

STRATEGY NOTE:

FX

IT IS NOT JUST ABOUT ITALY

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EM IS VULNERABLE TO GLOBAL \$-LIQUIDITY CONDITIONS TIGHTENING BENEATH THE SURFACE, WHICH WE BELIEVE WILL NOT BODE WELL FOR THE RAND AND EM FX



Source: BBG, Nedbank CIB

- The current narrative is that Italy is the reason for the stronger dollar. We do not subscribe to this theory as this only exacerbated the trend that has been in place for the past three months as global liquidity conditions has been tightening.
- Global \$-liquidity conditions are tightening beneath the surface as reflected by:
 - Rising shadow rates,
 - Falling petrodollar balances,
 - US Fed balance sheet tapering
 - And what is also unnoticed by the market is that the US Treasury has removed \$400bn from the financial system in recent weeks.
- Hence we believe that changes in liquidity conditions will override traditional economic fundamentals.
- We expect offshore USD funding (as reflected in USD cross-currency basis swap) to tighten over the coming months, which will lead to higher FX volatility and as a result risk-adjusted emerging market carry-trade returns will remain under pressure. We believe that this will not bode well for the rand.

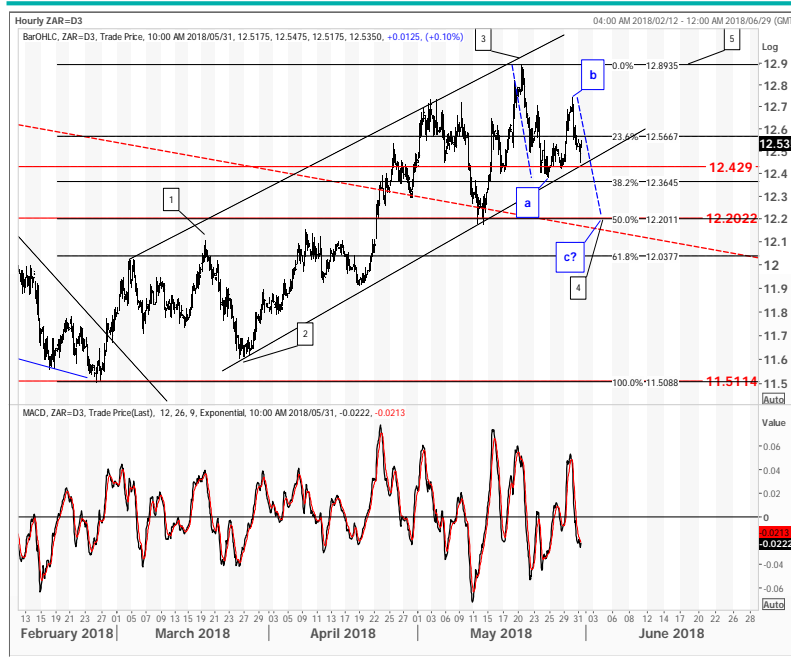
EURO-\$, MARKET REACHED OUR TARGET LEVEL



- Since the euro broke down out of the wedge that formed during 1Q18, the target was 1.15.
- The market reached this level with a text book 5-wave Elliott wave pattern and a corrective rally is imminent and is already playing out. The MACD is turning up, confirming the short-term loss of bearish momentum.
- The target levels for this **correction phase** are **1.188** and then our preferred target at **1.1992** if it is a normal counter trend move.
- However, as we have written numerous times in the past, there is no way of knowing whether the correction will be counter trend move or a consolidation phase for example a symmetrical wedge.
- We will keep readers informed which pattern is unfolding via our 'Flash Notes'.
- That said, we still expect the euro-\$ to be weaker at year-end.



\$-RAND, A CORRECTION IS LIKELY TO UNFOLD



Source: Reuters, Nedbank CIB

- The \$-rand stopped just short of our 12.93 target level and an ABC correction pattern is unfolding.
- A break out of the bull channel and below 12.43 is likely to project a move to 12.20 to complete the bigger wave 4.
- At 12.20 the market should correct 50% of the bull trend and the two waves down will likely be equal in length. It is also the mid-point line of the bear trend since the start of 2016.
- Our year-end target for the rand is 13.10.

SA TWR, THE BULL SINCE 2016 IS MOST LIKELY OVER



Source: Metastock & Nedbank CIB

- The trade weighted rand rallied with all risk assets since the start of 2016 in an ABC-pattern. The C-wave up in the SA rand was weaker relative to other risk-assets because the performance of gold and platinum prices were lacklustre.
- The trade weighted rand, however, failed at 67.86 against the (red) neckline that has been in place since the start of 2014.
- The MACD is also rolling over against a major trendline and the outlook for the rand is negative.
- A major trend reversal will obviously only be confirmed on a break below the trendline at 60.50, which will likely project a move to a new all time low.
- We expect this view to play out over the next year or two as the carry trade unwinds.