Another rollercoaster ride for the rand in 2019

By Bianca Botes

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Trumpenomics, Pravin Gordhan's axing as finance minister and Cyril Ramaphosa's appointment as ANC president contributed to the R2.04 price swing in the South African currency in 2017. This volatility continued through 2018 with the US-China trade war, Ramaphosa's swearing in as SA president, two new finance ministers and the emerging market rout taking their toll on the local currency.

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Amidst the turmoil, the biggest rand performance constraint has been sentiment and as long as investors opt for safer investment destinations, emerging markets will continue to bear the brunt of negative sentiment and risk-off strategies.

No respite expected in 2019

Significantly, we expect this to remain the case for 2019 as multiple factors weigh on the risk appetite of the ever-cautious investor. On the global front, while the trade spat between the US and China, with tit-for-tat tariffs, could be resolved early in the year, it could equally drag on for months if presidents Trump and Xi can’t settle their differences in an amicable, mutually beneficial manner.

Brexit is still no closer to being resolved, with the UK set to leave the EU at the end of March. On top of these woes, we also see declining global growth which will weigh heavily on all emerging markets and currencies.

Locally, elections are due to take place in May and the political manoeuvring and uncertainty in the lead-up is certain to make some waves. In addition, the stagnating local economy is struggling to secure foreign direct investment as well as local fixed capital formation.

Investors are no longer only looking for returns, but also liquidity. Investments in liquid assets such as bonds, makes the sale and purchase of investments much easier, meaning that a sudden change between a risk-off and risk-on environment could cause a burst of oversupply or undersupply in the market, driving the currency weaker or stronger in quicker intervals.

Bumpy does not necessarily mean weak

A more volatile rand does not automatically imply a weak local currency. In the first few trading days of 2019, we have already seen US political instability and a shaky dollar drive the rand stronger.

In addition, on the domestic front, if there were to be a clear turnaround strategy for SOEs as well as a recovery in economic growth, the rand would be able to regain some momentum based on local fundamentals.

In November 2018, the South African Reserve Bank (Sarb) began tightening monetary policy, raising the benchmark repo rate by 25 bps points to 6.75%. With a further 25 bp hike expected in the first quarter of 2019, we can expect a rise in portfolio inflows which would lend further support to the local currency. By the same token, higher interest rates will serve to drive inflation down to below 5% in Q4 of 2019.

On a purchasing power parity basis, the rand is significantly undervalued against the major currencies and we expect to see some correction in this position.

Four scenarios

We envisage four possible scenarios for the rand during 2019 and we have accorded a degree of likelihood to each:

1. Land of milk and honey (low probability)

- The government employs redistribution of land in an equitable fashion leading to enhanced economic participation and growth
- SOE debt and expenses are managed efficiently, and turnaround strategies produce positive results
- SA’s sovereign credit rating is raised from sub-investment to investment grade status
- The trade war is concluded and a mutually beneficial, trade-friendly deal is achieved between the US and China

This scenario could see the rand reach R10.00/$ by the end of 2019.

2. Step aside Venezuela (low probability)

- Attempts to redistribute land fail causing defaults on mortgage repayments to banks
- SOEs collapse and go bankrupt
- There is a rapid withdrawal of funds from the country
- Inflation skyrockets
- There is a complete collapse of investor, consumer and business confidence

In this instance, the rand would head towards R25/$.

3. Muddling along (moderate probability)

- There are no significant changes

- SOEs continue to perform poorly
- Economic activity remains lacklustre
- No real policy changes are effected
- Global geopolitics remains volatile

The rand would be likely to trade in the region of R14.00/$ to R16.00/$.

4. Steady as she goes (moderate probability)

- Positive changes in SOEs drive slow and steady change
- The ratings agencies retain a stable outlook regarding the country and they lift the sovereign credit rating by one notch
- Careful consideration of land redistribution sees it executed in a patient and equitable manner
- There is a steady increase in economic growth
- Interest rate increases take place in well-considered, paced increments
- An easing in global geopolitical tensions allow for a growth in investor risk appetite

In this instance, the rand's range would be between R11.50/$ and R13.00/$.

Middle ground the most likely – but will it be stronger or weaker?

As can be seen, South Africa is more likely to see a modestly strengthening or a mildly weakening currency, than either of the more extreme scenarios.

However, it is too soon to say whether we will be able to able to pull the country out of its current malaise. Much will depend on the outcome of the May general election and the extent to which Ramaphosa is given a mandate to implement the necessary policy changes that will take us to the next level.

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