ECONOMIC NEWSLETTER

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UNPACKING THE RAND'S MAY MELTDOWN

May has proven to be a particularly dire month for our local currency, with the ZAR depreciating by 8.4% against the dollar over the course of the month.

Starting the year at a rate of R17.04 against the dollar, the ZAR has depreciated by a whopping 16.5% over the past 5 months, and is now dangerously close to breaking through the R20.00 mark. May's level of deprecation is well-ahead of the historical average, which has seen the rand depreciate by an average of 0.6% on a monthly basis over the last 10 years.

Intra-month, the ZAR traded at an all-time low relative to the dollar, reaching an intraday level of R19.46 on the 12th of May. After a small degree of consolidation, the ZAR broke its own record and ended the month at R19.78 against the dollar.

THE RUSSIAGATE FIASCO

While there are many factors contributing to the current level of rand weakness, perhaps the most widely publicised has been the controversy surrounding our alleged supply of military arms to Russia aboard the Lady R naval vessel. On the 11th of May the US Ambassador to South Africa told local media outlets that the US believed there to be weapons and ammunition loaded on the Russian vessel which had docked in Simon's Town late last year.

The Rand responded in quick fashion on receiving the news and by the close of business on the 12th was trading at R19.34, over 5%, and a full rand weaker than it had been trading against the dollar a mere four days earlier.

The primary concern surrounding the US accusation is the potential threat it poses to South Africa's participation in the African Growth and Opportunity Act (AGOA). Essentially, AGOA allows for duty-free treatment to goods of its sub-Saharan African member countries. Enacted by the US in 2000, the program seeks to promote economic growth through free market trading and good governance. The act covers both textile and non-textile goods and accounts for roughly $2.7bn worth of South Africa's exports to the US.

Since the initial statement issued by the US ambassador, the ANC government has denied any involvement and has launched an investigation into the contents of the Lady R. Subsequently, the Biden administration has also made efforts to de-escalate the matter, citing their desire to keep the dispute private in an effort to maintain the ties between the US and South Africa. Despite the initial alarm (fuelled in part by several overblown news headlines), the present risk of South Africa losing its status as an AGOA member appears to be extremely low. Furthermore, the $2.7bn AGOA exports to the US account for less than 20% of South Africa's total exports to the US, which together only account for around 4% of SA's total GDP.

Despite the AGOA fiasco and related sanction risks blowing over in a mere two weeks, the effect on our local currency market has remained intact, with the ZAR failing to recover any of the losses brought about by the "#LadyR Russiagate" scandal.

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INTREST RATES CONTINUE THEIR UPWARD TRAJECTORY IN MAY

May also saw a further increase in the repo rate (repurchase rate) of 0.50%, bringing the figure to the level of 8.25%. As a result, the prime lending rate in South Africa (the rate charged by commercial banks, and therefore the rate felt by the end consumer) is now 11.75%. The South African Reserve Bank (SARB) cited several reasons for the rate increase, including food inflation, rising electricity prices, as well as imported inflation, amongst others.

Again the rand fell sharply after the interest rate decision, dropping to a level of around R19.75 against the dollar. Generally, an interest rate increase makes a currency more attractive to foreign investors on a relative basis, as it offers a higher return on investments, which attracts foreign capital flows and increases demand for the local currency, causing its value to strengthen. This is precisely what transpired at the previous interest rate decision in March, where the SARB also raised local interest rates by 0.50%. The rand reacted swiftly by strengthening nearly 2% over a two-day period due to the increased yield on offer.

Unfortunately, the evidence now suggests that there is simply too much negative sentiment directed towards South Africa to see our currency strengthen in any meaningful fashion, despite the interest rate increase. Taking into account the current state of the country this is not a wholly unsurprising outcome. From our fall from investment grade into junk status in April 2020, coupled with the greylisting in the first quarter of 2023, it is no surprise that foreigners would rather deploy their cash elsewhere.

Loadshedding also serves as a massive impediment to any sustainable bout of rand strength. In the first five months of 2023 South Africa has experienced more loadshedding hours than the whole of 2022. While there are plans underway for the construction and implementation of several private energy projects in South Africa, these will all take time to come online, with any material change to the loadshedding situation only expected to take place in late 2025.

Foreigners would, understandably, prefer to avoid investing their cash in a country that cannot keep the lights on for more than a few hours at a time.

INSIGHTS FROM THE ANALYTICS CURRENCY DECODER

The Analytics Currency Decoder allows us to understand the drivers of the current rand weakness, giving us a sense of how sustainable these factors are, and to then gauge the likelihood of a pullback in the currency. Firstly, the rand is driven primarily by the dollar. As a result, if the dollar weakens materially we will see subsequent rand strength. Once the effect of the dollar is accounted for, the remaining drivers of our local currency are the trend in a basket of Emerging Market currencies (of which South Africa is a constituent member), as well the SA-effect which encompasses the effect that SA-specific factors (such as those mentioned above) have on our local currency.

This year, Emerging Market currencies have been trading slightly stronger to their aggregate fair value against the US dollar, implying that all the current weakness in the rand is attributable to the SA-specific effect, i.e. the own-goals scored by the South African government and economy. These factors are not expected to reverse in the short-term and will instead take a significant amount of effort to rectify. As a result, sustained rand strength remains an unlikely outcome.

Source: Factset, Bloomberg, US Census Bureau USA Trade Portal