Investec

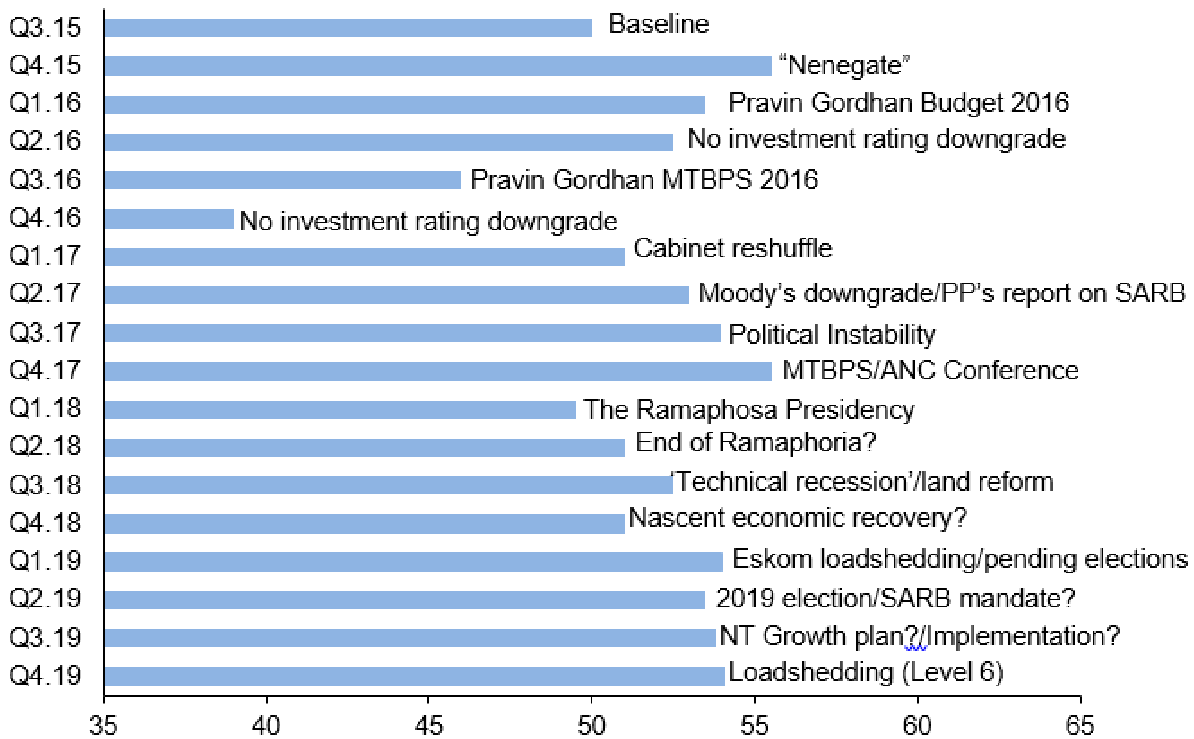
SA Economics

Rand Note

Monday 20 January 2020

Rand weakens on domestic issues following repo rate cut, weaker economic growth outlook and escalating SOE crises, failing to benefit from higher gold and other commodity prices, as domestic policy uncertainty rises

NWU Business School Policy Uncertainty Index



Source: NWU Business School

- Amid a benign global financial market environment, South Africa has seen its domestic currency steadily weaken since starting the year at R13.99/USD, R15.70/EUR and R18.56/GBP, with R14.49/USD, R16.07/EUR and R18.84/GBP today. The outlook for the global economy has improved, but that of SA has deteriorated.

- Policy uncertainty, a catch all phrase for essentially the impact of politics on both the perceptions of the future direction of government policies, and the perception of the implementation of actual government policies, is high. The latest measure shows policy uncertainty just below the Nenegate crisis and 2017 MTBPS/ANC levels.

- The NWU Business School's Policy Uncertainty Index shows that in Q4.19 "(n)egative factors outweighed positive ones in the fourth quarter of 2019… including Eskom blackouts, vulnerable public finances, crime and violence, political factionalism … (and) Moody's likely downgrade of SA's investment rating in 2020."

- Furthermore, the reading was suppressed by "the perception that the National Treasury's growth plan may not be successfully implemented. Business and consumer confidence remained at low levels", with "weak mining and manufacturing data". "Policy uncertainty … remained strongly elevated".

- The response from the state is seen to have been too slow to date, with too little action and implementation. Today the President essentially reiterated that "(s)tate companies that cannot deliver services – such as Eskom during load-shedding – or that require continual bailouts – such as SAA – diminish the capacity of the state."

- Adding "(t)hat is why a major focus of our work this year is to restore our SOEs to health. We will do this by appointing experienced and qualified boards and managers. We will be clarifying their mandates, and give them scope to execute those mandates." However financial markets are growing tired of waiting, as domestic risks build.

- There is a rising risk of further rand weakness in Q1.20, due to the uncertainty ahead of the Budget and Moody's review. Typically, the first quarter of the calendar is a fairly robust one for emerging market currencies, but the rand has seen rising (implied) volatility over the next few months, exceeding that of other EMs (Bloomberg reading).

- South Africa has nevertheless seen improvements over the past two years, as noted by the President, including “government audit outcomes are improving, money is being better used and properly accounted” and that government has “drastically reduced the time it takes to get a passport or receive a water licence”.

- The President writes that “(a)s we continue to improve, people will notice less interruption of services, more roads are being built, infrastructure is better maintained, more businesses are opening up and more jobs are being created”… but that “(n)one of this will happen overnight. Much of the work will not be immediately apparent.”

- He adds, “(w)here government needs help, we should be prepared to draw on the skills, expertise and resources of the private sector and civil society. If we all work together to build a more capable and developmental state, we will be that much closer to realising the South Africa that we all want.”

- SA is reaping the legacy of the previous administration, including its refusal to allow large scale development of private sector renewable energy infrastructure. and production of such electricity onto the grid. The current administration is working hard to turn the ship around, but it is a very lengthy process due to the extent of the prior deterioration.

- The rand is reflecting the severe weakness of the deteriorated state capacity, and is likely further factoring in the impact of a Moody’s downgrade on 27th March, with the rand gaining little support from the high gold price reached in 2020 (R23 364/oz), as SA’s gold production capability has slipped, with declining electricity supply one of a number of contributors.

- Commodity prices are 3.3% higher y/y, and metal prices are up 3.1% y/y, but the mining sector has been severely impacted by load shedding, with Eskom indicating that this year and next could see further significant outages, which is also dimming sentiment towards SA. Oil is SA’s largest import, and so a rising oil price is typically negative for SA.

- SA risks a uniform sub-investment grade rating from Moody’s, Fitch and S&P (the lite down case) becoming the expected case, should SA not get sufficient union and political support to limit wage increases at, or below, CPI inflation in 2020. The lite down case contains substantial currency volatility and an even weaker economic growth outlook.