

## Rand recovery on the back of a huge trade surplus

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It is encouraging when a trend change to a key economic indicator is explained by a combination of standard theory and quantifiable data.

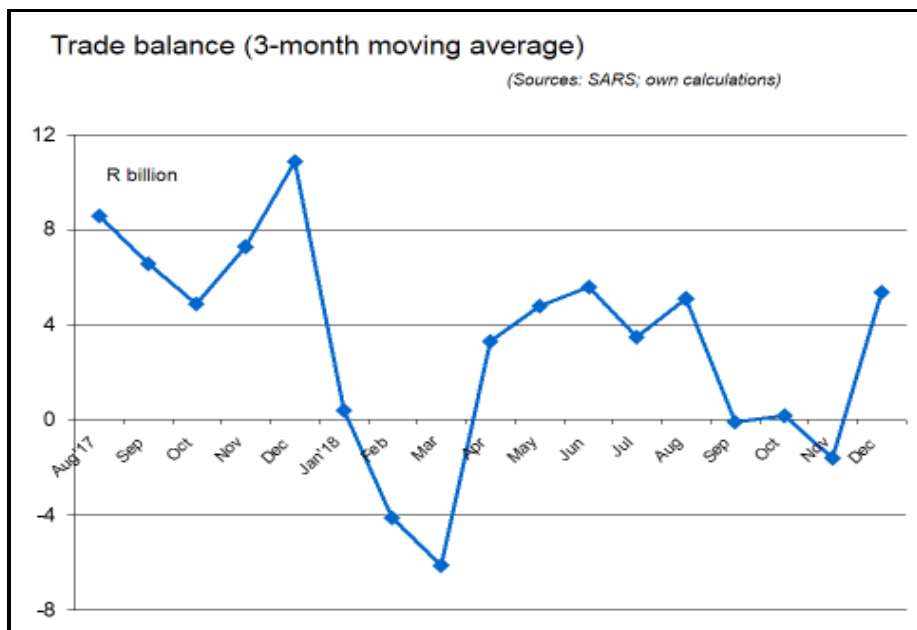
Such is the reason for the resilience of the rand exchange rate in recent months. In the beginning of August last year, the rand was trading at a level of around R13.30 to the US dollar (*Oanda* interbank rate). Merely four weeks later, the South African currency had taken a beating in the aftermath of the financial instability in Argentina and Turkey, trading at above R15.40.

On 4 February, the rand had recouped this loss and was right back at a level of R13.30 – a strengthening of 16% over the value recorded five months ago.

### Trade is 50% of GDP

According to standard macroeconomic theory, the first step in establishing reasons for currency fluctuations is to have a quick look at the trade balance. Export and import data are released earlier than figures for the other balance of payments (BoP) items and, as a rule, represent the largest share of international transactions.

In South Africa's case, merchandise exports and imports combined, represent almost exactly half of the country's GDP, a whopping R2.5 trillion in 2018.



In December last year, the country's trade surplus (SARS data) amounted to R17.2 billion, the second highest figure ever. A surplus of more than R3 billion was also recorded during the previous month and, in the absence of any significant political upheaval, the fairly predictable outcome was a strengthening of the rand exchange rate.

When viewed against the enormous monetary values at play with the financing of international trade, it becomes clear that currency trading is not for the faint-hearted.

### **Rand one of top-20 global currencies**

Although the South African rand is the 20<sup>th</sup> most traded currency in the world, it commands merely 0.25% of the total global turnover in currency trading. The US dollar remains the dominant global currency by an impressive margin, namely close to 45%. China is still lagging far behind, at a share of approximately 2% for the yuan/renminbi.

The top-five traded currencies command 80% of total global trade financing and the dollar is joined in this exclusive club by the euro, the Japanese yen, pound sterling and the Australian dollar.

Despite South Africa's modest share of the international currency market, the average daily turnover of transactions in rand (selling and buying) amounted to more than \$50 billion in 2018. It took less than eight days to record rand-denominated transactions equalling South Africa's GDP in 2018, which goes a long way to explaining the regular bouts of currency volatility (apart from the occasional influence of politics).

Returning to theory, it is important to note that a surplus on the current account of the BoP is not necessarily a positive economic phenomenon, much in the same way as cash in the bank not necessarily representing a positive business phenomenon.

### **Growth often requires a trade deficit**

Relatively high imports of machinery and equipment are often a prerequisite for economic growth in a developing country, even though such a trend may be accompanied by a (usually temporary) trade deficit.

The same principle holds for a thriving business operating at near-capacity, which can employ cash in the bank more usefully by purchasing stock or financing working capital required for further turnover growth.

A return to a trade deficit in the first quarter of 2019 would therefore be a welcome trend, despite the likelihood of the rand losing some ground in the process.