, with neutral to global risk-on. Partial expropriation of (certain groups') private commercial sector property (including productive land) without compensation.

Severe down case 9%

	Q1.19	Q2.19	Q3.19	Q4.19	Q1.20	Q2.20	Q3.20	Q4.20
Rand/USD (average)	14.01	14.38	16.10	18.50	19.50	20.00	19.25	18.70
Repo rate (end rate)	6.75	6.75	8.00	9.25	9.75	10.25	10.75	9.50

Faster than expected global (US) monetary policy normalisation, general market risk-off, global sharp economic slowdown (commodity slump) followed by marked escalation of US-China trade war – short US recession, global financial crisis. SA sub-investment grade, risks further credit rating downgrades. Significantly more severe recession than in lite down case. Confidence and investment depressed, marked rand weakness, significant strike action and widespread services load shedding. Expropriation of private sector property (title deeds not transferred to individuals nationalisation) without compensation.

Note: Event risk begins Q3.19. Source: Investec, Iress historical data

- The rand weakened to R14.93/USD, R16.45/EUR and R18.63/GBP at its close on Friday, similar this morning, as the ramp up of tensions in the middle east and the cautious stance of the Fed afflicted markets. Today's poor PMI data out of Europe has also dulled risk sentiment, afflicting EM currencies as global growth remains of concern.

- The outlook for the global economy and markets has become cloudier, as rising uncertainty negatively impacts risk assets, with concerns in particular over economic growth in 2020. The slowdown in the pace of global economic activity looks likely to continue, instead of the recovery indicated by key institutions, including the IMF, earlier in the year.

- The World Bank recently acknowledged that "(t)he slowdown in global growth is broad based" and recent developments signal 2019's world expansion will likely fall short of June's projection of 2.6% (in real terms). Its nominal global growth (includes inflation) forecast could slow to less than 3% from around 6% in 2017 and 2018.

- The BIS (Bank of International Settlements) has said "(t)here are some models that show the probability of recession has increased, but it's still far from being something sure." The IMF "sees a world economy where growth is fragile and under threat from trade frictions and Brexit, and perhaps an over-reliance on the efforts of central banks."

- Today shows both Germany and France's services and manufacturing PMI readings below market expectations, with Germany's manufacturing PMI well below 50, indicating contraction at 41.4, while France sees its manufacturing PMI on the cusp at 50.3. Services PMI's from the two nations are also below prior readings.

- Despite forthcoming monetary stimulus from the ECB, markets are not fully convinced that it will be sufficient to prevent the weakening in European economic activity gathering force, as ECB stimulus would improve financing ability but not necessarily stimulate economic activity when sentiment turns down.

- Fiscal stimulus is increasingly being seen as necessary in some countries, notably Germany. The BIS recently said "(t)he room for monetary policy manoeuvre has narrowed further. Should a downturn materialize, monetary policy will need a helping hand, not least from a wise use of fiscal policy in those countries where there is still room for manoeuver".

- Despite some perceived progress in US-China trade negotiations, markets remain hesitant on this front given the stop-start nature of the evolving trade discussions, while Brexit too does not have a clear outcome yet. The many unquantifiable risks on the horizon have stimulated some flight to safe havens, away from riskier assets.

- The rand is likely to continue to remain volatile, with September a month that can see a lot of churn, and with the risk that slower global growth sees commodity currencies such as the rand weaken further. Oil prices could come under some pressure in the remainder of this year, particularly if tensions in the Middle East inflame further.

- OPEC however has said it has sufficient spare capacity to meet supply shortages. The damage to Saudi production comes just after the International Energy Agency (IEA) warned that “(w)hile the relentless stock builds we have seen since early 2018 have halted, this is temporary”.

- Earlier this month (before the strikes on Saudi production) the IEA had said “(s)oon, the Opec+ producers (Opec and Russia) will once again see surging non-Opec oil production with the implied market balance returning to a significant surplus placing pressure on prices.”

- IEA added “(t)he challenge of market management remains a daunting one well into 2020”, with oil production from non-OPEC members also rising. Following the attack on Saudi oil production the IEA has said that it has sufficient stock to cover any resultant supply shortfall.

- In particular it said “IEA member countries hold about 1.55 billion barrels of emergency stocks in government-controlled agencies, which amount to 15 days of total world oil demand. These can be drawn upon in an emergency collective action and would be more than enough to offset any significant disruption in supplies for an extended period of time.”

- Currently in South Arica fuel price increases are building for October, of around 20c/litre for diesel and illuminating paraffin and above 12c/litre on petrol. Further weakness in the domestic currency and/or a higher oil price would push up the October fuel price increases. The Brent crude oil price is currently at US$64/bbl.