

# Interconnected fortunes: US policies and their broad impact on South Africa's economy



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*This article delves into the significant influence of the United States fiscal and monetary policies on commodity prices and the consequent impact on South Africa's crucial mining sector and the broader economy. South Africa is a bastion of diverse economic activities rooted deeply in mining, agriculture, and tourism, and its economic narrative has been resilient and adaptable to various global and local challenges. The piece explores how the fluctuations in the U.S. money supply have historically correlated with shifts in commodity prices, shedding light on a critical aspect that directly affects the profitability and sustainability of South Africa's mining industry.*

## Overview of South Africa's economic landscape

South Africa's economy, with its deep historical roots in mining, agriculture, and tourism, showcases a rich tapestry of strengths that have evolved over the years. From the discovery of diamonds and gold in the 19th century, which positioned it as a global mining giant, to its modern advancements in technology and finance, South Africa has demonstrated remarkable resilience and adaptability. The country's diversified economy now also thrives on agriculture, which benefits from fertile lands, and a booming tourism sector, celebrated for its breathtaking landscapes and cultural heritage.

## The mining sector: a cornerstone of South Africa's economy

At the heart of its economic prowess, the mining industry remains vital, contributing significantly to GDP and employment. However, this sector's fortunes remain closely tied to the impact of United States monetary and fiscal policies. The strength of the U.S. dollar, along with U.S. interest rates, significantly influences commodity prices and, consequently, the profitability of South Africa's mining exports. This dependency underscores the interconnectedness of global economies, highlighting the importance of strategic economic planning and international cooperation for South Africa's sustained growth and prosperity.

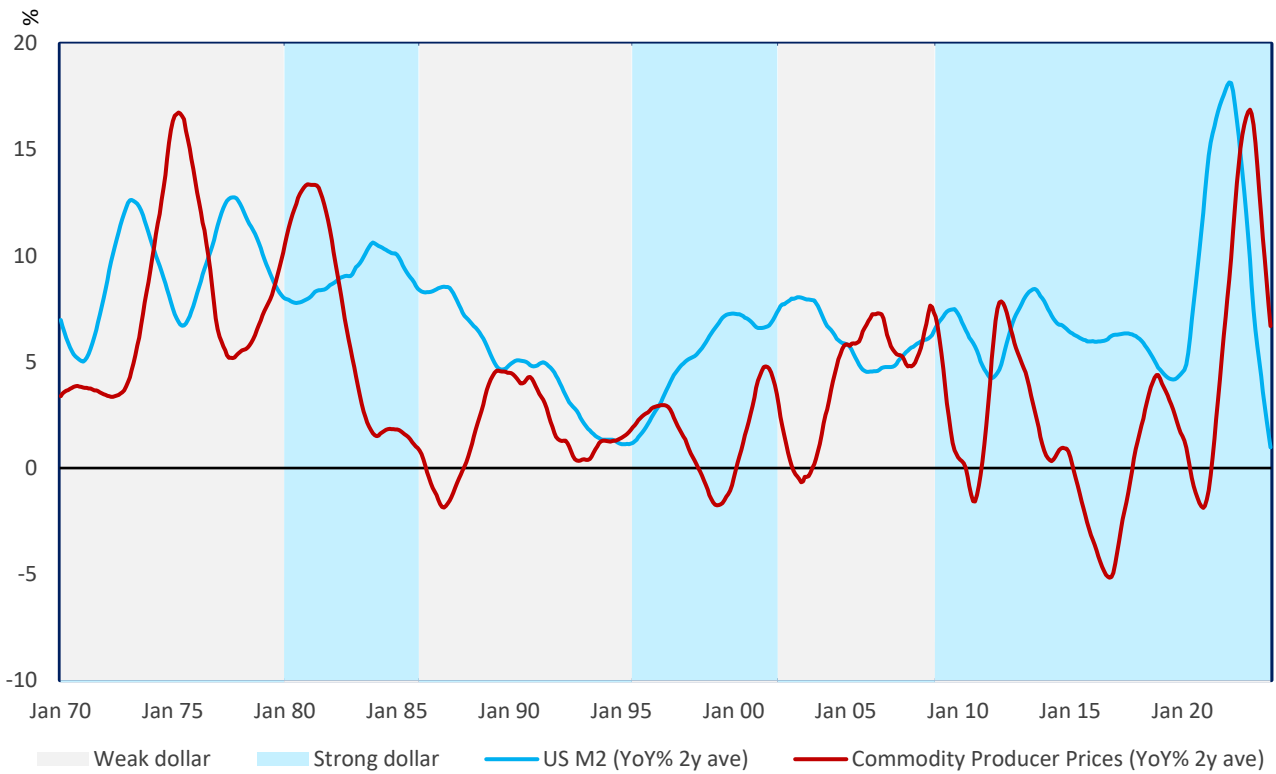
## Analysing the impact of U.S. monetary policy on South African Mining

The chart that follows highlights the link between the U.S. M2 money supply and commodity prices, outlining significant patterns:

1. Periods of increased money supply, such as during the 1970s and the Covid crisis, are followed by surges in commodity prices,
2. A slower expansion of money supply, observed from the 1980s to 2000, is associated with moribund and volatile commodity prices, and
3. The strength or weakness of the dollar has an inverse effect on the demand for commodities and consequently prices.

These observations offer valuable perspectives on the potential direction of the local mining industry.

Chart 3: Influencing SA's economy: US M2 and commodity prices



Source: Federal Reserve, dated as at: 31 Jan 2024

**Global economic repercussions and South Africa's mining outlook**

Global markets are still grappling with the extensive impact of the monetary and fiscal policy response to the Covid crisis, with South Africa's mining sector experiencing significant effects. Initially, the Federal Reserve responded by cutting interest rates to historically low levels, embarking on massive asset purchases, and the Treasury ramped up its spending. These actions led to an unprecedented increase in money supply, naturally driving a sharp rise in commodity and general asset prices. As a result, inflation in the United States surged to 9.2%, compelling the Fed to undertake corrective action by aggressively raising interest rates in March 2022 and balance sheet reductions in June 2022.

**The Fed's response to inflation and its effect on commodity prices**

Twenty-three months into these adjustments, the Fed Funds rate has risen from 0.25% to 5.5%, and the Fed has trimmed its balance sheet from \$9 trillion to \$7.7 trillion. Despite the ongoing pressures from sustained government spending, which saw the deficit increase from \$1.38 trillion to \$1.7 trillion over the past year, the Federal Reserve's measures have led to a significant reduction in the money supply, resulting in downward pressure on commodity prices.

**Future monetary policy trends and their implications for South Africa**

Consequently, inflation has moderated below the Fed Funds rate and closer to the 2% target, allowing the Federal Reserve to consider reducing rates. While opinions on when these cuts will occur differ, recent estimates suggest that there will be three rate cuts by the end of the year, beginning in the latter half of 2024. Furthermore, the Fed plans to continue reducing its balance sheet by approximately \$90 billion per month, resulting in an end-of-year target of around \$6.8 trillion and bringing a close to this round of quantitative tightening.

Meanwhile, U.S. government spending is on an upward trajectory, with projections indicating that the budget deficit of 6%-to-GDP won't narrow for the foreseeable future.

Amid the prevailing monetary policy dynamics, the economy remains stable, indicated by low unemployment (3.7% in December) and moderating inflation (3.1% in January). The Fed remains confident in its ability to sidestep a recession.

Significantly, after persistent declines in M2 since April 2022, the money supply has started to increase again. This dynamic coincided with a recent low in oil prices and other commodities, which have since risen.

The convergence of three key factors, the peak of interest rates, the foreseeable conclusion of quantitative tightening, and the positive shift in money supply after a 16-month downturn present a hint of optimism that commodity prices might be stabilising, suggesting the bulk of declines are in the past.

### Challenges and prospects for South Africa's mining industry

Despite the potential for future improvements in commodity prices, South African mining companies continue to grapple with a host of enduring challenges, marking a critical period for the sector and spotlighting Gwede Mantashe's pivotal role.

### The critical role of government leadership in mining sector stability

The landscape is fraught with regulatory uncertainties, infrastructure inadequacies, and strained labour relations, severely testing the sector's resilience and adaptability. These issues, compounded by the imperative for environmental sustainability and the impacts of global economic shifts and currency volatility, demand strategic foresight and robust solutions.

The guidance of the Minister of Mineral Resources and Energy is pivotal in navigating the industry through its challenges, ensuring not only the preservation of its legacy but also fostering the expansion and progress of broader sectors. Without proactive and supportive national government input into this sector, South Africa could miss out on any improvement in a somewhat stressed commodity cycle.

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