



SA Economics

Monday 4 July 2022

Rand note: SA is not yet expected to see a recession in the middle two quarters of the year, but severe loadshedding increases the risk, weakening the rand, as does risk-off

Economic Scenarios: note updated forecasts, scenarios									
		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	14.00	13.80	13.70	13.60	13.40	13.30
	Repo rate (end rate)	4.25	4.75	4.00	3.75	3.75	3.75	3.50	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.									
Up case 1%	USD/Rand (average)	15.21	15.59	15.00	14.90	14.90	14.70	14.60	14.50
	Repo rate (end rate)	4.25	4.75	4.50	4.25	4.00	4.00	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.									
Base case 50%	USD/Rand (average)	15.21	15.59	16.00	15.60	15.21	15.59	16.00	15.60
	Repo rate (end rate)	4.25	4.75	5.50	5.75	6.00	6.00	6.25	6.25
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.									
Lite (domestic) Down case 39%	USD/Rand (average)	15.21	15.59	16.90	17.00	17.50	17.60	17.50	17.00
	Repo rate (end rate)	4.25	4.75	5.75	6.25	6.75	7.25	7.75	8.25
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.									
Severe down case 9%	USD/Rand (average)	15.21	15.59	17.50	18.00	18.50	19.00	19.75	20.50
	Repo rate (end rate)	4.25	4.75	6.00	6.75	7.50	8.00	8.50	9.00
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. SA economy in depression. Failure to transition to renewable energy and to sufficient measures to alleviate the impact of climate change on the economy.									

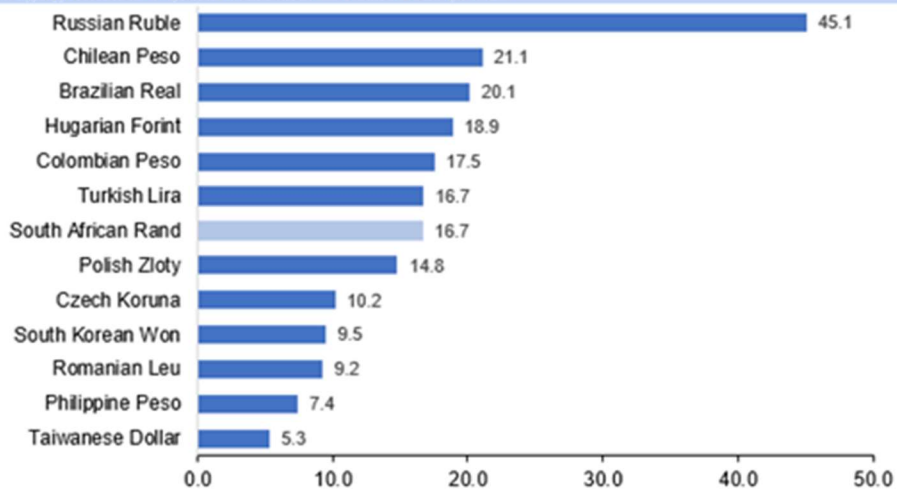
Note: Event risk begins Q3.22. Source: Investec

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

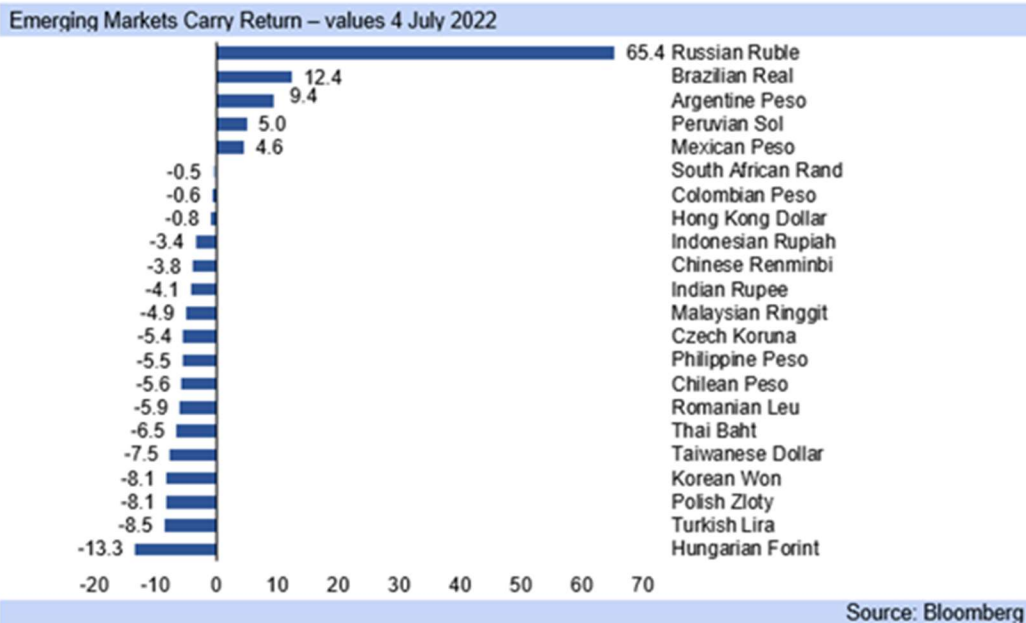


Source: Bloomberg

Emerging Markets Implied Volatilities – values 4 July 2022



Source: Bloomberg



Expected Case: Exchange Rate forecasts

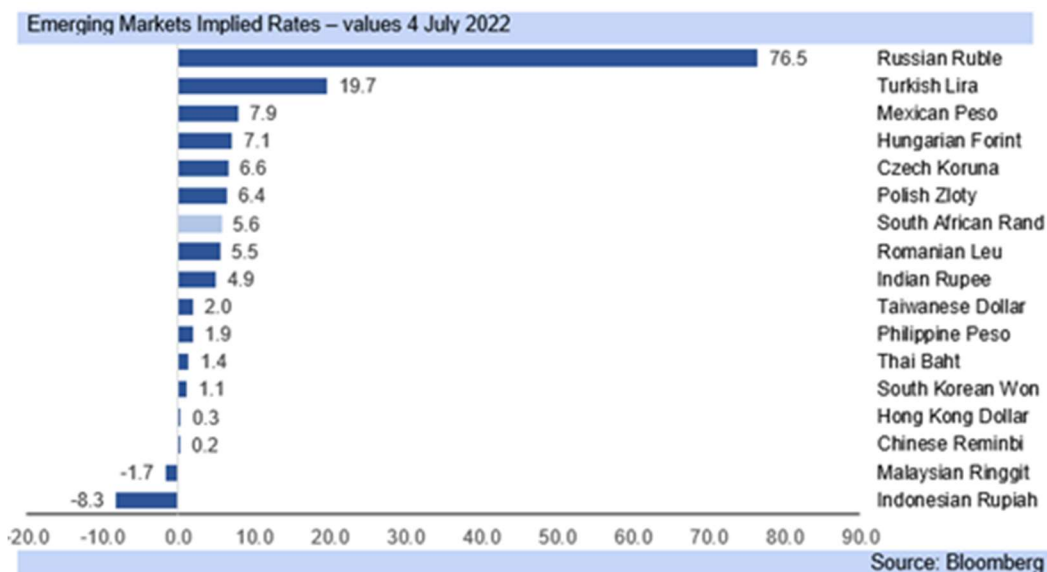
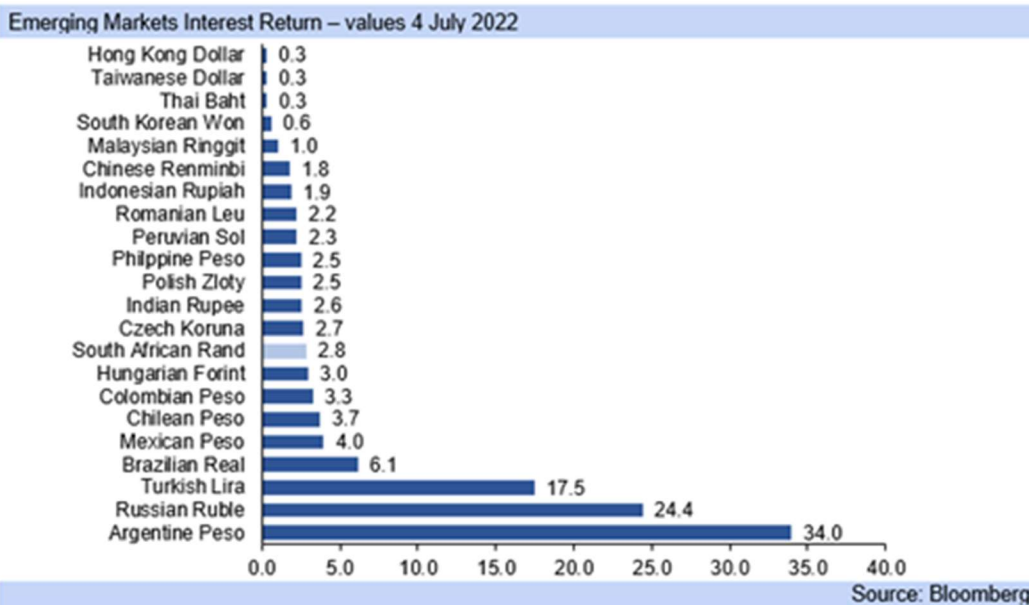
	2022				2023				2024			
	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
USD/ZAR	15.21	15.59	16.00	15.60	15.40	15.80	16.20	15.70	15.50	16.00	16.50	16.00
GBP/ZAR	20.40	19.59	19.52	18.88	18.79	19.75	20.57	20.10	20.15	21.28	22.28	22.08
EUR/ZAR	17.07	16.60	17.12	17.00	17.09	17.85	18.47	18.06	18.29	19.20	20.30	20.00
ZAR/JPY	7.65	8.33	8.44	8.59	8.51	8.16	7.84	8.03	7.94	7.38	6.97	6.88
CHF/ZAR	16.47	16.15	16.84	16.60	16.56	17.17	17.80	17.25	17.03	17.58	18.13	17.58
AUD/ZAR	11.02	11.14	11.36	11.23	11.40	11.85	12.31	12.25	12.09	12.48	12.87	12.48
GBP/USD	1.34	1.26	1.22	1.21	1.22	1.25	1.27	1.28	1.30	1.33	1.35	1.38
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	130	135	134	131	129	127	126	123	118	115	110

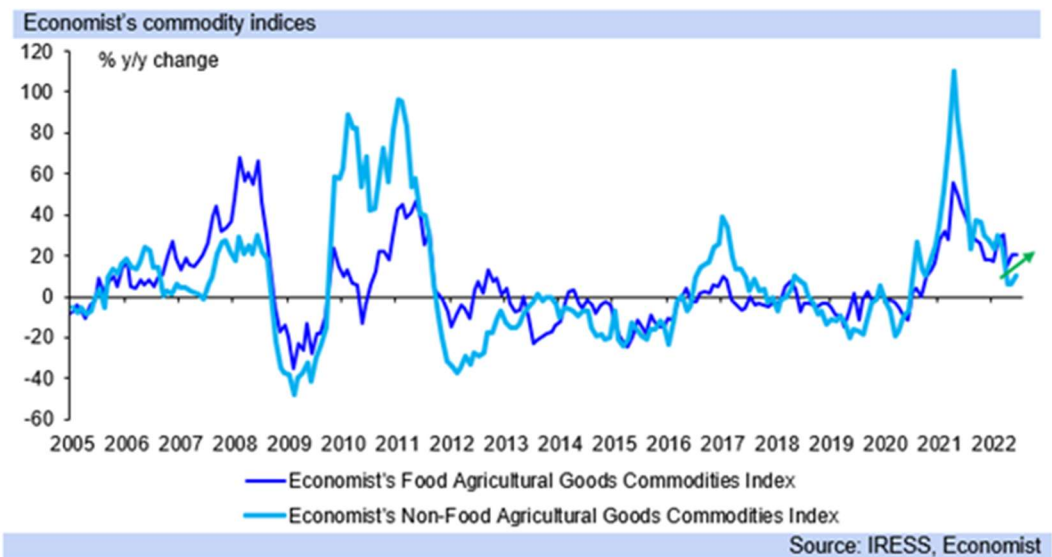
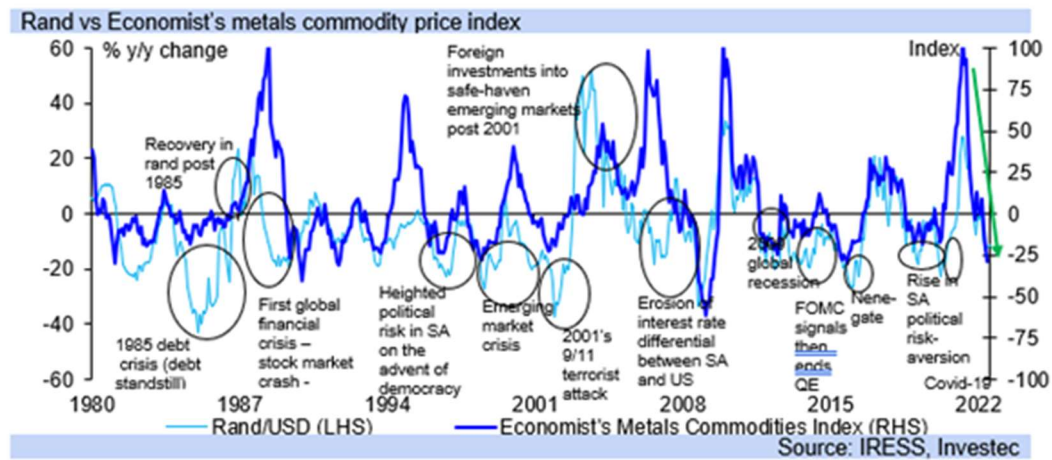
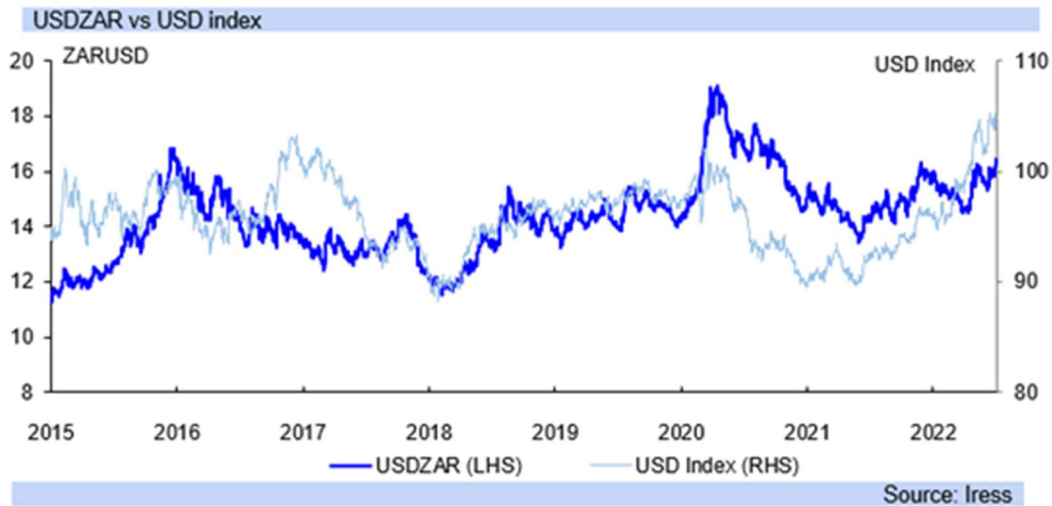
Note: averages, Source: Investec, Iress

- After weakening to R16.50/USD by the end of last week, as severe load shedding persisted on the back of the Eskom workers' strike, the rand has pulled back to R16.25/USD today, although also afflicted by global financial market risk sentiment.
- Stubbornly high inflation saw key Central Banks turn very hawkish in their communications, and a sharp downwards revision in global, and US, growth forecasts from mid-April caused a sharp drop in risk asset prices (including equities, and EM assets and currencies).
- Q3.22 is still at risk of marked weakness, both for the rand and for all risk assets, with lower liquidity levels in global financial markets as there is seasonally less trading activity in financial markets in the Northern Hemisphere summer months.
- That is, with the bulk of global wealth held in the Northern Hemisphere, and senior traders typically winding down risky positions in Q2.22, taking vacation in Q3.22, the very thin markets typically exacerbate risky events, increasing risk-off investor behaviour.
- The rand, and risk assets, typically see greater weakness in the middle two quarters of the year, and greater strength in the first and last quarters of the year, with the rand driven mostly by factors affecting global financial markets, with April's weakness not unusual.
- While seasonal effects have an influence on the rand, so do fundamental factors. With obdurately high inflation in the US and EU (with Euro-area CPI inflation now at 8.6% as well, jumping higher from 8.1% y/y in May), interest rate expectations are rising.

- Increased sanctions on Russia are expected to further push up oil prices towards the US\$200/bbl barrel, and if very severe, possibly towards US300/bbl, which is worrying markets, and adding to risk off sentiment, as uncertainty negatively affects risk sentiment.
- With the Russian/Ukraine war showing no signs of coming to an end, and continuing to negatively affect energy and food commodity prices, high inflation is expected over H2.22, and into H1.23, with high inflation also damaging consumer confidence and real spend.
- The US has been adamant in the need to suppress high inflation, and is currently likely to increase the fed funds rate to 3.00-3.25% by year end (if not 3.25/3.50), from its current 1.50-1.75% range, which is worrying markets, and adding to risk-off sentiment.

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- The strike as Eskom workers seek to achieve well above inflation wage increases (of 10-12% with CPI inflation at 6.5% y/y) is damaging the functioning of the electricity system,

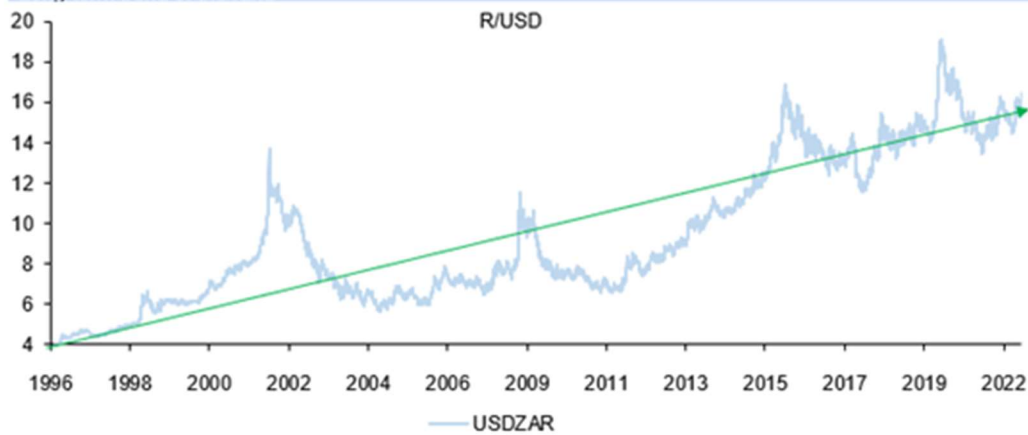
with load shedding expected to continue this week and next, and a wage settlement not yet reached.

- The current severe degree of load shedding is not expected to continue over Q3.22, but if it did it would collapse the South African economy into recession, after the contraction that is expected to have occurred in GDP in Q2.22.
- The Eskom strike is unprotected, and as its workers are deemed essential service workers, Eskom is reported to be investigating the situation, in conjunction with the police, given intimidation, violence and disruptions, with a view to dismissals via disciplinary procedures.
- The violence has been reported to include petrol bombing management’s personal homes and vehicles, while intimidating phone calls kept employees at home and reduced the ability for the power stations to function – reducing the amount of available electricity.
- Ramaphosa’s spokesperson, Vincent Magwenya, is reported to have said “(i)t is tragic that union leaders are engaging in an approach that ultimately will have a devastating impact on workers. Short-term gains are not worth losing an entire job a few months later”.
- “Action on intimidation is extremely important. Eskom needs the support of law-enforcement agencies. If it is allowed to continue, it will become a norm.” “As a result of the unlawful strike, routine maintenance work has had to be postponed. This backlog will ... weeks to clear.”
- The President’s spokesperson further said that if there are no arrests and criminal charges, Eskom would not be able to make verified excuses that load shedding is due to sabotage, purposeful negligence and intimidation of workers who would otherwise be working at Eskom.
- Electricity power stations cannot run on their own, and require a full quotient of workers to produce electricity optimally, as well as a high level of maintenance and repair, quality fuel and well run modern systems, with Eskom losing much needed revenue on the strike.
- Eskom has been identified as highly overstaffed (World Bank) and striking workers a direct cause of the current stage 6 load shedding (Eskom). Fractured labour unions are seeking to strengthen their hands in the industrial action at Eskom which risks causing a recession.

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	17.50	18.00	18.50	19.00	19.75	20.50	20.30	20.40	20.30	20.20
GBP/ZAR	20.40	19.59	21.35	21.78	22.57	23.75	25.08	26.24	26.39	27.13	27.41	27.88
EUR/ZAR	17.07	16.60	18.73	19.62	20.54	21.47	22.52	23.58	23.95	24.48	24.97	25.25
ZAR/JPY	7.65	8.33	7.71	7.44	7.08	6.79	6.43	6.15	6.06	5.78	5.67	5.45
CHF/ZAR	16.47	16.15	18.42	19.15	19.89	20.65	21.70	22.53	22.31	22.42	22.31	22.20
AUD/ZAR	11.02	11.14	12.43	12.96	13.69	14.25	15.01	15.99	15.83	15.91	15.83	15.76
GBP/USD	1.34	1.26	1.22	1.21	1.22	1.25	1.27	1.28	1.30	1.33	1.35	1.38
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	130	135	134	131	129	127	126	123	118	115	110

Note: averages, Source: Investec, Iress

Long-term trend of the rand



Source: Iress

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	16.90	17.00	17.50	17.60	17.50	17.00	17.30	17.20	17.00	16.80
GBP/ZAR	20.40	19.59	20.62	20.57	21.35	22.00	22.23	21.76	22.49	22.88	22.95	23.18
EUR/ZAR	17.07	16.60	18.08	18.53	19.43	19.89	19.95	19.55	20.41	20.64	20.91	21.00
ZAR/JPY	7.65	8.33	7.99	7.88	7.49	7.33	7.26	7.41	7.11	6.86	6.76	6.55
CHFZAR	16.47	16.15	17.79	18.09	18.82	19.13	19.23	18.68	19.01	18.90	18.68	18.46
AUDZAR	11.02	11.14	12.00	12.24	12.95	13.20	13.30	13.26	13.49	13.42	13.26	13.10
GBP/USD	1.34	1.26	1.22	1.21	1.22	1.25	1.27	1.28	1.30	1.33	1.35	1.38
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	130	135	134	131	129	127	126	123	118	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	15.00	14.90	14.90	14.70	14.60	14.50	14.60	14.50	14.40	14.40
GBP/ZAR	20.40	19.59	18.30	18.03	18.18	18.38	18.54	18.56	18.98	19.29	19.44	19.87
EUR/ZAR	17.07	16.60	16.05	16.24	16.54	16.61	16.64	16.68	17.23	17.40	17.71	18.00
ZAR/JPY	7.65	8.33	9.00	8.99	8.79	8.78	8.70	8.69	8.42	8.14	7.99	7.64
CHFZAR	16.47	16.15	15.79	15.85	16.02	15.98	16.04	15.93	16.04	15.93	15.82	15.82
AUDZAR	11.02	11.14	10.65	10.73	11.03	11.03	11.10	11.31	11.39	11.31	11.23	11.23
GBP/USD	1.34	1.26	1.22	1.21	1.22	1.25	1.27	1.28	1.30	1.33	1.35	1.38
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	130	135	134	131	129	127	126	123	118	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	14.00	13.80	13.70	13.60	13.40	13.30	13.10	12.90	12.80	12.60
GBP/ZAR	20.40	19.59	17.08	16.70	16.71	17.00	17.02	17.02	17.03	17.16	17.28	17.39
EUR/ZAR	17.07	16.60	14.98	15.04	15.21	15.37	15.28	15.30	15.46	15.48	15.74	15.75
ZAR/JPY	7.65	8.33	9.64	9.71	9.56	9.49	9.48	9.47	9.39	9.15	8.98	8.73
CHFZAR	16.47	16.15	14.74	14.68	14.73	14.78	14.73	14.62	14.40	14.18	14.07	13.85
AUDZAR	11.02	11.14	9.94	9.94	10.14	10.20	10.18	10.37	10.22	10.06	9.98	9.83
GBP/USD	1.34	1.26	1.22	1.21	1.22	1.25	1.27	1.28	1.30	1.33	1.35	1.38
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
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