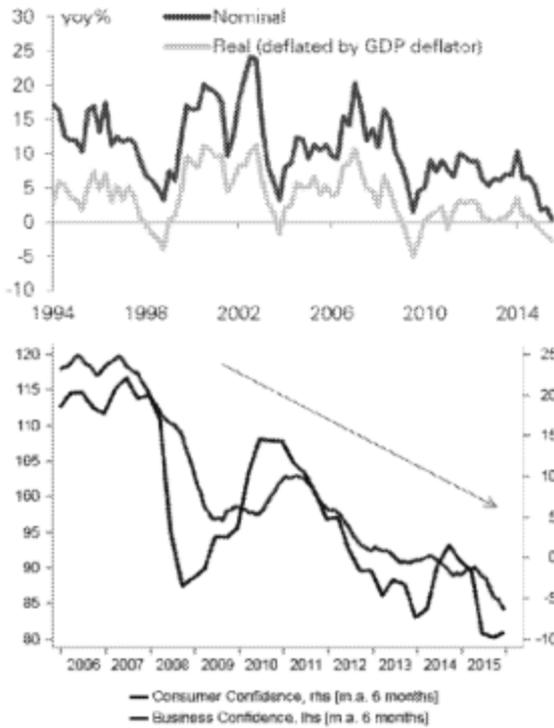




South Africa: Corporate profit growth turning negative, and confidence is low



Source: Deutsche Bank, Macrobond

For example, SARB's pre-emptive rate hike in November did not provide any material support to the rand. On the other hand, SARB can allow the currency to continue to be the adjustment valve to low growth and external imbalances, as pass-through to inflation has thus far been limited; spot headline CPI is at 4.8% YoY, well within the 3-6% target range. Further, an aggressive hiking cycle (+170bps in 2016) is already priced into the rates market, which we do not expect to be delivered (DB forecast is for only +75bps).

Political uncertainty will weigh on sentiment around the rand. Last month's decision to replace the fiscally-prudent Finance Minister Nene has increased concerns around a shift towards more populist policy, fiscal slippage, potential ratings downgrade to sub-investment grade and friction in the governing ANC.

Valuation has not provided much respite to the rand in the recent past, and is unlikely to do so now with elevated risks on both the external and domestic fronts. Further, in productivity-adjusted PPP terms, ZAR undervaluation is not yet at extreme levels, where we believe it should trade. ZAR TWI has around 6% further depreciation to go on this metric, which implies roughly an 8% move higher in USDZAR. Additionally, as global growth is currently generating only half as much trade growth as in earlier periods, greater FX adjustment is now required to correct external imbalances.

ZAR undervaluation is not yet at extremes



Source: Deutsche Bank, Haver Analytics

Other EMEA high betas: neutral on TRY and RUB
 TRY performed poorly in 2015 as domestic political uncertainty combined with a general EM FX sell-off. The focus has shifted from political uncertainty to policy direction (and quality), concern around which comes from three sources and continues to weigh on the lira. First, recent government comments have altered market perception about intensity of political externality on the CBT or a quicker-than-expected move towards executive presidency. Second, CBT credibility has likely fallen and monetary policy uncertainty increased following the Bank's inaction at the late-December meeting, where a hike in the base rate and narrowing of the corridor was expected. CBT's pro-growth bias could imply a reluctance to maintain rate differentials with the US, which clearly represents a risk for TRY and for the already elevated inflation – it also likely increases TRY's beta to adverse external shocks. Third, geopolitical concerns have risen, particularly on the deteriorating relations with Russia. These policy risks are somewhat offset by fundamental factors: growth is expected at 3-3.5%, which is reasonably good compared to the rest of EM; valuations on our fundamental metrics are attractive; carry is substantial even in vol-adjusted terms; Turkey is a commodity importer with limited direct trade links to China.

RUB movements in the near-term will be driven by crude; we therefore remain neutral for now given the volatility and continued search for the bottom in crude. If crude stabilizes, there are some reasons to be constructive on RUB: we expect monetary easing to be less aggressive than currently priced; growth and inflation are set to improve from a low base; valuations are attractive; double-digit carry provides a substantial buffer; FX reserves are large and the current account is in surplus; there is potential for sanctions to be lifted next year, improving capital flows and sentiment.

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