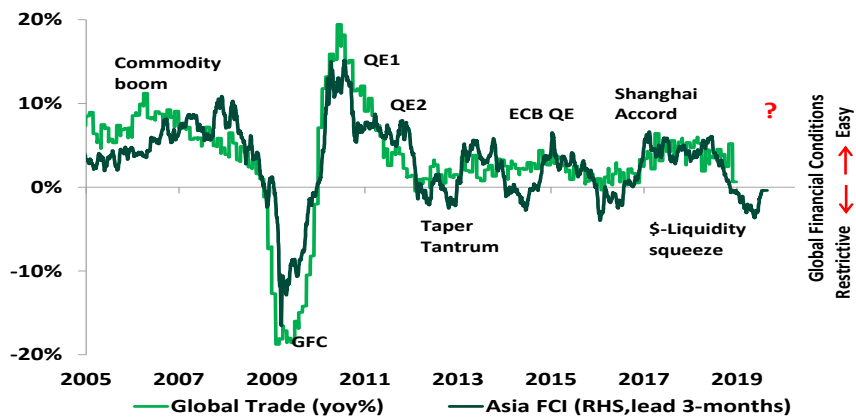


Executive summary:

- There are **many sources of Global \$-Liquidity** – the Fed’s balance sheet, US trade deficit, USD FX reserve accumulation by foreign central banks, **global trade** and the offshore \$-banking system. Global \$-Liquidity lubricates the global economy and financial system. For example, if there is a slowdown/contraction in Global \$-Liquidity, the global economy tends to slow, the cost of USD funding rises and financial markets – particularly growth-orientated assets (equities, EM FX and credit) – underperform; obviously, the opposite is also true.
- One of the largest sources of Global \$-Liquidity – global trade (worth USD34tn, according to the WTO) – is slowing, likely to exacerbate further the contraction in Global \$-Liquidity. Global trade and the global economy are in need of a liquidity injection, and the major **challenge** for investors is whether current stimulus packages will **be effective in countering this contraction in liquidity due to slower global trade**.
- Investment implications: If policymakers fail to provide meaningful stimulus (i.e., fail to do more than “jawbone”), the world would be set to enter the next major risk-off/deflationary environment, which would favour a defensive investment strategy, i.e., overweight cash vs bonds vs equities vs credit.
- Target ranges: Only a break below 92 (DXY Index) would signal that \$-Liquidity conditions are improving and that a major risk-on phase is materialising. However, if the contraction in \$-Liquidity continues, a break above 98 (DXY Index) would signal the next major risk-off phase.

Global trade is one of the largest contributors (USD34tn) to changes in Global \$-Liquidity.

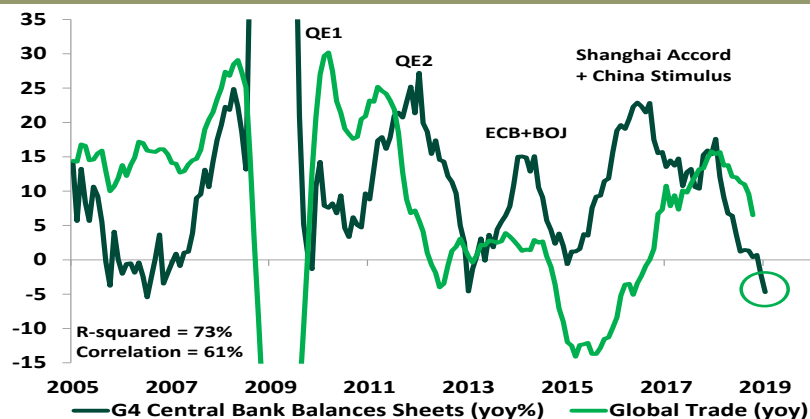
Chart 1: Global trade desperately needs a liquidity injection



Source: DataStream, Nedbank CIB

- Asia has become an important source of Global \$-Liquidity through various financial channels (i.e., China’s credit cycle, South Korea’s exports) over the past two decades. To highlight Asia’s importance from a Global \$-Liquidity perspective, Asia’s Financial Condition Index (FCI) leads global trade by approximately three months (**Chart 1**).
- **If financial conditions in Asia remain restrictive**, we expect the outlook for global trade and growth to remain weak for the rest of the year. From a Global \$-Liquidity perspective, this is negative and implies that risk assets are likely to have another tough year, just like 2018.
- Global trade is a function of many underlying economic factors (e.g., “animal spirits”, trade policies). However, a significant portion of global trade since the 2008/09 GFC could be explained by the change in global central banks’ balance sheets (high r-squared and correlations) (**Chart 2**), i.e., when central banks are adding liquidity to the financial system, sentiment improves and global trade remains healthy. The opposite is true as well.
- The impact of tighter monetary conditions (the slowdown in global central banks’ balance sheets) on markets in 2018 is now well known. **We expect central bank announcements in March 2019 to provide some information on policymakers’ appetite/ability to stimulate.**

Chart 2: Global trade desperately needs a liquidity injection



Source: DataStream, Nedbank CIB

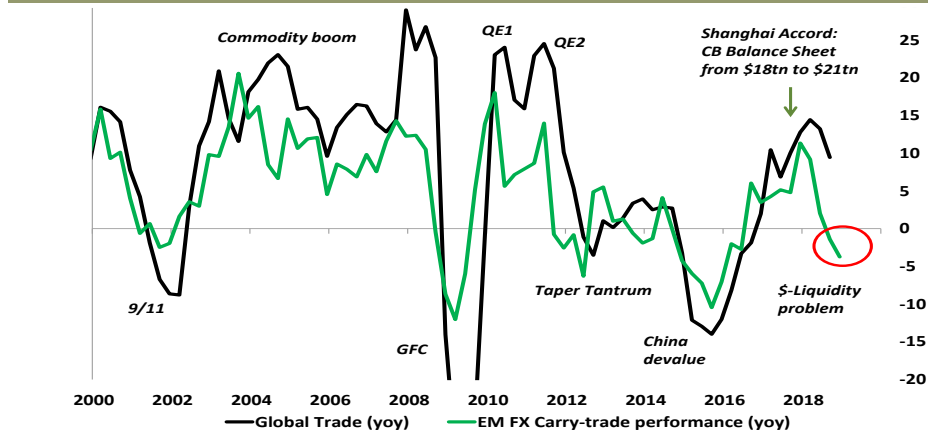
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Chart 3: The EM FX carry trade desperately needs a liquidity injection

Carry trades are very sensitive to global trade via Global \$-Liquidity channels.

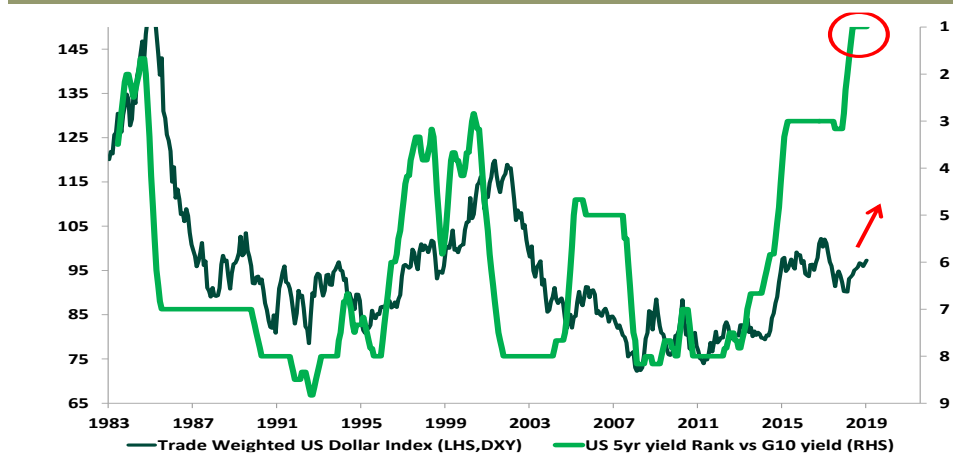


Source: DataStream, Nedbank CIB

- As explained above, global trade drives the global velocity of money. Global trade creates dollars, and these dollars are recycled back into the global financial system.
- It is, therefore, very evident that global trade and Global \$-Liquidity play an important part in the performance of the EM carry trade (Chart 3). Domestic fundamentals are not the only driver of the EM FX carry trade; we argue that the EM carry trade has become more sensitive to Global \$-Liquidity conditions over the past two to three decades. Hence, the EM FX carry trade performance is the beneficiary or victim of tidal changes in global liquidity.
- EM FX carry trade returns are currently under a lot of pressure, as evidenced by the performance of the SA rand over the past year. We, therefore, expect the rand and other high-beta EM FX to remain under pressure until the major central banks add enough liquidity to reverse this receding tide of liquidity.

Chart 4: US is the “cleanest dirtiest shirt”

The USD is likely to be the world’s reserve currency for a while.



Source: DataStream, Nedbank CIB

- The US remains the world’s “cleanest dirtiest shirt”, despite its deficits and controversial politics. The USD still ranks #1 when its five-year yield differential is compared to other G10 currencies’.
- That said, the strong USD is much more than just interest-rate differentials; it is the world’s currency; hence the importance of global trade. As we have pointed out in previous research, [the global velocity of money](#) is extremely low, and the Fed’s balance sheet and the US trade deficit remain important drivers of Global \$-Liquidity.
- Since the GFC, the US trade deficit as a percentage of global trade has collapsed but stabilised in recent years. Therefore, global USD supply by means of trade has remained lacklustre, exacerbating USD shortages and leading to a USD bull market.
- As long as the USD remains relatively strong (on Global \$-Liquidity factors, interest-rate differentials), risk assets will likely suffer from bouts of volatility.

Key forecasts and target values

	Target values (period-end)				Broad trading range	
	3m	6m	12m	Year-end	High	Low
Fed funds	2.50	2.75	2.75	2.75	2.50	2.75
US 10-year bond yield	2.80	3.00	2.80	2.80	2.30	3.20
Repo rate	6.75	6.75	7.00	7.00	6.75	7.00
SA 10-year bond yield	9.20	9.50	9.40	9.40	8.60	9.70
R208 (%)	7.00	7.10	7.20	7.20	6.90	7.40
R186 (%)	8.90	9.20	9.10	9.10	8.30	9.40
R2048 (%)	10.00	10.20	10.30	10.30	9.50	10.50
EURUSD	1,12	1,10	1,14	1,14	1,14	1,10
USDZAR	14,10	14,50	14,10	14,10	14,50	14,10
EURZAR	15,79	15,95	16,07	16,07	16,07	15,79
GBPZAR	17,80	18,10	17,90	17,90	17,80	17,80
AUDZAR	9,90	10,15	10,00	10,00	10,15	9,90
Δ Global \$-Liquidity	↔	↓	↓	↓	-	-

Nedbank CIB Markets Research/Nedbank Group Economics

	1Q19	2Q19	3Q19	4Q19	2019 Ave	2020 Ave
SA headline CPI	4.40	5.00	5.30	5.30	5.00	5.20
SA core inflation	4.40	4.40	4.40	4.40	4.50	4.50
SA GDP	1.60	1.70	2.10	2.30	1.3	1.8
Current account as a % of GDP					-3.4	-3.5

South African Reserve Bank

	1Q19	2Q19	3Q19	4Q19	2019 Ave	2020 Ave
SA headline CPI	4.60	4.70	4.80	4.80	4.80	5.30
SA core inflation	4.80	5.00	5.10	5.30	5.00	5.10
SA GDP	-	-	-	-	1.70	2.00
Current account as a % of GDP	-	-	-	-	-3.7	-4.1

National Treasury

	1Q19	2Q19	3Q19	4Q19	2019 Ave	2020 Ave
SA headline CPI	-	-	-	-	5.20	5.40
SA core inflation	-	-	-	-	-	-
SA GDP	-	-	-	-	1.5	1.70
Current account as a % of GDP	-	-	-	-	-3.4	-3.8

Source: Nedbank CIB Markets Research, Nedbank Group Economics, SARB, NT

2019 Macro Calendar

JANUARY							FEBRUARY							MARCH							APRIL						
Mo	Tu	We	Th	Fr	Sa	Su	Mo	Tu	We	Th	Fr	Sa	Su	Mo	Tu	We	Th	Fr	Sa	Su	Mo	Tu	We	Th	Fr	Sa	Su
31	1	2	3	4	5	6	28	29	30	31	1	2	3	25	26	27	28	1	2	3	1	2	3	4	5	6	7
7	8	9	10	11	12	13	4	5	6	7	8	9	10	4	5	6	7	8	9	10	8	9	10	11	12	13	14
14	15	16	17	18	19	20	11	12	13	14	15	16	17	11	12	13	14	15	16	17	15	16	17	18	19	20	21
21	22	23	24	25	26	27	18	19	20	21	22	23	24	18	19	20	21	22	23	24	22	23	24	25	26	27	28
28	29	30	31	1	2	3	25	26	27	28	1	2	3	25	26	27	28	29	30	31	29	30	1	2	3	4	5
4	5	6	7	8	9	10	4	5	6	7	8	9	10	1	2	3	4	5	6	7	6	7	8	9	10	11	12
17th Jan: SA MPC 24th Jan: ECB meeting 22-25 Jan: WEF Davos 30 Jan: Fed FOMC							7th Feb: BoE Meeting 7th Feb: SA SONA 13th-14th Feb: UK Mps to vote on Brexit 16th Feb: Nigeria election 20th Feb: SA budget							1st Mar: End of 90-day trade truce US-China 7th Mar: ECB Meeting 15th Mar: BoJ Meeting 20th Mar: FOMC Meeting 21st Mar: BoE Meeting 28th Mar: SARB Meeting							10th Apr: ECB Meeting 12-14th Apr: World Bank & IMF meet 17th Apr: Indonesia election 25th Apr: BoJ Meeting April/May: India election						
MAY							JUNE							JULY							AUGUST						
Mo	Tu	We	Th	Fr	Sa	Su	Mo	Tu	We	Th	Fr	Sa	Su	Mo	Tu	We	Th	Fr	Sa	Su	Mo	Tu	We	Th	Fr	Sa	Su
29	30	1	2	3	4	5	27	28	29	30	31	1	2	1	2	3	4	5	6	7	29	30	31	1	2	3	4
6	7	8	9	10	11	12	3	4	5	6	7	8	9	8	9	10	11	12	13	14	5	6	7	8	9	10	11
13	14	15	16	17	18	19	10	11	12	13	14	15	16	15	16	17	18	19	20	21	12	13	14	15	16	17	18
20	21	22	23	24	25	26	17	18	19	20	21	22	23	22	23	24	25	26	27	28	19	20	21	22	23	24	25
27	28	29	30	31	1	2	24	25	26	27	28	29	30	29	30	31	1	2	3	4	26	27	28	29	30	31	1
3	4	5	6	7	8	9	1	2	3	4	5	6	7	5	6	7	8	9	10	11	2	3	4	5	6	7	8
1st May: FOMC Meeting 2nd May: BoE Meeting 23-26th May: European Parliamentary election 26th May: Belgium election May-August: South African election							6th June: ECB Meeting 19th June: FOMC Meeting 20th June: BoE and BoJ Meeting 28-29th June: G20 Summit							18th July: SA MPC 25th July: ECB Meeting 30th July: BoJ Meeting 31st July: FOMC Meeting							1st August: BoE Meeting 25-27th Aug: G7 Summit						
SEPTEMBER							OCTOBER							NOVEMBER							DECEMBER						
Mo	Tu	We	Th	Fr	Sa	Su	Mo	Tu	We	Th	Fr	Sa	Su	Mo	Tu	We	Th	Fr	Sa	Su	Mo	Tu	We	Th	Fr	Sa	Su
26	27	28	29	30	31	1	30	1	2	3	4	5	6	28	29	30	31	1	2	3	25	26	27	28	29	30	1
2	3	4	5	6	7	8	7	8	9	10	11	12	13	4	5	6	7	8	9	10	2	3	4	5	6	7	8
9	10	11	12	13	14	15	14	15	16	17	18	19	20	11	12	13	14	15	16	17	9	10	11	12	13	14	15
16	17	18	19	20	21	22	21	22	23	24	25	26	27	18	19	20	21	22	23	24	16	17	18	19	20	21	22
23	24	25	26	27	28	29	28	29	30	31	1	2	3	25	26	27	28	29	30	1	23	24	25	26	27	28	29
30	1	2	3	4	5	6	4	5	6	7	8	9	10	2	3	4	5	6	7	8	30	31	1	2	3	4	5
12th Sep: ECB Meeting 18th Sep: FOMC Meeting 19th Sep: SA MPC 19th Sep: BoE and BoJ Meeting							18-20th Oct: World Bank and IMF meet 23rd Oct: SA MTBPS 24th Oct: ECB Meeting 27th Oct: Argentina election 30th Oct: FOMC Meeting 31st Oct: BoJ Meeting, End of term for ECG President (Draghi) and EC President (Juncker)							7 Nov: BoE Meeting 22 Nov: S&P/Fitch review SA credit rating							11th Dec: FOMC Meeting 12th Dec: ECB Meeting 19th Dec: BoJ Meeting						

- Central Bank Meeting
- World Summit/IMF/Trade war/Political
- Election

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