EFFICIENT GROUP

ECONOMIC COMMENTARY

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YOUR WEEKLY ECONOMIC UPDATE

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OUR DEARLY BELOVED RAND

Over the past year, the rand has been battered and it seems as if there will be no relief any time soon. Consequently, we have had to revise our year-end USD/ZAR forecast up from R16.50 to R17.50 and we will consider taking money offshore for our clients at R18.00 levels.

At first, it was the United States (US) Federal Reserve that started to increase interest rates, together with recession rumours that began to spread, which caused investors to run to the safety of US markets. As short-term capital flooded the US markets, the US dollar (USD) got stronger and stronger, and the rand, consequently, weaker and weaker. History told us that the USD usually started to depreciate again 12 to 18 months after its initial increase, as the US economy came under pressure. This usually causes investors to start looking for yield elsewhere, which, in turn, helps to support other emerging market currencies, like the rand. Unfortunately, 12 to 18 months later, the US economy is still the healthiest economy out there and shows very few signs of slowing down substantially. Because uncertainty scares investors, and because developed countries now offer even more attractive yields and their listed companies seem to be getting through tighter monetary conditions, emerging market currencies are bleeding (note that this is not something that can be sustained indefinitely). Unfortunately, owing to a failing state in South Africa (SA), the rand has not only been battered by global waves but local waves too. We all know about government's inefficiencies but the rate of deterioration has recently weighed more heavily on the rand.

Failing state-owned enterprises, like Eskom, have led to rumours about rolling blackouts. In fact, many larger corporates have already started to plan for a "no-grid" eventuality, when Eskom will simply fail and take the economy back to the dark ages. We do not believe that we are close to this point but markets seem to be starting to price this in as a potential eventuality. Even if we do not have a total grid collapse, government's persistent erosion of the business environment is weighing down any potential we have for growing our economy sustainably.

Failing state relationships, poor political allegiances, and news about SA's support of Russia's war in Ukraine have soured our association with important trade partners who represent the bulk of our annual trade volume. Markets fear that we will be excluded from important trade agreements, like the US-based African Growth and Opportunity Act, as well as that other trade partners will enforce trade restrictions against us, fuelling concerns about lower growth, more unemployment, and higher inflation.

Failing state finances mean that we continuously allocate scarce resources ineffectively and inefficiently. Ineffectively means that most of our budget is allocated to the wrong expenditure items, like salaries and grants, instead of to capital, which includes infrastructure, healthcare, and education. We also allocate resources inefficiently, which refers to wasteful and irregular expenditure, and the horrific performance of those items that we do spend on. Compared with most other countries, and on a range of performance indicators, we still have the weakest performing education and healthcare results in the world. Put this all together and it is no wonder the rand is having such a hard time!

For now, we believe that the rand will remain weak but that the recent fall to levels beyond R19.40 is a bit too much. Markets are a collective of emotional human beings and, therefore, tend to overreact. We should see the rand strengthen back towards levels closer to R17.50. However, the longer the rand stays above trend, the more it gets used to staying there.

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