



SA Economics
SA ECONOMICS

Rand Note

Monday 14 April 2020

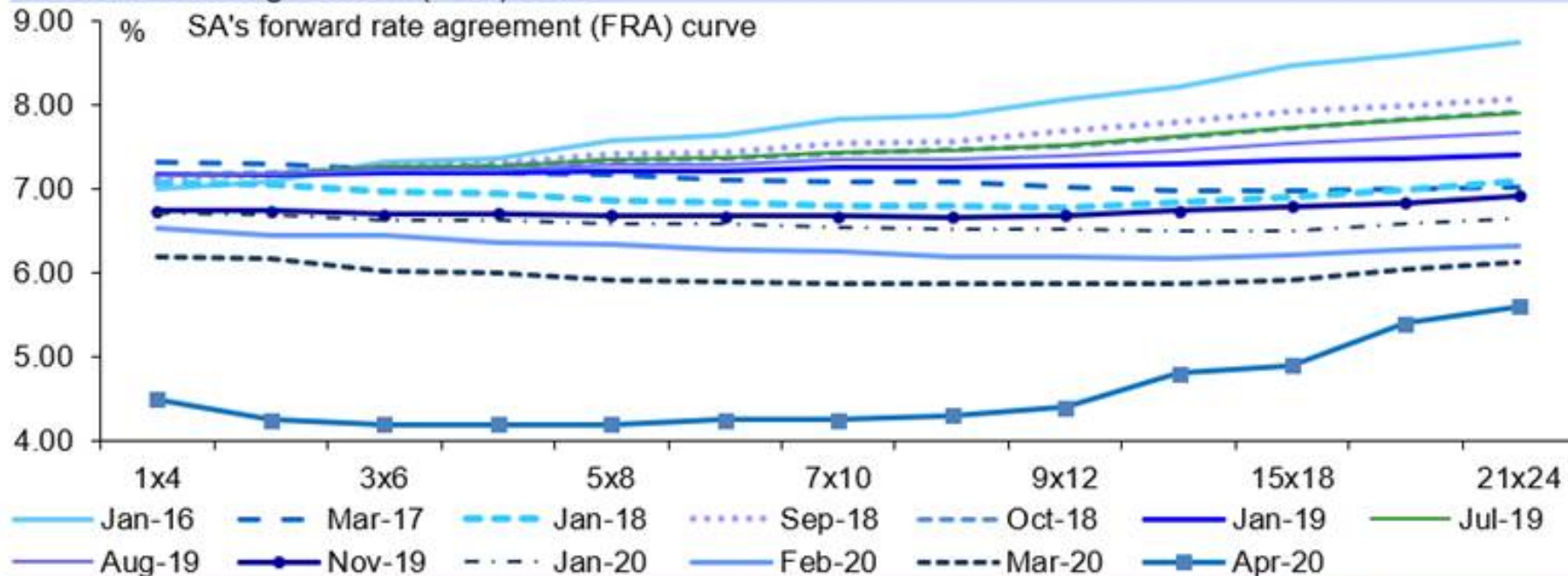
Rand weakens on SARB surprise 100bp cut announced today, to R18.40, after having closed yesterday at R18.27, we continue to expect an average of R17.50/USD for Q2.20

Expected Case: Exchange Rates forecasts

	2020				2021				2022		
	Q1.20	Q2.20	Q3.30	Q4.20	Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22
USDZAR	15.45	17.50	17.00	16.50	15.50	14.60	14.50	14.00	14.90	14.55	14.85
GBPZAR	19.60	20.46	19.99	19.66	18.84	18.35	18.82	18.67	19.97	19.64	20.20
EURZAR	16.78	18.73	18.19	17.99	17.05	16.06	16.10	15.68	16.84	16.59	17.08
ZARJPY	7.20	6.28	6.41	6.67	7.03	7.36	7.31	7.57	7.11	7.29	7.14
CHFZAR	15.70	17.75	17.24	16.81	15.71	14.67	14.57	14.06	14.90	14.55	14.85
AUDZAR	10.03	10.33	10.07	10.07	9.77	9.42	9.64	9.66	10.43	10.19	10.54

Note: averages, Source: Investec

Forward Rate Agreement (FRA) curve



Source: Bloomberg

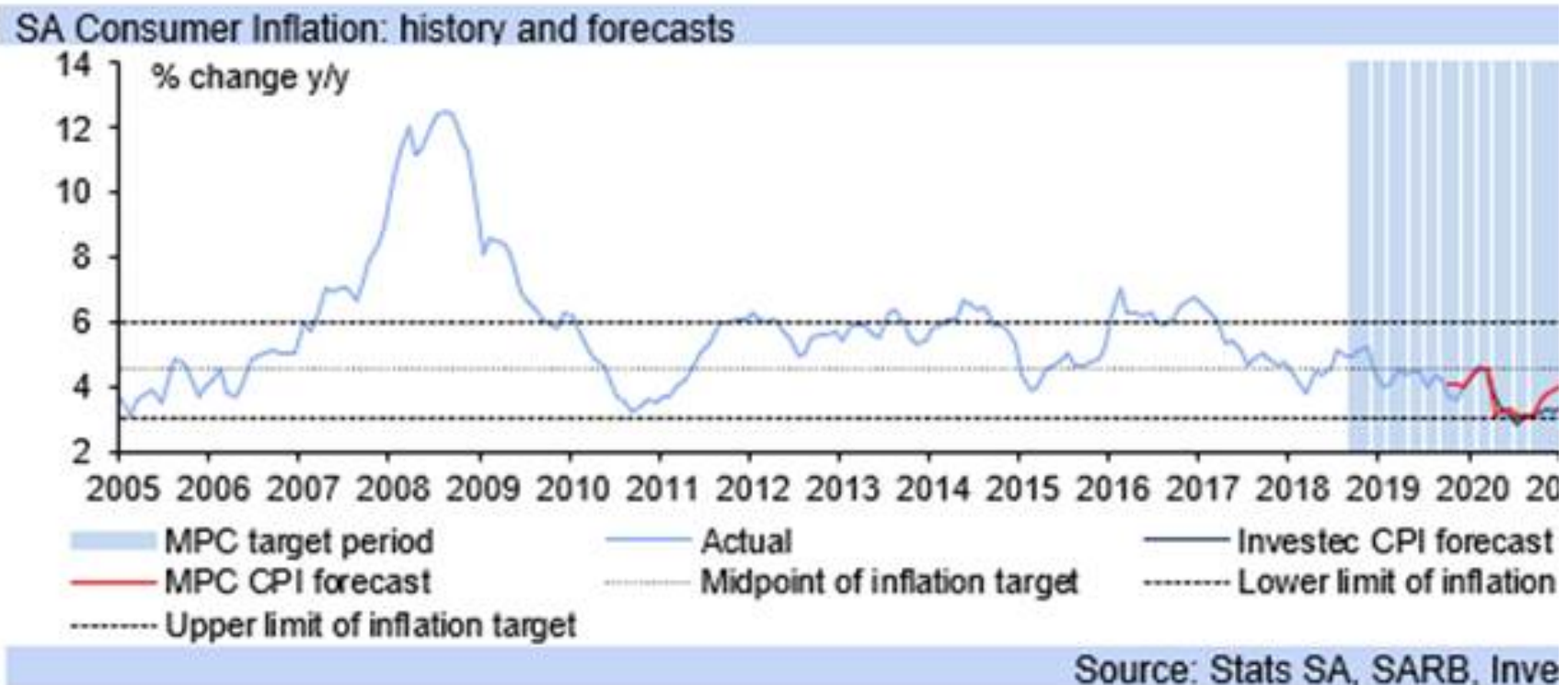
- The surprise 100bp cut in the SARB's repo rate today (to 4.25%) takes South Africa's interest rate cuts this year to 2.25% in total. The repo rate is at a historic low since it was recorded in 1998, the previous low was in 2013 at 5%. The prime lending rate was last at 7.75% in 1973.
- After an initial knee-jerk reaction, the rand retracted to R18.26/USD, R20.01/EUR and R22.93/GBP from R18.37/USD, R20.09/EUR and R23.03/GBP, with its close yesterday at R18.12/USD, R19.77/EUR and R22.65/GBP. The SARB has indicated more cuts are currently likely, potentially another 1.25%. The rand saw additional weakness this afternoon.

- Interest rates are low globally, with Central Bank rates respectively at 0.1% for the UK, 0.05% for the US, in Europe 0% and Japan at 0.3%. The degree of monetary and fiscal stimulus globally is unprecedented, with the Federal Reserve Bank expanding its assets on its balance sheet under a huge quantitative easing programme.
- This will prove inflationary, and in particular will weaken the US dollar over the course of this year (and potentially next), while the huge quantum of liquidity globally is likely to prove yield seeking, lowering risk appetite and driving portfolio flows into risky assets, which include equities generally and emerging market bonds, with the rand expected to benefit.
- The rand saw a more marked retracement against the US dollar, than against the euro and the UK pound, around midday, while the gold price rose to US\$1 748/oz from its close of US\$1 713/oz yesterday, with the gold price expected to gain further on the impact of global QE (Quantitative Easing).
- Currently however, global financial markets have not yet entered a period of risk-on and risk aversion is still heightened globally. The domestic currency is still at weak levels, and is likely to remain volatile and weak in the near term until evidence for the beginnings of a recovery in the global economy become clearer.
- The South African Reserve Bank (SARB) notes currently as well that “global financing conditions are no longer supportive of emerging market currency and asset values. Credit risk has risen back to 2008 levels and about R100 billion of local assets have been sold by non-resident investors.”
- The SARB adds that “(t)he overall risks to the inflation outlook at this time appear to be to the downside”. Its 2.25% cut in interest rates this year have helped both steepen, and lower the yield curve, along with its substantial operations to add liquidity in the mid to longer-end of the yield curve.
- The huge volumes of QE globally makes the interest rate cuts in South Africa easier for markets to stomach, and the SARB is likely to cut rates further to assist SA as additional measures of monetary stimulus occur globally. The rate cuts in SA are likely to keep the rand closer to R18.00/USD - R18.50/USD this month, but strengthening as risk-on emerges.

Trade weighted rand movements vs CPI inflation (both % change y/y)



Source: Stats SA, Iress



- GDP in South Africa is expected to see a deeper contraction now that the economic shutdown has been extended to the end of April, with expectations also changing on the path that reopening will take. In particular, a phased approach is expected, with some modest opening up of certain sub-sectors/sectors in the economy on a partial basis.
- The longer the economic shutdown persists, the more vulnerable household and corporate balance sheets will become, with an escalation in the negative impact on GDP as savings are run down, vulnerabilities rise and the strain of servicing debt is increased as savings wither further, both for the economy and for households and corporates.

- We are in the process of revising our expectations for the contraction in GDP this year, with a lengthening in the number of weeks of shutdown, full as well as partial shutdown (i.e. the economy is opened up to a degree), likely seeing production drop by between -5% and -10% (depending on the length of the shutdown – full or partial), previously -2.7% y/y, for 2020.
- While GDP from an expenditure perspective is supported by those firms, households and other entities continuing to pay their workers (and suppliers) during the shutdowns, deteriorating income/revenue streams and erosion of savings will lessen the ability for this to persist, substantially worsening the impact of additional weeks of shutdown on the economy.
- This risks the supply-side shock to the economy not proving temporary, and the demand-side shock (SA is also experiencing a demand side shock as available goods and services to purchase have been extremely limited) would then worsen as the length of the shutdown is extended, resulting in a slower, weaker recovery, and exacerbated job losses.
- We are in an unprecedented crisis, the interest rate cuts globally and domestically helps those who are indebted by lowering the cost of servicing their debt. Additionally, they provide some relief for households and corporates who, due to reduced incomes have been battling debt costs, and so aid reductions in bankruptcies and ability to pay staff costs.
- National Treasury says its “central scenario is for a deep recession in 2020, followed by a rapid upswing in economic growth. Critically, the path relies on an understanding of how the global economy will adjust”. Global recovery will prove a key ballast to a recovery in SA, if SA opens up its export and supply chains sufficiently to benefit.
- National Treasury said today that it will revise its fiscal framework, with clear estimates of additional (temporary) health costs (also reallocating unnecessary expenditure to health care costs instead), but that it will also include “a clear timetable or plan to stabilize debt over the current forecast period”.
- The rand lost its midday gains this afternoon, reaching R18.40/USD, R20.16/EUR and R23.13/GBP on the knee-jerk reaction from the opening of the US markets to SA rate cuts, while worries still linger over SA’s vulnerabilities to likely further credit rating downgrades (lite down case), or worse (severe down case).

Economic Scenarios: note updated probabilities, forecasts for the unprecedented crisis									
		Q1.20	Q2.20	Q3.20	Q4.20	Q1.21	Q2.21	Q3.21	Q4.21
Extreme	USD/Rand (average)	15.45	15.00	14.00	13.00	12.00	11.00	10.00	9.00
	Repo rate (end rate)	5.25	3.50	3.50	3.50	3.50	3.50	3.50	3.50
Up case 1%	Impact of Covid-19 pandemic 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 nationalisation. High business confidence and fixed investment growth, substantial FDI inflows, strong fiscal consolidation (government debt falls back to low ratios of 2000s). Strong global growth, commodity boom. Stabilisation of credit ratings, then credit rating upgrades.								
Up case 4%	USD/Rand (average)	15.45	16.00	15.00	14.00	13.50	12.00	11.50	11.00
	Repo rate (end rate)	5.25	3.75	3.75	3.75	3.75	3.75	3.75	3.75
	Quick rebound from Covid-19 pandemic, rising confidence and investment levels - structural problems worked down. No further credit rating downgrades, rating outlooks move to stable and eventually positive, strong fiscal consolidation (government debt projections fall substantially). Global risk-on, global demand quickly returns to trend growth. Limited impact of expropriation without compensation) to abandoned, unused, labour tenants" and government land (individuals are new owners and receive title deeds) does not have a negative effect on economy - no nationalisation.								
Base case 43%	USD/Rand (average)	15.45	17.50	17.00	16.50	15.50	14.60	14.50	14.00
	Repo rate (end rate)	5.25	4.00	4.00	4.00	4.00	4.25	4.25	4.25
	Temporary sharp global slowdown and global financial turmoil from Covid-19 pandemic (severe currency depreciation, low interest rates) – eventually sufficient global and domestic monetary and other policy supports to growth and financial markets occur and risk sentiment stabilises. South Africa exits recession in Q3.20. Market unfriendly policies like expropriation of private sector property put on hold in the crisis. SA remains BB+ rating from Moody's - government debt projections stabilise.								
Lite (domestic) Down case 42%	USD/Rand (average)	15.45	19.50	22.00	20.00	18.50	17.00	16.50	16.00
	Repo rate (end rate)	5.25	4.25	4.25	4.50	4.75	4.75	4.75	5.00
	The international risk sentiment environment is that of the base case. South Africa continues to fail to see its debt projections stabilise and loses its BB+ rating from Moody's and falls towards B ratings from all three rating agencies. More severe recession in SA over 2020 than in the expected case. Expropriation of some private commercial sector property without compensation, with some negative impact on the economy. Business confidence depressed even further, significant rand weakness, significant load shedding and weak investment growth until substantial fiscal repair ultimately effected.								
Severe down case 10%	USD/Rand (average)	15.45	22.00	24.00	21.00	20.00	19.00	18.00	16.50
	Repo rate (end rate)	5.25	4.50	4.75	5.00	5.50	6.00	6.50	7.00
	Lengthy global recession on impact of Covid-19 – global financial crisis – insufficient monetary and other policy supports to growth domestically and internationally. Depression in SA, unprecedented rand weakness. Nationalisation of private sector property (title deeds not transferred to individuals). SA rated single B from all three key agencies, with further rating downgrades occurring into C grade as government finances deteriorate (debt projections elevate even further - fail to ever stabilise. Government borrows from increasingly wider sources as it sinks deeper into a debt trap), eventually include widespread services load shedding, strike action and civil unrest.								

Note: Event risk begins Q2.20. Source: Investec

Lite Down Case: Exchange Rates forecasts												
	2020				2021				2022			
	Q1.20	Q2.20	Q3.30	Q4.20	Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22
USDZAR	15.45	19.50	22.00	20.00	18.50	17.00	16.50	16.00	15.50	16.00	16.50	16.00
GBPZAR	19.60	22.80	25.87	23.83	22.49	21.37	21.42	21.33	20.77	21.60	22.44	21.92
EURZAR	16.78	20.87	23.54	21.80	20.35	18.70	18.32	17.92	17.52	18.24	18.98	18.56
ZARJPY	7.20	5.63	4.95	5.50	5.89	6.32	6.42	6.63	6.84	6.63	6.42	6.63
CHFZAR	15.70	19.78	22.31	20.37	18.76	17.08	16.57	16.07	15.50	16.00	16.50	16.00
AUDZAR	10.03	11.51	13.04	12.20	11.66	10.97	10.97	11.04	10.85	11.20	11.72	11.36

Note: averages, Source: Investec, Iress

Severe Down Case: Exchange Rates forecasts												
	2020				2021				2022			
	Q1.20	Q2.20	Q3.30	Q4.20	Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22
USDZAR	15.45	22.00	24.00	21.00	20.00	19.00	18.00	16.50	16.80	17.50	18.00	17.00
GBPZAR	19.60	25.73	28.22	25.02	24.31	23.89	23.37	22.00	22.51	23.63	24.48	23.29
EURZAR	16.78	23.54	25.68	22.89	22.00	20.90	19.98	18.48	18.98	19.95	20.70	19.72
ZARJPY	7.20	4.99	4.54	5.24	5.45	5.66	5.89	6.42	6.31	6.06	5.89	6.24
CHFZAR	15.70	22.32	24.34	21.39	20.28	19.09	18.08	16.57	16.80	17.50	18.00	17.00
AUDZAR	10.03	12.99	14.22	12.81	12.60	12.26	11.97	11.39	11.76	12.25	12.78	12.07

Note: averages, Source: Investec, Iress

Up Case: Exchange Rates forecasts												
	2020				2021				2022			
	Q1.20	Q2.20	Q3.30	Q4.20	Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22
USDZAR	15.45	16.00	15.00	14.00	13.50	12.00	11.50	11.00	10.80	10.60	10.40	10.65
GBPZAR	19.60	18.71	17.64	16.68	16.41	15.09	14.93	14.67	14.47	14.31	14.14	14.59
EURZAR	16.78	17.12	16.05	15.26	14.85	13.20	12.77	12.32	12.20	12.08	11.96	12.35
ZARJPY	7.20	6.86	7.27	7.86	8.07	8.96	9.22	9.64	9.81	10.00	10.19	9.95
CHFZAR	15.70	16.23	15.21	14.26	13.69	12.05	11.55	11.05	10.80	10.60	10.40	10.65
AUDZAR	10.03	9.44	8.89	8.54	8.51	7.74	7.65	7.59	7.56	7.42	7.38	7.56

Note averages, Source: Investec, Iress

Extreme Up Case: Exchange Rates forecasts												
	2020				2021				2022			
	Q1.20	Q2.20	Q3.30	Q4.20	Q1.21	Q2.21	Q3.21	Q4.21	Q1.22	Q2.22	Q3.22	Q4.22
USDZAR	15.45	15.00	14.00	13.00	12.00	11.00	10.00	9.00	8.00	8.00	8.00	8.00
GBPZAR	19.60	17.54	16.46	15.49	14.59	13.83	12.98	12.00	10.72	10.80	10.88	10.96
EURZAR	16.78	16.05	14.98	14.17	13.20	12.10	11.10	10.08	9.04	9.12	9.20	9.28
ZARJPY	7.20	7.32	7.79	8.46	9.08	9.77	10.60	11.78	13.25	13.25	13.25	13.25
CHFZAR	15.70	15.22	14.20	13.24	12.17	11.05	10.05	9.04	8.00	8.00	8.00	8.00
AUDZAR	10.03	8.85	8.30	7.93	7.56	7.10	6.65	6.21	5.60	5.60	5.68	5.68

Note: averages, Source: Investec, Iress

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