

Tactical view:

We do not expect the rand to weaken above 14.50 in the near term. A rally to 14.30 is possible if global risk appetite improves.

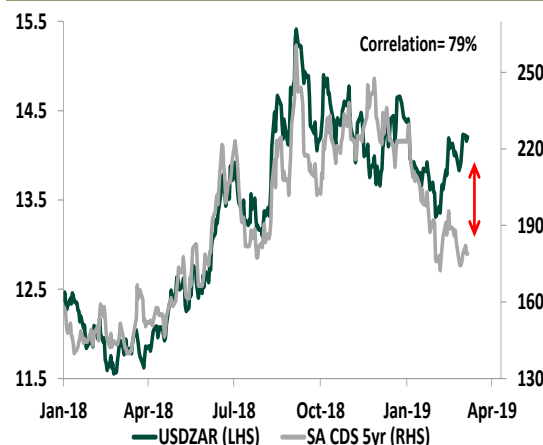
Strategic view:

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.

RAND: THE ANOMALY (RAND VS. DEFAULT RISK)

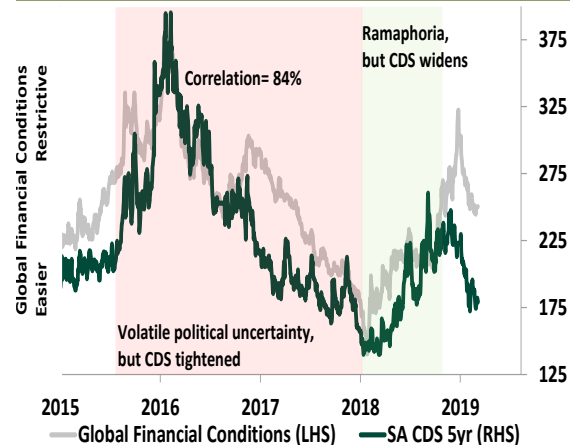
- Our rand view remains unchanged – with the rand trading within the **14.00-14.50** range, we are comfortable that local and external risks are being better reflected in the currency. As such, we were selling into rand strength below 14.00, and we would buy into weakness as it approaches 14.50. Although we believe further weakness, at least over the near term, is limited, **much would depend on central bank (FOMC, BOJ, SARB) monetary policy guidance at their respective policy meetings and Moody's review (29 March) of South Africa's (SA's) ratings.**
- "The Anomaly":** Local financial markets have witnessed an anomaly in recent weeks. Normally, there is a strong positive relationship between the probability of a country defaulting on its foreign currency debt and its exchange rate, i.e., when the probability of a country defaulting rises, as reflected in its sovereign credit default swap (CDS) spread, the value of its currency must drop.
- Since February, the relationship between the currency and the CDS spread has broken down. The rand has weakened 8% against the USD, while the sovereign CDS spread has compressed. **Intuitively, this does not make sense (Chart 1).** Either the market is too bearish on the rand or it is too optimistic on the sovereign CDS spread. **Surprisingly, this is not unique to SA; this "anomaly" can be seen in several EMs.**
- We believe the CDS spread is tightening because of a combination of local and international factors: **(1)** more appetite for hard-currency (USD) bonds than for domestic-currency (ZAR) bonds, anchored by the market perception that international rating agency Moody's will not downgrade SA (on 29 March), which is our view too, and **(2)** easier global financial conditions fuelling demand for riskier assets (Chart 2).
- From a currency perspective:** We believe this anomaly is not sustainable. Either further weakness in the rand is limited or further compression in the CDS is limited. **We believe it is the latter** – from current levels, downside for the rand is becoming limited.
- That said, we are cognisant that global growth is slowing, inflation remains low and downside risks to financial markets remain intact. As a result, major central bank policy decisions over the coming weeks will be crucial. Action is required by global central banks, not just "jawboning" to support risk appetite going forward; we believe they will largely deliver. If they fail to reflate risk appetite, our view would be negated, and downside risks to the rand would materialise (R14.50-R15.50).
- On a multi-month view, our year-end target range for the rand still stands at R14.00-R14.50**, as we believe the receding tide of Global \$-Liquidity will continue to exert pressure on carry trades as downside risks to financial instability continue to grow.
- At this point, we are closely monitoring the R14.50 level. If the USDZAR breaks above this level on a sustained basis, there is a chance it could extend to R15.05. If the R14.50 level holds, we could see the rand retrace to close to R14.30-R14.00. For a technical perspective, please refer to "Technical FX Strategy: How is the long-term picture unfolding? The USD bull remains alive".

Chart 1: The anomaly between the USDZAR and CDS is unlikely to be sustained



Source: BBG, Nedbank CIB Markets Research

Chart 2: SA CDS driven by changes in global financial conditions vs local fundamentals



Source: BBG, Nedbank CIB Markets Research

ANALYST DETAILS

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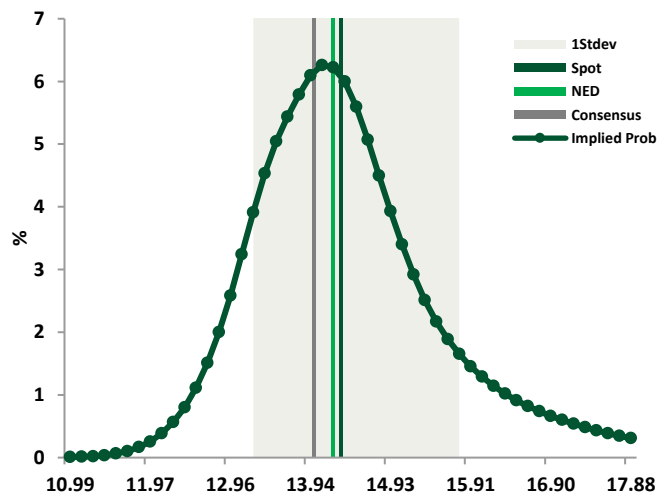
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FX VOL CURVES – VOL COMPRESSION

FX volatility in most of the tenures has fallen; the implied volatility curve is trading below the two-week average and well below the three-year average. However, risk of a steeper FX volatility curve remains intact, as Moody's is due to give a credit rating decision in the coming weeks (by 29 March). The options market's forecast for the USDZAR remains more bearish than Bloomberg consensus expectations:

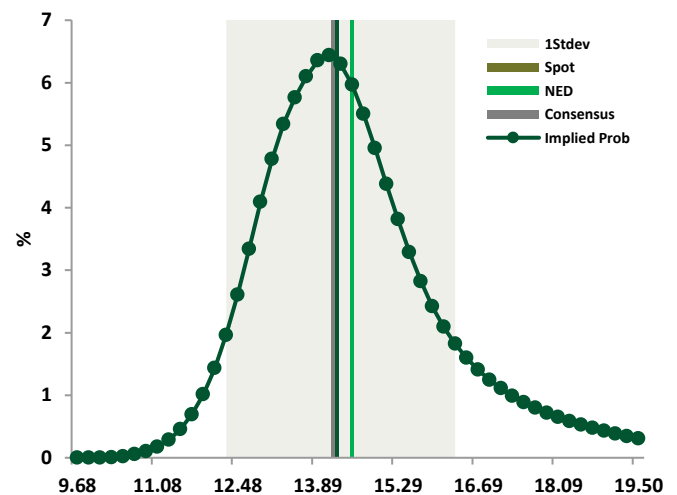
- On a three-month view, the options market suggests a one standard deviation trading range for the USDZAR of R13.15-15.71 (see Chart 3).
- On a six-month view, the probability is skewed towards weakness, as one would expect, with the implied probability distribution suggesting a one standard deviation range of R12.78-R16.42 (see Chart 4).

Chart 3: 3m implied probability distribution vs forecast



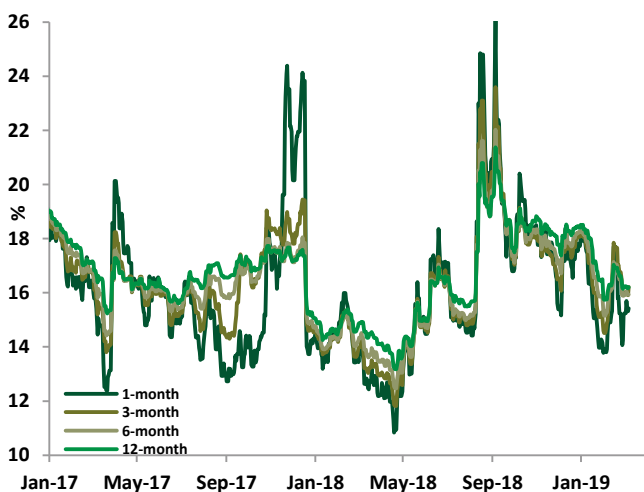
Source: Bloomberg, Nedbank CIB

Chart 4: 6m implied probability distribution vs forecast



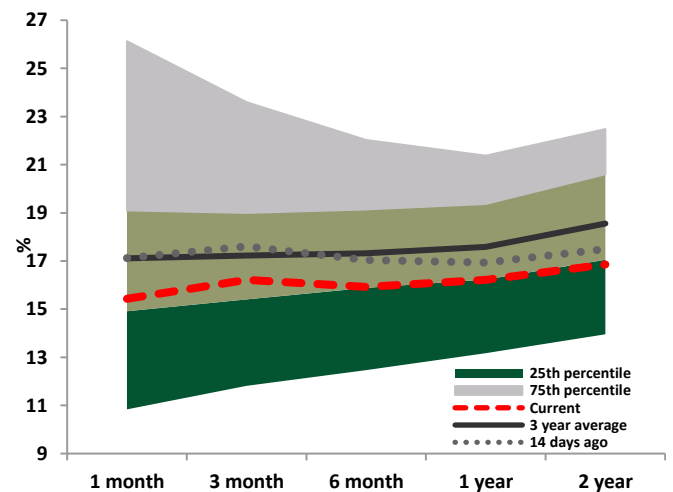
Source: Bloomberg, Nedbank CIB

Chart 5: USDZAR implied volatility



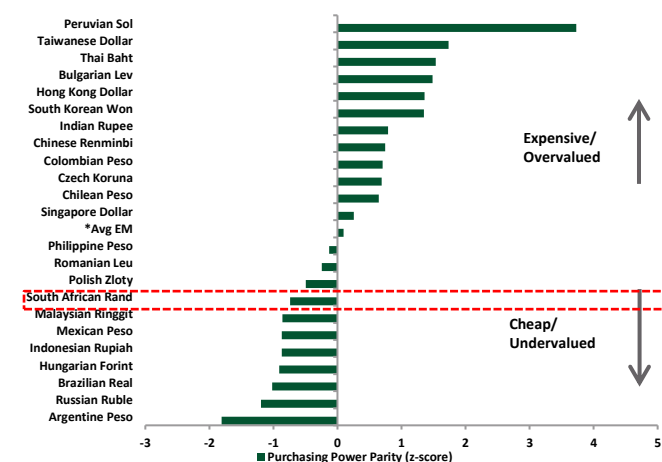
Source: Bloomberg, Nedbank CIB

Chart 6: ATM USDZAR implied volatility cone



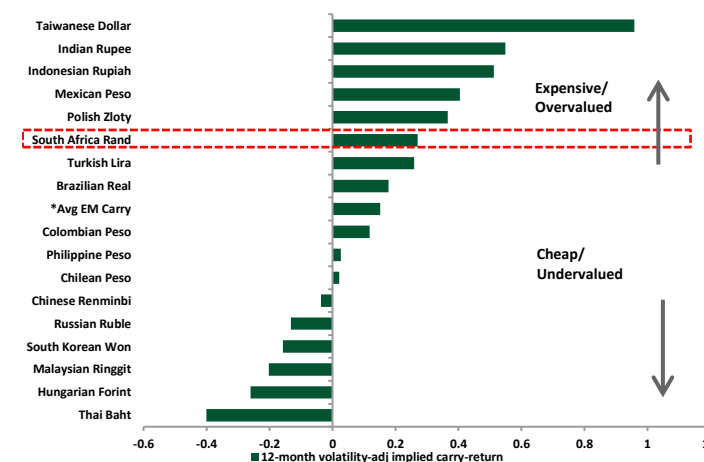
Source: Bloomberg, Nedbank CIB

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		4.230	3.944	5.419	0.627	-3.009	0.920	3.467	2.369	1.471	-0.439	3.600	1.572	1.942	2.573
JPY	-4.056		0.365	-1.439	3.461	7.716	3.120	0.937	1.696	2.849	5.019	0.413	3.326	2.035	1.814
KRW	-4.839	-0.547		-1.878	3.177	7.324	2.250	0.476	1.241	2.572	4.639	-0.088	3.006	1.424	1.356
TRY	-4.744	1.959	1.882		5.130	8.707	5.552	2.507	2.097	3.454	6.762	2.294	4.309	3.841	3.407
MXN	-0.887	-3.352	-3.107	-4.886		4.037	0.495	-2.128	-1.744	-0.572	1.503	-3.045	-0.157	-1.326	-1.629
RUB	3.040	-7.162	-6.822	-8.029	-3.863		-3.339	-6.000	-5.664	-4.424	-2.465	-6.647	-4.020	-4.718	-5.071
THB	-0.939	-3.861	-2.083	-5.330	-0.449	3.565		-1.732	-1.114	-1.023	1.727	-3.012	-0.605	-2.190	-1.661
INR	-3.341	-1.026	-0.481	-2.047	1.936	6.303	1.762		1.075	1.596	4.295	-0.340	1.851	0.468	0.871
AUD	-2.288	-1.649	-1.257	-2.525	1.806	5.911	1.020	0.000		1.149	3.291	-1.108	1.606	0.404	0.113
BRL	-1.462	-2.882	-2.508	-3.763	0.557	4.632	1.046	-1.332	-1.169		2.092	-2.328	0.422	-0.776	-1.090
GBP	0.657	-4.786	-4.428	-6.222	-1.256	2.679	-1.064	-2.679	-3.200	-1.981		-4.470	-1.617	-2.742	-3.098
EUR	-3.471	-0.518	-0.100	-2.224	2.935	6.349	2.093	1.041	1.137	2.428	4.512		2.764	1.478	1.249
CAD	-1.536	-3.219	-2.912	-4.154	0.144	4.192	0.631	-1.539	-1.591	-0.427	1.598	-2.694		-1.157	-1.467
ZAR	-2.311	-2.142	-1.799	-3.764	1.443	4.937	1.490	-0.585	-1.091	0.513	2.698	-1.691	0.885		-0.622
USD	-2.504	-1.767	-1.468	-2.301	1.674	5.788	2.110	-0.259	-0.128	1.087	3.185	-1.240	1.500	0.307	

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%	-41%	-28%	18%	-30%	-27%	-14%	21%	-23%	22%	28%
SPX	-81%		40%	26%	-16%	34%	32%	21%	-25%	37%	-27%	-33%
US 10yr	-41%	40%		89%	1%	17%	9%	-4%	-6%	0%	-10%	-9%
US TIPS	-28%	26%	89%		10%	8%	-1%	-11%	-3%	-13%	4%	2%
SA 10yr	18%	-16%	1%	10%		-26%	-61%	-4%	37%	-35%	29%	69%
TOP40	-30%	34%	17%	8%	-26%		22%	-2%	-9%	31%	-28%	-26%
EM FX	-27%	32%	9%	-1%	-61%	22%		-7%	-67%	64%	-49%	-82%
DM FX	-14%	21%	-4%	-11%	-4%	-2%	-7%		6%	16%	-6%	-7%
MXN	21%	-25%	-6%	-3%	37%	-9%	-67%	6%		-41%	41%	55%
AUD	-23%	37%	0%	-13%	-35%	31%	64%	16%	-41%		-61%	-61%
CAD	22%	-27%	-10%	4%	29%	-28%	-49%	-6%	41%	-61%		51%
ZAR	28%	-33%	-9%	2%	69%	-26%	-82%	-7%	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%	38%	8%	2%	1%	12%	-22%	52%	-41%	-43%	48%
Plat	63%		50%	0%	5%	11%	29%	-22%	55%	-46%	-50%	52%
Pall	38%	50%		-4%	7%	5%	27%	-14%	40%	-32%	-34%	35%
Ironore	8%	0%	-4%		-2%	-1%	-6%	-4%	5%	-10%	-2%	2%
Copper	2%	5%	7%	-2%		10%	13%	-5%	5%	-3%	-11%	2%
T-Coal	1%	11%	5%	-1%	10%		4%	-5%	3%	1%	-5%	3%
Brent	12%	29%	27%	-6%	13%	4%		-6%	19%	-37%	-17%	13%
BRL	-22%	-22%	-14%	-4%	-5%	-5%	-6%		-24%	19%	30%	-41%
AUD	52%	55%	40%	5%	5%	3%	19%	-24%		-61%	-61%	64%
CAD	-41%	-46%	-32%	-10%	-3%	1%	-37%	19%	-61%		51%	-49%
ZAR	-43%	-50%	-34%	-2%	-11%	-5%	-17%	30%	-61%	51%		-82%
EM FX	48%	52%	35%	2%	2%	3%	13%	-41%	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	9.50	9.40	9.40	8.60	9.70
R208 (%)	7.00	7.10	7.20	7.20	6.90	7.40
R186 (%)	8.90	9.20	9.10	9.10	8.30	9.40
R2048 (%)	10.00	10.20	10.30	10.30	9.50	10.50
EURUSD	1,12	1,10	1,14	1,14	1,14	1,10
USDZAR	14,10	14,50	14,10	14,10	14,50	14,10
EURZAR	15,79	15,95	16,07	16,07	16,07	15,79
GBPZAR	17,80	18.10	17.90	17.90	17,80	17,80
AUDZAR	9,90	10,15	10.00	10.00	10,15	9,90
Δ Global \$-Liquidity	↔	↓	↓	↓	-	-

Nedbank CIB Markets Research/Nedbank Group Economics

	1Q19	2Q19	3Q19	4Q19	2019 Ave	2020 Ave
SA headline CPI	4.40	5.00	5.30	5.30	5.00	5.10
SA core inflation	4.40	4.40	4.40	4.40	4.50	4.50
SA GDP	1.60	1.70	2.10	2.30	1,3	1,8
Current account as a % of GDP					-3,4	-3,5

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 a % of GDP	-	-	-	-	-3.7	-4.1

National Treasury

	1Q19	2Q19	3Q19	4Q19	2019 Ave	2020 Ave
SA headline CPI	-	-	-	-	5.20	5.40
SA core inflation	-	-	-	-	-	-
SA GDP	-	-	-	-	1.5	1.70
Current account as a % of GDP	-	-	-	-	-3.4	-3.8

All numbers in % unless otherwise indicated

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

2019 Macro Calendar

JANUARY							FEBRUARY							MARCH							APRIL						
Mo	Tu	We	Th	Fr	Sa	Su	Mo	Tu	We	Th	Fr	Sa	Su	Mo	Tu	We	Th	Fr	Sa	Su	Mo	Tu	We	Th	Fr	Sa	Su
31	1	2	3	4	5	6	28	29	30	31	1	2	3	25	26	27	28	1	2	3	1	2	3	4	5	6	7
7	8	9	10	11	12	13	4	5	6	7	8	9	10	4	5	6	7	8	9	10	8	9	10	11	12	13	14
14	15	16	17	18	19	20	11	12	13	14	15	16	17	11	12	13	14	15	16	17	15	16	17	18	19	20	21
21	22	23	24	25	26	27	18	19	20	21	22	23	24	18	19	20	21	22	23	24	22	23	24	25	26	27	28
28	29	30	31	1	2	3	25	26	27	28	1	2	3	25	26	27	28	29	30	31	29	30	1	2	3	4	5
4	5	6	7	8	9	10	4	5	6	7	8	9	10	1	2	3	4	5	6	7	6	7	8	9	10	11	12
17th Jan: SA MPC 24th Jan: ECB meeting 22-25 Jan WEF Davos 30 Jan: Fed FOMC							7th Feb: BoE Meeting 7th Feb: SA SONA 13th-14th Feb: UK Mps to vote on Brexit 16th Feb: Nigeria election 20th Feb: SA budget							1st Mar: End of 90-day trade truce US-China 7th Mar: ECB Meeting 15th Mar: BoJ Meeting 20th Mar: FOMC Meeting 21st Mar: BoE Meeting 28th Mar: SARB Meeting							10th Apr: ECB Meeting 12-14th Apr: World Bank & IMF meet 17th Apr: Indonesia election 25th Apr: BoJ Meeting April/May: India election						
MAY							JUNE							JULY							AUGUST						
Mo	Tu	We	Th	Fr	Sa	Su	Mo	Tu	We	Th	Fr	Sa	Su	Mo	Tu	We	Th	Fr	Sa	Su	Mo	Tu	We	Th	Fr	Sa	Su
29	30	1	2	3	4	5	27	28	29	30	1	2	3	1	2	3	4	5	6	7	29	30	31	1	2	3	4
6	7	8	9	10	11	12	3	4	5	6	7	8	9	8	9	10	11	12	13	14	5	6	7	8	9	10	11
13	14	15	16	17	18	19	10	11	12	13	14	15	16	15	16	17	18	19	20	21	12	13	14	15	16	17	18
20	21	22	23	24	25	26	17	18	19	20	21	22	23	22	23	24	25	26	27	28	19	20	21	22	23	24	25
27	28	29	30	31	1	2	24	25	26	27	28	29	30	29	30	31	1	2	3	4	26	27	28	29	30	31	1
3	4	5	6	7	8	9	1	2	3	4	5	6	7	5	6	7	8	9	10	11	2	3	4	5	6	7	8
1st May: FOMC Meeting 2nd May: BoE Meeting 23-26th May: European Parliamentary election 26th May: Belgium election May-August: South African election							6th June: ECB Meeting 19th June: FOMC Meeting 20th June: BoE and BoJ Meeting 28-29th June: G20 Summit							18th July: SA MPC 25th July: ECB Meeting 30th July: BoJ Meeting 31st July: FOMC Meeting							1st Augut: BoE Meeting 25-27th Aug: G7 Summit						
SEPTEMBER							OCTOBER							NOVEMBER							DECEMBER						
Mo	Tu	We	Th	Fr	Sa	Su	Mo	Tu	We	Th	Fr	Sa	Su	Mo	Tu	We	Th	Fr	Sa	Su	Mo	Tu	We	Th	Fr	Sa	Su
26	27	28	29	30	31	1	30	1	2	3	4	5	6	28	29	30	31	1	2	3	25	26	27	28	29	30	1
2	3	4	5	6	7	8	7	8	9	10	11	12	13	4	5	6	7	8	9	10	2	3	4	5	6	7	8
9	10	11	12	13	14	15	14	15	16	17	18	19	20	11	12	13	14	15	16	17	9	10	11	12	13	14	15
16	17	18	19	20	21	22	21	22	23	24	25	26	27	18	19	20	21	22	23	24	16	17	18	19	20	21	22
23	24	25	26	27	28	29	28	29	30	31	1	2	3	25	26	27	28	29	30	1	23	24	25	26	27	28	29
30	1	2	3	4	5	6	4	5	6	7	8	9	10	2	3	4	5	6	7	8	30	31	1	2	3	4	5
12th Sep: ECB Meeting 18th Sep: FOMC Meeting 19th Sep: SA MPC 19th Sep: BoE and BoJ Meeting							18-20th Oct: World Bank and IMF meet 23rd Oct: SA MTBPS 24th Oct: ECB Meeting 27th Oct: Argentina election 30th Oct: FOMC Meeting 31st Oct: BoJ Meeting, End of term for ECG President (Draghi) and EC President (Juncker)							7 Nov: BoE Meeting 22 Nov: S&P/Fitch review SA credit rating							11th Dec: FOMC Meeting 12th Dec: ECB Meeting 19th Dec: BoJ Meeting						

- Central Bank Meeting
- World Summit/IMF/Trade war/Political
- Election

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