EFFICIENT GROUP

ECONOMIC COMMENTARY

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YOUR WEEKLY ECONOMIC UPDATE

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INFLATION AND REFORMS

And then, it finally happened... Inflation in the developed world erupted. Germany's inflation came in at 4.5% in October, whereas inflation in the United States (US) rocketed to a 30-year-high of 6.2%. In the United Kingdom (UK), the Bank of England warned consumers that inflation could breach 5% in 2022. In many ways, inflation levels in the developed world are starting to look like something out of a third-world horror movie. One example is overall energy prices, which have increased by 30% year-on-year in the US. Considering the inflation eruption, the US Federal Reserve (Fed) Chairman, Jerome Powell, who, until now, has insisted that inflation will only be temporary, has finally started to change his tune. In his most recent address, he explained that inflation has been "longer lasting than initially anticipated", something we have been warning about for quite some time. What might initially have seemed to be COVID-related, has changed into something more lasting. Initially, inflation was contained to specific indexes, such as food and energy, but has now become more broad-based, transitioning to longer-lasting cyclical inflation, which is seen by the rise in wages and house prices.

On the other extreme, inflation might even turn to deflation as the world finally emerges from all the nasty COVID-19 restrictions and shortcomings, and superficially high demand starts to wind down as fiscal support stops and monetary policy tightens. Either way, we hope that the central banks, especially the Fed, can keep to their convictions, and not allow emotions and pressure from consumers to cause policy errors. For this reason, we believe that the world has reached the knife's edge: Increasing interest rates too quickly or too slowly, too much or too little, can have a severe impact on global markets and economies. We, therefore, urge you to speak to your financial advisor and plan accordingly, to ensure that you are invested with managers who can actively navigate your portfolios through this volatile period.

In South Africa (SA), risks associated with local interest rate increases are a little less for consumers, although decisions from abroad can, and most likely will, have a severe impact on our small, open economy. But, unlike the developed countries, where trillions of dollars of cash have made economies slow and fat, markets overpriced, and consumers too lazy to work, many emerging countries have grown resilient. Consumers in emerging countries, such as SA, have been battle-hardened over the last couple of years and company valuations were supressed. Overall, consumers and economies have been kept lean. Some, such as SA, have even been forced into reforms, which hurt a lot in the short-term, but bear much fruit in the long-term. Nowhere is this clearer than in our government's finances.

In his Medium-Term Budget Policy Statement (MTBPS), our new Minister of Finance, Enoch Godongwana, pledged to accelerate reforms to bolster the economy, while reining in debt. During the Zuma administration, words of this kind might have been empty, but in recent years we have seen the South African government hold firm. In the new Ramaphosa era, the civil service wage bill is being reduced, state-owned enterprises are being held accountable, non-strategic and non-performing assets are being sold or forgotten, and so the list goes on. So, even if the South African Reserve Bank (SARB) increases interest rates by 0.25% in the next week, we believe that consumers will be able to carry the load. Although increasing interest rates hurt (indebted) consumers, it will benefit savers who are crucial to SA's next developmental phase, growth through investment. Slowly starting to increase interest rates, to keep real rates positive, can do a lot to support both lower inflation and a healthier currency, whilst making capital investments look even more attractive.

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