

The Daily Market

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27 May 2021

USD-ZAR	13.762/13.7749	GBP-ZAR	19.424/19.448
GBP-USD	1.4114/1.4165	AUD-USD	0.774/0.7742
GOLD	\$1896.61	DJI	34323,05
EUR-ZAR	16.7839/16.7961	EUR-USD	1.2192/1.2196
USD-JPY	109.05/109.06	R 186	7.275%
BRENT	\$68.36	3m JIBAR	3,683

EVENTS

09:30	SA	PPI y/y	Apr	7,10%	5,20%
06:00	GE	GfK consumer confidence	Jun	-5,50	-8,80
12:30	US	Durable goods orders m/m	Apr P	0,80%	0,80%
12:30	US	GDP q/q annualised	1Q S	6,40%	6,40%
12:30	US	Personal consumption	1Q S		10,70%
12:30	US	Initial jobless claims	May 22		444k

Chinese industrial profits

- What happened? > Industrial profits slowed in April amid high commodity prices. Growth in profits fell to 57% y/y in Apr down from 92.3% in March
- Relevance > Low base factors of the Jan-April profits skew the result. Growth to fall
- Importance > 3/5 (economy)
- Analysis > Although this paints a picture of a strong recovery, the growth rate will moderate in the months ahead as the low base factors unwind.

UK QE

- What happened? > PM Johnson's former top adviser Cummings admitted that he was concerned that bond market investors would not tolerate the sharp rise in debt issuance at the start of the pandemic
- Relevance > Offers clear perspective on why the BoE was drafted in to play such an important role and stabilise markets
- Importance > 2/5 (economy, market)
- Analysis > That is not just a UK fear; it will have dominated most markets around the world, which would also explain the sheer scale of the quantitative easing efforts of the central banks as they sought to restore calm and order

Fedspeak

- What happened? > The Fed's head of supervision Quarles said yesterday he did not expect a 1970s breakout of inflation but acknowledged that risks to inflation were building
- Relevance > San Fran President Daly quickly added that nothing would be done now
- Importance > 3/5 (economy, monetary policy)
- Analysis > However, he was clear that he would be in no rush and did not wish to overstate his concern. Merely that he felt it appropriate to start thinking of and talking about tapering bond purchases

TODAY'S TALKING POINT

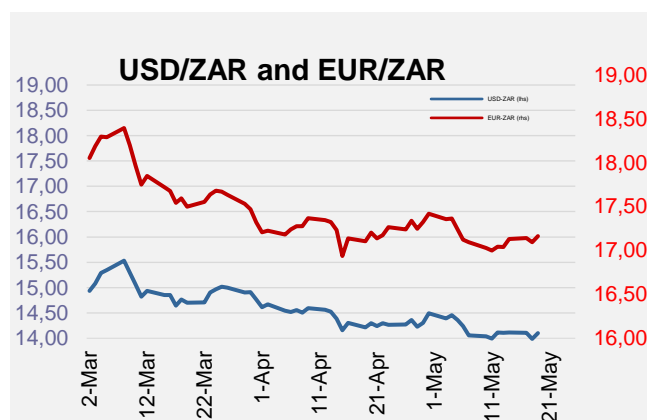
PPI y/y: Apr
Expected: 6.9%
Prior: 5.2%

Analysis: Factory price growth in South Africa has accelerated every month since reaching lows in May last year, and this is expected to have continued to April. Producer price inflation came in at 5.2% y/y in March, the fastest growth pace in more than a year as a result of increasing global commodity prices. Analysts surveyed by Bloomberg are pencilling in for producer price growth to surge even higher in April. Supply-side constraints due to the adverse impact of the COVID-19 pandemics and persistent rising commodity prices are likely to be the key drivers. Base effects will also play a major role here, given how low PPI was through Q2 of 2020. High supply-side inflation, however, may not filter through to the consumer side given SA's current demand dynamics, suggesting it will place suppliers under even more financial pressure.

RAND UPDATE

The ZAR extended its current winning streak against the USD for the fifth day yesterday. After hovering near 22-month lows through most of the day, the ZAR bulls found enough impetus to break through a July 2019 high around 13.8100/\$. While domestic developments this week have offered the local unit a tailwind, the ZAR has made steady progress since early March, where it was trading near the top of its wide 14.5000-15.5000 Q1 range at the time. The local currency's outperformance amongst other EM currencies has been notable due to the combination of a commodity-lifted domestic trade balance and overwhelming bias against the USD. As for the US dollar, the greenback has remained subdued this week by continued dovish Fed speak, and the market seems to be buying into the central bank's narrative that the coming inflationary pressure will be transitory. US Treasury yields have meanwhile eased from March highs and, as such, the dollar which received support earlier this year on higher Treasury yields has steadily declined on a trade-weighted basis over the past two months.

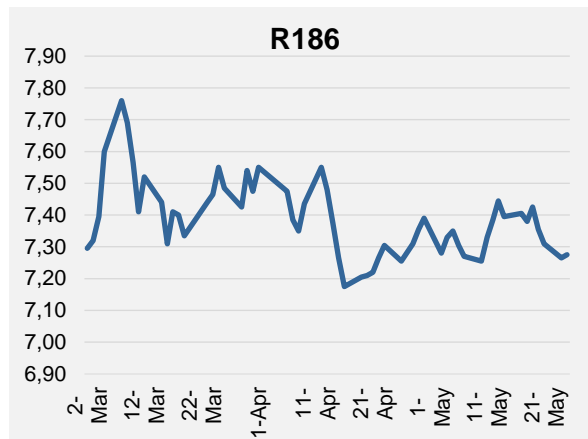
While the ZAR may continue to gain in the near term, the timeframe for ZAR strength will begin to disappear looking further out. Idiosyncratic factors will likely start to weigh on domestic assets once again after stimulus-driven flows into local markets begin to slow and as domestic imports improve and lessen the trade surplus. Further down the line, the ZAR does remain prone to correction once the stimulus taps in the developed world are closed and if the domestic economic recovery has not kept up the pace for the SARB to hike rates in response.



PPI data will hold some interest today for those concerned about inflation risk. Factory price growth in South Africa has accelerated every month since reaching lows in May last year, and this is expected to have continued in April. Producer price inflation came in at 5.2% y/y in March, the fastest growth rate in more than a year because of increasing global commodity prices. Analysts surveyed by Bloomberg are pencilling in for producer price growth to surge even higher in April.

SAGBs are clearly pricing in a lower inflation outlook on the back of the downside pressure on spot USD-ZAR, with the entire curve shifting lower in response. The longest-dated R2048 is notably lower at 10.56%, which marks a near 90bp gain from March peaks at 11.42%. The 20-year breakeven rate (expected inflation risk in the bond market) as calculated by Bloomberg has also compressed. At levels of 6.55%, it has trended lower from March peaks of 7.24%. However, the 5-year breakeven rate has stayed relatively buoyed at a level of 4.6%. The latter suggests that the current outlook for inflation to move back towards the midpoint of the SARB's target band remains in place, despite the ZAR's continued rally. This could change if PPI and other major inflation data surprise to the downside in the coming months.

The other major event of the day will be the SARB financial stability review, which takes place at 4:30 pm. The SARB will deliver a macroprudential analysis of the SA economy. We expect that the message delivered in this forum is unlikely to shift the existing narrative so soon after an MPC.



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