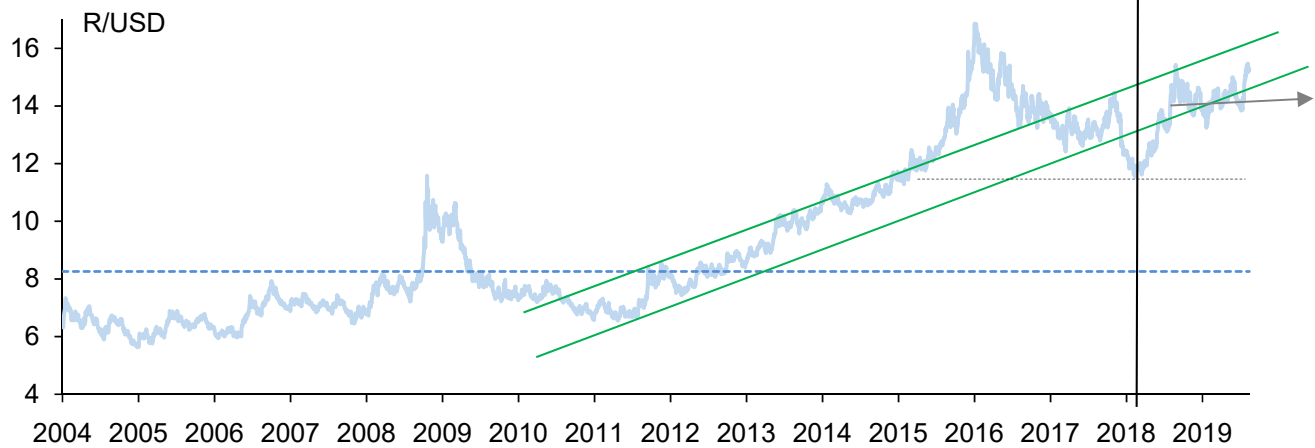




Figure 1: Rand channel of current decade



Source: Iress

The rand has weakened materially this month, to R15.50/USD, R17.19/EUR and R18.81/GBP from R13.81/USD, R15.42/EUR and R17.15/GBP earlier in the quarter. Renewed fears of global recession initially saw a material sell-off of EM currencies, reinforced by market concerns over a perceived insufficiently dovish tone from the Fed following its July FOMC meeting. The US economy is evincing strong economic growth, running at full employment, and leading to Fed caution on the monetary easing front. The FOMC was clear that the 25bp cut in interest rates at its July meeting did not necessarily indicate the start of a lengthy interest rate cut cycle, but more recently, commentary from Jackson Hole seems less opposed to additional easing. Rand weakness ensued in August on the back of the Fed commentary after its July meeting, alongside worsening policy uncertainty in SA, delayed growth-enhancing reforms, fears of the need for an IMF bailout and the lack of resolution to the Eskom debt crisis. Despite the IMF subsequently denying that SA needed financial rescue, the rand failed to strengthen, dragged down most recently by further trade developments at the past weekend. The domestic currency has been running towards the down side in August, as indicated by an earlier increase in the probability of the risks to the down side already in July, leading to a revision now of the H2.19 expected case currency forecasts, (see figures 2 and

Figure 2: Exchange rate forecasts – averages for the expected case

Forecasts:	Q1.19	Q2.19	Q3.19	Q4.19	Q1.20	Q2.20	Q3.20	Q4.20
USD/ZAR (Av)	14.01	14.38	14.55	14.15	13.70	14.00	14.20	13.60
GBP/ZAR (Av)	18.25	18.48	17.82	17.04	17.24	18.08	18.48	17.77
EUR/ZAR (Av)	15.92	16.16	16.43	15.85	15.34	15.82	16.26	15.64
ZAR/JPY (Av)	7.86	7.65	7.34	7.49	7.74	7.57	7.43	7.68
GBP/USD (Av)	1.30	1.29	1.22	1.20	1.26	1.29	1.30	1.31
EUR/USD (Av)	1.14	1.12	1.13	1.12	1.12	1.13	1.15	1.15
USD/JPY (Av)	110	110	107	106	106	106	106	105

Source: Investec



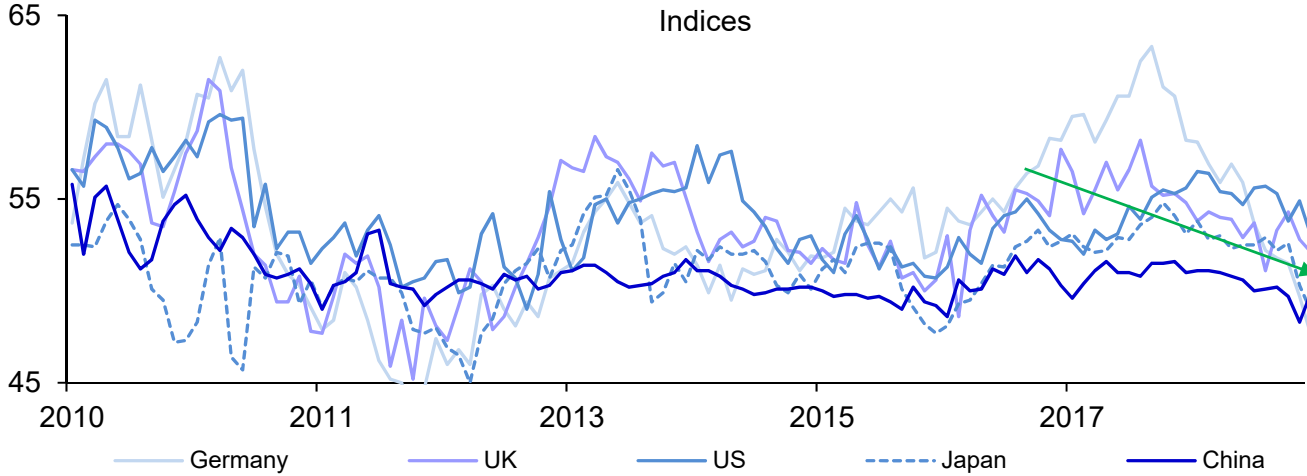
Figure 3: Economic Scenarios: - note change in probabilities

		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									
1%	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									
10%	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
	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' subsidies. Stabilisation of credit ratings, with ultimately credit rating upgrades.								
Base	Rand/USD (average)	14.01	14.38	14.55	14.15	13.70	14.00	14.20	13.60
	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
(domestic)									
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	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
down case	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.								
9%									

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



Figure 4: Advanced economies and China's manufacturing Purchasing Manager Index (PMI)

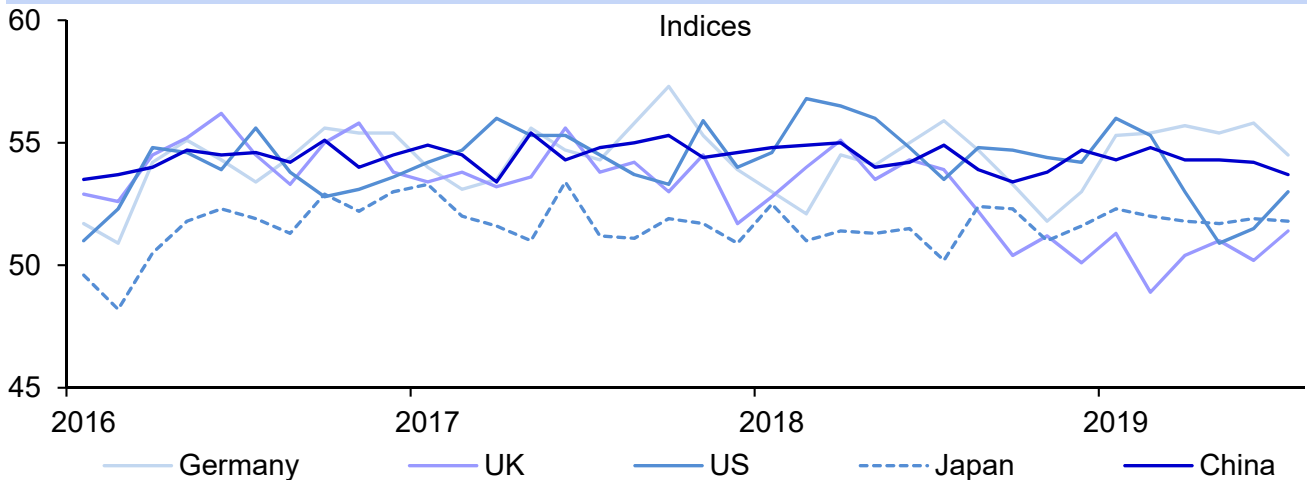


Source: Bloomberg, IHS market

3 and “Rand note: rand runs back through R14.00/USD as South Africa is seen to move closer to becoming a sub-investment grade country, as rated by all three of the key credit rating agencies - the probability of the lite down case increases”, 29th July 2019, website address below).

Weakening economic growth in many key global areas, notably Europe, China, the UK, has led to concerns of recession, and with interest rates globally already at low levels historically, concerns centre around leaving it too late to cut. Cutting earlier in the cycle is more supportive in staving off a slowdown in growth, particularly when there is not too much leeway to cut in total, and markets fear

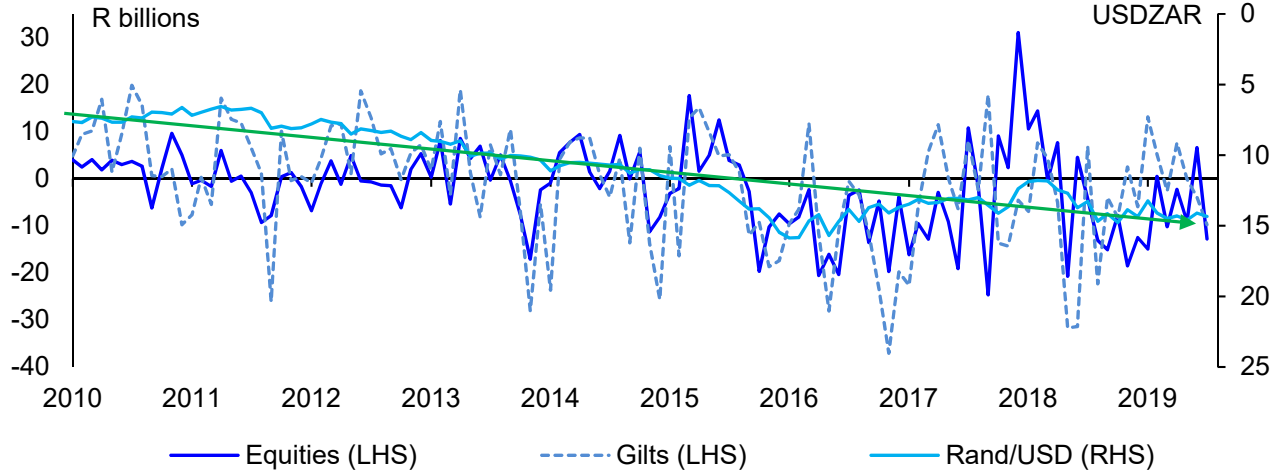
Figure 5: Advanced economies and China's services Purchasing Manager Index (PMI)



Source: Bloomberg



Figure 6: Non-resident portfolio net purchases (+)/ sales(-) vs USD/ZAR (monthly averages)



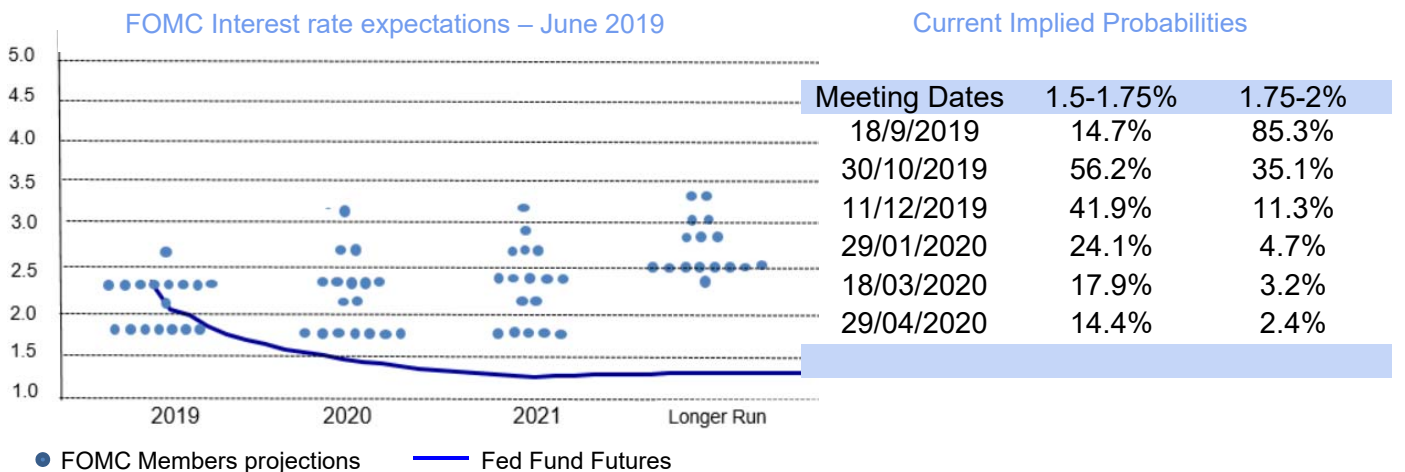
Source: Iress, Investec

Figure 7: Reuters August 2019 Foreign exchange rates poll: USDZAR

Release/Effective Date	30 Aug 2019	31 Oct 2019	31 Jan 2020	31 Jul 2020
Median	14.5300	14.4700	14.3050	14.2750
High	15.3000	15.1750	15.4800	15.9000
Low	13.7600	13.6700	13.3500	13.4700
No. of forecasts	29	33	34	32

Source: Reuters

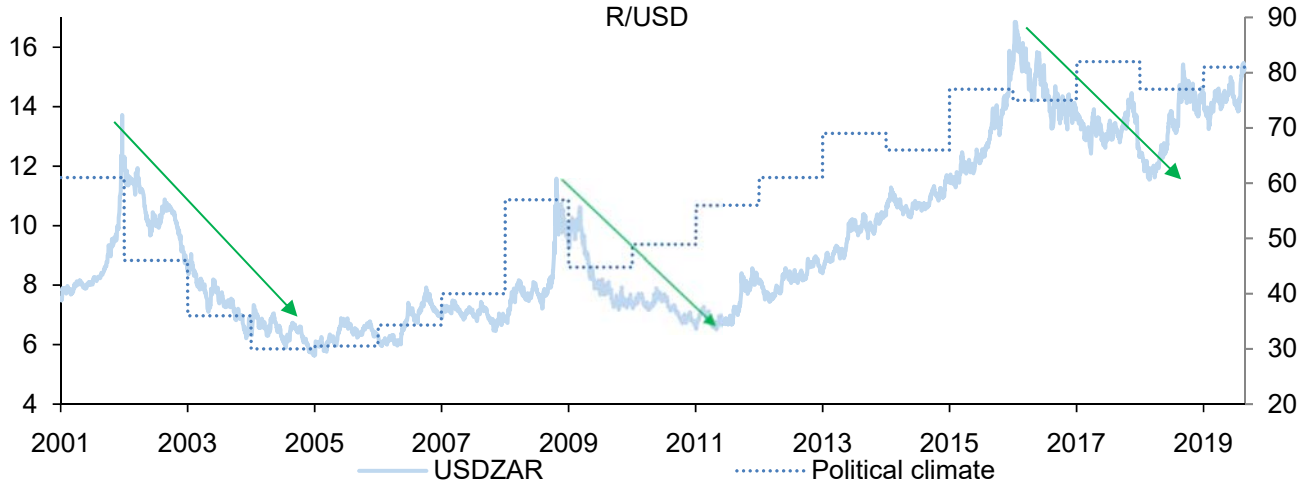
Figure 8: US interest rate projection from FOMC: June 2019 and Implied Probabilities



Source: Reuters and Federal Reserve Bank



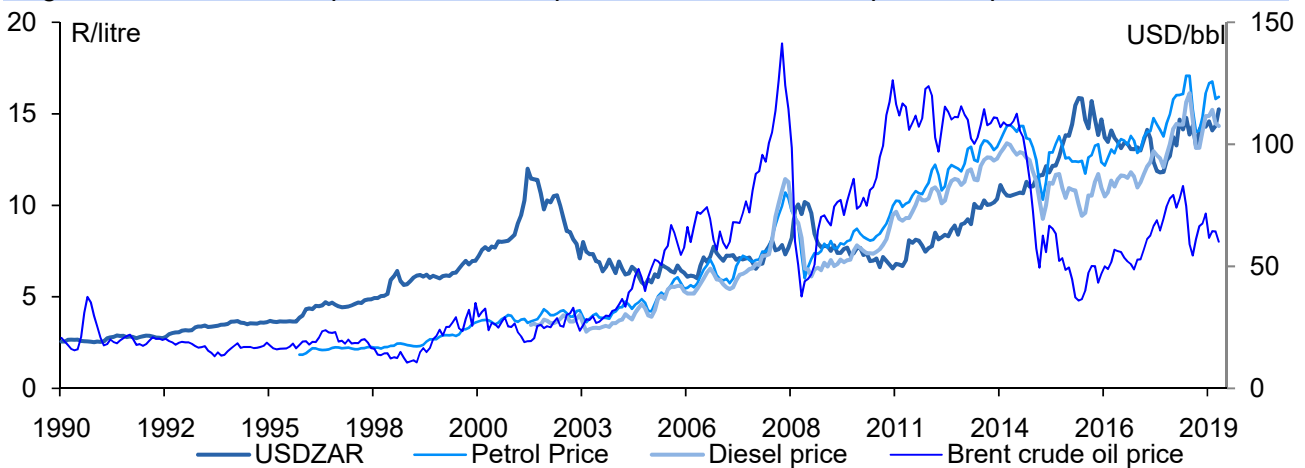
Figure 9: Politics and the rand



Source: Iress, BER

Central Banks are dragging their heels unnecessarily. This has led to some escalation in risk aversion in global financial markets, at a time when markets tend to be highly sensitive to risk – that is, the northern hemisphere key summer month as market players take time out for vacations. Their return in September typically sees some churn in markets, before the final quarter of the calendar year tends to build market confidence in risk taking, and is a time when the rand tends to strengthen materially through into the first quarter of the next calendar year as well. However, this pattern was disrupted last year by heightened US-Sino trade tensions and a near equity market collapse following on from markets progressively readjusting expectations of the US interest rate trajectory,

Figure 10: Rand versus petrol and diesel prices – rand weakness pushes up fuel costs



Source: Iress

Rand Outlook: rand outlook has weakened in the near term as global protectionism elevates risk concerns in financial markets

27th August 2019



Figure 11: US interest rate projections from FOMC (dots) versus market (line):

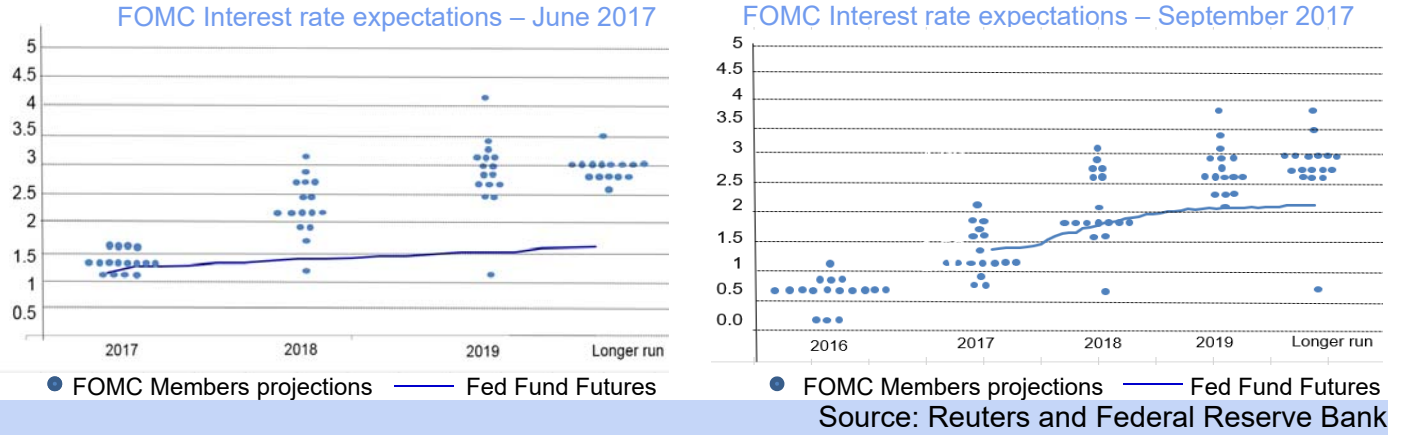


Figure 12: US interest rate projections from FOMC (dots) versus market (line):

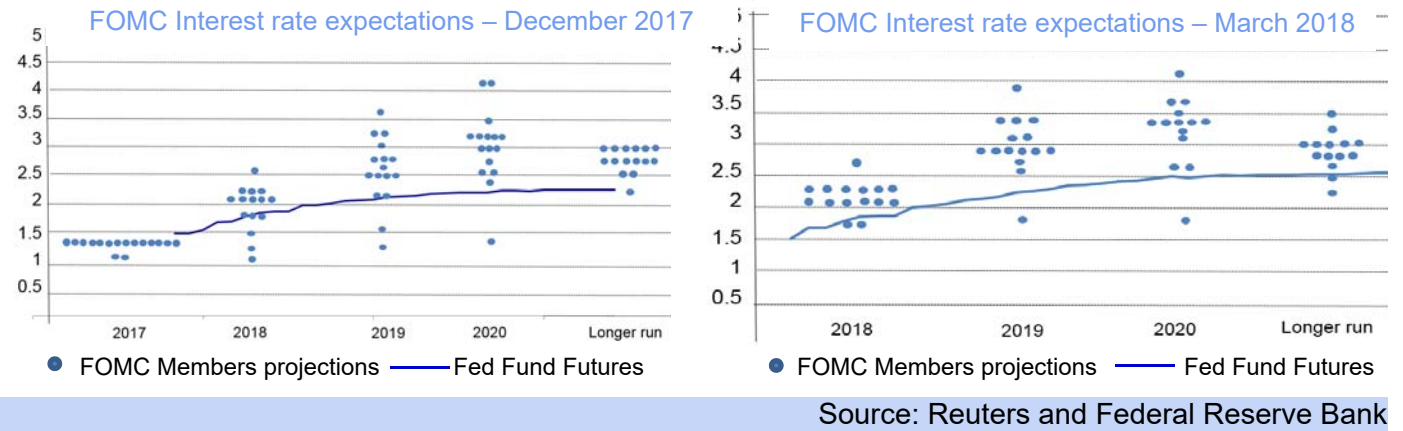


Figure 13: US interest rate projections from FOMC (dots) versus market (line):

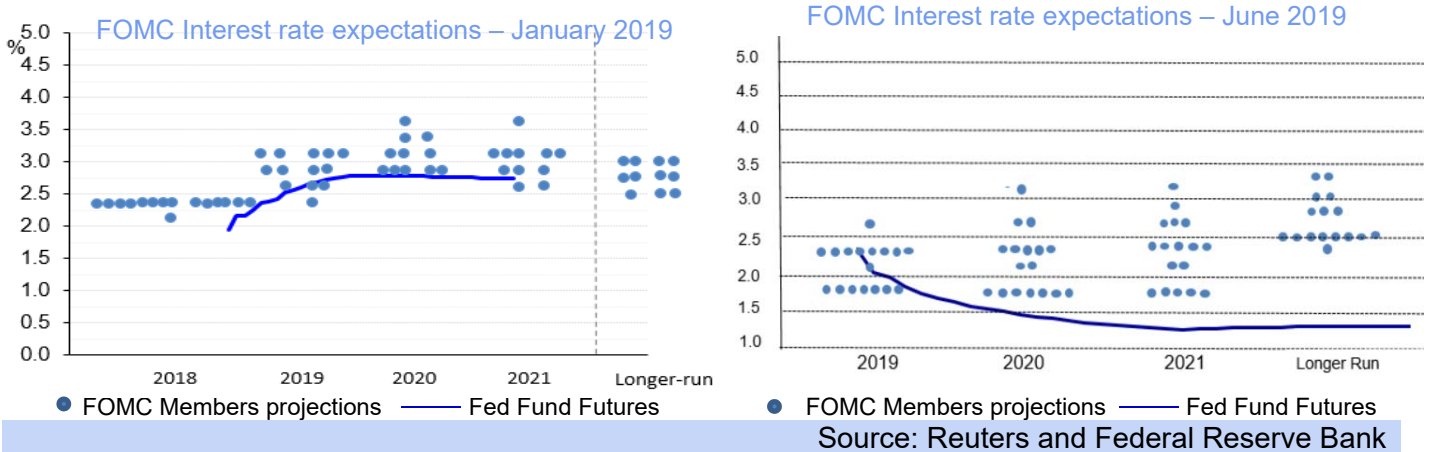




Figure 14: Key official interest rates (% , end quarter)

	US Fed funds	Eurozone refi rate	Eurozone deposit rate	UK Bank rate	Australia cash rate
Current	2.00-2.25	0.00	-0.40	0.75	1.25
2019					
Q1	2.25-2.50	0.00	-0.40	0.75	1.50
Q2	2.25-2.50	0.00	-0.40	0.75	1.25
Q3	1.75-2.00	0.00	-0.50	0.75	1.00
Q4	1.50-1.75	0.00	-0.60	0.75	0.75
2020					
Q1	1.25-1.50	0.00	-0.60	0.75	0.75
Q2	1.25-1.50	0.00	-0.60	0.75	0.75
Q3	1.25-1.50	0.00	-0.60	0.75	0.75
Q4	1.25-1.50	0.00	-0.60	0.75	0.75

Source: Macrobond, Investec UK

to one of additional hikes. This year, the Fed is not proposing interest rate hikes, with its latest minutes (namely the July FOMC meeting) instead seen by markets as fairly noncommittal. However, subsequent to this July FOMC meeting, risks on the international trade front have escalated, more

Figure 15: Target federal funds rate at year-end (%)

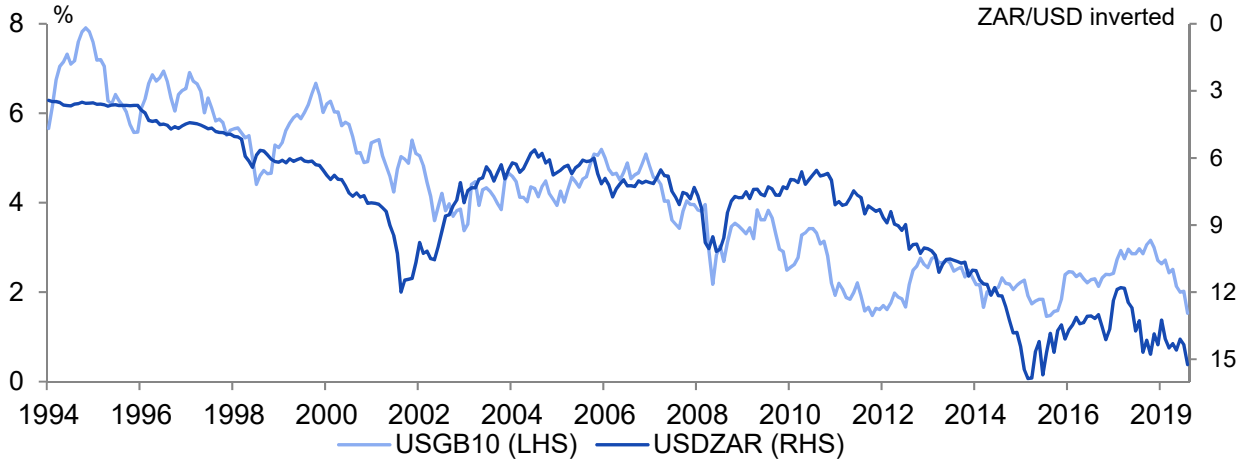
	2019	2020	2021	Longer-run
3.375				
3.250				2
3.125		1	1	
3.000				2
2.875			1	
2.750				3
2.625	1	2	3	
2.500				8
2.375	8	5	5	1
2.250				
2.125	1	2	2	
2.000				
1.875	7	7	5	

Source: FOMC

Note: Indicates the value (rounded to the nearest 1/8 percentage point) of an individual participant's judgment of the midpoint of the appropriate target range for the federal funds rate or the appropriate target level for the federal funds rate at the end of the specified calendar year or over the longer run. One participant did not submit longer-run projections for the federal funds rate.



Figure 16: SDZAR vs US 10 year bond (%)

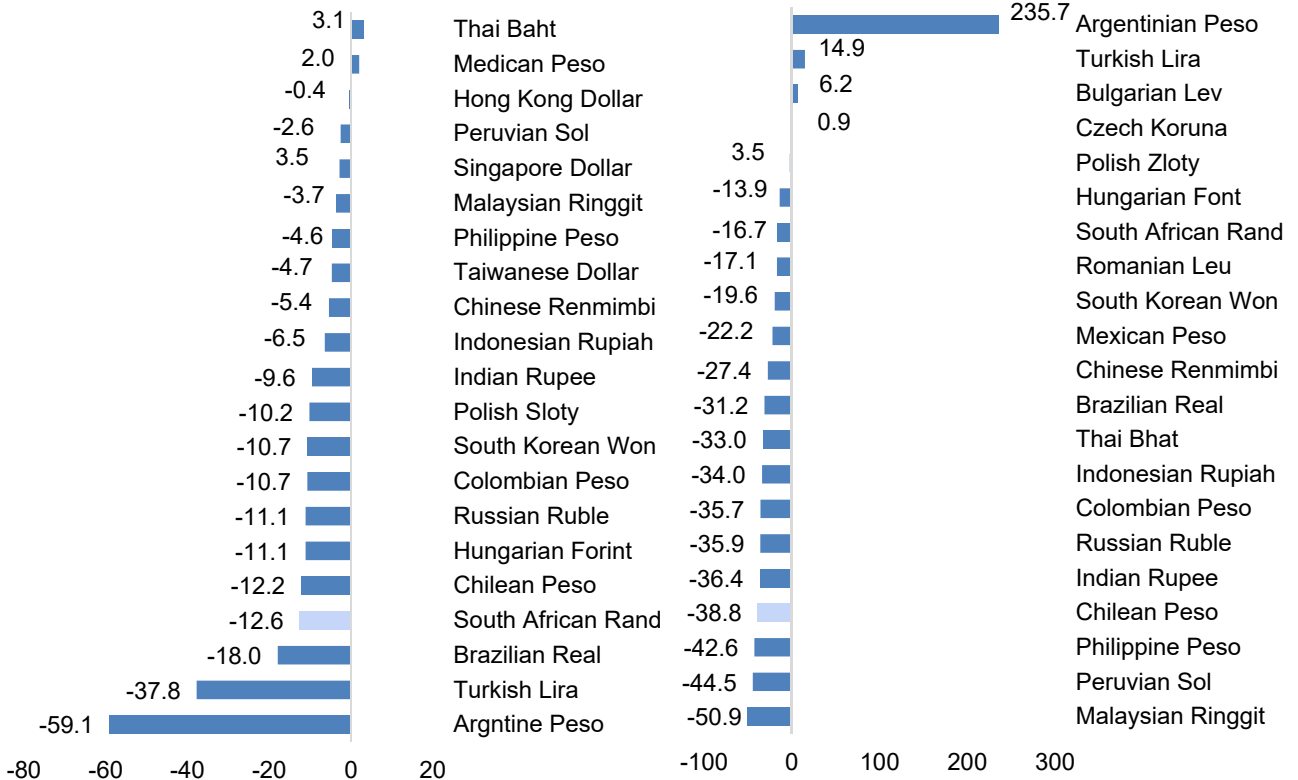


Source: Iress

Figure 17: EM currency depreciation (-) %, appreciation (+) %

Start 2018 to 15th May 2019

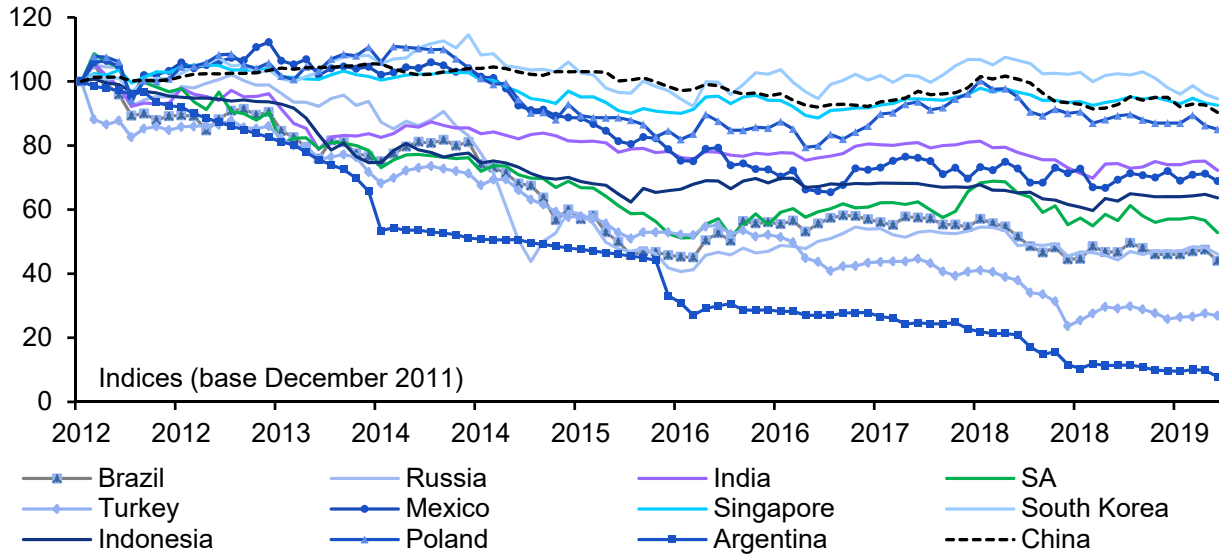
Start 2019 to 26 August 2019



Source: Bloomberg



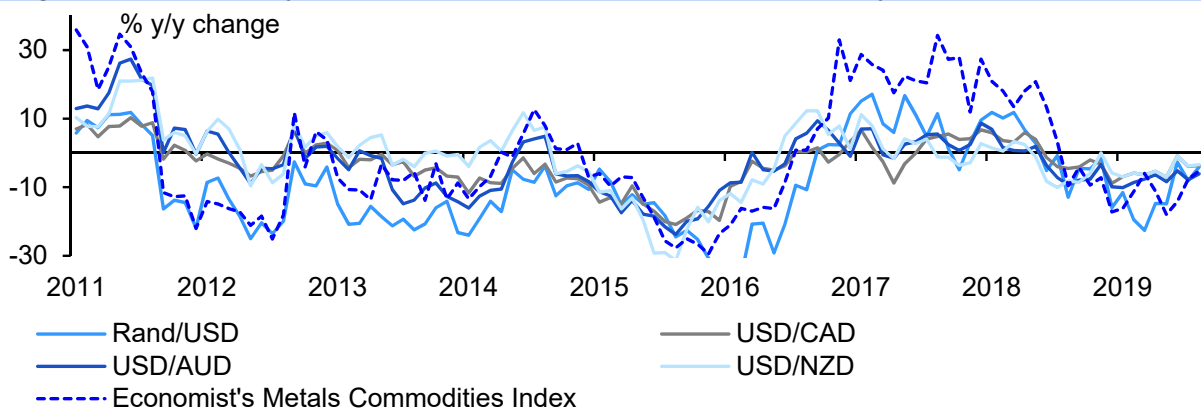
Figure 18: Volatility index for selected emerging market currencies



Sources: Iress, Investec

so over last weekend, where the US threatened to raise tariffs on US\$250bn worth of imports from China, and China announced new tariffs on US\$75bn of imports from the US. In the July minutes the FOMC noted that “the economy had been resilient in the face of ongoing global developments”, but that “participants generally saw uncertainty surrounding trade policy and concerns about global growth as continuing to weigh on business confidence and firms’ capital expenditure plans.” In addition, “(p)articipants generally judged that the risks associated with trade uncertainty would remain a persistent headwind for the outlook, with a number of participants reporting that their business contacts were making decisions based on their view that uncertainties around trade were

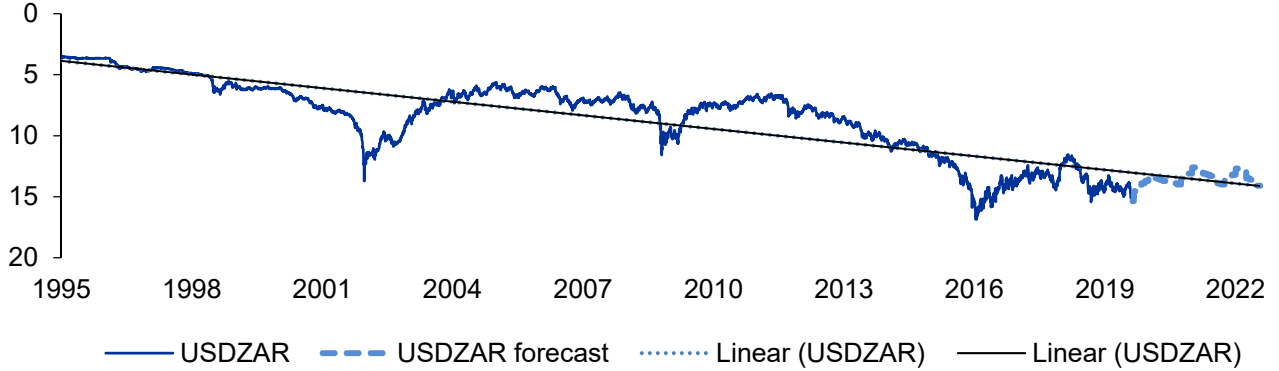
Figure 19: Commodity currencies vs Economist’s metals commodity price index



Source: Iress

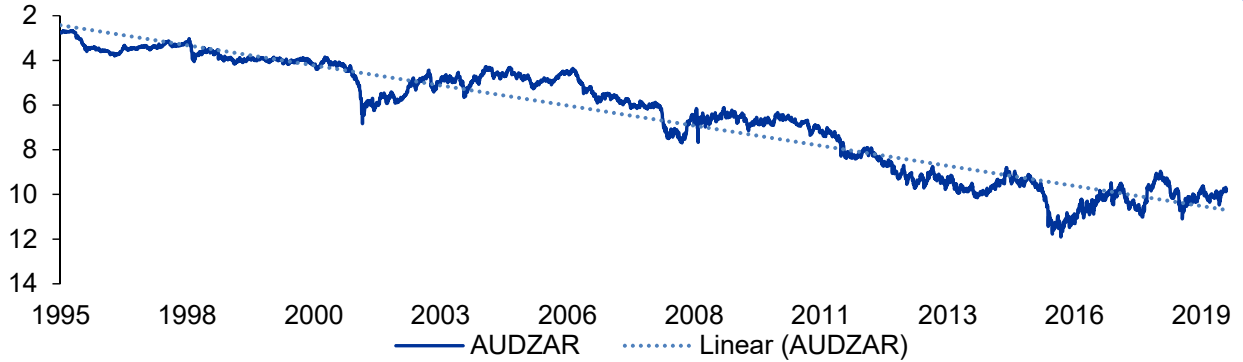


Figure 20: USDZAR



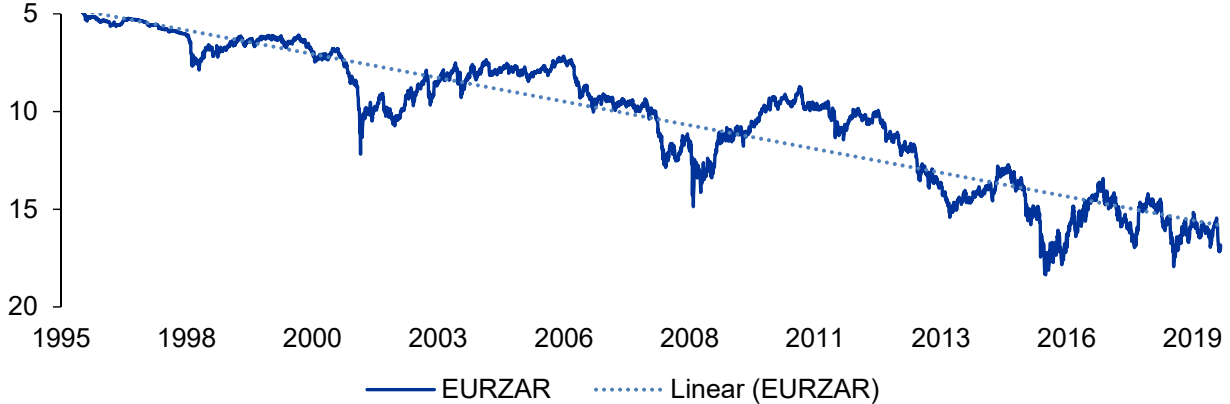
Source: Investec, Iress

Figure 21: AUDZAR



Source: Investec, Iress

Figure 22: EURZAR



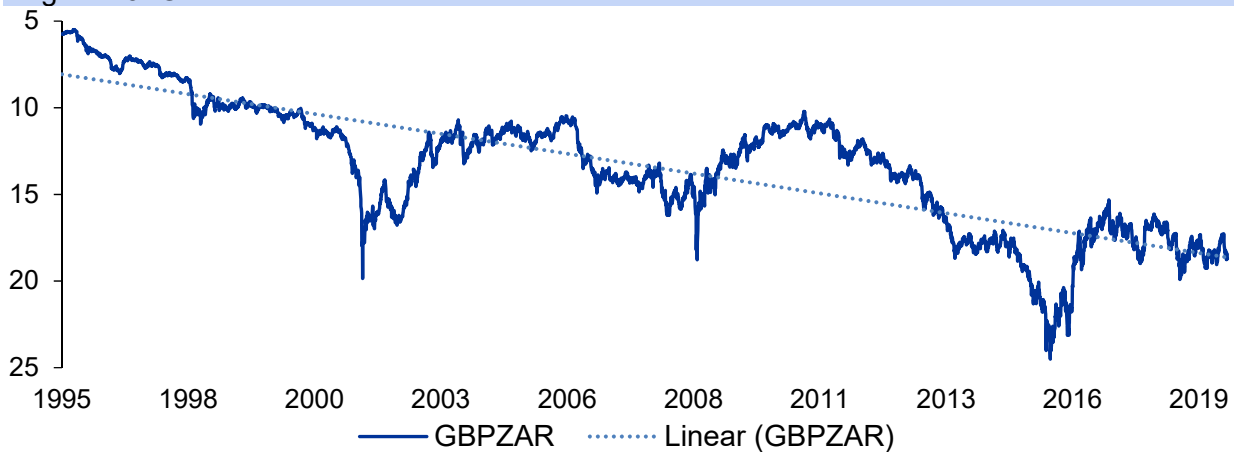
Source: Investec, Iress



Rand Outlook: rand outlook has weakened in the near term as global protectionism elevates risk concerns in financial markets

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Figure 23: GBPZAR



Source: Investec, Iress

not likely to dissipate anytime soon. Some participants observed that trade uncertainties had receded somewhat, especially with the easing of trade tensions with Mexico and China.” However, these participants views, some of which may have voted against the 25bp cut in July, occurred before the latest escalation in trade tensions. Indeed, one dissenting member to the outcome said “that the unemployment rate stood near 50-year lows, inflation seemed likely to rise toward the Committee’s 2 percent target, and financial stability concerns were elevated, as indicated by near-record equity prices and corporate leverage”. The other agreed that they “would be prepared to adjust policy should incoming data point to a materially weaker outlook for the economy”. The minutes added that “(m)anufacturing production had declined so far this year, dragged down in part by weak real exports, the ongoing global slowdown, and trade uncertainties”. Data showing a broad-based slowdown in the US economy would likely spur a further cut in the Fed funds rate to below 2 to 2¼ percent, while further strength, in the absence of any financial market weakness would not.

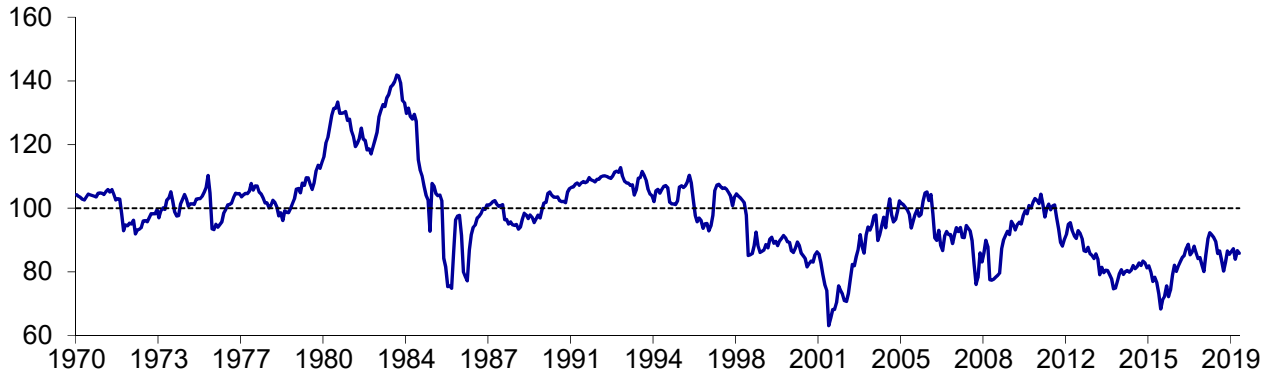
The strength of economic growth in the US, and particularly its labour market has been of some concern as it may risk igniting inflationary pressure, which would add to the Fed’s disinterest in further rate cuts. However, the financial markets expect further cuts - an 85% chance of a 25bp cut in September, and a 56% chance of another 25bp cut at the October meeting, with a 42% chance

Figure 24: Exchange Rates:	2018	2019	2020	2021	2022	2023	2024	2025
USD/ZAR	13.24	14.27	13.88	13.80	14.00	13.83	14.0	14.38
GBP/ZAR	17.64	17.90	17.89	19.10	19.52	19.36	19.6	20.13
EUR/ZAR	15.61	16.09	15.77	16.95	17.50	17.28	17.5	17.97
ZAR/JPY	8.38	7.59	7.61	7.69	7.63	7.75	7.63	7.45
GBP/USD	1.33	1.25	1.29	1.38	1.39	1.40	1.40	1.40
EUR/USD	1.18	1.13	1.14	1.23	1.25	1.25	1.25	1.25
USD/JPY	110	108	106	106	107	107	107	107

Source: Investec

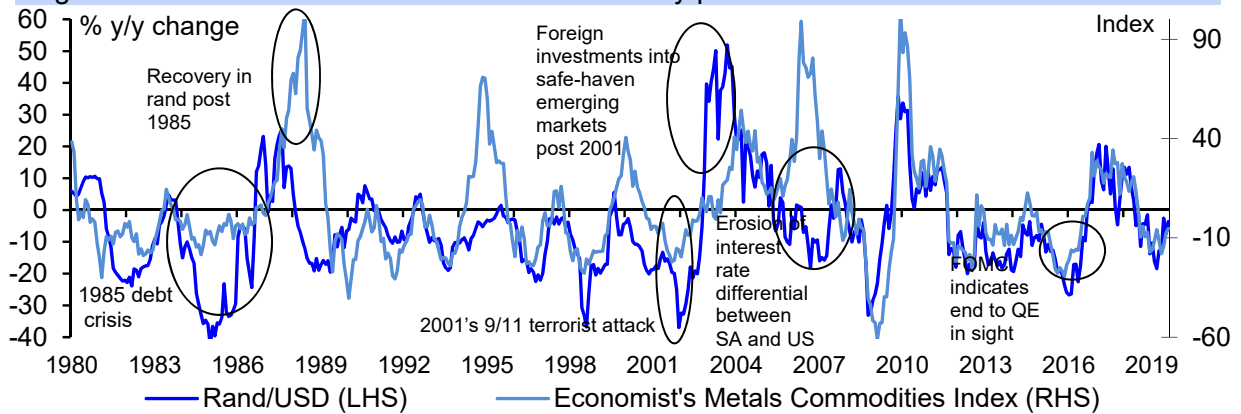


Figure 25: SA's real effective exchange rate



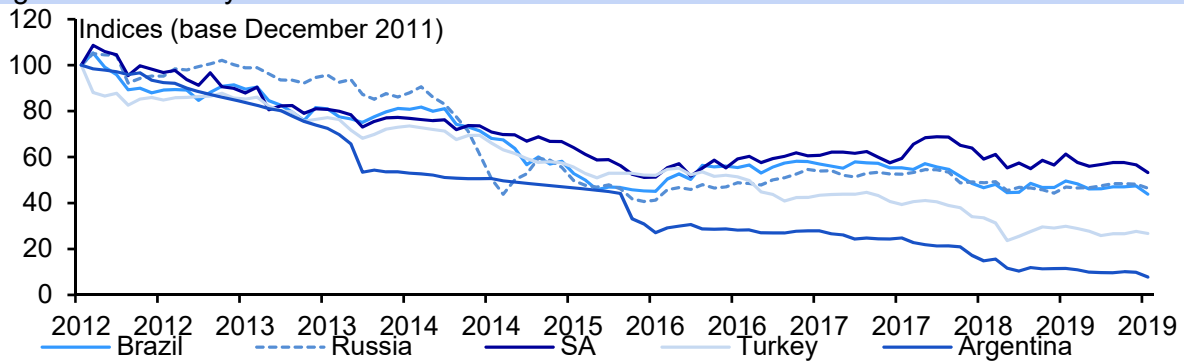
Source: SARB

Figure 26: Rand vs Economist's metals commodity price index



Source: Iress

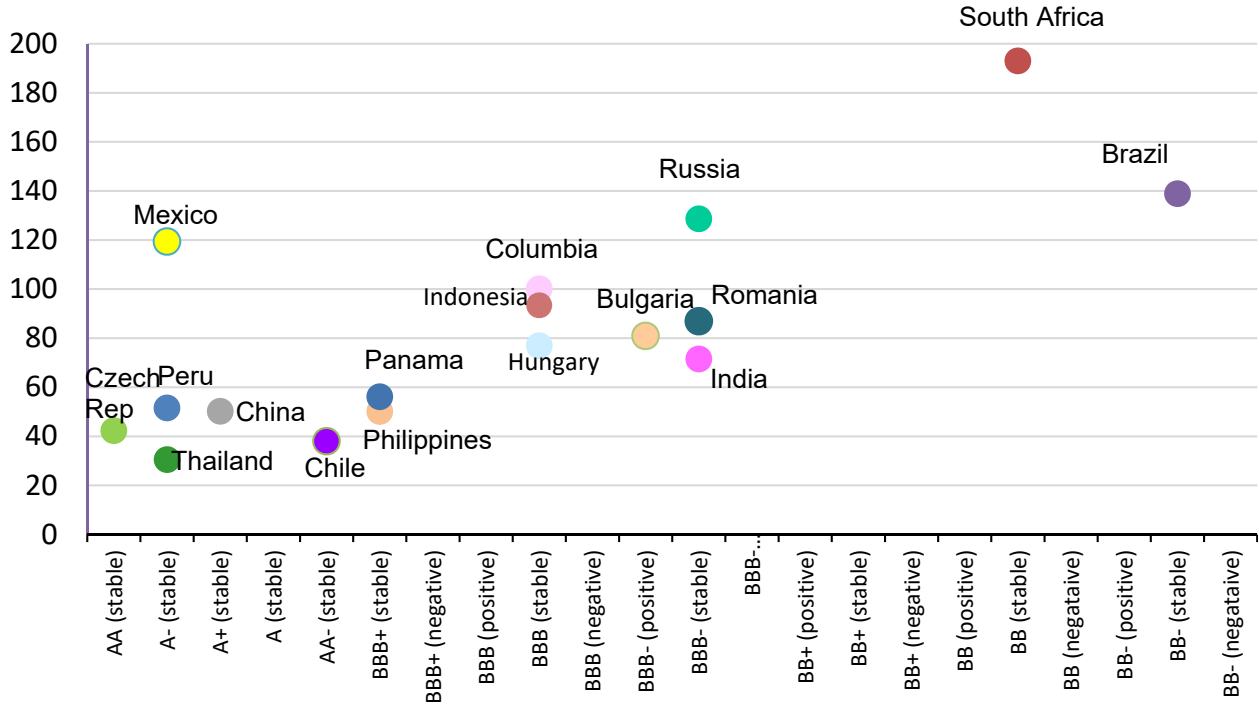
Figure 27: Volatility index



Sources: Iress, Investec



Figure 28: Credit Default Swaps and S&P local currency long-term sovereign debt ratings

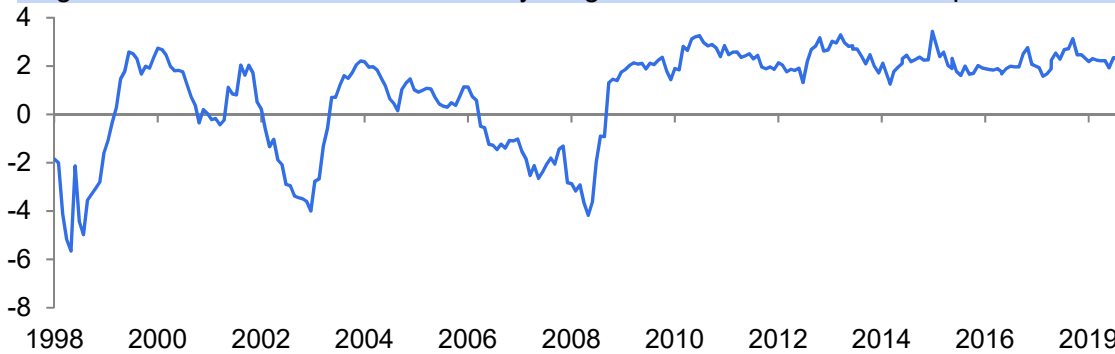


Source: Bloomberg

of a 25bp cut in December. Factoring out these expectations would likely spark further EM currency weakness, and resultant volatility in the rand.

We continue to believe that the rand will remain volatile, and have revised down the expected case forecast for a somewhat more depreciated level as global trade tensions have worsened, and show

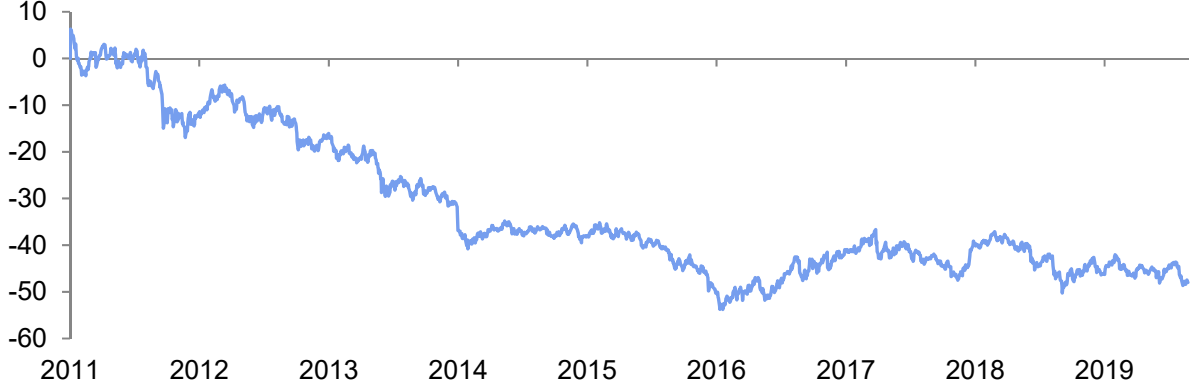
Figure 29: Differential between SA10 year government bond and the repo rate



Source: Iress

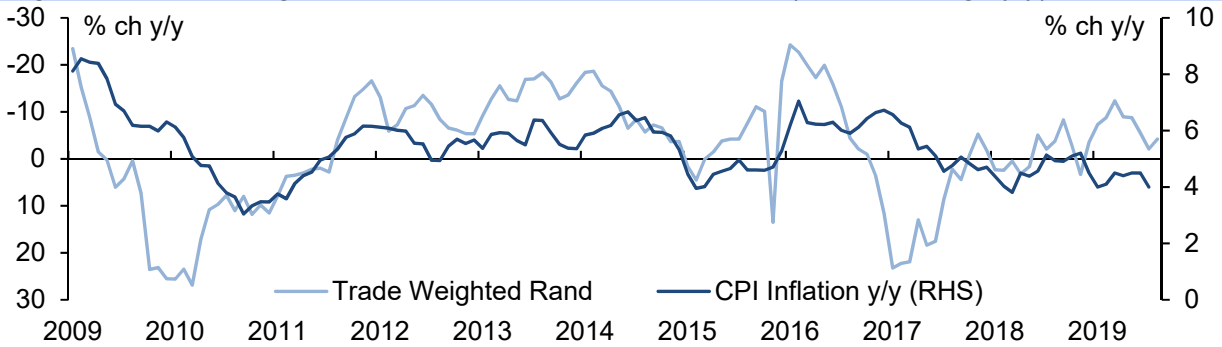


Figure 30: Nominal trade-weighted rand



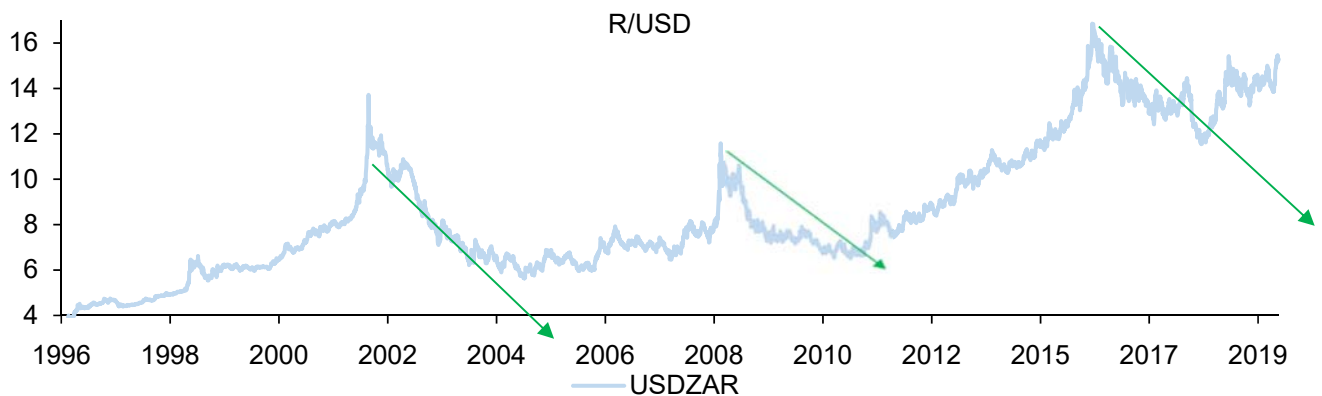
Source: Iress

Figure 31: Trade weighted rand movements vs CPI inflation (both % change y/y)



Source: Stats SA, Iress

Figure 32: Volatility of the domestic currency



Source: Iress



Figure 33: **Exchange rate history and forecast: annual averages**

	2017	2018	2019	2020	2021	2022	2023	2024	2025
EURUSD	1.13	1.18	1.13	1.14	1.23	1.25	1.25	1.25	1.25
EURGBP	0.88	0.88	0.90	0.88	0.89	0.90	0.89	0.89	0.89
GBPEUR	1.14	1.13	1.11	1.13	1.13	1.12	1.12	1.12	1.12
GBPUSD	1.29	1.33	1.25	1.29	1.38	1.39	1.40	1.40	1.40
USDJPY	112	110	108	106	106	107	107	107	107
EURJPY	127	130	122	120	130	133	134	134	134
GBPJPY	145	147	136	136	147	149	150	150	150
EURCHF	1.11	1.16	1.11	1.12	1.18	1.21	1.19	1.19	1.19
USDCHF	0.98	0.98	0.99	0.99	0.96	0.95	0.95	0.95	0.95
GBPCHF	1.27	1.31	1.24	1.33	1.33	1.32	1.33	1.33	1.33
AUDUSD	0.77	0.75	0.69	0.71	0.78	0.78	0.78	0.78	0.78
EURAUD	1.47	1.58	1.62	1.59	1.58	1.60	1.60	1.60	1.60
AUDJPY	86	83	75	75	82	83	83	83	83
GBPAUD	1.68	1.79	1.81	1.81	1.78	1.79	1.79	1.79	1.79
ZARUSD	13.30	13.24	14.27	13.88	13.80	14.00	13.83	14.05	14.38
ZARGBP	17.13	17.64	17.90	17.89	19.10	19.52	19.36	19.67	20.13
ZAREUR	15.03	15.61	16.09	15.77	16.95	17.50	17.28	17.56	17.97
JPYZAR	8.39	8.38	7.59	7.61	7.69	7.63	7.75	7.63	7.45
ZARCHF	13.51	13.53	14.48	14.03	14.34	14.74	14.55	14.79	15.13
ZARAUD	10.20	9.88	9.91	9.89	10.73	10.92	10.78	10.96	11.21

Source: Iress, Investec

little chance of resolving in the near term. Longer-term, while PPP is expected to guide the rand, much will depend on the resolutions to the Eskom crisis and alleviating pressures on economic growth. SA is likely to see Moody's downgrade the country outlook to negative in November, likely signaling a credit rating downgrade will occur unless the escalation in the debt trajectory is halted. Ongoing fiscal pressures, including the NHI still have to be factored in, and the tax buoyancy ratio has already showed SA is at risk of even slower economic growth if taxes are hiked further.

Some relief for the rand may still come from a September US interest rate cut however, as the inversion of the US yield curve persists, with treasury yields lower following market concerns over



Figure 34: **Exchange rate history and forecast: quarterly averages**

	2017				2018				2019			
	Q1.17	Q2.17	Q3.17	Q4.17	Q1.18	Q2.18	Q3.18	Q4.18	Q1.19	Q2.19	Q3.19	Q4.19
EURUSD	1.07	1.10	1.18	1.18	1.23	1.19	1.16	1.14	1.14	1.12	1.13	1.12
EURGBP	0.86	0.86	0.90	0.88	0.88	0.88	0.89	0.89	0.87	0.87	0.92	0.93
GBPEUR	1.16	1.16	1.11	1.13	1.13	1.14	1.12	1.13	1.15	1.14	1.08	1.08
GBPUSD	1.24	1.28	1.31	1.33	1.39	1.36	1.30	1.29	1.30	1.29	1.22	1.20
USDJPY	114	111	111	113	108	109	111	113	110	110	107	106
EURJPY	121	122	131	133	133	130	130	129	125	124	121	119
GBPJPY	141	142	145	150	151	148	145	145	143	141	131	128
EURCHF	1.07	1.08	1.14	1.16	1.17	1.17	1.14	1.14	1.13	1.13	1.10	1.09
USDCHF	1.00	0.98	0.96	0.99	0.95	0.99	0.98	1.00	1.00	1.00	0.97	0.97
GBPCHF	1.24	1.26	1.26	1.31	1.32	1.34	1.28	1.28	1.30	1.29	1.19	1.17
AUDUSD	0.76	0.75	0.79	0.77	0.79	0.76	0.73	0.72	0.71	0.70	0.69	0.68
EURAUD	1.41	1.47	1.49	1.53	1.56	1.57	1.59	1.59	1.59	1.61	1.65	1.65
AUDJPY	86	83	88	87	85	83	82	81	78	77	73	72
GBPAUD	1.64	1.70	1.66	1.73	1.77	1.80	1.78	1.79	1.83	1.84	1.79	1.77
ZARUSD	13.22	13.19	13.18	13.62	11.96	12.65	14.06	14.30	14.01	14.38	14.55	14.15
ZARGBP	16.35	16.85	17.22	18.08	16.65	17.19	18.33	18.40	18.25	18.48	17.82	17.04
ZAREUR	14.08	14.52	15.49	16.05	14.70	15.07	16.36	16.32	15.92	16.16	16.43	15.85
JPYZAR	8.54	8.39	8.36	8.27	9.06	8.64	7.95	7.89	7.86	7.65	7.34	7.49
ZARCHF	13.16	13.40	13.69	13.81	12.61	12.84	14.30	14.37	14.06	14.33	15.00	14.54
ZARAUD	1.07	1.10	1.18	1.18	1.23	1.19	1.16	1.14	1.14	1.12	1.13	1.12

Source: Iress, Investec

slowing growth as global trade tensions worsen, with the US dollar stronger as well in the risk-off environment. Avoiding a sustained yield curve inversion in this environment is seen to require further US rate cuts, and we continue to forecast a 25bp cut at the September FOMC meeting, with the latest round of acrimonious trade developments also likely requiring additional insurance rate cuts this year. We therefore believe that the chance of a 25bp cut in October is building as well for the



Figure 35: **Exchange rate history and forecast: quarterly averages**

	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
EURUSD	1.12	1.13	1.15	1.15	1.18	1.23	1.25	1.25	1.25	1.25	1.25	1.25
EURGBP	0.89	0.88	0.88	0.88	0.87	0.88	0.90	0.90	0.90	0.90	0.90	0.90
GBPEUR	1.12	1.14	1.14	1.14	1.14	1.13	1.12	1.12	1.12	1.12	1.12	1.12
GBPUSD	1.26	1.29	1.30	1.31	1.35	1.39	1.39	1.39	1.39	1.39	1.39	1.39
USDJPY	106	106	106	105	106	106	106	106	106	107	107	107
EURJPY	119	120	121	120	125	130	133	133	133	134	134	134
GBPJPY	133	137	137	137	143	148	148	148	148	149	149	149
EURCHF	1.10	1.11	1.14	1.15	1.14	1.18	1.20	1.20	1.21	1.21	1.21	1.21
USDCHF	0.98	0.98	0.99	1.00	0.97	0.96	0.96	0.96	0.95	0.95	0.95	0.95
GBPCHF	1.36	1.35	1.29	1.31	1.31	1.34	1.34	1.34	1.32	1.32	1.32	1.32
AUDUSD	0.70	0.71	0.72	0.73	0.76	0.79	0.78	0.78	0.78	0.78	0.78	0.78
EURAUD	1.6	1.6	1.6	1.6	1.6	1.56	1.60	1.60	1.60	1.60	1.60	1.60
AUDJPY	74	75	76	76	81	84	83	83	83	83	83	83
GBPAUD	1.81	1.83	1.81	1.79	1.78	1.77	1.79	1.79	1.79	1.79	1.79	1.79
ZARUSD	13.70	14.00	14.20	13.60	13.20	13.70	14.40	13.90	13.30	14.10	14.70	13.90
ZARGBP	17.24	18.08	18.48	17.77	17.82	19.10	20.08	19.38	18.55	19.66	20.50	19.38
ZAREUR	15.34	15.82	16.26	15.64	15.58	16.85	18.00	17.38	16.63	17.63	18.38	17.38
JPYZAR	7.74	7.57	7.43	7.68	8.03	7.74	7.36	7.63	7.97	7.59	7.28	7.70
ZARCHF	13.95	14.25	14.33	13.60	13.61	14.27	15.00	14.48	14.00	14.84	15.47	14.63
ZARAUD	9.52	9.87	10.22	9.93	10.03	10.82	11.23	10.84	10.37	11.00	11.47	10.84

Source: Iress, Investec

Fed (and is our expected case), with these cuts supported by financial market conditions and not those of the US economy to the same degree. These rate cuts would do much to alleviate the risk-off sentiment that global markets have returned to this month, and such US rate cuts would likely support rand strength, particularly in Q4.19 and Q1.20 (see figures 2, 3, 24 and 33 to 35).

Rand Outlook: rand outlook has weakened in the near term as global protectionism elevates risk concerns in financial markets

27th August 2019



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