momentum investments

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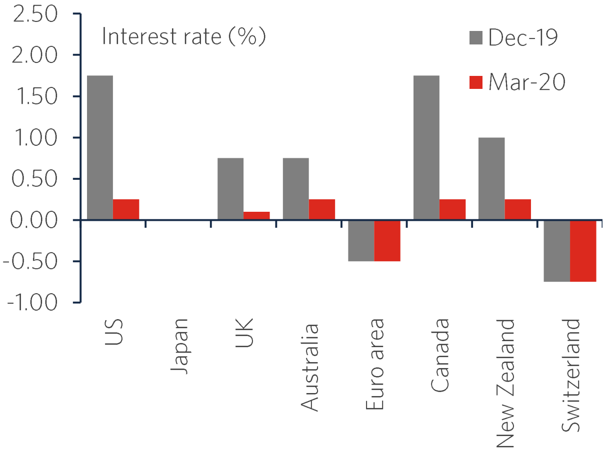
in the moment

Sarb delivers 100 basis point cut in an unscheduled meeting

Central banks come to the party

Globally, central banks have unleashed a new wave of stimulus to counter the effects of the economic fallout from the COVID-19 pandemic. Even though central banks in the most developed market (DM) economies had little monetary policy ammunition left, they continued to slash interest rates (see chart 1) to cushion their economies against government-ordered containment measures, to curb the spread of infection.

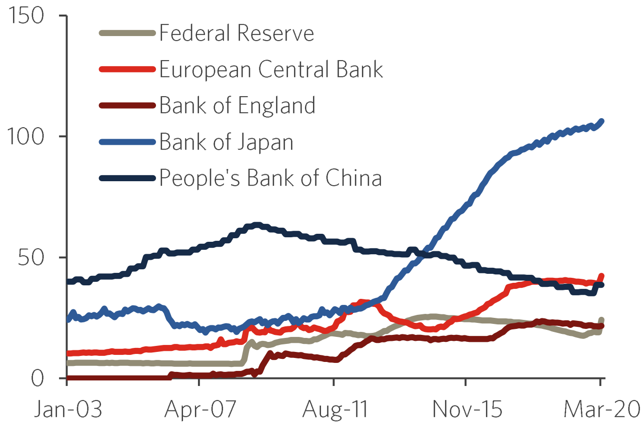
Chart 1: DM interest rates cut further (%)



Source: Bloomberg, Momentum Investments

The South African Reserve Bank (Sarb) acknowledged that global policy responses to the outbreak of the virus have been robust and, to this point, highlighted the expansion of the United States Federal Reserve and European Central Bank balance sheets (see chart 2).

Chart 2: Major central bank balance sheets (percentage of GDP) are on the rise again



Source: Bloomberg, Momentum Investments

The Sarb is also playing its part to soften the blow of the virus shock on the local economy. Following decreases of 50 basis points on 16 January 2020 and 100 basis points on 19 March 2020, the Sarb announced an emergency repo rate decrease of 100 basis points to 4.25% today, 14 April 2020.

In the question and answer (Q&A) session at the March 2020 Monetary Policy Committee (MPC) meeting, the governor conceded to the fluidity of the situation and mentioned the MPC had the option of convening an urgent meeting if the need arose. In the Q&A session at today's meeting, the governor noted that news of an extension in the lockdown raised concerns over the effects on the economy, which prompted the announcement out of the MPC's regular meeting schedule of every second month.

The governor noted the MPC meeting schedule would remain intact for the remainder of the year.

Growth revised sharply lower

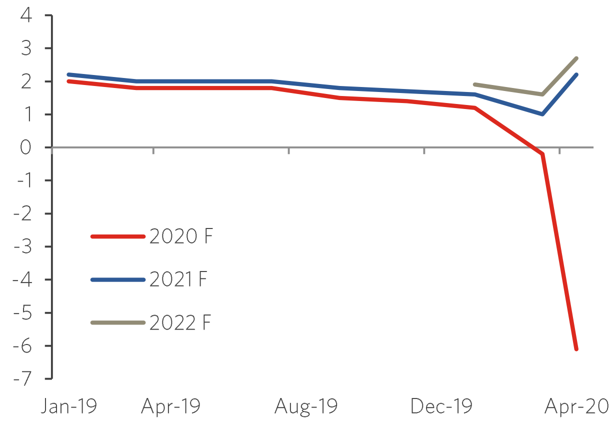
The Sarb noted the International Monetary Fund's global growth forecast for 2020 at negative 2.9%.

The Sarb explained that the contraction in economies is expected to be most severe in the second quarter of the year, with some signs of a recovery emerging in the third quarter of the year. In the Q&A session, the Sarb warned of the potential for repeated waves of the infection and a resumption in lockdowns across the globe. As such, the Sarb is closely watching the relatively modest recovery of China, to date.

The Sarb axed its growth forecast for 2020 from negative 0.2% at the March 2020 MPC meeting (just three weeks ago) to negative 6.1% (relative to our forecast of negative 4.9%) on the extension to the lockdown to 35 days and deepened negative effects to business operations and less household income.

The Sarb expects the economy to recover to 2.2% in 2021 (compared with our forecast of 1.2%) and 2.7% in 2022 (see chart 3). In the Q&A session, the MPC noted its growth forecast did not include any further credit downgrades and acknowledged its projections reflected more of a prolonged recovery rather than a V-shaped dip in demand.

Chart 3: The Sarb's real growth revisions (%)



Source: Sarb, Momentum Investments

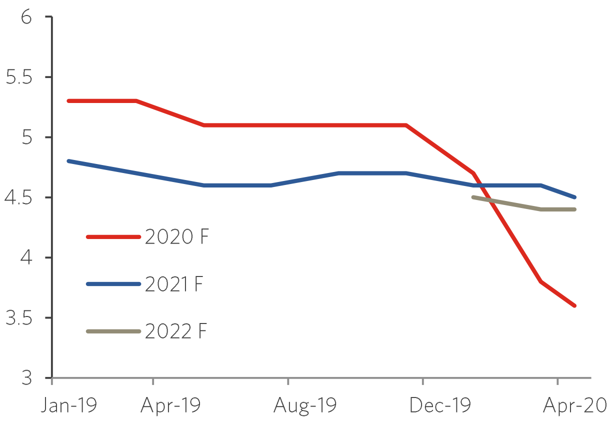
Downside risks to the Sarb's inflation forecast

A notch lower in oil prices since the March 2020 MPC meeting continues to exert downward pressure on the forecast for headline inflation, while the Sarb warned that rising fiscal risks and an aggressive depreciation in the currency pose upside pressures to the inflation rate. Nevertheless, the Sarb does not believe these forces offset each other and, due to the size and the timing of these risks, the Sarb still assesses risks to its inflation outlook to be to the downside.

The Sarb has raised its annual average oil price forecasts for 2020 from US$40.4/bbl to US$42/bbl and has kept its forecast for 2021 stable at US$45/bbl.

Overall, the Sarb expects headline inflation of 3.6% in 2020 from a previous 3.8% (compared with our forecast of 2.9%), 4.5% in 2021 from a prior estimate of 4.6% (relative to our expectation of 3.5%) and an unchanged rate of 4.4% for 2022 (see chart 4).

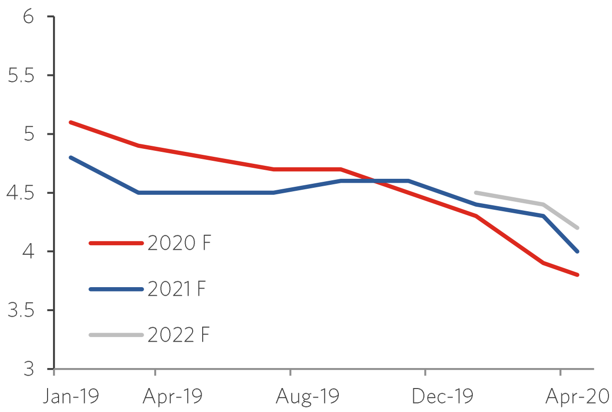
Chart 4: The Sarb's headline inflation forecasts (% y/y)



Source: Sarb, Momentum Investments

The Sarb's core or underlying inflation projections (excluding food and fuel prices) were downwardly revised by 0.1% for 2020 to 3.8% (compared with our estimate of 2.9%) and by 0.3% to 4.0% for 2021, relative to our forecast of 2.8% (see chart 5). Relative to its March 2020 projections, the Sarb expects core inflation to be 0.2% lower at 4.2% in 2022.

Chart 5: The Sarb's core inflation forecasts (%)



Source: Sarb, Momentum Investments

Aligned committee preferences to decrease interest rates to 4.25%

Table 1: Broad agreement at the unscheduled April 2020 meeting

Number of committee members	Favoured no move	Favoured a 25 basis point hike	Favoured a 25 basis point cut	Favoured a 100 basis point cut
18 January 2018	5	-	1	-
28 March 2018*	3	-	4	-
24 May 2018*	7	-	-	-
19 July 2018*	7	-	-	-
20 September 2018*	4	3	-	-
22 November 2018	3	3	-	-
17 January 2019**	5	-	-	-
28 March 2019**	5	-	-	-
23 May 2019**	3	-	2	-
18 July 2019**	-	-	5	-
19 September 2019**	5	-	-	-
21 November 2019**	3	-	2	-
16 January 2020**	-	-	5	-
19 March 2020**	-	-	-	5
14 April 2020**	-	-	-	5

Source: Sarb, Momentum Investments

Key:

**The March, May, July and September meetings for 2018 reflected the views of seven members*

***Meetings reflected the views of five members*

Preferences among the MPC members aligned to a decision to decrease interest rates by 100 basis points (see table 1). According to the MPC, the Quarterly Projection Model (QPM) indicated five repo rate cuts of 25 basis points each, stretching into the first quarter of 2021. Today's decision front loaded 100 basis points of the QPM's indication.

In the Q&A session, the Sarb noted that measures put in place to manage liquidity have worked. The Sarb reiterated its intention behind getting involved in the secondary market is to ensure there are sufficient buyers and sellers so the market can function rather than looking at the cost of financing for government.

It further warned about the dangers of printing money to fund the government deficit by remarking that "too much money chasing too few goods would result in a rise in prices".

Further room exists to cut further if needed

Globally, policymakers have responded aggressively in an attempt to avoid a prolonged economic crisis from the COVID-19 pandemic. In some countries, the fiscal responses unleashed exceed the stimulus triggered in the global financial crisis. Regrettably, as SA already had a large budget deficit going into COVID-19, the magnitude of its fiscal stimulus response to the virus is somewhat constrained. Fortunately, the country had much more room to maneuver on the monetary policy side, with real interest rates at significantly positive levels going into the crisis. As such, the Sarb has been able to provide a more aggressive monetary policy response to COVID-19, cutting interest rates by a combined 200 basis points so far since the end of January 2020.

The barrage of fiscal and monetary policy measures enacted by global and SA policymakers in reaction to COVID-19 should induce a lagged cyclical recovery in global growth in the aftermath of COVID-19. Once the effect of the virus has played out, global supply chains become unblocked again and isolation measures cease, there will be a significant rebound in global economic growth and company profits on the back of normalisation in economic activity and the lagged effect of massive policy stimulus undertaken during the crisis.

This economic rebound will ignite renewed risk appetite by global investors and will be discounted by rising risky asset prices ahead of the time. Whether this is already happening or will only occur within the coming months depends on how the COVID-19 pandemic plays out.

The governor noted the COVID-19 pandemic has led to a shock to demand and supply and policymakers are trying to deal with the demand shock. He noted the Sarb would use its entire range of tools in accordance with its mandate to cushion the SA economy from this shock.

Highlighted concerns over repeated waves of the infection in the Q&A session and a possible need to resume lockdowns in various parts of the global economy, with the MPC's sense this may be a more prolonged recovery rather than a V-shaped dip, gives way to the expectation of further interest rate decreases, in our view.

While our growth forecast for 2020 is shallower than the Sarb's, we are also anticipating a milder recovery in 2021. Our inflation forecasts also point to further downside risks in the Sarb's numbers. As such, we are forecasting interest rates to be cut to 3.25% by the end of 2020.