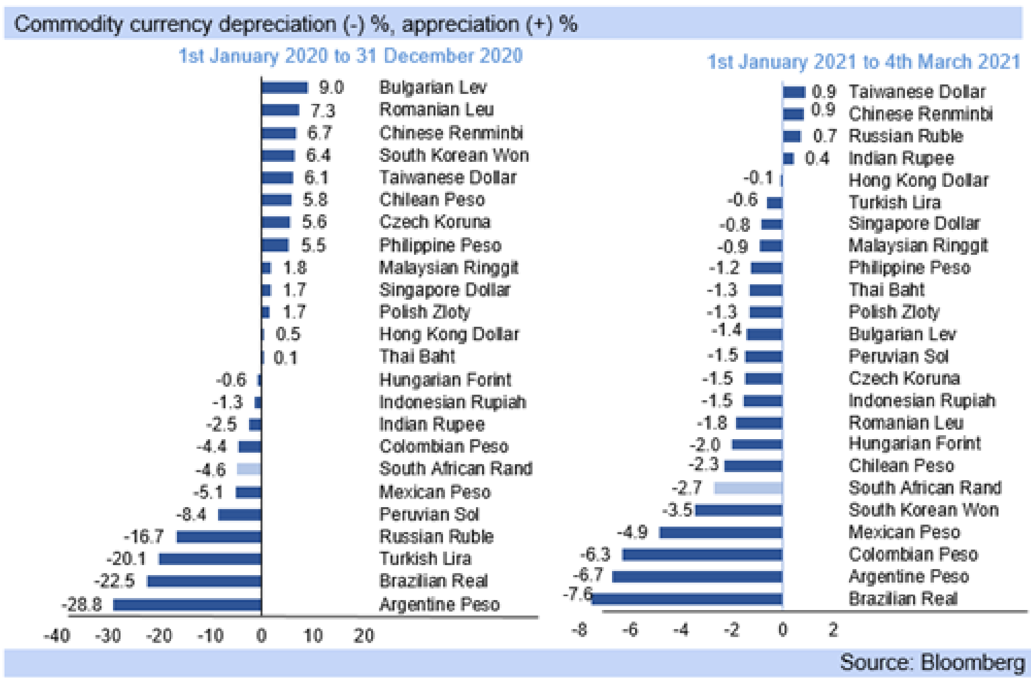
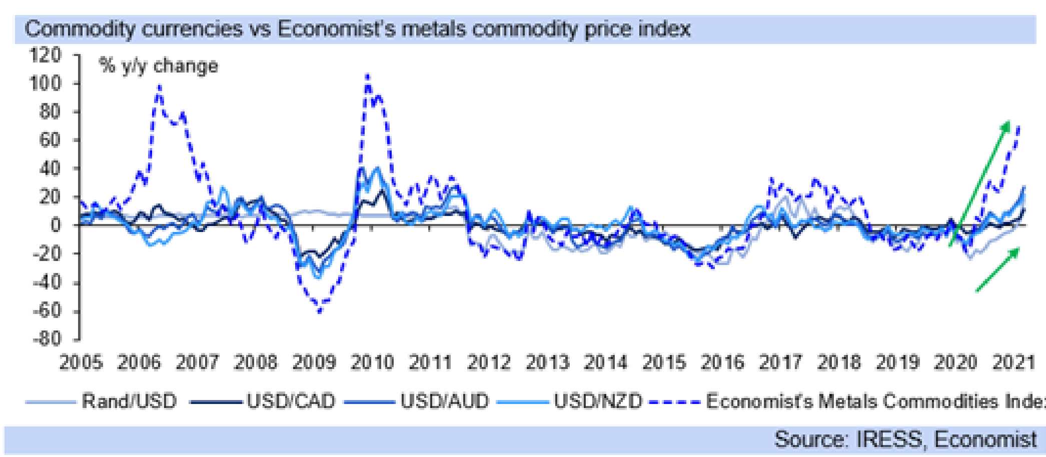
SA Economics

Thursday 4 March 2021

Commodity Currencies Note: the rand remains on track to average R15.00/USD this quarter, with commodity prices at all-time highs, counterbalancing some of impact of the risk-off in global markets to high-risk EM portfolio assets





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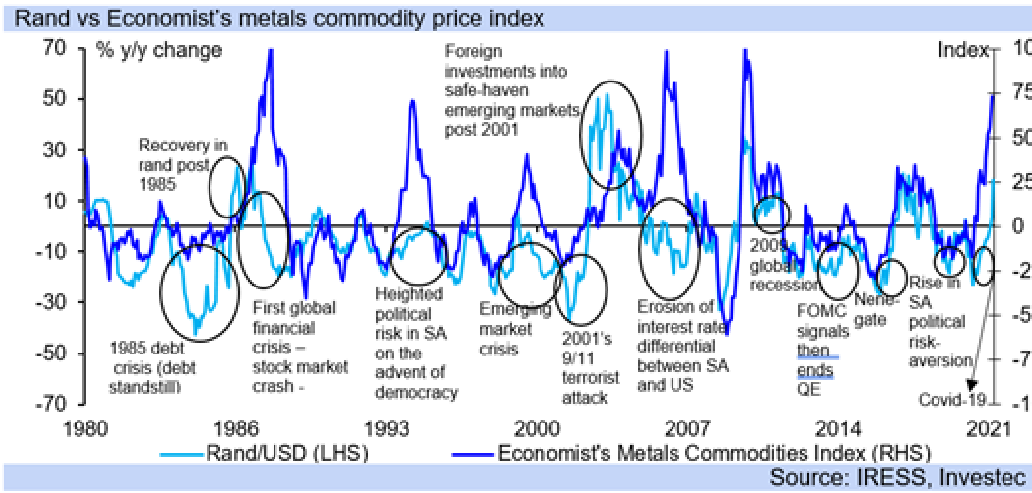

- Commodities prices leapt even higher in February, up 77.1% y/y with the Economist commodities price index at an all-time high of 194. There is still an element of propulsion from base effects, but even without this, prices would be over 50% higher y/y.
- Investor uncertainty about a future surge in inflation persists, even though the outlook is forecast to be relatively mild market participants worry that there will be a rapid, unexpected acceleration in prices. Commodities are often seen as a store of value in high inflation periods.
- With expectations of strengthening economic (GDP) activity this year and next as advanced economies progress with their vaccine rollouts (UK is above 30% of its population, US 25%, EU close to 10%), commodities are benefiting from expected future expected price growth.
- In turn, higher commodity prices spark fears of higher inflation, leading in turn to even further upwards pressures on prices, with metals and industrial commodities prices also at an all time high - these Economist indices are at 222 and 254 respectively.
- Metals prices are 73% higher y/y, with SA an exporter of a number of metals, and the rand well known as a commodity currency, while industrial commodities' prices are 110% higher y/y, boosted by ongoing market exuberance over expected global economic recovery.
- In contrast, foreigners have sold off a large -32.4Rbn worth of SA bonds, net of sales, this year to date (and -R11.8bn worth of equities), with -R14.7bn in SA bonds sold off since the Budget as its projections are still seen as insufficient to meaningfully reduce credit risk.
- This has been exerting strong adverse pressure of the domestic currency, and the rand is currently -3.3% weaker since the 24th February (the day of the 2021 Budget), with SA debt levels out of kilter with other EM/MIEs (Emerging Market/Middle Income Economies).

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- Excluding base effects caused by the collapse in commodity prices last year, metals prices are still over 50% higher y/y, while industrial prices are up 74% y/y. Another commodity currency, the Australian Dollar is 18% stronger y/y, and the New Zealand dollar up 15.3% y/y.
- Advanced economies' commodity currencies still lead the pack, with the Swedish Krona and Norwegian Krone up around 10% y/y. The rand is up 4.2% y/y, with the majority of commodity currencies benefiting both from their low bases a year ago and rampant commodity prices.

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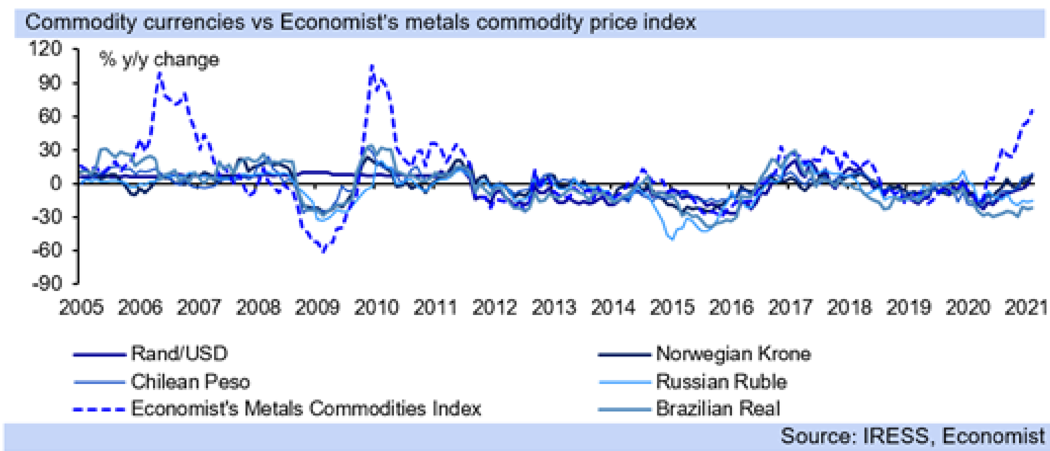

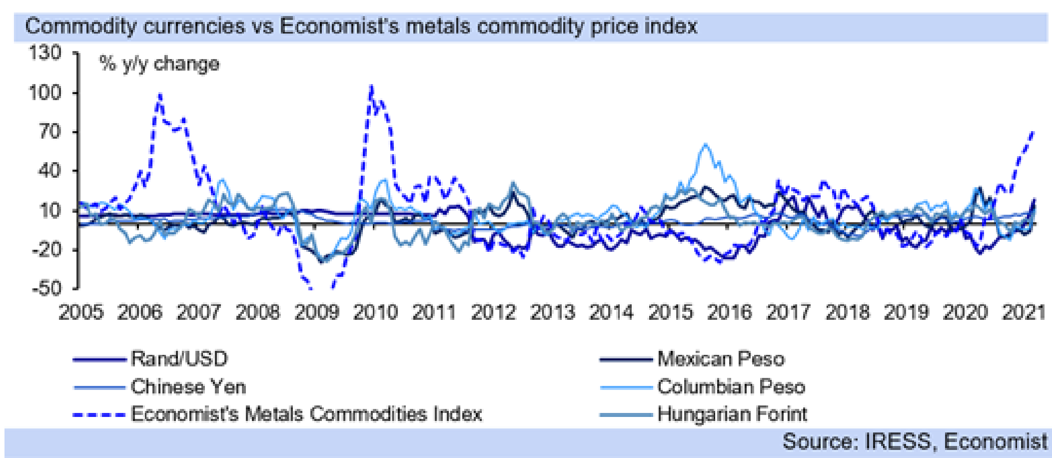

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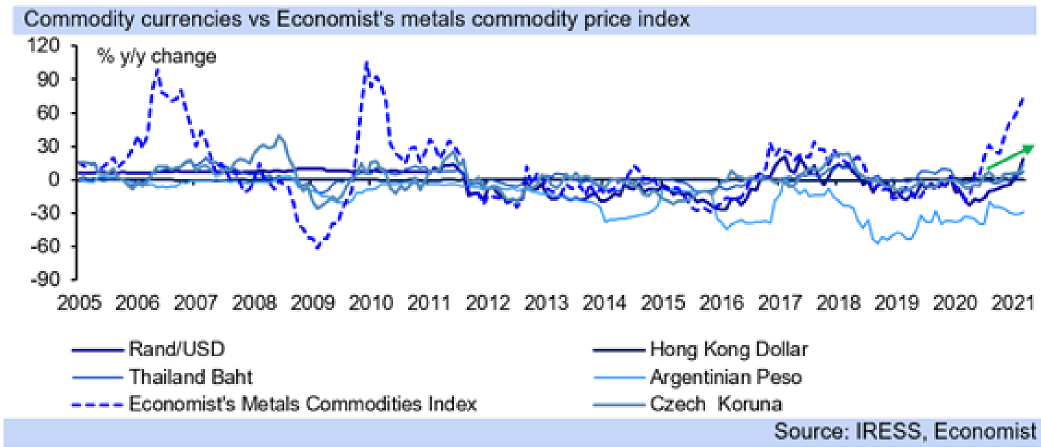
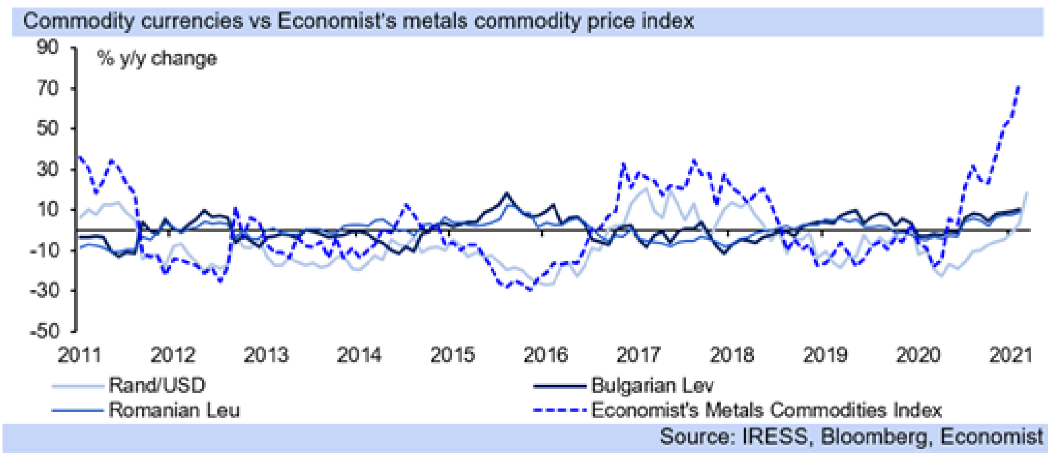
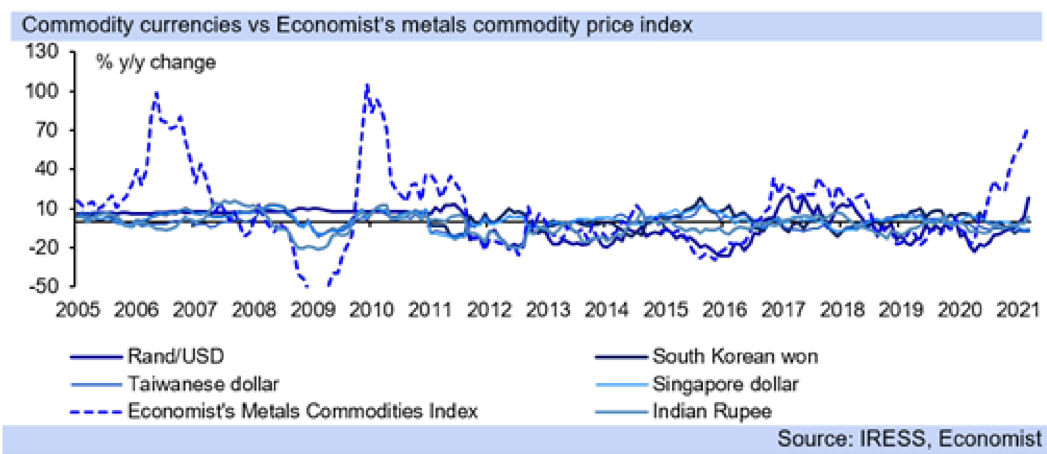


- Markets are unsettled by high US Treasury yields, with the ten year at 1.48 today, and appetite for bonds in general has weakened, with the elevating US yield curve still seen to herald higher US (and global) inflation despite Fed Chair Powell's previous placatory comments.
- In particular, the Fed has said that elevated longer-dated treasury yields over the short end are reflective not of likely high inflationary pressures, but instead of expectations of economic recovery. However, substantially faster GDP growth does tend to place pressure on inflation.
- With commodity prices gaining from inflation fears, and the rand a commodity currency, this has not been enough however to prevent it from weakening towards R15.15/USD, although it has pulled back towards R15.00/USD currently, but will remain volatile.
- The rand is almost 2% weaker since the start of the year, when global financial markets were in a strong risk taking (or risk-on) phase, and historic high commodity prices have not been sufficient to counter this.
- So too the Brazilian Real and Argentinian Peso are weaker since the start of this year by around -6%, the Colombian Peso -5% and the Chilean and Mexican Pesos down by around -3%, and the South Korean Won by close to -4% lower.
- With the next FOMC meeting statement due on 17th March, markets are awaiting Fed commentary then and also today in hopes that a more dovish tone (on QE) will be signalled as the US heads into a large fiscal stimulus programme and increased borrowings.
- Last year, commodity prices dropped to their lowest level for the full year in the March/April period, and with this anniversary now coming up, the statistical base effects will likely push up commodity prices substantially higher on a year on year basis.
- The current 'commodity boom' could prove to be relatively short lived, and will be dependent on actual strong demand for commodities. Base effects will wear out from mid-

year, and so market optimism could be impacted by the more modest increases in prices y/y then.

- Without the strong lift in global economic growth and particularly robust demand for commodities during H2.21, the current commodity price boom could fizzle out somewhat, and with it inflationary fears, further moderating prices and expectations further.





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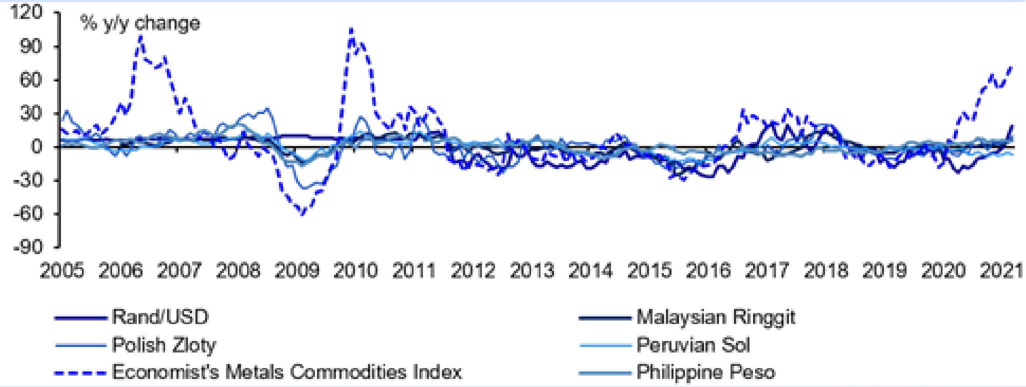
Commodity currencies vs Economist's metals commodity price index



Source: IRESS, Economist