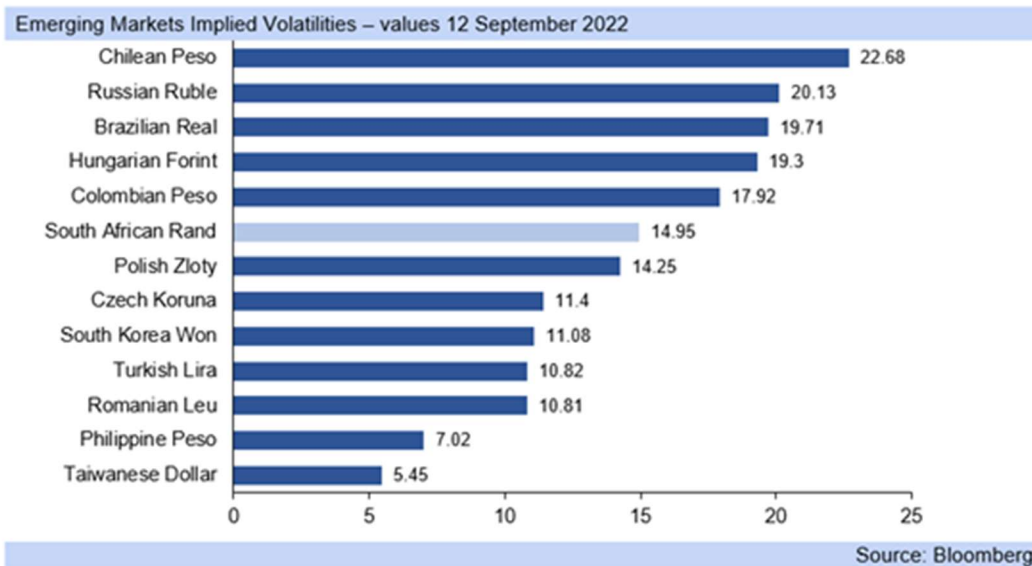




SA Economics

Monday 12 September 2022

Rand note: the volatile rand pulls stronger as risk sentiment in financial markets fluctuates

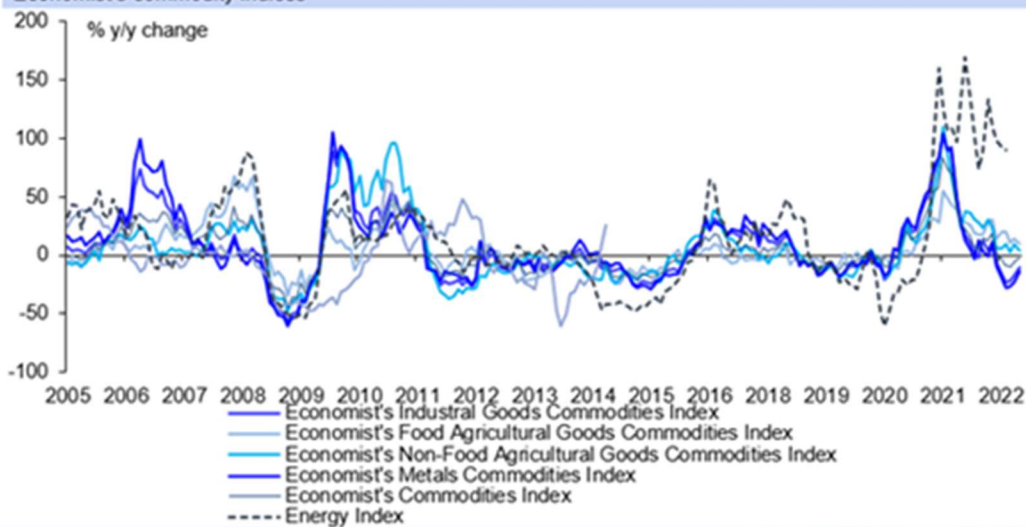


Emerging Markets currency depreciation (-) %, appreciation (+) %

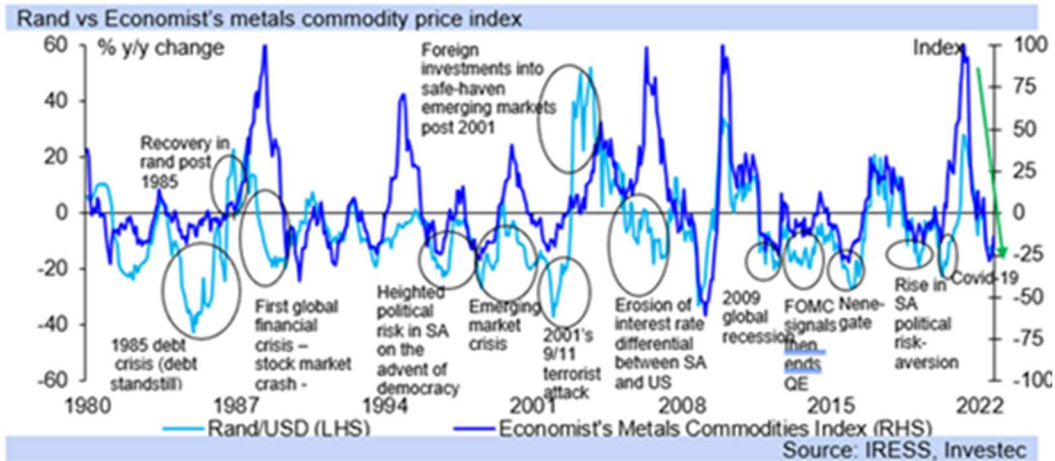


Source: Bloomberg

Economist's commodity indices



Source: IRESS, Economist, IMF



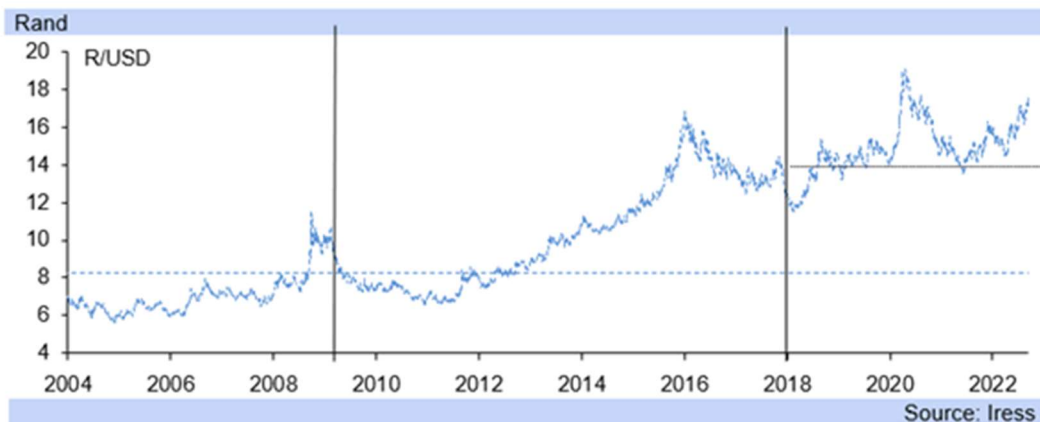
Expected Case: Exchange Rate forecasts												
	2022				2023				2024			
	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
USD/ZAR	15.21	15.59	16.80	16.00	15.80	16.20	16.60	16.10	15.90	16.40	16.90	16.40
GBP/ZAR	20.40	19.59	20.08	19.04	18.88	19.52	20.34	20.13	20.35	21.32	22.82	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

- US CPI inflation is due for release, with markets' expecting a second month of disinflation (falling inflation) in the print, driving some risk taking sentiment recently as the rand closed at R17.28/USD on Friday, and reached R17.07/USD today.
- The US dollar is weakening in anticipation of the US headline (CPI) inflation print dropping to 8.0% y/y for August, down from 8.5% y/y, and a -0.1% m/m move in CPI, although excluding food and energy, the reading is likely to rise to 6.1% y/y in August, from 5.9% y/y in July.
- While markets are taking a positive view of this week's headline US inflation release, the Fed will, in particular, look for broadening base effects, which the CPI excluding food and energy is likely to show, and so the recent dollar weakness/ rand strength risks being temporary.
- With the US CPI figures released tomorrow afternoon there could be space for the rand to strengthen in the interim. However, overall the rand is still very weak, well removed from fair value and still reflective of an elevated risk aversion environment, despite some volatility.
- The rand is likely to fluctuate, weaker and stronger, for the remainder of this month and into Q4.22, retaining high sensitivity to any and all US inflation figures, but key for the Fed remains the core PCE deflator. Q4.22 may bring increased possibility of rand strength however.

- This week, markets will react directly to the US CPI figures, influencing the US dollar and so the rand. Currently the Fed funds futures rate shows a 73bp hike is factored in by markets at the FOMC meeting this month (on 21st September), essentially factoring in a 75bp move.
- Market expectations for September's US interest rate move have been fluctuating, closer to between 50bp and 75 earlier in the month, and a lower than expected CPI print tomorrow could see the market move its rate hike view back closer to 50bp if this occurs.
- The rand could see further strength against the greenback on such an eventuality as the US dollar weakens a bit further, but this short-term volatility risks being overrode by the PPI print coming out higher than expected later in the week, or any following inflation indicator.
- Volatility is likely to persist for the rand against the US dollar, while it has experienced greater stability against the GBP and EUR. However, over Q4.22 it may well see some more fundamental strengthening, drawing towards R16.00/USD instead of R17.00/USD.

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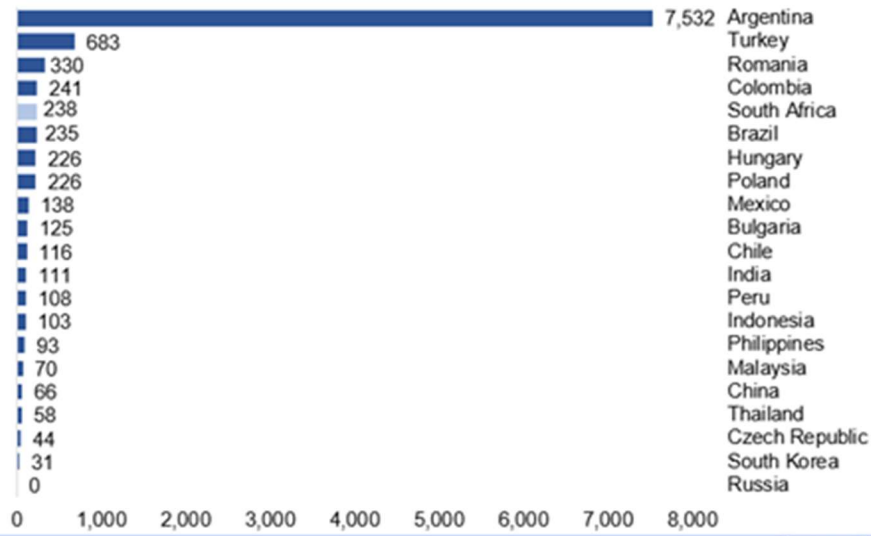


Economic Scenarios: note updated forecasts, scenarios

		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.								
Base case		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
50%	USD/Rand (average)	15.21	15.59	16.80	16.00	15.80	16.20	16.60	16.10
	Repo rate (end rate)	4.25	4.75	6.00	6.50	6.50	6.50	6.50	6.50
	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.								
Lite		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
(domestic)	USD/Rand (average)	15.21	15.59	17.25	17.40	17.70	17.80	17.70	17.90
Down case	Repo rate (end rate)	4.25	4.75	7.00	7.00	7.25	7.75	8.25	8.50
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.								
Severe down case		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
9%	USD/Rand (average)	15.21	15.59	17.60	18.00	18.30	18.50	18.60	19.00
	Repo rate (end rate)	4.25	4.75	7.50	7.50	8.00	8.50	9.00	9.00
	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.								

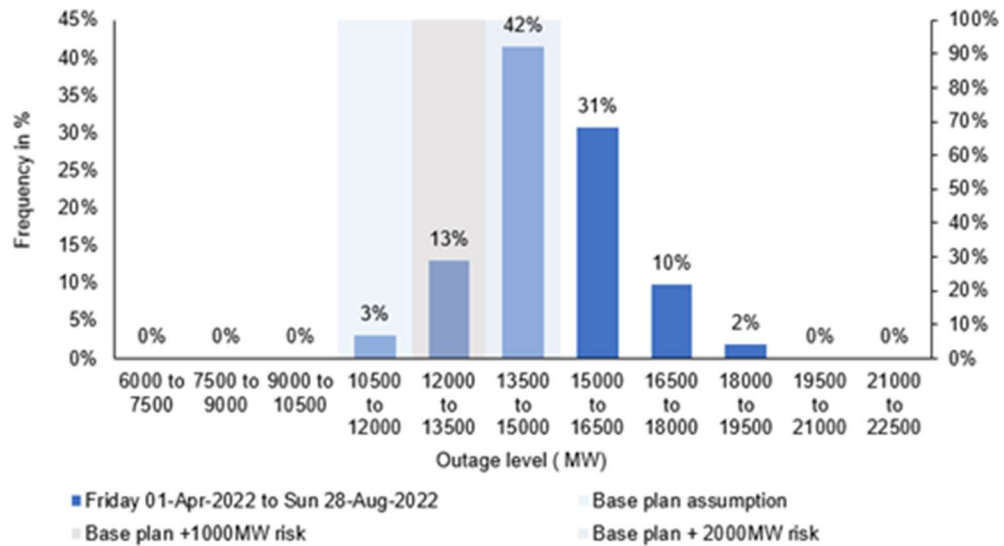
Note: Event risk begins Q3.22. Source: Investec

Emerging Markets CDS (risk) Spreads – values 12 September 2022

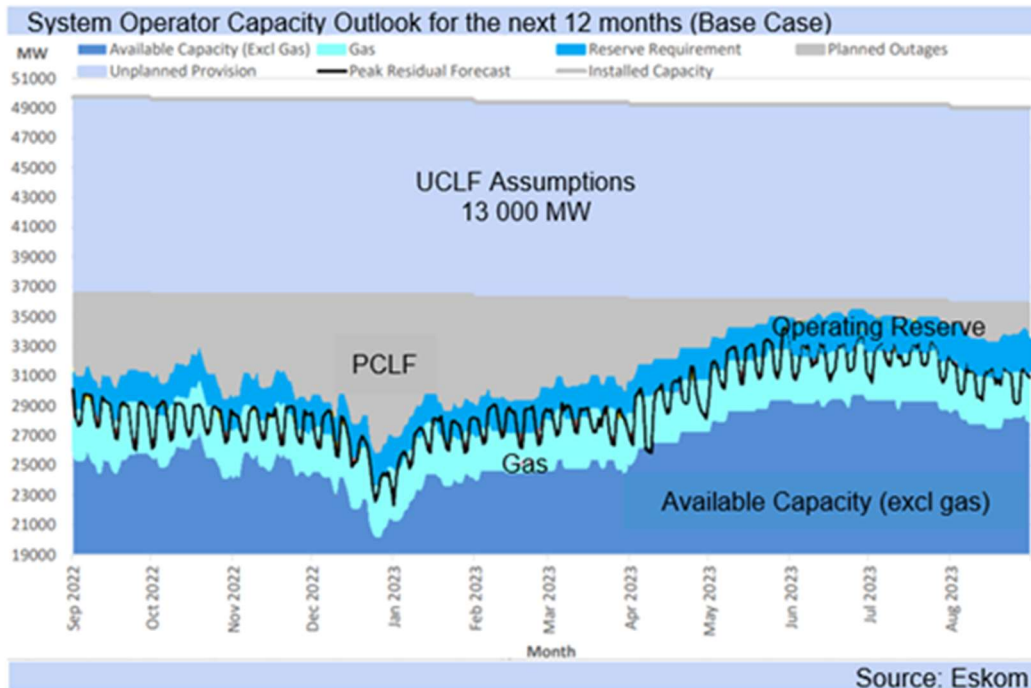


Source: Bloomberg

Unplanned outage performance: Winter 2022



Source: Eskom

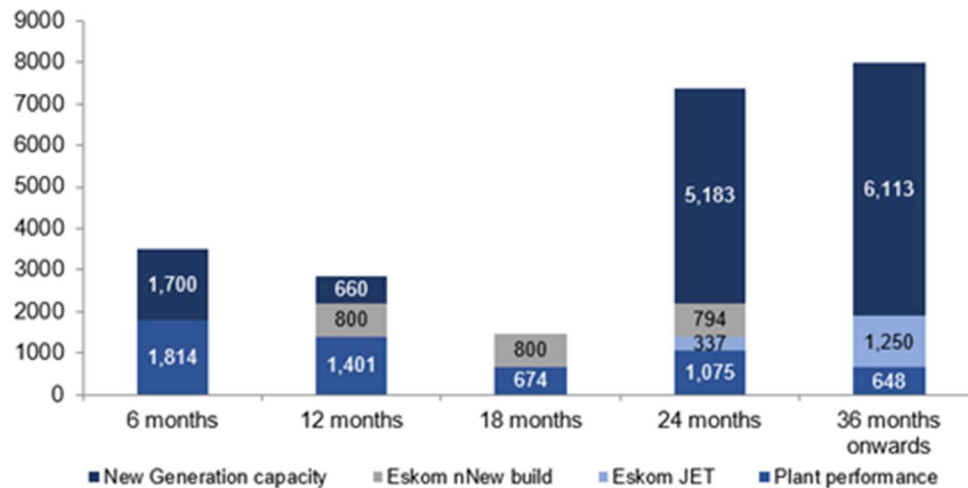


- That is, marked evidence US inflation is on a definite downwards trend would relieve a lot of the fundamental risk aversion that is in financial markets (versus the short-term volatility in reaction to key economic data readings which causes some currency swings).
- Indeed, the rand would likely strengthen quite quickly as the US dollar retreats, with the US Fed reducing the size of its rate hikes on a falling US inflation trend. Market expectations tend to run ahead of events, which could see a sudden rand acceleration in strength.
- Our forecast for Q4.22 may prove too strong, and the Q3.22 forecast average more in line with Q3.22's outcome. However, high volatility is likely too, with the potential for marked rand strength over the remainder of this month and Q4.22 seasonally as well.
- The last time the rand was below R17.00/USD was at the end of August, but September is often a month of churn where Northern Hemisphere market players take on more investment risk, having returned from summer vacations, and are back in the markets.
- The highly volatile rand could very easily track back towards R16.60/USD by the end of this month, but to move to R16.00/USD over Q4.22 will however require much more momentum, and a shift in global financial market sentiment to risk-on.
- While this is possible, and the rand has moved very substantially before, it will require more market certainty on the direction of US inflation and interest rates than currently, as well as a lessening in perceived risk of both US and global recession.
- For South Africa, frequent load shedding this year adds to risks of a weaker growth outlook, as does slowing global growth. The current load shedding is due to some unplanned outages (including Arnot, Duvha and Medupi) as well as scheduled maintenance (Koeberg- refueling).
- Other power stations are underperforming, particularly Kusile, with emissions controls (flue gas desulfurisation) causing unplanned outages, as the technology remains

problematic with a single point of failure causing an entire electricity producing unit to be shut down.

- Kriel power station experienced a reported a large theft of diesel by a criminal syndicate, causing a severe loss of power. These factors all add a weak underpin to the rand and the domestic currency is not expected to return to R15.00/USD in the remainder of this year.

Overview of estimated additional capacity over 36 months (MW)

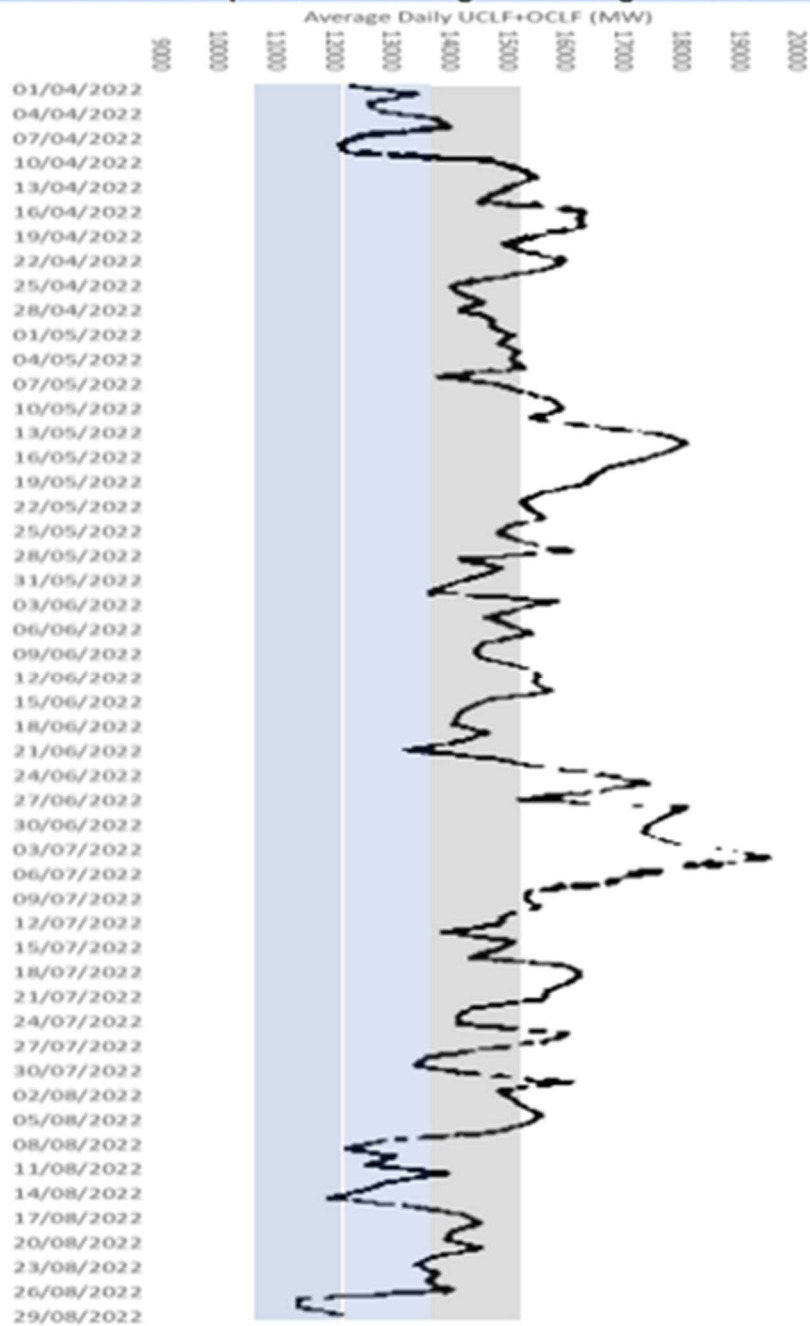


- Successful implementation of all the initiatives will greatly reduce the risk of load shedding
- Timing of the new generation capacity is dependant on the market response and regulatory processes

Source: Eskom

Notes: Plant performance is based on generation recovery plan to address load losses and includes Kusile units currently in operation. New build includes commissioning of units 5 and 6 at Kusile, and recovery of unit 4 at Medupi (Aug 2024). Procurement of new generation capacity consists of 1. Standard offer emergency procurement, imports from the region – 2300MW in the next 12 months. 2. Land leasing initiative and section 34 procurement (RMIPPPP, battery storage and bod window 5,6 included in the latter part of the plan), 24 months onwards. Additional -1450 MW of demand management interventions over 3 years.

Total view unplanned outages during winter 2022



Source: Eskom

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

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
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