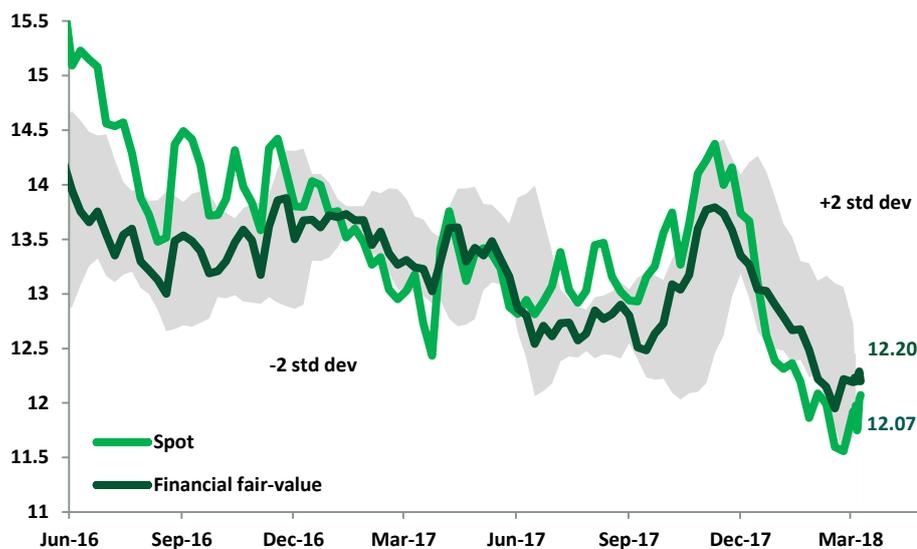


RAND SEARCHING FOR A CATALYST, COMPLACENCY GROWING IN OPTIONS MARKET

- The rand has been in a stubbornly narrow range, with no clear domestic catalysts on the horizon. However, government wage negotiations are ongoing and it could be important to keep an eye on the ANC's upcoming land summit (21 to 23 April 2018).
- SA CPI surprised to the downside, falling to 3.8% yoy vs 4.0% yoy previously. We believe further downside risks to inflation are now limited. Should there be further disinflationary pressures in the economy, then we could see one more rate cut later this year. This would then imply a lower carry-return for the rand.
- Emerging market FX, as a whole, has been relatively resilient, despite the escalating situation in Syria and the trade frictions between the U.S and China. That said, we still believe that a slowdown in global growth (as a result of protectionist trade policies between the US and China) combined with global central banks slowing down their quantitative easing programmes, will likely have an overwhelming influence on the rand. Notably, the [IMF's latest World Economic Outlook report](#) highlights this risk too: "The prospect of trade restrictions and counter-restrictions threatens to undermine confidence and derail growth prematurely".
- Today we take a closer look at the [market positioning \(CFTC data\) of emerging market currencies and other risk assets](#). We believe that positioning in the current growth 'narrative' is stretched, and deserves more attention. When positions are as large as they are currently, the reversal can be violent.
- **Our six-month and 12-month target ranges for the USDZAR remain unchanged at R12.40 and R13.00 respectively.** We believe there is too much complacency in risk assets, given our outlook for the global economy.
- **Short-term, keep an eye on support at R11.94 and resistance at R12.22** (see our latest [Technical Strategy Note](#) of 16 April 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

TAKING A CLOSER LOOK AT MARKET POSITIONING

Market positioning, as reflected by the Commodity Futures Trading Commission (Commitments of Traders report), indicates a high conviction in the current 'narrative' – ie that global synchronized growth will continue.

Market positioned for a continuation of the risk-on environment

The inflation narrative is reflected in record-high net-long positions in the oil and copper market. The oil price is very important for the global dollar liquidity environment, as we highlighted in last week's *FX insights 'The oil price is far more important for the rand than you think' - 04 April 2018*. A rising oil price adds to the supply of petrodollars that is injected into the global financial system. This weakens the U.S Dollar and bodes well for rand appreciation. However, a falling oil price reduces the supply of petrodollars into the global financial system, which in turn leads to a stronger dollar (tighter financial conditions) and does not bode well for the rand.

Positioning for a weaker US dollar is stretched, and is currently at the -2 SD level. Since 2016, EM and commodity FX net-long positioning grew substantially (amid the weaker USD environment). This is now currently just below the +2 SD level. As a result, these oversized positions have been supportive of the rand.

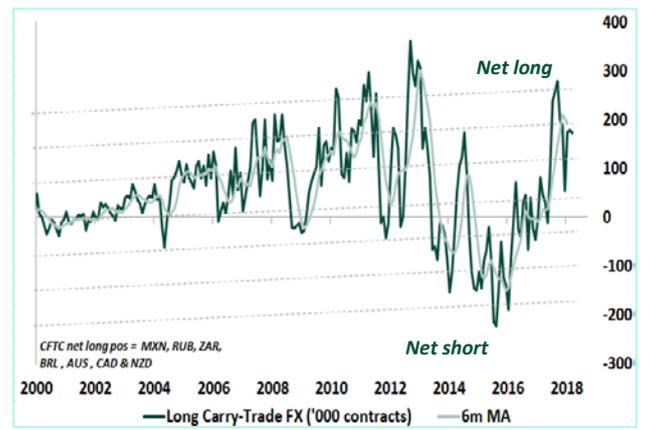
We believe this consensus and these outsized positions are fraught with risk, seeing as financial conditions are tightening. The drivers of this slowdown in dollar-liquidity are: A slowing of global trade, QT, and China slowing down its shadow banking system. Typically when positions are as large as they are currently, the risk is that if the prevailing narrative of the time does not play out perfectly, violent reversals will ensue. Hence, our forecasts for the rand (R12.40 in six months, and R13.00 in 12 months) are based on the premise that international developments will dominate the trajectory of the rand.

Chart 1: U.S Dollar positioning close to record short



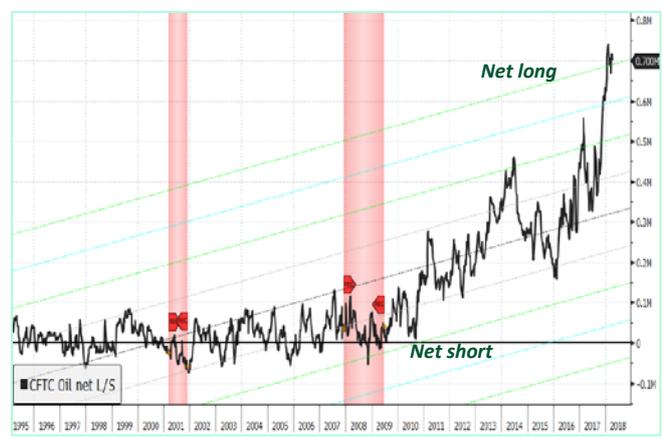
Source: BBG, Nedbank CIB markets Research, '000 contracts spec CFTC

Chart 2: EM currency positioning net long



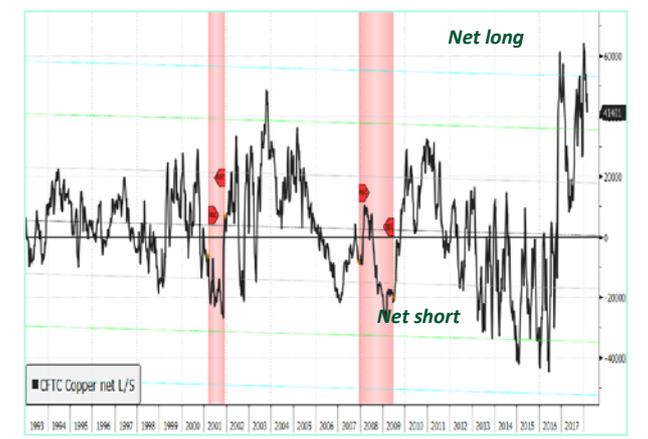
Source: BBG, Nedbank CIB Markets Research, '000 contracts spec CFTC

Chart 3: Oil long positioning at record highs



Source: BBG, Nedbank CIB markets Research, '000 contracts spec CFTC

Chart 4: Copper long positioning close to record highs



Source: BBG, Nedbank CIB Markets Research, '000 contracts spec CFTC

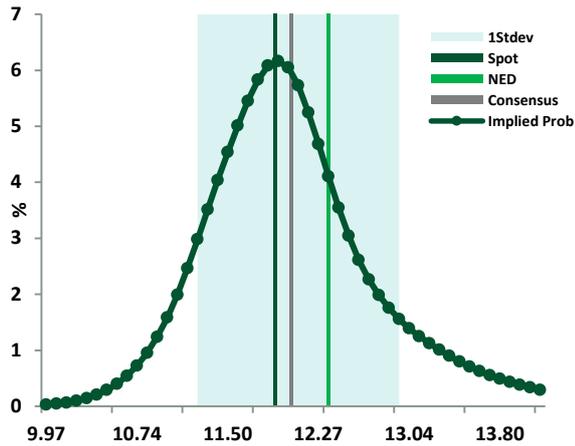
FX VOL AT A THREE-YEAR LOW

Implied volatility across most of the maturity buckets fell to a three-year low this week, as domestic risks abated (see Chart 5 and Chart 6). 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:

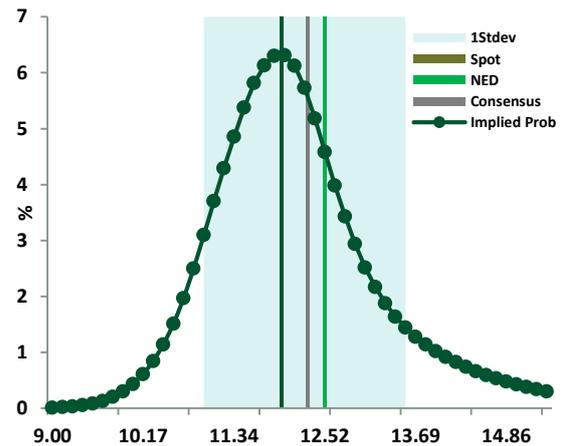
- On a three-month view, the option market suggests a one standard deviation trading range for the USDZAR of between 11.29 and 12.83 (see Chart 3).
- On a six-month view, the probability is skewed towards weakness, as one would expect, with the implied probability distribution suggesting a one standard deviation range of between 11.02 and 13.39 (see Chart 4).

Chart 3: 3m implied probability distribution vs forecast



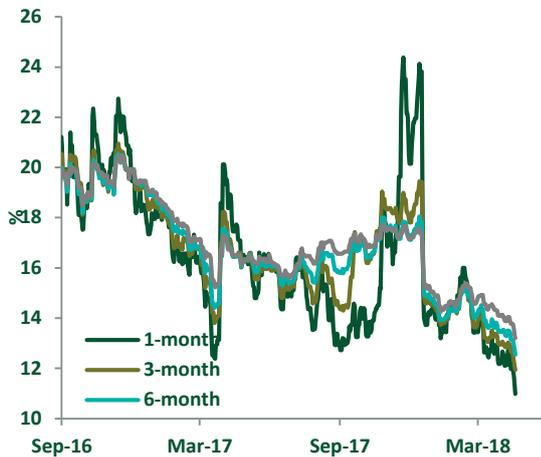
Source: Bloomberg

Chart 4: 6m implied probability distribution vs forecast



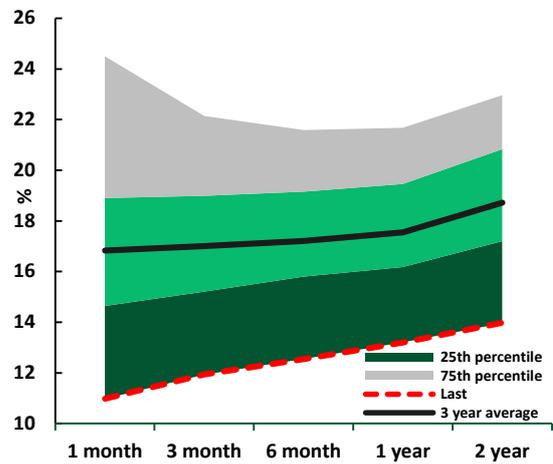
Source: Bloomberg

Chart 5: USDZAR implied volatility



Source: Bloomberg

Chart 6: ATM USDZAR implied volatility cone



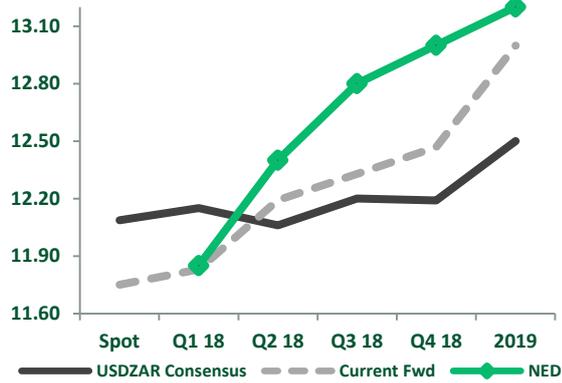
Source: Nedbank CIB Research; Bloomberg

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

	Current Spot	Q1 18	Q2 18	Q3 18	Q4 18	2019
USDZAR						
Nedbank	12.09	11.85	12.40	12.80	13.00	13.20
Current Fwd	12.09	11.83	12.19	12.33	12.47	13.00
Consensus	12.09	12.15	12.06	12.20	12.19	12.50
EURZAR						
Nedbank	14.84	14.40	14.88	15.23	15.15	15.64
Current Fwd	14.84	14.58	15.04	15.32	15.62	16.86
Consensus	14.84	14.82	14.83	15.25	15.36	16.25
GBPZAR						
Nedbank	16.95	16.47	17.36	17.92	18.46	19.14
Current Fwd	16.95	16.58	17.15	17.41	17.69	18.81
Consensus	16.95	16.89	16.88	17.20	17.43	17.43
AUDZAR						
Nedbank	9.29	9.24	9.67	10.50	10.66	10.96
Current Fwd	9.29	9.08	9.37	9.48	9.60	10.05
Consensus	9.29	9.48	9.41	9.52	9.63	10.13

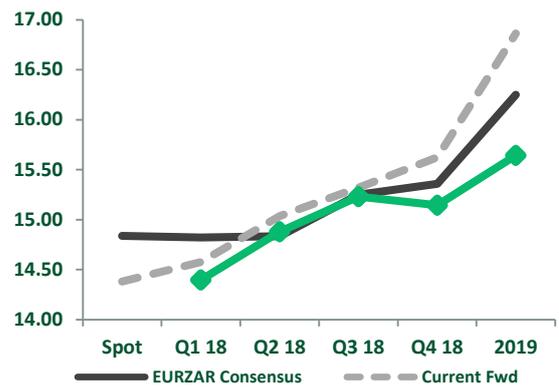
Source: Bloomberg, Nedbank CIB

Chart 8: USDZAR forecasts, consensus, and forwards



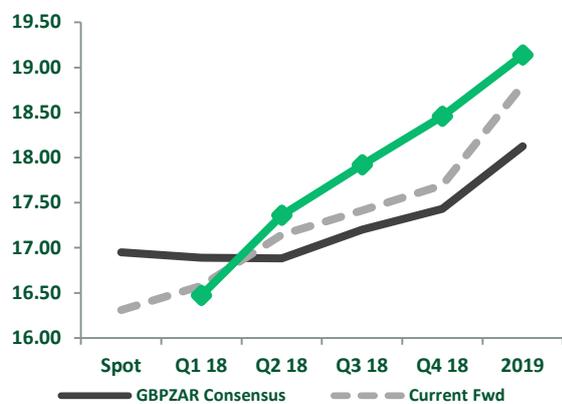
Source: Bloomberg, Nedbank CIB

Chart 9: EURZAR forecasts, consensus, and forwards



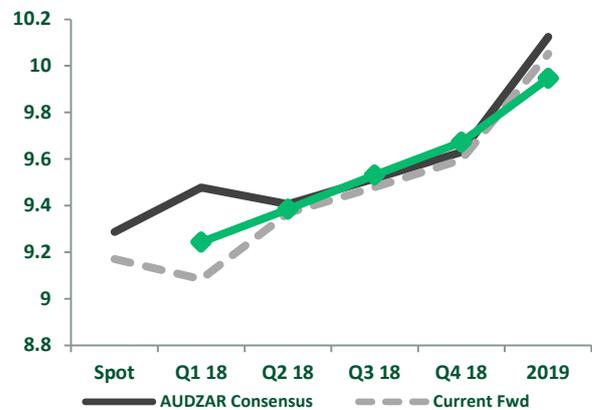
Source: Bloomberg, Nedbank CIB

Chart 10: GBPZAR forecasts, consensus, and forwards



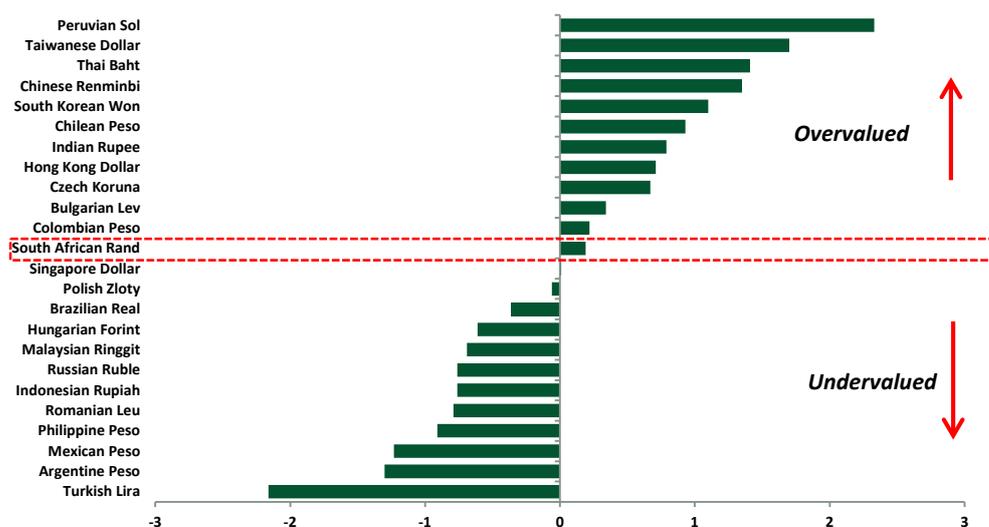
Source: Bloomberg, Nedbank CIB

Chart 11: AUDZAR forecasts, consensus, and forwards



Source: Bloomberg, Nedbank CIB

Chart 12: EM currencies overvalued vs undervalued (z-scores)
 South Africa in fair-value territory according to PPP metrics



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		-1.022	3.290	1.408	-0.754	5.497	-0.505	7.225	3.862	5.971	-1.143	0.593	4.352	0.369
JPY	1.032		-4.129	-2.639	-0.476	-6.155	-0.529	-7.691	-4.725	-6.586	0.117	-1.650	-5.144	-1.403
KRW	-3.279	4.344		1.597	3.488	-2.160	3.763	-3.677	-0.591	-2.568	4.443	2.607	-1.038	2.853
SGD	-1.715	3.043	-1.516		2.279	-3.701	2.190	-4.873	-2.154	-3.970	2.855	0.959	-2.491	0.458
MYR	0.193	0.821	-3.372	-1.961		-5.461	0.267	-6.929	-3.958	-6.157	1.002	-0.849	-4.565	-0.971
IDR	-5.292	6.444	2.224	4.054	5.792		6.068	-1.535	1.672	-0.553	7.136	4.912	1.403	5.839
THB	0.501	0.519	-3.607	-2.130	-0.265	-5.721		-7.178	-4.205	-6.076	0.805	-1.173	-4.629	-0.867
INR	-6.742	8.335	3.802	5.362	7.439	1.576	7.729		3.230	0.895	8.520	6.541	2.852	6.481
AUD	-3.741	4.936	0.583	2.193	4.076	-1.064	4.350	-2.985		-1.966	5.083	3.192	-0.207	3.865
BRL	-5.635	7.041	2.635	4.164	6.560	0.533	6.477	-0.906	2.014		7.384	5.133	1.574	5.508
GBP	1.361	-0.061	-4.256	-2.854	-0.984	-6.239	-0.826	-7.759	-4.829	-6.759		-1.766	-5.232	-1.171
EUR	-0.674	1.713	-2.536	-1.090	1.218	-4.405	1.172	-5.824	-2.985	-4.916	1.837		-3.279	0.743
CAD	-4.195	5.152	1.045	2.281	4.442	-1.081	4.817	-2.538	0.459	-1.556	5.554	3.598		4.232
ZAR	-1.203	1.001	-1.972	-1.341	0.919	-4.776	0.871	-6.111	-3.749	-4.495	1.521	-0.264	-4.023	

Source: Bloomberg

Chart 14: Correlation matrix – markets vs FX

	VIX	SPX	US	US	SA	TOP40	EM FX	DM FX	MXN	AUD	CAD	ZAR
VIX		-81%	-55%	-44%	13%	-34%	-31%	-4%	26%	-19%	21%	23%
SPX	-81%		45%	34%	-17%	44%	43%	11%	-40%	42%	-32%	-34%
US	-55%	45%		92%	-3%	19%	10%	3%	-14%	0%	-5%	-7%
US	-44%	34%	92%		1%	12%	-3%	1%	-5%	-7%	5%	4%
SA	13%	-17%	-3%	1%		-30%	-38%	-7%	22%	-10%	16%	53%
TOP40	-34%	44%	19%	12%	-30%		31%	-11%	-16%	25%	-23%	-10%
EM FX	-31%	43%	10%	-3%	-38%	31%		-34%	-71%	67%	-50%	-68%
DM FX	-4%	11%	3%	1%	-7%	-11%	-34%		13%	-6%	1%	2%
MXN	26%	-40%	-14%	-5%	22%	-16%	-71%	13%		-54%	58%	45%
AUD	-19%	42%	0%	-7%	-10%	25%	67%	-6%	-54%		-59%	-47%
CAD	21%	-32%	-5%	5%	16%	-23%	-50%	1%	58%	-59%		41%
ZAR	23%	-34%	-7%	4%	53%	-10%	-68%	2%	45%	-47%	-59%	

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		65%	35%	3%	-7%	1%	30%	-52%	50%	-36%	-40%	62%
Plat	65%		57%	-6%	4%	19%	39%	-43%	52%	-35%	-35%	59%
Pall	35%	57%		-15%	-6%	16%	42%	-26%	37%	-23%	-21%	37%
Ironor	3%	-6%	-15%		4%	-3%	-21%	10%	-2%	-5%	-10%	0%
Coppe	-7%	4%	-6%	4%		21%	8%	4%	0%	0%	-7%	-1%
T-Coal	1%	19%	16%	-3%	21%		8%	-25%	12%	1%	-20%	14%
Brent	30%	39%	42%	-21%	8%	8%		-36%	33%	-34%	-33%	41%
BRL	-52%	-43%	-26%	10%	4%	-25%	-36%		-47%	29%	44%	-65%
AUD	50%	52%	37%	-2%	0%	12%	33%	-47%		-59%	-47%	67%
CAD	-36%	-35%	-23%	-5%	0%	1%	-34%	29%	-59%		41%	-50%
ZAR	-40%	-35%	-21%	-10%	-7%	-20%	-33%	44%	-47%	41%		-68%
EM FX	62%	59%	37%	0%	-1%	14%	41%	-65%	67%	-50%	-68%	

Source: Bloomberg, YTD

Disclaimer

This report is personal to the recipient and any unauthorised use, redistribution, retransmission or reprinting of this report (whether by digital, mechanical or other means) is strictly prohibited.

The information furnished in this publication, which information may include opinions, estimates, indicative rates, terms, price quotations and projections, reflects the judgment of the author(s) and the prevailing market conditions as at the date of this report, which judgment and conditions are subject to change without notice, modification or amendment. This publication does not necessarily reflect the opinion of Nedbank Limited ('Nedbank') or its ultimate holding companies or any direct or indirect subsidiary undertakings of such holding companies (its 'Affiliates'). Information presented in this publication was obtained or derived from public sources that Nedbank believes are reliable but no representation or warranty, express or implied, is made as to its accuracy or completeness. Neither Nedbank nor its Affiliates (or their respective directors, employees, representatives and agents) accepts any responsibility or liability (whether in delict, contract or otherwise) for loss arising from the use of or reliance placed upon the material presented in this publication, except that this exclusion of liability does not apply to the extent that liability arises under specific statutes or regulations applicable to Nedbank or its Affiliates.

This publication has been forwarded to you solely for information purposes only. The information contained in this publication is confidential and is not intended to be, nor should it be construed as, 'advice' as contemplated in the South African Financial Advisory and Intermediary Services Act, 2002 (as amended) or otherwise, or a direct or indirect invitation or inducement to any person to engage in investment activity relating to any securities or any derivative instrument or any other rights pertaining thereto of any company mentioned herein.

Any prices or levels contained herein are preliminary and indicative only and do not represent bids or offers. These indications are provided solely for your information and consideration. The information contained in this publication may include results of analyses from a quantitative model which represent potential future events that may or may not be realized, and is not a complete analysis of every material fact representing any product.

You should seek independent advice (including tax, accounting, legal, regulatory and financial advice) in relation to the information contained herein. This publication is intended for use by professional investors only. It may not be considered as advice, a recommendation or an offer to enter into or conclude any transactions. The information contained in this publication is confidential and is not intended to be, nor should it be construed as, a direct or indirect invitation or inducement to any person to engage in investment activity relating to any securities or any derivative instrument or any other rights pertaining thereto ('financial instruments'). Any additional information relative to any financial instruments and/or financial products reviewed in this publication is available upon request.

This publication has been issued in the United Kingdom only to persons of a kind described in Article 19 (5), 38, 47 and 49 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (all such persons being referred to as 'relevant persons'). Any investment or investment activity to which this document relates is only available to relevant persons and will be engaged in only with relevant persons.

Directors, officers and/or employees of Nedbank or its Affiliates may at any time, to the extent permitted by law, own or have a position in the financial instruments of any company or related company referred to herein, and may add to or dispose of any such position or act as a principal in any transaction in such financial instruments. Nedbank and/or its Affiliates may make a market in these instruments for its customers and for its own account. Accordingly, Nedbank and/or its Affiliates may have a position in any such instrument at any time. Directors, employees or officers of Nedbank and/or its Affiliates may also be directors of companies mentioned in this publication. Nedbank and/or its Affiliates may from time to time provide or solicit investment banking, underwriting or other financial services to, for or from any company referred to herein. Nedbank and/or its Affiliates may to the extent permitted by law, act upon or use information or opinions presented herein, or research or analysis on which they are based prior to the material being published.

The distribution of this document in certain jurisdictions may be prohibited or restricted by rules, regulations and/or laws of such jurisdictions and persons into whose possessions this presentation comes should inform themselves about, and observe, any such restrictions. Any failure to comply with such prohibitions or restrictions may constitute a violation of the laws of such other jurisdictions.

Internet communications are not guaranteed to be secure or virus-free. Nedbank and its Affiliates do not accept responsibility for any loss arising from unauthorised access to, or interference with any internet communications by any third party.

All trademarks, service marks and logos used in this publication are trademarks or service marks or registered trademarks or service marks of Nedbank or its Affiliates