



Rand weakens as heightened global trade tensions add to the downside, while the lite down case becomes more likely, i.e. a weak economic growth outlook for SA and a Moody's credit rating downgrade

6 August 2019

Light 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	16.00	17.00	16.50	15.50	15.15	14.90	14.80	14.70	14.75	14.70
GBP/ZAR	18.24	18.48	19.99	21.36	21.00	20.09	20.14	19.98	20.42	20.50	20.57	20.50
EUR/ZAR	15.91	16.15	18.04	19.38	19.06	17.98	17.73	17.58	18.20	18.38	18.44	18.38
ZAR/JPY	7.87	7.65	6.75	6.35	6.48	6.84	6.96	7.01	7.16	7.21	7.19	7.21
ZARCHF	14.05	14.34	16.11	17.23	16.72	15.57	15.15	14.77	15.26	15.31	15.36	15.31
ZARAUD	9.98	10.07	10.80	11.56	11.47	10.93	10.91	10.88	11.25	11.61	11.51	11.47
GBP/USD	1.30	1.29	1.25	1.26	1.27	1.30	1.33	1.34	1.38	1.39	1.39	1.39
EUR/USD	1.14	1.12	1.13	1.14	1.16	1.16	1.17	1.18	1.23	1.25	1.25	1.25
USD/JPY	110	110	108	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	16.10	17.20	18.50	19.50	20.00	19.25	18.70	18.00	17.50	16.75
GBP/ZAR	18.24	18.48	20.11	21.61	23.55	25.27	26.59	25.81	25.81	25.10	24.40	23.36
EUR/ZAR	15.91	16.15	18.15	19.61	21.37	22.62	23.40	22.72	23.00	22.50	21.88	20.94
ZAR/JPY	7.87	7.65	6.71	6.28	5.78	5.44	5.28	5.43	5.67	5.89	6.06	6.33
ZARCHF	14.05	14.34	16.21	17.43	18.74	19.58	20.00	19.09	19.28	18.75	18.23	17.45
ZARAUD	9.98	10.07	10.87	11.70	12.66	13.75	14.40	14.05	14.21	14.22	13.65	13.07
GBP/USD	1.30	1.29	1.25	1.26	1.27	1.30	1.33	1.34	1.38	1.39	1.39	1.39
EUR/USD	1.14	1.12	1.13	1.14	1.16	1.16	1.17	1.18	1.23	1.25	1.25	1.25
USD/JPY	110	110	108	108	107	106	106	105	106	106	106	106

Note: averages, Source: IRESS, Investec

- The rand weakened markedly to R14.98/USD, R16.77/EUR and R18.19/GBP this week, as risk aversion elevated on concerns over slower global growth following US threats of additional trade tariffs (10% on a further US\$300bn of Chinese goods imported to the US), eroding much of the risk-on generated by July's US rate cut.
- Specifically, the US is positioning itself to place tariffs on most of its remaining Chinese imports from 1st September, ostensibly because China has not made substantial enough purchases of US agricultural produce. Markets fearing a freeze in US-Sino trade talks after around a month's truce, have seen EM currency and oil price weakness.

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Economic Scenarios: - note change in probabilities									
		Q1.19	Q2.19	Q3.19	Q4.19	Q1.20	Q2.20	Q3.20	Q4.20
Extreme	Rand/USD (average)	14.01	14.38	11.50	10.30	9.50	8.60	7.90	7.60
	Repo rate (end rate)	6.75	6.75	6.00	6.00	5.75	5.75	5.50	5.50
Up case	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.								
1%									
Up case	Rand/USD (average)	14.01	14.38	13.00	11.50	10.00	9.95	9.90	9.70
	Repo rate (end rate)	6.75	6.75	6.25	6.25	6.25	6.00	6.00	6.00
10%	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.								
Base case	Rand/USD (average)	14.01	14.38	14.30	13.90	13.40	13.70	13.90	13.30
	Repo rate (end rate)	6.75	6.75	6.50	6.50	6.50	6.50	6.50	6.50
45%	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).								
Lite	Rand/USD (average)	14.01	14.38	15.50	17.00	16.50	15.50	15.15	14.90
	Repo rate (end rate)	6.75	6.75	7.50	8.50	7.50	7.50	7.50	7.25
Down case	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.								
35%									
Severe down case	Rand/USD (average)	14.01	14.38	16.10	18.50	19.50	20.00	19.25	18.70
	Repo rate (end rate)	6.75	6.75	8.00	9.25	9.75	10.25	10.75	9.50
9%	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									

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Expected case: Exchange Rates forecasts averages	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	14.30	13.90	13.40	13.70	13.90	13.30	12.70	13.20	13.90	13.40
GBP/ZAR	18.25	18.48	17.87	17.46	17.05	17.76	18.48	17.83	17.53	18.41	19.38	18.69
EUR/ZAR	15.92	16.15	16.12	15.85	15.48	15.89	16.26	15.69	15.62	16.50	17.38	16.75
ZAR/JPY	7.87	7.65	7.55	7.77	7.99	7.74	7.59	7.86	8.35	8.03	7.63	7.91
ZARCHF	14.06	14.33	14.40	14.09	13.58	13.76	13.90	13.19	13.09	13.75	14.48	13.96
ZARAUD	9.98	10.07	9.65	9.45	9.31	9.66	10.01	9.71	9.65	10.43	10.84	10.45
GBP/USD	1.30	1.29	1.25	1.26	1.27	1.30	1.33	1.34	1.38	1.39	1.39	1.39
EUR/USD	1.14	1.12	1.13	1.14	1.16	1.16	1.17	1.18	1.23	1.25	1.25	1.25
USD/JPY	110	110	108	108	107	106	106	105	106	106	106	106

Source: IRESS, Investec

- The new move would extend US tariffs to nearly all imports from China, and in addition President Trump has also threatened to raise the actual tariff duties as well (to above 10%), if China's President Xi Jinping does not accelerate progress towards a trade deal between the two countries.
- In retaliation, this week China is reported to have ceased imports of US agricultural goods. Additionally, Chinese authorities have allowed the yuan to depreciate beyond 7 to the US dollar (a decade low), to provide support to their economy in the face of escalating trade tensions.
- Financial markets dropped, with a notable rise in the VIX echoing the drop in equity markets, while oil prices dipped on fears of a weakening in global demand. As both an emerging market, and a commodity, currency the rand has been negatively affected, weakening from R13.81/USD mid-July to R14.98/USD yesterday.
- Already at the end of July we revised the probability of the lite down case to 35% from 25% (see "Rand note: rand runs back through R14.00/USD as South Africa is seen to move closer to becoming a sub-investment grade country - the probability of the lite down case increases", 29th July 2019, website address below).
- The expected case probability fell from 50% to 45%, with the increased tilt to the downside reflecting the risk of further weakness for the domestic currency this year and next. The severe down case saw its probability fall to 9% from 14% on US rate cuts, but worsening global trade tensions would push its probability back to 14% again.
- While trade tensions between the US and China have exhibited stop-start tendencies, overall there has been a deterioration, as protectionism has increased notably, which is supportive of slower global economic growth, the latter being a support for the recent cut by the FOMC in the fed funds rate.

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Extreme Up case: Exchange Rates forecasts averages	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	11.50	10.30	9.50	8.60	7.90	7.60	7.40	7.10	6.95	6.75
GBP/ZAR	18.24	18.48	14.37	12.94	12.09	11.15	10.50	10.19	10.21	9.90	9.69	9.41
EUR/ZAR	15.91	16.15	12.97	11.74	10.97	9.98	9.24	8.97	9.10	8.88	8.69	8.44
ZAR/JPY	7.87	7.65	9.39	10.49	11.26	12.33	13.35	13.75	14.32	14.93	15.25	15.70
ZARCHF	14.05	14.34	11.58	10.44	9.63	8.64	7.90	7.54	7.63	7.40	7.24	7.03
ZARAUD	9.98	10.07	7.76	7.00	6.60	6.06	5.69	5.55	5.62	5.61	5.42	5.27
GBP/USD	1.30	1.29	1.25	1.26	1.27	1.30	1.33	1.34	1.38	1.39	1.39	1.39
EUR/USD	1.14	1.12	1.13	1.14	1.16	1.16	1.17	1.18	1.23	1.25	1.25	1.25
USD/JPY	110	110	108	108	107	106	106	105	106	106	106	106

Source: IRESS, Investec

Up case: Exchange Rates forecasts averages	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	13.00	11.50	10.00	9.95	9.90	9.70	9.65	9.45	9.30	9.15
GBP/ZAR	18.25	18.48	16.24	14.45	12.73	12.90	13.16	13.01	13.32	13.18	12.97	12.76
EUR/ZAR	15.92	16.15	14.66	13.11	11.55	11.54	11.58	11.45	11.87	11.81	11.63	11.44
ZAR/JPY	7.87	7.65	8.31	9.39	10.70	10.65	10.66	10.77	10.98	11.22	11.40	11.58
ZARCHF	14.06	14.33	13.09	11.65	10.13	9.99	9.90	9.62	9.95	9.84	9.69	9.53
ZARAUD	9.98	10.07	8.78	7.82	6.95	7.01	7.13	7.08	7.33	7.47	7.25	7.14
GBP/USD	1.30	1.29	1.25	1.26	1.27	1.30	1.33	1.34	1.38	1.39	1.39	1.39
EUR/USD	1.14	1.12	1.13	1.14	1.16	1.16	1.17	1.18	1.23	1.25	1.25	1.25
USD/JPY	110	110	108	108	107	106	106	105	106	106	106	106

Source: IRESS, Investec

- Indeed, the latest US-Sino trade spat increases the chance for further cuts in the fed funds rate this year, with initially another 25bp cut expected after July's move. However, a number of market players now believe this could extend to two further 25bps cuts instead, lowering the fed funds rate by 75bp in total this year.
- However, this is not yet the FOMC's view, and indeed the FOMC did not display as dovish a tone at its last meeting as markets expected (see "FOMC note: FOMC cuts by 25bp as expected", 1st August 2019). Instead, the FOMC highlighted that it was not necessarily embarking on a lengthy rate cut cycle.

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- The rand, and other EM currencies have weakened considerably on the worsening in the trade relationship between the US and China, in combination with the unexpected tone of the FOMC, which some market players are even deeming hawkish.
- However, with US global trade relations moving increasing towards the territory of a global trade war, the FOMC may change its tone and deliver further rate cuts this year, which would be supportive of some EM currency strength. Additionally, the US could pull back in its negotiations with China once again.
- While the probability of the severe down case reduced in July, as the chance of global recession was seen to have waned, this may be a temporary reduction and its likelihood may raise to 14% as noted above, if US-Sino trade relations deteriorate notably further. This could also necessitate a weakening of the expected case rand forecasts.
- We would expect to remove the additional 5% from the expected case and add it to the severe down case in this event, thereby rendering the expected and lite down case evenly weighted, to also evidence the rising probability of a Moody's credit rating downgrade for SA given the rising level of debt issuance and warnings from Moody's.

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