EFFICIENT GROUP

ECONOMIC COMMENTARY
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INFLATION AND INTEREST RATES IN SOUTH AFRICA

Statistics South Africa (Stats SA) announced last week that inflation was 4.4% for April (measured year-on-year against April 2018), only slightly up from January's 4.0% low. The only real change from last month was a decrease in prices of alcohol and tobacco products. Year-on-year the largest price increases (inflation) came from fuel (12%), public transport (10.5%), and water and other services (10.8%). The largest price decreases (deflation) came from telecommunication goods (-10.7%), packaged holidays (-2.4%), and meat (-1.2%).

A few years ago, inflation was 6.8%, now we're down to 4.4%. To give some more context about how this changes a household's buying power, consider the following examples. A household that earns R100 000 annually loses R200 each month if inflation is 4.4% and not 6.8%. Households that earn R650 000 and R1.5 million, respectively, lose R1 300 and R3 000 each month.

This was a good setup for the South African Reserve Bank (SARB)'s decision not to change interest rates; currently the repo-rate is at 6.75% and the prime lending rate at 10.25%. We agree with the Bank's decision.

First, prices in South Africa are stable and should remain so in the medium term. Governor Lesetja explained that they expect inflation to average only 4.5% during 2019, midway between their 3–6% target range and exactly where the governor wanted it. There might, however, be some medium-term inflationary risk if the US Dollar continues to strengthen, although many analysts expect the contrary. Like them, we believe the dollar should slowly start to depreciate as their current late-cycle relative strength starts to wind down. Other good news for South African inflation is that, despite Iranian pressures, we've seen the oil price (South Africa's largest cause of import-inflation) start to fall back to levels below $70 a barrel.

Second, the local economy is constrained (from both a supply and demand side) so decreases won't help too much. Governor Lesetja mentioned that the Bank lowered their 2019 GDP forecast from 1.3% to 1.0% – closer to our estimate of 0.9%. For this reason, it might be better to allow positive real interest rates (repo rate minus inflation, currently 2.35%), to support investors who have been stuck with the short end of the stick for many years.

Finally, and probably most importantly, the global interest rate environment is only starting to gather momentum towards looser/easier monetary policy. Until the end of December, the US was on a rampage to try and increase rates as fast as possible! To stay competitive in global liquidity markets, many countries were pushed in a similar direction even though their fundamentals couldn't really support it. Now that the US have completely changed direction, the rest of us can breathe a bit easier and take our time with implementing monetary policy changes.

Considering these points, we believe the SARB will most likely decrease interest rates at the end of 2019, by 0.25%. This can support consumers a bit by reducing the cost of debt without hurting medium-term prices, investors, or our competitiveness too much.