

Rand Note

Monday 28 October 2019

Rand runs stronger ahead of the expected FOMC 25bp cut this week, with progress in US-Sino trade talks also key, as both are seen as mitigating some of the risk of a further marked slowing in the synchronised global economic downturn

Expected case: Exchange Rates,	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	14.30	14.05	14.35	14.55	13.95	13.55	14.05	14.75	14.25
GBP/ZAR	18.25	18.48	18.53	18.08	18.03	18.53	18.93	18.23	18.29	19.25	20.57	19.87
EUR/ZAR	15.92	16.16	16.44	15.73	15.60	16.22	16.66	16.04	15.99	16.86	18.14	17.81
ZAR/JPY	7.86	7.65	7.34	7.52	7.58	7.39	7.25	7.49	7.82	7.54	7.19	7.44
GBP/USD	1.30	1.29	1.26	1.26	1.28	1.29	1.30	1.31	1.35	1.37	1.39	1.39
EUR/USD	1.14	1.12	1.12	1.10	1.11	1.13	1.15	1.15	1.18	1.20	1.23	1.25
USD/JPY	110	110	108	108	107	106	106	105	106	106	106	106

Note: averages, Source: IRESS, Investec

Life down case: Exchange Rates,	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	15.50	17.00	16.50	15.50	15.15	15.10	15.05	15.00	15.05
GBP/ZAR	18.25	18.48	18.53	19.60	21.82	21.31	20.17	19.80	20.39	20.62	20.92	20.99
EUR/ZAR	15.92	16.16	16.44	17.05	18.87	18.65	17.75	17.42	17.82	18.06	18.45	18.81
ZAR/JPY	7.86	7.65	7.34	6.94	6.26	6.42	6.81	6.90	7.02	7.04	7.07	7.04
GBP/USD	1.30	1.29	1.26	1.26	1.28	1.29	1.30	1.31	1.35	1.37	1.39	1.39
EUR/USD	1.14	1.12	1.12	1.10	1.11	1.13	1.15	1.15	1.18	1.20	1.23	1.25
USD/JPY	110	110	108	108	107	106	106	105	106	106	106	106

Note: averages, Source: IRESS, Investec

Severe down case: Exchange Rates,	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	16.10	18.50	19.50	20.00	19.25	18.70	18.00	17.50	16.75
GBP/ZAR	18.25	18.48	18.53	20.36	23.74	25.18	26.02	25.16	25.25	24.66	24.40	23.36
EUR/ZAR	15.92	16.16	16.44	17.71	20.54	22.04	22.90	22.14	22.07	21.60	21.53	20.94
ZAR/JPY	7.86	7.65	7.34	6.68	5.76	5.44	5.28	5.43	5.67	5.89	6.06	6.33
GBP/USD	1.30	1.29	1.26	1.26	1.28	1.29	1.30	1.31	1.35	1.37	1.39	1.39
EUR/USD	1.14	1.12	1.12	1.10	1.11	1.13	1.15	1.15	1.18	1.20	1.23	1.25
USD/JPY	110	110	108	108	107	106	106	105	106	106	106	106

Note: averages, Source: IRESS, Investec



- The rand's recent run of strength to R14.58/USD, R16.24/EUR and R18.80/GBP in the past week, from its close the previous week at R14.77/USD, R16.50/EUR and R19.13/GBP, was chiefly supported by progress in trade negotiations between the US and China, with partial trade deal having been achieved.
- The domestic currency has settled around R14.60/USD, R16.20/EUR and R18.70/GBP so far this morning, but still contains a material risk premium on investor concerns over Eskom, and the projections of further deterioration in public finances expected in the MTBPS (Medium-Term Policy Statement), which will occur this week on the 30th.
- Concerns around Eskom's finances, and the accelerated deterioration in public finances this year partly as government has injected cash into Eskom to keep it going, along with SAA and Denel, has added to market concerns. Weak revenue performance on SARS inefficiencies and low GDP growth have also been drivers of the deterioration in public finances.
- With the yield on the R186 at 8.2%, and closer to 9% on SA's generic ten year government bond, and with CPI inflation now close to 4.0%, there has been foreign appetite for bonds this month, with R6.6bn in net inflows. The deep, liquid and sophisticated nature of SA's financial markets adds support, as does the search for yield.
- The synchronised global economic slowdown has seen actual, or planned, easing in monetary policy in developed markets, when the majority have not yet normalised monetary policy since the last financial crisis; and the risk of global recession is now concerning investors (see "Risk note", 11th October 2019, website address below).
- The appetite for SA bonds from foreign investors this month has been in spite of expectations that SA's projection on its gross loan debt (domestic and foreign) as a % of GDP for 2019/20 could rise to 60%, well above forecasts made in February of 56% of GDP, and the 2019/20 fiscal deficit projection to -6.1% of GDP (previously -4.5% of GDP).

- We maintain our view of no credit rating downgrade from Moody's this year, but with a heightened risk of one occurring (see "Risk note", 11th October 2019), although a drop to a negative outlook remains more likely. Should an actual rating downgrade from Moody's occur the rand would see substantial depreciation (see scenario table below, lite down case).



- To date this year, South Africa has seen a net bond sell-off from foreigners, who have reduced their holdings by –R5.5bn, although -R24.8bn was in the second half of this year to date. Indeed, subsequent to the progress in the trade negotiations between the US and China foreigners have been net buyers of R8.0bn of SA bonds.
- Specifically, the US-Sino trade negotiations saw a 'phase-one', or interim, trade deal, achieved agreeing to defer the US tariff hikes (from 25% to 30%) on US\$250bn worth of imports from China, previously scheduled for 15th October, but it did not agree to delay additional tariff hikes scheduled for mid-December, of 15% on US\$160bn of Chinese goods.
- China is seen to have given greater concessions than the US in the agreement, including greatly increased Chinese purchases of US agricultural products, some intellectual property protection, exchange rate regime reform and opening of financial markets.
- The reduction in trade war risk has cheered markets notably and indeed created some lowering in risk aversion levels (risk-on), benefitting emerging market currencies while the 25bp cut in US interest rates anticipated this week is also seen as supportive of propping up world economic performance.
- With US elections next year, further (slow) progress is expected to be made in the US-Sino trade negotiations, and a completed deal in the US's favour is expected before the elections (bolstering the election outcome in the favour of President Trump), with a winding down of likely protectionism as well to provide a boost to the economic outlook.
- South Africa's economic outlook remains heavily exposed to the global outlook, and China's economic performance in particular, as SA is a key importer of SA commodities. The rand is likely to remain influenced by commodities prices reflection of demand, while Moody's upcoming assessment of SA will also drive the domestic currency.

- Should Moody's not downgrade SA, the rand is likely to see a relief rally. However, a credit rating downgrade would likely cause the domestic currency to weaken towards R15.50/USD (lite down case). Should the global environment not prove benign the domestic currency could weaken towards R16.00/USD, or worse in a global recession.

