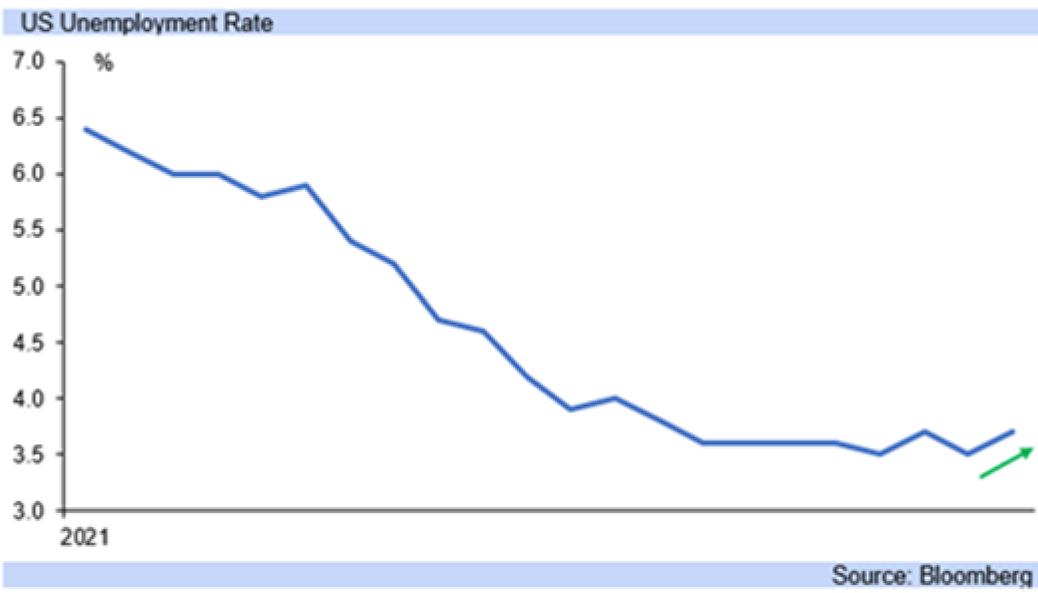
Investec | Out of the Ordinary

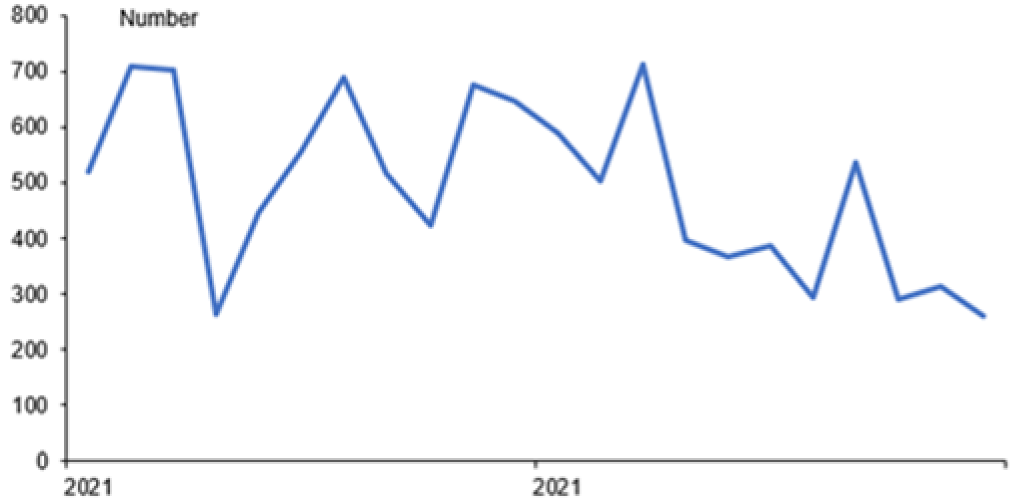
SA Economics

Monday 7 November 2022

Rand note: the rand has seen some modest strength as markets digest last week's FOMC, US jobs data

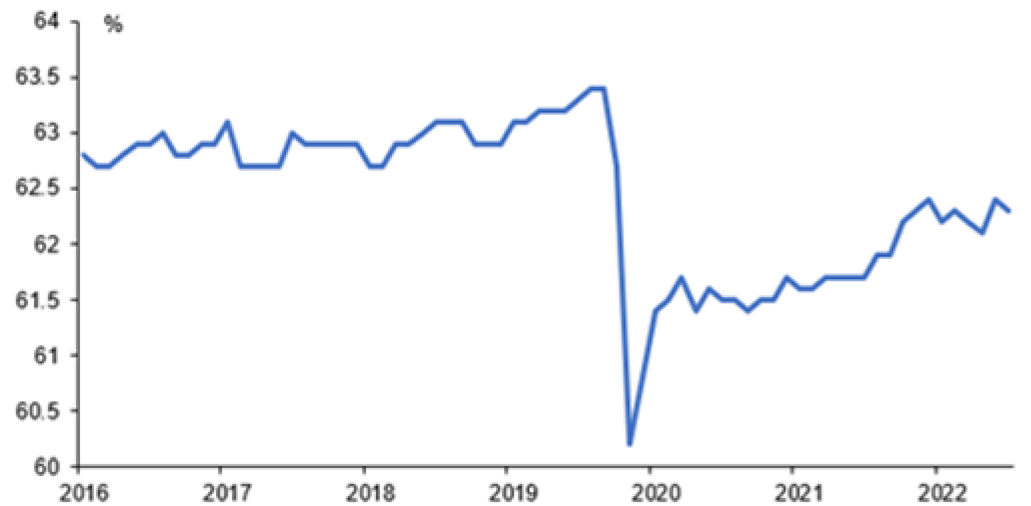


US Non-Farm Payrolls



Source: Bloomberg

US Labour Force Participation Rate



Source: Bloomberg

- The rand closed at R17.90/USD on Friday, and today reached its strongest point at R17.75/USD, after initially weakening on the September FOMC meeting to R18.53/USD as members signalled they raised expectations of the ultimate level of interest rates.
- Attention is turning to SA's own monetary policy meeting this month (24^{th}), with the MPC increasingly expected to deliver a 100bp hike, which would bring the cumulative size of SA and the US interest rate hikes in line in the current cycle.
- That is, the US so far has hiked by 3.75% in the current cycle, while SA has only hiked by 2.75%, which has narrowed the interest rate differential between the two countries, and supported rand weakness, with a 100bp hike temporarily restoring the balance.
- Markets have interpreted the FOMC statement as implying that a 50bp hike will occur in December and another in February 2023, slowing the pace of rate hikes in the US, which has seen 75bp lifts at the last four meetings, allowing for some US dollar weakness since.
- SA in contrast has only hiked by 75bp twice this year, and over the current interest rate cycle, causing the compression in the interest rate differential, and adding to rand weakness, with the FOMC meeting every six weeks, and SA two months, adding to the discrepancy.

- The rand strength has been limited, but likely still encapsulates the good news from the mini-Budget last month, which shows more planned fiscal consolidation than anticipated via projected reductions in borrowings, although there is some skepticism this will be achieved.
- We have raised the up case probability by 3% and the lite down case probability drops by a corresponding 3%, but left the probabilities of the other three scenarios unchanged, as the mini-Budget's plans are in favour of credit ratings, but only, if delivered.
- The rating agencies are likely to adopt a wait and see approach, and potentially not deliver credit rating upgrades this year. S&P's positive outlook may be mirrored by Fitch, but the credit rating agencies will likely wait for the outcome of the ANC elective conference.
- International events remain key drivers for the rand, which did not improve much on the mini-Budget, but gained against the USD on Friday's lift in US unemployment to 3.7% y/y. The rand should strengthen further on rising expectations of the US slowing rate hikes.

Please scroll down to the second section below

Economic Scenarios: note updated probabilities

		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
Extreme Up case 1%	USD/Rand (average)	15.21	15.59	17.05	16.40	15.50	14.50	14.00	13.60
	Repo rate (end rate)	4.25	4.75	6.25	5.25	4.25	3.75	3.75	3.50

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. No grey listing. Quick transition to renewable energy from fossil fuels.

		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
Up case 4%	USD/Rand (average)	15.21	15.59	17.05	17.00	16.40	15.50	15.00	14.70
	Repo rate (end rate)	4.25	4.75	6.25	5.50	4.75	4.25	4.25	4.25

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. No grey listing.

		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
Base case 48%	USD/Rand (average)	15.21	15.59	17.05	17.50	16.80	16.35	16.10	16.30
	Repo rate (end rate)	4.25	4.75	6.25	7.25	7.25	7.25	6.50	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.

		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
Lite (domestic) Down case 36%	USD/Rand (average)	15.21	15.59	17.05	18.30	18.50	18.00	18.20	17.90
	Repo rate (end rate)	4.25	4.75	6.25	7.50	8.00	8.50	9.00	9.00

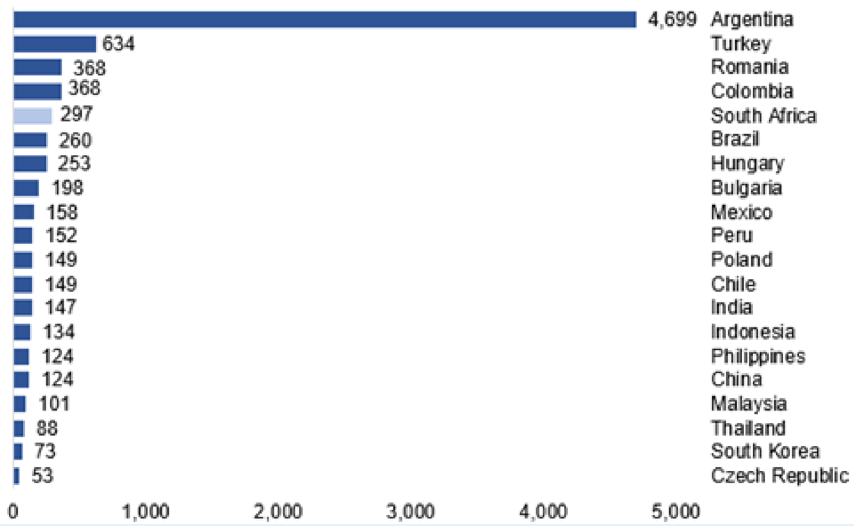
Weak GDP growth (0.9% average over 5-years), swing toward left leaning policies. Business confidence depressed, substantial electricity and water shedding, very weak rail capacity, civil and political unrest, very little investment growth, recession. Increased state borrowings, risk of credit rating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

		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
Severe down case 11%	USD/Rand (average)	15.21	15.59	17.05	18.70	19.30	19.50	19.70	19.90
	Repo rate (end rate)	4.25	4.75	6.25	8.00	9.00	10.00	10.50	10.50

Lengthy global recession, global financial crisis – insufficient monetary and other support domestically and internationally. ANC coalition with the extreme left 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, then 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. Very high inflation on very adverse weather conditions, severe rand weakness. Expropriation of private property without compensation with a marked negative economic impact. Grey listed

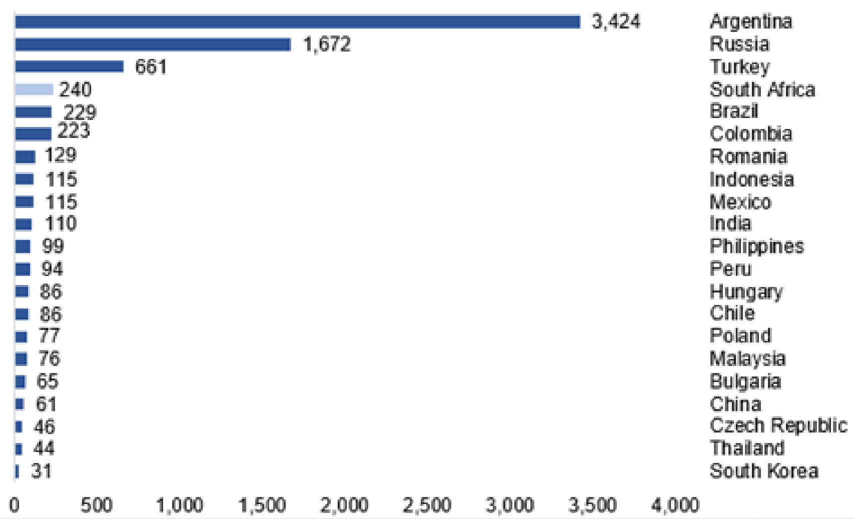
Note: Event risk begins Q4.22. Source: Investec

Emerging Markets CDS (risk) Spreads – values 7 November 2022



Source: Bloomberg

Emerging Markets CDS Spreads – values 7 March 2022



Source: Bloomberg

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

Source: Bloomberg

USDZAR

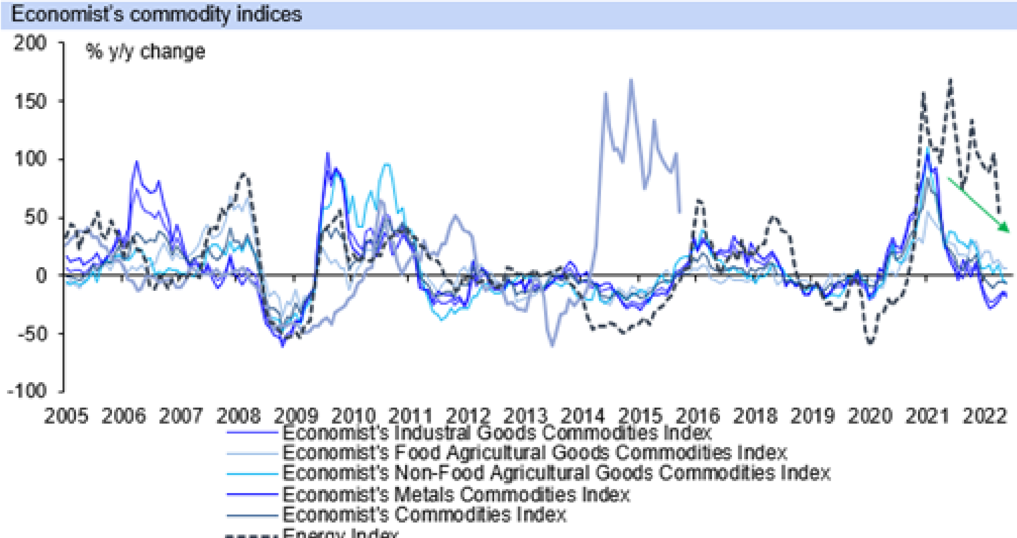
Source: Iress

- The lite down case may appear to need a lower weighting as National Treasury accelerated its planned fiscal consolidation, but it has not been achieved, while the risks to economic growth remain high from Eskom, Transnet and other SOEs providing insufficient services.
- Additionally, influential international commentors (including the IMF and Moody's) show significant skepticism on the achievement of the fiscal plans laid out, with valid concerns over the tendency of the civil service wage bill to come out above budget each year.
- This reduces the opportunity for fiscal consolidation, while concerns also centre on the SOEs needs for financial bailouts, another large expenditure item with insufficient electricity production also a worry as it limits economic growth and so fiscal revenue generation.
- These factors are not expected to improve over the short-term, while Transnet's diminishing capacity on its rail and ports has limiting factors for economic growth and so

revenue collection, in turn damaging for public finances, and so limiting credit rating uplift potential.

- For the lite down case, the deterioration of economic activity on the back of worsening fundamentals for economic growth, particularly Transnet and Eskom's capacity to meet the needs of a growing economy, remains a pertinent risk for South Africa.
- The lite down case is characterised by weak GDP growth of a 0.9% average over 5-years on a swing toward left leaning policies, depressed business confidence, very little investment growth and a short recession. SA is grey listed for an indefinite period.
- Increased state borrowings sees the risk of credit rating downgrades rise, then with rating downgrades later in the period for the lite down case. Some expropriation of private sector property without compensation with a negative impact on the economy.
- Rand weakens is also a feature of the lite down case, contributing to higher inflation, with little transition to renewable energy or measures to alleviate climate change, with increasingly unfavorable weather conditions further out in the period.
- The ANC elective conference in the second half of December (15th to 20th), February's Budget in 2023 and a quickening in the electricity build in SA and private sector provision coming onto the grid, are key domestic markers for our rand view and the scenarios (global above).

Economist's commodity indices



Source: IRESS, Economist, IMF

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	17.05	18.30	18.50	18.00	18.20	17.90	18.10	18.20	18.20	18.00
GBP/ZAR	20.40	19.59	20.06	20.79	21.46	21.42	22.11	21.84	22.44	22.75	24.02	24.84
EUR/ZAR	17.07	16.60	17.16	18.06	18.41	18.18	18.75	18.71	19.55	20.93	21.48	22.14
ZAR/JPY	7.65	8.33	8.12	8.13	8.05	8.08	7.75	7.65	7.18	6.59	6.32	6.11
CHFZAR	16.47	16.16	17.64	18.39	18.69	18.27	18.56	18.07	19.05	19.57	20.00	19.78
AUDZAR	11.02	11.14	11.65	11.62	12.03	12.06	12.56	12.71	13.58	14.20	14.20	14.04
GBP/USD	1.34	1.26	1.18	1.14	1.16	1.19	1.22	1.22	1.24	1.25	1.32	1.38
EUR/USD	1.12	1.06	1.01	0.99	1.00	1.01	1.03	1.05	1.08	1.15	1.18	1.23
USD/JPY	116	130	138	149	149	146	141	137	130	120	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	17.05	18.70	19.30	19.50	19.70	19.90	20.10	20.00	19.80	19.60
GBP/ZAR	20.40	19.59	20.06	21.25	22.39	23.21	23.94	24.28	24.92	25.00	26.14	27.05
EUR/ZAR	17.07	16.60	17.16	18.46	19.20	19.70	20.29	20.80	21.71	23.00	23.36	24.11
ZAR/JPY	7.65	8.33	8.12	7.96	7.72	7.46	7.16	6.88	6.47	6.00	5.81	5.61
CHFZAR	16.47	16.16	17.64	18.79	19.50	19.79	20.09	20.09	21.16	21.51	21.76	21.54
AUDZAR	11.02	11.14	11.65	11.87	12.55	13.07	13.59	14.13	15.08	15.60	15.44	15.29
GBP/USD	1.34	1.26	1.18	1.14	1.16	1.19	1.22	1.22	1.24	1.25	1.32	1.38
EUR/USD	1.12	1.06	1.01	0.99	1.00	1.01	1.03	1.05	1.08	1.15	1.18	1.23
USD/JPY	116	130	138	149	149	146	141	137	130	120	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	17.05	17.00	16.40	15.50	15.00	14.70	14.50	14.90	15.00	14.50
GBP/ZAR	20.40	19.59	20.06	19.32	19.02	18.45	18.23	17.93	17.98	18.63	19.80	20.01
EUR/ZAR	17.07	16.60	17.16	16.78	16.32	15.66	15.45	15.36	15.66	17.14	17.70	17.84
ZAR/JPY	7.65	8.33	8.12	8.75	9.09	9.39	9.40	9.32	8.97	8.05	7.67	7.59
CHFZAR	16.47	16.16	17.64	17.08	16.57	15.73	15.30	14.84	15.26	16.02	16.48	15.93
AUDZAR	11.02	11.14	11.65	10.79	10.66	10.39	10.35	10.44	10.88	11.62	11.70	11.31
GBP/USD	1.34	1.26	1.18	1.14	1.16	1.19	1.22	1.22	1.24	1.25	1.32	1.38
EUR/USD	1.12	1.06	1.01	0.99	1.00	1.01	1.03	1.05	1.08	1.15	1.18	1.23
USD/JPY	116	130	138	149	149	146	141	137	130	120	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	17.05	16.40	15.50	14.50	14.00	13.60	13.30	13.10	13.10	12.90
GBP/ZAR	20.40	19.59	20.06	18.63	17.98	17.26	17.01	16.59	16.49	16.38	17.29	17.80
EUR/ZAR	17.07	16.60	17.16	16.19	15.42	14.65	14.42	14.21	14.36	15.07	15.46	15.87
ZAR/JPY	7.65	8.33	8.12	9.07	9.61	10.03	10.07	10.07	9.77	9.16	8.78	8.53
CHFZAR	16.47	16.16	17.64	16.48	15.66	14.72	14.28	13.73	14.00	14.09	14.40	14.18
AUDZAR	11.02	11.14	11.65	10.41	10.08	9.72	9.66	9.66	9.98	10.22	10.22	10.06
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