22 May 2023

USD-ZAR	19.4812/19.4863	**EUR-ZAR**	21.0704/21.0815	**GBP-ZAR**	24.2346/24.2586	**EUR-USD**	1.0815/1.0819
GBP-USD	1.2441/1.2495	**USD-JPY**	137.91/137.94	**AUD-USD**	0.6638/0.664	**R 186**	10.025%
GOLD	$1975.09	**BRENT**	$74.68	**DJI**	33 426,63	**3m JIBAR**	8,092

Events (GMT)

GMT	Country	Event	Month	Exp./Act	Prior
09:00	EC	ECB Vice President Guindos Speaks			
11:30	EC	ECB's Holzmann Speaks			
12:30	US	Fed's Bullard Speaks on US Economy and Monetary Policy			
14:00	EZ	Consumer confidence	May P	-16.7	-17.5
14:15	EC	ECB's Lane Speaks			
14:15	EC	ECB's Villeroy speaks			

Factors on the radar

US debt ceiling talks

What happened?	President Biden and top lawmakers will meet today to discuss the debt ceiling after phone discussions over the weekend were described as positive
Relevance	Failure to reach a deal in the coming days would lead to significant recessionary pressure on the US economy
Importance	5/5 (fiscal policy)
Analysis	The government and lawmakers have until the end of May to break the deadlock over raising the $31.4trln US debt limit before an unprecedented default happens; although they agree that defaulting is not an option, the longer they take to reach a deal, the larger the impact on the US economy

Global PMIs

What happened?	PMI data scheduled for release out of the world's major economies this week 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	5/5 (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

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

Oil Update:

Analysis: As we kick off the new week, oil markets are on the defensive, tracking a broader retreat in commodities as traders focus on the US debt ceiling negotiations, which have failed to produce a compromise. Brent crude futures have dropped to $75 per barrel, with the global benchmark looking to potentially post a fifth-straight monthly loss in May, which would mark its longest losing streak since 2017. The front-month WTI contract, meanwhile, has dropped to $71 per barrel, although it expires today and will be replaced by the July contract, which is currently trading near $71.15 per barrel. Meanwhile, the supply situation in Canada remains volatile, which may be partially offsetting demand concerns and preventing further losses for oil this morning. At least two buyers in the Alberta region were notified of force majeure measures and reductions to their receipts given the ongoing wildfires. Around 300k barrels per day of oil and gas production remains offline in the region, with no indication of when it could be resumed.

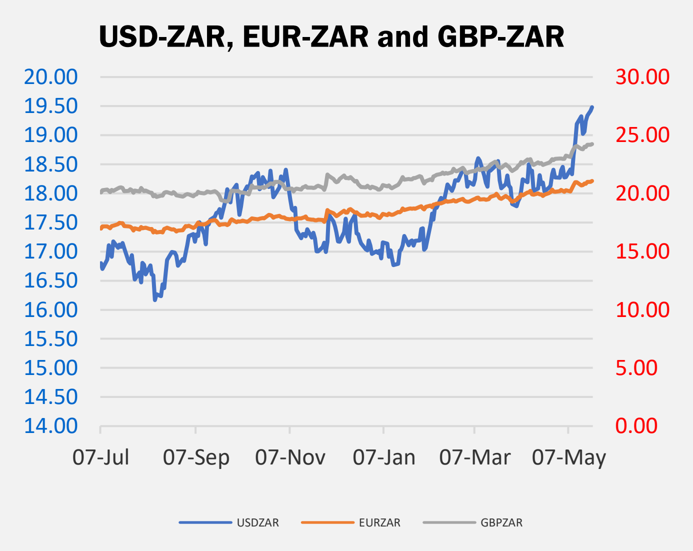
Rand Update

There has been no change to South Africa’s credit ratings after S&P Global’s review on Friday. Given everything that has unfolded since Finance Minister Godongwana’s budget speech in February, there were valid concerns that the ratings agency was going to downgrade its outlook on SA’s BB-minus-rated debt. The agency’s decision to hold off on any changes comes as a notable relief for the ZAR, which might have retreated further had any form of downgrade occurred.

The focus now shifts to the SARB, which is scheduled to provide a policy update on Thursday. CPI data scheduled for publication on Wednesday will likely not be the main determinant of the monetary authority’s decision this week, with the ZAR’s recent depreciation, instead, expected to be at the centre of discussions around second-round inflationary effects. The ZAR’s weakness represents a notable materialisation of a key upside risk to the inflation outlook, which explains why the market is currently positioned for an aggressive response from the SARB.

Specifically, the rates derivatives market is pricing in more than 50bps worth of rate-hike risk for the meeting, which is consistent with economists’ consensus expectations as derived from Bloomberg surveys. Forward guidance at the meeting will also be very important for the ZAR. Depending on how hawkish the SARB’s accompanying policy statement is, the market may consider pricing in even more rate hikes than the 50bps already anticipated beyond this week’s meeting and before September.

The ZAR recorded its weakest closing levels against the USD (19.4500) and GBP (24.2100) on Friday, and didn’t perform much better against the EUR (21.0100). SA’s deteriorating risk profile continues to weigh notably on the ZAR’s resilience against external market conditions, which, in turn, are tetchy as investors navigate ongoing US debt ceiling negotiations. These will remain at the forefront of market drivers ahead of the SARB’s policy update on Thursday, with recent talks between the White House and Congressional leaders not yet yielding any material progress. However, a breakthrough is, by and large, expected in the coming days, which could support both the USD and broader risk appetite as the week continues.



Bond Update

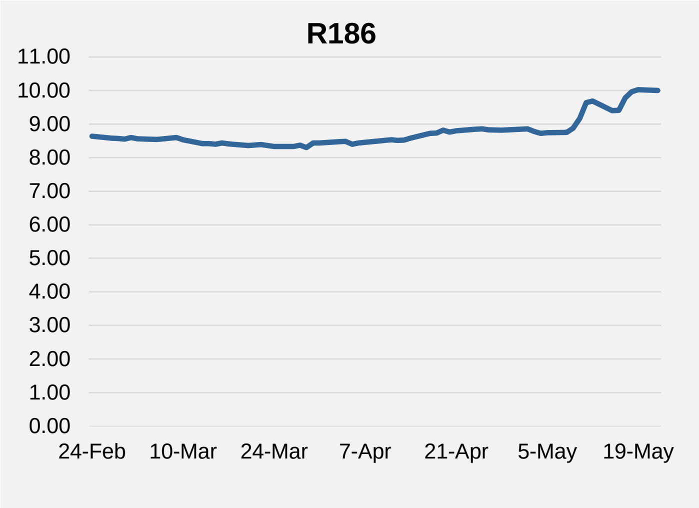
Bonds/Yield Curve: US Treasury yields are cruising higher once more and have broken out of a recent range, with the 10yr testing levels above 3.7% last week. The US debt deal and the resilience of the US economy are blamed for the rise in yields at a time when the Fed is hinting at rates topping out. However, the curve remains suitably inverted, and it will just be a matter of time before the cycle turns. In the interim, the rise in US Treasury yields will exert some upward pressure on SA’s bond yields as bonds adjust to compensate foreigners for the risk of investing in SA assets.

However, also keeping investors on the defensive locally, is speculation around the anticipated response that the SARB will have to the latest bout of ZAR depreciation. Most economists have tilted back towards a 50bp rate hike, although the market anticipates the risk of a 75bp hike to be reasonably high. Analysis of the ILB auction last week shows a sharp rise in breakeven rates despite the recovery in demand, implying a significant deterioration in inflation expectations. The SARB will want to respond to this deterioration and leave no room for speculation that it will hike until inflation is brought back under control.

For now, bonds remain on the defensive, which will keep the pressure on the ZAR. Through the week ahead, a further flattening in the overall curve is anticipated, especially with the FRA curve shifting higher. The IRS curve has followed suit with paying interest remaining the order of the day.

FRAs: Much of the adjustment for the FRA curve has already materialised. The FRA curve shows that a 50bp rate hike at this week's meeting is a fait-accompli and that there is even a high possibility that the SARB could do more as it attempts to change inflation expectations and the ZAR's fortunes. The SA government and its mismanagement of the economy and SOEs have done little to help the economy that now carries an uncomfortably high-risk assessment with it. It means that the SARB and fixed income and rates markets need to compensate for that risk, which will require more hikes. The FRA curve is comfortable with over 125bp being priced in and is approaching the possibility that the Repo rate could rise as high as 9.25%. The overall curve has shifted higher, and hopes of a future interest rate reduction appear to have dissipated.

Repo: It is likely that the SARB will hike by a minimum of 50bp at the next meeting to stabilise markets. This is not what forecasters or the SARB had in mind, but there was panic in the market last week, and bold decisions are needed. Any expectations of rate cuts early in 2024 have now disappeared, and all eyes will be on whether the ZAR makes a full recovery or not. The ZAR is vulnerable, which may even prompt the SARB to remain hawkish, although an intra-meeting emergency hike is no longer looking as necessary. The peak in interest rates priced into FRAs has now moved 100-125bp higher but could stabilise around current levels ahead of the SARB decision and statement next week.



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