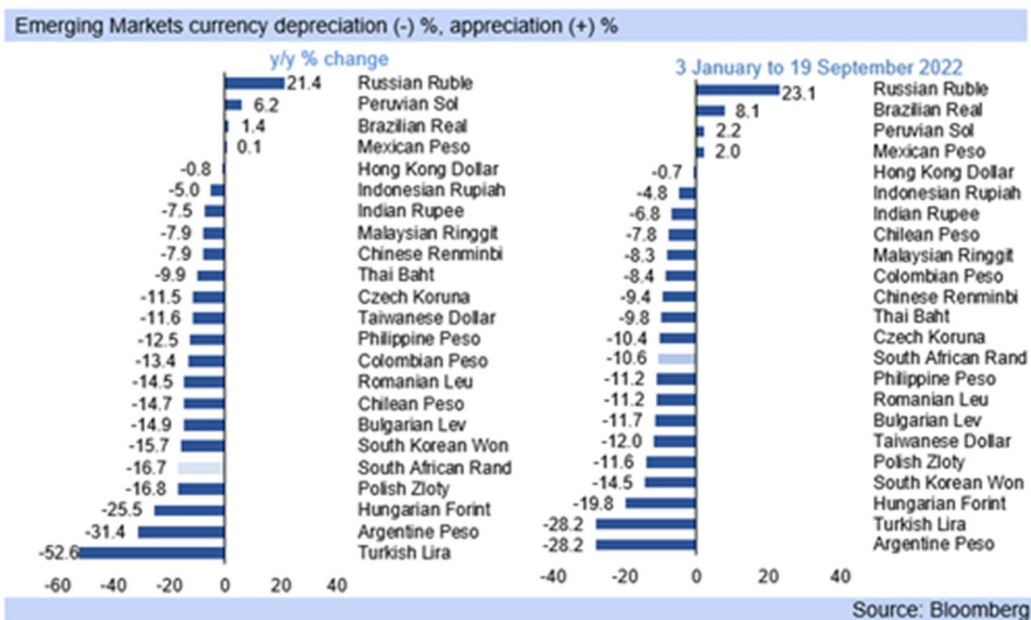




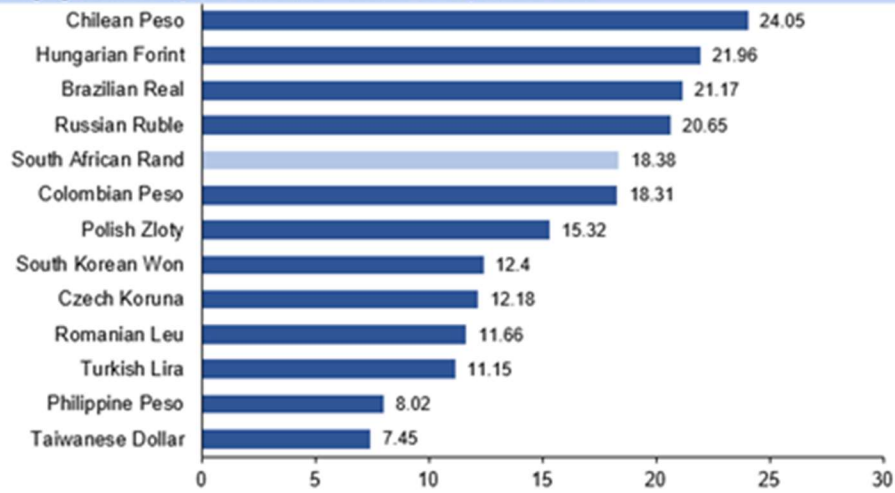
# SA Economics

Monday 19 September 2022

Rand note: the rand has reached R17.80/USD as markets worry over increased hawkishness at the FOMC meeting

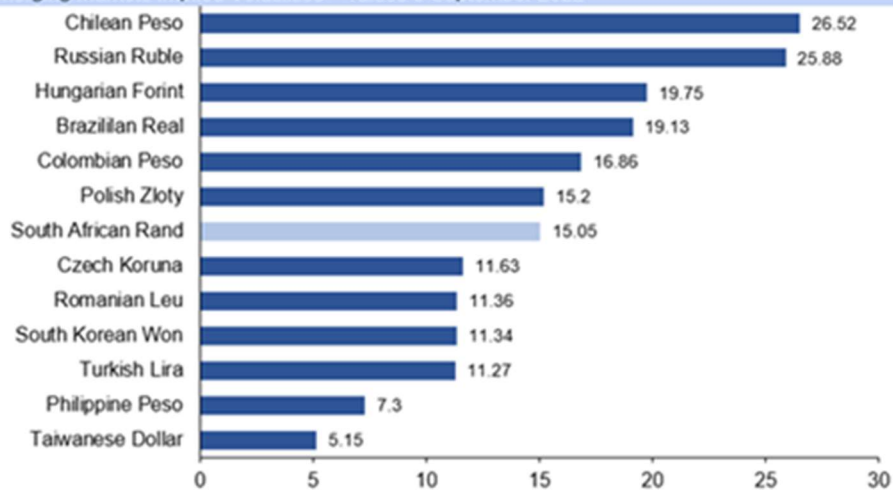


Emerging Markets Implied Volatilities – values 19 September 2022



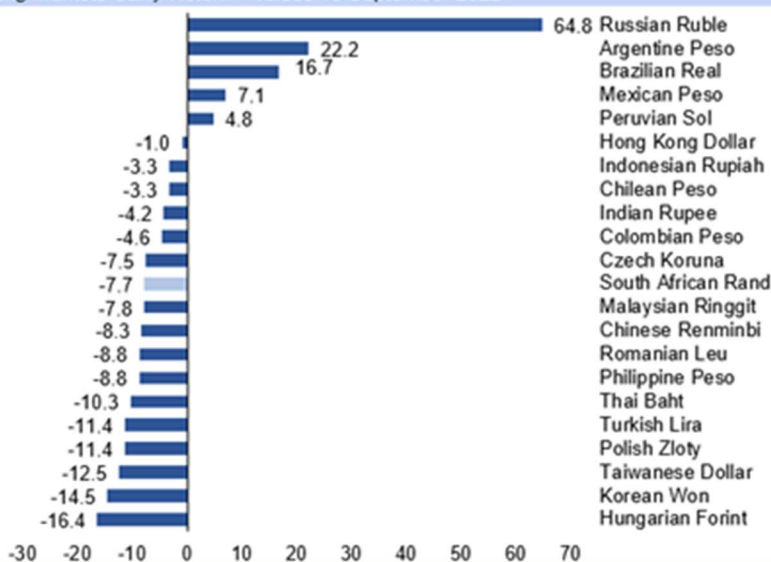
Source: Bloomberg

Emerging Markets Implied Volatilities – values 5 September 2022



Source: Bloomberg

Emerging Markets Carry Return – values 19 September 2022



Source: Bloomberg

Expected Case: Exchange Rate forecasts

	2022				2023				2024			
	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
USD/ZAR	15.21	15.59	16.80	16.00	15.80	16.20	16.60	16.10	15.90	16.40	16.90	16.40
GBP/ZAR	20.40	19.59	20.08	19.04	18.88	19.52	20.34	20.13	20.35	21.32	22.82	22.63
EUR/ZAR	17.07	16.60	17.14	16.32	16.27	17.01	17.76	17.55	17.81	18.86	19.94	20.17
ZAR/JPY	7.65	8.33	8.13	8.34	8.29	7.96	7.65	7.80	7.74	7.20	6.80	6.71
CHF/ZAR	16.47	16.15	17.37	16.65	16.60	17.18	17.59	16.96	17.47	18.02	18.57	18.02
AUD/ZAR	11.02	11.14	11.63	11.20	11.30	11.99	12.53	12.32	12.40	12.79	13.18	12.79
GBP/USD	1.34	1.26	1.20	1.19	1.20	1.21	1.23	1.25	1.28	1.30	1.35	1.38
EUR/USD	1.12	1.06	1.02	1.02	1.03	1.05	1.07	1.09	1.12	1.15	1.18	1.23
USD/JPY	116	130	137	134	131	129	127	126	123	118	115	110

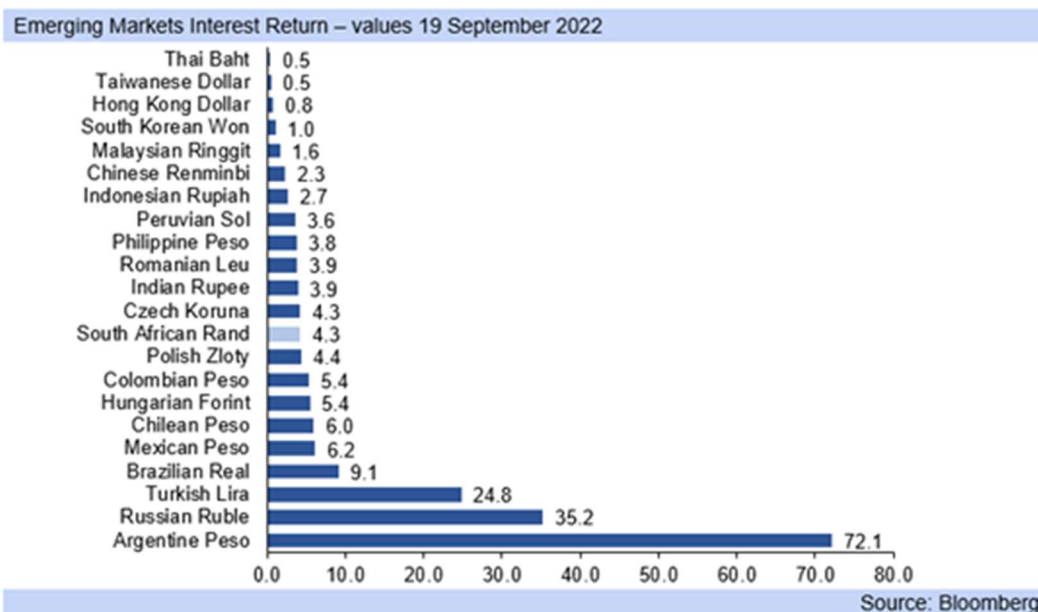
Note: averages, Source: Investec, Iress

- Financial markets have started to factor in more than a 75bp hike in the US, which has negatively affected risk sentiment, causing the rand to weaken towards R18.00/USD on substantial US dollar strength, with the dollar breaching parity with the euro already in August.
- The Fed Funds implied rate is at 81bp for the FOMC (Federal Bank Open Market Committee) meeting this week, as markets are increasingly concerned that the Fed's tone may become even more hawkish, with the outside chance of a 100bp hike feared.
- The US monetary policy decision takes place on Wednesday, after SA market hours, and will lead the decision for SA interest rates at the MPC meeting on 22<sup>nd</sup> September. SA is not expected to hike by more than the US, and this adds to rand weakness too.
- That is, FOMC members sounded increasingly unanimous about another large hike in the fed funds target rate, which was taken as signifying a September 75bp hike, but markets have now started to worry the FOMC may possibly hike for longer and even deliver bigger moves.
- With the differential between US and EU interest rates widening, the dollar has strengthened against the euro, with the rand at R17.71/EUR currently, while it is trading

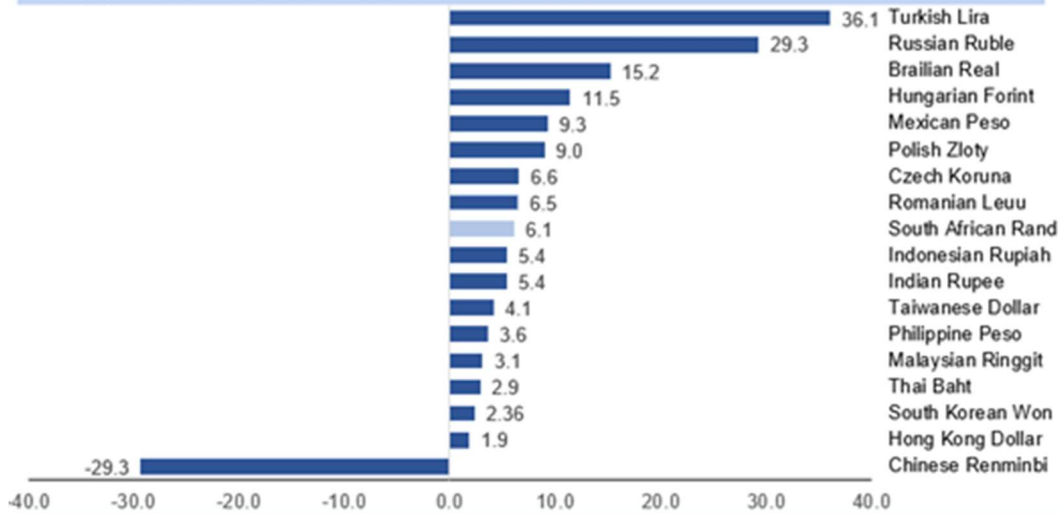
at R17.76/USD. The rand is also negatively affected by lower growth expectations on load shedding.

- This month's FOMC meeting will be key, as markets were hoping that Q4.22 would begin seeing lower US rate hike moves, as the Fed frontloaded its monetary policy normalisation mainly into the middle two quarters of this year.
- However, global financial markets are starting to re-evaluate their expectations, which is causing uncertainty to rise, in turn negatively affecting risk assets as risk aversion (risk-off) increases. Volatility in EM currencies has increased over last week.
- A reduction in FOMC hawkishness would reduce the risk-off environment somewhat while more hawkish communications than have occurred so far would increase risk aversion, and cause risk assets to weaken further, including EM currencies, and so the rand.
- Should the Fed deliver a 75bp hike on Wednesday, and take a slightly more balanced tone, the rand could strengthen later in this week from current very oversold levels, which are far removed from fair value.

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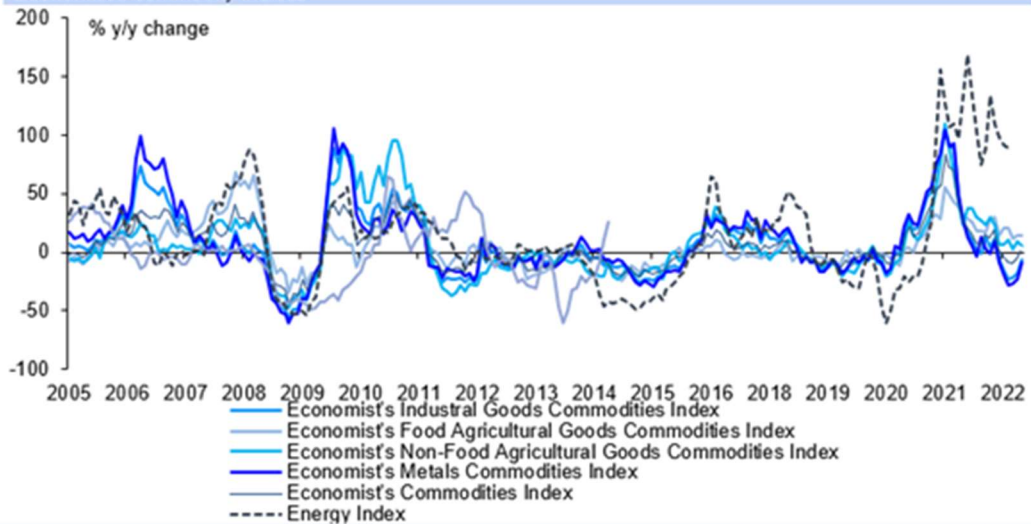


Emerging Markets Implied Rates – values 19 September 2022

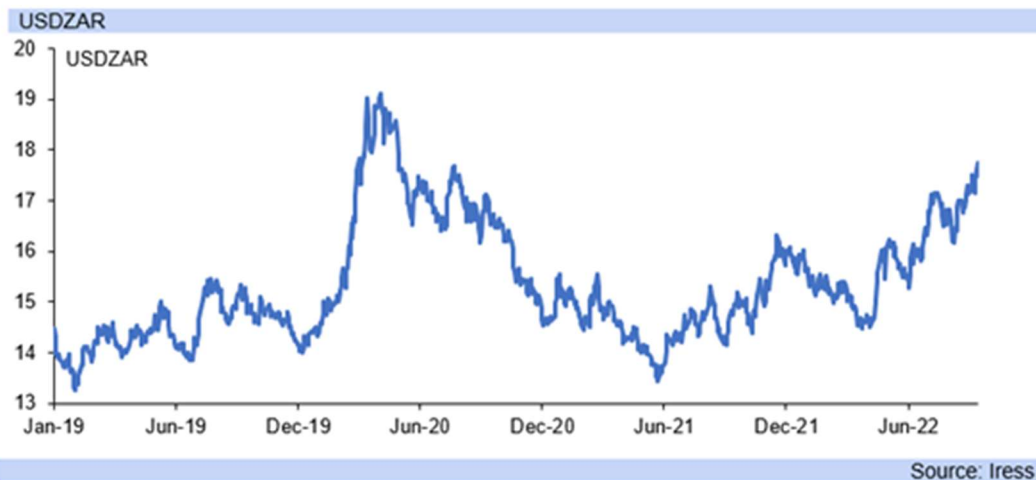
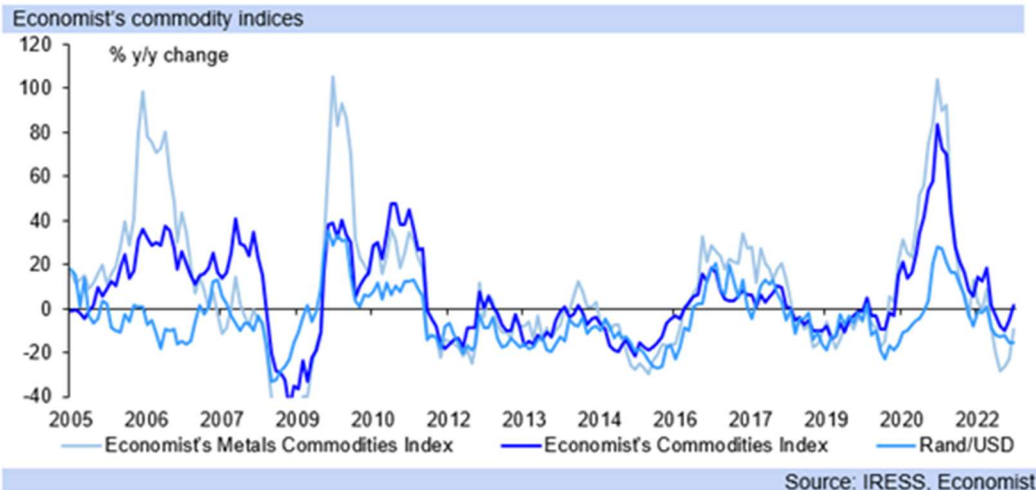


Source: Bloomberg

Economist's commodity indices



Source: IRESS, Economist, IMF



- For the repo rate, markets are pricing in an 81bp lift in as well, moving in lockstep with the expectations for the next move in US interest rates. Indeed, the SARB will likely move by at least 75bp, but could always surprise with a 1.00% lift, which would strengthen the rand.
- The CPI inflation rate in the US turned the corner last month at 8.3% y/y, down from 8.5% y/y in July, but there is no certainty it is now on a downwards trend. Moreover, the broadening of price pressures is quelling positivity, which Central Banks will be reacting to in particular.
- Food and energy prices have been key drivers of inflation, both globally and domestically, but excluding these components from US CPI inflation shows that these core measures of price acceleration are rising, i.e. prices are increasing more quickly than before at the core level.
- So far, both the CPI core inflation and GDP price index measures show higher than expected inflation, and a rise above the previous reading, while the PCE core deflator in the US shows a reading at 4.4% y/y, in line with expectations and the previous reading.
- However, the Fed seeks to implicitly target the core PCE deflator at 2.00% y/y as its preferred measure of inflation, and as such, has taken a very hawkish stance towards

monetary policy. Price inflation is also proving sticky (slow to descend) where disinflation is occurring.

- Disinflation (which is a slowing price acceleration, or falling price inflation) is in other words not occurring quickly enough for the Fed, and this will likely be another key reason for its large interest rate hike this week in the US, while the US labour market is still strong.
- The Fed will likely pay close attention to both inflation and economic activity indicators, but retain more support for quelling demand, and so weakening the labour market, in an ongoing attempt to weaken inflation more substantially than has occurred.
- For the rand, rising uncertainty in global financial markets causes weakness, and this has been an ongoing trend this year since April, when global economic growth forecasts were revised substantially lower.
- Markets are starting to digest the possibility of higher inflation for longer, and so a weak global economy and high interest rates for longer too, which is negatively affecting sentiment as it will weaken the return on risk assets.

Economic Scenarios: note updated forecasts, scenarios

		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
<b>Extreme Up case 1%</b>	USD/Rand (average)	15.21	15.59	15.00	14.50	14.00	13.60	13.40	13.30
	Repo rate (end rate)	4.25	4.75	4.50	4.00	3.75	3.75	3.50	3.50
	SA economic growth rises to 3–5%, then 5-7%. Good governance, growth-creating reforms (structural constraints eradicated), strong property rights, no nationalisation or expropriation without compensation. High business confidence and fixed investment growth, substantial FDI, fiscal consolidation drives debt to low ratios of 2000s. Very subdued domestic inflation on extreme rand strength, very favourable weather conditions. <b>Strong global growth, risk-on, commodity boom. Rapid upgrades of credit ratings.</b> Strong transition away from fossil fuel usage, a quick transition to renewable energy.								
<b>Up case 1%</b>	USD/Rand (average)	15.21	15.59	15.70	15.30	15.00	14.70	14.60	14.50
	Repo rate (end rate)	4.25	4.75	4.75	4.50	4.25	4.25	4.25	4.25
	Economic growth of 3%, rising confidence and investment levels, structural constraints eroded, global growth strong, global financial markets risk-on. No nationalisation or expropriation without compensation. Low domestic inflation on favourable weather and global conditions, rand strength, lower state-controlled price inflation on increased private privatisation. <b>Positive outlooks on credit ratings turn into upgrades fiscal consolidation, debt projections fall substantially.</b> Substantial transition to renewable energy away from fossil fuel usage, comprehensive measures to alleviate climate change impact on economy.								
<b>Base case 50%</b>	USD/Rand (average)	15.21	15.59	16.80	16.00	15.80	16.20	16.60	16.10
	Repo rate (end rate)	4.25	4.75	6.00	6.50	6.50	6.50	6.50	6.50
	Economic growth modest but lifts towards 3.0% y/y over five years on sufficient domestic policy support measures, global financial market risk sentiment is neutral to positive. <b>South Africa in the BB credit rating category bracket as fiscal consolidation (debt to GDP stabilisation) occurs leading to some positive outlooks.</b> The rand sees mild weakness and inflation is impacted by the course of weather patterns via food price inflation. Little expropriation without compensation occurs and has no negative effect on economy, no nationalisation. A modest transition to renewable energy and slow move away from fossil fuel usage occurs and measures to alleviate the impact of climate change on the economy are modestly implemented. The Russian/Ukraine conflict eases and does not exacerbate.								
<b>Lite (domestic) Down case 39%</b>	USD/Rand (average)	15.21	15.59	17.25	17.40	17.70	17.80	17.70	17.90
	Repo rate (end rate)	4.25	4.75	7.00	7.00	7.25	7.75	8.25	8.50
	The international environment (incl. risk sentiment) is that of the base case. <b>South Africa fails to see debt projections stabilise, falls into single B (local and foreign currency) credit ratings from all three agencies. Recession occurs.</b> Business confidence depressed, significant load shedding, weak investment growth, civil and political unrest. High inflation on unfavorable weather conditions, marked rand weakness. Little transition to renewable energy or measures to alleviate the impact of climate change. Very limited expropriation of private sector property without compensation, with some negative impact on the economy. <b>Substantial fiscal consolidation ultimately occurs, preventing ratings falling into the C grades.</b>								
<b>Severe down case 9%</b>	USD/Rand (average)	15.21	15.59	17.60	18.00	18.30	18.50	18.60	19.00
	Repo rate (end rate)	4.25	4.75	7.50	7.50	8.00	8.50	9.00	9.00
	Lengthy global recession, global financial crisis – insufficient monetary and other support domestically and internationally. Limited expropriation of private property without compensation with a marked negative economic impact. Very high inflation on very adverse weather conditions, severe rand weakness. <b>SA rated single B from all three key agencies, downgrades eventually into CCC grade, increased risk of default.</b> Government borrows from increasingly wider sources, sinks deeper into a debt trap, widespread, severe services load shedding, severe civil and political unrest. SA economy in depression. Failure to transition to renewable energy and to sufficient measures to alleviate the impact of climate change on the economy.								

Note: Event risk begins Q3.22. 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	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
USD/ZAR	15.21	15.59	17.25	17.40	17.70	17.80	17.70	17.90	18.10	18.20	18.20	18.00
GBP/ZAR	20.40	19.59	20.61	20.71	21.15	21.45	21.68	22.38	23.17	23.66	24.57	24.84
EUR/ZAR	17.07	16.60	17.60	17.75	18.23	18.69	18.94	19.51	20.27	20.93	21.48	22.14
ZAR/JPY	7.65	8.33	7.92	7.67	7.40	7.25	7.18	7.01	6.80	6.48	6.32	6.11
CHF/ZAR	16.47	16.15	17.83	18.11	18.60	18.88	18.75	18.85	19.89	20.00	20.00	19.78
AUD/ZAR	11.02	11.14	11.94	12.18	12.66	13.17	13.36	13.69	14.12	14.20	14.20	14.04
GBP/USD	1.34	1.26	1.20	1.19	1.20	1.21	1.23	1.25	1.28	1.30	1.35	1.38
EUR/USD	1.12	1.06	1.02	1.02	1.03	1.05	1.07	1.09	1.12	1.15	1.18	1.23
USD/JPY	116	130	137	134	131	129	127	126	123	118	115	110

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	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
USD/ZAR	15.21	15.59	17.60	18.00	18.30	18.50	18.60	19.00	19.30	19.40	19.30	19.30
GBP/ZAR	20.40	19.59	21.03	21.42	21.87	22.29	22.79	23.75	24.70	25.22	26.06	26.63
EUR/ZAR	17.07	16.60	17.95	18.36	18.85	19.43	19.90	20.71	21.62	22.31	22.77	23.74
ZAR/JPY	7.65	8.33	7.76	7.42	7.16	6.97	6.83	6.61	6.37	6.08	5.96	5.70
CHFZAR	16.47	16.15	18.20	18.73	19.23	19.62	19.71	20.01	21.21	21.32	21.21	21.21
AUDZAR	11.02	11.14	12.18	12.60	13.08	13.69	14.04	14.54	15.05	15.13	15.05	15.05
GBP/USD	1.34	1.26	1.20	1.19	1.20	1.21	1.23	1.25	1.28	1.30	1.35	1.38
EUR/USD	1.12	1.06	1.02	1.02	1.03	1.05	1.07	1.09	1.12	1.15	1.18	1.23
USD/JPY	116	130	137	134	131	129	127	126	123	118	115	110

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	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
USD/ZAR	15.21	15.59	15.70	15.30	15.00	14.70	14.60	14.50	14.90	15.00	14.50	14.50
GBP/ZAR	20.40	19.59	18.76	18.21	17.93	17.71	17.89	18.13	19.07	19.50	19.58	20.01
EUR/ZAR	17.07	16.60	16.02	15.61	15.45	15.44	15.62	15.81	16.69	17.25	17.11	17.84
ZAR/JPY	7.65	8.33	8.70	8.73	8.73	8.78	8.70	8.66	8.26	7.87	7.93	7.59
CHFZAR	16.47	16.15	16.23	15.92	15.76	15.59	15.47	15.27	16.37	16.48	15.93	15.93
AUDZAR	11.02	11.14	10.87	10.71	10.73	10.88	11.02	11.09	11.62	11.70	11.31	11.31
GBP/USD	1.34	1.26	1.20	1.19	1.20	1.21	1.23	1.25	1.28	1.30	1.35	1.38
EUR/USD	1.12	1.06	1.02	1.02	1.03	1.05	1.07	1.09	1.12	1.15	1.18	1.23
USD/JPY	116	130	137	134	131	129	127	126	123	118	115	110

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	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
USD/ZAR	15.21	15.59	15.00	14.50	14.00	13.60	13.40	13.30	13.10	13.10	12.90	12.80
GBP/ZAR	20.40	19.59	17.93	17.26	16.73	16.39	16.42	16.63	16.77	17.03	17.42	17.66
EUR/ZAR	17.07	16.60	15.30	14.79	14.42	14.28	14.34	14.50	14.67	15.07	15.22	15.74
ZAR/JPY	7.65	8.33	9.11	9.21	9.36	9.49	9.48	9.44	9.39	9.01	8.91	8.59
CHFZAR	16.47	16.15	15.51	15.09	14.71	14.42	14.20	14.01	14.40	14.40	14.18	14.07
AUDZAR	11.02	11.14	10.38	10.15	10.01	10.06	10.12	10.17	10.22	10.22	10.06	9.98
GBP/USD	1.34	1.26	1.20	1.19	1.20	1.21	1.23	1.25	1.28	1.30	1.35	1.38
EUR/USD	1.12	1.06	1.02	1.02	1.03	1.05	1.07	1.09	1.12	1.15	1.18	1.23
USD/JPY	116	130	137	134	131	129	127	126	123	118	115	110

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