sasfin beyond a bank

The Daily Market

17 May 2023

USD-ZAR	19,0887/19,0987	**USD-JPY**	136,76/136,77
GBP-ZAR	23,7967/23,8207	**GOLD**	$1989,3835
EUR-ZAR	20,7307/20,7451	**BRENT**	$74,55
GBP-USD	1,2469/1,2522	**DJI**	33 012,14
EUR-USD	1,0857/1,0861	**R 186**	9,4%
AUD-USD	0,6642/0,6643	**3m JIBAR**	8,083

Events (GMT)

Time	Country	Event	Month	Fc	Prior
11:00	SA	Retail sales constant y/y	Mar	-0.9%	-0.5%
09:00	EZ	CPI y/y	Apr F	7.0%	6.9%
09:00	EC	ECB's Elderson Speaks			
11:00	US	MBA mortgage applications	May 12		6.3%
12:30	US	Building permits	Apr	1428k	1413k
12:30	US	Housing Starts	Apr	1396k	1420k

Factors on the radar

Black Sea grain deal

What happened?	Today marks the deadline to extend Ukraine's grain-export deal, with Russia intent on withdrawing from the pact unless its demands are met
Relevance	Failure to extend the deal today could lead to another spike in global food inflation
Importance	5/5 (geopolitics, inflation)
Analysis	There are plenty of moving parts with Russia wanting progress towards removing obstacles to its own food and fertilizer exports, while G7 nations are meeting this week to discuss more wide-ranging sanctions on Russia

US debt ceiling

What happened?	President Biden and top lawmakers have edged closer to a deal that would avoid a US debt default, but remain far apart and will resume talks once Biden returns from a truncated trip to Asia
Relevance	Republicans are still vowing to support raising the debt ceiling only if Biden agrees to retroactive reductions in government spending
Importance	5/5 (fiscal policy)
Analysis	The government and lawmakers have two weeks to break the deadlock over raising the $31.4trln US debt limit before an unprecedented default happens, although they agree that defaulting is not an option

G7 leadership conference

What happened?	Leaders of the G7 nations will meet this week to discuss their nations' trade dependence on China and its scope for economic coercion, as well as additional ways to sanction Russia
Relevance	As China and Russia challenge the US hegemony, Washington is calling on its allies for support
Importance	4/5 (geopolitics)
Analysis	The meeting between the leaders of the G7 nations comes after the G7 finance ministers summit, where China and Russia were also the focal points of the agenda

Today's Talking Point

Retail sales y/y: Mar

Expected: -0.9%

Prior: -0.5%

Analysis: Retail sales at constant prices continued to contract in February, at -0.5% y/y, compared with a contraction of -0.8% y/y in January. Retail is vital to a consumption-driven economy such as South Africa and given the numerous headwinds facing consumers, has held up surprisingly well. However, this resilience is not expected to last in the face of a cost-of-living crisis, pessimistic consumers and a slowing credit cycle. Retail sales are expected to contract on a y/y basis in March once again. In the longer term, structural reforms are necessary to lift South Africa to a higher sustainable growth rate. This, in turn, would allow the middle class to stabilise and start expanding as economic growth returns.

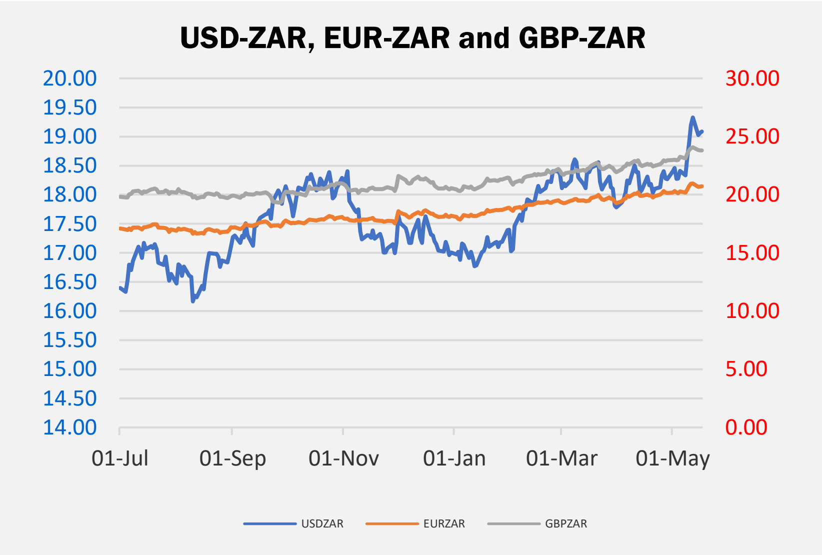
Rand Update

The latest Quarterly Labour Force Survey (QLFS) report showed South Africa's narrow unemployment rate edged up slightly from 32.7% to 32.9% in the three months through March. This was primarily due to an expansion of the labour participation rate, as a total of 258,000 jobs were actually added through the quarter. Nevertheless, the data contained very little to get optimistic about, with SA's unemployment rate still among the world's highest. Due to SA's structurally weak economy and the lack of skilled labour in the country (as highlighted yesterday by a study which showed that the proportion of grade 4 children unable to read for meaning in SA sits at 81%), the employment outlook is also not much better.

Structurally high unemployment is particularly concerning against a backdrop of already-high fiscal risk. Comments from FinMin Godongwana in parliament yesterday underscored this point as he highlighted that public sector wage hikes and the sharp rise in borrowing costs have highlighted SA's vulnerable fiscus. Add to that the need to support the country's unemployed with social grants while the income tax base shrinks, and you have a recipe for fiscal unsustainability. The high bond yields SAGBs offer reflect this, with investors demanding very high compensation to balance out the risks of investing in the country.

Regarding the session ahead, the market will have local retail sales numbers for March to digest, with consensus expectations being for the print to reflect increasingly weak household demand. Given that this is nothing new, the data hold limited market-moving potential. Instead, the focus will be on offshore developments, with Stateside debt ceiling talks and the potential end of the Black Sea grain export deal set to attract the most attention. President Biden and top lawmakers have edged closer to a deal that would avoid a US debt default, but remain far apart and will continue talks while Biden is on a truncated trip to Asia. As for the Black Sea grain deal, note that today marks the deadline to extend Ukraine's grain-export deal, with Russia intent on withdrawing from the pact unless its demands are met.

The USD-ZAR market again tested the 19-handle yesterday, with this now the floor of new, tighter trading range. As concerns over SA's relationship with Russia ease, there is a clear reluctance to trade the pair much higher from current levels. Still, it may be premature to say that the near-term risks are tilted to the downside, as market sentiment towards SA remains cautious to say the least. Instead, investors are awaiting a catalyst to provide fresh directional impetus, with external development front and centre and the ZAR's performance once again consistent with the rest of EMFX.



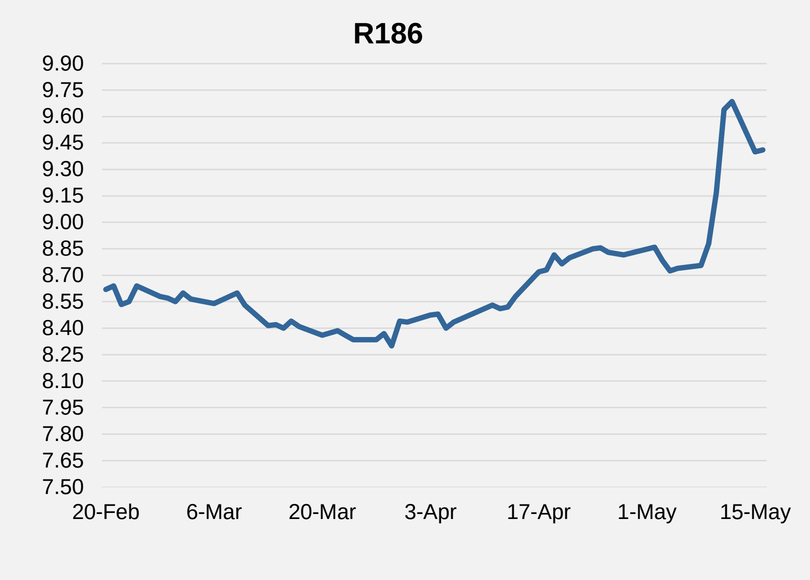
Bond Update

Bonds/Yield Curve: Bonds ended the trading session a little firmer yesterday, taking some direction from the ZAR that attempted another break of the 19.00/dlr handle. At these levels, there is still tremendous real yield available for local investors and some healthy nominal yields for foreigners. However, such has been the country's risk profile that the appetite to expose portfolios to SA's bonds has been lacking.

It was a relief to see some decent demand at yesterday's bond auction, where National Treasury opted to auction off the more liquid shorter, duration bonds. Predictably, the demand was strongest for the shortest dated R2032, followed by the R2035 and R2037 thereafter. Total bids stood at R11.015bn, which was not far off the year-to-date average of R12.517bn, although clearly, demand was still a little subdued. Clearing yields were obviously higher on the average of the previous auctions, but that is a function of the last week's developments. Bonds retain some attraction to local fund managers that will look to healthy, positive real yields. Direction today will come from a combination of the movements in the ZAR and the outcome of the latest retail sales figures.

FRAs: Unless the ZAR stages an impressive recovery, FRAs will likely consolidate around current levels, with investors seemingly comfortable in pricing in another 100bp worth of rate hikes. Although there is much concern about the overall weakness of the SA economy, protecting the value of the ZAR is the SARB's primary mandate. When the ZAR is appreciating it sets in motion a virtuous cycle that tends to be more growth generative in time. In the short term, investors will feel comfortable positioning for a South Africa that needs to sustain higher interest rates in order to regain some control of the ZAR and inflation, which remains stubbornly high. Today's retail sales data will be of interest, but unless it misses expectations significantly, it is unlikely to impact the FRA market much.

Repo: It is likely that the SARB will hike by a minimum of 50bp at the next meeting to stabilise markets. This is not what forecasters or the SARB had in mind, but there was panic in the market last week, and bold decisions are needed. Any expectations of rate cuts early in 2024 have now disappeared, and all eyes will be on whether the ZAR makes a full recovery or not. The ZAR is vulnerable, which may even prompt the SARB to remain hawkish, although an intra-meeting emergency hike is no longer looking as necessary. The peak in interest rates has now moved 100bp higher but could stabilise around current levels through the week ahead.



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