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ECONOMIC COMMENTARY

- By Francois Stofberg

The Rand – Sentimental Momentum

The good news seems to be pressing on. What started at the end of December, with the election of Cyril Ramaphosa as the new head of the ANC, seems to be continuing its trend into February. That is, a positive shift in sentiment and momentum towards South Africa. The result is an ever-stronger rand. It's also the first time, in recent years, that the deputy president has a strong footing at the annual World Economic Forum in Davos. A forum that is used to talk about big ideas but secretly used by big personalities in politics and business, to make some new friends.

Sentiment (or market and investor emotions) has played an ever-more important role in South Africa's real economic variables over the last couple of years. It isn't really supposed to, but consistent short-term volatility (most recently caused by President Zuma's persistent meddling) has changed our economy fundamentally (over the long term). In fact, sentiment has become an important factor when considering South Africa's real economy – how people feel, determines how our economy performs. By our estimates, almost 3% of the rand's annual 8% long-term depreciation consists of sentiment.

Because emotions are often very volatile, a single statement from the President can see the rand fall quite substantially. If emotions (sentiment) continue this trajectory, momentum starts building, until a critical point is reached where another statement pushes the rand to levels never seen before. The opposite would then also be true: good news associated with a new ANC-head should gather positive momentum. What favours this spurt of positive momentum, is the fact that in South Africa "no news, is good news". That is, if politicians can just stick to their script, do anything that resembles a good and honest job, and not meddle in the economy too much, the market (and by implication the rand) will sort itself out. In the end, it was this momentum of "good" news that finally pushed the rand below the R12.30- and R12.00-levels it was testing.

Two other factors have also contributed to the rand's strength. First, the US Dollar has become ever-weaker in recent months. From trading at levels around €1.06, the dollar has depreciated to levels around €1.23. This, of course, supports a stronger rand. Second, the rand came from a very low base. We are all aware that the rand has been struggling but, as explained above, much of this was caused by emotions and not by fundamentals. A reversal of this sentiment, which we are seeing now, has seen the rand gallop beyond normal levels. Currently, the rand has strengthened to levels well below its long-term undervaluation levels. We are, therefore, hesitant to get used to these emotional levels, because fundamentally nothing has changed. Anointing the new number one, was only the first step towards recovering a very sick economy. If real change isn't announced at government's next Budget Speech, the rand can easily slip back to more normal levels around R12.30, or even test new and lower normal levels.