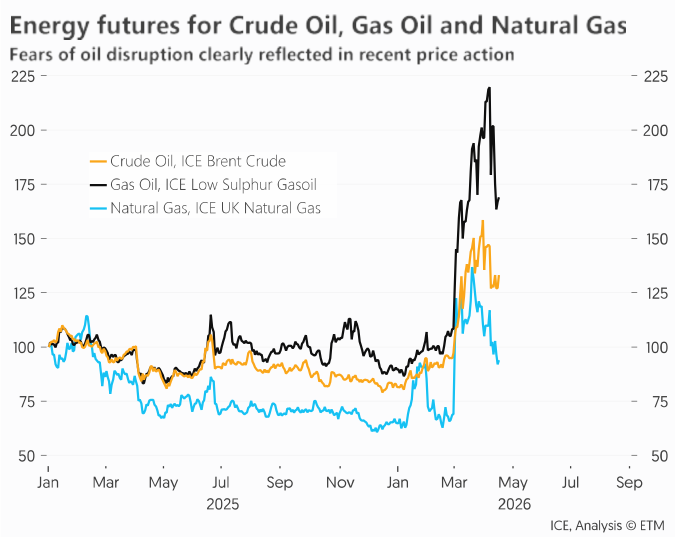
Viewpoint: War shows signs of ending and ZAR looks better

Key points

- There are early indications that US, Iranian and Israeli authorities are progressing towards a peace deal in the Middle East. Although it is a complex situation fraught with distrust, which will likely take many months to negotiate, financial markets are becoming increasingly convinced that a peace deal is likely.
- There are too many vested interests and too much to lose for this war to continue much longer. And so financial markets are now acting as though the war is coming to an end and that ceasefires will be extended until such time as negotiations conclude.

BASELINE VIEW: As oil prices retreat and metals prices recover to restore SA's favourable terms of trade, the ZAR will regain some of its tailwinds. Speculative positioning in the market suggests there is no obvious reason to turn bearish on the ZAR just yet and that there is justification for the ZAR's current. The risk is that the war drags on.

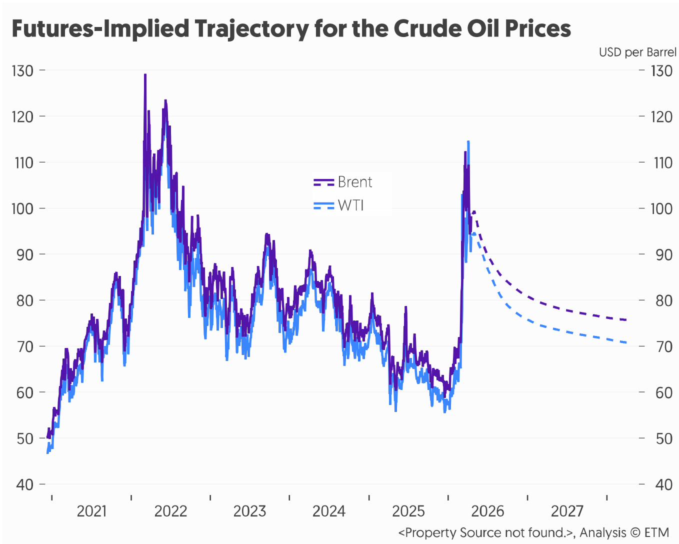
Energy prices are reversing quickly, and futures are looking even better



One positive outcome of the past week's events has been the retreat in oil and gas prices. News of a cease-fire in Lebanon lent credence to speculation that geopolitical tensions in the Middle East were abating and that peace was indeed on the horizon.

Although unfettered access to the Strait of Hormuz has not yet been agreed to, it appears that talks between the US and Iran are headed in that direction.

EU and Gulf State authorities believe negotiations between Iran and the US will be extremely complex and may last several months.

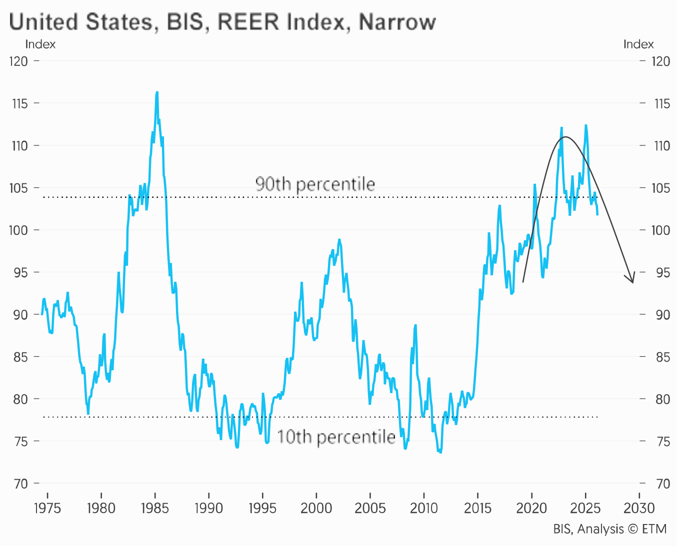


However, the markets only need to know that the talks are progressing and that the current ceasefire will be extended for as long as necessary to conclude the peace deal.

Evidently, the market sees this scenario as realistic, as evidenced by the right-hand chart, which shows significant backwardation.

If the scenario painted by the futures market proves accurate, the impact of the energy price crisis will not find meaningful traction in the second round effects on inflation, and the impact on financial markets will be limited.

USD Remains overvalued



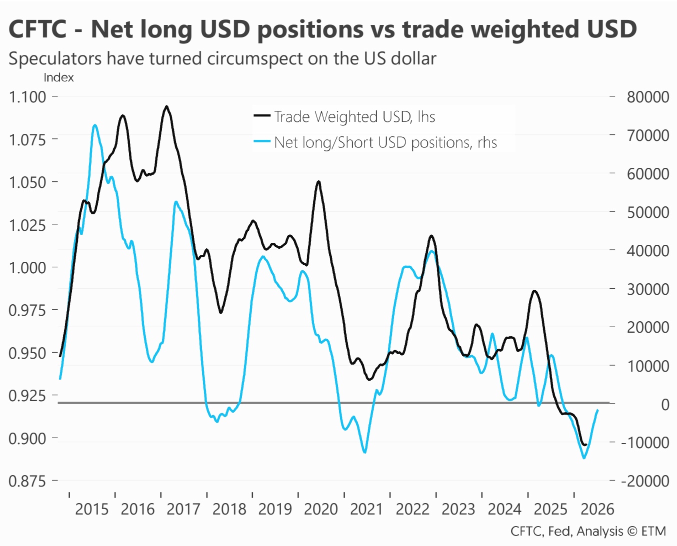
Against this backdrop, and of great relevance to the FX market, is the USD's performance. It is especially important given that the USD did not appreciate significantly amid investor safety-seeking.

In the broader scheme of things, it remained relatively subdued, almost as if the USD no longer held the same degree of attraction it once did.

It may be that the market sees the war and tensions in the Middle East as fleeting, but it may also be that the war in Iran and America's geopolitical behaviour regarding Venezuela, Greenland, Russia, and Iran have strengthened the resolve of governments and central banks to diversify away from USD-denominated assets.

Although it will be extremely difficult to dethrone the USD as the world's reserve currency, that does not preclude the USD from reflecting a geopolitically motivated rotation away from USD assets as countries like China and India reduce their dependence on the US.

Speculators still not convinced of any bullish USD argument



Building on the weaker USD theme, it is also instructive to note that net futures positions on the USD remain negative, despite the war in Iran and the escalation in geopolitical risk measures that would've typically bolstered demand for the safe-haven USD.

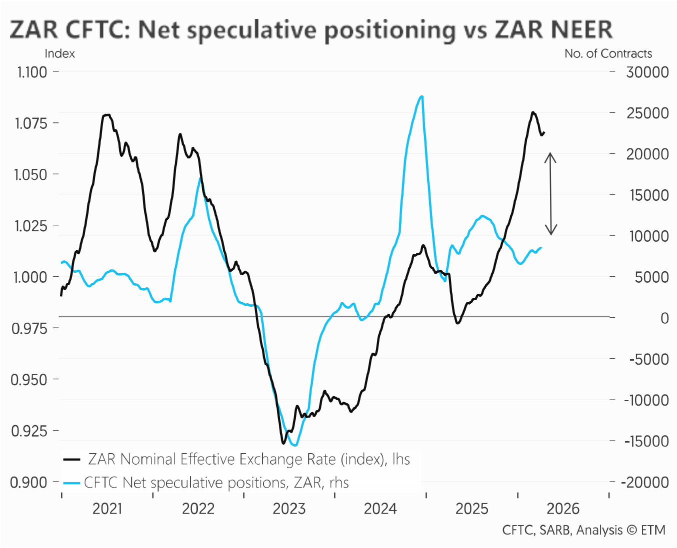
The accompanying chart shows that the net positions have become slightly less negative, which will weigh a little less on the USD.

However, they remain a far cry from the levels seen in previous decades, which were synonymous with stronger USD performance.

The implication is that the USD will enjoy some respite. However, that respite is unlikely to be enough to reverse the USD's fortunes.

Strategically speaking, the prospects for the USD remain weak, and that will remain the case so long as countries view the US as combative, domineering, and overreaching into other countries' affairs.

ZAR's 1yr appreciation is not just dependent on hot money flows

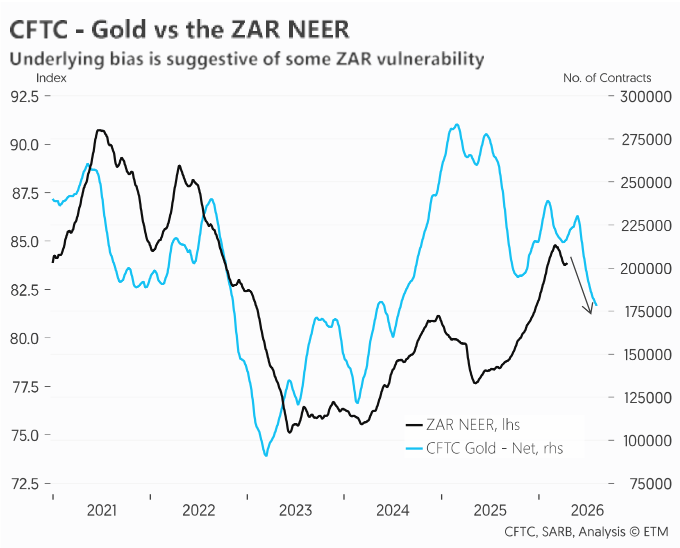


Conducting a similar study on the ZAR also makes for interesting reading. The trade-weighted ZAR NEER appears to have moved out of sync with the speculative positioning on the ZAR. The speculative positioning suggests the ZAR should be weaker than it is.

However, real-money flows related to improved terms of trade have boosted SA's trade account, and interest from foreigners in SA's bond market has also contributed to the sharp deviation of the ZAR vs the CFTC data.

The implication is that the ZAR lacks strong speculative support, which detracts somewhat from its short-term performance. However, that does not guarantee the ZAR will depreciate; it is simply worth noting that speculators are not as active. On the contrary, although strong speculative flows might help boost ZAR performance, they would also increase the ZAR's volatility. Fewer hot-money flows mean the ZAR's gains were more fundamentally driven.

Speculative gold interest has moderated, but could recover with the end of the war in sight



Arguably more concerning is the retreat in speculative long positions on the gold price. They have retreated from their recent highs and are well down on the highs in early 2025.

It raises the question of whether the momentum behind the surge in gold prices will extend much further.

Without the support of the gold price and the boost to SA's exports, the ZAR would lose at least one of its tailwinds.

It will therefore be important to gauge the performance of the gold price should further progress be made toward ending the war in Iran, and whether the trend that existed before the war reasserts itself.

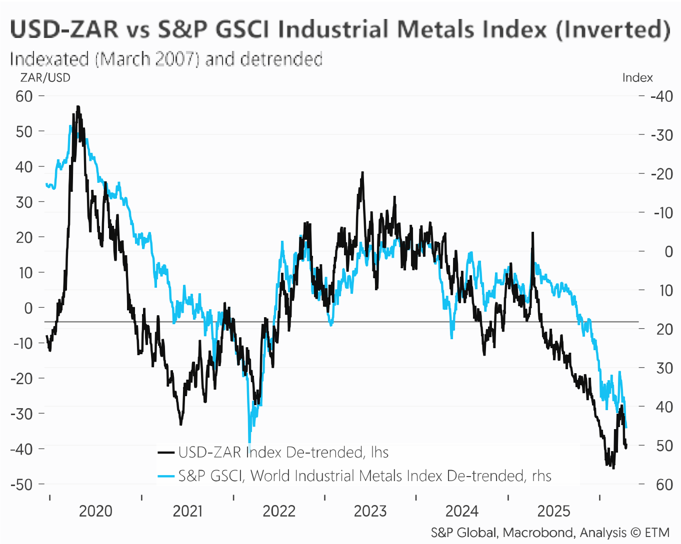
The gold price has not responded to the threat of inflation and has not acted as a safe-haven instrument to protect portfolios against uncertainty and volatility.

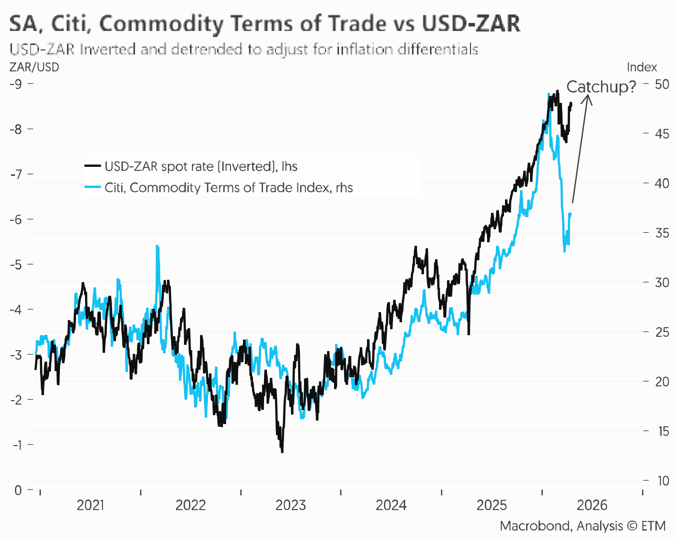
Instead, stale speculative longs are thought to have liquidated their positions to help cover losses sustained in either equity or bond markets. However, now that those markets have stabilised, the potential exists for the appreciative trend in gold to resume and help bolster the performance of commodity-linked currencies.

Metals prices and terms of trade suggest the ZAR is appropriately priced for an imminent end to the war

Whether one looks at ZAR vs metals prices or ZAR vs its terms of trade, the evidence is clear that the ZAR's performance is related to the USD (which directly affects commodity prices) and the underlying trend in commodity prices. Terms of trade have been negatively affected by the surge in oil prices, which is an obvious detractor from ZAR performance. However, traders are reluctant to bet too strongly on the oil price remaining elevated, given that market evidence suggests the war will be short-lived and that the effects on financial markets and economies will be the same.

Therefore, if one holds the view that there is enough vested interest to ensure that this war ends and that a deal is struck, then one would also want to trade on the higher probability that the ZAR will regain some of its support, the minute oil prices normalise, and the Strait of Hormuz is reopened for trade.





Analyst(s):

George Glynos

Get in touch with us!

research@etmanalytics.com