EFFICIENT GROUP

ECONOMIC COMMENTARY

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Newsletter

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THE WORLD AROUND US AND THE CONCERNS OVER INFLATION

OPEC+ and oil production.

The Organisation of the Petroleum Exporting Countries (OPEC) together with Russia (OPEC+) control roughly 50% of global oil supplies and about 90% of oil reserves. Its members decided to keep oil output unchanged in April, causing oil prices to increase steadily towards $72 a barrel. Markets were expecting a production increase of 1.5 million barrels a day but OPEC+ took a gamble and kept back on output increases. The organisation is betting that unlike in the past, recent oil price increases will not lead to a big increase in American shale gas drilling. Their next big hurdle is to keep member countries in check. In the past, higher oil prices were too enticing for members, who would rather break the agreement to line their own pockets and support their struggling economies. For now, however, their bet is playing out as expected and adding to concerns about global inflation.

Joe Biden's $1.9 trillion relief package.

The United States (US) Senate passed Biden's relief bill on Saturday leaving only Tuesday, 9 March's vote in the Democratically controlled House of Representatives before he can finally sign the bill into law. After the House approves the legislation the US will receive a large-scale dose of federal support which many experts, ourselves included, are a bit concerned about. We maintain that the plan is a bit too excessive and it risks an inflation spike. Most of last year's, much smaller, support package ended up inflating savings accounts and asset prices, more so than saving poor households and small businesses from going under. These were kept alive by all the other social assistance already built into the American support network.

Those rising US 10-year yields.

We are not too concerned, yet. We maintain that rising yields are merely pointing towards future inflation, the good kind of inflation. Inflation that speaks more about an economic recovery than a bubble. As inflation expectations and real yields expand simultaneously, the market still believes that the Fed will keep short-term interest unchanged. In fact, some experts doubt that we will see an increase in interest rates before 2024.

A bit more about inflation.

In emerging markets, the recent surge in inflationary expectations, along with higher commodity prices, has raised concerns that central banks may have to increase interest rates earlier than expected. In this instance, we refer to the bad type of inflation where food and fuel prices increase rapidly, and prices overall are not driven by economic recovery. As a result, the performance of indices like the MSCI EM Index has been under tremendous pressure over the last two weeks. This is important for us here in South Africa because negative sentiment towards emerging markets add pressure to our local market's performance. Locally, however, we are still less concerned about bad inflation as food prices remain more subdued and changes to fuel consumption allow for higher-than-normal oil prices.

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