

MUR £
€ ¥
ZAR \$
ZAR/USD

Product Information

INTRODUCTION

The South African Rand (ZAR) is the official currency of the Republic of South Africa. Until the late 1960's South Africa had a fixed exchange rate, later on the Rand was pegged to major foreign currencies. The government switched to a system that formally expressed parity against the United States Dollar (US\$) in 1979. The foreign debt crisis of 1985 took the Rand to an all time low of less than US\$ 0.43. During the mid eighties dual exchange rate system or the Financial Rand was introduced to provide protection to the domestic economy from adverse effects of large capital outflows. The Financial Rand was created by the sale of non-resident assets in the country and was available only to foreigners for investment in South Africa. During time of economic isolation, the Financial Rand served South Africa well, however it had many disadvantages. The Financial Rand invariably stood at a discount to commercial Rand and during 1992 this discount was almost 40% while, in 1993 the discount declined to 20%. In fact, the size of the discount also played a major role in determining South Africa's relative attraction as an investment destination. Due to its limitations, the government decided to terminate the Financial Rand and dual exchange rate system was scrapped in 1995.

Over the past one year, the Rand exchange rate has been volatile with the 5-day volatility rate increasing from an average of 9.6% in March 2010 to 14.7% in March 2011 (Bloomberg). According to the latest triennial of the Bank of International Settlement (BIS) survey, the daily average turnover for the Rand stood at about US \$ 24 billion making USD/ZAR the fifth most active emerging market currency. This could probably be one of the reasons for the Rand remaining volatile and sensitive to shifts in investor risk appetite. As in any emerging economy, South Africa had also witnessed a strong surge of portfolio inflows into the country. The rise in price of Gold and Platinum has also supporting the terms of trade, because the price of exported commodities still outpace the price of imported commodities.

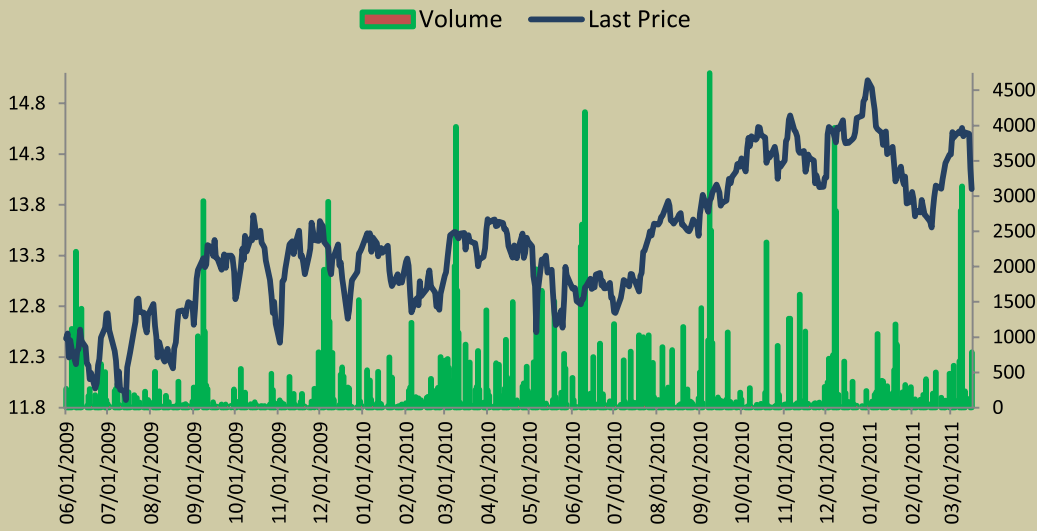
The interrelation between the prices of Gold and Platinum with the South African Rand is very visible. In fact, the currency of Africa's biggest economy depreciated as much as 2.8% to 7.0311 per dollar on 15th of March 2011, the biggest intraday decline since May 19, 2010. The terms of trade tend to influence the exchange rate over the medium to long term. It is important to note that gold fell as much as 3.5%, while platinum declined as much as 3.2% on 15th March 2011. South Africa was the world's biggest producer of gold in 2007 but was surpassed by China in 2010. Rand's movements against the US\$ are often influenced by the direction of gold and platinum prices. In turn, South African miner profits hinge on the metal price-

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and the US\$/ZAR exchange rate. According to a recent comment by the World Bank's Africa economist, Shanti Devarajan: Rising private capital flows and commodity prices are fuelling gains in the Rand, these flows are "volatile" and "difficult to manage".

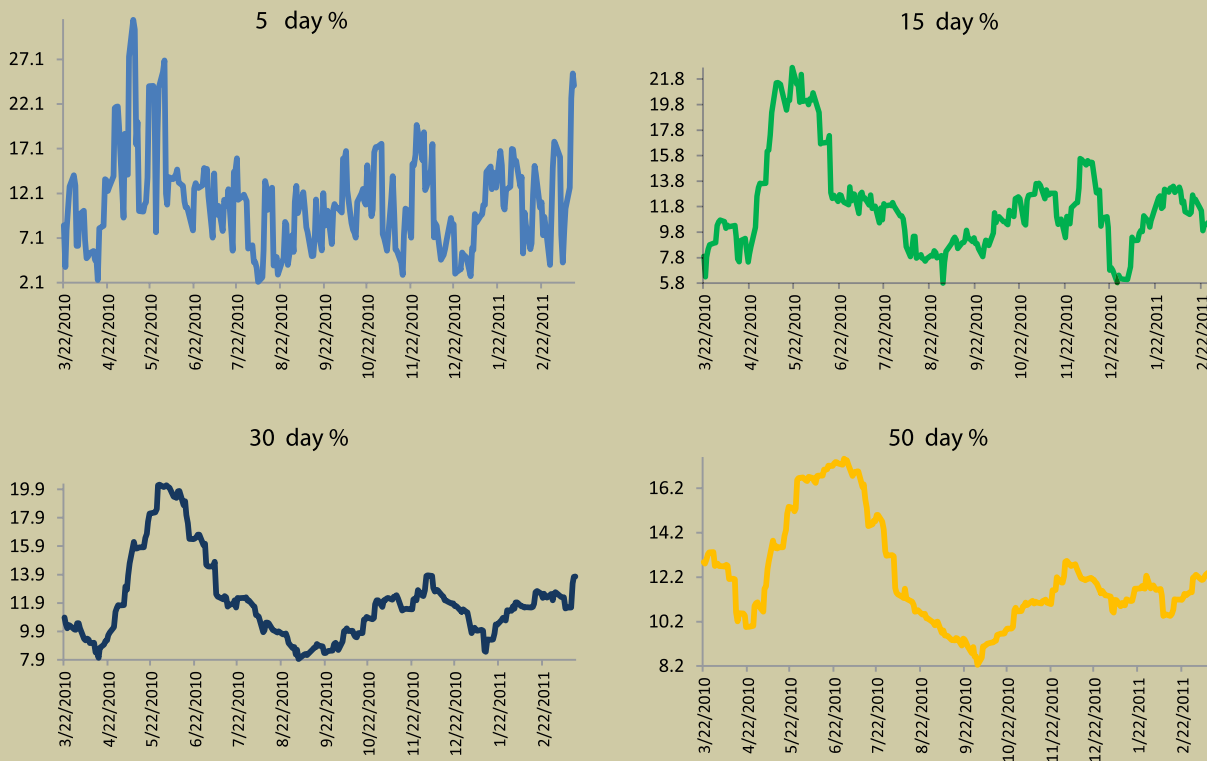
Recently, Japan was hit by a severe earthquake followed by a tsunami on March 11, 2011. This natural disaster had a effect on South Africa's currency with the Rand slumping to a 10 month low after Japan's crisis sparked a sell-off caused by a drop in the demand for gold and platinum, which makes up about fifth of South African export earnings.

Chart 1: ZAR/USD



Source: Bloomberg, GBOT Research

Chart 2: ZAR/USD volatility



Source: Bloomberg, GBOT Research

SIGNIFICANT FACTORS AFFECTING THE VALUE OF THE RAND

A. Commodity prices

The recent surge in commodity prices, particularly in gold, has helped strengthen the South African Rand. The Rand gained more than 28% against the US \$ since the start of 2009 and more than 7% since the beginning of 2010. However, the South African Rand weakened more than 1.7% to near a six-month low against the greenback on February 4, 2011.

B. Interest rate

The South African Rand rallied against the greenback in 2010 with interest rates in developed countries hovering near zero. This prompted investors to borrow cheaply in those countries and invest in South Africa; the 6% benchmark interest rate made the Rand a popular purchase. According to Bloomberg, the benchmark interest rate was 5.50% in the month of February 2011.