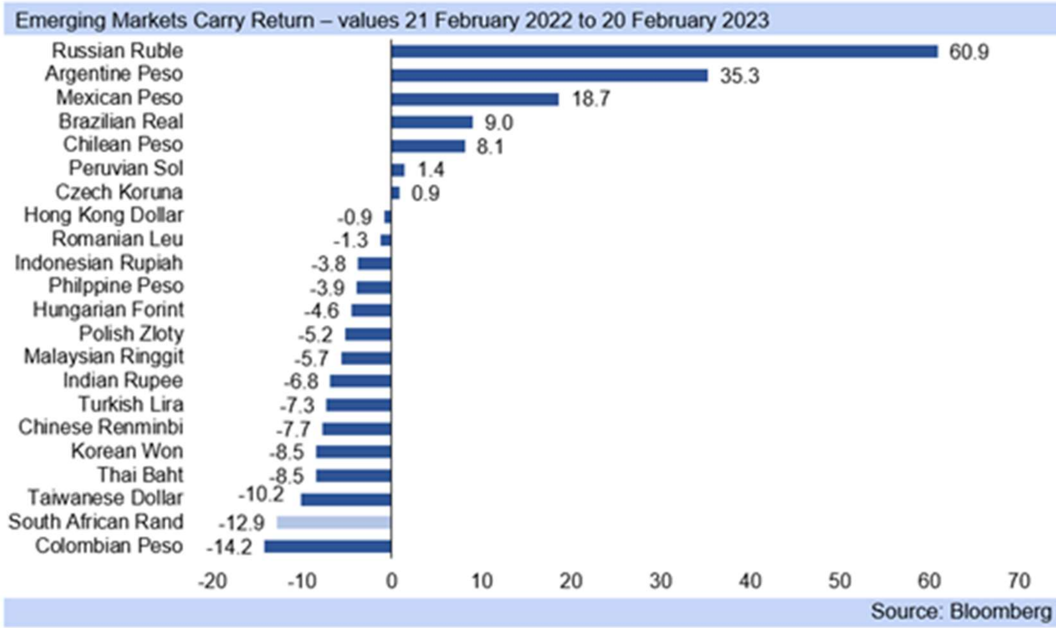
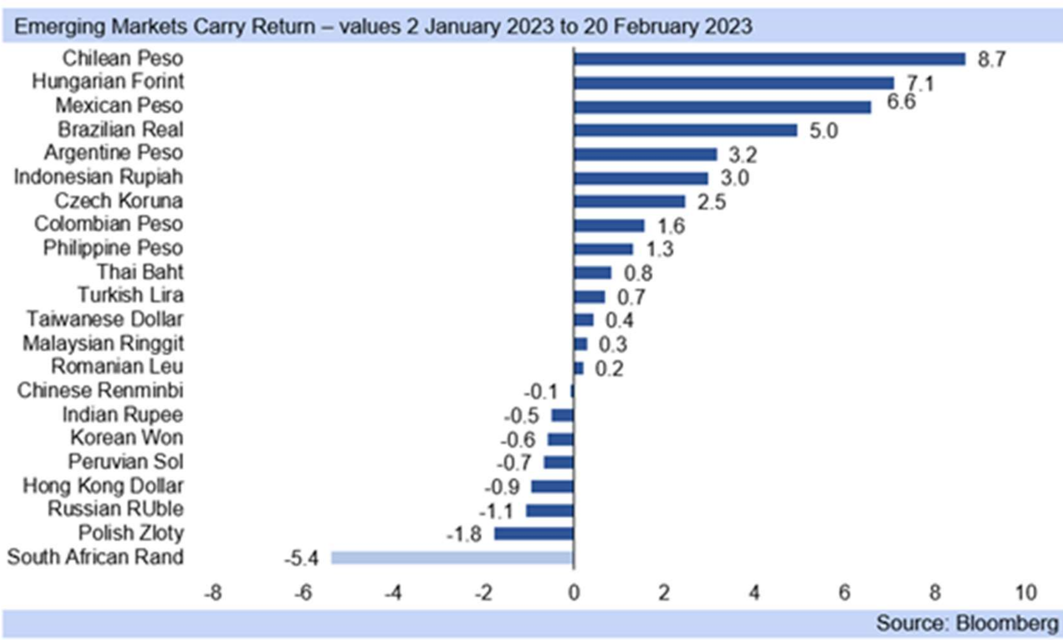
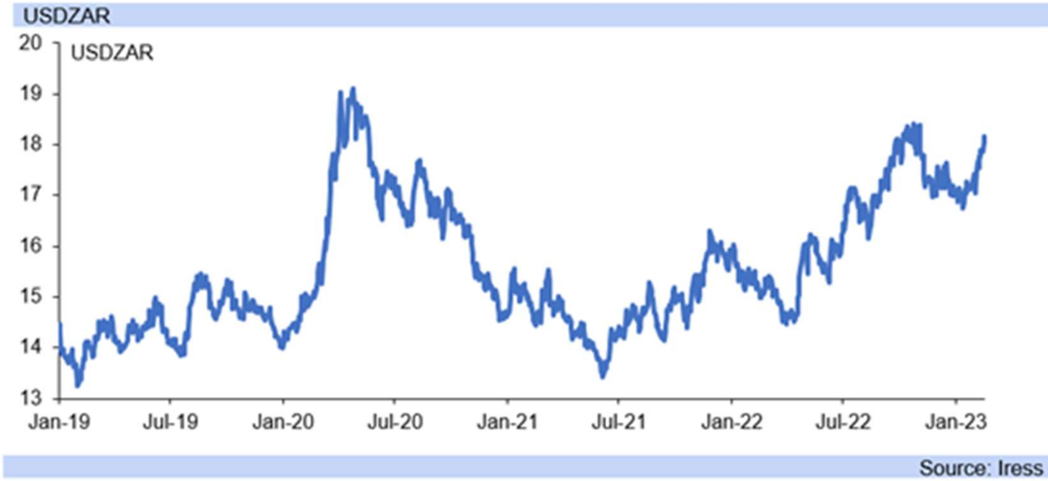
Investec

Rand note: weak and volatile on choppy market sentiment, lacking a sufficient buffer

Monday 20 February 2023


Emerging Markets Carry Return – values 21 February 2022 to 20 February 2023
Russian Ruble 60.9
Argentine Peso 35.3
Mexican Peso 18.7
Brazilian Real 9.0
Chilean Peso 8.1
Peruvian Sol 1.4
Czech Koruna 0.9
Hong Kong Dollar -0.9
Romanian Leu -1.3
Indonesian Rupiah -3.8
Philppine Peso -3.9
Hungarian Forint -4.6
Polish Zloty -5.2
Malaysian Ringgit -5.7
Indian Rupee -6.8
Turkish Lira -7.3
Chinese Renminbi -7.7
Korean Won -8.5
Thai Baht -8.5
Taiwanese Dollar -10.2
South African Rand -12.9
Colombian Peso -14.2
-20 -10 0 10 20 30 40 50 60 70
Source: Bloomberg


Emerging Markets Carry Return – values 2 January 2023 to 20 February 2023
Chilean Peso 8.7
Hungarian Forint 7.1
Mexican Peso 6.6
Brazilian Real 5.0
Argentine Peso 3.2
Indonesian Rupiah 3.0
Czech Koruna 2.5
Colombian Peso 1.6
Philippine Peso 1.3
Thai Baht 0.8
Turkish Lira 0.7
Taiwanese Dollar 0.4
Malaysian Ringgit 0.3
Romanian Leu 0.2
Chinese Renminbi -0.1
Indian Rupee -0.5
Korean Won -0.6
Peruvian Sol -0.7
Hong Kong Dollar -0.9
Russian RUble -1.1
Polish Zloty -1.8
South African Rand -5.4
-8 -6 -4 -2 0 2 4 6 8 10
Source: Bloomberg



Expected Case: Exchange Rate forecasts

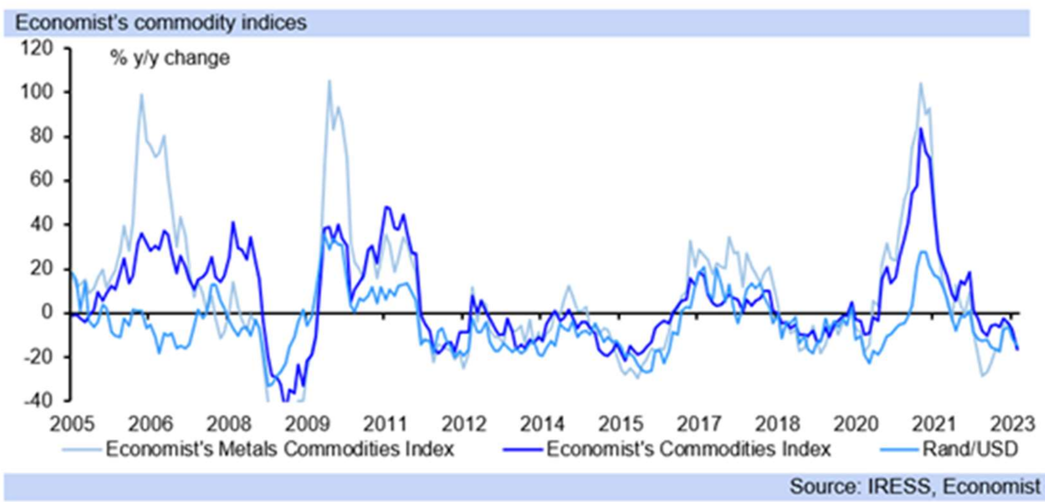
	2023				2024				2025			
	Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24	Q1.25	Q2.25	Q3.25	Q4.25
USD/ZAR	17.10	17.00	16.90	16.80	16.60	16.85	17.20	17.00	16.90	16.90	17.20	17.00
GBP/ZAR	21.02	21.08	21.13	21.00	20.92	21.40	22.10	22.19	21.97	21.97	22.36	22.10
EUR/ZAR	18.50	18.62	18.76	18.82	18.76	19.21	19.87	19.98	19.77	19.77	20.12	19.89
ZAR/JPY	7.57	7.56	7.46	7.44	7.44	7.24	7.03	7.06	7.93	7.81	7.62	7.65
CHFZAR	18.68	18.71	18.57	18.18	17.78	18.04	18.56	18.67	18.57	18.57	18.90	18.68
AUDZAR	11.85	12.07	12.25	12.35	12.28	12.47	12.81	12.75	12.84	13.01	13.59	13.43
GBP/USD	1.23	1.24	1.25	1.25	1.26	1.27	1.29	1.31	1.30	1.30	1.30	1.30
EUR/USD	1.08	1.10	1.11	1.12	1.13	1.14	1.16	1.18	1.17	1.17	1.17	1.17
USD/JPY	130	129	126	125	124	122	121	120	134	132	131	130

Note: averages, Source: Investec, Iress

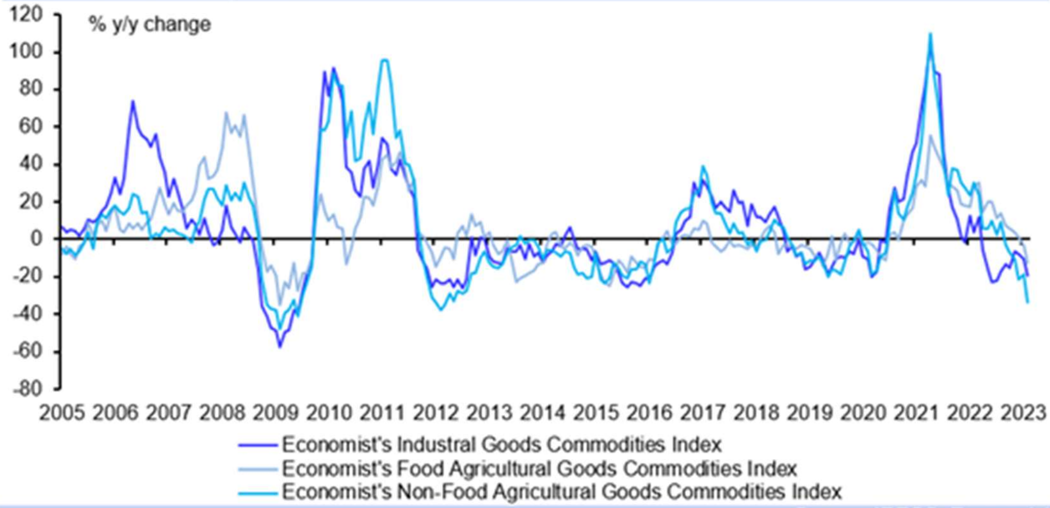
- Global financial market sentiment has become more risk averse, as market expectations of further US rate hikes have risen over this year on building concerns of a slower descent in key (core) inflation measures than initially hoped for.
- The implied Fed funds futures rate shows another 25bp hike expected in US interest rates next month at the 22nd March FOMC meeting, and a further 25bp by June but potentially occurring as early as the 3rd May FOMC meeting.
- Markets had priced in only one more 25bp hike by the end of Q2.23 previously (market expectations just after the February FOMC meeting), leading to a reduction in risk sentiment, although this has now largely been reversed as risk aversion rises.
- Markets now worry that FOMC minutes (released Wednesday evening) for the 1st February meeting will see a steepening in the FOMC members rate hike expectations (dot plot chart), and a higher end (terminal) rate.
- Hopes of a pause in US rate hikes in March have eroded, as the US labour market remains strong, the US unemployment rate ticked lower in January (to its lowest rate in over 50 years) and non-farm payrolls came out nearly triple what was expected.

- In addition, US core inflation fell by less than was anticipated in last week's publication of the January figures, while headline CPI inflation in the US disappointed as well (and by a larger margin), causing market concerns to rise.
- Fed Chair, Jerome Powell, has communicated that if the US economy does not see a marked slowdown, expected to be reflected in the labour market, then the US could speed up the pace of its rate hikes, as well as extend them.
- Better than anticipated data on the health of the US economy, and building market concerns over a more hawkish Fed approach has added volatility to the rand, which has lost ground too as the interest rate differential between the US and SA eroded.
- SA has only hiked by 375bp to date, and the FOMC by 450bp, with the rand weakening materially as a consequence as the return on risk diminished comparatively, eroding the protective buffer for the domestic currency.

Please scroll down to the second section below

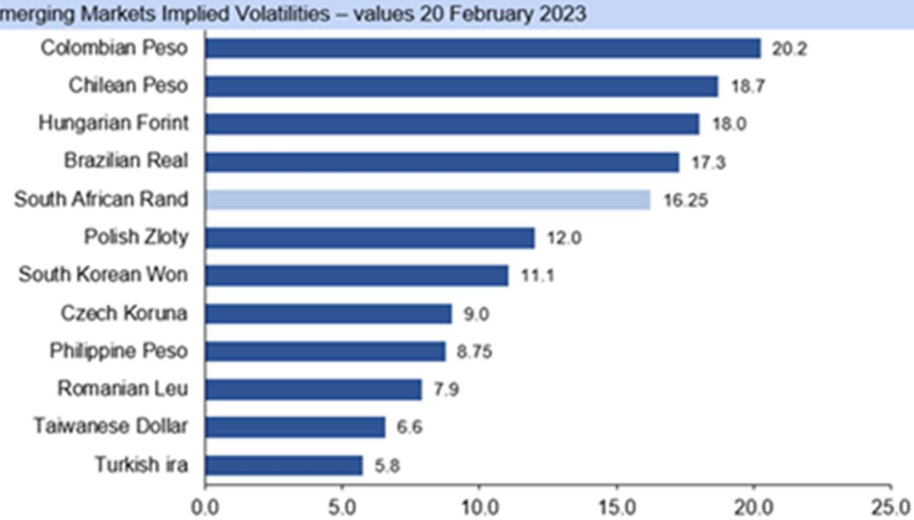


Economist's commodity indices

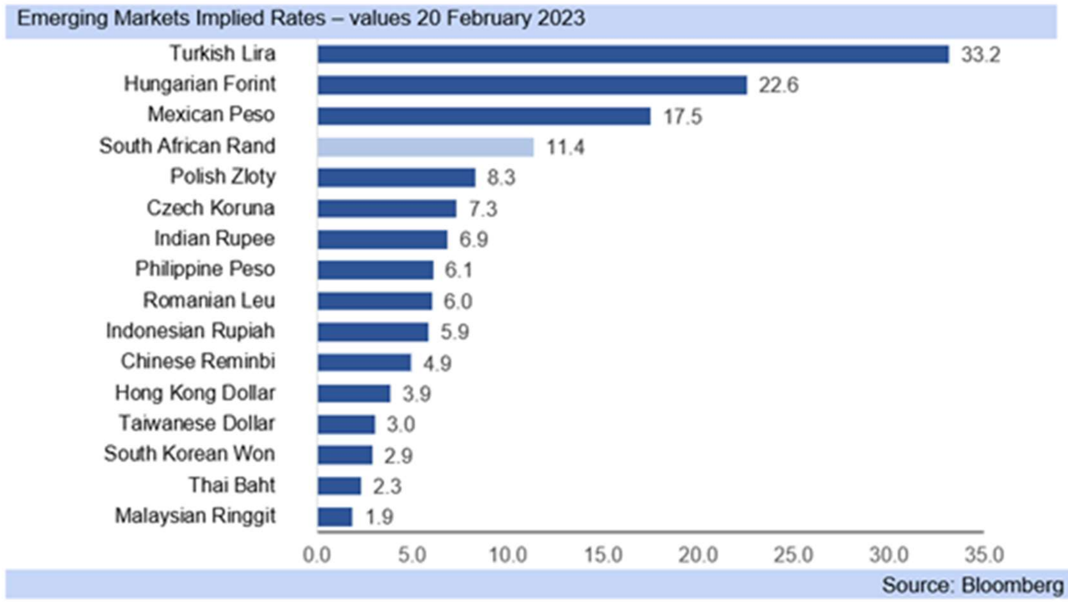


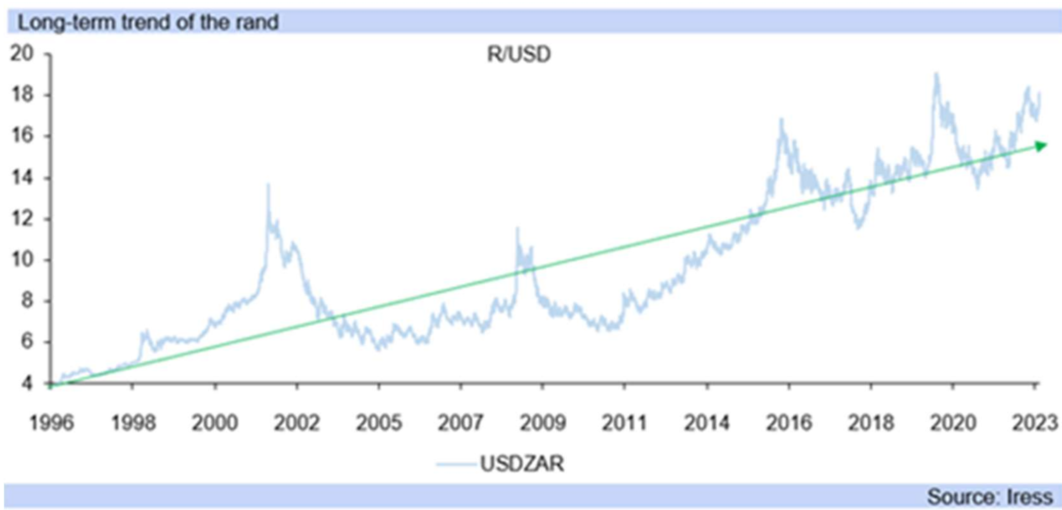
Source: IRESS, Economist

Emerging Markets Implied Volatilities – values 20 February 2023



Source: Bloomberg





- South Africa has implemented stage 6 loadshedding “continuously until further notice” as eight generation units broke down on Sunday afternoon, and warns of the risk of higher levels of loadshedding – with 6GW taken off the grid until further notice.
- Additionally, Eskom said in its statement, breakdowns amount to a huge 21 243MW, while 3 566MW have been taken off the grid for planned maintenance and repair to take place. This adds towards negative market sentiment towards SA.
- The rand reached R18.14/USD today, R18.34/USD on Friday, as the domestic currency weakened against the crosses, and R21.82/GBP (R21.84/GBP) as the rand heads towards R22.00/GBP .
- Against the euro the rand has weakened further as well this year, to R19.38/EUR today, R19.47/EUR on Friday, with the rand at risk of further weakness as global risk sentiment deteriorates, as does SA’s economic growth outlook.

- We forecast economic growth this year of 0.7% y/y on an average of stage 4 loadshedding along with better than expected global economic growth, without the latter SA's economic growth rate could come out closer to 0.5% y/y this year.
- The Reserve Bank forecasts growth of 0.3% y/y for this year, but the Bloomberg consensus (published last week) sees 1.1% y/y, down slightly from 1.2% y/y in January, with the impact of continuous loadshedding not fully factored in.
- The Reuters consensus (also published last week) shows a forecast of 1.0% y/y for this year, likely also still too high, but pulled higher by a couple of outlier forecasts, without which the average would be closer to 0.9% y/y.
- Foreigners have sold -R19.5bn worth of South African bonds (net of purchases – Bloomberg, JSE data) since the announcement of permanent load shedding on 22nd January, driving the rand weaker, with net sales of SA equities too.
- Markets are awaiting the Budget speech in Parliament this week, with any revision to National's Treasury's fiscal ratio projections likely to be to the downside as growth expectations weaken, which would be credit negative.

Economic Scenarios: note updated probabilities

		Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
Extreme Up case 1%	USD/Rand (average)	16.40	15.50	14.50	14.00	13.60	13.40	13.30	13.10
	Repo rate (end rate)	6.50	6.25	6.00	5.75	5.50	5.25	4.75	4.75

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.

		Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
Up case 4%	USD/Rand (average)	16.60	15.90	15.50	15.00	14.70	14.60	14.50	14.70
	Repo rate (end rate)	7.00	6.75	6.50	6.25	6.00	6.00	5.50	5.50

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.

		Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
Base case 50%	USD/Rand (average)	17.10	17.00	16.90	16.80	16.60	16.85	17.20	17.00
	Repo rate (end rate)	7.25	7.25	7.25	7.25	7.00	7.00	7.00	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.

		Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
Lite (domestic) Down case 34%	USD/Rand (average)	18.30	18.50	18.00	18.20	17.90	18.10	18.20	18.30
	Repo rate (end rate)	7.50	8.00	8.50	9.00	9.00	9.00	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.

		Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
Severe down case 11%	USD/Rand (average)	18.70	19.30	19.50	19.70	19.90	19.90	20.00	20.50
	Repo rate (end rate)	8.00	9.00	10.00	10.25	10.25	10.50	10.75	10.75

Lengthy global recession, global financial crisis – insufficient monetary and other support domestically and internationally. ANC/EFF coalition 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, eventually 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 on the economy. 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 Q1.23. Source: Investec

Lite Down Case: Exchange Rate forecasts

	2023				2024				2025			
	Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24	Q1.25	Q2.25	Q3.25	Q4.25
USD/ZAR	18.30	18.50	18.00	18.20	17.90	18.10	18.20	18.30	18.35	18.45	18.45	18.40
GBP/ZAR	22.49	22.94	22.50	22.75	22.55	22.99	23.39	23.88	23.86	23.99	23.99	23.92
EUR/ZAR	19.80	20.26	19.98	20.38	20.23	20.63	21.02	21.50	21.47	21.59	21.59	21.53
ZAR/JPY	7.08	6.95	7.00	6.87	6.90	6.74	6.65	6.56	7.30	7.15	7.10	7.07
CHFZAR	19.99	20.36	19.78	19.69	19.17	19.37	19.64	20.10	20.16	20.27	20.27	20.22
AUDZAR	12.69	13.14	13.05	13.38	13.25	13.39	13.56	13.73	13.95	14.21	14.58	14.54
GBP/USD	1.23	1.24	1.25	1.25	1.26	1.27	1.29	1.31	1.30	1.30	1.30	1.30
EUR/USD	1.08	1.10	1.11	1.12	1.13	1.14	1.16	1.18	1.17	1.17	1.17	1.17
USD/JPY	130	129	126	125	124	122	121	120	134	132	131	130

Note: averages, Source: Investec, Iress

Up Case: Exchange Rate forecasts												
	2023				2024				2025			
	Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24	Q1.25	Q2.25	Q3.25	Q4.25
USD/ZAR	16.60	15.90	15.50	15.00	14.70	14.60	14.50	14.70	14.80	14.60	14.70	14.80
GBP/ZAR	20.40	19.72	19.38	18.75	18.52	18.54	18.63	19.18	19.24	18.98	19.11	19.24
EUR/ZAR	17.96	17.41	17.21	16.80	16.61	16.64	16.75	17.27	17.32	17.08	17.20	17.32
ZAR/JPY	7.80	8.08	8.13	8.33	8.40	8.36	8.34	8.16	9.05	9.04	8.91	8.78
CHFZAR	18.14	17.50	17.03	16.23	15.74	15.63	15.65	16.14	16.26	16.04	16.15	16.26
AUDZAR	11.51	11.29	11.24	11.03	10.88	10.80	10.80	11.03	11.25	11.24	11.61	11.69
GBP/USD	1.23	1.24	1.25	1.25	1.26	1.27	1.29	1.31	1.30	1.30	1.30	1.30
EUR/USD	1.08	1.10	1.11	1.12	1.13	1.14	1.16	1.18	1.17	1.17	1.17	1.17
USD/JPY	130	129	126	125	124	122	121	120	134	132	131	130

Note averages, Source: Investec, Iress

Severe Down Case: Exchange Rate forecasts												
	2023				2024				2025			
	Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24	Q1.25	Q2.25	Q3.25	Q4.25
USD/ZAR	18.70	19.30	19.50	19.70	19.90	19.90	20.00	20.50	20.40	20.40	20.70	20.50
GBP/ZAR	22.99	23.93	24.38	24.63	25.07	25.27	25.70	26.75	26.52	26.52	26.91	26.65
EUR/ZAR	20.23	21.13	21.65	22.06	22.49	22.69	23.10	24.09	23.87	23.87	24.22	23.99
ZAR/JPY	6.93	6.66	6.46	6.35	6.21	6.13	6.05	5.85	6.57	6.47	6.33	6.34
CHFZAR	20.43	21.24	21.43	21.32	21.31	21.30	21.59	22.51	22.42	22.42	22.75	22.53
AUDZAR	12.96	13.70	14.14	14.48	14.73	14.73	14.90	15.38	15.50	15.71	16.35	16.20
GBP/USD	1.23	1.24	1.25	1.25	1.26	1.27	1.29	1.31	1.30	1.30	1.30	1.30
EUR/USD	1.08	1.10	1.11	1.12	1.13	1.14	1.16	1.18	1.17	1.17	1.17	1.17
USD/JPY	130	129	126	125	124	122	121	120	134	132	131	130

Note: averages, Source: Investec, Iress

Extreme Up Case: Exchange Rate forecasts												
	2023				2024				2025			
	Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24	Q1.25	Q2.25	Q3.25	Q4.25
USD/ZAR	16.40	15.50	14.50	14.00	13.60	13.40	13.30	13.10	12.90	12.80	12.70	12.60
GBP/ZAR	20.16	19.22	18.13	17.50	17.14	17.02	17.09	17.10	16.77	16.64	16.51	16.38
EUR/ZAR	17.74	16.97	16.10	15.68	15.37	15.28	15.36	15.39	15.09	14.98	14.86	14.74
ZAR/JPY	7.90	8.29	8.69	8.93	9.08	9.10	9.10	9.16	10.39	10.31	10.31	10.32
CHFZAR	17.92	17.06	15.94	15.15	14.57	14.34	14.35	14.39	14.18	14.07	13.96	13.85
AUDZAR	11.37	11.01	10.51	10.29	10.06	9.92	9.91	9.83	9.80	9.86	10.03	9.95
GBP/USD	1.23	1.24	1.25	1.25	1.26	1.27	1.29	1.31	1.30	1.30	1.30	1.30
EUR/USD	1.08	1.10	1.11	1.12	1.13	1.14	1.16	1.18	1.17	1.17	1.17	1.17
USD/JPY	130	129	126	125	124	122	121	120	134	132	131	130

Note: averages, Source: Investec, Iress