

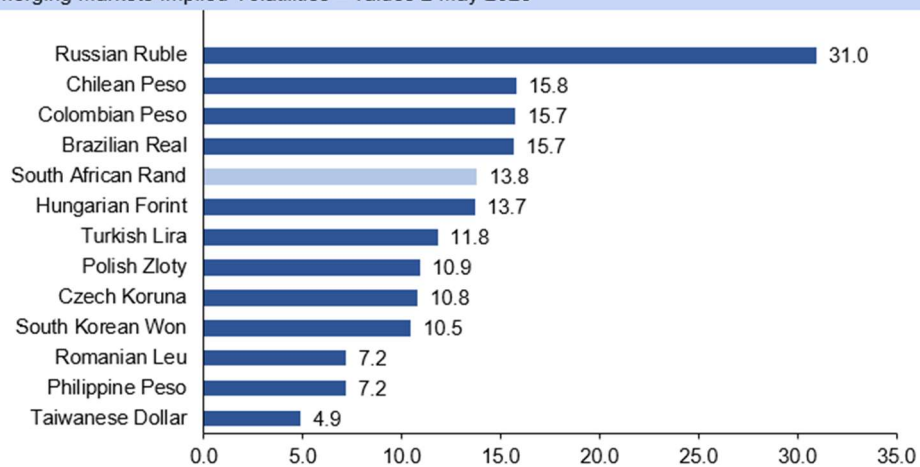
# SA Economics



Rand note: in the doldrums on still elevated risk aversion in global financial markets

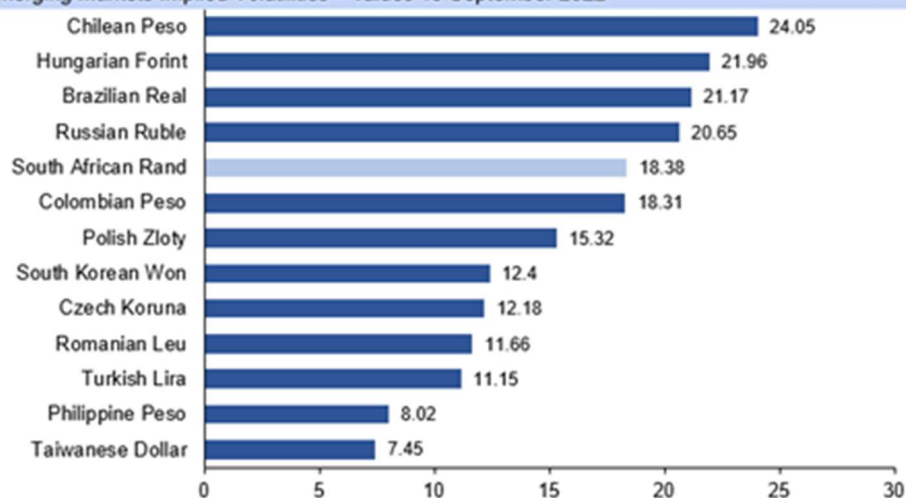
Tuesday 2 May 2023

Emerging Markets Implied Volatilities – values 2 May 2023



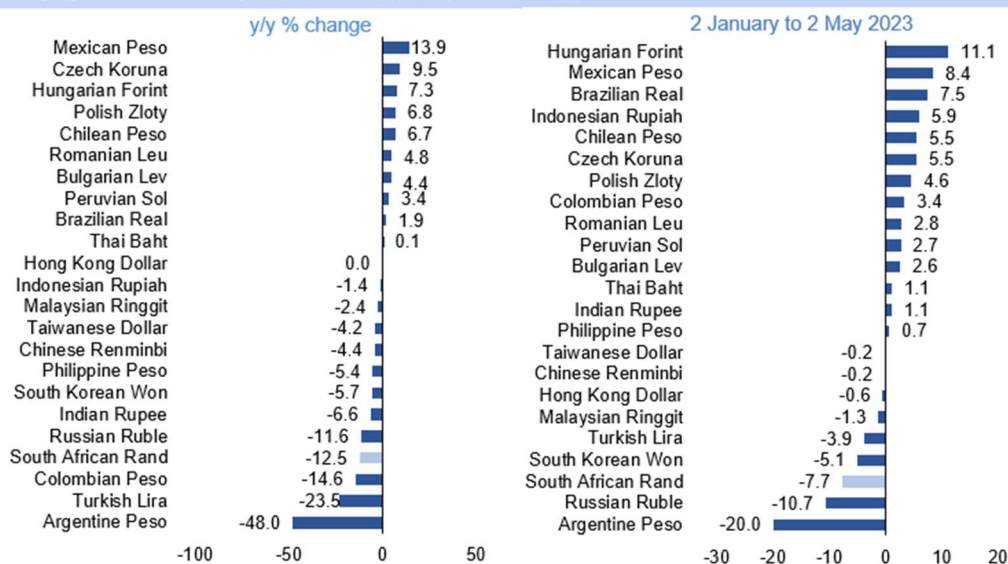
Source: Bloomberg

### Emerging Markets Implied Volatilities – values 19 September 2022

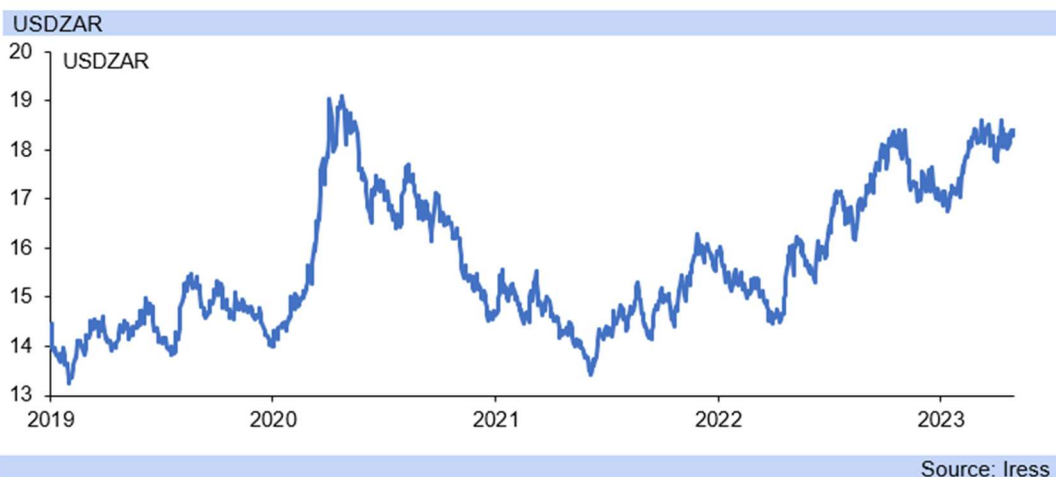


Source: Bloomberg

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



Source: Bloomberg



Expected Case: Exchange Rate forecasts												
	2023				2024				2025			
	Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24	Q1.25	Q2.25	Q3.25	Q4.25
USD/ZAR	17.76	18.00	17.80	17.60	17.25	17.45	17.65	17.35	17.05	17.05	17.15	16.95
GBP/ZAR	21.59	22.44	22.25	22.18	22.08	22.60	23.03	22.73	22.17	22.17	22.30	22.04
EUR/ZAR	19.06	19.79	19.76	19.89	19.84	20.33	20.74	20.47	19.95	19.95	20.07	19.83
ZAR/JPY	7.45	7.36	7.22	7.16	7.16	6.99	6.86	6.92	7.86	7.74	7.64	7.67
CHF/ZAR	19.20	20.01	19.56	19.22	18.80	19.09	19.38	19.13	18.74	18.74	18.85	18.63
AUD/ZAR	12.14	12.13	12.28	12.50	12.42	12.56	12.80	12.67	12.96	13.13	13.55	13.39
GBP/USD	1.22	1.25	1.25	1.26	1.28	1.30	1.31	1.31	1.30	1.30	1.30	1.30
EUR/USD	1.07	1.10	1.11	1.13	1.15	1.17	1.18	1.18	1.17	1.17	1.17	1.17
USD/JPY	132	132	129	126	124	122	121	120	122	125	128	130

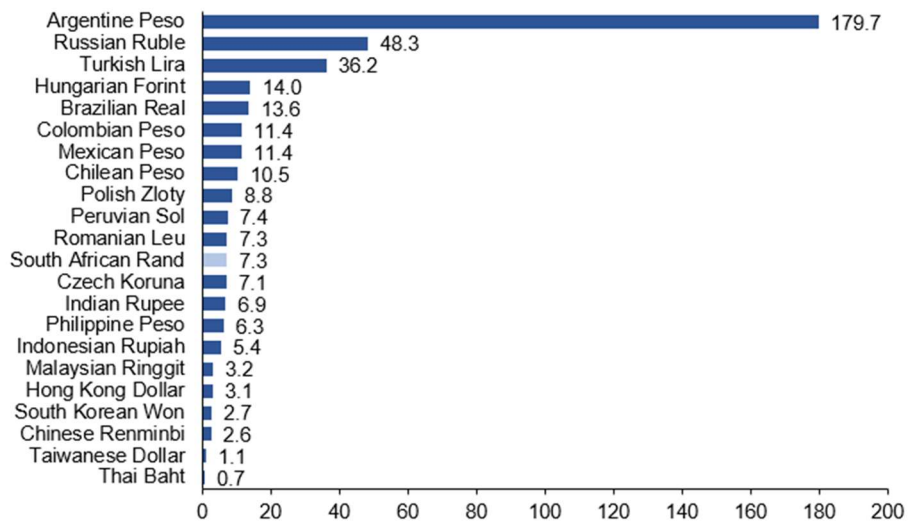
Note: averages, Source: Investec, Iress

- The past week saw one of the Fed's preferred measure of inflation, the core PCE deflator drop to 4.2% y/y, from 5.0% y/y in April, although slightly higher than the 4.1% y/y expected. This week the FOMC meeting is still expected to see a 25bp hike.
- The rand largely stagnated around the R18.30/USD mark last week, particularly towards the end of the week, in the build up to the US interest rate decision, with the FOMC statement in key focus as markets await communication on the terminal rate.
- The Fed is expected to signal at Wednesday's meeting that it has neared the end of its interest rate hike cycle, or at least will pause for a significant amount of time to allow the lagged effects of interest rate hikes to come through in the economic data.
- With around a two to three quarter lag between interest rate hikes and the impact on the economy, the rapid US rate hike cycle over last year, and this, has not fully reflected in the economic readings on activity, with a US recession still feared.

- The Fed is widely expected to raise its funds rate by 25bp tomorrow evening (SA time), with the implied futures seeing a 95% probability, but the following FOMC meeting is not expected to see a hike, on 14<sup>th</sup> June this year.
- That is, there is less than a 30% chance factored in by the implied Fed funds futures for a further 25bp hike in US interest rates this quarter, and in H2.23 no interest rate hikes at all are anticipated by the markets, nor in January 2024.
- From July this year already (with the FOMC meeting on the 26<sup>th</sup>) markets think cuts in US interest rates would be more likely than hikes, while by November (with the FOMC meeting on the 1<sup>st</sup>), a 25bp cut is fully factored in by the markets.
- December sees a further 25bp cut in the Fed funds rate built into the implied Fed funds futures, while a further one is fully factored in for the January 2024 FOMC meeting on the 31<sup>st</sup>.
- For South Africa, the FRAs have factored in about a 40bp hike in SA's interest rates for its next MPC meeting, on 25<sup>th</sup> May, closer to a 50bp than a 25bp hike, which would boost the rand if it occurred, likely causing it to strengthen below R18.00/USD.

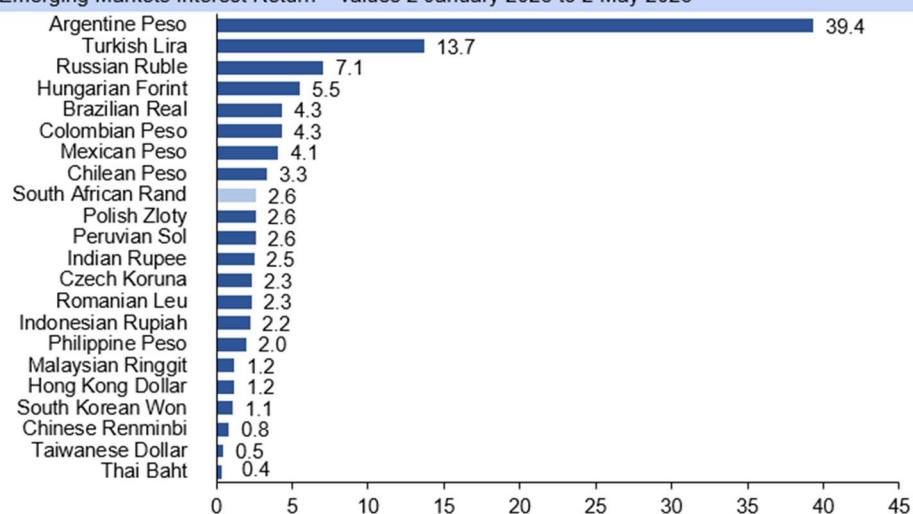
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Emerging Markets Interest Return – values 2 May 2022 to 2 May 2023



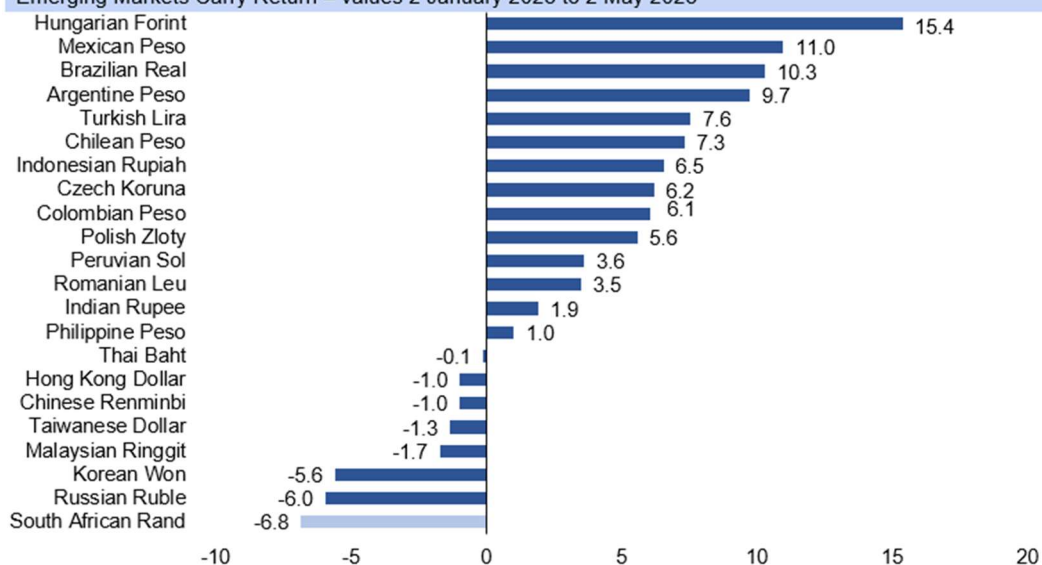
Source: Bloomberg

Emerging Markets Interest Return – values 2 January 2023 to 2 May 2023



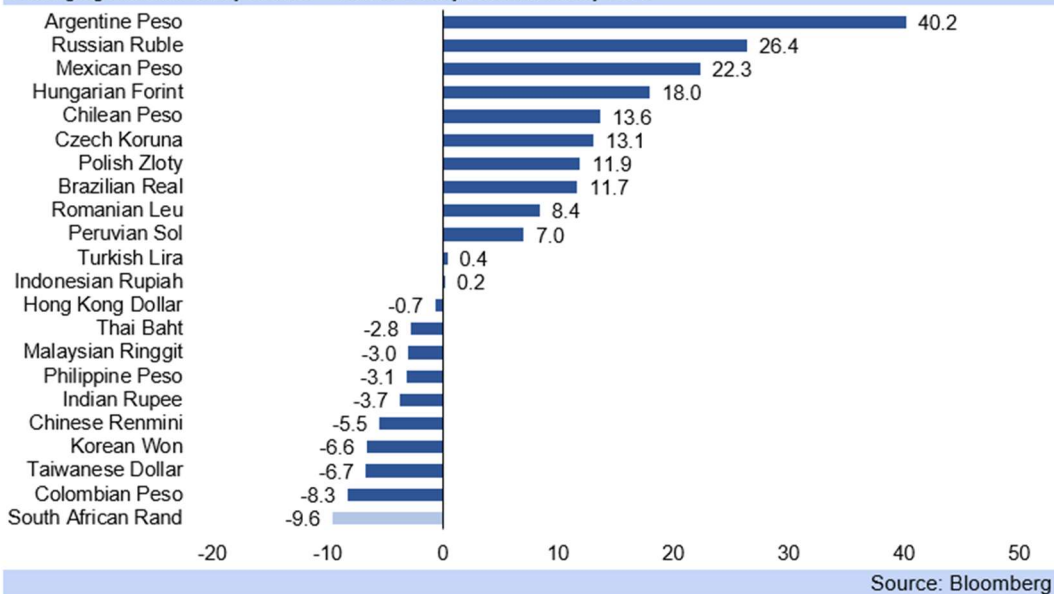
Source: Bloomberg

Emerging Markets Carry Return – values 2 January 2023 to 2 May 2023

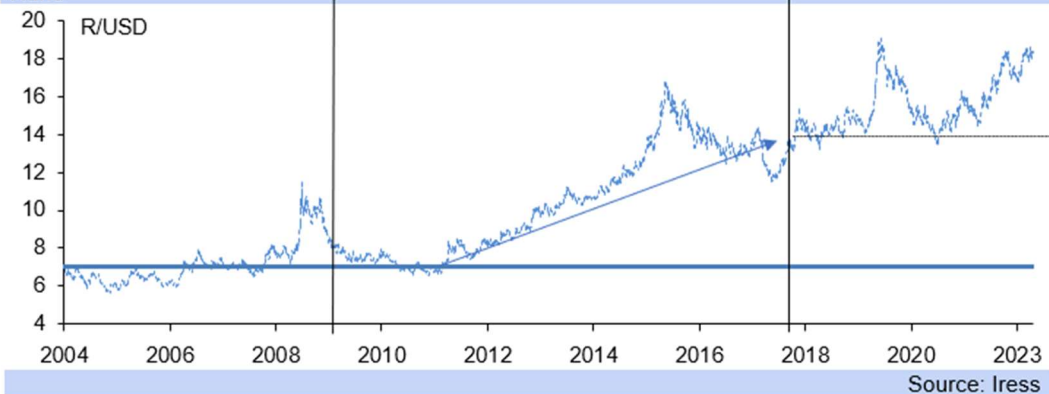


Source: Bloomberg

Emerging Markets Carry Return – values 2 May 2022 to 2 May 2023



Rand



- With SA's higher than expected inflation outcomes over most of Q1.23, as the targeted measure, CPI inflation reversed direction and began rising, the SARB is widely expected to hike later this month, and a 50bp move would not be amiss.
- Currently, SA has hiked its interest rates by 4.25% in its current rate hike cycle, exceeded by the Fed's 4.75% lift, which means that the differential between US and SA interest rates has been eroded by 50bp, leading to substantial rand weakness.
- Rand weakness in turn has fed through notably into CPI inflation, with the domestic currency around -18.0% weaker y/y over the respective periods in February and March which impact the CPI, aiding the rise in food price inflation.
- South Africa is a price taker, either through import, or export parity pricing, of international agricultural food prices, which are US dollar based, and so rand weakness against the US dollar has a significant effect.

- The SARB has noted that the pass through of the rand has increased under the severe, sustained depreciation experienced over the last twelve months, aiding in the sticky nature of inflation outcomes.
- Sustained, high inflation leads to second round inflation effects developing as well, which are particularly evident in SA's core CPI inflation measures, with the headline core rate rising to 5.2% y/y this year, well removed from 4.5% y/y.
- While SA targets CPI inflation and not core, CPI inflation is very high, at 7.1% in the last reading, well removed from the SARB's aim of seeing it average 4.5% y/y each year. High inflation has also pushed out the period it will likely regain the midpoint.
- That is, the upturn in CPI inflation in Q1.23, from 6.9% y/y in January, to 7.1% y/y by March, and the higher cost pressures driving it, has extended the point at which CPI inflation drops to, or below 4.5% y/y to October 2024.
- A 50bp hike from the SARB this month will be helpful both for bringing down inflation expectations, and aiding in inflation targeting, not least due to rand appreciation, with the domestic currency at R14.50/USD in April last year.



Economic Scenarios: note updated probabilities

		Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
<b>Extreme</b>	USD/Rand (average)	17.76	16.60	15.90	15.50	15.00	14.60	14.50	14.40
<b>Up case</b>	Repo rate (end rate)	7.75	7.00	6.75	6.50	6.00	6.00	5.75	5.50
<b>1%</b>	SA economic growth very quickly 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 to investment grade.</b> Very short grey listing. Quick transition to renewable energy from fossil fuels.								
<b>Up case</b>		Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
<b>1%</b>	USD/Rand (average)	17.76	17.50	17.20	16.90	16.50	16.10	16.00	15.70
	Repo rate (end rate)	7.75	7.25	7.25	7.25	6.75	6.75	6.50	6.00
	Economic growth averages 3.3% over five-year period, but lifts towards 5.0% y/y by period end, 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 privatisation. <b>Credit rating upgrades on fiscal consolidation, markedly lower borrowings.</b> Substantial transition to renewable energy away from fossil fuel usage, comprehensive measures to alleviate climate change impact on economy. Grey listed for less than eighteen months.								
<b>Base case</b>		Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
<b>48%</b>	USD/Rand (average)	17.76	18.00	17.80	17.60	17.25	17.45	17.65	17.35
	Repo rate (end rate)	7.75	7.75	7.75	7.50	7.00	7.00	7.00	6.50
	Economic growth modest (1.9% average over 5 years) but lifts towards 3.0% y/y by end period on reforms, global financial market risk sentiment is neutral to positive. <b>South Africa follows fiscal consolidation (debt to GDP stabilisation) leading to positive outlooks, then likely credit rating upgrades.</b> The rand stabilises, then strengthens somewhat. Inflation is impacted by the course of weather patterns via food price inflation. A 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. Little expropriation without compensation. Temporary grey listing.								
<b>Lite</b>		Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
<b>(domestic)</b>	USD/Rand (average)	17.76	18.60	18.70	19.00	18.60	18.75	18.90	18.70
<b>Down case</b>	Repo rate (end rate)	7.75	8.00	8.50	9.00	9.00	9.00	9.00	9.00
<b>40%</b>	Weak GDP growth (0.9% average over 5-years), swing toward <b>left leaning policies.</b> Business confidence depressed, <b>substantial electricity and water shedding, very weak rail capacity,</b> civil and political unrest, little investment growth, recession. <b>Increased state borrowings, risk of credit rating downgrades rises, then occurs later in period.</b> Some expropriation of private sector property without compensation with a negative impact on the economy. High inflation on unfavorable weather conditions, marked rand weakness. Little transition to renewable energy or measures to alleviate climate change. Lengthy greylisting.								
<b>Severe</b>		Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
<b>down case</b>	USD/Rand (average)	17.76	19.30	19.70	20.00	20.20	20.50	20.80	21.20
<b>10%</b>	Repo rate (end rate)	7.75	9.00	10.00	10.50	10.50	11.00	11.00	11.50
	Lengthy global recession, global financial crisis – insufficient monetary and other support domestically and internationally. <b>ANC/EFF coalition in 2024. Widespread, severe services load shedding, severe civil and political unrest.</b> Government borrows from increasingly wider sources, SA rated single B from all three key agencies, eventually CCC grade, <b>increased risk of default, sinks deeper into a debt trap.</b> Failure to transition to renewable energy and to sufficient measures to alleviate the impact of climate change on the economy. Very high inflation on very adverse weather conditions, severe rand weakness. Expropriation of private property without compensation with a marked negative economic impact. Blacklisted.								

Note: Event risk begins Q2.23. Source: Investec

Lite Down Case: Exchange Rate forecasts

	2023				2024				2025			
	Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24	Q1.25	Q2.25	Q3.25	Q4.25
USD/ZAR	17.76	18.60	18.70	19.00	18.60	18.75	18.90	18.70	18.60	18.70	18.70	18.60
GBP/ZAR	21.59	23.19	23.38	23.94	23.81	24.28	24.66	24.50	24.18	24.31	24.31	24.18
EUR/ZAR	19.06	20.45	20.76	21.47	21.39	21.84	22.21	22.07	21.76	21.88	21.88	21.76
ZAR/JPY	7.45	7.12	6.87	6.63	6.64	6.51	6.40	6.42	7.20	7.06	7.01	6.99
CHF/ZAR	19.20	20.68	20.55	20.74	20.27	20.51	20.75	20.62	20.44	20.55	20.55	20.44
AUD/ZAR	12.14	12.53	12.90	13.49	13.39	13.50	13.70	13.65	14.14	14.40	14.77	14.69
GBP/USD	1.22	1.25	1.25	1.26	1.28	1.30	1.31	1.31	1.30	1.30	1.30	1.30
EUR/USD	1.07	1.10	1.11	1.13	1.15	1.17	1.18	1.18	1.17	1.17	1.17	1.17
USD/JPY	132	132	129	126	124	122	121	120	122	125	128	130

Note: averages, Source: Investec, Iress



## Up Case: Exchange Rate forecasts

	2023				2024				2025			
	Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24	Q1.25	Q2.25	Q3.25	Q4.25
USD/ZAR	17.76	17.50	17.20	16.90	16.50	16.10	16.00	15.70	15.40	15.40	15.50	15.30
GBP/ZAR	21.59	21.82	21.50	21.29	21.12	20.85	20.88	20.57	20.02	20.02	20.15	19.89
EUR/ZAR	19.06	19.24	19.09	19.10	18.98	18.76	18.80	18.53	18.02	18.02	18.14	17.90
ZAR/JPY	7.45	7.57	7.47	7.46	7.48	7.58	7.56	7.64	7.92	8.12	8.26	8.50
CHF/ZAR	19.20	19.46	18.90	18.45	17.99	17.61	17.57	17.31	16.92	16.92	17.03	16.81
AUD/ZAR	12.14	11.79	11.87	12.00	11.88	11.59	11.60	11.46	11.70	11.86	12.25	12.09
GBP/USD	1.22	1.25	1.25	1.26	1.28	1.30	1.31	1.31	1.30	1.30	1.30	1.30
EUR/USD	1.07	1.10	1.11	1.13	1.15	1.17	1.18	1.18	1.17	1.17	1.17	1.17
USD/JPY	132	132	129	126	124	122	121	120	122	125	128	130

Note averages. Source: Investec, Iress

### Severe Down Case: Exchange Rate forecasts

	2023				2024				2025			
	Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24	Q1.25	Q2.25	Q3.25	Q4.25
USD/ZAR	17.76	19.30	19.70	20.00	20.20	20.50	20.80	21.20	20.90	20.90	21.00	20.80
GBP/ZAR	21.59	24.06	24.63	25.20	25.86	26.55	27.14	27.77	27.17	27.17	27.30	27.04
EUR/ZAR	19.06	21.22	21.87	22.60	23.23	23.88	24.44	25.02	24.45	24.45	24.57	24.34
ZAR/JPY	7.45	6.86	6.52	6.30	6.11	5.95	5.82	5.66	5.84	5.98	6.10	6.25
CHF/ZAR	19.20	21.46	21.65	21.84	22.02	22.42	22.84	23.38	22.97	22.97	23.08	22.86
AUD/ZAR	12.14	13.00	13.59	14.20	14.54	14.76	15.08	15.48	15.88	16.09	16.59	16.43
GBP/USD	1.22	1.25	1.25	1.26	1.28	1.30	1.31	1.31	1.30	1.30	1.30	1.30
EUR/USD	1.07	1.10	1.11	1.13	1.15	1.17	1.18	1.18	1.17	1.17	1.17	1.17
USD/JPY	132	132	129	126	124	122	121	120	122	125	128	130

Note: averages. Source: Investec, Iress

### Extreme Up Case: Exchange Rate forecasts

Exchange rate forecasts												
	2023				2024				2025			
	Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24	Q1.25	Q2.25	Q3.25	Q4.25
USD/ZAR	17.76	16.60	15.90	15.50	15.00	14.60	14.50	14.40	14.30	14.40	14.50	14.30
GBP/ZAR	21.59	20.70	19.88	19.53	19.20	18.91	18.92	18.86	18.59	18.72	18.85	18.59
EUR/ZAR	19.06	18.25	17.65	17.52	17.25	17.01	17.04	16.99	16.73	16.85	16.97	16.73
ZAR/JPY	7.45	7.98	8.08	8.13	8.23	8.36	8.34	8.33	8.53	8.68	8.83	9.09
CHF/ZAR	19.20	18.46	17.47	16.92	16.35	15.97	15.92	15.88	15.71	15.82	15.93	15.71
AUD/ZAR	12.14	11.18	10.97	11.01	10.80	10.51	10.51	10.51	10.87	11.09	11.46	11.30
GBP/USD	1.22	1.25	1.25	1.26	1.28	1.30	1.31	1.31	1.30	1.30	1.30	1.30
EUR/USD	1.07	1.10	1.11	1.13	1.15	1.17	1.18	1.18	1.17	1.17	1.17	1.17
USD/JPY	132	132	129	126	124	122	121	120	122	125	128	130

Note: averages. Source: Investec, Iress