

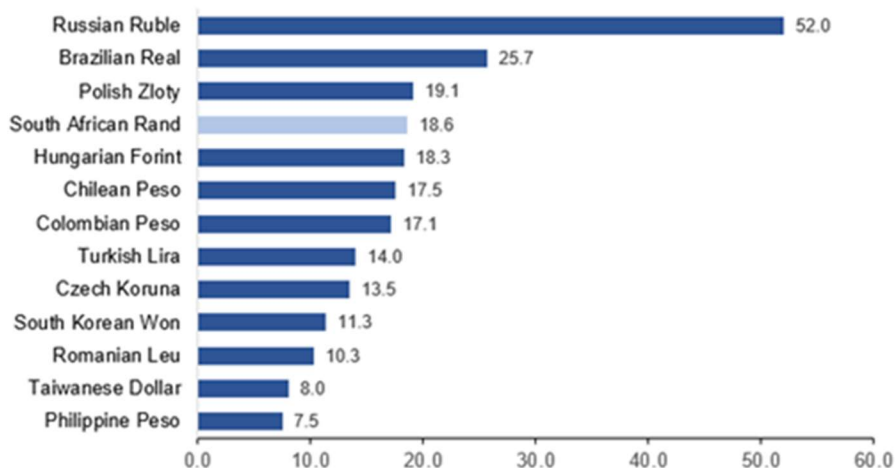
Tuesday 3 May 2022

Rand note: the rand has weakened substantially on concerns over the size, and pace of FOMC interest rate hikes

Expected Case: Exchange Rate forecasts												
	2022				2023				2024			
	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.22	Q1.24	Q2.24	Q3.24	Q4.24
USD/ZAR	15.21	15.40	15.60	15.30	15.10	15.50	15.90	15.40	15.20	15.70	16.20	15.10
GBP/ZAR	20.40	19.99	20.12	20.04	20.08	20.93	21.62	21.02	21.28	22.45	23.49	20.08
EUR/ZAR	17.07	16.72	16.69	16.68	16.76	17.52	18.13	17.63	17.94	18.84	19.93	16.76
ZAR/JPY	7.65	8.03	8.04	8.10	8.08	7.77	7.55	7.79	7.76	7.32	6.79	8.08
CHF/ZAR	16.47	16.25	16.05	15.73	15.59	16.07	16.48	16.03	16.34	17.25	17.80	15.59
AUD/ZAR	11.02	11.33	11.47	11.70	11.78	12.25	12.72	12.32	11.86	12.25	12.64	11.78
GBP/USD	1.34	1.30	1.29	1.31	1.33	1.35	1.36	1.37	1.40	1.43	1.45	1.46
EUR/USD	1.12	1.09	1.07	1.09	1.11	1.13	1.14	1.15	1.18	1.20	1.23	1.25
USD/JPY	116	124	126	124	122	121	120	120	118	115	110	107

Note: averages, Source: Investec, Iress

Emerging Markets Implied Volatilities – values 3 May 2022



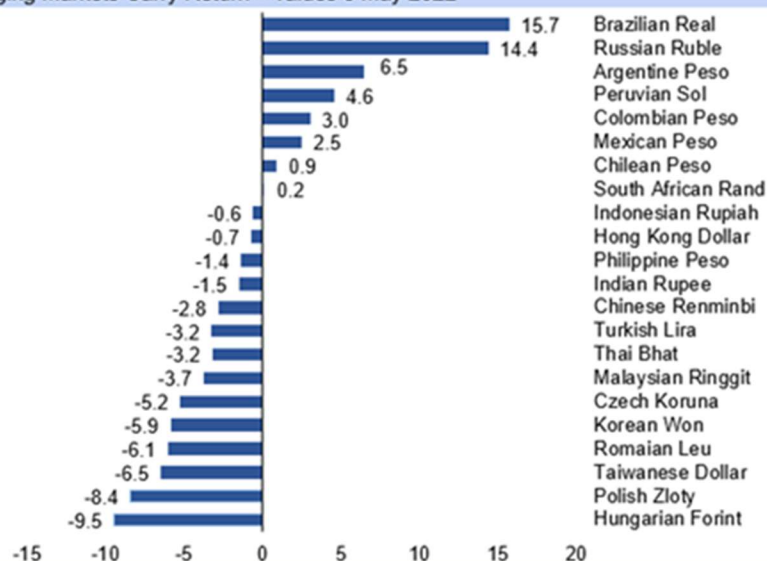
Source: Bloomberg

Emerging Markets currency depreciation (-) %, appreciation (+) %



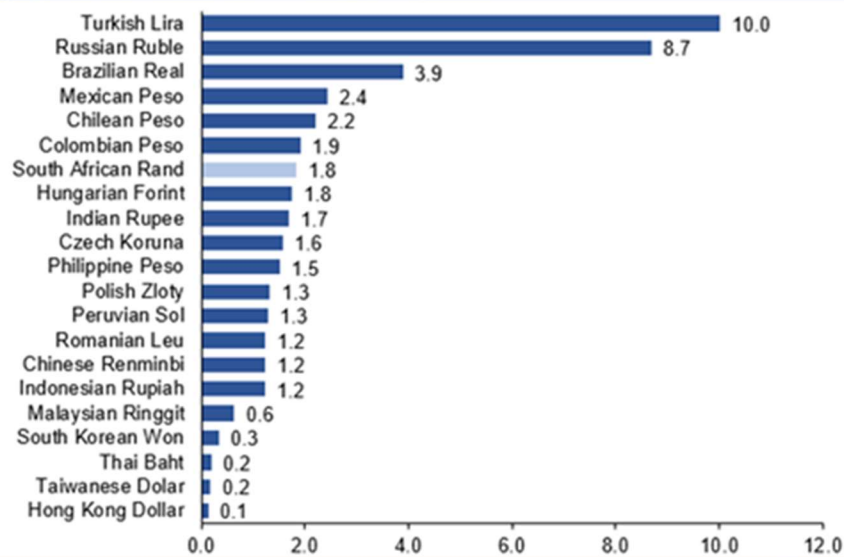
Source: Bloomberg

Emerging Markets Carry Return – values 3 May 2022



Source: Bloomberg

Emerging Markets Interest Return – values 3 May 2022

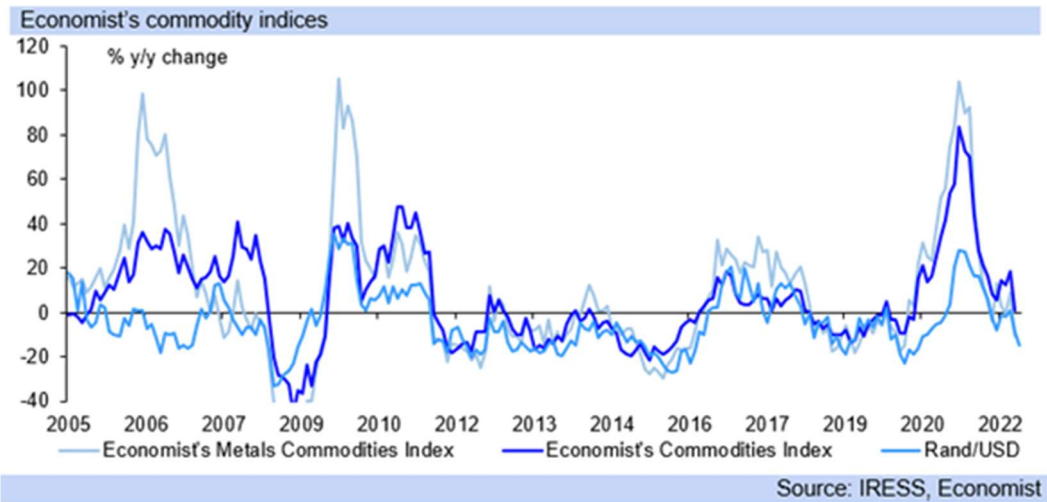
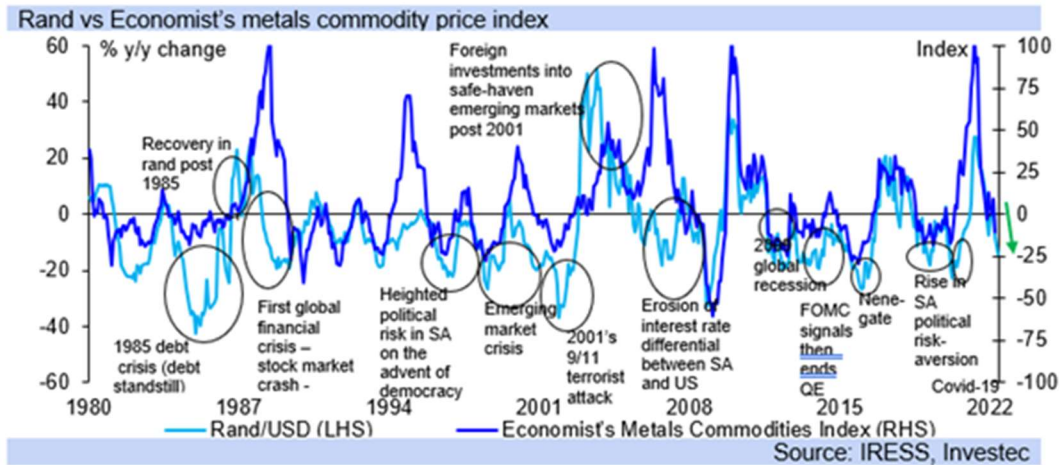


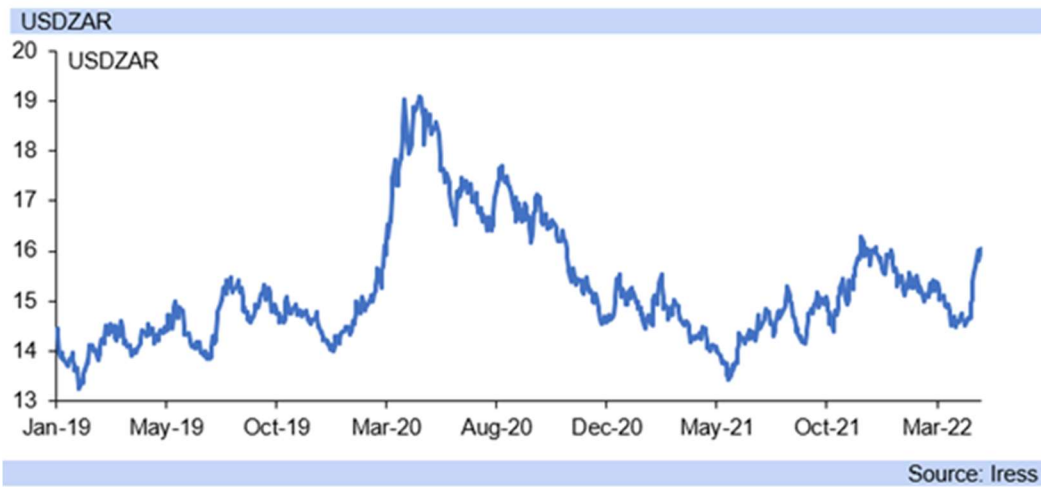
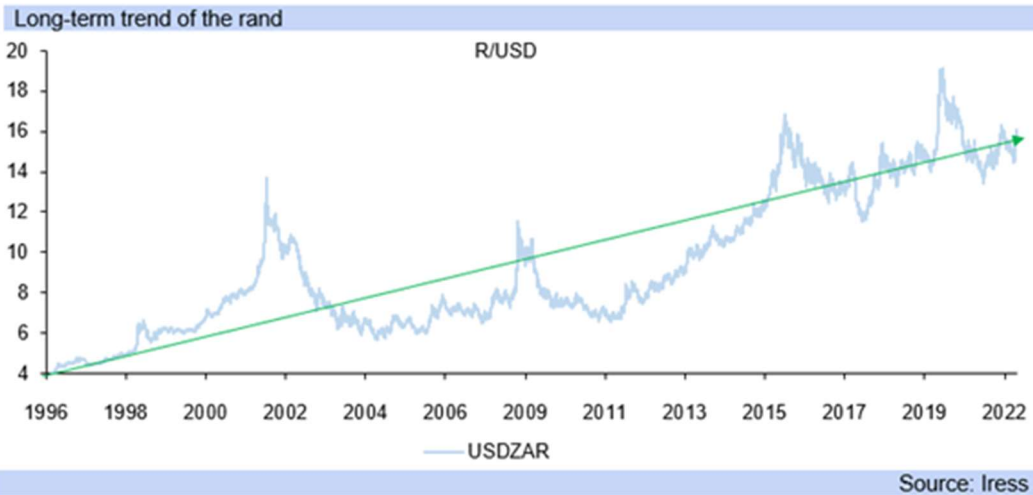
Source: Bloomberg

- So far this quarter, the rand averages R15.08/USD, weakening substantially over the second half of April as markets increasingly worried that the US would hike its interest rates significantly more than SA in Q2.22, and H2.22.
- Tomorrow night's (SA time) FOMC meeting will be a key determinate for the domestic currency, with a 50bp hike in US interest rates factored in by the markets, although there are some worries of a 75bp hike instead, which have driven the rand particularly weaker recently.
- While a 50bp lift is most likely, the FOMC sees another meeting next month (June) to assess, and change, monetary policy yet again, and markets have factored in another 50bp hike in June, and indeed two more at the FOMC's July and September meetings, a 2% lift in total.
- SA in comparison only has three monetary policy meetings in the period, and markets do not expect the same trajectory of rate hikes, with just under a 50bp hike in the repo rate anticipated this month (88% chance of a 50bp hike.)
- In fact, financial markets have fully factored in a 250bp hike in the fed funds rate by year end, while in SA just under a 2.00% hike in the repo rate is expected from here this year, less than that of the US which would narrow the differential between SA and US interest rates.
- Such an outcome typically results in rand weakness, and the rand is likely factoring this in ahead of time. Additionally however, a 2.00% lift in SA's repo rate in the remainder of this year would be negative for economic growth.
- Commodity prices have moderated, and are expected to drop further as global economic growth expectations have weakened for 2022, and the coal price (SA's leading export this year) is significantly lower than two weeks ago.
- The second half of April also saw a negative impact to SA's trade balance from the extreme floods in KZN and disruptions to exports, which would have had a negative effect on the rand, at the same time as the market concerns over FOMC hawkishness elevated.

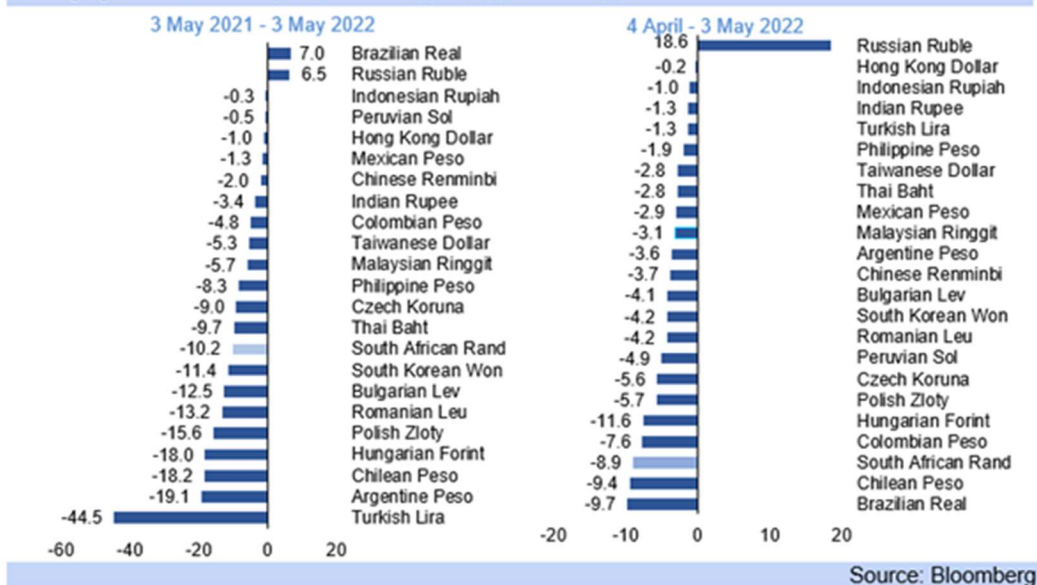
- The sell-in-May and-go-away adage for financial markets refers to the advent of the Northern hemisphere summer vacation period, and also adds to risk aversion and so typically some EM currency weakness, along with other perceived risk assets.

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Emerging Markets currency depreciation (-) %, appreciation (+) %



- The US dollar has seen marked strength, which has changed the EUR/USD forecast, and has also impacted the USD/ZAR projections, allowing for an average of R15.40/USD for the rand this quarter, although it is at risk of further weakness.
- That is, the rand remains at risk of a weaker interest rate hike cycle in South Africa than in the US, with the domestic currency seeing severe depreciation in the past when the differential between US and SA interest rates has been significantly narrowed.
- Additionally, the sell-in-May and-go-away phenomenon tends to see rand weakness in the middle two quarters of the year, and rand strength in the first and last quarter of the year. Markets also worry about the impact of a 2.50% US rate hike on future global growth.
- US CPI and PPI figures are due out on the 11th and 12th for this month, and are likely to see some further upwards pressure, but the large jumps in annual inflation are likely over, as base effects will increasingly come into effect for the remainder of 2022.
- However, this is the expected case of no further sharp elevation in commodity prices from here (particularly in fuel and food prices), and that the US avoids 75bp hikes in its interest rates, and indeed, slows down the rate hike pace to 25bp moves in Q3.22.
- Already in the EU, stagflationary (rising inflation and slowing economic growth) concerns are worrying investors, with Q1.22 seeing a drop in the growth rate while EU inflation reached a high in April, and core inflation for the bloc jumped up.
- The rand has retraced some of its losses, from R16.20/USD yesterday, to R15.93/USD today, while against the euro it is at R16.77/EUR (R15.88/USD in mid-April) , with substantial USD strength a key factor in recent rand movements.
- Against the GBP the rand has weakened to R19.95/USD (although yesterday it reached R20.28/USD), from R19.12/USD mid-April, and a low of R18.93/USD for this year at the end of March.
- The rand has weakened 9% against the USD since mid-April, 6% against the EUR and 5% against the GBP. In contrast in April 2020 the rand weakened beyond R19.00/USD, by 27.6% from R14.00/USD at the start of 2020.

Economic Scenarios: note tighter rate hike cycle for SA

		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
Extreme Up case 1%	USD/Rand (average)	15.21	14.00	13.80	13.70	13.60	13.40	13.30	13.10
	Repo rate (end rate)	4.25	4.00	4.00	3.75	3.75	3.75	3.50	3.50
	Impact of Covid-19 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 other EW or nationalisation. High business confidence and fixed investment growth, substantial FDI, strong fiscal consolidation (state debt falls back to low ratios of 2000s). Very subdued domestic inflation on extreme rand strength, rapid capacity expansion and very favourable weather conditions. Strong global growth, commodity boom. Stabilisation of credit ratings, then upgrades.								
Up case 2%	USD/Rand (average)	15.21	14.50	15.00	14.90	14.90	14.70	14.60	14.50
	Repo rate (end rate)	4.25	4.00	4.00	4.00	4.00	4.00	4.25	4.25
	Quick rebound from Covid-19 pandemic, rising confidence and investment levels - structural problems eroded. No further credit rating downgrades, become positive on fiscal consolidation (debt projections fall substantially). Global risk-on, global demand quickly returns to trend growth. Very limited impact of expropriation without compensation to abandoned, labour tenants' and government land (individuals are new owners and receive title deeds) does not have a negative effect on economy - no nationalisation. Low domestic inflation on favourable weather conditions, rand strength reduction in state-controlled price inflation on increased private privatisation.								
Base case 51%	USD/Rand (average)	15.21	15.40	15.60	15.30	15.10	15.50	15.90	15.40
	Repo rate (end rate)	4.25	4.50	5.00	5.00	5.25	5.50	5.75	5.75
	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 neutral to positive. 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 fiscal consolidation (debt to GDP stabilisation) occurs. Civil and political unrest wanes. Inflation impacted by normal course of weather patterns via food price inflation and rand, with modest transition to renewable energy and slow move away from fossil fuel usage, measures to alleviate impact of climate change on economy are modestly implemented.								
Lite (domestic) Down case 40%	USD/Rand (average)	15.21	15.70	16.65	16.90	17.00	17.50	17.60	17.50
	Repo rate (end rate)	4.25	4.75	5.25	5.50	5.75	6.00	6.25	6.50
	The international environment (incl. 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. Very limited expropriation of private commercial sector property without compensation, with some negative impact on the economy. Business confidence depressed, marked rand weakness and higher inflation (adverse weather), significant load shedding and weak investment growth. Substantial fiscal consolidation ultimately occurs, preventing ratings falling into the C grades.								
Severe down case 6%	USD/Rand (average)	15.21	16.80	17.50	18.00	18.50	18.70	19.20	19.55
	Repo rate (end rate)	4.25	5.00	5.50	5.75	6.00	6.50	7.00	7.00
	Lengthy global recession, global financial crisis - insufficient monetary and other policy supports to growth domestically and internationally. Depression in SA, severe rand weakness, very high inflation (very adverse weather). A somewhat wider level of nationalisation of private sector commercial property. SA rated single B from all three key agencies, with further rating downgrades eventually into CCC grade and the risk of moving towards default. Government borrows from increasingly wider sources as it sinks deeper into a debt trap, eventually include widespread civil unrest, services strike action and strike action.								

Note: Event risk begins Q222. Source: Investec

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Lite Down Case: Exchange Rate forecasts

	2022				2023				2024			
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USD/ZAR	15.25	15.70	16.65	16.90	17.00	17.50	17.60	17.50	17.20	17.00	16.80	17.00
GBP/ZAR	20.46	21.82	23.48	24.00	24.31	25.38	25.70	25.90	25.46	25.16	24.86	24.82
EUR/ZAR	17.10	18.06	19.31	19.94	20.23	21.00	21.30	21.35	21.50	21.25	21.00	21.25
ZAR/JPY	7.63	7.52	7.15	7.10	7.06	6.86	6.82	6.86	6.86	6.76	6.55	6.29
CHF/ZAR	16.51	17.07	18.10	18.57	18.48	19.02	19.13	19.02	18.90	18.68	18.46	18.68
AUD/ZAR	11.13	11.46	12.32	12.68	12.75	13.13	13.20	13.13	13.42	13.26	13.10	13.26
GBP/USD	1.34	1.39	1.41	1.42	1.43	1.45	1.46	1.48	1.48	1.48	1.48	1.46
EUR/USD	1.12	1.15	1.16	1.18	1.19	1.20	1.21	1.22	1.25	1.25	1.25	1.25
USD/JPY	116	118	119	120	120	120	120	120	118	115	110	107

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