

SA Economics



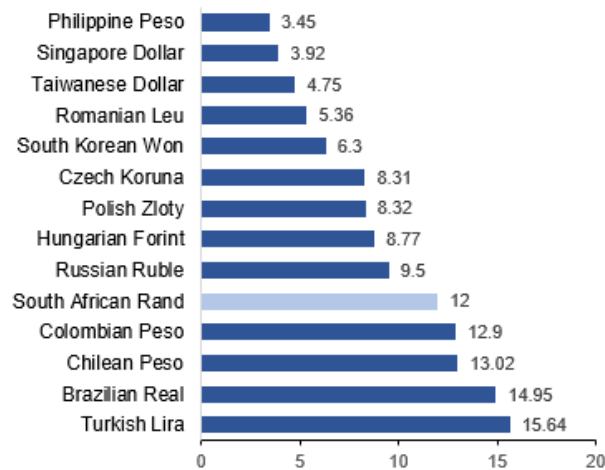
Monday 7 June 2021

Rand note: the rand has been targeting R13.40/USD, with the substantial strength driven by the combined favourable global market sentiment and SA's strong trade performance, but longer term risks persist for volatility

Expected Case: Exchange Rate forecasts												
	2021				2022				2023			
	Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
USD/ZAR	14.96	14.15	14.45	14.35	14.45	14.85	15.05	14.95	14.85	15.25	15.65	15.15
GBP/ZAR	20.64	19.38	19.80	19.95	20.52	21.24	21.82	21.38	21.09	21.50	21.91	21.21
EUR/ZAR	18.13	16.98	17.48	17.72	18.13	18.71	19.11	18.84	18.56	19.06	19.56	18.94
ZAR/JPY	7.09	7.42	7.27	7.28	7.20	7.00	6.98	7.02	7.14	6.95	6.77	7.00
CHF/ZAR	16.44	15.51	15.82	15.89	16.01	16.50	16.77	16.43	15.97	16.05	16.13	15.15
AUD/ZAR	11.53	10.90	11.20	11.19	11.42	11.73	11.74	11.36	11.14	11.44	11.74	11.36
GBP/USD	1.38	1.37	1.37	1.39	1.42	1.43	1.45	1.43	1.42	1.41	1.40	1.40
EUR/USD	1.21	1.20	1.21	1.24	1.26	1.26	1.27	1.26	1.25	1.25	1.25	1.25
USD/JPY	106	105	105	105	104	104	105	105	106	106	106	106

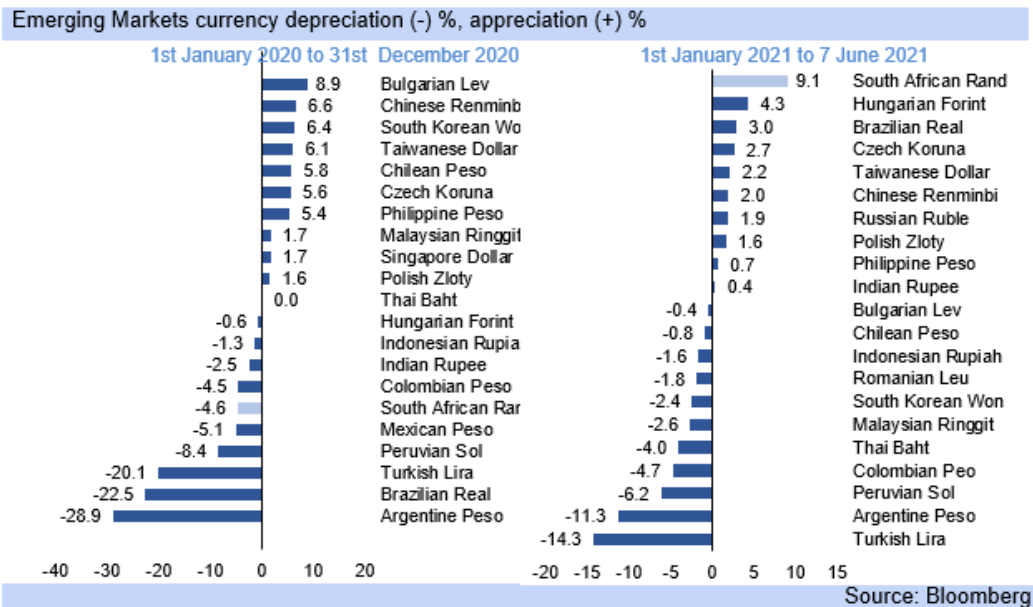
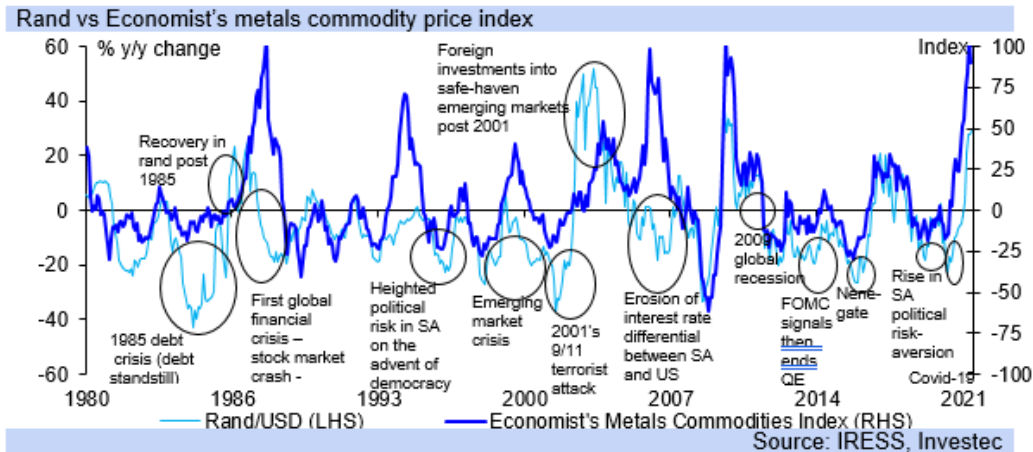
Note: averages, Source: Investec, Iress

Emerging Markets Implied Volatilities – values as at 7 June 2021

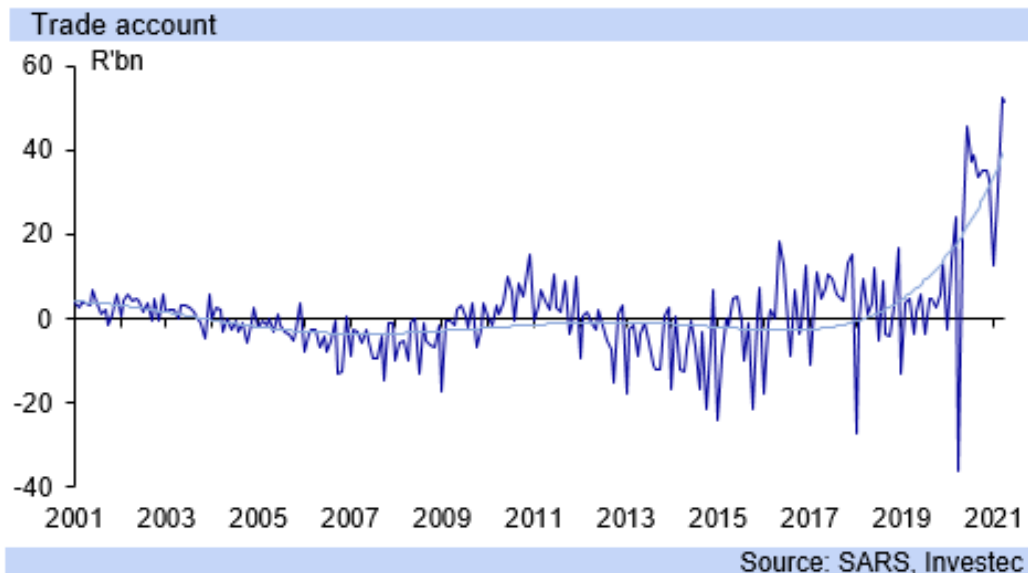


Source: Bloomberg

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- The rand has reached a low of R13.40/USD this year, last at such a level in early 2019, as the domestic currency has reversed its losses over the past two years on the strength of the trade account, as South Africa's exports continue to benefit from the commodity price boom.
- With SA unused to such strength in the domestic currency, after two decades averaging a trade deficit of close to -R0.1bn, the average trade surplus for 2020 and 2021 to date is R26.5bn, while for the first four months of 2021 on their own is R36.9bn.
- South Africa's terms of trade (or the ratio of exports to imports) is strongly positive, as exports continue to see their prices increase substantially more than imports, boosted by the strong prices for SA's commodity exports, while the rand's strength dulls oil import costs.
- The rand also continues to benefit from global growth expectations, which continue to underpin positive sentiment and the risk-on environment, as do supportive global monetary and fiscal policies. The rand continues to see a very supportive environment overall.
- However, the rand retains increased sensitivity to key US data releases, and we continue to believe that it will not be unscathed from a financial market taper tantrum. Evidence that the US is recovering strongly, particularly its labour market, will likely reduce rand strength.
- Friday's lower than expected US nonfarm payrolls figures (559 000 versus expectations of 650 000) consequently saw the rand briefly strengthen to R13.40/USD, before being rebuffed from this resistance level, but is now currently back around R13.48/USD.

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- So far, Q2.21 averages R14.18/USD, with our current forecast R14.15/USD. While the rand may prove to average closer to R14.00/USD this quarter, there remains a strong risk for marked weakness on a switch in market expectations on US QE and interest rates.
- That is, expectations that the US would reduce (taper) its bond buying programme, reducing the creation of US dollars and so this liquidity's search for high yielding investments, would reduce the attraction of the rand, which remains at risk of volatility from such a taper tantrum.
- This year continues to see a consequent differentiation in EM portfolio inflows. The Fed is likely to keep looking through higher inflation data focussing on employment instead, which could see a strong quarter end for the rand, with Q3.21 potentially more at risk of depreciation.

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Economic Scenarios: expected and up case strengthened exchange rates

		Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22
Extreme	USD/Rand (average)	14.96	13.75	13.50	13.40	13.10	12.90	12.70	12.50
	Repo rate (end rate)	3.50	3.25	3.25	3.25	3.25	3.25	3.25	3.25
Up case	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 inflows, strong fiscal consolidation (government debt falls back to low ratios of 2000s). Strong global growth, commodity boom. Stabilisation of credit ratings, then credit rating upgrades.								
Up case	USD/Rand (average)	14.96	14.00	13.80	13.70	13.60	13.50	13.70	13.60
	Repo rate (end rate)	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50
2%	Quick rebound from Covid-19 pandemic, rising confidence and investment levels - structural problems worked down. No further credit rating downgrades, rating outlooks move to stable and eventually positive, strong fiscal consolidation (government debt projections fall substantially). Global risk-on, global demand quickly returns to trend growth. Limited impact of expropriation without compensation) to abandoned, unused, labour tenants' and government land (individuals are new owners and receive title deeds) does not have a negative effect on economy - no nationalisation.								
Base case	USD/Rand (average)	14.96	14.15	14.45	14.35	14.45	14.85	15.05	14.95
	Repo rate (end rate)	3.50	3.50	3.50	3.75	3.75	3.75	4.00	4.00
50%	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 stabilises then improves. 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.								
Lite	USD/Rand (average)	14.96	15.00	15.75	16.50	16.70	17.00	17.50	17.00
	Repo rate (end rate)	3.50	3.75	3.75	4.00	4.00	4.25	4.25	4.50
(domestic)	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, rand weakness, significant load shedding and weak investment growth. Substantial fiscal consolidation ultimately occurs, preventing ratings falling into the C grades.								
Down case	USD/Rand (average)	14.96	15.50	17.00	17.50	18.00	18.50	19.00	19.50
	Repo rate (end rate)	3.50	4.00	4.00	4.25	4.50	4.50	4.75	5.00
42%	Lengthy global recession, global financial crisis – insufficient monetary and other policy supports to growth domestically and internationally. Depression in SA, unprecedented rand weakness. Nationalisation of private sector property (title deeds not transferred to individuals). 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 services load shedding, strike action and civil unrest.								
Severe down case									
5%									

Note: Event risk begins Q2.21. Source: Investec

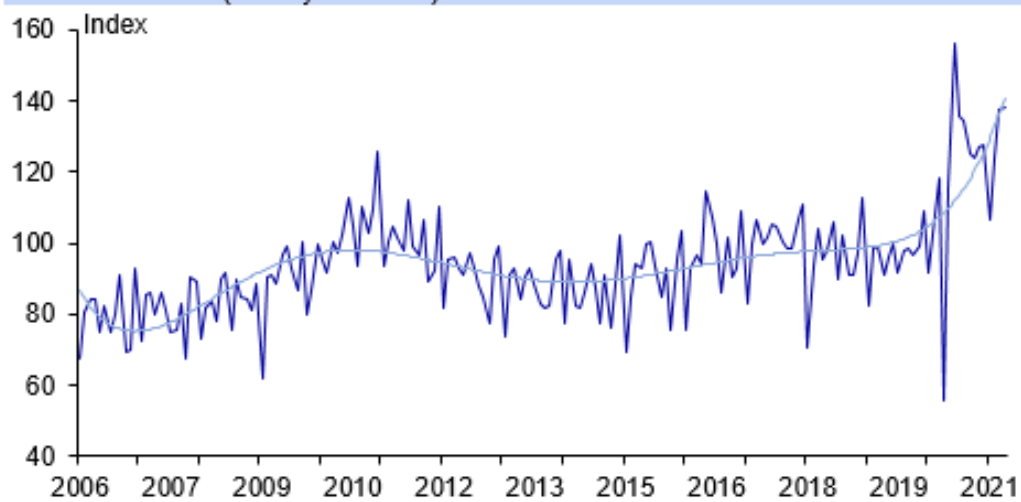
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Up Case: Exchange Rate forecasts												
	2021				2022				2023			
	Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
USD/ZAR	14.96	14.00	13.80	13.70	13.60	13.50	13.70	13.60	13.50	13.90	14.30	13.80
GBP/ZAR	20.64	19.18	18.91	19.04	19.31	19.31	19.87	19.45	19.17	19.60	20.02	19.32
EUR/ZAR	18.13	16.80	16.70	16.92	17.07	17.01	17.40	17.14	16.88	17.38	17.88	17.25
ZAR/JPY	7.09	7.50	7.61	7.63	7.65	7.70	7.66	7.72	7.85	7.63	7.41	7.68
CHF/ZAR	16.44	15.34	15.11	15.17	15.06	15.00	15.26	14.95	14.52	14.63	14.74	13.80
AUD/ZAR	11.53	10.78	10.70	10.69	10.74	10.67	10.69	10.34	10.13	10.43	10.73	10.35
GBP/USD	1.38	1.37	1.37	1.39	1.42	1.43	1.45	1.43	1.42	1.41	1.40	1.40
EUR/USD	1.21	1.20	1.21	1.24	1.26	1.26	1.27	1.26	1.25	1.25	1.25	1.25
USD/JPY	106	105	105	105	104	104	105	105	106	106	106	106

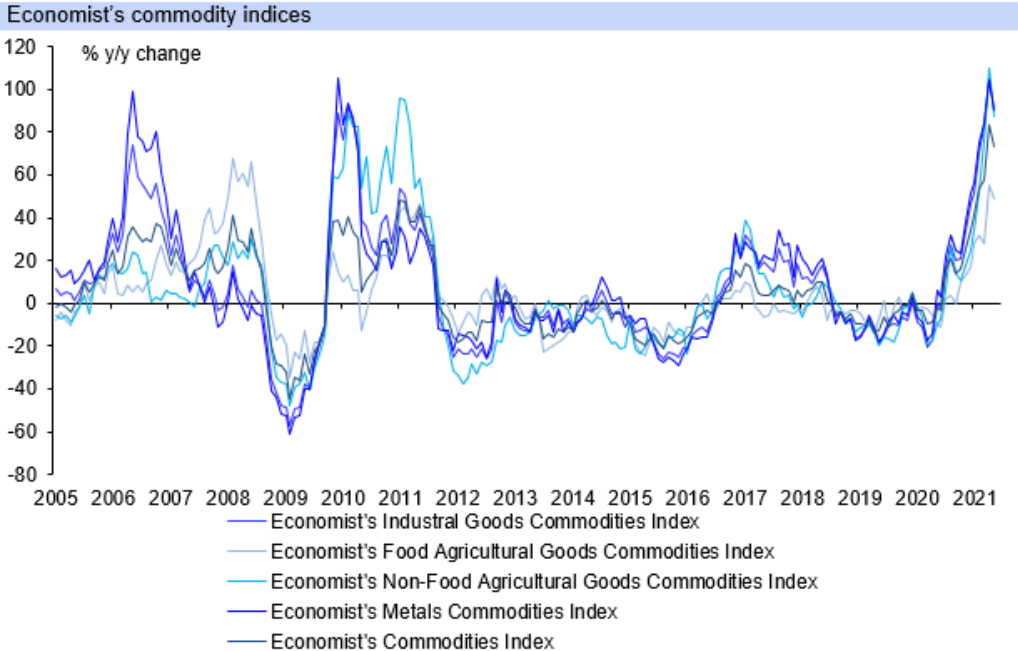
Note averages, Source: Investec, Iress

Terms of trade (base year 2011)

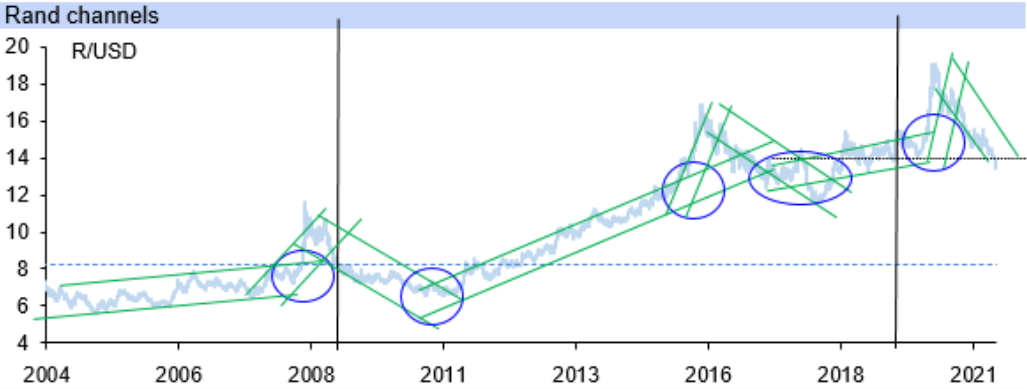


Source: SARS, Investec

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Source: IRESS, Economist



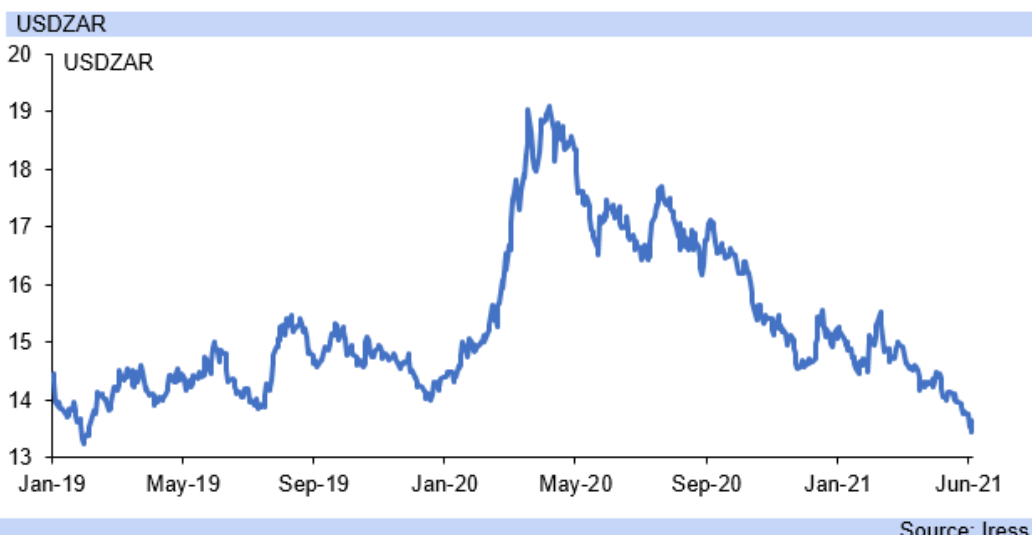
Source: Iress

- As part of the ongoing global effort to clamp down on profit shifting and base erosion, the G7 recently agreed a global minimum flat 15% corporate tax rate, with the majority of G20 countries likely to comply and with multinational companies in particular focus.
- Imposition of the flat global corporate tax would remove the competitive edges a number of countries have sought to obtain, like Ireland, in offering low corporate taxes as incentives to attract foreign investment and so spur economic growth.

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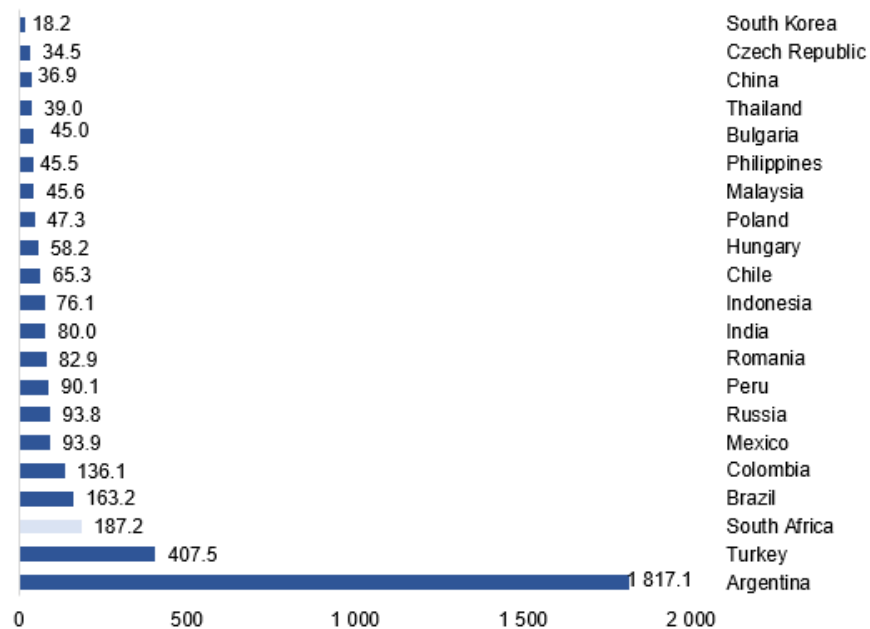
- Countries not complying may risk backlisting, including sanctions and reputational damage, as well as heightened reporting. Multinationals tend to operate in G7 countries and so noncompliance could even see punitive measures on their operations in G7s.
- Government finances have been hurt by COVID-19 and countries are looking to boost their fiscal revenues. However, South Africa's corporate tax rates are already relatively high and so relatively uncompetitive, while SA is a very small market.
- The weak fundamentals of the SA economy include deteriorated fiscal health, credit rating downgrade risks, low economic growth, restrictive regulations and onerous red tape, increased threats to property rights, populist and increasingly protectionist policies.
- The ramp up in protectionist policies threatens higher inflation from the supply side, with the vast majority of SA's inflationary pressures already coming from these supply side pressures (mainly state administered costs), quelling consumer demand for goods and services.
- The rand's strong run since R19.35/USD essentially a year ago, to R13.41/USD this month is not expected to be replicated, and so breach R10.00/USD, or even R11.00/USD, as the domestic currency is at strong risk of weakness as the US tapers QE.
- While commodity prices, priced against the US dollar, have seen more strength than the rand against the US dollar this year (both aided by US dollar weakness), this has caused a double whammy appreciation effect on the rand which is also benefiting from large trade surpluses.
- The US dollar is likely to see some strength from current levels as the Fed eventually announces QE tapering, and this will weaken the rand against this cross. The Fed cannot be expected to extend QE endlessly, and so the rand's potential for ongoing strength is limited.



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Emerging Markets CDS Spreads – values as at 7 June 2021



Source: Bloomberg

Extreme Up Case: Exchange Rate forecasts

	2021				2022				2023			
	Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
USD/ZAR	14.96	14.10	13.50	13.40	13.10	12.90	12.70	12.50	12.30	12.70	13.10	12.60
GBP/ZAR	20.50	19.32	18.50	18.63	18.60	18.45	18.42	17.88	17.47	17.91	18.34	17.64
EUR/ZAR	18.13	16.92	16.34	16.55	16.44	16.25	16.13	15.75	15.38	15.88	16.38	15.75
ZAR/JPY	6.96	7.45	7.78	7.80	7.94	8.06	8.27	8.40	8.62	8.35	8.09	8.41
CHF/ZAR	16.71	15.45	14.78	14.84	14.51	14.33	14.15	13.74	13.23	13.37	13.51	12.60
AUD/ZAR	11.53	10.86	10.46	10.45	10.35	10.19	9.91	9.50	9.23	9.53	9.83	9.45
GBP/USD	1.38	1.37	1.37	1.39	1.42	1.43	1.45	1.43	1.42	1.41	1.40	1.40
EUR/USD	1.21	1.20	1.21	1.24	1.26	1.26	1.27	1.26	1.25	1.25	1.25	1.25
USD/JPY	106	105	105	105	104	104	105	105	106	106	106	106

Note: averages, Source: Investec, Iress

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Lite Down Case: Exchange Rate forecasts												
	2021				2022				2023			
	Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
USD/ZAR	14.96	15.00	15.75	16.50	16.70	7.00	17.50	17.00	16.80	17.00	17.10	16.70
GBP/ZAR	20.64	20.55	21.58	22.94	23.71	10.01	25.38	24.31	23.86	23.97	23.94	23.38
EUR/ZAR	18.13	18.00	19.06	20.38	20.96	8.82	22.23	21.42	21.00	21.25	21.38	20.88
ZAR/JPY	7.09	7.00	6.67	6.33	6.23	14.86	6.00	6.18	6.31	6.24	6.20	6.35
CHFZAR	16.44	16.44	17.25	18.28	18.50	7.78	19.50	18.68	18.06	17.89	17.63	16.70
AUDZAR	11.53	11.55	12.21	12.87	13.19	5.53	13.65	12.92	12.60	12.75	12.83	12.53
GBP/USD	1.38	1.37	1.37	1.39	1.42	1.43	1.45	1.43	1.42	1.41	1.40	1.40
EUR/USD	1.21	1.20	1.21	1.24	1.26	1.26	1.27	1.26	1.25	1.25	1.25	1.25
USD/JPY	106	105	105	105	104	104	105	105	106	106	106	106

Note: averages, Source: Investec, Iress

Severe Down Case: Exchange Rate forecasts												
	2021				2022				2023			
	Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
USD/ZAR	14.96	15.50	17.00	17.50	18.00	18.50	19.00	19.50	19.40	19.90	20.00	19.80
GBP/ZAR	20.64	21.23	23.29	24.33	25.56	26.46	27.55	27.89	27.55	28.06	28.00	27.72
EUR/ZAR	18.13	18.60	20.57	21.61	22.59	23.31	24.13	24.57	24.25	24.88	25.00	24.75
ZAR/JPY	7.09	6.77	6.18	5.97	5.78	5.62	5.53	5.38	5.46	5.33	5.30	5.35
CHFZAR	16.44	16.99	18.62	19.38	19.94	20.56	21.17	21.43	20.86	20.95	20.62	19.80
AUDZAR	11.53	11.94	13.18	13.65	14.22	14.62	14.82	14.82	14.55	14.93	15.00	14.85
GBP/USD	1.38	1.37	1.37	1.39	1.42	1.43	1.45	1.43	1.42	1.41	1.40	1.40
EUR/USD	1.21	1.20	1.21	1.24	1.26	1.26	1.27	1.26	1.25	1.25	1.25	1.25
USD/JPY	106	105	105	105	104	104	105	105	106	106	106	106

Note: averages, Source: Investec, Iress