EFFICIENT GROUP

ECONOMIC COMMENTARY

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YOUR WEEKLY ECONOMIC UPDATE

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THE FED HALTS AND THE RAND STRENGTHENS

At their latest Monetary Policy Committee meeting, the United States (US) Federal Reserve (Fed) decided to leave interest rates unchanged at 5% to 5.25%, following 10 consecutive hikes over a 15-month period. But the Fed remains unwavering in its commitment to bringing inflation down to its 2% target. Jerome Powell, the Chairman of the Fed, therefore, made the comment that more hikes may be needed later this year. According to dot-plot projections, two more hikes may still be on the table in 2023. Investors anticipate a 61.5% chance that the Fed will hike rates during their July meeting.

The Fed deemed it appropriate to moderate the pace of increases, albeit only slightly, and we agree with this. Powell explained that the brief halt in the increasing cycle will allow the Fed to assess more data, which they are hoping will assist them in making better decisions going forward. But a halt also allows the economy a little more time to adapt to the tightening environment. Now that rates are at, or very close to, what most believe are restrictive levels, the Fed's job becomes increasingly difficult. If they do not do enough, inflation might spiral out of control again. But if they do too much, as they tend to do, then the US may experience that hard landing that many thought possible not too long ago.

The US economy and capital markets find themselves in a peculiar place. Up until now, they have been able to shrug off the monetary policy tightening cycle. Corporations keep on expanding and printing favourable earnings reports, unemployment keeps decreasing, and even the housing market seems to be bottoming out. This is because interest rates only impact the real economy at least a year or so after they are increased. Markets try to anticipate what could happen but they mostly get it wrong, as we believe they are currently doing in the US. Wall Street is betting that US markets will continue to outperform but Main Street is starting to think otherwise, as signs of a slowdown and cracks are starting to appear. The annual pace of US inflation eased last month to its lowest level in more than two years. Prices increased 4% in May compared with a year earlier, a significant step down from 4.9% in April, and a remarkable slowdown from the peak of 9.1% last June.

Overall, we believe that the US consumer, who has been insulated from pain, will experience a lot more of it in the short term (12 to 18 months). In the US, earnings will correct, markets will adjust, and more people will be laid off, which will assist in moving sentiment away from developed markets towards emerging markets. It is, however, worthwhile to note that this does not mean that all developed markets will underperform; we still see and invest in pockets of opportunity. But this is good news for South Africa's capital markets. The rand has already responded positively, strengthening to R18.19 levels, down from the R19.88 high that we were at only two weeks ago. Soon, short-term capital will look elsewhere for yield and the emerging markets will be all too ready to receive it.

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