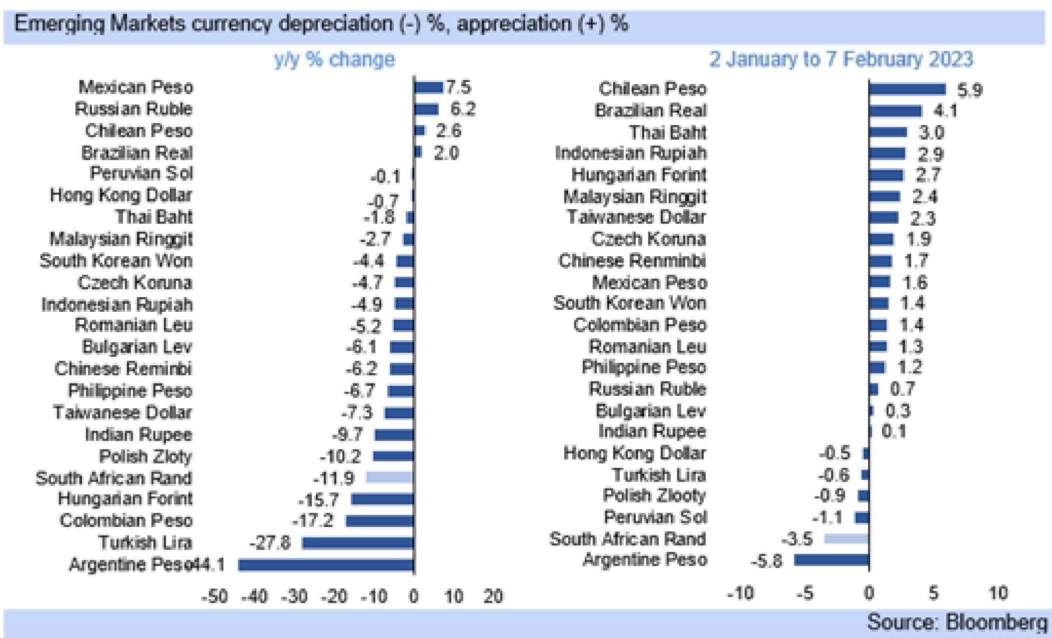
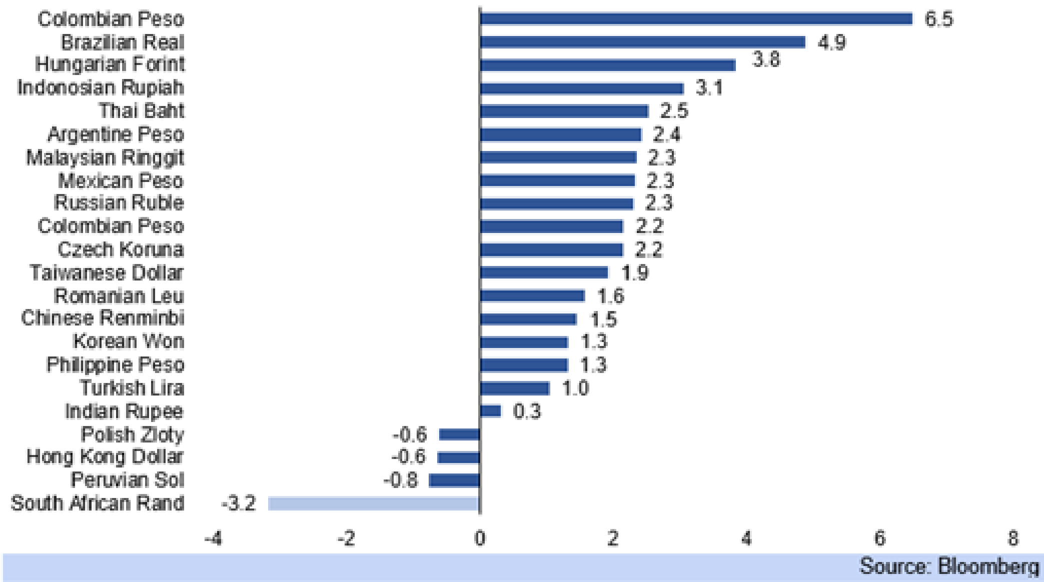
Investec

Rand note: markets see global risks, weakening the rand, along with domestic factors

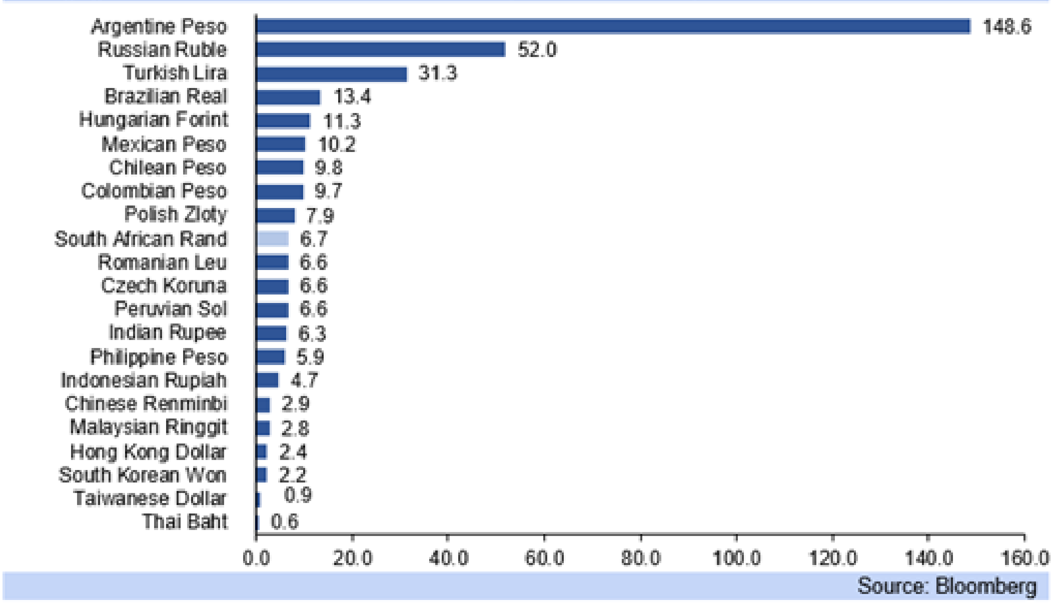
Tuesday 7 February 2023

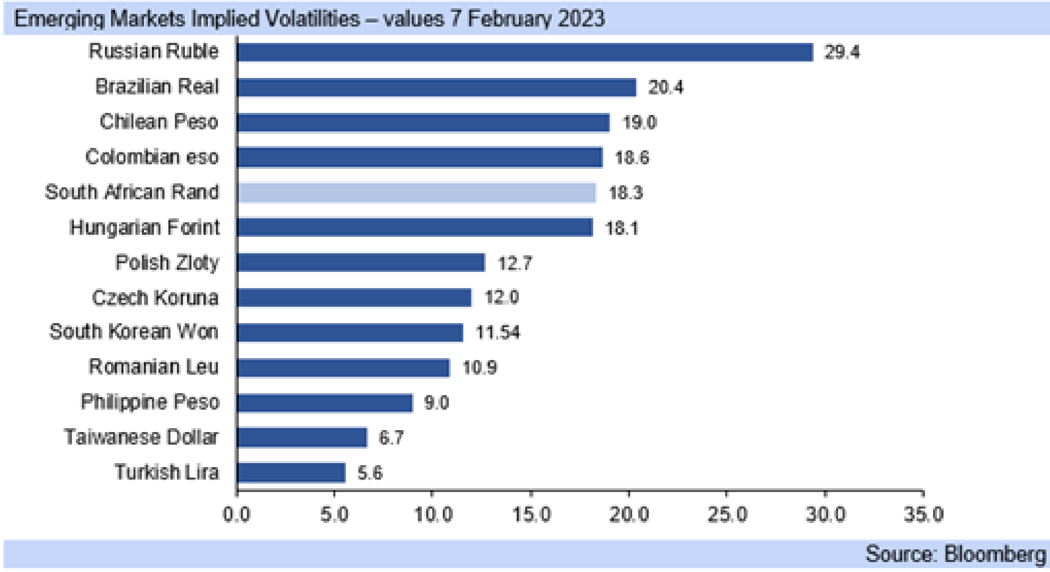


Emerging Markets Carry Return – values 2 January 2023 to 7 February 2023



Emerging Markets Interest Return – values 7 February 2022 to 7 February 2023





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

- The rand is weaker this week, having dipped below R17.00/USD, to R16.93/USD, after the FOMC meeting, but today has reached R17.69/USD, as markets still see some risks in the US inflation and interest rate outlooks.
- While the Fed last week was careful to highlight its rate hikes are not at an end, and core measures of inflation (excludes the volatile prices of food and energy) are proving sticky (slow to come down), and not just in the US.
- US Treasury Secretary Yellen reiterated this week that she does not expect a US recession, and legislative measures will aid inflation to fall more rapidly, but markets have started to worry about inflationary effects of stronger than expected economies.
- The US implicitly targets a core inflation measure of 2.0% y/y, a rate which is not seen as too high or too low for price increases, with higher rates of inflation having a negative effect on the cost of living.
- Aiming for too low a rate of inflation risks deflation, an environment where consumers delay purchases, waiting for even lower prices to come, and economic and investment drops while unemployment rises.

- A 2.0% y/y inflation target also provides some buffer to under measurement of inflation, a situation when actual inflation proves lower than the official measurement and so risks nearing deflationary (falling prices) territory.
- Deflation has further negative consequences, which include increasing the real value (the real value removes inflationary effects) of government debt, while conversely inflation reduces the real value of debt.
- South Africa sees its State of the Nation Address (SONA) on Thursday night, but markets anticipate little game changing reforms, with many past priorities unfulfilled and the economic environment instead deteriorating on weakening infrastructure.
- The rand has weakened on falling electricity supply, lack of broad state support for Eskom's CEO, and Transnet failing to meet rail and port capacity needs, while the size of the government and its poor governance is feared to increase under the NHI.

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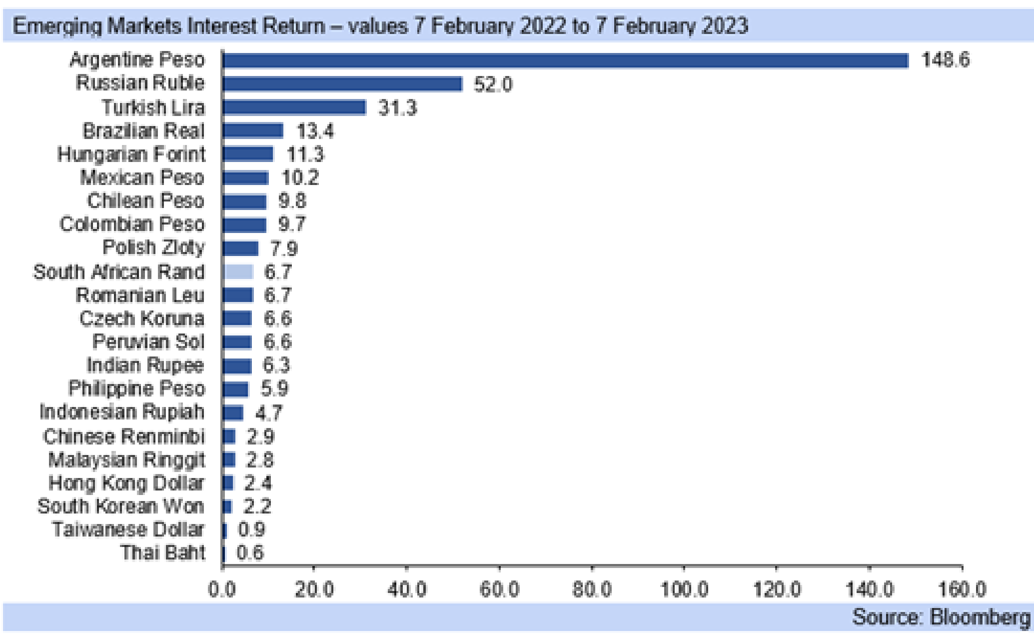
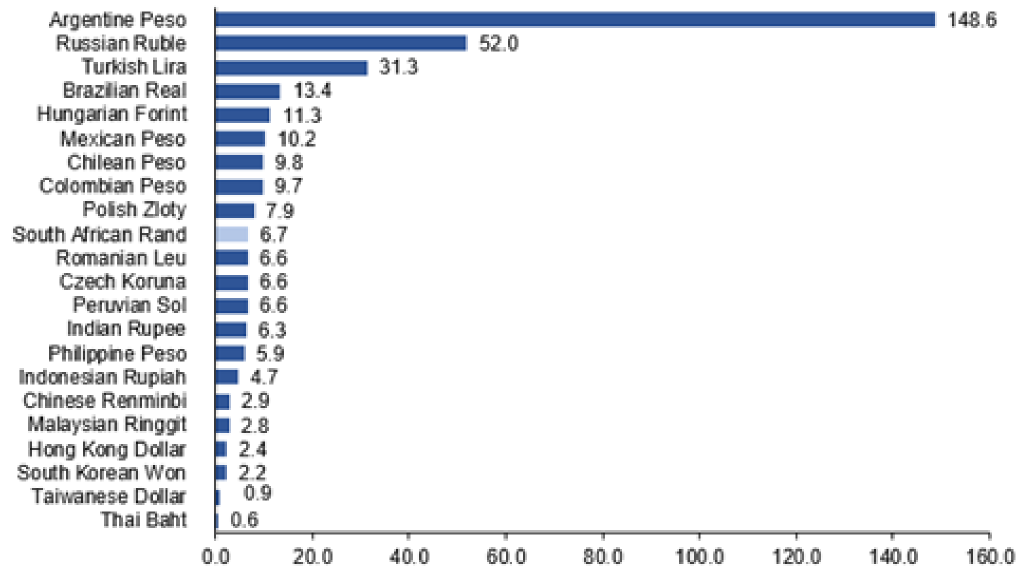
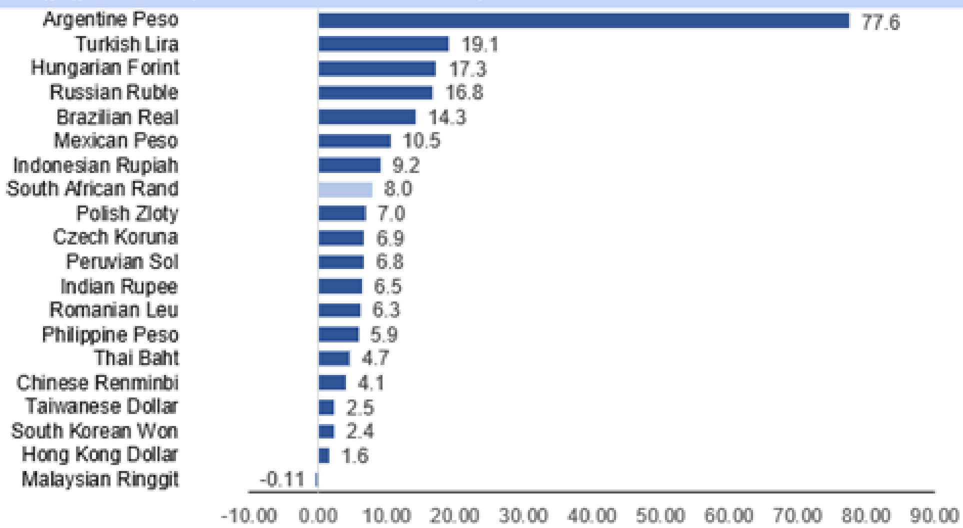


Emerging Markets Interest Return – values 7 February 2022 to 7 February 2023

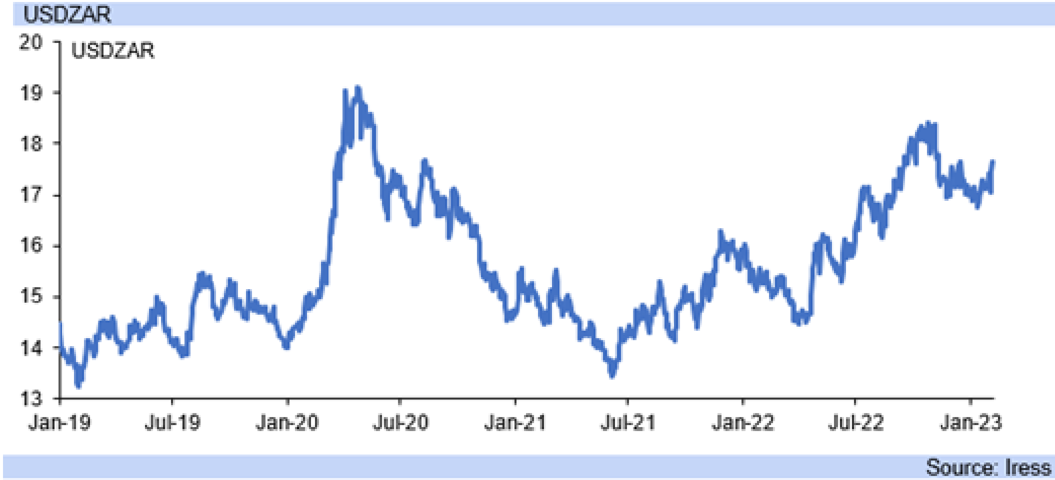


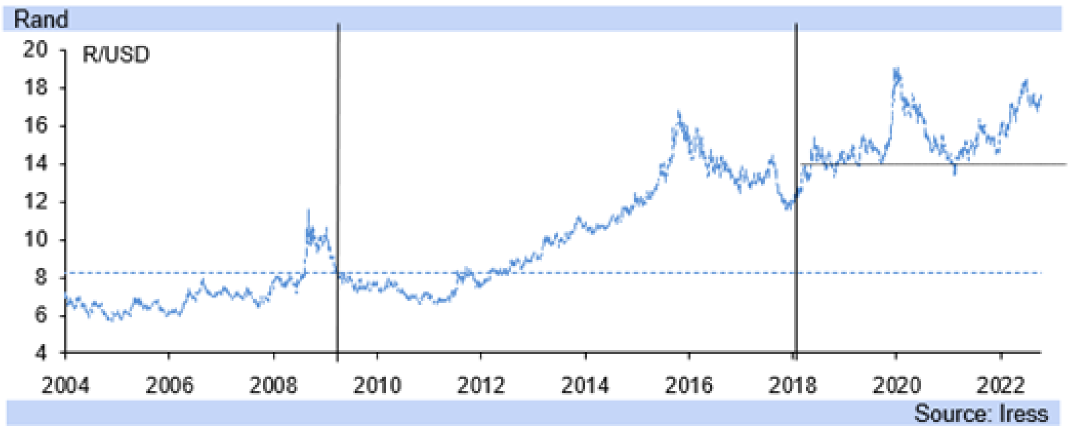
Source: Bloomberg

Emerging Markets Implied Rates – values 7 February 2023



Source: Bloomberg





- Secretary Yellen also noted “I see is a path in which inflation is declining significantly and the economy is remaining strong." "You don't have a recession when you have 500,000 jobs and the lowest unemployment rate in more than 50 years".

- The IMF adds "(t)he U.S. economy is … going to slow down this year. But, at least based on the data we have … (so far), we think U.S. would be able to go through the year narrowly avoiding falling into recession".

- "That means a possibility for a soft landing for the United States." And what about U.S. employment? "Our expectation towards the end of year is to see somewhat weaker labor markets".

- "But let's be very clear, we are not scared of some big unemployment wave swiping through the United States." "The biggest surprise is that the picture, while it remains very concerning, is less dire than it was just two months ago”.

- "We are still going for a year of slowing growth. We're still going to have interest rates relatively high because inflation hasn't evaporated. So it is not much better. It is just less bad."

- Inflationary pressures also differentiate around the world, with different countries affected by differing factors, and SA seeing lower inflationary pressures than some key advanced economies.
- The IMF has advised that "Central banks should communicate the likely need to keep interest rates higher for longer until there is evidence that inflation — including wages and prices of services — has sustainably returned to the target".
- "Loosening prematurely could risk a sharp resurgence in inflation once activity rebounds, leaving countries susceptible to further shocks which could de-anchor inflation expectations".
- "Crucially, central banks must avoid misreading sharp declines in goods prices and easing policy before services inflation and wages, which adjust more slowly, have also moderated markedly".

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 48%	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 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	22.49	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
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