



I took up my pen as usual on Wednesday morning ahead of the expected SA Reserve Bank announcement of yet another interest rate hike which would, if enacted, inevitably spell further deep hardship throughout the country and, equally, see a further swathe of job losses and small business failures.

And it is all so unnecessary because, within a moribund economy like that of SA, interest rate hikes have little chance of curbing inflation which is largely an imported phenomenon!

I have emphasised that I began writing this on Wednesday morning which is my usual habit because it allows me plenty of time to do the research that is often necessary to provide my readers with appropriate balance. But that means I am sometimes overtaken by events – and in this case a known one because Reserve Bank governor Lesetja Kganyago was scheduled to speak on Thursday ahead of my Friday publication date and that could understandably disarm what I planned to say if he went against expectations and, in the light of news that SA headline inflation has cooled to its lowest reading in 20 months, opted not to increase rates once more.

The consensus of our leading economists is, however, that although the headline inflation decline has brought the numbers back within the Reserve Bank's three to six percent target range, it might not be enough to tame other points of future concern. Issues such as recent public service pay hikes and Russia's ending of the Ukraine grain shipments agreement could pose future pressure points.

The major philosophical issue is, however, that while the science of economics has progressed immensely in the past half-century, many observers still regard it more as alchemy than science because it is governed by some very deeply conflicting belief systems. Meanwhile the poorest of the poor continue to be the victims when economists get things wrong in.

As a financial writer with over a half century experience of the mistakes central banks have frequently made, I am all too aware that there are people...millions of people...going to bed tonight with empty stomachs because of raised interest rates which have cost countless jobs and destroyed many small businesses. Furthermore, it should be self-evident that when an economy is barely moving one can achieve little by pushing harder on the brakes. So my fundamental point is that this week's Reserve Bank decision is arguably irrelevant because it has already been preceded by excessive and, in my view, unnecessarily increased rates which will forever scar millions of poor South Africans!

Today, however, writing ahead of the event provides me with the opportunity to explain the needless hardship South Africans are being subject to by a Reserve Bank which in truth is only doing what it is mandated to do: to **try** to protect the integrity of the Rand by curbing the principal force that *normally* would undermine its value: inflation.

But let us examine interest rates as a tool which is often abused because economics is an imprecise science. As most readers understand, increasing interest rates cuts into the disposable income of ordinary citizens because, as fixed expenses such as their household bond repayments and HP commitments rise in cost, there is an ever-diminishing sum available to spend on everyday items like groceries, trips to the movies and entertainments generally.

The effect is to lessen the total amount of money in circulation within an economy which is fine in the face of "demand pull" inflation where too much money is chasing too few sale items: which is often the case when a central bank has printed more money than normal economic activity warrants. When central banks print excessive money in such circumstances the inevitable consequence is monetary inflation which effectively

reduces the buying power of a currency.....which equally makes it hard for the poor to put bread on the table because bread costs more over time.

Arguably, ordinary folk can adapt to change if it happens slowly....such as with slowly-rising inflation. But interest rate increases are a sudden hammer blow which are really difficult to absorb! In mitigation of bank action, however, we do know that if inflation is not nipped in the bud it often becomes an uncontrollable runaway!

But it is also important to note that currencies lose value for other reasons than inflation although the consequence looks the same. Thus my first graph illustrates how the rand has lost value EVERY YEAR since the ANC came to power at a compound annual average rate of 6 percent.



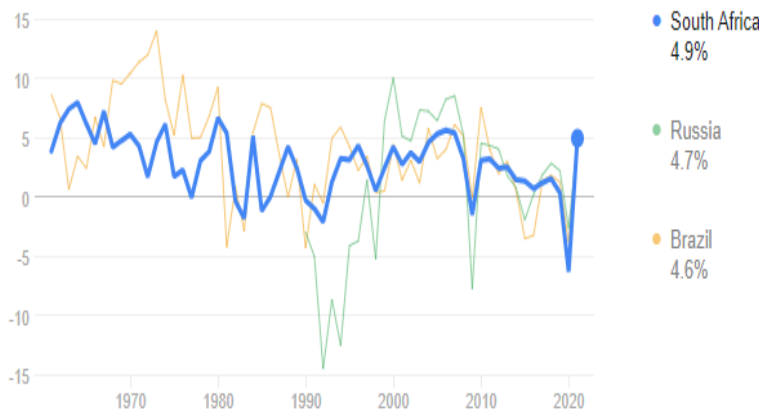
On the day the ANC Government was inaugurated, on May 10 1994, it required 3.608 Rands to buy one US dollar. On May 30 this year in required R19.8672 to buy the same one dollar. So over the past 29 years our money has lost **nearly five sixths of its 1994 value** and since our economy has been in decline for most of that time, inflation had NOT been the sole cause.

In part that steady loss of value can be attributed to the fact that South Africa has tolerated a higher inflation rate than the US has. But it is not the complete explanation. A major factor has been South Africa's declining rate of GDP and an insidious economic phenomenon: the dreaded 'stagflation.'

By effectively taking money out of circulation through the use of interest rate hikes, the Reserve Bank has merely worsened our economic stagnation. Thus, my second graph, courtesy of the World Bank illustrates how South Africa's GDP growth rate has declined during the ANC years; from 3.2 percent annually in 1994 to - 6.3 percent in 2020 and 2 percent last year.



Incidentally, our GDP progress has borne a remarkable similarity to our BRICS partners as the next World Bank graph illustrates. But that is another story for another day, though it does a lot to explain why Vladimir Putin found it necessary to invade the Ukraine.....to perhaps divert the attention of the Russian people from the increasing economic hardship in Russia when most other former Soviet Union countries have been prospering very successful after casting off the shackles of communism.



Now the fact is that inflation is only one way of destroying the buying power of your currency. Leading industrial nations indeed cause it by printing more money than the GDP growth they achieve. But they can fix that by raising interest rates and cooling inflation as the US is now successfully doing.

However, noting that the SA government expenditure accounts for 33 percent of all GDP generated in the country whereas other African countries such as Nigeria take 13.3 percent, the Central African Republic takes 6.9 percent, Congo 7.6 percent, Angola 9.2 percent and Tanzania 17.51 percent, countries like South Africa destroy the value of their currencies by over-taxing their people and then misusing the proceeds. Were that money left in the hands of job-creating entrepreneurs it would unquestionably be put to far more efficient use and, arguably there would be far less need for a monthly dole which is now being paid to two thirds of our population.

Worse, that tax is being drawn from one of the world's smallest tax bases and so our principal job-creators are leaving the country. By discouraging their entrepreneurial class who subsequently emigrate in droves taking both their ability and their money with them and, finally by giving foreign investors the cold shoulder so that they sell up and leave, currencies are also eroded.....by actions which are common to Brazil, Russia and South Africa: all declining economies as the World Bank graph so clearly illustrates!

Indonesia	18.21
Tanzania	17.51
Gabon	16.58
Guinea	15.38
Madagascar	14.11
Ethiopia	13.8
Guatemala	13.54
Nigeria	13.3
Bangladesh	12.97
Equatorial Guinea	12.66
Iran	12.38
Haiti	10.84
Venezuela	10.55
Sudan	9.65

Note: Of 16 leading South African economists polled by Bloomberg in the first half of July, **half** predicted the central bank's monetary policy committee would lift the benchmark interest rate by a quarter percentage point to 8.50%, and the rest forecast a hold on the rate hikes. That's compared with almost two-thirds who expected a pause last month. The MPC has raised the key rate by 475 basis points since it started tightening in November 2021 to rein in inflation that has been above the 4.5% midpoint of its target range, where it prefers to anchor price-growth expectations, for more than two years.

Finally, in explaining why observers like myself frequently indulge in writing ahead of events about which they have no certain knowledge will occur, I need to say this is quite common. It is something old-time newspaper men long ago got used to. Back in the day of hot metal printing when my newspaper used stripped-down sports cars to rush bundles of newspapers to readers in remote areas of Northern Zululand and even a Dragon Rapide biplane to fly them into the vastnesses of Lesotho and the Transkei, the early printing deadlines to facilitate that required that I, for instance, every morning used to write a stock exchange report about trading activity which was yet to take place several hours later.... and only once or twice got it wrong. Our resort in such instances was to go into the works with a hammer and chisel to bash out an offending word or two directly off printing plates already bolted onto the presses.

It did not end in the 'Finance Department' which I edited at the time. Sports writers wrote dual commentaries anticipating rugby matches in which both sides won and lost so that at the last minute they could remove the wrong passages. They did the same thing about horse races and all manner of other events.....and most importantly that approach taught us to think objectively about events: what outcomes would be in either scenario and that is how we were later able to become editorial writers and newspaper editors: because we thus learned about balance!

The month ahead:

New York's SP500: I correctly predicted continued gains and I expect it to last until early September.

Nasdaq: I correctly warned the gains were peaking today with declines likely to the first week of September before the up-trend resumes.

London's Footsie: I correctly predicted a fortnight of gains that would precede another loss. Now I see an extremely volatile but declining period until the end of August followed by gains until mid October.

France's Cac 40: I correctly predicted a short recovery within a longer-term declining trend set to last well into the New Year.

Hong Kong's Hangsen: I correctly predicted the start of a recovery from July 10 which appears likely to last until late November.

Japan's Nikkei: I correctly warned of considerable volatility within a modestly rising medium-term trend to the end of the year.

Australia's All Ordinaries: I correctly predicted a brief recovery which I expect to last until the 27th followed by a drop to August 8 and then fresh gains to the 23rd ahead of two months of declines.

JSE Top 40 Index: I correctly warned that the gains would be brief and now the decline is returning with weakness until the end of October.

ShareFinder JSE Blue Chip Index: I correctly predicted a brief bounce followed by a volatile slightly declining trend to the end of August ahead of protracted gains until well into the New Year.

Rand/Dollar: I correctly predicted continued gains until next March.

Rand/Euro: I correctly predicted a gain. Now I see a brief weakness to the end of the month within an overall long-term recovery lasting until March.

The Predicts accuracy rate on a running average basis since January 2001 has been 86.94 percent. For the past 12 months it has been 91.67 percent.

Why rate hikes are the wrong weapon

BY GRAHAM BARR AND BRIAN KANTOR

The Reserve Bank persists in arguing that its interest hike will benefit the South African economy, and hence society in general, because it will bring down the rate of inflation.

The Bank accepts that the hike will have the undesirable short-term effect of limiting growth but maintains that in the longer term it is “worth it” because of the positive economic impact of lower rates of inflation and, it stresses, lower *expected* rates of inflation.

The Bank is referring to consumer price headline inflation, which covers all consumer goods in the economy. It is this measure of inflation that the Bank targets with monetary policy, using a target range of between 3% and 6%.

The Bank takes it as a given that inflation is particularly bad for the economy at this time of low growth and rand weakness. In fact, so bad that it is worth damping down growth further to hold back the rate of inflation.

In reality, the problem with inflation is the *uncertainty* attached to rising prices, rather than the rising prices themselves. If all prices and wages rose at a predictable rate, it would have very little impact on an economy as business and consumers could plan for the future. Business would know that their input costs and selling prices would rise together, and consumers would know that their wages and the prices of goods they purchased would rise together.

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This of course is not the case, and price rises in South Africa are unpredictable because they are mainly influenced by the rand exchange rate which, itself, is very unpredictable. What’s more, the higher the rate of inflation, the higher the variability of that inflation and the higher the levels of associated price uncertainty for business and consumers, as future prices become increasingly unpredictable.

What we mean by higher variability is this: larger things have more measured variability than smaller things (same units assumed). So if inflation was really high from year to year, say in the region of 50%, then it would probably be swinging mainly between 40% and 60%. In other words, a businessperson would be facing these wild swings of 20 percentage points in prices for inputs and items they sell. That is a real problem.

If, however, inflation was generally low at about 3%, then it might be swinging between 2.5% and 3.5%. In other words, the businessperson is only dealing with a 1 percentage point swing, which wouldn’t be a huge problem.

Therefore, high rates of inflation tend to dampen growth because of this added uncertainty and the resulting difficulty for future planning.

In the case of South Africa — a small, open economy — price changes are particularly difficult to forecast and have proved volatile in the past. This is because most price changes are closely correlated with the rand exchange rate, which is subject to a backdrop of supply-side shocks, including high levels of load-shedding, disintegrating infrastructure and an often dysfunctional government.

Reflecting this weakness and instability, our sovereign risk has risen, leading to a sharply weakening currency over the past six months, and very low and inadequate growth rates in an economy with 33% unemployment.

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Strangely, in the face of this economic crisis, the Bank's playbook sounds more like something from the US Federal Reserve than from Pretoria.

Bank governor Lesetja Kganyago said in a recent address to the American Chamber of Commerce: "Our primary goal as a central bank is to anchor inflation expectations and to reduce the extent to which higher inflation does spill over into pricing behaviour in the following year. Our role as central banks is to keep inflation expectations anchored to prevent wage spirals from generating permanently higher inflation."

Managing inflationary expectations may be a focus of the US or European central banks, but it is curious why it is the primary goal of their South African counterpart.

In fact, we may easily extract inflationary expectations (as perceived in the market) as the difference between the yields on inflation-linked and fixed-rate RSA government bonds. These inflationary expectations closely track the movements in the rand/\$ exchange rate over time. Actual measured inflation also follows the rand/\$ closely, but with a lag of between three and six months.

Critically, neither inflation expectations nor inflation itself are consistently related to short-term interest rates, the tool used by the Bank to implement monetary policy. The overwhelming determinant of South Africa's rate of inflation is the exchange rate. So while inflationary expectations may constitute an input into, say, public sector wage bargaining, they constitute a misconstrued focus for the Bank.

By raising interest rates in a depressed economy already facing higher prices and depressed demand, the Bank has achieved little beyond crushing any residual growth prospects. This might be appropriate for an overheating economy with full employment in North America or the EU, but is entirely inappropriate for South Africa's situation now.

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