EFFICIENT GROUP Weekly Economic Newsletter

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ECONOMIC COMMENTARY

- By Francois Stofberg

Weaker Rand, Higher Prices

You've probably noticed that the rand has depreciated quite substantially against the US Dollar in recent weeks. In fact, it was only about three weeks ago when we were still talking about R13 to the dollar. Now, it seems the rand is more comfortable at R13.70 levels. Although the jump came as quite a surprise, the reasoning behind it is sound and understandable; if few market-players are aware of the relevant information, jumps like these occur.

Of course, there are many different factors that play at the value of a currency. One factor that is currently weighing down our rand is the expectations of a weak / struggling government fiscus – which is to be announced on the 25th of October. A weak fiscus fuels speculations that South Africa (SA) might experience another investment downgrade by those pesky credit agencies. However, it seems the recent fall came more indirectly through the mass sell-off of SA shares.

Despite the forthcoming interest rate increases in the US, emerging market sentiment is strong. Investors are hunting for the high-yielding, riskier investments found in emerging markets. However, because of the dismal economic growth (signalling structural strain and weak potential long-term returns), a wealth-destroying government (SAA, Eskom, need we say more), and ineffective policies, SA has seen a substantial outflow of investors' funds. As of September, roughly R91 billion has flown out of SA and analysts believe we'll exceed last year's record of R126 billion. To put these figures in perspective, after the most severe recession SA went through in 2008 only R57 billion flowed out of SA. Although credit agencies might not have downgraded our investment grade again, it appears the investors themselves might have already given us another downgrade.

This is how it impacts the value of our currency. Every year, SA import more than what we export. The result is a current account that is in deficit. To fund this deficit, we rely on the sale of shares and bonds to foreigners, whereby we acquire other currencies (mostly US Dollars). However, what we're seeing now is a net sell-off, implying that there won't be enough US Dollar (and other currencies) to cover the deficit. In fact, the deficit has already winded from 1.9% (as a percentage of GDP) to 2.4%. This increases our demand for dollars (and other currencies) and as we all know, higher demand equals higher prices – so the rand amount we pay for each dollar is now higher, not R13 anymore but R13.70.

Some more bad news for SA consumers. Petrol prices increased by 25 cents and diesel prices by 42 cents, an increase which is believed to impact most severely on the agricultural sector. The reason being twofold this round; rand depreciation and an increase in the prices of crude oil. Recent hurricanes have put a strain on global oil production and it seems that the Organisation of the Petroleum Exporting Countries (OPEC) and Russia are set on continuing their oil production cuts. This double whammy is why we've seen the price per barrel etch ever upwards to roughly $56.