

SA Economics



Monday 10 May 2021

Rand note: Moody's gives SA the benefit of the doubt, leaving its rating and outlook unchanged at Ba2 (i.e. BB) negative, adopting a wait and see approach to SA's fiscal consolidation, and in particular eyeing wage agreements

Economic Scenarios: reduced downside, stronger expected case									
		Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22
Extreme Up case 1%	USD/Rand (average)	14.96	14.10	13.50	13.40	13.10	12.90	12.70	12.50
	Repo rate (end rate)	3.50	3.25	3.25	3.25	3.25	3.25	3.25	3.25
	Impact of Covid-19 pandemic very rapidly resolved - economic growth of 3-5%, then 5-7% for SA. Good governance, growth-creating reforms (structural constraints overcome), strengthening of property rights - individuals obtain title deeds in EWC - no nationalisation. High business confidence and fixed investment growth, substantial FDI inflows, strong fiscal consolidation (government debt falls back to low ratios of 2000s). Strong global growth, commodity boom. Stabilisation of credit ratings, then credit rating upgrades.								
Up case 2%	USD/Rand (average)	14.96	14.30	14.00	13.90	14.00	14.40	14.70	14.30
	Repo rate (end rate)	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50
	Quick rebound from Covid-19 pandemic, rising confidence and investment levels - structural problems worked down. No further credit rating downgrades, rating outlooks move to stable and eventually positive, strong fiscal consolidation (government debt projections fall substantially). Global risk-on, global demand quickly returns to trend growth. Limited impact of expropriation (without compensation) to abandoned, unused, labour tenants' and government land (individuals are new owners and receive title deeds) does not have a negative effect on economy - no nationalisation.								
Base case 50%	USD/Rand (average)	14.96	14.50	15.00	14.90	15.00	15.40	15.70	15.30
	Repo rate (end rate)	3.50	3.50	3.50	3.75	3.75	3.75	4.00	4.00
	Recovery from the sharp global economic slowdown by 2024 in real terms - sufficient global and domestic monetary and other policy supports to growth and financial markets occur and risk sentiment stabilises then improves. Expropriation of private sector property is limited and does not have a negative impact on the economy or on market sentiment. SA remains in the BB category rating bracket for Moody's - fiscal consolidation (debt to GDP stabilisation) occurs.								
Lite (domestic) Down case 42%	USD/Rand (average)	14.96	15.00	15.75	16.50	16.70	17.00	17.50	17.00
	Repo rate (end rate)	3.50	3.75	3.75	4.00	4.00	4.25	4.25	4.50
	The international environment (including risk sentiment) is that of the base case. South Africa fails to see its debt projections stabilise and falls into single B credit ratings from all three agencies for local and foreign currency. Recession occurs. Expropriation of some private commercial sector property without compensation, with some negative impact on the economy. Business confidence depressed, rand weakness, significant load shedding and weak investment growth. Substantial fiscal consolidation ultimately occurs, preventing ratings falling into the C grades.								
Severe down case 5%	USD/Rand (average)	14.96	15.50	17.00	17.50	18.00	18.50	19.00	19.50
	Repo rate (end rate)	3.50	4.00	4.00	4.25	4.50	4.50	4.75	5.00
	Lengthy global recession, global financial crisis - insufficient monetary and other policy supports to growth domestically and internationally. Depression in SA, unprecedented rand weakness. Nationalisation of private sector property (title deeds not transferred to individuals). SA rated single B from all three key agencies, with further rating downgrades eventually occurring into CCC grade and lower to D (default) as government finances deteriorate (debt projections elevate even further - fail to ever stabilise. Government borrows from increasingly wider sources as it sinks deeper into a debt trap), eventually include widespread services load shedding, strike action and civil unrest.								

Note: Event risk begins Q2.21. Source: Investec

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Expected Case: Exchange Rate forecasts												
	2021				2022				2023			
	Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
USD/ZAR	14.96	14.50	15.00	14.90	15.00	15.40	15.70	15.30	15.10	15.50	15.90	15.40
GBP/ZAR	20.50	19.86	20.55	20.71	21.30	22.02	22.77	21.88	21.44	21.86	22.26	21.56
EUR/ZAR	18.13	17.40	18.15	18.40	18.83	19.40	19.94	19.28	18.88	19.38	19.88	19.25
ZAR/JPY	6.96	7.24	7.00	7.01	6.93	6.75	6.69	6.86	7.02	6.84	6.67	6.88
CHFZAR	16.71	15.89	16.43	16.50	16.61	17.11	17.49	16.81	16.24	16.32	16.39	15.40
AUDZAR	11.53	11.17	11.63	11.62	11.85	12.17	12.25	11.63	11.33	11.63	11.93	11.55
GBP/USD	1.38	1.37	1.37	1.39	1.42	1.43	1.45	1.43	1.42	1.41	1.40	1.40
EUR/USD	1.21	1.20	1.21	1.24	1.26	1.26	1.27	1.26	1.25	1.25	1.25	1.25
USD/JPY	106	105	105	105	104	104	105	105	106	106	106	106

Note: averages, Source: Investec, Iress

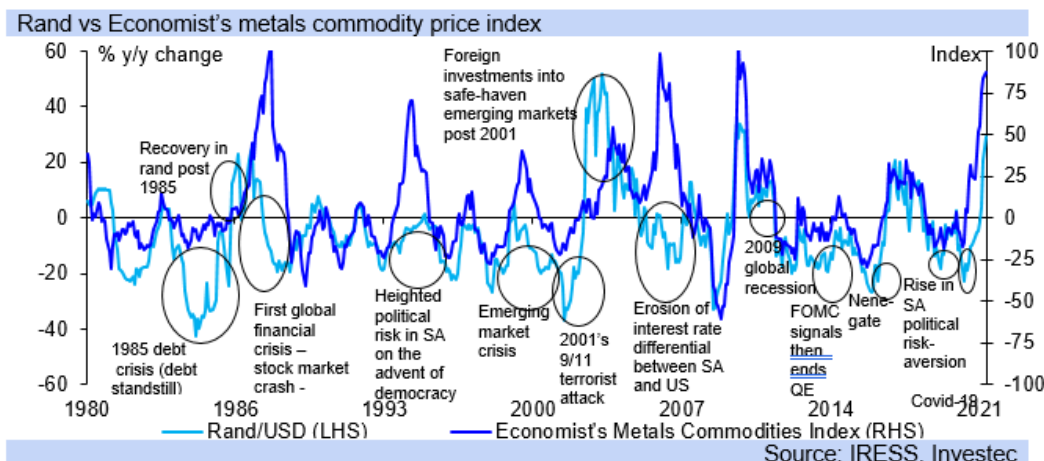
Lite Down Case: Exchange Rate forecasts												
	2021				2022				2023			
	Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
USD/ZAR	14.96	15.00	15.75	16.50	16.70	7.00	17.50	17.00	16.80	17.00	17.10	16.70
GBP/ZAR	20.64	20.55	21.58	22.94	23.71	10.01	25.38	24.31	23.86	23.97	23.94	23.38
EUR/ZAR	18.13	18.00	19.06	20.38	20.96	8.82	22.23	21.42	21.00	21.25	21.38	20.88
ZAR/JPY	7.09	7.00	6.67	6.33	6.23	14.86	6.00	6.18	6.31	6.24	6.20	6.35
CHFZAR	16.44	16.44	17.25	18.28	18.50	7.78	19.50	18.68	18.06	17.89	17.63	16.70
AUDZAR	11.53	11.55	12.21	12.87	13.19	5.53	13.65	12.92	12.60	12.75	12.83	12.53
GBP/USD	1.38	1.37	1.37	1.39	1.42	1.43	1.45	1.43	1.42	1.41	1.40	1.40
EUR/USD	1.21	1.20	1.21	1.24	1.26	1.26	1.27	1.26	1.25	1.25	1.25	1.25
USD/JPY	106	105	105	105	104	104	105	105	106	106	106	106

Note: averages, Source: Investec, Iress

Up Case: Exchange Rate forecasts												
	2021				2022				2023			
	Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
USD/ZAR	14.96	14.30	14.00	13.90	14.00	14.40	14.70	14.30	14.10	14.50	14.90	14.40
GBP/ZAR	20.50	19.59	19.18	19.32	19.88	20.59	21.32	20.45	20.02	20.45	20.86	20.16
EUR/ZAR	18.13	17.16	16.94	17.17	17.57	18.14	18.67	18.02	17.63	18.13	18.63	18.00
ZAR/JPY	6.96	7.34	7.50	7.52	7.43	7.22	7.14	7.34	7.52	7.31	7.11	7.36
CHFZAR	16.71	15.67	15.33	15.40	15.51	16.00	16.38	15.71	15.16	15.26	15.36	14.40
AUDZAR	11.53	11.01	10.85	10.84	11.06	11.38	11.47	10.87	10.58	10.88	11.18	10.80
GBP/USD	1.38	1.37	1.37	1.39	1.42	1.43	1.45	1.43	1.42	1.41	1.40	1.40
EUR/USD	1.21	1.20	1.21	1.24	1.26	1.26	1.27	1.26	1.25	1.25	1.25	1.25
USD/JPY	106	105	105	105	104	104	105	105	106	106	106	106

Note averages, Source: Investec, Iress

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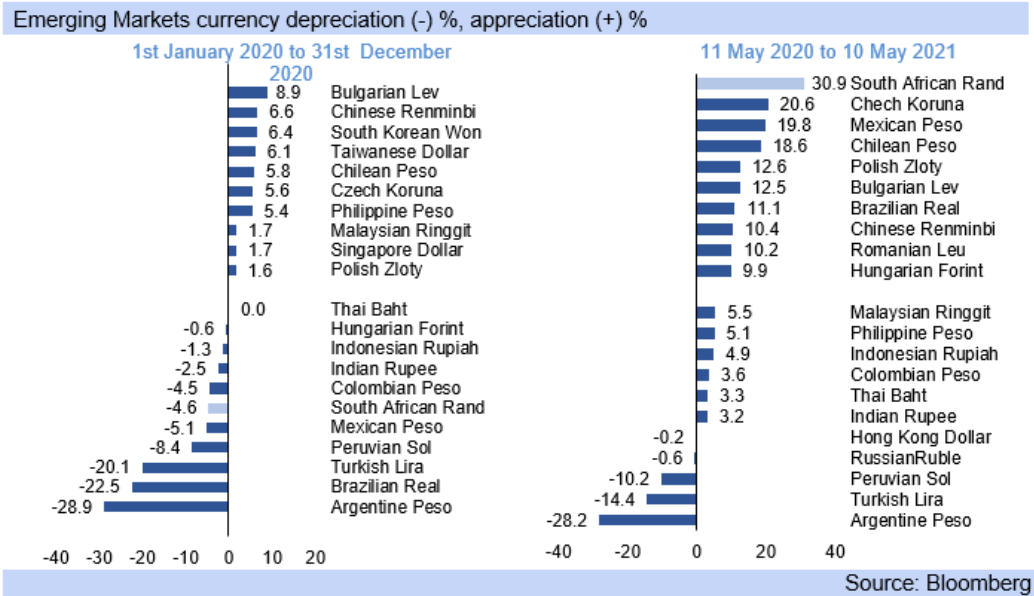
- With Moody's leaving South Africa's rating and outlook unchanged as expected, the rand received a further boost, moving through the R14.00/USD barrier this morning, and still supported by global market risk-on and the boom in many commodity prices.
- The rand also continues to benefit from the US dollar's weakness as well. Moody's did not update a number of ratings on the scheduled date, 7th May, including SA, Denmark and Italy. The rand strengthened to R13.96/USD on SA's outcome and is still near R14.00/USD.
- The rand was 31.7% stronger y/y today, also leading the EM currency ranker, both on a y/y comparison and since the start of 2021. The perceived improved political environment is also aiding the domestic currency as the clean up in government and the ruling party continues.
- Moody's is giving SA a window to repair its government finances after the blowout years of corruption of the 2010s decade which decimated the fiscus, before the spending pressures (and revenue collapse) from the COVID-19 lockdown last year worsened the situation.
- However, any indication that the SA government will cave in to severe pressures for higher wages from civil servants, parastatal employees and any other remuneration pressure on the fiscus would reduce SA's ability to avoid further credit rating downgrades.
- The rating agencies can adjust SA's rating between meetings just as easily as they choose not to provide any rating review when it is scheduled, and they are also able to move by more than one rating level, with SA not yet deemed able to move off Moody's negative outlook.
- With Moody's pausing to provide a grace period on SA, Fitch which also has SA on a negative outlook at BB- could do the same, and indeed we expect it will, and this has allowed us to slightly increase the probability weighting of the expected case and lower that of the lite down.

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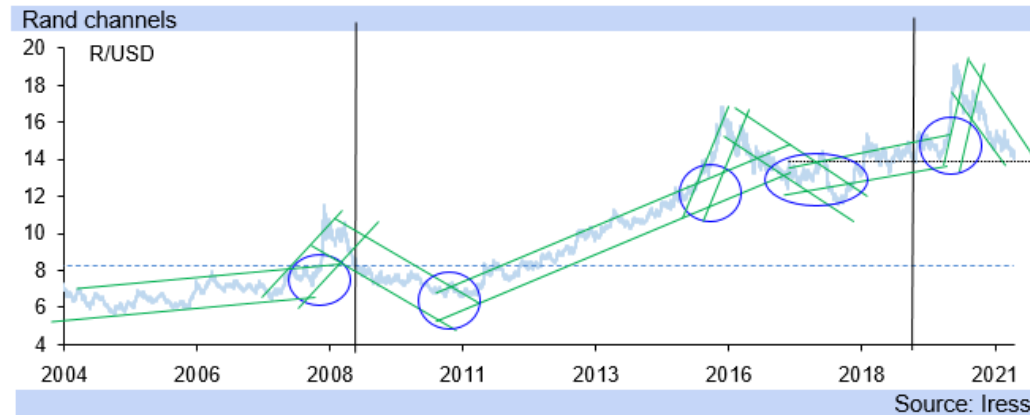
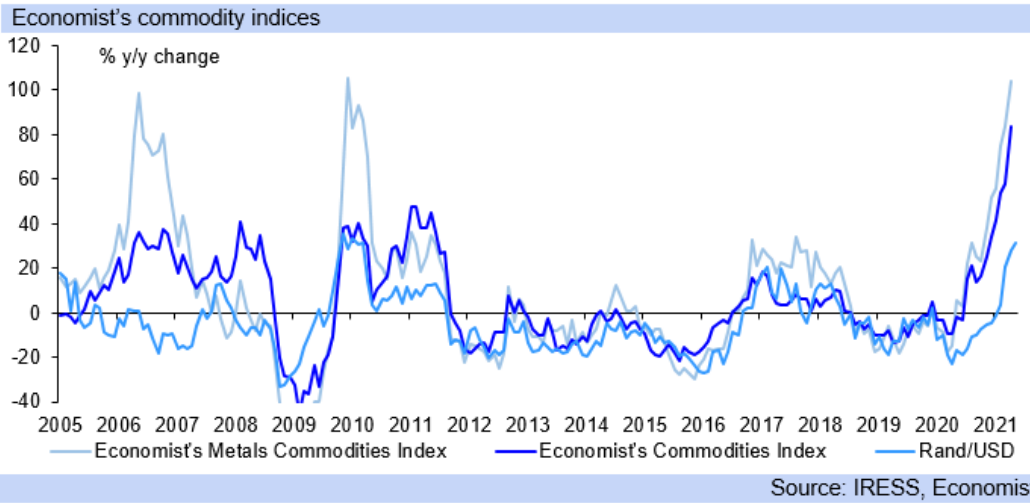


- However, for SA to increase its weighting of its up case probability it will need to show a much quicker trajectory for both its regulatory reform and vaccine rollouts, both of which are inadequate currently as they are proceeding at far too slow a pace.
- We have adjusted the probability weightings to pull them closer to the expected case, which is now at 50% and shows SA does not lose Moody's double B grade equivalent rating, while implementing regulatory reforms and quickening its vaccine rollout from the current pace.

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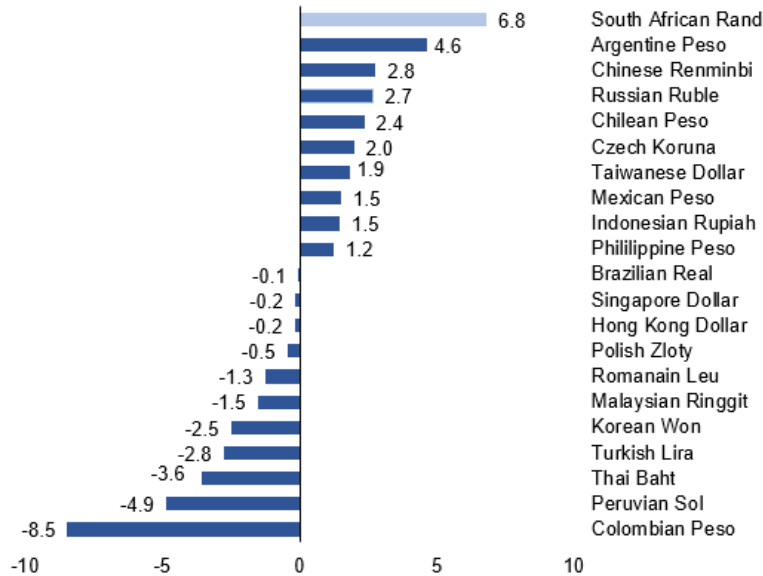
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Emerging Markets Carry Return – values as at 10 May 2021



Source: Bloomberg

USDZAR



Source: Iress

- That is, for a meaningful upwards revision to the up and extreme up scenario probabilities, SA will need to show faster economic growth ensuing from its reforms, as well continue its corruption eradication programme and make much greater strides in fiscal consolidation.

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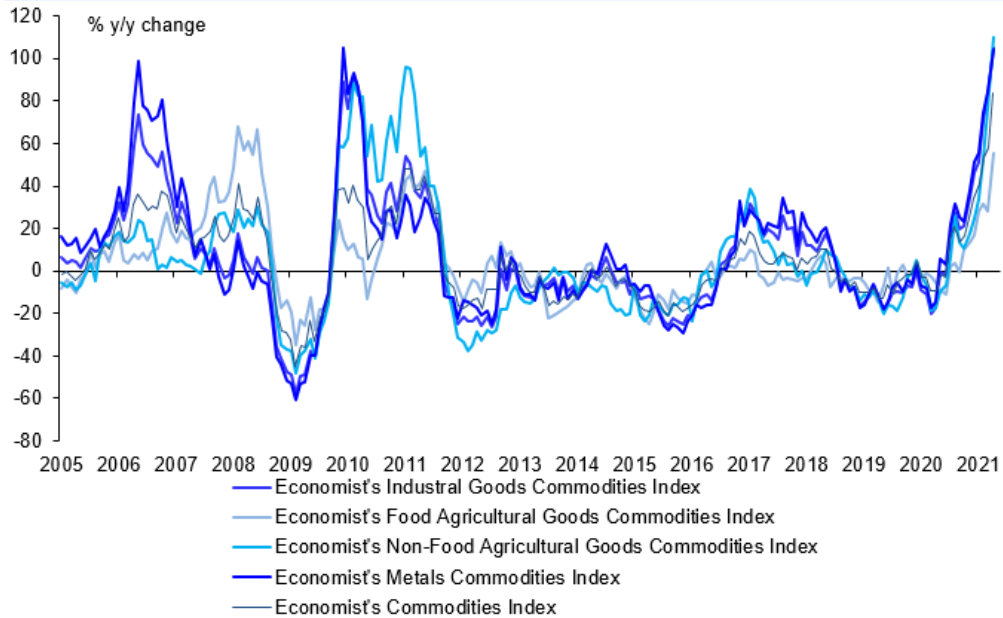


- The severe down case has also not seen a change to its probability weight either (neither have the up and extreme up cases), although the severe down case could see an adjustment if SA gets through its strike season without giving into union pressure and fiscal slippage.
- The rand's strength could persist this quarter, if not this year, although it is still beholden to many risks on both the up and down sides. While Moody's outcome gave it a fillip, and Fitch is also not expected to downgrade this month, nor S&P, the rand is still subject to volatility.
- That is, while global financial markets are in a risk on phase currently, market sentiment is focused on economic recovery and so stronger demand for commodities, the strong positive market outlook will not last indefinitely, or even consistently.
- The rand has battled to maintain its hold below the key resistance level of R14.00/USD today, with recent US jobs market data also showing the fragility and uncertainties of the global economic recovery, and this too will have an impact on risk assets.
- While the rand may average closer to R14.50/USD than R15.00/USD in Q2.21, the domestic currency is always at high risk of weakness, as its economic and fiscal fundamentals still have not improved dramatically, and risk aversion results in selling of risk assets.
- SA needs to continue to forge ahead with divesting the corrupt of key political and/or governmental positions, both to build political and policy stability in SA and to continue to underpin investor confidence in SA which was severely battered by the past decade.
- SA is also seeing modest inflation outcomes still, and the base effect in April is expected to be a once off adjustment which does not lead to the SARB hiking interest rates substantially, and instead is also expected to adopt a wait and see approach to inflation this year.
- While the domestic currency is in a strong position currently, it has not recouped as much against the crosses as it has against the USD. The rand was rebuffed today from R14.00/USD and eroding its weak fundamentals will put it in a stronger position for further strength.

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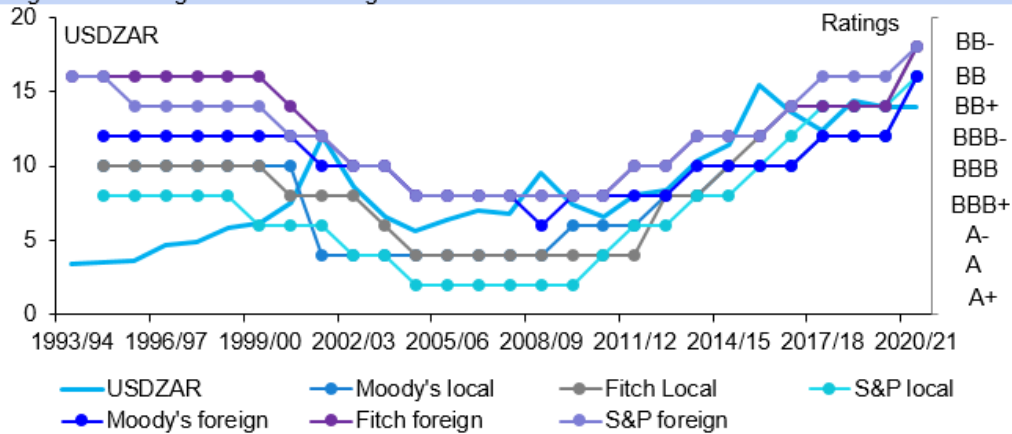


Economist's commodity indices



Source: IRESS, Economist

Long-term sovereign debt credit ratings vs USDZAR

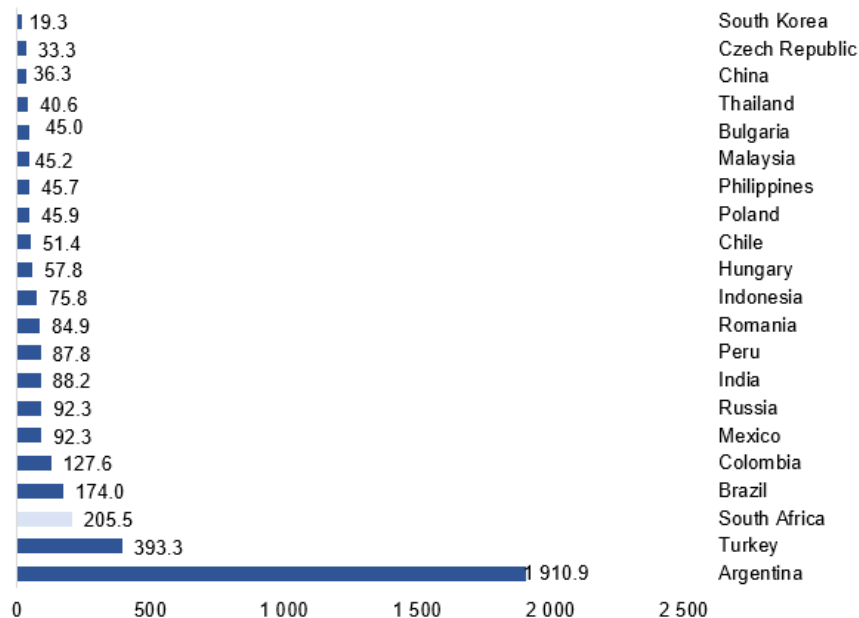


Source: Credit rating agencies, National treasury, Bloomberg

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Emerging Markets CDS Spreads – values as at 10 May 2021



Source: Bloomberg

Severe Down Case: Exchange Rate forecasts

	2021				2022				2023			
	Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
USD/ZAR	14.96	15.50	17.00	17.50	18.00	18.50	19.00	19.50	19.40	19.90	20.00	19.80
GBP/ZAR	20.64	21.23	23.29	24.33	25.56	26.46	27.55	27.89	27.55	28.06	28.00	27.72
EUR/ZAR	18.13	18.60	20.57	21.61	22.59	23.31	24.13	24.57	24.25	24.88	25.00	24.75
ZAR/JPY	7.09	6.77	6.18	5.97	5.78	5.62	5.53	5.38	5.46	5.33	5.30	5.35
CHF/ZAR	16.44	16.99	18.62	19.38	19.94	20.56	21.17	21.43	20.86	20.95	20.62	19.80
AUD/ZAR	11.53	11.94	13.18	13.65	14.22	14.62	14.82	14.82	14.55	14.93	15.00	14.85
GBP/USD	1.38	1.37	1.37	1.39	1.42	1.43	1.45	1.43	1.42	1.41	1.40	1.40
EUR/USD	1.21	1.20	1.21	1.24	1.26	1.26	1.27	1.26	1.25	1.25	1.25	1.25
USD/JPY	106	105	105	105	104	104	105	105	106	106	106	106

Note: averages, Source: Investec, Iress

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Extreme Up Case: Exchange Rate forecasts												
	2021				2022				2023			
	Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
USD/ZAR	14.96	14.10	13.50	13.40	13.10	12.90	12.70	12.50	12.30	12.70	13.10	12.60
GBP/ZAR	20.50	19.32	18.50	18.63	18.60	18.45	18.42	17.88	17.47	17.91	18.34	17.64
EUR/ZAR	18.13	16.92	16.34	16.55	16.44	16.25	16.13	15.75	15.38	15.88	16.38	15.75
ZAR/JPY	6.96	7.45	7.78	7.80	7.94	8.06	8.27	8.40	8.62	8.35	8.09	8.41
CHF/ZAR	16.71	15.45	14.78	14.84	14.51	14.33	14.15	13.74	13.23	13.37	13.51	12.60
AUD/ZAR	11.53	10.86	10.46	10.45	10.35	10.19	9.91	9.50	9.23	9.53	9.83	9.45
GBP/USD	1.38	1.37	1.37	1.39	1.42	1.43	1.45	1.43	1.42	1.41	1.40	1.40
EUR/USD	1.21	1.20	1.21	1.24	1.26	1.26	1.27	1.26	1.25	1.25	1.25	1.25
USD/JPY	106	105	105	105	104	104	105	105	106	106	106	106

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