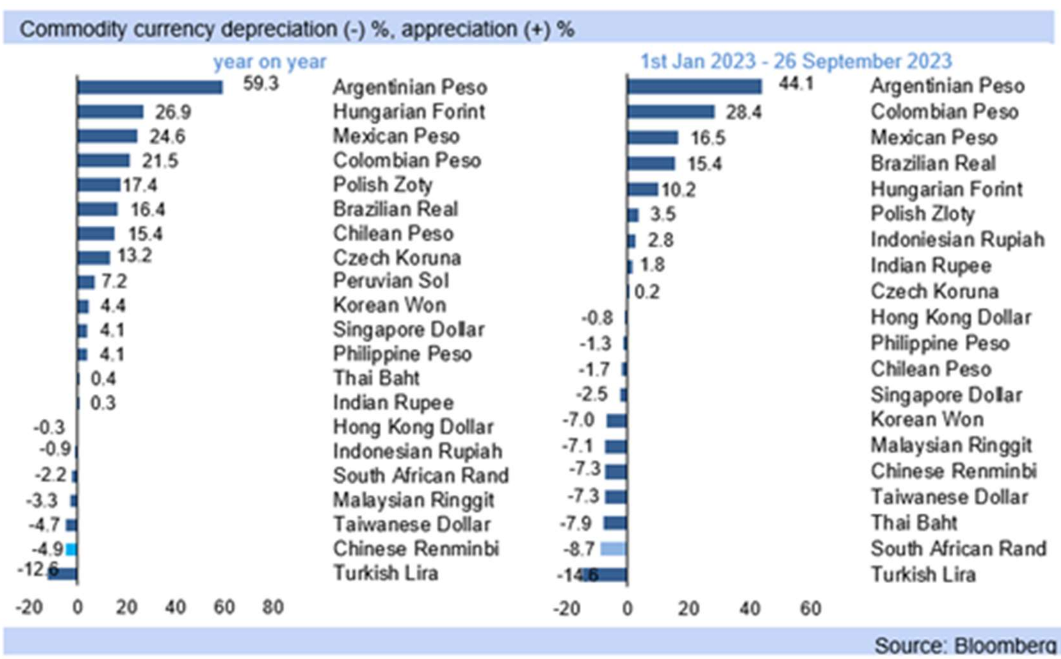
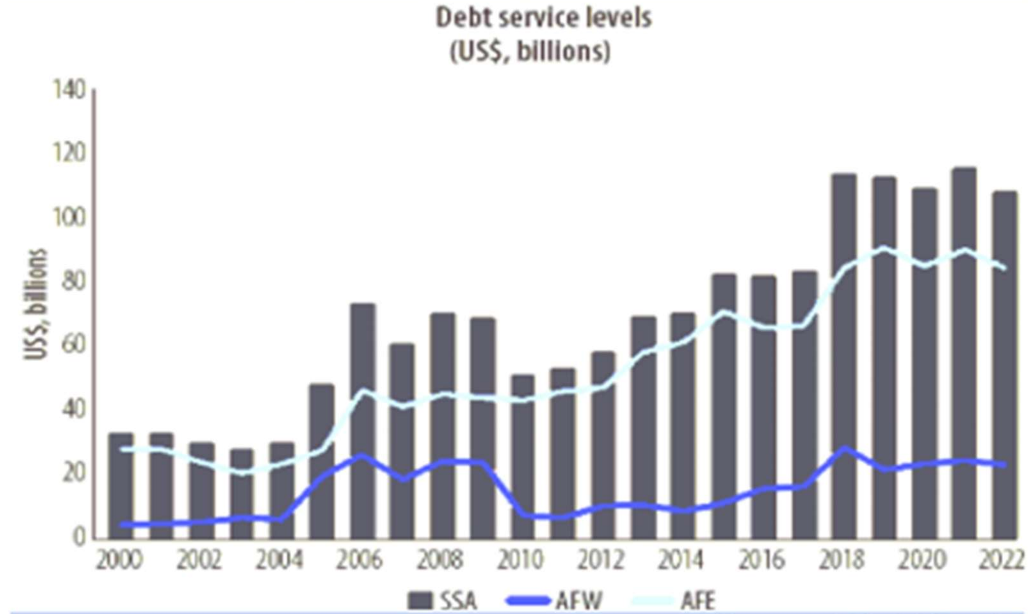
Commodity currencies: still facing risk-off, as central banks remain hawkish

Friday 6 October 2023



Debt Service Levels (borrowing costs)



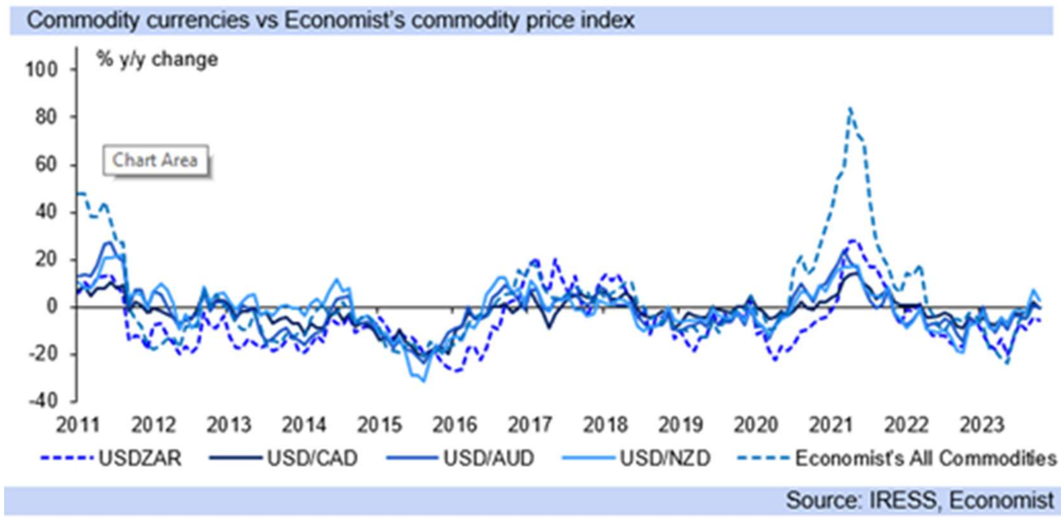
Source: World Bank

Note: AFE = Easter and Southern Africa; AFW = Western and Central Africa.
SSA = Sub-Sahara Africa

Drivers of inflation

Decomposing recent dynamics of headline inflation reveals the growing importance of near-term inflation expectations

Source: IMF



- The rand has remained very weak this year, far removed from its fair value of closer to R15.00/USD. Substantial US dollar strength has been a key reason (see Rand outlook, 5th October), but the currency has also underperformed on its own.
- Compared to other commodities and EM currencies the rand is particularly weak on the year against the greenback, and has also depreciated against the key crosses, at R20.62/EUR and R23.84/GBP, versus R15.65/EUR and R18.77/GBP in H1.22.
- The rand recorded R14.40/USD in H1.22, and has been beset by prolonged financial market risk-off since the second half of Q2.22, but also by internal fundamental (structural) weaknesses of the economy, particularly weak economic growth.
- GDP growth is likely to come out around 0.5% y/y this year, and the World Bank supports this view highlighting "(e)conomic activity in South Africa is expected to … (be) subdued, with growth decelerating sharply to 0.5(%) in 2023 from 1.9%.
- "Scheduled power outages … increased in 2023, … holding back manufacturing and mining. Poor port and rail performance have stymied domestic and foreign trade … limiting the ability of commodity exports to reach their destinations".
- Additionally, hawkish Central Bank commentary, also dulling EM and commodity currencies, persists to control inflation and reduce the need for a continuation of the severity of the interest rate hike cycles which have been under way.
- That is, being able to manage inflation expectations by the tone (of hawkishness) of the communications of the Central Banks, instead of additional hikes, increases the chances of soft landings for economies, avoiding recessions.
- The IMF adds "the more effective monetary policymakers are in influencing inflation expectations, the lower the cost in forgone output involved in central banks achieving their inflation objective." Particularly when "inflation rises sharply or becomes volatile."

- For commodity currencies, and EM’s, what will be key is the advent of interest rate cuts, particularly in the US, expected in July 2024 currently, and a strengthening in production in the Chinese economy, which could continue to lag.

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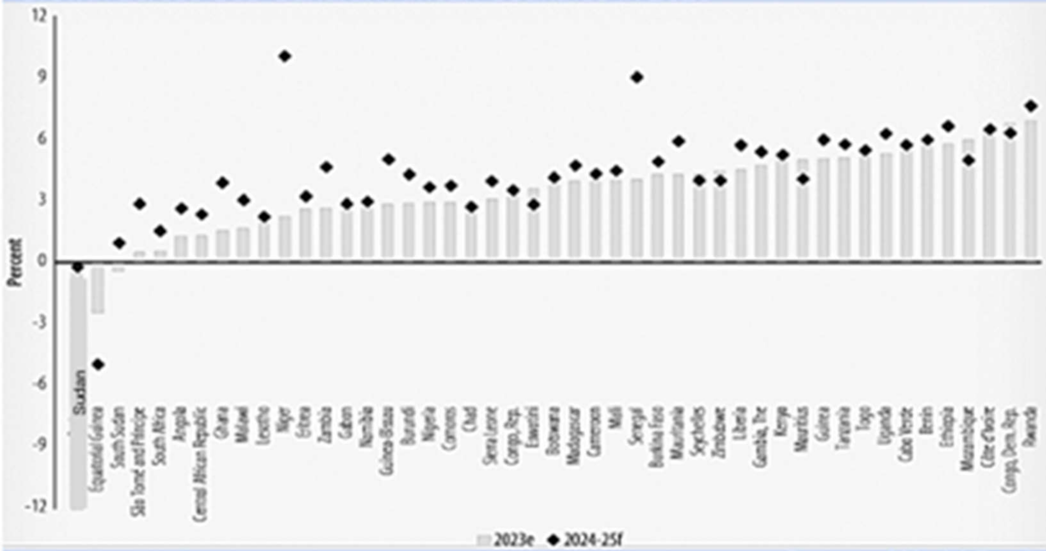
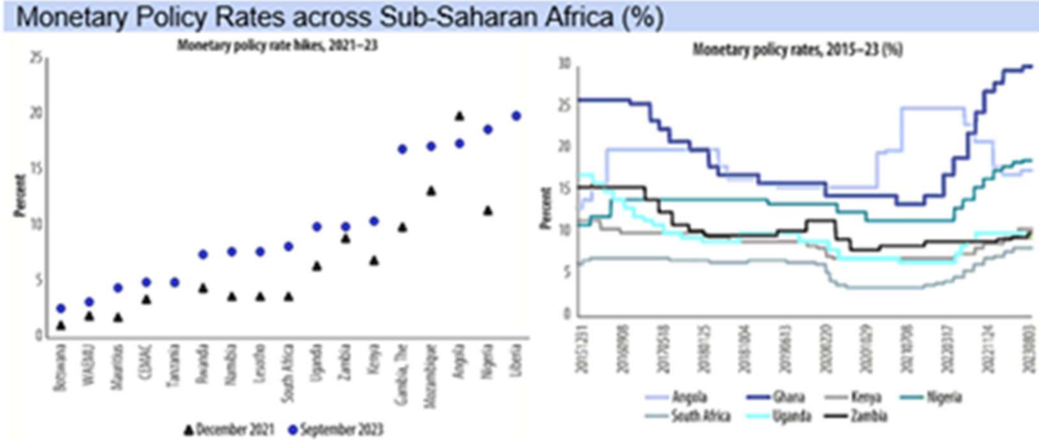
Growth across Sub-Saharan African Countries in 2023



Source: World Bank

Note: The long-term average growth for each country (as denoted by the black diamonds) is the average gross domestic product growth during 2000-14 (prior to the plunge in commodity prices) i.e. = estimate; f = forecast.

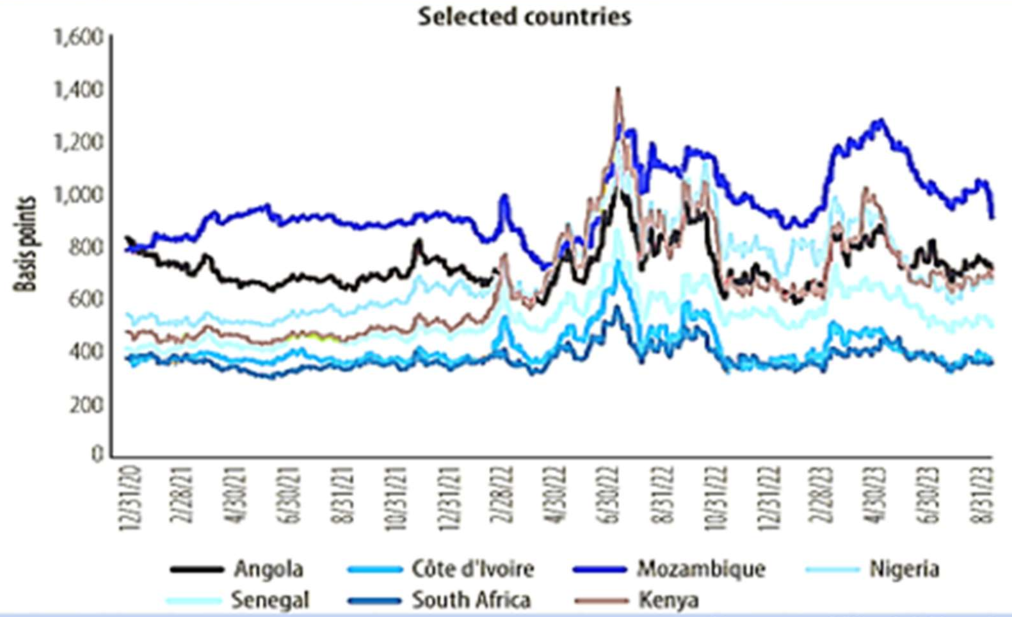
Monetary Policy Rates across Sub-Saharan Africa (%)



Source: World Bank

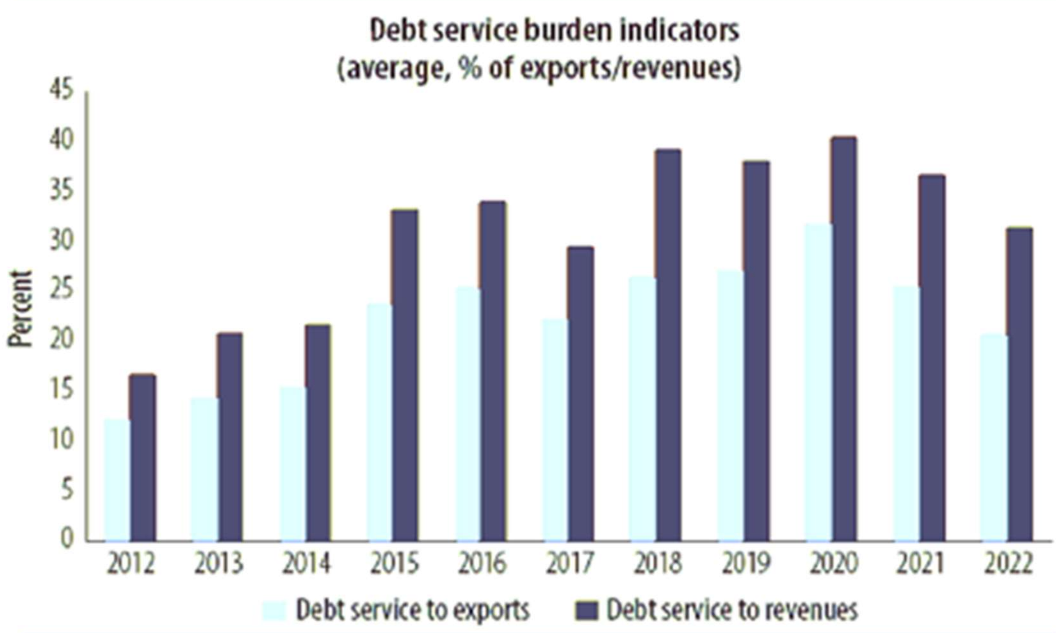
Note: CEMAC = Economic and Monetary Community of Central Africa; WEAMU = West African Economic and Monetary Union.

Bond Spreads in Selected Sub-Saharan African Countries



Source: World Bank

Burden indicators



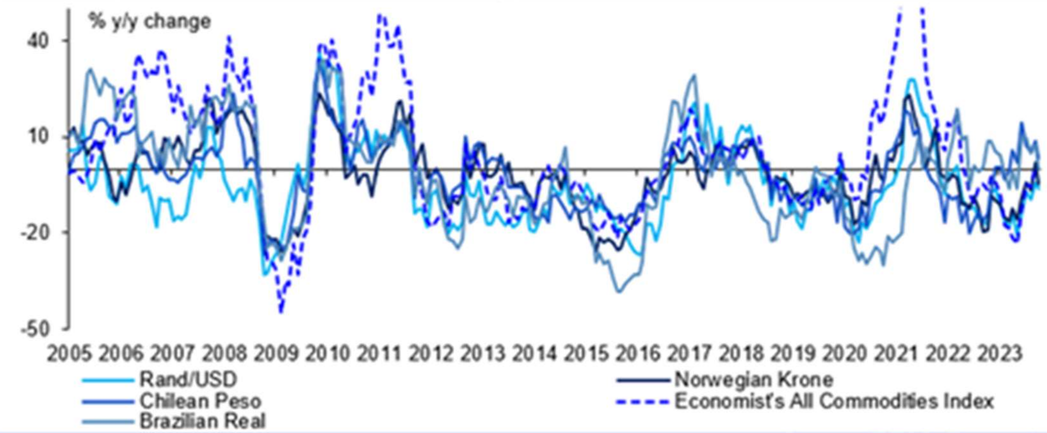
Source: World Bank

- Countries with healthier government finances have stronger economic fundamentals and lower bond yields, contributing to faster economic growth and can become a virtuous cycle, which SA was in under President Mbeki in most of the 2000s.

- “The World Bank warns “pressures for higher government spending in South Africa (in particular, social spending and an increase in the wage bill), weaker domestic growth, and a decline in … commodity export prices are weighing on the budget deficit.”
- “Fiscal risks include the relief of the heavy debt burden of state power utility Eskom and increasing debt service costs. The fiscal deficit is expected to narrow slightly to 4.6 percent by 2025.”
- “Nearly two-thirds of Sub-Saharan African Market-Access Countries (MACs) have tapped international markets over the past decade. Angola and South Africa are the largest issuers among the Sub-Saharan African MACs, which also include Côte d’Ivoire, Ghana, and Nigeria.”
- “(N)ow, however, the sell-off of developing countries’ Eurobonds and increasing investor fears about the global outlook amplify the risks for SubSaharan African countries facing large Eurobond redemptions.”
- “Sovereign credit ratings, on average, deteriorated after 2018, and SubSaharan African countries tapped international markets amid worsening creditworthiness. Furthermore, countries lengthened the maturities of new bond issuances at marginally higher costs.”
- Countries have been under strain as (non-oil) commodities prices weakened. Non-commodity exporters have seen benefits from rising demand for services, while manufacturing demand is weak in China, typically a main commodity importer.
- The World Bank finds “(g)rowth of global trade in goods slowed in the first half of 2023 in tandem with weakening global industrial production, while (in contrast) services trade strengthened in the aftermath of the easing of pandemic-induced mobility restrictions that supported tourism.”
- The delay in the global interest rate cut cycle, switch to services from goods (commodities) trade and the imbedded weakness in the Chinese economy limiting its recovery has stalked commodity prices, weakening currencies, with China’s growth expected to be services led.

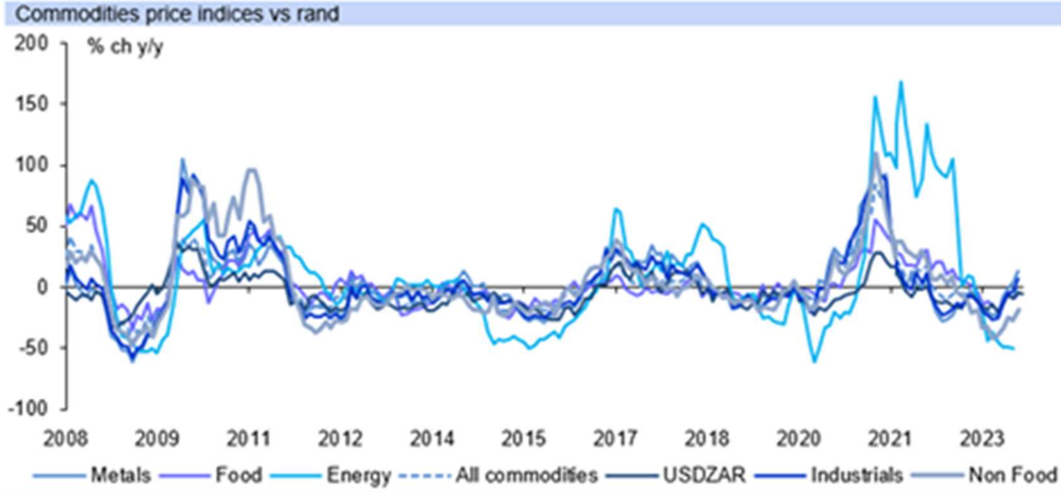
Commodity prices		
Commodity	**% ch y/y**	**% month to date**
Energy		
NYM WTI crude	-6.53%	-5.55%
ICE Brent crude	-10.60%	-6.83%
ICE ARA Gasoil	-27.18%	-7.25%
NYM NYH Gasoline	-17.22%	-14.63%
NYM NYH heating oil	-24.63%	-8.74%
NYM HH Nat gas	-54.27%	+26.93%
ICE NBP Nat gas	-72.14%	+20.22%
Metals		
LME Aluminum	-5.10%	+1.78%
LME Copper	+2.86%	-6.93%
Spot Gold	+6.39%	-4.94%
DCE Iron ore	+22.11%	+1.31%
LME Nickel	-18.14%	-12.12%
Spot Silver	+2.24%	-8.93%
SHF Steel Rebar	-7.95%	-0.77%
Agriculture		
CME Live cattle	+25.76%	+1.11%
ICE Coffee	-33.21%	-4.18%
CBT Corn	-26.31%	+5.57%
ICE Cotton	-5.46%	-1.99%
CBT Soybeans	-5.30%	-5.44%
ICE sugar	+43.45%	+0.99%
CBT SRW Wheat	-34.41%	-0.77%
		Source: Bloomberg

Commodity currencies vs Economist's commodity price index



Source: IRESS, Economist

Commodities price indices vs rand



Source: IMF, Iress

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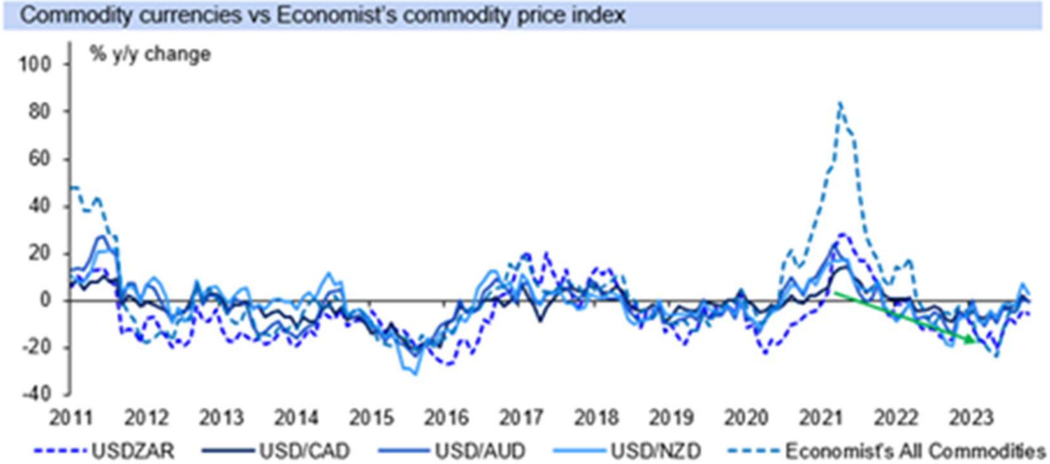

Source: IRESS, Economist