sasfin beyond a bank

The Daily Market

23 May 2023

USD-ZAR	19.2419/19.2483	**USD-JPY**	138.5/138.51
GBP-ZAR	23.9039/23.9279	**GOLD**	$1962.29
EUR-ZAR	20.7922/20.8017	**BRENT**	$76.28
GBP-USD	1.2426/1.248	**DJI**	33 286,58
EUR-USD	1.0804/1.0808	**R 186**	9.965%
AUD-USD	0.6655/0.6656	**3m JIBAR**	8.108

Events (GMT)

07:00	SA	Leading Indicator	Mar		120.1
09:00	SA	Vanilla auction (R3.9bn R2035, R2037 and R2040)			
07:30	GE	S&P Global/BME manufacturing PMI	May P	45	44.5
07:30	GE	S&P Global services PMI	May P	55	56
08:00	EZ	S&P Global composite PMI	May P	53.5	54.1
08:00	EZ	S&P Global/BME manufacturing PMI	May P	45.8	45.8
08:00	EZ	S&P Global services PMI	May P	55.5	56.2
08:00	EC	ECB's Muller Speaks			

Factors on the radar

Global PMIs

What happened?	PMI data scheduled for release out of the world's major economies today will provide a fresh read on global growth momentum during the second quarter
Relevance	Amid warnings of a broad-based global downturn, the PMIs will provide some jurisdictional nuance
Importance	4/5 (economy)
Analysis	Survey data are reflecting still-positive, but deteriorating economic sentiment, which will likely continue to build in the coming months as the full extent of last year's aggressive rate-hike cycle filters through into the real economy

UK inflation

What happened?	April CPI data scheduled for publication out of the UK this week will likely reflect the first concrete signs of easing price pressures in the UK as base effects come into play
Relevance	Disinflation may limit the scope for more BoE rate hikes, with OIS markets currently positioned for another 50bps in total
Importance	4/5 (economy, monetary policy)
Analysis	CPI growth has hovered above 10% for the most part since July last year, but base effects will likely drive a notable drop in the headline inflation rate as a near 50% rise in household energy bills last year falls out of the annual comparison

Fed meeting minutes

What happened?	The minutes of the Fed's May policy meeting will shed light on just how united the FOMC is around the idea that the current rate constitutes the peak

Relevance	With uncertainty around the Fed's policy outlook still prevalent, the minutes will hold insights into the bank's thinking
Importance	5/5 (monetary policy)
Analysis	Many participants likely supported the decision to signal an impending policy pause amid concerns over tightening credit conditions, but some policymakers may still prefer additional rate hikes amid slow progress in curbing inflation

Today's Talking Point

The composite PMI for May is expected to have remained in expansion territory, supported in the main by the services sector. Analysis of the different PMI data reflect the US economy's mixed performance in recent months, with the manufacturing sector clearly lagging services. The services PMI broke into expansionary territory (above 50.0) in February, with the manufacturing PMI only following suit in April. Demand in the services sector remains relatively robust, and has, by and large, driven inflationary pressures in the US recently. The manufacturing sector, meanwhile, only gained some momentum in Q2 as improvements in supply chains helped reduce order backlogs. While the PMIs suggest business conditions in the US are improving, the May print might reflect recent concerns over the debt ceiling impasse that raised the risk of a recession later this year. More broadly, dark clouds also continue to build on the horizon as the full extent of the US Federal Reserve's monetary tightening cycle filters through into the real economy.

Rand Update

The ZAR has started the new week off on a much more positive footing than it ended the last. It staged a mini-recovery against all of the majors as the market expressed relief at S&P Global's decision to defer its ratings review and not downgrade SA's debt outlook, while positioning for an aggressive SARB response to recent ZAR weakness also provided support. The market has priced in a minimum of a 50bp rate hike on Thursday, and is increasingly leaning towards 75bps. The risk is thus that the SARB disappoints with a smaller or insufficiently-hawkish rate hike, which would pile the pressure back onto the ZAR into the weekend.

In the meantime, investors will have leading indicator stats for March to navigate today. The leading indicator is a helpful gauge of future economic conditions in the country. Since around mid-2022, the leading indicator has been pointing toward a downturn in economic growth. Unfortunately, there are few reasons to expect any short-term improvement in the leading indicator. By contrast, reasons for further weakness are clear: slowing global growth and long-term structural weaknesses form the backdrop to a domestic cost-of-living crisis (which has stifled demand), a weak labour market and high input costs due to load-shedding, a weaker rand and other public infrastructure failings. As such, the SARB's leading indicator may fall further in March, highlighting the reality that South Africa remains in an economic downturn and reinforcing the expectation that South African growth prospects will worsen through 2023.

Externally, the spotlight remains on US debt ceiling negotiations. President Biden and House Speaker McCarthy could not reach an agreement on how to raise the US government's $31.4 trillion debt ceiling yesterday, but ended talks with optimism as they vowed to keep negotiating. Failure to reach a deal in the coming days would lead to significant recessionary pressure on the US economy, although this is an extremely unlikely scenario. Both sides have stressed the need to avoid a debt default, suggesting they will reach a deal before the end-of-May-deadline and avert an unprecedented crisis. However, negotiations may go down to the wire, which will keep markets cautious through the coming days.

The ZAR outperformed its emerging-market peers on Monday, recovering more than 1% of its value against the USD throughout the session. It also performed well against the EUR and GBP, gaining 1% and 1.25%, respectively. Still, volatility implied through options pricing suggests that the market remains extremely cautious towards the ZAR, even though it has shown a reluctance to depreciate much further from current levels. Sentiment towards SA has not stabilised completely and may well require an outsized 50bp or 75bp rate hike from the SARB on Thursday to accommodate investors for the risk they are taking by allocating capital to SA. Accordingly, the near-term risk to the ZAR's outlook is that the SARB disappoints, which would lead to a fresh selloff into the weekend.

Bond Update

Bonds still on the defensive ahead of SARB as rates markets rise and UST yields nudge higher

Bonds/Yield Curve: Bonds retain a bearish undertone, even though the ZAR made a recovery. They are torn between the performance of the ZAR which has improved, and the rising rate hike expectations reflected in the rates market. Furthermore, US Treasury yields are also trending firmly higher as investors wait for some guidance on the US debt-ceiling negotiations, and that too will weigh on emerging market bond yields that will remain elevated to help compensate for the risk inherent in a global slowdown or calamitous event.

Today will see the National Treasury auction off the R2035, the R2037 and the R2040. Officials have guarded against issuing at the ultra-long end of the curve, although in the 2040, there is some duration that will test the appetite of investors for longer-term bonds. However, the authorities are no longer behaving like they are in crisis mode and only issuing at the short end. Demand at today's auction will offer further insight into how foreigners perceive SA bonds. Some foreign banks have started talking about the value found in SA's vanilla bond yields, which is a departure from the constant selling seen so far this year.

No material shift in the shape of the yield curve so far, although the flattening that was evident in the yield curve now appears to have dissipated to some degree ahead of the SARB's decision and guidance on Thursday. At some point, we would expect the fixed-income market to behave in a more consolidative manner, and if the ZAR can hold on to its recent gains or even post fresh gains, then that might characterise the bond market over the next few sessions.

FRAs: The relentless paying interest has not abated. At the very short end of the curve, investors are convinced that the SARB will need to hike rates by at least 50bp and may even hike by 75bp. Across the curve, the market is now convinced that the SARB will hike by a further 150bp from current levels, even though that will harm GDP growth, and the inflation episode is not the result of domestic demand. However, their commitment to price stability and a collapsing ZAR is in nobody's interests. On the contrary, it simply enhances inflation and places the SARB in an awkward position of hiking more aggressively to compensate investors for risk. The curve has also steepened back out at it is notable that the 9X12 is trading at a spread of 62bp above the 1X4 and that the 12X15 is

Global rates update: US Treasury yields were higher yesterday as the market digested some positive news regarding the US fiscal stand-off, while two hawkish Fed speakers provided an additional boost to front-end yields. The 2yr tenor closed yesterday at 4.32% after Fed member Bullard said that he backed two more rate hikes from the FOMC this year in order to contain inflation pressures. These comments were followed by slightly less hawkish comments from Kashkari, who suggested that if the Fed does pause its rate hikes at the next meeting, it should signal that the tightening is not yet over. Both their comments suggest that even if the Fed does pause at the next meeting, there could still be room for more rate hikes down the line. As such, traders upped their expected peak rate for the Fed to 5.173% at the July meeting, pricing in a roughly 35% chance of a 25bp hike by then. However, we expect that the UST market, and in turn, expectations for further Fed hikes, will be volatile over the near term until the US can resolve its debt-ceiling crisis.

Core European bond markets tracked the weakness in Treasuries, with UK gilts underperforming on the session. Two-year gilt yields were up more than 10bp on the day as traders upped their bets of peak BoE rate to 5.02%, up 6bp on the day. There was no major catalyst on the day for the move, but UK CPI data out tomorrow is expected to show that despite cooling headline inflation, core inflation remains elevated and should keep the BoE hawkish over the coming months.

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