EFFICIENT GROUP

ECONOMIC COMMENTARY

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STIMULATION, CONSTRAINTS AND THE CORONAVIRUS

In a surprising, and unexpected, announcement Jerome Powel, chair of the United States (US) Federal Reserve (Fed), decreased interest rates by 0.50%. The last time a large rate cut like this was announced, the global economy slipped into its biggest recession in recorded history, the 2008/09 global financial crisis. Fears about the potential impact of the coronavirus caused the Fed to act abruptly by providing more monetary stimulus, an adequate response to supply-side shocks like these. By pushing more fuel (liquidity) into the economic engine, their hope is that the US can absorb and possibly avert some of the negative consequences of this mild, over sensationalised, flu.

While monetary policy can help, the real magic happens when both monetary and fiscal policy, tax cuts and more government spending, are introduced simultaneously. Depending on the type of fiscal policy that is used, the short-term cost increase can be paid off by higher levels of productivity in the longer term. As an example, spending more on healthcare in the short term, to reduce the impact of the coronavirus, increases debt levels. But a healthier society is a more productive society, which increase output capacity and the overall size of the economy. That is, in the long-term there's more money to pay off debt and the economy is bigger, which makes debt (expressed as a percentage of GDP) appear smaller.

Economic data from South Africa (SA) once again disappointed, and shockingly so. Statistics South Africa (StatsSA) reported that SA's economy contracted by -1.4% during the 4th quarter of 2019 (4Q19). By implication SA slipped into its 3rd recession since 1994, in 2019. Technically a country enters a recession if it experiences two consecutive quarters of economic contraction; SA's economy contracted by -0.8% during the 3rd quarter of 2019. For the full year of 2019 SA's economy only grew by 0.2%. Down from 2018's 0.8%, which was down from 2017's 1.4%. Although we've grown accustomed to bad news, seeing the actual figures is still upsetting. Commentators ascribe much of the 4th quarter's contraction to December's load shedding, the worst since the scheme's introduction in 2007/08, and low levels of investor confidence. Remember, investor confidence is needed to attract both short-term (equities and bonds) and long-term (gross fixed capital formation) investment, which helps to lift both short- and longterm economic growth.

To give some more context about the severity of these numbers only 3 of the 10 aggregate industries in SA grew during 4Q19, the financial (2.7%), mining (1.8%) and personal service (0.7%), industries. Those industries who contracted the most, were the agricultural (-7.6%), transport and communications (-7.2%) and construction (-5.9%) industries. In fact, all three these industries contracted during each of the four quarters of 2019. The agricultural and construction industries have been contracting at such a rapid pace during the last couple of years that these industries are now smaller than they were in 2014.

Despite the nature of SA's structurally constrained economy we expect the South African Reserve Bank (SARB) will cut interest rates by 0.50% in 2020, even though interest rate cuts don't do much in a country where demand is constrained. However, lower levels of inflation give the SARB some room to fulfil their secondary mandate and assist the economy in these troubling times, albeit only marginally. Usually when the rand plummets against the US dollar (USD) the SARB is concerned about medium-term inflation. However, the price for oil, our largest import, has also fallen substantially, which reduces the inflationary impact of a weaker currency. For two simple reasons fiscal stimulus shouldn't even be considered in SA at this point:

+ There is no money; and
+ Government spending is grossly unproductive.

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