The Daily Market

Make it your business

07 July 2021

USD-ZAR	14.3488/14.3649	**GBP-ZAR**	19.7952/19.8192
GBP-USD	1.3798/1.3849	**AUD-USD**	0.7492/0.7494
GOLD	$1797.99	**DJI**	34577,37
EUR-ZAR	16.9654/16.9718	**EUR-USD**	1.182/1.1821
USD-JPY	110.48/110.51	**R 186**	7.52%
BRENT	$74.53	**3m JIBAR**	3,692

EVENTS

09:00	SA	Bond auction (R3,900mn of R 2030, R 2037, R 2040)			
04:30	AU	RBA rate decision	Jul 6	0,10%	0,10%
06:00	GE	Factory orders y/y	May	60,00%	78,90%
09:00	EZ	ZEW economic sentiment	Jul		81,30
09:00	GE	ZEW economic sentiment	Jul	75,00	79,80
14:00	US	ISM non-manufacturing composite PMI	Jun	63,80	64,00

FACTORS ON THE RADAR

Minimum corporate tax

What happened?	>	US Treasury Secretary Yellen will press G20 countries to raise the global minimum tax threshold to levels higher than the 15% agreed to recently
Relevance	>	With so many countries facing difficult fiscal environments, this will be endorsed
Importance	>	4/5 (economy, fiscal policy)
Analysis	>	It is an initiative that has been launched at an opportune time, given the desperate need of so many governments to boost their revenue intake in order to help stabilise debt

Oil Supply

What happened?	>	The breakdown of oil talks between OPEC+ countries was interpreted as bullish for oil in that no output rise was agreed to. However, that does not stop unregulated supply from rising
Relevance	>	The market is short of supply, and the price of oil is high, a recipe for unregulated oil supply to enter the market
Importance	>	3/5 (market)
Analysis	>	Forecasts of Brent crude oil prices rising to $80 pb by the start of next year, a strengthening global economy and supply shortages will result in OPEC reconvening to debate raising production from current levels.

Central bank minutes

What happened?	>	On Wed the Fed will release its minutes of the latest FOMC when the taper was debated, while the ECB will release its meeting minutes on Thursday
Relevance	>	The former in particular will be closely watched and has market-moving potential
Importance	>	4/5 (monetary policy)
Analysis	>	The timing of the taper and normalisation is central to any portfolio positioning at the moment and will be key to determining broader USD direction.

TODAY'S TALKING POINT

Gross & Net Reserves: Jun
Expected:
Prior: $51.14bn & $52.24bn

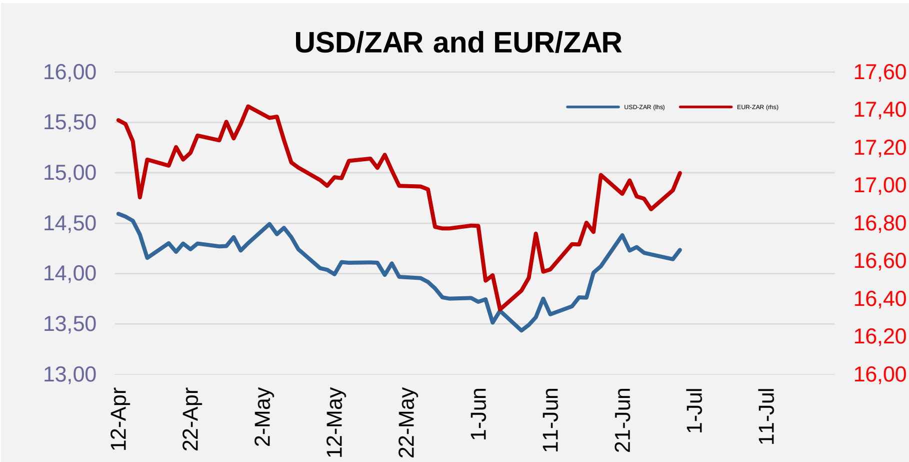
Analysis: Both SA's gross and net reserves rose for the second straight month in May. The former rose to $54.14bn, its highest level in four months while the latter climbed to $52.24bn, its highest level on record since Bloomberg started tracking this series. The rise in reserves was supported by the increase in the value of gold and the weaker USD. The relatively robust reserves are likely to help shield the economy from external shocks and, by extension, support the rand. With the SARB not actively building reserves, they remain a function of the oscillation in the market value of gold and currencies. The US dollar's resurgence and the drop in the value of gold suggest that SA reserves are likely to have dropped in June.

RAND UPDATE

The USD-ZAR attempted a downwards break yesterday, but a resurgent greenback pressured major and emerging currencies broadly ahead of the Fed's FOMC meeting minutes due later this evening. With markets cautious that the dollar may catch a potential tailwind from the June meeting's minutes, the ZAR's earlier gains, which took it below the 14.2000/$-handle for the first time in over a week, were ultimately reversed as the unit retreated against a buoyant USD.

With the USD holding steady overnight, investors are positioning for a reaction that may result in Fed policy tapering bets being brought forward, similar to what occurred at the June meeting. Given the mixed rhetoric from Fed officials since the last meeting, investors will closely analyse just how hawkish the Fed has turned. That said, the minutes could swing sentiment either way as the central bank maintains that it will wait to see a sustained improvement in labour market conditions.

While the Fed's last meeting drove the USD to a near 3% trade-weighted gain in June, this did not stop inflows into EM stocks and bonds, which continued at quite a pace and almost tripled from the month prior, according to data from the Institute of International Finance (IIF). This suggests that the outlook remains positive for EMs while DM yields remain low in comparison. That said, idiosyncratic risks do exist for specific EMs. China accounted for the majority of the flows, and thus some more vulnerable emerging markets could still be subject to outflows as the prospects of Fed tapering rise.



There has been some upside pressure on rate expectations over the last three weeks, with FRAs from one month to two years paid higher. The market is now pricing in a quicker rate hike cycle, with nearly 70bp of rate risk priced in by year-end, up from 31bp roughly a month ago. By the end of 2022, 175bp or seven 25bp rate hikes have been priced in. This would take repo up to 5.25%, and prime to 8.75%. Further out the curve, the 21x24 FRA rate, which maps to the period of March-June 2023, suggests that rates could be around 225bp higher. If FRA's are correct, the hikes would take the repo rate up to 5.75%, and prime to 9.25%.

Yet with the inflation rate still expected to average around 4.5% for the foreseeable future, there are still question marks over how feasible this will be. The upside pressure on FRAs would stand to reason if inflation pressures were to accelerate and widen into the entire CPI basket or the ZAR were to experience heightened volatility. Neither is looking all that likely when considering that a relatively strong ZAR should contain import price inflation. Weak levels of domestic demand, low credit growth and weak business investment feed into the view, while higher commodity prices buoy export earnings as a support to the local currency.

Repo sitting at 5.25% by the end of 2022 and then rising to 5.75% by mid-2023 is on the upper end of rate risk. Expectations for inflation to sit around 4.5% through 2022 and 2023 are key to this view. The monetary policy review projects the neutral real rate around 2.3% by the end of 2022 and into 2023. The QPM seeks to establish balance with this through a gradual move towards neutral real rates. The last projection had real rates sitting around 0.6% at the end of 2022 and 1.1% by mid-2023, implying repo levels around 5.1% (FRA at 5.25%) by the end of 2022 and around 5.6% (FRA at 5.75%) by mid-2023. The SARB has already started to lay the groundwork for a softer rate hiking cycle, given a weak growth outlook. Kganyago highlighted that the SARB is data-dependent and makes decisions pragmatically while considering the QPM at the last meeting.