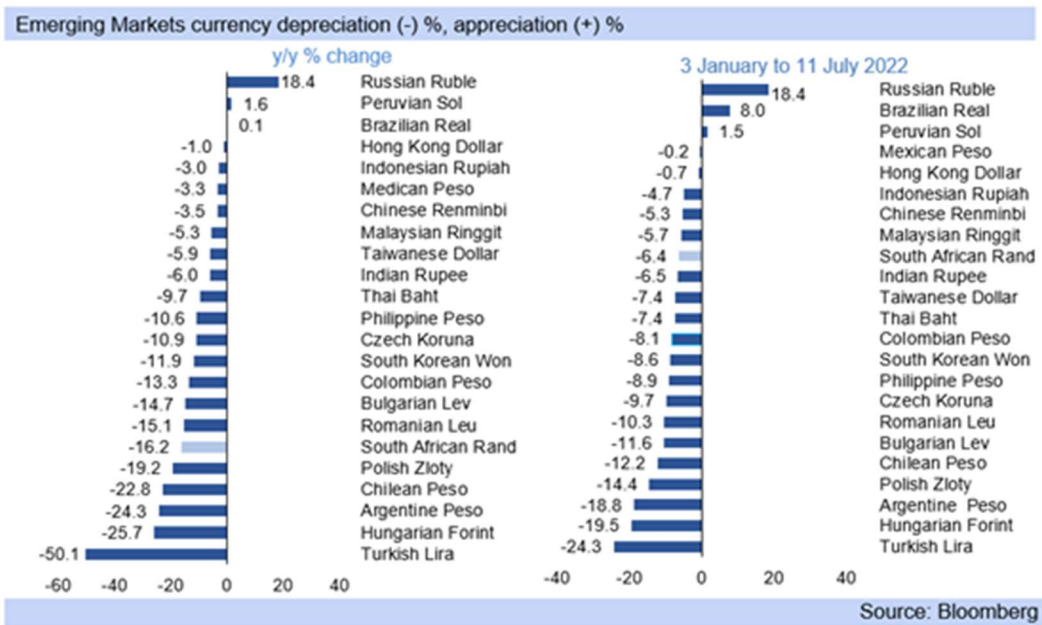




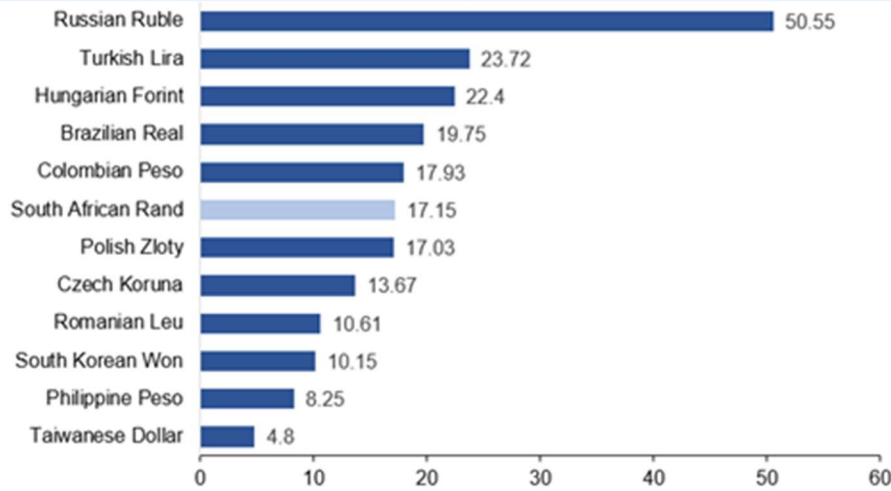
# SA Economics

Monday 11 July 2022

Rand note: expected weak domestic economic growth and insufficiently high interest rates versus the US investors sees little to recommend the rand

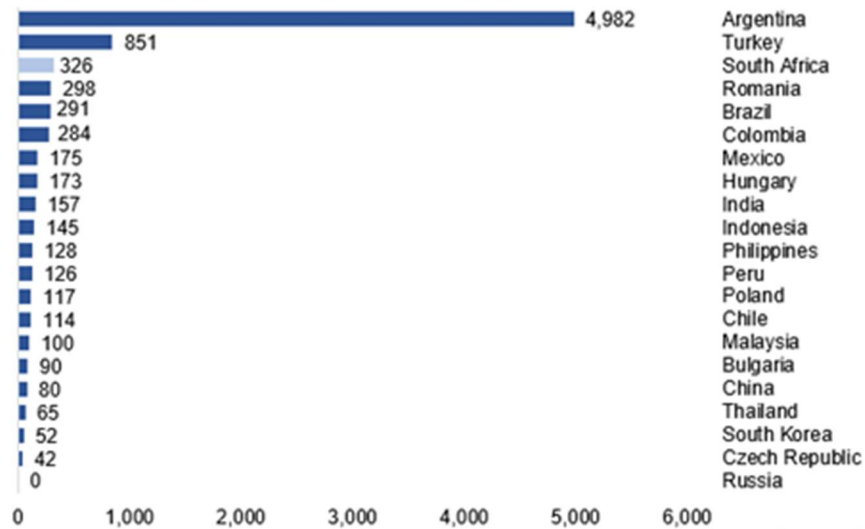


Emerging Markets Implied Volatilities – values 11 July 2022

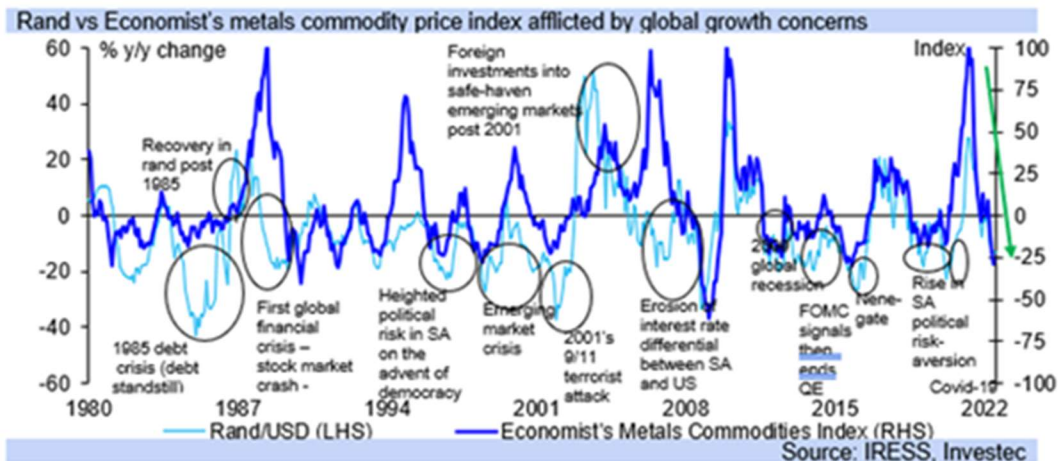


Source: Bloomberg

Emerging Markets CDS Spreads – values 11 July 2022



Source: Bloomberg



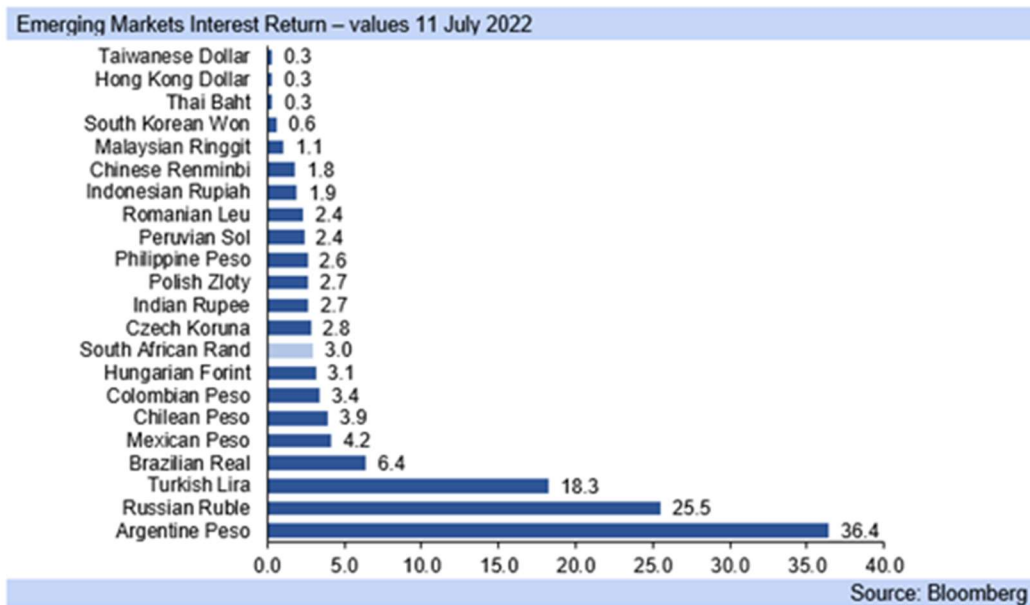
Expected Case: Exchange Rate forecasts												
	2022				2023				2024			
	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
USD/ZAR	15.21	15.59	16.00	15.60	15.40	15.80	16.20	15.70	15.50	16.00	16.50	16.00
GBP/ZAR	20.40	19.59	19.52	18.88	18.79	19.75	20.57	20.10	20.15	21.28	22.28	22.08
EUR/ZAR	17.07	16.60	17.12	17.00	17.09	17.85	18.47	18.06	18.29	19.20	20.30	20.00
ZAR/JPY	7.65	8.33	8.44	8.59	8.51	8.16	7.84	8.03	7.94	7.38	6.97	6.88
CHF/ZAR	16.47	16.15	16.84	16.60	16.56	17.17	17.80	17.25	17.03	17.58	18.13	17.58
AUD/ZAR	11.02	11.14	11.36	11.23	11.40	11.85	12.31	12.25	12.09	12.48	12.87	12.48
GBP/USD	1.34	1.26	1.22	1.21	1.22	1.25	1.27	1.28	1.30	1.33	1.35	1.38
EUR/USD	1.12	1.06	1.07	1.09	1.11	1.13	1.14	1.15	1.18	1.20	1.23	1.25
USD/JPY	116	130	135	134	131	129	127	126	123	118	115	110

Note: averages, Source: Investec, Iress

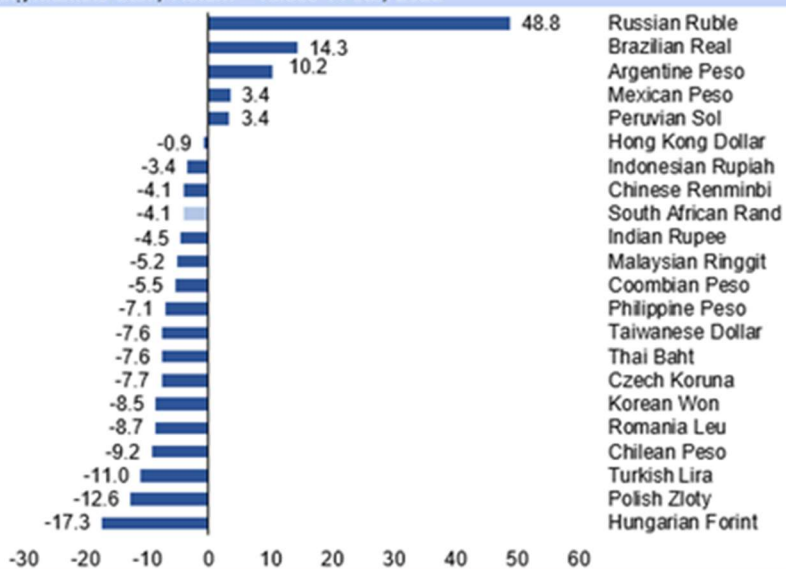
- The rand is at 17.03/USD (from R16.97/USD on Friday), with USD strength bringing it close to the R17.17/EUR rate, as the euro is essentially at parity with the US dollar. The rand is also being afflicted by negative sentiment on both international and domestic events.
- Foreigners remain net sellers of SA government bonds this quarter so far (Bloomberg JSE settled data for foreigner purchase, sales of SA bonds) at -R0.1bn, although on two days alone last week -R4.3bn was sold, versus -R3.6bn over the whole of Q2.22.
- The second, and particularly third, quarters of the year are usually weak periods for the rand, as trade thins in risk assets, including EM currencies and portfolio assets as the July/August months of peak northern hemisphere summer see senior (risk-taking) traders on vacation.
- Market worries over high inflation are being increasingly replaced by fears of excessive interest rate hikes that drive economies into recession, and risk sentiment in global financial markets is fragile and significantly risk averse.
- Indeed, Friday's publication of the higher than expected US payroll figures and low unemployment rate, static at 3.6%, have spiked market worries for continued severe US rate hikes over H2.22, a further 175bp lift according to the FOMC member predictions.
- The markets are expecting a 185bp lift and so are fairly aligned to the FOMC communication, but market players worry that the anticipated rate hikes, which will take the fed funds rate well above its neutral level and so will dampen economic growth, will prove overly negative.

- Domestically, severe load shedding has also worried markets over SA's growth prospects, which in turn risk negatively impacting state finances via revenue generation. Foreigners sold-off -R3.6bn of SA equities (net of purchases) in the last two days alone (Iress).
- Load shedding continues in SA, with the business day impacted by the harsh stage 4 electricity outages, while the extreme pressure unions brought to bear on the state owned electricity utility (Eskom) is seen as negative from a political as well as economic perspective.
- The run-up to the 2024 ANC elective conference has seen the political noise rise in SA generally, with any possible negative attempts made to smear the current president by the state capture (often known as the RET) faction of the ANC, and this is also investor negative.

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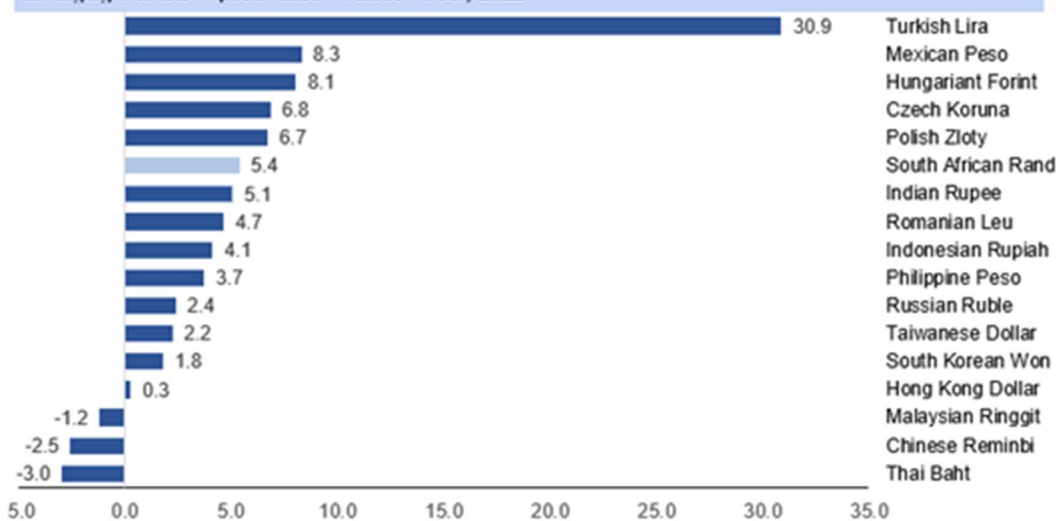


Emerging Markets Carry Return – values 11 July 2022



Source: Bloomberg

Emerging Markets Implied Rates – values 11 July 2022

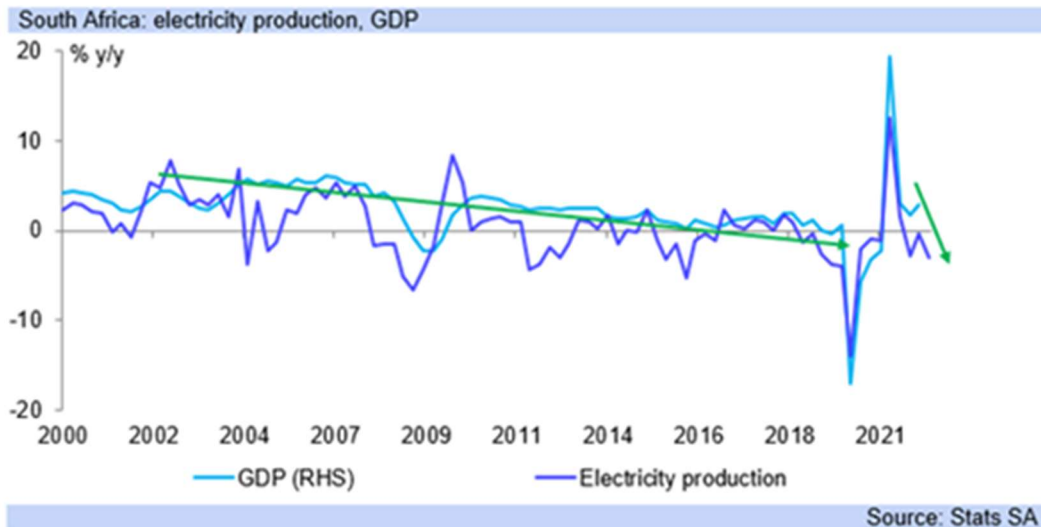


Source: Bloomberg

**Economic Scenarios: note updated forecasts, scenarios**

		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
<b>Extreme</b>	USD/Rand (average)	15.21	15.59	14.00	13.80	13.70	13.60	13.40	13.30
<b>Up case</b>	Repo rate (end rate)	4.25	4.75	4.00	3.75	3.75	3.75	3.50	3.50
<b>1%</b>	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. <b>Strong global growth, risk-on, commodity boom. Rapid upgrades of credit ratings.</b> Strong transition away from fossil fuel usage, a quick transition to renewable energy.								
<b>Up case</b>		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
<b>1%</b>	USD/Rand (average)	15.21	15.59	15.00	14.90	14.90	14.70	14.60	14.50
	Repo rate (end rate)	4.25	4.75	4.50	4.25	4.00	4.00	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. <b>Positive outlooks on credit ratings turn into upgrades fiscal consolidation, debt projections fall substantially.</b> Substantial transition to renewable energy away from fossil fuel usage, comprehensive measures to alleviate climate change impact on economy.								
<b>Base case</b>		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
<b>50%</b>	USD/Rand (average)	15.21	15.59	16.00	15.60	15.21	15.59	16.00	15.60
	Repo rate (end rate)	4.25	4.75	5.50	5.75	6.00	6.00	6.25	6.25
	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. <b>South Africa in the BB credit rating category bracket as fiscal consolidation (debt to GDP stabilisation) occurs leading to some positive outlooks.</b> 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.								
<b>Lite</b>		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
<b>(domestic)</b>	USD/Rand (average)	15.21	15.59	16.90	17.00	17.50	17.60	17.50	17.00
<b>Down case</b>	Repo rate (end rate)	4.25	4.75	5.75	6.25	6.75	7.25	7.75	8.25
<b>39%</b>	The international environment (incl. risk sentiment) is that of the base case. <b>South Africa fails to see debt projections stabilise, falls into single B (local and foreign currency) credit ratings from all three agencies. Recession occurs.</b> 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. <b>Substantial fiscal consolidation ultimately occurs, preventing ratings falling into the C grades.</b>								
<b>Severe down case</b>		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
<b>9%</b>	USD/Rand (average)	15.21	15.59	17.50	18.00	18.50	19.00	19.75	20.50
	Repo rate (end rate)	4.25	4.75	6.00	6.75	7.50	8.00	8.50	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. <b>SA rated single B from all three key agencies, downgrades eventually into CCC grade, increased risk of default.</b> 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



- Additionally, it is the anniversary month of the July insurrection of last year which caused a marked contraction in GDP in Q3.21, and markets are worried about another contraction in Q3.22 from the Eskom workers strike, which weakens SA's investor attractiveness.
- Despite the negative growth effects from the Eskom strike, SA's Reserve Bank is expected to continue hiking interest rates over Q3.22, and indeed investors globally have been seen recently favoring very low interest rate economies in the face of global recession worries.
- That is, low interest rates are expected to stimulate economic growth, and high interest rates quell it, and in combination with the Eskom strike, flood damage in KZN in Q2.22 and weak structural reform, investors have drawn back from SA's portfolio assets.
- This is also because the interest rate hikes expected in SA are not seen to likely keep up or exceed the US interest rate hikes this year, while economic growth is flagging, exacerbated by the reasons above, placing SA in neither a good growth nor high interest rate category.
- Markets still worry over SA's hugely weakened government finances over the past three years, and despite recent small improvements, the risk of further deterioration is still seen as a risk high. S&P recently clarified its positive country outlook in the face of weak growth.
- S&P is reported to have said "(w)e need to just clarify what a positive outlook means in our world," with a positive outlook from S&P on a below-investment grade country indicating only a third of a chance of a credit rating upgrade over twelve months.
- S&P added, "(w)e are also monitoring load shedding, the infrastructure bottlenecks (seen as significantly self-inflicted), and the political developments, for what it may mean for the macroeconomic outlook".
- S&P adds that the short-term 7% wage settlement with Eskom workers is "sub-optimal" as it "is higher than ... budgeted for, it is above the official inflation rate, ... is obviously precedent-setting to an extent, ... opens ... the risk ... (for) the same situation this time next year."
- "There is a structural problem here because the wage-setting mechanism in general in South Africa is not a typical emerging-market mechanism". "It's more ... (like) in France with very strong, powerful unions." there are "implications for the government's fiscal position".

**Severe Down Case: Exchange Rate forecasts**

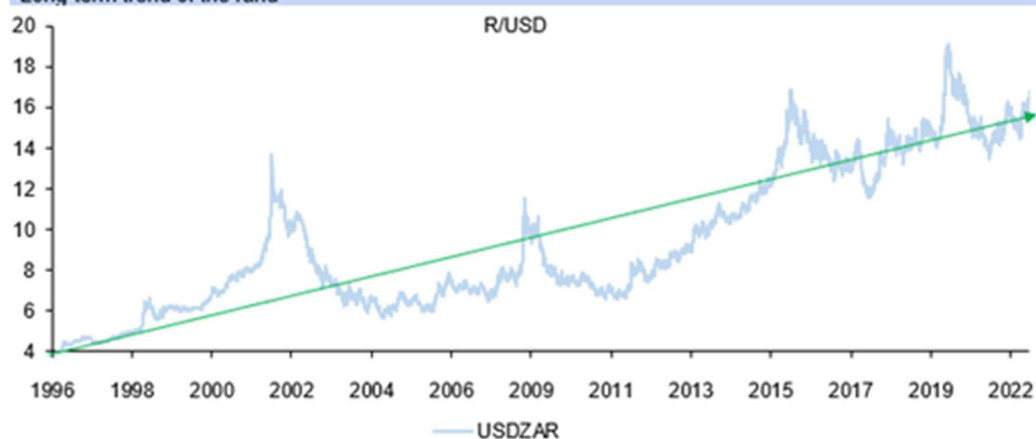
	2022				2023				2024			
	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
USD/ZAR	15.21	15.59	17.50	18.00	18.50	19.00	19.75	20.50	20.30	20.40	20.30	20.20
GBP/ZAR	20.40	19.59	21.35	21.78	22.57	23.75	25.08	26.24	26.39	27.13	27.41	27.88
EUR/ZAR	17.07	16.60	18.73	19.62	20.54	21.47	22.52	23.58	23.95	24.48	24.97	25.25
ZAR/JPY	7.65	8.33	7.71	7.44	7.08	6.79	6.43	6.15	6.06	5.78	5.67	5.45
CHFZAR	16.47	16.15	18.42	19.15	19.89	20.65	21.70	22.53	22.31	22.42	22.31	22.20
AUDZAR	11.02	11.14	12.43	12.96	13.69	14.25	15.01	15.99	15.83	15.91	15.83	15.76
GBP/USD	1.34	1.26	1.22	1.21	1.22	1.25	1.27	1.28	1.30	1.33	1.35	1.38
EUR/USD	1.12	1.06	1.07	1.09	1.11	1.13	1.14	1.15	1.18	1.20	1.23	1.25
USD/JPY	116	130	135	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	16.90	17.00	17.50	17.60	17.50	17.00	17.30	17.20	17.00	16.80
GBP/ZAR	20.40	19.59	20.62	20.57	21.35	22.00	22.23	21.76	22.49	22.88	22.95	23.18
EUR/ZAR	17.07	16.60	18.08	18.53	19.43	19.89	19.95	19.55	20.41	20.64	20.91	21.00
ZAR/JPY	7.65	8.33	7.99	7.88	7.49	7.33	7.26	7.41	7.11	6.86	6.76	6.55
CHFZAR	16.47	16.15	17.79	18.09	18.82	19.13	19.23	18.68	19.01	18.90	18.68	18.46
AUDZAR	11.02	11.14	12.00	12.24	12.95	13.20	13.30	13.26	13.49	13.42	13.26	13.10
GBP/USD	1.34	1.26	1.22	1.21	1.22	1.25	1.27	1.28	1.30	1.33	1.35	1.38
EUR/USD	1.12	1.06	1.07	1.09	1.11	1.13	1.14	1.15	1.18	1.20	1.23	1.25
USD/JPY	116	130	135	134	131	129	127	126	123	118	115	110

Note: averages, Source: Investec, Iress

**Long-term trend of the rand**


Source: 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	15.00	14.90	14.90	14.70	14.60	14.50	14.60	14.50	14.40	14.40
GBP/ZAR	20.40	19.59	18.30	18.03	18.18	18.38	18.54	18.56	18.98	19.29	19.44	19.87
EUR/ZAR	17.07	16.60	16.05	16.24	16.54	16.61	16.64	16.68	17.23	17.40	17.71	18.00
ZAR/JPY	7.65	8.33	9.00	8.99	8.79	8.78	8.70	8.69	8.42	8.14	7.99	7.64
CHFZAR	16.47	16.15	15.79	15.85	16.02	15.98	16.04	15.93	16.04	15.93	15.82	15.82
AUDZAR	11.02	11.14	10.65	10.73	11.03	11.03	11.10	11.31	11.39	11.31	11.23	11.23
GBP/USD	1.34	1.26	1.22	1.21	1.22	1.25	1.27	1.28	1.30	1.33	1.35	1.38
EUR/USD	1.12	1.06	1.07	1.09	1.11	1.13	1.14	1.15	1.18	1.20	1.23	1.25
USD/JPY	116	130	135	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	14.00	13.80	13.70	13.60	13.40	13.30	13.10	12.90	12.80	12.60
GBP/ZAR	20.40	19.59	17.08	16.70	16.71	17.00	17.02	17.02	17.03	17.16	17.28	17.39
EUR/ZAR	17.07	16.60	14.98	15.04	15.21	15.37	15.28	15.30	15.46	15.48	15.74	15.75
ZAR/JPY	7.65	8.33	9.64	9.71	9.56	9.49	9.48	9.47	9.39	9.15	8.98	8.73
CHFZAR	16.47	16.15	14.74	14.68	14.73	14.78	14.73	14.62	14.40	14.18	14.07	13.85
AUDZAR	11.02	11.14	9.94	9.94	10.14	10.20	10.18	10.37	10.22	10.06	9.98	9.83
GBP/USD	1.34	1.26	1.22	1.21	1.22	1.25	1.27	1.28	1.30	1.33	1.35	1.38
EUR/USD	1.12	1.06	1.07	1.09	1.11	1.13	1.14	1.15	1.18	1.20	1.23	1.25
USD/JPY	116	130	135	134	131	129	127	126	123	118	115	110

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