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An analysis of the current account deficit ratio

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Abstract

As a ratio of GDP, the current account deficit widened to 2.9% in the first quarter of 2019 from 2.2% in the fourth quarter of 2018 while its trade surplus decreased from R71.8 billion to R43.0 billion over the same period. The deterioration in the trade balance was triggered by excess merchandise imports that. Further to this, was the shortfall on the services, income and current transfer account, widening somewhat to R185.5 billion in the first quarter of 2019 from R182 billion in the fourth quarter of 2018. The slow growth in 2018 served an impetus for governments and central banks to adopt more expansionary fiscal and monetary policies and the impact on growth is yet to be seen.

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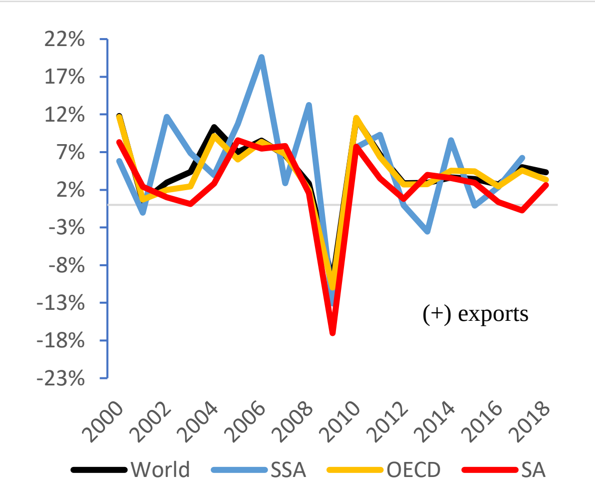
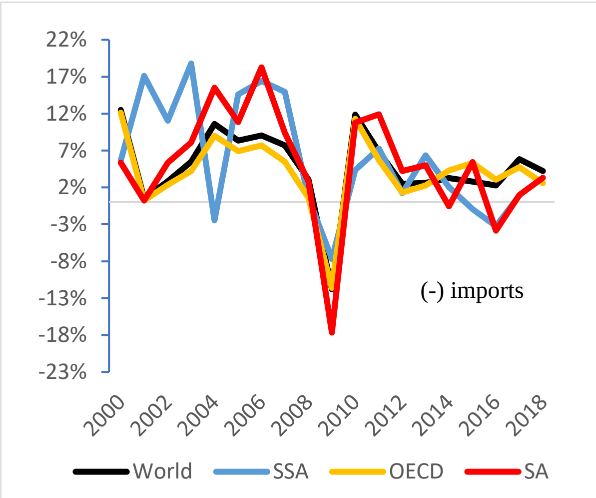
1. Introduction

Global trade growth remains sluggish amid renewed headwinds as trade tensions between the United States and China accelerate. Year-on-year growth in world merchandise trade fell from 3.9% in the first half of 2018 to 2.7% in the second half of 2019. In addition, emerging market economies' merchandise exports slowed by 4.6% in 2018, compared to 5.3% in 2017, while merchandise imports decelerated to 4.8% in 2018, compared to 8.1% in 2017. Meanwhile, advanced market economies' merchandise exports remained relatively flat, growing at 3.5% in 2018, compared to 3.4% in 2017, while merchandise imports grew by 3.2% in 2017, an improvement from 3% in 2017. Notably, the slow growth of merchandise trade was largely driven by weak global demand amid heightening trade tensions, increased volatility in financial markets and tightened monetary conditions. Trade tensions in particular, appear to have contributed significantly to the slowdown in global trade volume. Figures 1 and 2 show trends in merchandise exports and imports, respectively.





Through closely integrated supply chains, international trade in Asian economies has also been impacted by rising US-China trade war[1], as have exchange rates with the US dollar. For example, exports contracted by -4.3% in Indonesia, -2.3% in Japan and -7.1% in Korea while imports contracted by -15.3%, -4.7% and -7.7%, respectively. As a result, real economic growth in emerging market economies remained unchanged at 4.2% in the first quarter of 2019. Growth in the G20 merchandise trade remained weak in the first quarter of 2019. G20 exports rose

[1] The US-China trade war is an ongoing economic conflict between the world's two largest national economies, China and the United States, amid what is referred to as "unfair trade practices".

marginally by 0.4% on a quarterly basis while imports fell by 1.2%. Contrast to the third quarter of 2018, when the first round of tariffs came into effect, G20 exports are down by 0.8% and imports by 2.7%. Ultimately, sluggish global trade growth appeared to have a negative impact on emerging market economies. GDP growth in emerging market economies expanded by 4.5% in 2018, down from 4.8% in 2017. Developing Asia was the fastest growing region globally, achieving an average growth rate of 6.4% in 2018, albeit slightly down from 6.6% in 2017.

Nonetheless, African economies expanded by 3.4% in 2018, compared down from 3.6% in 2017. The expansion was broad-based, with more than 90% of African countries enjoying growth accelerations in 2018. Albeit still below its potential, Africa emerged among the fastest-growing regions in the world, highlighting the continued resilience of its economies to negative shocks and global volatility. South Africa in particular, saw an improvement in terms of trade in the first quarter of 2019 as the rand price of imports decreased while that of exports rose slightly. Despite this, South Africa's trade deficit on the current account widened to R142.5 billion in the first quarter of 2019, compared to R110.2 billion in the fourth quarter of 2018.

As a ratio of GDP, the current account deficit widened to 2.9% in the first quarter of 2019 from 2.2% in the fourth quarter of 2018 while its trade surplus decreased from R71.8 billion to R43.0 billion over the same period. The deterioration in the trade balance was triggered by excess merchandise imports that. Further to this, was the shortfall on the services, income and current transfer account, widening somewhat to R185.5 billion in the first quarter of 2019 from R182 billion in the fourth quarter of 2018. The slow growth in 2018 served an impetus for governments and central banks to adopt more expansionary fiscal and monetary policies and the impact on growth is yet to be seen. The SARB have released the figures on current account for 2019Q2 in September, which showed a trade balance deficit of R27.2 billion, compared to a surplus of R41.9 billion recorded in the first quarter.

2. International Finance

The financial market and exchange rates are susceptible to global and domestic economic events. Therefore, in the midst of various economic events including politics and economic performance, the immediate pain or benefit is felt mostly by the financial markets. Following a rebound of the growth in Gross Domestic Product of South Africa in the second quarter of 2019, the rand exchange rate has gained some momentum towards the end of September 2019. The gain was further supported by improved global risk sentiment owing to signals for a likely truce (in October) between US and China on their trade dispute.

Figure 13: Exchange rates amongst selected countries

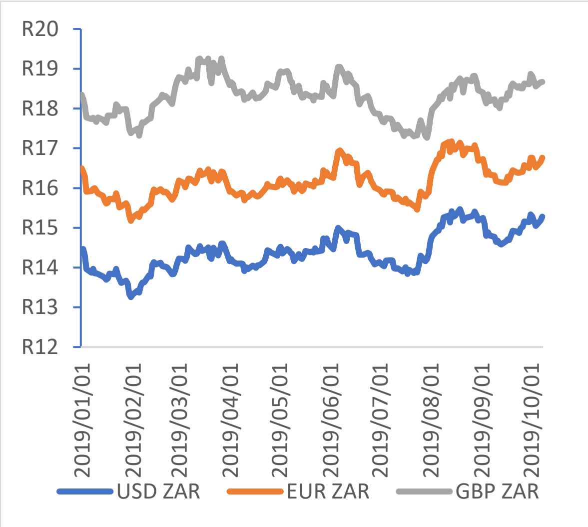
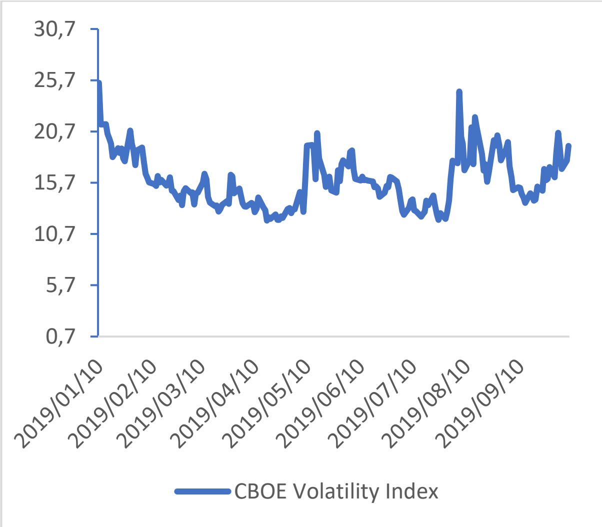


Figure 14: Trends in Volatility Index



The SARB in its second issue of 2019 Quarterly Bulletin has mentioned that the prices of domestic assets were driven volatile by both domestic and external factors. In that regard, the rand has also experienced sharp movements in the previous six months, whereby it somehow breaked-through to record a value above R15 to the US dollar. The rand came under severe pressure in 2018. Having started the year relatively strong vis-à-vis the US dollar, averaging ZAR/USD 11.95 in Q1 2018, it subsequently depreciated sharply towards an average of ZAR/USD 14.25 in Q4 2018. The rand came under severe pressure in 2018. Having started the year relatively strong vis-à-vis the US dollar, averaging ZAR/USD 11.95 in Q1 2018, it subsequently depreciated sharply towards an average of ZAR/USD 14.25 in Q4 2018.

Several factors have contributed to the depreciation of the rand in the external front, including monetary policy tightening in the US during 2018; dollar strength; and escalating tension in global trade. Domestically, these included uncertainty regarding the land reform process; Eskom's financial and operational challenges, including load-shedding; the issue of nationalising the SARB; the run-up to the national elections; and the economy's weak growth prospects. Even worse, in 2019 Q1 ZAR/USD was averaging between R14.5-R14.60; R15.17-R16.49(ZAR/Euro) and

R17.31-R19.25(ZAR/GBP) (See figure 13). Additionally, in September 2019, ZAR/USD was ranging between R14.57-R15.14; R16.13-R16.72(ZAR/EURO), and ZAR/GBP is between R18.00-18.62. World trade volumes contracted at a year-on-year rate of 1.0% in September 2019, reflecting the ongoing trade tensions. Export volumes in emerging markets fell even more over this period, mainly due to lower exports from Africa and the Middle East, China as well as the rest of emerging Asia. Meanwhile, exports from advanced economies contracted by a lesser 0.4% in September 2019, largely due to lower exports from the Euro area. After contracting for five consecutive months, US exports remained unchanged in September 2019.

The international prices of metals and minerals as well as agricultural products decreased modestly in the third quarter of 2019, while the decline in energy prices was more pronounced. The price of Brent crude oil fell from a market boom of US$74 per barrel in May 2019 to a trough of US$59 per barrel in early September 2019 amid concerns about slowing global economic growth. In mid-September 2019, attacks on Saudi Arabia's oil facilities caused oil prices to surge by around US$10 per barrel, but production was restored in early October 2019, allowing prices to decline to levels prevailing before the attack. Oil prices have since trended somewhat higher, reaching US$61 per barrel in early December 2019 (see figure 3).

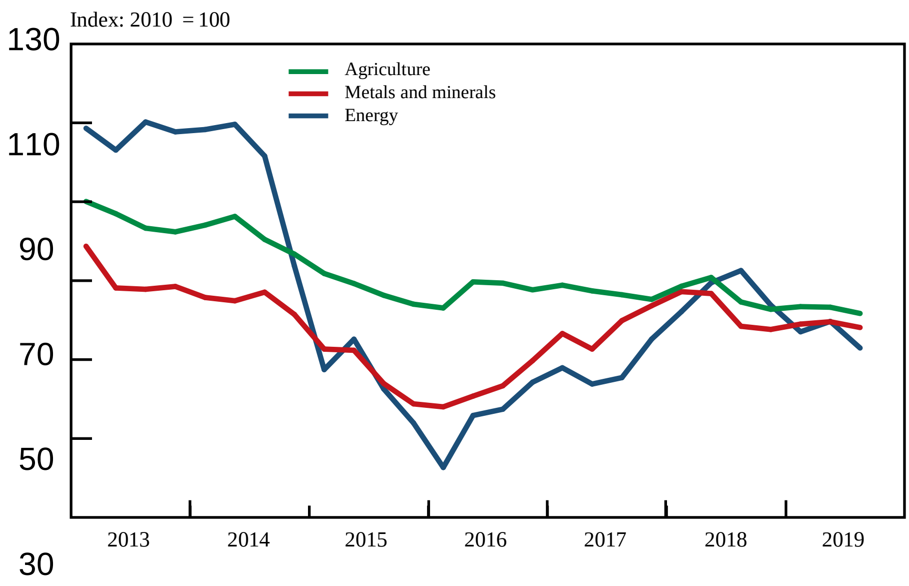


Figure 3: International commodity prices in US dollars

Source: World Bank (2019)

South Africa's net exports made the largest contribution to growth in real GDP in the third quarter of 2019 at 3.2%. Real exports of goods and services increased by 0.9% in the third quarter of 2019, from a contraction of 0.4% in the second quarter. In addition, the increase in foreign demand for vehicles and transport equipment as well as machinery and electrical equipment boosted manufacturing exports while vegetable products contributed to a substantial rise in agricultural exports. The decrease in overall mining exports reflected lower export volumes of mineral products and base metal articles. Nevertheless, real imports declined by 1.8% in the third quarter, following an increase in the second quarter of 2019. The contraction was driven by lower volumes of mining imports, mainly mineral products as well as base metals and articles.

Strong growth in the imports of vehicles and transport equipment as well as machinery and electrical equipment outweighed lower import volumes of chemical products as well as prepared foodstuffs, beverages and tobacco. The real value of agricultural imports rose marginally due to an increase in domestic demand for imported vegetable products. Amid persistent weak domestic economic outcomes and increased global risk aversion, the rand traded at an average of R14.70 against the US dollar in the third quarter of 2019, substantially weaker than in the first half of the year. However, this trend was also evident among other emerging market currencies, largely due to geopolitical factors. Nonetheless, the rand, as well as other emerging market currencies, were to a large extent influenced by global developments and risk aversion in the third quarter.

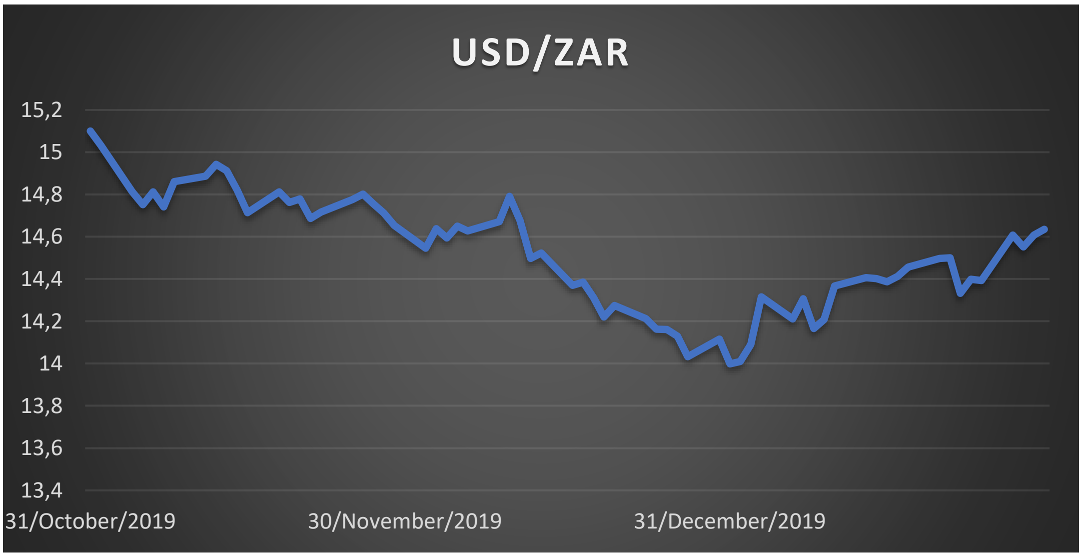


Figure 4: Fluctuations in USD/ZAR exchange rate

Source: Investing.com

The exchange value of the rand depreciated sharply in late October after the release of the 2019 MTBPS, which reflected a marked deterioration in South Africa's fiscal situation. This triggered renewed concerns regarding further credit rating downgrades as Moody's revised South Africa's sovereign rating outlook from stable to negative, followed by Standard and Poor's on 22nd of November 2019. However, the exchange value of the rand stabilized towards the end of November 2019 (see figure 4). Further, the real effective exchange rate (REER) of the rand decreased by 0.3% from December 2018 to September 2019, reflecting an improvement in the external competitiveness of domestic producers in foreign markets.

Moreover, the value of forex transactions against the rand within the monetary sector remained broadly unchanged at US$1.9 billion from the second to the third quarter of 2019. Similarly, the value of forex transactions against the rand with other resident counterparties remained unchanged at US$2.2 billion over the same period. Forex transactions in third currencies within the monetary sector remained unchanged at US$0.1 billion in the third quarter of 2019, while forex transactions in third currencies with other resident counterparties declined marginally from US$0.4 billion in the second quarter of 2019 to US$0.3 billion in the third quarter.

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