

Rand Note

Monday 6 January 2019

Rand pierces R14.00/USD mark during festive period on global risk-on seasonality, before depreciating as the US kills Iran's top military leader. SA economic growth realities, as load shedding is reinstated, also sour rand sentiment

Severe Down case: Exchange Rates forecasts (led by global event/s)	2020 Q1	2020 Q2	2020 Q3	2020 Q4	2021 Q1	2021 Q2	2021 Q3	2021 Q4	2022 Q1	2022 Q2	2022 Q3	2022 Q4
USD/ZAR	16.00	17.50	18.50	19.80	19.50	18.90	18.50	18.00	17.50	17.00	16.60	16.25
GBP/ZAR	21.02	22.86	24.07	26.32	26.33	25.89	25.80	25.10	24.40	23.71	23.15	22.66
EUR/ZAR	17.76	19.78	21.18	22.77	23.01	22.68	22.76	22.50	21.88	21.25	20.75	20.31
ZAR/JPY	6.66	6.06	5.70	5.28	5.44	5.61	5.73	5.89	6.06	6.29	6.45	6.58
ZARCHF	16.15	17.82	18.83	20.15	20.10	19.69	19.27	18.75	18.42	17.89	17.47	17.11
ZAR/AUD	10.88	11.73	12.49	13.46	13.65	13.80	13.88	14.04	13.65	13.26	12.95	12.68
GBP/USD	1.31	1.31	1.30	1.33	1.35	1.37	1.39	1.39	1.39	1.39	1.39	1.39
EUR/USD	1.11	1.13	1.15	1.15	1.18	1.20	1.23	1.25	1.25	1.25	1.25	1.25
USD/JPY	107	106	106	105	106	106	106	106	106	107	107	107

Note: averages, Source: IRESS, Investec

Expected case: Exchange Rates forecasts	2020 Q1	2020 Q2	2020 Q3	2020 Q4	2021 Q1	2021 Q2	2021 Q3	2021 Q4	2022 Q1	2022 Q2	2022 Q3	2022 Q4
USD/ZAR	14.30	14.60	14.80	14.45	13.90	14.05	14.55	14.15	13.75	14.40	14.70	14.00
GBP/ZAR	18.78	19.07	19.26	19.21	18.77	19.25	20.29	19.73	19.17	20.08	20.50	19.52
EUR/ZAR	15.87	16.50	16.95	16.62	16.40	16.86	17.90	17.69	17.19	18.00	18.38	17.50
ZAR/JPY	7.45	7.26	7.13	7.23	7.63	7.54	7.29	7.49	7.71	7.43	7.28	7.64
ZARCHF	14.43	14.86	15.06	14.71	14.33	14.64	15.16	14.74	14.47	15.16	15.47	14.74
ZAR/AUD	9.72	9.78	9.99	9.83	9.73	10.26	10.91	11.04	10.73	11.23	11.47	10.92
GBP/USD	1.31	1.31	1.30	1.33	1.35	1.37	1.39	1.39	1.39	1.39	1.39	1.39
EUR/USD	1.11	1.13	1.15	1.15	1.18	1.20	1.23	1.25	1.25	1.25	1.25	1.25
USD/JPY	107	106	106	105	106	106	106	106	106	107	107	107

Note: averages, Source: IRESS, Investec

- The rand strengthened to R13.96/USD, R15.58/EUR and R18.27/GBP in the last few days of 2019, buoyed by the typical strengthening trajectory this time of year, until the unexpected shock of the US's killing of General Qassem Soleimani. Resultant risk-off saw the domestic currency weaken to R14.37/USD, R16.00/EUR and R18.79/GBP.
- The US ordered military strike, which resulted in the death of the Iranian General, saw Iran cancel its 2015 nuclear deal agreement, with both the US and Iran threatening very severe attacks going forward, causing tensions in other countries in the Middle East to flare, with risk of war harming sentiment in global financial markets .
- Oil prices rose on fears of tightening supply as retaliatory attacks are feared on oil pipelines, shipping in the Strait of Hormuz and/or the Red Sea, as well as on cyber and American targets. The WTI (West Texas Intermediate) oil price has risen to around US\$64/bbl, and the Brent crude oil price to close to US\$70/bbl.
- The WTI crude oil price has run closer to US\$55/bbl in 2019, with a high number of US shale oil producers indicating breakeven above the US\$55/bbl mark for WTI crude. Indeed, even with the WTI crude price closer to US\$57/bbl in Q4.19, US drilling activity contracted, with a negative impact also on firms in related services industries.
- A number of US firms in the industry were reported to be expected to cut capital expenditure this year, with weak oil prices and high costs cited, and some worries also around solvency and bankruptcy. However, this generally depressed sentiment of US shale oil producers was recorded prior to the jump in oil prices following the death of Iran's General.
- With the US-led global trade war expected to see a first phase deal signed between the US and China mid-January, the rand had been gaining fairly steadily since October to the end of 2019, before it weakness in January. Today, the rand has pulled back somewhat, to R14.22/USD, R15.92/EUR and R18.67/GBP, from its weak levels on Friday.
- Rand volatility tends to be lower in the first quarter of the calendar year, as neutral to risk-on sentiment tends to prevail during the Northern Hemisphere winter as traders are typically more active, and larger risk takers than during the Northern Hemisphere summer months of vacation, resulting in some seasonality for the rand and other EM currencies.
- This seasonality may be aiding a less subdued response to the US-Iran military conflict (absent further escalation). The global seasonal effects for EM currencies often see the search for yield shrug off bad news, more quickly than the more risk averse, and often thinner, trading months in the middle two quarters of the year.
- Eskom's reinstatement of load shedding likely also weakened the domestic currency in January. Indeed, Eskom warns that insufficient electricity supply could persist for two years, which is clearly negative for South Africa's GDP growth and so for market sentiment on the rand.

Lite Down case: Exchange Rates forecasts (led by domestic events)	2020	2020	2020	2020	2021	2021	2021	2021	2022	2022	2022	2022
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
USD/ZAR	15.50	16.50	16.80	16.10	15.80	15.90	15.70	15.30	15.00	15.10	15.05	14.80
GBP/ZAR	20.36	21.55	21.86	21.40	21.33	21.78	21.89	21.34	20.92	21.06	20.99	20.64
EUR/ZAR	17.21	18.65	19.24	18.52	18.64	19.08	19.31	19.13	18.75	18.88	18.81	18.50
ZAR/JPY	6.87	6.42	6.28	6.49	6.71	6.67	6.75	6.93	7.07	7.09	7.11	7.23
ZARCHF	15.64	16.80	17.10	16.38	16.29	16.56	16.35	15.94	15.79	15.89	15.84	15.58
ZARAUD	10.54	11.06	11.34	10.95	11.06	11.61	11.78	11.93	11.70	11.78	11.74	11.54
GBP/USD	1.31	1.31	1.30	1.33	1.35	1.37	1.39	1.39	1.39	1.39	1.39	1.39
EUR/USD	1.11	1.13	1.15	1.15	1.18	1.20	1.23	1.25	1.25	1.25	1.25	1.25
USD/JPY	107	106	106	105	106	106	106	106	106	107	107	107

Note: averages, Source: IRESS, Investec

- The first quarter of each calendar year has seen a contraction in GDP in the past four years, and Q1.20 is expected to be no different. However, Q4.19 GDP likely contracted as well, while Q3.19 saw GDP contract by -0.6% qoq. This would see three successive quarters of contraction in GDP.
- Substantial load shedding in Q4.19 reached previously unattained stage six, and is expected to have damaged economic production, with GDP likely contracting in excess of -1% qoq in Q4.19. Further load shedding is expected in Q1.20, which would support a further contraction in GDP.
- Some of Q1.20's load shedding will likely be to effect maintenance that has been insufficiently done over the years. This would contribute to stabilising the system by reducing unplanned breakdowns, which are reported to have been substantial over 2019.
- Eskom has said unplanned breakdowns have also been due to inadequate scheduled maintenance occurring for many years. Unplanned maintenance is planned in less than 28 days, and is often insufficient to address all the issues, while planned maintenance includes the lengthy time periods needed to order and receive required parts as well as servicing.
- In the absence of substantial repair of SA's electricity capacity, it is clear producers relying on state supplied electricity will increasingly see their productive capacity reduce going forward, not least due to the aging of many of SA's power stations. The risk is for a lengthy, entrenched downturn in GDP led by deep structural issues on the supply-side.
- Potential GDP is likely around 0.5% y/y currently, from above 3.0% in 2011, on the persistent downwards trend in the growth in the productive capacity of the economy since 2012. SA risks potential GDP continuing to drop to 0%, and then below, without drastic action to repair the productivity of public services and infrastructure (including electricity supply).
- Indeed, this year and next, SA risks at least one severe supply-side recession just as the risk of a global supply-side recession on the US-led trade war may be receding on the expected phase-one trade deal with China this month. So far, the trade war has led to falling business confidence and manufacturing production, with easing monetary policy.
- A 2020 risk, if the trade war does not subside (if trade deals prove elusive – not the expected case), is higher inflation globally, particularly on higher oil prices if the US- Middle East conflict escalates. Under such a scenario, the rand could weaken substantially, a severe down case determined by global led event/s) which also includes global recession.

- Risks appear slightly more poised to the downside with the recent heightened US military aggression in the Middle East, generating some volatility in a typically calm period for EM currencies. Oil prices are not expected to elevate substantially further without a marked escalation in US Iranian military tensions, but these cannot yet be ruled out by any means.

Up case: Exchange Rates forecasts	2020	2020	2020	2020	2021	2021	2021	2021	2022	2022	2022	2022
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
USD/ZAR	13.00	11.50	10.00	9.95	9.90	9.70	9.65	9.45	9.30	9.15	9.00	9.20
GBP/ZAR	17.08	15.02	13.01	13.23	13.37	13.29	13.46	13.18	12.97	12.76	12.55	12.83
EUR/ZAR	14.43	13.00	11.45	11.44	11.68	11.64	11.87	11.81	11.63	11.44	11.25	11.50
ZAR/JPY	8.19	9.22	10.55	10.50	10.71	10.93	10.98	11.22	11.40	11.69	11.89	11.63
ZARCHF	13.12	11.71	10.18	10.13	10.21	10.10	10.05	9.84	9.79	9.63	9.47	9.68
ZARAUD	8.84	7.71	6.75	6.77	6.93	7.08	7.24	7.37	7.25	7.14	7.02	7.18
GBP/USD	1.31	1.31	1.30	1.33	1.35	1.37	1.39	1.39	1.39	1.39	1.39	1.39
EUR/USD	1.11	1.13	1.15	1.15	1.18	1.20	1.23	1.25	1.25	1.25	1.25	1.25
USD/JPY	107	106	106	105	106	106	106	106	106	107	107	107

Note: averages, Source: IRESS, Investec

Extreme Up case: Exchange Rates forecasts	2020	2020	2020	2020	2021	2021	2021	2021	2022	2022	2022	2022
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
USD/ZAR	11.50	10.30	9.50	8.60	7.90	7.60	7.40	7.10	6.95	6.75	6.95	7.15
GBP/ZAR	15.11	13.46	12.36	11.43	10.67	10.41	10.32	9.90	9.69	9.41	9.69	9.97
EUR/ZAR	12.77	11.64	10.88	9.89	9.32	9.12	9.10	8.88	8.69	8.44	8.69	8.94
ZAR/JPY	9.26	10.29	11.11	12.15	13.42	13.95	14.32	14.93	15.25	15.85	15.40	14.97
ZARCHF	11.60	10.49	9.67	8.75	8.14	7.92	7.71	7.40	7.32	7.11	7.32	7.53
ZARAUD	7.82	6.90	6.41	5.85	5.53	5.55	5.55	5.54	5.42	5.27	5.42	5.58
GBP/USD	1.31	1.31	1.30	1.33	1.35	1.37	1.39	1.39	1.39	1.39	1.39	1.39
EUR/USD	1.11	1.13	1.15	1.15	1.18	1.20	1.23	1.25	1.25	1.25	1.25	1.25
USD/JPY	107	106	106	105	106	106	106	106	106	107	107	107

Note: averages, Source: IRESS, Investec