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Newsletter

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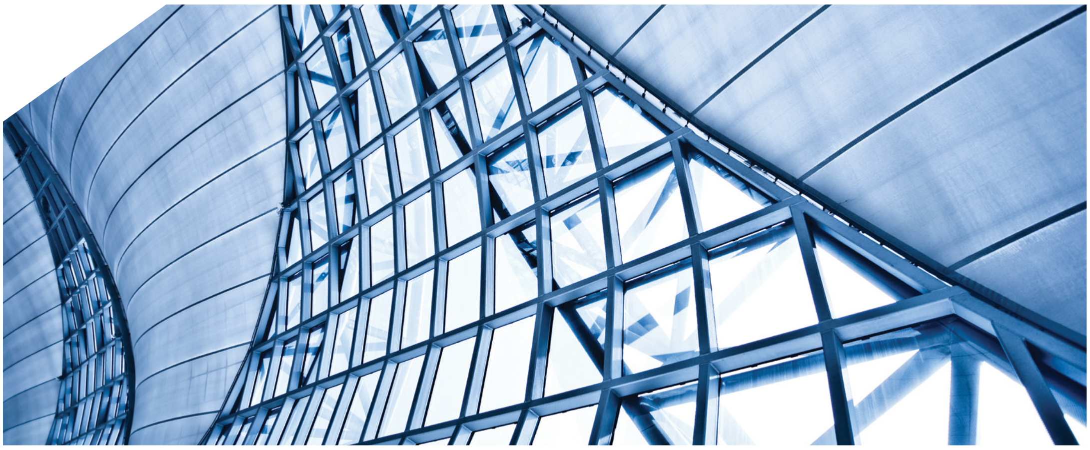

ECONOMIC COMMENTARY

- By Francois Stofberg

Local wages and business as usual

Wage negotiations have always been a contentious point in South Africa (SA). Often workers ask for wage increases that are much higher than inflation, which isn't necessarily a bad thing. Higher-than-inflation wage increases imply that workers are, in fact, becoming richer, in real terms, which is good for many reasons. However, wage increases in SA are often set much higher than efficiencies, profits or global competitiveness would allow for. The result is that companies falter and are forced to move towards capital intensive operations. Government ends up borrowing money to pay salaries, which reduces economic efficiency, slows the economy, and reduces the potential for job creation. Also, investors simply stop investing, worried that companies will not be able to produce goods and services competitively and profitably. A reduction in investment further reduces the potential for economic growth and job creation. Workers are, therefore, exchanging short-term benefits (higher wages) for long-term misery (slow income growth and fewer "decent" jobs). Paying wages that are higher-than-efficiency-would-allow-for, are, however, not just an SA problem. In fact, Nigerian workers went on an indefinite strike this week for wage increases of 66%.

Although Eskom fell into the wage trap again this year, allowing unsustainably-high wage increases, the ailing company made an important announcement earlier this month. Eskom will be reducing the size of their executive team and start a restructuring program to reduce the size of the wage pool, by as much as 7000 employees over the next five years. This structural reform will do much to decrease the operational expenses, bloated by an unjustifiably large wage bill, to force the company towards something that resembles an efficient business. The truth is that although output at Eskom has remained relatively flat over the last couple of years, the number of employees needed to produce the same level of output has ballooned – which makes absolutely no economic sense.

Global markets got what they wanted last week, interest rates in the United States (US) remained unchanged and the US mid-term elections went as planned. The Federal Reserve (Fed) decided, as expected, to keep interest rates unchanged between 2%–2.25%. Fed chairman, Jerome Powel, clarified their decision by explaining that although consumers have grown strong over the last couple of quarters (good wages and full employment), business investment has started to slow down. A Bloomberg poll on likely future increases showed that there is a 78% chance of seeing an interest rate increase in December, with three more expected in 2020. The good news about these polls and the current market expectations about future interest rate increases, is that their effects should already be priced in. Markets that anticipate the outcome of likely decisions, therefore, help to keep the impact of those decisions subtle on equity and foreign exchange markets.

Similarly, markets anticipated that Republicans would keep the Senate but lose the House of Representatives during the US mid-term elections. When the anticipated results were realised, markets blistered onwards. The new confidence even saw investors demanding higher-yielding, riskier investments, which boosted the performance of emerging market currencies. It seems the net-effect of losing the House to Republicans won't do too much to change US progression. By winning the House, Democrats will most likely increase the amount of investigations into various deals, negotiations and businesses. We most likely won't see any further tax cuts or a recall of Obamacare, and legislation will be under gridlock. President Trump, however, still has sway over sanctions and trade war.