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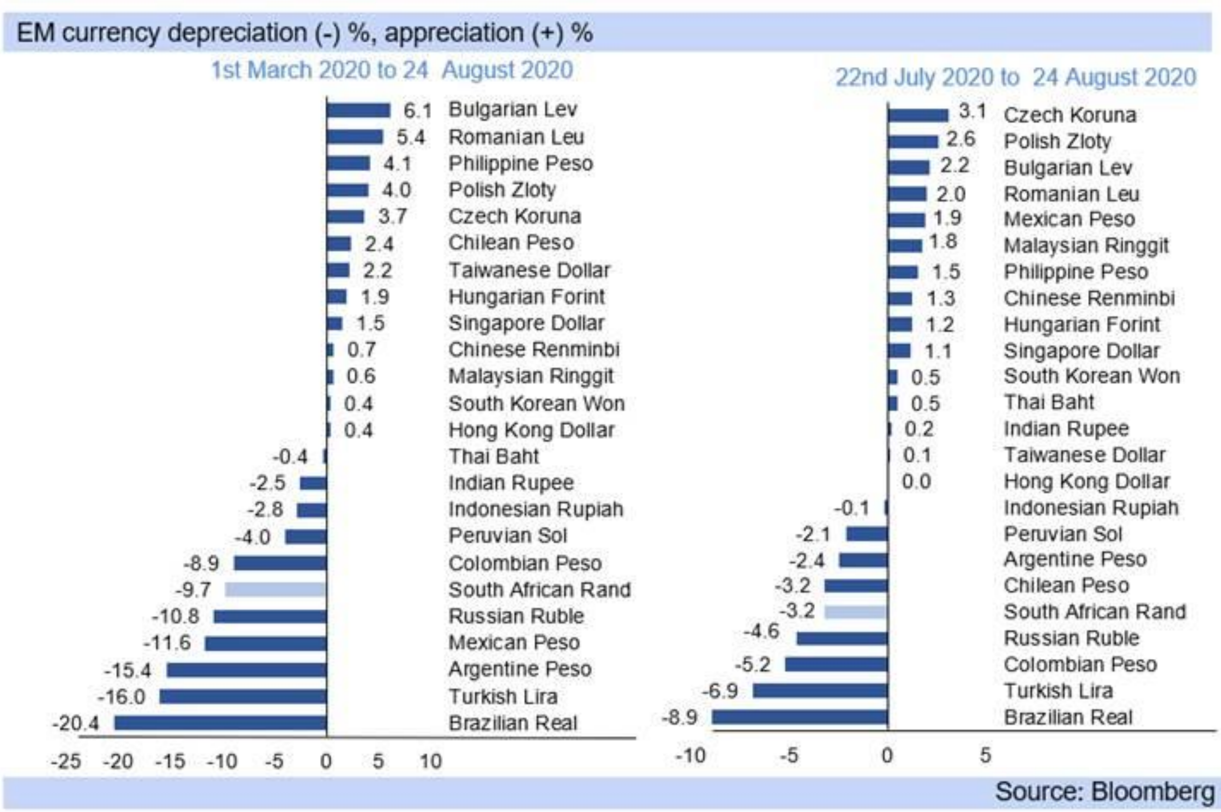
SA Economics

# Rand Note

Monday 24 August 2020

## Rand reaches R17.00/USD, breaks through the key resistance level of R17.00/USD, still driven by a weak dollar in relatively thin market conditions, with the Northern Hemisphere August summer vacation effect weighing on markets








- The rand has drifted to, then temporarily through, the key resistance level of R17.00/USD this morning, stronger this month instead of weaker as is traditional in the Northern Hemisphere summer. With many market players on vacation in this period (even if reduced this year on restrictions) thin trade in prior years often meant higher risk aversion levels.

- However, this year the directional trend is towards strength for emerging markets in Q3.20, instead of weakness as has been normal. Q3.20 has been underlaid with US dollar weakness on a departure from safe haven assets as markets continue to price in recovery for the global economy, with traders fearful of missing out on this play.

- Indeed, market players likely feel that the most severe events this year have already transpired from a risk-off perspective, while the severe shutdowns, and resultant crippling impact to economic activity, has been localised in Q2.20 and by default both Q3.20 and Q4.20 will experience strong recovery.

- The rand has battled to convincingly break through the key resistance level of R17.00/USD this morning, reaching R16.98/USD before being rebuffed back above R17.00/USD, and will likely continue to vacillate around R17.00/USD early afternoon.

- Against the key crosses the domestic currency is at R20.11/EUR and R22.29/GBP, from a close on Friday of R20.24/EUR and R22.46/GBP, and will likely attempt to pierce R20.00/EUR this week, absent any severe market moving events.

- Commodity prices have seen substantial strength, also on market belief that the global economic recovery is firmly underway, bolstering the domestic currency, along with the other commodity currencies, a support which is also likely to persist as long as market participants bet on the global recovery play.

- While the rand will struggle to cleanly break through R17.00/USD, as it typically does with any major resistance level, it will also, as usual, take its cue from international events, along with the other emerging market currencies. However, it is likely to finally break through R17.00/USD, in the absence of any significant negative global market events.

- So far, the average for the rand is R17.01/USD in Q3.20 to date (and R19.76/EUR and R21.88/GBP), with just over half of Q3.20 now complete. As mentioned last week, the dollar has also been weakened by the delay in US senate approved fiscal stimulus extensions. The senate is due to return from its summer vacation break on 8th September.

- The rand could move through R17.00/USD before the end of this month, and begin tracking towards R16.50/USD in the first week of September, but then run into some volatility thereafter. Market risk averse asset sentiment could rise as early as the second week of September on politicking ahead of the US Presidential elections.

- Also in the US, markets have gained on positive sentiment ahead of annual monetary policy discussion at Wyoming's Jackson Hole symposium, with US monetary policy a key driver of global financial market sentiment, particularly as the US economy is not on a firm footing for recovery, despite market optimism.

- While the Fed is expected to reiterate that it will retain an ultra-supportive momentary stance for as long as is necessary, markets will also be seeking colour on other key events on the horizon, including the ongoing growth-negative impact of heighted tensions between the US and China.

- Domestically, monetary policy also remains of importance in South Africa. We continue to expect that the SARB will leave interest rates unchanged for the rest of this year, with the FRA curve also now signalling agreement, which is supportive for the rand on the carry trade.

- At 3.50%, South Africa's repo rate is supportive in the carry trade, domestically and for foreigners, with South Africa's benchmark ten year bond yields above 9.0%, and advance economies seeing their benchmark yields well below the 1.0% mark, which is lending support to the rand.

- Additionally, SA's inflation rate is still extremely low historically, at 2.2% y/y, although we continue expect it will rise towards 3.0% y/y this year, this is still well below the historical average since 2009, when the current CPI inflation rate series started being recorded.

- July's CPI inflation print, due to be published this week, is likely to come out at 2.7% y/y, with CPI inflation rising to 3.0% y/y by November, and 4.0% y/y by April next year, temporarily reaching 5.0% y/y in Q2.21 on statistical base effects, before settling close to 4.5% y/y for the rest of 2021.

- A lengthy accommodative stance from the US would reduce pressure for SA to hike its interest rates, and with US inflation on the upside not expected to be a concern for the Fed over next year, as it is widely expected to become more tolerant about a higher rate, QE and also the carry trade is expected to continue to lend support for the rand.

- Next year the domestic currency could move towards R15.00/USD, as it continues to be driven by high levels of global liquidity, the positive directional carry trade towards EM currencies and the positive sentiment spurred by an ongoing recovery in the global economy (under the expected case, not the severe down case).

- However, longer-term the rand continues to face a depreciating trend, damaged by South Africa's poor credit ratings, with markedly further rating downgrades likely in the next few years, as well as the poor economic growth fundamentals which leads to poor economic growth prospects.