

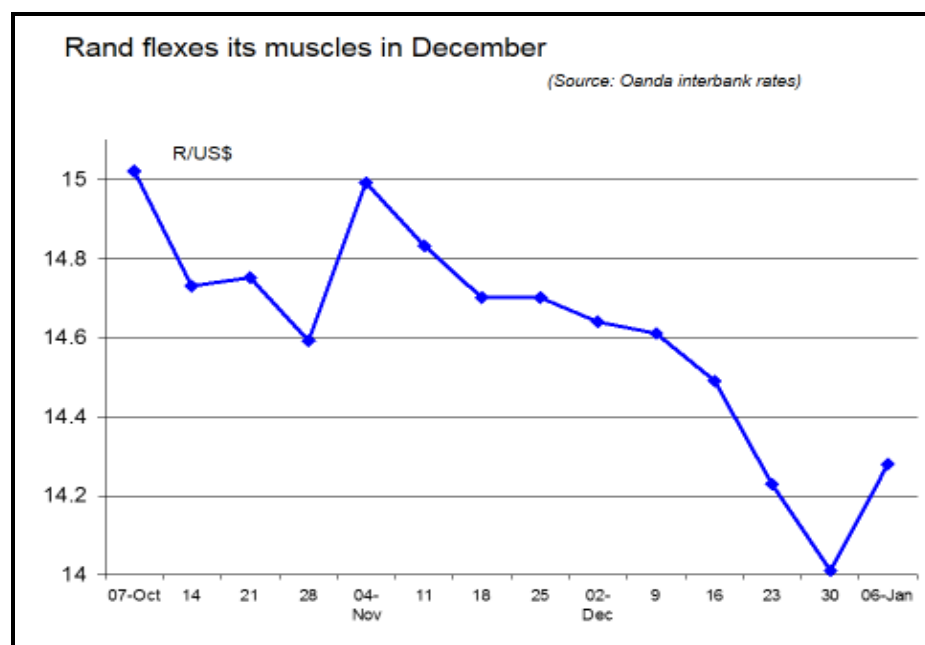
Rand recovers, gold shines

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South Africa's currency and the gold price are making headlines again – for a variety of reasons. The rand ended 2019 on a high note, having gained more than 7% against the US dollar since the beginning of October, returning to a level of close to R14.

During November and December, the rand was the star performer amongst emerging market currencies, gaining 6.5% against the dollar and outperforming the Brazilian real and the Mexican peso.



The easing of trade tensions between the US and China and a US dollar that weakened against the Euro and the British pound proved to be the key catalysts for the resurgence of most emerging market currencies. The Turkish lira was the only notable exception, losing 4% of its value against the dollar (between the end of November and 31 December).

As usual, South Africa's long-term bond yield provided another clue to the stellar performance of the rand. It has become apparent that any easing of geo-political tensions enhances investor appetite for higher yields on offer in emerging markets.

The domestic 10-year bond yield shed 60 basis points between the beginning of November and the end of the year, before adding 10 basis points early in January, due to capital market jitters over a US air strike in Iraq.

At its most recent level of 8.25% (on 7 January), South Africa's bond yield remains a spectacularly more attractive investment option than European bonds, many of which currently offer negative real returns.

Future prospects for the rand will continue to be influenced by international capital market trends, but also by the next credit rating review of Moody's, due in March. Retention of investment grade status will almost certainly benefit the South African currency and drive bond yields even lower.

In the interim, however, the fairly dramatic escalation of tensions in the Middle East will continue to hurt emerging market currencies.

Gold miners will not mind such a scenario one bit, as it allows them to reap the handsome rewards of a double bonus in the form of a higher gold price and a weaker domestic currency.

The US drone strike that killed the commander of Iran's special armed forces while on a visit to Iraq has galvanised anti-US sentiment in the Middle East, with threats of retaliation and counter-retaliation being flung around by Iran, Iraq and the US.

US president Donald Trump has even threatened sanctions against Iraq if the country expels US forces, adding that the US will attack 52 sites in Iran, including historic cultural sites if the oil-rich country retaliates for the deadly drone strike.

The response of the gold price was ruthless, with a gain of more than 8% in the space of one month, rising to above \$1,600 per fine ounce to reach a six-year high. At the current exchange rate, South African gold mines are earning R140,000 more per kilogram of gold than a year ago.

It would not be a surprise, therefore, if the resurgence of gold shares on the JSE continues well into the New Year.

A higher oil price represents one of the downsides to these developments, with Brent crude rising to above \$70 per barrel – its highest level in eight months. Due to the recent resilience of the rand, the inflationary effect of the higher oil price will nevertheless be muted.

South Africa's consumer price inflation is at its lowest level in more than a decade and the higher oil price certainly does not warrant a deviation from the urgent need for lower money market rates. Capital market rates are clearly calling for such a move, which could become a reality later in January.