sasfin beyond a bank

The Daily Market

21 January 2022

USD-ZAR	15.2033/15.2278	**GBP-ZAR**	20.669/20.693
GBP-USD	1.3591/1.3642	**AUD-USD**	0.7188/0.7194
GOLD	$1840.6816	**DJI**	44581,00
EUR-ZAR	17.2246/17.2389	**EUR-USD**	1.1322/1.1326
USD-JPY	113.83/113.84	**R 186**	7.785%
BRENT	$86.89	**3m JIBAR**	3,892

Events (GMT)

09:00	SA	ILB auction (R1.20bn)			
O/N	JN	National CPI y/y	Dec	0,90%	0,60%
00:01	GB	GfK consumer confidence	Jan		-15,00
07:00	GB	Retail sales excluding auto fuel y/y	Dec		2,70%
15:00	EZ	Consumer confidence	Jan	-8,70	-8,30
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15:00	US	Leading Indicators	Dec	0,80%	1,10%

Factors on the radar

BoE poll

What happened?	A poll by Reuters shows that investors anticipate the Bank to lift rates to 0.50% on the 3rd Feb, with 29 out of 45 voting for a hike while 16 argued for unchanged
Relevance	The consensus also anticipates that rates will rise to 0.75% by the end of the year, implying two hikes
Importance	3/5 (monetary policy)
Analysis	GDP growth will be buoyant in 2022 at 4.5% and dip to 2.2% in 2023, while inflation will average 5.2% in Q1 and 5.5% in Q2 as it peaks. This will ensure a more hawkish BoE

Chinese Evergrande

What happened?	Evergrande indicated this morning that it would employ the services of more financial and legal advisors to help it restructure and deal with the demands of creditors
Relevance	All signs point to the company managing a debt consolidation process and engineering a softer landing
Importance	4/5 (economy, markets)
Analysis	The sooner the restructure is complete, and this situation handled, the better for the industry and, more broadly, the Chinese economy. It also offers a warning against excessive leverage in a system

Russia – Ukraine

What happened?	The West has warned Russia against any Ukrainian incursion or it will face grave consequences. The West has warned that it will not hesitate to take action
Relevance	Although this could lead to major conflict in Europe, Russia stands to gain little from doing so
Importance	4/5 (geopolitics)

Analysis Instead, this is more likely a political effort on the part of Russia to push back against the rising Nato presence on its borders and to use its position to negotiate some settlement

Today's Talking Point

Oil Update:

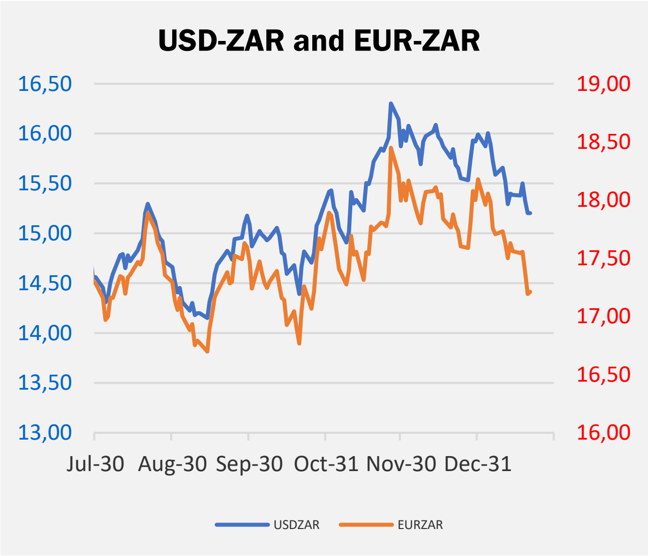
Analysis: Oil markets have gapped lower overnight after reaching seven-year highs. Futures in New York have dropped more than 3% at the time of writing while the Brent front-month contract fell from highs of over $89.50 per barrel to currently trade near $86.60. This was driven by a broad sell-off in stocks and commodities, while the first gain in US stockpiles in eight weeks added to the bearish sentiment. Given the recent rally, however, it isn't surprising to see some form of a pullback in the market, with fundamentals unchanged and still looking very bullish for oil over the coming weeks and months. The IEA noted yesterday that demand has been more robust than previously estimated, which has kept the market structurally tight. This has increased forecasts for oil prices for the year ahead across most major institutions, with Morgan Stanly now adding to the chorus of those predicting $100 oil. Such price levels may be possible temporarily, but they will not be sustained for a significant period of time given that there is room for greater output from US shale producers, while demand levels are not far from their peaks in our view. Therefore, we can expect a near-term jump following this recent correction and bout of profit-taking.

Rand Update

Overall, it has been a strong week for the ZAR. While it started the week on the defensive, it has turned around and gained appreciative traction through Wednesday and Thursday's trade. The catalyst was the domestic inflation data that strengthened the argument for monetary tightening, and while inflation might be peaking, it does appear that containing inflation will require more effort, and inflation expectations may prove to be more buoyant than initially anticipated.

As we wind down the week, there is not much in the way of data to focus on other than the US leading indicators data, which is not traditionally market moving. Domestically, the focus will be shifting strongly towards the SARB's first decision of the year, where another 25bp rate hike is priced in. Although the inflation data came in higher than anticipated, it is unlikely that the SARB will move more aggressively than that, given the weak state of the underlying economy and the persistently weak credit cycle, which will help contain inflation going forward.

Lest we forget, this latest inflation episode has not resulted in the inflation rate punching through the upper limit of the 3-6% inflation target range. There is no reason to panic as the rate hike cycle is underway. Internationally, there are also signs that the inflation spike is near or at its peak and that it will also moderate through the course of 2022. The conclusion is that the SARB will continue to shift incrementally and take on board the latest data as it arrives to gauge whether it has done enough to contain inflation or whether it needs to do more.



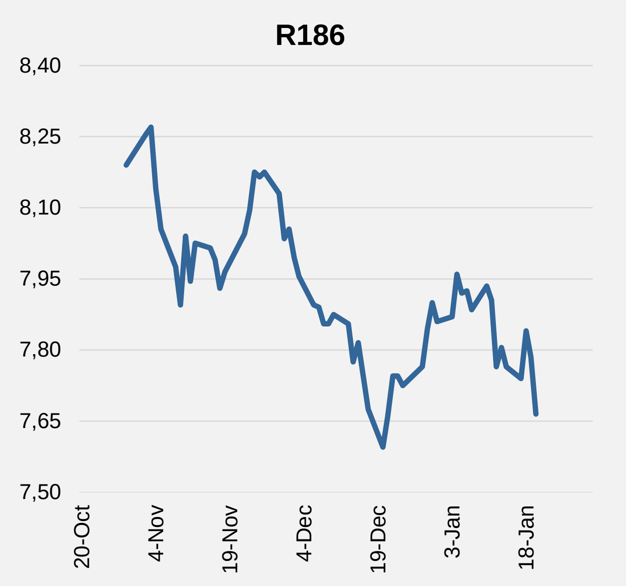
Bond Update

The buoyancy of oil prices remains a crucial inflation risk that the SARB will need to process at its meeting next week, with prices at current levels of $86.77/barrel well above the bank's November assumptions for oil to average $73/barrel in 2022. When priced in ZAR, the oil price is around R1,377/barrel, up in y/y terms by 60%, a y/y rate similar to December, although the nominal oil price was a little lower at an average rate of R1188/barrel. This suggests that further fuel price hikes could be expected.

Considering that the ZAR price of oil determines around 50% of the local fuel price (the rest is tax and handling fees), inflation risk extends from higher oil import prices. Note that fuel prices are around 4.6% of the CPI basket, while a one-month price adjustment period applies with the prior month's over or under-recovery in input prices used to change fuel price. It follows that January and February, at the very least, will see relatively high fuel prices. This will feed into the CPI metric at a 4.6% weighting, suggesting that around 140bp worth of CPI inflation in January and February will be fuel-driven.

While still high and likely to eat into the purchasing power of the ZAR, it is also worth noting that this would represent a reduced rate of inflation relative to the December CPI print, which experienced over 200bp worth of pass-through to the CPI basket. A look more closely at the oil market suggests that this upside pressure is not expected to last, with the prices of oil for delivery 1-year out holding a great discount on spot pricing for immediate delivery of around 9% through January so far. In traditional market theory, this suggests that the market is currently in a supply squeeze scenario that is not all that likely to last.

Data released in the US session showed an environment of rising US oil inventories, which has tarnished the bull rally in oil. However, market participants remain concerned about the potential for upside pressure on oil prices to continue. Morgan Stanley has recently released research arguing that $100/barrel oil could be seen in the months ahead as supplies struggle to meet demand.



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