EFFICIENT GROUP

ECONOMIC COMMENTARY

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YOUR WEEKLY ECONOMIC UPDATE

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DO NOT MISS THE SHIFT TOWARDS EMERGING MARKETS

The strong June jobs report in the United States (US) is likely to leave the Federal Reserve (Fed) on course to raise interest rates to a 22-year high during their next meeting to cool off the economy and to combat inflation. Employers in the US added 209 000 jobs in June, causing the unemployment rate to fall from 3.7% in May to 3.6% in June. This is ever closer to the 53-year low of 3.4%. June's increase was the smallest since December 2020 and is one of the indicators pointing towards a slowdown in the world's largest economy. However, a tight labour market means average hourly earnings for private-sector workers rose 4.4% since 2022, maintaining the pace set over the last few months. Because hours worked also increased, the overall income in the US also rose in June. Persistently-higher incomes mean spending should remain elevated and add upward pressure to inflation. As the outlook for above-target inflation and a stronger-than-expected labour market persists, more restrictive monetary policy will be needed for a longer period. Consequently, many emerging markets and their currencies took a bit of a beating.

In South Africa (SA), the local equity market contracted 2.4% when the news broke, and the rand depreciated more than 2% to levels above R19.10 against the US dollar. Tighter monetary policy in the US will likely translate into more interest rate hikes in SA too. The South African Reserve Bank (SARB) has unequivocally shown that their primary concern is inflation and that they care very little for consumers or the broader economy. Although, with today's data, we doubt that the SARB will need to raise interest rates by more than an additional 0.5% in 2023.

As the US Fed is likely to continue to increase interest rates, fears about a global economic slowdown have heightened. This, in turn, brought about some price alleviation in the energy market where oil prices fell despite this year's supply cuts from the Organisation of the Petroleum Exporting Countries and Russia (OPEC+). Overall, production efficiencies and larger production outputs from countries outside of OPEC+, especially the US, together with weaker-than-expected demand in China, meant that oil prices have fallen more than 13% over the last year, despite OPEC+ cutting output by more than 6%.

Our base case also includes an eventual slowdown in the US but we do not believe that this will translate into a deep global economic crash. Rich-world countries, like the US, have been driven, to a large extent, by extremely loose monetary policy and generous fiscal policy, which have now dried up. This contrasts with emerging economies and their capital markets that have been under severe strain for multiple years, scraping by, fighting for every cent, and forced into structural change. We believe that global investors have not yet effectively priced in the expected slowdown in the US or the hard work that has gone into many emerging markets. When these realities sink in, and investor sentiment shifts to chase the real-world lucrative yields of emerging markets, an upward correction is much more likely in emerging markets. Unfortunately, like all good things, shifts like these do not materialise overnight. We will probably have to wait another 12 to 18 months, at least.