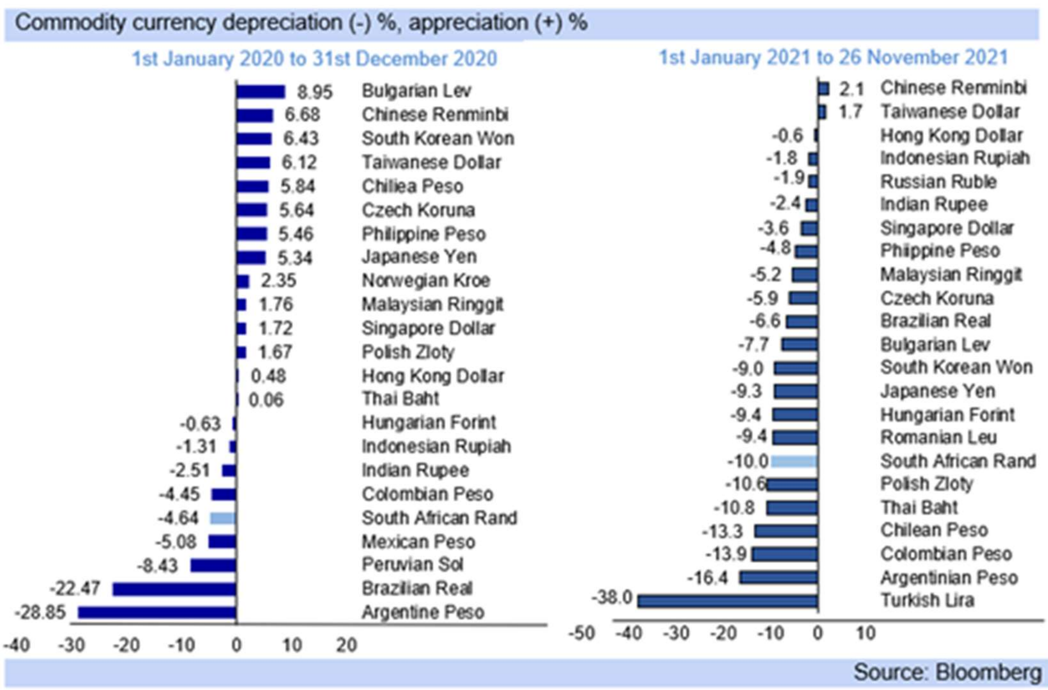
SA Economics

Wednesday 12 January 2022

Commodity currencies note: the rand has successfully pierced the R15.50//USD mark, buoyed by increased market certainty



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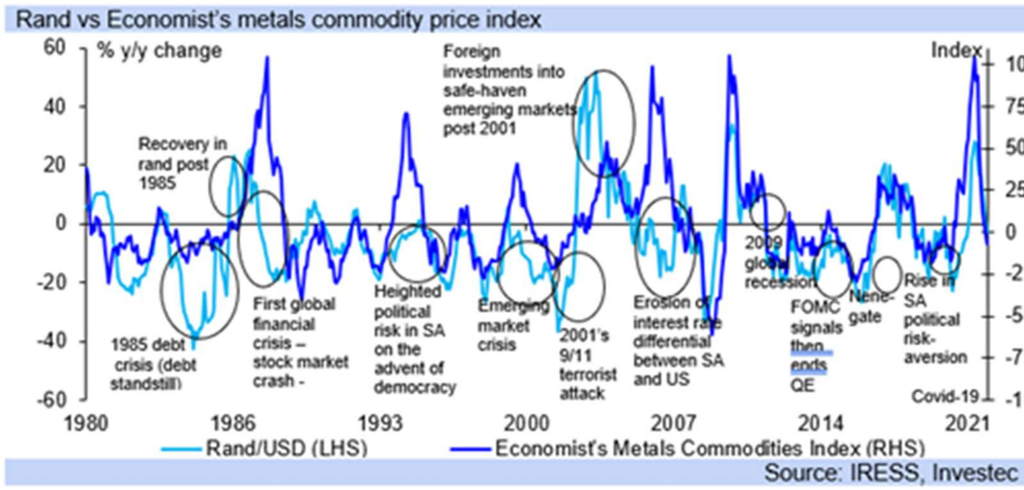

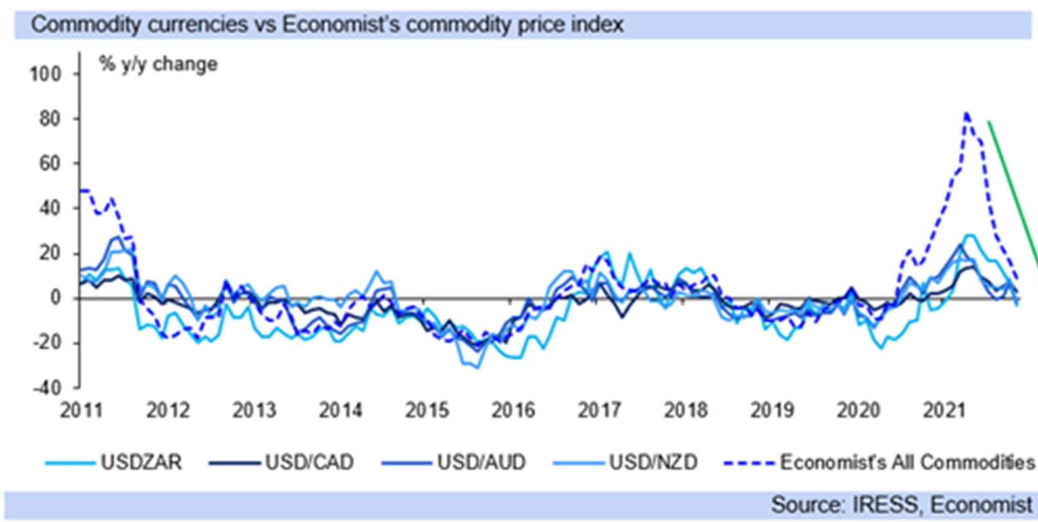

- The rand continues to run towards R15.20/USD, successfully piercing the R15.50/USD mark today, and reaching R15.47/USD, averaging R15.76/USD so far for the first few days of this quarter, but likely to average R15.50/USD for Q1.22, if not stronger.
- Markets are gaining optimism from the increased certainty of US monetary policy, and the rand is gaining from the still very elevated domestic FRA curve, with about a 2.00% hike in interest rates factored in this year, starting with a 25bp lift at this month's MPC meeting.

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- We expected a 25bp lift in the repo rate this quarter, after the 25bp hike at the last MPC meeting (November 2021), but only it in March, as it would be quite aggressive of South Africa's Reserve Bank (SARB) to hike the repo rate at every meeting.
- Indeed, with six meetings a year, the MPC would have to hike in larger increments than 25bp to achieve a 2.00% hike overall in 2022. Such a steep trajectory is unlikely, and even a hike at every meeting, although the current MPC has proved more hawkish than dovish.
- The next FOMC meeting is on 26th January, six weeks after the last one, and is expected to see quicker QE tapering and also signal US rate hikes and Fed balance sheet reduction later 2022. US monetary policy is clearly still accommodative currently at zero bound levels.
- December's US CPI inflation rate, due out today, is expected to rise to 7.0% y/y from 6.8% y/y (5.4% y/y from 4.9% y/y excl. food and energy), pushed up also by commodity prices rising by 5.5% y/y overall in December (Economist commodities price index).
- Food and agricultural nonfood prices in particular are up 17.8% y/y and 27.6% y/y respectively (both economist commodity price indices as well), adding to the upwards price pressures for global inflation, but also driven by base effects.
- As base effects reverse from April, US CPI inflation is likely to drop substantially this year, expected to average 3.6%, and excluding food and energy below this. Recently also on the more dovish side was the nonfarm payrolls outcome of 199K vs expectations of 450K.
- While the US may not be as quick to hike rates as some in the markets expect (some even forecast as early as the March FOMC meeting), the Fed funds futures' pricing of three 25bp hikes seems likely as it is a more gradual rise, potentially from Q2.22.

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USZAR vs USD index

Source: Iress

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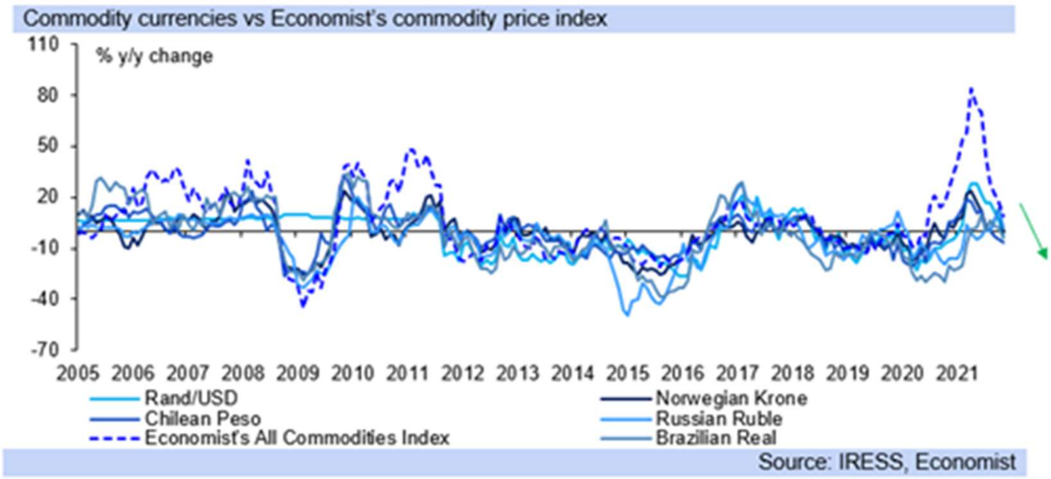

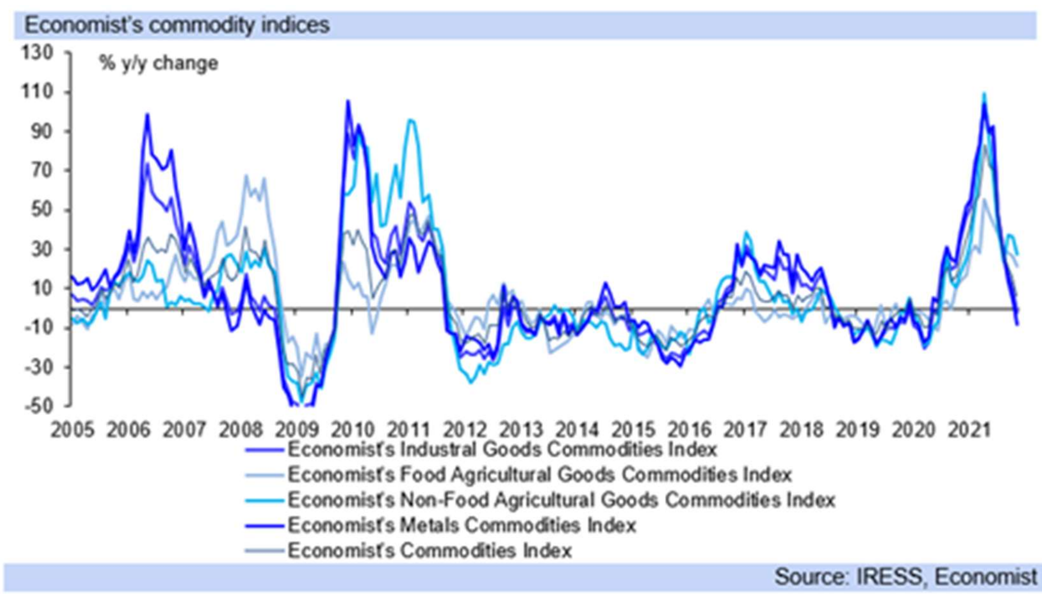

- Commodity currencies have gained from the expected good growth for the global economy in 2022, with growth expected at 4.3% y/y for 2022 (Focus Economics), after last year's 5.7% y/y, while China's easing monetary policy is also seen as supportive for commodities.

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- China is expected to see economic growth of 5.1% y/y this year (the US 3.9% y/y and EU 4.3% y/y – all also January's Focus Economics forecasts, along with the inflation forecast on the first set of bullets above for the US).
- Strengthening global growth, off last year's fast pace would add impetus for commodity prices and commodity currency strength, with the rand both a commodity currency and an emerging market currency.
- The mildness of new variants of the coronavirus so far are also increasing market certainty of continued economic recovery, adding to commodity price, and so rand strength, although it should be borne in mind that the COVID-19 pandemic is not yet over.
- Should new variants of COVID-19 emerge which have a significant degree of vaccine immunity (not widely expected by the medical community but certainly raised as a risk and so feared by scientists) this would have a negative impact on risk sentiment.
- The risk is for further lockdown restrictions and so harm to economic demand, which would negatively impact commodity price and commodity currencies and so remains the downside risk.
- Raw material shortages are still an issue, as are high input costs and freight costs, while having eased somewhat towards the end of last year are still extremely elevated, as demand is supporting high prices and capacity has not recovered in the global supply chain.
- Indeed, shipping and logistics costs could see further marked increase over this year, and there are concerns that these cost increases could be in double digits, which would provide some risk to expected moderating global inflation this year.
- This may encourage the Fed to act to subdue inflation from becoming entrenched, and 2022 is likely to see some market volatility. Higher than expected global inflation and so quicker monetary policy normalisation would have negative impacts on growth.

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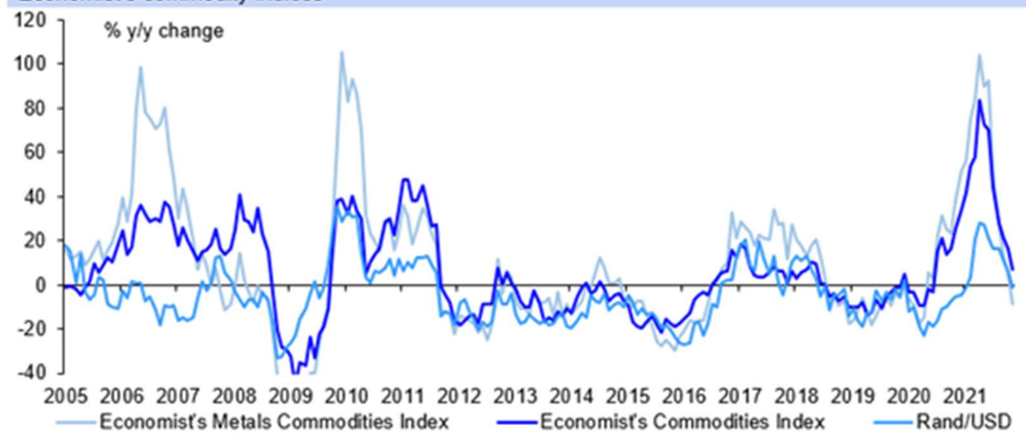
Economist's commodity indices



Source: IRESS, Economist

Commodity currencies vs Economist's metals commodity price index

Source: IRESS, Economist

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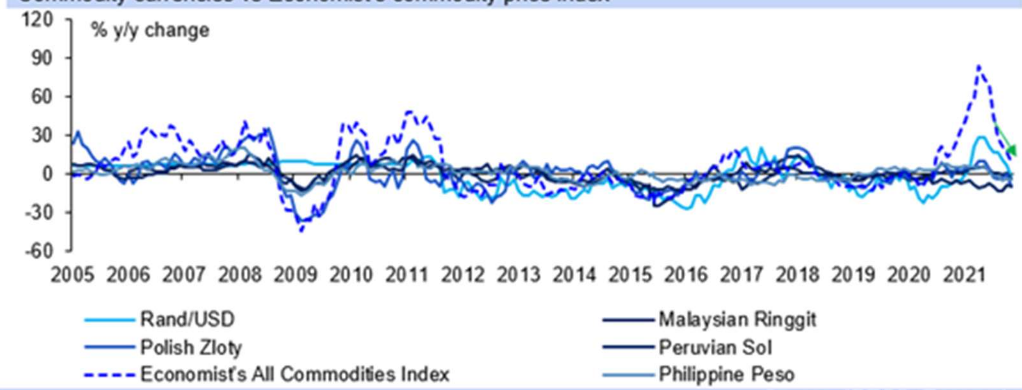
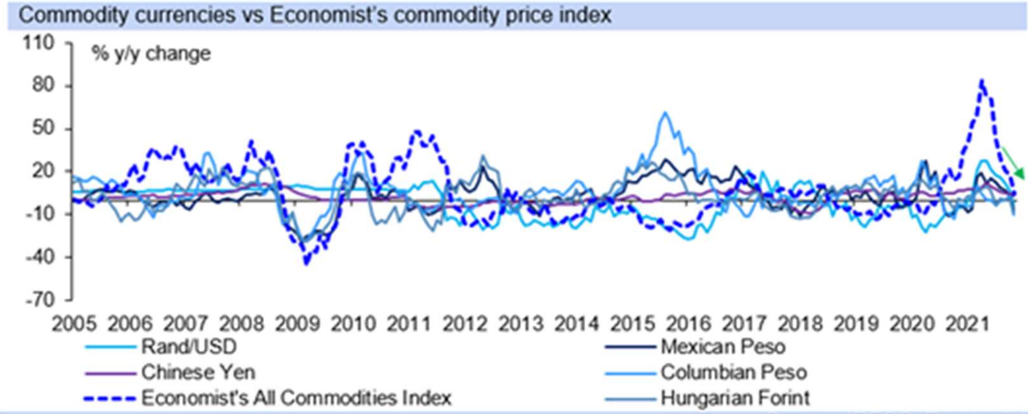
Commodity currencies vs Economist's commodity price index



Source: IRESS, Economist

Commodity currencies vs Economist's commodity price index



Source: IRESS, Economist