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The Daily Market

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03 June 2021

USD-ZAR	13.515/13.5268	**GBP-ZAR**	19.1377/19.1617
GBP-USD	1.416/1.4211	**AUD-USD**	0.7738/0.774
GOLD	$1903.51	**DJI**	34600,38
EUR-ZAR	16.4945/16.5027	**EUR-USD**	1.2201/1.2204
USD-JPY	109.72/109.73	**R 186**	7.355%
BRENT	$71.76	**3m JIBAR**	3,683

EVENTS

07:15	SA	Standard Bank SA PMI	May	52,00	53,70
12:15	US	ADP employment change	May	700k	742k
12:30	US	Initial jobless claims	May 29		406k
13:45	US	Markit composite PMI	May F		68,10
13:45	US	Markit services PMI	May F	70,00	70,10
14:00	US	ISM non-manufacturing composite PMI	May	63,00	62,70

FACTORS ON THE RADAR

Chinese services

What happened?	>	China's services activity growth slowed in May, according to a private survey released on Thu. The Caixin/Markit services PMI fell to 55.1 in May from 56.3
Relevance	>	This still represents a relatively strong expansion from a country already past pre-covid levels
Importance	>	3/5 (economy)
Analysis	>	This data contrasts the official data, which showed a stronger expansion. This data suggests that weaker demand from abroad as many countries locked down again was to blame

Japanese services

What happened?	>	Services sector activity in Japan has contracted for the 16th consecutive month in May as an extension of coronavirus emergency curbs at home, bite
Relevance	>	Any recovery remains elusive while this contraction continues and lockdowns persist
Importance	>	3/5 (economy)
Analysis	>	Lacklustre demand from abroad is just as problematic as the weaker demand domestically. While businesses remained optimistic about the future, they are the least optimistic in 4 months

Fed – corporate bonds

What happened?	>	The Fed announced on Wed that it plans on unwinding its corporate bond holdings it acquired last year through its emergency lending facility
Relevance	>	The sale represents the first step in the normalisation of monetary policy and will be gradual
Importance	>	4/5 (market, monetary policy)
Analysis	>	The Fed will drip feed bonds back into the market so as not to disrupt broader market behaviour. The unwind will likely take some time so as not to affect the companies whose bonds they own

TODAY'S TALKING POINT

Standard bank PMI: May
Expected: 52.3
Prior: 53.7

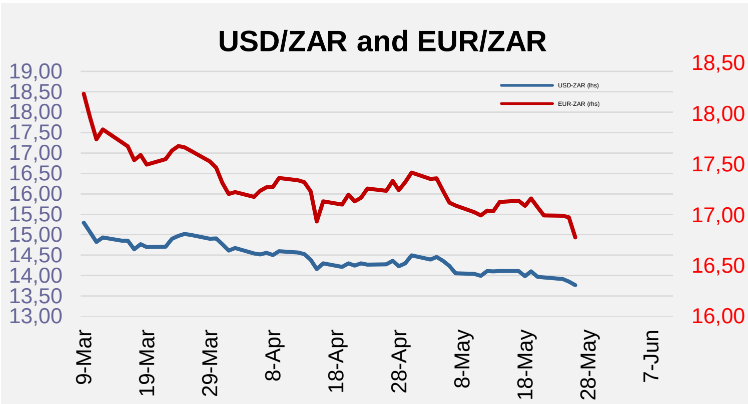
Analysis: The Standard Bank PMI has spent the last seven months in expansionary territory, reflecting a continued improvement in economic activity as operating conditions gradually normalise and underlying drivers of demand improve. Should SA avoid additional lockdown measures in the months ahead and the vaccination rollout accelerates, the economy will continue to recover through 2021 and 2022 before structural constraints begin to set in once more in the continued absence of growth-enhancing reforms. For the May PMI reading, expectations are that we could see it dip as the pace of growth from month to moth may start to slow.

RAND UPDATE

Following intraday losses which pushed the local currency back above the 13.8000/$-handle, the ZAR caught a tailwind and traded firmer through the local session yesterday, despite emerging market currencies coming under broad pressure. The ZAR was amongst a handful of EM currencies that snapped the general weakening trend stemming from a rebounding US dollar. The US dollar index (DXY) ultimately notched higher as low levels of risk-taking ahead of critical US employment data buoyed the greenback. Still, a series of technical breaks for the ZAR saw the local currency close 1.45% stronger on the day, just above the 13.5500/$-handle.

While it remains to be seen whether SA fiscal policy will turn more consolidative in the years ahead, prudent monetary policy has undoubtedly offered support during the pandemic downturn. Specifically, prudent central bank action and policy certainty has been a reason for ZAR resilience. Case in point has been the Turkish lira's decline this year. In addition, the lira suffered another blow yesterday as President Erdogan continued to pressure the central bank to cut interest rates. Lower policy rates, especially in an environment where both developed and emerging market nations are gauging when to begin rate hiking cycles, will likely lead to capital outflows and currency depreciation. Domestically, prudent monetary policy over recent years allowed the SARB front-load rate cuts last year to support the economy while still leaving policy rates high enough to entice yield-starved investors from developed nations. This has led to the ZAR's outperformance over the past year, alongside high commodity prices and favourable trade dynamics, and explains the ZAR's continued resilience.

For the day ahead, the Standard Bank economy-wide PMI will provide an update on economic activity through May. The gauge is expected to have remained in expansionary territory and should do so in the months ahead until structural constraints begin to hold back productivity once more in the continued absence of growth-enhancing reforms.



Talk amongst US policy regulators of an orderly removal of COVID regulations in the US is sentiment supportive, insofar as it suggests that the worst of the crisis is over. High domestic yields in SA will also be at play, with strong inflows in the market through May suggesting that SAGBs are in a moment of market favour. The kicker would be for an adjustment in the Fed policy outlook favouring policy tightening, with many fearful that such a move could tip the SAGB market. Fed comments have suggested that this is still far from likely, with current inflation pressures expected to be transitory.

Note that SA's sovereign yields are at very distended levels, especially when adjusted for inflation. This will be the primary attraction for capital in SA, while higher import earnings against the backdrop of a tighter monetary environment are helping the ZAR to maintain a high degree of support. By contrast, SARB rates are very low by historical standards, despite being higher than most countries. Moreover, weak growth sentiment could also be at play in driving low credit extension and a rise in savings rates, keeping the overall ZAR supply relatively tight.

The bond market will likely get a boost heading into the session today, while FRA rates may experience some receiving interest. However, it is unlikely that the ZAR at these levels would meaningfully alter the outlook for rates with base effects and high commodity prices already supporting an outlook for sharp y/y growth in fuel costs. The ZAR would likely have to experience a sustained appreciation of another 10% or so down to the R12.0000/$ region before this outlook changes, representing a statistically very stretched overvaluation.