EFFICIENT GROUP

ECONOMIC COMMENTARY
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YOUR WEEKLY ECONOMIC UPDATE
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INTEREST RATES: TO INCREASE OR NOT TO INCREASE, THAT IS THE QUESTION

Last week, the South African Reserve Bank (SARB) increased interest rates for the eighth consecutive time since they started their rate-hiking cycle in November 2021. Since then, the prime interest rate has increased by 3.75% to 10.75%, its highest level since 2009. This means that every R1 million debt that a household has, will now be roughly R3 125 more expensive each month; a thought that is keeping many South Africans awake at night. Data shows that the middle class, roughly 4.1 million adults earning between R8 000 and R30 000 per month, are now spending almost two-thirds of their salary on servicing debt. In general, South African consumers seem to be hanging on by a thin thread with very limited room left to manoeuvre in their personal finances. We are, however, confident that we have reached the end of the rate-hiking cycle in South Africa (SA) and that there is, most likely, only one more hike left. The next hike will probably be 0.25% or 0.50% and should be announced in the upcoming months. Our view is also that South Africans can expect to see the first rate cut early in 2024.

But why all these interest rate increases? Interest rate increases are usually applied to dampen demand, which they can do effectively and, therefore, they assist in cooling demand-driven inflation. This is why the Americans have also been increasing interest rates at such a rapid pace. But unlike the United States (US), we do not have enough demand to push prices up. In SA, consumers have been battered by a poor-performing economy and market for many years now. Our economy is not even growing fast enough to slow down the pace of unemployment, which is fast approaching a new all-time high, and our equity markets have been underperforming for many more years.

On the other end, the US economy has only recently come out of its longest expansionary cycle ever; for more than 10 years the US economy grew without a recession. Consequently, US unemployment reached a historic low, US incomes flourished, and household wealth ballooned as property prices soared and the US equity market delivered unbeatable returns. If that was not enough, the US government gave out cash to all US households to support them during the pandemic. So, while excessive demand in the US helped to boost inflation to near 40-year highs, demand in SA has had an insignificant effect on prices. In fact, the current, slightly higher-than-normal inflation levels that we have in SA today have very little to do with what is happening in SA. External factors, such as a strong US economy, put pressure on the rand, which increases all of our import prices, which are more than 30% of our gross domestic product (GDP). Other external factors, such as the war in Ukraine, tensions in the Middle East, oil supply constraints enforced by OPEC+, and droughts in high-yielding agricultural countries, all put pressure on the prices of important necessities, such as food and fuel; the two items that contribute most to inflation in SA. Local interest rate changes have a very limited impact, if at all, on external forces and supply-based inflation forces such as these.

Nevertheless, the SARB has been trying to keep short-term interest rates as high as possible, albeit at a high cost to South African consumers. This is done to attract short-term capital inflows, which can boost the rand's performance, which, in turn, should help to reduce import inflation. Although, until now, the SARB's efforts have been as useless as fighting against a tsunami, they should pay off soon. We believe that the rand can strengthen to at least R16.50 against the US dollar in 2023, although it might appreciate well below R15.50 for brief periods. This is not because of a success story in our local economy (load shedding is making that impossible), but because of a slowdown in developed economies, a shift towards emerging markets, a normalisation in global currency markets, and the frontloading done by the SARB to attract capital to our markets. As for inflation in SA, it should gradually decrease as markets grow more certain about external forces, and supply-based forces are resolved.

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