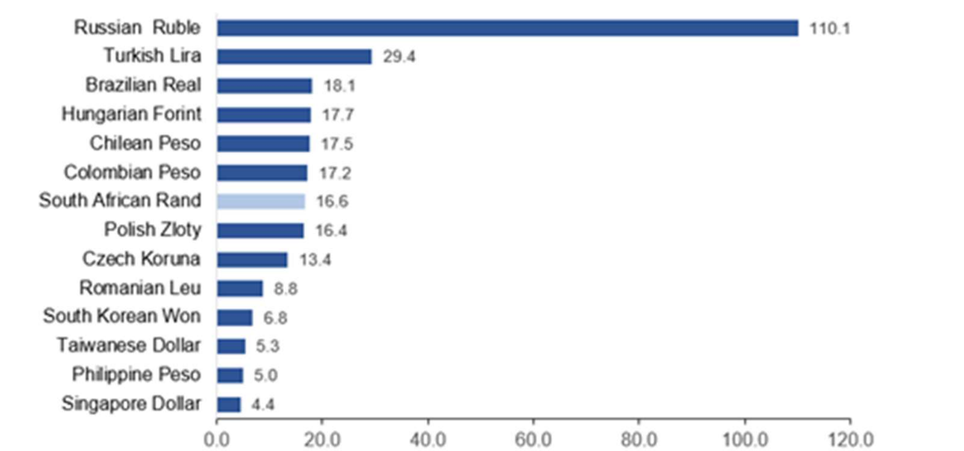
Tuesday1 March 2022

Rand note: the domestic currency is volatile on the Russian/Ukraine war, weakening on uncertainty, with no resolution in sight yet and the conflict instead likely to intensify

Emerging Markets Implied Volatilities – values 1 March 2022

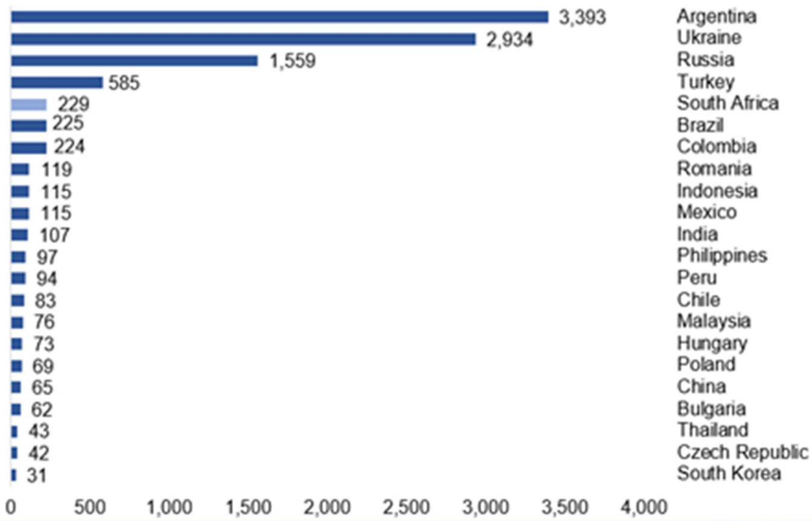


Source: Bloomberg

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

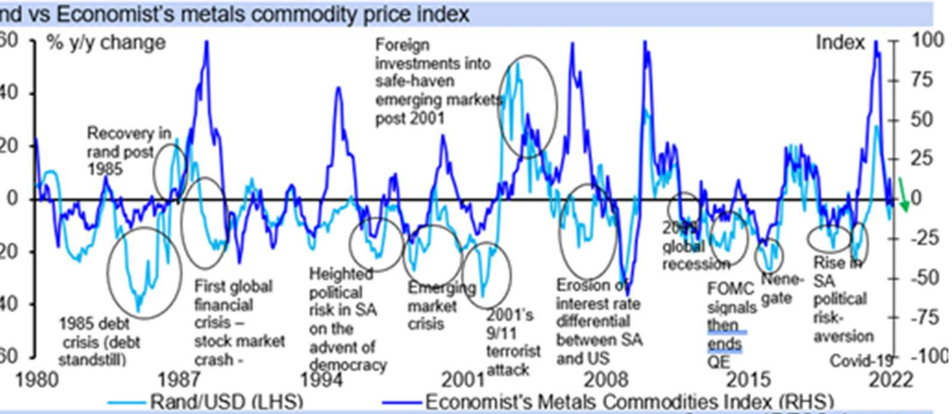
Source: Bloomberg

Emerging Markets CDS Spreads – values 1 March 2022

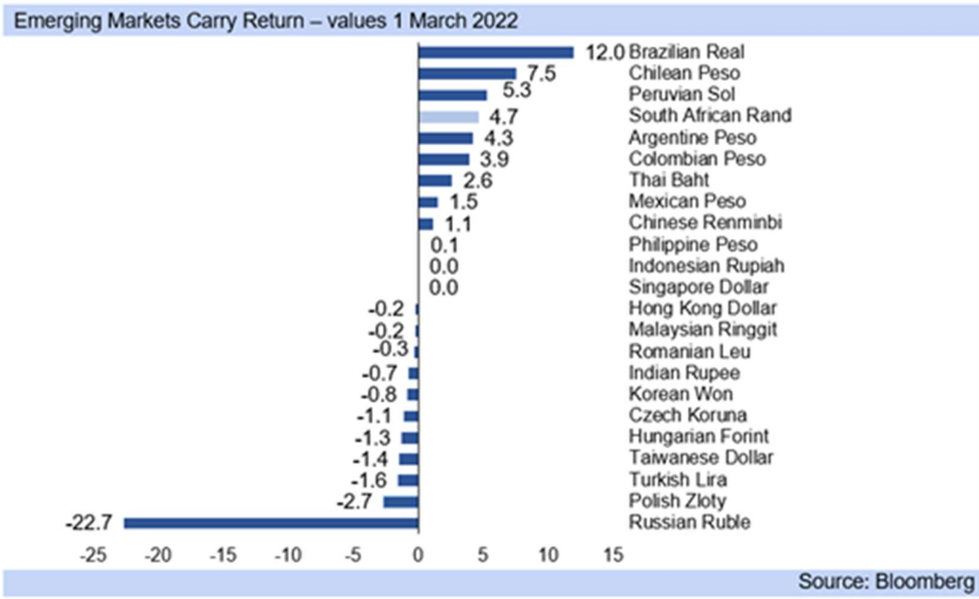


Source: Bloomberg

Rand vs Economist's metals commodity price index



Source: IRESS, Investec



- The rand has since pulled back from its weak point on Thursday last week of R15.53/USD when the Russian/Ukraine war began, as no other countries have actively joined the conflict, although the financial, humanitarian and military equipment aid has been substantial.
- Very severe and broad based sanctions imposed by most Western countries on Russia has seen the rouble weaken by -24.4% to date since the start of the year, while the Ukrainian Hryvnia is -7.3% weaker over the same period.
- This morning the rand was just -1.9% weaker since the start of January, improved on yesterday's -2.45% depreciation in the comparable period, as risk aversion eased somewhat on talks underway between Russia and the Ukraine on a ceasefire.
- The rand even broke through R15.30/USD level, reaching at R15.25/USD, as markets hoped for resolution on the conflict, although the Ukraine was not optimistic on a ceasefire and Russian forces were reported to have continued their attacks during the talks.
- The EU, Britain and other Western alliances have instituted broad sanctions and export controls of military equipment to Russia so far, including sanctions against Russian companies, business leaders, government officials and banks.
- China has not indicated that it will increase imports of Russian goods to fully counteract the impact from sanctions, and instead is particularly concerned about its reported US$1.6trillion in trade with the EU and US. China's trade with Russia is estimated only at US$0.1trillion.
- China buys mainly oil and gas from Russia, and has been keen to buy more. It is also reported to be increasing wheat imports from Russia. The oil price reached US$103/bbl today and is likely to climb further on an intensification of conflict, bolstering inflationary concerns.
- Around midday today it was reported that Russia is set to intensify its attack, with a long convoy of vehicles enroute to encircle Kyiv, with missile strikes on Kharkiv (Ukraine's second largest city). The rand has retreated to R15.43/USD, and is likely to remain volatile.
- There is no certainty when the Russian/Ukraine war will end, or by how much more it will intensify, but Russia is unlikely to back down easily, and instead deliver a much harsher second wave of attack. The rand is at risk of further weakness this month.

Please scroll down to the second section below

Expected Case: Exchange Rate forecasts

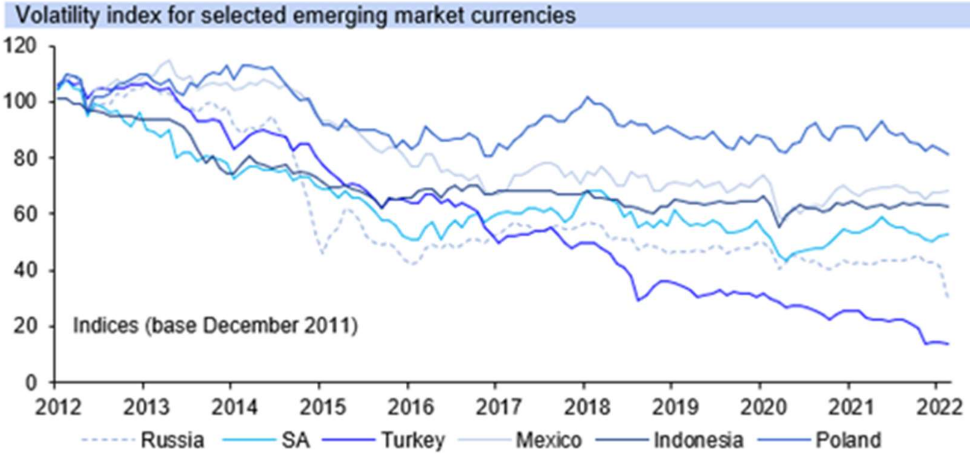
	2022				2023				2024			
	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.22	Q1.24	Q2.24	Q3.24	Q4.24
USD/ZAR	15.50	15.60	15.85	15.65	15.50	15.90	16.30	15.80	15.60	16.10	16.60	16.10
GBP/ZAR	21.24	21.68	22.35	22.22	22.17	23.06	23.80	23.38	23.09	23.83	24.57	23.51
EUR/ZAR	17.67	17.94	18.39	18.47	18.45	19.08	19.72	19.28	19.50	20.13	20.75	20.13
ZAR/JPY	7.48	7.56	7.51	7.67	7.74	7.55	7.36	7.59	7.56	7.14	6.63	6.65
CHFZAR	17.03	16.96	17.23	17.20	16.85	17.28	17.72	17.17	17.14	17.69	18.24	17.69
AUDZAR	11.32	11.39	11.73	11.74	11.63	11.93	12.23	11.85	12.17	12.56	12.95	12.56
GBP/USD	1.37	1.39	1.41	1.42	1.43	1.45	1.46	1.48	1.48	1.48	1.48	1.46
EUR/USD	1.14	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

Note: averages, Source: Investec, Iress

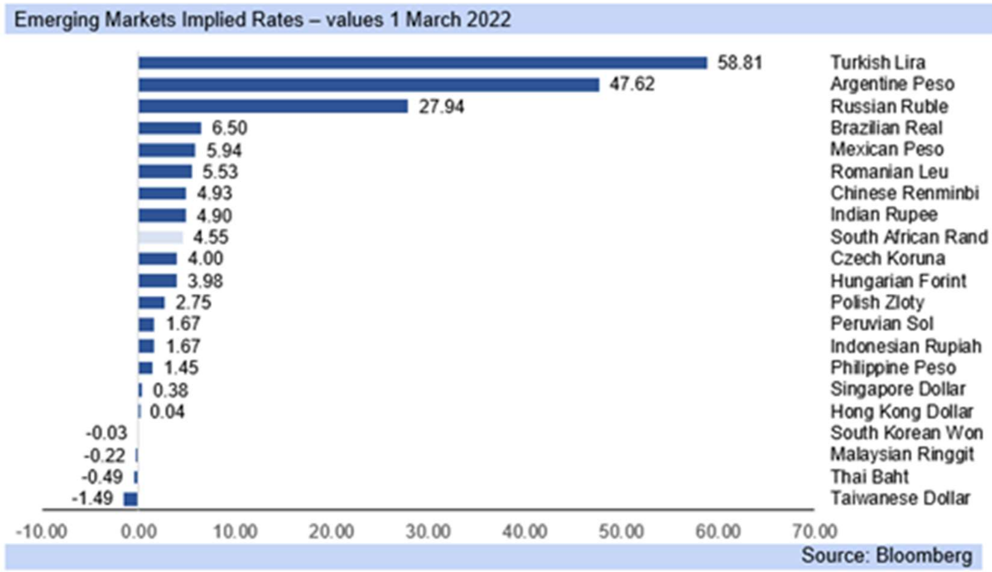
USDZAR vs USD index

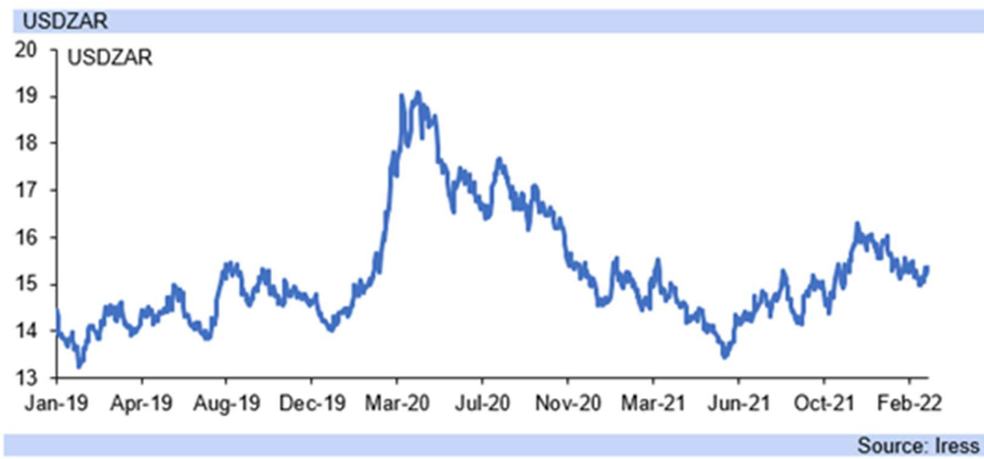
Source: Iress

Volatility index for selected emerging market currencies



Sources: Iress, Investec





- With the war remaining only between Russia and the Ukraine, there is little current likelihood perceived of a third world war (WWIII). Markets will see a significantly adverse reaction on an intensification of Russian attack, which is quite possible this month (but still not WWIII).
- Foreign companies are leaving Russia, after investing there for several decades. Markets rely on various sources for updates on the progress of the war, with reports today of satellite images showing a 67km convoy of Russian military vehicles heading to the Ukraine.
- This is reported to be a doubling in length of this convoy of military vehicles since yesterday's images, with Russia seen to be strengthening its forces after its initial attacks were rebuffed by heavy Ukrainian resistance at the end of last week, and over the weekend.
- Indeed, the next few days already are expected to see an intensification of Russia's attack on the Ukraine, with the majority of Russia's troops and heavy artillery not yet engaged, and Russian attacks risking evolving to a ultimate scorched earth policy.
- Such a harsh doubling down (or worse) is currently not anticipated by markets and would drive oil prices even higher. SA already will see a R1.46/litre fuel price hike

tomorrow, as government passes the bulk of the impact of February's higher oil prices onto consumers.

- In February SA's government administered a smaller petrol price hike, of 53c/litre, even though the rand oil price rose by 11.6% on average over January compared to December, heralding a hike of around R2/litre instead, but the slate levy was used to reduce most of it.
- While the slate levy is used to absorb sudden fuel price changes, and this particularly occurred in February when the under recovery was running close to R2.00/lite at times, it has been heavily depleted and the slate levy cannot absorb much of the March increase.
- A R1.85/litre under recovery was recorded by the end of February in South Africa's petrol price (versus the R1.46/litre hike tomorrow), so a small amount is still being absorbed but far more is being passed through than last month, and April could see a worsening of this.
- Inflation expectations continue to rise in SA, and SA bond yields have elevated as breakeven rates rise. Globally, inflation expectations have also lifted somewhat, with the FOMC likely to watch this closely, meeting on 16th March and still expected to hike by 25bp currently.

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)	14.50	14.00	13.80	13.70	13.60	13.40	13.30	13.10
	Repo rate (end rate)	4.00	4.00	4.00	3.75	3.75	3.75	3.50	3.50
	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, strong fiscal consolidation (government 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%**		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
	USD/Rand (average)	15.00	15.10	15.00	14.90	14.90	14.70	14.60	14.50
	Repo rate (end rate)	4.00	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, rating outlooks stabilise and then 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 provision of…								
		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
Base case **49%**	USD/Rand (average)	15.50	15.60	15.85	15.65	15.50	15.90	16.30	15.80
	Repo rate (end rate)	4.00	4.25	4.25	4.50	4.75	4.75	5.00	5.25
	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 t 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 for Moody's – 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.								
		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
Lite (domestic) Down case **42%**	USD/Rand (average)	15.70	16.00	16.65	16.90	17.00	17.50	17.60	17.50
	Repo rate (end rate)	4.25	4.50	4.75	5.00	5.25	5.50	5.75	6.00
	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, severe rand weakness and higher inflation (also adverse weather), significant load shedding and weak investment growth. Substantial fiscal consolidation ultimately occurs, preventing ratings falling into the C grades.								
		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
Severe down case **6%**	USD/Rand (average)	16.00	16.80	17.50	18.00	18.50	18.70	19.20	19.55
	Repo rate (end rate)	4.50	4.75	5.00	5.25	5.75	6.00	6.50	7.00
	Lengthy global recession (more than two quarters), global financial crisis – temporarily insufficient monetary and other policy support domestically and globally. Nationalisation of private sector property. Widespread services load shedding, strike action and civil unrest. Depression in SA, unprecedented rand weakness. Government borrows from increasingly wider sources as it sinks deeper into a debt trap). SA rated single B from all three key agencies, with further rating downgrades eventually occurring into CCC grade and lower by the end of the period to D (default) as government finances deteriorate.								

Note: Event risk begins Q1.22. Source: Investec

Lite Down 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	15.70	16.00	16.65	16.90	17.00	17.50	17.60	17.50	17.20	17.00	16.80	17.00
GBP/ZAR	21.51	22.24	23.48	24.00	24.31	25.38	25.70	25.90	25.46	25.16	24.86	24.82
EUR/ZAR	17.90	18.40	19.31	19.94	20.23	21.00	21.30	21.35	21.50	21.25	21.00	21.25
ZAR/JPY	7.39	7.38	7.15	7.10	7.06	6.86	6.82	6.86	6.86	6.76	6.55	6.29
CHFZAR	17.25	17.39	18.10	18.57	18.48	19.02	19.13	19.02	18.90	18.68	18.46	18.68
AUDZAR	11.46	11.68	12.32	12.68	12.75	13.13	13.20	13.13	13.42	13.26	13.10	13.26
GBP/USD	1.37	1.39	1.41	1.42	1.43	1.45	1.46	1.48	1.48	1.48	1.48	1.46
EUR/USD	1.14	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

Note: averages, Source: Investec, Iress

Severe Down 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	16.00	16.80	17.50	18.00	18.50	18.70	19.20	19.55	19.70	19.75	19.85	19.80
GBP/ZAR	21.92	23.35	24.68	25.56	26.46	27.12	28.03	28.93	29.16	29.23	29.38	28.91
EUR/ZAR	18.24	19.32	20.30	21.24	22.02	22.44	23.23	23.85	24.63	24.69	24.81	24.75
ZAR/JPY	7.25	7.02	6.80	6.67	6.49	6.42	6.25	6.14	5.99	5.82	5.54	5.40
CHFZAR	17.58	18.26	19.02	19.78	20.11	20.33	20.87	21.25	21.65	21.70	21.81	21.76
AUDZAR	11.68	12.26	12.95	13.50	13.88	14.03	14.40	14.66	15.37	15.41	15.48	15.44
GBP/USD	1.37	1.39	1.41	1.42	1.43	1.45	1.46	1.48	1.48	1.48	1.48	1.46
EUR/USD	1.14	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

Note: averages, Source: Investec, Iress

Up 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	15.00	15.10	15.00	14.90	14.90	14.70	14.60	14.50	14.50	14.40	14.40	14.30
GBP/ZAR	20.55	20.99	21.15	21.16	21.31	21.32	21.32	21.46	21.46	21.31	21.31	20.88
EUR/ZAR	17.10	17.37	17.40	17.58	17.73	17.64	17.67	17.69	18.13	18.00	18.00	17.88
ZAR/JPY	7.73	7.81	7.93	8.05	8.05	8.16	8.22	8.28	8.14	7.99	7.64	7.48
CHFZAR	16.48	16.41	16.30	16.37	16.20	15.98	15.87	15.76	15.93	15.82	15.82	15.71
AUDZAR	10.95	11.02	11.10	11.18	11.18	11.03	10.95	10.88	11.31	11.23	11.23	11.15
GBP/USD	1.37	1.39	1.41	1.42	1.43	1.45	1.46	1.48	1.48	1.48	1.48	1.46
EUR/USD	1.14	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

Note averages, Source: Investec, Iress

Extreme Up 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	14.50	14.00	13.80	13.70	13.60	13.40	13.30	13.10	12.90	12.80	12.60	12.30
GBP/ZAR	19.87	19.46	19.46	19.45	19.45	19.43	19.42	19.39	19.09	18.94	18.65	17.96
EUR/ZAR	16.53	16.10	16.01	16.17	16.18	16.08	16.09	15.98	16.13	16.00	15.75	15.38
ZAR/JPY	8.00	8.43	8.62	8.76	8.82	8.96	9.02	9.16	9.15	8.98	8.73	8.70
CHFZAR	15.93	15.22	15.00	15.05	14.78	14.57	14.46	14.24	14.18	14.07	13.85	13.52
AUDZAR	10.59	10.22	10.21	10.28	10.20	10.05	9.98	9.83	10.06	9.98	9.83	9.59
GBP/USD	1.37	1.39	1.41	1.42	1.43	1.45	1.46	1.48	1.48	1.48	1.48	1.46
EUR/USD	1.14	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

Note: averages, Source: Investec, Iress