sasfin beyond a bank

The Daily Market

18 May 2023

USD-ZAR	19,3135/19,325	**USD-JPY**	137,51/137,54
GBP-ZAR	24,0719/24,0959	**GOLD**	$1977,69
EUR-ZAR	20,918/20,9317	**BRENT**	$76,67
GBP-USD	1,2465/1,2519	**DJI**	33 420,77
EUR-USD	1,0829/1,0833	**R 186**	9,785%
AUD-USD	0,6643/0,6644	**3m JIBAR**	8,083

Events (GMT)

Time	Country	Event	Month	Fc	Prior
12:30	US	Initial jobless claims	May		264k
12:30	US	Philadelphia Fed index	May	-21.1	-31.3
13:05	US	Fed's Jefferson Gives Speech on Economic Outlook			
13:30	US	Fed's Barr Testifies Before Senate Banking Committee			
14:00	US	Existing home sales	Apr	4.28mn	4.44mn
14:00	US	Leading Indicators	Apr	-0.5%	-1.2%

Factors on the radar

US jobless claims

What happened?	Initial jobless claims data scheduled for publication today may show continued labour market loosening in the week through 13 May
Relevance	The US labour market is a key determinant of when a Fed policy pivot can take place
Importance	3/5 (labour market, inflation, monetary policy)
Analysis	The US labour market remains tight, but layoffs are rising as the economy loses momentum after an aggressive rate-hike cycle and a period of very high inflation

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

US Leading Indicators: Apr

Expected: -0.5%

Prior: -1.2%

Analysis: The Conference Board's leading economic index has gradually trended lower in recent months, underperforming consensus expectations for the most part since mid-2021. It has fallen 4.5% over the six-month period between September 2022 and March 2023, marking a steeper rate of decline than the 3.5% drop over the previous six months between March 2022 and September 2022. This signals that recession risks in the US are intensifying. Persistently high inflation and an aggressive monetary tightening cycle are starting to take a toll on US economic activity. The current downturn may deepen through the months ahead as bank lending standards tighten amid rising financial sector stress. Therefore, although consensus expectations are for a lower rate of contraction in April, the broader downtrend will remain intact to suggest economic headwinds in the US are on the rise.

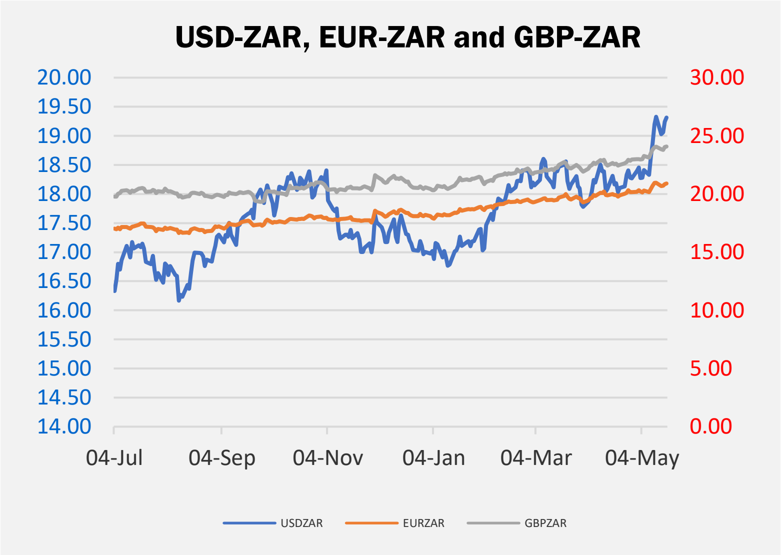
Rand Update

The ZAR's retreat continued on Wednesday, with the market unwinding all of Monday's recovery to take the local currency back towards its weakest-ever levels. Although much of this has been a function of USD strength this week, the ZAR's lack of resilience cannot be ignored. It has come to the fore as the trade-weighted USD index advanced to its strongest since late March amid growing optimism that the US will avoid a debt default given perceived progress in talks to raise the debt ceiling. The US government and lawmakers still have two weeks to break the deadlock over raising the $31.4trln US debt limit before an unprecedented default happens, although they have agreed that defaulting is not an option and are continuing talks even as President Biden travels through Asia.

Above and beyond USD strength, the ZAR's idiosyncratic weakness also remains in play, as reflected in its declines against other major currencies such as the EUR and GBP. The weak labour market and retail sales data published out of SA this week are likely contributing to this. Following Tuesday's Quarterly Labour Force Survey (QLFS) report, which showed a rise in unemployment, data released yesterday showed retail sales at constant prices continued to contract for a fourth consecutive month in March. Specifically, retail sales growth came in at -1.6% y/y (prior: -0.7 y/y), which was well below consensus expectations for a -0.7% y/y print.

The weak data seen this week leave the SARB with some difficult decisions to make. On the one hand, it will need to consider the risk of additional import inflation if it does not defend the ZAR by hiking rates further. On the other, there is the potential damage it might do to capital structures by raising interest rates too much. With that in mind, note that rates derivatives markets are currently pricing in around 100bps of rate-hike risk for the remainder of the current cycle, although it remains to be seen whether Governor Kganyago and Co. will need to be that aggressive. There are valid questions about whether hiking that aggressively would be counter-productive given the sources and nature of the inflation; however, interest rates are the only mechanism the SARB has to discourage negative speculation against the ZAR, meaning a rather large quantum of rate hikes seems likely.

The ZAR remains on the back foot with investor sentiment towards SA extremely weak at present. Weak economic data out of SA this week has done little to support the local currency, as it highlights the potential backlash the SARB will face if its hikes rates aggressively through the months ahead. Accordingly, any hopes of a ZAR recovery from current levels primarily lie in external developments and the potential for major currency weakness. So far, this has not been seen, with the USD-ZAR and GBP-ZAR moving back towards the all-time highs reached last week, and EUR-ZAR also rising back towards the 21-handle.



Bond Update

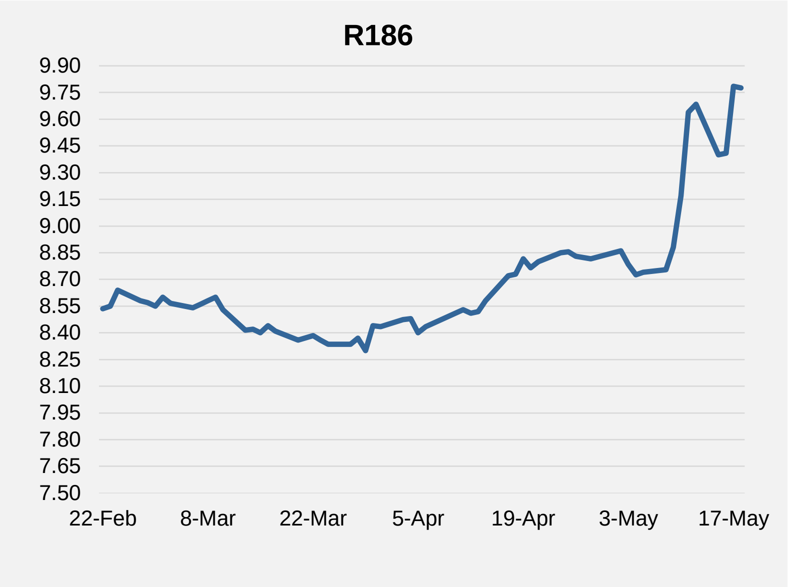
Bonds/Yield Curve: Bonds came under considerable pressure yesterday. The curve shifted higher across the board. It is unclear whether the weaker ZAR drove bonds or it was the other way around, and ultimately it does not matter. What matters is that both markets are signalling the need for higher rates to compensate investors for SA's deteriorating risk profile. What was also notable was the manner in which the yield curve flattened, with the R2053 vs R186 spread narrowing to just 277bp. The story was similar at the very short end of the curve, with the R213 vs R186 spread narrowing to 170bp.

Bonds appear to be taking some of their cues from the sentiment in the FRA curve, and the sentiment in FRAs is that SA needs higher yields to compensate for risk. SA has been run so poorly that there is a broad-based exodus out of SA, principally out of bonds and equities. AngloGold Ashanti's announcement that its principal listings would shift to NY and London highlighted this recently. The company is looking for more stable jurisdictions and deeper, more accessible pools of capital.

Over recent months, foreigners have steadily sold out of SA bonds, and their foreign holdings continue to slide. Whereas foreigners used to hold approximately 42% of SA's bonds before SA lost its credit rating, that is now dropping closer to 27%, and the trajectory is still lower. With no more data scheduled for this week, focus will turn to developments abroad, particularly the US debt ceiling and US data in the form of the weekly jobless claims, the Philly Fed index and the latest existing home sales. Only some weaker data and a reduction in risk aversion may help riskier jurisdictions regain some lost ground.

FRAs: While the ZAR remains under considerable pressure, the FRA market will move to price in the possibility of a bold stance from the SARB. At the moment, the feeling is that a 50bp rate hike is appropriate, but the risk is gradually shifting into the possibility that the SARB could hike by even more. Clearly, the ZAR needs some assistance, and current interest rate levels are not providing enough protection. FRAs are convinced that the SARB will hike by at least 50bp and are pricing in the possibility of a bolder 75bp hike, with more than 125bp worth of hikes between now and the end of the year.

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 priced into FRAs has now moved 100-125bp higher but could stabilise around current levels ahead of the SARB decision and statement next week.



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