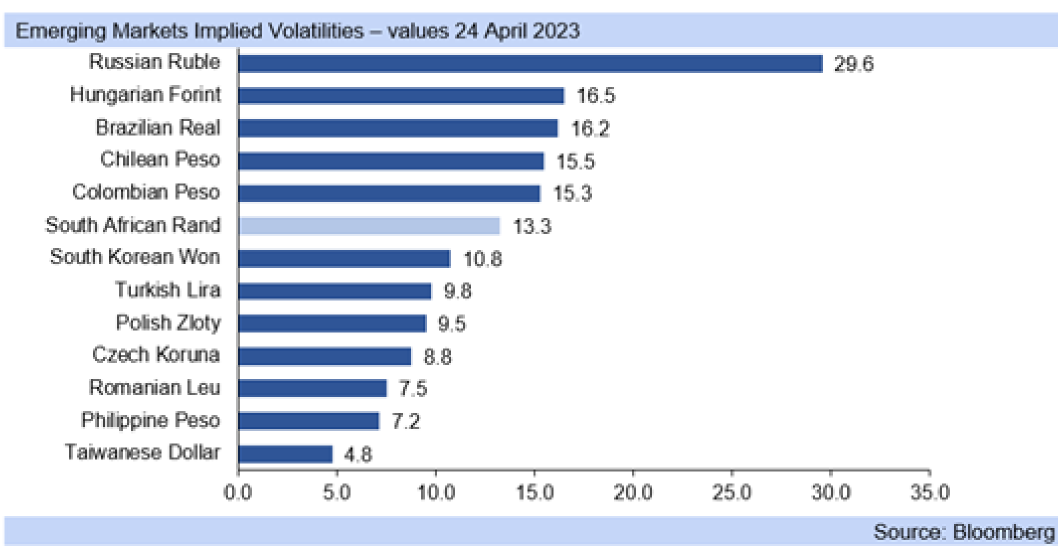
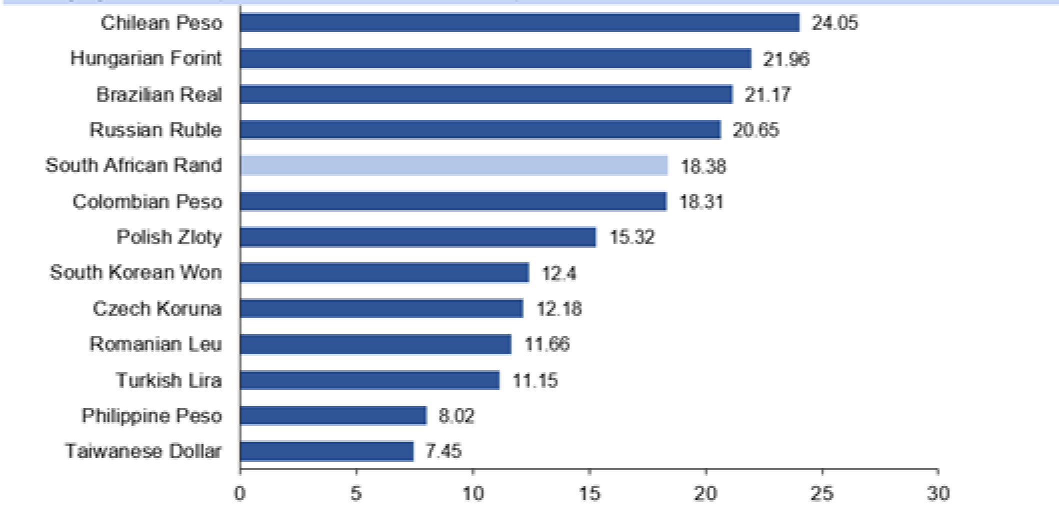
Investec

Rand note: ticks weaker on recent US economic resilience, ongoing recession watch

Monday 24 April 2023

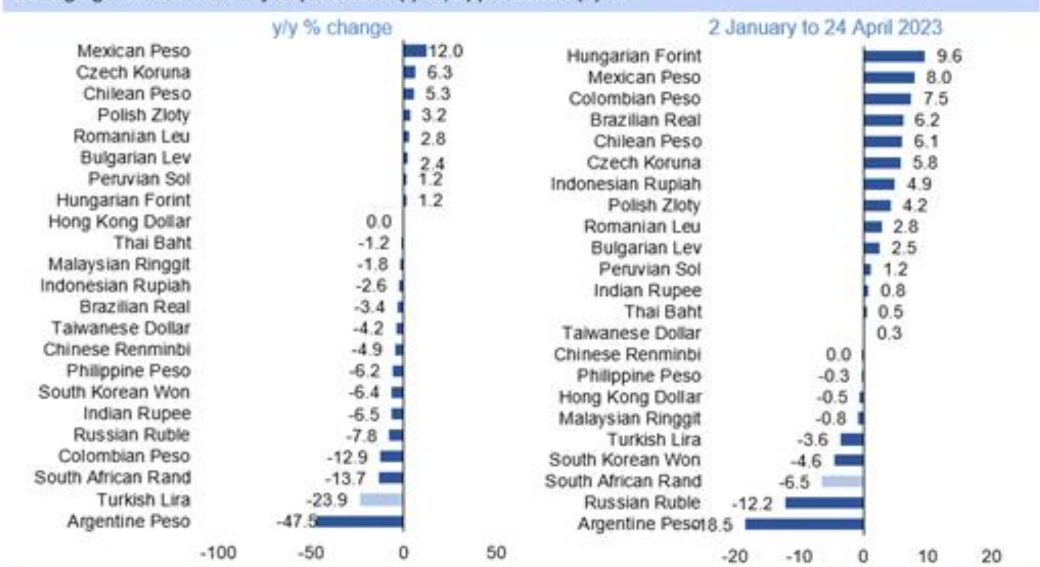


Emerging Markets Implied Volatilities – values 19 September 2022



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	17.95	17.75	17.55	17.20	17.40	17.60	17.30	17.00	17.00	17.10	16.90
GBP/ZAR	21.59	22.26	22.19	22.11	22.02	22.53	22.97	22.66	22.10	22.10	22.23	21.97
EUR/ZAR	19.06	19.57	19.70	19.83	19.78	20.36	20.77	20.41	19.89	19.89	20.01	19.77
ZAR/JPY	7.45	7.19	7.10	7.12	7.18	7.01	6.88	6.94	7.88	7.76	7.66	7.69
CHFZAR	19.20	19.66	19.51	19.16	18.75	19.03	19.33	19.08	18.68	18.68	18.79	18.57
AUDZAR	12.14	12.12	12.25	12.46	12.38	12.53	12.76	12.63	12.92	13.09	13.51	13.35
GBP/USD	1.23	1.24	1.25	1.25	1.26	1.27	1.29	1.31	1.30	1.30	1.30	1.30
EUR/USD	1.08	1.10	1.11	1.12	1.13	1.14	1.16	1.18	1.17	1.17	1.17	1.17
USD/JPY	130	129	126	125	124	122	121	120	123	125	128	130

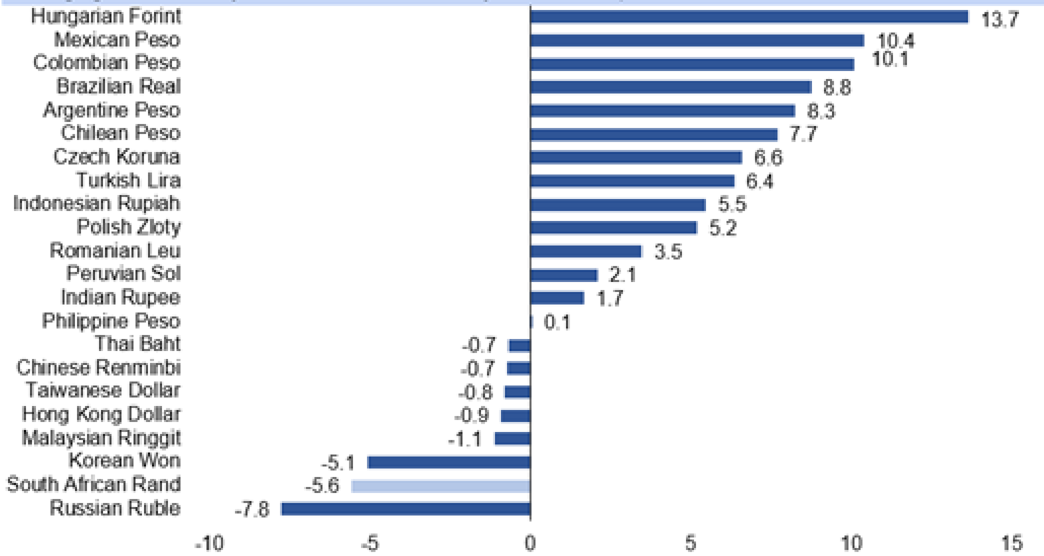
Note: averages, Source: Investec, Iress

- Markets continue to worry that the US will fall into recession in H2.23, as its interest rate hike cycle overshoots. With at least a two to three quarter lag between interest rate changes and the impact on the economy, further hikes entrench these concerns.
- With mixed US economic data, there is (lowish) volatility, with the domestic currency reaching at R18.20/USD today, on some US dollar strength on better than expected S&P PMI data on Friday, from a recent low of R17.42/USD on Friday.
- The US PMI data in particular showed upwards price pressures at the production level which increased some expectations of US interest rate hikes, and so aided the US dollar, although by midday the rand had pulled back to R18.11/USD.

- Friday's US PMI report highlighted that "(s)tronger demand conditions support sharper growth in April, but also bring renewed inflation momentum", as US business activity was seen to have quickened in April across the services and manufacturing sectors.
- "Output rose at the sharpest pace for almost a year, as stronger demand conditions, improving supply and a steeper uptick in new orders supported the expansion. … The increase in output was the third in as many months."
- "The faster rise in activity was broad-based, with service sector firms registering the sharper rate of growth … linked this to greater customer confidence and … (s)ome … improvement in their ability to hire staff had boosted output."
- "April data indicated a pick-up in rates of input cost and output charge inflation. Operating expenses rose at a marked and historically elevated pace that was the steepest for three months, seen as contributing to core inflation".
- In the US, core CPI inflation (CPI excluding food and energy) rose to 5.6% y/y in the latest print, up from 5.5% y/y, obdurately high, and the PMI data raised some concerns it would further support Fed hawkishness. The core PCE deflator is due this week.
- Financial markets are factoring in almost a 100% change of a 25bp hike in the US next week, while expectations of a recession are a lot lower, at 44% according to NABE (National Association of Business Economics). Uncertainty is elevated.

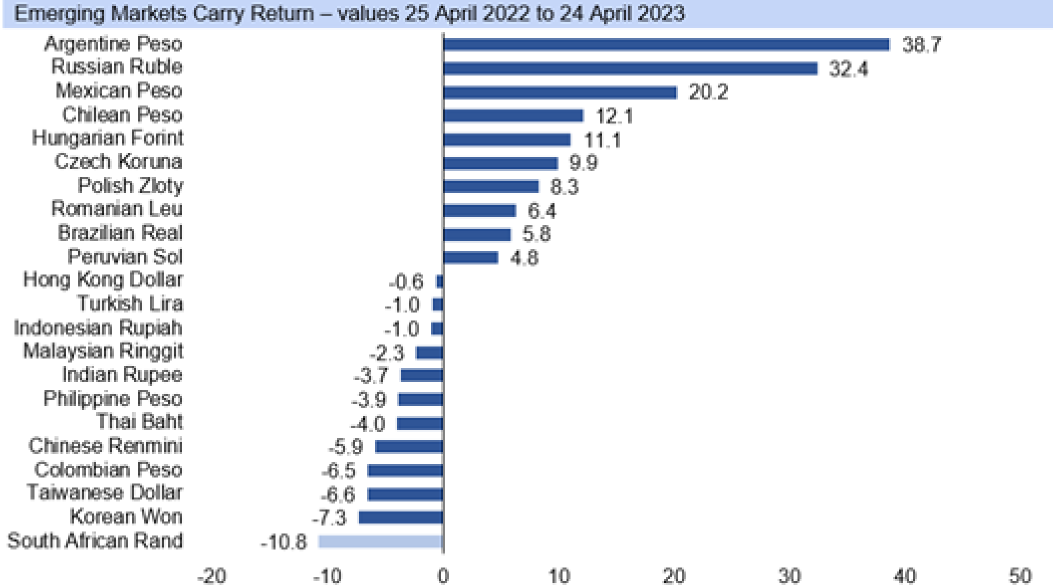
Please scroll down to the second section below

Emerging Markets Carry Return – values 2 January 2023 to 25 April 2023



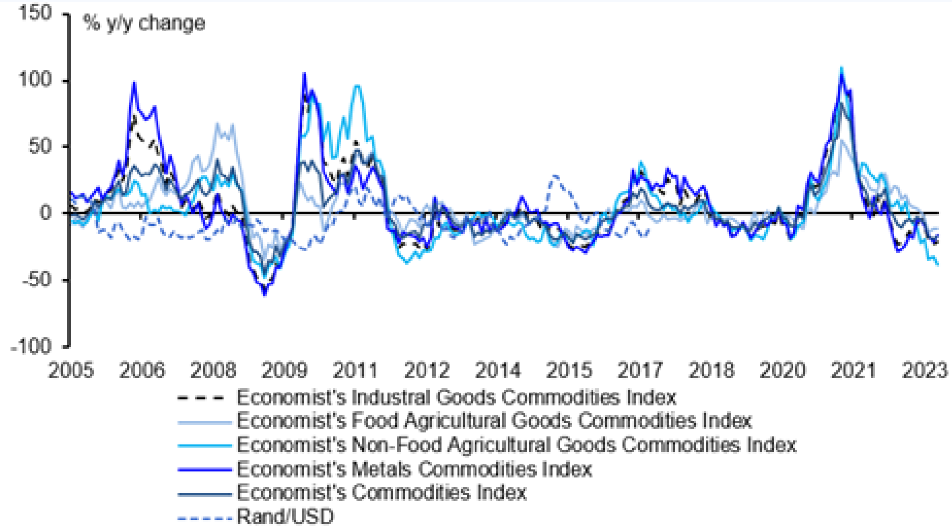
Source: Bloomberg

Emerging Markets Carry Return – values 25 April 2022 to 24 April 2023



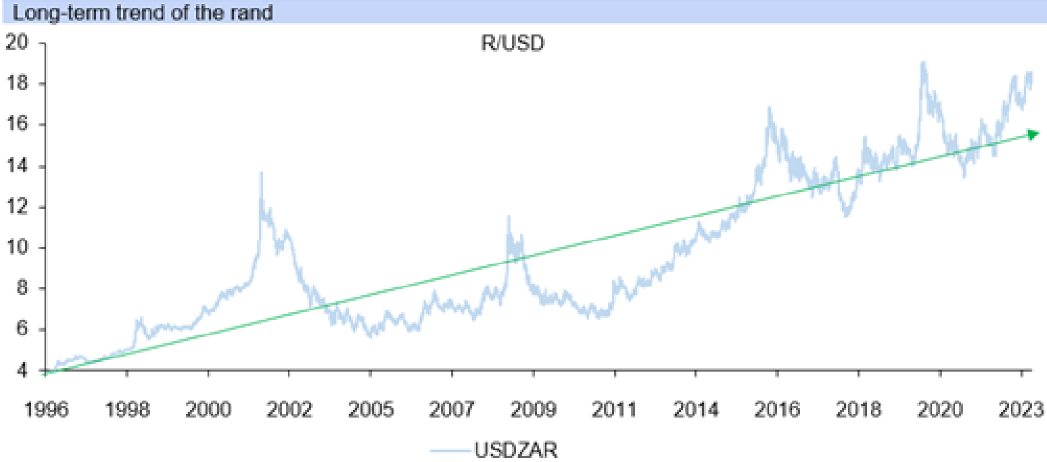
Source: Bloomberg

Economist's commodity indices

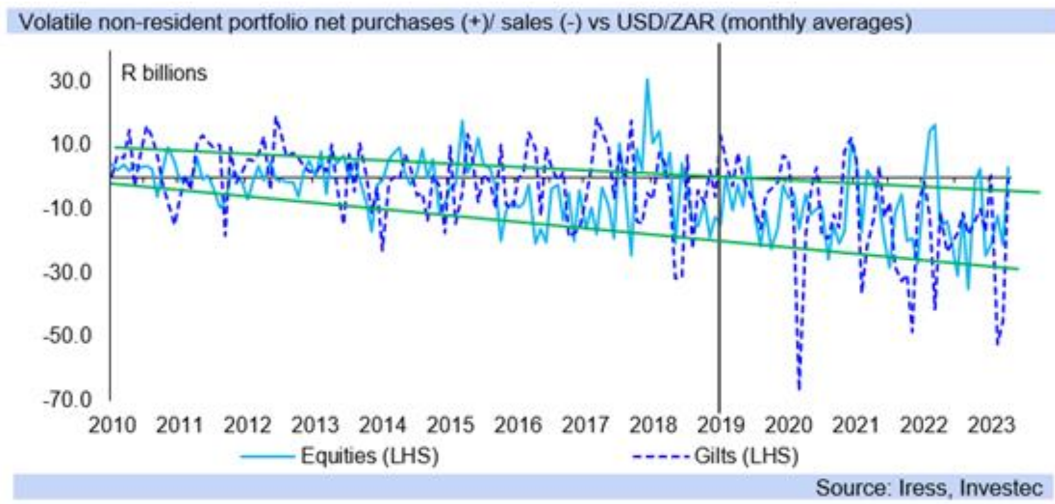


Source: IRESS, Economist, IMF

Long-term trend of the rand



Source: Iress



- That is, the rand's weakness over the past year has been driven by increased uncertainty and the downgrades of the global economic outlook, as uncertainty elevated, although another sharp depreciation in the rand is not the base case.
- With global risks, and particularly a meaningful chance of US recession factored in (although likely not fully), the rand remains at risk of further weakness, but is not expected to lose another R4/USD over the next twelve months.
- The NABE recession outlook is down from 54% in January, while Forbes' recession tracker shows "more and more of our data points are drifting into neutral territory rather than remaining positive."
- "This could mean the U.S. is drifting closer toward a recession as well, … however, … not every data point we rank above would be weighted equally in deciding whether the U.S. is in recession."
- "If GDP can continue growing—which experts seem to believe is unlikely—while inflation moderates, we may be able to avoid a recession and come in for what the Fed has referred to as a soft landing."
- "Even the U.S. unemployment rate, which figures heavily into when a recession might be called, is starting to weaken. The U.S. may not be in a recession yet, but things aren't looking good."
- Sentiment, amongst other factors, has a part to play in whether the US achieves the NBR defined recession (National Bureau of Economic Research), of roughly a contraction in the business cycle (after the peak), with a number of areas of focus.

- "Monthly US data on payroll employment, civilian employment, industrial production and the unemployment rate are used to define a recession-dating algorithm that nearly perfectly reproduces the NBER official peak and trough dates."
- Activity in the US business cycle is expected to slow in H2.23, but whether it will be enough for a NBER defined recession is not clear, giving hope for a 'soft-landing', although much will also depend on global financial market risk perceptions for the rand.

Economic Scenarios: note updated probabilities

		Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
Extreme Up case 1%	USD/Rand (average)	17.76	16.60	15.90	15.50	15.00	14.60	14.50	14.40
	Repo rate (end rate)	7.75	6.75	6.50	6.25	6.00	6.00	5.50	5.50

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. Strong global growth, risk-on, commodity boom. Rapid upgrades of credit ratings to investment grade. Very short grey listing. Quick transition to renewable energy from fossil fuels.

		Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
Up case 1%	USD/Rand (average)	17.76	17.20	17.40	17.00	16.90	17.10	16.90	16.60
	Repo rate (end rate)	7.75	7.00	7.00	7.00	6.50	6.50	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. Credit rating upgrades on fiscal consolidation, markedly lower borrowings. 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.

		Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
Base case 48%	USD/Rand (average)	17.76	17.95	17.75	17.55	17.20	17.40	17.60	17.30
	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. South Africa follows fiscal consolidation (debt to GDP stabilisation) leading to positive outlooks, then likely credit rating upgrades. 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.

		Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
Lite (domestic) Down case 40%	USD/Rand (average)	17.76	18.90	19.30	19.00	18.70	19.00	19.10	18.90
	Repo rate (end rate)	7.75	8.00	8.50	9.00	9.00	9.00	9.00	9.00

Weak GDP growth (0.9% average over 5-years), swing toward left leaning policies. Business confidence depressed, substantial electricity and water shedding, very weak rail capacity, civil and political unrest, little investment growth, recession. Increased state borrowings, risk of credit rating downgrades rises, then occurs later in period. 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.

		Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
Severe down case 10%	USD/Rand (average)	17.76	19.30	19.70	20.00	20.20	20.50	20.80	21.20
	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. ANC/EFF coalition in 2024. Widespread, severe services load shedding, severe civil and political unrest. Government borrows from increasingly wider sources, SA rated single B from all three key agencies, eventually CCC grade, increased risk of default, sinks deeper into a debt trap. 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	18.90	19.30	19.00	18.70	19.00	19.10	18.90	18.60	18.70	18.70	18.60
GBP/ZAR	21.59	23.44	24.13	23.94	23.94	24.61	24.93	24.76	24.18	24.31	24.31	24.18
EUR/ZAR	19.06	20.60	21.42	21.47	21.51	22.23	22.54	22.30	21.76	21.88	21.88	21.76
ZAR/JPY	7.45	6.83	6.53	6.58	6.60	6.42	6.34	6.35	7.20	7.06	7.01	6.99
CHFZAR	19.20	20.70	21.21	20.74	20.38	20.78	20.97	20.84	20.44	20.55	20.55	20.44
AUDZAR	12.14	12.76	13.32	13.49	13.46	13.68	13.85	13.80	14.14	14.40	14.77	14.69
GBP/USD	1.23	1.24	1.25	1.25	1.26	1.27	1.29	1.31	1.30	1.30	1.30	1.30
EUR/USD	1.08	1.10	1.11	1.12	1.13	1.14	1.16	1.18	1.17	1.17	1.17	1.17
USD/JPY	130	129	126	125	124	122	121	120	123	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	23.93	24.63	25.20	25.86	26.55	27.14	27.77	27.17	27.17	27.30	27.04
EUR/ZAR	19.06	21.04	21.87	22.60	23.23	23.99	24.54	25.02	24.45	24.45	24.57	24.34
ZAR/JPY	7.45	6.68	6.40	6.25	6.11	5.95	5.82	5.66	6.41	6.32	6.24	6.25
CHFZAR	19.20	21.14	21.65	21.84	22.02	22.42	22.84	23.38	22.97	22.97	23.08	22.86
AUDZAR	12.14	13.03	13.59	14.20	14.54	14.76	15.08	15.48	15.88	16.09	16.59	16.43
GBP/USD	1.23	1.24	1.25	1.25	1.26	1.27	1.29	1.31	1.30	1.30	1.30	1.30
EUR/USD	1.08	1.10	1.11	1.12	1.13	1.14	1.16	1.18	1.17	1.17	1.17	1.17
USD/JPY	130	129	126	125	124	122	121	120	123	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	17.20	17.40	17.00	16.90	17.10	16.90	16.60	16.30	16.30	16.40	16.20
GBP/ZAR	21.59	21.33	21.75	21.42	21.63	22.14	22.05	21.75	21.19	21.19	21.32	21.06
EUR/ZAR	19.06	18.75	19.31	19.21	19.44	20.01	19.94	19.59	19.07	19.07	19.19	18.95
ZAR/JPY	7.45	7.50	7.24	7.35	7.31	7.13	7.16	7.23	8.22	8.10	7.99	8.02
CHFZAR	19.20	18.84	19.12	18.56	18.42	18.71	18.56	18.31	17.91	17.91	18.02	17.80
AUDZAR	12.14	11.61	12.01	12.07	12.17	12.31	12.25	12.12	12.39	12.55	12.96	12.80
GBP/USD	1.23	1.24	1.25	1.25	1.26	1.27	1.29	1.31	1.30	1.30	1.30	1.30
EUR/USD	1.08	1.10	1.11	1.12	1.13	1.14	1.16	1.18	1.17	1.17	1.17	1.17
USD/JPY	130	129	126	125	124	122	121	120	123	125	128	130

Note averages, Source: Investec, Iress

Extreme 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	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	20.58	19.88	19.53	19.20	18.91	18.92	18.86	18.59	18.72	18.85	18.59
EUR/ZAR	19.06	18.09	17.65	17.52	17.25	17.08	17.11	16.99	16.73	16.85	16.97	16.73
ZAR/JPY	7.45	7.77	7.92	8.06	8.23	8.36	8.34	8.33	9.37	9.17	9.03	9.09
CHFZAR	19.20	18.18	17.47	16.92	16.35	15.97	15.92	15.88	15.71	15.82	15.93	15.71
AUDZAR	12.14	11.21	10.97	11.01	10.80	10.51	10.51	10.51	10.87	11.09	11.46	11.30
GBP/USD	1.23	1.24	1.25	1.25	1.26	1.27	1.29	1.31	1.30	1.30	1.30	1.30
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