

## EURZAR – Not much different from the USDZAR

- We analyse the EURZAR in the same manner as we did the USDZAR in our note [FX Insight: ZAR – Consistency in extreme peaks](#), dated 8 May 2020.
- Rand weakness in the current cycle seems to have peaked at extremes against the EUR similar to those seen in 2001, 2009 and 2016. This is consistent with what we have observed in the USDZAR (see our [FX Insight: ZAR – Consistency in extreme peaks](#), dated 8 May 2020).
- Our analysis suggests that the EURZAR should be below 17.00 rather than at the current level around 19.20. As a result, we set a target for the EURZAR of 17.00. Like our USDZAR target, we view this as a six- to nine-month target (with bias for this to be reached sooner rather than later).
- Our USD view from early April remains unchanged – we believe the rand has reached a broad top and maintain a target of 15.00 against the USD.

### Consistency in extremes

In our [FX Insight: ZAR – Consistency in extreme peaks](#), dated 8 May 2020, we analysed periods of extreme rand weakness against the USD. We found that (1) there is consistency in extreme bouts of weakness, (2) current rand weakness experienced since early 2020 is no different from weakness seen in 2016, 2009 and 2001 and (3) history suggests that the rand may strengthen by some margin over the coming months. This would be consistent with our call from early April that most of the rand weakness has passed and our target level of a rand closer to 15.00 against the USD over the coming months. In this note, we assess levels for the EURZAR.

#### Are extremes consistent against the EUR too?

We analyse the EURZAR in the same manner as we did the USDZAR, i.e., we look at extreme peaks in the EURZAR after accounting for EUR strength/weakness and the rand's long-term trend of depreciation. Specifically, we regress the EURZAR on a linear trend and against the trade-weighted EUR index.

- The linear trend captures the structural decline in the rand against other major currencies, largely because South Africa has a higher inflation rate vis-à-vis its trading partners and a greater country risk premium vis-à-vis other major currencies.
- The broad value of the EUR is captured by the weighted value of the EUR against the Eurozone's major trading partners (the USD, GBP, JPY, SEK and CHF) and is a good proxy for general EUR strength or weakness. This index excludes the rand, so there is no "double-counting".

#### A EURZAR closer to 17.00 would be consistent with appreciation after the previous blow-outs

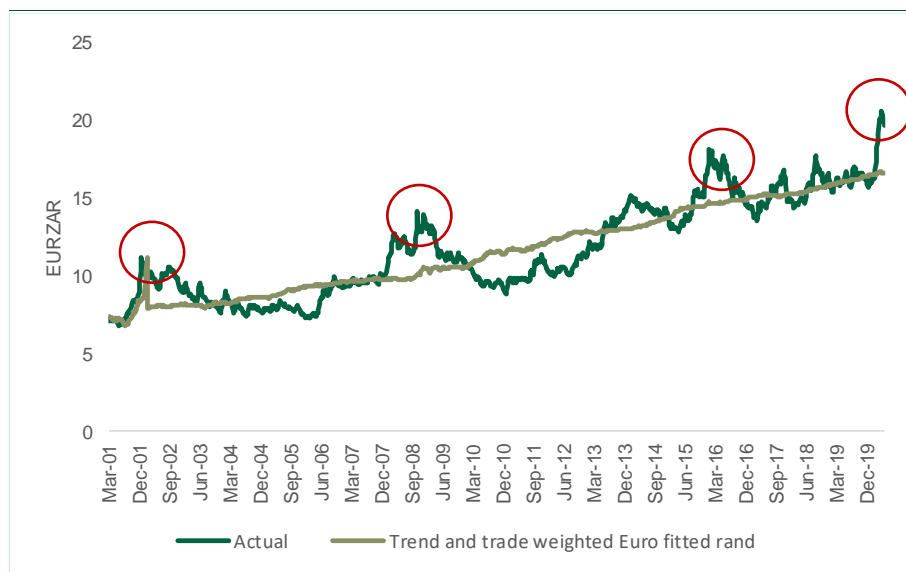
Exhibit 1 shows the result of our analysis. We use weekly data starting from 2001. Like the USDZAR, it is evident from the chart that the EURZAR trades around the value suggested by the regression and that the actual EURZAR always reverts to the "fitted" line after some period of deviation (which, sometimes, could be months). Right now, the "fitted" line suggests that the EURZAR should be closer to 16.80 rather than the current level around 19.20.

#### ANALYST DETAILS

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Exhibit 1: The EURZAR relative to a trend and the trade-weighted EUR



Source: Nedbank CIB Markets Research

### How can we be confident that the EURZAR will move lower in coming months?

But, perhaps more importantly, how can we say with some degree of confidence that the rand has reached cyclical weakness against the EUR?

There are many ways to analyse the currency. However, when the global financial environment is as uncertain as it is now, a useful way to think about the rand is in the context of a distribution of possible outcomes. In order to put current rand depreciation and previous periods of rand weakness in context, we turn to the residual for the equation above. The residual is simply the difference between the actual value of the EURZAR and the value suggested by the trade-weighted EUR index and the linear trend. This residual provides the historical distribution of how far the actual EURZAR deviated from the value suggested by the specified relationship in Exhibit 1.

We provide this residual in Exhibit 2 below. Very similar to the USDZAR, during previous periods of financial stress, rand weakness peaked whenever the actual EURZAR moved close to 2.5 standard deviations away from where the regression suggested the EURZAR should be. Rand weakness peaked at these “extreme” levels in 2001, 2009 and 2016. We believe rand weakness will likely peak again at these levels.

*When the global financial environment is as uncertain as it is now, a useful way to think about the rand is in the context of a distribution of possible outcomes*

Exhibit 2: EURZAR – 2.5 standard deviations tend to signal “peak” weakness for the rand



Source: Nedbank CIB Markets Research

## As with the USD, expect a stronger rand against the EUR

Our analysis suggests that (1) the EURZAR trades around a long-term trend and (2) weakness in the rand against the EUR is at levels where strength is likely to return.

As a result, we set a target for the EURZAR of 17.00. Like our USDZAR target, we see this as a six- to nine-month target (with bias for this to be reached sooner rather than later).

The fact that the analysis of both the EURZAR and the USDZAR suggests that the rand is likely to strengthen from here indicates that some of this strength will come from the rand, rather than, for example, from only USD weakness. But this should not come as a complete surprise. We have pointed out before that rand weakness was not alone – most major EM currencies such as the BRL and MXN suffered substantial weakness. As such, any rand strength against the USD and EUR is likely to coincide with broader EM currency strength.

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## Summary of our core views

|                       |  |
|-----------------------|--|
| <b>FX view</b>        | Our target for the USDZAR stands unchanged at 15.00. We see this as a six- to nine-month target, with the bias that it is reached sooner. We have a target of 17.00 against the EUR.   |
| <b>Inflation view</b> | <p>We believe upside inflation risks being contained in the absence of a severe drought, along with the sharp depreciation in the rand exchange rate, will have a limited impact on inflation given the weaker pass-through during a recession.</p> <p>Our estimates point to an average inflation rate of 3.9% in 2020, but with significant downside risks.</p>                    |
| <b>Repo view</b>      | In line with our expectations, the SARB cut by 50bps at its May MPC meeting. Downside growth and inflation surprises would warrant further easing. We expect another 25-50bps of cuts, but most likely after a pause at the July meeting.  |
| <b>Bond view</b>      | <p>Our fair value estimate of South Africa's 10y R2030 bond yield is 9.0%, unchanged from our last update as the rise in credit risk offset the lower US 10-year yield estimate. We see our fair value estimate as a six- to 12-month view.</p> <p>Given that we have reached this level, we are neutral bonds, especially ahead of the revised Budget that the NT is preparing.</p> |