sasfin beyond a bank

The Daily Market

14 January 2022

USD-ZAR	15,398/15,4139	**GBP-ZAR**	21,1378/21,1618
GBP-USD	1,3727/1,3778	**AUD-USD**	0,7278/0,7279
GOLD	$1826,15	**DJI**	44574,00
EUR-ZAR	17,6707/17,6841	**EUR-USD**	1,1474/1,1475
USD-JPY	113,74/113,75	**R 186**	7,765%
BRENT	$84,37	**3m JIBAR**	3,892

Events (GMT)

07:00	GB	Manufacturing production y/y	Nov	-0.30%	1,30%
13:30	US	Advance retail sales m/m	Dec	0,20%	0,30%
14:15	US	Industrial production m/m	Dec	0,30%	0,50%
15:00	US	Michigan consumer confidence	Jan P	70,30	70,60

Factors on the radar

U.N. growth outlook

What happened?	A U.N. report released yesterday predicts the global economy will expand 4% vs 5.5% forecast in 2021, to expand by a further 3.5% in 2022
Relevance	High and rising inflationary pressures have been blamed for the softer growth outlook expectation
Importance	4/5 (economy)
Analysis	This concurs with the IMF and the World Bank that have also downgraded their forecasts for growth recently and highlights the impact that high inflation will have in eroding GDP dynamism

U.K. Staff absences

What happened?	Although the U.K. reported record staff absences over Dec due to Omicron, the numbers are starting to improve to ease the pressure
Relevance	It ultimately means that Q1 could be the low point in 2022 and that a recovery will unfold thereafter
Importance	3/5 (economy)
Analysis	Staff absences vs physical lockdowns are far less damaging to the economy, so the impact through Q1 will not be as dramatic as it was in the wake of the hard lockdowns in June 2020

ECB Inflation

What happened?	ECB Vice President de Guindos said yesterday that the E.Z.'s inflation spike was not as transitory as first thought
Relevance	De Guindos added that the risk to the inflation outlook was tilted to the topside
Importance	4/5 (economy, monetary policy)
Analysis	Energy prices and supply chain difficulties would keep inflation elevated, although, through 2023 and 2024, inflation should drop below 2.0%

Today's Talking Point

GB Manufacturing production y/y: Dec

Expected: -0.30%

Prior: 1.30%

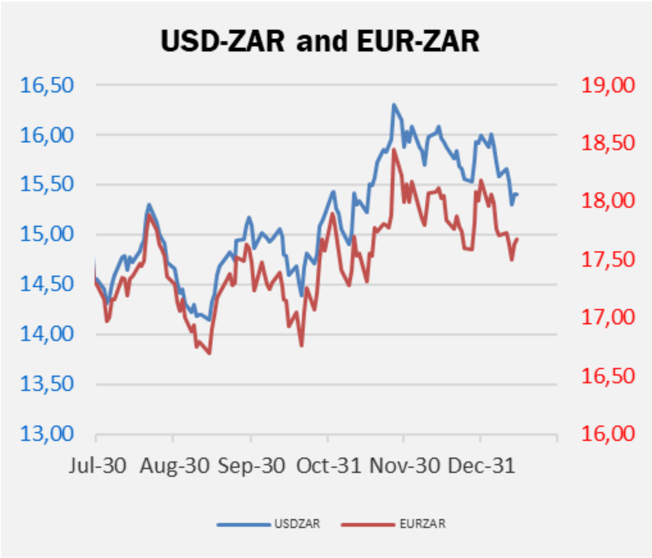
Analysis: The UK manufacturing sector may post its first y/y contraction since February 2021 for December, with consensus pencilling in a minor drop of 0.3%. Rising COVID cases, which resulted in some new restrictions, as well as supply chain issues and higher commodity prices, will all have weighed on the sector's performance at the end of the year. Some of these factors still persist, suggesting that the sector will unlikely be able to grow at levels seen earlier in 2021, even when taking base effects into account. Nevertheless, the outlook for the economy is still relatively strong and we should see the sector rebound in the near term.

Rand Update

Following a strong advance earlier in the week, the ZAR ran out of steam and gave back some of its recent gains on Thursday. The local unit depreciated 0.60% after bouncing off of its 100-session moving average, as the market booked some profits and looked to reassess its valuation after this week's move. The ZAR's recent rally away from the R16.0000/$ mark has effectively reopened the door for the bears, who had previously pushed the market to its limits.

The fact of the matter is that the US Federal Reserve is still expected to begin a new rate-hike cycle in the current quarter, with both the Fed Funds Futures and the Overnight Index Swaps markets pricing in an 85%+ probability of rates lift-off in March. While this week's events were triggered by an easing of quantitative tightening expectations and more general correction of Fed monetary tightening pricing, the prospect of a new rate-hike cycle means underlying anxiety will remain, which could keep the market on high alert in the weeks ahead.

That being said, Fedspeak this week has emphasised that it would not allow monetary tightening to derail the economy's expansion, which has brought an end to the 10-year UST yield's recent uptrend. In reality, whether the Fed can, in fact, curb inflation effectively without slowing the US economy is unlikely, but the market has nevertheless welcomed its pledge to attempt doing so and at least maintain some focus on economic growth.



Bond Update

Note that FRAs rediscovered some paying interest yesterday, implying there is some healthy demand underpinning rates, with many in the economy generally exposed to interest rate risk. The 1x4 FRA as it stands is pricing in a little over 30bp worth of rate hikes, suggesting that the 27th of January rate decision is a live one from the market's perspective. Around 180bp is priced into the 9x12, which delivers from mid-September to December, which seems excessive given the potential effect on an already-constrained economy that has more structural suppressing factors than cyclical drivers of rates. The USD-ZAR also found a base at its 100-SMA, which will have reduced the attractiveness of receiving rates at the margin.

While low inflation risk, a relatively stable ZAR, reduced levels of business investment, and negative real credit growth reduce the risk that the SARB ultimately hikes as aggressively as the Quarterly Projection Model (QPM) is pricing in, some pre-emptive tightening seems likely. The balance of risks is tilted towards a weaker ZAR if the Fed hikes, while the policy rate is very accommodative at current levels. Another 25bp rate hike would take the repo rate up to 4%, leaving SA's current real interest rates around -0.5% if the SARB's forecast for 4.5% average inflation in 2022 proves correct. At least another 100bp could be expected in this cycle, while it is worth highlighting the low prediction capacity of the QPM since its inception.

However, note that another risk to inflation has started to emerge as Eskom argues for higher electricity prices. The power utility has requested a 20.5% price hike, which makes up part of the “electricity and other fuels” portion of the housing and utilities portion of the CPI index, with electricity specifically carrying a 3.75% weight in the headline index. It follows that if granted, electricity will buoy headline CPI by 70-80bp in the year ahead. To what degree this will alter systemic inflation risk is up for debate, particularly given a low overall level of money supply growth that reduces the space for higher prices to filter into broader goods and services prices.

S Forex

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