EFFICIENT GROUP

Weekly Economic Newsletter

Contact Us

81 Dely Road
Hazelwood
Pretoria
0081

+27 (0)87 944 7999

info@efgroup.co.za

www.efgroup.co.za

ECONOMIC COMMENTARY

- By Francois Stofberg

US Interest Rates and Local Politics

The United States Federal Reserve (Fed) decided to keep the target range of their federal funds rate unchanged at 1.25 - 1.50%. Their decision to keep rates unchanged seems to originate from a multitude of smart choices. First, this was Janet Yellen's last committee meeting as Chair of the Fed. To honour her rather exceptional term, Fed-employees all wore popped collars on her final day (Yellen wore a popped collar on each of her committee meetings). By keeping rates unchanged, she has left the door open to her successor, Jerome Powel, to decide on the path and speed of policy implementation.

Furthermore, waiting until March before a change is made to interest rates, gives the Fed more time to gather information about the likely path of the short and medium terms. As volatility is expected to increase, information will become ever more important to ensure that policies are accurately and timely implemented to grow the US economy sustainable. Until recently, the Fed has mastered this skill of walking on a tightrope – doing just enough to dampen growth. For this reason, we do not share the sentiment that pushed the US markets down on Friday; by many estimates, the largest single-day Dow Jones drop in many years. There have been many record-breaking economic prints from the US over the past two years, each showing how the US economy is gathering momentum and each pointing towards more inflation. Last week, another good jobs-report showed the biggest increase in wages in nine years. This was the last tick-box in the search for inflation and seems to have finally convinced markets that inflation is imminent. It is exactly for this reason that the Fed has increased rates five times over the past two years, whilst most large economies were still busy with monetary easing.

It is also important to remember that the returns of the US stock markets have been considerable over the past two and five years. In many cases, returns from these markets have been the greatest in the world. The Dow Jones, S&P500, and Nasdaq have printed five-year annualised returns between 13% and 19%. Two-year annualised returns are even more substantial, between 21% and 27%. It is only natural that these markets blow off some steam. Our estimate is that US markets will blow off about 10% in the next 18 months. It is for this reason, amongst others, that we have diversified away from US markets towards Europe and Japan.

As a final comment, we share market expectations that interest rates in the US can increase at least three times in 2018. But, as the Fed likes to state, "interest rate changes will be data-dependant".

A note on South African politics. The upcoming weeks leading to the president's State of the Nations address and the Minister of Finance's Budget Speech, will draw a lot of attention – both locally and abroad. It seems the charges against the president are gaining momentum, creating another opportunity for a vote of impeachment. Also, should the president be removed from his position and Cyril Ramaphosa instated before the 2019 elections, this period will not count towards Cyril Ramaphosa's first term. He will therefore, be able to stand for another two, five-year periods, in addition to the time leading up to the 2019 elections. This further incentivises the ruling party to reduce some of the negative press associated with President Jacob Zuma, which can be a smart move to win back some of the votes in crucial municipalities. It can also do much to divert some of the ensuing negative press that will accompany the budget; we expect another report that highlights the dire state of South Africa's economy and government's lack of doing something substantial about it.