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NEWSLETTER

23 November 2018

ECONOMIC COMMENTARY - By Francois Stofberg

A bold move towards global competitiveness

Last week the governor of the South African Reserve Bank (SARB), Lesetja Kganyago, took a bold step when he decided to increase SA's short-term interest rate by 0.25%. The decision paid off nicely as markets reacted positively towards the news that would increase SA's investor competitiveness. In an even bolder move, the president, Cyril Ramaphosa, used the euphoria to push through a cabinet reshuffle – a leaner team of robust leaders. The net effect was a stronger rand that seems to be gaining momentum towards our forecasted levels of around R13/$1. This momentum is supported by a weaker US Dollar, as many analysts expect the US economy and markets to slow down in 2019.

Bloomberg's consensus on the likely outcome of SA's interest rate decision was split in half, with the deciding vote finally leaning towards an increase. Similarly, three of the six monetary policy committee members were against a rate hike and the other three for the hike. In the end, the deciding vote fell on the governor, who increased SA's repurchase (repo) rate by 0.25%. Initially we thought consumers might be spared until January 2019 before they felt another rate increase; remember all our debt (shot and long term) is now more expensive! Our reasoning was simple – prices are stable and the economy is under pressure, so why increase rates? Even the medium-term price outlook is healthy. Inflation will most likely come in at 4.6% in 2018 and 5.4% in 2019. In recent weeks, the rand has been appreciating nicely against the US Dollar which is expected to come under pressure in 2019. Also, oil prices have come down by as much as $20 a barrel, as Libya and the US surprised with greater output. Increasing interest rates, therefore, seems not primarily concerned about inflation but more, it would seem, about international competitiveness. For this reason, we support this bold move by the governor. A slight increase also doesn't take too much away from a demand-constrained economy.

In a world where monetary policy is tightening, it becomes increasingly difficult to keep interest rates low in a small open economy like SA. In recent years the US has been able to continuously increase interest rates, with four more rate hikes expected for 2019. As a result, liquidity has been sucked up from poor and rich countries alike as global investors seek after the higher, less risky returns they earn in the US. As if that wasn't enough, even the EU started making noises about an interest rate increase in 2019. Higher interest rates in these risk-free environments helps to explain why in SA we recently experienced a substantial sell-off of bonds and shares. Increasing interest rates, therefore, is a smart move if you want to remain relevant in the world of investments.

The bottom line: we are still positive about SA's economic and market outlook. The recent changes to interest rates and the ministerial cabinet support our view that the decision makers in SA have changed their strategy towards a "make South Africa great again"-strategy. Although real economic benefits of smart policies take multiple years to come into fruition, the change in sentiment is felt in the short term. Most likely, we will see the JSE jump in the next two years, as positive sentiment forces the earnings-multiple of companies upward in line with the robust growth they continue to produce. So, don't change your long-term strategy now. Keep calm and carry on.

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