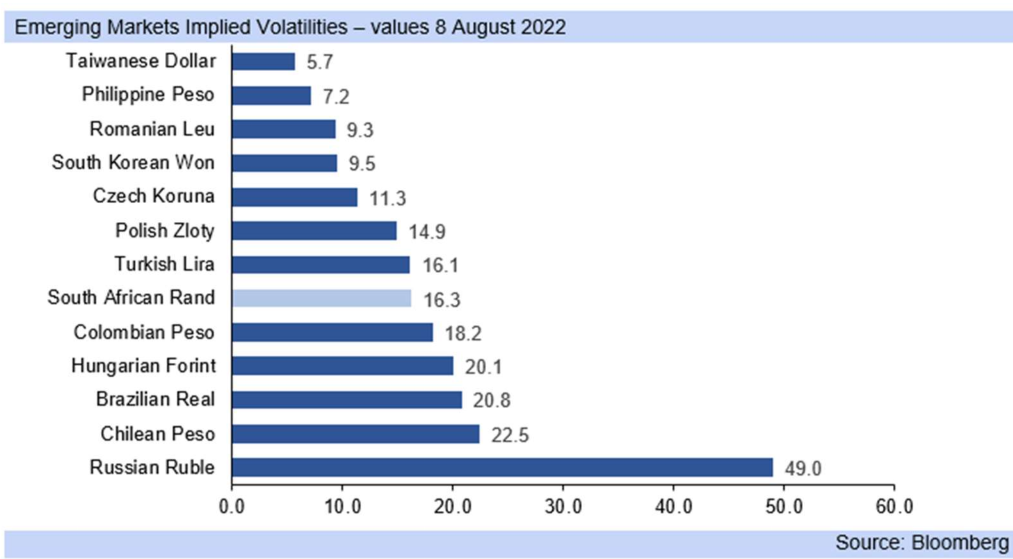
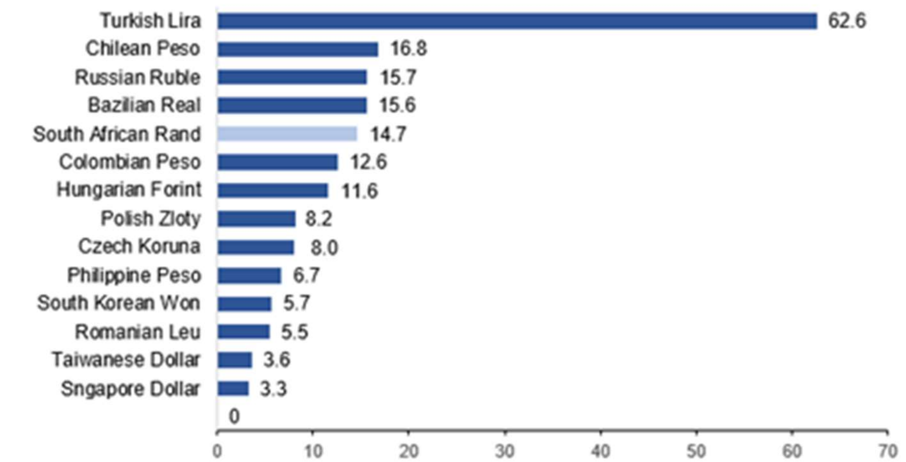
SA Economics

Monday 8 August 2022

Rand note: the currency remains volatile in Q3, pulled back towards R17.00/USD, with August likely another weak month

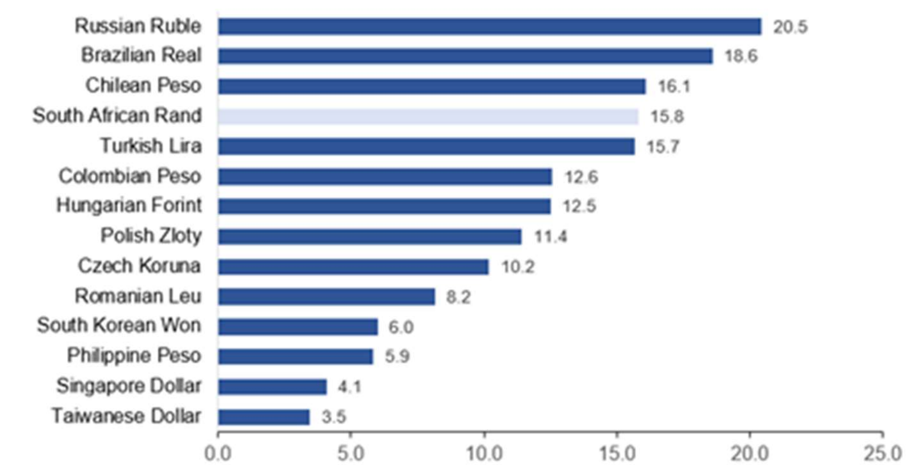


Emerging Markets Implied Volatilities – values 10 January 2022

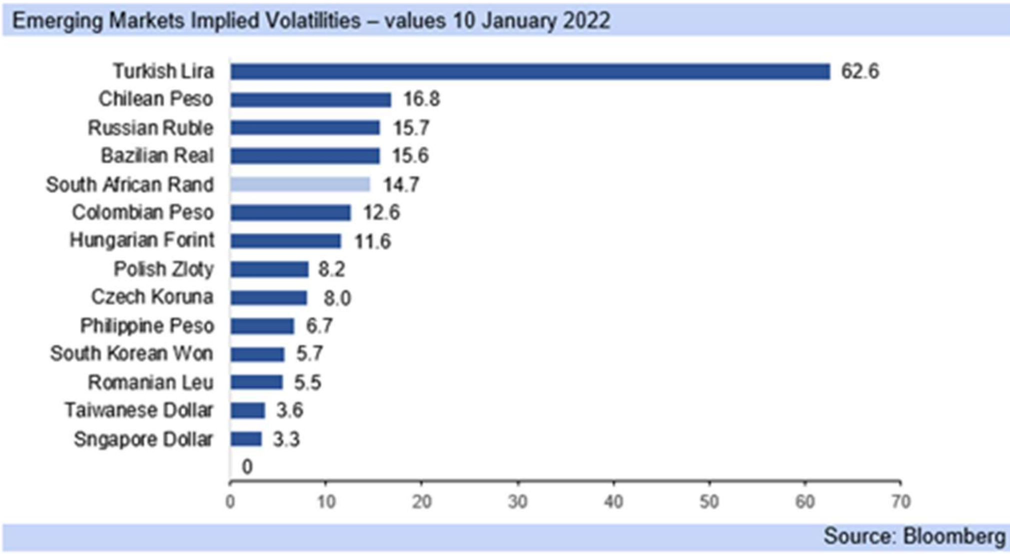


Source: Bloomberg

Emerging Markets Implied Volatilities – values 14 February 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	16.60	15.80	15.60	16.00	16.40	15.90	15.70	16.20	16.70	16.20
GBP/ZAR	20.40	19.59	19.87	18.80	18.64	19.28	20.09	19.88	20.10	21.06	22.55	22.36
EUR/ZAR	17.07	16.60	16.88	16.35	16.46	16.96	17.55	17.33	18.06	19.12	20.04	19.93
ZAR/JPY	7.65	8.33	8.32	8.70	8.49	8.06	7.74	7.89	7.83	7.28	6.89	6.79
CHFZAR	16.47	16.15	17.47	16.81	16.77	17.39	18.02	17.47	17.25	17.80	18.35	17.80
AUDZAR	11.02	11.14	11.50	11.08	11.15	12.00	12.55	12.00	12.25	12.64	13.03	12.64
GBP/USD	1.34	1.26	1.20	1.19	1.20	1.21	1.23	1.25	1.28	1.30	1.35	1.38
EUR/USD	1.12	1.06	1.02	1.04	1.06	1.06	1.07	1.09	1.15	1.18	1.20	1.23
USD/JPY	116	130	138	138	133	129	127	126	123	118	115	110

Note: averages, Source: Investec, Iress

- The rand remains influenced by international growth concerns, with the possibility of recession still spooking markets, and monetary policy authorities continuing to hike interest rates, tightening financial conditions in the face of high inflation.
- While Q2.22 Eurozone growth surprised on the upside, H2.22 is not expected to repeat this, and markets have been factoring in these weaker expectations, not just for the Eurozone, but globally, supporting safe haven flows and USD strength.
- Elevated levels of uncertainty create risk aversion, and risk-off in financial markets is elevated “(T)he magnitude of the inflation surge has been a surprise to central banks and markets, and there remains substantial uncertainty about the outlook for inflation” (IMF).
- The IMF adds “inflation risks appear strongly tilted to the upside. There is a substantial risk that high inflation becomes entrenched, and inflation expectations de-anchor.” Markets fear the persistence of a harsh interest rate hike cycle this year and into next.
- This has caused a notable withdrawal from risk assets over both Q2.22 and Q3.22, resulting in USD strength on safe haven inflows, and weakness in commodity prices and EM assets; and so the rand, which is both a commodity and EM currency.

- The volatility of the rand is lower than a number of other EM countries, running closer to the middle of the Bloomberg basket than at the high end, but overall volatilities are higher for EM currencies than they were in Q1.22, reflecting elevated risk.
- The IMF notes second round effects are occurring as consumer price inflation for services, and indeed "everything" from housing rents to personal services, are picking up from already elevated levels, and are unlikely to come down quickly.
- Warning "(t)hese pressures may be reinforced by rapid nominal wage growth. In countries with strong labor markets, nominal wages could start rising rapidly, faster than what firms reasonably could absorb, with the associated increase in unit labor costs passed into prices."
- The rand will remain at risk over Q3.22, with the third quarter of the year typically the weakest period for the rand as risk aversion levels tend to be elevated on thin trade as market players tend to withdraw from riskier investment to take vacataion .

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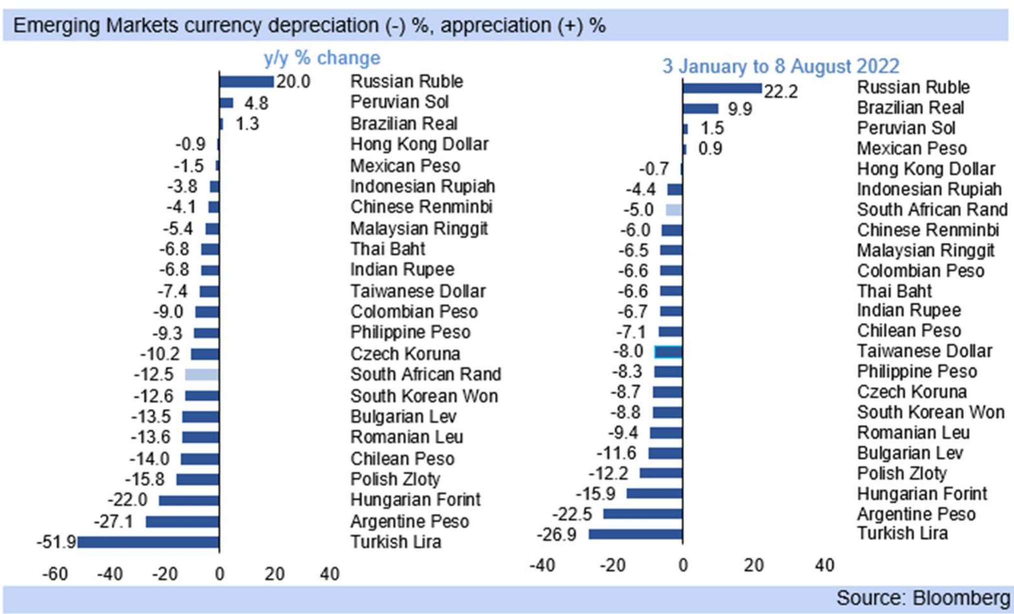
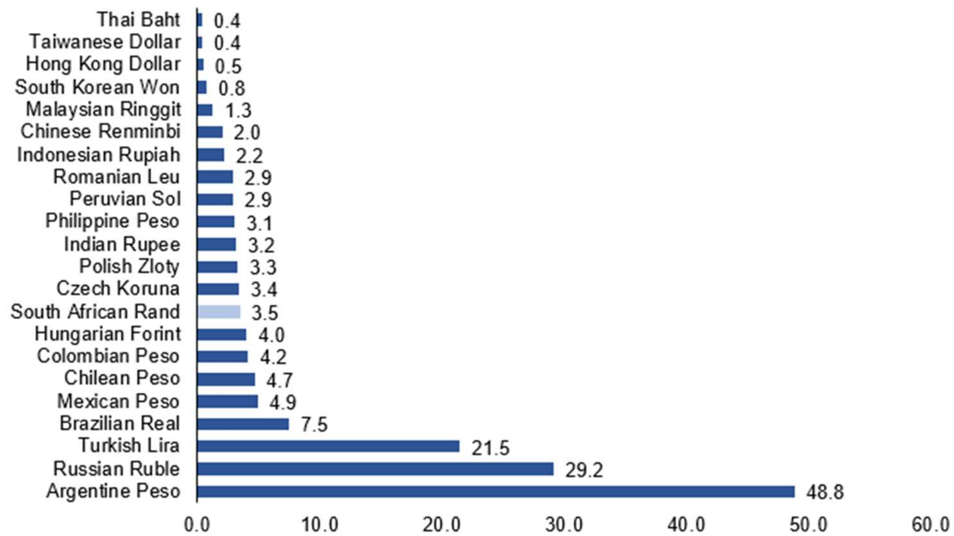
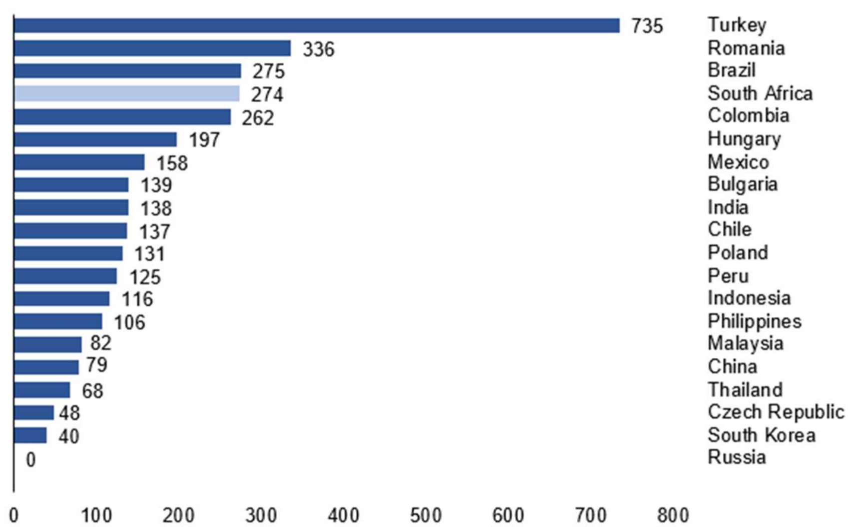


Emerging Markets Interest Return – values 8 August 2022



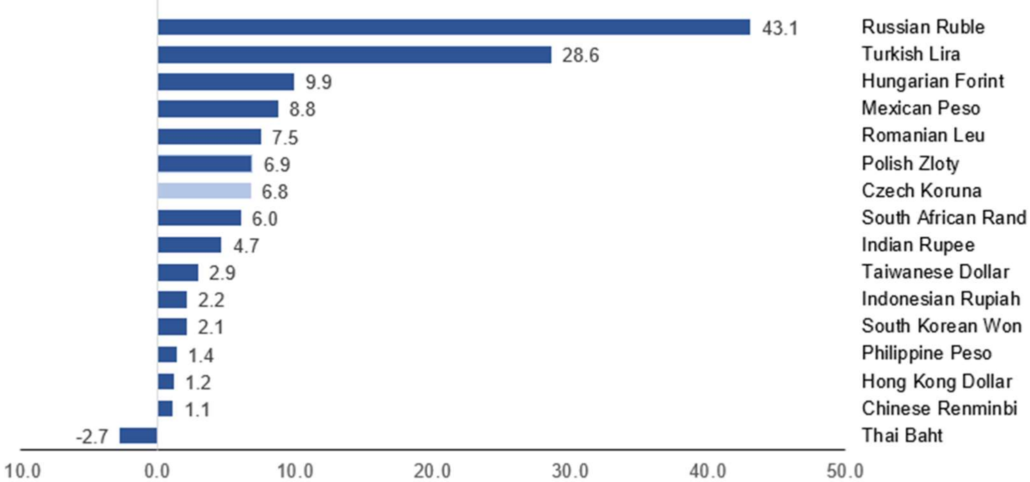
Source: Bloomberg

Emerging Markets CDS Spreads – values 8 August 2022



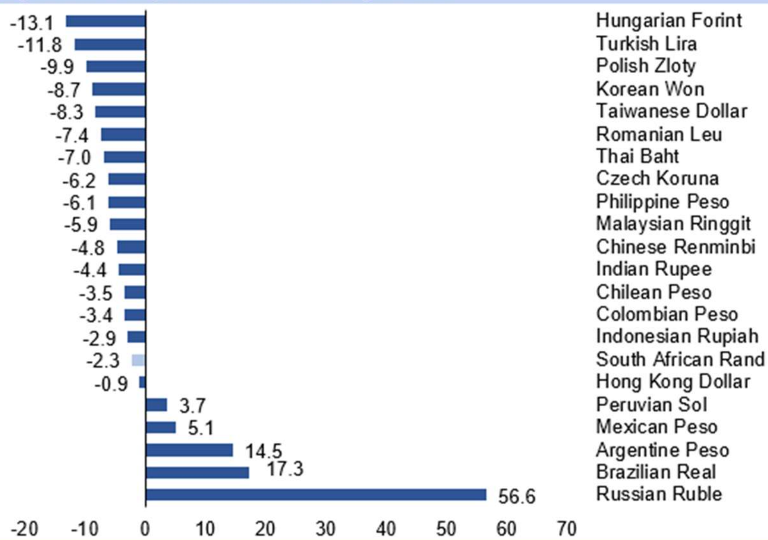
Source: Bloomberg

Emerging Markets Implied Rates – values 8 August 2022



Source: Bloomberg

Emerging Markets Carry Return – values 8 August 2022



Source: Bloomberg

- September, and particularly October tends to see some rand strength, as risk aversion levels ease notably. However, the second half of this year, particularly Q4.22 is worrying markets as the slowdown in global growth is expected to be notable then.
- This means that the fourth quarter of this year, when traditional strength in the domestic currency tends to prevail, and the first quarter of 2023 could also be afflicted by negative market sentiment.
- Warnings from multilaterals have the ability to negatively affect market sentiment, particularly those with large economic research divisions such as the IMF and World Bank, both of whose concerns over global growth hit markets hard in April.

- This negative impact on financial market sentiment persisted over Q2.22 and Q3.22, causing risk aversion in investing in risky assets as the prospect for return is seen to be weakening as the global growth outlook does.
- Many key private sector and regulatory institutions also support the view of a strongly weakening prospect for economic activity over H2.22 and H1.23, if not the whole of 2023, which has added to the risk-off market view.
- Additionally, the Russian/Ukraine war has not ceased, and the impact on energy prices is still noticeable, elevating them over a year ago, even though they have fallen recently on global growth concerns.
- That is, while oil and gasoline, as well as natural gas, prices have eased in Q3.22 to date they are markedly higher versus this time last year, which adds to inflationary pressure as inflation is measured year on year.
- High inflation is still worrying markets, and the prospects for it to remain higher for longer than was initially expected, which is being signalled by key private sector, regulatory and multilaterals research houses and departments.
- There is consequently risk for further high volatility (EM currency volatility is elevated compared to Q1.22) and the risk for even further rand weakness, with the IMF warning last week “(m)ore forceful tightening may be needed.”

Economic Scenarios: note updated forecasts

Extreme Up case **1%**

	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
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%**

	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
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%**

	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
USD/Rand (average)	15.21	15.59	16.60	15.80	15.60	16.00	16.40	15.90
Repo rate (end rate)	4.25	4.75	5.50	6.50	6.50	6.50	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.

Lite (domestic) Down case **39%**

	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
USD/Rand (average)	15.21	15.59	16.90	17.00	17.50	17.60	17.50	17.70
Repo rate (end rate)	4.25	4.75	5.75	6.75	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%**

	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
USD/Rand (average)	15.21	15.59	17.50	18.00	18.30	18.50	18.60	19.00
Repo rate (end rate)	4.25	4.75	6.00	7.00	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

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	17.70	18.00	17.80	17.60	17.70
GBP/ZAR	20.40	19.59	20.23	20.23	20.91	21.21	21.44	22.13	23.04	23.14	23.76	24.43
EUR/ZAR	17.07	16.60	17.18	17.60	18.46	18.66	18.73	19.29	20.70	21.00	21.12	21.77
ZAR/JPY	7.65	8.33	8.17	8.09	7.57	7.33	7.26	7.09	6.83	6.63	6.53	6.21
CHFZAR	16.47	16.15	17.79	18.09	18.82	19.13	19.23	19.45	19.78	19.56	19.34	19.45
AUDZAR	11.02	11.14	11.71	11.90	12.51	13.20	13.39	13.36	14.04	13.88	13.73	13.81
GBP/USD	1.34	1.26	1.20	1.19	1.20	1.21	1.23	1.25	1.28	1.30	1.35	1.38
EUR/USD	1.12	1.06	1.02	1.04	1.06	1.06	1.07	1.09	1.15	1.18	1.20	1.23
USD/JPY	116	130	138	138	133	129	127	126	123	118	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	17.50	18.00	18.30	18.50	18.60	19.00	19.30	19.40	19.30	19.30
GBP/ZAR	20.40	19.59	20.94	21.42	21.87	22.29	22.79	23.75	24.70	25.22	26.06	26.63
EUR/ZAR	17.07	16.60	17.79	18.63	19.31	19.61	19.90	20.71	22.20	22.89	23.16	23.74
ZAR/JPY	7.65	8.33	7.89	7.64	7.24	6.97	6.83	6.61	6.37	6.08	5.96	5.70
CHFZAR	16.47	16.15	18.42	19.15	19.68	20.11	20.44	20.88	21.21	21.32	21.21	21.21
AUDZAR	11.02	11.14	12.12	12.60	13.08	13.88	14.23	14.35	15.05	15.13	15.05	15.05
GBP/USD	1.34	1.26	1.20	1.19	1.20	1.21	1.23	1.25	1.28	1.30	1.35	1.38
EUR/USD	1.12	1.06	1.02	1.04	1.06	1.06	1.07	1.09	1.15	1.18	1.20	1.23
USD/JPY	116	130	138	138	133	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	14.90	15.00	14.50	14.50
GBP/ZAR	20.40	19.59	17.95	17.73	17.81	17.71	17.89	18.13	19.07	19.50	19.58	20.01
EUR/ZAR	17.07	16.60	15.25	15.42	15.72	15.58	15.62	15.81	17.14	17.70	17.40	17.84
ZAR/JPY	7.65	8.33	9.21	9.23	8.89	8.78	8.70	8.66	8.26	7.87	7.93	7.59
CHFZAR	16.47	16.15	15.79	15.85	16.02	15.98	16.04	15.93	16.37	16.48	15.93	15.93
AUDZAR	11.02	11.14	10.39	10.43	10.65	11.03	11.17	10.95	11.62	11.70	11.31	11.31
GBP/USD	1.34	1.26	1.20	1.19	1.20	1.21	1.23	1.25	1.28	1.30	1.35	1.38
EUR/USD	1.12	1.06	1.02	1.04	1.06	1.06	1.07	1.09	1.15	1.18	1.20	1.23
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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	13.10	12.90	12.80
GBP/ZAR	20.40	19.59	16.76	16.42	16.37	16.39	16.42	16.63	16.77	17.03	17.42	17.66
EUR/ZAR	17.07	16.60	14.23	14.28	14.45	14.42	14.34	14.50	15.07	15.46	15.48	15.74
ZAR/JPY	7.65	8.33	9.87	9.96	9.67	9.49	9.48	9.44	9.39	9.01	8.91	8.59
CHFZAR	16.47	16.15	14.74	14.68	14.73	14.78	14.73	14.62	14.40	14.40	14.18	14.07
AUDZAR	11.02	11.14	9.70	9.66	9.80	10.20	10.25	10.04	10.22	10.22	10.06	9.98
GBP/USD	1.34	1.26	1.20	1.19	1.20	1.21	1.23	1.25	1.28	1.30	1.35	1.38
EUR/USD	1.12	1.06	1.02	1.04	1.06	1.06	1.07	1.09	1.15	1.18	1.20	1.23
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