Viewpoint: ZAR impressively resilient given the war

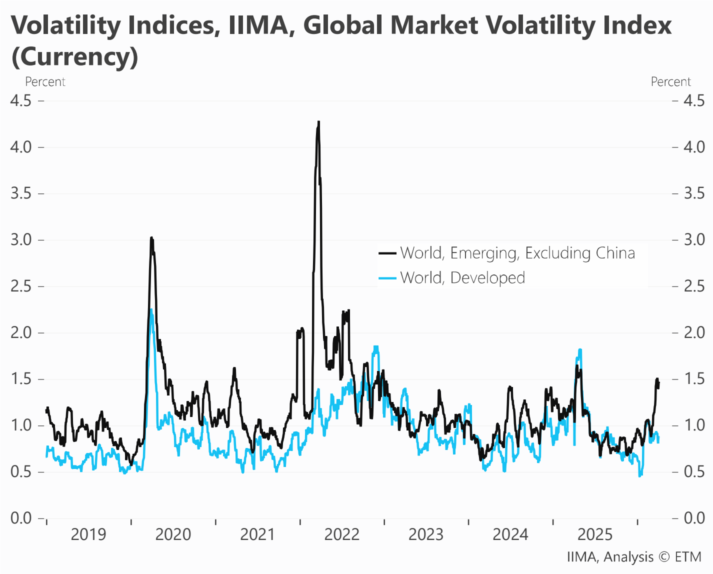
Key points

- There is a lot of hope riding on this weekend's developments in Pakistan and whether a lasting peace deal can be negotiated. Although Israel and the US would've preferred outright regime change like the US accomplished in Venezuela, it is now obvious that this will not be repeated in Iran. The Iranian government's structure is designed to withstand leadership decapitation and has proven impressively resilient.

- The result is a stalemate. Both sides can continue the war, but at tremendous cost, and it is in no one's best interest to do so. Getting caught up in the negativity of the news headlines is easy. More challenging is to assess whether the pressure points from both sides are strong enough to help forge an acceptable outcome that both sides can live with. There is deep distrust on all sides, so a final resolution is unlikely this weekend. However, some signs of progress will go a long way to placating financial markets.

BASELINE VIEW:
Markets are hopeful that progress will be made to end this war. FX markets and the ZAR in particular have not responded as dramatically as one might have feared, given the escalation in energy markets, implying that this was never considered a 'forever war'. A quick resolution would boost the ZAR, to give importers an advantage.

FX volatility remains well contained



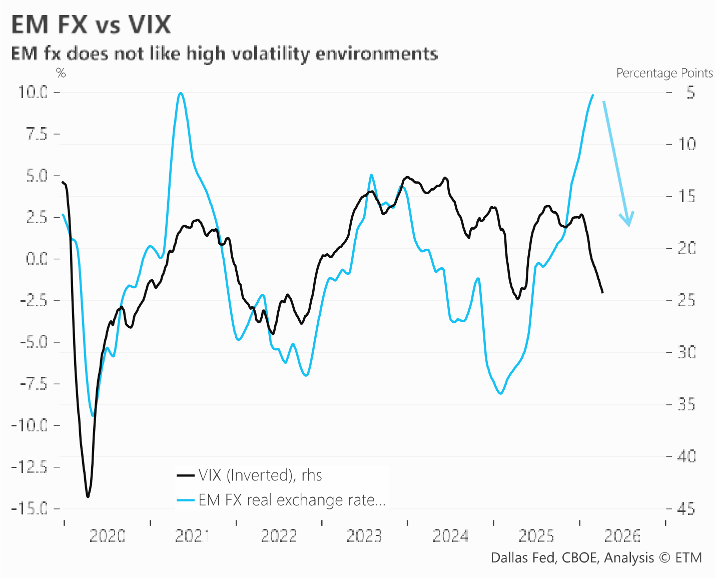
One would be forgiven for thinking that the war in Iran and the complex consequences it could drive would be tearing financial markets apart.

After all, oil is such an important input into so many aspects of life that it holds the potential to be massively disruptive. And yet, so far, financial market movements have remained fairly well-contained.

An assessment of currency volatility across both developed and emerging markets, conducted by the Institute for International Monetary Affairs (IIMA), shows that while FX volatility has risen due to the war, the spike, especially in EM currencies, has been well contained.

The media coverage seems at odds with developments in financial markets, which have taken much of the spike in energy prices in their stride. It means that either investors are overly optimistic that this will blow over soon, or it suggests it is less of a crisis than first thought.

Overall risk aversion has deteriorated only moderately



Analysis of the VIX historically vs an EM FX index generated by the Federal Reserve of Dallas shows that emerging market currencies typically do not enjoy high volatility. The fit with the VIX is reasonable, and the VIX is widely regarded as a good barometer for risk appetite.

However, even when one looks at the spike in the VIX (black line INVERTED) in the accompanying chart, it is very clear that this surge in the VIX cannot be compared to the spikes seen at the start of the pandemic in March of 2020 or the invasion of Ukraine by Russia.

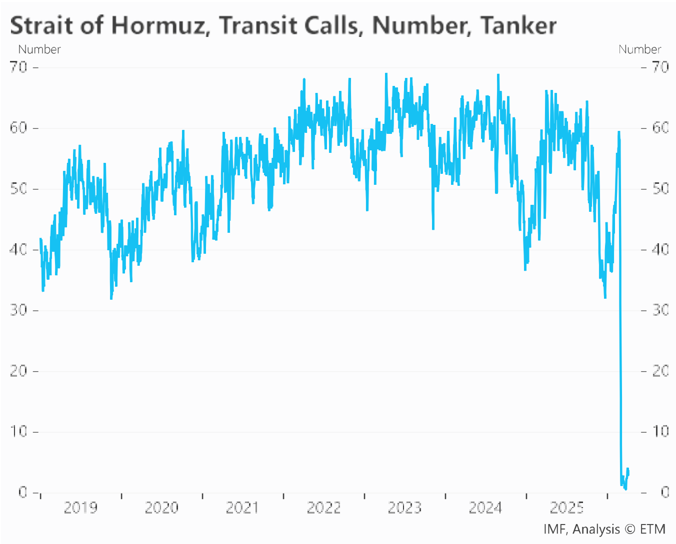
So, while elevated, this is just one more indicator suggesting that the market is much less concerned about the ultimate outcome than media outlets have characterised events in the Middle East.

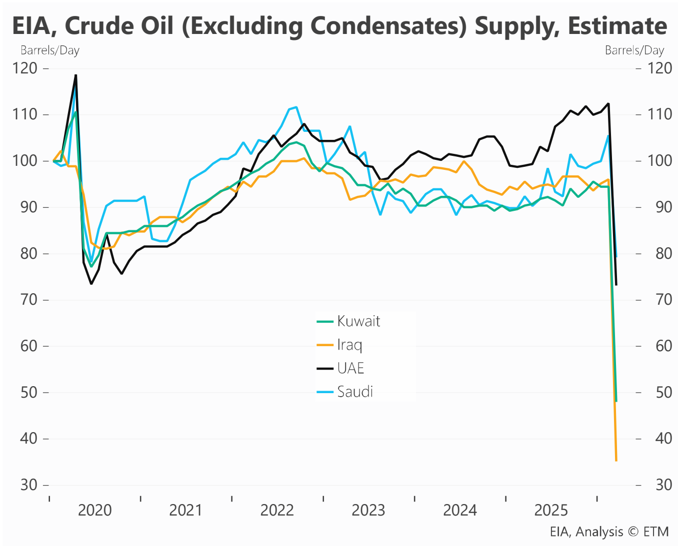
One could argue that the markets are far too sanguine about the war's outcome and that this will all turn calamitous if this weekend's peace negotiations do not go well. But perhaps the markets are assessing the risks more objectively.

Sometimes, the collective wisdom of the market can misjudge a situation. It has happened before and will happen again. So that can never be ruled out. But in this instance, it might also be that there are enormous vested interests for all parties concerned to find a solution, and to find one quickly

Concerns are understandable

While it is easy to see why investors would be concerned about current developments given the collapse in the amount of traffic through the Strait of Hormuz and the sharp drop off in production, this ultimately comes down to how long the war drags on for and whether negotiations will lead to an opening of the Strait. Countries beyond just the Gulf states are fed up with the impact that Iran's position of bombing regional infrastructure and closing the Strait is having on their economies.





Iran has so far shown little willingness to yield. Officials have rejected proposals linking a temporary cease-fire to the Strait's reopening and have instead escalated retaliatory attacks on energy, desalination, and power infrastructure across the Persian Gulf region. This mirrors the US strategy but shifts the battlefield outward, aiming to raise global energy costs and erode Washington's and its partners' resolve.

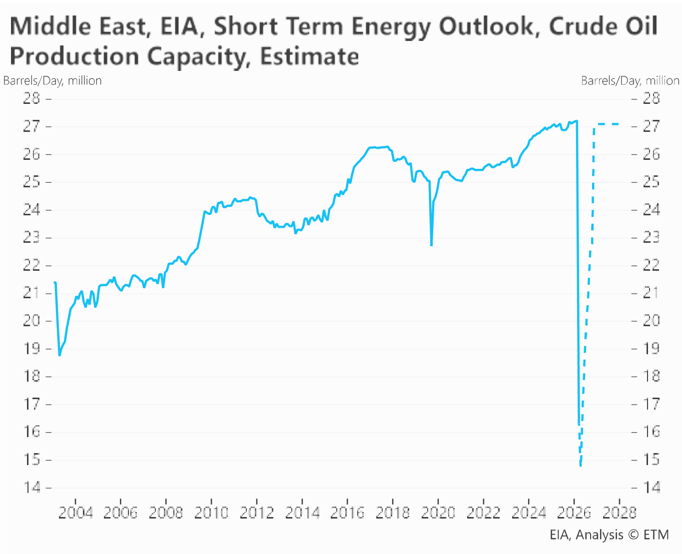
Iranian leaders appear prepared to endure domestic hardship—rising food prices, factory closures, and mounting unemployment—provided they can sustain pressure on adversaries and preserve regime stability.

Even if the Strait were cleared, damage to refineries and export terminals could keep millions of barrels of refined products offline for months, prolonging supply shocks.

However, any credible sign of de-escalation could quickly reverse any premia baked into the market, underscoring how market confidence hinges on a constructive outcome to the talks this weekend. The biggest risk of all is that the talks fail and the Gulf nation states display a growing appetite to join the conflict and intensify pressure on Iran to open the Strait of Hormuz. As indicated above, the stakes are high for all parties, and there are strong vested interests looking for a resolution to this crisis, even from the Iranian regime, which will not want to suffer further infrastructural damage

Gulf analysts view Iran as damaged but resilient and vengeful, requiring sustained regional pressure before it yields control of the waterway. Iran's ambition to convert the Strait of Hormuz into a toll gate is tactically plausible in the short term. Tehran has already established a de facto system, selectively authorising passage for friendly or paying vessels—often in yuan or cryptocurrency—while parliament has approved formal transit legislation. Geographic dominance of the northern shore and low-cost asymmetric tools (drones, missiles) allow enforcement without full closure, generating revenue for Iran and negotiation leverage amid the conflict.

EIA is expecting a quick resolution

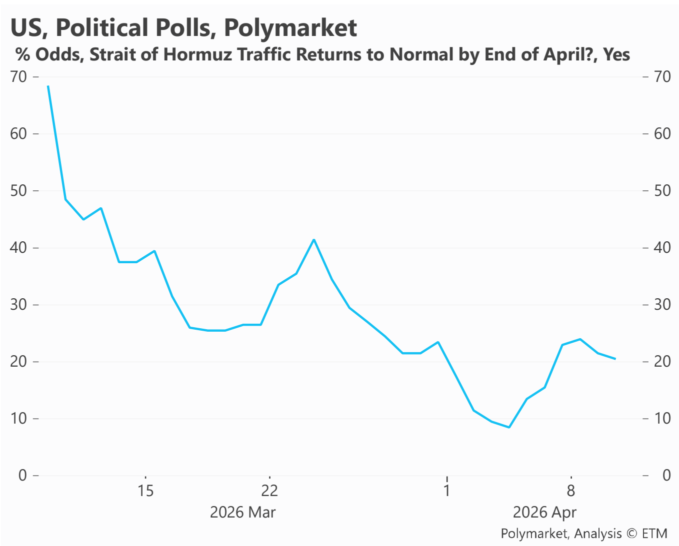


However, the international community will likely not tolerate such an outcome. The US, EU, Gulf exporters, India, and Japan have denounced the scheme as illegal economic coercion and are pushing naval coalitions or UN measures to restore open navigation.

Iran could plausibly pressure Yemen's Houthis to replicate the model at Bab el-Mandeb in the Red Sea, creating dual chokepoints, but retaliation risks from Gulf countries and the West may dissuade them from following through. Doing so would only anger Gulf nations and Western economies, so, for now, this is not considered the base case.

The EIA's forecast is for a quick resumption of oil production and supply should this war end, and the Strait of Hormuz be reopened. The EIA has modelled its forecasts on the belief that the Trump Administration is looking for an offramp and that the ultimate disruption will be short lived.

Betting odds still uncertain of the reopening of the Strait



The speculative betting market is less convinced and currently sees the reopening of the Strait of Hormuz at just 20%. Iran knows this is its point of leverage, and entering the weekend's negotiations, it will try to use it as much as possible.

But that does not mean that it is therefore unwilling to compromise. Not compromising risks further infrastructure damage, and that is neither helpful to the Islamic Regime that wants to remain in power, nor for the economy, which is already struggling and likely already in a recession.

So far, because Iran wasn't the initial aggressor, many countries have given Iran the benefit of the doubt heading into these peace negotiations. However, that patience is not infinite and pushing the Strait of Hormuz leverage too far will not help their cause. What little sympathy and latitude Iran currently enjoys can disappear quickly. On this basis, one hopes that a resolution can be negotiated.

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