ZAR Sentiment Indicator Points to Consolidation Amid Low Volatility

Key points

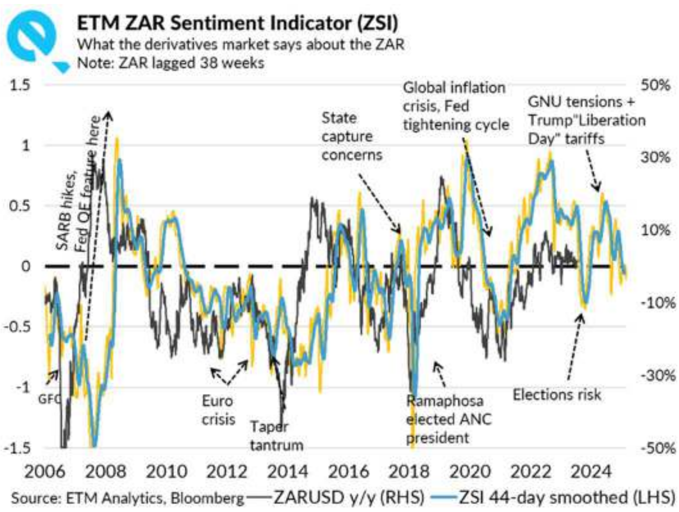
- ETM's ZAR Sentiment Indicator (ZSI) has remained in positive territory for the past year, recently dipping marginally below zero, suggesting the ZAR should remain relatively well supported over the next eight to nine months. With local funds comfortable with offshore exposure and lacking a clear catalyst, the ZAR is set for consolidative trading.
- FX volatility has compressed to its lowest level in over a decade, driven by structurally lower inflation, reduced offshore bond market participation (less hot money), sustained trade surpluses from improved terms of trade, and healthy yield spreads that make speculating against the ZAR costly. These structural factors suggest volatility may remain lower going forward.
- Speculative positioning has shifted dramatically in 2025, with traders moving from net long to net short on the USD, reducing speculative pressure against the ZAR. Although recent spikes in risk reversals and pressure on gold and platinum prices risk bouts of ZAR weakness as stale short USD positions clear out, the absence of strong speculative bias against the ZAR should limit significant depreciation whilst global risk sentiment remains supportive.

BASELINE VIEW:
The ZAR appears well positioned for consolidative trading in the near term, supported by structural improvements in volatility drivers and benign speculative positioning.

Whilst recent risk reversal spikes point to some fear of a modest near-term selloff as traders cleared positions following pressure on precious metals, the ZSI indicates this should be limited in scope.

More broadly the currency's resilience depends on sustained global risk appetite and constructive emerging market sentiment, with SA's potential FATF grey list exit representing a key catalyst. Importers should monitor developments closely, although any weakness is likely short-lived absent a major Wall Street selloff or significant spike in risk aversion.

ZSI has been positive to neutral recently



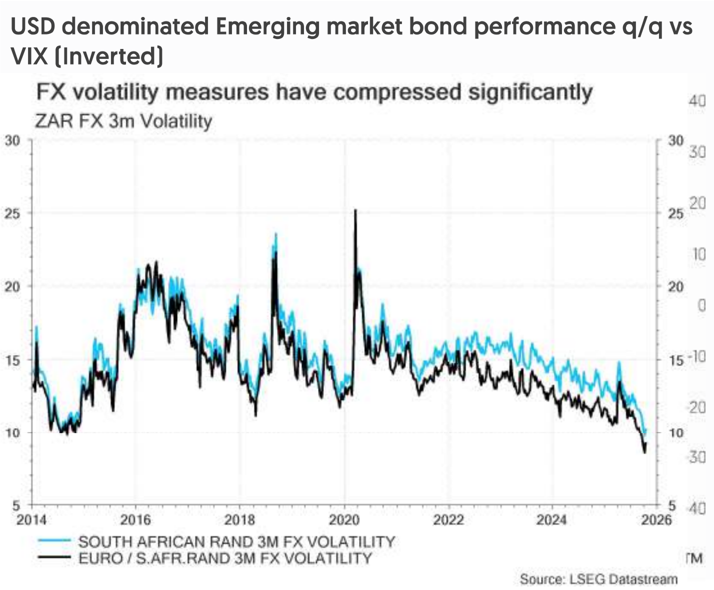
ETM's ZAR Sentiment Indicator (ZSI) has been in positive territory for the past year. More recently, it has dipped back below the zero bound, but only just. This ZSI implies that the ZAR should remain relatively well supported through the next eight to nine months.

With the local fund community comfortable with its offshore exposure and waiting for the next real catalyst to trigger some directional momentum, the ZAR appears to be in a more consolidative trading range, which looks set to hold through the foreseeable future.

Delta hedging from the banks does not appear to be strongly biased, while several cross-currents make selecting a clear-cut direction on the ZAR a little more difficult to achieve.

Therefore, investors will wait for a fresh catalyst before adopting any clear-cut direction, one way or another.

International sentiment still seems to be holding up



There are many reasons why sentiment matters. Sentiment towards a market can often drive portfolio flows.

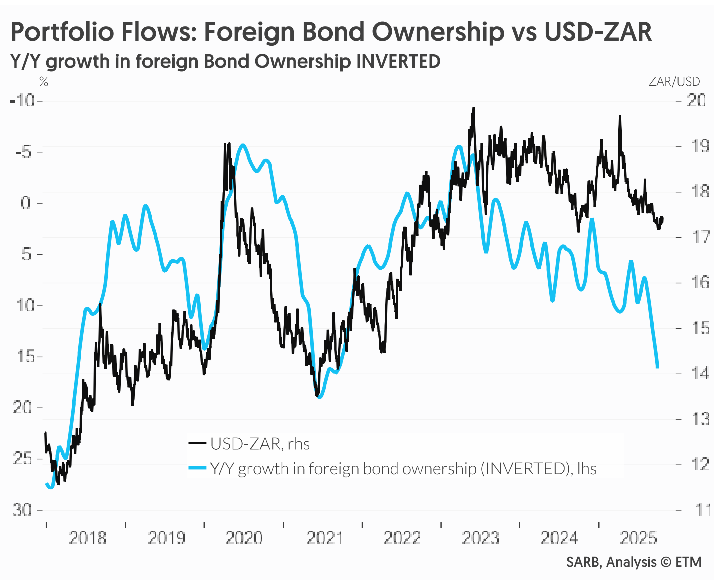
One of the best examples of this is evident in the adjacent chart, which highlights the relationship between the VIX and the emerging market bond ETF. The lower the VIX, the better emerging market bonds tend to perform.

In other words, one must consider many factors impacting sentiment. Some are local, but some are international as well.

The VIX is often utilised as an indicator for global risk aversion. The stronger the risk sentiment, the greater the appetite for riskier markets.

Risk-off environments result in a withdrawal from the most risky, higher beta markets, as investors default to lower risk markets such as US Treasuries and commodities like gold.

Portfolio flows remain a key driver of ZAR



Understanding the link between sentiment and markets that attract portfolio flows allows investors to understand the causal linkages between how sentiment across financial markets finds expression in significant USD-ZAR movements.

The more constructive the environment for attracting bonds and equities, the greater the probability that the ZAR will appreciate. It therefore matters that global sentiment remains supportive of emerging market capital inflows. Alongside other emerging markets, South Africa also stands to benefit, as the accompanying chart shows.

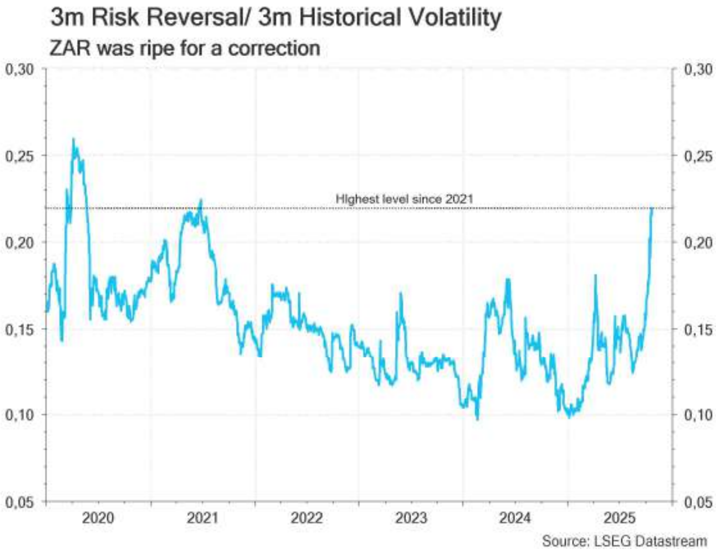
Later this week, SA will learn its fate concerning its inclusion in the FATF grey list. Should SA exit the grey list and further reduce the perceived risk element to any SA and bond market exposures, the potential for entrenching the virtuous cycle increases.

Recent volatility levels have compressed to the lowest in over a decade

Recent FX volatility rates make for interesting reading. They are the lowest in over a decade, and with recent developments, one might argue that they will remain structurally lower. Several factors could help explain this:

1. Structurally lower inflation means there is less parity pricing pressure to pressure the ZAR weaker vs the majors constantly.
2. Offshore bond market participation has declined relative to the bonds in issue, implying that hot money flows have also declined over time.
3. SA's terms of trade have helped propel the trade account to a sustained surplus in recent years, implying less sensitivity towards market events.
4. SA retains a healthy yield spread over its trading partners, which ensures that the cost of speculating against the ZAR is high and has a positive carry.

Spike in Risk Reversals has hinted at a potential near-term ZAR selloff



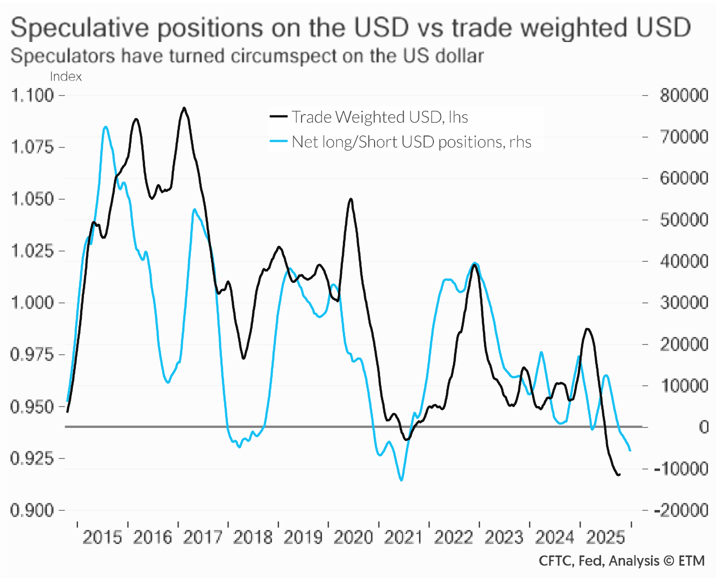
As reflected in the chart above, such low volatility levels tend to raise the risk of a correction of sorts. This is especially true when the currency starts to run out of steam and momentum has those with existing positions considering locking in profits, or hedging their positions more vigorously.

There were some strong indications that this was happening this week as gold markets came under pressure, and the ZAR's temporary retreat was not entirely surprising.

On the contrary, certain market signals alluded to this, and the accompanying chart is one of them. When risk reversals as a ratio to historical volatility rise like they are, it is an indication that the market anticipates a shift in sentiment.

The most recent retreat in the gold and platinum prices posed such a risk and the market now appears to be in the midst of a clear-out of stale short USD positions.

Speculators retain a net short position on the USD



Yet another factor for investors to consider is the pressures that are building on the majors. One big standout development through 2025 has been the switch in speculative positions on the USD from net long to net short. As the positions have turned short, so the pressure on the USD has built.

This is relevant because a build in net short positions on the USD ensures that a strong speculative element against the ZAR is absent.

For a host of reasons, the USD is no longer viewed as the automatic safety net for FX traders in the way it was before the Trump administration. That offers currencies such as the ZAR some reprieve and greater resilience.

The ZSI will reflect this by not dipping significantly further. In conclusion, while speculative positioning remains bearish for the USD, the ZSI will likely resist the temptation to dip deep into negative territory and allude to ZAR depreciation.

That might change should Wall Street sell off aggressively and there is a spike in risk aversion. However, for the time being, any such movements are deemed short-term in nature given that earnings results out of corporate America remain stronger than many had anticipated.

Once the government shutdown ends, more data on the US will become available to offer a more up-to-date perspective on the business cycle and the pressures across FX markets.

Analyst(s):

George Glynos

Get in touch with us!

research@etmanalytics.com