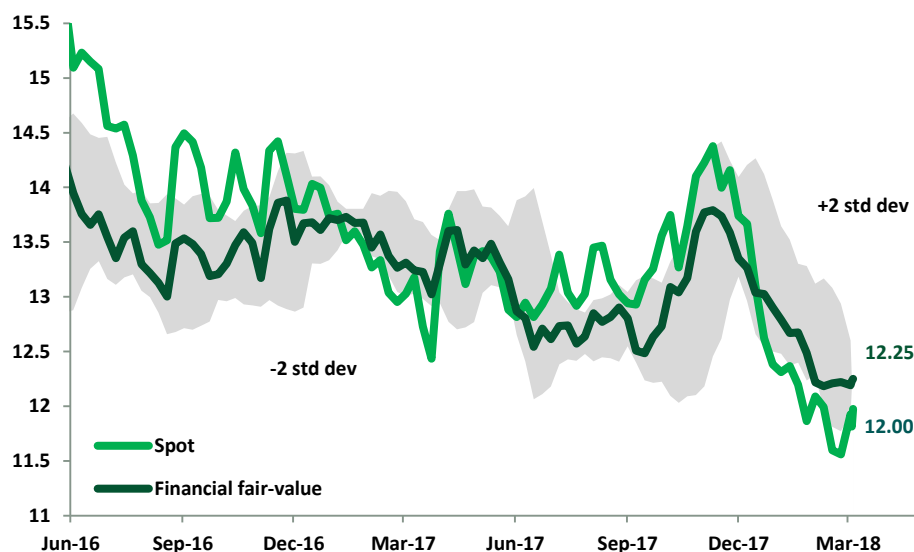


## MOODY'S SHOULD DOMINATE THIS WEEK DESPITE RISING EXTERNAL PRESSURES

- Global markets remain cautious amid uncertainties regarding US trade policies and also around how US monetary policy may play out over the next 12 months. The Fed is expected to hike the Fed funds rate by 25bps this week, although this is fully priced in.
- **Locally, the positive momentum seen in local markets, especially in the rand since late December 2017, is starting to reflect in the underlying economic data.** Specifically, the BER Business Confidence rose to 45 from 34, moving closer to the neutral 50-point mark. This is still well below the pre-2009 highs, but nevertheless this is positive for the private sector investment outlook (which tends to lag confidence by about two quarters). The robustness that we are seeing in the underlying data is also spilling over into substantially lower implied volatility in the FX market.
- **Local markets, however, could be dominated by Moody's rating review** of South Africa, due on Friday 23 March 2018. We expect Moody's to keep South Africa's local and foreign rating at Baa3 (negative outlook), ie the country would still be considered 'investment grade'. While the bond market seems to reflect this outcome already, the currency may well find some short-term support on the back of this news as short rand-hedge positions unwind.
- **Furthermore**, we expect the headline CPI print for February 2018 (due for release on 20 March 2018) to come in at 4.1% yoy, down from 4.4% yoy in January. Although 4.1% yoy is likely to be the low print for the year, largely due to the VAT increase starting in April, inflationary pressures remain benign and local markets should read a lower CPI print as a positive development (see [Tax hikes and a read-through to monetary policy](#) of 2 March 2018).
- **As a result, and as pointed out last week**, we would not be surprised to see the rand rally closer to **R11.75 on the back of a ratings reprieve.**
- **Our six-month and 12-month target range for the USDZAR remains unchanged at R12.40 and R13.00 respectively.** We remain largely in line with the Bloomberg consensus view on a six-month view, but we are more bearish on the rand on a 12-month view. **Short-term, keep an eye on support at R11.70, and resistance at R12.00** (see our latest technical strategy note [Strategy Note: FX and Bonds](#) of 13 March 2018 for a more detailed technical view on the currency).

**Figure 1: ZAR is expensive on our short-term valuation metrics**



Source: Bloomberg, Nedbank CIB Research. Estimated using OLS regression method. Variable include DXY, Equity prices, US10yr, CDS spread, local-to-US 2y swap spread and oil price

## GROWTH UNDERPINS EM CURRENCIES, BUT MOMENTUM MAY SLOW

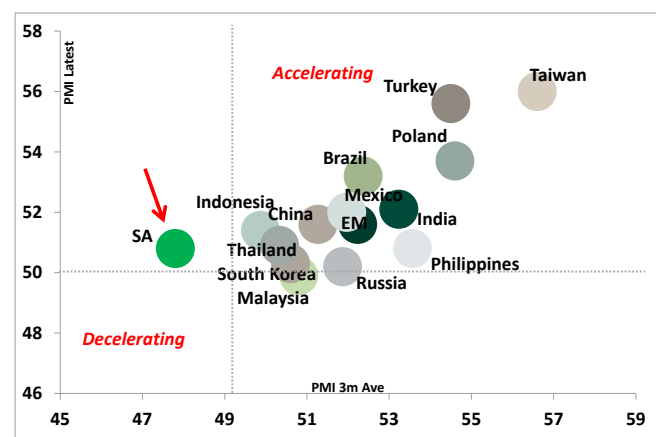
### Emerging markets growth strong, but SA lags its peers

Growth in Emerging Markets has been on the upswing, reflected by a marked improvement in PMI data (which has been signalling the fastest rate of expansion in five years). Almost all Emerging Market nations registered an increase in PMI, the exceptions being contractions in Russia and India. The biggest improvement was seen in Brazil, where the PMI jumped to a five-year high, indicating that businesses and consumers are recovering from the lingering effects of the recession.

Closer to home, South Africa's PMI rose slightly above expansionary territory, coming in at 50.8 in February, compared to 49.9 in the previous month. However, that said, South Africa still lags its EM peers (**Chart 1**). Overall, Emerging Markets have been on an upward trajectory, supported by a weaker dollar which has had a positive impact through a variety of channels (examples being capital flows, exports, and accommodative monetary policy conditions).

Our less-bullish stance on the rand is not because we are concerned about the outlook for the local economy. In fact we have revised our GDP forecasts higher, to 1.6% for 2018 (previously 1.4%) and 1.8% for 2019 (previously 1.7%). This revision comes amid the improvement in political sentiment due to swift action from the nation's president Cyril Ramaphosa, and other developments such as lower inflation and stabilizing fiscals which should provide a tailwind for domestic growth.

Chart 1: EM growth grid



Source: BBG, Nedbank CIB markets Research

Chart 2: Momentum of EM FX gains slowing



Source: BBG, Nedbank CIB Markets Research

### Horizon presented by headwinds for risk assets like the rand

Over the coming 12 months, a number of risks (mainly from abroad) will probably weigh on EM currency performance, including the rand and other high-beta or market-sensitive Emerging Market currencies like the Brazilian real, Turkish lira and Mexican peso. However, we are cognisant that each country's vulnerability to the external environment is different and that the exposure to these vulnerabilities is differently priced (see [SA and EM peers: External vulnerabilities](#) of 8 March 2018).

Broadly speaking though, momentum in Emerging Markets' performance as a whole is facing headwinds. We believe that the three main risks for Emerging Markets (which we explain in detail in our [2018 Strategic Outlook](#) of 4 December 2017) are: i) A cyclical slowdown in China; ii) Rising global interest rates; iii) Global trade frictions.

The performance of a basket of Emerging Market currencies against the dollar has risen by 5% since the start of 2018 (+15% in 2017) driven by gains in the Mexican peso, Columbian peso and the South African rand. Gains in Emerging Market currencies have largely been driven by a weaker dollar, as well as the improvement in global trade and global growth. Closer examination of the performance of Emerging Market currencies shows that momentum has begun to slowdown (**Chart 2**).

Over the coming 12 months we expect Emerging Market currencies to move closer to the 1-year moving average, which would imply the rand trading closer to R12.80-R13.00 against the dollar by year-end.

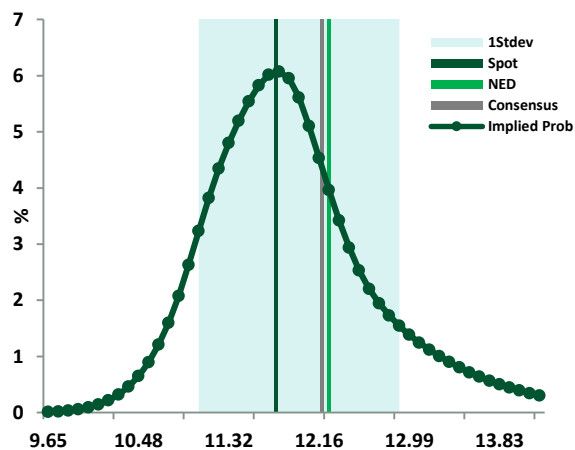
## FX VOL MOVES EVEN LOWER AS SOUTH AFRICA'S OPTIMISM SETTLES

We continue to observe low volatility in FX markets, especially in the rand, with ATM implied volatility reaching multi-month lows across all maturities (Chart 5 and Chart 6). The low implied volatility indicates that the market is quite comfortable with current trading ranges. The low implied volatility, also, appears quite attractive from a hedging perspective in our opinion.

The forecast from the option market for the USDZAR remains largely unchanged from a week ago:

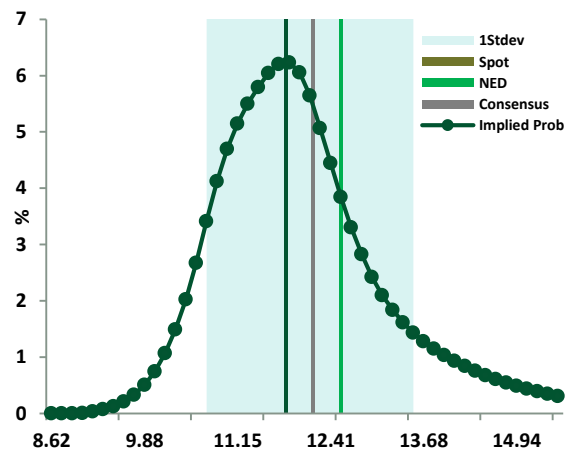
- On a three-month view, the option market suggests a 1 standard deviation trading range for the USDZAR, of between 11.00 and 12.80 (Chart 3).
- On a six-month view, the probability is skewed towards weakness, as one would expect, with the implied probability distribution suggesting a 1 standard deviation range of between 10.70 and 13.50 (Chart 4).

Chart 3: 3m implied probability distribution vs forecast



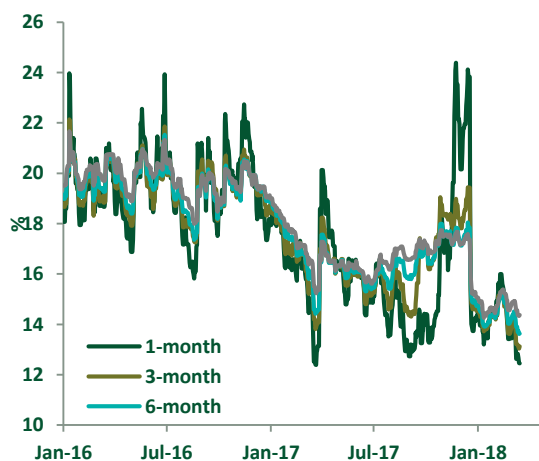
Source: Bloomberg

Chart 4: 6m implied probability distribution vs forecast



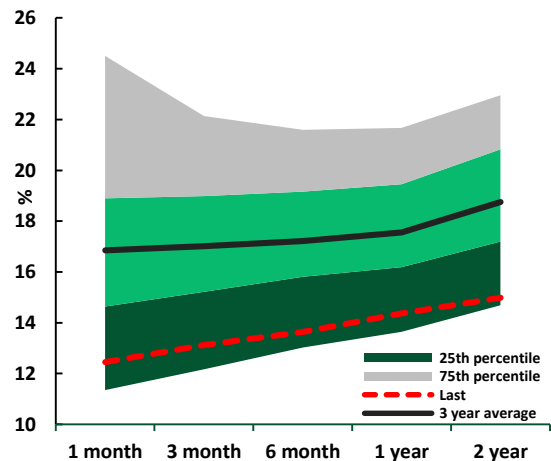
Source: Bloomberg

Chart 5: USDZAR implied volatility



Source: Bloomberg

Chart 6: ATM USDZAR implied volatility cone



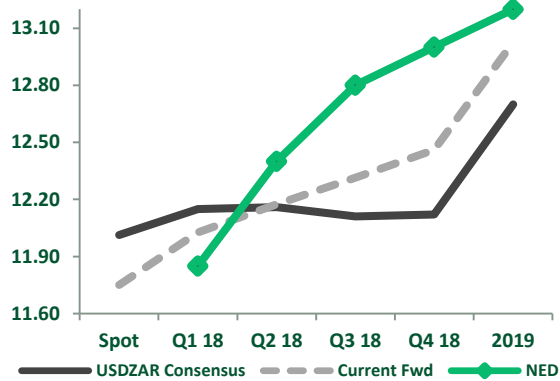
Source: Nedbank CIB Research; Bloomberg

Chart 7: Rand currency forecast table vs consensus and forwards (period end)

	Current Spot	Q1 18	Q2 18	Q3 18	Q4 18	2019
<b>USDZAR</b>						
Nedbank	12.01	11.85	12.40	12.80	13.00	13.20
Current Fwd	12.01	12.03	12.18	12.32	12.46	13.03
Consensus	12.01	12.15	12.16	12.11	12.12	12.70
<b>EURZAR</b>						
Nedbank	14.74	14.40	14.88	15.23	15.15	15.64
Current Fwd	14.74	14.76	15.05	15.33	15.63	16.89
Consensus	14.74	14.82	14.96	15.14	15.27	16.51
<b>GBPZAR</b>						
Nedbank	16.71	16.47	17.36	17.92	18.46	19.14
Current Fwd	16.71	16.74	17.02	17.28	17.56	18.67
Consensus	16.71	16.89	16.90	16.95	17.21	17.21
<b>AUDZAR</b>						
Nedbank	9.24	9.24	9.67	10.50	10.66	10.96
Current Fwd	9.24	9.25	9.37	9.48	9.61	10.08
Consensus	9.24	9.48	9.61	9.57	9.70	10.41

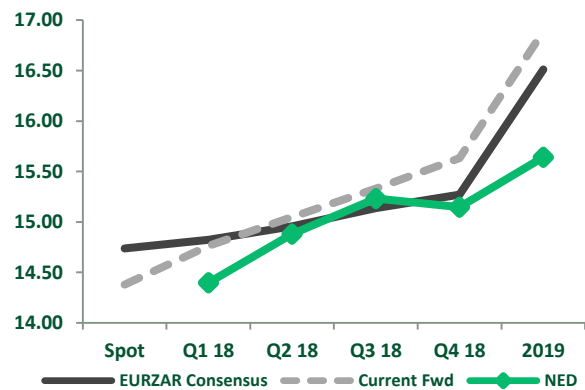
Source: Bloomberg, Nedbank CIB

Chart 8: USDZAR forecasts, consensus, and fws



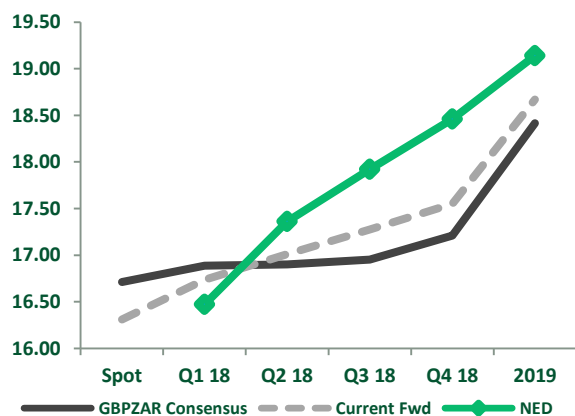
Source: Bloomberg, Nedbank CIB

Chart 9: EURZAR forecasts, consensus, and fws



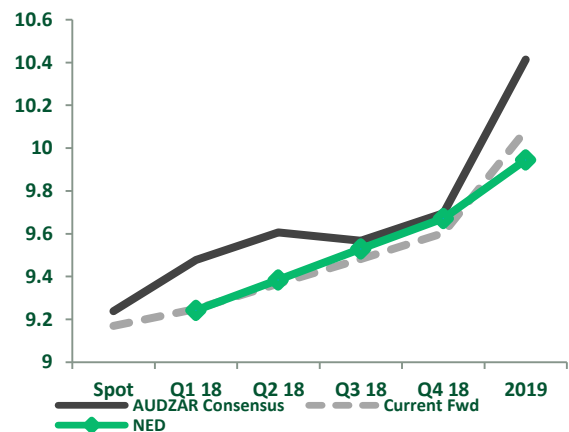
Source: Bloomberg, Nedbank CIB

Chart 10: GBPZAR forecasts, consensus, and fws



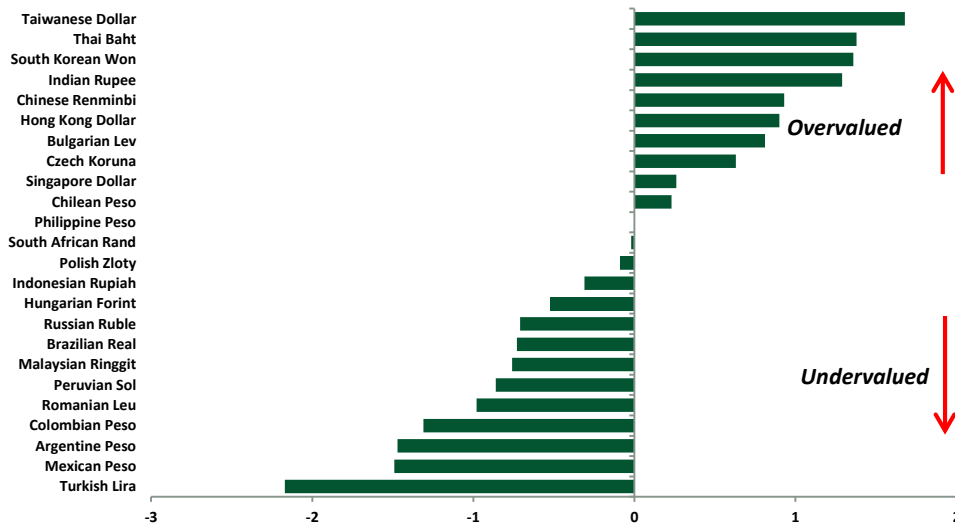
Source: Bloomberg, Nedbank CIB

Chart 11: AUDZAR forecasts, consensus, and fws



Source: Bloomberg, Nedbank CIB

Chart 12: EM currencies overvalued vs undervalued (z-scores)



Source: Bloomberg and BIS. A larger value indicates the spot rate has a larger deviation from the PPP rate to the

Chart 13: EM currency performance vs USD – YTD (%)

	CNY	JPY	KRW	SGD	MYR	IDR	THB	INR	AUD	BRL	GBP	EUR	CAD	ZAR
CNY		-3.095	2.923	0.728	-0.690	4.341	-1.400	5.079	2.287	1.395	-0.352	-0.148	6.269	-1.588
JPY	3.200		-5.833	-4.036	-2.519	-7.107	-1.740	-7.787	-5.263	-4.430	-2.788	-2.996	-8.801	-1.544
KRW	-3.279	6.201		1.930	3.153	-1.525	4.338	-2.055	0.630	1.458	3.247	2.979	-3.131	4.549
SGD	-1.041	4.539	-1.836		1.641	-3.285	2.190	-3.583	-1.293	-0.248	1.322	1.028	-4.888	1.830
MYR	0.224	2.943	-3.058	-1.330		-4.523	1.147	-5.039	-2.493	-1.974	0.141	-0.138	-6.312	0.941
IDR	-4.313	7.548	1.549	3.626	4.754		5.950	-0.534	2.193	2.696	5.140	4.587	-1.516	6.684
THB	1.401	1.781	-3.934	-2.324	-1.147	-5.617		-6.122	-3.556	-2.699	-0.905	-1.311	-7.162	0.231
INR	-4.834	8.441	2.094	3.945	5.314	0.554	6.527		2.733	3.343	5.466	5.173	-1.023	6.425
AUD	-2.245	5.543	-0.583	1.306	2.496	-1.064	3.686	-2.488		0.828	2.617	2.362	-3.510	4.251
BRL	-1.385	4.626	-1.443	0.347	2.011	-2.707	2.782	-3.220	-0.843		1.901	1.380	-4.551	2.977
GBP	0.529	2.927	-3.116	-1.391	-0.164	-4.404	0.879	-5.172	-2.540	-1.746		-0.211	-6.149	1.505
EUR	0.065	3.127	-2.915	-1.154	0.487	-4.078	1.329	-4.598	-2.185	-1.404	0.249		-5.727	1.932
CAD	-5.913	9.372	3.253	4.871	6.405	1.946	7.670	1.015	3.895	4.746	6.602	6.282		8.268
ZAR	0.771	1.183	-3.542	-2.622	-1.001	-5.509	-0.264	-6.059	-4.161	-2.150	-1.297	-1.487	-7.598	

Source: Bloomberg

Chart 14: Correlation matrix – markets vs FX

	VIX	SPX	US	US	SA	TOP40	EM FX	DM FX	MXN	AUD	CAD	ZAR
VIX		-82%	-56%	-46%	18%	-35%	-32%	0%	22%	-20%	27%	31%
SPX	-82%		38%	25%	-28%	46%	51%	10%	-39%	48%	-46%	-50%
US	-56%	38%		92%	-1%	16%	11%	0%	-13%	-2%	-14%	-10%
US	-46%	25%	92%		5%	8%	-2%	2%	-4%	-6%	-4%	0%
SA	18%	-28%	-1%	5%		-43%	-38%	-13%	23%	-13%	26%	49%
TOP40	-35%	46%	16%	8%	-43%		39%	-12%	-26%	26%	-41%	-21%
EM FX	-32%	51%	11%	-2%	-38%	39%		-43%	25%	-15%	16%	0%
DM FX	0%	10%	0%	2%	-13%	-12%	-43%		25%	-15%	16%	0%
MXN	22%	-39%	-13%	-4%	23%	-26%	-72%	25%		-61%	63%	49%
AUD	-20%	48%	-2%	-6%	-13%	26%	71%	-15%	-61%		-62%	-48%
CAD	27%	-46%	-14%	-4%	26%	-41%	-58%	16%	63%	-62%		44%
ZAR	31%	-50%	-10%	0%	49%	-21%	-68%	0%	49%	-48%	44%	

Source: Bloomberg, YTD

Chart 15: Correlation matrix – commodities vs currencies

	Gold	Plat	Pall	Ironor	Coppe	T-Coal	Brent	BRL	AUD	CAD	ZAR	EM FX
Gold		75%	45%	-1%	0%	3%	47%	-61%	61%	-46%	-39%	76%
Plat	75%		60%	-9%	7%	19%	57%	-56%	58%	-43%	-36%	63%
Pall	45%	60%		-10%	-9%	11%	43%	-34%	41%	-27%	-22%	41%
Ironor	-1%	-9%	-10%		-3%	1%	-21%	8%	-9%	7%	-9%	-1%
Coppe	0%	7%	-9%	-3%		26%	15%	5%	0%	5%	-13%	7%
T-Coal	3%	19%	11%	1%	26%		23%	-22%	6%	-17%	-23%	10%
Brent	47%	57%	43%	-21%	15%	23%		-47%	48%	-41%	-43%	52%
BRL	-61%	-56%	-34%	8%	5%	-22%	-47%		-60%	46%	50%	-72%
AUD	61%	58%	41%	-9%	0%	6%	48%	-60%		-62%	-48%	71%
CAD	-46%	-43%	-27%	7%	5%	-17%	-41%	46%	-62%		44%	-58%
ZAR	-39%	-36%	-22%	-9%	-13%	-23%	-43%	50%	-48%	44%		-68%
EM FX	76%	63%	41%	-1%	7%	10%	52%	-72%	71%	-58%	-68%	

Source: Bloomberg, YTD

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