Investec

SA Economics

Rand Note

7th October 2019

After pulling back towards R15.00/USD over the last few days on growing expectations of another US interest rate cut (on 30th October), the domestic currency fell prey, again, to risk-off sentiment this morning over global trade concerns

Economic Scenarios: - note some changes in forecast figures

Scenario		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	14.69	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.

Scenario		Q1.19	Q2.19	Q3.19	Q4.19	Q1.20	Q2.20	Q3.20	Q4.20
Up case 10%	Rand/USD (average)	14.01	14.38	14.69	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 are 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, 'trade war' subsides. Stabilisation of credit ratings, with ultimately credit rating upgrades.

Scenario		Q1.19	Q2.19	Q3.19	Q4.19	Q1.20	Q2.20	Q3.20	Q4.20
Base case 45%	Rand/USD (average)	14.01	14.38	14.69	14.30	14.05	14.35	14.55	13.95
	Repo rate (end rate)	6.75	6.75	6.50	6.50	6.50	6.50	6.50	6.50

Annual growth rate of close to 2.0% y/y reached by 2020, 3.0% y/y by 2024. Higher confidence and investment levels than past decade. 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. 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).

Scenario		Q1.19	Q2.19	Q3.19	Q4.19	Q1.20	Q2.20	Q3.20	Q4.20
Lite (domestic) Down case 35%	Rand/USD (average)	14.01	14.38	14.69	15.50	17.00	16.50	15.50	15.15
	Repo rate (end rate)	6.75	6.75	6.50	7.50	8.50	7.50	7.50	7.50

Business confidence remains depressed, marked rand weakness, significant load shedding and weak investment growth. SA sub-investment grade Moody's rating but substantial repair avoids further marked downgrades. SA experiences a V shaped, 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. Partial expropriation of (certain groups') private commercial sector property (including productive land) without compensation.

Scenario		Q1.19	Q2.19	Q3.19	Q4.19	Q1.20	Q2.20	Q3.20	Q4.20
Severe down case 9%	Rand/USD (average)	14.01	14.38	14.69	16.10	18.50	19.50	20.00	19.25
	Repo rate (end rate)	6.75	6.75	6.50	8.00	9.25	10.75	12.00	13.75

Faster than expected global (US) monetary policy normalisation, general market risk-off, global sharp economic slowdown (commodity slump) followed by marked escalation of US-China trade war – short US recession, global financial crisis. SA sub-investment grade, risks further credit rating downgrades. Significantly more severe recession than in lite down case. Confidence and investment depressed, marked rand weakness, significant strike action and widespread services load shedding. Expropriation of private sector property (title deeds not transferred to individuals nationalisation) without compensation.

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

- The rand closed last week at R15.03/USD, R16.52/EUR and R18.56/GBP, running somewhat stronger on rising expectations that the US will cut its interests again this year - specifically at its 30th October FOMC meeting. Markets expectations rose to 77% for this 25bp easing at the end of the month, weakening the US dollar somewhat.

- However, this morning the volatile domestic currency has weakened back towards the levels mainly prevailing last week over concerns of renewed global trade tensions. The domestic currency may still attempt to break through R15.00/USD in the run-up to the FOMC meeting at the end of this month if risk aversion subsides.

- The rand weakened to R15.18/USD, R16.65/EUR and R18.69/GBP this morning, largely ignoring the report of a strengthening in SA's foreign exchange and gold reserves by US$4.9bn. Typically higher foreign exchange reserves are a positive factor under Moody's rating assessments, but the international liquidity position declined at the same time.

- While the drop in South Africa's international liquidity was relatively small, at US168m, it is an overall negative outcome for SA with the Reserve Bank highlighting that it reflects "the significant change in the foreign currency deposits received and the decline in the forward position, which was offset by the increase in the gross reserves."

- Furthermore, the upcoming MTBPS (or Medium-term budget policy statement) is being seen to cast a pall over the rand's fortunes, as is a potential Moody's country review with possibly rating action on the SA sovereign's perceived credit worthiness. However, we continue to expect only a downgrade to the rating outlook this year, or in H1.20.

- On the global front, the trade (and other areas of) conflict between the US and China continue to show little sign of ending, with Chinese officials reported as increasingly opposed to agreeing to a broad trade deal between themselves and the US, contributing significantly to rand weakness today.

- Fears of a slowdown in global economic growth is likely to become increasingly concerning for the Federal Reserve Bank as the US is not sheltered from global economic activity, while SA, as a small open economy, would likely see even its current pace of economic activity challenged by a further significant weakening in global economic growth.

- Domestically, South Africa’s settling of economic growth last year (and likely this) in the sub 1% category for these calendar years is not inspiring consistent portfolio investment into South Africa, and so rand strength, given also the increasing weakness of state finances.

- Markets perceive that the ANC’s recent response to Finance Minister Mboweni and National Treasury’s economic growth plan has been limp, with the agreed version seen to be diluted, and so not containing all the necessary impetus to economic growth that was initially proposed.

- This is despite the growth plan (Economic transformation, inclusive growth, and competitiveness - Towards an Economic Strategy for South Africa) being largely adopted, in the main, by a number of other ministries including Trade and Industry, Public Enterprises, Minerals and Energy and Small Business Development.

- Perceptions that the ANC and its alliance partners continue to see infighting and an inability to embrace the pro-market reforms needed to rapidly embrace the requirements for laying the groundwork to achieve robust economic growth are unfortunate, as a number of key suggestions are progressing and would likely contribute to lifting growth somewhat.

- However, with not enough done so far to create a sea change in the risk-reward metric for SA as an investment destination (and opportunity for local investors) the rand sees little domestic led impetus to strengthen, continuing to follow global events.

- Tangible evidence of a marked reduction in risk for fixed investment in South Africa, and/or a significant rise in reward (which includes likely faster economic growth), preferably happening simultaneously, and without deterioration in the other, is required to spark robust economic growth in SA from a domestic private sector investment perspective.

- A material export-led pick-up in SA’s growth is unlikely in 2020 as the global economy is increasingly expected to weaken further. A consumer led recovery also remains unlikely given the deterioration in household finances since 2009 on rising unemployment, among other factors, and partly a legacy issue of the previous administrations policy choices.