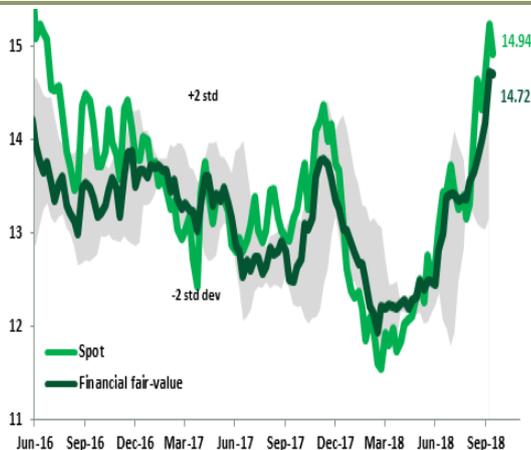


RAND: STILL A CORRECTION WITHIN A BEAR TREND

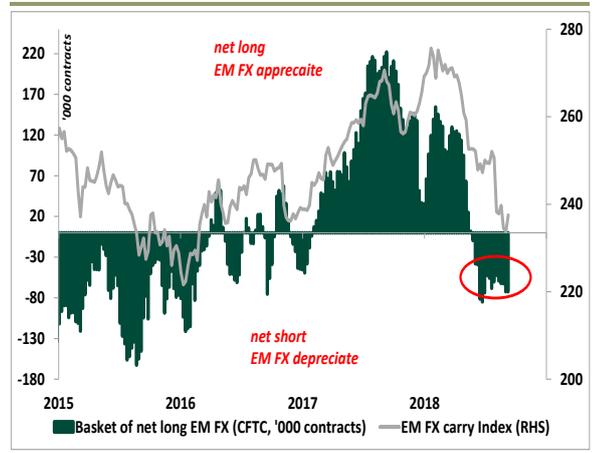
- **Positive sentiment** internationally and locally offered the rand short-term relief as the USDZAR strengthened below R15.00 for the first time since the release of South Africa's 2Q18 GDP data, which showed that the country has entered a technical recession. **With emerging-market (EM) pressures easing somewhat, and a hawkish SARB this week, we expect this tactical correction in the rand, within a broader bear trend, to continue.**
- **Internationally**, EM currencies are finding better support, led by a stronger Turkish lira, following a rate hike of 6.25% in Turkey. Concerns over the Central Bank of the Republic of Turkey's (CBRT's) independence were a key driver in Turkey's recent market turmoil. This also resulted in pressure building on other EM central banks more widely, to show their willingness to hike interest rates despite slowing growth. The move by the CBRT is likely to relieve some of this pressure on EM central banks, including South Africa's.
- **Locally**, we expect the SARB to remain on hold this week at its MPC meeting. Despite weak economic growth, however, its tone will likely be hawkish, aiding the rand. At the same time, indications that Moody's may well leave South Africa's credit rating unchanged next month with a 'stable' outlook should further support the currency.
- **With EM pressures easing somewhat, and a hawkish SARB, we expect the tactical correction in the rand, within a broader bear trend, to continue.** We can expect a rally from current levels to R14.60, possibly extending to R14.10. We recognise that currencies tend to overshoot in the near term, both to the upside and downside, driven by external liquidity factors. As pointed out before, daily forex turnover for the rand as a percentage of annual GDP is a staggering 18%, but SA trade is only less than 1% of global trade volumes. A weaker US dollar in the short term will likely support this view, also as the rand and other EM currencies seem to be oversold in the short term.
- **Why are we reluctant to change our medium-term bearish stance on the rand?** Because we would need to see the following factors (not mutually exclusive): the US Federal Reserve becoming less hawkish, China's economic data improving, commodity prices beginning to rise, global economic data (PMIs) improving, global trade tensions easing and our Global \$-Liquidity indicators improving. We do not believe these changes are likely to occur by year-end.
- From a technical perspective, we recommend keeping an eye on the USDZAR resistance level of R14.60 and the USDZAR support level of R15.00 (please see our latest Technical Strategy note "[Further ST Dollar Weakness is on the Cards](#)" of 11 September 2018).

Chart 1: Fair value model for the rand as a function of financial market variables is R14.72



Source: BBG, Eviews Econometric model, Nedbank CIB Research

Chart 2: Contagion risks for the rand still intact as bearish positioning in EM-FX remains



Source: CFTC, BGB, Nedbank CIB Research

Tactical view:
A correction within the bear trend targeting R14.60, with a possibility of overextending to R14.10

Strategic view:
We believe tighter global financial conditions are negative for the carry trade, leaving downside risk to the rand intact

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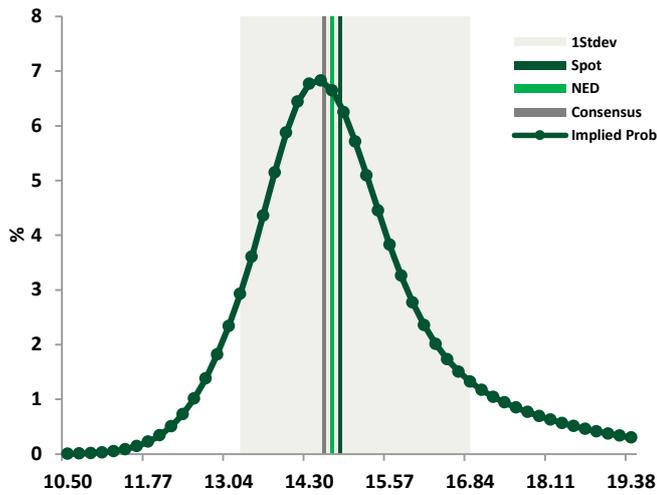
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FX VOL CURVES – ANOTHER SHARP SPIKE IN VOLATILITY

Implied volatility in the options market remains elevated, and the vol curve is still inverted, highlighting near-term concerns for EM contagion risks and the weak domestic environment (see Chart 6). The options market’s forecast for the USDZAR remains more bearish than Bloomberg consensus expectations:

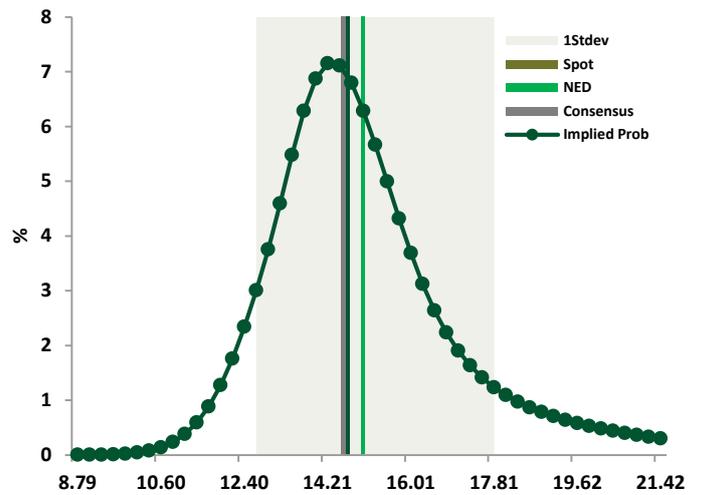
- On a three-month view, the options market suggests a one standard deviation trading range for the USDZAR of R13.57-17.45 (see Chart 3),
- On a six-month view, the probability is skewed towards weakness, as one would expect, with the implied probability distribution suggesting a one standard deviation range of R13.05-18.34 (see Chart 4).

Chart 3: 3m implied probability distribution vs forecast



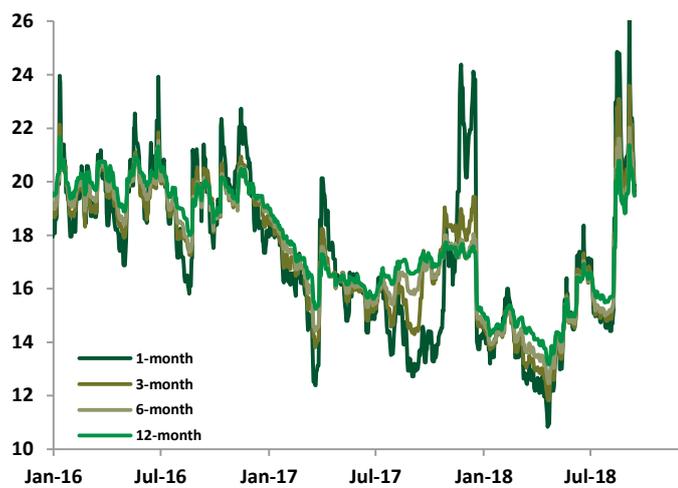
Source: Bloomberg, Nedbank CIB

Chart 4: 6m implied probability distribution vs forecast



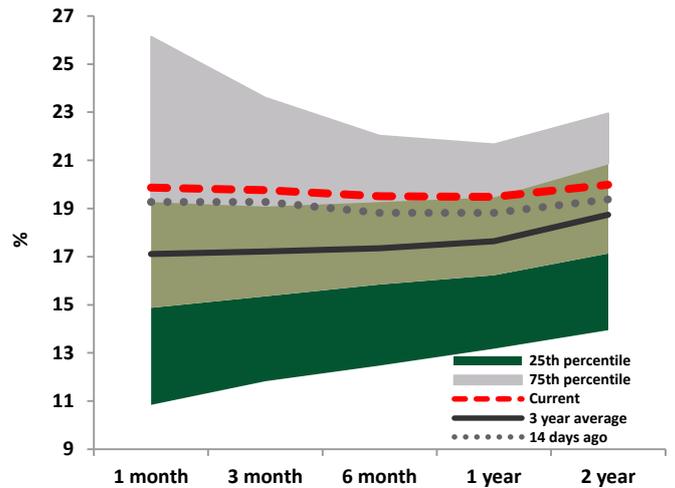
Source: Bloomberg, Nedbank CIB

Chart 5: USDZAR implied volatility



Source: Bloomberg, Nedbank CIB

Chart 6: ATM USDZAR implied volatility cone



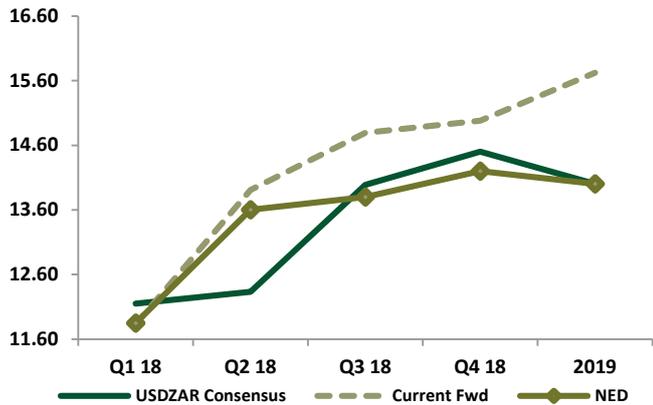
Source: Bloomberg, Nedbank CIB

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

	Current	Q2 18 Actual	Q3 18F	Q4 18F	2019F
USDZAR	14.94	13.72			
Nedbank CIB Markets		13.60	13.80	14.20	14.00
Forward market		13.91	14.96	15.15	15.91
Consensus		12.33	13.99	14.59	14.00
EURZAR	17.38	16.03			
Nedbank CIB Markets		15.78	16.08	16.54	16.59
Forward market		16.13	17.41	17.77	19.30
Consensus		14.80	16.09	16.92	17.50
GBPZAR	19.54	18.18			
Nedbank CIB Markets		17.95	18.77	20.16	20.30
Forward market		18.25	19.57	19.91	21.31
Consensus		16.77	18.19	18.97	18.97
AUDZAR	10.27	10.16			
Nedbank CIB Markets		10.06	10.21	10.51	10.50
Forward market		10.17	10.70	10.84	11.46
Consensus		9.37	10.21	10.65	10.50

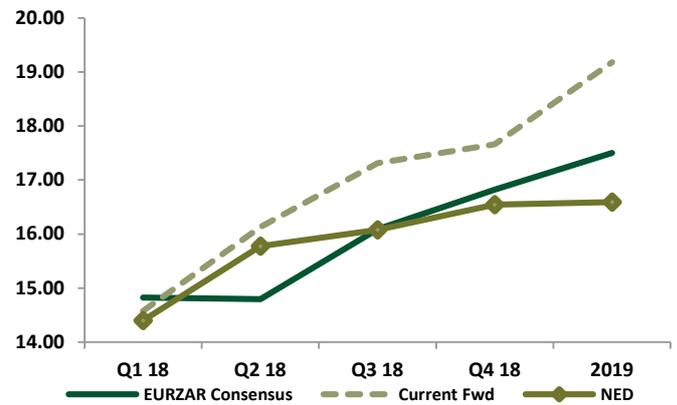
Source: Bloomberg, Nedbank CIB

Chart 8: USDZAR forecasts, consensus and forwards



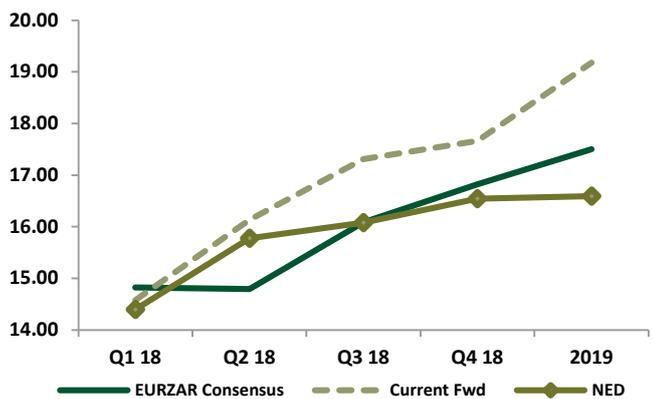
Source: Bloomberg, Nedbank CIB

Chart 9: EURZAR forecasts, consensus and forwards



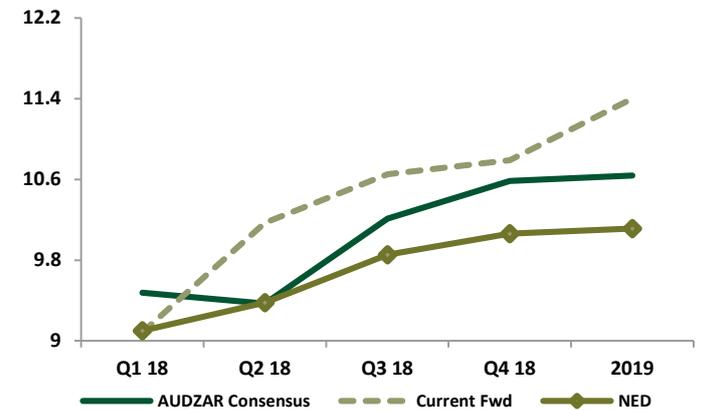
Source: Bloomberg, Nedbank CIB

Chart 10: GBPZAR forecasts, consensus and forwards



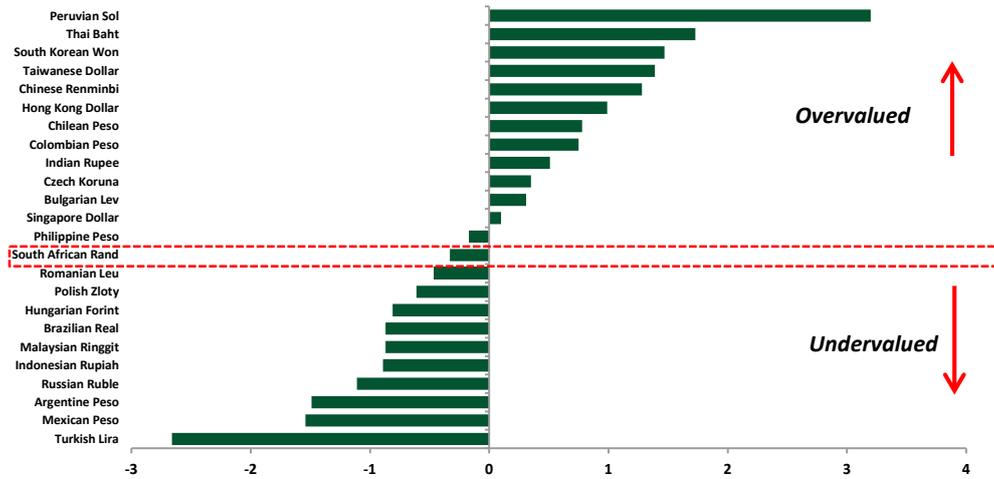
Source: Bloomberg, Nedbank CIB

Chart 11: AUDZAR forecasts, consensus and forwards



Source: Bloomberg, Nedbank CIB

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		-5.734	-0.499	52.154	-9.250	12.894	-5.066	7.092	2.998	20.585	-2.199	-2.692	-1.762	13.723	-5.049
JPY	6.089		-5.218	-38.410	3.688	-16.042	-0.714	-11.974	-8.472	-21.832	-3.667	-3.225	-4.030	-17.126	-0.728
KRW	0.000	5.547		-34.607	9.529	-11.389	4.757	-7.080	-3.398	-17.528	1.656	2.120	1.286	-12.551	4.791
TRY	-34.277	61.331	53.000		67.470	35.676	59.966	42.237	47.524	26.194	55.778	57.111	54.992	35.181	61.095
MXN	10.170	-4.000	-8.726	-40.228		-19.094	-4.305	-14.935	-11.807	-24.613	-7.095	-6.698	-7.469	-19.747	-4.237
RUB	-10.864	19.073	12.855	-26.305	23.609		18.941	5.347	9.131	-6.925	15.462	15.778	14.305	-0.455	18.681
THB	5.305	0.715	-4.590	-37.679	4.646	-15.437		-11.324	-7.794	-21.247	-2.807	-2.569	-3.324	-16.501	-0.052
INR	-6.625	13.591	7.605	-29.697	17.573	-4.888	12.760		3.992	-11.468	9.495	9.922	9.121	-6.125	12.776
AUD	-2.897	9.229	3.583	-32.372	13.364	-8.145	8.419	-3.980		-14.615	5.251	5.696	5.103	-9.179	8.449
BRL	-17.074	27.925	21.251	-20.840	32.503	7.405	26.990	12.956	17.113		23.439	23.612	22.813	6.029	27.007
GBP	2.416	3.857	-1.630	-35.681	7.713	-13.281	2.874	-8.621	-4.978	-18.890		0.460	-0.340	-13.712	3.056
EUR	2.628	3.363	-2.085	-36.335	7.076	-13.194	2.618	-8.736	-5.277	-19.138	-0.417		-0.544	-13.967	2.653
CAD	1.787	3.927	-1.274	-35.913	7.981	-12.521	3.395	-8.122	-4.609	-18.587	0.383	0.757		-13.386	3.349
ZAR	-12.801	20.200	15.293	-26.060	26.263	0.419	19.747	6.525	9.997	-4.931	16.195	16.747	15.517		19.284
USD	5.318	0.721	-4.535	-37.486	4.423	-15.460	0.000	-11.067	-7.774	-21.265	-2.908	-2.542	-3.243	-15.892	

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%	-44%	-35%	16%	-29%	-27%	-7%	22%	-19%	21%	25%
SPX	-81%		37%	28%	-20%	36%	35%	13%	-31%	36%	-31%	-33%
US	-44%	37%		92%	-6%	19%	16%	-12%	-9%	4%	-16%	-15%
US	-35%	28%	92%		-3%	12%	10%	-14%	-7%	-4%	-7%	-9%
SA	16%	-20%	-6%	-3%		-32%	-59%	-3%	42%	-32%	30%	69%
TOP40	-29%	36%	19%	12%	-32%		23%	-3%	-11%	31%	-27%	-26%
EM FX	-27%	35%	16%	10%	-59%	23%		-8%	-70%	65%	-52%	-80%
DM FX	-7%	13%	-12%	-14%	-3%	-3%	-8%		-1%	6%	4%	-7%
MXN	22%	-31%	-9%	-7%	42%	-11%	-70%	-1%		-47%	51%	60%
AUD	-19%	36%	4%	-4%	-32%	31%	65%	6%	-47%		-63%	-59%
CAD	21%	-31%	-16%	-7%	30%	-27%	-52%	4%	51%	-63%		51%
ZAR	25%	-33%	-15%	-9%	69%	-26%	-80%	-7%	60%	-59%	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		69%	39%	7%	4%	1%	27%	-24%	54%	-41%	-45%	50%
Plat	69%		56%	-5%	5%	14%	35%	-24%	57%	-42%	-48%	51%
Pall	39%	56%		-15%	0%	8%	35%	-12%	38%	-32%	-27%	31%
Ironor	7%	-5%	-15%		-1%	-1%	-13%	5%	-2%	-12%	-2%	-1%
Coppe	4%	5%	0%	-1%		12%	15%	-3%	3%	1%	-10%	-2%
T-Coal	1%	14%	8%	-1%	12%		5%	-7%	4%	1%	-7%	4%
Brent	27%	35%	35%	-13%	15%	5%		-6%	29%	-33%	-19%	18%
BRL	-24%	-24%	-12%	5%	-3%	-7%	-6%		-24%	22%	30%	-40%
AUD	54%	57%	38%	-2%	3%	4%	29%	-24%		-63%	-59%	65%
CAD	-41%	-42%	-32%	-12%	1%	1%	-33%	22%	-63%		51%	-52%
ZAR	-45%	-48%	-27%	-2%	-10%	-7%	-19%	30%	-59%	51%		-80%
EM FX	50%	51%	31%	-1%	-2%	4%	18%	-40%	65%	-52%	-80%	

Source: Bloomberg, YTD

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