FX AT A GLANCE

13 August 2018

NEDBANK CIB

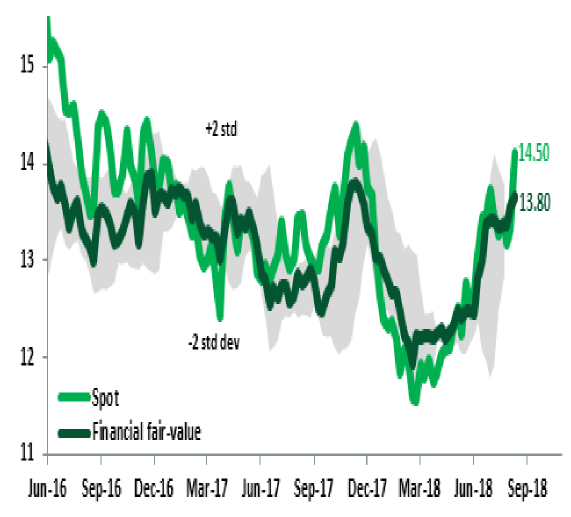
RAND: LACK OF DOLLAR-LIQUIDITY STRIKES AGAIN

Tactical view:
We do not expect sustained weakness above R14.50 on a multi-week, multi-month basis.

Strategic view:
We believe tighter global financial conditions are negative for the carry-trade, leaving the rand vulnerable.

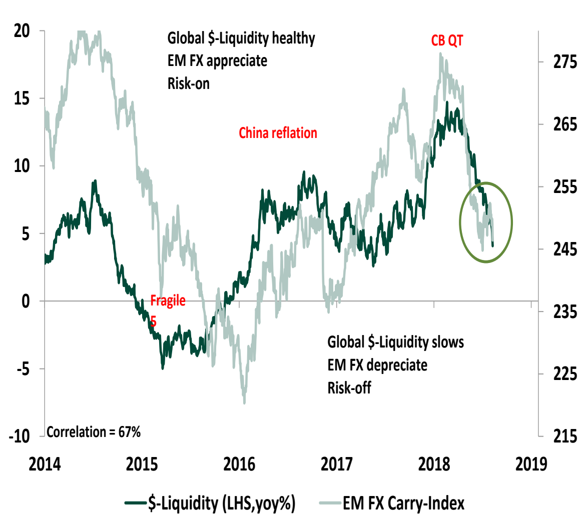
- **The recent slide in the rand has little to do with local developments, instead as we have maintained throughout the year, it is all about the shrinking pool of Global $-Liquidity (see feature chart).**
- The lack of market liquidity combined with emerging market contagion from Turkey and Russia is exerting downward pressure on the rand. The Turkish lira is under severe pressure, largely on the back of a central bank that lacks credibility and independence to act on run-away inflation. The weaker lira which has also seen Turkish bond yields much higher is threatening to erupt into a full-blown balance-of-payment problem as Turkey's foreign reserves continues to decline. At the same time, the Russian rouble is sharply weaker as the US imposes more sanctions on Russia.
- **The dollar is also stronger in its own right.** US dollar strength is evident against the euro. The EURUSD is trading below the 1.15 level for the first time since July 2017.
- **As far as the dollar is concerned and the risk of further downside risks escalating,** we focus on our proprietary **Global $-Liquidity indicator** which measures excess global money supply (USD terms) relative to money supply growth in the US economy. We monitor this closely because the USD is still the most used, and only reserve currency in the world. **How does Global $-Liquidity work?** When the growth in global money supply (USD terms) exceeds the growth in money supply from the US economy, it implies that that there is excess dollars in the global economy, leaving financial conditions accommodative and the carry-trade attractive. This benefits riskier assets such as EM currencies. The reverse also holds - when the growth in global money supply is less than the growth in money supply from the US economy, it creates a shortage of dollars in the global economy. This shortage results in tighter financial conditions and makes the carry-trade (and risky assets) less attractive.
- **The latter scenario has been the case for most of 2018** not only because of major central banks (in particular the Fed) tightening monetary policy, but also because protectionist global trade polices dampen the prospects for global growth. This is the main driver of our bearish view on the rand relative to Bloomberg consensus (consensus at R13.10 vs. Nedbank R13.85 for year-end 2018).
- For the rand to depreciate **above R14.50 on a multi week/month basis we** believe four factors need to materialise. **Firstly**, commodity prices need to decline sharply (we remain cognisant that the rand remains a commodity currency). **Secondly**, the credit cycle in China must weaken despite fiscal and monetary stimulus by the authorities. **Thirdly**, our Global $-Liquidity indicator must move into negative territory (it has merely slowed down lately) and **lastly** downside risks from the local economy must gain further momentum.
- From a technical perspective, we recommend keeping an eye on the **USDZAR** resistance level of **R15.20** and USDZAR support level of **R14.39.**

Figure 1: Spot vs. rand financial model



Source: Nedbank CIB Research, BBG. Econometric model

Chart 2: Shrinking Global $-Liquidity is exerting downward pressure on the rand and EM-FX



Source: Nedbank CIB Research, DS

ANALYST DETAILS

Mehul Daya
Strategy Analyst
MehulD@Nedbank.co.za

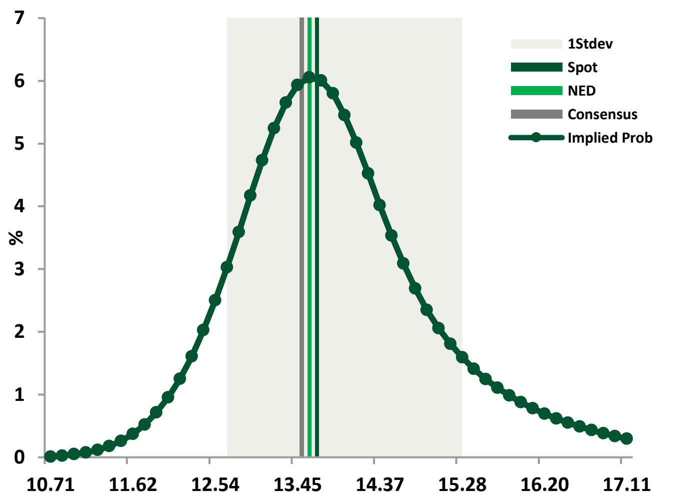
Walter de Wet, CFA
Senior Strategy Analyst,
WalterD2@Nedbank.co.za

FX VOL CURVES - STEADY AS TENSION EASES

Implied volatility in the option market is moving higher, closer to historic average levels (Chart 6). The forecast from the option market for the USDZAR remains more bearish than the Bloomberg consensus expectations:

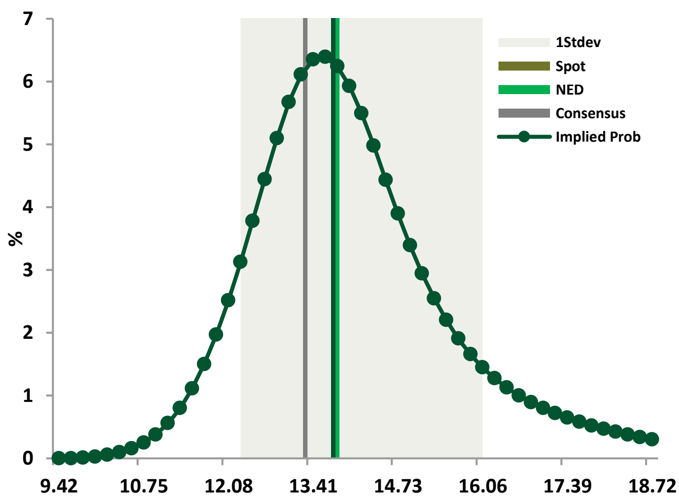
- On a three-month view, the option market suggests a one standard deviation trading range for the USDZAR of R12.70 to R15.15 (Chart 3).
- On a six-month view, the probability is skewed towards weakness, as one would expect, with the implied probability distribution suggesting a one standard deviation range of R12.30 to R15.90 (see Chart 4).

Chart 3: 3m implied probability distribution vs forecast



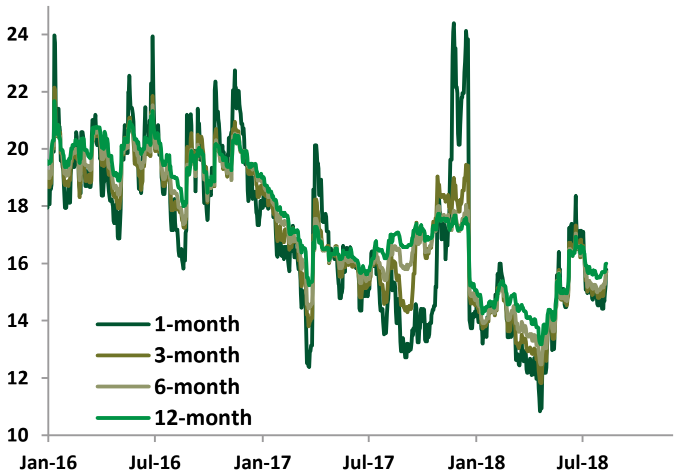
Source: Bloomberg, Nedbank CIB

Chart 4: 6m implied probability distribution vs forecast



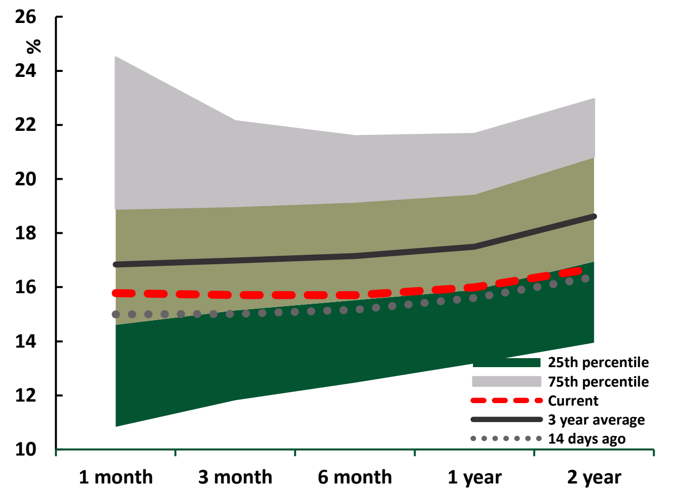
Source: Bloomberg, Nedbank CIB

Chart 5: USDZAR implied volatility



Source: Bloomberg, Nedbank CIB

Chart 6: ATM USDZAR implied volatility cone



Source: Bloomberg, Nedbank CIB

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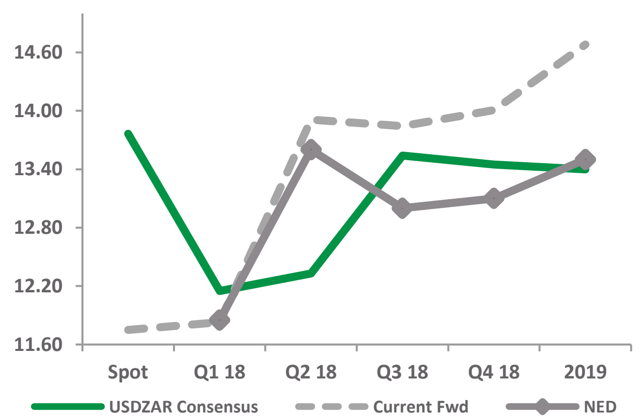
Chart 7: Rand currency forecast table vs consensus and forwards (period end)

	Current Spot	Q2 18	Q3 18	Q4 18	2019
USDZAR					
Nedbank CIB Markets	14.58	13.72	13.50	13.85	14.00
Current Fwd	14.58	13.91	14.66	14.84	15.58
Consensus	14.58	12.33	13.54	13.45	13.40
EURZAR					
Nedbank CIB Markets	16.61	15.92	15.73	16.14	16.59
Current Fwd	16.61	16.13	16.76	17.10	18.53
Consensus	16.61	14.80	15.84	15.87	16.75
GBPZAR					
Nedbank CIB Markets	18.61	18.11	18.36	19.67	20.30
Current Fwd	18.61	18.25	18.75	19.07	20.39
Consensus	18.61	16.77	17.87	17.89	17.89
AUDZAR					
Nedbank CIB Markets	10.62	10.15	9.99	10.25	10.50
Current Fwd	10.62	10.17	10.68	10.81	11.41
Consensus	10.62	9.37	10.02	9.95	10.32

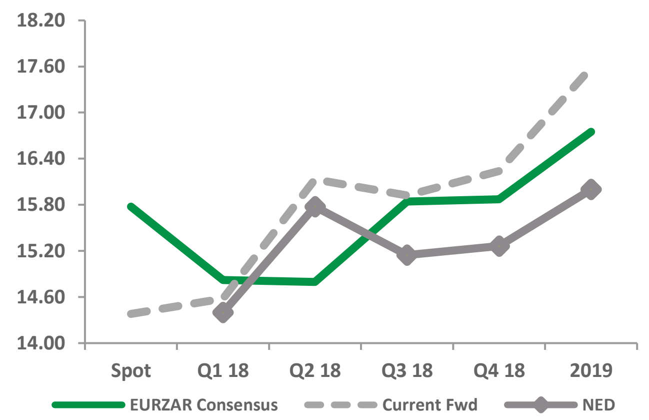
Source: Bloomberg, Nedbank CIB

Chart 8: USDZAR forecasts, consensus and forwards



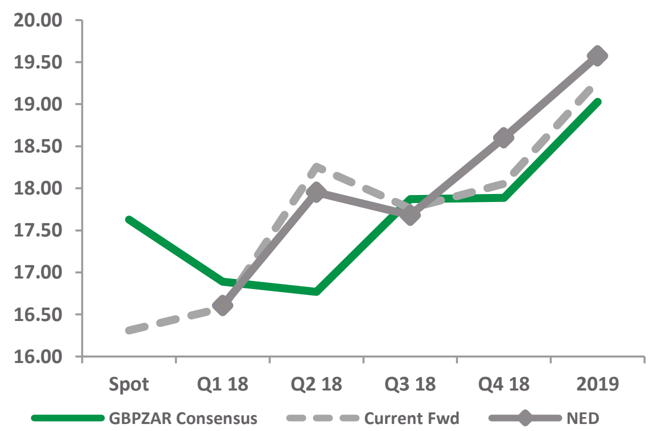
Source: Bloomberg, Nedbank CIB

Chart 9: EURZAR forecasts, consensus and forwards



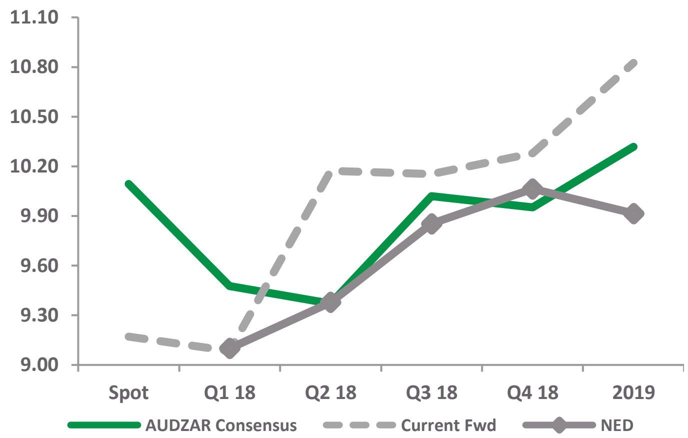
Source: Bloomberg, Nedbank CIB

Chart 10: GBPZAR forecasts, consensus and forwards



Source: Bloomberg, Nedbank CIB

Chart 11: AUDZAR forecasts, consensus and forwards



Source: Bloomberg, Nedbank CIB

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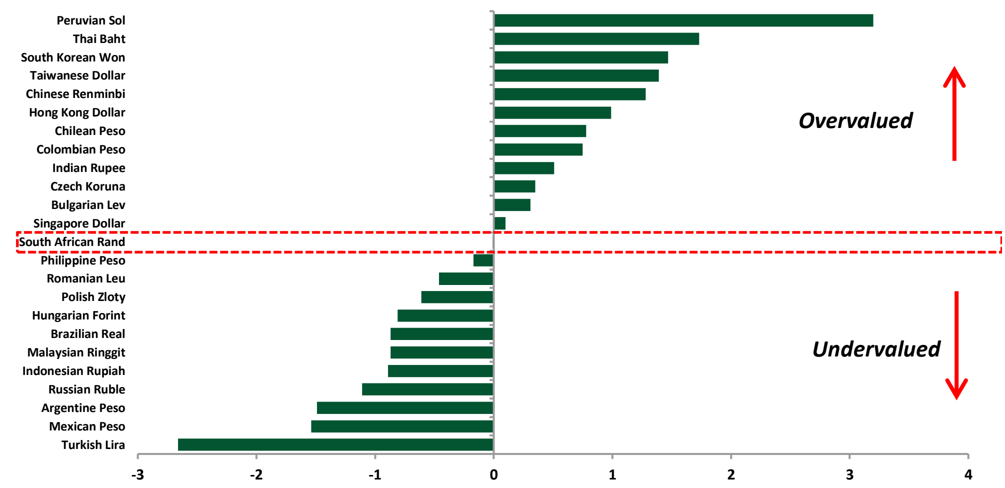
Chart 12: EM currencies overvalued vs undervalued (z-scores)
Rand in fair value territory according to PPP metrics



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

Chart 13: EM currency performance

	CNY	JPY	KRW	TRY	MXN	RUB	THB	INR	AUD	BRL	GBP	EUR	CAD	ZAR	USD
CNY		-6.542	0.480	41.616	-9.547	10.299	-2.997	2.810	1.118	9.016	0.264	-0.663	-1.088	5.983	-5.030
JPY	6.995		-6.941	-34.443	3.150	-14.767	-3.659	-9.092	-7.575	-14.230	-6.766	-5.962	-5.504	-11.812	-1.580
KRW	0.000	7.495		-29.049	10.984	-8.383	3.507	-2.267	-0.661	-7.859	0.182	1.084	1.552	-5.243	5.801
TRY	-29.366	51.447	40.943		56.429	29.315	45.911	38.063	40.003	29.867	41.386	43.341	43.174	34.985	49.947
MXN	10.533	-3.429	-9.865	-36.061		-17.446	-6.623	-11.688	-10.480	-16.880	-9.608	-8.858	-8.413	-14.162	-4.562
RUB	-8.816	17.245	9.152	-22.675	21.155		13.729	6.950	8.538	0.518	10.093	10.829	10.843	4.314	15.897
THB	3.053	3.802	-3.279	-31.469	7.272	-11.524		-5.613	-4.027	-10.971	-3.028	-2.423	-1.920	-8.487	2.112
INR	-2.730	9.981	2.312	-27.601	13.273	-6.493	5.947		1.670	-5.968	2.607	3.452	4.029	-3.299	8.255
AUD	-1.114	8.182	0.750	-28.588	11.674	-7.692	4.194	-1.493		-7.217	0.878	1.711	2.497	-4.251	6.473
BRL	-8.272	16.599	8.543	-22.998	20.581	-0.582	12.326	6.343	7.787		8.920	10.145	10.240	2.791	14.747
GBP	-0.043	7.317	-0.173	-29.253	10.638	-8.594	3.134	-2.586	-0.866	-8.102		0.864	1.393	-5.184	5.571
EUR	0.569	6.378	-1.061	-30.194	9.670	-9.722	2.462	-2.989	-1.569	-9.227	-0.826		0.771	-5.795	4.718
CAD	1.073	5.548	-1.554	-30.623	9.077	-9.833	1.884	-3.553	-2.172	-9.307	-1.331	-0.562		-6.496	4.057
ZAR	-6.429	12.921	6.386	-25.937	18.072	-4.190	9.213	3.366	4.391	-1.974	5.693	6.629	6.904		11.147
USD	5.298	1.600	-5.442	-32.918	4.777	-13.434	-2.114	-7.357	-6.071	-12.885	-5.210	-4.475	-3.897	-9.746	

Source: Bloomberg

Chart 14: Correlation matrix – markets vs FX

	VIX	SPX	US	US	SA	TOP40	EM FX	DM FX	MXN	AUD	CAD	ZAR
VIX		-81%	-46%	-35%	14%	-30%	-27%	-7%	20%	-20%	20%	24%
SPX	-81%		37%	28%	-18%	35%	38%	14%	-29%	37%	-31%	-34%
US	-46%	37%		92%	-3%	21%	13%	-9%	-6%	7%	-15%	-12%
US	-35%	28%	92%		1%	13%	5%	-12%	-4%	-2%	-6%	-4%
SA	14%	-18%	-3%	1%		-30%	-50%	-5%	36%	-32%	26%	63%
TOP40	-30%	35%	21%	13%	-30%		28%	-3%	-9%	33%	-27%	-20%
EM FX	-27%	38%	13%	5%	-50%	28%		-14%	-72%	74%	-58%	-79%
DM FX	-7%	14%	-9%	-12%	-5%	-3%	-14%		1%	1%	2%	-7%
MXN	20%	-29%	-6%	-4%	36%	-9%	-72%	1%		-48%	51%	58%
AUD	-20%	37%	7%	-2%	-32%	33%	74%	1%	-48%		-67%	-66%
CAD	20%	-31%	-15%	-6%	26%	-27%	-58%	2%	51%	-67%		51%
ZAR	24%	-34%	-12%	-4%	63%	-20%	-79%	-7%	58%	-66%	51%	

Source: Bloomberg , YTD

Chart 15: Correlation matrix – commodities vs currencies

	Gold	Plat	Pall	Ironor	Coppe	T-Coal	Brent	BRL	AUD	CAD	ZAR	EM FX
Gold		66%	37%	8%	-1%	2%	26%	-25%	54%	-39%	-44%	56%
Plat	66%		52%	-5%	0%	15%	35%	-24%	60%	-43%	-49%	57%
Pall	37%	52%		-14%	-3%	8%	33%	-11%	44%	-33%	-32%	42%
Ironor	8%	-5%	-14%		-2%	-1%	-13%	7%	-3%	-13%	-2%	-1%
Coppe	-1%	0%	-3%	-2%		13%	16%	-2%	0%	6%	0%	-4%
T-Coal	2%	15%	8%	-1%	13%		5%	-8%	4%	1%	-9%	5%
Brent	26%	35%	33%	-13%	16%	5%		-11%	35%	-35%	-23%	28%
BRL	-25%	-24%	-11%	7%	-2%	-8%	-11%		-32%	25%	32%	-47%
AUD	54%	60%	44%	-3%	0%	4%	35%	-32%		-67%	-66%	74%
CAD	-39%	-43%	-33%	-13%	6%	1%	-35%	25%	-67%		51%	-58%
ZAR	-44%	-49%	-32%	-2%	0%	-9%	-23%	32%	-66%	51%		-79%
EM FX	56%	57%	42%	-1%	-4%	5%	28%	-47%	74%	-58%	-79%	

Source: Bloomberg, YTD

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