Moses Kotane Institute
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COMMENTARY

ECONOMICS COMMENTARY: INTEREST RATE REVIEW

14 April 2020, Tuesday, Durban.

MKI Economics Commentary is a brief note intended to provide MKI's interpretation of key economic events such as the Budget, MTBPS, Monetary Policy (Interest Rates), Employment data releases and other topical economic events.

SARB CUTS INTEREST RATE BY 100 BASIS POINTS

Moses Kotane Institute notes the 100 basis points (-1%) reduction in repo rate to 4.25%, a third straight cut since January 2020. It is noteworthy that the decision by the Monetary Police Committee was unanimous, furthermore, the decision to cut was taken at a meeting that was brought forward from May to today, Tuesday 14 April 2020. This urgent intervention was necessitated by the worsening economic fallout from the COVID-19 pandemic.

LOWEST INTEREST RATE SINCE 1973

Having already lowered rates as recently as 19 March 2020, the interest rate cut was a positive step by the SARB.

The SARB acted in line with peer reserve banks that have cut in recent times. This cut is against a background of worsening GDP outlook. The International Monetary Fund warned global growth will recede by 2.9% this year. SARB's economic models project a record 6.1% GDP contraction this year. The inflation outlook has surprised on the downside and the rand has depreciated by 22% since the January 2020 MPC meeting. In all, the 1% reduction is the right measure given the current inflation, growth and currency depreciation environment.

EFFECTS ON HOUSEHOLD DEBT PAYMENTS

The Repo rate is the benchmark rate that the SARB lends money to other banks. By lowering the repo rate, the SARB makes borrowing cheaper and more accessible. When consumers and businesses can access credit, aggregate demand increases, lifting the economy.

Consumers with variable/floating interest rates, when the repo rate decreases, banks also decrease prime rates resulting in lower interest payments. Lower interest payments have the effect of a reduction in monthly instalment. A consumer with a debt of about R1m can expect savings of about R628 per month as a result of a 1% reduction in interest rate. If the same consumer has car loan of around R500 000, the reduction will equate to about R240 per month. The total is about R868. Over the 20-year period the total savings reach R165 120 on the house and car loans combined.

EFFECTS ON SAVINGS AND INVESTMENTS

Savers will see a reduction on their returns. Savers have seen a cumulative -2.25% reduction in interest returns since January 2020. Investors with large exposure to interest bearing instrument are negatively affected in the same was as savers, however, for people still contributing to pension funds the net effect cannot be accurately attributed due to the complexity of the financial instruments in the underlying portfolio. Suffice to say the cut in interest rate is as a result of deteriorating economics fundamentals, thus affect all forms of investments.

RAND RESUMES SLIDE AMID SURPRISE CUT

The rand was trading at R18.33 to the US dollar at 19h00 GMT, 31 cents weaker from the R18.02 when the markets opened. A lower interest rate makes it less attractive for international market players chasing interest rates deferential, causing a lower rand. The wild move can also be explained by the fact that the MPC meeting was not on the cards until May 2020, therefore the move surprised the markets. The JSE ended the day 3.88% higher.

FURTHER ACTIONS LIKEY

According to the MPC statement released today in announcing the rate reduction, "the Committee notes that the more prolonged lockdown and slower recovery creates downside risk to inflation and allows further space for monetary policy to respond to the virus-induced demand shock to the economy". To this effect, we expect another reduction in each of the remaining scheduled meetings. Together with bond-buying, the SARB has shown willingness to act in a data dependent manner.

FISCAL SUPPORT MEASURES

The SARB has instituted three rate cuts this year amid the COVID-19 and embarked on bond-buying programme. These measures are the limited tools available for monetary policy there remains scope for fiscal support measures to bring about aggregate demand in the economy, for example, direct income grant. The fiscal measures available include macroeconomic policies and structural reforms, reduction of costs, capital investments and job creation. These have more impact on the economy than monetary policy.

Moneyweb reported Treasury is mulling a Fiscal Framework Revision. The fiscal revision framework will have a clear one-year time frame accompanied by a detailed recovery plan. It is MKI's assessment that the fiscus' ability to respond to the current crisis is limited. The expected Consolidated Budget Statement will contain measures anchored by re-prioritisation of spending towards health and growth initiatives. Furthermore, any help from the IMF is expected to be COVID-19 specific without structural reform conditions attached.

CONCLUDING REMARKS

The 1% cut in repo rate is most welcome in these unprecedented times. We are encouraged by the explicit message in the MPC statement highlighting the capacity for further monetary policy accommodations responding to the virus-induced demand shock to the economy, suggesting a room for another cut as and when it becomes necessary. Treasury is alluding to further fiscal framework measures and combined with appropriate monetary policy actions such as this repo rate reduction from SARB, the economic fallout may well be confronted, notwithstanding the damage is likely to last for longer.