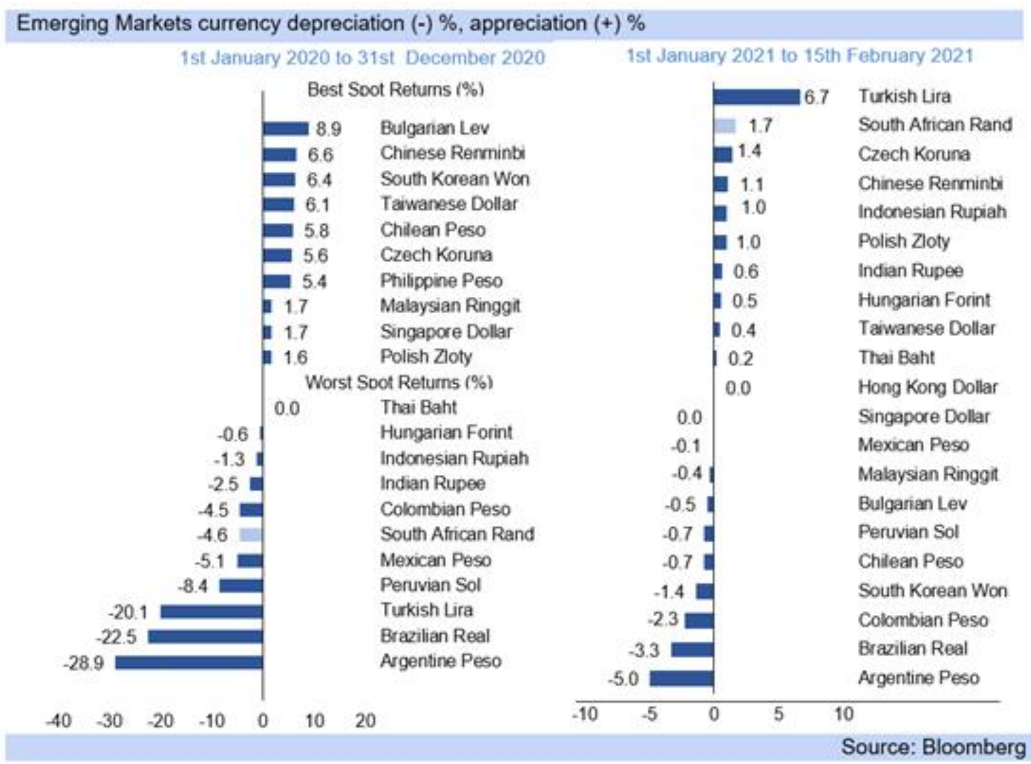
SA Economics

Monday 15 February 2021

Rand note: the rand is currently reflecting the up case of strong global financial market confidence of a quick rebound from the COVID-19 pandemic, with low investor risk aversion (risk-on), but not reflecting SA's fundamentals



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Economic Scenarios: extreme up case sees some rand adjustment

		Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22
Extreme Up case 1%	USD/Rand (average)	14.25	14.00	13.50	13.25	13.00	12.75	12.75	12.50
	Repo rate (end rate)	3.00	3.00	3.00	3.00	3.00	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.

		Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22
Up case 2%	USD/Rand (average)	14.50	14.50	14.50	14.00	13.50	14.00	14.50	13.50
	Repo rate (end rate)	3.25	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.

		Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22
Base case 44%	USD/Rand (average)	15.00	15.40	15.50	15.20	15.30	15.70	15.90	15.60
	Repo rate (end rate)	3.50	3.50	3.50	3.75	3.75	4.00	4.50	4.50

Recovery from the sharp global economic slowdown – sufficient global and domestic monetary and other policy supports to growth and financial markets occur and risk sentiment stabilises then improves. South Africa exits recession in Q3.20. 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.

		Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22
Lite (domestic) Down case 44%	USD/Rand (average)	16.30	16.50	17.00	16.80	16.50	17.00	17.50	17.00
	Repo rate (end rate)	3.75	3.75	3.75	4.00	4.00	4.25	4.75	4.75

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. More severe recession in SA than in the expected case. Expropriation of some private commercial sector property without compensation, with some small 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 CCC grade.

		Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22
Severe down case 9%	USD/Rand (average)	16.50	17.00	17.50	18.00	17.50	17.80	18.00	17.80
	Repo rate (end rate)	4.00	4.00	4.00	4.50	4.50	4.50	5.00	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 Q1.21. Source: Investec

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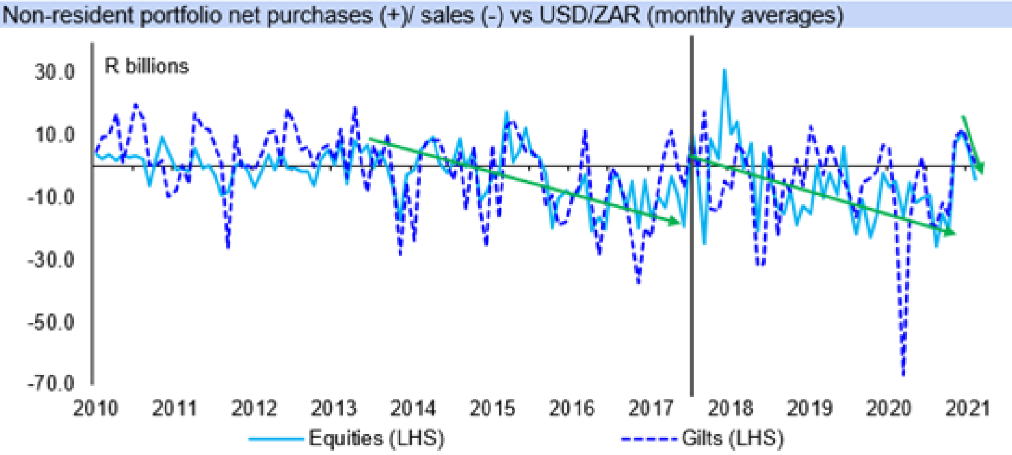
Extreme Up Case: Exchange Rate forecasts	2021				2022				2023			
	Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
USD/ZAR	14.25	14.00	13.50	13.25	13.00	12.75	12.75	12.50	12.50	12.25	12.00	11.75
GBP/ZAR	19.24	18.90	18.50	18.42	18.46	17.98	18.11	17.63	17.50	17.15	16.80	16.45
EUR/ZAR	17.27	16.80	16.34	16.36	16.32	15.81	15.68	15.25	15.25	15.07	14.88	14.57
ZAR/JPY	7.31	7.50	7.78	7.89	8.08	8.24	8.24	8.40	8.48	8.65	8.83	9.02
CHFZAR	15.92	15.34	14.78	14.56	14.29	13.86	13.42	12.50	12.50	12.25	12.00	11.75
AUDZAR	10.83	10.64	10.13	9.94	9.75	9.44	9.44	9.25	9.38	9.19	9.00	8.81
GBP/USD	1.35	1.35	1.37	1.39	1.42	1.41	1.42	1.41	1.40	1.40	1.40	1.40
EUR/USD	1.21	1.20	1.21	1.24	1.26	1.24	1.23	1.22	1.22	1.23	1.24	1.24
USD/JPY	104	105	105	105	105	105	105	105	106	106	106	106

Note: averages, Source: Investec, Iress

Non-resident portfolio net purchases (+)/ sales (-) vs USD/ZAR (monthly averages)



Source: Iress, Investec

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	14.50	14.50	14.50	14.00	13.50	14.00	14.50	13.50	13.00	13.75	14.00	13.50
GBP/ZAR	19.58	19.57	19.87	19.46	19.17	19.74	20.59	19.04	18.20	19.25	19.60	18.90
EUR/ZAR	17.57	17.40	17.55	17.29	16.94	17.36	17.84	16.47	15.86	16.91	17.36	16.74
ZAR/JPY	7.18	7.24	7.24	7.46	7.78	7.50	7.24	7.78	8.15	7.71	7.57	7.85
CHFZAR	16.19	15.89	15.88	15.38	14.84	15.22	15.26	13.50	13.00	13.75	14.00	13.50
AUDZAR	11.02	11.02	10.88	10.50	10.13	10.36	10.73	9.99	9.75	10.31	10.50	10.13
GBP/USD	1.35	1.35	1.37	1.39	1.42	1.41	1.42	1.41	1.40	1.40	1.40	1.40
EUR/USD	1.21	1.20	1.21	1.24	1.26	1.24	1.23	1.22	1.22	1.23	1.24	1.24
USD/JPY	104	105	105	105	105	105	105	105	106	106	106	106

Note averages, Source: Investec, Iress

- The rand reached R14.42/USD today, powering through key resistance levels, and so far averages R15.02/USD this quarter, with Q1.21 around the halfway mark. The US dollar

has weakened, as safe haven flows diminish, while EM investor appetite is particularly strong.

- The rand has seen a marked bout of strength over the past week as global financial markets' risk aversion levels have been eroded, and the rand remains highly sensitive to market movements given high risk status of its portfolio assets.
- Currently, foreigners have increased their net purchases of SA's bonds by R8.0bn so far this year, after purchasing R5.1bn on a net basis in Q4.20, but having sold off a massive -R133.8bn net of purchases over Q2.20 and Q3.20 combined.
- To date this year, foreigners sold off -R2.6bn worth of SA equities on a net basis, after selling -R1.9bn in Q4.20 also net of purchases, -R49.8bn in Q3.20 and -R26.8bn in Q2.20, following on from -R27.1bn in Q1.20 as foreigners continue to dump SA equities.
- However, this year, particularly over February, such has been the degree of extreme risk-on, that the rand is now the second best performing currency since the start of this year, stronger by almost 2% against the USD, although its rating peer Turkey is up 6.8% in the same period.
- That is, Fitch rates both Brazil and Turkey at the same level (BB-) as SA on its long-term foreign currency sovereign debt rating, and such is the level of exacerbated risk-on that SA and Turkey's currencies are key gainers, both of which have CDS spreads of 200-300bps.
- While a lot of market exuberance is being built into investor appetite presently, the rand could strengthen somewhat further, but at some point the reality of domestic weak economic fundamentals will become a market consideration again.
- The rand is also expected to have seen some strength on the outcome of the ANC's NEC meeting this weekend, with reports that proven corrupt ANC members must step aside, a blow to factions opposing the Ramaphosa Presidency and its drive to eradicate state capture.
- ANC factions/individuals opposing Ramaphosa, and hoping to further/also benefit from highly lucrative corruption in dealing with the state/SOEs in the past, have been a key stumbling block to substantially strengthening SA's economic growth and employment.

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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	15.00	15.40	15.50	15.20	15.30	15.70	15.90	15.60	15.40	15.80	16.20	15.70
GBP/ZAR	20.26	20.79	21.24	21.13	21.72	22.14	22.58	22.00	21.56	22.12	22.68	21.98
EUR/ZAR	18.18	18.48	18.76	18.77	19.20	19.47	19.56	19.03	18.79	19.43	20.09	19.47
ZAR/JPY	6.94	6.82	6.77	6.88	6.86	6.69	6.60	6.73	6.88	6.71	6.54	6.75
CHFZAR	16.75	16.88	16.97	16.70	16.81	17.07	16.74	15.60	15.40	15.80	16.20	15.70
AUDZAR	11.40	11.70	11.63	11.40	11.48	11.62	11.77	11.54	11.55	11.85	12.15	11.78
GBP/USD	1.35	1.35	1.37	1.39	1.42	1.41	1.42	1.41	1.40	1.40	1.40	1.40
EUR/USD	1.21	1.20	1.21	1.24	1.26	1.24	1.23	1.22	1.22	1.23	1.24	1.24
USD/JPY	104	105	105	105	105	105	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	16.30	16.50	17.00	16.75	16.50	17.00	17.50	17.00	17.25	17.50	18.00	17.50
GBP/ZAR	22.01	22.27	23.29	23.28	23.43	23.97	24.85	23.97	24.15	24.50	25.20	24.50
EUR/ZAR	19.75	19.80	20.57	20.69	20.71	21.08	21.53	20.74	21.05	21.53	22.32	21.70
ZAR/JPY	6.39	6.36	6.18	6.24	6.36	6.18	6.00	6.18	6.14	6.06	5.89	6.06
CHFZAR	18.21	18.08	18.62	18.41	18.13	18.48	18.42	17.00	17.25	17.50	18.00	17.50
AUDZAR	12.39	12.54	12.75	12.56	12.38	12.58	12.95	12.58	12.94	13.13	13.50	13.13
GBP/USD	1.35	1.35	1.37	1.39	1.42	1.41	1.42	1.41	1.40	1.40	1.40	1.40
EUR/USD	1.21	1.20	1.21	1.24	1.26	1.24	1.23	1.22	1.22	1.23	1.24	1.24
USD/JPY	104	105	105	105	105	105	105	105	106	106	106	106
Note: averages, Source: Investec, Iress												

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	16.50	17.00	17.50	18.00	17.50	17.75	18.00	17.80	17.80	18.00	18.50	18.00
GBP/ZAR	22.28	22.95	23.98	25.02	24.85	25.03	25.56	25.10	24.92	25.20	25.90	25.20
EUR/ZAR	20.00	20.40	21.18	22.23	21.96	22.01	22.14	21.72	21.72	22.14	22.94	22.32
ZAR/JPY	6.31	6.18	6.00	5.81	6.00	5.92	5.83	5.90	5.96	5.89	5.73	5.89
CHFZAR	18.43	18.63	19.16	19.78	19.23	19.29	18.95	17.80	17.80	18.00	18.50	18.00
AUDZAR	12.54	12.92	13.13	13.50	13.13	13.14	13.32	13.17	13.35	13.50	13.88	13.50
GBP/USD	1.35	1.35	1.37	1.39	1.42	1.41	1.42	1.41	1.40	1.40	1.40	1.40
EUR/USD	1.21	1.20	1.21	1.24	1.26	1.24	1.23	1.22	1.22	1.23	1.24	1.24
USD/JPY	104	105	105	105	105	105	105	105	106	106	106	106
Note: averages, Source: Investec, Iress												

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Rating tier definitions

Moody's Long-term	Moody's Short-term	S&P Long-term	S&P Short-term	Fitch Long-term	Fitch Short-term	Equivalent to SVO Designations NAIC	Rating description	
Aaa		AAA		AAA			Prime	
Aa1		AA+	A-1	AA+	F1+			
Aa2		AA		AA			High grade	
	P-1					1		
A1		A+		A+				
A2		A	A-1	A	F1		Upper medium grade	Investment-grade
A3		A-		A-				
	P-2		A-2		F2			
Baa1		BBB+		BBB+				
Baa2	P-3	BBB		BBB		2	Lower medium grade	
Baa3		BBB-	A-3	BBB-	F3			
Ba1		BB+		BB+				
Ba2		BB		BB		3	Non-investment grade speculative	
Ba3		BB-		BB-				
B1		B+	B	B+	B			
B2		B		B		4	Highly speculative	
B3		B-		B-				
Caa1	Not prime	CCC+					Substantial risks	Non-investment grade AKA high-yield bonds AKA junk bonds
Caa2		CCC				5	Extremely speculative	
Caa3		CCC-	C	CCC	C			
Ca		CC					Default imminent with little prospect for recover	
		C						
C				DDD		6		
/		D	/	DD	/		In default	
				D				

Source: Wikipedia

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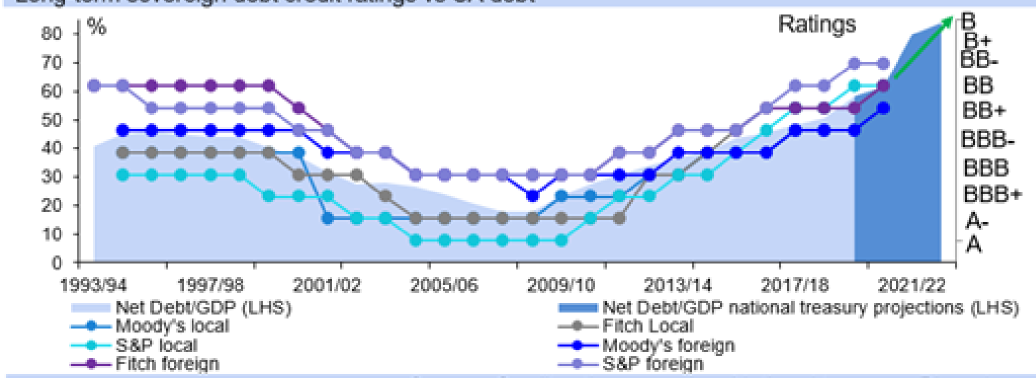

Long-term sovereign debt credit ratings vs SA debt

Source: Credit rating agencies, National treasury, Bloomberg

- Markets are cheering the clean-up of the state/parastatals, with hopes that this will persist into a second term with Ramaphosa. The slow pace of reforms have disappointed investors but markets hope these could now quicken on a strengthening in Ramaphosa's position.
- In the past, market friendly reforms aimed at boosting economic growth have even been labelled "neo-liberalism" by factions opposing efforts to eradicate corruption and state capture as they seek to undermine/prevent economic successes for the Ramaphosa Presidency.
- Markets were doubtless cheered today by President Ramaphosa stating in his weekly email that "(u)nless we can bring our national debt down to sustainable levels no meaningful economic recovery will be possible."
- Adding "(w)e need to make sure that these relief measures provide a firm foundation for a broader recovery without driving the country deeper into debt." "As government, hard decisions on public spending will need to be made and implemented this year."
- While markets are very keen to hear these sentiments, and most likely debt projections will be lowered slightly, as opposed to being increased once again, it will not be peaking below 60% of GDP (seen as sustainable for an EM), or even below 80%.)
- The President adds, "(i)mportant as these relief measures are now, we will not be able to sustain them indefinitely." "Our national consciousness must now move beyond the realm of relief into that of recovery".
- The rand is also likely strengthening ahead of the Budget next week, 24th February, as markets anticipate a favourable outcome, but the domestic currency is at risk of weakening thereafter as investors price improvement in ahead of the Budget Speech.
- However, higher interest rates in SA, along with Turkey, increase returns, and this is a key incentive for yield (interest rate) seekers currently, with SA deposit rates at 5.5% and Turkey 16.4% (Bloomberg), fuelling investor appetite in the global low rate environment.

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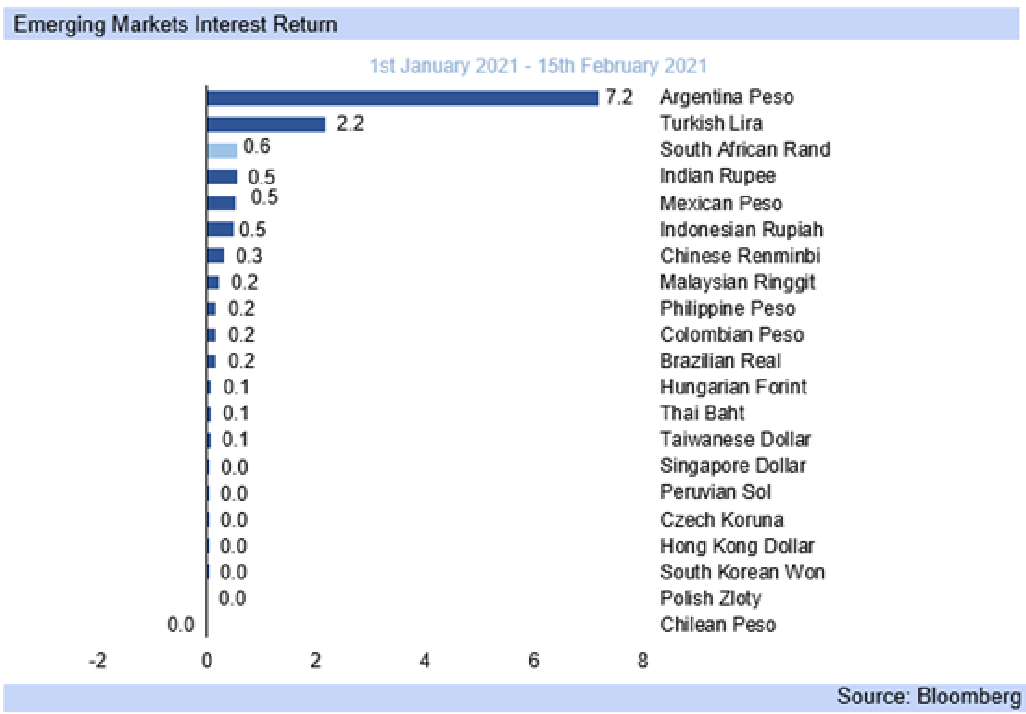
- Such temporary flows are characterised by their extreme short-termism however, retreating rapidly in periods of marked risk-off in global financial markets, and driving volatility, with the domestic currency likely to remain highly volatile in the foreseeable future.



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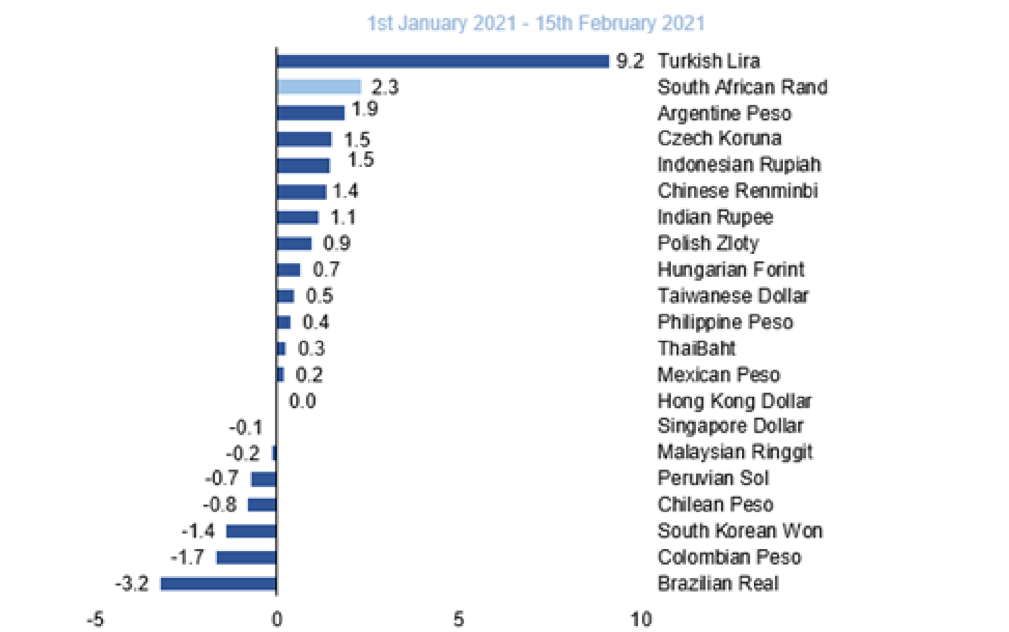
Emerging Markets Carry Return



Source: Bloomberg

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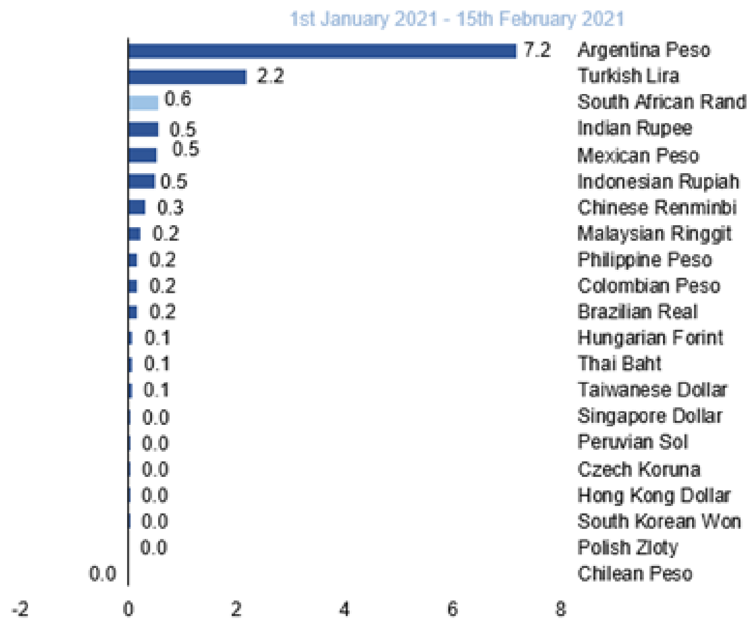
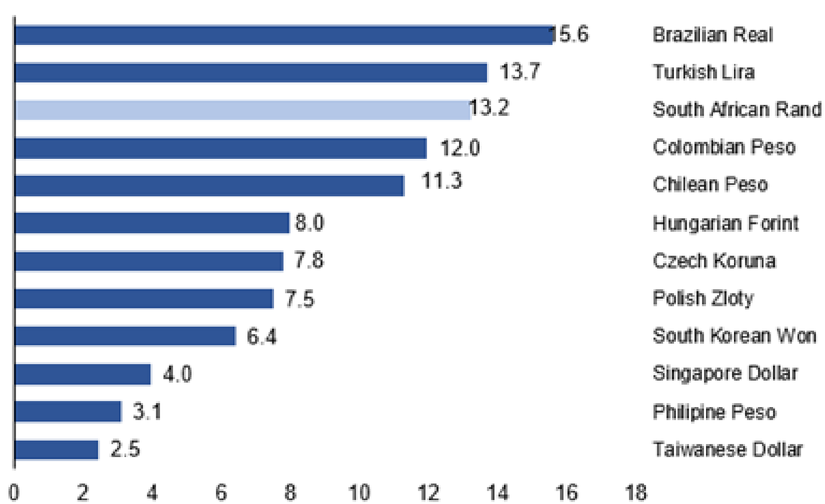
Emerging Markets Interest Return



Source: Bloomberg

Emerging Markets Implied Volatilities – values as of 15 February 2021



Source: Bloomberg

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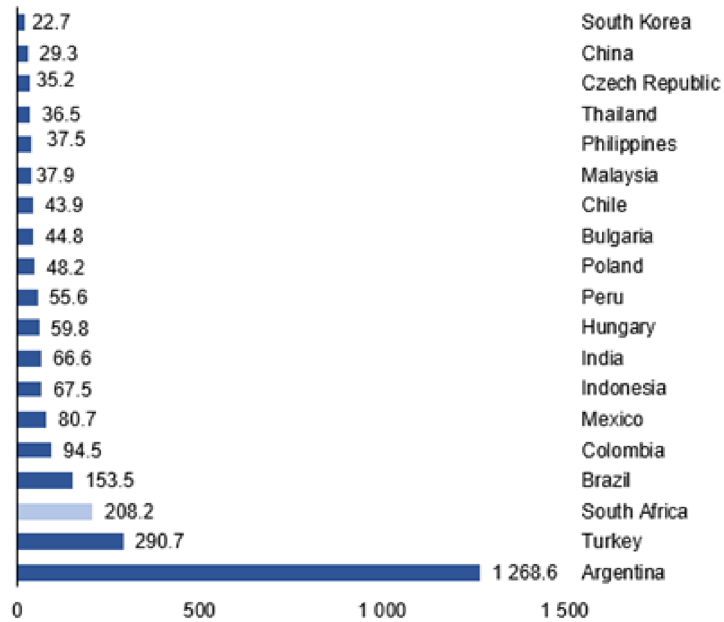
Emerging Markets CDS Spreads - as at 15th February 2021



Source: Bloomberg