Hawkish monetary policy takes its toll on GDP

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For the past two years, the South African economy has been suffering from a demand deficiency, which has become more pronounced during 2019 and constitutes one of the key reasons for real GDP growth having stopped in its tracks.

Third quarter GDP data released by Stats SA during the first week of December confirms the continued lethargy of the economy, with year-on-year growth of virtually zero (in real terms).

The depth of the Reserve Bank's ignorance of the economic realities of South Africa was aptly illustrated at the end of November when one of its deputy governor's stated that: "Cutting interest rates is not a remedy for the country's economic woes".

From a short-term perspective, exactly the opposite is true. Lower interest rates will automatically lead to a decline in the cost of credit and the cost of capital, thereby stimulating capital formation and household consumption expenditure, which account for 78% of South Africa's GDP.

It defies comprehension that the monetary policy committee (MPC) of the Reserve Bank has not been able to grasp the error of its ways and provide much-needed stimulus to consumers and businesses alike.

Cost of capital up by 100%

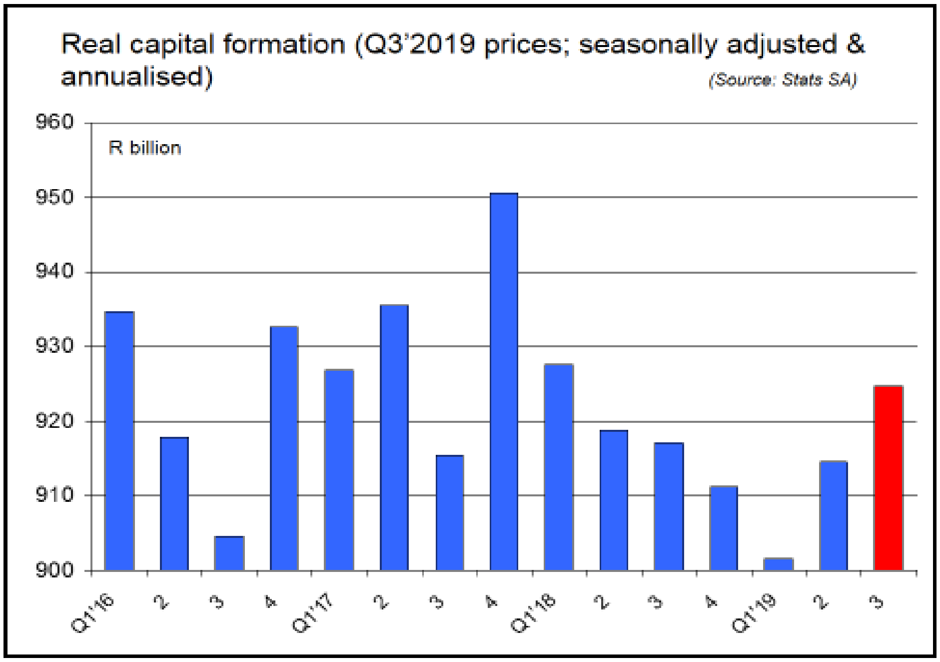
Ever since the retirement of Gill Marcus, the previous governor of the Reserve Bank, the real prime overdraft rate has increased from an average of 3% to the current level of above 6%. This represents an astounding increase in the cost of capital (and of credit) of more than 100%.

After almost a decade of public administration characterised by nepotism, incompetence, corruption and fraud, Pres. Cyril Ramaphosa inherited a dire fiscal situation from his predecessor. Higher demand will automatically lead to higher economic growth and increased taxation revenues, thereby relieving pressure on government's budget deficit (as a percentage of GDP).

Few, if any economists in the country will argue against the statement that higher economic growth and employment creation constitute the country's overriding policy priorities - also from the perspective of combating inequality.

The MPC has run out of excuses for its apparent obsession with trying to secure ultra-low inflation, whilst a number of key data sets confirm the absurdity of some of its arguments. Two of them are the country's long-term bond yield, which is 74 basis points lower than a year ago, and the rand exchange rate, which is 15% stronger against the US dollar than at the beginning of 2016.

Fortunately, the latest GDP figures were not all doom and gloom. The past two quarters have witnessed an increase in capital formation of more than 18%, in real terms, compared to the previous two quarters.



Current investment in new productive capacity, including infrastructure, exhibits an exceptionally strong positive correlation with future GDP, subject to a time lag that varies from sector to sector.

The Development Bank of Southern Africa (DBSA) has announced that a project pipeline valued at more than R700-billion had already been identified by the new Infrastructure Fund. Pres. Ramaphosa announced the formation of the Fund in 2018, which has been created to raise funding from both the public and private sectors in an attempt to reduce the country's infrastructure backlog and to contribute to the quest for higher economic growth.

New investment in productive capacity is a key component of Pres. Ramaphosa's new Economic Stimulus and Recovery Plan. It is high time for the MPC to start supporting this plan and to make a deep cut into money market rates.