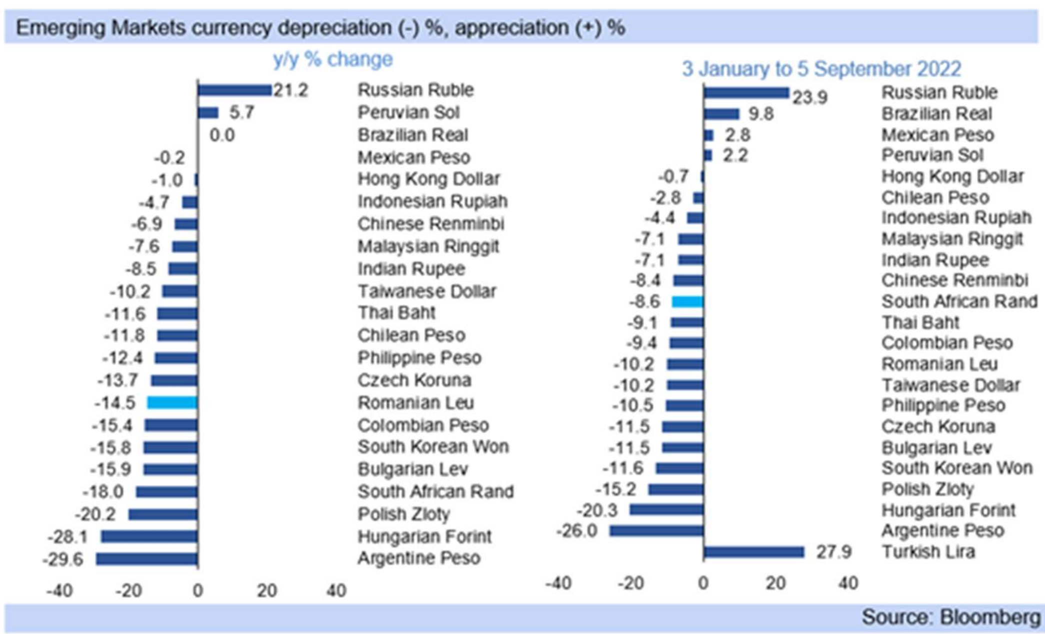
Investec | Out of the Ordinary

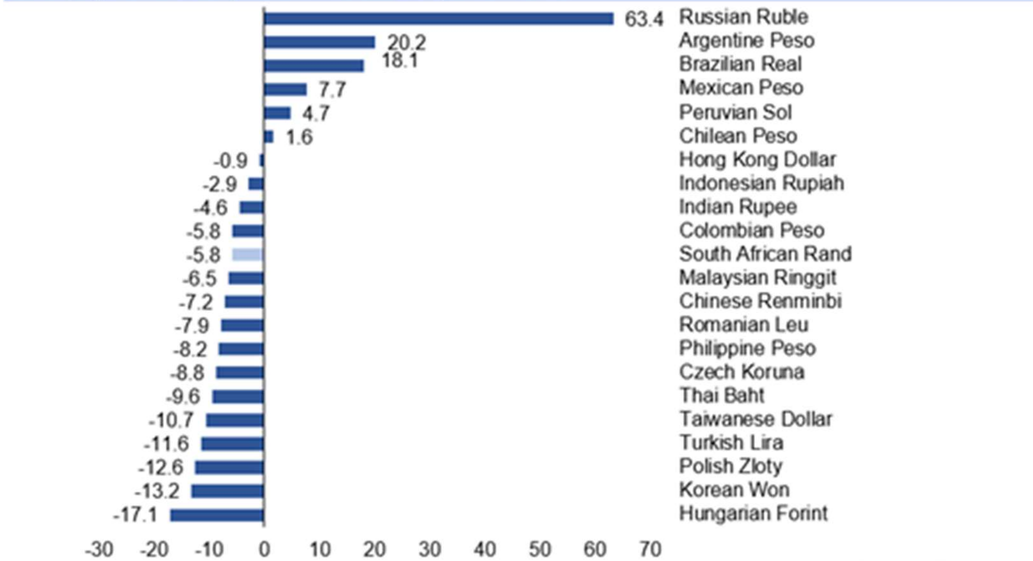
SA Economics

Monday 5 September 2022

Rand note: market volatility persist on US data focus, risks of high inflation and interest rates

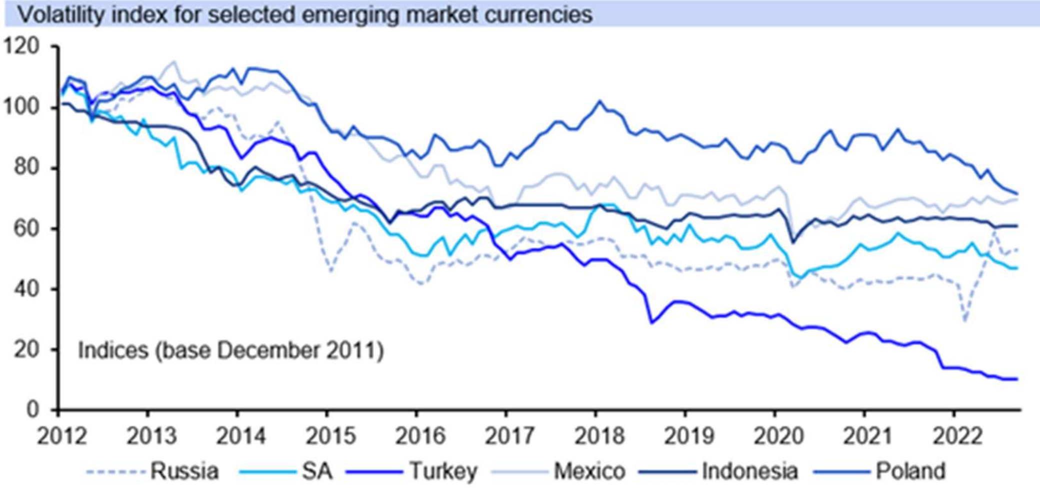


Emerging Markets Carry Return – values 5 September 2022

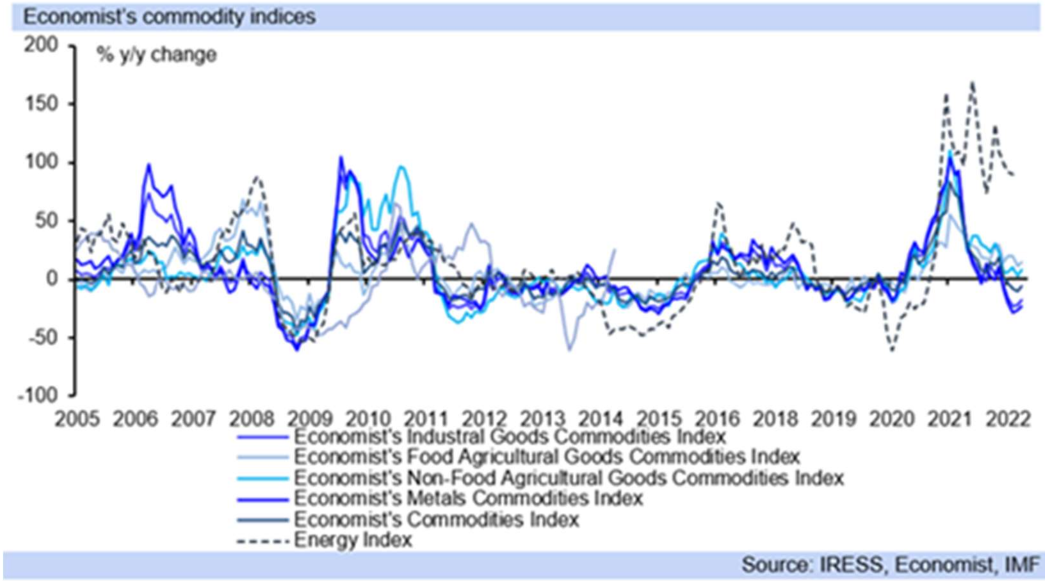


Source: Bloomberg

Volatility index for selected emerging market currencies



Sources: Iress, Investec



Expected Case: Exchange Rate forecasts

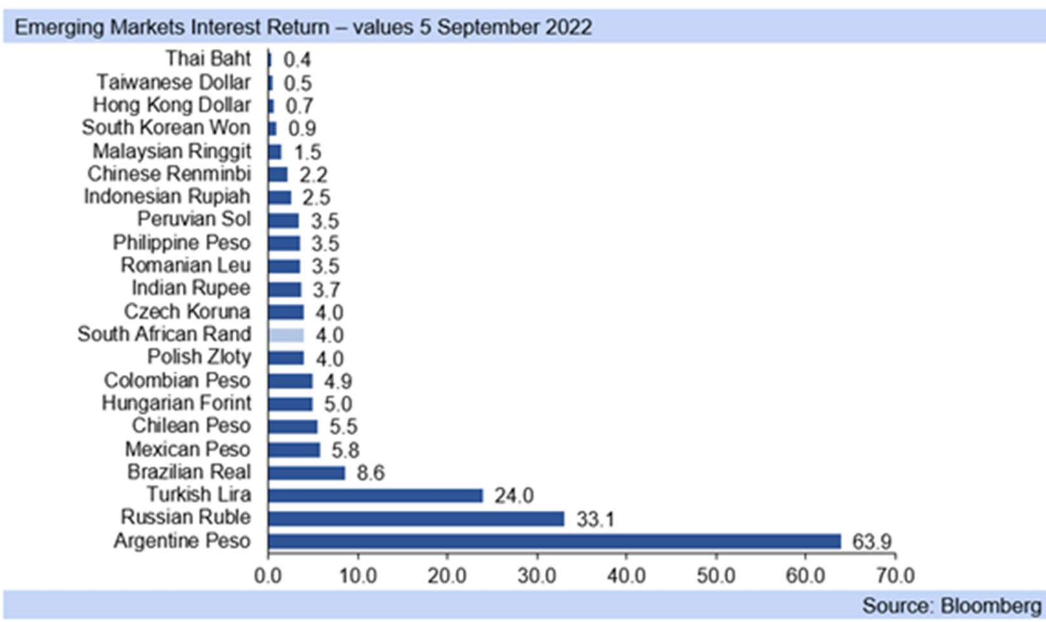
	2022				2023				2024			
	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
USD/ZAR	15.21	15.59	16.80	16.00	15.80	16.20	16.60	16.10	15.90	16.40	16.90	16.40
GBP/ZAR	20.40	19.59	20.08	19.04	18.88	19.52	20.34	20.13	20.35	21.32	22.82	22.63
EUR/ZAR	17.07	16.60	17.14	16.32	16.27	17.01	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
CHFZAR	16.47	16.15	17.37	16.65	16.60	17.18	17.59	16.96	17.47	18.02	18.57	18.02
AUDZAR	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

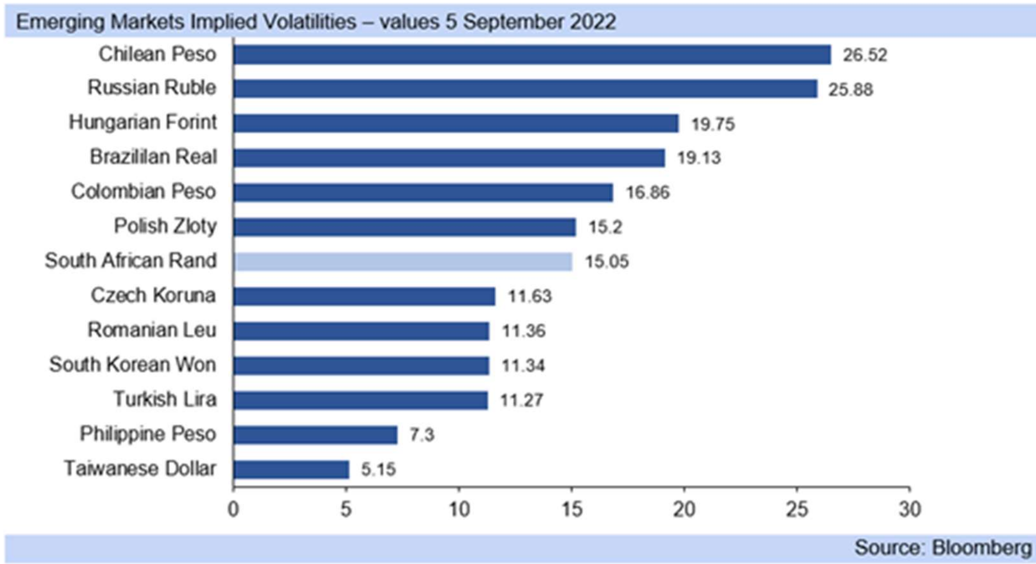
Note: averages, Source: Investec, Iress

- The US dollar continues to run close to parity against the euro, with the rand's exchange rate versus the dollar and the euro very similar. Indeed, the rand is unusually slightly stronger against the USD than EUR, on the lengthy risk-off environment in global financial markets.
- Today the domestic currency is back above R17.00 to the USD (and the EUR), reaching R17.42/USD (and R17.23/EUR) from R16.86/USD (R16.85/EUR) a week ago, with risk aversion exacerbated in global financial markets by Friday's US jobs data prints.
- Financial markets reacted negatively to the ongoing strength in US labour markets, with the addition of new workers to the payroll (non-farm) system seeing a higher than expected jump, to 308 000 in August (298 000 expected), but still very low unemployment.
- At around 3.5%, the US unemployeemt rate was at a five decade low just before the pandemic in February 2020, returning to this level in July, and only showing a modest uptick to 3.7% in the figure released for August on Friday.
- The Fed will still be concerned overall on the tightness of the US labour market, although hourly earnings subsided slightly to 0.3%, from 0.5%, while the actual pace of hiring also slowed, as non-farm payrolls rose by 528 000 in July (versus August's 315 000).

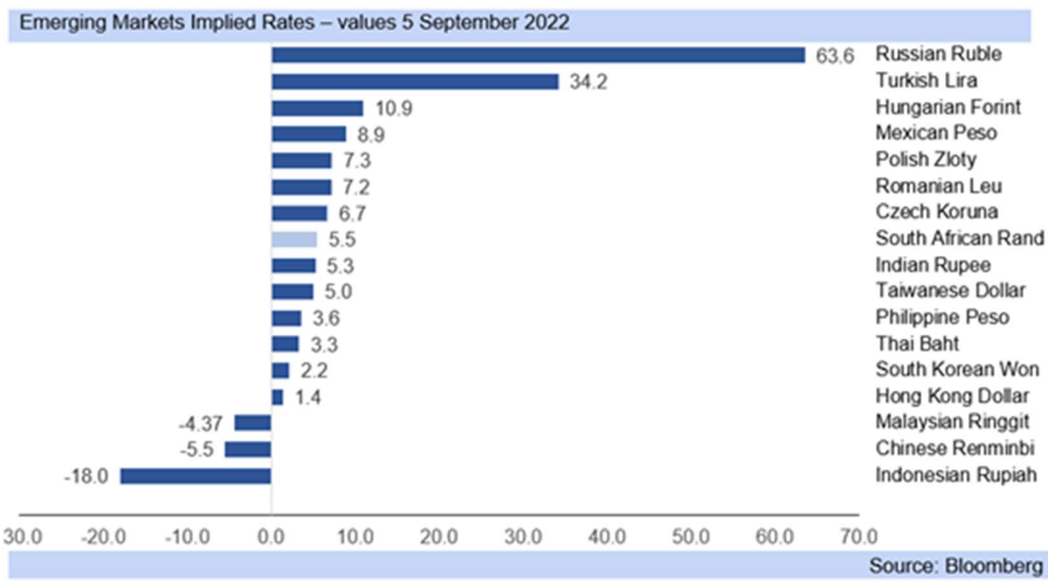
- While the jobs data was slightly mixed overall, markets have now settled lower in terms of factoring in expectations on the next hike in the US's Fed funds rate - the decision between 50bp or 75bp at the upcoming FOMC meeting this month on the 21st.
- That is, a 64bp as opposed to 67bp hike in the fed funds rate is now factored in by the implied Fed funds futures, still closer to 75bp than 50bp however, and so adding to the risk-off environment and safe haven flows.
- While the Fed has taken an optimistic tone on economic activity, and retained a hardline in communications against inflation, the markets are still worried about future economic activity, particularly a sharp slowdown in production, and so a contraction in the economy.
- The rand is likely to remain volatile and tend towards weakness in the remainder of the quarter, but markets also traditionally see greater risk taking into, and during Q4, and risk appetite could pick up somewhat towards year end if market fears prove overdone on GDP.

Please scroll down to the second section below





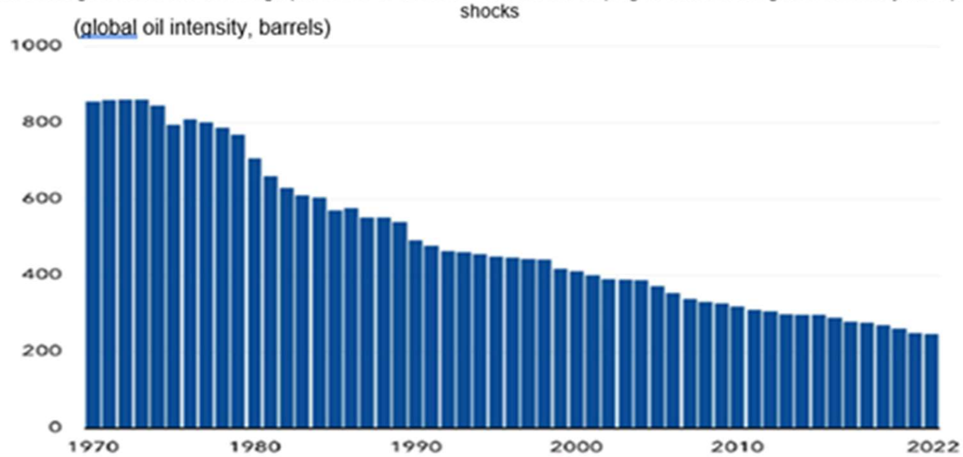
Emerging Markets Implied Volatilities – values 5 September 2022
Chilean Peso
Russian Ruble
Hungarian Forint
Brazililan Real
Colombian Peso
Polish Zloty
South African Rand
Czech Koruna
Romanian Leu
South Korean Won
Turkish Lira
Philippine Peso
Taiwanese Dollar
26.52
25.88
19.75
19.13
16.86
15.2
15.05
11.63
11.36
11.34
11.27
7.3
5.15
0
5
10
15
20
25
30
Source: Bloomberg



Emerging Markets Implied Rates – values 5 September 2022
63.6
34.2
10.9
8.9
7.3
7.2
6.7
5.5
5.3
5.0
3.6
3.3
2.2
1.4
-4.37
-5.5
-18.0
Russian Ruble
Turkish Lira
Hungarian Forint
Mexican Peso
Polish Zloty
Romanian Leu
Czech Koruna
South African Rand
Indian Rupee
Taiwanese Dollar
Philippine Peso
Thai Baht
South Korean Won
Hong Kong Dollar
Malaysian Ringgit
Chinese Renminbi
Indonesian Rupiah
30.0
-20.0
-10.0
0.0
10.0
20.0
30.0
40.0
50.0
60.0
70.0
Source: Bloomberg

More fossil-free

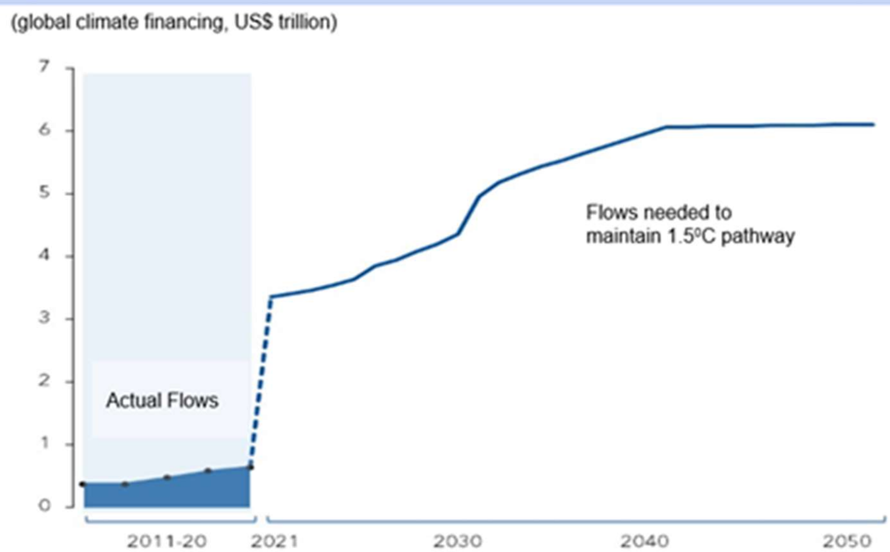
The world gets much more mileage per barrel of oil than in the 1970s, helping to insulate the global economy from price shocks



Source: IMF

Note: Oil intensity is defined as barrels of oil needed to produce $1 million in real GDP. Real DP is based on constant 2017 purchasing-power-parity international dollars

Falling short - At $630 billion a year, climate finance is a fraction of what's needed for developing countries.



Source: IMF

- The current environment is unique in recent times as it is provides forewarning of a marked global economic slowdown, to the potential point of, or actual, recession, as opposed to the pandemic and 2008/09 financial crisis, which were sudden and not possible to prepare for.
- That is, a substantial amount of risk is being factored into the rand, both from the evolving economic global data readings, which indicate a worse, not better, economic outlook, and the relentless focus on higher interest rates to combat inflation by Central Banks.
- Markets worry that the global inflation environment may get worse from this point, not better, given the persistence of the Russian/Ukraine war, retaliatory sanctions and Russia

cutting gas supplies (including Nord Stream 1 today), as the Northern Hemisphere winter draws in.

- The pressure to reduce fossil fuel usage with the implementation of higher taxes adds to inflationary concerns. If these taxes are not implemented, or other effective measures used then the hot house world of current policies/ business-as-usual will likely eventuate.
- Climate change is also having damaging effects by changing the seasons, with the World Economic Forum highlighting summers are getting longer, and so winters shorter, with 78 days of summer in 1952 versus 95 in 2011 (source IPCC's RCP 8.5 scenario).
- "(U)nder the current business-as-usual scenario from the IPCC (RCP 8.5) - which forecasts that emissions will continue to rise throughout the 21st century - summer could even last for six months (166 days) by 2100". (Statistica, Cruel Summer, Claire Jenik).
- "(A)nd while longer summers might sound pleasant …, even small seasonal shifts can throw off the … ecosystem, … negatively effecting crop production or increasing the occurrence of … diseases … the length of heat waves and wildfires and … air pollution."
- Climate change for 2050 requires action this year and in the next few years particularity, to reach zero emissions by 2050 and global warming of only 1.5°C, with only a small amount of leeway for the below 2°C scenario, both of which are currently on course to be missed.
- So far 1.2?°C of global warming has already occurred since pre-industrial times. Cutting back emissions of greenhouse gases is urgent with destructive evidence of climate change already evident. The transition will see higher inflation, but likely lower cost pressures thereafter.

Economic Scenarios: note updated forecasts, scenarios

		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
Extreme	USD/Rand (average)	15.21	15.59	15.00	14.50	14.00	13.60	13.40	13.30
Up case	Repo rate (end rate)	4.25	4.75	4.50	4.00	3.75	3.75	3.50	3.50

1% 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. Strong global growth, risk-on, commodity boom. Rapid upgrades of credit ratings. Strong transition away from fossil fuel usage, a quick transition to renewable energy.

Up case		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
1%	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. Positive outlooks on credit ratings turn into upgrades fiscal consolidation, debt projections fall substantially. Substantial transition to renewable energy away from fossil fuel usage, comprehensive measures to alleviate climate change impact on economy.

		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
Base	USD/Rand (average)	15.21	15.59	16.80	16.00	15.80	16.20	16.60	16.10
case	Repo rate (end rate)	4.25	4.75	6.00	6.50	6.50	6.50	6.50	6.50

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. South Africa in the BB credit rating category bracket as fiscal consolidation (debt to GDP stabilisation) occurs leading to some positive outlooks. 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.

		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
Lite	USD/Rand (average)	15.21	15.59	17.25	17.40	17.70	17.80	17.70	17.90
(domestic)	Repo rate (end rate)	4.25	4.75	7.00	7.00	7.25	7.75	8.25	8.50

Down case **39%** The international environment (incl. risk sentiment) is that of the base case. South Africa fails to see debt projections stabilise, falls into single B (local and foreign currency) credit ratings from all three agencies. Recession occurs. 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. Substantial fiscal consolidation ultimately occurs, preventing ratings falling into the C grades.

		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
Severe	USD/Rand (average)	15.21	15.59	17.60	18.00	18.30	18.50	18.60	19.00
down	Repo rate (end rate)	4.25	4.75	7.50	7.50	8.00	8.50	9.00	9.00

case **9%** 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. SA rated single B from all three key agencies, downgrades eventually into CCC grade, increased risk of default. 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
CHFZAR	16.47	16.15	17.83	18.11	18.60	18.88	18.75	18.85	19.89	20.00	20.00	19.78
AUDZAR	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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