Viewpoint: Three risk factors conspiring to undermine the ZAR

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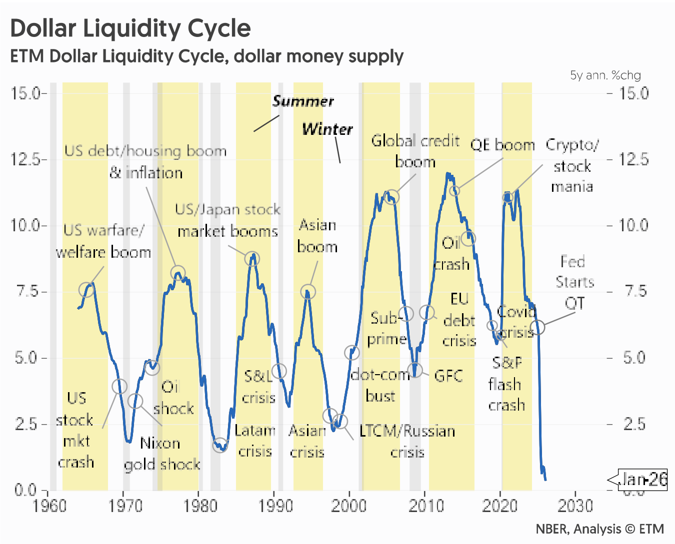
Key points

- There are three distinct risk factors in the market at the moment that could negatively disrupt emerging-market currencies. Those include the maturing business cycle, the potential for an AI bubble, and, more recently, the outbreak of war. Any one of the three would be enough to trigger a major stock market correction. But when all three exist concurrently, the probability of an uncomfortable outcome increases substantially.
- The risk for the ZAR is that all three unfold together, raising the probability of a significant sell-off. Risk reversals already point to more aggressive hedging against ZAR depreciation, suggesting the market is primed for it. It is an uncomfortable situation for the South African Reserve Bank, which will already be bracing itself for an inflation episode to which it will need to respond. Hiking rates will detract from the bond market's appeal, which, in turn, will erode the ZAR's resilience.

BASELINE VIEW:
This confluence of factors is difficult to ignore, as it tilts the scales very firmly against the ZAR. While exporters will hope for more ZAR depreciation to boost the value of their repatriated foreign earnings, importers will face the prospect of an expensive ZAR, making their goods that much more expensive.

Given the current balance of risks, exporters will need to plan their strategies to take advantage of any near-term ZAR depreciation and secure some of the best forward rates they have seen in months.

War hits markets just as USD liquidity dries up



Current developments are not happening in isolation. There was a pre-existing economic reality that preceded the war, which also needs to be considered.

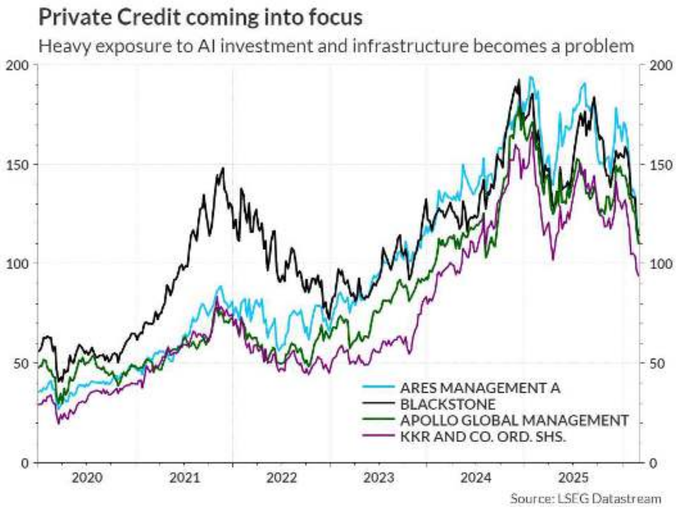
That reality stems from the initial central bank response to the pandemic and the subsequent liquidity-draining quantitative tightening.

Stated differently, the stimulatory effects of the Fed's monetary approach were largely, if not completely, unwound, and that will have consequences for the underlying business cycle.

The logical implication is that if a ramp-up in liquidity will prop up the business cycle, the withdrawal of that same liquidity will undermine it.

The main point to take away from this is that the war with Iran and the oil price shock that followed couldn't have happened at a worse time. If one were looking for a catalyst for trouble, the sharp rise in oil prices would certainly feature prominently.

Private Credit becomes the second potential trigger of a major downturn



A second catalyst that has slipped under the radar has been developments in the US regarding private credit and its exposure to the Artificial Intelligence Industry. In the past two weeks, private credit stocks listed on the NYSE have sold off aggressively, and all indications are that they have further to go. Investors have been speculating for some time now on whether AI stocks are in a bubble.

This is the first indication of strain in the front-line finance sector, raising serious questions about the sustainability of the stock market gains seen in recent months. At the moment, stocks are correcting across most sectors as investors position for some strong growth headwinds. However, when one considers how AI stocks have rallied and driven US markets higher, the obvious conclusion is that this market is potentially ripe for disruption.

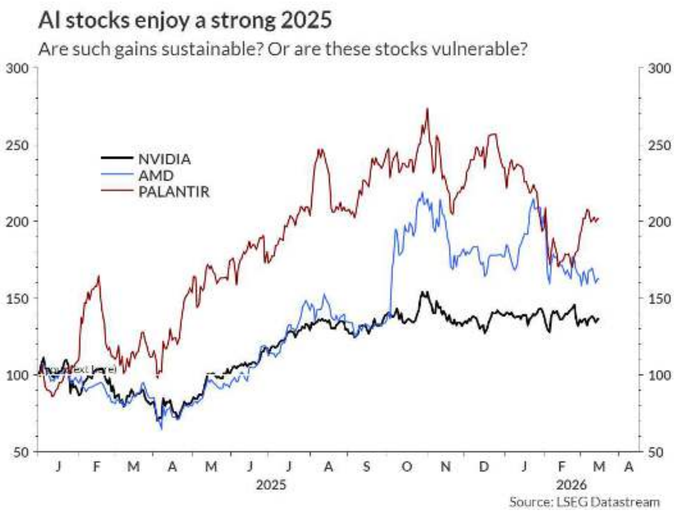
Given the recent focus on AI's prospects, the productivity gains it will generate, the investment it will attract, and the inflationary impact it will likely have, this has become an important sector. In 2025 alone, private sector investment rose to around $250bn, with some analysts anticipating this trend will continue into 2026. Such colossal capital injections imply that this sector is now structurally important for the US and, indeed, the global economies.

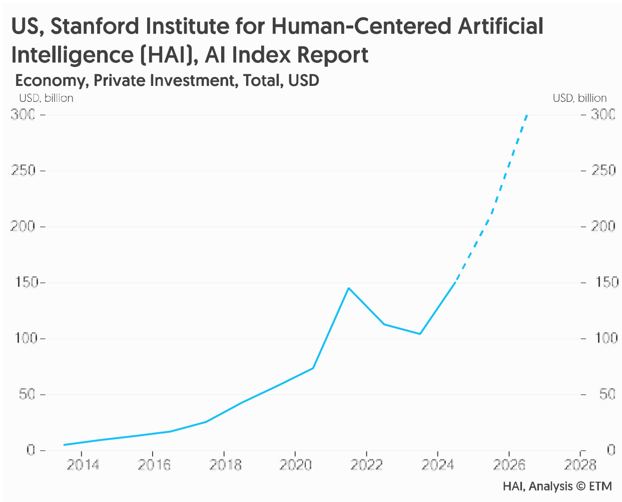
Once again, it is worth noting that the correction in this sector, which could have far-reaching consequences for the economy, is unfolding alongside the tightening of USD liquidity. This is the second potential trigger of a major financial market correction with unfortunate timing, dialling up the possibility of a downturn.

AI bubble back in the spotlight

On the promise that vast amounts of capital will continue to be invested in this sector and that it will drive massive productivity improvements, these AI stocks have, in some cases, doubled in price in just one year. Nvidia which was one of the less prolific AI companies, has gained nearly 50% in the past year alone, and while the trend appears to have stabilised, the prospects still look strong.

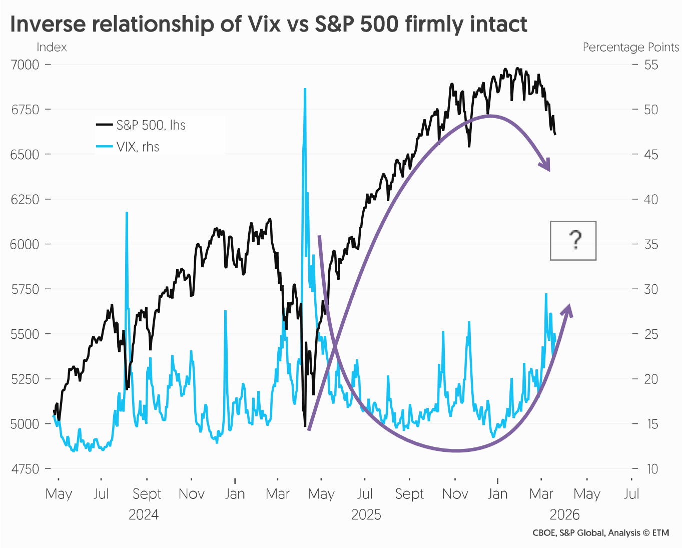
The question is whether there is a business case for continuing to invest the amounts already invested. In 2025 alone, estimates place the investment at levels approaching $200bn, with that set to rise towards $300bn per annum in 2026 with further growth anticipated in 2027. Increasingly, questions are being asked about the level of returns one would require to justify this degree of investment, and answering them is becoming increasingly difficult, especially with the outbreak of war and the maturity of the business cycle.





That holds implications for overall levels of risk appetite.

Equity market vulnerability rises with VIX



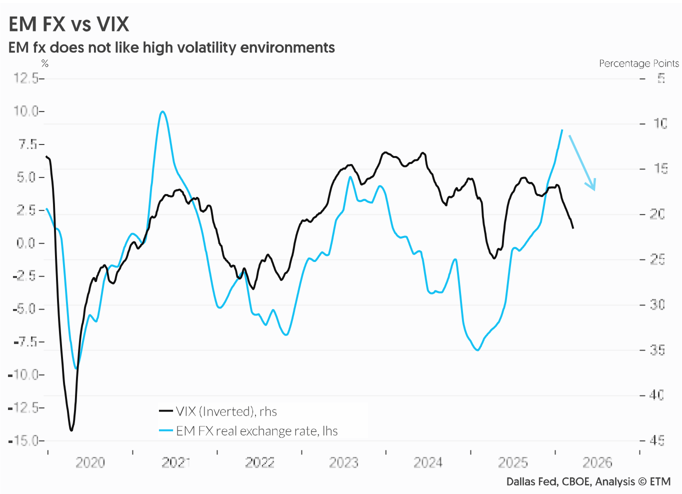
The relevance of these equity market developments for understanding broader financial market volatility should not be underestimated. The existing backdrop to the current equity market is one of great stress.

Not only has the business cycle matured considerably, but the risk of an AI bubble deflating is real, and it's all unfolding against the backdrop of an energy price shock that will undermine global GDP growth dynamics.

The current energy price shock is inescapable. It permeates all aspects of society and affects consumer demand just as much as it impacts production schedules and logistics. The overall inflation hit is enough of a trigger on its own.

Still, when added to the possibility of fuel, fertiliser and other shortages, the stage is set for a tumultuous period in global equity markets, especially if the war drags on for longer than anticipated. The damage inflicted by Iran on Gulf country oil and fuel refineries becomes difficult to recover from.

As VIX levels rise, so emerging market FX underperform



The VIX (cost of hedging oneself against a sell-off in the S&P 500) has long been considered a good barometer for risk appetite.

The higher the VIX, the lower the risk appetite. If the anecdotal evidence often quoted by FX traders that the ZAR or emerging market exchange rates come under pressure when risk aversion rises, then it should reflect in the data.

Indeed, it does, as reflected in the accompanying chart, which highlights the typical underperformance of emerging-market currencies during periods when global stock markets are under pressure.

This offers further insight into why the business cycle, a possible AI bubble, and the war should all be taken into consideration, and why they have tilted the scales against emerging-market currencies, including the ZAR.

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