EFFICIENT GROUP

ECONOMIC COMMENTARY

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YOUR WEEKLY ECONOMIC UPDATE

14 June 2022

A RESILIENT RAND

The rand has remained resilient, albeit volatile, as negative global drivers continue to clash against many positive local drivers. At one point, the rand touched R15.18 last week, before poor performing global indicators caused the rand to depreciate back to levels around R15.90. But, excluding the rumours that President Ramaphosa might have to step down, the multitude of positive local factors caused the rand to close last week off at R15.36. On a side note, we still believe that long-term investors who want to get into global markets should take their money offshore at levels below R15.50.

Globally, the European Central Bank (ECB) announced that they would start to increase interest rates for the first time since 2011. Following the guidance provided by the ECB, July should see rates in the European Union (EU) increase by 0.25%, from the current rate of -0.50% to -0.25%. If inflation does not slow down sufficiently, the markets expect the ECB to follow this initial increase up with a 0.50% increase in September. How the ECB will use quantitative tightening to reduce their balance sheet and to attempt to keep the yield curve from inverting, remains to be seen. Unlike the United States (US) Federal Reserve (Fed), if the ECB makes changes, 19 countries are directly impacted and, unfortunately, these countries are on different ends of the spectrum of what is considered a healthy economy. On the one end, Germany seems able to stomach increases with a smile but, on the other end, Italy and Greece might already be fearing recessions.

In other disheartening global news, the Organization for Economic Co-operation and Development (OECD), an intergovernmental agency positioned to stimulate economic progress and world trade, sharply reduced their global growth forecasts for 2022, and almost doubled their inflation forecast. The OECD now believes that the global economy will only grow by 3.0% during 2022, down from their 4.5% forecast in December 2021. Inflation, they believe, will, on average, increase around 9% among their member states this year. The World Bank reduced their global growth forecast to 2.9%, even though China continues to support their economy's growth. More good news from China was their regulatory approval of dozens of new video games. Markets are hopeful that it might signal the end of the long-running and painful crackdown on the sector, which has even set rules about how many hours children are allowed to play video games in China. The good news from China was, however, quickly snuffed out by record-high inflation in the US. Many were hoping that US inflation peaked at 8.5% in March and were surprised when government authorities announced that inflation accelerated beyond expectations to 8.6% in May. We should, therefore, see the Fed increase interest rates by 0.5% during their June and July meetings, while markets remain under a tremendous amount of pressure. If these increases can cool the economy off enough, we might see the Fed relent, a bit. If not, the Fed will continue to increase interest rates by 0.5%.

In South Africa (SA), however, and unlike the trend that we have seen over the last couple of years, good news economic stories have been rolling in: The gross domestic product (GDP) came in higher than experts expected. During the first quarter of 2022, the South African economy grew by 1.9%, measured against the previous quarter, which only grew by 1.2%. By implication, the size of the economy, now roughly R4.62 billion in real terms, is finally higher than it was pre-pandemic. In our view, the South African economy should grow by about 1.6% in 2022, as lower local and global demand take their toll. Quite surprising was the 3.6% increase in gross fixed capital formation (GFCF), which has been lagging for many years and is crucial for long-term sustainable wealth creation. Higher GFCF numbers mean that there are more long-term investments being made in SA, which points towards a positive shift in economic sentiment. More good news is that, during the first quarter of 2022, the surplus on the current account of the balance of payments widened to 2.2% of the GDP, R143 billion, from R132 billion in the fourth quarter of 2021. The current account measures SA's transactions with the rest of the world, and a surplus means that more money flowed into the country than out of it. More money flowing into SA supports our financial account and increases the demand for rands, which helps to keep the rand strong.