

RAND: REDUCE RISK INTO STRENGTH

Tactical view:

We will use EURUSD 1.13 as an important level for the rand to pivot from. EURUSD above 1.13 would raise the chance for further gains in the rand, targeting 13.50. A short squeeze in the EURUSD below 1.12 would lead to the rand weakening close to R14.10.

Strategic view:

Tighter global financial conditions and global USD shortages, coupled with policy uncertainty and a low growth environment, would be negative for carry trades, leaving downside risks to the rand intact.

- **Our view on the currency remains unchanged.** Our metrics (\$-Liquidity, technicals and fair value models) indicate that we should expect short-term rand strength towards 13.50 and possibly 13.30. We would, however, use such rand strength to reduce exposure – we sell into rand strength. Our year-end target for the rand is between 14.00 and 14.50.
- We have seen a largely range-bound rand over the past two weeks, and we thought the currency would have appreciated somewhat against the USD already. However, concerns over global growth and a SARB that turned more dovish than expected on interest rate hikes and inflation prohibited strength. Nevertheless, weaker global growth and a more dovish SARB provides us with more comfort that rand strength may well be temporary and that it should be sold into strength as the 13.50/13.30 range approaches.
- **Growth concerns were highlighted by the IMF's latest forecasts**, where the global growth forecast for this year was reduced by 20bps to 3.5%. At the same time, the US administration rejected an offer by the Chinese authorities of a preparatory trade discussion, highlighting that the ongoing trade disputes are likely to remain a feature for some time to come.
- **Locally, the dovish MPC statement last week was, on balance, also rand-negative** (see [MPC Review](#) of 17 January 2019). For the currency, specifically, an important adjustment by the SARB came via the Quarterly Projection Model (QPM), which now shows just one hike of 25bps over the forecast period, compared to three hikes of 25bps each projected in November 2018 (or four hikes, including the November hike). From a **carry-trade perspective**, a SARB that hikes less, rather than more, should weigh on the currency if global liquidity recedes again; we expect this to happen later in the year.
- We note that valuation-wise, while on a PPP basis the rand appears undervalued relative to other EM currencies, other metrics such as a one-year carry-trade valuation indicate that the rand is overvalued at current levels, relative to other EM currencies (see [Chart 7](#) and [Chart 8](#)).
- **On global liquidity: we expect global financial conditions to ease somewhat** (not reverse trend) on an improvement in Global \$-Liquidity over the next three months due to an injection of dollars by the US Treasury. We expect that easier global financial conditions and an improvement in Global \$-Liquidity stemming from an injection of dollars by the US treasury amid the increasing likelihood that an agreement on the debt ceiling would not be reached before the 1 March 2019 deadline. As a result, excess \$-Liquidity is likely to rise, leading to a weaker USD ([Chart 2](#)) (for more details, see [Global macro insight: Incoming tide of \\$-Liquidity](#) of 22 January 2019).
- **From a fundamental view**, the rand and other riskier assets are likely to benefit from easier financial conditions and improved risk sentiment, supported by the rise in excess \$-Liquidity. However, we believe this improvement in \$-Liquidity will not be sustainable and will likely last only for about a quarter. **We will use this opportunity to reduce exposure to risk assets. In this scenario, we expect the rand to target R13.50, with the probability of extending to R13.30.**
- **From a technical perspective**, we recommend keeping an eye on the USDZAR resistance level of R14.12 and the USDZAR support level of R13.53 (see [The correction phase that started in 3Q18 in SA bonds and FX is not over](#) of 23 January 2019).

Chart 1: Spot vs our financial fair value model on the rand, based on a range of financial market variables

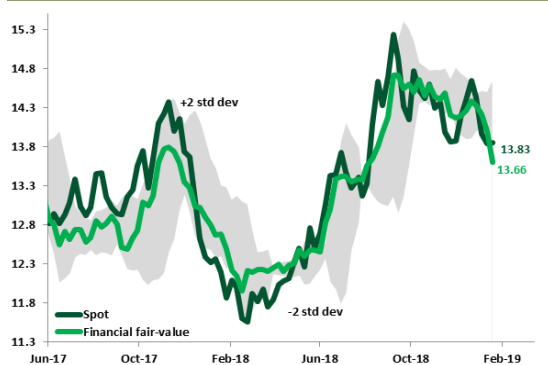
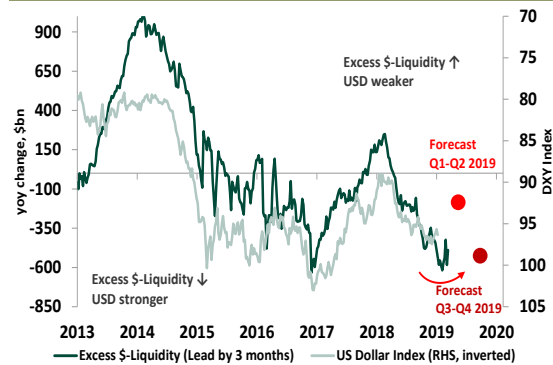


Chart 2: Incoming tide of \$-Liquidity will support USD weakness and carry trades in EMs



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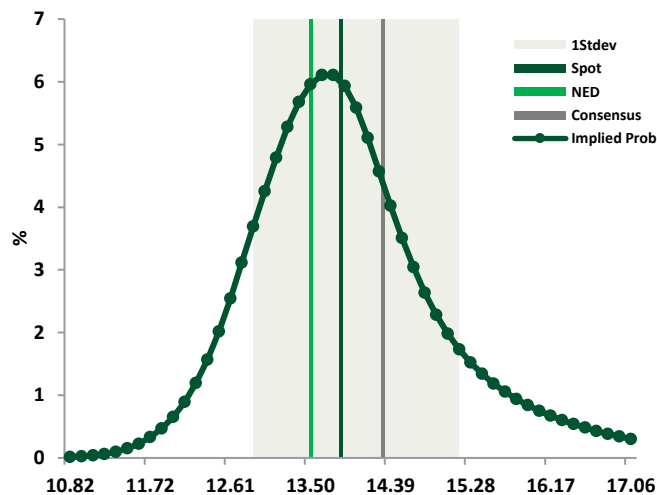
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FX VOL CURVES – BELOW THE THREE-YEAR AVERAGE

Implied volatility in the options market has improved after having fallen to levels last seen in August 2018 (see Chart 5). As a result, the volatility curve is below the three-year average for the first time in many months. That said, the options market's forecast for the USDZAR remains more bearish than Bloomberg consensus expectations:

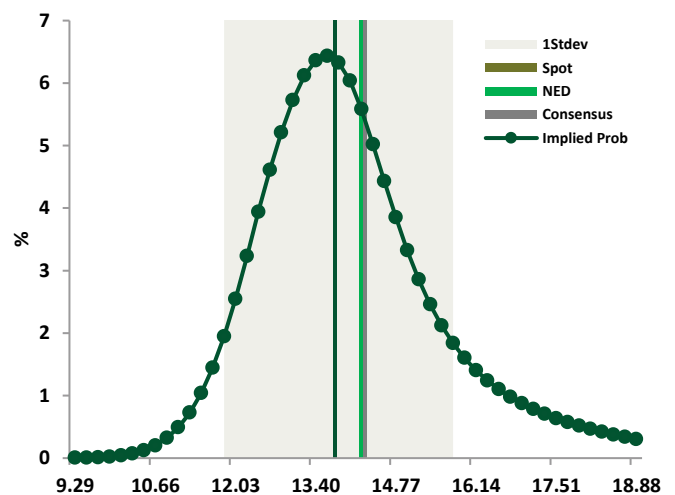
- On a three-month view, the options market suggests a one standard deviation trading range for the USDZAR of R12.80-15.11 (see Chart 3)
- On a six-month view, the probability is skewed towards weakness, as one would expect, with the implied probability distribution suggesting a one standard deviation range of R12.32-18.88 (see Chart 4).

Chart 3: 3m implied probability distribution vs forecast



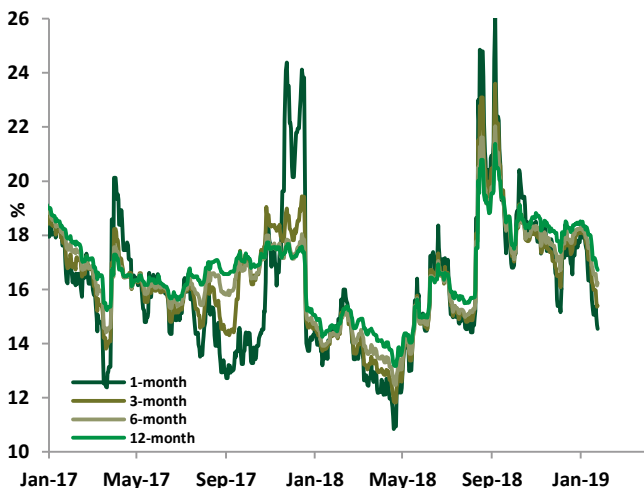
Source: Bloomberg, Nedbank CIB

Chart 4: 6m implied probability distribution vs forecast



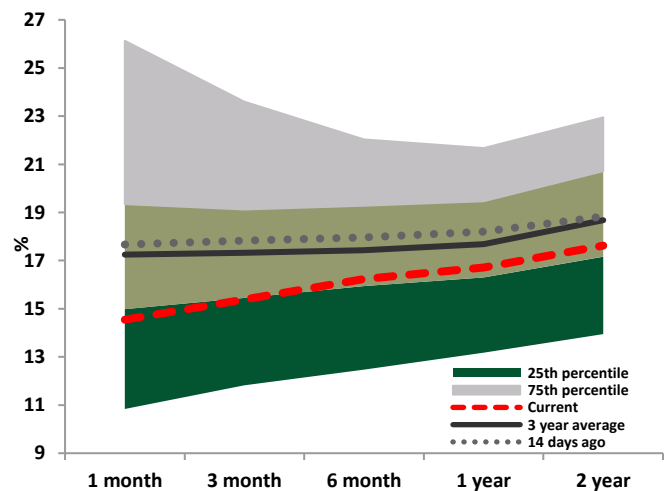
Source: Bloomberg, Nedbank CIB

Chart 5: USDZAR implied volatility



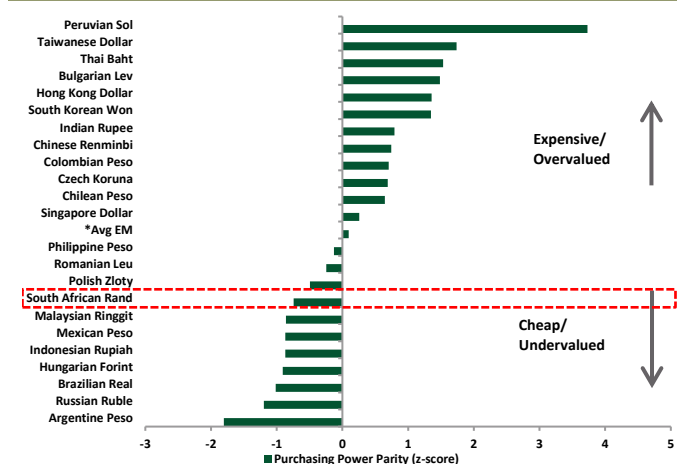
Source: Bloomberg, Nedbank CIB

Chart 6: ATM USDZAR implied volatility cone



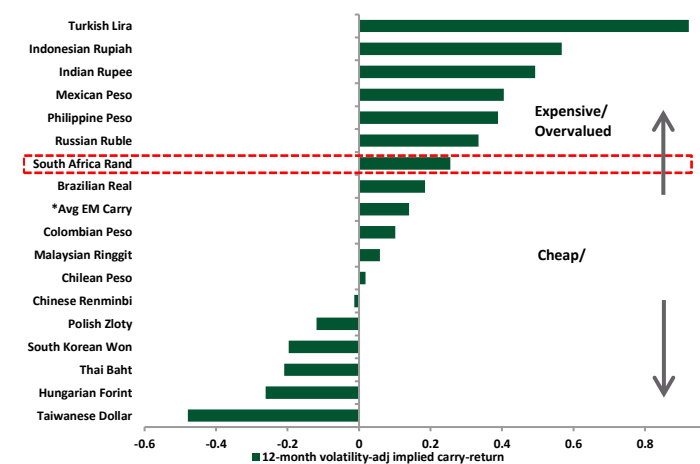
Source: Bloomberg, Nedbank CIB

Chart 7: EM currency valuations from a PPP fundamental perspective



A large value indicates that the spot rate has a larger deviation from PPP metrics
Source: Bloomberg

Chart 8: EM currency valuations from a carry-trade perspective



Carry trade calculated as the difference between the 1-year implied yield of the currency and 1-year LIBOR adjusted for its 1-year implied volatility
Source: Bloomberg

Chart 9: YTD EM currency performance vs USD

	CNY	JPY	KRW	TRY	MXN	RUB	THB	INR	AUD	BRL	GBP	EUR	CAD	ZAR	USD
CNY		1.158	2.750	1.245	-2.125	-3.856	-0.413	4.092	0.290	-1.489	-1.054	1.753	-0.254	-2.683	1.390
JPY	-1.151		-1.450	-0.425	3.190	5.574	1.426	-2.620	0.721	3.134	2.494	-0.779	2.136	3.727	-0.046
KRW	-3.226	1.298		1.140	4.814	7.076	2.409	-1.274	2.130	4.440	4.014	0.689	3.702	5.035	1.342
TRY	-0.827	0.882	-0.994		3.776	5.301	2.714	-2.111	0.077	2.344	3.132	0.047	2.019	4.495	0.487
MXN	1.889	-2.793	-4.633	-3.661		2.160	-0.825	-5.319	-2.424	-0.059	-0.684	-3.965	-1.058	0.561	-3.186
RUB	4.053	-5.302	-6.649	-5.062	-2.144		-3.017	-7.386	-4.657	-2.478	-2.889	-5.932	-3.211	-1.184	-4.975
THB	0.376	-2.247	-2.431	-2.715	0.982	3.200		-3.594	-0.415	0.610	0.937	-2.546	-0.117	1.130	-1.825
INR	-3.917	2.573	1.283	2.585	5.400	7.913	3.738		3.768	5.271	5.502	2.082	4.355	5.864	2.648
AUD	-0.285	-0.697	-2.042	-0.538	2.500	4.926	0.310	-2.956		2.324	1.775	-1.334	1.404	3.033	-0.762
BRL	1.512	-2.854	-4.256	-2.700	0.000	2.570	-0.611	-4.770	-2.382		-0.653	-3.751	-0.720	0.886	-3.138
GBP	1.211	-2.435	-3.846	-2.906	0.754	3.571	-0.290	-4.464	-1.761	0.446		-3.274	-0.365	1.280	-2.512
EUR	-1.726	0.676	-0.727	-0.018	4.063	5.556	1.616	-1.361	1.364	3.990	3.227		2.796	4.434	0.607
CAD	0.264	-2.093	-3.565	-1.980	1.010	3.308	0.112	-4.103	-1.394	0.740	0.311	-2.726		1.682	-2.134
ZAR	2.353	-3.749	-5.166	-4.358	-0.467	1.162	-1.828	-5.604	-3.629	-1.159	-1.426	-4.452	-1.925		-4.034
USD	-1.377	0.055	-1.457	0.558	3.308	5.509	2.299	-1.984	0.752	2.950	2.573	-0.602	2.182	3.871	

Source: Bloomberg

Chart 10: Correlation matrix – Markets vs FX

	VIX	SPX	US	USTIPS	SA 10yr	TOP40	EM FX	DM FX	MXN	AUD	CAD	ZAR
VIX		-81%	-42%	-31%	17%	-31%	-27%	-13%	21%	-23%	21%	28%
SPX	-81%		42%	30%	-14%	34%	31%	19%	-26%	36%	-26%	-33%
US 10yr	-42%	42%		89%	-3%	18%	12%	-2%	-8%	3%	-10%	-12%
USTIPS	-31%	30%	89%		5%	10%	3%	-6%	-4%	-9%	2%	-1%
SA 10yr	17%	-14%	-3%	5%		-28%	-60%	-1%	36%	-33%	28%	68%
TOP40	-31%	34%	18%	10%	-28%		23%	-4%	-9%	32%	-28%	-28%
EM FX	-27%	31%	12%	3%	-60%	23%		-9%	-67%	64%	-49%	-82%
DM FX	-13%	19%	-2%	-6%	-1%	-4%	-9%		8%	10%	-3%	-4%
MXN	21%	-26%	-8%	-4%	36%	-9%	-67%	8%		-42%	43%	55%
AUD	-23%	36%	3%	-9%	-33%	32%	64%	10%	-42%		-61%	-61%
CAD	21%	-26%	-10%	2%	28%	-28%	-49%	-3%	43%	-61%		51%
ZAR	28%	-33%	-12%	-1%	68%	-28%	-82%	-4%	55%	-61%	51%	

Source: Bloomberg, YTD

Chart 11: Correlation matrix – Commodities vs currencies

	Gold	Plat	Pall	Ironore	Copper	T-Coal	Brent	BRL	AUD	CAD	ZAR	EM FX
Gold		63%	37%	8%	1%	1%	11%	-21%	49%	-38%	-42%	48%
Plat	63%		51%	-3%	4%	12%	29%	-21%	56%	-44%	-50%	52%
Pall	37%	51%		-9%	6%	6%	29%	-15%	39%	-32%	-37%	36%
Ironore	8%	-3%	-9%		-2%	-1%	-8%	0%	-1%	-7%	0%	-1%
Copper	1%	4%	6%	-2%		10%	15%	-6%	5%	-2%	-11%	2%
T-Coal	1%	12%	6%	-1%	10%		4%	-5%	3%	1%	-6%	3%
Brent	11%	29%	29%	-8%	15%	4%		-5%	21%	-36%	-18%	14%
BRL	-21%	-21%	-15%	0%	-6%	-5%	-5%		-21%	18%	29%	-40%
AUD	49%	56%	39%	-1%	5%	3%	21%	-21%		-61%	-61%	64%
CAD	-38%	-44%	-32%	-7%	-2%	1%	-36%	18%	-61%		51%	-49%
ZAR	-42%	-50%	-37%	0%	-11%	-6%	-18%	29%	-61%	51%		-82%
EM FX	48%	52%	36%	-1%	2%	3%	14%	-40%	64%	-49%	-82%	

Source: Bloomberg, YTD

Key forecasts and target values

	Target values (period end)				Broad trading range	
	3m	6m	12m	Year-end	High	Low
Fed funds	2.50	2.75	3.00	3.00	2.50	3.00
US 10-year bond yield	2.80	3.00	2.80	2.80	2.30	3.20
Repo rate	6.75	6.75	7.00	7.00	6.75	7.00
SA 10-year bond yield	9.20	9.60	9.40	9.40	8.60	9.70
R208 (%)	7.00	7.10	7.20	7.20	6.90	7.40
R186 (%)	8.90	9.30	9.10	9.10	8.30	9.40
R2048 (%)	10.00	10.20	10.30	10.30	9.50	10.50
EURUSD	1.16	1.12	1.14	1.14	1.16	1.12
USDZAR	13.50	14.40	14.10	14.10	14.40	13.50
EURZAR	15.66	16.19	16.00	16.00	16.19	15.66
GBPZAR	17.60	18.10	17.90	17.90	18.10	17.60
AUDZAR	9.80	10.20	10.00	10.00	10.20	9.80
Δ Global \$-Liquidity	↔ to ↑	↔ to ↓	↓	↓	-	-

Nedbank CIB Market Research/Nedbank Group Economics

	1Q19	2Q19	3Q19	4Q19	2019 Ave	2020 Ave
SA headline CPI	5.00	4.90	5.30	5.40	5.30	5.20
SA core inflation	4.40	4.50	4.50	4.60	4.50	4.50
SA GDP	1.60	1.70	2.10	2.30	1.60	2.00
Current account as % of GDP					-3,3	-3,6

South African Reserve Bank

	1Q19	2Q19	3Q19	4Q19	2019 Ave	2020 Ave
SA headline CPI	4.60	4.70	4.80	4.80	4.80	5.30
SA core inflation	4.80	5.00	5.10	5.30	5.00	5.10
SA GDP	-	-	-	-	1.70	2.00
Current account as % of GDP	-	-	-	-	- 3.70	- 4.10

National Treasury

	1Q19	2Q19	3Q19	4Q19	2019 Ave	2020 Ave
SA headline CPI	-	-	-	-	5.60	5.40
SA core inflation	-	-	-	-	-	-
SA GDP	-	-	-	-	0.70	1.70
Current account as % of GDP	-	-	-	-	-3,2	-3,7

Source: Nedbank CIB Markets Research, Nedbank Group Economics, SARB, NT

All numbers in % unless otherwise indicated

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