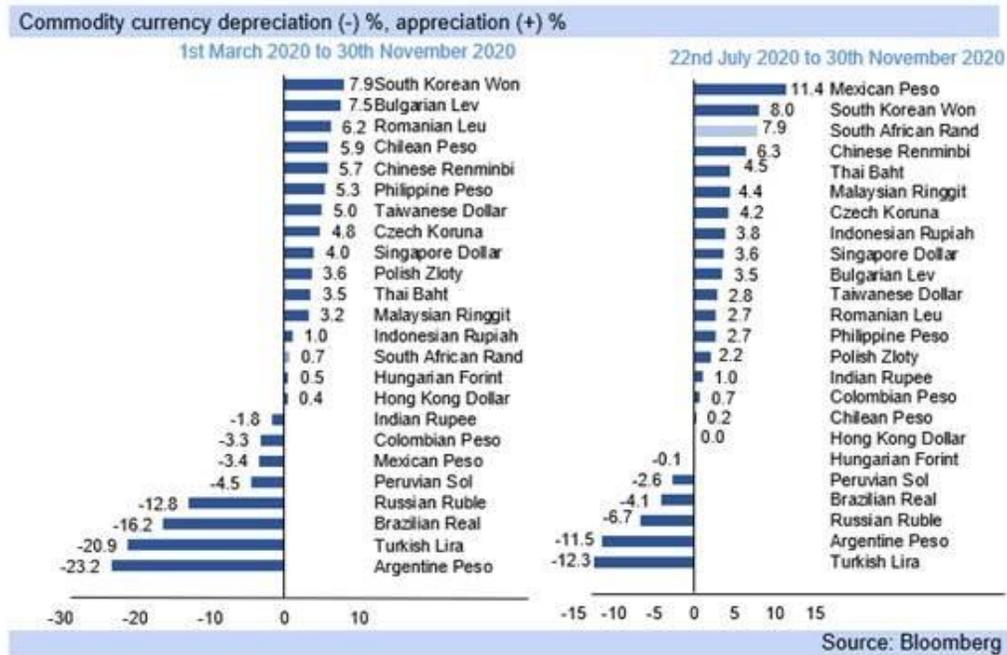


SA Economics

Monday 30 November 2020

Rand note: some modest restocking of foreign investor portfolios with EM debt in early November supported rand strength, although there has since been some pullback, as the currency consolidates above R15.00/USD

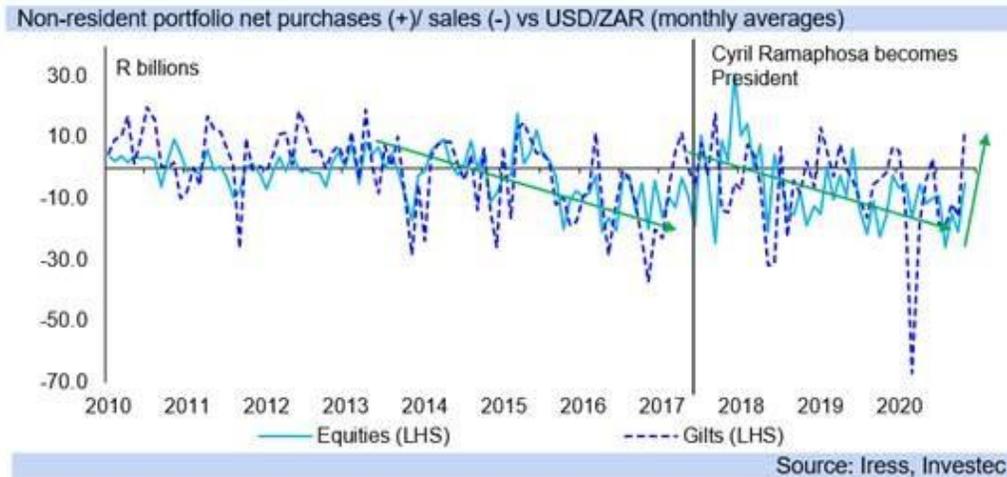


Expected Case: Exchange Rate forecasts												
	2020				2021				2022			
	Q1.20	Q2.20	Q3.20	Q4.20	Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22
USD/ZAR	15.38	17.95	16.91	15.80	15.40	15.20	15.50	15.10	15.00	15.20	15.50	15.20
GBP/ZAR	19.64	22.28	21.84	20.79	20.64	20.52	21.24	20.99	21.22	20.82	21.24	20.98
EUR/ZAR	16.95	19.77	19.76	18.59	18.17	18.09	18.76	18.65	18.75	18.54	18.29	17.78
ZAR/JPY	7.12	5.99	6.28	6.69	6.95	7.07	6.84	6.92	6.93	6.91	6.77	6.91
CHFZAR	15.89	18.63	18.38	17.21	16.75	16.52	16.97	16.73	16.52	15.20	15.50	15.20
AUDZAR	10.09	11.79	12.09	11.35	11.17	11.10	11.39	11.17	11.18	10.64	11.01	10.79
GBP/USD	1.28	1.24	1.29	1.32	1.34	1.35	1.37	1.39	1.41	1.37	1.37	1.38
EUR/USD	1.10	1.10	1.17	1.18	1.18	1.19	1.21	1.24	1.25	1.22	1.18	1.17
USD/JPY	109	108	106	106	107	108	106	105	104	105	105	105

Note: averages, Source: Investec, Iress

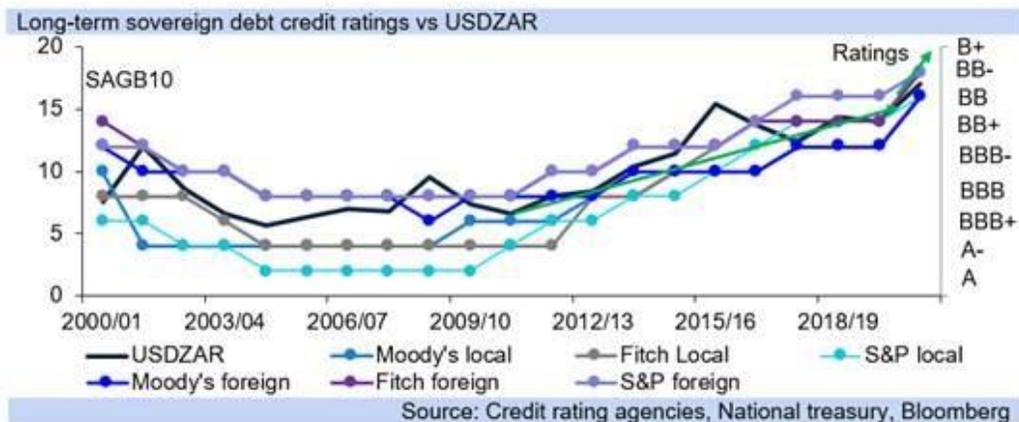
Up Case: Exchange Rate forecasts												
	2020				2021				2022			
	Q1.20	Q2.20	Q3.20	Q4.20	Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22
USD/ZAR	15.38	17.95	16.91	15.50	15.00	14.00	13.50	13.00	12.50	12.40	12.50	12.60
GBP/ZAR	19.64	22.28	21.84	20.40	20.10	18.90	18.50	18.07	17.69	16.99	17.13	17.39
EUR/ZAR	16.95	19.77	19.76	18.23	17.70	16.66	16.34	16.06	15.63	15.13	14.75	14.74
ZAR/JPY	7.12	5.99	6.28	6.82	7.13	7.68	7.85	8.04	8.32	8.47	8.40	8.33
CHFZAR	15.89	18.63	18.38	16.88	16.31	15.21	14.78	14.40	13.77	12.40	12.50	12.60
AUDZAR	10.09	11.79	12.09	11.13	10.88	10.22	9.92	9.62	9.31	8.68	8.88	8.95
GBP/USD	1.28	1.24	1.29	1.32	1.34	1.35	1.37	1.39	1.41	1.37	1.37	1.38
EUR/USD	1.10	1.10	1.17	1.18	1.18	1.19	1.21	1.24	1.25	1.22	1.18	1.17
USD/JPY	109	108	106	106	107	108	106	105	104	105	105	105

Note averages, Source: Investec, Iress



- Foreigners showed some appetite for SA bonds in the first two thirds of November, with R14.9bn in purchases, net of sales, but then net sales of -R2.3bn occurred in the rest of November to date. Overall, sales heavily overshadow purchases.
- In March foreigners sold off a hefty -R66.7bn in SA government debt on a net basis, in April -R17.7bn, and in May -R3.8bn ahead of net purchases of R2.9bn in June as markets prematurely shifted to pre-recovery positioning, before selling off -R64.4bn to end October.

- In total this year foreigners have sold off -R163.4bn in SA debt on a net basis from February to end October, chiefly on the back of the global financial crisis driven by the Covid-19 pandemic, with the February Budget having a negative impact earlier in the year.
- In contrast, total purchases of SA debt in November are only at R12.6bn on a net basis for the month to date, with other EM portfolio assets also gaining somewhat from the rise in risk-on but also not to any extent either that would eradicate the losses earlier in the year.
- That is, South Africa saw unprecedented foreign net sales of its debt up to November this year, with the IIF (Institute of International Finance) highlighting earlier that outflows relative to the size of the economy were the largest in Mexico, South Africa, and Turkey.
- With financial markets now anticipating the global economy increasingly recovering on the back of the protection offered by incoming vaccines next year, higher returning risks assets have recently seen some limited favour, including ZAR assets.
- The domestic currency currently averages R16.00/USD, R18.88/EUR and R20.95/GBP this quarter so far. While the run in the rand earlier this month has now consolidated, the rand will remain highly volatile, but could see some additional strength into the new year.
- With further recovery in global economic activity likely next year, high levels of liquidity on QE and expected low interest rates globally, risk assets are likely to remain relatively attractive, but the rand has not recouped its losses since the start of the year, nor SA its bond outflows.
- However, strong risk-on financial market sentiment this month, as vaccine news improves each week, masks the deterioration in SA's credit quality, and so brings a false sense of security on the market reaction to SA's rating downgrades, and so on longer term rand levels.



Economic Scenarios: historical updates included

		Q1.20	Q2.20	Q3.20	Q4.20	Q1.21	Q2.21	Q3.21	Q4.21
Extreme Up case 1%	USD/Rand (average)	15.38	17.95	16.91	15.00	14.00	13.50	13.00	12.50
	Repo rate (end rate)	5.25	3.75	3.50	3.00	3.00	3.00	3.00	3.00
	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.								
Up case 1%	USD/Rand (average)	15.38	17.95	16.91	15.50	15.00	14.00	13.50	13.00
	Repo rate (end rate)	5.25	3.75	3.50	3.25	3.25	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.								
Base case 44%	USD/Rand (average)	15.38	17.95	16.91	15.80	15.40	15.20	15.50	15.10
	Repo rate (end rate)	5.25	3.75	3.50	3.50	3.75	4.00	4.25	4.25
	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.								
Lite (domestic) Down case 44%	USD/Rand (average)	15.38	17.95	16.91	16.30	17.50	18.80	19.20	20.50
	Repo rate (end rate)	5.25	3.75	3.50	3.75	4.00	4.00	4.25	4.25
	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.								
Severe down case 10%	USD/Rand (average)	15.38	17.95	16.91	17.15	19.50	21.00	22.00	23.00
	Repo rate (end rate)	5.25	3.75	3.50	4.00	4.25	4.25	4.75	5.25
	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 Q4.20. Source: Investec

Severe Down Case: Exchange Rate forecasts

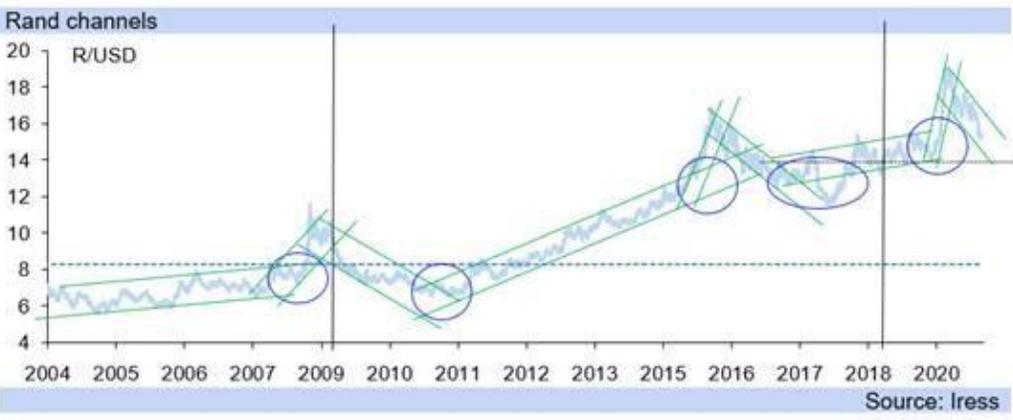
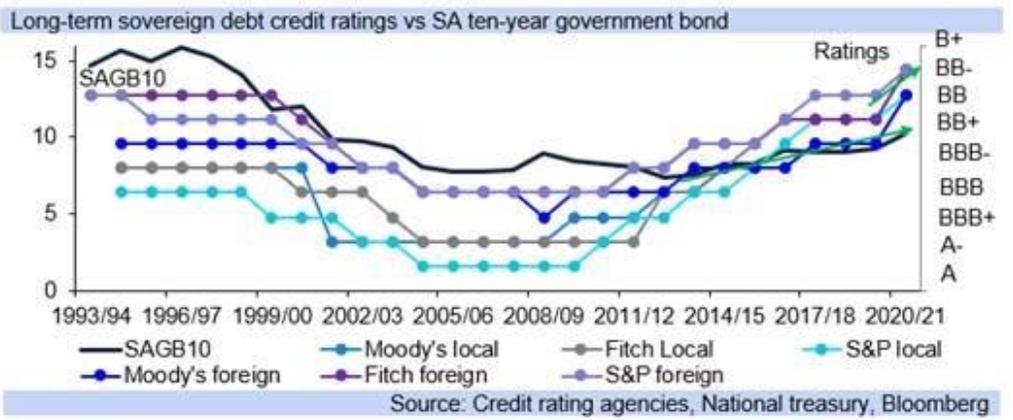
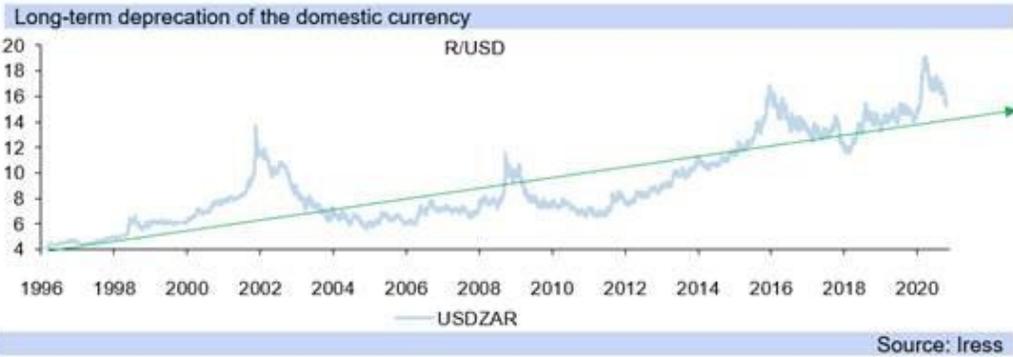
	2020				2021				2022			
	Q1.20	Q2.20	Q3.20	Q4.20	Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22
USD/ZAR	15.38	17.95	16.91	17.15	19.50	21.00	22.00	23.00	24.00	22.00	20.00	22.00
GBP/ZAR	19.64	22.28	21.84	22.57	26.13	28.35	30.14	31.97	33.96	30.14	27.40	30.36
EUR/ZAR	16.95	19.77	19.76	20.18	23.01	24.99	26.62	28.41	30.00	26.84	23.60	25.74
ZAR/JPY	7.12	5.99	6.28	6.17	5.49	5.12	4.82	4.54	4.33	4.77	5.25	4.77
CHF/ZAR	15.89	18.63	18.38	18.68	21.21	22.82	24.09	25.48	26.43	22.00	20.00	22.00
AUD/ZAR	10.09	11.79	12.09	12.32	14.14	15.33	16.17	17.02	17.88	15.40	14.20	15.62
GBP/USD	1.28	1.24	1.29	1.32	1.34	1.35	1.37	1.39	1.41	1.37	1.37	1.38
EUR/USD	1.10	1.10	1.17	1.18	1.18	1.19	1.21	1.24	1.25	1.22	1.18	1.17
USD/JPY	109	108	106	106	107	108	106	105	104	105	105	105

Note: averages, Source: Investec, Iress

Lite Down Case: Exchange Rate forecasts												
	2020				2021				2022			
	Q1.20	Q2.20	Q3.20	Q4.20	Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22
USD/ZAR	15.38	17.95	16.91	16.30	17.50	18.80	19.20	20.50	20.00	19.50	18.50	17.50
GBP/ZAR	19.64	22.28	21.84	21.45	23.45	25.38	26.30	28.50	28.30	26.72	25.35	24.15
EUR/ZAR	16.95	19.77	19.76	19.18	20.65	22.37	23.23	25.32	25.00	23.79	21.83	20.48
ZAR/JPY	7.12	5.99	6.28	6.49	6.11	5.72	5.52	5.10	5.20	5.38	5.68	6.00
CHF/ZAR	15.89	18.63	18.38	17.75	19.03	20.43	21.02	22.71	22.03	19.50	18.50	17.50
AUD/ZAR	10.09	11.79	12.09	11.71	12.69	13.72	14.11	15.17	14.90	13.65	13.14	12.43
GBP/USD	1.28	1.24	1.29	1.32	1.34	1.35	1.37	1.39	1.41	1.37	1.37	1.38
EUR/USD	1.10	1.10	1.17	1.18	1.18	1.19	1.21	1.24	1.25	1.22	1.18	1.17
USD/JPY	109	108	106	106	107	108	106	105	104	105	105	105

Note: averages, Source: Investec, Iress

- While some positioning earlier in November increased into areas where strong sell-off occurred in March/April this year as investors move into higher risk EM assets, this is not a sustainable long-term rand support, and the domestic currency will remain highly volatile.
- Market sentiment will not remain in a strong risk-on phase forever, and the long-term trend of the rand is one of depreciation, both due to the persistent inflation differential with key trading partners and in the absence of SA's failure to achieve fiscal consolidation.
- SA is on the cusp of the single B ratings with negative outlooks from two agencies and, falling down the credit rating ladder into the single B category is a major move and will have negative consequences, bringing marked rand weakness.
- While the rand may only see substantial weakness eventually, as opposed to initially if a very strong risk-on phase is underway, as is currently the case in market sentiment, market sentiment always dulls or turns, exposing fundamental weaknesses.
- The domestic currency remains undervalued on a purchasing power parity basis, and will likely remain undervalued in the short-term, but in the medium-term is expected to return to its PPP valuation, and in the longer-term continue to depreciate on a PPP basis.
- While the rand could attempt to pierce R15.00/USD in coming weeks, or into next year, as further progress on mass vaccine development occurs, as well as on start of the rollout of these vaccines, with markets already pricing in some of these developments.
- Additionally, SA's high real bond yields are expected to see more than around 1% erosion as CPI inflation rises to around 4.5% y/y, from its current 3.3% y/y, but still offer relatively attractive returns and taken up during strong risk-on periods.
- These factors could drive the rand temporarily stronger, or just provide support to it around current levels (which is the expected case), in the remainder of this year and next, with a number of weak fundamentals still undermining the domestic currency.
- With news on vaccine developments coming out each Monday, the rand is currently trading at R15.27/USD, R18.31/EUR and R20.36/USD, and could strengthen this afternoon, but sustainably breaking through the key resistance level of R15.00/USD will prove difficult.



Extreme Up Case: Exchange Rate forecasts												
	2020				2021				2022			
	Q1.20	Q2.20	Q3.20	Q4.20	Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22
USD/ZAR	15.38	17.95	16.91	15.00	14.00	13.50	13.00	12.50	12.00	11.50	11.00	10.90
GBP/ZAR	19.64	22.28	21.84	19.74	18.76	18.23	17.81	17.38	16.98	15.76	15.07	15.04
EUR/ZAR	16.95	19.77	19.76	17.65	16.52	16.07	15.73	15.44	15.00	14.03	12.98	12.75
ZAR/JPY	7.12	5.99	6.28	7.05	7.64	7.96	8.15	8.36	8.67	9.13	9.55	9.63
CHF/ZAR	15.89	18.63	18.38	16.34	15.23	14.67	14.24	13.85	13.22	11.50	11.00	10.90
AUD/ZAR	10.09	11.79	12.09	10.78	10.15	9.86	9.56	9.25	8.94	8.05	7.81	7.74
GBP/USD	1.28	1.24	1.29	1.32	1.34	1.35	1.37	1.39	1.41	1.37	1.37	1.38
EUR/USD	1.10	1.10	1.17	1.18	1.18	1.19	1.21	1.24	1.25	1.22	1.18	1.17
USD/JPY	109	108	106	106	107	108	106	105	104	105	105	105

Note: averages, Source: Investec, Iress