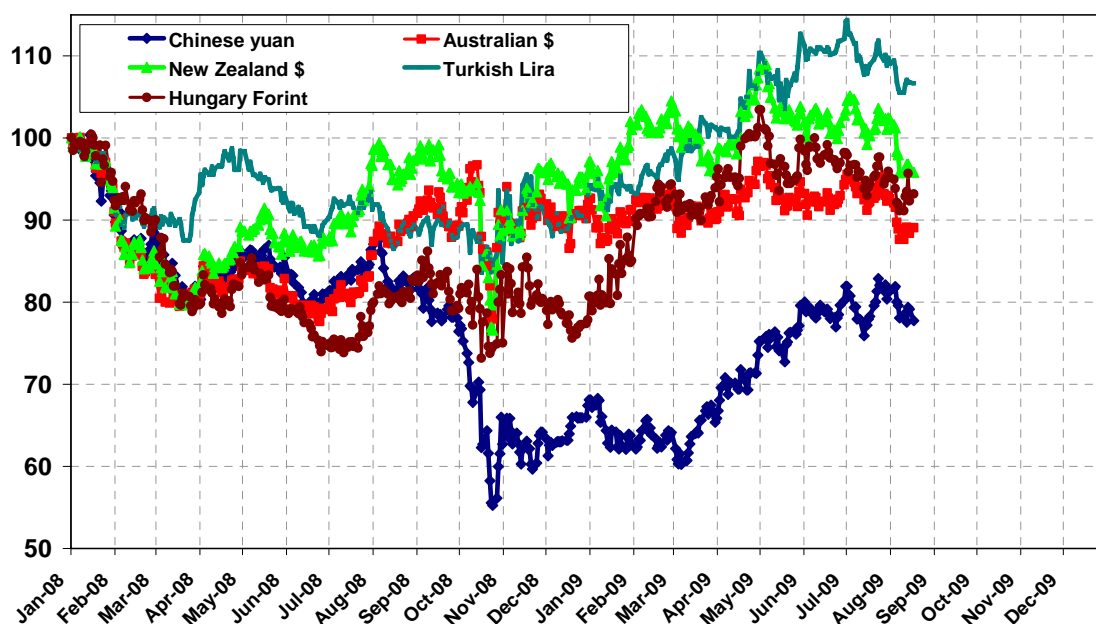


Rand prospects: early signs of vulnerability?

The rand had a volatile month against the major currencies, initially helped by foreign direct investment hopes and dollar weakness, but later hampered by concerns of increased strike activity, a firmer US dollar and jitters in financial markets. Over the month the rand eased by 1,4% against the trade-weighted basket and by 1,1% against the US dollar, 1,3% against sterling, 1,2% against the euro and 0,1% against the yen. Over the past year it has fallen by 2,5% against the basket, but it is still up 12,2% in the year-to-date. The rand has also started to show some vulnerability against its peer emerging market and commodity currencies (see figure 1). This could mean that investors are starting to differentiate more actively between currencies after the fairly uniform treatment during the first half of the year. However, for the moment, global factors – the ebb and flow of risk aversion and the hopes and fears around the state of the global economy – are still the key determinants of the local unit's fortunes.

Figure 1: Some easing against peer currencies, but still in the pack

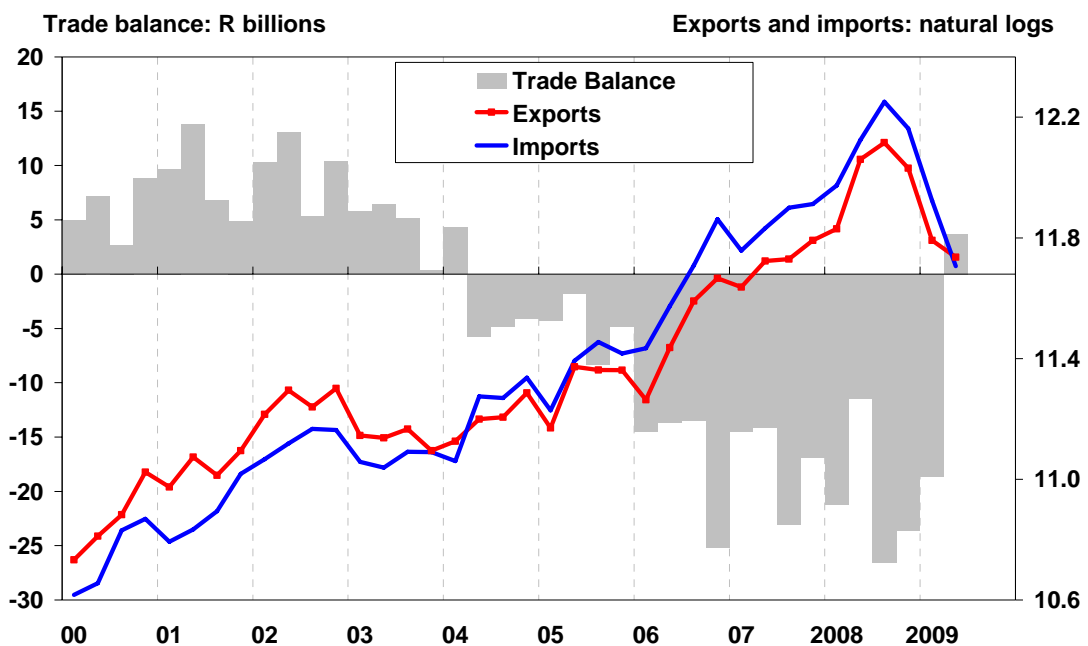
Rand versus peer currencies: Index 2 Jan 2008=100



Since March global equity markets have experienced a remarkable run, rising strongly after the massive falls in 2008. The world MSCI has risen by 50% from its trough. In part this was a reaction to the size of the fall in 2008 and in early 2009, when markets collapsed by around 57% in anticipation of a potential repeat of the 1929 to 1934 experience. However, government and central bank policies have been highly stimulatory and global economic activity has gradually started to level off. Markets anticipated the rebound, but there is still some confusion as to its strength and sustainability. Altered credit markets, and high levels of indebtedness and unemployment distinguish this recession from previous ones. Our guess remains that the positive effects of short-term fiscal stimulus measures will start to fade as the northern hemisphere winter approaches and that the rebound caused by the inventory cycle currently underway will also be relatively disappointing. Although the global economy will start to grow as the second half of the year progresses, the extent and durability will probably disappoint and could lead to setbacks in forward-looking equity prices. If this thesis is correct the rand will become increasingly vulnerable – the dollar will firm and commodity prices will come under renewed pressure.

One potentially supportive factor is the current account deficit, which has shown signs of narrowing significantly in the second quarter. The trade balance has moved back into surplus for the first time since the first quarter of 2004 and it is likely that the services deficit would also have narrowed on lower dividend payments. We estimate that the deficit could narrow to below 5% of gdp for 2009 as a whole from 2008's 7,4%. Given that the large and, until recently, growing current account deficit has been a major concern for investors, any improvement should be viewed positively. Unfortunately, the narrowing has been due to imports contracting, which, in turn, is a sign of economic weakness and slowing fixed investment spending. Under these circumstances a narrowing in the current account deficit does not always help investor sentiment and the currency might therefore not be as well supported as it would have been if both exports and imports were booming.

Figure 2: Trade balance has swung back into surplus



Conclusion

The rand has recently started to show some signs of vulnerability following its strong rebound in the second quarter. Its fortunes have remained tied to developments in the global economy and markets. We are still anticipating some weakness, particularly over the September to October period, with the rand ending the year lower on a trade-weighted basis. The currency should then consolidate in 2010 on local optimism and a better based recovery.

17 August 2009

Influences on the rand			
Factors	Effect	Tendency	
		Recent	Expected longer-term
External or international			
US dollar	Weak dollar normally implies firmer trade-weighted rand.	Dollar performance has been mixed, at times hurt by lower risk aversion, but at other times helped by European woes.	Becoming more ambiguous given EU weakness and a substantial narrowing of the US current account deficit.
Commodity prices	Strong commodity prices are rand supportive.	Strong rebound in industrial commodities and oil on global recovery hopes has recently started to falter.	In the long term Chinese demand will again be a dominating force. However, medium-term weakness is likely, given the serious deterioration in the global economy.
Interest rate gap	Higher = positive, but depends on circumstances.	SARB has resumed interest rate easing with little effect on the currency.	MPC will probably ease later in the year again, but interest rates are now close to the trough.
Emerging market perceptions	Positive = good for rand.	Risk aversion has eased but investors are becoming more wary.	Strong risks of a relapse in sentiment if global economy disappoints later in the year.
Predominantly domestic			
Growth perceptions	Rand strength if perceptions of relative growth are positive	SA's first quarter gdp figure was terrible, falling by an annualised 6.4%. Early indications from the second quarter are not favourable.	Depends on global growth cycle, but could become more favourable in relative terms in 2010.
Current account	Large unsustainable deficit would be rand negative.	Rose to 7,0% of gdp in the first quarter after narrowing to 5,8% of gdp in the 4 th quarter 2008. Recent trade figures have shown significant improvement and the deficit will narrow.	Will remain wide in the global context; sustainability depends on consumer/ investment mix, commodity price cycle, policy and external perceptions. Lower dividend payments will help.
Policy and policy perceptions	Rand positive, if promotes financial stability and economic growth.	Policy debate has re-opened with potentially negative consequences for the rand. The mandates of the current economic portfolios need to be clarified. Despite this, Moody's has moved SA into the A3 category.	Less supportive in the medium term, with dangers of policy relapses occurring if weak global conditions persist.
Exchange controls	Relaxing potentially negative for rand in short term, positive in long term as foreign investment picks up.	No major changes expected in the short term.	Uncertain, but probably less impetus for relaxation.
Abnormal flows	Inflows/ outflows related to FDI transactions	Expected MTN deal recently provided a boost for the rand, but effect fading on uncertainty.	Uncertain. Inflows should pick up once political and policy environment becomes clearer and global climate settles.
Rand under- or overvalued?	If overvalued then will depreciate in long term and vice versa.	Probably slightly overvalued at current levels although undervalued on strict PPP.	Should revert to long-run fair value based on adjusted PPP.

While every care is taken to ensure the accuracy of the information and views contained in this document, no responsibility can be assumed for any action based thereon.