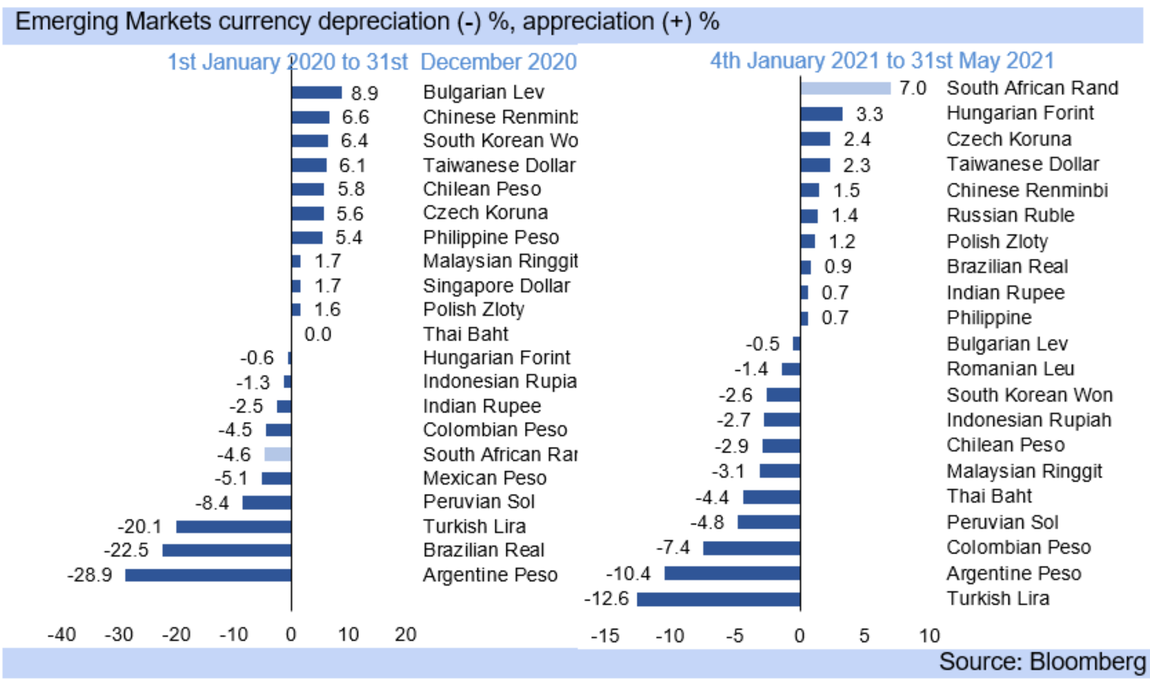
SA Economics

Monday 31 May 2021

Rand note: SA sees -R1.3bn in portfolio outflows in May as foreigners sell -R7.1bn worth of equities net of purchases, with the rand benefiting instead from the commodity boom and SA's higher comparative interest rates



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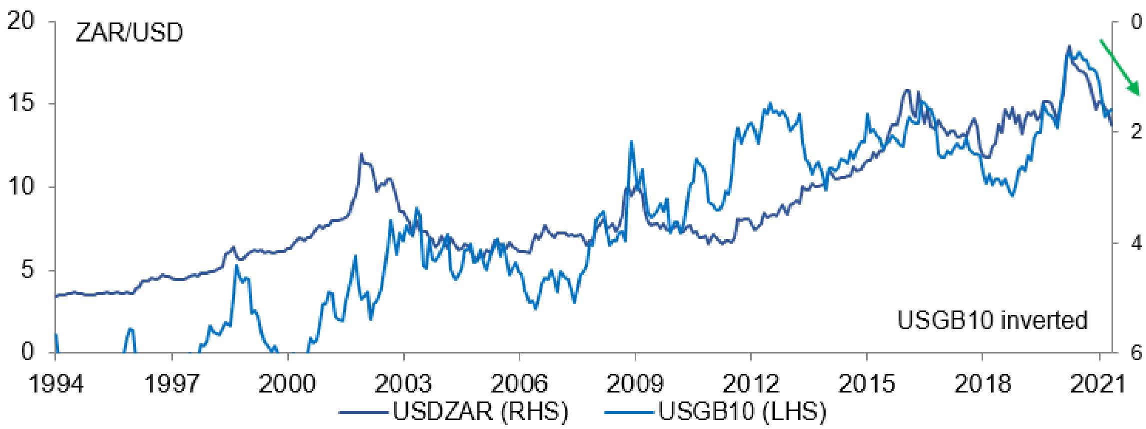
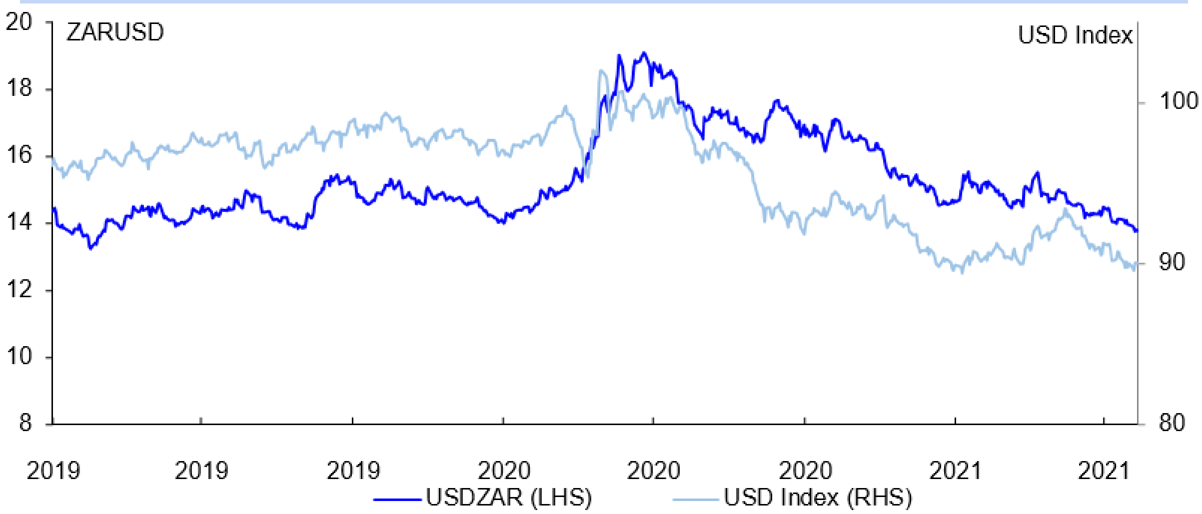
USDZAR vs US 10-year bond (%) – USGB yield inverted



Source: Iress

USZAR vs USD index



Source: Iress

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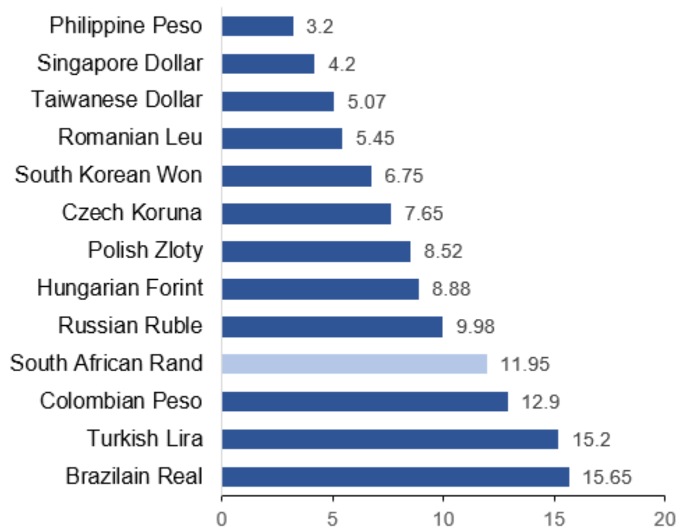
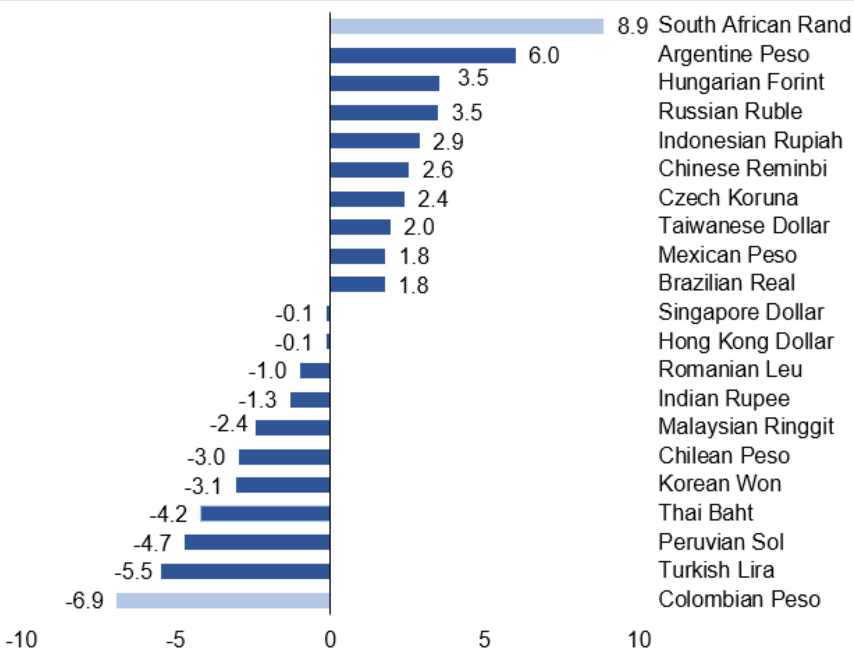
Emerging Markets Implied Volatilities – values as at 31 May 2021



Source: Bloomberg

Emerging Markets Carry Return – values as at 31 May 2021



Source: Bloomberg

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- May is showing a modest net inflow of foreign investment into SA bonds (R5.9bn), but a more substantial sell-off of SA's equities (-R7.1bn), with an overall net portfolio outflow of -R1.3bn, with the negative impact on the rand likely counteracted by strong commodity exports.
- The rand reached R13.73/USD today and is likely to average R14.05/USD this month, and potentially R14.15/USD this quarter. The strongly supportive global monetary policy environment is also benefiting the domestic currency, as are SA's interest rate differentials.
- The differential between the yield on the ten-year US treasury and SA's ten-year bond has widened to 7.67% since close to 6.00% in 2018, making SA bonds attractive to foreign investors, although this spread has been narrowing this year.
- At the start of 2021 the spread between the US and SA ten-year yields was at 8.00%, and has gradually worked down to 7.67% currently, with global financial markets also in yield seeking (risk-on) mode.
- US yields have risen somewhat this year, with the ten year at 1.58% currently, up from 0.91% at the start of this year. The slight lift in US yields has accounted for the modest narrowing in the spread with SA, but not to a degree significant enough to substantially erode the return.
- The rand has been sensitive to market expectations on US interest rates and yields, with some inter day and inter week volatility, but this has been relatively mild, with the global risk-taking environment a supportive backdrop for both the commodity boom and EM assets.
- US yields may see some further lift this year if inflationary concerns worry markets materially again, with the US not expected to keep its interest rates on hold indefinitely, and the strength of commodity prices and other supply side pressures causing some concern.
- While the US has seen very substantial fiscal stimulation, with the stimulus cheques US households have been receiving supporting economic activity, the pressure is essentially supply side in nature and the US is not yet seeing true demand side price pressures.
- Such demand side price pressures, which will develop as wages rise and unemployment wind down, will be key for higher US interest rates. With this not expected in the immediate future the rand could retain its strength this quarter.

Please scroll down to the second section below

SA Economics

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	14.15	14.45	14.35	14.45	14.85	15.05	14.95	14.85	15.25	15.65	15.15
GBP/ZAR	20.64	19.38	19.80	19.95	20.52	21.24	21.82	21.38	21.09	21.50	21.91	21.21
EUR/ZAR	18.13	16.98	17.48	17.72	18.13	18.71	19.11	18.84	18.56	19.06	19.56	18.94
ZAR/JPY	7.09	7.42	7.27	7.28	7.20	7.00	6.98	7.02	7.14	6.95	6.77	7.00
CHFZAR	16.44	15.51	15.82	15.89	16.01	16.50	16.77	16.43	15.97	16.05	16.13	15.15
AUDZAR	11.53	10.90	11.20	11.19	11.42	11.73	11.74	11.36	11.14	11.44	11.74	11.36
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

SA Economics

Economic Scenarios: expected and up case strengthened exchange rates

		Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22
Extreme	USD/Rand (average)	14.96	13.75	13.50	13.40	13.10	12.90	12.70	12.50
Up case	Repo rate (end rate)	3.50	3.25	3.25	3.25	3.25	3.25	3.25	3.25
1%									

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.

		Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22
Up case									
2%	USD/Rand (average)	14.96	14.00	13.80	13.70	13.60	13.50	13.70	13.60
	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.

		Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22
Base	USD/Rand (average)	14.96	14.15	14.45	14.35	14.45	14.85	15.05	14.95
case	Repo rate (end rate)	3.50	3.50	3.50	3.75	3.75	3.75	4.00	4.00
50%									

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.

		Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22
Lite	USD/Rand (average)	14.96	15.00	15.75	16.50	16.70	17.00	17.50	17.00
(domestic)	Repo rate (end rate)	3.50	3.75	3.75	4.00	4.00	4.25	4.25	4.50
Down case									
42%									

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.

		Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22
Severe	USD/Rand (average)	14.96	15.50	17.00	17.50	18.00	18.50	19.00	19.50
down	Repo rate (end rate)	3.50	4.00	4.00	4.25	4.50	4.50	4.75	5.00
case									
5%									

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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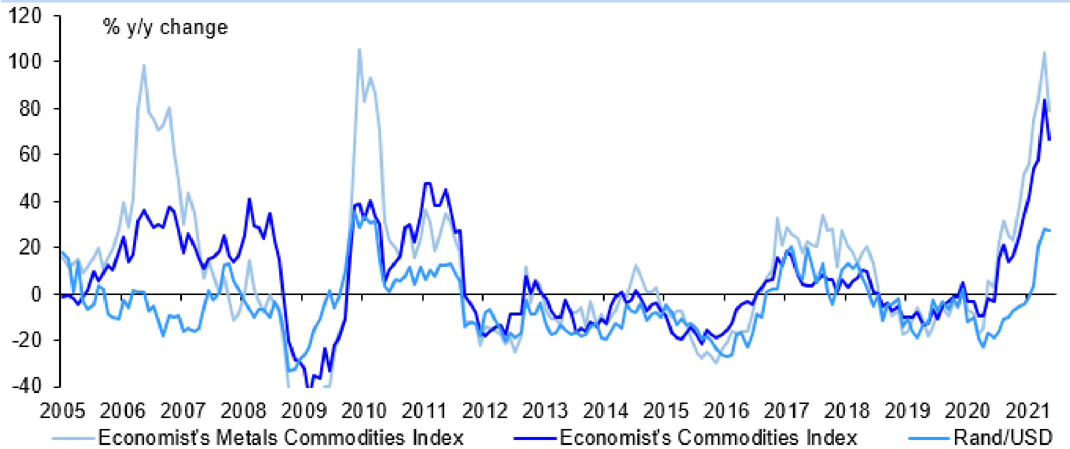
Up Case: Exchange Rate forecasts												
	2021				2022				2023			
	Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
USD/ZAR	14.96	14.00	13.80	13.70	13.60	13.50	13.70	13.60	13.50	13.90	14.30	13.80
GBP/ZAR	20.64	19.18	18.91	19.04	19.31	19.31	19.87	19.45	19.17	19.60	20.02	19.32
EUR/ZAR	18.13	16.80	16.70	16.92	17.07	17.01	17.40	17.14	16.88	17.38	17.88	17.25
ZAR/JPY	7.09	7.50	7.61	7.63	7.65	7.70	7.66	7.72	7.85	7.63	7.41	7.68
CHFZAR	16.44	15.34	15.11	15.17	15.06	15.00	15.26	14.95	14.52	14.63	14.74	13.80
AUDZAR	11.53	10.78	10.70	10.69	10.74	10.67	10.69	10.34	10.13	10.43	10.73	10.35
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

Economist's commodity indices



Source: IRESS, Economist

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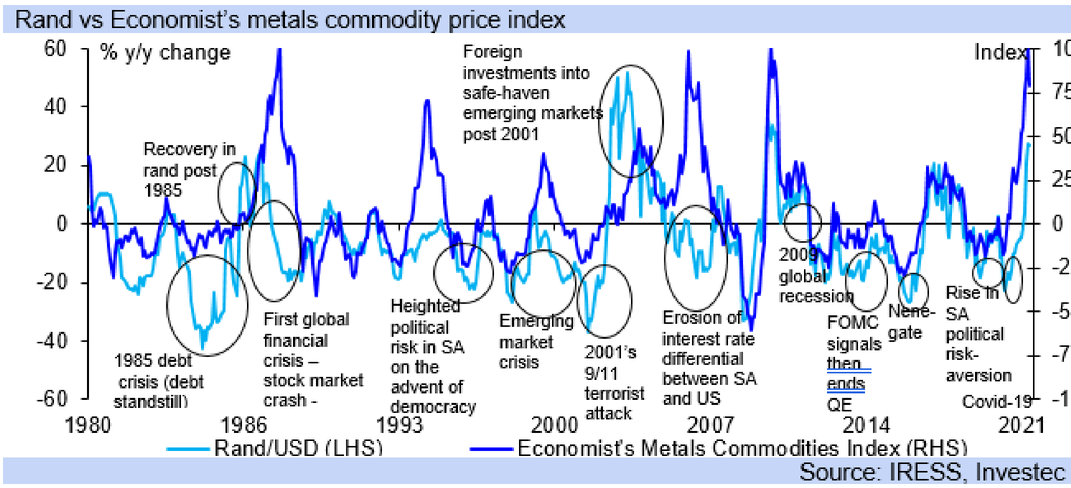

- Indeed, the recent unexpected rise in the US unemployment rate, while to only 6.1% y/y for April from 6.0% y/y in March, still saw the rand react, as markets had expected US unemployment at 5.8%. This sensitivity added to the rand's ongoing strength.
- However, going forward any indication that US unemployment is being wound down fairly quickly, and significant US price pressures emerging from wages overall on the demand side, would likely be negative for the domestic currency.
- This increased sensitivity to key US data releases is likely going to impact movements in the rand for most of the rest of this year, with the US having vaccinated around half its population, and expected to reach 75% coverage in five months' time, which will aid economic recovery.
- The rapid roll out of vaccines in the US has bolstered market expectations of economic recovery, and increased market sensitivity to potential price pressures which could eventually cause the Fed to look to higher rates, with concerns also for potential reductions in QE.
- The domestic currency is unlikely to be unscathed from a global financial market taper tantrum, and evidence of the US recovering strongly, particularly its labour market, would risk giving rise to such an event.
- From this perspective then, the rand's run of current strength does remain at risk of ceasing and being wound back by US developments. Further very substantial fiscal stimulus measures are in the process of being approved in the US as well, which will bolster its growth.
- The rand's substantial run in strength to date is not expected to be endless, and as the US shows greater signs of recovery, so market fears about the US tapering its QE programme will grow and this would be expected to reduce market appetite for risk taking.

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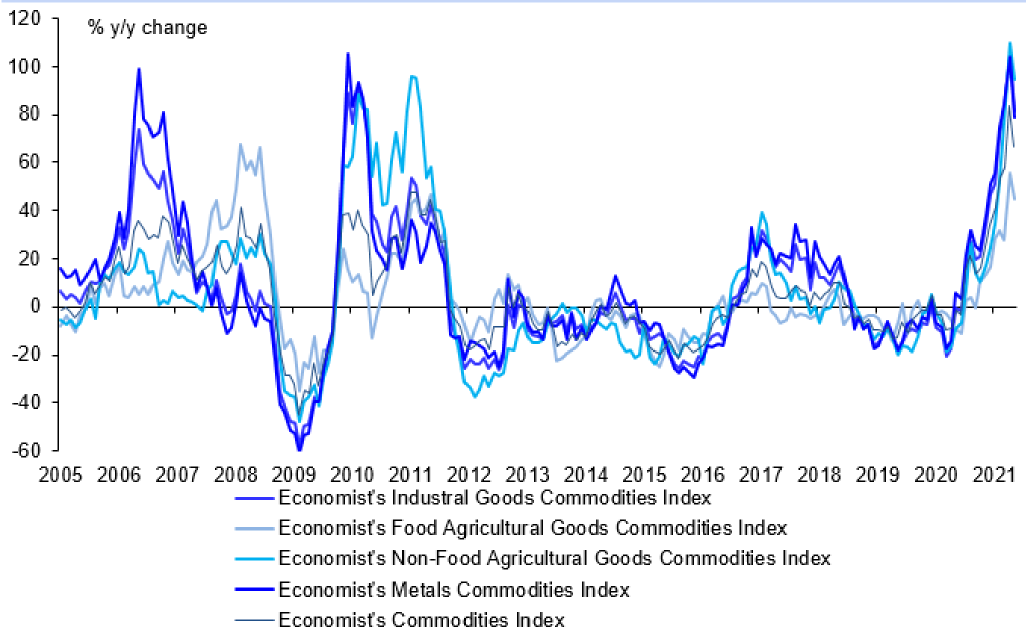
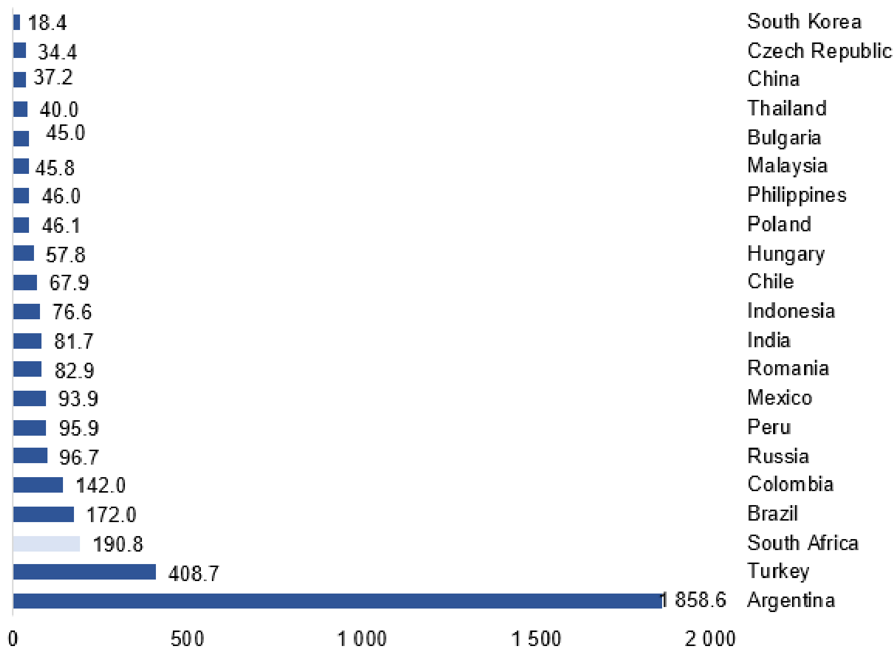
- Reduced market risk taking would typically negatively impact the rand, with market interest in bonds having differentiated this year, with Asia benefiting the most, although the rand is getting a particularly strong boost from its commodity exports in the current boom.
- High commodity prices may keep the rand from depreciating very markedly as a quickening US recovery is positive for global economic recovery, and so for commodity prices. While the rand could see some weakness from a taper tantrum it is unlikely to be extreme.

Economist's commodity indices



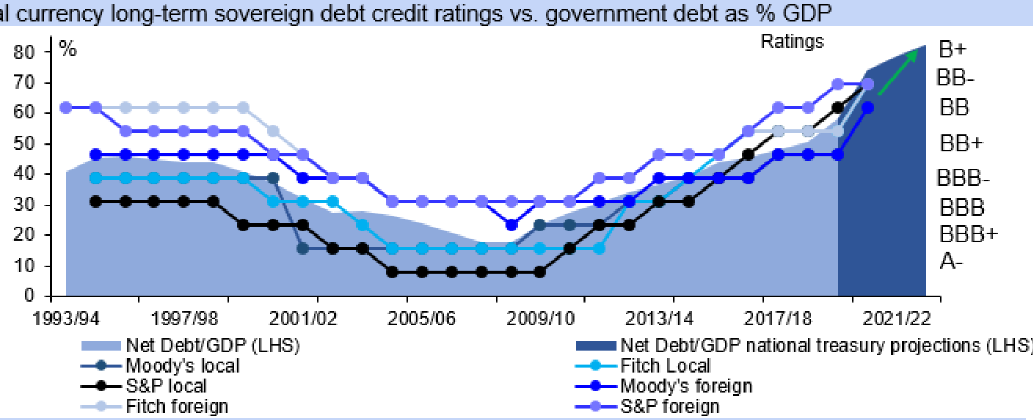
Source: IRESS, Economist

Emerging Markets CDS Spreads – values as at 31 May 2021



Source: Bloomberg

Local currency long-term sovereign debt credit ratings vs. government debt as % GDP



Source: Credit rating agencies, National treasury, Bloomberg

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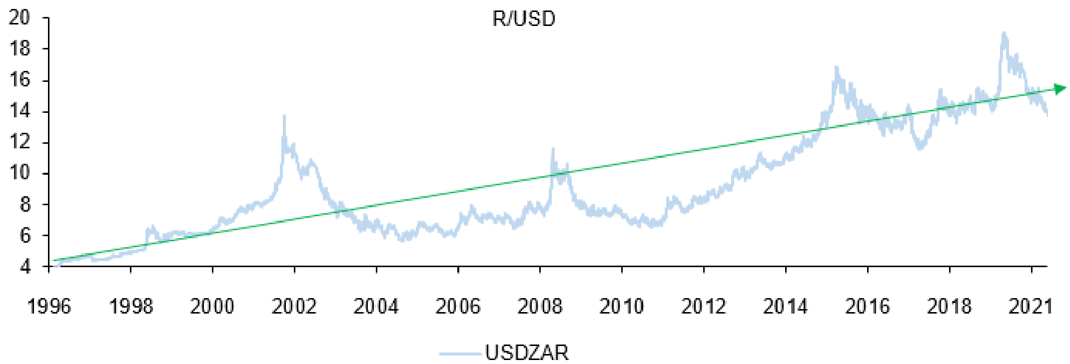
Long-term trend of the rand



Source: Iress

USDZAR

Source: Iress