

RAND: ALL ABOUT THE “L” WORD - LIQUIDITY

Rand overshoots; we expect the rand to correct to 13.50-13.40 in the short-term.

However, rising US borrowing cost and a dollar shortage will be negative for the carry-trade and will leave the rand vulnerable

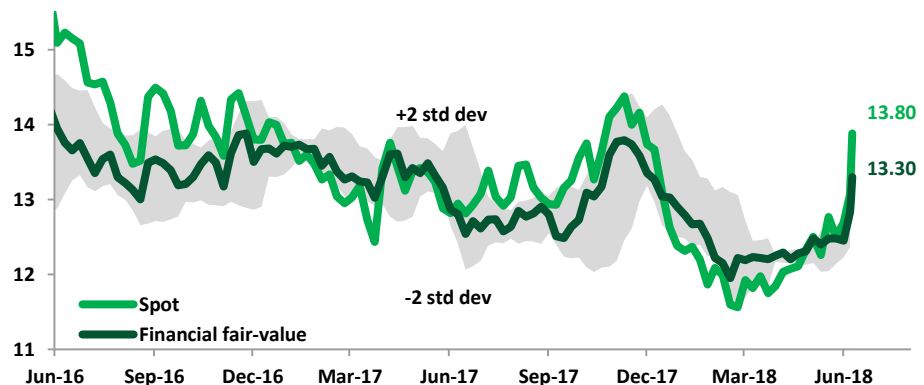
Our forecasts:

R13.00, 3Q18

R13.10, 4Q18

- **The rout in the rand continues as global headwinds intensify:** the bias for major DM central banks, in particular the Fed, remains firmly towards further monetary tightening. At the same time a growing trade dispute between the US and China are dampening expectations for the global growth outlook. To put US/China trade in perspective, the total trade between the US and China was \$650bn in 2017, of which the US imports from China constituted \$505bn. The US threatens to impose tariffs on almost \$300bn of these imports.
- These are key factors (amongst others) which are currently contributing to the **withdrawal of liquidity, resulting in an unwinding of the carry-trade**. This is driving not only the rand weaker, but also other carry-trade favourites such as the AUS/USD and JPY/ZAR crosses. **We provide 6 charts of key factors that we monitor closely for the outlook of the rand (page 2).**
- **At this point** our base case is for global \$-Liquidity growth metrics (y/y) **not to turn negative, but merely to slow down** which is currently materializing – a key reason why we kept our year-end target unchanged at the 13.10 level.
- **However, what if the external environment for EM’s worsen and our global \$-Liquidity indicators contract (instead of just slowing down)?** We stress test our fair value model which takes into account changes in the local economy and the international environment. In particular, we push commodity prices 8% weaker, the US Dollar Index 2% stronger and market volatility 300bps higher from current levels). In this stress test our model forecasts the rand weakening close to **R14.30**, which is much higher than our current forecast of R13.10 for end of 2018.
- **On the local front, South Africa’s external vulnerability, in the form of South Africa’s current account balance for 1Q18, will be published on Thursday.** In the current environment where there are portfolio outflows from South Africa, the current account is likely to attract more attention than usual – even though the data is backward looking. Bloomberg consensus is at -4% of GDP and we believe the bias is for a marginally wider current account than this.
- **From a technical perspective, we recommend keeping an eye on the \$-rand resistance level of R13.40 and support of R14.00** (see our latest Technical Strategy note: [“SA rand and bonds in a blow-off phase”](#) of 13 June 2018 for a more detailed technical view on the currency).

Figure 1: Rand financial fair-value estimate



Source: Nedbank CIB. Estimated using OLS regression. Variables include DXY, Equity prices, US10yr, CDS spread, local-to-US 2y swap spread and oil price

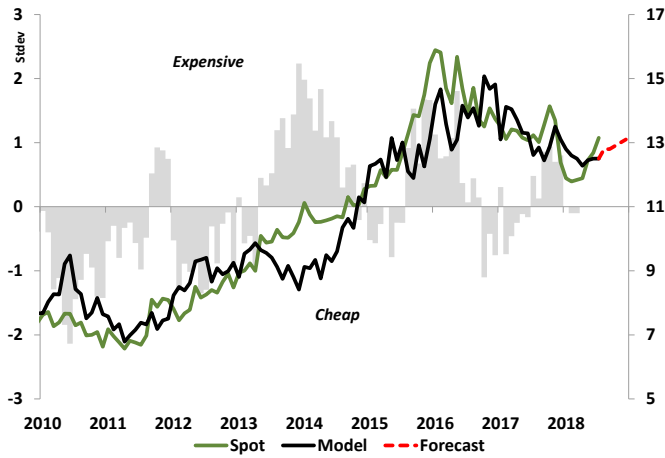
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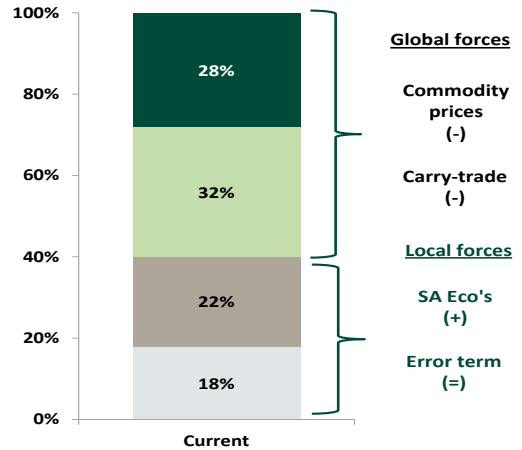
KEY CHARTS WE MONITOR CLOSELY FOR OUR RAND VIEW

Chart 1: Our rand fair-value model forecasts the rand to be in the range of 13.10-13.50 for 2H18. (our base case)



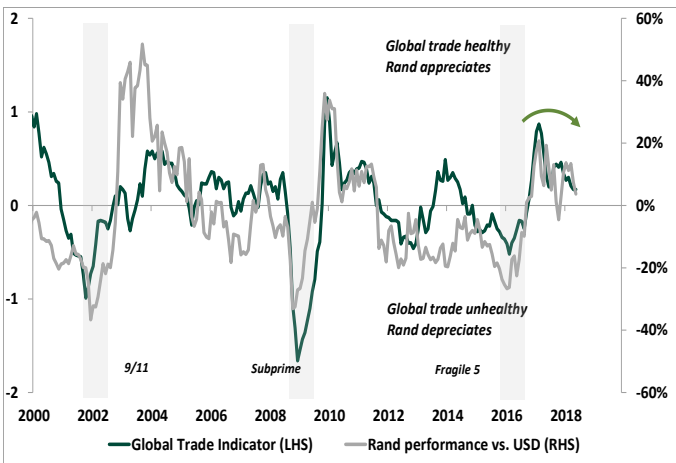
Source: Nedbank CIB markets Research

Chart 2: Decomposition of rand fair-value model. Global forces remain a headwind for rand



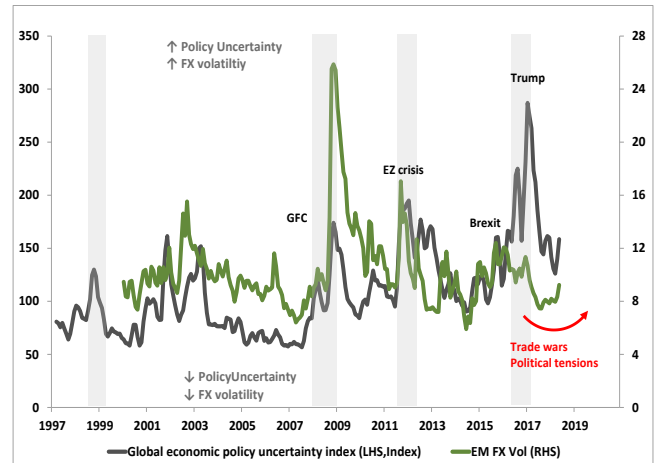
Source: Nedbank CIB markets Research

Chart 3: The rand's performance is linked to global trade. Trade wars will dent global trade and prospects for the rand



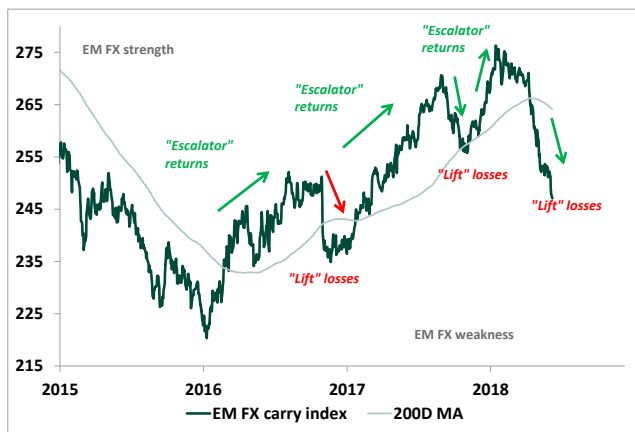
Source: Nedbank CIB markets Research

Chart 4: Stable FX volatility is essential in the carry-trade. Rising political uncertainty will lead to higher FX volatility



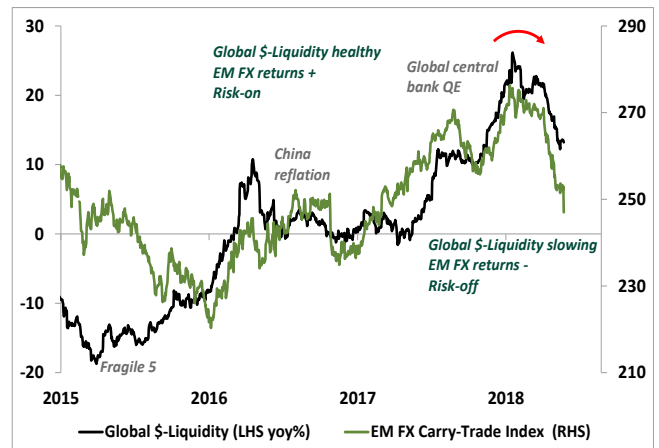
Source: Nedbank CIB markets Research

Chart 5: EM FX gains are steady, like going up an escalator, but losses are like going down a lift



Source: Nedbank CIB markets Research

Chart 6: There is a strong relationship between \$-Liquidity and EM FX. Currently not in good shape



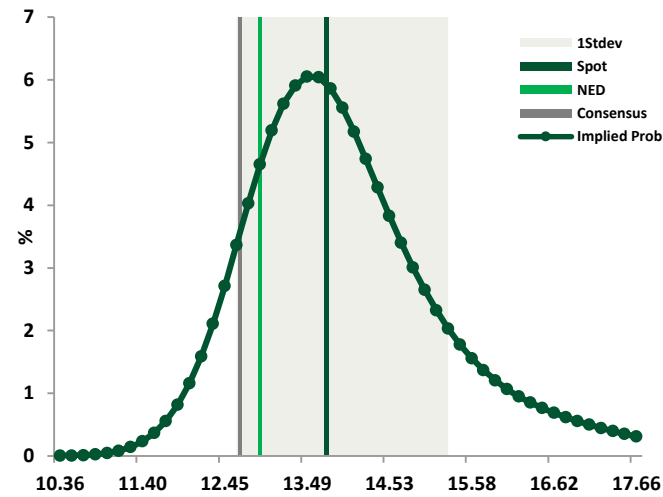
Source: Nedbank CIB markets Research

FX VOL STILL RISING BUT NO STRESS YET

The forecast from the options market for the USDZAR remains more bearish than the Bloomberg consensus expectations:

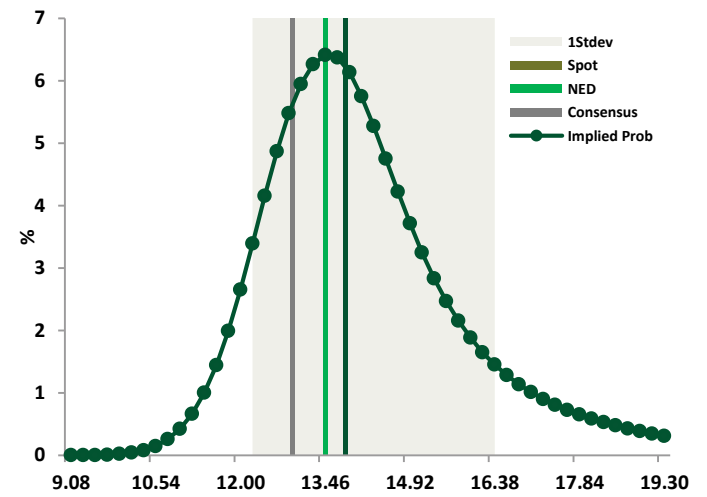
- On a three-month view, the options market suggests a one standard deviation trading range for the USDZAR of between 12.60 and 15.13 (see Chart 4).
- On a six-month view, the implied probability distribution suggesting a one standard deviation range of between 12.20 and 16.15 (see Chart 5).

Chart 7: 3m implied probability distribution vs forecast



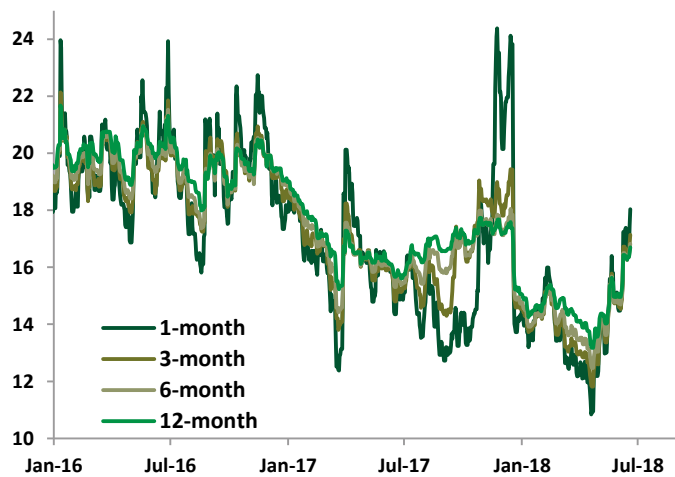
Source: IIF and Nedbank CIB Markets Research

Chart 8: 6m implied probability distribution vs forecast



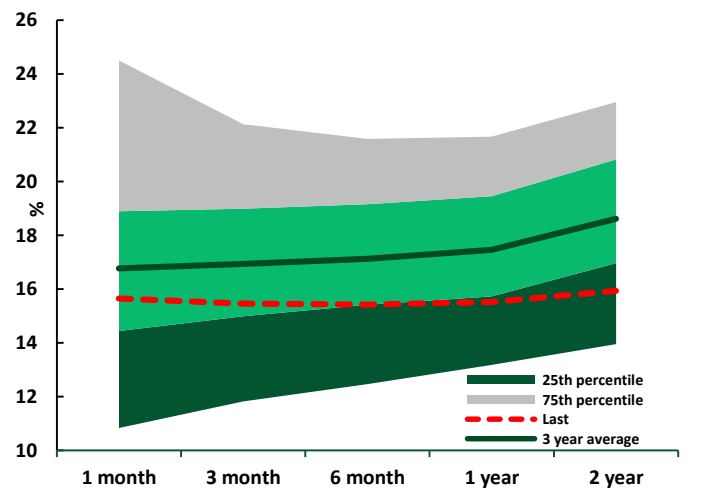
Source: IIF and Nedbank CIB Markets Research

Chart 9: USDZAR implied volatility



Source: IIF and Nedbank CIB Markets Research

Chart 10: ATM USDZAR implied volatility cone



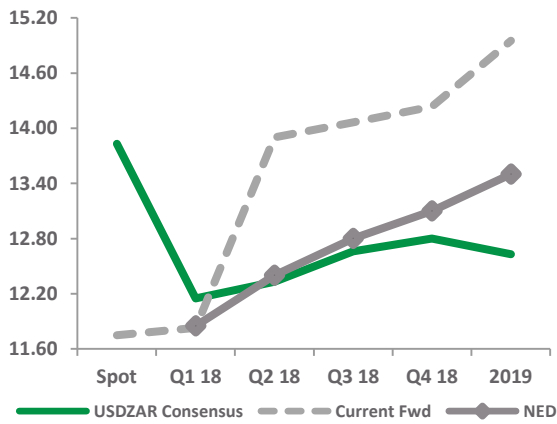
Source: IIF and Nedbank CIB Markets Research

Chart 11: Rand currency forecast table vs consensus and forwards (period end)

	Current Spot	Q2 18	Q3 18	Q4 18	2019
USDZAR					
Nedbank CIB Markets	13.89	13.60	13.00	13.10	13.50
Current Fwd	13.89	13.90	14.07	14.24	14.97
Consensus	13.89	12.33	12.66	12.80	12.63
EURZAR					
Nedbank CIB Markets	16.03	15.78	15.15	15.26	16.00
Current Fwd	16.03	16.05	16.36	16.69	18.13
Consensus	16.03	14.80	15.07	15.62	16.17
GBPZAR					
Nedbank CIB Markets	18.30	17.95	17.68	18.60	19.58
Current Fwd	18.30	18.32	18.62	18.94	20.29
Consensus	18.30	16.77	17.09	17.54	17.54
AUDZAR					
Nedbank CIB Markets	10.24	10.06	9.62	9.69	10.13
Current Fwd	10.24	10.25	10.37	10.51	11.08
Consensus	10.24	9.37	9.62	9.86	9.98

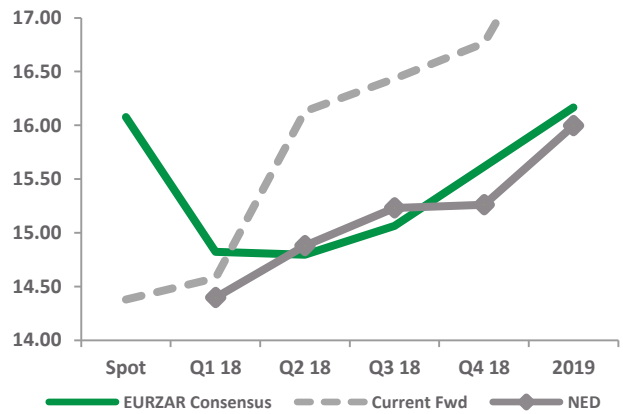
Source: Bloomberg, Nedbank CIB

Chart 12: USDZAR forecasts, consensus and forwards



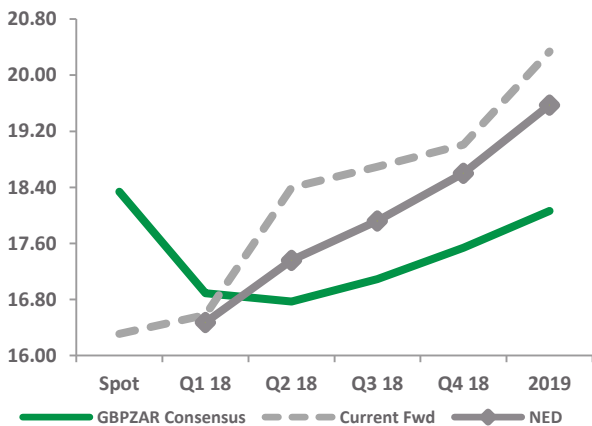
Source: Bloomberg, Nedbank CIB

Chart 13: EURZAR forecasts, consensus and forwards



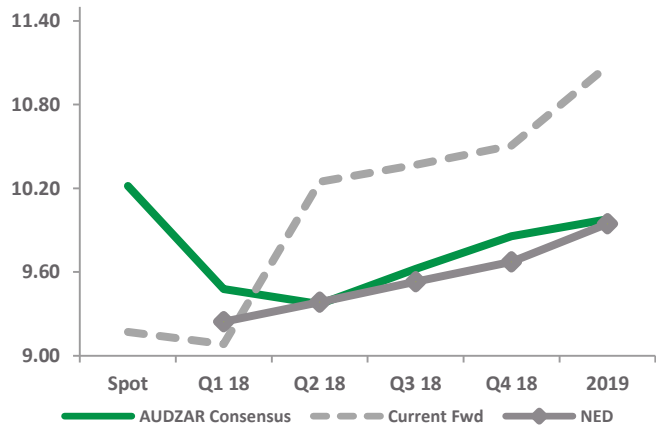
Source: Bloomberg, Nedbank CIB

Chart 14: GBPZAR forecasts, consensus and forwards



Source: Bloomberg, Nedbank CIB

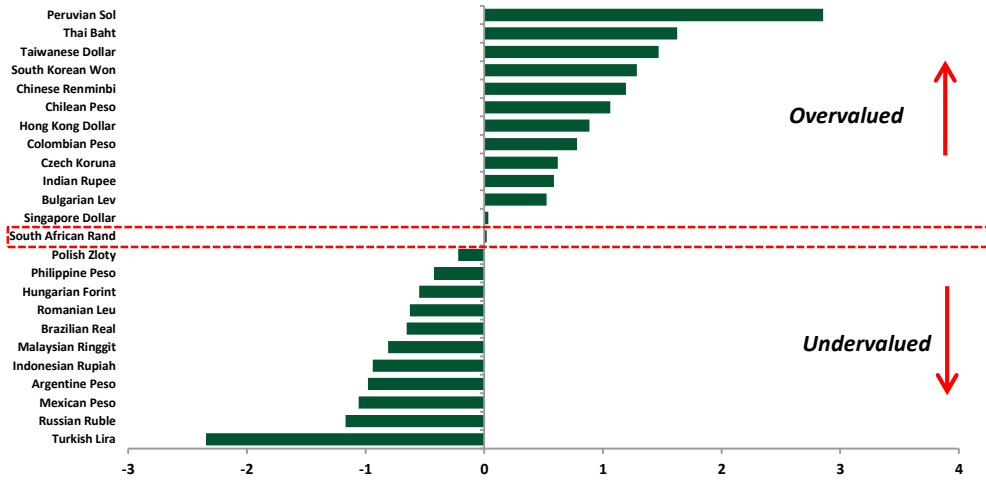
Chart 15: AUDZAR forecasts, consensus and forwards



Source: Bloomberg, Nedbank CIB

Chart 16: EM currencies overvalued vs undervalued (z-scores)

Rand in fair value territory according to PPP metrics



Source: Bloomberg and BIS. A larger value indicates the spot rate has a larger deviation from PPP metrics

Chart 17: EM currency performance

	CNY	JPY	KRW	TRY	MXN	RUB	THB	INR	AUD	BRL	GBP	EUR	CAD	ZAR	USD
CNY		-1.957	4.773	24.877	5.616	11.707	1.319	7.889	6.707	13.946	2.902	4.159	6.218	13.195	0.716
JPY	2.000		-6.449	-21.998	-7.352	-11.755	-3.240	-9.115	-8.121	-13.913	-4.749	-5.918	-7.663	-13.383	-2.671
KRW	-4.918	6.861		-16.102	-0.846	-5.664	3.371	-2.896	-1.749	-8.040	1.827	0.606	-1.259	-7.421	3.983
TRY	-19.908	27.410	19.146		18.173	12.677	23.254	16.027	17.077	9.601	21.576	20.728	17.698	11.575	24.817
MXN	-5.327	7.429	0.867	-15.373		-4.854	4.470	-1.623	-0.913	-7.143	2.803	1.519	-0.356	-6.152	5.071
RUB	-9.884	13.318	6.009	-11.264	5.112		10.292	2.901	4.265	-2.521	8.650	7.102	4.660	-1.033	10.711
THB	-1.301	3.351	-3.279	-18.886	-4.054	-8.803		-6.043	-5.003	-11.065	-1.390	-2.791	-4.553	-10.498	0.540
INR	-7.310	10.016	2.982	-13.881	1.788	-3.174	6.427		1.119	-5.609	4.859	3.532	1.694	-5.000	7.085
AUD	-6.284	8.789	1.833	-14.615	0.922	-4.072	5.244	-0.995		-6.311	3.656	2.358	0.737	-5.507	5.895
BRL	-12.243	16.225	8.743	-8.770	8.244	2.583	12.453	5.919	6.813		10.925	9.416	7.373	0.633	13.051
GBP	-2.655	5.046	-1.789	-17.667	-2.660	-7.813	1.393	-4.310	-3.516	-9.714		-1.218	-3.024	-8.863	2.190
EUR	-4.053	6.314	-0.512	-17.119	-1.651	-6.250	2.853	-3.142	-2.185	-8.622	1.269		-1.587	-7.578	3.493
CAD	-5.845	8.007	1.266	-15.599	0.313	-4.453	4.716	-1.523	-0.469	-6.881	3.157	1.812		-6.004	5.298
ZAR	-12.387	15.014	8.898	-10.406	7.982	1.024	11.695	5.282	5.696	0.146	9.962	8.648	6.379		11.925
USD	-0.744	2.749	-3.884	-19.333	-4.836	-9.323	-0.573	-6.361	-5.558	-11.626	-2.072	-3.350	-5.028	-10.367	

Source: Bloomberg

Chart 18: Correlation matrix – markets vs FX

	VIX	SPX	US	US	SA	TOP40	EM FX	DM FX	MXN	AUD	CAD	ZAR
VIX		-80%	-47%	-37%	13%	-32%	-26%	-4%	21%	-18%	20%	22%
SPX	-80%		38%	28%	-17%	40%	39%	10%	-34%	39%	-34%	-32%
US	-47%	38%		92%	-2%	22%	9%	-7%	-8%	6%	-13%	-10%
US	-37%	28%	92%		1%	15%	1%	-10%	-5%	0%	-5%	-3%
SA	13%	-17%	-2%	1%		-27%	-47%	-9%	35%	-25%	23%	63%
TOP40	-32%	40%	22%	15%	-27%		27%	-6%	-10%	26%	-24%	-14%
EM FX	-26%	39%	9%	1%	-47%	27%		-20%	-73%	70%	-57%	-74%
DM FX	-4%	10%	-7%	-10%	-9%	-6%	-20%		0%	-3%	0%	-4%
MXN	21%	-34%	-8%	-5%	35%	-10%	-73%	0%		-47%	52%	53%
AUD	-18%	39%	6%	0%	-25%	26%	70%	-3%	-47%		-65%	-60%
CAD	20%	-34%	-13%	-5%	23%	-24%	-57%	0%	52%	-65%		50%
ZAR	22%	-32%	-10%	-3%	63%	-14%	-74%	-4%	53%	-60%	50%	

Source: Bloomberg, YTD

Chart 19: Correlation matrix – commodities vs currencies

	Gold	Plat	Pall	Ironor	Coppe	T-Coal	Brent	BRL	AUD	CAD	ZAR	EM FX
Gold		68%	34%	14%	-6%	1%	24%	-26%	49%	-36%	-40%	55%
Plat	68%		51%	5%	-2%	20%	30%	-27%	51%	-40%	-41%	54%
Pall	34%	51%		-12%	-4%	9%	34%	-15%	42%	-29%	-27%	39%
Ironor	14%	5%	-12%		3%	-1%	-1%	9%	4%	-14%	-12%	3%
Coppe	-6%	-2%	-4%	3%		15%	7%	7%	-1%	6%	-1%	-8%
T-Coal	1%	20%	9%	-1%	15%		7%	-9%	5%	1%	-11%	6%
Brent	24%	30%	34%	-1%	7%	7%		-8%	28%	-38%	-21%	24%
BRL	-26%	-27%	-15%	9%	7%	-9%	-8%		-31%	27%	32%	-51%
AUD	49%	51%	42%	4%	-1%	5%	28%	-31%		-65%	-60%	70%
CAD	-36%	-40%	-29%	-14%	6%	1%	-38%	27%	-65%		50%	-57%
ZAR	-40%	-41%	-27%	-12%	-1%	-11%	-21%	32%	-60%	50%		-74%
EM FX	55%	54%	39%	3%	-8%	6%	24%	-51%	70%	-57%	-74%	

Source: Bloomberg, YTD

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