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SA Economics

Rand Note

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Elevated risk aversion in global markets causes marked rand sell-off in what is typically a risk off period for the domestic currency. The fourth quarter of the calendar year tends, in contrast, to see the rand recover

- The rand has seen a further marked sell-off at the start of this week, depreciating to R15.46/USD, R17.28/EUR and R18.66/GBP from R13.98/USD, R15.77/EUR and R17.59/GBP a month ago. Risk aversion in global financial markets has elevated, leading to EM currency sell-off.

- Financial market players' concerns over global economic growth have sparked the latest sell-off (see "Rand note: Rand weakens as heightened global trade tensions add to the downside", 6th August 2019, see website address below), a sell-off exacerbated by the inherent risk aversion of the northern hemisphere summer period.

- Typically global financial markets experience a sell in May-and-go-away phenomenon, namely the northern hemisphere summer vacation effect which tends to result in an exodus from riskier assets as many market players take time off, and are mostly out of the markets away on holiday.

- The dovish FOMC tone in the first half of the year, and even most of July, countered most of the May-and-go-away phenomenon this year, as a series of US interest rate cuts were expected, and as such, were seen to provide protection against the weakness in global economic growth.

- However, at the end of July FOMC commentary did not deliver the very dovish tone that markets were expecting, and financial markets consequently reduced expectations of further US interest rate cuts this year, cuts that were seen to be needed to stave off market concerns over economic growth (see “FOMC note”, 1st August 2019).

- July’s US interest rate cut itself was deemed insufficient in the face of the risks for economic activity emanating from the escalation in trade tensions, which, combined with weak data from other key areas such as the Eurozone and China, has also exacerbated the risk-off environment.

- Market players are now particularly concerned that, in the absence of further US interest rate cuts this year, aggressive US-led trade protectionism will see US, and indeed global, economic growth slow markedly, typically negative for equities, and other perceived risky assets, such as EM assets.

- The marked increase in US-led trade protectionism over the past few years is concomitant with President Trump's pre-election campaign attempt to bring manufacturing jobs back to the US via trade restrictions - on the view that trade restrictions will assist the US in this regard, even though many in the US believe this is not the case.

- While trade tensions between the US and China have tended to exhibit stop-start tendencies, overall there has been a deterioration, as protectionism has increased notably, which is supportive of slower future global economic growth.

- The rand, as both a commodity and EM currency has weakened on the worsening in the trade relationship between the US and China due to the implications for global economic growth, with oil prices also seeing marked weakness. Domestically, politics, concerns over Eskom and a potential Moody's downgrade also weakened the rand.

- Furthermore, with yet another Brexit date fast approaching, still in an environment of no deal on the particulars of the UK's exit from the EU, market risk aversion has risen. Indeed, the chance of a 'no-deal' or disorderly Brexit is seen to have increased.

- However, we continue to believe the negative market reaction over the latest US-Sino trade spat increases the chance for further cuts in the fed funds rate this year, despite the FOMC's initial reticence in this regard at the end of July after its 25bp easing.

- The third quarter of each year is typically one in which global financial markets see the most elevation in risk aversion, particularly August, the key month in the Northern hemisphere summer period. September then tends to see significant market churn, often with increasing rand strength through the fourth quarter and the new year.

- The last, and first, quarters of the calendar year usually sees EM currencies strengthen as many northern hemisphere market players return from vacation and riskier, higher yielding assets typically return to favour. The rand could strengthen by a substantial amount in Q4.19 on this seasonal effect, and in Q1.20.