Another cut in the repo rate

The Monetary Policy Committee (MPC) once again voted in favour of lowering the repo rate this month by 50bp to 3.75%. The policy rate has lowered by 2.75% this year, with a cut every month apart from February, taking interest rates to levels last seen in the early '70s.

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“Rates have been lowered aggressively, both locally and abroad to provide support to economies that have been weakened by the Covid-19 shutdowns. The South African Reserve Bank (Sarb) once again lowered its forecast for domestic GDP growth for this year to -7%, compared to the -6.1% forecast last month, and the -0.2% in March.

“This is significantly worse than expected global growth, with the International Monetary Fund currently forecasting a contraction of 3% in 2020. These forecasts indicate the extent of SA’s vulnerability, and underscore the bank’s attempt to ease conditions for households and firms in the current environment, in addition to the fiscal measures announced,” says Reza Hendrickse, portfolio manager at PPS Investments

Softening the blow

Low food inflation, slower wage growth, modest services inflation, a muted pass-through from the local currency and lower international oil prices led to a downward revision in the Sarb’s headline inflation forecast from 3.6% to 3.4% in 2020 and from 4.5% to 4.4% in 2021, says Sanisha Packirisamy, Economist at Momentum Investments

“Unlike many developed market economies, higher interest rates in SA have provided the Sarb with the space for further monetary policy ammunition to shield the economy from the negative economic effects of Covid-19 and related financial market turbulence. In our view, the Sarb may be more inclined to temporarily cut real interest rates by more than usual to play its role in softening the blow of the virus shock on the local economy and we see further space for marginal easing to 3.25% by the end of the year,” she says.

No free lunch

There is no such thing as a free lunch. Yet recent times have provided South African savers with something close to this, as risk-free returns from money market investments have comfortably beaten inflation and riskier asset classes, says Mark Dunley-Owen, portfolio manager, Allan Gray

“Lower interest rates can be thought of as a lifejacket for indebted businesses and consumers who must continue to make interest payments despite a lower stream of income. It is a necessary policy response to support an economy in recession. Unfortunately, for net savers who are invested in cash proxies, such as money market funds, lower rates decrease their future return opportunities.”