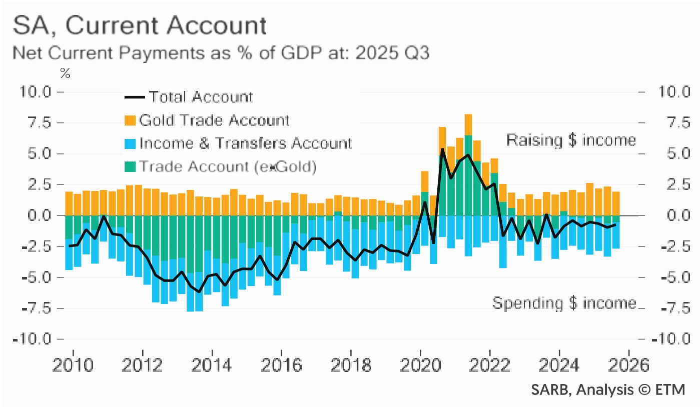
Key points

- South Africa's current account is in a period of relative balance, with the deficit narrowing to -0.7% of GDP as trade surpluses and lower income outflows support the balance. However, this improvement is unlikely to be permanent: a stronger rand, accelerating private-sector credit growth, and weaker global demand are expected to lift imports and soften export momentum. Even so, without a major growth surge, the deep deficits of the mid-2010s are unlikely to return.
- The improved current account has boosted ZAR resilience, supported further by strong terms of trade, prudent SARB policy, and rising foreign inflows into SA bonds. Elevated gold and PGM prices, lower oil costs, the FATF grey-list exit, and better political sentiment are reinforcing this "virtuous cycle." While some softening in fundamentals may occur as the current account deficit potentially widens, the ZAR's overall resilience score should remain robust.

BASELINE VIEW: Although the current account remains in a deficit, it is much smaller than of the deficits recorded in recent history. The deficit could widen further if imports accelerate amid a more positive economic outlook. However, factors such as strong terms of trade and foreign portfolio inflows should continue to bolster the ZAR's resilience.

SA enjoying a period of smaller C/A deficits



The current account is a useful tool for gauging South Africa's external position. South Africa's current account deficit narrowed to -R57bn in Q3 from a revised reading of -R72.2bn in Q2.

As a percentage of GDP, the current account shortfall also fell back to -0.7% in Q3, from -1.0% in Q2 and below consensus expectations of -1.2%.

Of the three main components that make up the current account, the goods trade surplus (i.e. exports minus imports of goods) narrowed further to R178.3bn in Q3 (from R187.2bn in Q2).

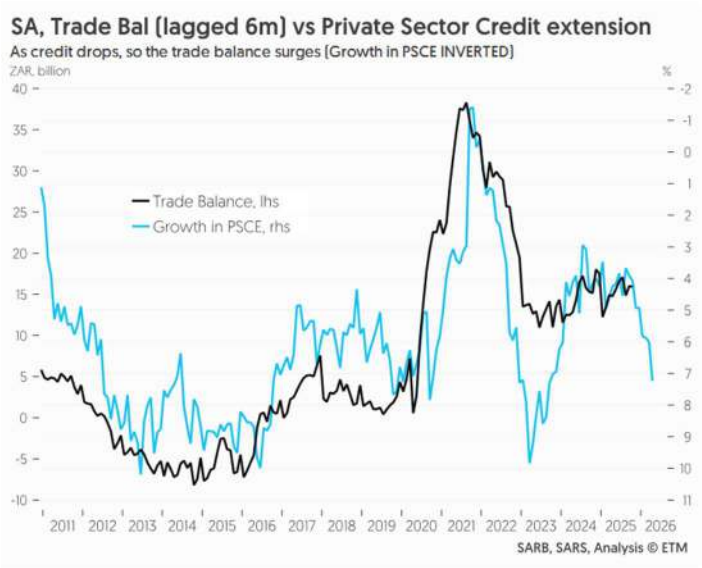
SA imports increased by relatively more than exports did over the quarter. The services trade deficit (i.e. exports minus imports of services) worsened over Q3 to -R69.0bn (from -R58.0bn in Q2), while the income and current transfer deficit (money flowing in and out from investments across borders) narrowed slightly to -R166bn in Q3 (from -R202bn in Q2). A deficit implies that SA is paying more in income, dividends, and interest on debt to the rest of the world than it is receiving from foreign assets.

Will this be sustained?

Due to its structural makeup, including frequent trade deficits and persistent primary income outflows, South Africa has historically run large current account deficits.

More recently, trade surpluses have supported the current account. The current account as a percentage of GDP remains smaller (less negative) than at almost any point over the last 20 years (excluding the CV19 shock).

However, these trade surpluses are expected to narrow as US tariffs and turbulent global growth weigh on exports. At the same time, a strong ZAR is already working to lift imports; foreign goods become relatively cheaper for locals, who naturally demand more of them.

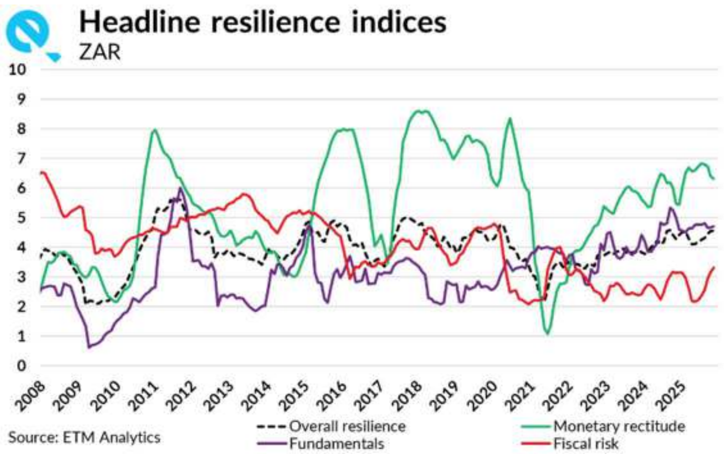


Furthermore, private sector credit growth has picked up in recent months. The accompanying chart shows how a rise in credit (inverted in the chart) can lead to a reduced trade surplus (i.e., rising imports).

The latest PSCE data indicate that demand for credit is accelerating, in line with what one would expect during a rate-cut cycle. It implies that demand for imports will pick up as the economy enters a credit upswing.

Investors should, therefore, not take it for granted that SA's trade surplus will continue indefinitely. However, unless economic growth picks up significantly, the large deficits seen through the mid-2010s are unlikely to materialise once again.

Current account contributing to improved ZAR resilience



South Africa's recent positive current account developments provide an opportune time to revisit our resilience framework.

As a reminder, we define a currency's resilience as its ability to handle external shocks to the global economy and adverse market conditions.

As seen in the accompanying chart, the ZAR's resilience score has improved notably since 2021.

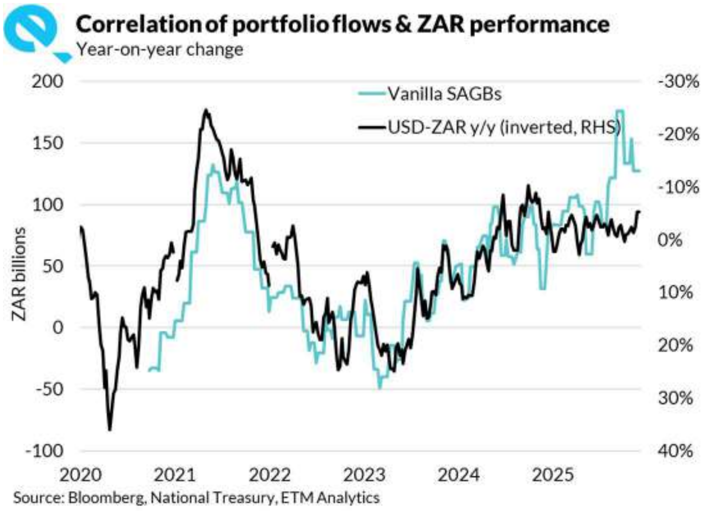
The most significant driver of this has been the SARB's prudent monetary policy approach, with the recent shift to a lower inflation target likely to further support this in the months ahead. However, the fundamentals score has also significantly improved.

The fundamentals component considers whether there are significant changes in a country's terms of trade, whether economic growth is sustainable, whether the currency tends to weaken sharply in times of stress, and finally, whether consumption dynamics across borders are sustainable, as viewed through the lens of the current account.

As we have noted before, SA's terms of trade remain very favourable, and with gold and PGM prices elevated, and oil under pressure, there is little to suggest this will change anytime soon.

While expectations for a potentially wider current account deficit suggest that the ZAR may lose some fundamental resilience going forward, the degree to which it weakens will unlikely cause SA's overall score to drop too significantly, given the aforementioned strong terms of trade, prudent monetary policy, and the potential for an improvement in fiscal risk given the progress being made by the GNU.

Bond market inflows keep virtuous cycle intact



A final point to note is that South Africa has experienced significant inflows into its bond market this year. These inflows typically have a direct impact on the ZAR, but the relationship has weakened to some degree in recent months.

Part of this can be attributed to global uncertainty, as well as domestic political issues. However, with the recent removal from the FATF grey list, the ratings outlook upgrade, and a general improvement in sentiment toward the government, inflows into the bond market are likely to continue.

When the relationship between these inflows and the ZAR reasserts itself, we will see another period of strong ZAR appreciation.

SA yields also remain buoyant compared to DM bond yields, and inflation is trending lower. The outlook for bonds, therefore, remains constructive. Although the easy gains have now been secured, domestic bonds are still expected to attract foreign capital in the foreseeable future to help bolster current account surplus-related inflows.

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