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Weekly Economic Newsletter

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ECONOMIC COMMENTARY - By Francois Stofberg

Rates Unchanged

After their latest meeting, the monetary policy committee (MPC) of the South African Reserve Bank (SARB) decided to leave interest rates unchanged. Once again, we agree with the Bank's decision. Currently, there is too much uncertainty to make an effective decision. This is especially true if one considers the fact that changing interest rates has a greater impact on the economy in the medium-term than it does in the short-term. It is, therefore, wise to first gather more information and better understand the possible implications, before changing strategy.

Some of the uncertainty that needs to be understood, before a better medium-term strategy can be formulated, include: inflation expectations, Rand volatility, political uncertainty, and economic growth. It's true that inflation etched substantially lower to 5.3% (it's lowest since December 2015), but higher international oil prices may undo some of the food- and petrol-price decreases we've enjoyed recently.

The Rand also plays an important role as it impacts on the price of imports (roughly 30% of GDP) and ultimately the final prices we pay for goods and services in South Africa. Of course, a weaker currency may also help exports, as our products become more competitive in the medium-term. In the end, the volatility of the Rand is important to take into consideration as large swings in the currency disrupt price stability; the mandate of the SARB.

Another uncertainty on which more clarity is needed includes political instability and the lingering impact thereof. We're still waiting to hear from Moody's concerning our local currency rating. Should we receive another local currency downgrade, investors' sentiment towards SA will drop further and capital (both short- and long-term) will flow out, ultimately impacting the Rand and thereby inflation expectations. December's vote for the new head of the ANC will, of course, add to the uncertainty.

Ultimately we do agree with the SARB that inflation momentum has changed – prices should remain well within their 3% - 6% target, the extent of the reduction will, of course, be impacted by the factors explained above. The final point of uncertainty, that should start to play an ever-increasing role in determining the interest rate strategy, is GDP growth. Once the SARB is more sure that prices are stable, they can start using (decreasing) interest rates to alleviate some of the pressure on consumers.

This is illustrated in a simple example. Assume the average medium income household has R1.3 million debt (R750 000 left on their house, two cars valued at R250 000, and R50 000 credit card debt). By reducing interest rates with 0.5% each one of these households has R542 more to spend each month, a 1% reduction gives each household R1083 more to spend. Quite a substantial amount if you multiply it with the roughly 2 million middle-income individuals; an annual increase in consumption power of R21 bn.