Rand note: Risk aversion rises on concerns about extreme rate hikes

Fears that interest rates will be hiked aggressively both globally and domestically in response to rising inflation are resulting in concerns about the outlook for economic growth and could lead to increased market volatility.

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
CHFZAR	17.03	16.96	17.23	17.20	17.22	17.67	18.11	17.56	17.14	17.69	18.24	17.69
AUDZAR	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

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

Extreme Up case 1%

	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
USD/Rand (average)	14.50	14.00	13.80	13.70	13.60	13.40	13.30	13.10
Repo rate (end rate)	4.00	4.00	4.00	3.75	3.75	3.75	3.50	3.50

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.

Up case 2%

	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
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 .

Base case 49%

	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
USD/Rand (average)	15.50	15.60	15.85	15.65	15.50	15.90	16.30	15.80
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 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.

Lite (domestic) Down case 42%

	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
USD/Rand (average)	15.70	16.00	16.65	16.90	17.00	17.50	17.60	17.50
Repo rate (end rate)	4.25	4.50	4.75	5.00	5.25	5.50	5.75	6.00

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.

Severe down case 6%

	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
USD/Rand (average)	16.00	16.80	17.50	18.00	18.50	18.70	19.20	19.55
Repo rate (end rate)	4.50	4.75	5.00	5.25	5.75	6.00	6.50	7.00

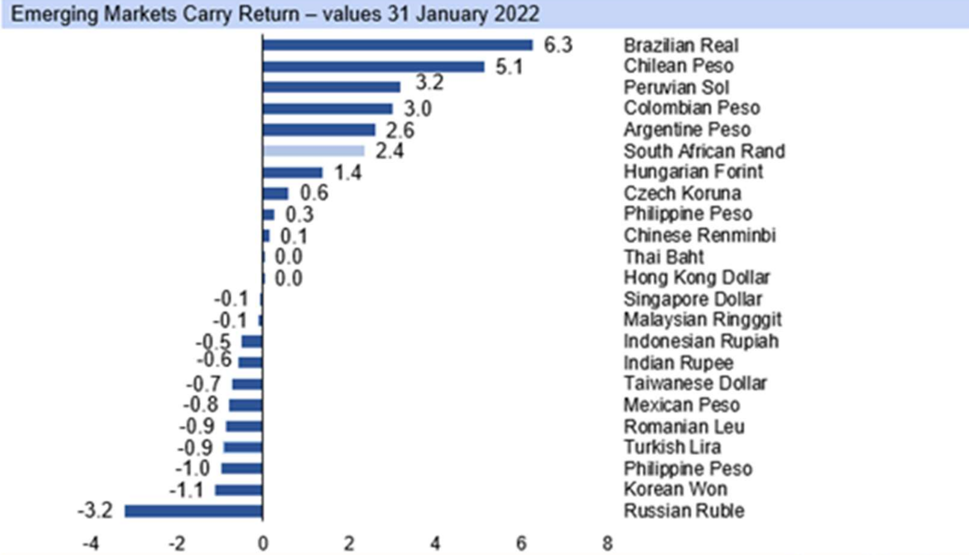
Lengthy global recession, global financial crisis – insufficient monetary and other policy supports to growth domestically and internationally. Depression in SA, unprecedented rand weakness, very high inflation (very adverse weather). Nationalisation of private sector property (individuals do not receive title deeds 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.

Note: Event risk begins Q1.22. Source: Investec

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

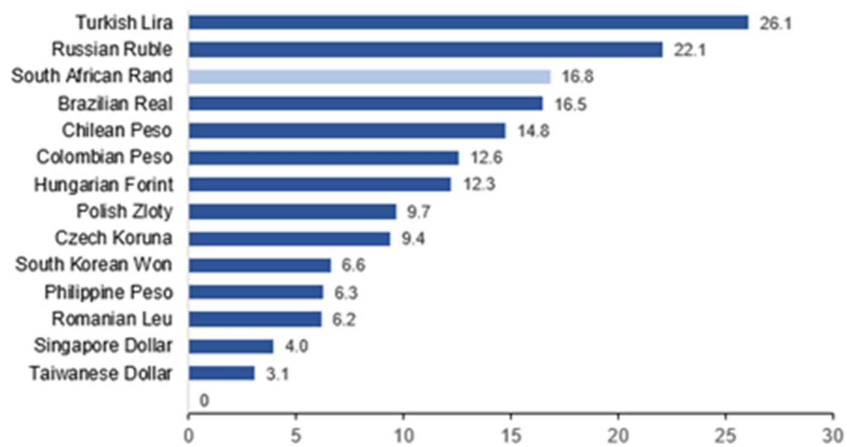
Source: Bloomberg

Emerging Markets Carry Return – values 31 January 2022



Source: Bloomberg

Emerging Markets Implied Volatilities – values 31 January 2022



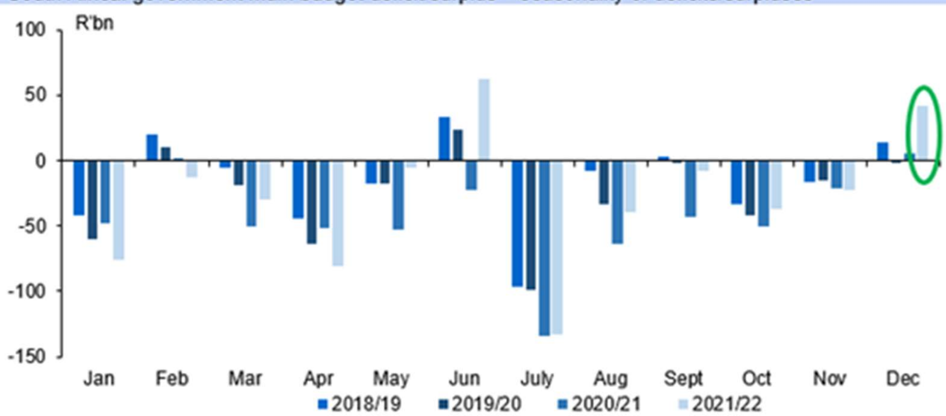
Source: Bloomberg

- The rand has weakened to R15.76/USD today. It is highly volatile on the deterioration in market sentiment as excessive interest rate hike cycles are being priced in, causing concerns about economic growth outlooks, and raising risk aversion levels.
- The rand today mostly traded around R15.50/USD, at the expected average level for Q1.22 overall, but we expect to see ongoing volatility this quarter. Market expectations about interest rates are likely to eventually become more rational, but sensitivities remain elevated.
- Foreigners are now sellers of SA markets year-to-date, dumping -R3.6 billion of SA equities (net of purchases), and -R5.5 billion worth of SA bonds (also on a net basis) in the last week alone. Foreign outflows from South African portfolio assets this year so far total -R3.0 billion.
- Investors have been re-positioning for a higher global interest rate/lower economic growth environment. The fed funds futures (which indicate how the market expects Federal Reserve policy to change) currently price in a 1.25% overall hike in the fed funds target rate this year. This equates to a 25bp hike at virtually each monetary policy meeting (five out of seven).
- Such a severe rate hike trajectory is seen as likely to be destructive for economic growth. Meanwhile, inflationary pressures in the US are expected to ease from Q2.22, meaning that markets could see further volatility as investors adjust their expectations once again.
- The rand continues to be influenced by global markets, ignoring good news on the domestic front. For example, revenues are 34.4% higher year-on-year (y/y) for the first three quarters of the year 2021/2022 compared to the same period of 2020/2021. That said, the increase comes off a very low base given 2020/2021 was the period most affected by lockdown.
- These main budget revenue figures show that 76.8% of planned revenue of R1.5 trillion has been collected so far, while only 71.8% of allocated expenditure has occurred. A significantly smaller deficit, of closer to 5.0% of GDP (versus -6.6%), is likely if this trend continues.
- A quicker moderation in the fiscal deficit than the forecast provided in the November 2021 Medium Term Budget Policy Statement (MTBPS) would be positive for the rand. The higher revenue figures tie in with the improved transactions seen over December from BankservAfrica (see last COVID-19 note, email address below).

- Data continues to show strengthening evidence that the SA economy is recovering from the effects of the pandemic, albeit not in full yet. Markets are worried about the impact of substantially higher global and domestic interest rates.

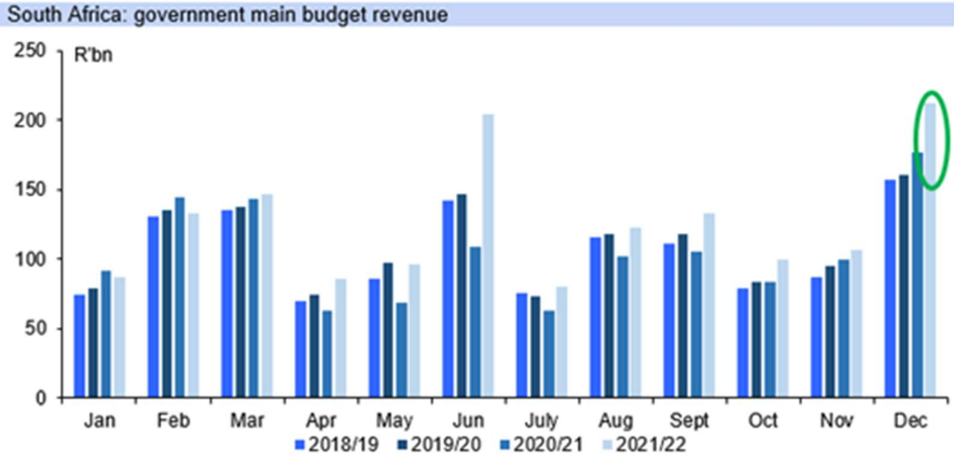
Please scroll down to the second section below

South Africa: government main budget deficit/surplus – seasonality of deficits/surpluses



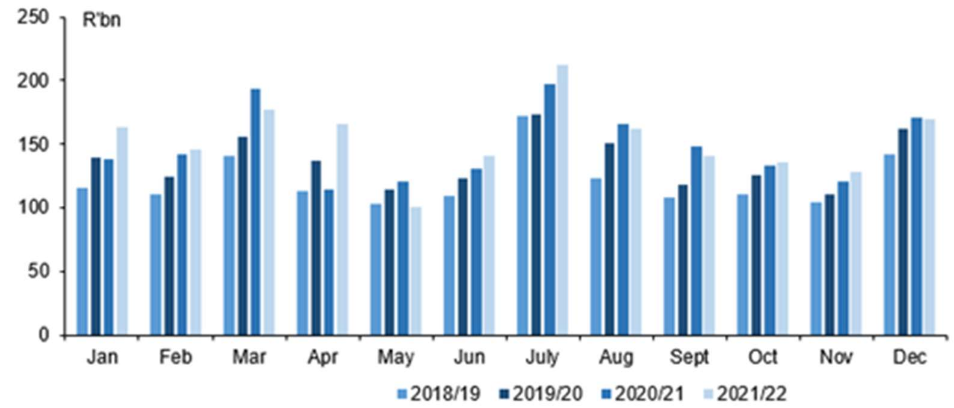
Source: National Treasury

South Africa: government main budget revenue



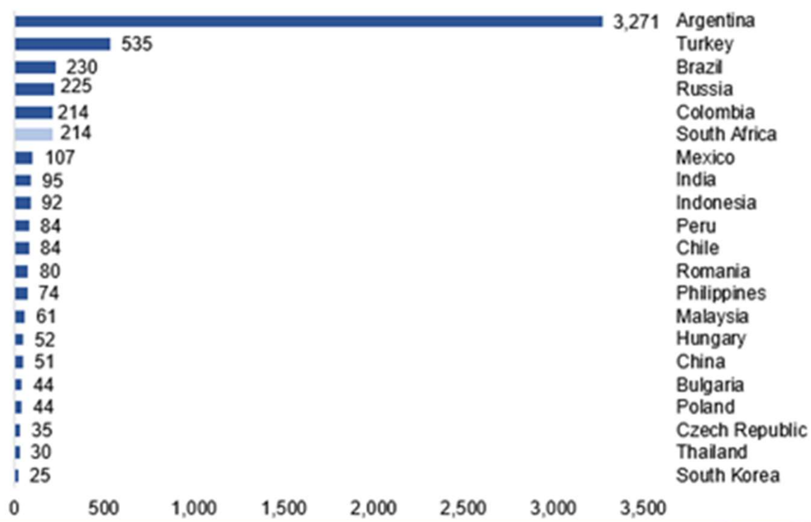
Source: National Treasury

South Africa: government main budget expenditure – general escalation in borrowings



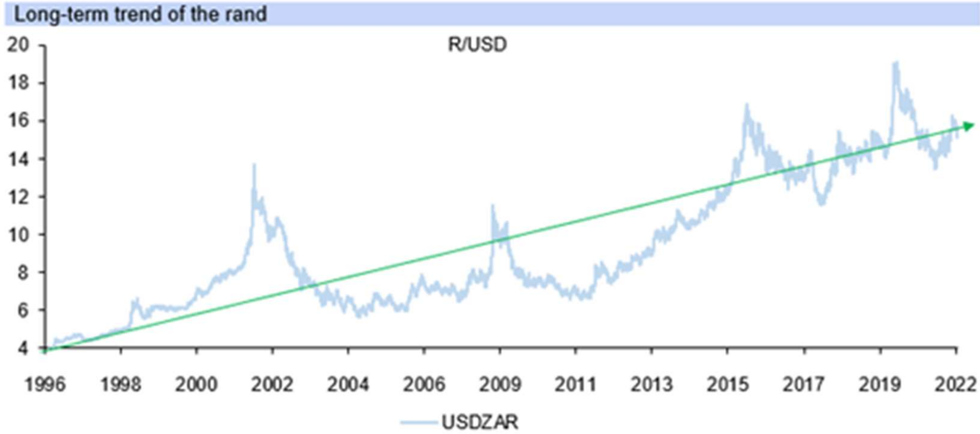
Source: National Treasury

Emerging Markets CDS Spreads – values 31 January 2022



Source: Bloomberg

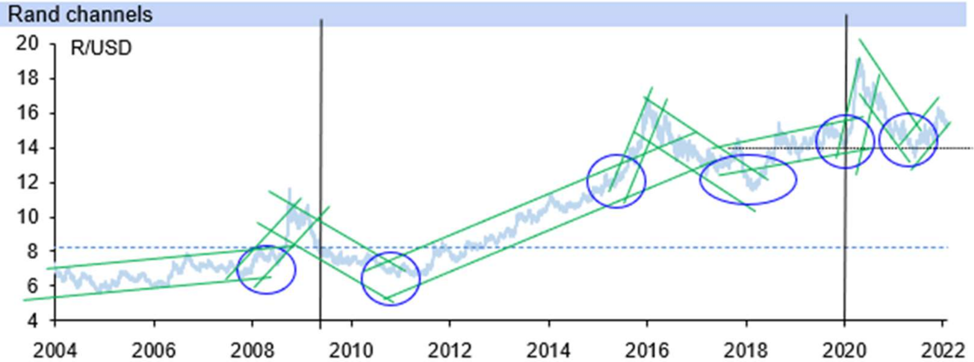
Long-term trend of the rand



Source: Iress

- The rand is being heavily influenced by global financial market sentiment, which is proving risk-off as US market rate hike bets keep escalating. A slowdown in growth in the US would have a marked effect on global growth and investments.
- Markets are also concerned about the detail of the Q4.21 US GDP growth figure. While it seems strong at 6.9% qqsaa (seasonally adjusted, annualised), a substantial portion was inventory stockpiling for the festive period, with retail sales disappointing in December.
- US stores entered January with a stock overhang as a consequence. At the same time, fiscal support has weakened materially in the US after the extreme stimulus of last year. Indeed, easing demand pressure should help supply chains and moderate some inflationary pressure.
- However, oil prices that are now at seven-year highs are a real threat to the inflation outlook if they persist. High inflation, combined with higher interest rates in the US, will eat into US economic growth substantially and make five hikes in the US this year unlikely.
- It's expected that oil will continue to experience price pressure in the near term as OPEC+ battles to make supply target increases. Tension in eastern Europe between the Ukraine and Russia is adding to price elevation and could push oil prices even higher.
- Q1.22, and indeed 2022 itself, is set for high volatility, but not the extreme volatility of the magnitude markets experienced over 2020. The rand is likely to weaken further this week and into next, and markets fear the publication of even higher inflation figures next month.
- The near 40-year high of 7.0% y/y print for US Consumer Price Index (CPI) inflation in December (compared to 7.1% y/y seen in June 1982) is unlikely to have been the peak, and markets are factoring in a 7.3% outcome next.
- The rand is in the upper quadrant of emerging market currencies, still stronger on the start of this year but at risk of weakness until markets rebalance to a more sensible outlook for US interest rates, particularly given very high oil prices.
- While risk-off dominates currently, market sentiment is not extremely sour. The rand will likely have periods of strength, but also of marked weakness this year. There is a risk of more substantial weakness if SA politics deteriorate significantly.

Rand channels



Source: Iress

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
CHFZAR	17.25	17.39	18.10	18.57	18.89	19.44	19.56	19.44	18.90	18.68	18.46	18.68
AUDZAR	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												
		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
CHFZAR	17.58	18.26	19.02	19.78	20.56	20.78	21.33	21.72	21.65	21.70	21.81	21.76
AUDZAR	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			