

Rand Note

Monday 13 January 2020

Rand volatility persists ahead of material risks for SA in 2020, with the proposed changes to the constitution on EWC, Moody's country review and the Budget. Global events will also continue to materially impact the rand

Expected case: Exchange Rates forecasts	2020	2020	2020	2020	2021	2021	2021	2021	2022	2022	2022	2022
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
USD/ZAR	14.30	14.60	14.80	14.45	13.90	14.05	14.55	14.15	13.75	14.40	14.70	14.00
GBP/ZAR	18.78	19.07	19.26	19.21	18.77	19.25	20.29	19.73	19.17	20.08	20.50	19.52
EUR/ZAR	15.87	16.50	16.95	16.62	16.40	16.86	17.90	17.69	17.19	18.00	18.38	17.50
ZAR/JPY	7.45	7.26	7.13	7.23	7.63	7.54	7.29	7.49	7.71	7.43	7.28	7.64
ZARCHF	14.43	14.86	15.06	14.71	14.33	14.64	15.16	14.74	14.47	15.16	15.47	14.74
ZARAUD	9.72	9.78	9.99	9.83	9.73	10.26	10.91	11.04	10.73	11.23	11.47	10.92
GBP/USD	1.31	1.31	1.30	1.33	1.35	1.37	1.39	1.39	1.39	1.39	1.39	1.39
EUR/USD	1.11	1.13	1.15	1.15	1.18	1.20	1.23	1.25	1.25	1.25	1.25	1.25
USD/JPY	107	106	106	105	106	106	106	106	106	107	107	107

Note: averages, Source: IRESS, Investec

Lite Down case: Exchange Rates forecasts (domestic event)	2020	2020	2020	2020	2021	2021	2021	2021	2022	2022	2022	2022
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
USD/ZAR	15.50	16.50	16.80	16.10	15.80	15.90	15.70	15.30	15.00	15.10	15.05	14.80
GBP/ZAR	20.36	21.55	21.86	21.40	21.33	21.78	21.89	21.34	20.92	21.06	20.99	20.64
EUR/ZAR	17.21	18.65	19.24	18.52	18.64	19.08	19.31	19.13	18.75	18.88	18.81	18.50
ZAR/JPY	6.87	6.42	6.28	6.49	6.71	6.67	6.75	6.93	7.07	7.09	7.11	7.23
ZARCHF	15.64	16.80	17.10	16.38	16.29	16.56	16.35	15.94	15.79	15.89	15.84	15.58
ZARAUD	10.54	11.06	11.34	10.95	11.06	11.61	11.78	11.93	11.70	11.78	11.74	11.54
GBP/USD	1.31	1.31	1.30	1.33	1.35	1.37	1.39	1.39	1.39	1.39	1.39	1.39
EUR/USD	1.11	1.13	1.15	1.15	1.18	1.20	1.23	1.25	1.25	1.25	1.25	1.25
USD/JPY	107	106	106	105	106	106	106	106	106	107	107	107

Note: averages, Source: IRESS, Investec

- After seeing some recovery last week to R14.11/USD, R15.66/EUR and R18.38/GBP as the US and Iran evinced a desire for more peaceful relations, the rand weakened to R14.39/USD, R16.00/EUR and R18.72/GBP today, as the markets increasingly factor in SA's weakening growth outlook on supply-side issues. The rand is likely to remain volatile.
- This quarter also risks insufficient fiscal consolidation in the Budget (towards the end of February), a Moody's credit rating downgrade on 27th March 2020 and proposed changes to the constitution on EWC (Expropriation Without Compensation), with this year also likely seeing Parliament vote on a constitutional amendment.
- The President's advisory panel on EWC already contained a number of recommendations, including identifying and releasing state land for EWC, conducting a land audit and a land register for (land) donations, sub division of land already required by the state, tenure grants for certain existing occupiers and finalising restitution and labour tenant claims.
- This appears to dovetail with the previous indications from the ANC on expropriating state owned land without compensation, as well as EWC of abandoned properties and land occupied by labour tenants on farms, and proposed EWC of speculative property.
- The Presidential advisory panel's report also includes recommendations to reallocate water rights in conjunction with land allocation and splitting the budget between reforming the commercial sector vis-à-vis land reform for social considerations, as well as rooting out corruption.
- A two thirds majority is needed for a change to the constitution. All three key SA political parties differ on their stance to EWC, and consequently a proposed change to the existing wording in the constitution on EWC is not a certainty, due to these differences, when Parliament does vote on it.
- The rating agencies do not anticipate a marked negative impact on the economy from EWC, Moody's has said "(s)hould the expropriation remain selective and conditional to economic interests, such a reform would on balance be credit positive." In the interim however, lack of formal resolution of EWC adds to policy uncertainty, weakening confidence.

Economic Scenarios: note downside currency updates

		Q1.20	Q2.20	Q3.20	Q4.20	Q1.21	Q2.21	Q3.21	Q4.21
Extreme Up case 1%	USD/Rand (average)	11.50	10.30	9.50	8.60	7.90	7.60	7.40	7.10
	Repo rate (end rate)	6.00	6.00	5.75	5.75	5.50	5.50	5.25	5.25
<p>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.</p>									
Up case 7%	USD/Rand (average)	13.00	11.50	10.00	9.95	9.90	9.70	9.65	9.45
	Repo rate (end rate)	6.25	6.25	6.25	6.00	6.00	6.00	6.00	6.00
<p>Persistent growth of 3–5%, higher probability of extreme up case. Better governance, growth-creating reforms (structural constraints 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.</p>									
Base case 39%	USD/Rand (average)	14.30	14.60	14.80	14.45	13.90	14.05	14.55	14.15
	Repo rate (end rate)	6.50	6.25	6.25	6.25	6.25	6.25	6.25	6.25
<p>Annual growth approaches 2.0% y/y by 2021. Rising confidence and investment levels over the five-year forecast period. SA retains one investment grade (Moody's) rating on its local currency long-term sovereign debt in 2019 and 2020 on a negative outlook. Avoids severe global risk-off environment, neutral to global risk-on. Modestly strengthening global demand to trend growth. Limited impact of EWC (expropriation without compensation) to abandoned, unused, labour tenets and government land (individuals are new owners and receive title deeds) does not have a negative effect on economy.</p>									
Lite (domestic) Down case 38%	USD/Rand (average)	15.50	16.50	16.80	16.10	15.80	15.90	15.70	15.30
	Repo rate (end rate)	6.75	7.25	7.25	7.25	7.25	7.25	7.25	7.25
<p>SA is rated sub-investment grade by Moody's but substantial repair avoids further marked downgrades. Business confidence depressed, rand weakness, significant load shedding and weak investment growth until substantial repair effected. V shaped, credit-rating-downgrade related recession. However, a neutral to risk-on global financial market environment (the international environment is that of the base case) lessens the impact of the rating downgrade. Potentially combined with a modest expropriation of some private commercial sector property without compensation, with modest negative impact on economy.</p>									
Severe down case 15%	USD/Rand (average)	16.00	17.50	18.50	19.80	19.50	18.90	18.50	18.00
	Repo rate (end rate)	7.00	7.75	8.50	9.25	10.00	10.00	9.50	9.00
<p>Continued global sharp economic slowdown resulting in a global recession, on a marked escalation of the US-China trade war – may include a global financial crisis. May also include severe escalation of US Middle East military conflict. A significantly more severe recession occurs in SA than in the lite down case, marked rand weakness, may eventually include widespread services load shedding and strike action. Potentially combined with expropriation of private sector property (title deeds not transferred to individuals) without compensation – severe negative impact on economy. SA rated sub-investment grade from all three key agencies, with further rating downgrades occurring.</p>									

Note: Event risk begins Q1.20. Source: Investec, Iress historical data

- Moody's says SA's negative rating outlook "reflects the material risk that the government will not succeed in arresting the deterioration of its finances through a revival in economic growth and fiscal consolidation measures. The challenges the government faces are evident in the continued deterioration in South Africa's growth and public debt trends".
- While markets are believed to expect SA will see its ratings downgraded to sub-investment grade by Moody's, this does not mean there will be no, or even little market reaction. Countries that are ranked sub-investment grade tend to have more volatility in their financial indicators, and more severe reactions to negative events, particularly at the lower ratings.

- Moody's has said its negative outlook reflects that "government will absorb some of the costs related to capital support to Eskom and that tax elasticity will strengthen thanks to improved efficiency at ... (SARS) ... consistent with ... the 2019 medium-term budget policy statement (MTBPS), ... (which) shows debt rising to 73% of GDP by fiscal 2023".
- It said it "would .. change the rating outlook back to stable if the government's efforts to rein in spending, improve tax compliance and lift potential growth became increasingly likely to successfully stabilize debt ratios. In this respect, ... (it) will focus on the government's progress ... in delivering the additional fiscal adjustments the MTBPS identifies".
- However, government will also need to make significant progress "in addressing long-standing issues related to corruption and the financially weak SOEs sector, especially Eskom. If achieved, these would ultimately enhance business confidence and private sector investment prospects."
- Market expectations that Moody's will likely downgrade SA are also likely providing a drag on the rand, as are likely the weak performance of the economy in 2020 (see "Q1.20 Macro-economic outlook 2020–2025: South Africa sees its growth outlook sag further on lack of sufficient regulatory reforms and repair", 10th January 2020).
- We increased the tilt to the downside in the probabilities of the scenario table this year (see "Bond note", 8th January 2020). We would reduce the probability of the expected case further, to an even weighting with the lite down case, if insufficient progress is made in the Budget. SA risks the lite down case becoming the expected case.

Up case: Exchange Rates forecasts	2020	2020	2020	2020	2021	2021	2021	2021	2022	2022	2022	2022
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
USD/ZAR	13.00	11.50	10.00	9.95	9.90	9.70	9.65	9.45	9.30	9.15	9.00	9.20
GBP/ZAR	17.08	15.02	13.01	13.23	13.37	13.29	13.46	13.18	12.97	12.76	12.55	12.83
EUR/ZAR	14.43	13.00	11.45	11.44	11.68	11.64	11.87	11.81	11.63	11.44	11.25	11.50
ZAR/JPY	8.19	9.22	10.55	10.50	10.71	10.93	10.98	11.22	11.40	11.69	11.89	11.63
ZARCHF	13.12	11.71	10.18	10.13	10.21	10.10	10.05	9.84	9.79	9.63	9.47	9.68
ZARAUD	8.84	7.71	6.75	6.77	6.93	7.08	7.24	7.37	7.25	7.14	7.02	7.18
GBP/USD	1.31	1.31	1.30	1.33	1.35	1.37	1.39	1.39	1.39	1.39	1.39	1.39
EUR/USD	1.11	1.13	1.15	1.15	1.18	1.20	1.23	1.25	1.25	1.25	1.25	1.25
USD/JPY	107	106	106	105	106	106	106	106	106	107	107	107

Note: averages, Source: IRESS, Investec

Extreme Up case: Exchange Rates forecasts	2020	2020	2020	2020	2021	2021	2021	2021	2022	2022	2022	2022
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
USD/ZAR	11.50	10.30	9.50	8.60	7.90	7.60	7.40	7.10	6.95	6.75	6.95	7.15
GBP/ZAR	15.11	13.46	12.36	11.43	10.67	10.41	10.32	9.90	9.69	9.41	9.69	9.97
EUR/ZAR	12.77	11.64	10.88	9.89	9.32	9.12	9.10	8.88	8.69	8.44	8.69	8.94
ZAR/JPY	9.26	10.29	11.11	12.15	13.42	13.95	14.32	14.93	15.25	15.85	15.40	14.97
ZARCHF	11.60	10.49	9.67	8.75	8.14	7.92	7.71	7.40	7.32	7.11	7.32	7.53
ZARAUD	7.82	6.90	6.41	5.85	5.53	5.55	5.55	5.54	5.42	5.27	5.42	5.58
GBP/USD	1.31	1.31	1.30	1.33	1.35	1.37	1.39	1.39	1.39	1.39	1.39	1.39
EUR/USD	1.11	1.13	1.15	1.15	1.18	1.20	1.23	1.25	1.25	1.25	1.25	1.25
USD/JPY	107	106	106	105	106	106	106	106	106	107	107	107

Note: averages, Source: IRESS, Investec

Severe Down case: Exchange Rates forecasts (global event/s)	2020	2020	2020	2020	2021	2021	2021	2021	2022	2022	2022	2022
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
USD/ZAR	16.00	17.50	18.50	19.80	19.50	18.90	18.50	18.00	17.50	17.00	16.60	16.25
GBP/ZAR	21.02	22.86	24.07	26.32	26.33	25.89	25.80	25.10	24.40	23.71	23.15	22.66
EUR/ZAR	17.76	19.78	21.18	22.77	23.01	22.68	22.76	22.50	21.88	21.25	20.75	20.31
ZAR/JPY	6.66	6.06	5.70	5.28	5.44	5.61	5.73	5.89	6.06	6.29	6.45	6.58
ZARCHF	16.15	17.82	18.83	20.15	20.10	19.69	19.27	18.75	18.42	17.89	17.47	17.11
ZARAUD	10.88	11.73	12.49	13.46	13.65	13.80	13.88	14.04	13.65	13.26	12.95	12.68
GBP/USD	1.31	1.31	1.30	1.33	1.35	1.37	1.39	1.39	1.39	1.39	1.39	1.39
EUR/USD	1.11	1.13	1.15	1.15	1.18	1.20	1.23	1.25	1.25	1.25	1.25	1.25
USD/JPY	107	106	106	105	106	106	106	106	106	107	107	107

Note: averages, Source: IRESS, Investec

