

FM Features

RAND

A passing fever?

Last week was its worst ever, but history shows that the rand always comes back

In a week that roiled international markets and punished emerging market currencies, the rand spiked to its worst-ever level against the US dollar before almost fully recovering as panic subsided.

With the rand having stabilised in a range of R13/\$-R13,20/\$ at the time of writing, having briefly hit R14/\$ last Monday, the question is whether it could continue to weaken and if so, just how far it could go.

Institute of Race Relations (IRR) chief economist Ian Cruickshanks finds it easy to construct a nasty scenario where the rand blows out to R15/\$ in the next few months.

"We just need continuing Eskom unreliability, a few more strikes, and a case of public violence and the rand will get

dumped again," he says.

Equally likely, he feels, is that growth could contract again in the third quarter, tipping SA into a technical recession and inviting sovereign credit downgrades and further rand weakness.

Perhaps, but the fact that the rand didn't weaken anew when SA posted a ghastly second-quarter real GDP number of -1,3% q/q last week, and didn't firm when the Reserve Bank raised the repo rate by 25 basis points in July, seems to suggest that international factors hold sway at present.

Barclays currency strategist Mike Keenan had the rand ending the year at a bearish R13/\$ before last week's rout. He's pushed that out but only to R13,50 because the sense among analysts is that the rand at R14/\$ was overdone and lacked conviction.

"I'm not convinced we'll see permanent rand weakness from here," says Keenan. "I don't think things will keep getting worse, mainly because I don't think global policy makers will let everything go to the wall."

He expects the US Federal Reserve to back off from its first rate hike and China's central bank to step in with further stimulus measures if the global or their own domestic growth climates deteriorate further.

As recently as June 15, the federal funds futures rate indicated there was a 50,5% probability that the Fed would increase

interest rates in September 2015. Since last week's turmoil that probability has halved (see graph). Expectations are now that the lift-off will occur in December 2015.

WHAT IT MEANS

RAND OVERSOLD, SHOULD BOUNCE BACK

COULD HIT R20/\$ IF SA LOSES THE PLOT

Expectations have moderated for a number of reasons, says Stanlib chief economist Kevin Lings. This includes fresh worries that China's growth is less resilient than previously believed; increased global financial market volatility; sustained low US inflation; and recent dovish comments by key Fed officials.

Even though last week's upward revision to US second-quarter growth from 2,3% to 3,7% q/q was much

bigger than expected, economists say this still doesn't mean the Fed will automatically hike in September.

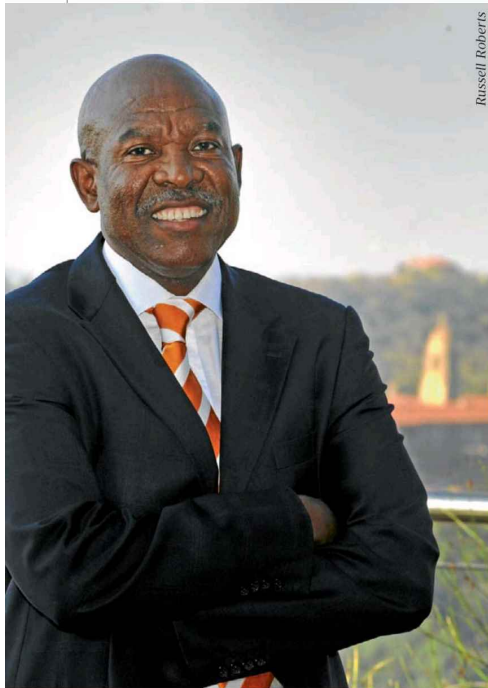
Lings explains that while the Fed has become increasingly concerned about the market distortions caused by sustained zero interest rates, it wouldn't want to disrupt the current growth trajectory or unsettle financial markets by hiking rates substantially.

The rand and other high-yielding currencies are vulnerable to capital outflows now that the US is exhibiting growth at a lower risk, making it an attractive investment destination once again. Higher US interest rates will put a seal on this process.

Tighter Fed policy has negative implications for global growth and commodity prices, which also counts against a commodity-based currency such as the rand.

This suggests that the rand could weaken anew once the Fed actually starts hiking. This is certainly the Reserve Bank's concern, having listed the rand exchange rate as one of the biggest risks to SA's inflation outlook.

At the height of last week's crisis, the rand received support from the Bank in the form of a statement warning that it "may



Russell Roberts



TO THE EXTENT THAT THE DEPRECIATION OF THE RAND IS DRIVEN BY FUNDAMENTALS, NO AMOUNT OF CENTRAL BANK INVOLVEMENT, OR EVEN INTERVENTION, WILL STEM THE DEPRECIATION OF THE CURRENCY

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