

Rand Note

Monday 4th November 2019

Rand strengthens on relief SA did not see a credit rating downgrade from Moody's late on Friday night, but the risk of a downgrade has clearly increased with a negative outlook, and is weighing on the domestic currency

Local Currency – Long term			
	S&P	Moody's	Fitch
Czech Republic	AA	Aa3	AA-
Chile	AA-	A1	A+
China	A+	A1	A+
Poland	A	A2	A-
Mexico	A-	A3	BBB
Peru	A-	A3	A-
Thailand	A-	Baa1	BBB+
Botswana	A-	A2	NR
Russia	BBB	Baa3	BBB
Colombia	BBB	Baa2	BBB
Hungary	BBB	Baa3	BBB
India	BBB-	Baa2	BBB-
Philippines	BBB+	Baa2	BBB
Croatia	BBB-	Ba2	BBB-
Bulgaria	BBB-	Baa2	BBB
Indonesia	BBB	Baa2	BBB
Romania	BBB-	Baa3	BBB-
South Africa	BB+	Baa3	BB+
Brazil	BB-	Ba2	BB-
Turkey	BB-	B1	BB-
Kenya	B+	B2	B+
Nigeria	B	B2	B+
Ghana	B	B3	B
Ethiopia	B	B1	B
Rwanda	B+	B2	B+
Uganda	B	B2	B+
Mozambique	B-	Caa2	CC
Zambia	CCC+	Caa2	CCC
Angola	B-	B3	B
Dem. Rep of Congo	CCC+	Caa1	NR
Namibia	NR	Ba1	BB

Source: Rating Agencies

- The rand strengthened to R14.75/USD, R16.47/EUR and R19.08/GBP today, from Friday's close of R15.02/USD, R16.78/EUR and R19.44/GBP, as markets rallied in relief on Moody's decision to only drop SA onto a negative outlook, instead of actually downgrading the sovereign's long-term, dual currency credit ratings to sub-investment grade.
- Specifically, Moody's said the drop to a negative outlook on South Africa's credit ratings "reflect the material risk that the government will not succeed in arresting the deterioration of its finances through a revival in economic growth and fiscal consolidation measures."
- The agency listed the challenges to SA's credit rating as "(s)ocial and political divisions that hamper reform progress, generate policy uncertainty" and that "(c)redit constraints stem from strong, widespread fiscal pressures and persistently low growth amid social and political obstacles to reforms, which could leave government debt on its upward trend."
- In particular, the agency said "(t)he challenges the government faces are evident in the continued deterioration in South Africa's growth and public debt trends despite ongoing policy responses", "(d)ebt-to-GDP climbed 11 ... (%) to 57% in 2014-18 and will rise a further 10-15(%) over the next five years unless ... (the) savings identified ... are implemented."
- South Africa is not out of the woods yet with Moody's, and is now just barely hanging on to its last investment grade credit rating from the last of the three key credit rating agencies. Fitch and S&P already have SA on sub-investment grade, with only Moody's maintaining SA on Baa3 (a BBB-) equivalent.
- Indeed, on Friday night Moody's highlighted the factors which could still lead to a credit rating downgrade for SA, stating that "South Africa's ratings would likely be downgraded if we concluded that those conditions ... (that return SA to a stable outlook) ... will not be met and that South Africa's fiscal and economic strength will continue to erode."
- Q4.19's expected case forecasts for the rand have weakened as was the risk given October's weak performance (see "Rand note", 21st October 2019, website address below). Only recently global events have lent some support from the progress in trade negotiations, and the US signalling no further interest rate hikes are likely, along with Moody's outcome.

Expected 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	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	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	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

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

Extreme Up 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	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

- While the rand has seen a relief rally as Moody's did not prove to downgrade SA (see "Rand note", 28th October 2019), the domestic currency will nevertheless likely remain volatile and at risk of weakness, both due to domestic and global growth factors, the latter as the synchronised global economic slowdown persists this year.
- The higher likelihood of a Moody's rating downgrade is shown by the drop to a negative outlook from stable on the back of the October MTBPS (see "MTBPS Snapshot: an extreme ramp up in debt to GDP projections makes a Moody's credit rating downgrade substantially more likely, and a revision to a negative outlook a certainty", 30th October 2019).
- In order to avoid a downgrade from investment to sub-investment grade, SA needs to see the outlook on its rating return to stable from negative, with Moody's indicating this would occur "if the government's efforts to rein in spending, improve tax compliance and lift potential growth became increasingly likely to successfully stabilize debt ratios."
- The agency specifically clarifies that, in assessing whether SA's outlook should return to stable, it "will focus on the government's progress early on in its tenure in delivering the additional fiscal adjustments the MTBPS identifies, but also in addressing long-standing issues related to corruption and the financially weak SOEs sector, especially Eskom."
- Should the outlook not return to stable from negative, SA will be downgraded and this drop to sub-investment grade could occur in around eighteen months (lite down case). Moody's is focussing on the achievement of spending cuts, which the MTBPS also identifies requires curtailment of civil service remuneration but political opposition here is likely.
- A drop to sub-investment grade would also "likely reflect diminishing prospects that growth will be sufficient to preserve current income levels for the majority and halt the rise in government debt over the medium term. Signs of diminishing resilience to external financing shocks would also exert downward pressure on the rating."
- South Africa is by no means out of the woods yet on the credit rating front, and indeed the situation is worse than a year ago, as a downgrade is now more likely. We maintain a high probability of such a downgrade at 37%, improving only very slightly from 38% recently (see "Credit Ratings Note", 1st November 2019).

Economic Scenarios: - note updated table

		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	14.89	11.50	10.30	9.50	8.60	7.90
	Repo rate (end rate)	6.75	6.75	6.50	6.00	6.00	5.75	5.75	5.50
	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 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 case 40%	Rand/USD (average)	14.01	14.38	14.89	14.85	14.15	14.45	14.65	14.00
	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 (domestic) Down case 37%	Rand/USD (average)	14.01	14.38	14.89	15.80	16.50	16.30	15.50	15.15
	Repo rate (end rate)	6.75	6.75	6.50	6.75	7.25	7.25	7.25	7.25
	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.								
Severe down case 15%	Rand/USD (average)	14.01	14.38	14.89	16.10	18.50	19.50	20.00	19.25
	Repo rate (end rate)	6.75	6.75	6.50	7.00	7.75	8.50	9.25	10.00
	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.								

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

