

## Pound sterling clawing back the Brexit discount

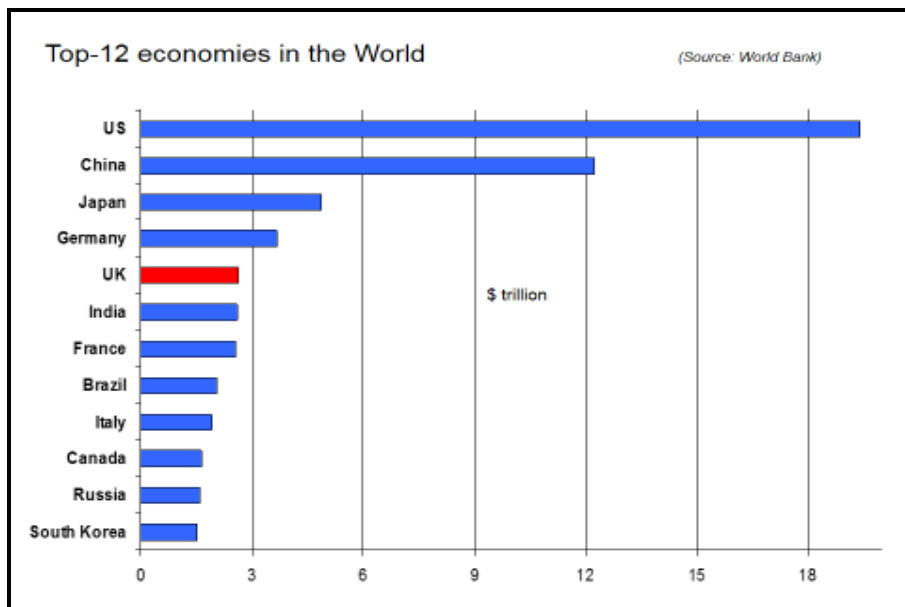
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Theresa May's first visit to sub-Saharan Africa coincided with a renewed bout of rand weakness, with August having raised tensions amongst currency traders around the globe.

The visit by the British government delegation had a decidedly Brexit flavour, as she was punting improved trade relations based on import opportunities for South African firms and increased tourism into the UK.

It was the first visit by a British prime minister since December 2013, when David Cameron attended the funeral of Nelson Mandela. Mrs May made it clear that England stands to benefit from increased trade with countries in Africa and the visit included Africa's largest economy, Nigeria, and Kenya, which still enjoys close ties with the UK.

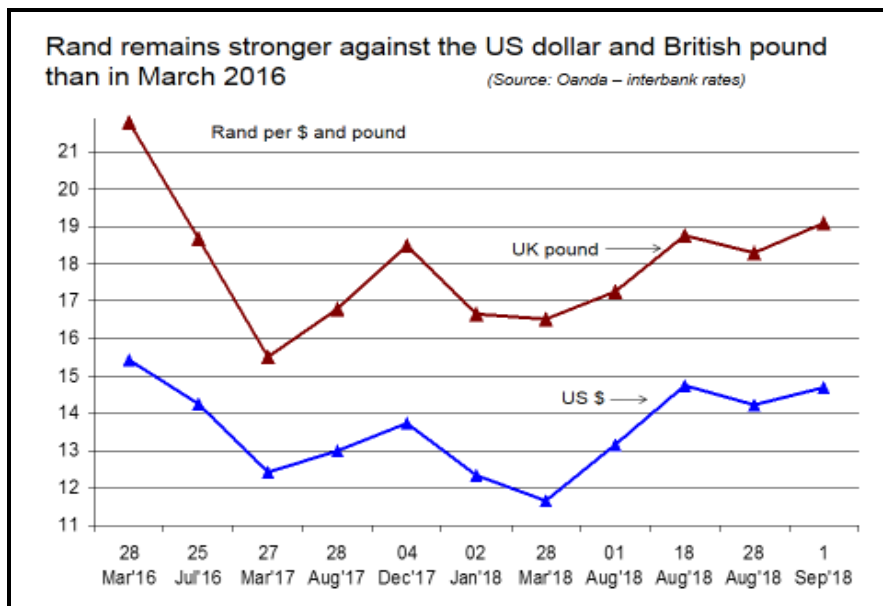


Mrs May was probably slightly embarrassed by the fact that the rand was 19% stronger against pound sterling on the day of her arrival in South Africa than at the end of March 2016, a lingering hangover from the beating that the pound took in the aftermath of the decision to leave the European Union. The UK nevertheless remains the fifth largest economy in the World.

Upon her departure for the next leg of the African trip, the pound had strengthened quite sharply against the rand, but this was mainly due to the meltdown of the Argentine peso and renewed dollar strength, which even dragged down Australia's currency.

In a referendum on 23 June 2016, a slim majority of British voters supported leaving the European Union. Brexit alarmists were warning of a return to recession as a result of the vote, but were eating humble pie at the end of 2016, when it transpired that the UK's economic growth rate had outperformed the US and the advanced economies in the Euro area.

The fundamental mistake made by several leading economic research agencies, including the Bank of England, was to underestimate the positive effect on growth inherent in a more competitive currency (which follows an exchange rate depreciation).



Returning to the weakness of the South African currency during August, there does not seem to be reason for undue concern. Although the rand depreciated by more than 9% against the US dollar between 5 August and 1 September, this was very modest when compared to the decimation of the Argentine peso and Turkish lira over the same period, namely declines of 27% and 23%, respectively (at Oanda interbank rates).

A number of reasons exist for the rand having returned to an undervalued status in recent months, including:

- Lingering socio-political uncertainties in South Africa, especially surrounding the vexed issue of radical land reform and the cooperation between the ANC and the populist EFF in taking control of the Nelson Mandela Bay Metropolitan Municipality
- Global geo-political tensions involving the US, China and Turkey have resulted in a temporary aversion towards emerging market currencies
- During the first half of 2018, South Africa's trade balance moved sharply back to a marginal deficit, compared to a record trade surplus in 2017
- Profit-taking on South African bonds and equities by global fund managers

It is clear, therefore, that fundamental balance of payments flows have played a major part in the performance of the rand since the second quarter of 2018. It is also clear that a combination of unpredictable domestic and global political factors have conspired to make any exchange rate forecasts an extremely hazardous venture. For investors, this has elevated the importance of diversification.

In the meantime, exporters are smiling all the way to the bank and prospects for an economic growth rate of close to 2% for 2018 have also improved.