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ECONOMIC COMMENTARY - By Dr. Francois Stofberg

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MARCH ECONOMICS: SOME NASTIES AND SOME NOT

When March kicked off, we were greeted by a few nasties. OPEC+, the Organization of the Petroleum Exporting Countries, together with Russia, decided to keep oil output unchanged even though global economic recovery was speeding ahead. Owning 50% of global supply and 90% of oil reserves, the decision made by OPEC+ caused oil prices to shoot up to $72 a barrel. As we entered April, oil prices slumped back to $63 a barrel. As usual, the oil coalition was unable to control oil output tightly enough resulting in somewhat of an oversupply. In another familiar trend, other countries, in this case Iran, produced much more than initially anticipated.

With rising commodity prices, talk about higher wages, a decade's worth of monetary stimulus and the recent trillions of fiscal support offered to COVID-19-battered economies as well as fear about higher inflation left global investors worried, especially when long-dated United States (US) yields started to increase rapidly, and rather unexpectedly. What shook investors even more was the expectation that the US Federal Reserve (Fed), amongst others, would have to increase interest rates sooner than expected. However, it turned out that higher yields were most likely pointing towards the good type of inflation somewhere in the distant future: the type of inflation that occurs because an economy is booming, not the type that occurs because an economy is stagnating, although we might see this in some European and African countries. It also does not refer to the type of bad inflation resulting from supply shortages, although we might see this in certain industries, or because of some pricing bubble, like we saw during the 2008/2009 global financial crisis. Even though the Fed announced that the US economy would recover much faster than expected, around 6.5% instead of their December estimate of around 4.6%, they were quick to add that even if inflation breaches their upper limit of 2% this year, they will not increase interest rates too soon or by too much. Market volatility, therefore, eased-off and yields started to slowly stabilise. We are also less concerned about the Fed increasing rates too soon, than we are about the market's reaction to a tapering down of asset purchasing (quantitative easing) programmes. If the 2015 taper-tantrum is anything to go by, we might have a bumpy ride ahead of us.

During March we were also pleased about the South African Reserve Bank's (SARB's) decision to keep the short-term interest rate unchanged at 3.5%, allowing the South African economy a bit more room to recover. Although their Quarterly Projection Model (QPM) indicates that there are likely two interest rate hikes of 0.25% needed for 2021, we believe that they have overshot on some of their important assumptions. For one, the South African economy will, mostly likely, not grow by 3.8% during 2021. Our forecast is that growth will be closer to 2.8%. But more importantly, oil prices should remain subdued and the rand will most likely remain strong even if the US dollar continues to appreciate against other major currencies. Theoretically, when the US dollar appreciates, the rand depreciates. However, in practice, this is not always the case. As we have, once again, seen in recent weeks, the rand appreciated despite the US dollar's strength. Attractive local yields and a relatively cheap market continue to attract short-term capital. Our favourable capital account also helps in the short-term. But, more importantly, political and fiscal stability is starting to separate us from our developing peers. The SARB's inflation outlook might, therefore, be a bit too high. Nevertheless, we still believe that one increase of 0.25% is needed in 2021, but the second increase might best be left for early 2022.

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