

SA Economics



Monday 24 May 2021

Rand note: Both Fitch and S&P leave South Africa's ratings unchanged at BB- (with Fitch maintaining a negative, and S&P a stable, outlook) expecting some degree of fiscal consolidation, and in particular constraint in wage agreements

Economic Scenarios: reduced downside, stronger expected case									
		Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22
Extreme Up case 1%	USD/Rand (average)	14.96	14.10	13.50	13.40	13.10	12.90	12.70	12.50
	Repo rate (end rate)	3.50	3.25	3.25	3.25	3.25	3.25	3.25	3.25
	Impact of Covid-19 pandemic very rapidly resolved - economic growth of 3–5%, then 5-7% for SA. Good governance, growth-creating reforms (structural constraints overcome), strengthening of property rights - individuals obtain title deeds in EWC – no nationalisation. High business confidence and fixed investment growth, substantial FDI inflows, strong fiscal consolidation (government debt falls back to low ratios of 2000s). Strong global growth, commodity boom. Stabilisation of credit ratings, then credit rating upgrades.								
Up case 2%	USD/Rand (average)	14.96	14.30	14.00	13.90	14.00	14.40	14.70	14.30
	Repo rate (end rate)	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50
	Quick rebound from Covid-19 pandemic, rising confidence and investment levels - structural problems worked down. No further credit rating downgrades, rating outlooks move to stable and eventually positive, strong fiscal consolidation (government debt projections fall substantially). Global risk-on, global demand quickly returns to trend growth. Limited impact of expropriation (without compensation) to abandoned, unused, labour tenants' and government land (individuals are new owners and receive title deeds) does not have a negative effect on economy - no nationalisation.								
Base case 50%	USD/Rand (average)	14.96	14.50	15.00	14.90	15.00	15.40	15.70	15.30
	Repo rate (end rate)	3.50	3.50	3.50	3.75	3.75	3.75	4.00	4.00
	Recovery from the sharp global economic slowdown by 2024 in real terms– sufficient global and domestic monetary and other policy supports to growth and financial markets occur and risk sentiment stabilises then improves. Expropriation of private sector property is limited and does not have a negative impact on the economy or on market sentiment. SA remains in the BB category rating bracket for Moody's – fiscal consolidation (debt to GDP stabilisation) occurs.								
Lite (domestic) Down case 42%	USD/Rand (average)	14.96	15.00	15.75	16.50	16.70	17.00	17.50	17.00
	Repo rate (end rate)	3.50	3.75	3.75	4.00	4.00	4.25	4.25	4.50
	The international environment (including risk sentiment) is that of the base case. South Africa fails to see its debt projections stabilise and falls into single B credit ratings from all three agencies for local and foreign currency. Recession occurs. Expropriation of some private commercial sector property without compensation, with some negative impact on the economy. Business confidence depressed, rand weakness, significant load shedding and weak investment growth. Substantial fiscal consolidation ultimately occurs, preventing ratings falling into the C grades.								
Severe down case 5%	USD/Rand (average)	14.96	15.50	17.00	17.50	18.00	18.50	19.00	19.50
	Repo rate (end rate)	3.50	4.00	4.00	4.25	4.50	4.50	4.75	5.00
	Lengthy global recession, global financial crisis – insufficient monetary and other policy supports to growth domestically and internationally. Depression in SA, unprecedented rand weakness. Nationalisation of private sector property (title deeds not transferred to individuals). SA rated single B from all three key agencies, with further rating downgrades eventually occurring into CCC grade and lower to D (default) as government finances deteriorate (debt projections elevate even further - fail to ever stabilise. Government borrows from increasingly wider sources as it sinks deeper into a debt trap), eventually include widespread services load shedding, strike action and civil unrest.								

Note: Event risk begins Q2.21. Source: Investec

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Expected Case: Exchange Rate forecasts												
	2021				2022				2023			
	Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
USD/ZAR	14.96	14.50	15.00	14.90	15.00	15.40	15.70	15.30	15.10	15.50	15.90	15.40
GBP/ZAR	20.50	19.86	20.55	20.71	21.30	22.02	22.77	21.88	21.44	21.86	22.26	21.56
EUR/ZAR	18.13	17.40	18.15	18.40	18.83	19.40	19.94	19.28	18.88	19.38	19.88	19.25
ZAR/JPY	6.96	7.24	7.00	7.01	6.93	6.75	6.69	6.86	7.02	6.84	6.67	6.88
CHFZAR	16.71	15.89	16.43	16.50	16.61	17.11	17.49	16.81	16.24	16.32	16.39	15.40
AUDZAR	11.53	11.17	11.63	11.62	11.85	12.17	12.25	11.63	11.33	11.63	11.93	11.55
GBP/USD	1.38	1.37	1.37	1.39	1.42	1.43	1.45	1.43	1.42	1.41	1.40	1.40
EUR/USD	1.21	1.20	1.21	1.24	1.26	1.26	1.27	1.26	1.25	1.25	1.25	1.25
USD/JPY	106	105	105	105	104	104	105	105	106	106	106	106

Note: averages, Source: Investec, Iress

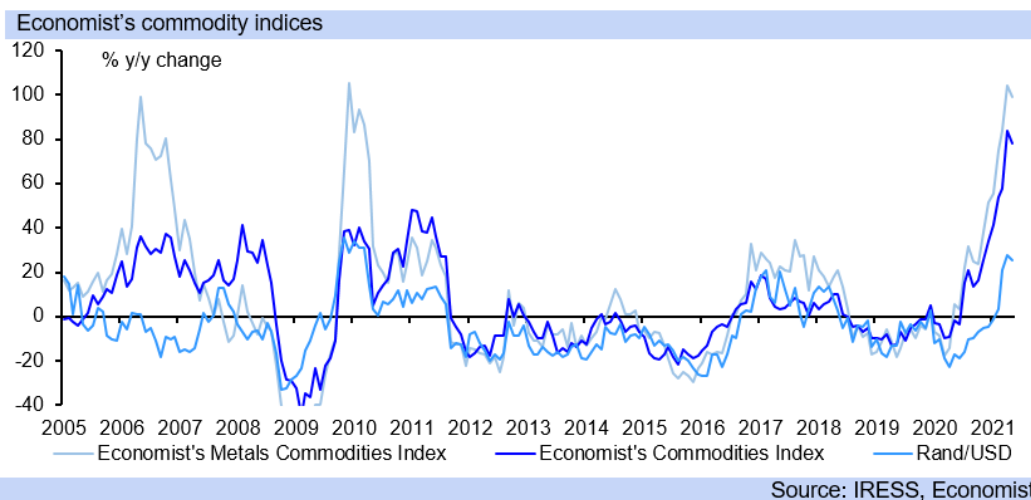
Lite Down Case: Exchange Rate forecasts												
	2021				2022				2023			
	Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
USD/ZAR	14.96	15.00	15.75	16.50	16.70	7.00	17.50	17.00	16.80	17.00	17.10	16.70
GBP/ZAR	20.64	20.55	21.58	22.94	23.71	10.01	25.38	24.31	23.86	23.97	23.94	23.38
EUR/ZAR	18.13	18.00	19.06	20.38	20.96	8.82	22.23	21.42	21.00	21.25	21.38	20.88
ZAR/JPY	7.09	7.00	6.67	6.33	6.23	14.86	6.00	6.18	6.31	6.24	6.20	6.35
CHFZAR	16.44	16.44	17.25	18.28	18.50	7.78	19.50	18.68	18.06	17.89	17.63	16.70
AUDZAR	11.53	11.55	12.21	12.87	13.19	5.53	13.65	12.92	12.60	12.75	12.83	12.53
GBP/USD	1.38	1.37	1.37	1.39	1.42	1.43	1.45	1.43	1.42	1.41	1.40	1.40
EUR/USD	1.21	1.20	1.21	1.24	1.26	1.26	1.27	1.26	1.25	1.25	1.25	1.25
USD/JPY	106	105	105	105	104	104	105	105	106	106	106	106

Note: averages, Source: Investec, Iress

Up Case: Exchange Rate forecasts												
	2021				2022				2023			
	Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
USD/ZAR	14.96	14.30	14.00	13.90	14.00	14.40	14.70	14.30	14.10	14.50	14.90	14.40
GBP/ZAR	20.50	19.59	19.18	19.32	19.88	20.59	21.32	20.45	20.02	20.45	20.86	20.16
EUR/ZAR	18.13	17.16	16.94	17.17	17.57	18.14	18.67	18.02	17.63	18.13	18.63	18.00
ZAR/JPY	6.96	7.34	7.50	7.52	7.43	7.22	7.14	7.34	7.52	7.31	7.11	7.36
CHFZAR	16.71	15.67	15.33	15.40	15.51	16.00	16.38	15.71	15.16	15.26	15.36	14.40
AUDZAR	11.53	11.01	10.85	10.84	11.06	11.38	11.47	10.87	10.58	10.88	11.18	10.80
GBP/USD	1.38	1.37	1.37	1.39	1.42	1.43	1.45	1.43	1.42	1.41	1.40	1.40
EUR/USD	1.21	1.20	1.21	1.24	1.26	1.26	1.27	1.26	1.25	1.25	1.25	1.25
USD/JPY	106	105	105	105	104	104	105	105	106	106	106	106

Note averages, Source: Investec, Iress

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- Both Fitch and S&P left their ratings and outlooks unchanged as expected, but their commentary was fairly negative. The rand was below R14.00/USD this morning, reaching R13.92/USD, but is mainly receiving support from the strength of commodity prices instead.
- The rand also continues to benefit from the US dollar's weakness and is 5.6% stronger since the start of this year leading several other EM currencies. The domestic currency continues to lead the EM currency ranker on a y/y basis, up 26.3%.
- At its country review of SA on Friday night, S&P recognised SA's strengths of "a credible central bank, a flexible exchange rate, an actively traded currency, and deep capital markets should help counterbalance relatively low economic growth and fiscal pressures."
- But highlights that "(a) particular concern is that even if, on the back of tough political decisions, personnel expenditure can be reduced from current levels, the increase in interest payments over the same period implies there will be little progress in narrowing the large fiscal deficit or debt to GDP--except under scenarios of significantly higher GDP growth than we currently project."
- In particular, S&P warns that it "could lower the ratings if South Africa's economy fails to recover during the forecast period and fiscal financing or external pressures mount."
- Adding "(t)his could, for example, arise from further financing risks emanating from contingent liabilities, including public electricity utility Eskom, or tightening financing conditions increasing the government's interest burden as a proportion of revenue."
- With South Africa experiencing severe, ongoing political tensions in its ruling party, structural reforms have been very slow, but are urgently needed to boost economic growth and job creation, and in particular to see economic recovery.
- Further action is expected from the ANC against Ace Magashule, the suspended secretary general of the ANC, who issued orders to suspend President Ramaphosa after receiving

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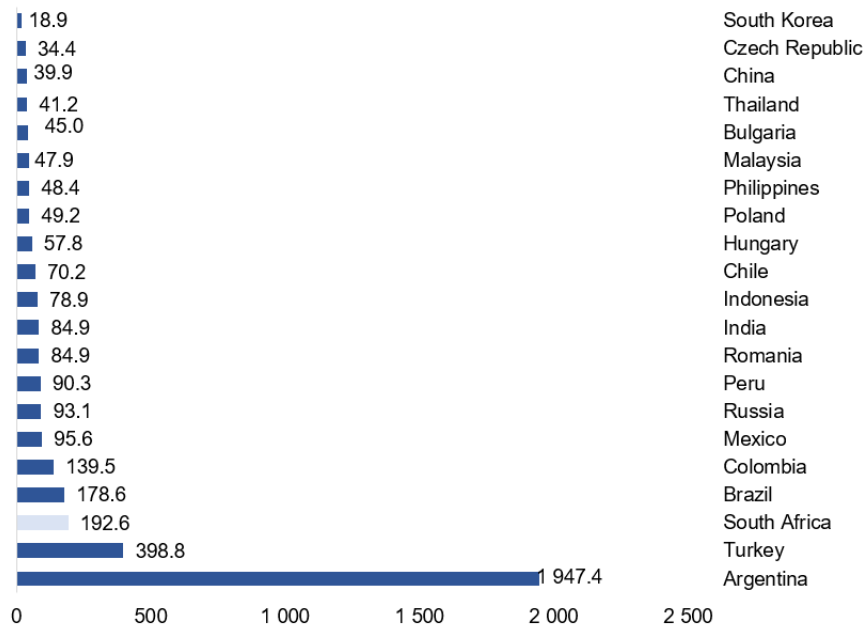


his own suspension papers, creating confusion and so seen to tarnish sentiment towards SA.

- A long, slow fight against corruption is occurring in SA, which has impeded the momentum for economic change, and Fitch also worries about SA's slow progress, retaining its negative outlook, with the rand at risk if the commodity boom collapses (not the expected case).

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Emerging Markets CDS Spreads – values as at 24 May 2021

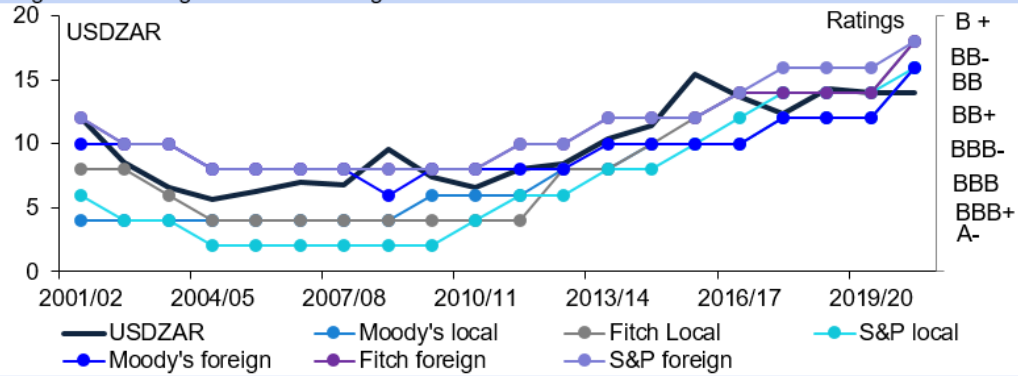


Source: Bloomberg

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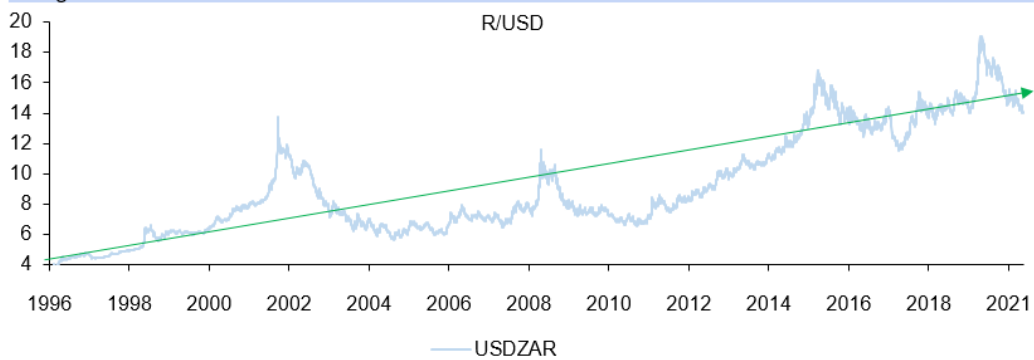


Long-term sovereign debt credit ratings vs USDZAR



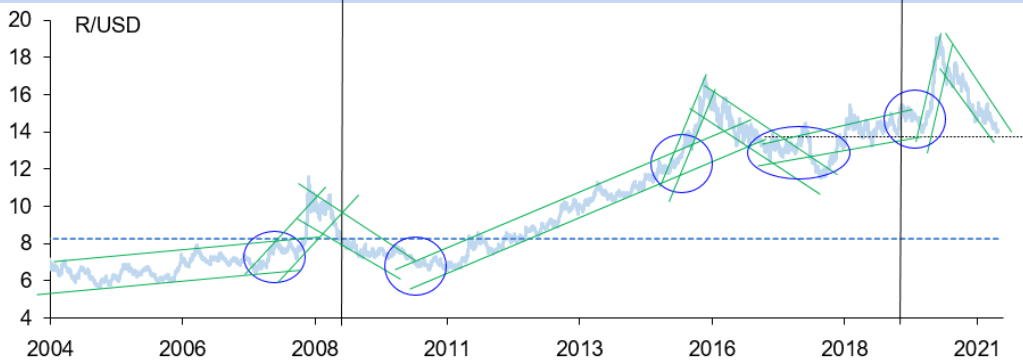
Source: Credit rating agencies, National treasury, Bloomberg

Long-term trend of the rand



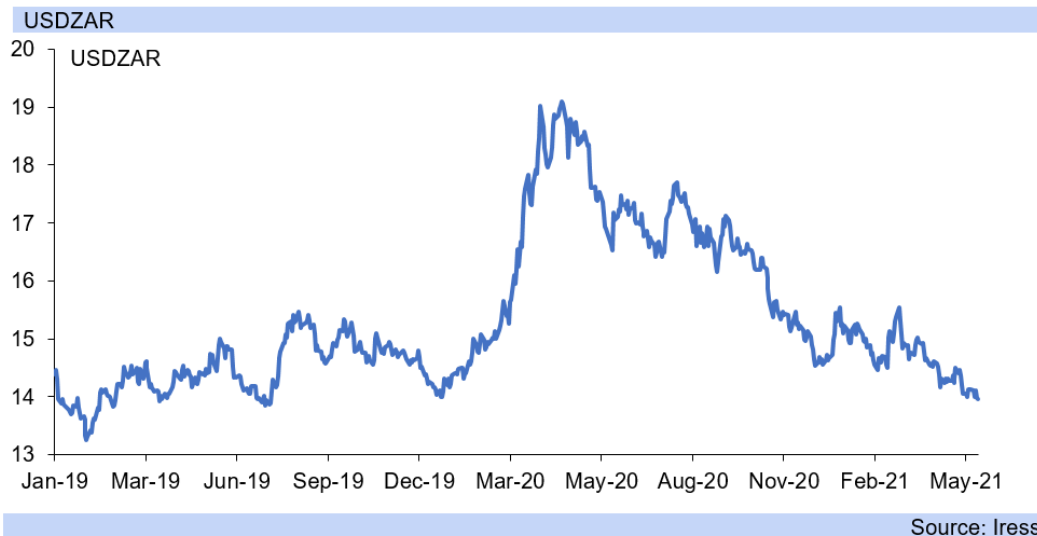
Source: Iress

Rand channels



Source: Iress

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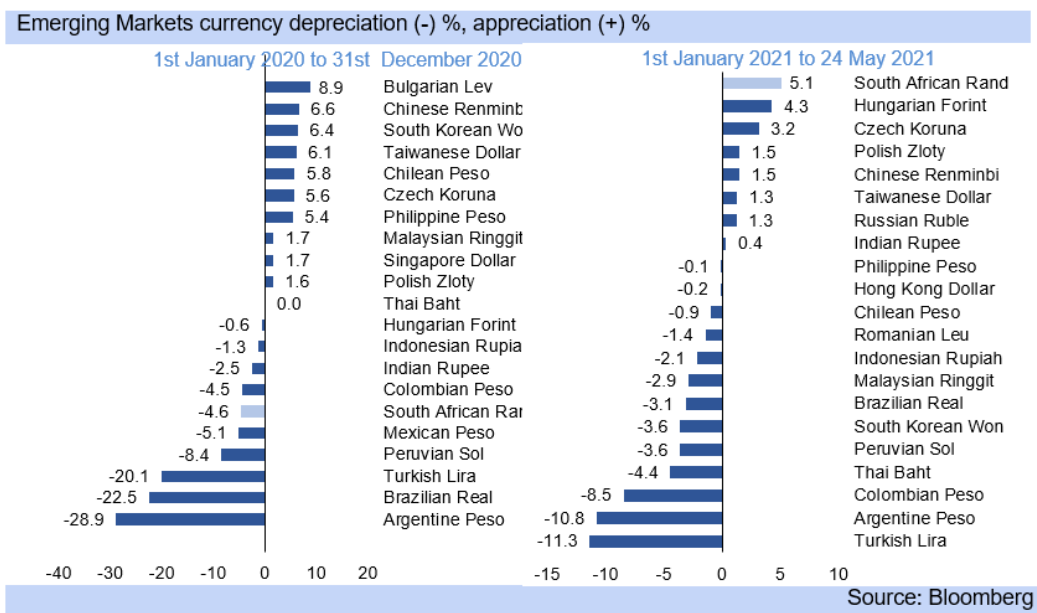


- S&P emphasises that its “ratings are constrained by weak economic growth performance since well before the COVID-19 pandemic, ...as well as weak public finances, including high fiscal deficits, a high debt burden, and sizable contingent liabilities from weak state-owned enterprises (SOEs).”
- Fitch concurs, saying that it is “not factoring in a large impact from the government’s reforms, which seem limited in scale and slow in implementation.” Adding, “the government’s fiscal consolidation plan relies heavily on containing public sector wages”.
- Fitch adds “(w)hile the government built a strong record before the pandemic of sticking to expenditure ceilings, it no longer emphasised these ceilings in the 2021 budget, and building political support for fiscal consolidation remains challenging.”
- “As a result, we do not believe the government will achieve its target of a primary surplus in FY24/25 and a stabilisation of CG government debt at 88.9% of GDP in the following year”, this is particularly worrying as Fitch has SA on a negative outlook on its BB- rating.”
- The rating agencies can adjust SA’s ratings between meetings and they are also able to move by more than one rating level, with SA not yet deemed able to move off Fitch’s negative outlook. A downgrade from Fitch would place it in the single B ratings category.
- SA needs to continue to forge ahead with divesting the corrupt of key political and/or governmental positions, both to build political and policy stability in SA and to continue to underpin investor confidence in SA which was severely battered by the past decade.
- The boom in the commodity markets, particularly in metals prices, and gold’s higher prices too, boosted SA’s terms of trade substantially, and so its trade account, and SA will likely record a marked current account surplus in Q1.21, which has been boosting rand strength.

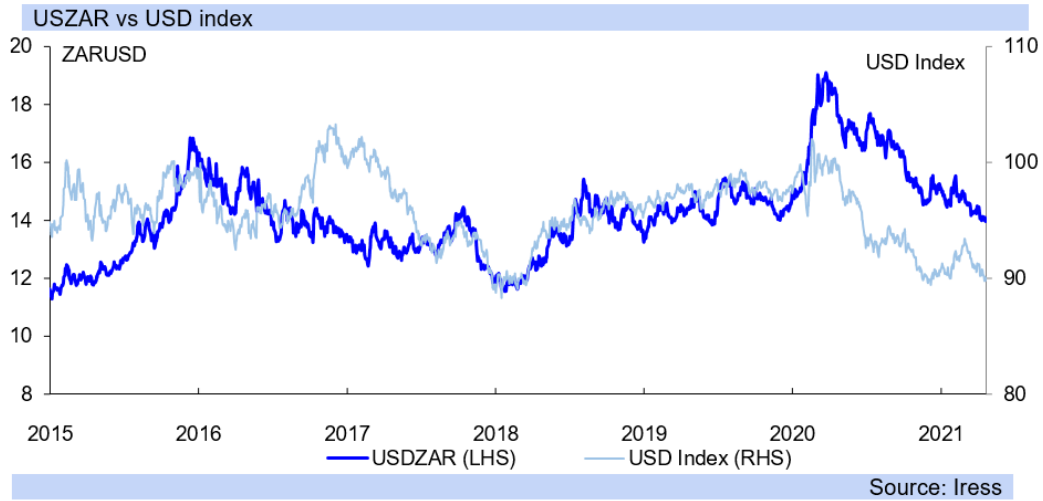
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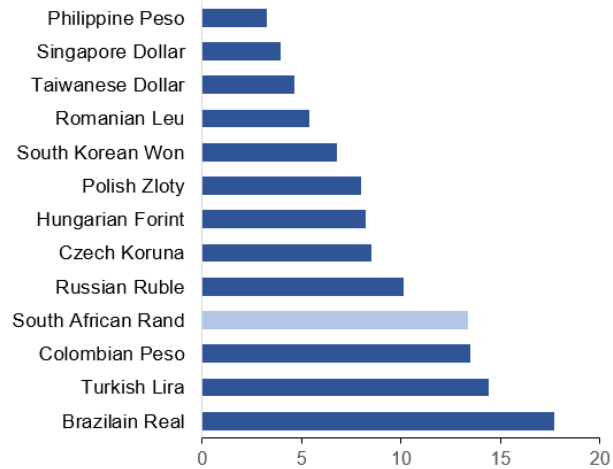
- Absent the global commodity price boom, the rand would not be seeing the degree of strength it has experienced this year against the US dollar, and indeed Q2.21 looks set to record a current account surplus as well.
- The rand is currently averaging R14.26/USD this quarter, versus the R14.50/USD expected previously for Q2.21, and we will revise stronger our average forecast for the quarter, likely closer to R14.25/USD at the end of this month for publication at the start of June.



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Emerging Markets Implied Volatilities – values as at 24 May 2021



Source: Bloomberg

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Extreme Up Case: Exchange Rate forecasts												
	2021				2022				2023			
	Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
USD/ZAR	14.96	14.10	13.50	13.40	13.10	12.90	12.70	12.50	12.30	12.70	13.10	12.60
GBP/ZAR	20.50	19.32	18.50	18.63	18.60	18.45	18.42	17.88	17.47	17.91	18.34	17.64
EUR/ZAR	18.13	16.92	16.34	16.55	16.44	16.25	16.13	15.75	15.38	15.88	16.38	15.75
ZAR/JPY	6.96	7.45	7.78	7.80	7.94	8.06	8.27	8.40	8.62	8.35	8.09	8.41
CHFZAR	16.71	15.45	14.78	14.84	14.51	14.33	14.15	13.74	13.23	13.37	13.51	12.60
AUDZAR	11.53	10.86	10.46	10.45	10.35	10.19	9.91	9.50	9.23	9.53	9.83	9.45
GBP/USD	1.38	1.37	1.37	1.39	1.42	1.43	1.45	1.43	1.42	1.41	1.40	1.40
EUR/USD	1.21	1.20	1.21	1.24	1.26	1.26	1.27	1.26	1.25	1.25	1.25	1.25
USD/JPY	106	105	105	105	104	104	105	105	106	106	106	106

Note: averages, Source: Investec, Iress

Severe Down Case: Exchange Rate forecasts												
	2021				2022				2023			
	Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
USD/ZAR	14.96	15.50	17.00	17.50	18.00	18.50	19.00	19.50	19.40	19.90	20.00	19.80
GBP/ZAR	20.64	21.23	23.29	24.33	25.56	26.46	27.55	27.89	27.55	28.06	28.00	27.72
EUR/ZAR	18.13	18.60	20.57	21.61	22.59	23.31	24.13	24.57	24.25	24.88	25.00	24.75
ZAR/JPY	7.09	6.77	6.18	5.97	5.78	5.62	5.53	5.38	5.46	5.33	5.30	5.35
CHFZAR	16.44	16.99	18.62	19.38	19.94	20.56	21.17	21.43	20.86	20.95	20.62	19.80
AUDZAR	11.53	11.94	13.18	13.65	14.22	14.62	14.82	14.82	14.55	14.93	15.00	14.85
GBP/USD	1.38	1.37	1.37	1.39	1.42	1.43	1.45	1.43	1.42	1.41	1.40	1.40
EUR/USD	1.21	1.20	1.21	1.24	1.26	1.26	1.27	1.26	1.25	1.25	1.25	1.25
USD/JPY	106	105	105	105	104	104	105	105	106	106	106	106

Note: averages, Source: Investec, Iress