

Rand Note

Monday 25 November 2019

Rand reaches the Q4.19 forecast on a level basis (but not as an average for the quarter), shrugging off S&P's negative outlook as progress on a US-Sino trade deal is seen to support global growth prospects in 2020

Expected case: Exchange Rates forecasts	2019 Q1	2019 Q2	2019 Q3	2019 Q4	2020 Q1	2020 Q2	2020 Q3	2020 Q4	2021 Q1	2021 Q2	2021 Q3	2021 Q4
USD/ZAR	14.01	14.38	14.69	14.65	14.15	14.45	14.65	14.00	13.75	14.05	14.55	14.15
GBP/ZAR	18.25	18.48	18.10	18.39	18.16	18.66	19.06	18.30	18.56	19.25	20.29	19.73
EUR/ZAR	15.92	16.16	16.33	16.04	15.71	16.33	16.77	16.10	16.23	16.86	17.90	17.69
ZAR/JPY	7.86	7.65	7.31	7.34	7.53	7.34	7.20	7.46	7.71	7.54	7.29	7.49
ZARCHF	14.06	14.33	14.90	14.69	14.28	14.71	14.91	14.25	14.18	14.64	15.16	14.74
ZARAUD	9.98	10.07	10.07	9.99	9.83	10.19	10.55	10.22	10.45	10.82	11.35	11.04
GBP/USD	1.30	1.29	1.23	1.26	1.28	1.29	1.30	1.31	1.35	1.37	1.39	1.39
EUR/USD	1.14	1.12	1.11	1.10	1.11	1.13	1.15	1.15	1.18	1.20	1.23	1.25
USD/JPY	110	110	107	108	107	106	106	105	106	106	106	106

Note: averages, Source: IRESS, Investec

Lite Down case: Exchange Rates forecasts	2019 Q1	2019 Q2	2019 Q3	2019 Q4	2020 Q1	2020 Q2	2020 Q3	2020 Q4	2021 Q1	2021 Q2	2021 Q3	2021 Q4
USD/ZAR	14.01	14.38	14.69	15.80	16.50	16.30	15.50	15.15	15.10	15.05	15.00	15.05
GBP/ZAR	18.25	18.48	18.10	19.83	21.17	21.05	20.17	19.80	20.39	20.62	20.92	20.99
EUR/ZAR	15.92	16.16	16.33	17.30	18.32	18.42	17.75	17.42	17.82	18.06	18.45	18.81
ZAR/JPY	7.86	7.65	7.31	6.81	6.45	6.50	6.81	6.90	7.02	7.04	7.07	7.04
ZARCHF	14.06	14.33	14.90	15.84	16.65	16.59	15.78	15.42	15.57	15.68	15.63	15.68
ZARAUD	9.98	10.07	10.07	10.78	11.47	11.49	11.16	11.06	11.48	11.59	11.70	11.74
GBP/USD	1.30	1.29	1.23	1.26	1.28	1.29	1.30	1.31	1.35	1.37	1.39	1.39
EUR/USD	1.14	1.12	1.11	1.10	1.11	1.13	1.15	1.15	1.18	1.20	1.23	1.25
USD/JPY	110	110	107	108	107	106	106	105	106	106	106	106

Note: averages, Source: IRESS, Investec

- The rand has strengthened to R14.65/USD, R16.16/EUR and R18.83/GBP today - at the Q4.19 forecast on a level basis against the US dollar, but not on an average to date basis. Continued progress on US-Sino trade negotiations has seen EM currencies benefitting as global growth fears wane somewhat, causing risk aversion to do so too.
- With an initial trade deal, or phase-one, between the US and China recently indicated as likely to be signed before the end of the year, fears of a trade-war led global recession in the first half of 2020 have been reduced somewhat, with recent data from the US industrial and services side showing some improvement, adding to the positive market mood.
- However further trade agreement, or phase-two, is seen as harder to achieve, centring around all the US's concerns on intellectual property protection, privacy and security. Phase one essentially focussed on increased Chinese purchases of US agricultural products and only some, limited intellectual property agreement in exchange for delaying tariffs.
- Nevertheless, as market optimism has improved somewhat, safehaven flows have waned and the search for yield heightened, given the relatively low rates of advanced economies and monetary easing more likely globally than tightening. SA's government debt offers attractive returns, with the liquidity of its market adding to the draw.
- SA's benchmark bond yield runs above 8% while CPI inflation has dropped to 3.7%, with inflation declining, likely on a structural basis too (see "CPI outlook (resend): the structural rate of inflation is likely declining, if it persists it would support lower interest rates, but only if Moody's outlook returns to stable", 21st November 2019, website address below).
- Standard & Poor's has dropped SA's outlook on its long-term government debt from stable to negative this month, alongside Moody's, stating that "(t)he negative outlook indicates that South Africa's debt metrics are rapidly worsening as a result of the country's low GDP growth and high fiscal deficits."
- With more key rating agencies warning of approaching credit rating downgrades for SA, and Fitch also likely to follow suite with a negative outlook for SA as well, the rand has made less gains than it could in the absence of these rating downgrade threats. The Q4.19 foreign exchange rate forecasts are likely to be weakened somewhat at month end.

Extreme Up case: Exchange Rates forecasts	2019	2019	2019	2019	2020	2020	2020	2020	2021	2021	2021	2021
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
USD/ZAR	14.01	14.38	14.69	11.50	10.30	9.50	8.60	7.90	7.60	7.40	7.10	6.95
GBP/ZAR	18.25	18.48	18.10	14.44	13.22	12.27	11.19	10.32	10.26	10.14	9.90	9.69
EUR/ZAR	15.92	16.16	16.33	12.59	11.43	10.74	9.85	9.09	8.97	8.88	8.73	8.69
ZAR/JPY	7.86	7.65	7.31	9.35	10.34	11.16	12.27	13.23	13.95	14.32	14.93	15.25
ZARCHF	14.06	14.33	14.90	11.53	10.39	9.67	8.75	8.04	7.84	7.71	7.40	7.24
ZARAUD	9.98	10.07	10.07	7.85	7.16	6.70	6.19	5.77	5.78	5.70	5.54	5.42
GBP/USD	1.30	1.29	1.23	1.26	1.28	1.29	1.30	1.31	1.35	1.37	1.39	1.39
EUR/USD	1.14	1.12	1.11	1.10	1.11	1.13	1.15	1.15	1.18	1.20	1.23	1.25
USD/JPY	110	110	107	108	107	106	106	105	106	106	106	106

Note: averages, Source: IRESS, Investec

Severe Down case: Exchange Rates forecasts	2019	2019	2019	2019	2020	2020	2020	2020	2021	2021	2021	2021
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
USD/ZAR	14.01	14.38	14.69	16.10	18.50	19.50	20.00	19.25	18.70	18.00	17.50	16.75
GBP/ZAR	18.25	18.48	18.10	20.21	23.74	25.18	26.02	25.16	25.25	24.66	24.40	23.36
EUR/ZAR	15.92	16.16	16.33	17.63	20.54	22.04	22.90	22.14	22.07	21.60	21.53	20.94
ZAR/JPY	7.86	7.65	7.31	6.68	5.76	5.44	5.28	5.43	5.67	5.89	6.06	6.33
ZARCHF	14.06	14.33	14.90	16.14	18.67	19.85	20.36	19.59	19.28	18.75	18.23	17.45
ZARAUD	9.98	10.07	10.07	10.98	12.86	13.75	14.40	14.05	14.21	13.86	13.65	13.07
GBP/USD	1.30	1.29	1.23	1.26	1.28	1.29	1.30	1.31	1.35	1.37	1.39	1.39
EUR/USD	1.14	1.12	1.11	1.10	1.11	1.13	1.15	1.15	1.18	1.20	1.23	1.25
USD/JPY	110	110	107	108	107	106	106	105	106	106	106	106

Note: averages, Source: IRESS, Investec

Up case: Exchange Rates forecasts	2019	2019	2019	2019	2020	2020	2020	2020	2021	2021	2021	2021
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
USD/ZAR	14.01	14.38	14.69	13.00	11.50	10.00	9.95	9.90	9.70	9.65	9.45	9.30
GBP/ZAR	18.25	18.48	18.10	16.32	14.76	12.91	12.95	12.94	13.10	13.22	13.18	12.97
EUR/ZAR	15.92	16.16	16.33	14.24	12.77	11.30	11.39	11.39	11.45	11.58	11.62	11.63
ZAR/JPY	7.86	7.65	7.31	8.27	9.26	10.60	10.60	10.56	10.93	10.98	11.22	11.40
ZARCHF	14.06	14.33	14.90	13.03	11.60	10.18	10.13	10.08	10.00	10.05	9.84	9.69
ZARAUD	9.98	10.07	10.07	8.87	7.99	7.05	7.16	7.23	7.37	7.43	7.37	7.25
GBP/USD	1.30	1.29	1.23	1.26	1.28	1.29	1.30	1.31	1.35	1.37	1.39	1.39
EUR/USD	1.14	1.12	1.11	1.10	1.11	1.13	1.15	1.15	1.18	1.20	1.23	1.25
USD/JPY	110	110	107	108	107	106	106	105	106	106	106	106

Note: averages, Source: IRESS, Investec

- In particular, S&P has said that the imposition of its negative outlook indicates the next move will be a downgrade “if we were to observe continued fiscal deterioration, for example, due to higher pressure on spending, rising interest costs, or the crystallization of contingent liabilities related to state-owned enterprises (SOEs), especially Eskom.”
- “We could also lower the ratings if economic performance weakened further or if external funding pressures were to mount. We could also consider lowering the ratings if the rule of law, property rights, or enforcement of contracts were to weaken significantly, undermining the investment and economic outlook. We currently view this as unlikely.”
- The rating agency also expressed severe concern over SA’s “low GDP per capita; the weak pace of economic growth, particularly on a per capita basis; its large and rising government debt burden; and sizable contingent liabilities, primarily tied to the energy utility, Eskom.”
- “Weaker-than-expected growth in the already sluggish macroenvironment has had a disproportionately negative effect on revenue collections. At the same time, enduring problems at key public enterprises--especially Eskom--are estimated to lead to higher expenditure outturns throughout the forecast period.”
- “We now anticipate that the general government deficit will average 6.2% of GDP through 2019-2022. This implies that debt, net of liquid assets, will reach 67.7% of GDP by 2022.” S&P will drop SA’s ratings lower (currently BB+ foreign currency, BB local currency) in around likely an eighteen month period, unless the outlook returns to stable.
- It consequently says it “could revise the outlook to stable if the government credibly arrested the rise in the net government debt-to-GDP ratio, controlled fiscal deficits, and improved SOEs. We could also revise the outlook if we saw a substantial improvement in the economic growth outlook.”
- A uniform sub-investment grade credit rating profile for South Africa, which is deteriorating through speculative grade, would most likely cause significant currency, bond yield and a number of other financial indicators’ volatility when global financial markets switch between risk on and risk off sentiment and vice versa (a lowering or rise in risk aversion).

Economic Scenarios: - note updated table

		Q1.19	Q2.19	Q3.19	Q4.19	Q1.20	Q2.20	Q3.20	Q4.20
Extreme	Rand/USD (average)	14.01	14.38	14.89	11.50	10.30	9.50	8.80	7.90
Up case	Repo rate (end rate)	6.75	6.75	6.50	6.00	6.00	5.75	5.75	5.50
1%	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		Q1.19	Q2.19	Q3.19	Q4.19	Q1.20	Q2.20	Q3.20	Q4.20
7%	Rand/USD (average)	14.01	14.38	14.89	13.00	11.50	10.00	9.95	9.90
	Repo rate (end rate)	6.75	6.75	6.50	6.25	6.25	6.25	6.00	6.00
	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, Trump protectionism reduce significantly. Stabilisation of credit ratings, with ultimately credit rating upgrades.								
Base		Q1.19	Q2.19	Q3.19	Q4.19	Q1.20	Q2.20	Q3.20	Q4.20
case	Rand/USD (average)	14.01	14.38	14.89	14.85	14.15	14.45	14.65	14.00
40%	Repo rate (end rate)	6.75	6.75	6.50	6.50	6.50	6.50	6.50	6.50
	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 land, labour tenets land and government land (individuals are new owners and receive title deeds) does not have a negative effect on economy.								
Lite		Q1.19	Q2.19	Q3.19	Q4.19	Q1.20	Q2.20	Q3.20	Q4.20
(domestic)	Rand/USD (average)	14.01	14.38	14.89	15.80	16.50	16.30	15.50	15.15
Down	Repo rate (end rate)	6.75	6.75	6.50	6.75	7.25	7.25	7.25	7.25
case	SA is rated sub-investment grade by Moody's but substantial repair avoids further marked downgrades. Business confidence depressed, marked 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 limited impact on economy.								
37%		Q1.19	Q2.19	Q3.19	Q4.19	Q1.20	Q2.20	Q3.20	Q4.20
Severe	Rand/USD (average)	14.01	14.38	14.89	16.10	18.50	19.50	20.00	19.25
down	Repo rate (end rate)	6.75	6.75	6.50	7.00	7.75	8.50	9.25	10.00
case	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. SA rated sub-investment grade from all three key agencies, with further rating downgrades. A significantly more severe recession occurs in SA than in the lite down case, marked rand weakness, eventually widespread services load shedding and strike action. Expropriation of private sector property (title deeds not transferred to individuals' and so nationalisation) without compensation – severe negative impact on economy.								
15%									

Note: Event risk begins Q4.19. Source: Investec, Iress historical data