

Steady as she goes

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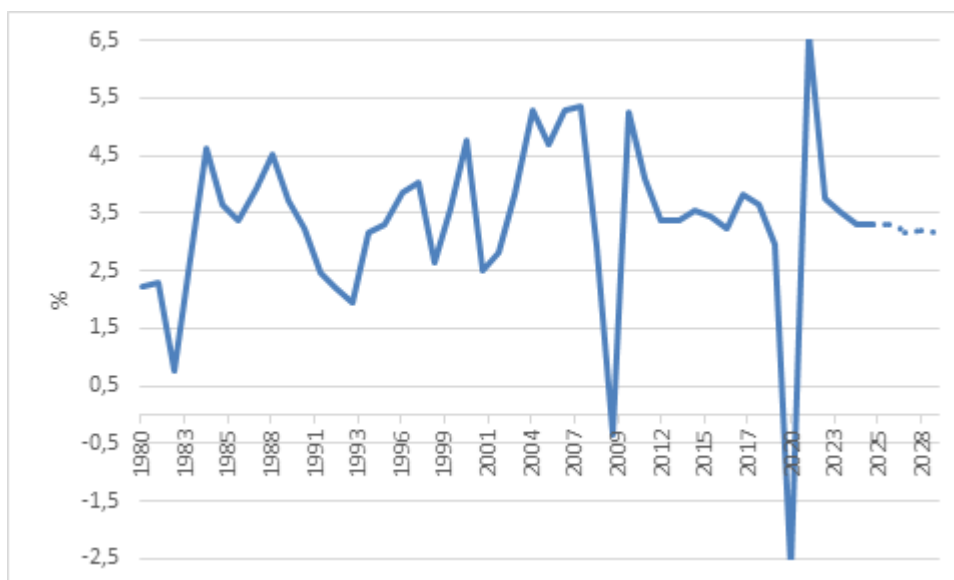
A lot can change in a year. Eleven central banks cut interest rates in January 2025, while only one did so in January 2026. Last week central banks in Canada, South Africa and the US left policy rates unchanged. The global rate-cutting cycle is running out of steam, though there will still be cuts here and there. Is this good news or bad news?

Those who want to see lower interest rates at all costs, including the current occupant of the White House, will see it as bad news. However, since it largely reflects a stabilisation of the growth outlook it is positive.

Though the global cutting cycle that started around 2023 was initially due to a decline in inflation, many central banks accelerated rate reductions last year in the wake of the sharp increase in US trade tariffs and their associated risks to economic activity. Fortunately, and somewhat surprisingly, the impact of these tariffs has been muted, and global economic growth has remained steady. Most countries did not retaliate to US tariffs and effective tariff rates ended up lower than headline levels, meaning that global trade did not suffer a serious blow. There were also other important factors that supported global growth, including a lower oil price, loose fiscal policy, and the artificial intelligence boom. Judging by the latest guidance from the likes of Meta and Microsoft last week, the AI capex frenzy shows no sign of slowing down.

Overall, global growth has been resilient despite all the uncertainties and unknowns. The International Monetary Fund's army of economists recently forecast growth of 3.3% this year, in line with the long-term average. Steady, if unexciting.

Chart 1: IMF Global Growth



Source: LSEG Datastream

Dollar down

An important factor behind the global rate-cutting cycle last year was the behaviour of the US dollar. Typically, when there is a shock to the global system, the dollar rallies. This immediately puts central banks in some countries in a bind. They want to respond

to the shock by easing rates and providing liquidity to domestic markets, but they cannot do so as their currencies fall sharply, risking inflation and disorderly capital flight. At the extreme, central banks in some of these developing countries are forced to increase interest rates to attract or retain scarce capital.

Last year's April 2nd "Liberation Day" tariff announcements were a shock to financial markets. Emerging market currencies also wobbled, but because the dollar fell against other hard currencies, stabilisation was relatively quick. The rand, for instance, slumped from R18.39/\$ to R19.89/\$, but recovered those losses within a month. By the end of May, the Reserve Bank lowered the repo rate at a scheduled meeting, days after Indonesia, Sri Lanka, Egypt and Mexico did the same.

Chart 2: Trade-weighted dollar index



Source: LSEG Datastream

The dollar was initially expected to rally in 2025 based on the stated agenda of the incoming Trump administration. However, the implementation of that agenda, including the tariffs, was so chaotic and extreme that it seriously undermined confidence in US macro policy and its standing as a trusted partner globally. The dollar's decline reflected this. This year has seen renewed weakness following the Greenland incident, among others. The greenback remained under pressure despite the Treasury Secretary (finance minister) last week repeating the decades-long statement that the US has a "strong dollar policy". Perhaps this is because investors know that key figures in Trump's inner circle have at times complained about the dollar being too strong, hurting export competitiveness and leading to a flood of imports.

Hawkish, but no lift

The outcome of the Federal Reserve's interest rate decision last week also wasn't enough to lift the dollar. The Fed statement upgraded its assessment of economic activity from "moderate" to "solid", noted improved labour market conditions as well as "somewhat elevated" inflation. This not only led to an unchanged interest rate stance but also implies a fairly high bar to rate cuts in the coming months, which should have supported the dollar. It was only when the nomination of Kevin Warsh as the new Fed chair was announced on Friday that the dollar firmed somewhat. Warsh was a known hawk in his

previous stint at the Fed more than a decade ago, pushing for tighter policy. However, more recently he has argued that a technology-led productivity boom will keep a lid on inflation and that rates could be lower. It seems unlikely that Trump would have nominated Warsh if he didn't expect him to be dovish. We'll have to see how this plays out.

Self-fulfilling

To be clear, a weaker dollar is not the same as de-dollarisation. The former relates to its value in foreign exchange markets relative to other currencies, while the latter refers to a process whereby the dollar is used less often in daily commercial or financial life and/or by official bodies like reserve managers. There have been notable cycles in the past where the dollar weakened without resulting in de-dollarisation (such as the early 2000s) and where the dollar strengthened without an obvious change in its status as reserve currency (notably from 2013 onwards).

These cycles have been long, lasting several years. One reason is that a weaker currency can become self-fulfilling. If investors expect the currency to fall, eroding their returns, they reduce or hedge their exposure. This, in turn, causes the currency to weaken, prompting further hedging, creating a self-reinforcing cycle. This cycle, one which we've often seen with the rand, can continue until the currency becomes too cheap to ignore or interest rate differences become large enough to override sentiment, or some other shock short-circuits the process.

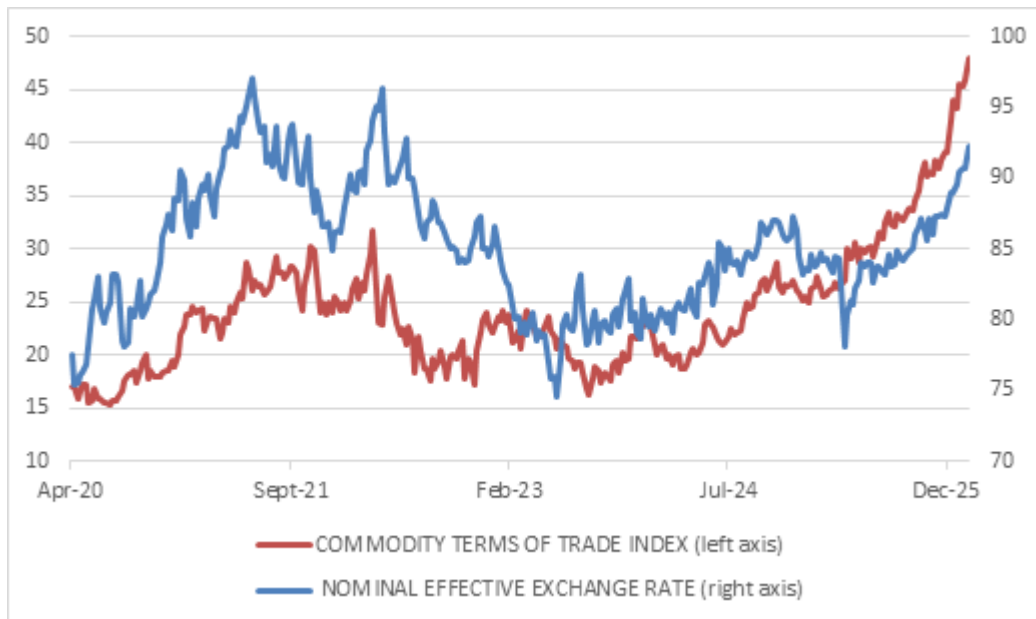
Bullion bulls

The big winner has been gold. A weaker dollar has tended to coincide with higher commodity prices, but the current bullion bull market seems to go beyond that traditional relationship. The world is running out of safe havens as each large currency has deep flaws and public debt levels keep rising. Therefore, more investors are turning to gold, which has captivated humans for 5 000 years. The gold market is also relatively small, meaning that even modest allocations by large reserve managers and institutional investors can make a difference. However, there is also clearly a lot of retail money pouring into the gold market and many speculators hoping for a quick buck. This makes it vulnerable to a pullback, and indeed the gold price fell sharply on Friday following the Warsh news. As a rule of thumb, anything that can double in 12 months can also halve in six, though Warsh's candidacy alone will not result in a gold collapse.

The last two bull markets, in the late 1976 to 1980 and 2008 to 2012, were ultimately undone by big shifts in Fed policy. In 1980, Fed Chair Paul Volcker hiked interest rates dramatically to curb inflation, while in 2013 the Fed began scaling back its quantitative easing policy causing the "Taper Tantrum", and ultimately starting to normalise rates in 2015. Therefore, volatility aside, the biggest risk to the current record-breaking gold rally is probably that investors start positioning for a Fed hiking cycle, which will probably only happen if growth accelerates and results in rising inflation. This seems unlikely for now.

With the surge in gold and other precious metals prices, South Africa's terms of trade (export prices relative to import prices) increased sharply. In very simple terms, it means more money will flow into the country than out, supporting the currency. This, in turn, will put some downward pressure on domestic inflation.

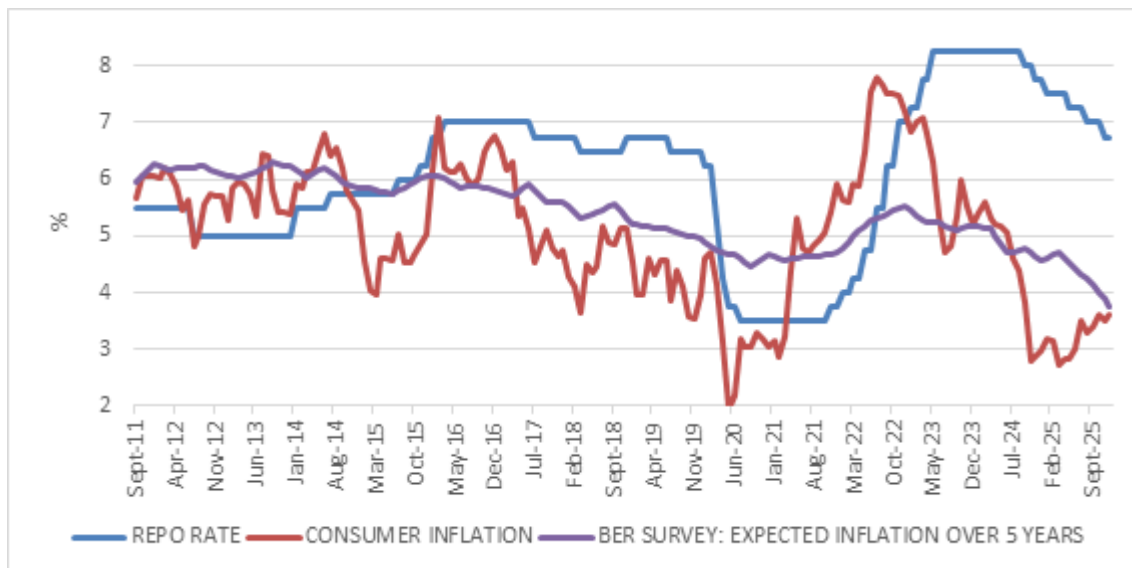
Chart 3: Terms of trade and trade-weighted rand index



Source: Citi via LSEG Datastream

Despite this, the South African Reserve Bank’s Monetary Policy Committee (MPC) kept the repo rate unchanged last week. This was expected, as the central bank navigates the shift to a lower inflation target. Four committee members were in favour of this outcome, with two preferring a -25-basis point cut. The MPC is still likely to reduce rates two or three times this year but is proceeding cautiously amid a very uncertain global environment, as evidenced by Friday’s big market moves.

Chart 4: SA rate and inflation



Source: Stats SA, SA Reserve Bank, Bureau for Economic Research

The Reserve Bank’s growth forecasts also point to medium-term acceleration, implying no great urgency in easing borrowing costs further. It estimates growth of 1.4% in 2026 and 1.9% 2027.

It lowered the inflation outlook for 2026 from 3.5% to 3.3% as it expects that the December print of 3.6% was the peak. By late 2027, inflation should be very close to the 3% target, but it will be within the 1% tolerance band around the target over the whole forecast period. This will be the case even under an adverse shock it modelled in which the rand weakens and the oil price jumps, an entirely possible scenario given the current sabre rattling in the Persian Gulf.

This still implies that rates will gradually decline towards 6%, which is the Reserve Bank's estimate of a neutral interest rate, the rate that is neither tight nor loose.

The pace of the decline will depend on how the global outlook and domestic dynamics evolve, but the base case is for lower rates, supported by a rand that is stable or firmer against the dollar. The path of the dollar will clearly be key, as will precious metals and energy prices. On the local front, an important factor will be whether inflation expectations anchor closer to 3%. The Bureau for Economic Research's quarterly survey showed that South Africans' expectation for inflation over the next 2 to 5 years declined to 3.7% late last year, the lowest level yet. This is important progress towards sustainable lower inflation, but the Reserve Bank will want to see further progress.

The broader investment implications of this base case scenario are largely positive. Two negatives would be lower cash returns and a drag on offshore and rand-hedge investments. These headwinds will impact highly concentrated portfolios, but diversified portfolios should benefit from gains elsewhere as lower interest rates support valuations of bonds and domestically-focused shares. However, markets don't move in straight lines and volatility and pullbacks should be expected, particularly in such an uncertain international landscape. As always, patience and a steady hand will serve investors well.