

Emerging market currencies bounce back

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The abnormality that has besieged the world economy has been particularly evident in wildly fluctuating currency markets.

One commentator at Investec recently referred to the foreign exchange markets as possessing a “psychotic bipolar disorder”, a view that is probably warranted when noting the high level of volatility in emerging market currencies since March.

It was impossible to predict the next move of the rand during April. On two occasions, its value against the US dollar strengthened significantly in the space of six days, but it also depreciated by almost 6% on two occasions. The net effect during the month of April was a depreciation of 2.6%, which was not entirely out of line with several other emerging market currencies, including Turkey and most of Latin America.

The unpredictability of market sentiment towards emerging market currencies has been attributed mainly to the scramble for safe-haven assets in the wake of unprecedented uncertainty over the depth of the imminent global recession and the general state of anxiety that has gripped the world.

Renewed tension between the US and China has also played its part, whilst commodity exporters like South Africa, Brazil and Chile, have felt the brunt of dwindling demand induced by global economic lockdowns.

However, as predicted by the author during a recent Optimum-webinar, rand weakness was always going to be a short-term phenomenon. Attractive local bond yields and record highs for dividend yields of an impressive number of blue-chip companies on the JSE have caught the eye of fund managers and should lead to substantial inflows of portfolio investment in coming months.

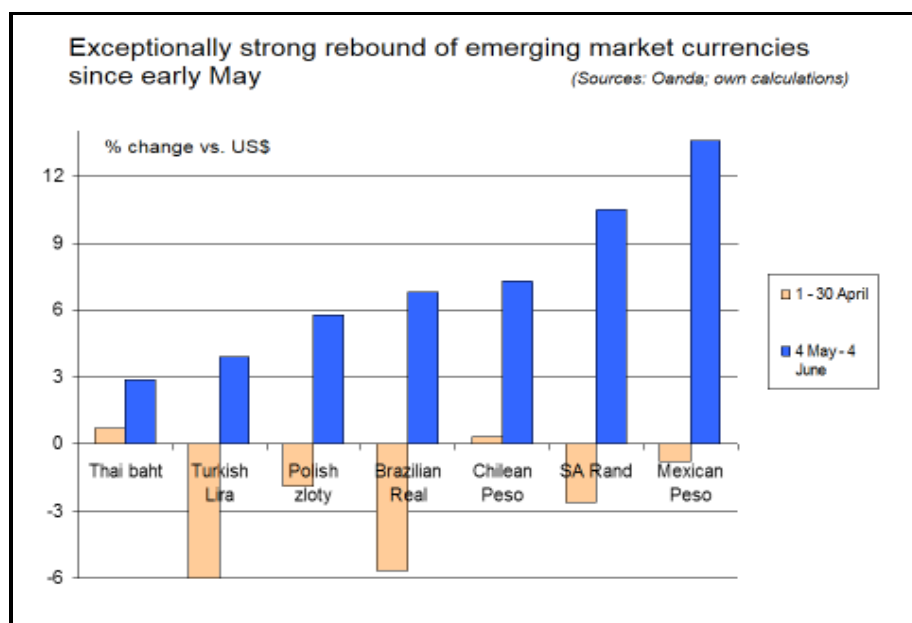
Attractive return on SA bonds

Bond yield spreads between high-income countries and emerging markets have hit record highs in recent weeks and the current yield on South Africa’s ten-year bond is a mouth-watering opportunity for fund managers with wider discretion than the quite narrow guidelines of ratings agencies.

With negative real bond yields in the US, Japan, Canada and the European Union, it is inevitable that fund managers will seek to diversify investments in those emerging markets that tick the crucial boxes relating to the size of the economy, the quality of financial markets, private sector

corporate governance standards and fundamental socio-political stability. South Africa certainly makes this list, as evidence by the exceptionally strong recovery of the rand since the beginning of May, namely more than 10% against the US dollar.

Several other key emerging market currencies, most notably in Latin America, also bounced back during May and early June. In a sharp reversal of fortunes during March and April, a total of nine key emerging market currencies posted solid gains during the past five weeks, with indications that this trend could continue at least in the short-term.



The solid performance of emerging market currencies since May was rather predictable when viewed against the backdrop of the following developments:

- Significant oversold values prior to May, as indicated by 100-day and 200-day moving averages
- Gains in emerging market equities and sovereign bonds as investors started renewing their search for positive yields
- The strong recovery in China's Caixin purchasing managers' index (PMI) to above the neutral 50-level for three successive months, which has benefited commodity exporters
- Abundant liquidity on offer in high-income countries
- A systematic easing of lockdown regulations in most countries

The above factors are not expected to recede in a hurry and the rand should continue its impressive recovery into the second half of the year.