Sarb's rate cut surprise

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In a surprise move, the South African Reserve Bank (Sarb) has cut interest rates by another 100 basis points to help support the country's economy as it grapples with a rapidly deteriorating situation as result of the extended Covid-19 lock down.

Rates are now down 225 bps since the start of the year, and down 250bps since July last year.

"By the Sarb announcing a substantial pre-emptive reduction in the repo rate, and hence facilitating a marked relief in borrowing costs, means that monetary policy is playing its part in helping to sustain business and consumer confidence.

Monetary policy must nevertheless remain responsive to an economy in which the ‘output gap’ is steadily widening and where inflation is not an immediate threat. It is therefore also welcome that the SARB’s Quarterly Projection Model (QPM) is being recalibrated to take account of the changed economic dynamics," says Professor Raymond Parsons, North West University economist.

On the positive side the Sarb still expects a modest economic upturn in 2021. Its extent, however, will depend on how rapidly the global economy recovers, on whether there are repeated waves of coronavirus later in the year, and on how long the lock downs in South Africa and other countries will last. The degree to which other economic supportive measures in South Africa are rapidly and effectively implemented will also shape the rate of South Africa’s economic recovery and its growth performance next year. There remain downside risks. Monetary policy must remain proactive where necessary, he says.

Room for quantitative easing

The Sarb now expects inflation to average 3.6% in 2020 (versus my forecast of 3%) acknowledging that inflation risks are mostly on the downside. I think there is enough room for the bank to cut more – at least another 100bps, says Johann Els, chief economist, Old Mutual Investment Group.

"There is also room to implement massive quantitative easing (QE) USA-style and a need to help finance the budget deficit, with less risk in executing massive QE than not doing it. I am more worried about deflation than inflation. Thus, I am not worried about the traditional concern of hyperinflation in the case of a central bank financing budget.

"Ramaphosa promised an economic support package, which is likely to be announced this week. I do wonder about the Sarb’s timing. Did they want to get ahead of the announcement in an effort to maintain their independence?" he says.