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RAND IS ONE OF THE BEST PERFORMING EMERGING MARKET CURRENCIES MONTH-TO-DATE

Focus will shift to the next key economic data releases to ascertain whether interest rates are working to sustain the risk-on environment and support emerging market currencies

The Rand has been one of the best performing emerging market currencies month to date, gaining 6.7% against the dollar in the first two and a half weeks of November 2022 and is now down only 7.4% year-to-date compared with 13.2% at the end of October 2022. Incredibly, the Rand/Dollar has outperformed our Emerging Market Currency Index (3.8% month-to-date), the Emerging Market Commodity Currency Index (3.5%) as well as other indices of Emerging Market currencies. Although the extent of Rand/Dollar strength has been far greater than expected, the Rand has been significantly undervalued on a PPP basis. A move from “risk-off” to “risk-on” investor sentiment typically immediately supports emerging markets with valuation gaps or countries with strong economic fundamentals or, in South Africa’s case, sophisticated financial markets.

The focus in global currency market will now shift to the next release of critical economic data, including the US employment report on 2 December, the US inflation data on 13 December and the Federal Reserve interest rate meeting on 14 December. In order for the current risk-on sentiment to persist there needs to emerge further evidence that the increase in interest rates is working to reduce inflation and slow economic activity. Most critically, US consumer inflation needs to continue to slow, at least in line with market expectations.

While the US consumer and producer inflation data for October 2022 was lower than expected, the monthly rate of increase in inflation needs to moderate further for the US to achieve their inflation target. This includes a significant slowdown in shelter (rental) inflation. (Shelter inflation comprises roughly a third of the US inflation basket). Currently, shelter is up at around 7%y/y, which means that the US cannot achieve their inflation target unless higher interest rates continue to dampen housing market activity, which will lead to a moderation in rental inflation. The US labour market presents a similar challenge. While US job openings are slowing, they remain extremely high at over 10 million, reflecting ongoing high demand for labour and persistent upward pressure on wages.

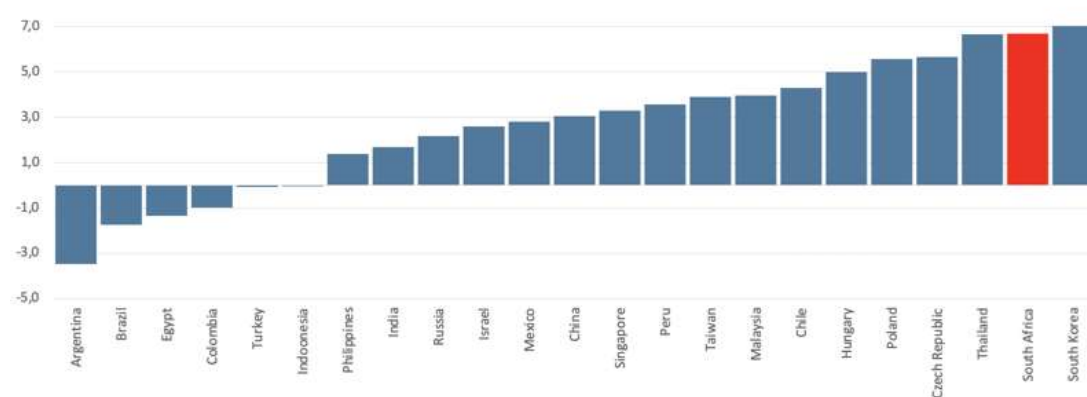
Lastly, most major central banks will continue to push interest rates higher given their ongoing efforts to control inflation. Under these circumstances, it is understandable that economic activity will slow further, and many economies are likely to experience recession conditions during 2023 including the United States and Euro-area. **This also suggests that while the current global risk-on sentiment can persist in the short-term, leading to further Rand strength, there is still a long-road ahead to get global inflation back down to pre-COVID target levels.** All of which highlights that financial markets are likely to remain volatile over the coming months until it is clear that the major central banks has won the fight against inflation and that the global economy is moving past the worst of the current phase of economic turmoil.

The Analytics Decoder by Dr. Lance Vogel has current fair value at R17.46/USD. This is on market and suggests current levels offer good value for externalizing Rands under current conditions.

Source: Alison Barker, Head of Analytics Consulting FX Solutions

EMERGING MARKET EXCHANGE RATE VS USD

% change Month to Date



RAND PER US DOLLAR

Year to Date



Source: Alison Barker, Head of Analytics Consulting FX Solutions

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