Why only a 25bps cut in rates? Why not 50bps?

The last quarter saw the much-anticipated first cut in the repo rate since July of 2020. This was a welcome relief to most consumers, who are certainly feeling the pinch after a very long rate-hiking cycle that ended with the repo rate at its highest level since 2009. With inflation having moderated significantly, there was much debate about whether the South African Reserve Bank (SARB) should have cut by more – so much so that we even had a few bets on Bar Ones among the team.

With an economy teetering around a 1% growth level, South Africa could have done with a boost to growth. A 50bps rate cut would have built on the confidence already being felt in the economy over the Government of National Unity (GNU). The formation of the GNU has been a massive boon to bond yields and general investor sentiment. We have seen foreign buying in the bond and equity markets after a very long spell of selling, and a yield curve decline of nearly 200bps. To add to this, inflation has moderated globally – and especially in the US, where rates were cut by 50bps.

by Bronwyn Blood

Why is South Africa cutting rates at a slower pace?

South Africa generally follows what the US does, so why was the SARB so conservative with its first cut in the cycle? Why couldn't it deliver more relief for us consumers and give the economy the kickstart it so desperately needs?

The mandate of the SARB (and in fact, of most central banks) is first and foremost price stability. High inflation is bad because it tends to be extremely volatile and distorts price signals, which makes the future murky. Take Zimbabwe as an extreme example, where hyperinflation makes it impossible to plan for the future. Confidence is eroded and investment potential is destroyed when investors cannot plan ahead due to extreme and volatile price levels.

South Africa is a more muted example. We don't have excessive inflation like Zimbabwe, but our inflation rate is certainly higher inflation than that of our trading partners. This weighs on export competitiveness and creates persistent downward pressure on the rand. Because South Africa is a small and open economy, it must balance this downward pressure on the rand by keeping interest rates higher. This helps to maintain the attractiveness of the country as an investment destination for global investors, which serves as a counterbalance. Of course, there are many other factors that the SARB must consider. The currency is an important one, but there are many other issues influencing inflation and ultimately where rates are set.

Despite its slower pace, we don't believe the SARB is behind the curve

South Africa, as a small and open economy, is pretty much a price taker when it sets interest rates. The SARB must be mindful of making policy rates too low, and of the impact this will have on the rand. If the rand is weak, it feeds through to inflation through imports. If this is not carefully controlled,

runaway inflation can quickly erode any investor confidence or any positive impact that lower interest rates would have had in the first place.

We believe we can take our hats off to the SARB for being cautious with its 25bps cut. Setting interest rates in the economy and getting inflation under control is a tough job, and we should be grateful that we have such a credible and responsible central bank in control of our monetary policy.

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