EFFICIENT GROUP

ECONOMIC COMMENTARY

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YOUR WEEKLY ECONOMIC UPDATE

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THE IMPACT OF INTEREST RATE DECISIONS ON SOUTH AFRICA AND CHINA

In a daring move, the South African Reserve Bank (SARB) last week decided to increase interest rates by 0.5%, despite the pressure that it will undoubtedly place on South African consumers. Although 15 out of the 24 analysts that were surveyed, expected a 0.5% increase, I cannot help but wonder if it was not a little too much.

I understand that the SARB wants to front-run potential inflation. I also understand that, from a capital competitive position, they almost did not have a choice: If countries like the United Kingdom (UK) and the United States (US), which are much safer investment destinations, are rapidly increasing interest rates, they will undoubtedly pull liquidity from countries who are not increasing interest rates and are riskier, like South Africa (SA). But, in our case, unlike these rich countries, consumers have faced extreme pressure for many years now. Not only has our local market been underperforming for a longer period, but unemployment rates and grant recipients continue to set new all-time highs. The gross domestic product (GDP) per capita, which is a good measure of the rate at which incomes are growing, was declining even before the COVID-19 pandemic, before it finally fell off the cliff. Why then increase interest rates more rapidly if consumers are under such a tremendous amount of pressure?

The primary mandate of the SARB is to combat inflation, but we do not have an inflation problem. At most, inflation might temporarily breach the upper limit of the SARB's target range of 3% to 6%. But even then, inflation will be well below long-term averages, which most South Africans are comfortable with. The secondary mandate of the SARB is to support economic growth, which they do by creating a stable pricing environment, which we have. But if prices are stable, why put more pressure on the economy, on demand, and on consumers? I understand that higher interest rates support long-term growth over short-term consumption, but long-term growth is not going to help indebted, struggling households now, when they really need it the most. For these reasons, I would have preferred a 0.25% increase. Increasing rates by 0.5% sends the wrong message; it almost seems like the SARB has grown too distant and too insensitive to the needs of average, hardworking South African households.

Over in the US, retail sales data was positive, once again improving on a month-to-month basis. But the stronger than expected sales data was not enough to offset the terrible earnings reported by large US retailers, like Target and Walmart. Consequently, markets in the US, once again, took a bit of a beating. Some concerns about global growth were, however, eased after China's central bank announced that they will be cutting their key interest rates. The five-year prime lending rate that governs how lenders base their mortgage rates was cut from 4.60% to 4.45%. A decrease of this kind will not only reduce mortgage costs in China, but it will also boost demand and support the Chinese economy that has been struggling with a property slump and work stoppages at ports and factories, owing to COVID restrictions. A stronger China will, in turn, help to boost global market sentiment, something that is in short supply nowadays.

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