

Monday 21 February 2022

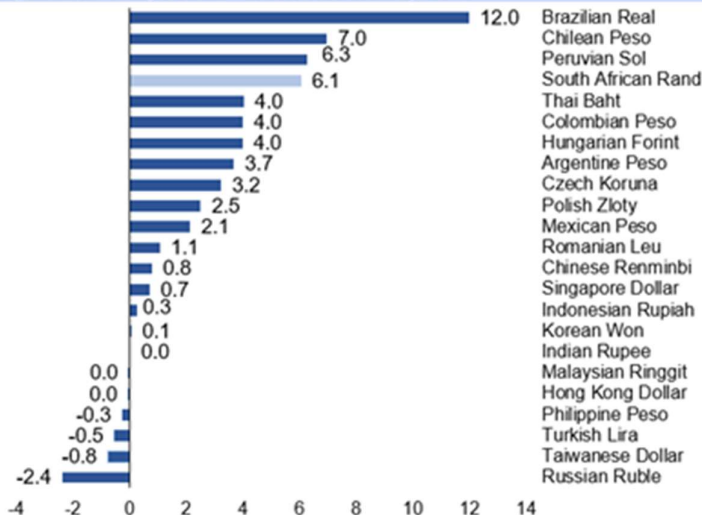
Rand note: the underlying weakness of the Budget, tightening global monetary policy environment and weakness of SA economy is eventually likely to catch up to domestic currency

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



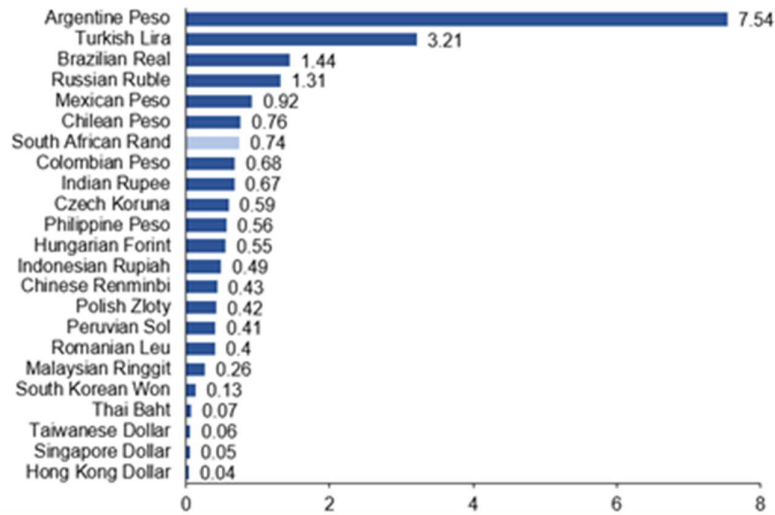
Source: Bloomberg

#### Emerging Markets Carry Return – values 21 February 2022



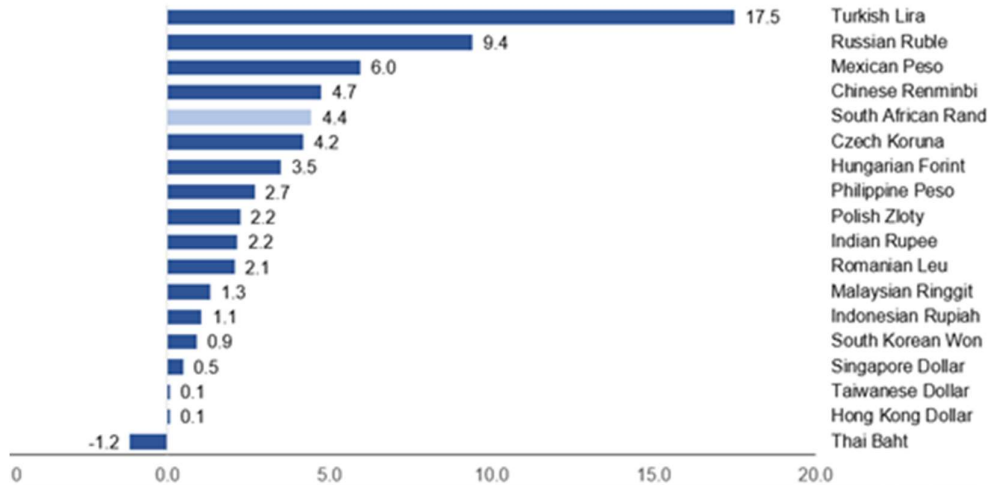
Source: Bloomberg

#### Emerging Markets Interest Return – values 21 February 2022



Source: Bloomberg

#### Emerging Markets Implied Rates – values 21 February 2022



Source: Bloomberg

#### Expected Case: Exchange Rate forecasts

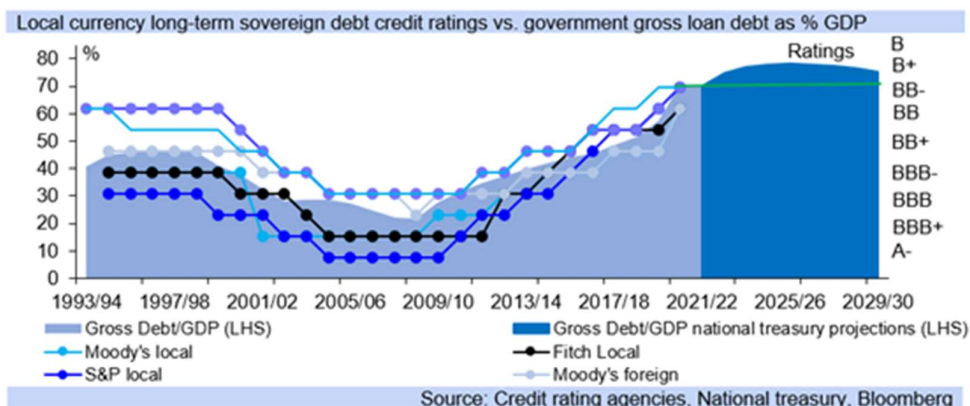
	2022				2023				2024			
	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.22	Q1.24	Q2.24	Q3.24	Q4.24
USD/ZAR	15.50	15.60	15.85	15.65	15.50	15.90	16.30	15.80	15.60	16.10	16.60	16.10
GBP/ZAR	21.24	21.84	22.82	23.01	22.94	23.69	24.78	24.17	23.71	24.31	24.90	23.99
EUR/ZAR	17.67	17.94	18.39	18.62	18.76	19.56	20.38	19.75	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
CHF/ZAR	17.03	16.96	17.23	17.20	17.22	17.67	18.11	17.56	17.14	17.69	18.24	17.69
AUD/ZAR	11.32	11.54	12.05	12.05	11.94	12.24	12.55	12.17	12.17	12.56	12.95	12.56
GBP/USD	1.37	1.40	1.44	1.47	1.48	1.49	1.52	1.53	1.52	1.51	1.50	1.49
EUR/USD	1.14	1.15	1.16	1.19	1.21	1.23	1.25	1.25	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

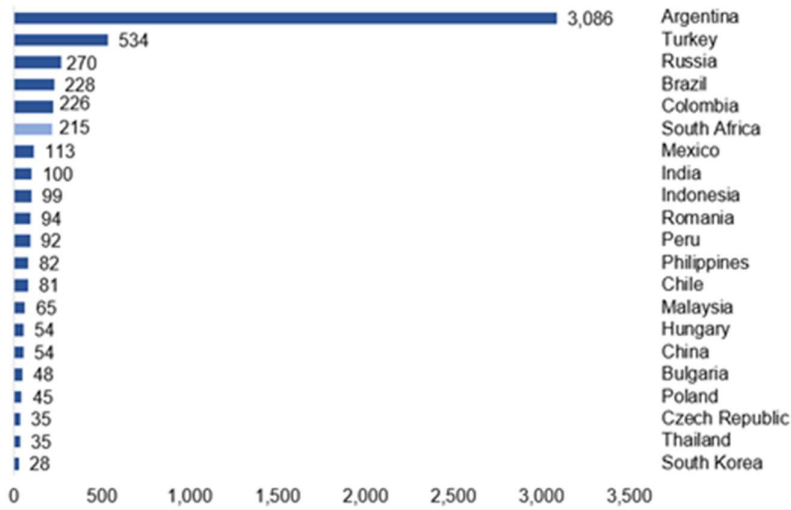
- The rand continues firmer on the commodity surge, bolstered also somewhat by its far geographical distance from the building Russian/Ukraine tensions and the usual seasonal risk-on strength at the start of each year, and the fading pandemic.

- In any event, Russia's Vladimir Putin has agreed to talks with the US's Joe Biden, as both Presidents are to attend a summit on the crisis. Putin is unlikely to back down easily or by much permanently, but markets have taken the move as positive.
- An actual third world war is not anticipated, despite key nations increasingly lending support to the UN peacekeeping corps, with high levels of tech reducing the need for heavy foot soldier deployment and so the heavy participation from countries in WW1 and WW2.
- In South Africa, the Budget this week is not expected to see substantially improved (lowered) fiscal projections and certainly not fiscal consolidation in the near term back to pre-pandemic levels, and so fiscal health remained a drag on the economy even before the pandemic.
- South African rand bonds continue to attract investors with high yields, and should Minister Godongwana show a further lowering in debt and deficit projections (although substantial moves are unlikely), this would add to positive sentiment towards ZAR debt and the ZAR.
- No credit rating upgrades are expected as a result of the budget, with debt projection needed to drop to those pre pandemic to change this, although Moody's may possibly begin considering the removal of the negative outlook on a positive budget, if it occurs.
- Moody's is set to meet on 1<sup>st</sup> April and 18<sup>th</sup> November this year to potentially deliver a credit rating action, while S&P's dates are 20<sup>th</sup> May and 18<sup>th</sup> November for this year. Fitch does not publish dates for South Africa's credit action, but tends to show a similar pattern.
- South Africa's current or projected debt levels are not consistent with credit rating updates (see graph directly below), with the credit rating agencies' primary objective to assess the likelihood of repayment of debt in assessing a sovereign/entity's credit worthiness.
- Should SA lower its projected debt trajectory to peak around the current ratio (unlikely), then SA would be likely closer to seeing a positive credit rating move from one of the three key agencies, which in turn would be positive for the rand and SA's bonds.

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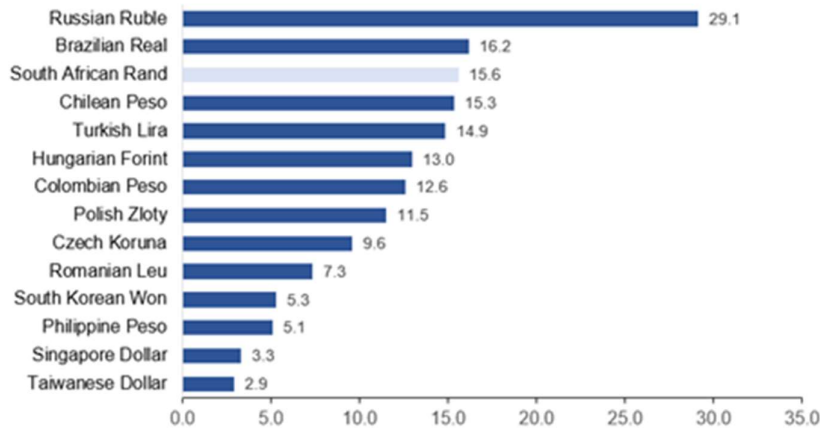


Emerging Markets CDS Spreads – values 21 February 2022



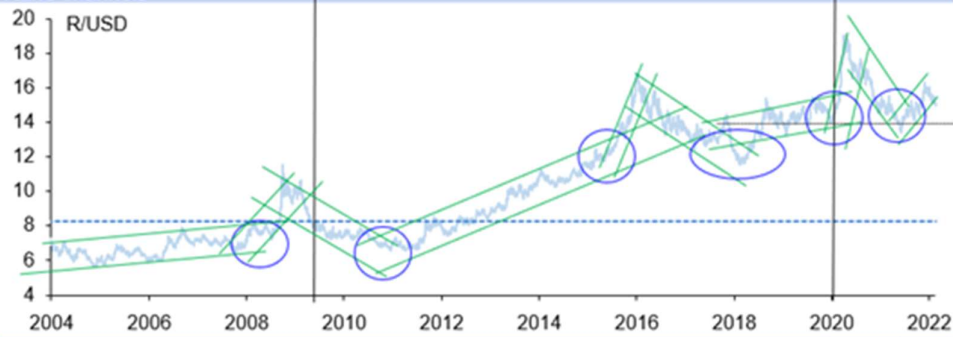
Source: Bloomberg

Emerging Markets Implied Volatilities – values 21 February 2022

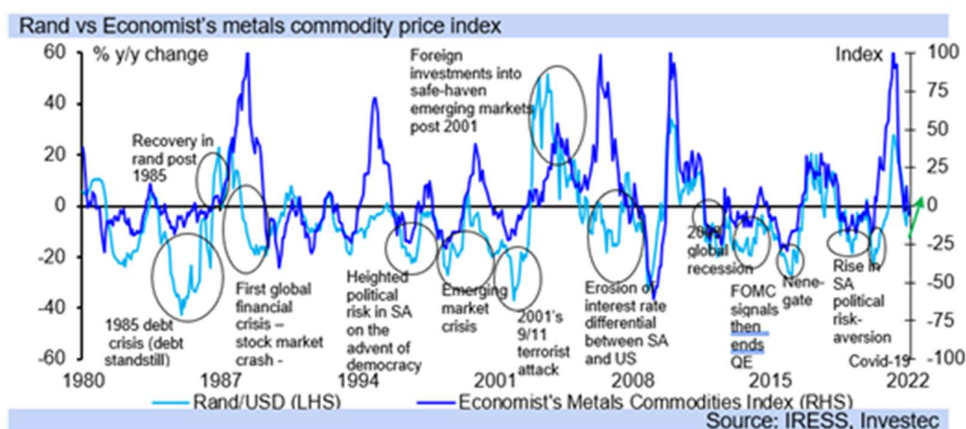


Source: Bloomberg

Rand channels



Source: Iress



- The IMF has warned recently in its Article IV consultation that South Africa's medium-term economic outlook is lacklustre, caused by "structural constraints to investment, prevailing policy uncertainty, and elevated public debt."
- "(O)ver the medium term, the growing interest bill and demands from SOEs and public servants will keep the fiscal deficit high, above 7 percent of GDP. The debt ratio is expected to continue rising."
- The IMF recommends "ambitious fiscal consolidation to reduce public debt, while protecting the most vulnerable ... mainly focused on the expenditure side and complemented by revenue administration enhancements and a credible public debt anchor" in its conclusion.
- This week's Budget is seen "as an opportunity to define concrete measures, including containing public sector compensation, rationalizing transfers to state owned enterprises (SOEs), streamlining tax expenditures, and better targeting education subsidies."
- "Noting the deteriorating performance of SOEs, ... (IMF) Directors urged prompt action to strengthen their operations and finances and advance anti-corruption efforts in procurement and administration."
- The credit rating agencies are unlikely to hold a substantially different view. The IMF warns South Africa's "lackluster medium-term performance capped by structural constraints, weak confidence, and less-favorable terms of trade."
- The IMF strongly recommends South Africa "tak(es) ... additional fiscal measures to reverse the concerning upward trend in public debt", stating this as "imperative" in order to put "public debt on a sustainable path".
- Overall the Budget is likely to be fairly credit neutral, not delivering the deep cuts in projected borrowings that the markets and the credit rating agencies hope for, and so not resulting in immediate credit rating upgrades in April/May or substantial rand strength.
- The rand has weakened this afternoon, to R15.17/USD, from R15.04/USD earlier, with weak fundamentals placing a drag on the currency, and this will be particularly pronounced when the commodity boom fades, and risk aversion rises.



**Economic Scenarios: note tighter rate interest rate hike cycle for SA, increased inflation focus**

		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
<b>Extreme</b>	USD/Rand (average)	14.50	14.00	13.80	13.70	13.60	13.40	13.30	13.10
<b>Up case</b>	Repo rate (end rate)	4.00	4.00	4.00	3.75	3.75	3.75	3.50	3.50
<b>1%</b>	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.								
<b>Up case</b>		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
<b>2%</b>	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.								
<b>Base</b>		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
<b>case</b>	USD/Rand (average)	15.50	15.60	15.85	15.65	15.50	15.90	16.30	15.80
<b>49%</b>	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 & 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.								
<b>Lite</b>		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
<b>(domestic)</b>	USD/Rand (average)	15.70	16.00	16.65	16.90	17.00	17.50	17.60	17.50
<b>Down</b>	Repo rate (end rate)	4.25	4.50	4.75	5.00	5.25	5.50	5.75	6.00
<b>case</b>	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.								
<b>42%</b>		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
<b>Severe</b>	USD/Rand (average)	16.00	16.80	17.50	18.00	18.50	18.70	19.20	19.55
<b>down</b>	Repo rate (end rate)	4.50	4.75	5.00	5.25	5.75	6.00	6.50	7.00
<b>case</b>	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). Nationalisation of private sector property (individuals do not receive title deeds). SA rated single B from all three key agencies, with further rating downgrades eventually occurring into CCC grade and lower to D (default) as government finances deteriorate (debt projections elevate even further - fail to ever stabilise). 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.								
<b>6%</b>		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23

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	22.40	23.98	24.84	25.16	26.08	26.75	26.78	26.14	25.67	25.20	25.33
EUR/ZAR	17.90	18.40	19.31	20.11	20.57	21.53	22.00	21.88	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
CHF/ZAR	17.25	17.39	18.10	18.57	18.89	19.44	19.56	19.44	18.90	18.68	18.46	18.68
AUD/ZAR	11.46	11.84	12.65	13.01	13.09	13.48	13.55	13.48	13.42	13.26	13.10	13.26
GBP/USD	1.37	1.40	1.44	1.47	1.48	1.49	1.52	1.53	1.52	1.51	1.50	1.49
EUR/USD	1.14	1.15	1.16	1.19	1.21	1.23	1.25	1.25	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

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	23.52	25.20	26.46	27.38	27.86	29.18	29.91	29.94	29.82	29.78	29.50
EUR/ZAR	18.24	19.32	20.30	21.42	22.39	23.00	24.00	24.44	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
CHF/ZAR	17.58	18.26	19.02	19.78	20.56	20.78	21.33	21.72	21.65	21.70	21.81	21.76
AUD/ZAR	11.68	12.43	13.30	13.86	14.25	14.40	14.78	15.05	15.37	15.41	15.48	15.44
GBP/USD	1.37	1.40	1.44	1.47	1.48	1.49	1.52	1.53	1.52	1.51	1.50	1.49
EUR/USD	1.14	1.15	1.16	1.19	1.21	1.23	1.25	1.25	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	21.14	21.60	21.90	22.05	21.90	22.19	22.19	22.04	21.74	21.60	21.31
EUR/ZAR	17.25	17.37	17.40	17.73	18.03	18.08	18.25	18.13	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	16.35	16.41	16.30	16.37	16.56	16.33	16.22	16.11	15.93	15.82	15.82	15.71
AUDZAR	11.10	11.17	11.40	11.47	11.47	11.32	11.24	11.17	11.31	11.23	11.23	11.15
GBP/USD	1.37	1.40	1.44	1.47	1.48	1.49	1.52	1.53	1.52	1.51	1.50	1.49
EUR/USD	1.14	1.15	1.16	1.19	1.21	1.23	1.25	1.25	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	19.60	19.87	20.14	20.13	19.97	20.22	20.04	19.61	19.33	18.90	18.33
EUR/ZAR	16.53	16.10	16.01	16.30	16.46	16.48	16.63	16.38	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	15.11	14.89	14.78	14.56	14.18	14.07	13.85	13.52
AUDZAR	10.59	10.36	10.49	10.55	10.47	10.32	10.24	10.09	10.06	9.98	9.83	9.59
GBP/USD	1.37	1.40	1.44	1.47	1.48	1.49	1.52	1.53	1.52	1.51	1.50	1.49
EUR/USD	1.14	1.15	1.16	1.19	1.21	1.23	1.25	1.25	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