sasfin beyond a bank

The Daily Market

20 January 2023

USD-ZAR	17.277/17.2819	**USD-JPY**	129.26/129.29
GBP-ZAR	21.3487/21.3727	**GOLD**	$1925.99
EUR-ZAR	18.7033/18.7204	**BRENT**	$86.31
GBP-USD	1.2371/1.2425	**DJI**	33 044,56
EUR-USD	1.0829/1.0831	**R 186**	8.2%
AUD-USD	0.6921/0.6925	**3m JIBAR**	7,333

Events (GMT)

Time	Country	Event	Month	Fc	Prior
09:00	SA	ILB auction (R1.2bn)			
00:01	GB	GfK consumer confidence	Jan	-41%	-42%
07:00	GE	Producer prices y/y	Dec	20.8%	28.2%
07:00	GB	Retail sales excluding auto fuel y/y	Dec	-4.4%	-5.9%
14:00	US	Fed's Harker Discusses the Economic Outlook			
15:00	US	Existing home sales	Dec	3.96mn	4.09mn

Factors on the radar

Russia's nuclear war rhetoric

What happened?	Russian security council member Medvedev warned NATO that Russian defeat in Ukraine could trigger nuclear war, while the head of the Orthodox Church said the world would end if the West tried to destroy Russia.
Relevance	With the Russia-Ukraine war stretching on, the risk of escalation remains prevalent given that the West is overtly fighting a proxy war
Importance	4/5 (war, geopolitics)
Analysis	Apocalyptic rhetoric is intended to deter the US-led NATO alliance from getting even more involved in the Russia-Ukraine war, and should not be ignored given the high stakes of the matter

US debt ceiling

What happened?	The US government hit its $31.4trln borrowing limit amid a standoff between the Republican-controlled House and President Biden's Democrats on lifting the debt ceiling
Relevance	Should it persist, the standoff holds the potential to rattle markets and unsettle an already-shaky global economy
Importance	3/5 (fiscal policy)
Analysis	Congress will likely reach a deal to avert a debt default, but the negotiations could go down to the wire, contributing to market volatility at a time when recessionary risks are already weighing on sentiment

Fedspeak

What happened?	Fed Williams, Harker, and Waller are all set to speak at public events into the weekend, and will likely signal smaller rate hikes and a tighter-for-longer policy outlook for the year ahead
Relevance	The Fed's tightening cycle is nearing an end, but there is still uncertainty over how long it will keep interest rates high before cutting
Importance	5/5 (monetary policy)
Analysis	As growth headwinds in the US become stronger and the labour market loosens, the argument for maintaining tight monetary conditions will weaken. In turn, there will be significant pressure on the Fed to cut interest rates later this year

Today's Talking Point

Oil Update

Analysis: Oil looks set to post its second weekly advance in three, with optimism over China's reopening and increased demand there outweighing a weakening outlook for the rest of the world. Brent is trading above $86.50, while WTI has breached the $81 per barrel mark when looking at the front-month contracts. The former has gained just more than 2.50%, while the latter has increased by just over 1% on the week so far. Trading activity has also picked up over the last two weeks, with holdings of the global benchmark Brent rising to their highest since March last year. This increase in open interest has helped drive the gains for the market, as well as eased some of the volatility that it experienced in 2022. Going forward, trades will be looking to assess what the impact will be of the Russian crude price cap and EU ban on imports that starts from 5 February. The price cap has so far had very little impact on the market, while Russia has so far managed to maintain a relatively high level of exports despite the already imposed sanctions from the West. The source of the greatest demand growth, China, has managed to continue to receive crude from Russia, mitigating the impact of the ban. This could help limit gains for the market, for now, by preventing a shift into a structural deficit.

Rand Update

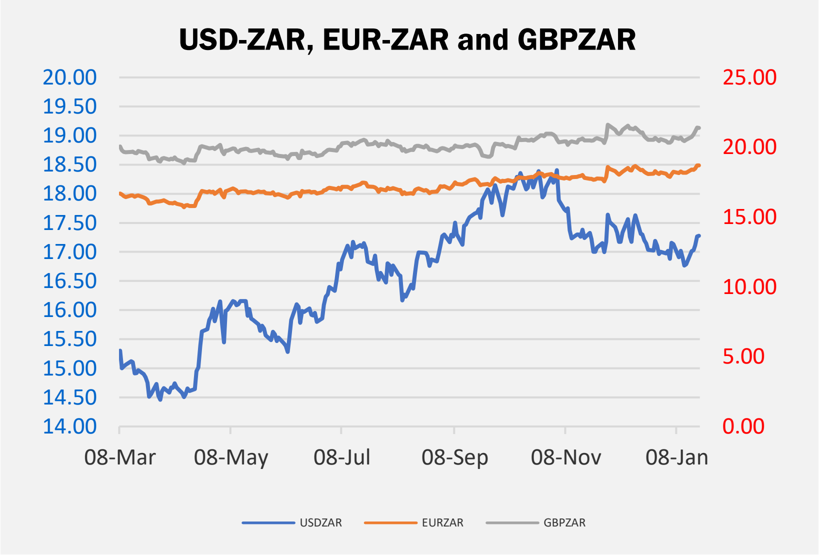
The ZAR extended its bear run to a fifth consecutive session on Thursday, depreciating 1.20% to levels north of R17.3000/$ through the session. This followed as comments from US Federal Reserve officials pointed to further rate hikes in the months ahead, while the argument for more rate hikes was also bolstered by robust US jobless claims data.

A tight labour market continues to keep the Fed from turning more dovish even as the economic conditions in the US deteriorate. However, it is worth remembering that the labour market tends to lag behind the rest of the economy, and it is only a matter of time before economic weakness translates into labour market weakness that will spur rate cuts down the line.

Still, for the time being, the market anticipates higher rates, so the USD will enjoy some support. But over the medium term, the balance of risks is tilted against the greenback. Time will tell, but it seems unlikely that the Fed will stubbornly hold on to higher rates amid balance sheet pressures arising from a house price and equity markets downturn.

The full impact of last year's coordinated monetary tightening has yet to manifest, with the real test for the Fed and the US economy set to present itself through the second and third quarters of this year. Phases of USD appreciation should thus be treated with caution in the meantime, with the ZAR poised for recovery due to its high carry appeal.

After five straight sessions of depreciation, the ZAR looks set for a stronger end to the week. Market sentiment has recovered overnight, with relatively higher-risk currencies and equities all trading in the green this morning. Looking further out, however, more volatility is expected in the near term as the global monetary cycle turns. Investors are facing strong crosscurrents as they navigate rising global recession risk, as well as moderating interest-rate pressure amid bets that economic weakness will force central banks into implementing more supportive monetary policy.

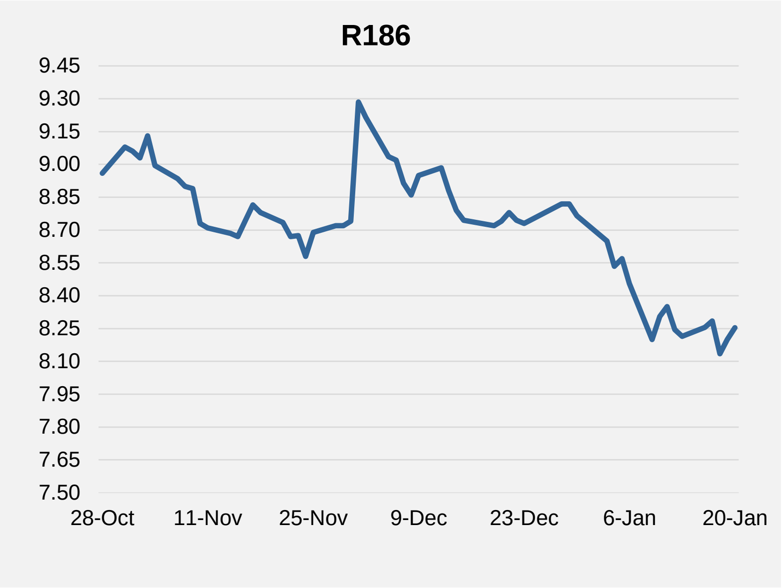


Bond Update

Bonds/Yield Curve: It has been a tough week for the ZAR, which has depreciated by more than 40 cents this week, giving rise to concerns that there is a lot more to come that holds the potential to derail the great inflation moderation. Focusing too squarely on the ZAR when inflation expectations are moderating, when the GDP cycle is about to turn lower, and when rates have adjusted as far as they have, seems too simplistic. Today's ILB auction and the breakeven rates that comes from it will be telling. They are a leading indicator to the BER's inflation expectations survey and offer a far more up-to-date assessment of where inflation is headed. Those breakeven rates are expected to remain subdued and will raise the probability that the cycle has turned to favour bonds.

FRAs: ZAR volatility has raised the degree of indecision in the FRA market. As the ZAR weakened further, FRAs unwound some of what they had been pricing in. Coming into clear focus is the SARB's MPC decision next week, amid all the comments from Fed speakers that there will be more tightening announced at the upcoming FOMC. The message sent is that rates have not yet peaked and have a little further to go. While that is the message and economic data holds up, investors will be somewhat reluctant to price in rate cuts towards the end of the year and the start of next. The 12X15 vs 1X4 FRA spread recovered slightly to -16 to reflect this, although, for the most part, investors remain comfortable calling a turn in the cycle.

Repo: The SARB has thus far kept in lockstep with the Fed to ensure that negative speculation against the ZAR is discouraged. They have been successful in that, and their conservative stance on monetary policy means that the monetary space for inflation to take hold no longer exists. There may be one more 25bp hike at the first meeting of 2023, but after that, the SARB may signal that they have done enough.



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140 West Street, Sandown, Sandton, Johannesburg, 2196

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