Geopolitical risks once again spoil recovery of the Rand and the JSE

Almost a repetition of last year during May the geo-political risk surrounding the trade war between the US and China imposes a worrying risk for financial markets, despite the Covid-19 pandemic woes. The decision of China on Thursday to introduce a new national security law in Hong Kong to deal with pro-democracy protest brought about a new fear that US-China trade negotiations and deals of the last three years may collapse. Hong Kong as a manufacturing hub in Asia now stands a change to subside as an economic power. In reaction global equity markets, especially emerging market bourses contracted, bond rates climbed, and the Dollar strengthened.

Domestically the JSE felt the China-Hong-US uncertainty with the ALSI losing more than 2000 points alone last Thursday and Friday, after trading above the 52 100 (52 143) level during the middle of last week or 5.1% higher than the close of 49 628 the previous Friday. The index ended Friday on 50 147 or an increase of a mere 1.0% for the week.

The decision by the Monetary Policy Committee (MPC) last Thursday to lower the repo rate with 0.5%, the fourth consecutive time this year came as expected. The MPC stressed that overall risks for the inflation rate appear to be on the downside, given the stronger Rand, lower international oil prices and lower bond rates. The Reserve Bank now expects that the inflation rate will reach a low 3.4% for 2020 and 4.4% in 2021 and 2022. In this regard it is forecasted by the Reserve Bank's Quarterly Projection Model a further two more cuts of 25 basis points in the repo rate during the next two quarters.

The MPC stressed its worry on the expected economic growth rate for South Africa in 2020 due to the Covid-19 virus and foresee a negative growth rate of 7.0% in 2020, but expects the economy to rebound strongly to growth rates of 3.8% in 2021 and 2.9% in 2022. The MPC also mentioned that: *"Monetary policy can ease financial conditions and improve the resilience of households and firms to the economic implications of Covid-19"."* In this regard the Bank has introduced lower regulatory requirements on banks and steps to secure liquidity in domestic markets.

The Rand exchange rate started to discount this continuation of sound Monetary Policy already last Monday. The currency traded as weak as R18.55/$ at the close the previous Friday but quickly tested the R18.00/$last Tuesday. After the announcement of the cut in the repo rate on Thursday the Rand appreciated strongly to levels of around R17.56/$. The uncertainty on the US- China- Hong Kong debacle on Friday had seen the Rand to lose ground again to a level of close to R17.90/$ but recovered in late trade again to R17/70/$, still 83 cents stronger than the previous week. The Gold price remains strong on $1 732 but the price of Brent crude subsided to $33.67 per barrel. On the capital market bonds continue to recover. The R186 Government treasury ended the week on 7.65% against 7.80% the previous Friday close. This morning markets opened with not much movement, given that the US has a public holiday. The Rand however recovered fully over the weekend and is trading again at levels lower than R17.60/$

This coming week investors' attention will concentrate on the release of South Africa's inflation number for April. Markets expected a rate of 4.0%, marginally lower than the 4.1% recorded in March 2020. The release of the South Africa's Balance of Trade for April will also be of importance as a surplus of R1.8 billion is forecasted.

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Dr Chris Harmse completed his doctorate degree in Economics at the University of Pretoria. Prior to entering the financial services industry, he was a lecturer and professor at the Department of Economics of the University of Pretoria between 1986 and 2005. Dr Harmse was awarded an extraordinary professorship at the School of Economics of the University of Pretoria in January 2006. He served on various Investment Committees and is extensively involved in economic research and asset management.

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