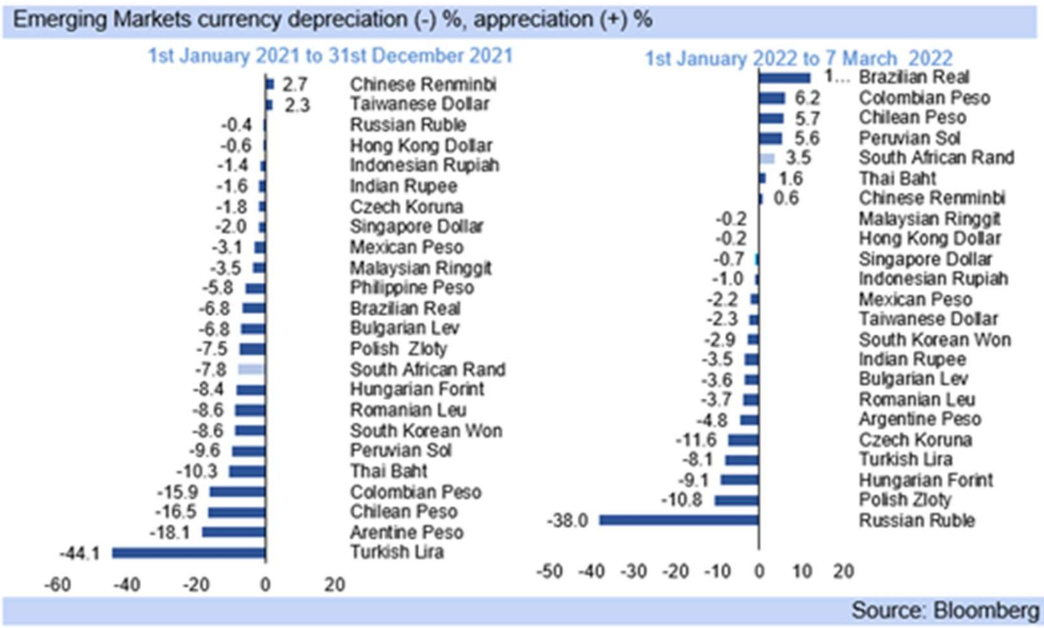
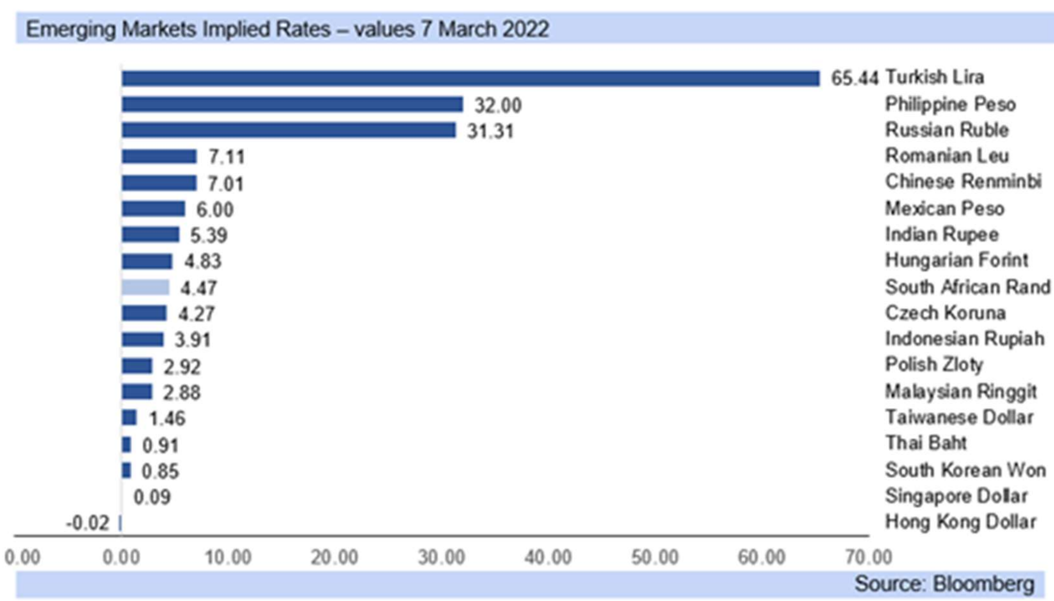
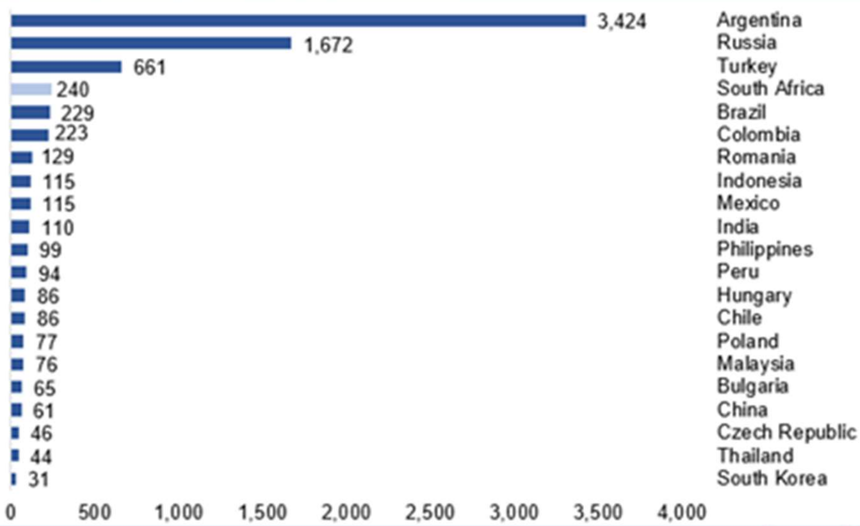
Monday 7 March 2022

## Rand note: markets begin considering a lengthier Russian/Ukraine war, as commodity prices soar, but markets are also not yet anticipating a deterioration to WWIII



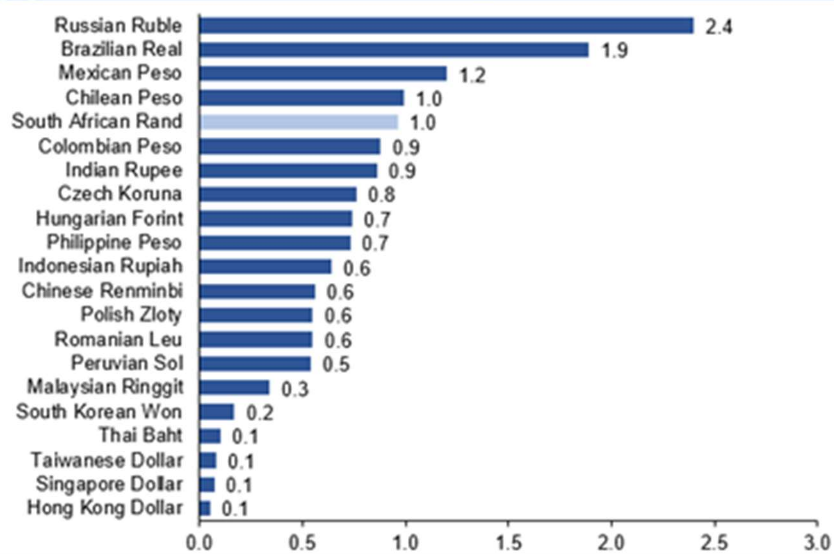



Emerging Markets CDS Spreads – values 7 March 2022

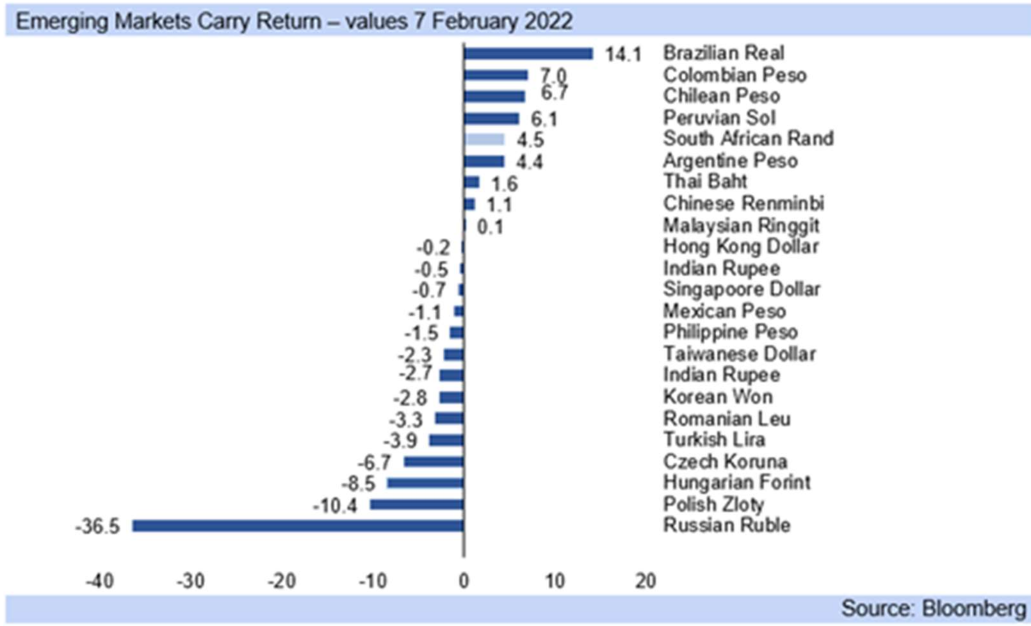



Source: Bloomberg

Emerging Markets Interest Return – values 7 March 2022




Source: Bloomberg




- As South Africa heads towards the middle of March, and then on to completing Q1.22, the rand so far averages R15.35/USD, supported by commodity prices as markets have viewed the Russian/Ukraine conflict as more of a supply disruption than a severe threat to global growth.
- Currently the rand is at R15.37/USD, and we still expect R15.40/USD as the quarter average, although the domestic currency is at risk of weakness in the remainder of this month – for as long as the Russian invasion of the Ukraine continues, and worsens.
- Markets are now worrying that the Russian/Ukraine war will persist substantially longer than the quick conflict originally anticipated, and a lengthy invasion will have more severe effects on the global supply chain and so commodity prices, but WWIII is not yet expected.
- Sanctions are deepening, with global discussions now on banning/limiting imports of Russian fuels, and the Brent crude oil price spiking to US$128.7/bbl and at risk of reaching US150/bbl. Strategic oil reserves have been released into the markets already to attempt to quell the price pressure.
- The Western response has been substantial, coordinated and committed, while Russia has been unwavering in its objectives for the Ukraine. Hope persists for a resolution, but it is not likely going to be easy, or necessarily quick and markets are beginning to reflect this.
- Financial markets have seen also some jitters as the US currently continues with its plans to hike interest rates (with a 25bp hike next week), but the rand remains among the top five EM currencies in terms of performance, both from the start of the year and on a year ago.
- However, US treasuries' yields have subsided, with the benchmark ten year now at 1.72% from 1.88%, as markets now worry over a worsening of the war in Eastern Europe, and so financial market instability, leading to less likelihood of a marked interest rate hike cycle.
- Should the tensions with Russia and Western countries escalate further and cause marked financial market instability, the US may delay its interest rate hike next week. It would likely add in supportive measures if markets near a crisis (not the expected case).

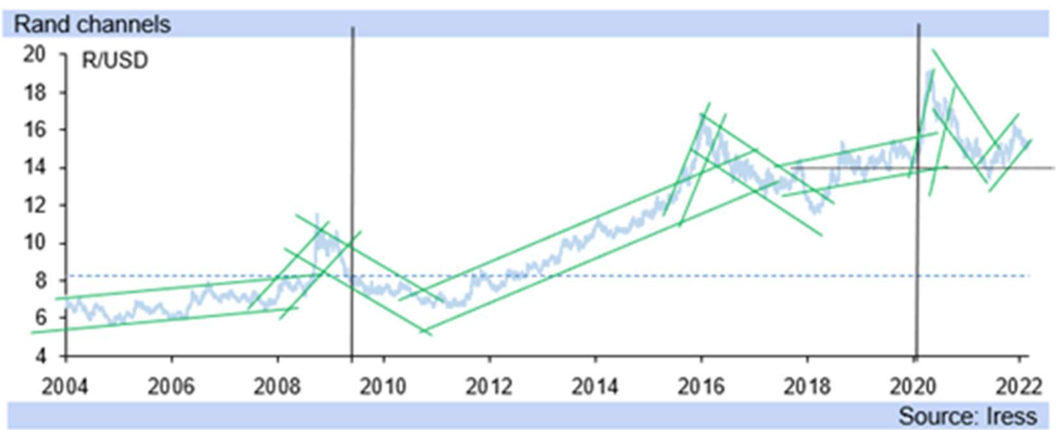
- A high proportion of SA's fuel prices are government levies, and temporarily removing these would reduce a sudden extreme fuel price jump, while state support to combat the effects of food spikes such as bread prices on rapid wheat price escalations would also be necessary.

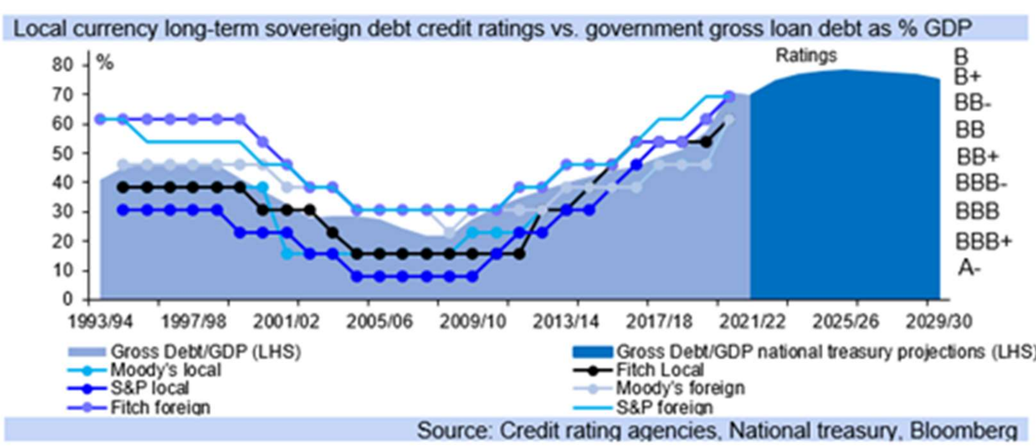
Please scroll down to the second section below

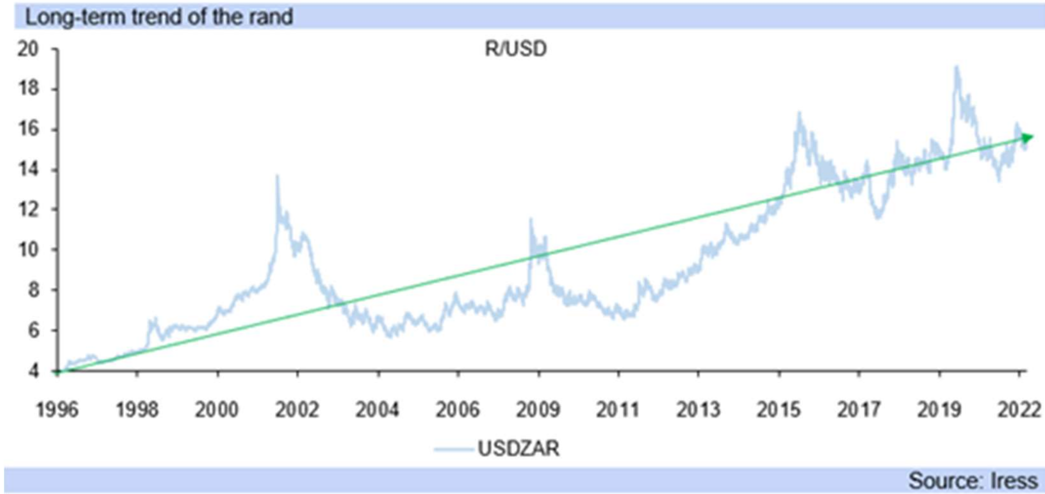
Expected Case: Exchange Rate forecasts

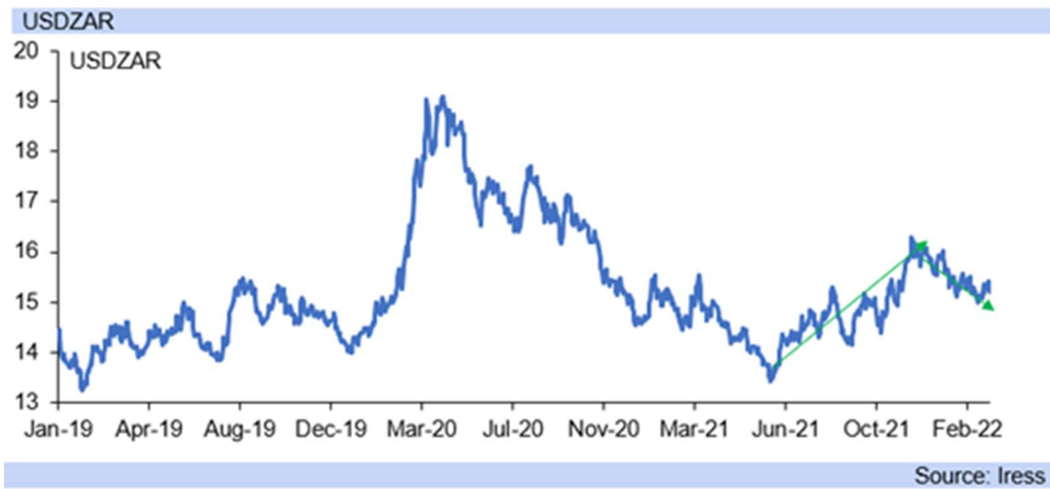
| | 2022 | | | | 2023 | | | | 2024 | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Q1.22 | Q2.22 | Q3.22 | Q4.22 | Q1.23 | Q2.23 | Q3.23 | Q4.22 | Q1.24 | Q2.24 | Q3.24 | Q4.24 |
| USD/ZAR | 15.50 | 15.60 | 15.85 | 15.65 | 15.50 | 15.90 | 16.30 | 15.80 | 15.60 | 16.10 | 16.60 | 16.10 |
| 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






- While SA does produce wheat, it does not produce enough for domestic consumption and is a net importer, influenced by import parity pricing for its domestic crop too. SA has the potential to grow more wheat but this has been limited by cheap wheat imports historically.
- However, overall SA has high food security and produces the vast majority of its food requirements. Additionally, consumers tend to substitute with less pricey items when significant price increases occur if possible, and switching between staples is quite normal.
- SA is a maize exporter, and the Crop Estimates Committee's latest data is reported to show 2021/22's maize crop will be well above the annual production averages of the last ten years, despite some moderation over the previous crop due rainfall damage in the current season.
- SA's soybean harvest is also likely be the second largest on record, SA's sunflower seed harvest the third largest, while the groundnuts and dry bean harvests likely up on last year. SA is not expected to suffer from food insecurity even if global tensions escalate to WWIII.

- However, there will be upwards food price inflation pressures, given both import and export parity pricing in SA, and both inflation and consumers will be impacted. Should SA risk price extremes in the war spreads government can institute some price controls for staple foods.
- Markets have started to worry that Russia may be looking more broadly into Europe in its military endeavors, with the former USSR leader reported unhappy about European countries looking increasingly to join NATO, with Finland recently reported to be considering it.
- This has been part of the contention in the Ukraine, with the former a member of the soviet union. Nuclear threats have also occurred, and there is likely to be further upward commodity price pressure, unless an outright global economic growth collapse occurs, or ceasefire.
- Should the tensions with Russia and Western countries escalate further and cause marked financial market instability, the US may delay its interest rate hike next week. It would likely add in supportive measures to financial markets if markets near a crisis (not the expected case).
- South Africa’s monetary policy committee meets towards the end of this month and was expected to show further interest rate hikes this year. However, should financial markets become severely risk-off, supportive measures may be needed instead.

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** | USD/Rand (average) | 14.50 | 14.00 | 13.80 | 13.70 | 13.60 | 13.40 | 13.30 | 13.10 |
| Up case | Repo rate (end rate) | 4.00 | 4.00 | 4.00 | 3.75 | 3.75 | 3.75 | 3.50 | 3.50 |
| **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, 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.

| | | Q1.22 | Q2.22 | Q3.22 | Q4.22 | Q1.23 | Q2.23 | Q3.23 | Q4.23 |
|---|---|---|---|---|---|---|---|---|---|
| **Up** case | | | | | | | | | |
| **2%** | 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** | USD/Rand (average) | 15.40 | 15.50 | 15.65 | 15.45 | 15.30 | 15.70 | 16.10 | 15.60 |
| case | Repo rate (end rate) | 4.00 | 4.25 | 4.25 | 4.50 | 4.75 | 4.75 | 5.00 | 5.25 |
| **49%** | | | | | | | | | |

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** | USD/Rand (average) | 15.70 | 16.00 | 16.65 | 16.90 | 17.00 | 17.50 | 17.60 | 17.50 |
| (domestic) | Repo rate (end rate) | 4.25 | 4.50 | 4.75 | 5.00 | 5.25 | 5.50 | 5.75 | 6.00 |
| Down case | | | | | | | | | |
| **42%** | | | | | | | | | |

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. Veery limited expropriation of 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** | USD/Rand (average) | 16.00 | 16.80 | 17.50 | 18.00 | 18.50 | 18.70 | 19.20 | 19.55 |
| down | Repo rate (end rate) | 4.50 | 4.75 | 5.00 | 5.25 | 5.75 | 6.00 | 6.50 | 7.00 |
| case | | | | | | | | | |
| **6%** | | | | | | | | | |

Lengthy global recession, global financial crisis – insufficient monetary and other policy supports to growth domestically and internationally. Depression in SA, unprecedented rand weakness, very high inflation (very adverse weather). A somewhat wiser 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 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