ECONOMIC EXPRESS

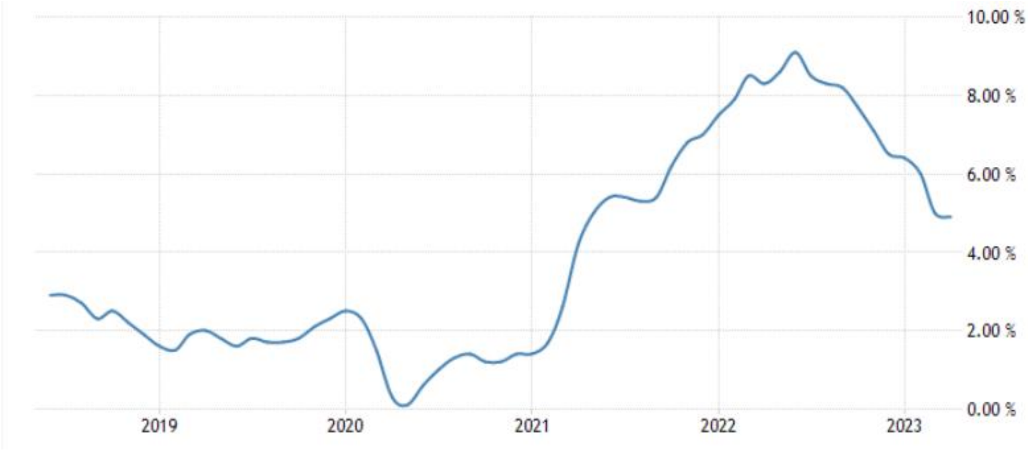
MAY 2023

Global financial markets saw some weakness come through in May. The US debt ceiling negotiations weighed on short term sentiment however discussions were close to a resolution into month end. As global inflation remains elevated and growth more resilient than expected, it became more evident that monetary policy could remain restrictive for longer than expected.

The month started with the US Federal Reserve (US Fed) hiking rates by 0.25% to bring the new Fed Funds range to 5%-5.25%. It was the central bank's tenth increase since it started hiking rates in March last year, bringing interest rates to the highest level since before the Global Financial Crises in 2007. The statement released gave the impression that the Fed will look to pause the current rate hikes to assess what the impact of the tighter monetary policy and credit conditions have been on inflation and economic growth. In the press conference, Chairman Powell stressed that if inflation did not decidedly ease, that rate hikes would need to be raised further. It is also important to note that the US Fed is not implying a reduction of rates into year-end but rather keeping interest rates at current levels, while they assess if inflation is meaningfully moving towards the 2% target.

Inflation remained a significant market driver given its importance in determining the extent to which central banks will need to tighten monetary policy further. US inflation has been coming down steadily over the past year, declining 4.2% from its peak in June last year at 9.1%. The problem remains however, that even with the significant easing of price pressures, inflation remains at 4.9%, well above the 2% target. The most recent release was slightly better than expectations reaffirming the markets outlook that the US Fed will choose not to hike at their next meeting in June.

Figure 1: US Inflation Rate

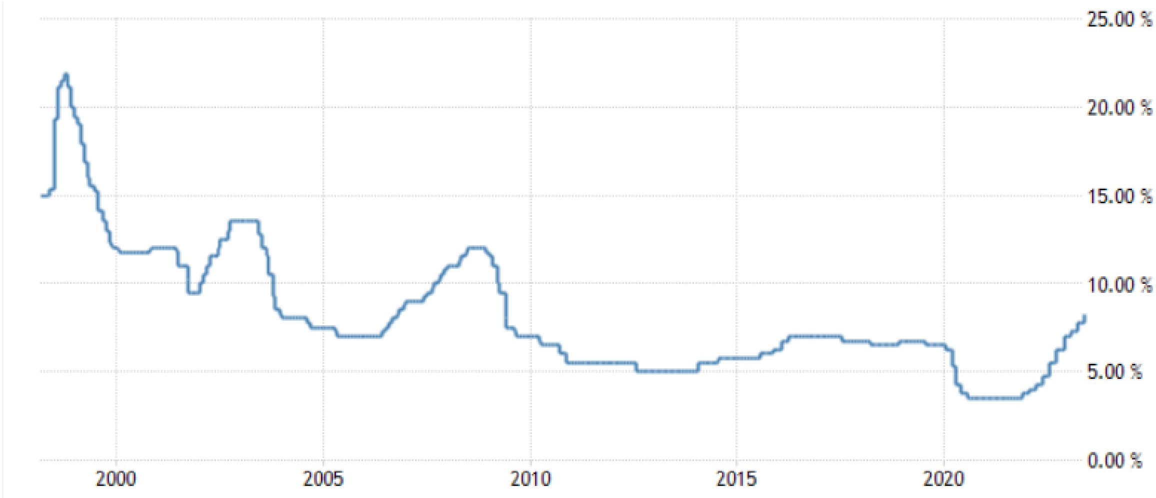


Source: US Bureau of Labor Statistics, www.tradingeconomics.com

Early in the month, the allegations by the US ambassador that South Africa had secretly supplied arms and ammunition to Russia, drove significant risk off sentiment in local markets. Local assets saw a significant loss in value as the market started pricing in the consequences of sanctions or the removal of South Africa from the preferential trade agreement, AGOA (African Growth and Opportunities Act) with the US. The South African government denied the allegations and responded with an inquiry into the matter which did little to ease market concerns. This could be put down to other factors driving South Africa's risk premium higher such as the intensifying power crisis where the possibility of a grid collapse increased the compensation demanded by investors.

At the May Monetary Policy Committee (MPC) meeting that was held in the second half of the month, the SARB voted to increase the repo rate by a further 0.50% to bring it to 8.25%. It was the tenth consecutive increase since the rate hiking cycle started, to increase the repo rate by 4.75%, leaving it at the highest level since May 2009.

Figure 2: South African Repo Rate



Source: South African Reserve Bank, www.tradingeconomics.com

While the 0.50% rate hike was unanimous and widely expected, the statement following the announcement that the currency could weaken further "given upside inflation risks, larger domestic and external financing needs, and load shedding" led to the rand depreciating significantly on the day. The MPC consider the current policy to be restrictive which gives the indication that they see interest rates nearing their peak, however, later they clarified that this does not keep them from moving policy to be more restrictive if required.

The 0.50% increase in interest rates came despite the headline inflation rate falling more than what was expected by the market as it declined from 7.1% to 6.8%, relative to the expectation of 7%. The decline was predominantly driven by the easing of fuel prices and encouragingly food price increases are waning. Falling fuel prices are expected to help headline inflation return into the 3% to 6% inflation target range in the second half of this year, however inflation risks remain to the upside given the weak currency, excessive loadshedding and increasing administered prices - all adding upward pressure to prices.

Index	Asset Class	MAY 2023
STEFI Composite Index	Local Cash	0.65%
FTSE/JSE All Bond (Total Return)	Local Bonds	-4.79%
FTSE/JSE SA Listed Property (Total Return)	Local Property	-5.32%
FTSE/JSE Africa All Share (Total Return)	Local Equities	-3.92%
JP Morgan World Govt Bond index (USD)	Global Bonds	-2.15%
FTSE EPRA/NAREIT Global Index (USD)	Global Property	-3.76%
MSCI AC World (USD)	Global Equities	-1.00%

Source: Morningstar

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