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ECONOMIC COMMENTARY - By Dr. Francois Stofberg

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PANDEMIC STIMULUS AND INTEREST RATES

Recently published research showed that pandemic stimulus failed in emerging markets. Among the top emerging and developed economies, there is no correlation between the stimulus programmes of 2020 and the strength of the ensuing recovery. The disconnect was, however, the largest among emerging markets. Among emerging markets, those who stimulated aggressively during the pandemic suffered weaker recoveries owing to higher inflation, higher interest rates, higher budget deficits, and in many instances, a depreciating local currency. These countries include Brazil, Hungary, the Philippines, and Greece. Greece was reclassified by most experts in 2013 as an emerging economy after their financial mismanagement.

Two main reasons for this disappointing outcome seem to be pandemic-related. The first reason was supply-chain bottlenecks that prevented economies from running at full capacity. The second reason was the continued fight against the persisting virus. The research showed a strong correlation between economic growth and both lockdowns and vaccines: the stricter the lockdown and the slower the vaccine rollout, the worse the economy performed (something South Africans are all too familiar with). Two factors that prevented emerging markets from increasing spending without unbalancing the economy were the lack of financial resources and institutional credibility.

Research like this helps to guide policy as we easily forget the lessons from our past. In the 1990s, when emerging countries were in a weaker position and unable to spend themselves out of trouble, they were forced to reform their economies. The result was an economic boom in the next decade! But then, flush with cash, emerging economies tried to spend themselves out of trouble after the 2008 financial crisis. Unfortunately, this time it resulted in one of the worst-performing decades on record for emerging economies.

Last week, Jerome Powel, the chairman of the United States (US) Federal Reserve (Fed), conceded that it was time to start tapering back their asset programme without increasing interest rates. Fed policymakers are currently divided between whether they should increase interest rates in 2022 or only in 2023. Those who maintain that interest rates should only be increased in 2023 believe that inflation is transitory, and those supply disruptions will soon abate and reduce inflationary pressures. We are not so convinced… The persistent rise in wages and the persistent nature of short-term inflationary shocks (from supply shortages to global energy prices) mean that prices will most likely remain elevated for longer than we initially expected.

What does a higher interest rate mean for me and you, the consumer? Well, if things go according to our expectations in South Africa, we believe the South African Reserve Bank (SARB) will start to increase interest rates in November 2021, eventually totalling around 1.25% by the end of 2022. This will result in a higher monthly interest payment of R1 042 for each R1 million of debt you have. As mentioned, the rate will not immediately increase by the full 1.25%, though keeping in mind how much interest rates can increase can help guide your budget planning for the year ahead.

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