EFFICIENT GROUP

# Weekly Economic Newsletter


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## ECONOMIC COMMENTARY - By Francois Stofberg

I've been asked quite a lot about the likely impact of the drought on the economy, and after careful consideration and researching what the top-dogs had to say about it, we came to the following conclusions.

Fortunately (if anything can be fortunate in these severe circumstances) the size of the "agriculture, forestry and fishing" sector is only about 2.4% of the entire economy. Unfortunately this sector has the largest multiplier effect; for every R1 invested in the sector roughly R1.85 worth of output is generated. The multiplier shows how value is created by a specific sector, as an example: maize is farmed, transported to the miller, crushed into flower, transported to the baker, baked into bread, transported to the retailer and sold to the consumer. Estimates have been made that as many as a thousand farmers will only be able to make 50% of their previous investments following the two-season drought. On average, investments in the agricultural sector increased annually by R39 bn since 2011. If investments in the sector fall by 50% as a result of the drought, it is reasonable to believe, by implementing the multiplier that GDP will grow 0.01% slower than expected. This is however, only the short term immediate effect, the longer term effect of a contraction in investments in the sector might increase the negative impact on the economy. Other factors like a shortage of key agricultural products, that now have to be imported, will also impact on the economy.

Another likely risk to the economy, caused by the severe droughts, is the effect a shortage of agricultural products will have on consumer prices. Belated rainfall increased yields of winter crops like wheat which edged prices down. However, a shortage in summer crop yields (which have now lead to a possible import substitution) inflated prices directly and indirectly as these crops, like maize, are used as inputs in the production of other food products such as meat. There is also a possibility that meat producers will have to cull herds in which case meat prices might fall, reducing the likely impact the drought will have on consumer prices. Nevertheless, there is a very real chance that food price inflation might edge up towards the 14% year-on-year rates we saw in 2014, in which case inflation can be as high as 1.5% above expectations, all other things remaining constant.

This brings us to our final point: a consistent and persistent depreciation of the Rand to new record lows against major currencies, the severity of the droughts an it's likely impact on consumer prices, as well as the likely chance (60%) of a US rate hike, have lead us to believe that the South African Reserve Bank (SARB) will in fact hike interest rates by 25 basis points on Thursday, 19 November, during their last meeting for the year.