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Op-ed

RECORD HIGH INTEREST RATES – A SELF-INFLICTED ECONOMIC BLOW

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The inability of the South African economy to even remotely grow at rates commensurate with its potential output since the initial recovery from the Covid-19 pandemic has been a source of frustration amongst business leaders and economic policy makers. In recent years a low rate of economic growth has been responsible for an ever-increasing unemployment rate, which is the highest of any of the advanced economies (AEs) and emerging market and developing economies (EMDEs).

It is acknowledged that low growth has been caused by many factors, including excessive regulation of economic activity, government's apparent inflexibility apropos its ideological objectives at the expense of economic expediency, the decay of infrastructure during the era of state capture, widespread corruption and the dysfunctionality of dozens of municipalities.

However, there is also growing consensus among economists and business leaders that restrictive monetary policy has to shoulder much of the blame for the fairly dramatic downturn in the GDP growth rate since the normalisation of economic activity after the Covid-19 pandemic.

It should be pointed out that South Africa managed to record an average annualised GDP growth rate of 2.4% between the third quarter of 2021 and the third quarter of 2022, just before the Monetary Policy Committee (MPC) of the South African Reserve Bank (SARB) decided to start raising the benchmark lending rate (via the repo rate) to its highest level in 14 years, despite the absence of any sign of demand-induced inflation. Since then, real annualised GDP growth has slumped to between zero and one percent and the broadly defined number of unemployed people has increased to 11.6 million.

By the time that millions of indebted South Africans were under financial stress because of an increase of close to 40% in the ratio of debt service costs to disposable income, it had become clear that the MPC had made a grave error in virtually replicating a policy approach suited for US circumstances. In its effort to tame higher inflation caused almost exclusively by the unheard-of increases of around 700% in maritime freight charges and a 400% increase in the oil price, the central bank deliberately set the country on a path that almost caused a recession. In fact, the country's real annualised GDP in the 3rd quarter of 2024 was lower than two years earlier.

Cost-push inflation cannot be lowered by restrictive monetary policy. Unfortunately, it can be worsened, as occurred in South Africa via the increase in unutilised manufacturing capacity. The latter was caused by insufficient demand in the economy, due to households and businesses being forced to spend a significantly larger slice of disposable incomes and revenues on servicing the cost of debt.

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As at the end of the 2nd quarter of 2025, South Africa's broadly defined unemployment rate stood at 47%, with fewer people in formal employment than those looking for jobs – a frightening statistic against the background of widespread poverty, rampant crime and repeated incidents of socio-economic unrest.

It is trite to argue that high interest rates will ultimately provide the benefit of lower inflation when a dire need exists in the short term to create employment for the 11.7 million South Africans that cannot find any form of employment – not even in the informal sectors – which feeds off job creation in the formal sectors. At this juncture in South Africa's history, job creation should be afforded an over-arching priority.

Several empirical studies covering a wide spectrum of EMDEs have confirmed that high interest rates are detrimental to capital formation and economic growth. Other significant negative side effects of elevated interest rate hikes in EMDEs include the aggravation of cost pressures on the supply-side (due to lower capacity utilisation in the manufacturing sectors) and the worsening of income inequality.

A notable shift towards growth-inhibiting monetary policy became evident from 2015 onwards, which became excessively restrictive between 2023 and 2024. The negative macro-economic impact of the record high interest rates that accompanied this policy shift is both pervasive and alarming. Key conclusions drawn from a thorough analysis of the damage inflicted on the economy include:

- The decimation of the value of residential building plans passed
- A dramatic decline in the value of construction works
- A decline in the average real salary in the formal sectors of the economy
- More than half of SMMEs are in a state of contraction, difficulty, or risk of closure
- Capital formation in South Africa now comprises less than 15% of GDP, compared to the global average of 28%
- The real value of household credit, which is the life-blood of aggregate demand in the economy, has declined by 8.3% since 2012
- The real disposable incomes of South African households have declined consistently over the past decade, with a more pronounced downward trend since the record high interest rates of 2024

Econometric modelling of a modestly lower interest rate trajectory after 2021 shows that GDP would have been R206.4 billion higher at the end of the first quarter of 2025, which would have led to higher employment and also increased fiscal revenues.

Real lending rates need to be lowered to the same level that existed during the tenure of the MPC between 2011 and 2015, namely between 3% and 4%. During this period, a high level of tolerance existed for accommodating increases in price levels that were regarded as temporary – especially when caused by exchange rate weakness. More importantly, these interest rate levels realised an average annual rate of real GDP growth of between 2% and 3%. Moreover, the recently announced change in the country's inflation target to 3% with a tolerance band of 1 percentage point is, in our view, a mistake. The target range of between 3% and 6% should be retained in order to enable inflation flexibility so as to allow for the stimulation of growth, given the country's high unemployment.

It is recommended that the composition of the MPC should be amended to become more inclusive of economic participation, as any decision on interest rates has profound direct and indirect effects on the well-being of South African households. It is recommended that the MPC should consist of twelve members - two persons from each of the following six institutions/organisations: The SARB; the National Treasury; Parliament; the financial services sector; key employer organisations; and key trade unions. Each of these MPC members should possess at least 20 years' experience in macroeconomic research and a minimum qualification of a master's degree in economics.

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