INTUITION
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The Rand Rollercoaster

Last week our country recorded a new record, but not one of which we should necessarily be proud. The Rand fell to its weakest level ever – against all major currencies. Furthermore, it weakened against those of our peer group as well, suggesting that the reason behind the move was a local issue, not necessarily a global one. In part, the Rand weakness can be ascribed to deteriorating trade fundamentals. But there is no doubt that we continue to score "own goals" with nauseating consistency. This week we delve into the Rand's performance to shed light on the underlying issues.

Michael Porter

Last week South Africa achieved a new record, but not one over which we should be immensely proud. The Rand reached a new low against all major currencies, surpassing even the weakness experienced at the height of the Covid Pandemic. In fact, amongst the sixteen "major" currencies tracked by Bloomberg, the Rand has performed the worst against the US Dollar for the year so far. This is in stark contrast to some of our peer countries (such as Brazil and Mexico) whose currencies have actually appreciated against the Dollar this year. In fact, the Rand's weakness comes at a time when the Dollar itself is starting to weaken as markets start to discount a peak in US interest rates. That should be good news for emerging market currencies, yet the Rand is under pressure. Why?

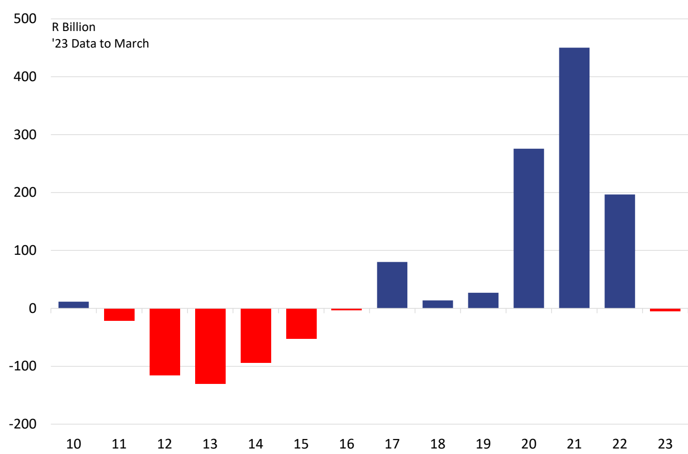
In part, the weakness can be explained by a deterioration in our trade statistics. South Africa has always traditionally been known for its "twin deficits" – a reference to the deficit on both the Government's Budget and the Current Account. However, over the past six years SA has generated a trade surplus – the value of our exports has exceeded that of our imports – and the past three years have been record surpluses at that. A quick glance at the chart below shows the magnitude of the surpluses relative to the past thirteen years. They have been substantial, driven by a collapse of imports during Covid in 2020 and then a surge of exports in 2021 and 2022 due to rampant commodity prices – especially iron ore, rhodium and coal.

Not only did these exports bring in much-needed foreign revenue, but they also generated a significant amount

SPEED READ

- After three bumper years of exports, our trade balance is normalizing, removing one of the key factors that has supported the Rand in recent years.
- Foreign investors have been selling SA investments for the past seven years. That trend has accelerated over the past two years, especially in the bond market.
- While a peak in US interest rates should imply a weaker Dollar, and therefore stronger commodity prices and the Rand, we need to stop scoring own goals for this to be realized.

SA TRADE BALANCE

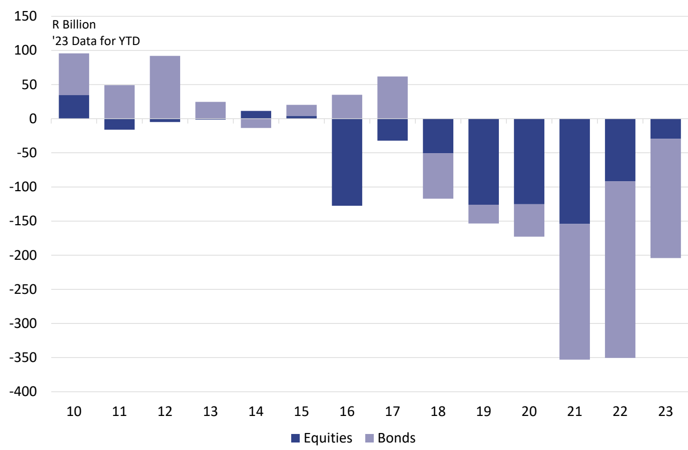


We have recorded a trade surplus for six years in a row, the last three being bumper years. But weaker commodity prices and a surge in imports to counter the electricity shortfall have eroded this trend. So far this year SA has recorded a modest trade deficit.

of extra tax revenue through royalties. Unfortunately, this windfall has now disappeared. Commodity prices have retreated to more normal levels and crumbling rail infrastructure has restricted the volume of exports. Even if commodity prices surged again, we would struggle to take advantage of it because Transnet cannot provide sufficient rail capacity. On the other side of the coin, imports are surging, not least to mitigate the unprecedented electricity crisis. For example, and quite unsurprisingly, imports of solar panels have reached R2 billion so far this year – and that is data to the end of March only. The trend can only accelerate as the year moves on.

Compounding this weakness in trade is a deterioration in government's own finances. Treasury announced last week that it had failed to generate a primary surplus for the FY23 fiscal year – in contrast to the forecasts made just three months ago in the February Budget. Tax revenue was lower and spending was higher – not a good combination. Foreign investors were already nervous. They have been selling SA equities and bonds for years thanks to weak growth, electricity shortages and precarious government finances. Our greylisting at the end of February – which could have been avoided - just added salt into the wound. The chart below shows the extent to which foreigners have sold both local shares and local bonds over the past eight years. Initially, selling was concentrated in equities, but recently, that has spread aggressively to government bonds. Since January 2016, foreign investors have sold a cumulative R737 billion worth of SA equities and R677 billion worth of bonds. All things considered, it is actually remarkable that the Rand had held up as well as it had in the face of this onslaught.

ANNUAL FOREIGN PORTFOLIO INVESTMENT INTO SA



For many years post Democracy, we attracted foreign investment into our equities and bonds. Unfortunately, that trend has disappeared. Foreigners have been aggressive net sellers for the past eight years. Monthly data for April actually showed a small reversal, but it is likely to prove short-lived as our Government scores another own goal.

South Africa's trade deficit is not ideal as we are importing more and exporting less.

If loadshedding and corruption were not enough, unfortunately our government continues to score "own goals" with a consistency that would be the envy of every English Premier League football club. Last week, the US accused SA of selling arms and ammunition to Russia. Relations with the US are already strained over our "non-aligned" policy towards Russia and our stance may jeopardize our access to AGOA – the Africa Growth & Opportunities Act – which provides SA firms (and exports) with favourable access to US markets. If this were to be rescinded for any reason, exports worth R400 billion could be affected. Needless to say, investors ran for the hills – just another reason to write off SA and look elsewhere.

Unfortunately, government's actions have consequences – something over which they seem to be blindly unaware! For starters, the weaker rand will fuel inflation. Whereas our market had started to anticipate an end to our interest rate cycle, that has now been turned on its head. Far from expecting that our interest rates may have peaked, the market is now expecting the Reserve Bank to raise interest rates by a further 0.5% when they meet next week, with an outside possibility of more increases later in the year. That in turn will put even more pressure on consumer spending and an already fragile local economy.

History has taught us not to panic when the Rand weakens sharply, and certainly not to make knee-jerk decisions. Invariably it stabilizes and indeed, it has already done so from the weakest levels. Yet it is hard to see a catalyst for a strong rally in the currency in the near term. Nonetheless, global conditions are turning more favourable. A weaker Dollar implies both stronger commodity prices and a stronger Rand. Locally, investment into electricity infrastructure by the private sector is growing exponentially, which offers a ray of hope that this year will see a peak in loadshedding. But to realise the benefit of a weaker Dollar and better global conditions, we need to stop scoring own goals. That is far harder to forecast!

Our next Insight seminar will take place in June and provide an update on what has driven markets over the first six months of the year, and what might lie ahead for the balance of the year. We are very excited to be expanding our seminar program to Cape Town.

Topic:	**Mid Year Market Update**
Natal Midlands	
Date:	Thursday, 22nd June 2023
Venue:	Oasis Conference Centre, 72 Main Road, Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm
Johannesburg	
Date:	Tuesday, 13th of June
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am
Cape Town	
Date:	Wednesday, 14th of June
Venue:	ABRU Motor Studio, Lourensford Wine Estate, Somerset West
Time:	5.30pm for 6pm

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