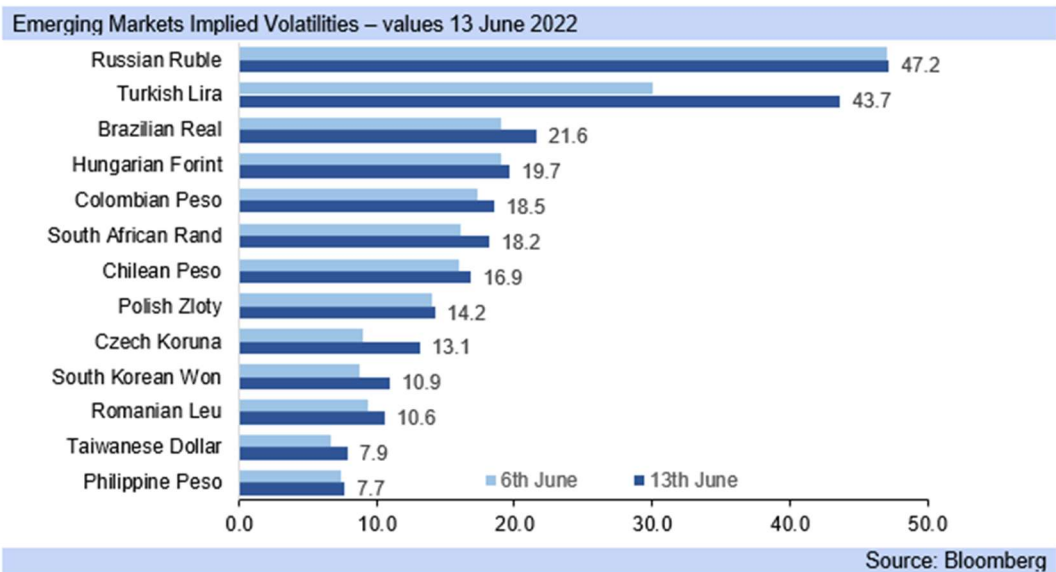




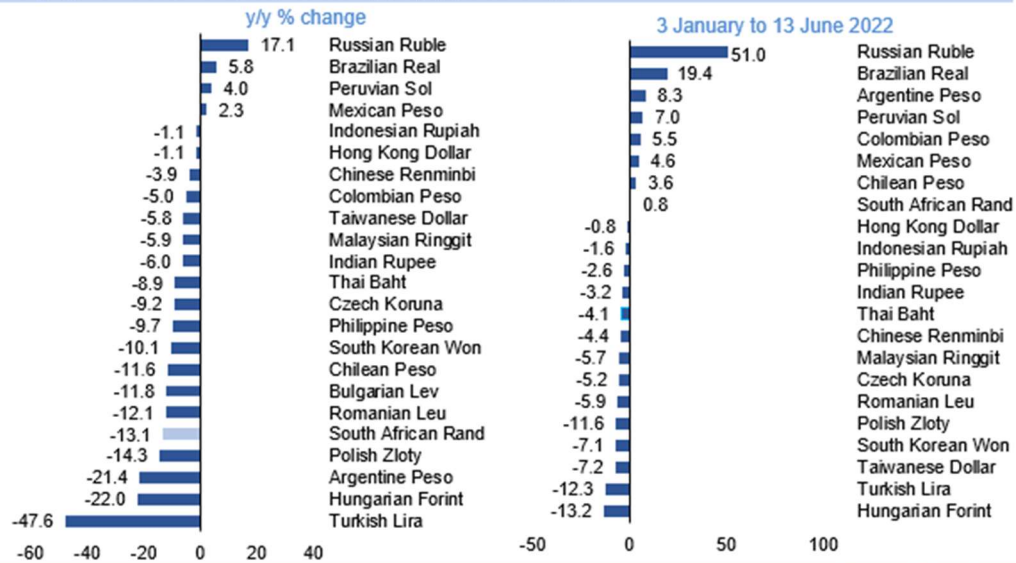
# SA Economics

Monday 13 June 2022

Rand note: risk-off returns to markets sending the rand past R16.00/USD, as stagflation fears increase globally

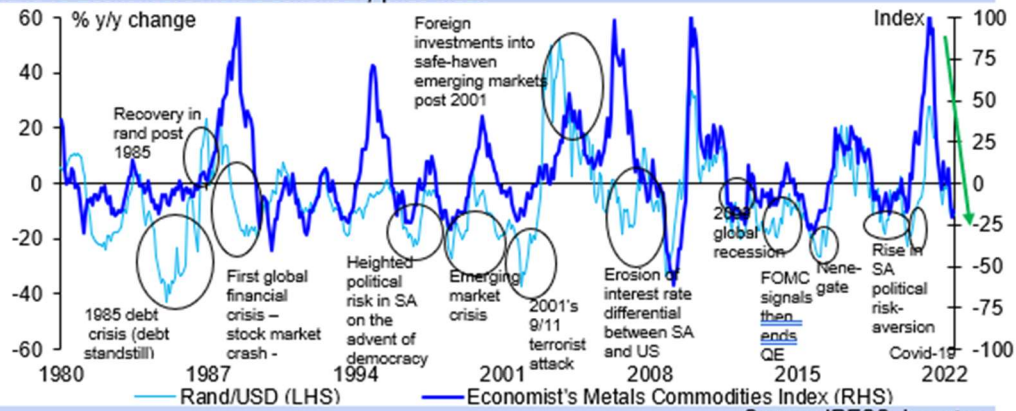


Emerging Markets currency depreciation (-) %, appreciation (+) %

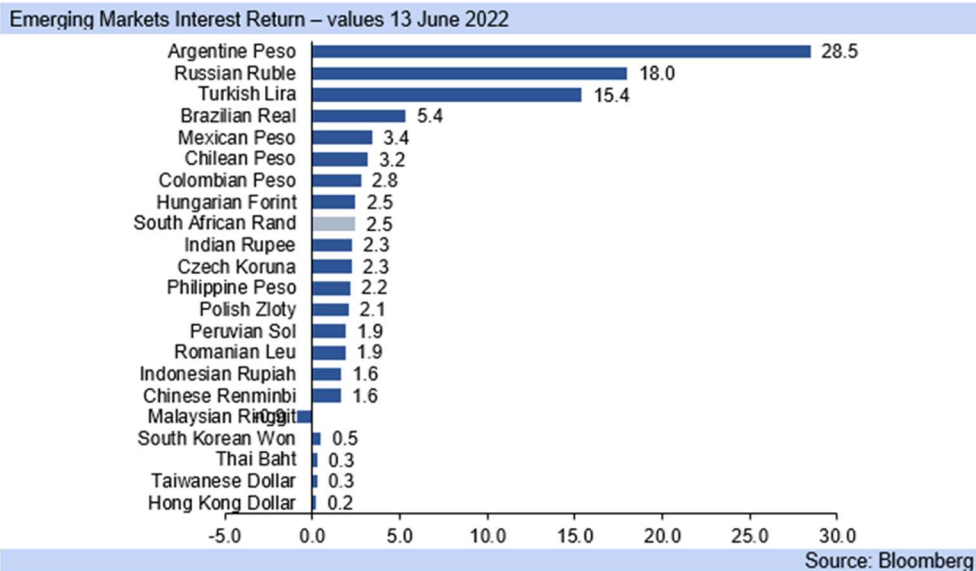


Source: Bloomberg

Rand vs Economist's metals commodity price index



Source: IRESS, Investec



**Expected Case: Exchange Rate forecasts**

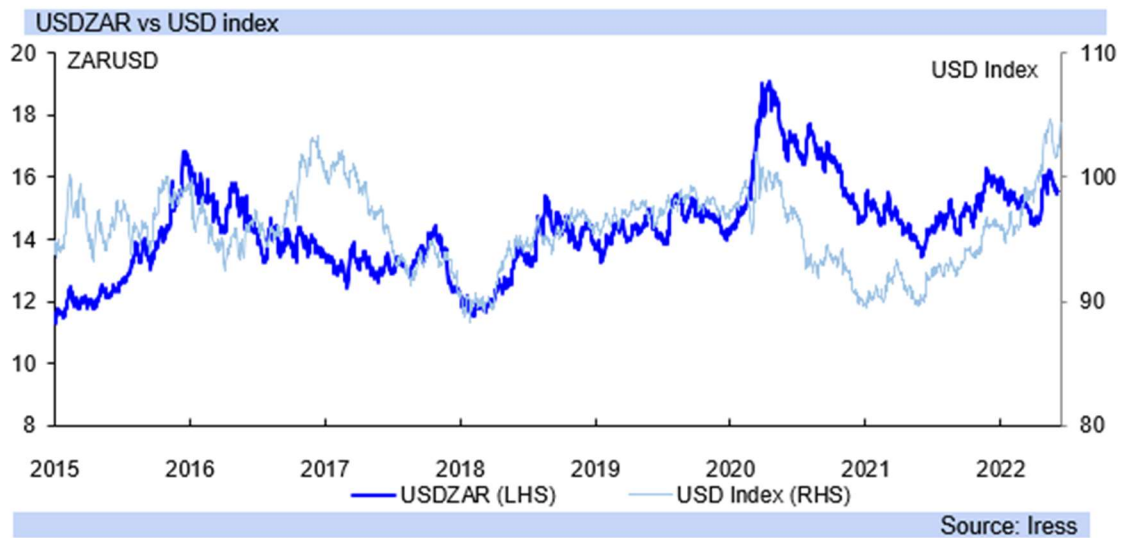
	2022				2023				2024			
	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.22	Q1.24	Q2.24	Q3.24	Q4.24
USD/ZAR	15.21	15.60	15.80	15.40	15.21	15.60	15.80	15.40	15.21	15.60	15.80	15.40
GBP/ZAR	20.40	19.64	19.99	19.87	20.40	19.64	19.99	19.87	20.40	19.64	19.99	19.87
EUR/ZAR	17.07	16.57	16.91	16.79	17.07	16.57	16.91	16.79	17.07	16.57	16.91	16.79
ZAR/JPY	7.65	8.17	7.94	8.05	7.65	8.17	7.94	8.05	7.65	8.17	7.94	8.05
CHF/ZAR	16.47	16.07	16.26	15.84	16.47	16.07	16.26	15.84	16.47	16.07	16.26	15.84
AUD/ZAR	11.02	11.18	11.61	11.63	11.02	11.18	11.61	11.63	11.02	11.18	11.61	11.63
GBP/USD	1.34	1.26	1.27	1.29	1.32	1.35	1.36	1.37	1.40	1.43	1.45	1.46
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	127	126	124	122	121	120	120	118	115	110	107

Note: averages, Source: Investec, Iress

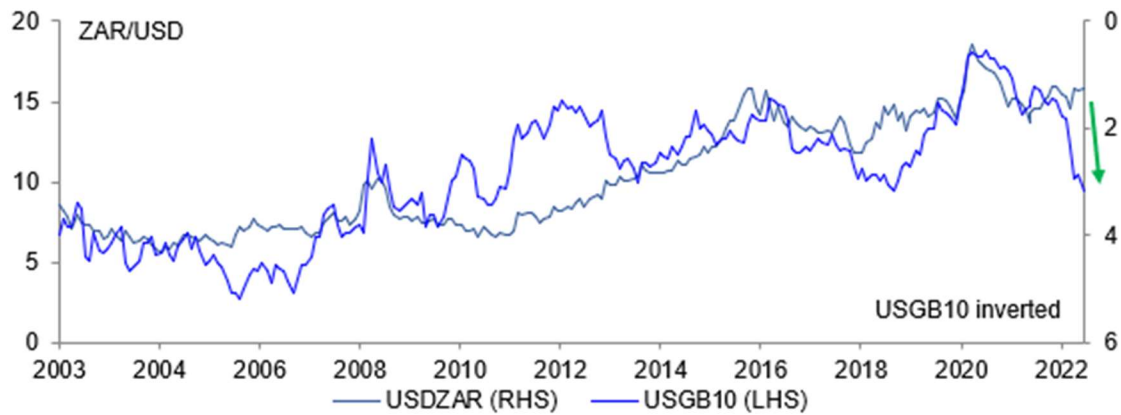
- The rand is on course to average R15.60/USD this quarter, with inflation outcomes surprising markets on the upside, as US CPI inflation rose to 8.6% y/y in May, showing the peak did not occur as markets hoped for in April, raising investors risk aversion levels.
- The US dollar has strengthened against the Euro, now at 1.0476 as it pulls toward the 1.04 mark, from 1.08 at the end of May, with the spread closing between the rand against the USD and EUR, at R16.04/USD and R16.80/EUR respectively.
- A year ago the rand was trading at R13.78/USD and R16.70/EUR respectively, with the US dollar at 1.21 to the euro, and with the dollar having weakened to 1.22 to the euro already at the start of June 2021, when risk aversion levels were particularly low a year ago.
- With the US dollar, and in particular US treasury's, seen as a store of safe haven for turbulent times, global financial market fears of high inflation, low growth, and particularly rising inflation/falling growth, have reinforced stagflation concerns.
- Volatile market sentiment is once again beginning to worry over the potential for a 75bp hike in the US's fed funds rate instead of a 50bp hike as the FOMC meeting on the 15th approaches, or if not then, then potentially on the 27<sup>th</sup> of July instead.

- Market sentiment is running on the latest data from the US on a daily/weekly basis. US PPI inflation figures are due tomorrow and while expectations are for a drop in producer price acceleration, to 10.8% y/y from 11.0% y/y, the risk for markets is a higher print.
- Retail sales figures are due in the US along with import price inflation (expected at 12.2% y/y for May after April's 12.0% y/y) on Wednesday, both before the FOMC meeting that evening, with the retail sales data also yielding retail price inflation insight.
- The closely watched PCE deflator of the FOMC in its monetary policy deliberations is due at the end of this month, at 6.3% y/y previously and the more important core reading at 4.9% y/y. Market worries are likely to grow towards month end of further inflation elevation.
- FOMC members have been convinced of the extremely robust nature of US economic growth, and as such the tone at this week's FOMC meeting is likely to remain significantly hawkish, which would place further pressure on the rand this week.

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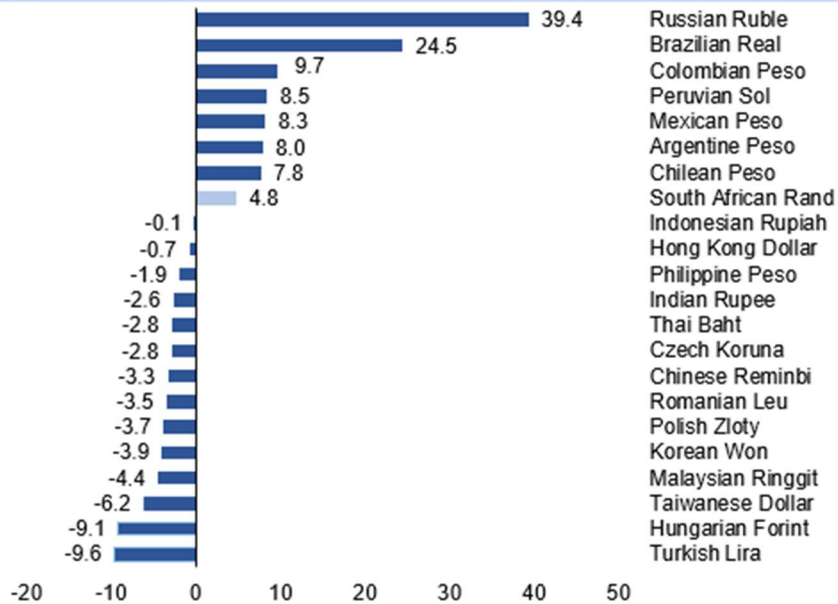


USDZAR vs US 10-year bond (%)



Source: Iress

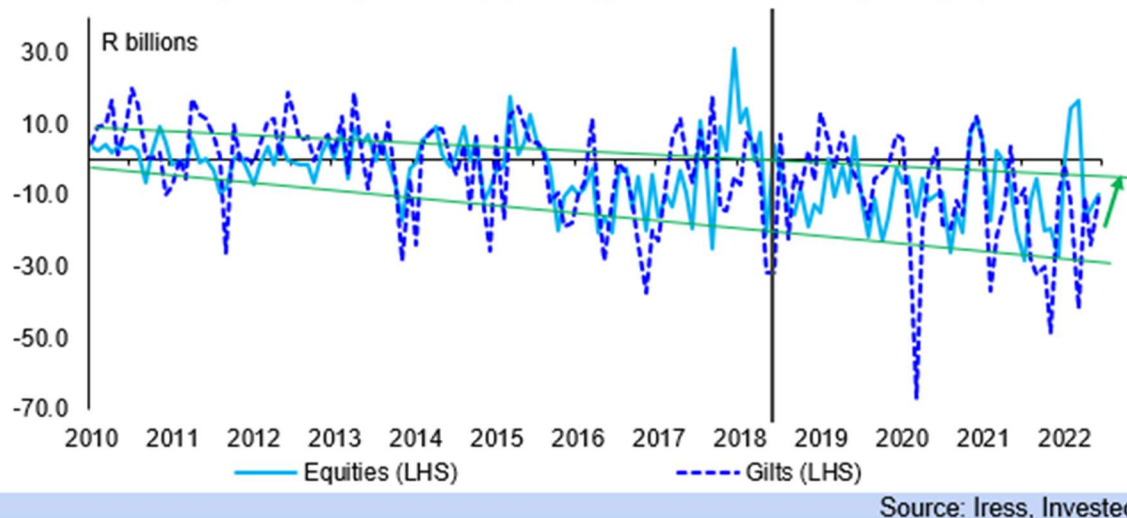
Emerging Markets Carry Return – values 13 June 2022



Source: Bloomberg



Volatile non-resident portfolio net purchases (+)/ sales (-) vs USD/ZAR (monthly averages)



- The domestic currency has shrugged off the good news of last week very quickly, from R15.46/USD and eyeing the R15.00/USD mark, to back above R16.00/USD today and reaching a weak point R16.09/USD as markets continue to digest Fridays' US inflation figures.
- Both globally and locally inflation is high, and price pressures are expected to remain heady over Q2.22, and now into Q3.22, negatively impacting consumers. The risk is now that inflation does not peak in Q2.22 and continues rising into Q3.22.
- The persistence of high inflationary conditions globally and locally, particularly at the production level, does not provide the environment for a rapid deceleration in price pressures. Markets are recalibrating expectations, elevating risk aversion, driving rand depreciation.
- For the rand, domestic good news is quickly discounted, as the focus remains on the international environment. The lower inflation rate in SA than many of its key trading partners is providing some support to the rand, although it is mainly being buffeted by risk aversion.

- A 50bp hike for SA next month has been building for 21<sup>st</sup> July, but this rate hike will not match the US for long. The MPC also sounding hawkish, particularly against inflationary pressures embedding into the environment via higher salary and wage increases.
- A further 50bp hike from the US on 27<sup>th</sup> July will erode the differential between SA and US interest rates established by SA's expected 50bp hike on 21<sup>st</sup> July, and the rand will be subject to further depreciation pressures as a result.
- Indeed, the Fed's 50bp hike this week Thursday (markets see only a 13% chance of a 75bp hike) will already substantially erode the differential between SA and US interest rates for over a month, and the rand will be under pressure to depreciate from this source from Friday.
- Much lower than expected inflation prints in key economies, particularly in the US could reverse this trend, but this is not expected in the near term, and indeed June's inflation figures will once again see strong upward price pressure from energy costs, particularly oil.
- Given the lower average in oil prices in May than in June to date means if oil prices remain unchanged for the rest of this month, they will be around US\$10/bbl higher for June than in May, exerting considerable upwards price pressure on global and local inflation.



Economic Scenarios: note up case rises

		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
<b>Extreme</b> Up case 1%	USD/Rand (average)	15.21	14.00	13.80	13.70	13.60	13.40	13.30	13.10
	Repo rate (end rate)	4.25	4.00	4.00	3.75	3.75	3.75	3.50	3.50
	Impact of Covid-19 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 other EW or nationalisation. High business confidence and fixed investment growth, substantial FDI, strong fiscal consolidation (state debt falls back to low ratios of 2000s). Very subdued domestic inflation on extreme rand strength, rapid capacity expansion and very favourable weather conditions. <b>Strong global growth, commodity boom. Stabilisation of credit ratings, then upgrades.</b>								
<b>Up case</b> 4%	USD/Rand (average)	15.21	14.50	15.00	14.90	14.90	14.70	14.60	14.50
	Repo rate (end rate)	4.25	4.00	4.00	4.00	4.00	4.00	4.25	4.25
	Quick rebound from Covid-19 pandemic, rising confidence and investment levels - structural problems eroded. <b>No further credit rating downgrades, become positive on fiscal consolidation (debt projections fall substantially).</b> Global risk-on, global demand quickly returns to trend growth. Very limited impact of expropriation without compensation) to abandoned, labour tenants' and government land (individuals are new owners and receive title deeds) does not have a negative effect on economy - no nationalisation. Low domestic inflation on favourable weather conditions, rand strength reduction in state-controlled price inflation on increased private privatisation.								
<b>Base case</b> 50%	USD/Rand (average)	15.21	15.60	15.80	15.40	15.20	15.60	16.00	15.50
	Repo rate (end rate)	4.25	4.75	5.50	5.50	5.75	5.75	6.00	6.00
	Recovery from the sharp global economic slowdown by 2024 in real terms– <b>sufficient global and domestic monetary and other policy supports to growth and financial markets occur and risk sentiment neutral to positive.</b> Expropriation of private sector property is limited and does not have a negative impact on the economy or on market sentiment. <b>SA remains in the BB category rating bracket fiscal consolidation (debt to GDP stabilisation) occurs.</b> Civil and political unrest wanes. Inflation impacted by normal course of weather patterns via food price inflation and rand, with modest transition to renewable energy and slow move away from fossil fuel usage, measures to alleviate impact of climate change on economy are modestly implemented.								
<b>Lite</b> (domestic) Down case 39%	USD/Rand (average)	15.21	16.00	16.65	16.90	17.00	17.50	17.60	17.50
	Repo rate (end rate)	4.25	5.00	5.75	5.75	6.00	6.00	6.25	6.50
	The international environment (incl. risk sentiment) is that of the base case. <b>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.</b> Recession occurs. Very limited expropriation of private commercial sector property without compensation, with some negative impact on the economy. Business confidence depressed, marked rand weakness and higher inflation (adverse weather), significant load shedding and weak investment growth. Substantial fiscal consolidation ultimately occurs, preventing ratings falling into the C grades.								
<b>Severe</b> down case 6%	USD/Rand (average)	15.21	16.80	17.50	18.00	18.50	18.70	19.20	19.55
	Repo rate (end rate)	4.25	5.25	6.00	6.25	6.50	7.00	7.50	7.75
	Lengthy global recession, global financial crisis – insufficient monetary and other policy supports to growth domestically and internationally. Depression in SA, severe rand weakness, very high inflation (very adverse weather). A somewhat wider level of nationalisation of private sector commercial property. <b>SA rated single B from all three key agencies, with further rating downgrades eventually into CCC grade and the risk of moving towards default.</b> Government borrows from increasingly wider sources as it sinks deeper into a debt trap), eventually include widespread civil unrest, services strike action and strike action.								

Note: Event risk begins Q222. 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	Q4.22	Q1.24	Q2.24	Q3.24	Q4.24
USD/ZAR	15.21	16.00	16.65	16.90	17.00	17.50	17.60	17.50	17.20	17.00	16.80	17.00
GBP/ZAR	20.40	20.14	21.06	21.80	22.36	23.54	23.94	23.89	24.08	24.31	24.36	24.82
EUR/ZAR	17.07	17.00	17.82	18.42	18.87	19.78	20.06	20.04	20.30	20.40	20.66	21.25
ZAR/JPY	7.65	7.97	7.54	7.34	7.18	6.89	6.82	6.86	6.86	6.76	6.55	6.29
CHFZAR	16.47	16.48	17.13	17.38	17.55	18.14	18.24	18.22	18.49	18.68	18.46	18.68
AUDZAR	11.02	11.47	12.24	12.76	13.09	13.83	14.08	14.00	13.42	13.26	13.10	13.26
GBP/USD	1.34	1.26	1.27	1.29	1.32	1.35	1.36	1.37	1.40	1.43	1.45	1.46
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	127	126	124	122	121	120	120	118	115	110	107

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	Q4.22	Q1.24	Q2.24	Q3.24	Q4.24
USD/ZAR	15.21	14.50	15.00	14.90	14.90	14.70	14.60	14.50	14.50	14.40	14.40	14.30
GBP/ZAR	20.40	18.25	18.98	19.22	19.59	19.77	19.86	19.79	20.30	20.59	20.88	20.88
EUR/ZAR	17.07	15.40	16.05	16.24	16.54	16.61	16.64	16.60	17.11	17.28	17.71	17.88
ZAR/JPY	7.65	8.79	8.37	8.32	8.19	8.20	8.22	8.28	8.14	7.99	7.64	7.48
CHFZAR	16.47	14.93	15.43	15.32	15.38	15.24	15.13	15.09	15.59	15.82	15.82	15.71
AUDZAR	11.02	10.39	11.03	11.25	11.47	11.61	11.68	11.60	11.31	11.23	11.23	11.15
GBP/USD	1.34	1.26	1.27	1.29	1.32	1.35	1.36	1.37	1.40	1.43	1.45	1.46
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	127	126	124	122	121	120	120	118	115	110	107

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	Q4.22	Q1.24	Q2.24	Q3.24	Q4.24
USD/ZAR	15.21	14.00	13.80	13.70	13.60	13.40	13.30	13.10	12.90	12.80	12.60	12.30
GBP/ZAR	20.40	17.62	17.46	17.67	17.88	18.02	18.09	17.88	18.06	18.30	18.27	17.96
EUR/ZAR	17.07	14.87	14.77	14.93	15.10	15.14	15.16	15.00	15.22	15.36	15.50	15.38
ZAR/JPY	7.65	9.10	9.09	9.05	8.97	8.99	9.02	9.16	9.15	8.98	8.73	8.70
CHFZAR	16.47	14.42	14.20	14.09	14.04	13.89	13.78	13.64	13.87	14.07	13.85	13.52
AUDZAR	11.02	10.03	10.14	10.34	10.47	10.59	10.64	10.48	10.06	9.98	9.83	9.59
GBP/USD	1.34	1.26	1.27	1.29	1.32	1.35	1.36	1.37	1.40	1.43	1.45	1.46
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	127	126	124	122	121	120	120	118	115	110	107

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	Q4.22	Q1.24	Q2.24	Q3.24	Q4.24
USD/ZAR	15.21	16.80	17.50	18.00	18.50	18.70	19.20	19.55	19.70	19.90	20.20	20.40
GBP/ZAR	20.40	21.15	22.14	23.22	24.33	25.15	26.11	26.69	27.58	28.46	29.29	29.78
EUR/ZAR	17.07	17.85	18.73	19.62	20.54	21.13	21.89	22.38	23.25	23.88	24.85	25.50
ZAR/JPY	7.65	7.59	7.17	6.89	6.59	6.44	6.25	6.14	5.99	5.78	5.45	5.25
CHFZAR	16.47	17.30	18.00	18.51	19.10	19.39	19.90	20.35	21.18	21.87	22.20	22.42
AUDZAR	11.02	12.04	12.86	13.59	14.25	14.77	15.36	15.64	15.37	15.52	15.76	15.91
GBP/USD	1.34	1.26	1.27	1.29	1.32	1.35	1.36	1.37	1.40	1.43	1.45	1.46
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
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