EFFICIENT GROUP

ECONOMIC COMMENTARY

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Newsletter

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THE GOOD, THE BAD AND THEN JUST NEWS

The Good News

The South African Reserve Bank (SARB) decreased interest rates, as markets were expecting. The monetary policy committee (MPC) unanimously decided to decrease interest rates by 0.25%. This is a welcome relief for households and a possible boost for economic growth. It was interesting that the rand appreciated after the announcement because usually, when interest rates decrease currencies depreciate. This happens ost notably because short-term capital flows to higher yielding assets elsewhere. Even though the flows don't occur immediately, the assumption in markets are that they will eventually start flowing, and this puts pressure on a currency. A sell-off of assets reduces the demand for rands, relative to other currencies, which in turn reduces the value of the rand. But, there's no reason for capital to flow elsewhere. Global sentiment favours emerging markets, and relative to other emerging economies South Africa still offers higher real-returns: nominal returns minus inflation. Like us, markets believe that the boost consumption will get from lower interest rates will be growth-positive.

The total household debt in South Africa is roughly R2.17 trillion and decreasing interest rates by -0.25% would add about R5.4 billion to households' buying power. But we don't think the SARB is done cutting rates. They'll have more room to cut rates after the United States also cuts interest rates.Our view is that the United States will cut interest rates by -0.25% by the end of the year, and that the SARB will decrease interest rates by another -0.25%. Considering that household consumption is roughly 60% of gross domestic expenditure, any increase in spending will help our aisling economy. Despite this however, the SARB decreased their 2019 GDP forecast to 0.6%. We don't completely agree with this because the recent uptick in retail trade data makes us a bit more optimistic. April retail trade was upwardly revised by Statistics South Africa (StatsSA) to 2.7% (annual growth, measured against April 2018). In May, retail trade grew by 2.2%, much higher than the 1.7% which markets were expecting.

The Bad News

Recently a report found that foreign investors believe Eskom poses the greatest threat to South Africa's economic growth. We agree! Expensive power equals slow growth, and no power equals no growth. In South Africa we are frequently plagued by both. Not only do we have some of the most expensive electricity rates in the world, but it's also not very reliable; like most government-related institutions in South Africa. What worries foreign investors, and us, is that the gross incompetence at Eskom has led to persistent deficits and a total debt burden of roughly R440 billion. To put this into perspective, this is a quarter of South Africa's total debt. Furthermore, from 2023 Eskom will be liable to pay R11.5 billion in carbon taxes. If the inefficiencies at Eskom are not addressed post-haste the economy will not be able to drag itself out of the grave.

Other News

China reported their slowest quarterly economic growth since growth data was compiled in 1992. Trade wars seem to be quickening the natural slowdown rate China experiences as they shift their economy from secondary to tertiary services. Growth slowed to 6.2% in Q2, down from Q1's already low 6.4%. Recent retail and manufacturing data from China do however show that growth should stabilise around these levels. Although the slowdown was expected, this gives Trump a stronger negotiating footing, something we are very positive about.