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IN THIS ISSUE

For years, the Big Mac Index has deceived media and pundits with its supposed insights into the true value of the South African Rand against the US Dollar. Despite its persistence, Magnus Heystek argues that this index has consistently missed the mark, rendering it worthless as an economic indicator.

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THE BIG MAC INDEX A RATHER USELESS METRIC

By Magnus Heystek | Director and Investment Strategist, Brenthurst Wealth

I wonder why the media and other ill-informed commentators still waste their time publishing the so-called Big Mac Index as a guide to the “real value” of the rand against the US dollar.

For decades now this index has been entirely wrong and utterly useless, and yet, time after time, the SA media picks up on the story and wastes column inches of scarce media space pontificating on what the ZAR value really should be against the US dollar.

Last month the Big Mac Index reflected that the “true value” of the rand should be R8.63/USD. Compare this to the actual rate on the markets which was trading at around R19/USD at the time.

This index is drivel, worthless and has no reliability or predictability as an economic indicator, yet on talk shows and radio programs this mythical value of the rand is used by certain commentators to justify a certain view on the rand, which has been proven wrong for many years now. Many ill-informed investors — judging from the comments that follow these articles — make their long-term investment decisions based on the Big Mac Index. It's like saying the reading from the scale you used 30 years ago, which reflected a weight 20 or 30 kilograms less than what you weigh today, is your “real” weight, and that the more accurate scale in the bathroom, which you are reluctant to use, is wrong and unreliable.

Ill-informed investors have fallen prey to the inaccuracies of the **Big Mac Index**, making critical decisions based on its misleading data. As one of the world's significant forex markets, the rand's actual value is far more complex and can't be simplified by a fast-food index. Time to flip the narrative and seek reliable economic modelling for true insights.

The local currency market is the 17th largest forex market in the world, and annual trade in the ZAR with other currencies, such as the USD, euro, yen and pound, runs into trillions of dollars per annum. Some of the largest banks and financial institutions in the world deal in our market, which is very liquid and often a proxy for emerging market currencies, due to this liquidity.

Japanese housewives are major players in the ZAR/yen trade and have used the carry-trade — borrow in Japan and invest in SA — to make profits over many years. The large swings in our currency market also attracts the big players who make fortunes due to the massive movements in the ZAR against global currencies.

Anyone who based decisions on the future behaviour of the rand according to the Big Mac Index would have gone bankrupt many years ago. So next time you read an article on the “true value” of the rand using the Big Mac Index, just delete it and move on.

FOR AS LONG AS I CAN REMEMBER, THE BIG MAC INDEX HAS BEEN UTTERLY AND HOPELESSLY WRONG. THE MARKET IS THE MARKET AND IS THE REAL-TIME REFLECTION OF WHAT MILLIONS OF INVESTORS ACROSS THE WORLD BASE THE RAND'S WORTH ON.

Better still, base your rand-exchange values on real economic modelling, such as that of Annabel Bishop from Investec, who has built up a very good reputation as one of the better forecasters of the behaviour of the rand. Her latest economic scenario modelling shows exactly what conditions would have to be met for the rand to return to the R14/\$ mark by the end of next year. However, South Africans should not hold out hope for this happening. According to Bishop, there is a 1% chance of this happening in the near future. On the other end of the scale, she says there is an 8% chance of the ZAR/USD reaching R22 or more in the next two years.

Bishop says that the summer that the summer holiday period in the Northern Hemisphere increased risk aversion, which hurts emerging economies like South Africa.

“While the US dollar has been generally softer since the start of this year, with investors anticipating the end of the US rate hiking cycle as inflation eases, some uncertainties surrounding the peak in US policy rates and growing hopes of a soft landing in the US economy appear to be supporting the greenback in recent weeks,” economists at Nedbank added, as quoted in the Daily Investor. The rand has faced a period of extreme weakness for several years, and according to the Economist’s latest Big Mac Index, it is one of the most undervalued currencies in the world, with an implied exchange rate of R8.94/\$.

Adjusted for GDP, the rand should be trading closer to R11.00 to the dollar, the index showed, but most economists pin the “fair value” of the rand at about R14.00 to the dollar, given its various core issues. The last time the rand was even close to R14.00 to the dollar was almost two years ago, when it traded at R14.12 to the dollar in September 2021. Given the extreme volatility of the rand, economists have remained divided on exactly where the rand will go in the coming months and years, with both upside and downside risks present.

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INVESTEC LOOKED AT ALL THE POSSIBLE DIRECTIONS THAT THE RAND COULD HEAD IN, AND HOW LIKELY THESE ARE:

R14.40/\$ – EXTREME UP CASE – 1% CHANCE

For the Extreme Up Case, which would send the rand closer to its fair value, South Africa's economic growth rate would have to rise to 3-5% and then 5-7% per annum.

The country would also need good governance, growth-creating reforms, strong property rights, no nationalisation or expropriation without compensation, high business confidence, fixed investment growth; while fiscal consolidation drives debt to the low ratios of the 2000s. Domestic inflation would also have to drop due to extreme rand strength and the country would have to experience extremely favourable weather conditions.

There would also have to be strong global growth, a commodity boom, an upgrade of credit ratings to investment grade, a short greylisting and a quick transition to renewable energy. When factoring in all these requirements, it becomes clear that this is extremely unlikely. HENCE, THE RAND ONLY HAS A 1% CHANCE OF REACHING R14.40/\$ BY Q4 2024, INVESTEC'S MODELLING SHOWS.

	Q1 23	Q2 23	Q3 23	Q4 23	Q1 24	Q2 24	Q3 24	Q4 24
USD/Rand	17.76	18.68	16.70	16.00	15.20	14.70	14.50	14.40
Repo	7.75	8.25	7.50	7.25	7.00	6.50	6.50	6.00

R16.60/\$ – UP CASE – 1% CHANCE

THERE IS ALSO ONLY A 1% CHANCE THAT THE RAND WILL DROP BELOW R17.00/\$ BY Q4 2024, THE FINANCE GROUP SAID.

In the Up Case, economic growth would need to lift towards 5.0%, leading to increased business confidence and investment. There would also have to be no nationalisation or expropriation without compensation. Good weather and global conditions would also be needed to keep domestic inflation low.

Furthermore, credit ratings would have to be upgraded due to fiscal consolidation and lower borrowing. South Africa would also need to be greylisted for less than 18 months. In addition, there would also need to be a substantial transition to renewable energy, while comprehensive measures would be required to alleviate climate change.

	Q1 23	Q2 23	Q3 23	Q4 23	Q1 24	Q2 24	Q3 24	Q4 24
USD/Rand	17.76	18.68	17.40	16.90	16.70	16.60	16.80	16.60
Repo	7.75	8.25	7.75	7.75	7.50	7.00	7.00	6.50

R17.25/\$ – BASE – 47% CHANCE

THE BASE CASE SCENARIO IS THE MOST PROBABLE RESULT FOR SOUTH AFRICA, WHERE THE RAND WILL DROP SLIGHTLY TO R17.25 BY Q4 2024.

Economic growth will rise to 3.0% on reforms, with global financial risk sentiment being neutral to positive, whilst South Africa retains its BB credit rating. The rand will stabilise slightly and strengthen somewhat, while inflation is impacted by weather patterns which will affect food prices.

The transition away from fossil fuel usage is slow, and the war in Ukraine eases. There is little to no expropriation without compensation, and the greylisting is temporary.

	Q1 23	Q2 23	Q3 23	Q4 23	Q1 24	Q2 24	Q3 24	Q4 24
USD/Rand	17.76	18.68	18.00	17.60	17.25	17.35	17.55	17.25
Repo	7.75	8.25	8.25	8.25	8.00	7.50	7.50	7.00

R19.60/\$ – LITE DOWNSIDE – 43% CHANCE

Although the Lite Case has the same international environment as the Base Case, the domestic environment differs. Business confidence is down due to load and water shedding, there is a weak rail capacity, there is civil and political unrest, a swing towards left-leaning policies and a recession.

Although there is a temporary increase in state borrowing, resulting in the risk of credit-rating downgrades furthering, there should be eventual fiscal consolidation.

There is also slight expropriation of private property, which moderately impacts on the economy; a slow move to implement renewable energy and mitigate the effects of load shedding, and high inflation due to the unfavourable weather conditions and a lengthy greylisting. This would lead to a period of sustained rand weakness, with the rand jumping over R20.00/\$ and reaching R19.60/\$ in Q4 2024.

	Q1 23	Q2 23	Q3 23	Q4 23	Q1 24	Q2 24	Q3 24	Q4 24
USD/Rand	17.76	18.68	19.70	20.50	20.90	20.50	20.00	19.60
Repo	7.75	8.25	8.50	9.00	9.50	9.50	9.50	9.50

R22.80/\$ – SEVERE – 8% CHANCE

A severe case would spell a period of sustained weakness for the rand, with the scenario seeing the rand jump above R20.00 as early as this quarter (Q3). This would need a lengthy global recession, resulting in a global financial crisis.

The ANC/EFF would also have to enter into a coalition in 2024, with severe service shortages resulting in widespread civil unrest. The government would also start borrowing from an increasing number of sources, and South Africa would be rated a single B by all major agencies – eventually dropping to CCC grade. The country will also increase its risk of default and sink deeper into a debt trap. The country would also fail to transition to renewable energy and fail to mitigate the effects of climate change.

In addition, there would be the full implementation of expropriation without compensation, with a noticeably negative impact on the economy. High inflation also occurs in this scenario due to changing weather conditions, and the rand suffers extreme weakness. According to Investec, it is eight times more likely that the rand will jump to R22.80 instead of R14.40 by Q4 2024 – although both outcomes are based on extremely low probabilities.

	Q1 23	Q2 23	Q3 23	Q4 23	Q1 24	Q2 24	Q3 24	Q4 24
USD/Rand	17.76	18.68	20.50	21.60	22.30	23.00	23.00	22.80
Repo	7.75	8.25	9.25	10.50	11.00	11.00	11.50	11.50

BRENTHURST'S VIEW ON THE RAND

It is well known that Brenthurst has been bearish on the performance of the rand since about 2013 when the first signs of the structural collapse starting emerging. It made us unpopular amongst local fund managers, but this view has been vindicated by superior returns on offshore investments, relative to local markets.

Morningstar recently reported that, like-for-like, offshore funds outperformed local funds by between 6% and 8% per annum over the past ten years. Very few local equity funds have beaten the inflation rate over ten, seven and five years. Pension funds, which were not allowed to invest more than 25% of their funds offshore for most part of ten years, have similarly suffered and returns have been very poor, not beating inflation for most of this period.

MAGNUS HEYSTEK | CO-FOUNDER, DIRECTOR AND INVESTMENT STRATEGIST AT BRENTHURST

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