ECONOMIC COMMENTARY - By Dr. Francois Stofberg

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EUROPEAN CAPEX AND LOCAL INTEREST RATES

There are not many things that excite an economist too much when it comes to the developed countries of Europe. A shared currency, a reluctance to change, a culture of being too accommodating and enough bureaucratic red tape to cover the globe a few times over, usually mean that all you hear from these countries is more of the same. Nowhere is this more evident than in the reluctance of governments and corporates to spend sufficiently on capital expenditure (capex).

However, unlike Europe's usual muddling around, there seems to be a slow but steady shift in mindset. More recently, the intentions around capex have improved in all developed eurozone countries except for France, where business confidence has also been lagging. During the fourth quarter of 2020, most firms were reluctant to increase capex. But now the share of firms expecting to increase capex has risen to 38% while those who are planning to cut capex has decreased to 30%. Potentially increasing government capex, albeit through infrastructure projects, has also been voiced by European politicians.

The reason this excites me so much is because a productivity-led economy revolves around capex rather than current expenditure. Wealth must first be created through capex before it can be redistributed. And having neglected capex over the last couple of decades resulted in the eurozone falling into a slumber, ruminating on past successes. If these old mindsets can truly be renewed, the developed countries of Europe might just wake from their slumber and add a lot of value to global output.

In a unanimous decision, members of the South African Reserve Bank's (SARB) Monetary Policy Committee (MPC) voted to keep interest rates unchanged at 3.5%. SARB Governor, Lesetja Kganyago, said that the risks to the inflation outlook appear to be balanced but added that their 2021 forecast for inflation increased from 4% to 4.3%.

Strong crop yields have helped to keep food price inflation lower compared to global highs and medical services inflation remains low, an outlook that is likely to be temporary. I believe that the SARB is too concerned about oil prices and their eventual impact on inflation. How we use fuel and how much we have changed because of the COVID-19 pandemic. SARS is also too concerned about a depreciating rand. We maintain our view that the rand should remain around R14.75 levels throughout 2021. Despite a United States (US) dollar that has strengthened unprecedently the rand has remained resilient. Our view is that the US dollar will come under pressure over the next couple of quarters and that growth confidence will continue to shift to the developing world. But I do share their concern about electricity and other administered prices, which remain an upside risk to the inflation trajectory.

The SARB's Quarterly Projection Model (QPM) indicates two rate increases of 25 basis points in the second and fourth quarters of 2021. However, the QPM is only a broad policy guide that changes from meeting to meeting as new data becomes available. Our view is that it will only be necessary to increase interest rates once by 25 basis points. That being said, two increases will not hurt too much. In fact, two increases will help to attract short-term capital to both our equity and bond markets which can aid local investors who have been hurt by a protracted market recession.

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