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SOUTH AFRICAN RESERVE BANK MONETARY POLICY COMMITTEE INTEREST RATE REVIEW

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Introduction

The **MKI Economics Commentary** is a brief note intended to provide the Moses Kotane Institute (MKI)'s interpretation of key economic events such as the Budget, Medium Term Budget Policy Statement (MTBPS), Monetary and Fiscal Policy decisions, Employment, data releases and other topical economic events. This commentary looks at the recent interest rate decision taken by the South African Reserve Bank's Monetary Policy Committee on 21 January 2021.

SARB keeps the repo rate on hold

The Monetary Policy Committee (MPC) of the South African Reserve Bank (SARB)'s first meeting of 2021 has resolved to keep the repurchase rate (repo) at 3.5 %. This comes at the back of another 'hold' decision at the MPC's November 2020 meeting. For the current decision, two of the committee's members had preferred a 25-basis point (0.25%) cut while three preferred to hold. The hold decision thus prevailed.

The repo rate is the rate at which the SARB lends money to commercial banks. When this rate changes it affects people who have borrowed any form of a loan from the commercial banks such as home loans, personal loans, or car loans. This is because it is linked to the prime interest rate, the interest rate utilized by banks to calculate the loan repayment for customers who are borrowing.

Economic developments

The prevailing slow economic recovery in South Africa is expected to keep inflation below the mid-point of the target (3-6%) range for this year as well as for 2022. Further, the Bank sees expectations of future inflation tending towards more stability after sustained moderation last year. The inflation aspect therefore appears to be well contained.

Economic growth, however, surprised on the upside in the third quarter of 2020, growing by a quarter on quarter, seasonally adjusted and annualised 66.1% (StatsSA,2020). This was in contrast to the Bank's expected 50.3% growth thus necessitating an upward revision of -7.1% for the full year (2020) compared to a forecast contraction of 8.0% by the time of the November 2020 meeting. Despite having way less restrictive lockdown restrictions, growth in the first quarter of 2021 is expected to remain muted. The Bank forecasts Gross Domestic Product (GDP) to grow by 3.6% in 2021, 2.4% in 2022 and 2.5% in 2023.

Expected effects of low interest rates

The maintenance of low interest rates means that consumers will pay lower interest rate on the money they owe to banks. They can then plan their purchases and spending patterns accordingly. For example, large purchases on credit become more affordable, such as home mortgages, auto loans, and credit card expenses. The province could additionally raise awareness to small businesses to take advantage of the low cost of borrowing to obtain funds for their businesses.

Positive GDP growth figures, as forecast above, generally mean that businesses may plan to increase their inventories (in anticipation of higher demand), hire workers, and expand operations. For government, higher economic growth fosters higher tax revenues, and less need to spend money on social benefits while ordinary people can be optimistic about their employment prospects.

Conclusion

The MPC's decision was mostly in line with the market consensus of a rate hold. The current slow economic growth necessitates various stimuli to kickstart a faster growth trajectory and create employment. The prevailing low interest rates are welcome as they drive consumer spending and create an environment conducive to real investment. However, the latter will require greater effort from the authorities as investors look for more than just a low cost of capital.

The implied policy rate path of the SARB's Quarterly Projection Model (QPM) indicates two increases of 25 basis points in the second and third quarters of 2021.These increases, if they materialise, will introduce only a slightly tighter monetary move which is still very accommodative in the main. As noted by the SARB Governor, and as we reiterate here, a faster economic growth rate now depends on implementing more prudent macroeconomic policies and structural reforms.

References:

South Africa Reserve Bank – Statement of the Monetary Policy Committee issued by Lesetja Kganyago, Governor of the South African Reserve Bank.

Statistics South Africa- Statistical Release: Gross Domestic Product, 3rd Quarter 2020.