

Tactical view:

Further gains in the currency are likely to be limited. We continue to use rallies to reduce exposure to the rand.

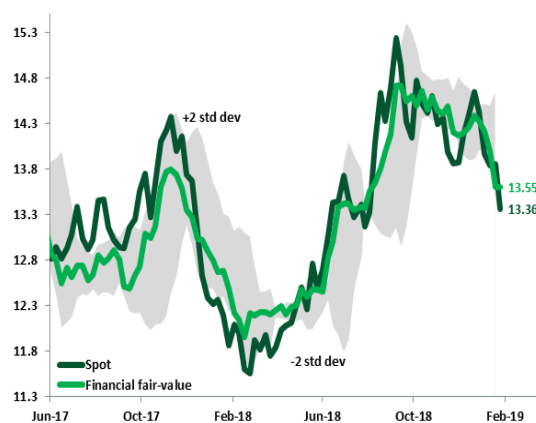
Strategic view:

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

RAND: FED PUT ALIVE AND WELL, BUT WILL IT BE ENOUGH?

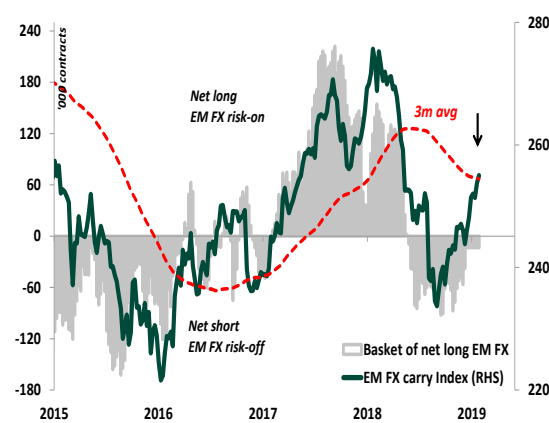
- We have reached our tactical targets (R13.50 and R13.30, respectively) on the currency. Our overall view remains unchanged. We expect the improvement in Global \$-Liquidity and positive sentiment towards the rand/EM FX to be short-lived (at this point, we expect its impact to fade beyond 1Q19). This is likely to support the rand at current levels, with the possibility of strength towards R13.00. As such, we will use rand strength to reduce exposure – sell rand into rallies, as our year-end target for the rand is **R14.00-R14.50**.
- In terms of our baseline expectations, we now expect only one more interest rate hike from the Fed this year (versus two hikes previously). The Fed has supercharged gains in risk assets (rand, EM FX) after making notable changes in its new policy statement, which was more dovish than the market had expected. While we believe the US economy can endure two rate hikes this year, we believe the fact that financial markets are not coping with tighter monetary conditions has likely forced the Fed to become more dovish, i.e., that the Fed put is alive and well.
- From a currency perspective, a more dovish Fed does not change our year-end target for the rand. We believe the Fed alone will not be enough to reverse tighter global financial conditions and Global \$-Liquidity for the remainder of the year. As such, we are reluctant to extrapolate current rand strength and change our year-end view on the rand.
- We believe the following global macro factors will challenge investor risk appetite and impact the currency negatively: (1) A slowdown in credit creation and the uncertainty surrounding the trade war are likely to weigh on China's growth, (2) global synchronised growth of the past two years is fading, and (3) global policy uncertainty continues to climb to new highs amid Brexit negotiations, escalating trade wars and growing populist movements.
- As a guide to gauge investor sentiment, we will use the three-month moving average (3mma) of the Bloomberg EM FX carry-trade index as well as CFTC investor positioning (net long). The EM FX carry-trade index is currently testing the 3mma, and positioning towards EM FX is net short. A move higher from the 3mma would indicate that investors are not too concerned about the global macro environment. This would support carry trades and bode well for the rand. However, should the EM FX carry-trade index battle to sustain a move higher, it would indicate that investor risk appetite is waning and that the outlook for the global macro environment is deteriorating; this would not bode well for carry trades or the rand ([Chart 2](#)).
- From an external vulnerability perspective, SA posted a trade surplus of R17.2bn for December (vs R3.3bn in November 2018) amid a sharp drop in imports. We expect the current account deficit to compress to 3.4% of GDP (vs 3.7% of GDP in 2018) amid lacklustre demand from the domestic economy. This is a positive for the rand. From a local calendar perspective, we are heading into a period of notable risk events in which we can expect volatility in the rand to climb: SONA (7 February 2019), the SA budget speech (20 February 2019) and Parliament's vote on land expropriation without compensation (31 March 2019).
- From a technical perspective, we recommend keeping an eye on the USDZAR resistance level of R13.60 and the USDZAR support level of R13.30 (see [Technical FX Strategy: EMs testing resistance levels of 31 January 2019](#)).

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



Source: BBG, Eviews Econometric model, Nedbank CIB Markets Research

Chart 2: Investor risk sentiment towards EM carry trades will be tested over the next couple of months



Source: DataStream, Nedbank CIB Markets Research

ANALYST DETAILS

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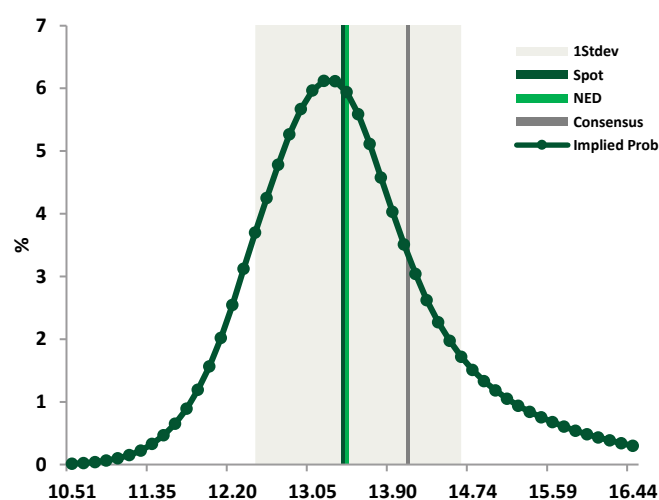
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FX VOL CURVES – BELOW THE THREE-YEAR AVERAGE

Implied volatility in the options market has declined on the back of the Fed's comments and as investor appetite towards riskier assets has improved (see Chart 5). As a result, the volatility curve is now below the three-year average. That said, the options market's forecast for the USDZAR remains more bearish than Bloomberg consensus expectations:

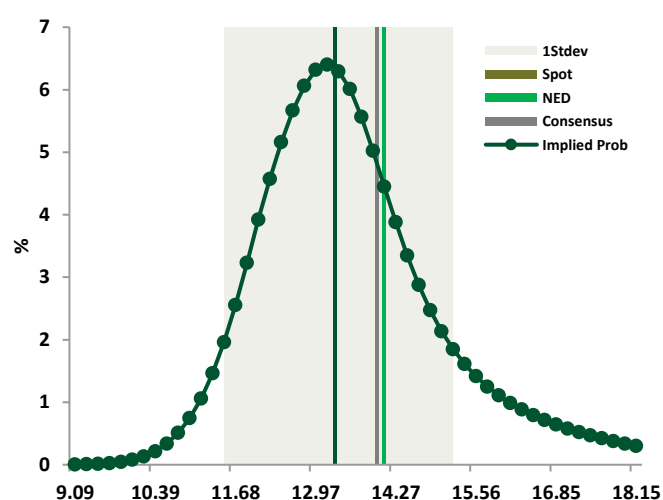
- On a three-month view, the options market suggests a one standard deviation trading range for the USDZAR of R12.41-14.29 (see Chart 3)
- On a six-month view, the probability is skewed towards weakness, as one would expect, with the implied probability distribution suggesting a one standard deviation range of R11.99-15.31 (see Chart 4).

Chart 3: 3m implied probability distribution vs forecast



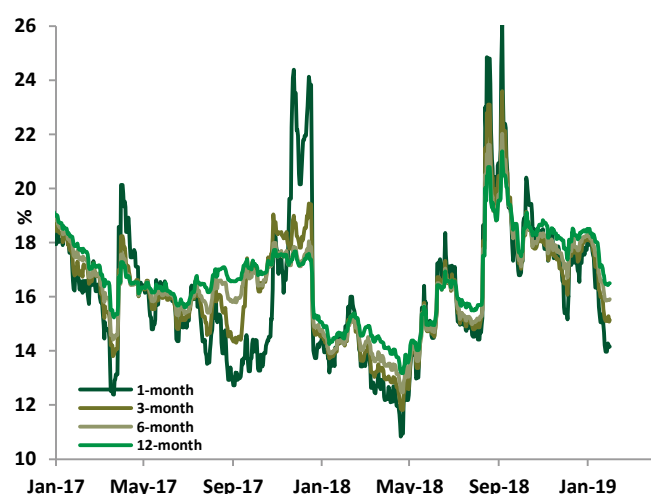
Source: Bloomberg, Nedbank CIB

Chart 4: 6m implied probability distribution vs forecast



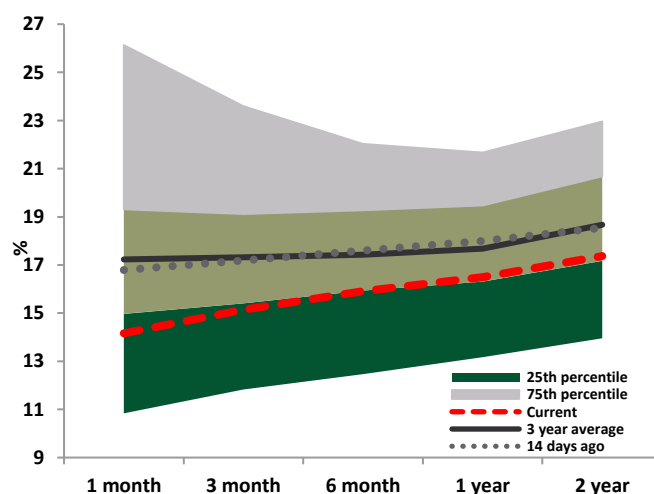
Source: Bloomberg, Nedbank CIB

Chart 5: USDZAR implied volatility



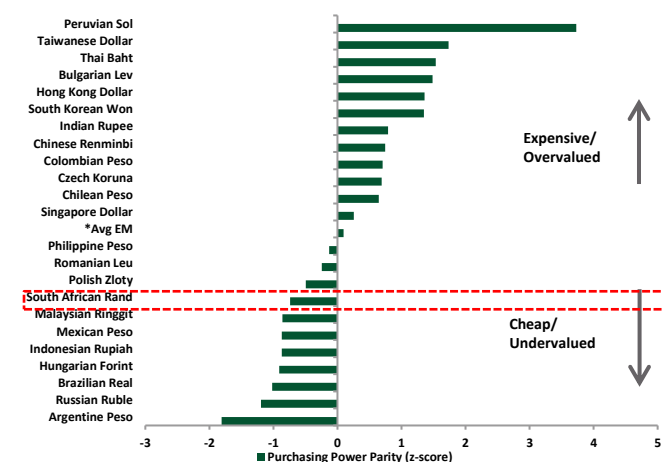
Source: Bloomberg, Nedbank CIB

Chart 6: ATM USDZAR implied volatility cone



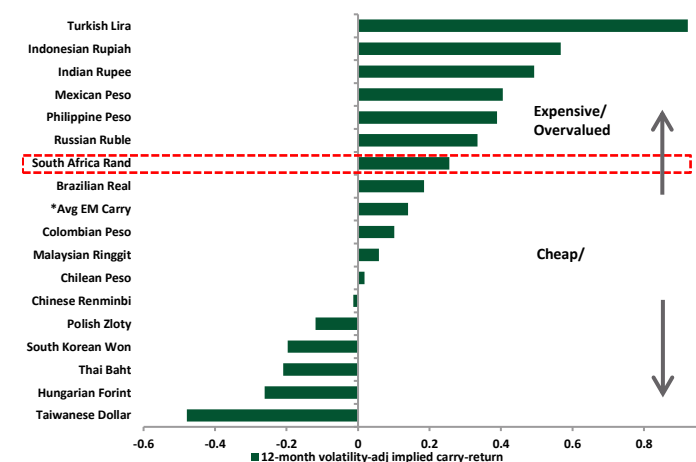
Source: Bloomberg, Nedbank CIB

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		1.533	2.322	1.454	-0.488	-3.670	-0.732	5.043	-0.677	-2.516	-0.176	1.941	-0.609	-4.731	2.703
JPY	-1.539		-0.619	-0.153	1.980	5.651	2.181	-3.094	2.153	4.455	2.019	-0.596	2.931	6.419	-0.884
KRW	-3.226	0.503		0.400	2.722	6.341	2.313	-2.580	2.719	5.109	2.655	-0.018	3.623	6.845	-0.355
TRY	-1.059	0.626	-0.381		2.301	5.064	3.270	-2.902	1.295	3.666	2.357	-0.018	2.614	6.946	-0.608
MXN	0.229	-1.676	-2.655	-2.301		3.506	0.990	-4.610	0.121	2.445	0.025	-2.624	0.894	4.362	-2.861
RUB	3.749	-5.345	-5.942	-4.847	-3.364		-2.367	-7.889	-3.381	-1.128	-3.386	-5.785	-2.565	1.357	-5.762
THB	0.705	-2.976	-2.431	-3.198	-0.958	2.512		-4.785	0.259	1.346	-0.274	-3.085	-0.074	2.937	-3.381
INR	-4.795	3.062	2.647	3.318	4.715	8.644	5.031		5.761	7.396	5.528	2.785	5.684	9.208	2.283
AUD	0.712	-2.090	-2.671	-1.700	-0.139	3.448	-0.351	-4.434		2.215	-0.122	-2.542	0.750	4.247	-2.983
BRL	2.573	-4.267	-4.855	-3.900	-2.229	1.144	-1.330	-6.642	-2.244		-2.364	-4.874	-1.409	1.994	-5.174
GBP	0.332	-1.973	-2.583	-2.248	0.000	3.571	0.923	-4.464	0.099	2.427		-2.639	0.887	4.388	-2.881
EUR	-1.929	0.485	-0.109	0.048	2.709	5.556	2.204	-2.002	2.615	5.150	2.553		3.405	7.061	-0.435
CAD	0.633	-2.847	-3.500	-2.523	-1.010	2.597	0.079	-5.128	-0.759	1.423	-0.926	-3.295		3.470	-3.718
ZAR	4.518	-6.121	-6.787	-6.567	-4.123	-1.355	-3.589	-8.528	-4.737	-2.244	-4.366	-6.691	-3.657		-7.249
USD	-2.630	0.911	0.223	1.621	2.973	6.555	3.935	-1.656	3.063	5.357	2.965	0.437	3.859	7.471	

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%	-14%	21%	-23%	22%	29%
SPX	-81%		42%	30%	-15%	34%	31%	19%	-26%	36%	-26%	-33%
US 10yr	-42%	42%		89%	-3%	18%	12%	-2%	-8%	5%	-11%	-12%
US TIPS	-31%	30%	89%		5%	10%	3%	-6%	-4%	-7%	1%	-1%
SA 10yr	17%	-15%	-3%	5%		-28%	-60%	-2%	36%	-32%	29%	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	-14%	19%	-2%	-6%	-2%	-4%	-9%		7%	9%	-3%	-4%
MXN	21%	-26%	-8%	-4%	36%	-9%	-67%	7%		-41%	42%	55%
AUD	-23%	36%	5%	-7%	-32%	32%	64%	9%	-41%		-62%	-61%
CAD	22%	-26%	-11%	1%	29%	-28%	-49%	-3%	42%	-62%		50%
ZAR	29%	-33%	-12%	-1%	68%	-28%	-82%	-4%	55%	-61%	50%	

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%	39%	8%	1%	1%	11%	-21%	51%	-39%	-42%	49%
Plat	63%		51%	-2%	4%	12%	29%	-22%	55%	-44%	-50%	52%
Pall	39%	51%		-8%	5%	6%	30%	-15%	41%	-34%	-37%	37%
Ironore	8%	-2%	-8%		-2%	-1%	-7%	-1%	0%	-8%	-1%	0%
Copper	1%	4%	5%	-2%		10%	15%	-6%	5%	-2%	-10%	2%
T-Coal	1%	12%	6%	-1%	10%		4%	-5%	3%	1%	-6%	3%
Brent	11%	29%	30%	-7%	15%	4%		-5%	21%	-36%	-18%	14%
BRL	-21%	-22%	-15%	-1%	-6%	-5%	-5%		-21%	18%	29%	-40%
AUD	51%	55%	41%	0%	5%	3%	21%	-21%		-62%	-61%	64%
CAD	-39%	-44%	-34%	-8%	-2%	1%	-36%	18%	-62%		50%	-49%
ZAR	-42%	-50%	-37%	-1%	-10%	-6%	-18%	29%	-61%	50%		-82%
EM FX	49%	52%	37%	0%	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	2.75	2.75	2.50	2.75
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	14.20	14.10	14.10	14.40	13.50
EURZAR	15.66	15.96	16.00	16.00	16.19	15.66
GBPZAR	17.60	18.10	17.90	17.90	18.10	17.60
AUDZAR	9.80	10.10	10.00	10.00	10.20	9.80
Δ Global \$-Liquidity	↔ to ↑	↔ to ↓	↓	↓	-	-

Nedbank CIB Markets 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 a % 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 a % of GDP	-	-	-	-	-3,2	-3,7

All numbers in % unless otherwise indicated

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

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