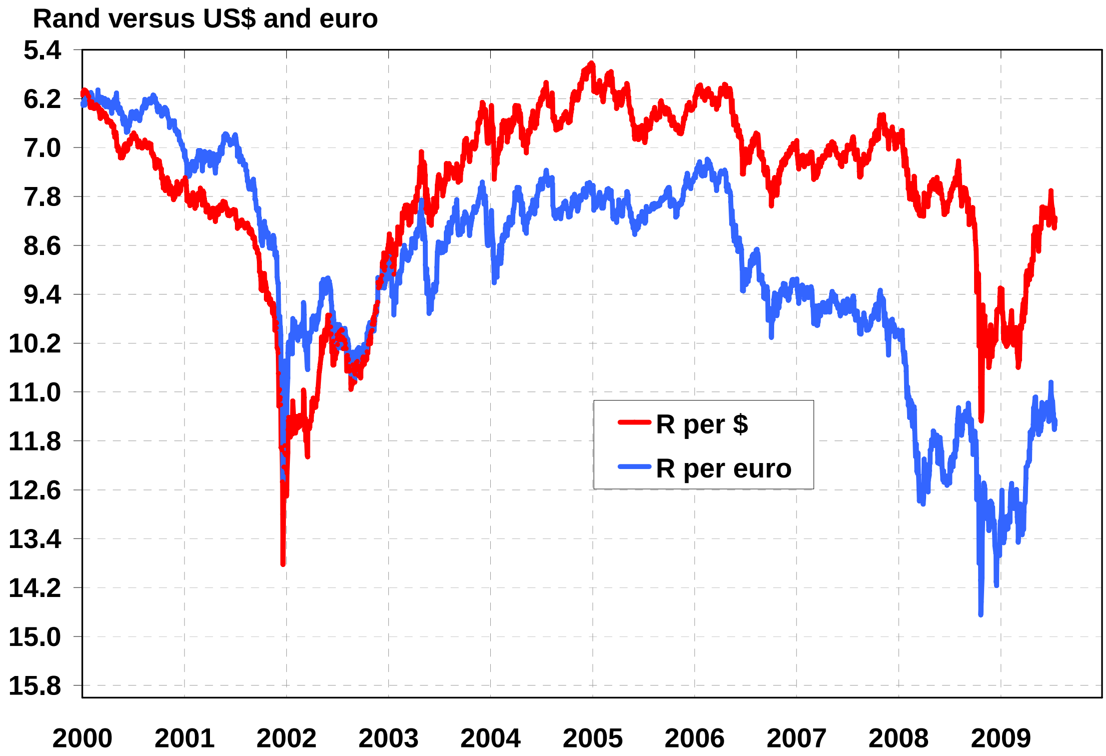
Rand prospects: weakness likely towards year end

The rand weakened marginally over the course of the last month, but fell more substantially from its early July highs. On 1 July it reached an eleven month high against the trade-weighted basket of currencies, but has since eased by over 5%. Over the month the rand slipped by 1,7% against the basket and by 0,8% against the US dollar, 0,9% against sterling, 2,2% against the euro and 5,5% against the yen. However, it remains well above the levels experienced in the last quarter of 2008 and the first quarter of 2009.

Figure 1: The rand continues to reflect global sentiment



The rand is still being largely controlled by global factors. Its recent weakness was a combination of a small pullback in the dollar and some concerns that the 'green shoots' of recovery were beginning to frost over, with recent US employment, consumer confidence and industrial production figures not at all encouraging. However, it continues to track peer currencies (emerging market as well as commodity currencies) quite closely, with all these still reflecting a fairly cheerful view of the global economy. The Chinese stimulus-driven economic rebound – with growth rising to just under 8% in the second quarter – has raised hopes that emerging market economies will continue to outperform advanced economies in the short term before a more general upswing commences in 2010. There are also hopes that a slower drawdown in inventories could result in some growth surprises in developed economies from the third quarter onwards. All this has been reflected in a general pause in interest rate and fairly buoyant stock markets.

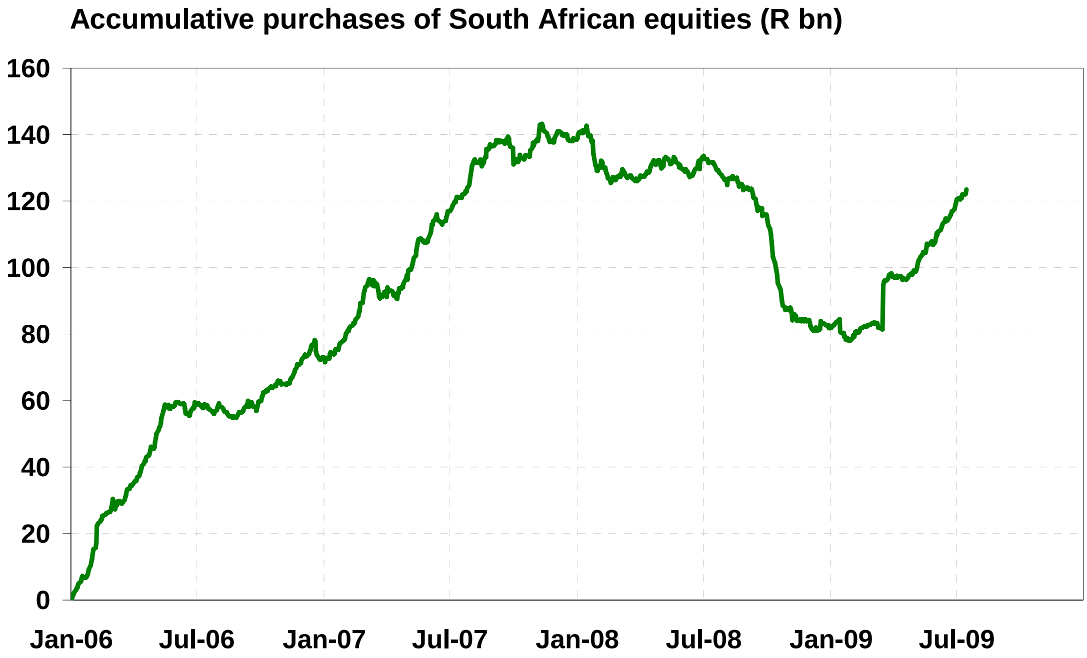
In our view this happier picture could be a bit premature. While the global economy will stabilise over the next few quarters, the medium-term outlook is still very murky with the risks mainly to the downside. Money markets have normalised, helped by massive government backing, but credit markets are still far from normal, both at commercial bank level as well as in securitised markets.

Confidence is still brittle and job losses are continuing, hampering any real possibility of a sustained upswing in final demand.

From the rand's perspective there also seems to be a seasonal element that may relate to financial market vulnerability. The rand tends to rise in the middle part of the year, possibly on the good cheer caused by summers in the northern hemisphere, but often falls back over the third and early fourth quarters – periods associated with international market setbacks in the past. This was particularly the case in 2008, but also applied to varying degrees in 2006, 2002, 2001, 2000, 1999 and 1998. The strong rand bull market from 2002 to 2004 – when the global economy entered its best 'Great Moderation' years (low inflation, but strong, consistent growth) – tended to override seasonal considerations. If this same pattern is repeated this year, then the rand might already be beyond its local peak and could be headed for a short-term correction.

Any weakness thereafter could be relatively shortlived, however. More sustained confidence should start to seep back into global financial markets as 2010 progresses and South Africa will have the added benefit of the FIFA 2010 World Cup, which should help local confidence as well as the economy.

Figure 2: Net foreign purchases of South African securities have picked up



Conclusion

The rand has been helped by hopes of a stabilising global economy. However, the risks of further setbacks over the next few months are high and markets will probably get jitterier as the northern hemisphere's autumn approaches. Although some improvement could then occur late in the year we still expect that the rand will end the year weaker on a trade-weighted basis.

17 July 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 has been mixed, at times hurt by lower risk aversion, but 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.	Some improvement in industrial commodities and oil as hopes of firmer Chinese demand increases. However, precious metals have faltered on lower risk aversion.	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 paused its easing. Interest rates are still attractive in nominal terms and will attract flows on carry trade.	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.	Some easing in risk aversion but climate still potentially volatile.	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 as 2010 approaches.
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 4th quarter 2008. Recent trade figures have shown significant improvement and the deficit will probably 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, although uncertainty will be reduced after the elections.
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	Vodacom deal recently provided a boost to the rand.	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.