sasfin beyond a bank

The Daily Market

16 November 2022

USD-ZAR	17,3151/17,328	**USD-JPY**	139,67/139,68
GBP-ZAR	20,5486/20,5726	**GOLD**	$1773,96
EUR-ZAR	17,9597/17,9787	**BRENT**	$93,31
GBP-USD	1,1869/1,192	**DJI**	33 592,92
EUR-USD	1,0372/1,0376	**R 186**	8,685%
AUD-USD	0,6764/0,6766	**3m JIBAR**	6,617

Events (GMT)

Time	Country	Event	Month	Fc	Prior
11:00	SA	Retail sales constant y/y	Sep	1,10%	2,00%
07:00	GB	CPI y/y	Oct	10,80%	10,10%
13:30	US	Advance retail sales m/m	Oct	0,90%	0,00%
13:30	US	Retail sales ex. auto and gas	Oct	0,20%	0,30%
14:15	US	Industrial production m/m	Oct	0,20%	0,40%

Factors on the radar

ECB guidance

What happened?	ECB member and France's central bank chief Francois Villeroy de Galhau has indicated that the ECB will need to raise rates beyond 2% but that large rate hikes will not become a habit
Relevance	Rate hikes are in the pipeline but will be more gradual than those in the US and UK and will be sensitive to growth
Importance	4/5 (economy, Monetary policy)
Analysis	The ECB has been the laggard, but it is also facing the strongest geopolitical headwinds and is at high risk of a recession that would only compound government finances if the central bank turns too aggressive in its stance

UK budget and recession probability

What happened?	The unemployment rate is rising, and job vacancies have fallen for the fifth consecutive report a row as Britain prepares for an austerity budget on Thursday
Relevance	Higher taxes and less government spending will only exacerbate the weaker growth dynamic
Importance	4/5 (politics, fiscal policy, economy)
Analysis	All this tightening of monetary and fiscal policy comes over and above the more visible impacts of Brexit that will detract from overall growth levels and raise the risk of recession starting in Q4

G20 in Bali

What happened?	The G20 enters its second day of talks, interrupted by an emergency meeting to discuss the missile landing in Poland that killed two people
Relevance	Poland has claimed a Russian-made rocket landed in its territory, sparking fears of NATO retaliation
Importance	4/5 (economy)
Analysis	The world is on high alert, and the war in Ukraine may take a far more serious turn if the missile landing in Poland is deemed a reason for NATO to arm itself and consider retaliating

Today’s Talking Point

Retail Sales y/y: Sep

Expected: 1.0%

Prior: 2.0%

Analysis: Retail sales provide valuable insight into the state of the consumer market in South Africa. The retail sector has struggled to gain traction this year, with sales growth stalling as inflation remains elevated and erodes the purchasing power of households. The SARB's prudent monetary policy in an attempt to combat inflation and constrained household budgets due to the rising cost of living also continue to weigh. As a result, we have seen monthly declines in retail sales every month since May. However, the sector could draw some support from the end-of-year discounts in the lead-up to the festive period, but sales are unlikely to be significantly higher than what they were in 2021 as rising interest rates and a bleaker outlook on the economy will continue to weigh on household disposable incomes. A weak retail sector will feed the narrative that the economy is struggling, and that the SARB may not need to hike rates as aggressively as it currently envisions.

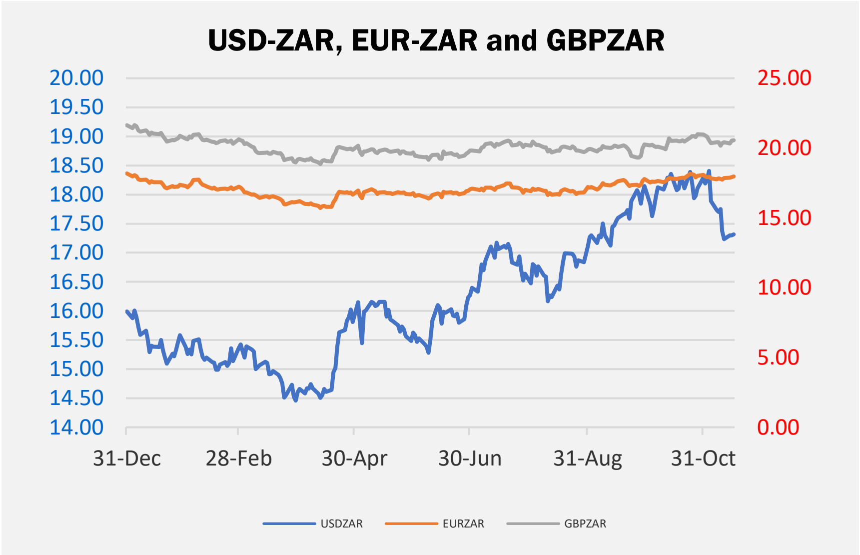
Rand Update

There just seems to be no relief from Eskom’s load shedding, with the SOE warning that load shedding will be with us for another six to twelve months. It has been one calamity after the next, and far from fixing the problems at Eskom, they appear to be getting worse. Another head of generation has resigned, and seven months into this financial year, Eskom has already exceeded its budget of R11bn for diesel expenditure, implying that it will now become less affordable to run its diesel generators. This potentially implies greater degrees of load shedding mainly due to constrained financial resources.

Municipalities owe Eskom approximately R53bn, and there is simply no way that that funding will be recovered in the near term. Worse still is that due to the state of the municipalities, the amount owed to Eskom by the municipalities is rising rapidly. Eskom’s debt pile has now risen to R400bn, and if this were an analysis of any other company, investors would be positioning for liquidation, defaults and a collapse. Only due to its strategic importance for the country and its status as an SOE does it continue to garner support.

It remains a major constraint to the economy and will heavily impact SA’s ability to grow or attract foreign capital. It is the most prominent systemic risk to SA and must command a risk adjustment in how financial markets, including the ZAR, are priced. Although much of this is known, the intensity of the problem is escalating.

Were it not for the weakness of the USD, the prospects for the ZAR might’ve looked even worse. Again it is evident that the USD’s weakness is masking some of the ills in SA and making it appear as though the market is more stable than it is. Against this backdrop, ZAR appreciation against the USD through the next 6-9 months needs to be treated with a healthy dose of scepticism.



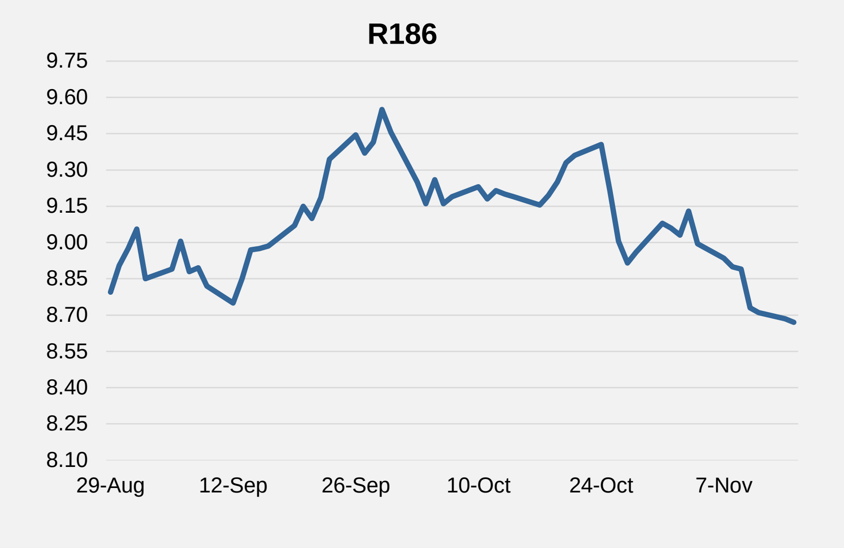
Bond Update

The big conundrum emerging for SA’s fixed-income investors is whether the derivatives market that prices interest rate expectations accurately depicts SARB rate risk. Since the ZAR’s rally towards the R17 mark, the market has been compressing the interest rate spread, suggesting that the November interest rate decision may be coming into question.

As of the close, the market was pricing in rates 48.3bp higher over the period – down quite sharply from the initial pricing of 79bp. This will be partially driven by a 3-month JIBAR rate that has risen 17bp to 6.62% from 6.45% at the end of October but will also be due to the 15bp moderation in the 1x4 FRA. It should be noted that this compares with a SARB repo rate that sits around 6.25% - suggesting that the 3-month JIBAR rate also has a rate hike or two priced into it.

Given that SARB will only feel pressed to hike in an environment of above-target inflation risk, we could see FRAs continue to compress their spread to JIBAR in the months ahead as base effects in CPI, ZAR appreciation and a possible growth slowdown in the US are priced in. However, receivers’ risk is being under-priced at the meeting that takes place in less than two weeks.

Some back-of-the-envelope calculations suggest that FRA pricing would still be vindicated in an environment where we see a 75bp rate hike and a 50bp rate hike over the 1x4’s time horizon. This suggests that there is no fat in the price for two 75bp rate hikes. Further compression in FRAs would suggest that investors are mulling the potential for a return to a 25-50bp rate hike outlook at the November and January meetings.



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