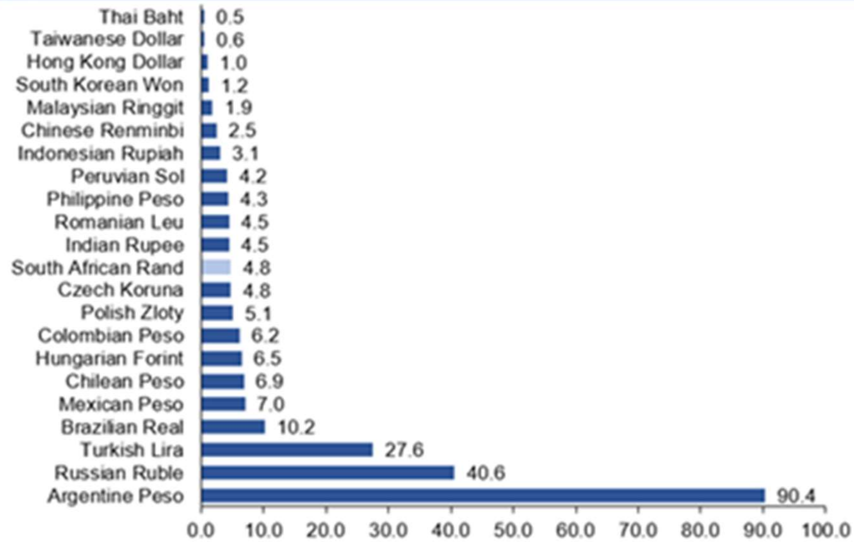
SA Economics

Monday 17 October 2022

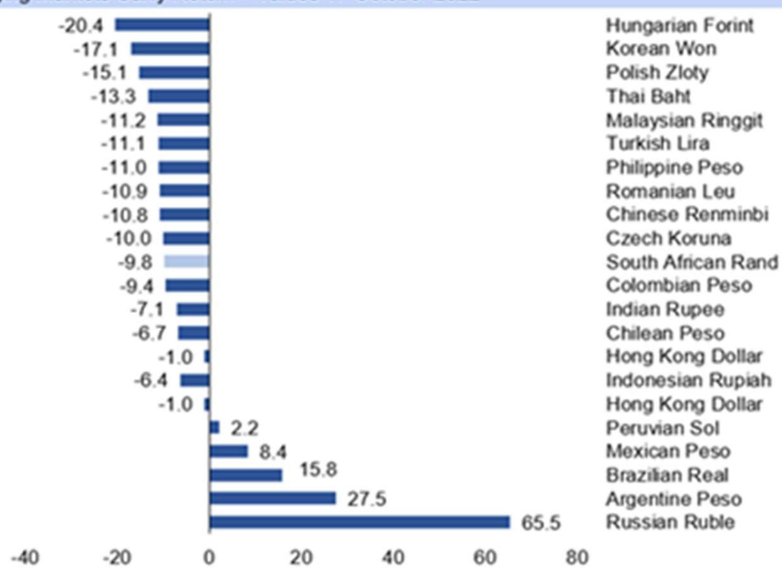
Rand note: undervalued rand continues to see no respite from lengthy risk averse period

Emerging Markets Interest Return – values 17 October 2022



Source: Bloomberg

Emerging Markets Carry Return – values 17 October 2022



Source: Bloomberg

Economic Scenarios: note updated probabilities

Scenario		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	15.40	14.50	14.00	13.60	13.40
	Repo rate (end rate)	4.25	4.75	6.25	5.25	4.25	3.75	3.75	3.50

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.

Scenario		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
Up case 1%	USD/Rand (average)	15.21	15.59	17.05	16.00	15.30	15.00	14.70	14.60
	Repo rate (end rate)	4.25	4.75	6.25	5.50	4.75	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.

Scenario		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	17.30	17.60	17.40	17.00	16.90
	Repo rate (end rate)	4.25	4.75	6.25	7.00	7.50	7.50	7.25	7.00

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.

Scenario		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
Lite (domestic) Down case 39%	USD/Rand (average)	15.21	15.59	17.05	17.40	17.70	17.80	17.70	17.90
	Repo rate (end rate)	4.25	4.75	6.25	7.50	8.00	8.50	9.00	9.00

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.

Scenario		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	18.00	18.30	18.50	18.60	19.00
	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. 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. Failure to transition to renewable energy and to sufficient measures to alleviate the impact of climate change on the economy.

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

- The rand has reached a new weak point this year against the US dollar, at R18.58/USD, still below its historic low of R19.35/USD in April 2020, but experiencing a longer sustained period of weakness than in 2020 as US dollar strength persists.
- Tightening financial conditions continue to spur risk aversion, keeping the rand weak, with policy makers expected to remain focused on quelling price inflation, crushing hopes of economic improvement and market recovery.
- US Treasury Secretary, Janet Yellen, recently stated "(i)n the United States, our top economic priority is to bring down inflation while maintaining a strong labor market," while recognizing that there will be "global repercussions".

- The IMF added the need for fiscal policy tightening as well, highlighting “(g)overnments should keep trimming the budget deficits they ran up in the pandemic, even as they seek to help households hit by soaring energy and food prices”.
- “Global public debt is set to reach 91% of GDP this year, some 7.5 percentage points above its pre-Covid level.” “Fiscal policy should protect the most vulnerable while pursuing a tightening stance to avoid overburdening monetary policy in the fight against inflation.”
- The UK has just undone most of the proposed unfunded fiscal stimulus announced by its Chancellor’s predecessor, in a turbulent political year which has seen high levels of market volatility. The UK is now set to carry out fiscal tightening which has soothed markets.
- The IMF adds “(p)oliticians in charge of national budgets should avoid across-the-board subsidies and make sure support is targeted to those who need it most. Prioritizing policies and programs is increasingly vital as governments operate within tighter budgets.”
- Next week South Africa sees its own mini-Budget, which is likely to make some strides in fiscal consolidation, but the impact of the good mini-budget this year on markets is likely to be overshadowed by the heavy risk aversion environment in global financial markets.
- The rand is currently trading at R17.69/EUR, R18.12/USD and R20.49/GBP, slightly stronger than last week Thursday when a US inflation miss was published, compared to market expectations, which are increasingly factoring in a slow, lengthy fall in inflation.

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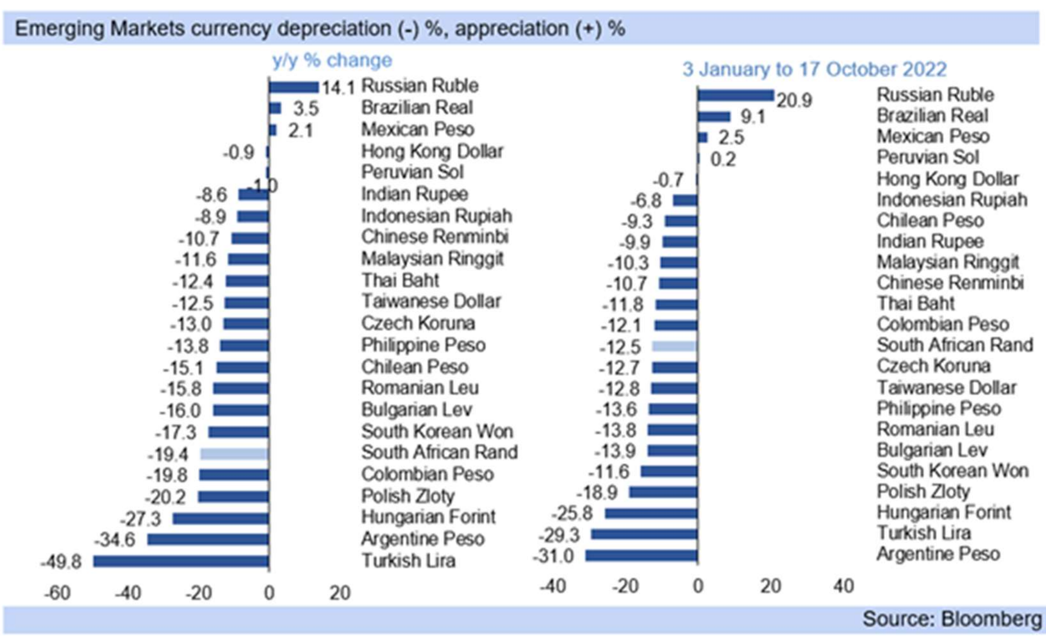
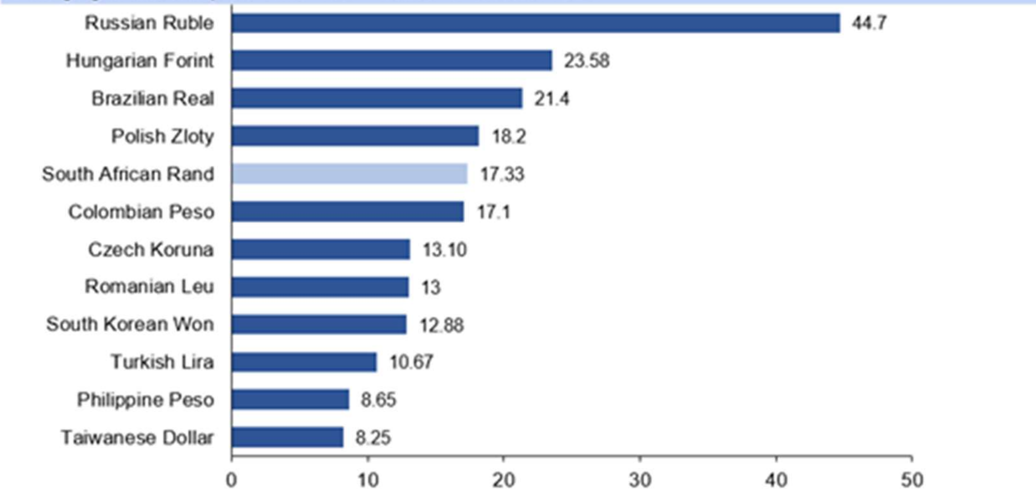


Emerging Markets Implied Volatilities – values 17 October 2022



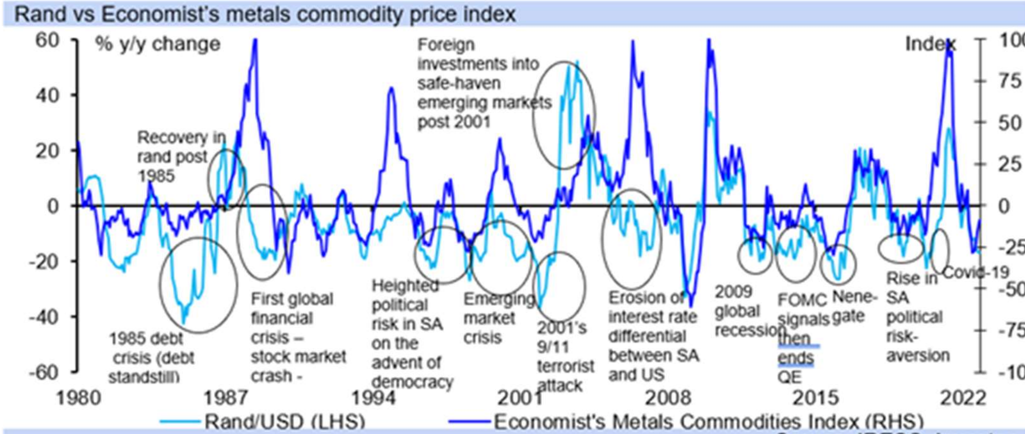
Source: Bloomberg

Expected Case: Exchange Rate forecasts

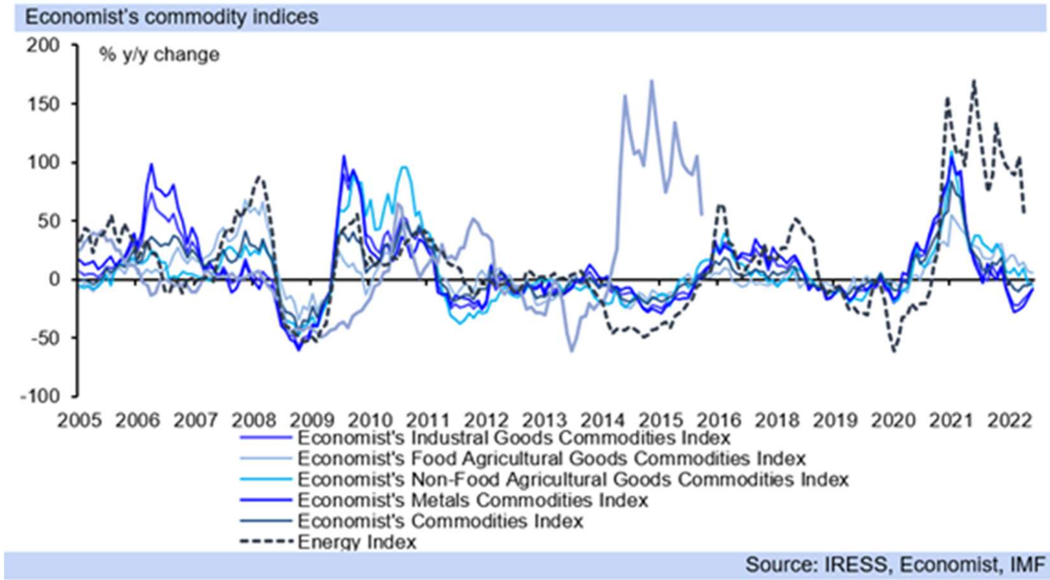
	2022				2023				2024			
	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
USD/ZAR	15.21	15.59	17.05	17.30	17.60	17.40	17.00	16.90	16.70	17.20	17.70	17.20
GBP/ZAR	20.40	19.59	20.06	17.73	17.95	18.36	18.53	19.10	19.71	21.50	23.36	23.74
EUR/ZAR	17.07	16.60	17.16	16.95	17.78	18.18	18.19	18.42	18.70	19.78	20.89	21.16
ZAR/JPY	7.65	8.33	8.12	8.21	7.90	7.84	7.85	7.75	7.66	6.98	6.50	6.40
CHFZAR	16.47	16.16	17.64	17.12	17.95	18.27	18.01	17.80	17.96	18.90	19.45	18.90
AUDZAR	11.02	11.14	11.65	11.42	12.06	12.44	12.58	12.84	13.03	13.42	13.81	13.42
GBP/USD	1.34	1.26	1.18	1.03	1.02	1.06	1.09	1.13	1.18	1.25	1.32	1.38
EUR/USD	1.12	1.06	1.01	0.98	1.01	1.05	1.07	1.09	1.12	1.15	1.18	1.23
USD/JPY	116	130	138	142	139	137	134	131	128	120	115	110

Note: averages, Source: Investec, Iress

Rand vs Economist's metals commodity price index



Source: IRESS, Investec



- Markets continue to worry about recession, with high and rising interest rates one concern, but the self-correcting mechanism of commodity prices in shortening and reducing recessions are being impeded by OPEC+ quota cuts, as the cartel supports still high oil prices.
- The Brent crude oil price has averaged US$57/bbl since 1995, and US$65/bbl since the year 2000, from 2018 OPEC+ further limited supply to maintain a higher level, closer to US$70/bbl, and now, since the pandemic is attempting to keep it nearer to US$90/bbl.
- Inflationary pressures globally would have been more subdued if the upwards pressure on oil prices post the pandemic had been limited to around US$70/bbl, with OPEC+ failing to drop quotas (and so increase oil supply) in order to weaken inflation.
- Still relatively high oil prices are slowing, and interrupting in some areas, the downwards momentum in inflation. Weakening global economic activity typically causes commodity prices to fall, but OPEC+ artificially keeps prices high via limiting supply.
- The IEA (International Energy Agency) warns that “with unrelenting inflationary pressures and interest rate hikes taking their toll, higher oil prices may prove the tipping point for a global economy already on the brink of recession”.
- The IMF forecasts “GDP growth among the oil exporting nations that benefit from expensive oil will outperform”, and “Middle East and North African GDP will grow by 5% this year, up from 4.1% in 2021.”
- At a G-20 meeting of Finance Ministers the warning emerged that “(t)he world is in a dangerous condition. We are now facing increasing and compounding risk, high inflation, weak growth, energy and food insecurity or crisis, climate risk and geopolitical fragmentation".
- “The room to maneuver is becoming so narrow, or even now has been eliminated, so the trade-off is becoming so painful. We have to take a painful step in order for us to be able to restore the stability and recovery of the economy.”
- A drop in oil prices to below US$60/bbl would help to quickly bring down inflation, likely by around 2.0% y/y, restoring some market confidence, as well as having some knock-on

effects in reducing inflation expectations, and so could lower inflation further by up to another 1%.

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	17.40	17.70	17.80	17.70	17.90	18.10	18.20	18.20	18.00
GBP/ZAR	20.40	19.59	20.06	17.84	18.05	18.78	19.29	20.23	21.36	22.75	24.02	24.84
EUR/ZAR	17.07	16.60	17.16	17.05	17.88	18.60	18.94	19.51	20.27	20.93	21.48	22.14
ZAR/JPY	7.65	8.33	8.12	8.16	7.85	7.67	7.54	7.32	7.07	6.59	6.32	6.11
CHFZAR	16.47	16.16	17.64	17.22	18.05	18.69	18.75	18.85	19.46	20.00	20.00	19.78
AUDZAR	11.02	11.14	11.65	11.48	12.12	12.73	13.10	13.60	14.12	14.20	14.20	14.04
GBP/USD	1.34	1.26	1.18	1.03	1.02	1.06	1.09	1.13	1.18	1.25	1.32	1.38
EUR/USD	1.12	1.06	1.01	0.98	1.01	1.05	1.07	1.09	1.12	1.15	1.18	1.23
USD/JPY	116	130	138	142	139	137	134	131	128	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	18.00	18.30	18.50	18.60	19.00	19.30	19.40	19.30	19.30
GBP/ZAR	20.40	19.59	20.06	18.45	18.67	19.52	20.27	21.47	22.77	24.25	25.48	26.63
EUR/ZAR	17.07	16.60	17.16	17.64	18.48	19.33	19.90	20.71	21.62	22.31	22.77	23.74
ZAR/JPY	7.65	8.33	8.12	7.89	7.60	7.38	7.18	6.89	6.63	6.19	5.96	5.70
CHFZAR	16.47	16.16	17.64	17.82	18.66	19.43	19.71	20.01	20.75	21.32	21.21	21.21
AUDZAR	11.02	11.14	11.65	11.88	12.54	13.23	13.76	14.44	15.05	15.13	15.05	15.05
GBP/USD	1.34	1.26	1.18	1.03	1.02	1.06	1.09	1.13	1.18	1.25	1.32	1.38
EUR/USD	1.12	1.06	1.01	0.98	1.01	1.05	1.07	1.09	1.12	1.15	1.18	1.23
USD/JPY	116	130	138	142	139	137	134	131	128	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	16.00	15.30	15.00	14.70	14.60	14.50	14.90	15.00	14.50
GBP/ZAR	20.40	19.59	20.06	16.40	15.61	15.83	16.02	16.50	17.11	18.63	19.80	20.01
EUR/ZAR	17.07	16.60	17.16	15.68	15.45	15.68	15.73	15.91	16.24	17.14	17.70	17.84
ZAR/JPY	7.65	8.33	8.12	8.88	9.08	9.10	9.08	8.97	8.83	8.05	7.67	7.59
CHFZAR	16.47	16.16	17.64	15.84	15.60	15.75	15.57	15.38	15.59	16.37	16.48	15.93
AUDZAR	11.02	11.14	11.65	10.56	10.48	10.73	10.88	11.10	11.31	11.62	11.70	11.31
GBP/USD	1.34	1.26	1.18	1.03	1.02	1.06	1.09	1.13	1.18	1.25	1.32	1.38
EUR/USD	1.12	1.06	1.01	0.98	1.01	1.05	1.07	1.09	1.12	1.15	1.18	1.23
USD/JPY	116	130	138	142	139	137	134	131	128	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	15.40	14.50	14.00	13.60	13.40	13.30	13.10	13.10	12.90
GBP/ZAR	20.40	19.59	20.06	15.79	14.79	14.77	14.82	15.14	15.69	16.38	17.29	17.80
EUR/ZAR	17.07	16.60	17.16	15.09	14.65	14.63	14.55	14.61	14.90	15.07	15.46	15.87
ZAR/JPY	7.65	8.33	8.12	9.22	9.59	9.75	9.82	9.78	9.62	9.16	8.78	8.53
CHFZAR	16.47	16.16	17.64	15.24	14.79	14.70	14.41	14.11	14.30	14.40	14.40	14.18
AUDZAR	11.02	11.14	11.65	10.16	9.93	10.01	10.06	10.18	10.37	10.22	10.22	10.06
GBP/USD	1.34	1.26	1.18	1.03	1.02	1.06	1.09	1.13	1.18	1.25	1.32	1.38
EUR/USD	1.12	1.06	1.01	0.98	1.01	1.05	1.07	1.09	1.12	1.15	1.18	1.23
USD/JPY	116	130	138	142	139	137	134	131	128	120	115	110
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