



SA Economics

Monday 30 May 2022

Rand note: the rand gains as markets settle on the Fed's minutes indicating a steady rate hike cycle and little chance of recession

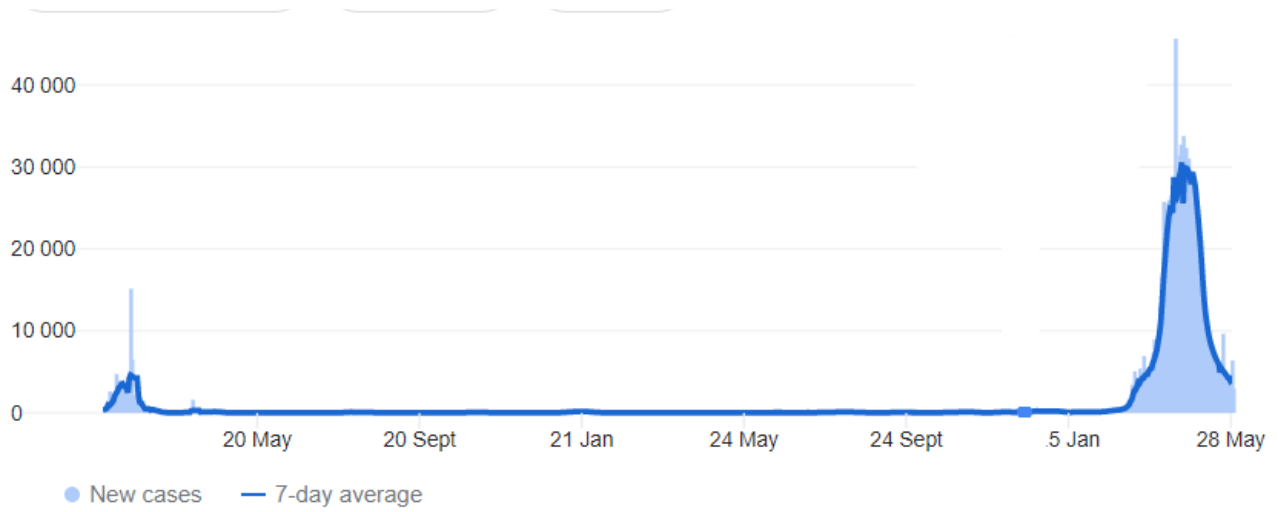
Emerging Markets currency depreciation (-) %, appreciation (+) %



Source: Bloomberg

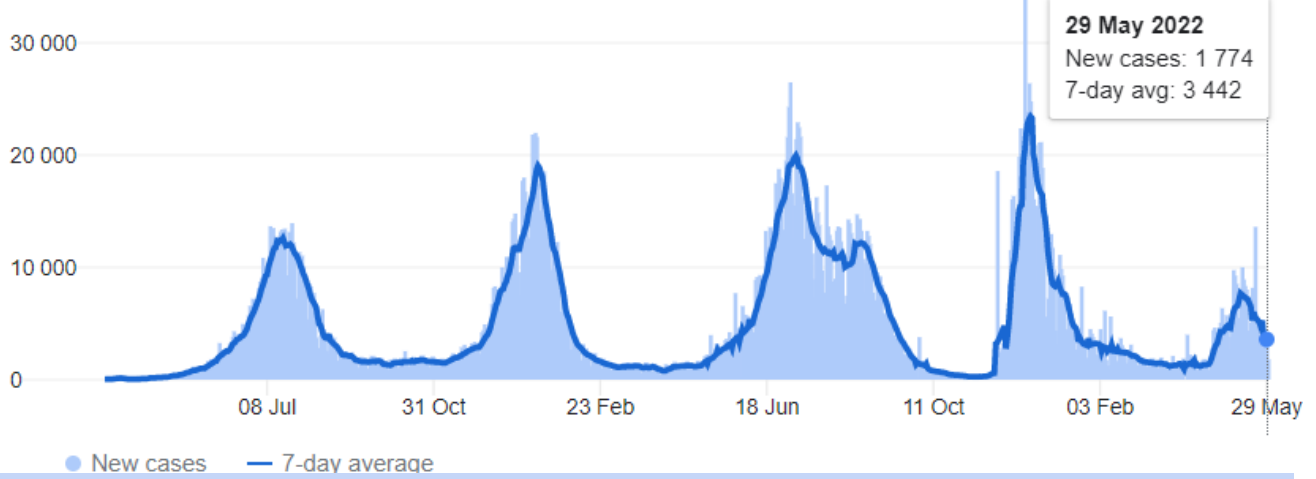
China daily new cases – 7 day rolling average

29 May 2022
 New cases: 2936
 7-day avg: 3 578



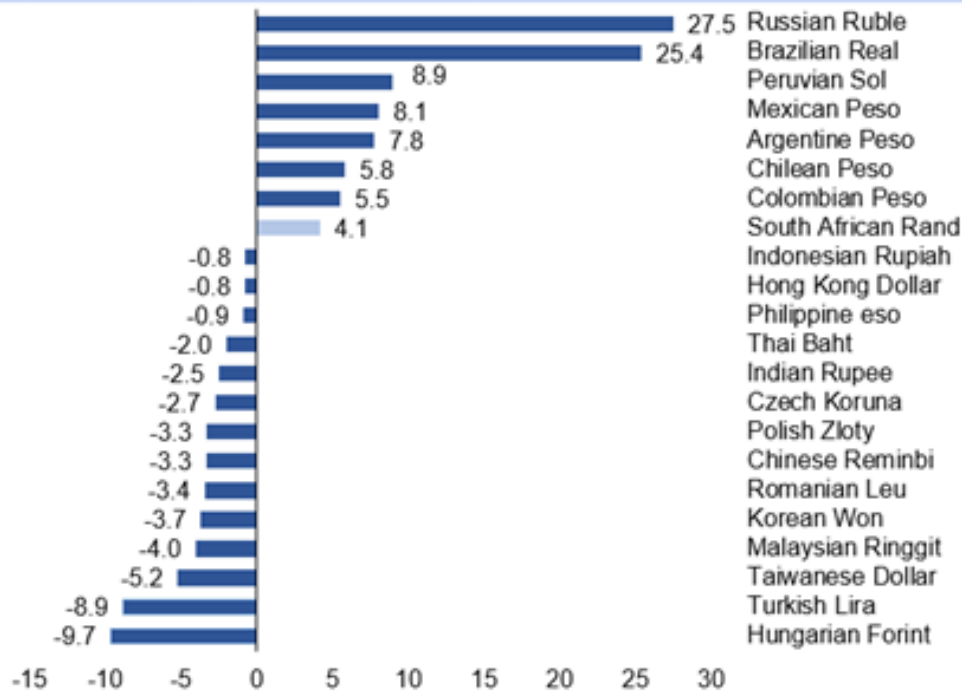
Source: Our World in Data

South Africa daily new cases – 7 day rolling average



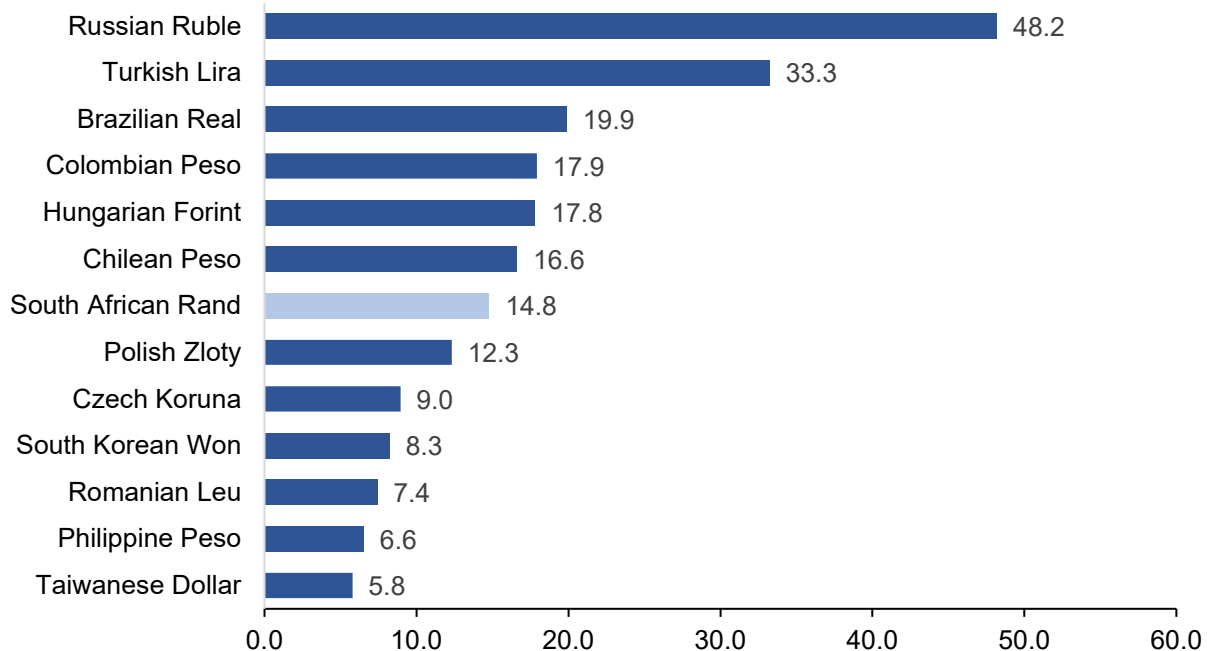
Source: JHU CSSE

Emerging Markets Carry Return – values 30 May 2022



Source: Bloomberg

Emerging Markets Implied Volatilities – values 30 May 2022

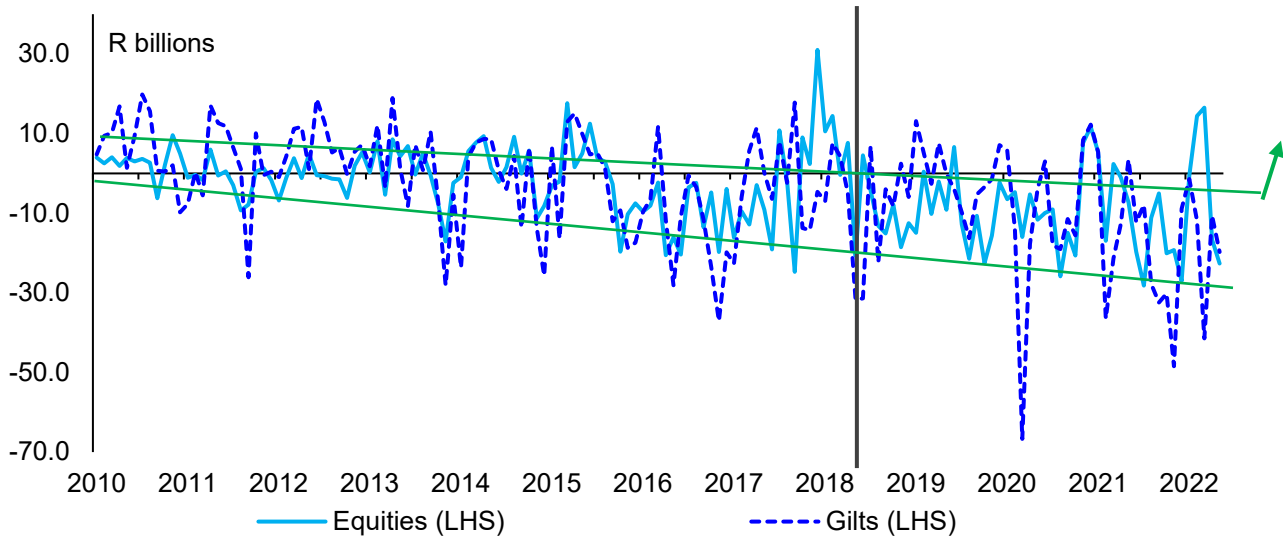


Source: Bloomberg

- Markets have continued digesting the FOMC minutes, cheering further on the reading of the US economy, which “all participants concurred ... was very strong”, and on growing optimism for a quick bounce back in Q3.22 for Chinese economic activity as its COVID cases collapse.

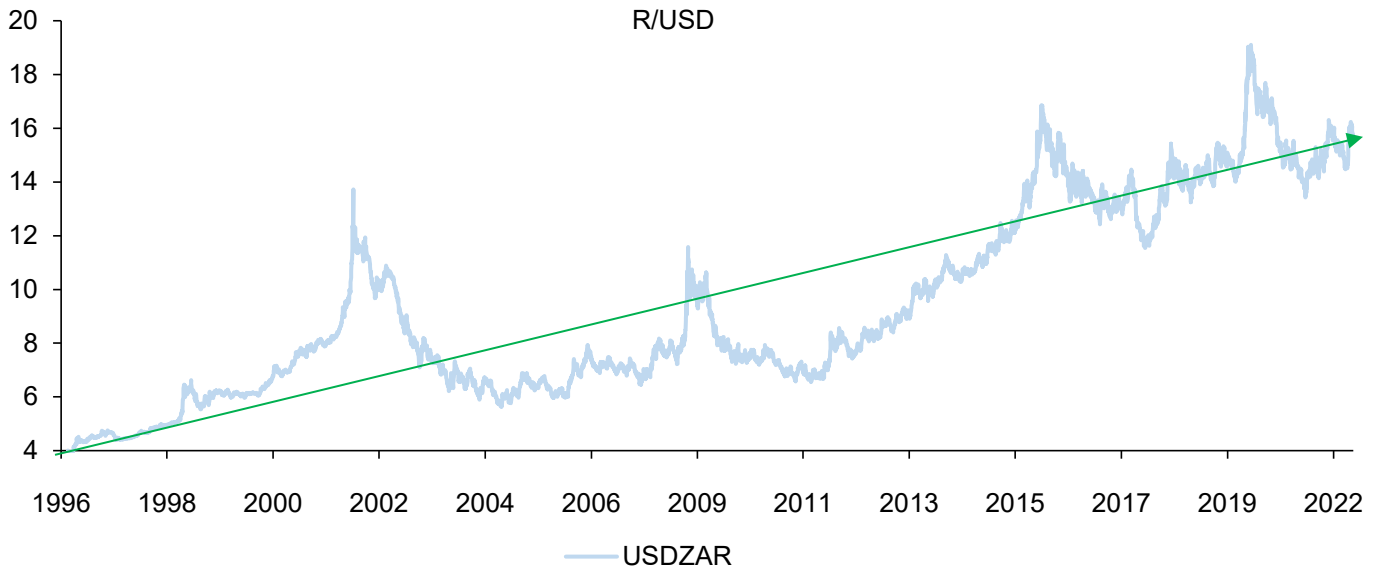
- Lockdowns are easing in China and expected to end over Q3.22, allowing the world's second largest economy to recover, while appetite for its zero-covid policy is waning and divergence is emerging politically on support for the onerous regulations.
- The relative mildness of the Omicron variant, and easier levels of restrictions globally, have also boosted optimism, and markets are fretting somewhat less about the severity of US rate hikes as the FOMC reiterated its broad based approach.
- Specifically, FOMC members "concurred that their assessments would take into account a wide range of information, including readings on public health, labor market conditions, inflation pressures and inflation expectations, and financial and international developments."
- "Members agreed that, in assessing the appropriate stance of monetary policy, they would continue to monitor the implications of incoming information for the economic outlook and that they would be prepared to adjust the stance of monetary policy as appropriate".
- These are usual statements that the FOMC has made historically and do show that US monetary policy is not solely focused on inflation, seeking to remain balanced in its approach, with the FOMC minutes showing 50bp hikes are likely (not 75bp) at the next two meetings.
- Currently, markets appear to be placing their trust in the Fed's ability to bring inflation down without landing the US in recession, and indeed inflation expectations for the US are starting to tip lower, adding to the reduction in risk-off sentiment.
- The second quarter of the year is however often very volatile for markets, with the rand often experiencing market weakness, as well as some recovery at times, and the domestic currency is not yet expected to run back below R15.00/USD this quarter.

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



Source: Iress, Investec

Long-term trend of the rand



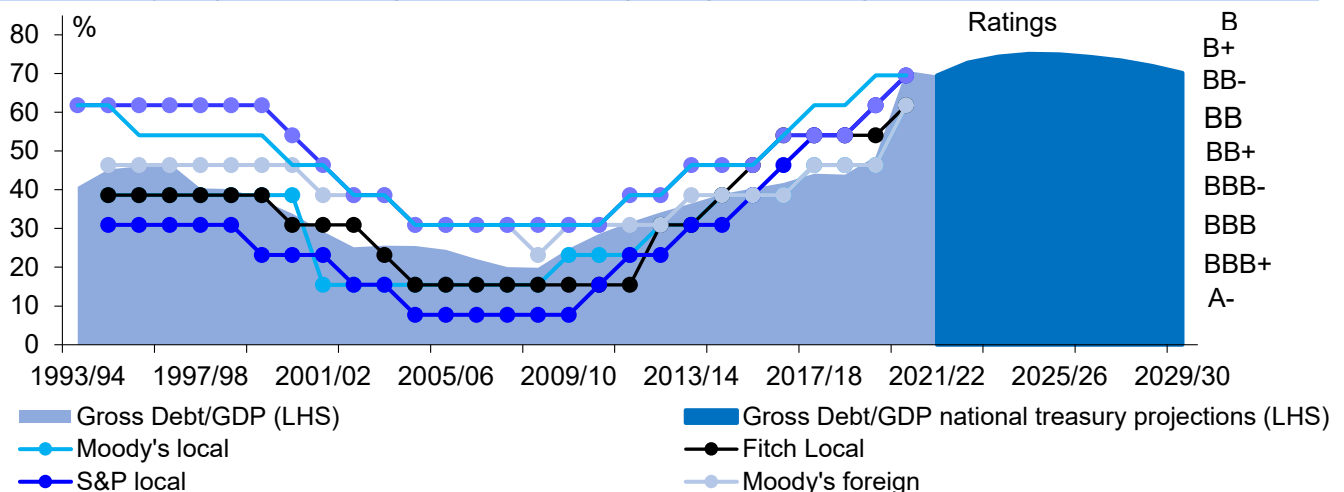
Source: Iress

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
CHFZAR	16.47	16.07	16.26	15.84	16.47	16.07	16.26	15.84	16.47	16.07	16.26	15.84
AUDZAR	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

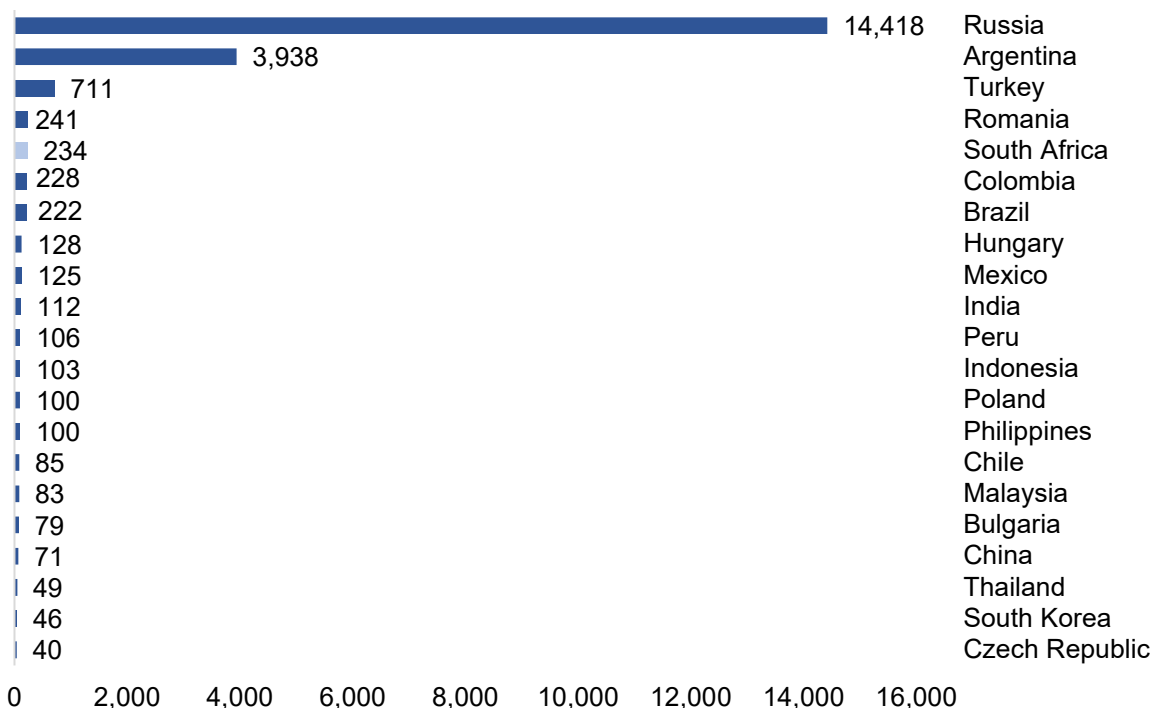
Note: averages, Source: Investec, Iress

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



Source: Credit rating agencies, National treasury, Bloomberg

Emerging Markets CDS Spreads – values 30 May 2022



Source: Bloomberg

- We recently raised the up case probability by 2% on the positive outlook for SA from S&P, dropping the expected case and lite down cases by 1% each. S&P's positive outlook has also reduced the rand's volatility, along with support from some commodities.
- However, the rand will remain at risk this quarter and next, given that it is largely determined by international events, and evidence of weak US economic data would provide a particularly negative impact if inflation is slow to subside, unless the FOMC slows its rate hikes.
- A number of uncertainties still persist, and today's rand rally, reaching R15.45/USD so far, cannot be relied upon to continue. Additionally, as SA enters strike season there is particular risk that it will give away its fiscal savings and even lose its positive S&P outlook.
- In the UK, fiscal pressure, particularly given the impact on households from high inflation and rising interest rates, has led to a temporary (additional) 25% tax on oil and gas companies, which have been making super profits on the energy boom.
- The temporary tax, which takes the oil and gas companies overall tax burden to 65%, will raise £5bn in its first year, and provide for subsidies for households. The additional levy will be removed when energy prices subside back to more normal levels.
- In South Africa however, it is the unionized employed who are lobbying for large salary and wage increases, well above inflation, while the bulk of households are in poverty, without adequate employment, and are particularly in need of state welfare.
- The overall UK cost-of-living support package, of a total of £15bn, is not expected to have a heavy inflationary impact, with Finance Minister, Rishi Sunak, stating "it will have a minimal impact on inflation," "(m)uch, much less than" 1.00% y/y.
- The UK is expected to see inflation reach double digits by year end, as energy costs rise sharply, and with more expected in Q4.22. Against the British pound, the rand is trading at R19.55/USD, also stronger than most of this month so far.
- While the rand has fared particularly well today, and could see further strength this week, many of the underlying factors which have pulled it weaker in Q2.22 are still able to do so again, particularly a more severe US interest rate hike cycle than in SA.

- Indeed, the third quarter can see marked seasonal weakness as well, but recently some of the areas markets had grave concerns over are easing, causing the rand to attempt to break convincingly below R15.50/USD today.

Economic Scenarios: note up case rises

		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	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. Strong global growth, commodity boom. Stabilisation of credit ratings, then upgrades.								

		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
Up case 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. No further credit rating downgrades, become positive on fiscal consolidation (debt projections fall substantially). 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.								

		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
Base case 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	5.00	5.00	5.25	5.50	5.75	5.75
	Recovery from the sharp global economic slowdown by 2024 in real terms– sufficient global and domestic monetary and other policy supports to growth and financial markets occur and risk sentiment neutral to positive. Expropriation of private sector property is limited and does not have a negative impact on the economy or on market sentiment. SA remains in the BB category rating bracket fiscal consolidation (debt to GDP stabilisation) occurs. 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.								

		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	16.00	16.65	16.90	17.00	17.50	17.60	17.50
	Repo rate (end rate)	4.25	5.00	5.25	5.50	5.75	6.00	6.25	6.50
	The international environment (incl. risk sentiment) is that of the base case. 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. 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.								

		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
Severe 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	5.75	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. SA rated single B from all three key agencies, with further rating downgrades eventually into CCC grade and the risk of moving towards default. 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

	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
USD/JPY	116	127	126	124	122	121	120	120	118	115	110	107

Note: averages, Source: Investec, Iress

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