ECONOMIC COMMENTARY - By Dr. Francois Stofberg

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US INTEREST RATES AND SOME MORE GOOD NEWS LOCALLY

Last week United States (US) markets closed the week in negative territory: the Dow Jones fell 1.6%, the S&P 500 lost 1.3%, and the Nasdaq fell 0.9%. This came after the US Federal Reserve (Fed) had a much more hawkish outlook than initially anticipated, driven by a faster than expected recovery. Since their last meeting, the Fed has now increased their outlook for US GDP growth from 6.5% to 7% for 2021, and inflation from 3.4% to 4.4%. As we have mentioned in the past, we firmly believe that the Fed will start tapering their quantitative easing programme by the end of this year which will cause a lot of equity market volatility. But it now seems that most analysts expect the Fed to hike interest rates twice in 2023. Some Fed officials even believe that one rate hike by the end of 2021 is possible.

Higher interest rates are not all bad news. The severely depressed levels where we are currently are not sustainable for long-term growth; recall the 2008 global financial crisis or the protracted zombie-like period the Japanese economy was in. The mere expectation of interest rates increasing has already calmed inflation fears. Higher interest rates would also mean that conservative savers who rely on short-term interest rates will not be losing out as much anymore. Just imagine you had to live through 4.6% inflation in the US, whist short-term interest rates were as low as 0.05%. You would earn a guaranteed loss of 4.55% on those investments. Higher interest rates are also good news for the US dollar. Since the Fed's more hawkish tone, the US dollar strengthened considerably against other major currencies. Take the Euro as an example. The USD is now trading $1.18 against the Euro, down from its $1.23 levels just a few weeks ago. Higher interest rates usually mean more attractive yields which in turn attract scarce global capital - which ultimately supports your local currency. It should however be noted that the dollar's current level is a bit stretched. Market uncertainty and a very low level of liquidity during the US summer holiday also had their share in the dollar strengthening more than expected.

So, do not read too much into the rand's current level against the US dollar. It is not sustainable. We will most likely see the rand return to levels closer to R14 in the next couple of months. Unless the capital account of the balance of payments deteriorates quicker than expected because of the recent retracement in commodity prices. Although it seems the Chinese will intervene and use their dominance in the commodity supply chain to stabilise prices. Our rand has been supported heavily by the low levels of demand, which have kept imports constrained. But also, by the high levels of exports, mostly driven by higher commodity prices. As our export and imports start to normalise back to pre-pandemic levels, we will once again move into deficit territory on our current account. This implies that the demand for foreign currency will increase, which in turn will cause our rand to depreciate (considerably, if I might add).

Some good news from South Africa. Our confidence indicators have slowly but surely started their recovery. The SACCI business confidence indicator increased from April 2020's low of 77.8 to 94 in April 2021 and reached 97 in May of this year. I understand they are still far off from the 140-highs we had during South Africa's 2002 to 2007 glory years period. But I maintain that the slow and steady increase is not something to ignore. Just like the news that the ruling party is about to sell a majority share in South African Airways is not something to ignore. By my estimate, all this is pointing towards a slow, but steady U-turn. Away from Zumanomics that all but destroyed this economy, back to Ramaphoria.

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