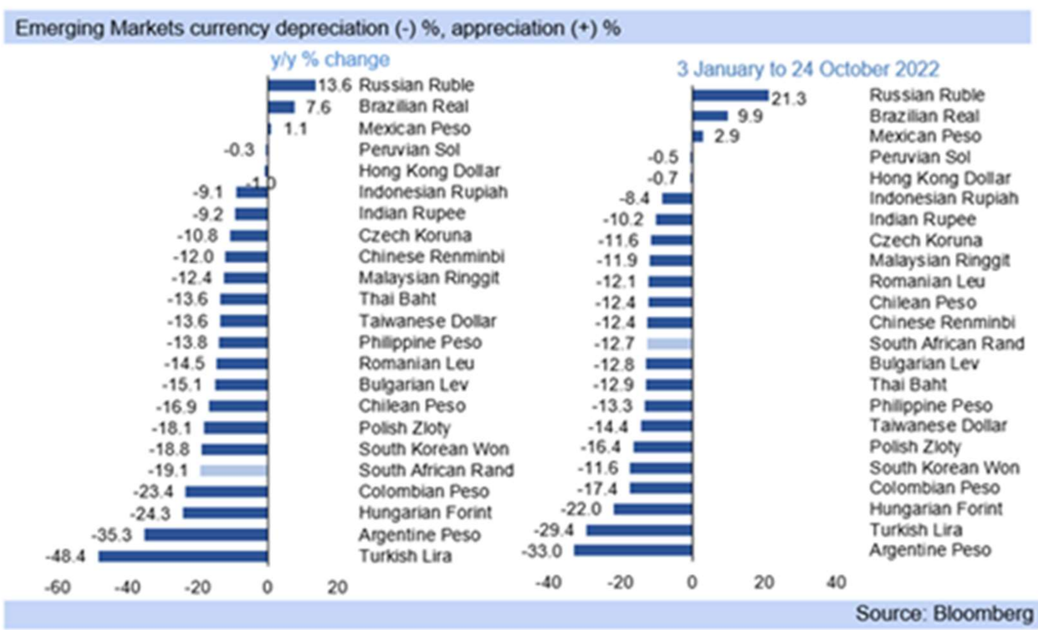
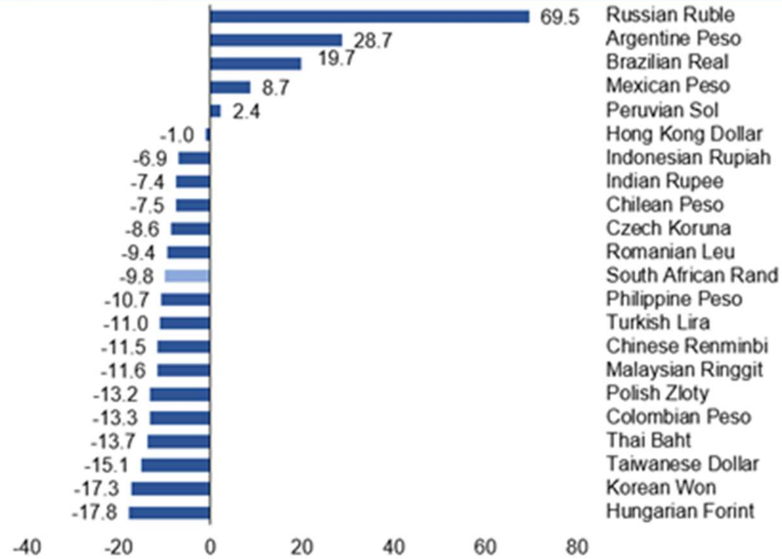
SA Economics

Monday 24 October 2022

Rand note: SOEs and rise in bond yields will erode the opportunity for fiscal consolidation

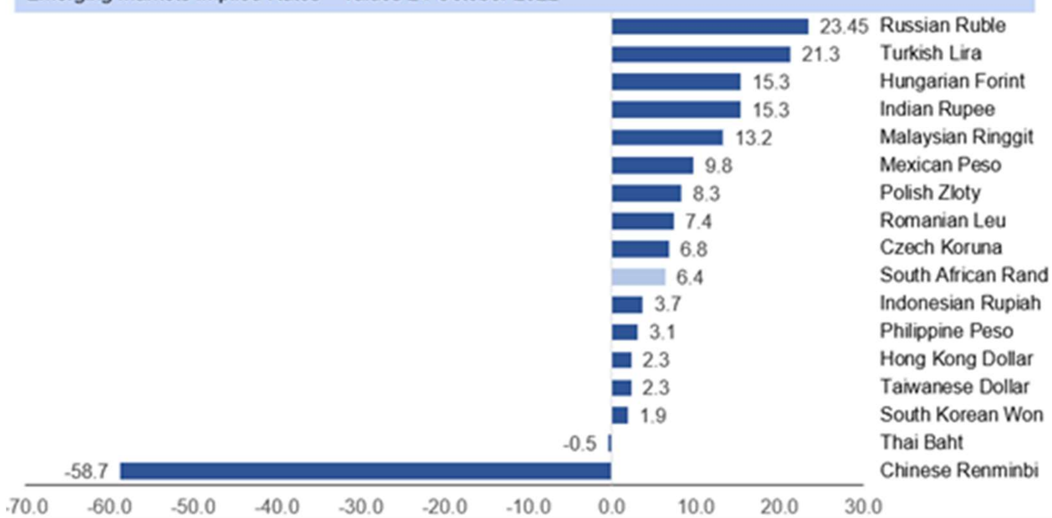


Emerging Markets Carry Return – values 24 October 2022

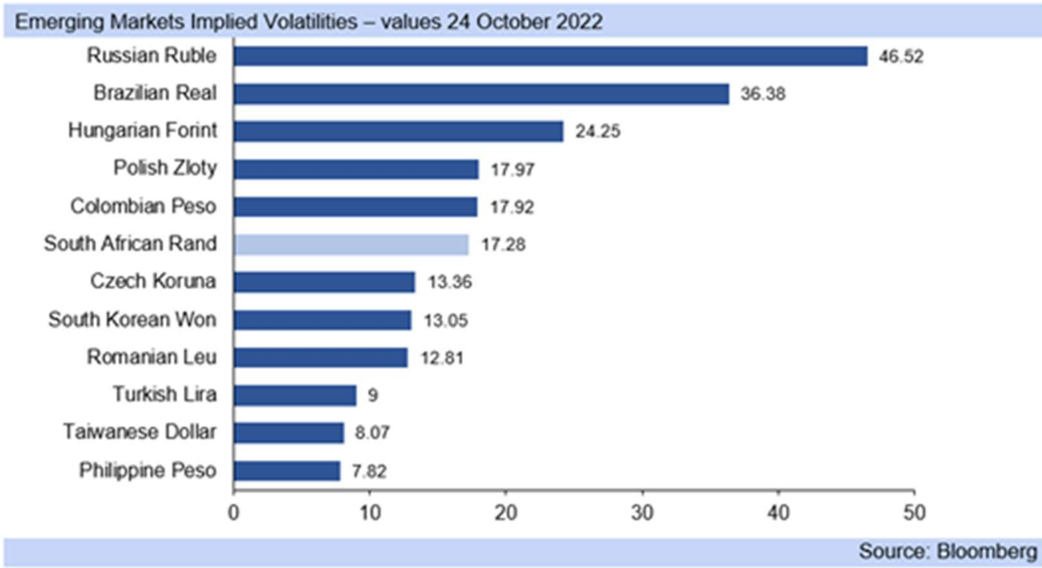


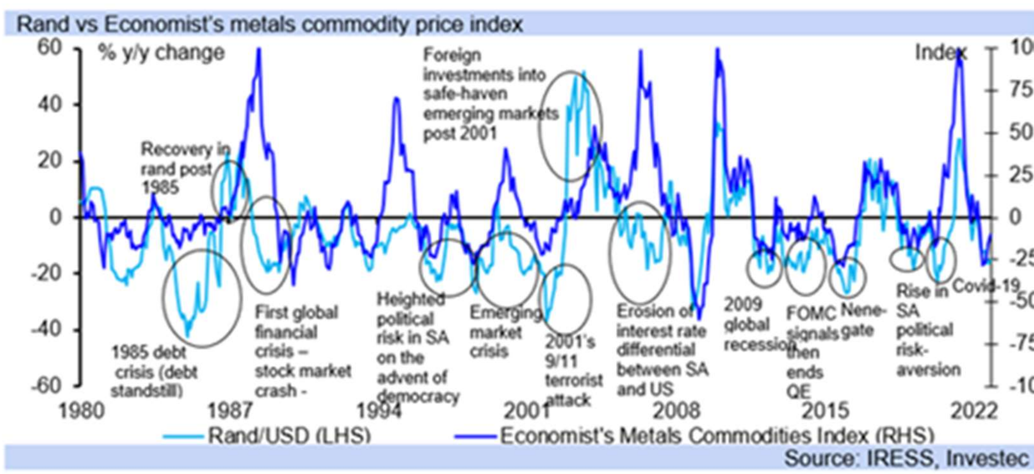
Source: Bloomberg

Emerging Markets Implied Rates – values 24 October 2022



Source: Bloomberg





- The rand weakened today against the key crosses, at R18.39/USD from its close of R18.05/USD on Friday, R18.03/EUR from Friday's R17.84/EUR, and R20.81/GBP (after closing at R20.43/GBP last week) as risk aversion levels rise globally.
- Domestic factors are also contributing to rand weakness, particularly the growth negative effects of Transnet and Eskom's inability to consistently meet demand for their services, with no immediate solutions for electricity, rail and port transport seen in 2022 or 2023.
- Ahead of the MTBPS (Medium-term Budget Policy Statement) this week Wednesday, markets have been factoring in likely assistance from the fiscus for both Transnet and Eskom, which will lower the opportunity for fiscal consolidation and so has undermined the rand.
- Government is expected to absorb at least part of Eskom's debt onto to its balance sheet in future, and while markets have been disappointed before at previous budgets (both mini and the February Budgets), government is expected to give some clarity on its plans this week.

- Transnet will also need substantial state financial assistance as it will be reportedly unable to operate profitability next year, as insufficient capacity to meet the demand for its services has eroded its earning capability as has been the case with Eskom.
- Both Eskom and Transnet suffer from insufficient repair, maintenance and replacement of working infrastructure following years of state capture which has decimated the SOE's finances, governance capabilities and recently still have seen bulk commodities theft.
- That is, Eskom has reported theft of diesel needed to fire its open-cycle gas turbines, and Transnet has seen the loss of customers' minerals commodities in transit and replacement with low grade commodities instead, as the stolen high grade goods are exported.
- Finance Minister Enoch Godongwana warns "Transnet presented a facade of an efficient institution, but now things begin to burst out into the open… If we don't make an intervention, we will have another Eskom on our hands."
- Both SOE's are vital for the functioning of SA's economy, with markets reacting negatively to bad news in the risk averse environment, while the GBP has seen some recent strength as markets now see an improved fiscal plan versus September's mini-budget in the UK.

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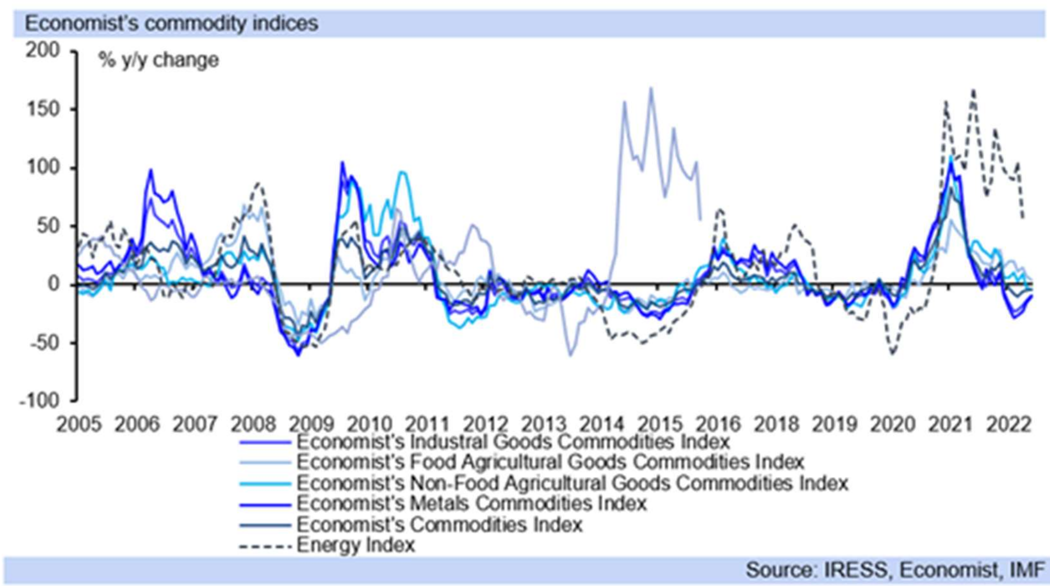
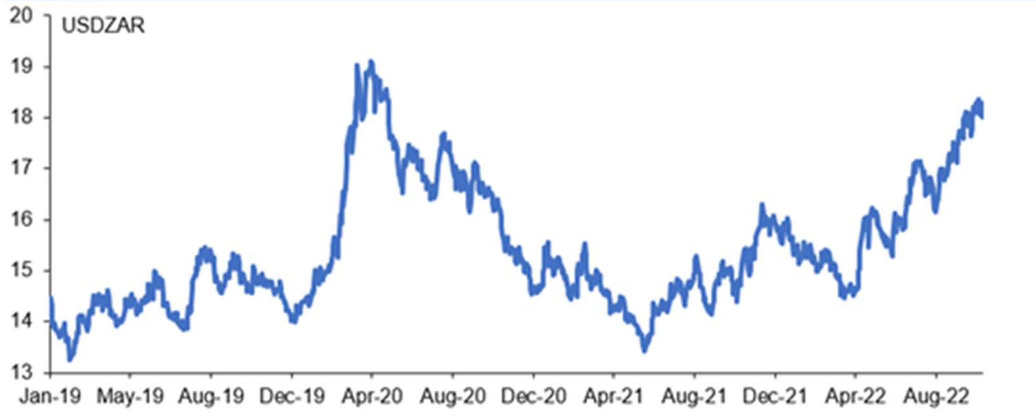
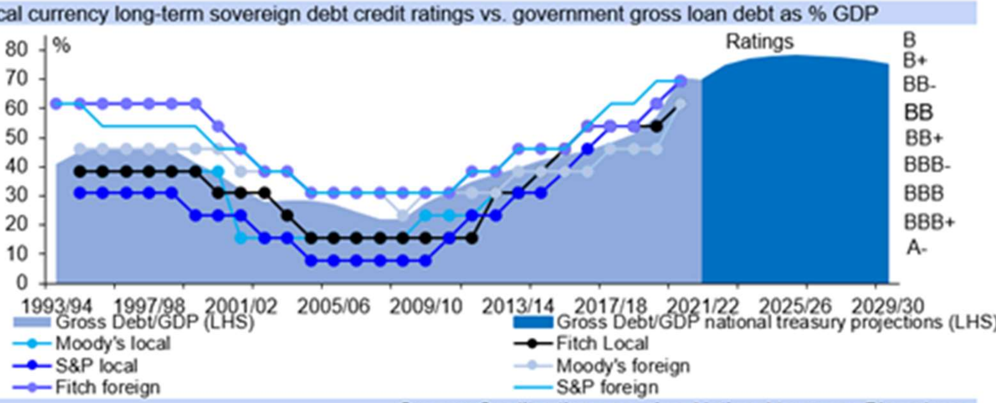


USDZAR



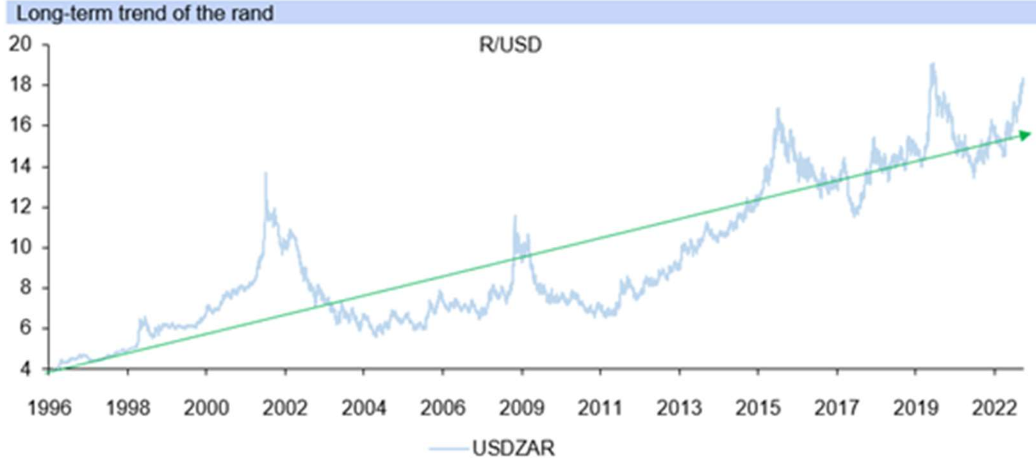
Source: Iress

Local currency long-term sovereign debt credit ratings vs. government gross loan debt as % GDP



Source: Credit rating agencies, National treasury, Bloomberg

Long-term trend of the rand



Source: Iress

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	7.25	7.25	7.25	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.

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

- South Africa is a commodity exporter, and substantial fiscal revenue is garnered from taxation of its commodities sector. Reducing SA's export capacity due to problems at the ports and on the rails harms government finances, and negatively affects the economic outlook.
- While good commodity prices earlier in the year boosted state revenues, and high coal prices persist, insufficient transport capacity has seen an estimated R50 billion loss in tax revenue for the year to date (Minerals Council) as Transnet cannot meet its full logistical demand.

- Weakened international trade dynamics have also affected the pace of the gains made earlier in the year for government revenue, but are expected to still enable further debt stabilisation, and there is scope for some mild lowering in SA's debt to GDP projections.
- For the MTBPS itself this week, strong tax receipts earlier in the year are expected to lift revenues and aid some fiscal consolidation, along with high inflation rates, and so on a credit rating front, no downgrades are expected this year.
- However, SA's debt and fiscal deficit ratios will improve in the current fiscal year mainly due to the deflationary effect of a higher nominal GDP. But the risk of global recession could impact the March quarter of the current fiscal year, a risk for the 2023/2024 fiscal year as well.
- The rating agencies will worry about the growth outlook, particularly as SOEs fail to support demand for their services in full, limiting the pace of economic growth, and so employment in the private sector.
- The rand has also weakened as investors have increasingly factored in the chance of recession next year, with Bloomberg recently showing that the % of investors expecting recession has now risen to 100%, increasing risk aversion in global financial markets.
- South Africa also continues to see a score of risks from the external environment, including ongoing monetary policy tightening in advanced economies, which is driving rising domestic borrowing costs, while high inflation also adds to the pressure on bond yields.
- Higher borrowing costs increase state expenditure, which will also erode the opportunity for fiscal consolidation, and so place pressure on the rand. The MTBPS could overall prove credit neutral this week, but is unlikely to bring major respite for the rand.

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

Note: averages, Source: Investec, Iress

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