



# RAND DEFIANT IN FACE OF CAPITAL OUTFLOWS AND LOCAL POLITICS

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## ABOUT THE AUTHOR

Rian is the head of the Economic Research Unit responsible for providing insight into and forecasts of how macroeconomic developments may impact financial markets. This research informs the boutiques' top-down views.

After ending 2016 at R13.69 to the US dollar, a sharp firming from the almost R17.00/US\$ reached at the beginning of the year, the rand strengthened further in January this year, at one stage reaching R13.25/US\$, before slipping a bit to end the month at R13.46/US\$.

The sustained strength of the rand continues to surprise analysts and commentators, given the ongoing large-scale selling by foreigners of local financial assets (foreigners sold more than R150 billion of assets last year, with the selling continuing in January), the still wide current account deficit (requiring some US\$700 million of net capital inflows a month to finance), and the ongoing political noise and uncertainties in the run-up to the ruling ANC's elective conference later this year. While the actual sources of demand for the rand will only become clearer once the South African Reserve Bank (SARB) publishes detailed data on SA's foreign trade and capital accounts, speculation continues as to the underlying reasons for the rand's solid performance over the past year.

## POSSIBLE REASONS FOR A RISING RAND

We reckon a number of fundamental issues may be supporting the rand.

First is the better performance recently of a few key emerging market currencies, including the Brazilian real, Russian rouble and Malaysian ringgit. This positive sentiment may have lent support to the rand too.

A second possible reason for the rand's strength is a solid rise in recent months in the prices of a number of our key commodity exports, such as coal and iron ore. In fact, looking back over 2016 shows that the price of a basket of SA's four largest commodity prices rose by about 30% in US dollar terms from late in 2015 to the end of January 2017.

A third possible reason for the stronger rand is a perception that the economy has finally turned the corner. While fourth quarter GDP numbers are in all likelihood still very weak – and in fact could have contracted – a number of high frequency indicators have started to send more positive signals about the economy. These include several months of successive increases in the leading indicators index (a reliable predictor of future growth trends), surveys of manufacturing conditions and vehicle sales. In addition, the good rains during the summer rainfall season have vastly improved agricultural conditions over broad swathes of the country, promising good crops and much-improved grazing conditions. As a result, our long-held view that GDP growth will rebound from 2016's estimated 0.4% pace to little under 1.5% in 2017, remains unchanged. While such growth is still way too slow, given the rapid growth in the labour force and already high unemployment, at least it seems as if the five year long slowdown in the economy may have been arrested.

A fourth possible reason for the rand's surprisingly good performance is that the underlying deficit on the current account of the balance of payments may have narrowed further. While the deficit is still large, the latest trade numbers and a sharp surge in foreign tourist arrivals during the summer months may point to a narrowing of the shortfall.

Lastly, but on a more negative note, the unexpected rise in the inflation rate in December to 6.8%, from November's 6.6%, came as an unpleasant surprise and has caused the SARB to raise its inflation forecast for 2017 to 6.2%, from the previous 5.8%, and led to the Bank maintaining a hawkish stance at its late-January Monetary Policy Committee (MPC) meeting. The prospect of local interest rates remaining at current relatively high levels for quite some time still, may also have supported the rand.

Looking forward, the biggest risks to the currency, and the economy, are unfavourable developments abroad, especially the risk of a stronger US dollar as the US Federal Reserve raises interest rates later in the year, and local politics. Should these risks not materialise, prospects for a relatively stable rand through 2017 and a much-needed recovery in the economy, look promising.



### KEY TAKEOUTS:

- RAND'S RESILIENCE CONTINUES TO SURPRISE
- HAS THE ECONOMY FINALLY TURNED THE CORNER?
- TOURISTS HELP BALANCE THE BOOKS