COMMENTARY

INTEREST RATE REVIEW, July 2020

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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 25- BASIS POINTS

The South African Reserve Bank (SARB) Monetary Policy Committee (MPC)'s meeting of 21-23 July 2020 has culminated in the central bank lowering the repo rate to 3.5 % from 3.75%. This 25-basis point cut in the key rate was supported by 3 out of the 5 MPC members. Two other members had favoured a hold on the rate.

ECONOMIC DEVELOPMENTS

The rate cut comes amid job losses and record high unemployment (over 30%) exacerbated by the coronavirus induced lockdowns of the national economy. A study conducted by NIDS-CRAM, part of a broader study which aims to inform policy using rapid reliable research on employment, income and welfare in South Africa, estimates that more than 3 million people lost their jobs between February and April this year. A further 1.5 million have been furloughed thus losing income in the process. Gross Domestic Product which was initially forecasted to contract by 7.0% in May is now expected to contract by 7.3% this year.

Consumer inflation has, in the meantime, reached a 15 year low of 2.1%. Average inflation expectations for 2020 further declined from 4.4% to 3.9%. Inflation expectations are crucial for the central bank's inflation targeting monetary policy framework.

The deteriorating economic conditions, a low inflation outlook and worrying signs for the economic outlook where the coronavirus has seen the country being ranked among the world's top 5 in terms of confirmed cases of Covid-19, most probably strengthened the case for a rate cut. The MPC has now lowered the repo rate by 300 basis points this year. However, the lockdown has muted the impact of the cuts with monetary policy easing yet to filter through.

FURTHER RATE CUTS LIKELY

We expect the coronavirus pandemic to confine the South African economy in a recession for much longer. The economy is likely to take further strain from global economic disruptions that have impacted our major trading partners. This is mostly felt in the logistics and tourism sectors. There are therefore high chances that there will be more cuts this year but at a much slower pace. Indications are that the rate-cutting cycle could be nearing the end.

COMMENTS AND CONCLUDING REMARKS

With indications that we are approaching the end of the rate cutting cycle, the SARB seems to be lowering rates towards a level at which they will stay to avoid any further up or down movements. Stability is critical. Past financial and economic crises clearly demonstrate how crucial it is for monetary policy to remain focused on its core mandate and on sustainability. The economy should avoid falling into the belief that monetary policy will have a solution for every problem. Most of the problems in our real economy are structural in nature. In this sense, it is the responsibility of the government to introduce reforms. Tackling such challenges is outside the scope of monetary policy. Tension between fiscal and monetary policy should be avoided as this could lead to excessive demands being placed on monetary policy. The latter would then stray from its path for stability maintenance.