sasfin beyond a bank

The Daily Market

02 December 2021

USD-ZAR	16.0061/16.0157	**GBP-ZAR**	21.2629/21.2869
GBP-USD	1.3286/1.3337	**AUD-USD**	0.7098/0.71
GOLD	$1775.57	**DJI**	44531,00
EUR-ZAR	18.1123/18.1251	**EUR-USD**	1.1315/1.1318
USD-JPY	113.07/113.08	**R 186**	8.055%
BRENT	$69.48	**3m JIBAR**	3,867

Events (GMT)

10:00	EZ	PPI y/y	Oct		16,00%
10:00	EZ	Unemployment rate	Oct	7,40%	7,40%
13:30	US	Initial jobless claims	Nov 27		199k
13:30	US	Fed's Bostic Discusses the High Cost of Housing			
16:00	US	Fed's Quarles Shares His Departing Thoughts			
16:30	US	Fed's Bostic Takes Part in a Reuters Event			

Factors on the radar

Omicron – latest

What happened?	Moderna has indicated that it could have a booster shot for Omicron ready for distribution by March, with other vaccine makers likely to offer similar
Relevance	Much will depend on the transmissibility of the virus and the severity of the illness it elicits
Importance	5/5 (market)
Analysis	A clear strategy will only be possible once a full analysis of the Omicron variant is released and its interaction with the vaccines is better understood. Until then, this is all conjecture

OPEC

What happened?	Today OPEC will decide on its production and output policy. Oil prices are well off their recent highs, Omicron has emerged, and DM economies have released some of their strategic reserves
Relevance	The need for OPEC to raise production has dropped. OPEC may well leave current output unchanged to stabilise the price
Importance	4/5 (economy, market)
Analysis	Wed's meeting ended without any recommendation on output. OPEC has indicated that there will be no knee-jerk reaction to the Omicron variant, hinting that production levels may remain unchanged

US debt ceiling

What happened?	Top Democrats and Republicans scrambled yesterday to secure enough support to pass a bill that would avert a government shutdown due to those opposed to Biden's vaccine mandates
Relevance	It is important for global markets that they succeed to remove one possible source of market volatility through Dec
Importance	4/5 (fiscal policy, economy, markets)

Analysis

The deadline is Friday. Complicating matters has been a group of conservative Senate Republicans that will not fund a government that forces vaccine mandates on its population on principle. This will go down to the wire

Today's Talking Point

Oil Update

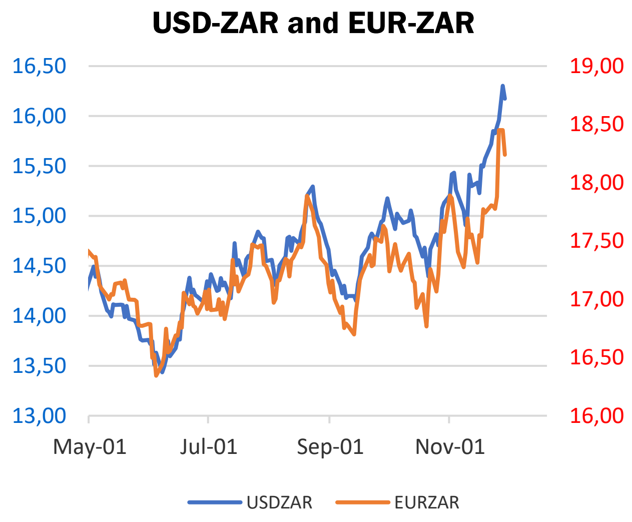
Analysis: Oil prices remain near their three-month lows this morning as yesterday's initial rebound faltered, leading to a further drop which has seen Brent fall over 20% from its October highs. The benchmark front-month contract is currently trading just below the $70 per barrel mark, with the market waiting to see what happens with today's OPEC+ meeting. The start of the meeting yesterday saw the cartel once again confirm that it estimates that the market will enter a surplus next year, which could average around 3.3mn barrels a day through Q1. The uncertainty surrounding the new COVID variant and its impact on travel was also highlighted, suggesting that the balance of risks remains skewed towards a pause on the supply increases being announced. However, this outcome is most likely priced in already, which suggests that, barring some kneejerk reactions, the announcement may not help drive prices all that much higher. The weaker outlook for oil demand has seen some notable changes along Brent's price structure, with the prompto around 30 cents in backwardation, well below the $1.30 seen a week ago. The spread between the January 2022 and December 2022 contracts, meanwhile, has also narrowed to levels last seen in August, highlighting weakening fundamentals across the foreseeable time period.

Rand Update

The ZAR's recovery was questionable. It happened against the backdrop of disappointing domestic data, highlighting a rising unemployment rate, a narrowing trade surplus, a weak credit cycle, and government finances deteriorating again. Add to that the correction weaker in commodity prices, and there really were no good reasons for the ZAR to stage a recovery. At best, one could argue that the ZAR's recovery was merely a market positioning correction that will soon pass once profit-taking and re-positioning have taken place.

This morning, the ZAR finds itself back above 16.00/dlr after testing the mid15.70s yesterday. As SA enters its fourth wave heading into the December festive season and infections rise rapidly, with the Omicron variant becoming dominant, investors will likely err on the side of caution and refrain from selling the USD just yet. On the contrary, many might prefer to purchase USDs even at these ZAR undervalued levels.

The higher prevalence of the Omicron variant in SA and its rapid spread mean that travel bans will likely persist for a while to come. The first Omicron case has been identified, and it now appears that it is far more prevalent across the globe than first thought. As we await the scientists' studies to know whether this is a more or less aggressive variant, concerns will drive market sentiment and enhance global levels of volatility. The ZAR's behaviour is a case in point. The danger is that we are heading into the end of year festive season domestically, where trading volumes are traditionally much thinner and where volatility can be enhanced.



Bond Update

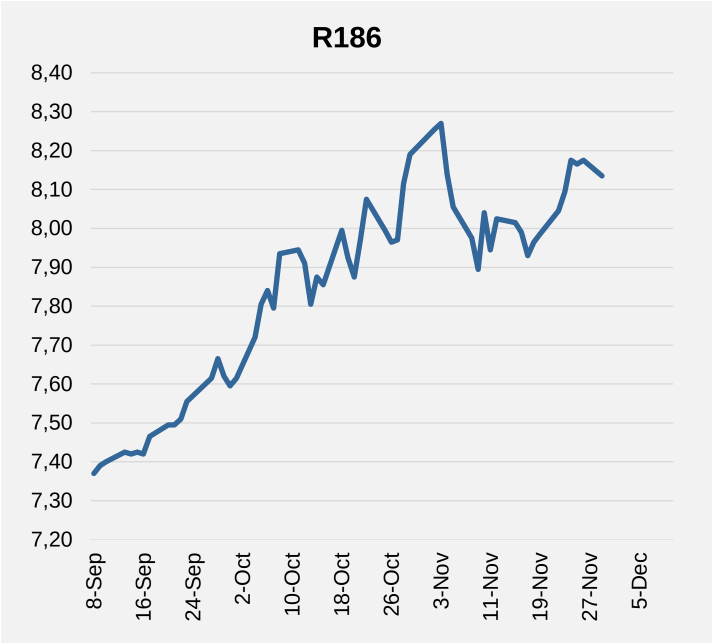
An outlook for a weak domestic growth cycle remains the core prognosis heading into the festive season and 2022. Various familiar drivers suggest that investors will be looking at a below-trend growth outlook for some time. These include the potential continuation of Eskom load-shedding, the unintended consequences of lockdown policies, constrained employment and income levels, and the risk of further socio-political disorder. Fears regarding the omicron COVID variant will add to the downside risks given that the tourism sector is likely to remain constrained, while households are also a little less likely to spend. The risk of a double-dip recession remains an emerging theme heading into 2022 against this backdrop. However, with many parts of the economy at highly depressed levels already, a deeper catalyst may be needed.

The government remains ill-equipped to help, given its unsustainable debt levels after almost a decade of aggressive deficit spending. At the same time, many of its interventions, such as the implementation of tight labour law and lessening education standards, have led to structural problems well represented in a young population yet shrinking tax and skills base.

This leaves the economy's productive base fragile, with FDI and below-par business investment levels still ultimately suggesting that many remain hesitant on putting further skin in the game. Record high levels of youth unemployment suggest that political disorder could remain a feature for decades to come.

This raises some questions over SARB policy, namely whether the SARB will be able to tighten rates at each meeting over the next two years, which would represent around 300bp worth of tightening. This would lump a significant increase in interest costs to the indebted, including the government, and decrease new loan affordability, particularly in the housing sector. The knock-on effects on the property market will likely remain damaging. Increasing the prime rate from 7.25% to 10.25% would result in a more than 20% reduction in affordability on a 20-year mortgage. Weak money supply and private sector credit growth also suggest that inflation pressures will not have much in the way of room to take hold, with demand-side inflation generally the problem that the SARB's monetary policy is intended to solve.

It is also worth mentioning the downside pressure on oil prices, which feeds into the assessment that much of SA's inflation risk at present could have moderated by the end of Q1. If oil and the ZAR hold at current levels, by the end of Q1 2022, oil price inflation will have almost entirely left the CPI index. The net addition to headline inflation will have reduced from over 200bp to a mere 30bp. With core CPI close to the lower end of the SARB target band, this suggests that inflation pressure could be sub-4% before H1 2022 is over.



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