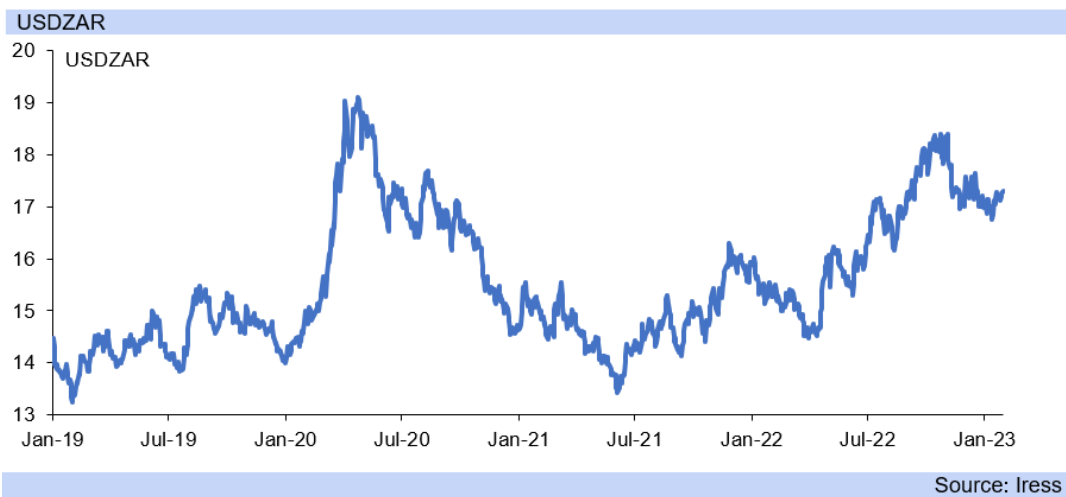
Investec


Hi

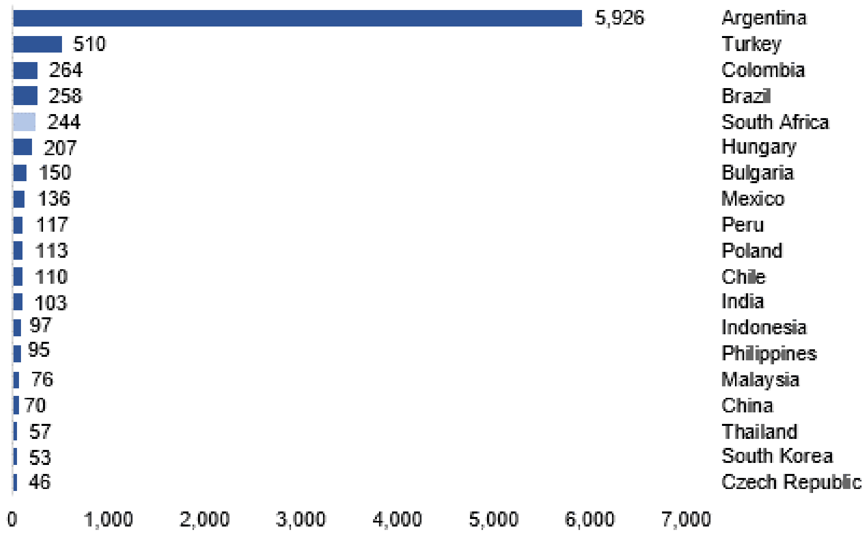
# Rand note: weakness against the key crosses reflects concerns over SA's growth

Monday 30 January 2023

---

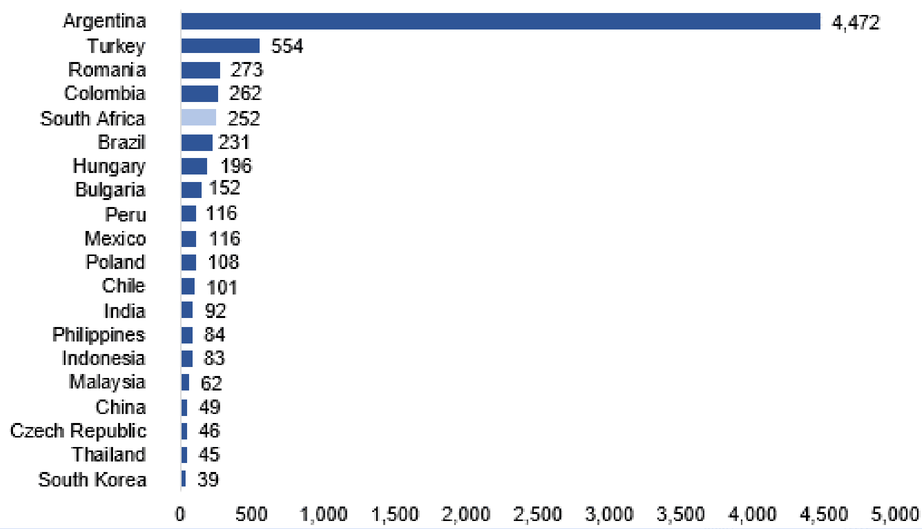


Emerging Markets CDS (risk) Spreads – values 5 January 2023

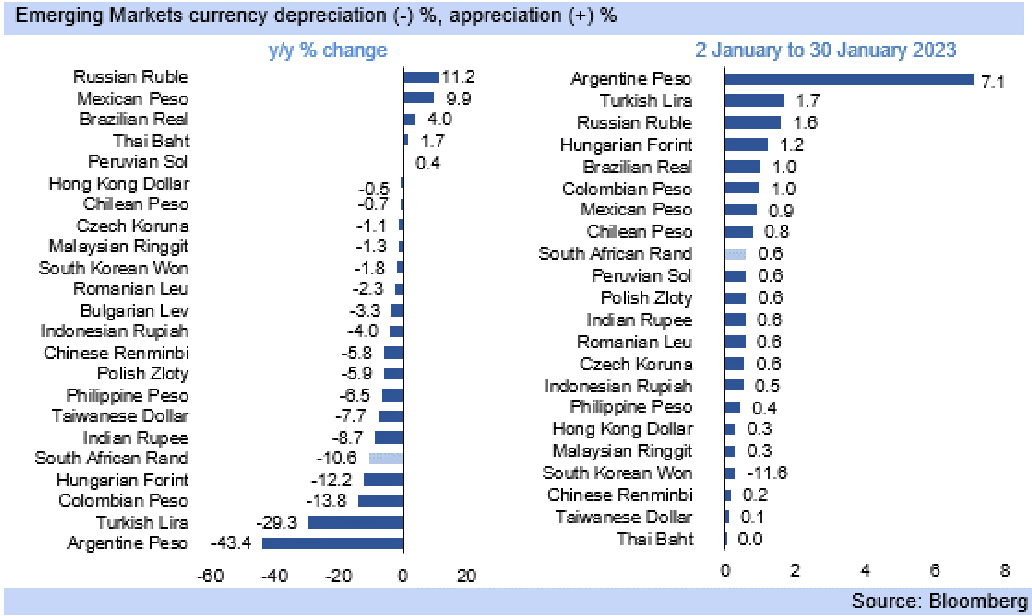



Source: Bloomberg

Emerging Markets CDS (risk) Spreads – values 30 January 2023




Source: Bloomberg




Expected Case: Exchange Rate forecasts

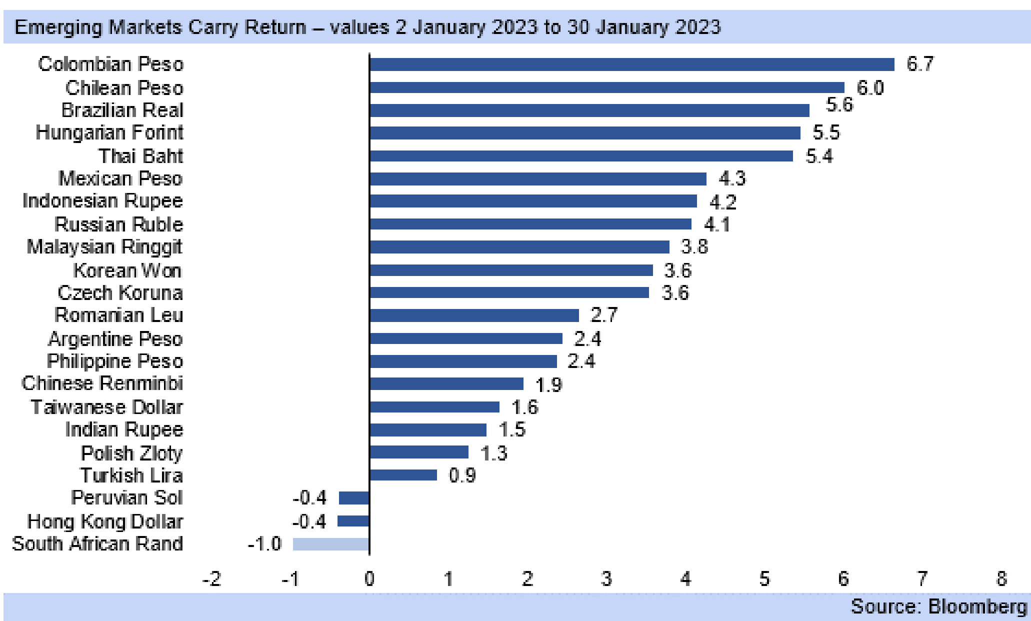
| | 2023 | | | | 2024 | | | | 2025 | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Q1.23 | Q2.23 | Q3.23 | Q4.23 | Q1.24 | Q2.24 | Q3.24 | Q4.24 | Q1.25 | Q2.25 | Q3.25 | Q4.25 |
| USD/ZAR | 16.90 | 16.45 | 16.20 | 16.40 | 16.20 | 16.45 | 16.80 | 16.60 | 16.50 | 16.50 | 16.80 | 16.60 |
| GBP/ZAR | 20.37 | 20.24 | 20.25 | 20.50 | 20.58 | 21.39 | 22.18 | 22.91 | 23.10 | 23.27 | 24.03 | 23.74 |
| EUR/ZAR | 17.58 | 17.28 | 17.26 | 17.80 | 18.15 | 18.92 | 19.83 | 20.42 | 20.63 | 20.63 | 21.00 | 20.75 |
| ZAR/JPY | 8.19 | 8.30 | 8.30 | 8.14 | 8.02 | 7.29 | 6.84 | 6.63 | 6.48 | 6.48 | 6.37 | 6.44 |
| CHFZAR | 17.79 | 17.32 | 17.06 | 17.27 | 17.06 | 17.69 | 18.46 | 18.24 | 18.13 | 18.13 | 18.46 | 18.24 |
| AUDZAR | 11.49 | 11.52 | 11.67 | 12.06 | 12.15 | 12.83 | 13.11 | 12.95 | 12.87 | 12.87 | 13.11 | 12.95 |
| GBP/USD | 1.21 | 1.23 | 1.25 | 1.25 | 1.27 | 1.30 | 1.32 | 1.38 | 1.40 | 1.41 | 1.43 | 1.43 |
| EUR/USD | 1.04 | 1.05 | 1.07 | 1.09 | 1.12 | 1.15 | 1.18 | 1.23 | 1.25 | 1.25 | 1.25 | 1.25 |
| USD/JPY | 139 | 137 | 135 | 134 | 130 | 120 | 115 | 110 | 107 | 107 | 107 | 107 |

Note: averages, Source: Investec, Iress

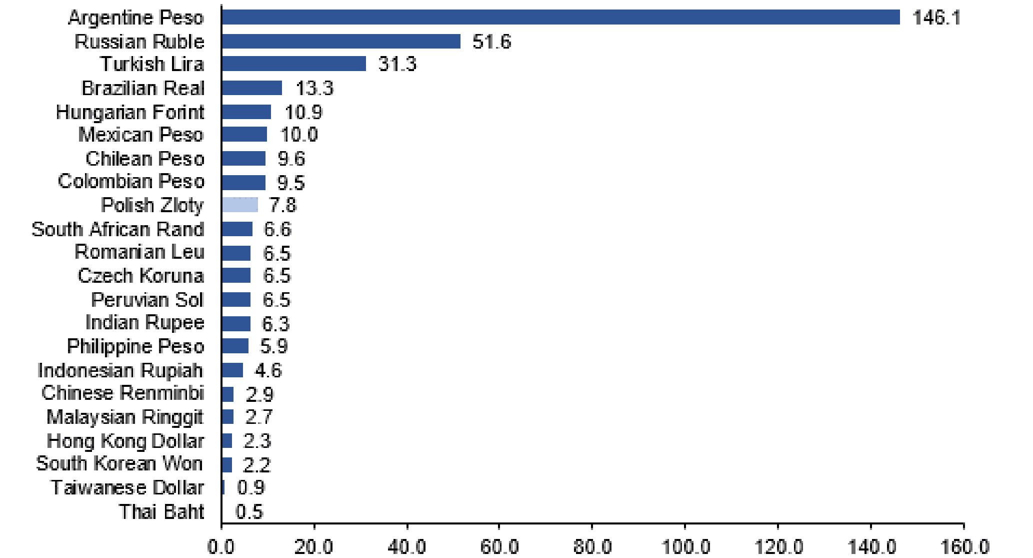
- The persistence of loadshedding has eroded investor confidence in the domestic economy, with no state solution to end the damaging effect on the economy in the near term, as we have been increasingly noting over the course of this month.
- January typically sees seasonal strength in the rand, but this year market players are penalising the domestic currency, as the state fails to allay investor concerns over the electricity crisis (see rand note of 23rd January 2023).
- Additionally, Transnet's deteriorating ability to meet demand for its rail and port transport services has further dented investor and business confidence, threatening export-led growth, and afflicting the rand (see rand note of 16th January 2023).
- The rand reached R17.29/USD, R18.80/EUR and R21.37/GBP on Friday, trading weaker this morning against the key crosses, as investor sentiment against SA has dipped, and the interest rate differential with the US has not narrowed significantly.

- SA's growing electricity crisis implies a substantially weaker 2023 outcome for the economy as we have increasingly noted this year so far, well below the 1.1% y/y growth rate we had forecast end December/start January (likely closer to 0.6% y/y).
- Already industrial production contracted in the first two months of Q4.22, down by -1.4% versus the same period in Q3.22 (seasonally adjusted) for South Africa, on the country's deepening supply side energy shortages.
- Additionally, Eskom faces high and rising costs from its usage of diesel to fuel open-cycle gas turbines, and desperately needs cash injections (and a wholesalers license) to purchase diesel, absent which the stages of load shedding have risen.
- The looming threat of stage 8 load shedding, and outages including stage 6 so far, have eroded confidence in the domestic economic outlook, with no government solution in sight in the near-term, pushing the rand weaker (rand note 16th January 2023).
- Little improvement is expected this year in terms of state infrastructure, particularly on the rail, port, electricity and water supply front, which will impede economic growth and so job creation, keeping the rand weak (rand note 9th January 2023).

Please scroll down to the second section below

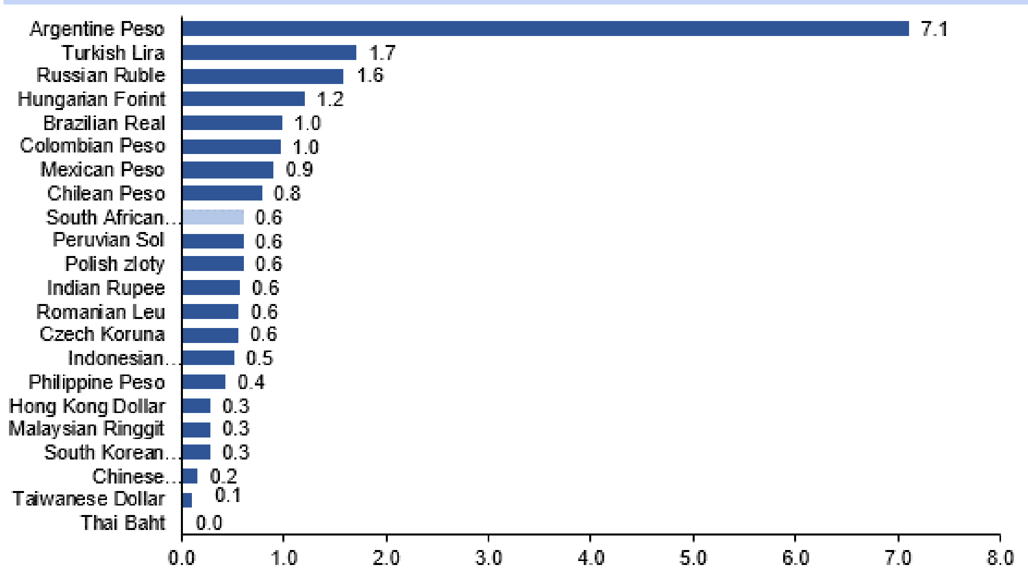


Emerging Markets Interest Return – values 31 January 2022 – 30 January 2023



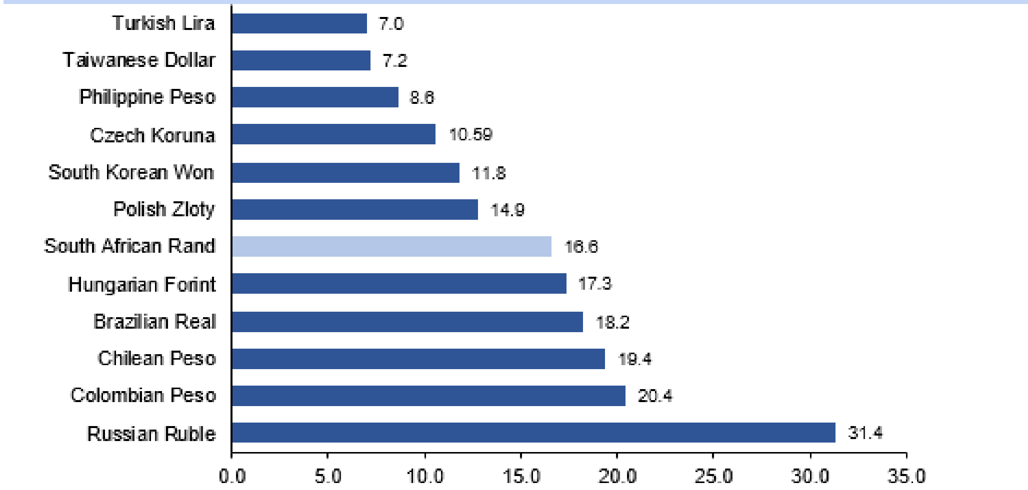

Source: Bloomberg

Emerging Markets Interest Return – values 2 January 2023 to 30 January 2023



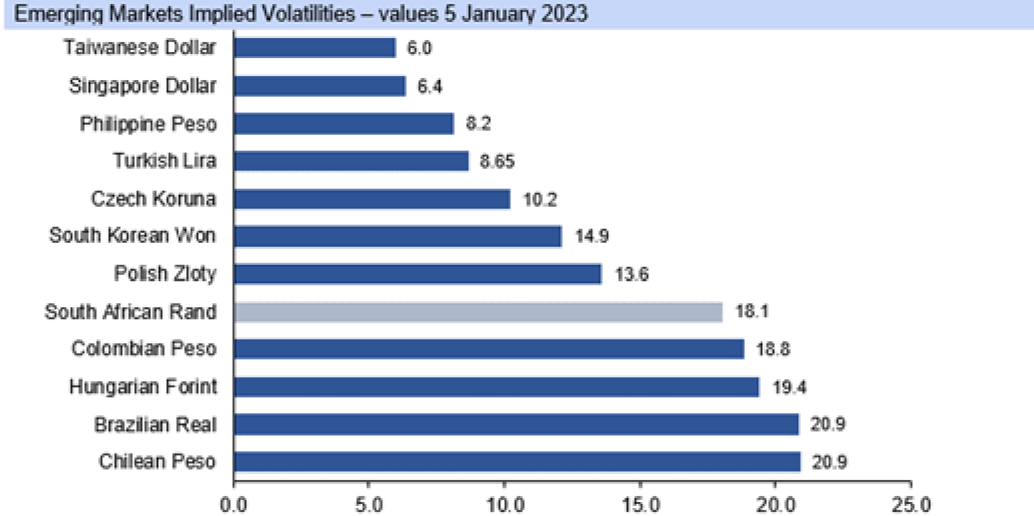

Source: Bloomberg

Emerging Markets Implied Volatilities – values 30 January 2023




Source: Bloomberg

Emerging Markets Implied Volatilities – values 5 January 2023




Source: Bloomberg

- On the positive front, evidence is emerging that inflation is falling faster than anticipated, and 2023 is expected to see supply chains strengthen, and associated cost increases slow aiding down inflation globally.
- A better than expected global economic performance this year, with the avoidance of overheating, will prove positive for financial market sentiment internationally, which is already in the process of recovering.
- Indeed, 2023 started in a sweet spot, with economic outlooks improving for key advanced economies (which previously were expected to drive a severe recession), while the improved outlooks are not to the extent of being inflationary.

- However, this is not the case for SA's domestic economy, with the announcement of permanent load shedding this year in the second half of January, along with political risk this year and next has seen a downgrade in SA's growth outlook.
- The global economy is improving in contrast, with the US seeing better than expected growth in Q4.22, lifting 2.9% qqsaa (quarter on quarter, seasonally adjusted, annualised) – without annualisation it came out at 0.7% qqsa.
- However for SA, economic activity likely stalled in Q4.22, with the risk of contraction as shown by the recent industrial production figures ( for the first two months of Q4.22) as the SA economy continues to underperform (Industrial production note, 17th January 2023).
- The US in comparison has had a markedly steeper interest rate hike cycle to date (with a 4.25% lift and likely another 25bp next week) than SA's (3.75%). A key reason for rand weakness and not a factor which is likely to change in H1.23.
- This will suppress the domestic currency, preventing it from gaining substantially on US dollar weakness and weakening it against the major crosses in Q1.23. Markets were disappointed by the SARB's small hike last week, seeing the rand drop.
- That is, the rand weakened on the 25bp hike the SARB delivered instead of the expectation of 50bp, from R17.01/USD to R17.25/USD, failing to recover back to R17.01/USD on Friday or today.

| 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 | 14.90 |
| | 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 48% | USD/Rand (average) | 16.90 | 16.45 | 16.20 | 16.40 | 16.20 | 16.45 | 16.80 | 16.60 |
| | 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 36% | 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 | 22.05 | 22.76 | 22.50 | 22.75 | 22.73 | 23.53 | 24.02 | 25.25 | 25.69 | 26.01 | 26.38 | 26.31 |
| EUR/ZAR | 19.03 | 19.43 | 19.17 | 19.75 | 20.05 | 20.82 | 21.48 | 22.51 | 22.94 | 23.06 | 23.06 | 23.00 |
| ZAR/JPY | 7.57 | 7.38 | 7.47 | 7.34 | 7.26 | 6.63 | 6.32 | 6.01 | 5.83 | 5.80 | 5.80 | 5.82 |
| CHFZAR | 19.26 | 19.47 | 18.95 | 19.16 | 18.84 | 19.46 | 20.00 | 20.11 | 20.16 | 20.27 | 20.27 | 20.22 |
| AUDZAR | 12.44 | 12.95 | 12.96 | 13.38 | 13.43 | 14.12 | 14.20 | 14.27 | 14.31 | 14.39 | 14.39 | 14.35 |
| GBP/USD | 1.21 | 1.23 | 1.25 | 1.25 | 1.27 | 1.30 | 1.32 | 1.38 | 1.40 | 1.41 | 1.43 | 1.43 |
| EUR/USD | 1.04 | 1.05 | 1.07 | 1.09 | 1.12 | 1.15 | 1.18 | 1.23 | 1.25 | 1.25 | 1.25 | 1.25 |
| USD/JPY | 139 | 137 | 135 | 134 | 130 | 120 | 115 | 110 | 107 | 107 | 107 | 107 |

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 | 22.53 | 23.74 | 24.38 | 24.63 | 25.27 | 25.87 | 26.40 | 28.29 | 28.56 | 28.76 | 29.60 | 29.32 |
| EUR/ZAR | 19.45 | 20.27 | 20.77 | 21.37 | 22.29 | 22.89 | 23.60 | 25.22 | 25.50 | 25.50 | 25.88 | 25.63 |
| ZAR/JPY | 7.41 | 7.07 | 6.90 | 6.78 | 6.53 | 6.03 | 5.75 | 5.37 | 5.25 | 5.25 | 5.17 | 5.22 |
| CHFZAR | 19.68 | 20.32 | 20.53 | 20.74 | 20.95 | 21.40 | 21.98 | 22.53 | 22.42 | 22.42 | 22.75 | 22.53 |
| AUDZAR | 12.72 | 13.51 | 14.04 | 14.48 | 14.93 | 15.52 | 15.60 | 15.99 | 15.91 | 15.91 | 16.15 | 15.99 |
| GBP/USD | 1.21 | 1.23 | 1.25 | 1.25 | 1.27 | 1.30 | 1.32 | 1.38 | 1.40 | 1.41 | 1.43 | 1.43 |
| EUR/USD | 1.04 | 1.05 | 1.07 | 1.09 | 1.12 | 1.15 | 1.18 | 1.23 | 1.25 | 1.25 | 1.25 | 1.25 |
| USD/JPY | 139 | 137 | 135 | 134 | 130 | 120 | 115 | 110 | 107 | 107 | 107 | 107 |
| 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 | 14.90 | 15.00 | 14.50 | 14.50 | 14.60 |
| GBP/ZAR | 20.00 | 19.56 | 19.38 | 18.75 | 18.67 | 18.98 | 19.14 | 20.56 | 21.00 | 20.45 | 20.74 | 20.88 |
| EUR/ZAR | 17.26 | 16.70 | 16.51 | 16.28 | 16.46 | 16.79 | 17.11 | 18.33 | 18.75 | 18.13 | 18.13 | 18.25 |
| ZAR/JPY | 8.34 | 8.58 | 8.68 | 8.90 | 8.84 | 8.22 | 7.93 | 7.38 | 7.13 | 7.38 | 7.38 | 7.33 |
| CHFZAR | 17.47 | 16.74 | 16.32 | 15.79 | 15.47 | 15.70 | 15.93 | 16.37 | 16.48 | 15.93 | 15.93 | 16.04 |
| AUDZAR | 11.29 | 11.13 | 11.16 | 11.03 | 11.03 | 11.39 | 11.31 | 11.62 | 11.70 | 11.31 | 11.31 | 11.39 |
| GBP/USD | 1.21 | 1.23 | 1.25 | 1.25 | 1.27 | 1.30 | 1.32 | 1.38 | 1.40 | 1.41 | 1.43 | 1.43 |
| EUR/USD | 1.04 | 1.05 | 1.07 | 1.09 | 1.12 | 1.15 | 1.18 | 1.23 | 1.25 | 1.25 | 1.25 | 1.25 |
| USD/JPY | 139 | 137 | 135 | 134 | 130 | 120 | 115 | 110 | 107 | 107 | 107 | 107 |
| 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 | 13.10 | 12.90 | 12.80 | 12.70 |
| GBP/ZAR | 19.76 | 19.07 | 18.13 | 17.50 | 17.27 | 17.42 | 17.56 | 18.08 | 18.34 | 18.19 | 18.30 | 18.16 |
| EUR/ZAR | 17.06 | 16.28 | 15.44 | 15.19 | 15.23 | 15.41 | 15.69 | 16.11 | 16.38 | 16.13 | 16.00 | 15.88 |
| ZAR/JPY | 8.45 | 8.81 | 9.28 | 9.54 | 9.56 | 8.96 | 8.65 | 8.40 | 8.17 | 8.29 | 8.36 | 8.43 |
| CHFZAR | 17.26 | 16.32 | 15.26 | 14.74 | 14.32 | 14.41 | 14.62 | 14.40 | 14.40 | 14.18 | 14.07 | 13.96 |
| AUDZAR | 11.15 | 10.85 | 10.44 | 10.29 | 10.20 | 10.45 | 10.37 | 10.22 | 10.22 | 10.06 | 9.98 | 9.91 |
| GBP/USD | 1.21 | 1.23 | 1.25 | 1.25 | 1.27 | 1.30 | 1.32 | 1.38 | 1.40 | 1.41 | 1.43 | 1.43 |
| EUR/USD | 1.04 | 1.05 | 1.07 | 1.09 | 1.12 | 1.15 | 1.18 | 1.23 | 1.25 | 1.25 | 1.25 | 1.25 |
| USD/JPY | 139 | 137 | 135 | 134 | 130 | 120 | 115 | 110 | 107 | 107 | 107 | 107 |
| Note: averages, Source: Investec, Iress | | | | | | | | | | | | |