

## Rand Note

3<sup>rd</sup> July 2019

Rand flirts with R14.00/USD, but piercing this key resistance level will prove hard for the domestic currency, and likely require a 25bp cut at the next FOMC meeting, absent any domestic events negative for the currency

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## Economic Scenarios:

		Q1.19	Q2.19	Q3.19	Q4.19	Q1.20	Q2.20	Q3.20	Q4.20
Extreme Up case 1%	Rand/USD (average)	14.01	14.38	11.50	10.30	9.50	8.60	7.90	7.60
	Repo rate (end rate)	6.75	6.75	6.00	6.00	5.75	5.75	5.50	5.50
Fast, sustainable economic growth of 5.0-7.0% y/y plus. SA sees change in political will with growth creating economic reforms in line with global norms that structurally lift private sector investor confidence and so fixed investment. Global growth boom (including commodities), Trump protectionism removed, SA export and domestic growth boom lifts employment and incomes to the degree that poverty is eliminated. Property rights strengthened, individuals obtain title deeds in EWC without disruption to economy. Fiscal consolidation, credit rating upgrades to A grade.									
Up case 10%	Rand/USD (average)	14.01	14.38	13.00	11.50	10.00	9.95	9.90	9.70
	Repo rate (end rate)	6.75	6.75	6.25	6.25	6.25	6.00	6.00	6.00
Persistent growth of 3.0 – 5.0%, higher probability of extreme up case. Better governance, growth creating reforms in line with global norms (structural constraints are overcome) and greater socio-economic stability, some strengthening in property rights, individuals obtain title deeds in EWC without disruption to economy. 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.									
Base case 47%	Rand/USD (average)	14.01	14.38	14.30	13.90	13.40	13.70	13.90	13.30
	Repo rate (end rate)	6.75	6.75	6.50	6.50	6.50	6.50	6.50	6.50
Annual growth rate of 2.0% y/y reached by 2020, 3.0% y/y by 2024. Higher confidence and investment levels than past decade, limited impact of EWC/expropriation without compensation (to abandoned and unused land of government and agricultural sector – individuals are new owners and receive title deeds). Rand structurally stronger nears PPP by 2021. SA retains one investment grade (Moody's) rating on its local currency long-term sovereign debt in 2019. Sedate global monetary policy normalisation – avoid severe global risk-off environment, neutral to global risk-on. Modestly strengthening global demand.									
Down case 37%	Rand/USD (average)	14.01	14.38	15.80	17.00	18.50	18.90	17.50	16.50
	Repo rate (end rate)	6.75	6.75	7.25	8.00	8.50	8.50	8.50	8.50
Partial expropriation of (certain groups') private commercial sector property (including productive land) without compensation, plus wide scale land grabs, title deeds not transferred to individuals under semi-nationalisation. Confidence and investment depressed, marked rand weakness, significant strike action and widespread load shedding. SA sub-investment grade (loses Moody's rating), increased chance of further credit downgrades. Faster than expected global (US) monetary policy normalisation, general market risk-off, global sharp economic slowdown (commodity slump), marked escalation of US-China trade war, short global financial crisis (SA V shaped recession).									
Extreme down case 5%	Rand/USD (average)	14.01	14.38	17.00	19.00	22.00	24.00	25.50	26.00
	Repo rate (end rate)	6.75	6.75	9.50	13.00	16.50	18.00	21.00	21.50
Wide scale expropriation of private sector property (assets and land) rights without compensation with state as custodian - nationalisation. Credit ratings junk & sovereign debt default - state bankruptcy/failed state. Partial to no payment of public sector employees' wages and social grants, persistent government services outages and rolling mass strike action, civil unrest/war. Global economy falls into recession, severe global trade war, severe lengthy global financial crisis, SA economic depression.									

Note: Event risk begins Q3.19. Source: Investec, Iress historical data

- The rand closed last week at R14.08/USD, R16.00/EUR and R17.87/GBP, moving stronger this week to R14.04/USD, R15.90/EUR and R17.77/GBP on US dollar weakness ahead of an expected cut in US interest rates at the next FOMC meeting (31<sup>st</sup> July).
- The rand, and other emerging market currencies, have benefitted from financial market expectations that the US will cut its interest rates this year by 50bp (see "Q3.19 Macro-economic outlook 2019–2025: SA markets, rand follow global, ignores GDP which stutters on structural (regulatory) impediments to growth", 1<sup>st</sup> July 2019, website address below).



- While the rand is likely to continue to gain from perceptions, and particularly the occurrence, of global monetary policy easing, the third quarter tends to be a quarter in which financial markets often experience risk-off. In particular, fears of slowing global economic growth have impacted markets, and could limit EM currencies gain in Q3.19.
- We have revised our forecast for world GDP growth down again, to 2.6% y/y for 2019, versus the forecast we made in Q2.19 of 2.9% y/y in line with the World Bank which highlights that "(g)lobal growth has continued to weaken and momentum remains fragile."
- R14.00/USD is a key resistance level, and the domestic currency will likely find it difficult to pierce it sustainably, without very strong momentum. We expect this could only be likely if the FOMC cuts its fed funds rate by 25bp, with the earliest interest rate meeting on 31<sup>st</sup> July 2019.

#### Economic scenarios: lite down case and severe down case

		Q1.19	Q2.19	Q3.19	Q4.19	Q1.20	Q2.20	Q3.20	Q4.20
Domestic (lite)	Rand/USD (average)	14.01	14.38	16.00	17.00	16.50	15.50	15.15	14.90
Down case 25%	Repo rate (end rate)	6.75	6.75	7.50	8.50	7.50	7.50	7.50	7.25
	Prime rate (end rate)	10.25	10.25	11.00	12.00	11.00	11.00	11.00	10.75

Partial expropriation of (certain groups') private commercial sector property (including productive land) without compensation. Business confidence remains depressed, marked rand weakness, significant load shedding and weak investment growth. SA sub-investment grade Moody's rating in 2019, but substantial repair avoids further marked downgrades. SA experiences a mild, credit rating downgrade related, recession. However, modestly strengthening global demand and elevated commodity prices help lessen the longer-term impact of domestic disturbances. Sedate global monetary policy normalisation occurs – a severe global risk-off environment is avoided, with neutral to global risk-on.

25%+12%=37%

		Q1.19	Q2.19	Q3.19	Q4.19	Q1.20	Q2.20	Q3.20	Q4.20
International & (worse) domestic	Rand/USD (average)	14.01	14.38	16.10	17.20	18.50	19.50	20.00	19.25
Down Case 12%	Repo rate (end rate)	6.75	6.75	8.00	8.50	9.25	9.75	10.25	10.75
	Prime rate (end rate)	10.25	10.25	11.50	12.00	12.75	13.25	13.75	14.25

Expropriation of private commercial sector property (full or partial, and including productive land) without compensation, plus wide scale land grabs, title deeds not transferred to individuals - nationalisation. Confidence and investment depressed, marked rand weakness, significant strike action and widespread electricity (water and other services) load shedding. SA sub-investment grade, further credit downgrades. Faster than expected global (US) monetary policy normalisation, general market risk-off, global sharp economic slowdown (commodity slump), marked escalation of US-China trade war, short global financial crisis (SA V shaped recession). Material risk of further credit rating downgrades to junk.

Note: Event risk begins Q3.19. Source: Investec

- Indeed, today the rand has weakened slightly on trade tensions directed now at the EU, as the US threatens additional tariffs of US\$4bn on EU goods over aircraft subsidies. While a small amount, given the escalation in US-Sino trade tensions, markets are taking the threat against the EU as a higher risk of further momentum from the US towards eventual global trade war.
- Additional tariffs against the EU would assist a slowdown in global economic growth, which is worrying financial markets. The latest trade spat comes just after agreement between the US and China this weekend at the G-20 meeting on resuming trade negotiations.

- US tariffs already applied on Chinese goods imported by the US, as well as the retaliatory measures from China remain in place, with little breakthrough on the US Chinese trade relationship at the weekend G-20, other than agreeing to continue negotiations. Many believe a final deal is unlikely to be reached soon.
- A further escalation in trade tensions between the US and China is our down case, as is a Moody's credit rating downgrade and a prolonged global financial markets risk-off environment. The split in the down case into a domestic (lite) Moody's driven event, and a severe escalation in global trade tensions (war) and multiple credit rating downgrades is the severe down case.
- While the rand could see further strength this year, this may be more likely to be sustained in the last quarter, as global financial markets tend to be less risk averse in that period (the last and first quarters of the year. Longer-term the rand is expected to return to its purchasing power parity valuation (in the expected case).

<b>Extreme Up case:</b>	2019	2019	2019	2019	2020	2020	2020	2020	2021	2021	2021	2021
<b>Exchange Rates forecasts averages</b>	<b>Q1</b>	<b>Q2</b>	<b>Q3</b>	<b>Q4</b>	<b>Q1</b>	<b>Q2</b>	<b>Q3</b>	<b>Q4</b>	<b>Q1</b>	<b>Q2</b>	<b>Q3</b>	<b>Q4</b>
USD/ZAR	14.01	14.38	11.50	10.30	9.50	8.60	7.90	7.60	7.40	7.10	6.95	6.75
GBP/ZAR	18.24	18.48	14.37	12.94	12.09	11.15	10.50	10.19	10.21	9.90	9.69	9.41
EUR/ZAR	15.91	16.15	12.97	11.74	10.97	9.98	9.24	8.97	9.10	8.88	8.69	8.44
ZAR/JPY	7.87	7.65	9.39	10.49	11.26	12.33	13.35	13.75	14.32	14.93	15.25	15.70
ZARCHF	14.05	14.34	11.58	10.44	9.63	8.64	7.90	7.54	7.63	7.40	7.24	7.03
ZARAUD	9.98	10.07	7.76	7.00	6.60	6.06	5.69	5.55	5.62	5.61	5.42	5.27
GBP/USD	1.30	1.29	1.25	1.26	1.27	1.30	1.33	1.34	1.38	1.39	1.39	1.39
EUR/USD	1.14	1.12	1.13	1.14	1.16	1.16	1.17	1.18	1.23	1.25	1.25	1.25
USD/JPY	110	110	108	108	107	106	106	105	106	106	106	106

Source: IRESS, Investec

<b>Up case: Exchange Rates forecasts averages</b>	2019	2019	2019	2019	2020	2020	2020	2020	2021	2021	2021	2021
	<b>Q1</b>	<b>Q2</b>	<b>Q3</b>	<b>Q4</b>	<b>Q1</b>	<b>Q2</b>	<b>Q3</b>	<b>Q4</b>	<b>Q1</b>	<b>Q2</b>	<b>Q3</b>	<b>Q4</b>
USD/ZAR	14.01	14.38	13.00	11.50	10.00	9.95	9.90	9.70	9.65	9.45	9.30	9.15
GBP/ZAR	18.25	18.48	16.24	14.45	12.73	12.90	13.16	13.01	13.32	13.18	12.97	12.76
EUR/ZAR	15.92	16.15	14.66	13.11	11.55	11.54	11.58	11.45	11.87	11.81	11.63	11.44
ZAR/JPY	7.87	7.65	8.31	9.39	10.70	10.65	10.66	10.77	10.98	11.22	11.40	11.58
ZARCHF	14.06	14.33	13.09	11.65	10.13	9.99	9.90	9.62	9.95	9.84	9.69	9.53
ZARAUD	9.98	10.07	8.78	7.82	6.95	7.01	7.13	7.08	7.33	7.47	7.25	7.14
GBP/USD	1.30	1.29	1.25	1.26	1.27	1.30	1.33	1.34	1.38	1.39	1.39	1.39
EUR/USD	1.14	1.12	1.13	1.14	1.16	1.16	1.17	1.18	1.23	1.25	1.25	1.25
USD/JPY	110	110	108	108	107	106	106	105	106	106	106	106

Source: IRESS, Investec

<b>Expected case: Exchange Rates forecasts averages</b>	<b>2019 Q1</b>	<b>2019 Q2</b>	<b>2019 Q3</b>	<b>2019 Q4</b>	<b>2020 Q1</b>	<b>2020 Q2</b>	<b>2020 Q3</b>	<b>2020 Q4</b>	<b>2021 Q1</b>	<b>2021 Q2</b>	<b>2021 Q3</b>	<b>2021 Q4</b>
USD/ZAR	14.01	14.38	14.30	13.90	13.40	13.70	13.90	13.30	12.70	13.20	13.90	13.40
GBP/ZAR	18.25	18.48	17.87	17.46	17.05	17.76	18.48	17.83	17.53	18.41	19.38	18.69
EUR/ZAR	15.92	16.15	16.12	15.85	15.48	15.89	16.26	15.69	15.62	16.50	17.38	16.75
ZAR/JPY	7.87	7.65	7.55	7.77	7.99	7.74	7.59	7.86	8.35	8.03	7.63	7.91
ZARCHF	14.06	14.33	14.40	14.09	13.58	13.76	13.90	13.19	13.09	13.75	14.48	13.96
ZARAUD	9.98	10.07	9.65	9.45	9.31	9.66	10.01	9.71	9.65	10.43	10.84	10.45
GBP/USD	1.30	1.29	1.25	1.26	1.27	1.30	1.33	1.34	1.38	1.39	1.39	1.39
EUR/USD	1.14	1.12	1.13	1.14	1.16	1.16	1.17	1.18	1.23	1.25	1.25	1.25
USD/JPY	110	110	108	108	107	106	106	105	106	106	106	106

Source: IRESS, Investec

<b>Down case: Exchange Rates forecasts averages</b>	<b>2019 Q1</b>	<b>2019 Q2</b>	<b>2019 Q3</b>	<b>2019 Q4</b>	<b>2020 Q1</b>	<b>2020 Q2</b>	<b>2020 Q3</b>	<b>2020 Q4</b>	<b>2021 Q1</b>	<b>2021 Q2</b>	<b>2021 Q3</b>	<b>2021 Q4</b>
USD/ZAR	14.01	14.38	15.80	17.00	18.50	18.90	17.50	16.50	16.20	15.90	16.00	15.85
GBP/ZAR	18.25	18.48	19.74	21.36	23.55	24.50	23.27	22.13	22.36	22.17	22.31	22.10
EUR/ZAR	15.92	16.15	17.81	19.38	21.37	21.92	20.48	19.47	19.93	19.88	20.00	19.81
ZAR/JPY	7.87	7.65	6.84	6.35	5.78	5.61	6.03	6.33	6.54	6.67	6.63	6.69
ZARCHF	14.06	14.33	15.91	17.23	18.74	18.98	17.50	16.36	16.70	16.56	16.67	16.51
ZARAUD	9.98	10.07	10.67	11.56	12.86	13.32	12.60	12.05	12.31	12.56	12.48	12.36
GBP/USD	1.30	1.29	1.25	1.26	1.27	1.30	1.33	1.34	1.38	1.39	1.39	1.39
EUR/USD	1.14	1.12	1.13	1.14	1.16	1.16	1.17	1.18	1.23	1.25	1.25	1.25
USD/JPY	110	110	108	108	107	106	106	105	106	106	106	106

Source: IRESS, Investec



Light 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	16.00	17.00	16.50	15.50	15.15	14.90	14.80	14.70	14.75	14.70
GBP/ZAR	18.24	18.48	19.99	21.36	21.00	20.09	20.14	19.98	20.42	20.50	20.57	20.50
EUR/ZAR	15.91	16.15	18.04	19.38	19.06	17.98	17.73	17.58	18.20	18.38	18.44	18.38
ZAR/JPY	7.87	7.65	6.75	6.35	6.48	6.84	6.96	7.01	7.16	7.21	7.19	7.21
ZARCHF	14.05	14.34	16.11	17.23	16.72	15.57	15.15	14.77	15.26	15.31	15.36	15.31
ZARAUD	9.98	10.07	10.80	11.56	11.47	10.93	10.91	10.88	11.25	11.61	11.51	11.47
GBP/USD	1.30	1.29	1.25	1.26	1.27	1.30	1.33	1.34	1.38	1.39	1.39	1.39
EUR/USD	1.14	1.12	1.13	1.14	1.16	1.16	1.17	1.18	1.23	1.25	1.25	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 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	16.10	17.20	18.50	19.50	20.00	19.25	18.70	18.00	17.50	16.75
GBP/ZAR	18.24	18.48	20.11	21.61	23.55	25.27	26.59	25.81	25.81	25.10	24.40	23.36
EUR/ZAR	15.91	16.15	18.15	19.61	21.37	22.62	23.40	22.72	23.00	22.50	21.88	20.94
ZAR/JPY	7.87	7.65	6.71	6.28	5.78	5.44	5.28	5.43	5.67	5.89	6.06	6.33
ZARCHF	14.05	14.34	16.21	17.43	18.74	19.58	20.00	19.09	19.28	18.75	18.23	17.45
ZARAUD	9.98	10.07	10.87	11.70	12.86	13.75	14.40	14.05	14.21	14.22	13.65	13.07
GBP/USD	1.30	1.29	1.25	1.26	1.27	1.30	1.33	1.34	1.38	1.39	1.39	1.39
EUR/USD	1.14	1.12	1.13	1.14	1.16	1.16	1.17	1.18	1.23	1.25	1.25	1.25
USD/JPY	110	110	108	108	107	106	106	105	106	106	106	106

Note: averages, Source: IRESS, Investec

Extreme Down case: Exchange Rates forecasts averages	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	17.00	19.00	22.00	24.00	25.50	26.00	25.15	24.90	24.60	24.90
GBP/ZAR	18.25	18.48	21.24	23.87	28.00	31.11	33.90	34.86	34.71	34.72	34.30	34.72
EUR/ZAR	15.92	16.15	19.17	21.66	25.41	27.84	29.84	30.68	30.93	31.13	30.75	31.13
ZAR/JPY	7.87	7.65	6.35	5.68	4.86	4.42	4.14	4.02	4.21	4.26	4.31	4.26
ZARCHF	14.06	14.33	17.11	19.25	22.29	24.10	25.50	25.78	25.93	25.94	25.63	25.94
ZARAUD	9.98	10.07	11.48	12.92	15.29	16.92	18.36	18.98	19.11	19.67	19.19	19.42
GBP/USD	1.30	1.29	1.25	1.26	1.27	1.30	1.33	1.34	1.38	1.39	1.39	1.39
EUR/USD	1.14	1.12	1.13	1.14	1.16	1.16	1.17	1.18	1.23	1.25	1.25	1.25
USD/JPY	110	110	108	108	107	106	106	105	106	106	106	106

Source: IRESS, Investec