

Rand Note

Monday 3 August 2020

The domestic currency is in a consolidation phase currently, after running into overbought territory in recent weeks, with the rand expected to average R17.00/USD this quarter

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	18.00	17.00	16.50	15.75	15.50	15.50	15.10	15.00	15.20	15.50	15.20
GBP/ZAR	19.64	22.34	20.70	20.44	20.15	19.83	20.12	20.13	20.42	20.52	21.08	20.82
EUR/ZAR	16.95	19.82	19.15	18.73	18.03	17.83	17.90	17.52	17.40	17.63	17.98	17.78
ZAR/JPY	7.12	5.97	6.41	6.67	6.92	6.94	6.84	6.92	6.93	6.91	6.77	6.91
CHFZAR	15.89	18.68	18.02	17.50	16.62	16.28	16.20	15.71	15.54	15.20	15.50	15.20
AUDZAR	10.09	11.82	11.63	11.22	10.79	10.70	10.77	10.57	10.73	10.64	11.01	10.79
GBP/USD	1.28	1.24	1.22	1.24	1.28	1.28	1.30	1.33	1.36	1.35	1.36	1.37
EUR/USD	1.10	1.10	1.13	1.14	1.15	1.15	1.16	1.16	1.16	1.16	1.16	1.17
USD/JPY	109	108	109	110	109	108	106	105	104	105	105	105

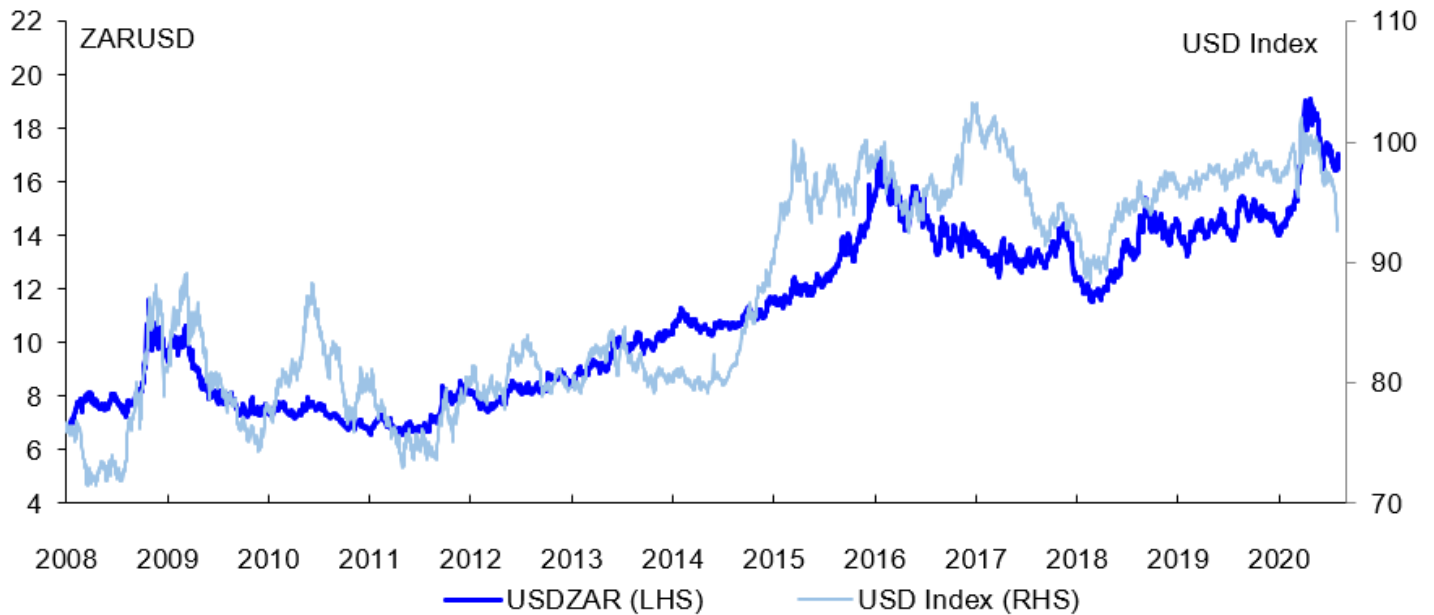
Note: averages, Source: Investec, Iress

Economic Scenarios: note updated forecasts

		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	18.00	15.00	14.00	13.50	13.00	12.50	12.00
	Repo rate (end rate)	5.25	3.75	3.00	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 2%	USD/Rand (average)	15.38	18.00	16.00	15.00	14.00	13.50	12.00	11.50
	Repo rate (end rate)	5.25	3.75	3.25	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 47%	USD/Rand (average)	15.38	18.00	17.00	16.50	15.75	15.50	15.50	15.10
	Repo rate (end rate)	5.25	3.75	3.50	3.50	3.75	4.00	4.25	4.25
	Temporary sharp global slowdown and global financial turmoil from Covid-19 pandemic (severe currency depreciation, low interest rates) – eventually sufficient global and domestic monetary and other policy supports to growth and financial markets occur and risk sentiment stabilises. South Africa exits recession in Q3.20. Market unfriendly policies like expropriation of private sector property put on hold in the crisis. SA retains BB category rating from Moody’s - government debt projections stabilise.								
Lite (domestic) Down case 46%	USD/Rand (average)	15.38	18.00	18.50	19.50	20.00	18.50	17.00	16.50
	Repo rate (end rate)	5.25	3.75	3.75	3.75	4.00	4.00	4.25	4.25
	The international risk sentiment environment is that of the base case. South Africa continues to fail to see its debt projections stabilise and falls towards B ratings from all three rating agencies. More severe recession in SA over 2020 than in the expected case. Expropriation of some private commercial sector property without compensation, with some negative impact on the economy. Business confidence depressed even further, significant rand weakness, significant load shedding and weak investment growth until substantial fiscal repair ultimately effected.								
Severe down case 4%	USD/Rand (average)	15.38	18.00	19.50	21.00	22.00	23.00	24.00	22.00
	Repo rate (end rate)	5.25	3.75	4.00	4.00	4.25	4.25	4.75	5.25
	Lengthy global recession on impact of Covid-19 – 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 C grade 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 Q3.20. Source: Investec

USZAR vs USD index

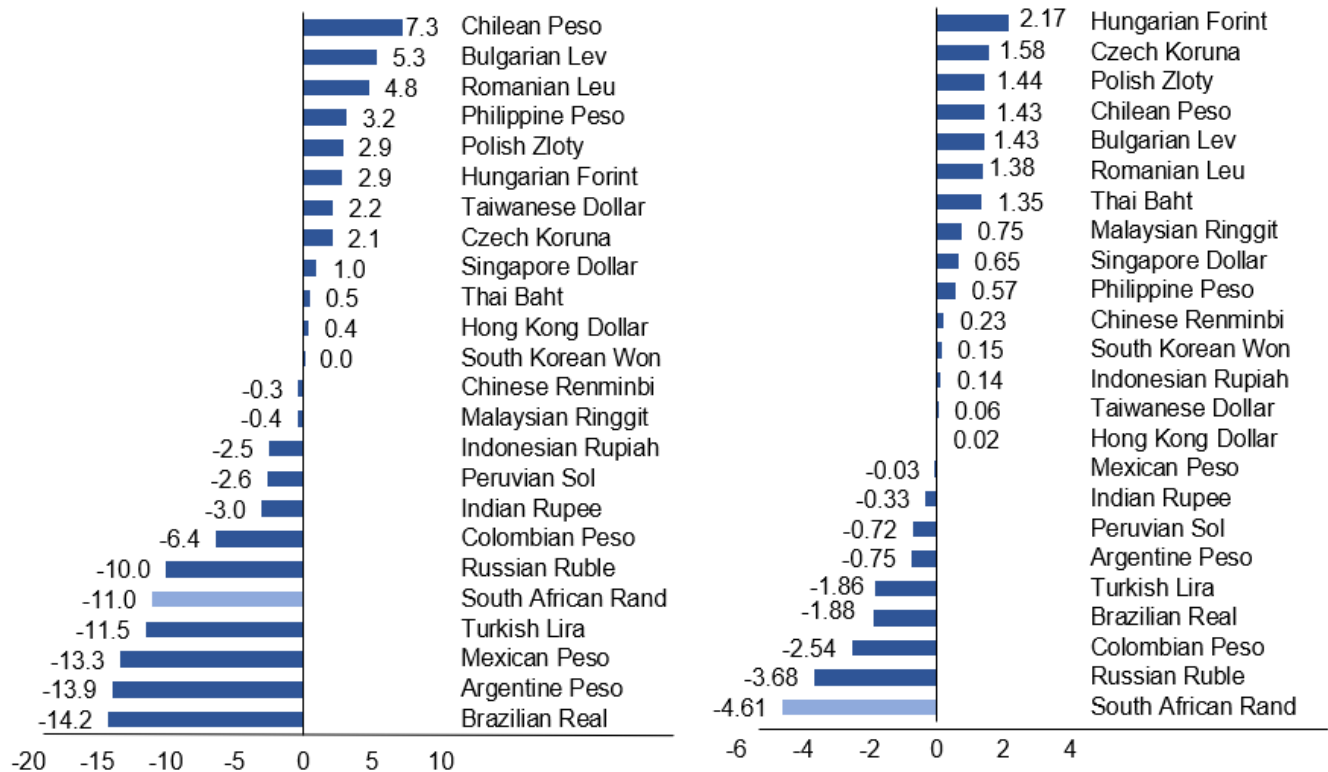


Source: Iress

EM currency depreciation (-) %, appreciation (+) %

1st March 2020 to 3 August 2020

22nd July 2020 to 3 August 2020

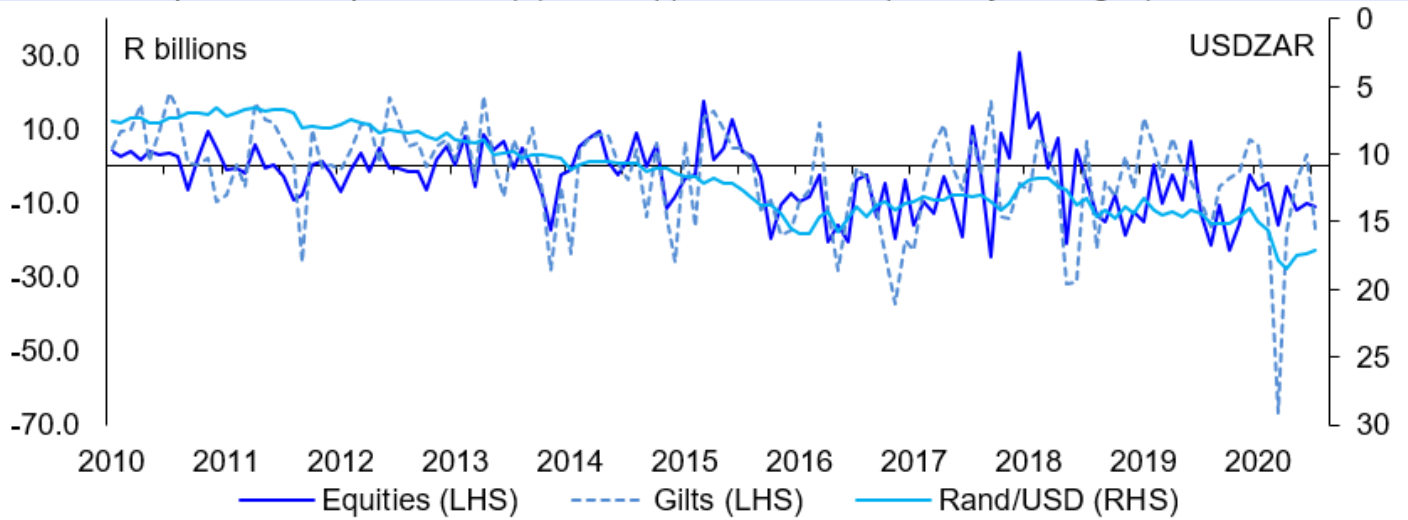


Source: Bloomberg

- While the rand so far averages R16.76/USD this quarter, it is only for the month of July where it reached substantial overbought territory by strengthening through to R16.34/USD and subsequently has been consolidating back from that level to around R17.25/USD currently.

- While the recent bounce back in the rand from its attempt at returning to levels pre the Covid-19 crisis (of R16.26/USD) has been slightly over done, we expect the domestic currency will attempt to settle around the R17.00/USD level for much of this quarter, but in a very wide band as the rand remains highly volatile.
- Indeed, the rand could even trade temporarily by more than R1.00/USD on each side of the R17.00/USD mark, as such is the extreme volatility of the domestic currency, which is highly reflective of all risk sentiment switches in global financial markets.
- The global economic recovery is not firmly underway, and will not be linear nor synchronised. Instead the global economy will see some individual economies lead in their recovery from the Covid-19 lockdowns and resultant economic slumps, while other economies will lag.
- The global economy will consequently see an unsynchronised recovery across different countries, and even inside country's economies, while the global recovery itself will be patchy (or stop start), in nature and not follow a smooth linear trajectory.
- The uneven nature of the recovery will continue to trip up market sentiment, and so cause EM currency volatility, in particular reflected by the rand, with unexpected data readings having marked impacts, as will changes in policy measures, with the failure to extend supportive policy measures in particular likely to have a key impact.
- Monetary policy measures are providing some support, and have persisted, both domestically and in key economies, with QE in the US the biggest support for the rand in this regard. However, fiscal policies tend to have the far greater stimulatory impact for economic growth, but are also expensive with global debt levels ballooning this year.
- In the US in particular, the failure to date to extend the fiscal stimulus measures to households by Friday last week has seen the rand sag since then, and even before as markets worried the measures would not be implemented in time to prevent a gap in payments, and so a negative impact on household spend and economic activity data.
- Such patchy outcomes in policies lead to patchy outcomes in economic activity, risking a slowdown in recovery in the world's largest economy, by having a suppressing impact on employment and economic growth in Q3.20, the quarter in which markets expected a strong recovery to occur.

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



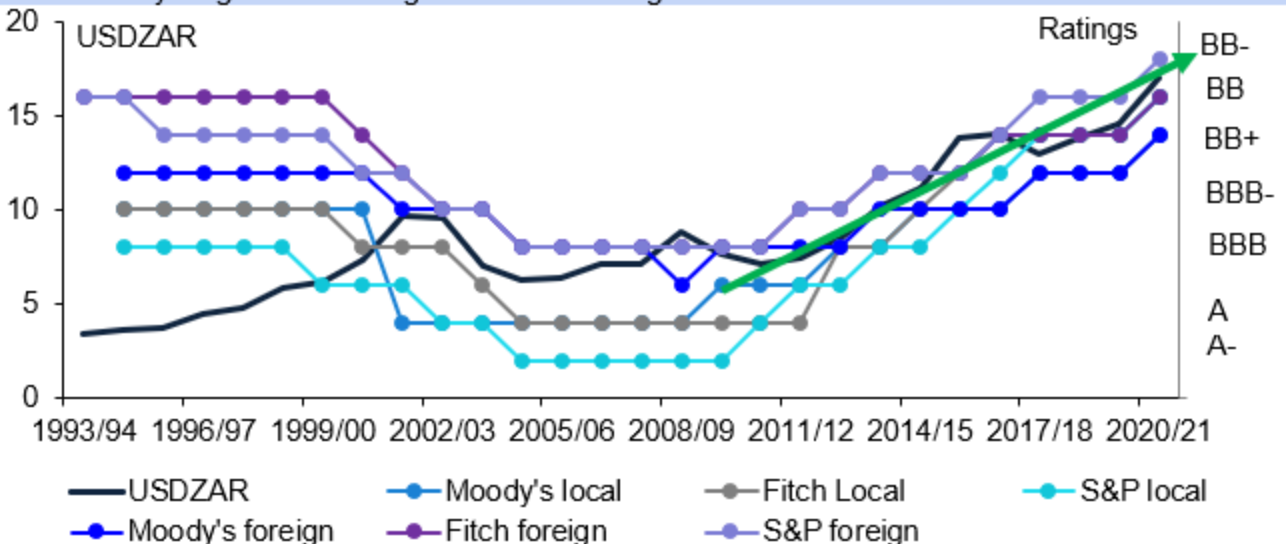
Source: Iress, Investec

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	18.00	18.50	19.50	20.00	18.50	17.00	16.50	16.00	15.80	16.00	16.00
GBP/ZAR	19.64	22.32	22.53	24.16	25.59	23.66	22.07	22.00	21.78	21.33	21.76	21.92
EUR/ZAR	16.95	19.95	20.84	22.13	22.90	21.28	19.64	19.14	18.56	18.33	18.56	18.72
ZAR/JPY	7.12	5.97	5.89	5.64	5.45	5.81	6.24	6.33	6.50	6.65	6.56	6.56
CHF/ZAR	15.89	18.79	19.62	20.68	21.11	19.43	17.77	17.17	16.57	15.80	16.00	16.00
AUD/ZAR	10.09	11.72	12.66	13.26	13.70	12.77	11.82	11.55	11.44	11.06	11.36	11.36
GBP/USD	1.28	1.24	1.22	1.24	1.28	1.28	1.30	1.33	1.36	1.35	1.36	1.37
EUR/USD	1.10	1.10	1.13	1.14	1.15	1.15	1.16	1.16	1.16	1.16	1.16	1.17
USD/JPY	109	108	109	110	109	108	106	105	104	105	105	105

Note: averages, Source: Investec, Iress

Local currency long-term sovereign debt credit ratings vs USDZAR



Source: Credit rating agencies, National treasury, Bloomberg

Enhancements to the South African Reserve Bank's open market operations

The South African Reserve Bank (SARB) continuously reviews the appropriateness and effectiveness of its open market operations (OMOs), and makes amendments where necessary.

Recently, a review of the toolkit for OMOs was undertaken. Based on the review, the following changes will be introduced to OMOs with effect from 3 August 2020 to enhance the SARB's ability to manage money market liquidity conditions:

1. Debentures and Long Term Reverse Repos

- 1.1 The SARB's Debentures and Long Term Reserve Repos are offered via a competitive multiple-price auction system, where bidders are allotted at their bid yields if the bid yields are lower or equal to the cut-off yield. In the past, the cut-off yield was capped at the prevailing repurchase rate (repo rate). Going forward, the SARB will apply greater flexibility by allotting below and above the repo rate. The allocation decision will be made at the discretion of the SARB, taking into consideration the prevailing money market liquidity conditions as well as other tools at its disposal. The tenors will remain unchanged, at 7 days, 14 days, 28 days and 56 days.
- 1.2 Debenture auctions will be conducted every Wednesday between 08:30 and 10:00. In the event of a Wednesday falling on a public holiday, the auction will be conducted on the preceding Tuesday, at the same time. Long Term Reverse Repo auctions will be conducted every Monday between 08:30 and 10:00, except on public holidays.

2. Short-term buy-sell backs on a bilateral basis with commercial banks

- 2.1 The SARB will commence conducting short-term buy-sell backs, of up to one month, with commercial banks on a bilateral basis for the purposes of managing money market liquidity.
- 2.2 The buy-sell backs will be conducted on an ad hoc basis, as and when required. The quantum on offer as well as the term will be at the discretion of the SARB.

3. Monetary Policy Portfolio

- 3.1 The SARB's Monetary Policy Portfolio (MPP) has increased in size following the introduction of the bond purchasing programme at the end of March 2020. This makes the MPP an effective tool for draining and injecting liquidity on a permanent basis. The MPP will continue to be used actively to manage money market liquidity through outright purchases and sales of government bonds in the secondary market.

Source: SA Reserve Bank

- Market concerns over the future strength of the US economy's recovery have increased safe haven flows into the US dollar, causing dollar strength and so exacerbating the weakness in the rand. The rand has weakened to R17.35/USD, R20.34/EUR and R22.62/GBP today, from Friday's close of R17.06/USD, R20.11/EUR and R22.34/GBP.
- Just under two weeks ago the rand reached R16.34/USD, R18.84/EUR and R20.78/GBP, with the highly volatile domestic currency benefiting from US dollar weakness at that time, as yield-seeking stimulated by US QE has benefitted EM currencies and weakened the US dollar.

- Concerns over global growth, led by worries over US led events (including the resumption of US-Sino tensions, lack of extension of the \$600 per week checks to households and degree of drop in Q2.20 GDP), have since boosted demand for US dollars and weakened demand for EM currencies, with the rand particularly sensitive to these flows.
- Consequently, the gold price continues to gain support, both from a safe haven status, as well as from the consequences of US QE, which has both driven the very low level of US treasury yields and weakened the value of the US dollar. The lower US bonds' yields, the lower the opportunity cost of holding gold is seen in comparison.
- With US treasuries and gold both seen as safe haven assets, but with fears of devaluation of the US dollar due to the vastly increased supply of US dollars on QE, gold has become increasingly attractive as an investment, boosting its price. The gold price is likely to see further marked gains this year, and is on track to exceed US\$2 000/oz.
- US bond yields are expected to remain at current very low levels in the foreseeable future (for the remainder of this year and into next), supporting the gold price, due to ongoing US QE. The bond buying programme of the South African Reserve Bank is also not seeing an end in the near term either (see table above).
- In the current mid-cycle of the recovery from the Covid-19 crisis for both the global economy and global financial markets, there is no anticipation that monetary support (either QE or simpler bond buying programmes) will be withdrawn, and so markets seek additional reason for optimism from fiscal stimulus to bolster economic recovery.
- That is, global risk sentiment, which is a direct driver of the domestic currency, does not typically get as much of a boost from additional monetary, as additional fiscal, support at this point. The global economic recovery is not yet fully secure, with demand weak and unemployment high, and uncertainties still abound.
- Furthermore, the third quarter of the calendar year is typically the most at risk period for the rand, as it is when the key northern hemisphere summer period occurs. Many take a break from financial market trading in August to take annual vacations (or staycations), and so any risk averse event tends to see a greatly exacerbated response.

Gold price vs USD index



Source: Iress

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	18.00	19.50	21.00	22.00	23.00	24.00	22.00	20.00	22.00	20.00	19.00
GBP/ZAR	19.64	22.32	23.74	26.02	28.15	29.42	31.16	29.33	27.23	29.70	27.20	26.03
EUR/ZAR	16.95	19.95	21.97	23.84	25.19	26.45	27.72	25.52	23.20	25.52	23.20	22.23
ZAR/JPY	7.12	5.97	5.59	5.24	4.95	4.67	4.42	4.75	5.20	4.77	5.25	5.53
CHFZAR	15.89	18.79	20.68	22.28	23.22	24.16	25.09	22.89	20.71	22.00	20.00	19.00
AUDZAR	10.09	11.72	13.34	14.28	15.07	15.87	16.68	15.40	14.30	15.40	14.20	13.49
GBP/USD	1.28	1.24	1.22	1.24	1.28	1.28	1.30	1.33	1.36	1.35	1.36	1.37
EUR/USD	1.10	1.10	1.13	1.14	1.15	1.15	1.16	1.16	1.16	1.16	1.16	1.17
USD/JPY	109	108	109	110	109	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	18.00	16.00	15.00	14.00	13.50	13.00	12.50	12.40	12.50	12.60	12.45
GBP/ZAR	19.64	22.32	19.48	18.58	17.91	17.27	16.88	16.67	16.88	16.88	17.14	17.06
EUR/ZAR	16.95	19.95	18.03	17.03	16.03	15.53	15.02	14.50	14.38	14.50	14.62	14.57
ZAR/JPY	7.12	5.97	6.81	7.33	7.79	7.96	8.15	8.36	8.39	8.40	8.33	8.43
CHFZAR	15.89	18.79	16.96	15.91	14.77	14.18	13.59	13.00	12.84	12.50	12.60	12.45
AUDZAR	10.09	11.72	10.95	10.20	9.59	9.32	9.04	8.75	8.87	8.75	8.95	8.84
GBP/USD	1.28	1.24	1.22	1.24	1.28	1.28	1.30	1.33	1.36	1.35	1.36	1.37
EUR/USD	1.10	1.10	1.13	1.14	1.15	1.15	1.16	1.16	1.16	1.16	1.16	1.17
USD/JPY	109	108	109	110	109	108	106	105	104	105	105	105

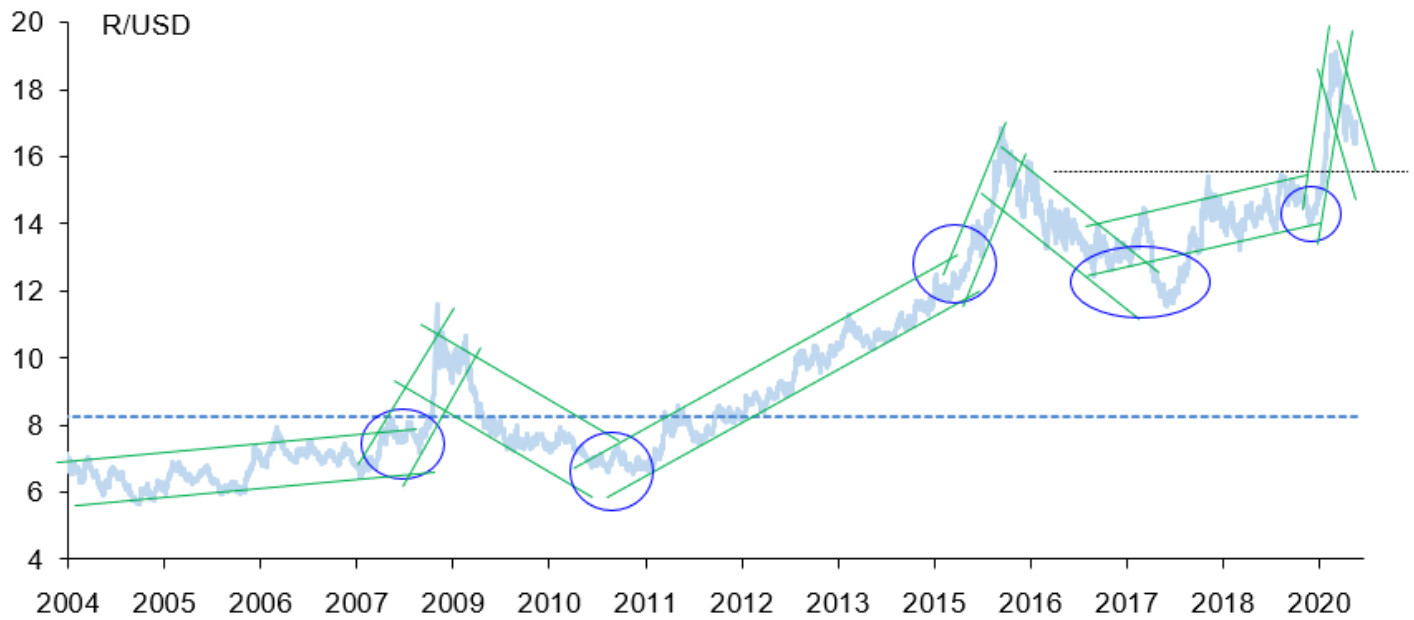
Note averages, Source: Investec, Iress

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	18.00	15.00	14.00	13.50	13.00	12.50	12.00	11.50	11.00	10.90	10.60
GBP/ZAR	19.64	22.32	18.26	17.34	17.27	16.63	16.23	16.00	15.66	14.85	14.82	14.52
EUR/ZAR	16.95	19.95	16.90	15.89	15.46	14.95	14.44	13.92	13.34	12.76	12.64	12.40
ZAR/JPY	7.12	5.97	7.26	7.86	8.07	8.27	8.48	8.71	9.04	9.55	9.63	9.91
CHFZAR	15.89	18.79	15.90	14.85	14.25	13.65	13.07	12.48	11.91	11.00	10.90	10.60
AUDZAR	10.09	11.72	10.27	9.52	9.25	8.97	8.69	8.40	8.22	7.70	7.74	7.53
GBP/USD	1.28	1.24	1.22	1.24	1.28	1.28	1.30	1.33	1.36	1.35	1.36	1.37
EUR/USD	1.10	1.10	1.13	1.14	1.15	1.15	1.16	1.16	1.16	1.16	1.16	1.17
USD/JPY	109	108	109	110	109	108	106	105	104	105	105	105

Note: averages, Source: Investec, Iress

Rand channels



Source: Iress