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ECONOMIC COMMENTARY

- By Francois Stofberg

November – happy investors and happy markets

The big news in November was the South African Reserve Bank (SARB)'s decision to increase SA's repurchase (repo) rate by 0.25%. On a side note, the repo- or overnight rate is the interest rate that the SARB levies on money that banks borrow from them to maintain minimum deposit requirements. SA banks are required to keep 2.5% of the money you deposit, the other 97.5% the banks can lend out to others (scary, I know, to think that only 2.5% of your money is held at the bank). So, after a day of buying and selling in SA and money flowing across different banks, some banks do not have enough money left to maintain that 2.5% requirement. These banks must then borrow money from the SARB at the overnight rate. By changing the overnight (repo) rate, central banks can therefore, influence overall interest rates in an economy. If they charge more, your bank will start charging you more to borrow from them.

It was a bit of a surprise when the SARB decided to increase interest rates because rates are usually not increased if the medium-term outlook for prices is stable. In fact, the rand has strengthened considerably from its R15/\$1 lows to well below R14/\$1. This implies that imports (roughly 30% the size of our economy) will be a lot cheaper in coming months and therefore reduce the inflationary pressures from imports. Even oil prices (our largest import) have fallen from highs of \$85 a barrel to levels closer to \$60, which has helped to ease inflation concerns for 2019 back to 5.4% levels. Although higher interest rates imply that South Africans will now be paying more for their debt, which in normal instances can dampen economic demand, we believe it was a healthy, bold move. The reason is simple, the demand side of SA's economy is already struggling but increasing the rate of return investors receive can attract capital (short- and long-term) back to SA's shore. Capital inflows can help to strengthen the rand and the economy in the short term, but it can also lift the potential for stronger economic performance in the long term. So, the reason for the increase was not so much in keeping with the SARB's primary mandate of price stability, but more because of international competitiveness. Considering that the rest of the world are in a monetary-tightening cycle, not increasing interest rates would be to our own detriment.

Other good news that occurred in November was the slight turn towards riskier investments (like those made to emerging economies like SA), when markets got what they were looking for from the United States (US) Federal Reserve (Fed), and US mid-term elections. The Fed decided to keep interest rates unchanged between 2% and 2.25% after the chair, Jerome Powel, explained that business investment in the US has started to slow down. Markets are expecting the Fed to continue cautiously as many analysts believe we're approaching the end of the hiking cycle in the US, with a hike expected in December and only three, or possibly four, expected in 2019. Many market observers are already concerned about the rate of increases, as tightening too quickly has led to multiple recessions in our modern history. During the US mid-term elections Republicans kept the Senate but lost the House of Representatives to the Democrats. It seems the net-effect of losing the House won't do too much to change US progression. Democrats will use their new power to increase investigations into various deals and businesses; they'll keep Trump from scrapping Obamacare; we'll most likely not see tax cuts 2.0; and the US will most likely get stuck in legislative gridlock. None of which is too bad for the US economy, or its markets. So, in the end, it seems to be business as usual in the US and elsewhere.