The year ahead, a local economic update

By Tendani Mantshimuli

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Indicators to watch in the year ahead include; a possible global recession, rand and rising prices and what will happen to interest rates.

A possible global recession

Economic performance in 2012 is not expected to be much of an improvement on what we experienced in 2011. Global economic developments will still have a major impact on the domestic economy. As it doesn't look like the European economy will strengthen in a meaningful way, the OECD [1] is even forecasting a mild recession.

Also, the US sovereign debt problems have not been resolved. As 2012 is an election year, it might actually make resolutions more difficult to reach.

These developments might lead to a very bleak global economic outlook, which will result in our growth remaining weak. Consequently, we cannot hope to see our exports faring well, which will have an impact on manufacturing performance in the year. As things stand now there is no indication that the SA economy might slide into a recession in 2012, but this is dependent on events outside of this country.

The rand and rising prices

The strength of the rand will be another thing to watch out for. A significant deterioration in the rand will have a negative influence on inflation developments.

International food prices and higher petrol prices are partly behind inflation being over the upper target band. While oil prices are high they haven't been increasing steeply, so most of the increases we've seen in petrol prices were related to the weak rand. The weakness of the rand recently has been related to risk aversion and investors selling off emerging-market assets as a result of euro-zone problems, not a result of SA economic fundamentals. Administered prices [2] will still continue to pose an upward risk to inflation. Eskom will be adding another tranche of the higher tariffs they requested from the energy regulator to finance power stations. These are mainly cost-push pressures, in other words created by the supplier rather than consumer demand, so an increase in interest rates would not be very effective against this type of inflation.

A concern for the SARB [3] will be if these price increases feed into expectations of higher salaries, which will then influence wage negotiations - and so the spiral in price increases will become generalised throughout the economy.

What will happen to interest rates?

2012 will be a year of increasing inflation and weak economic growth, at least for the first half of the year. This will make the SARB's job a bit tricky. Reading between the lines it is clear that price stability remains the primary focus of the bank. The bank is right to focus on inflation because higher prices affect everyone negatively, particularly low income earners; the rands you have at the beginning of the year should be able to buy more or less the same number of goods at the end of the year.

Currently, the inflation rate for lower-income earners is 7.8 percent, well above the national average. The bank will have to fulfil its mandate of maintaining price stability while monitoring global economic developments and the potential impact on the domestic economy. This was made clear in the MPC [4] statement. The MPC is aware of the dangers of the worsening euro area crisis, and its possible effects on the global and domestic economy and on inflation. Should the need arise, the MPC will act and could even cut rates.

References:

1. Organisation for Economic Co-operation and Development (OECD)
2. Utility costs set by government like electricity, tolls, water and rates
3. South African Reserve Bank
4. Monetary Policy Committee

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