



Monetary Policy Review April 2020



Having monetary policy
space, and using it



“A good banker will have accumulated in ordinary times the reserve he is to make use of in extraordinary times.”

Walter Bagehot, *Lombard Street*, 1873

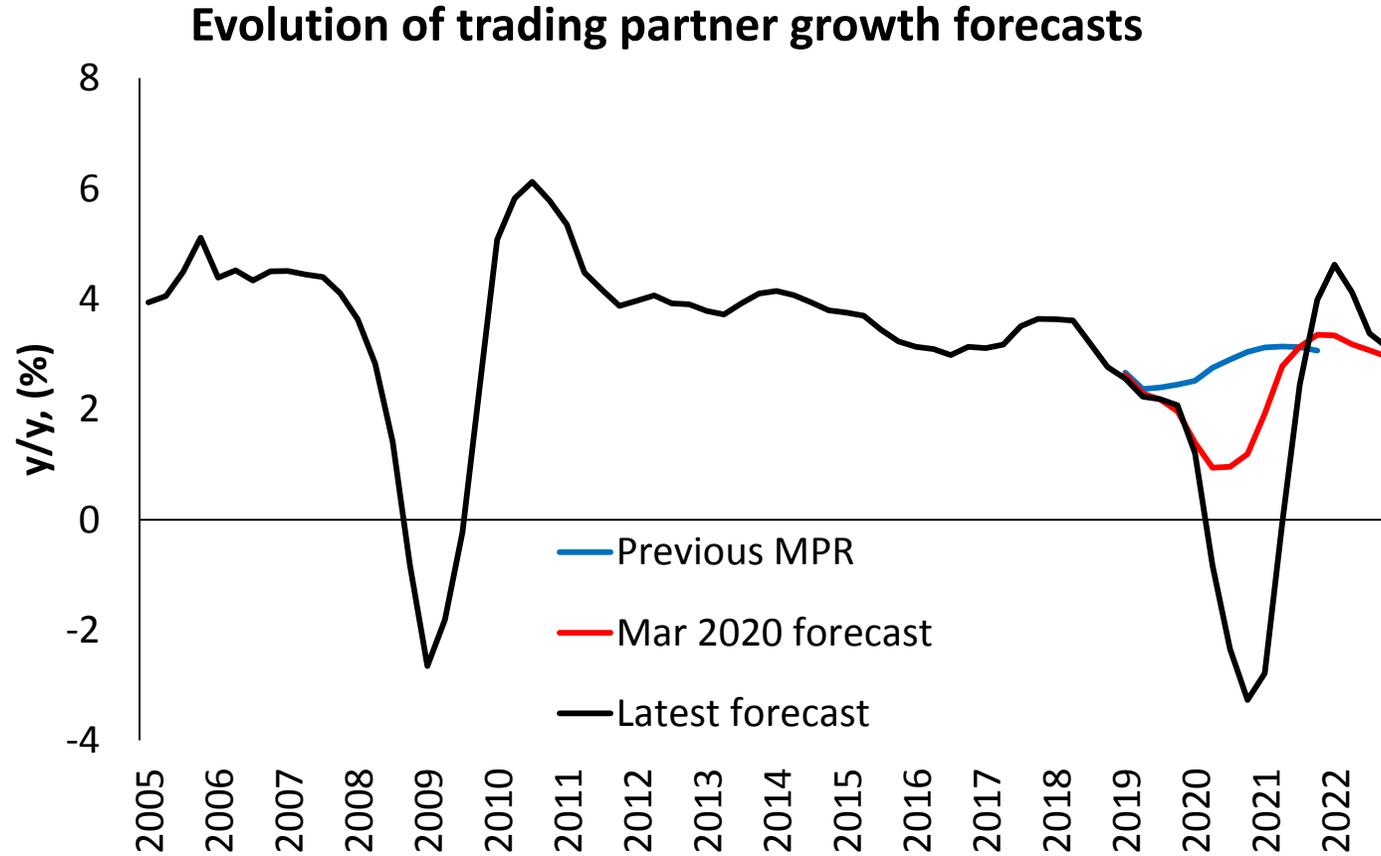


Overview

- COVID-19 biggest shock to global economy since Lehman Brothers' bankruptcy
- SA economy likely to contract this year, by at least 2%
- Monetary policy has space to respond, given lower inflation
- Stronger recovery needs “bridging” and longer-run fixes



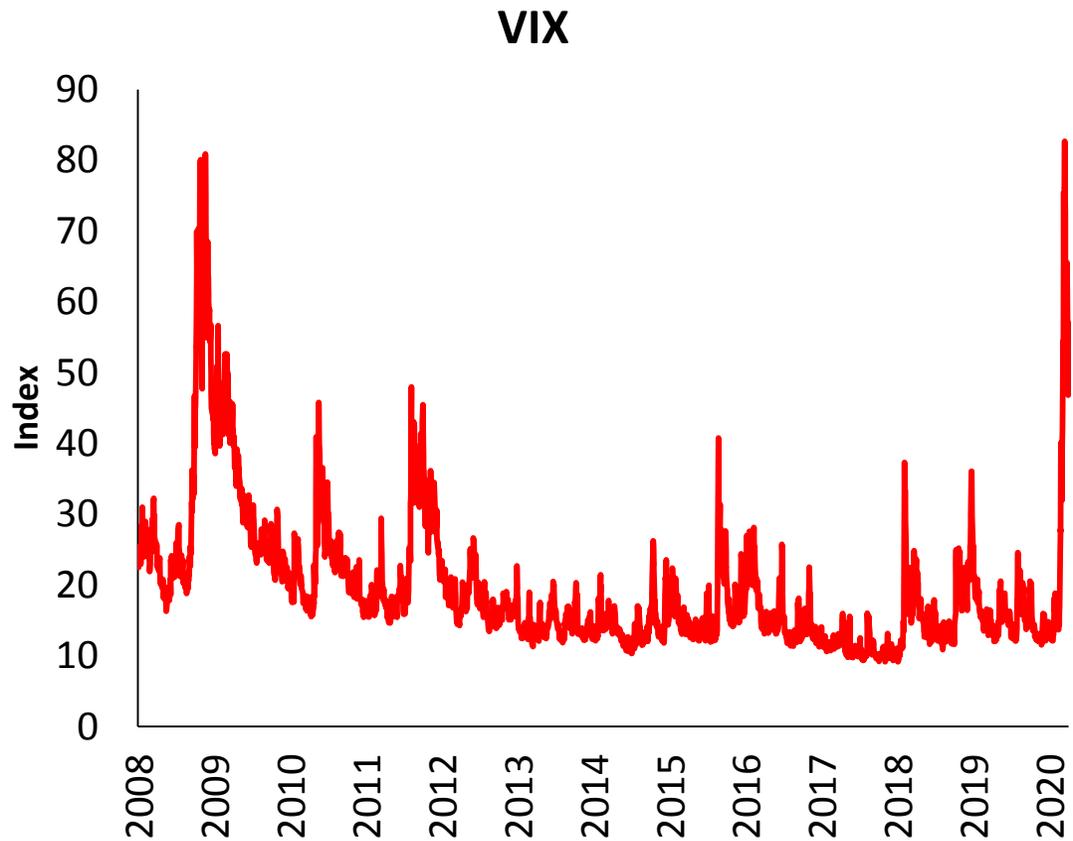
Sharp decline in global growth forecasts



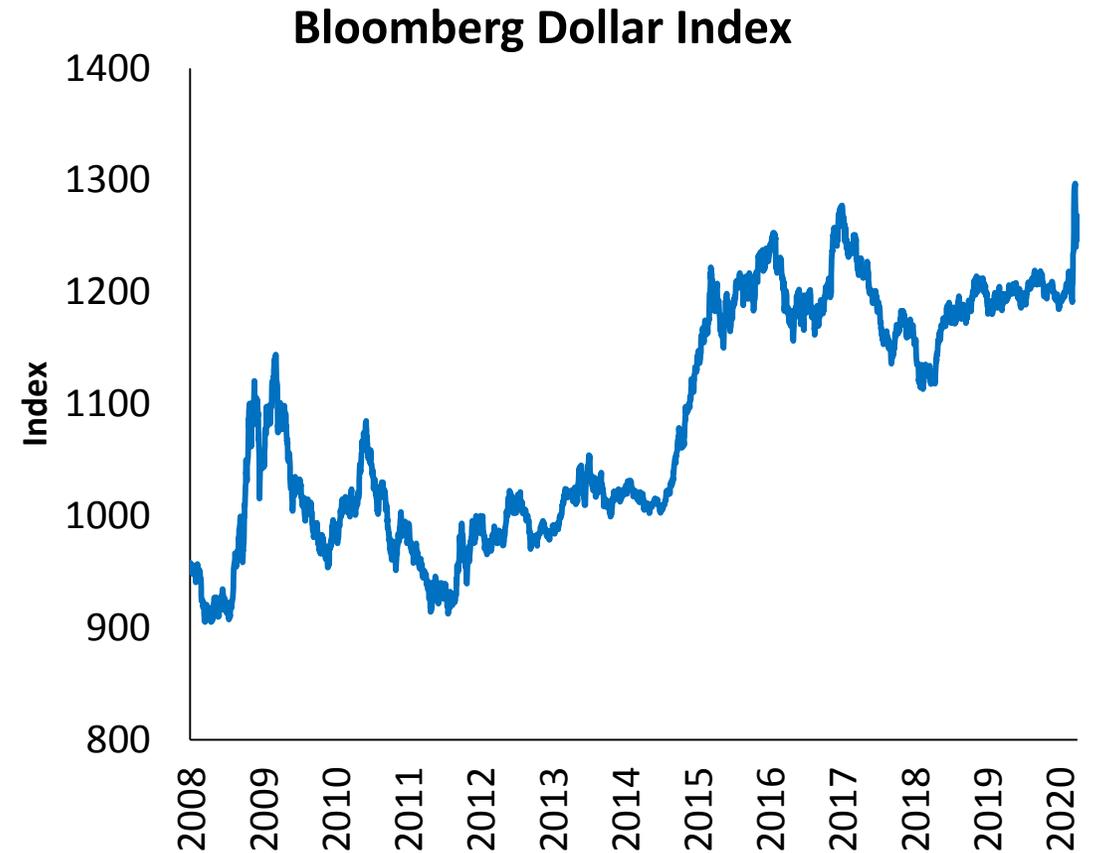
Source: SARB



Massive spike in volatility and flight to dollars



Source: Bloomberg

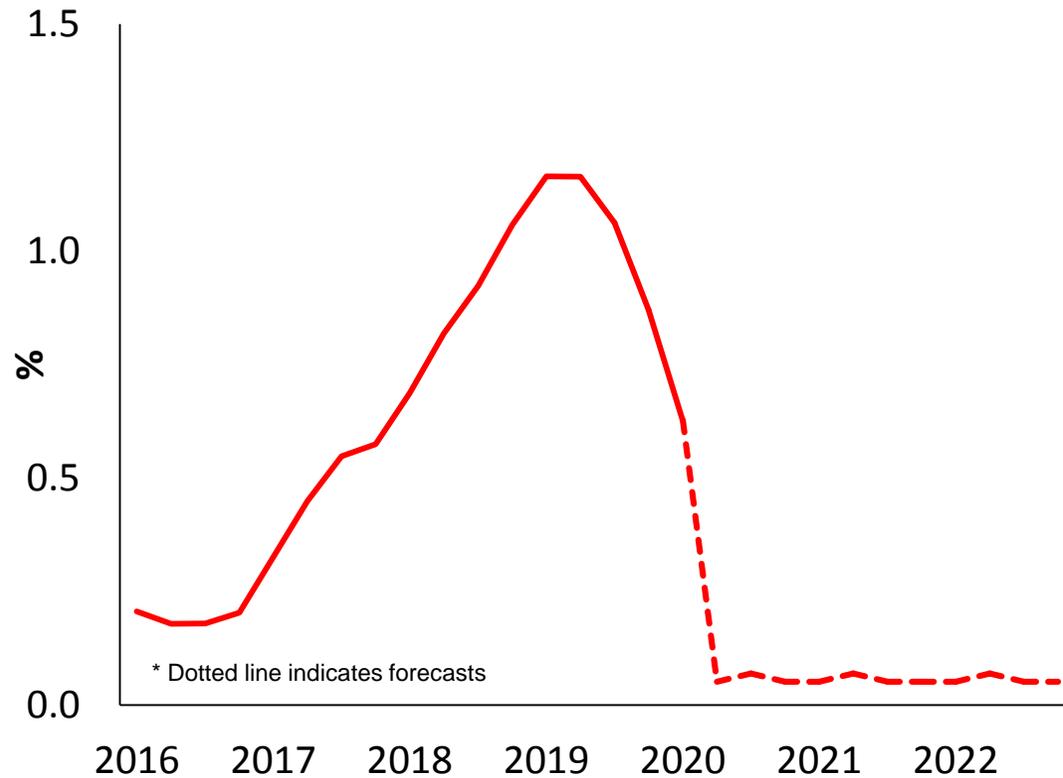


Source: Bloomberg



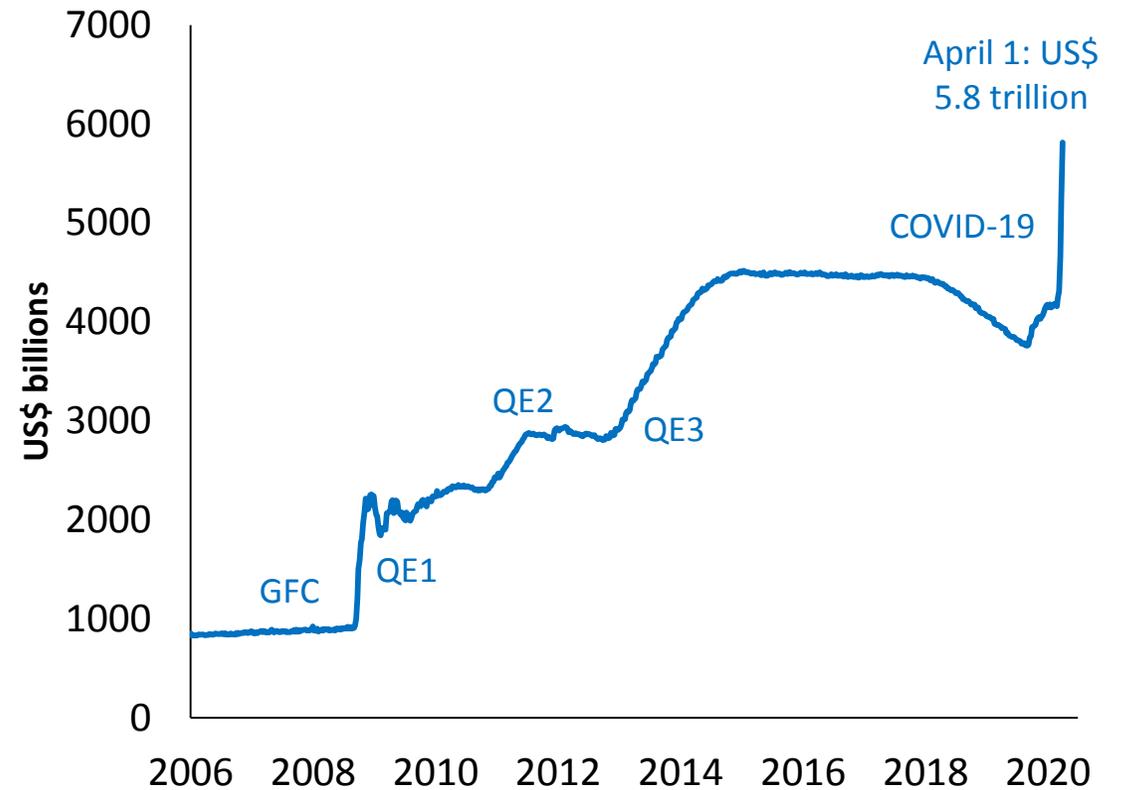
Major central banks cutting interest rates, expanding balance sheets

G3 interest rates



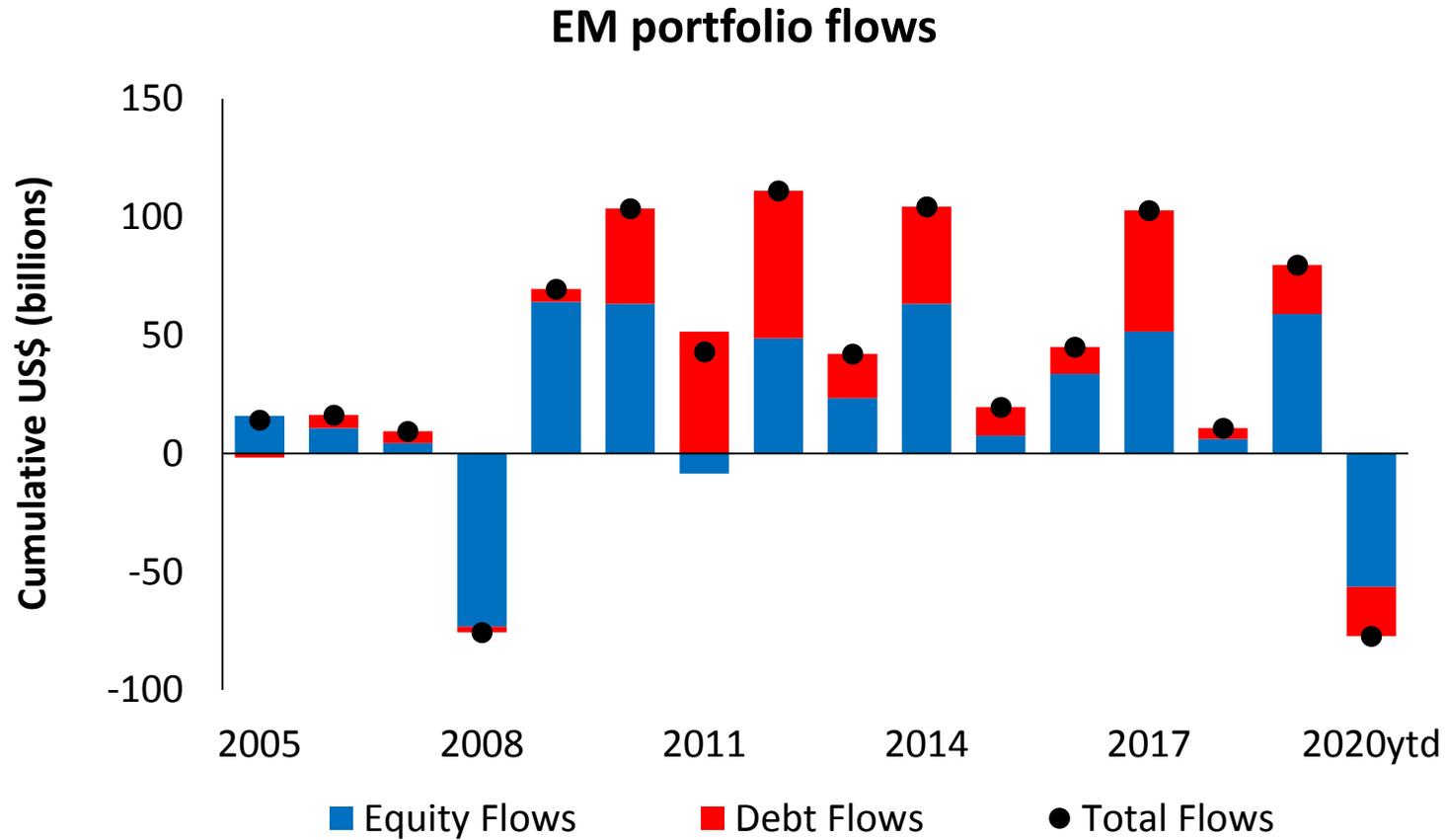
Source: SARB. G3 – weighted US, euro area, Japan

US Fed Balance Sheet



Source: FRED, St Louis Fed

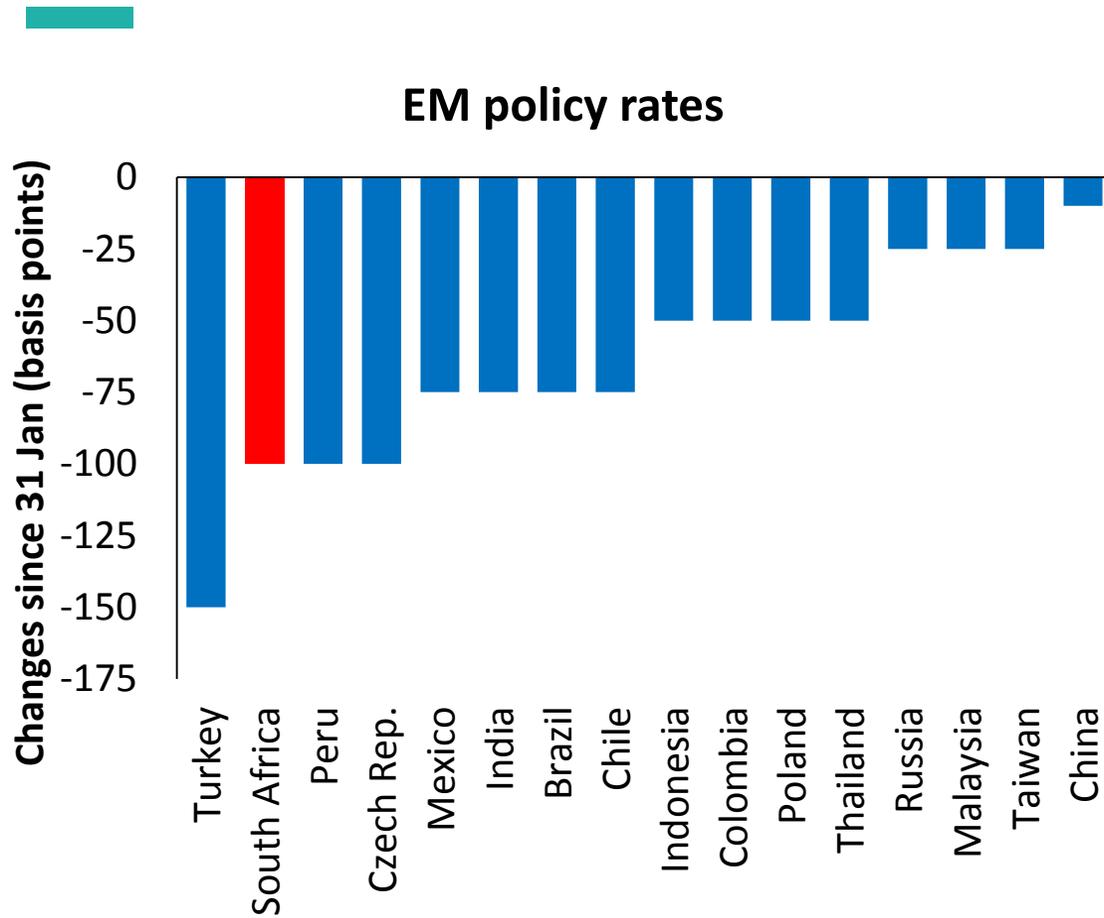
Sudden stop in capital flows to emerging markets



Sources: IIF and SARB



EM policy space more available now...



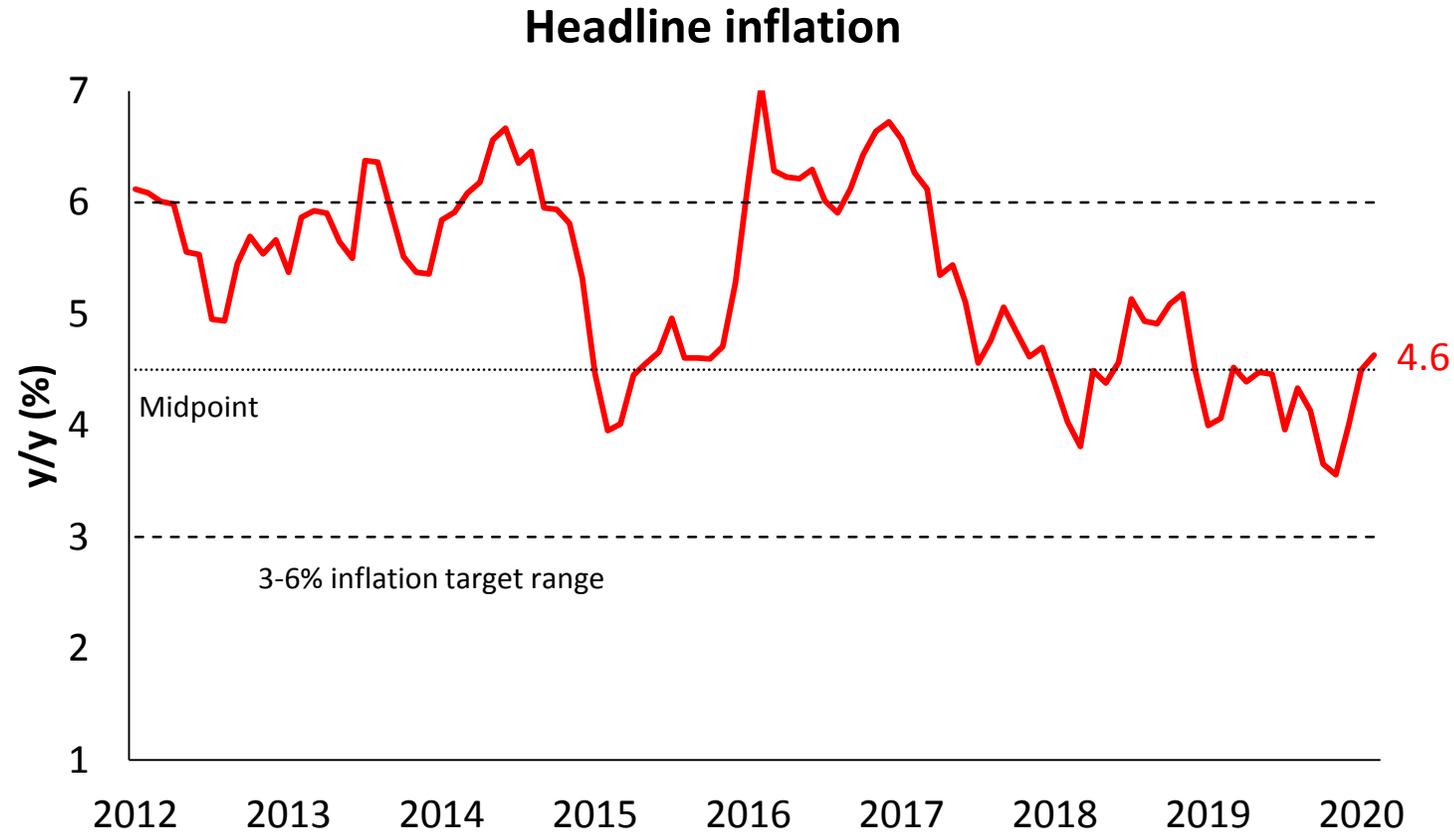
Sources: Haver and SARB



* Unweighted average of Brazil, Chile, China, Colombia, India, Indonesia, Malaysia, Mexico, Peru, Philippines, Russia, South Africa and Thailand

Sources: Haver and SARB

SA inflation also lower, near the middle of the target

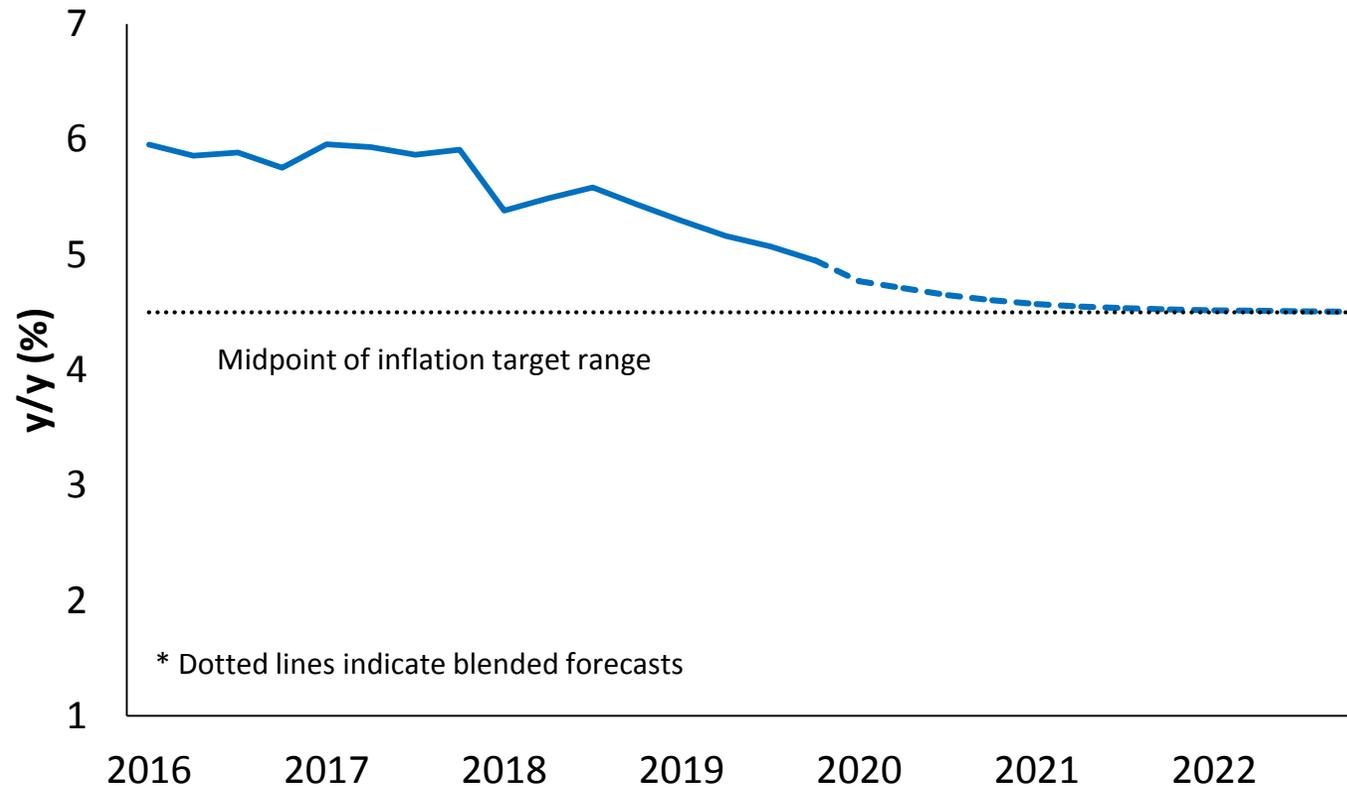


Sources: Stats SA and SARB



Expectations better anchored, closer to 4.5%

Two-year-ahead inflation expectations, with forecast

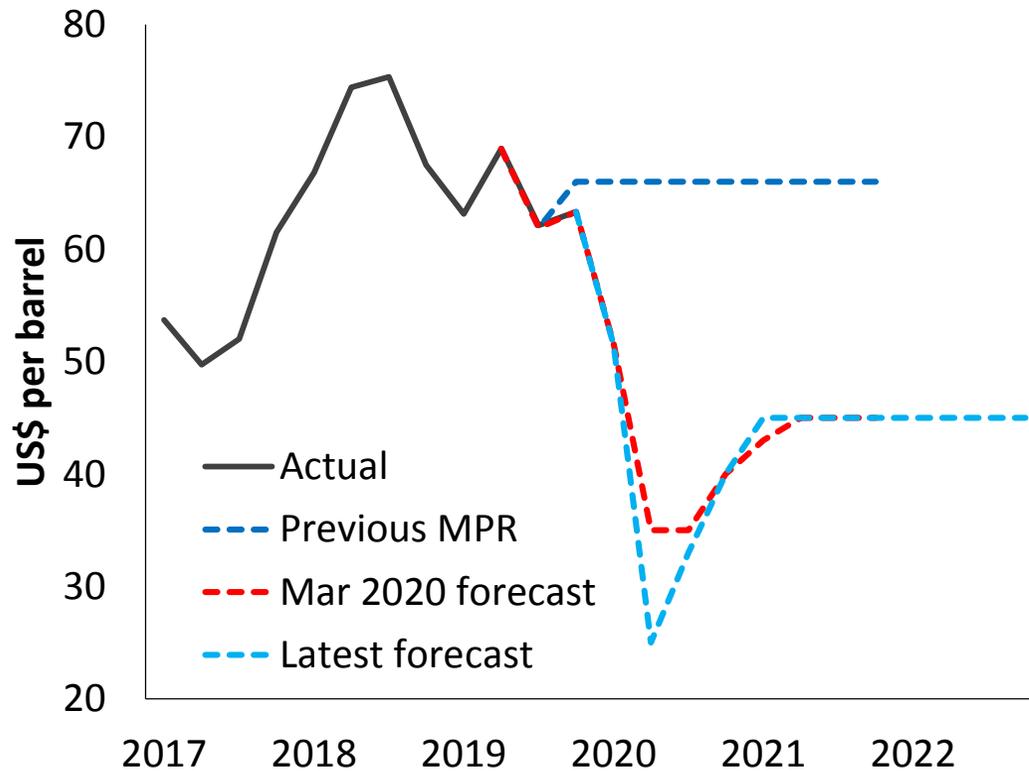


Sources: BER and SARB



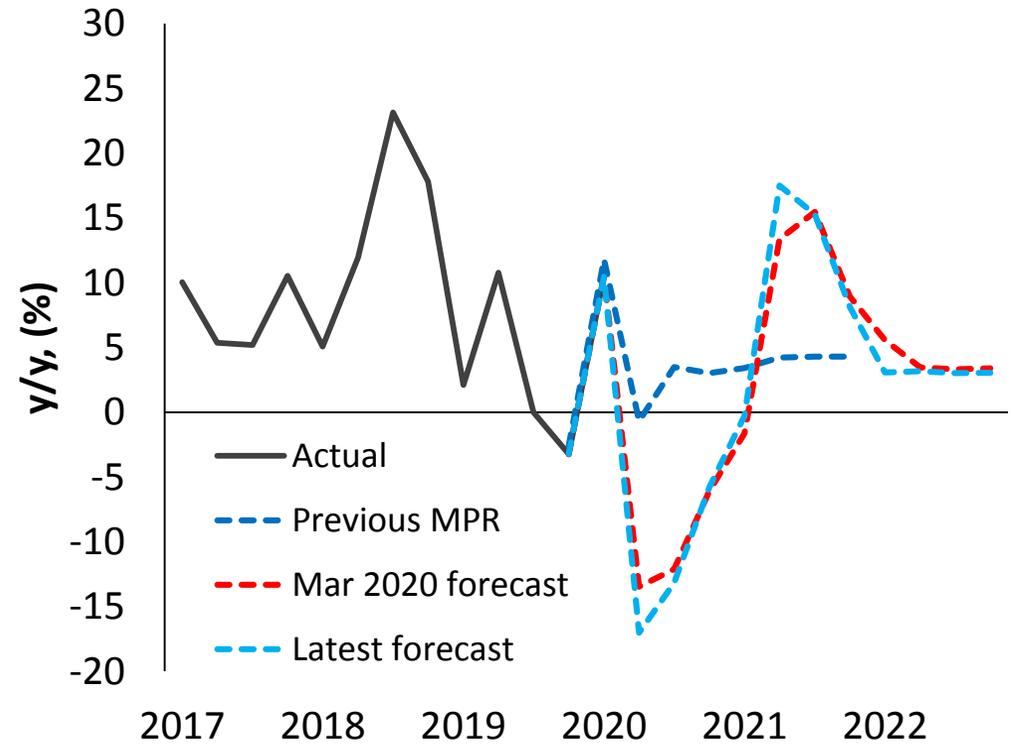
Collapse in world oil prices lowers inflation further

Evolution of crude oil forecasts



Source: SARB

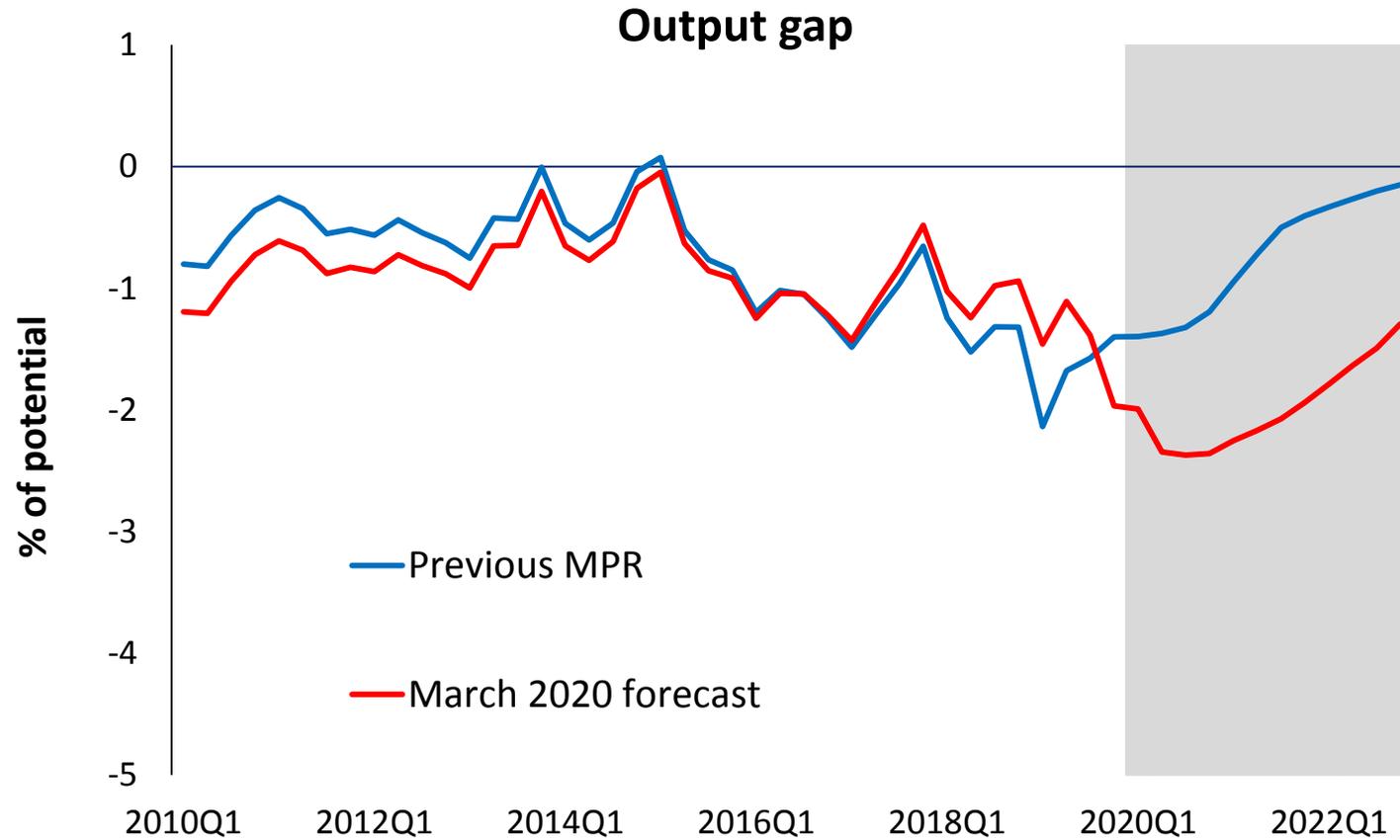
Evolution of petrol inflation forecasts



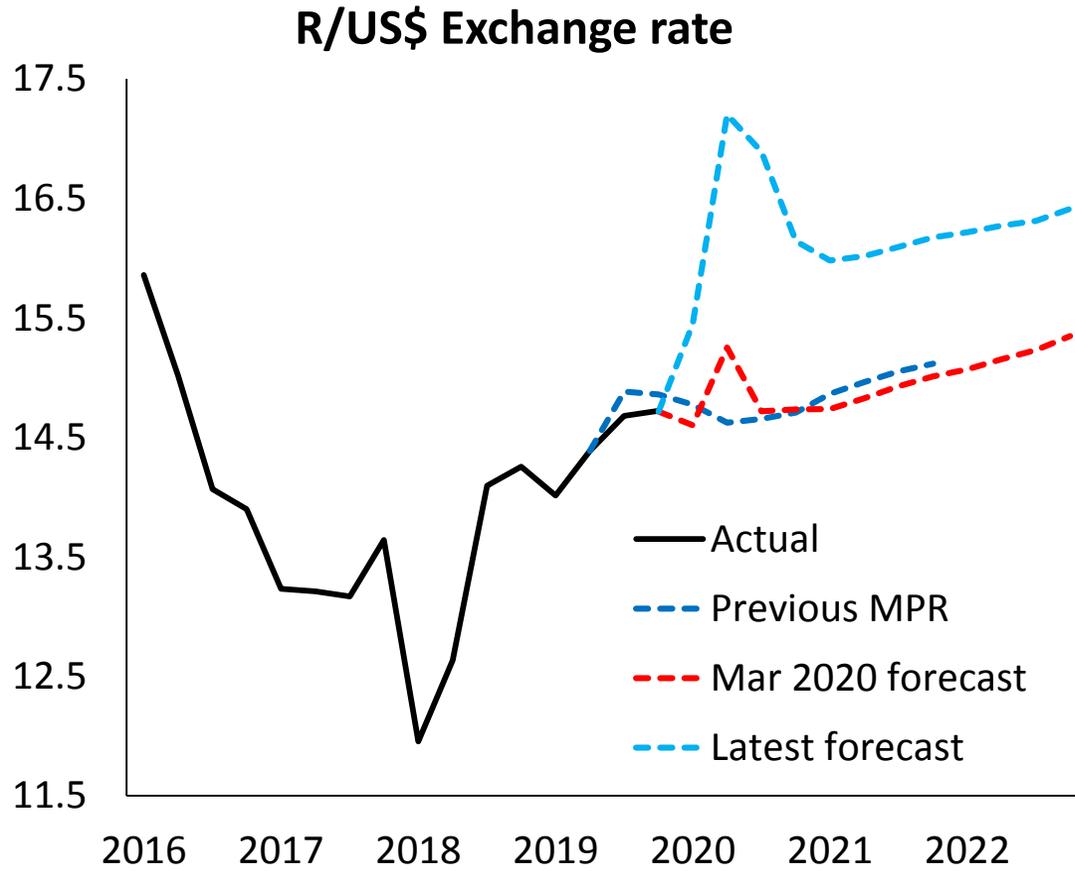
Source: SARB



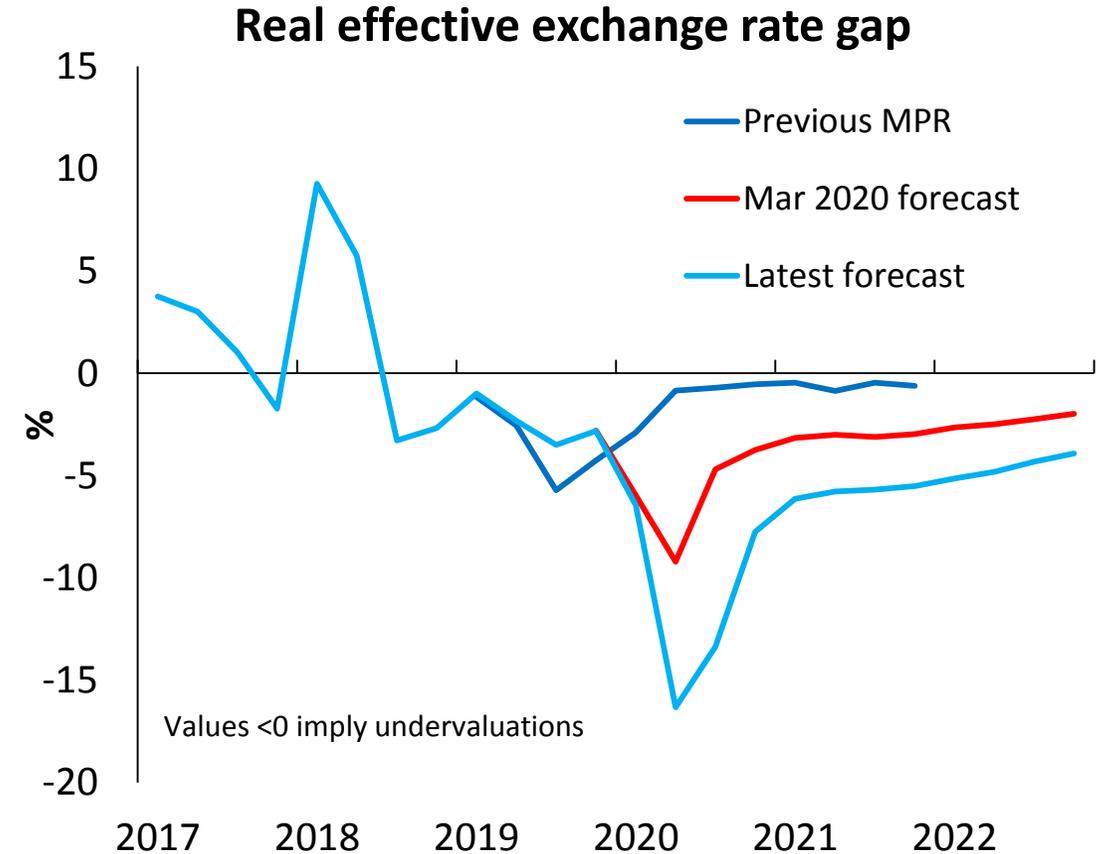
Weak demand also disinflationary



Exchange rate depreciation adds to inflation...



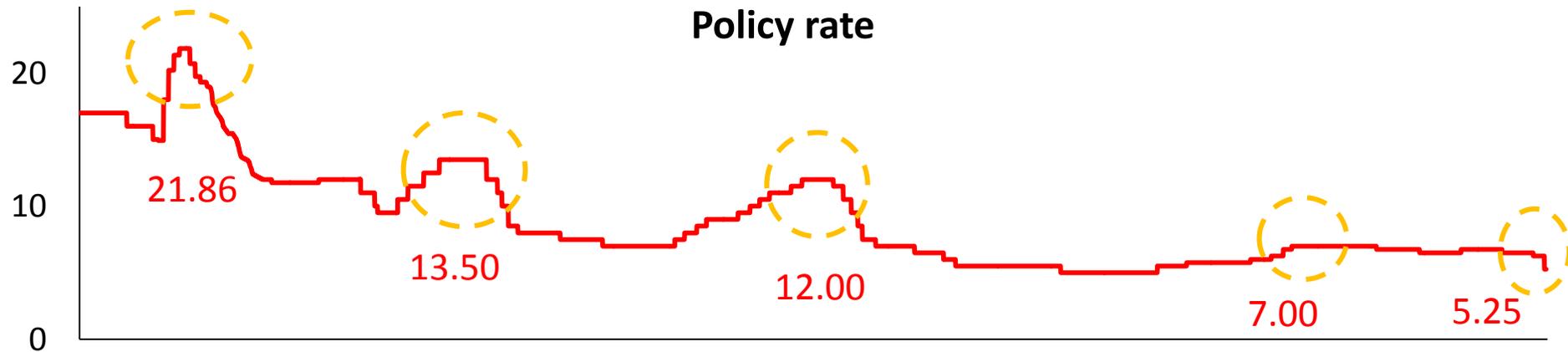
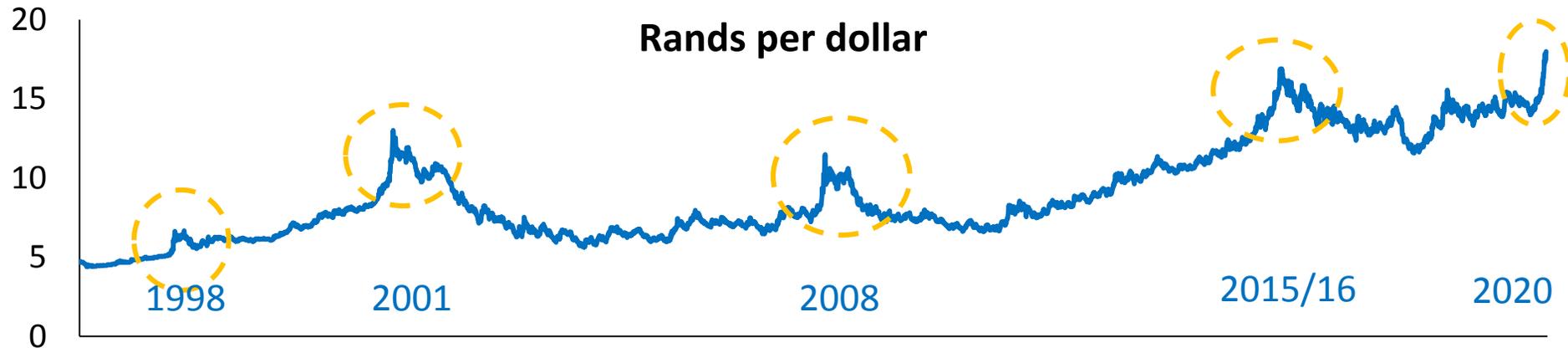
Source: SARB



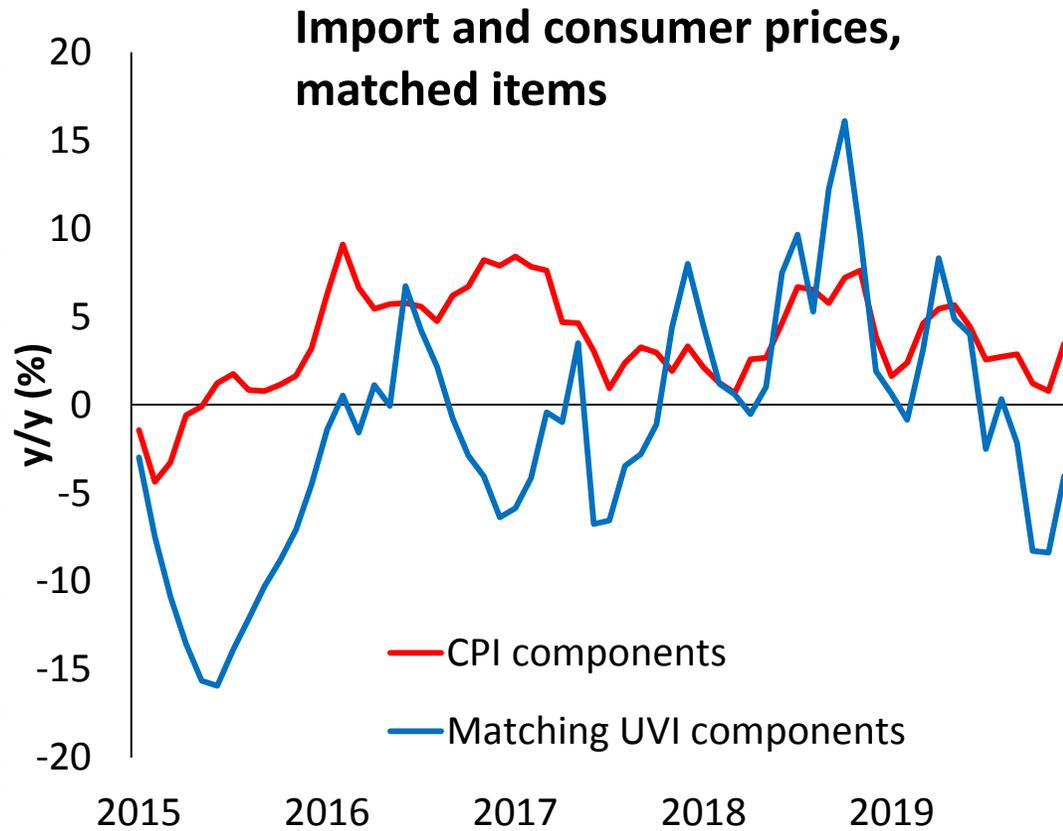
Source: SARB



But pass-through to inflation now lower...

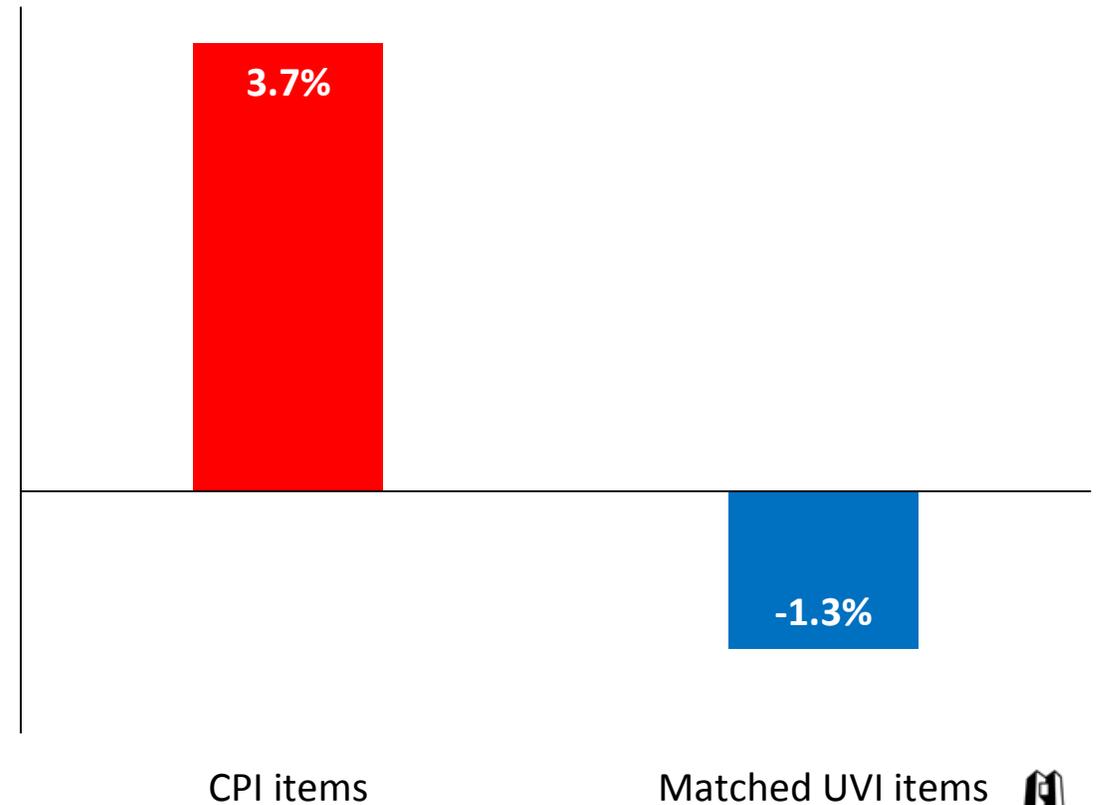


Import prices also deflating... not all about pass-through

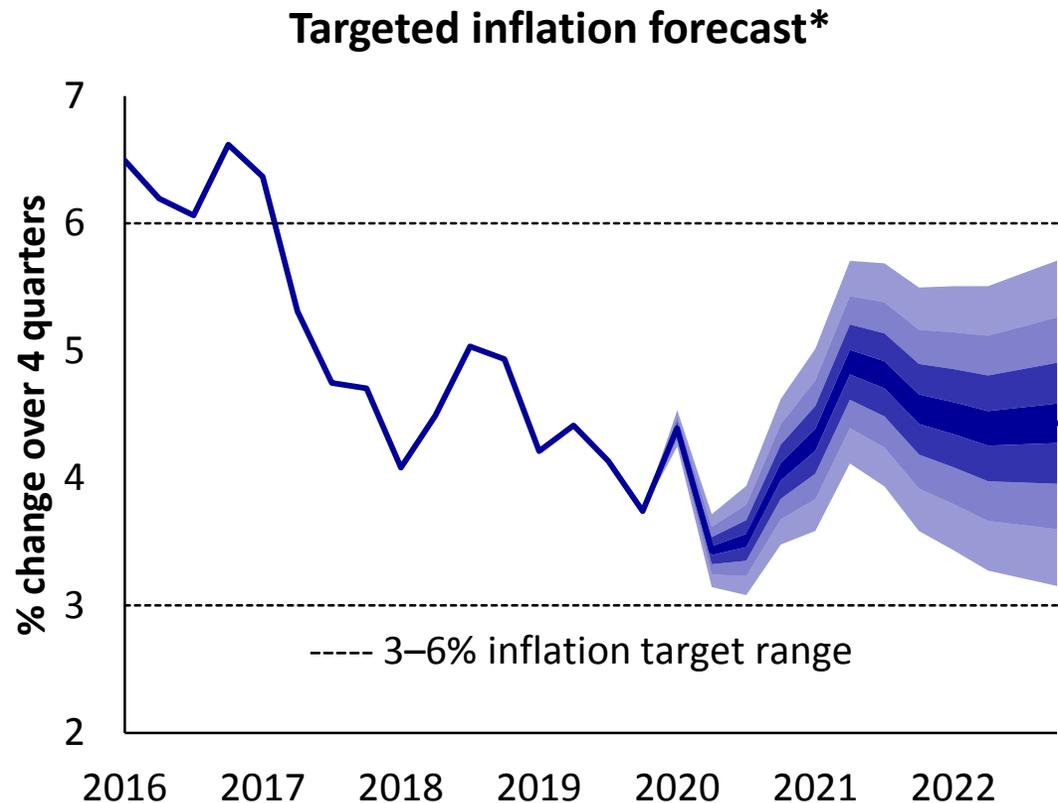


Source: SARB

Average price change, 2015-2019

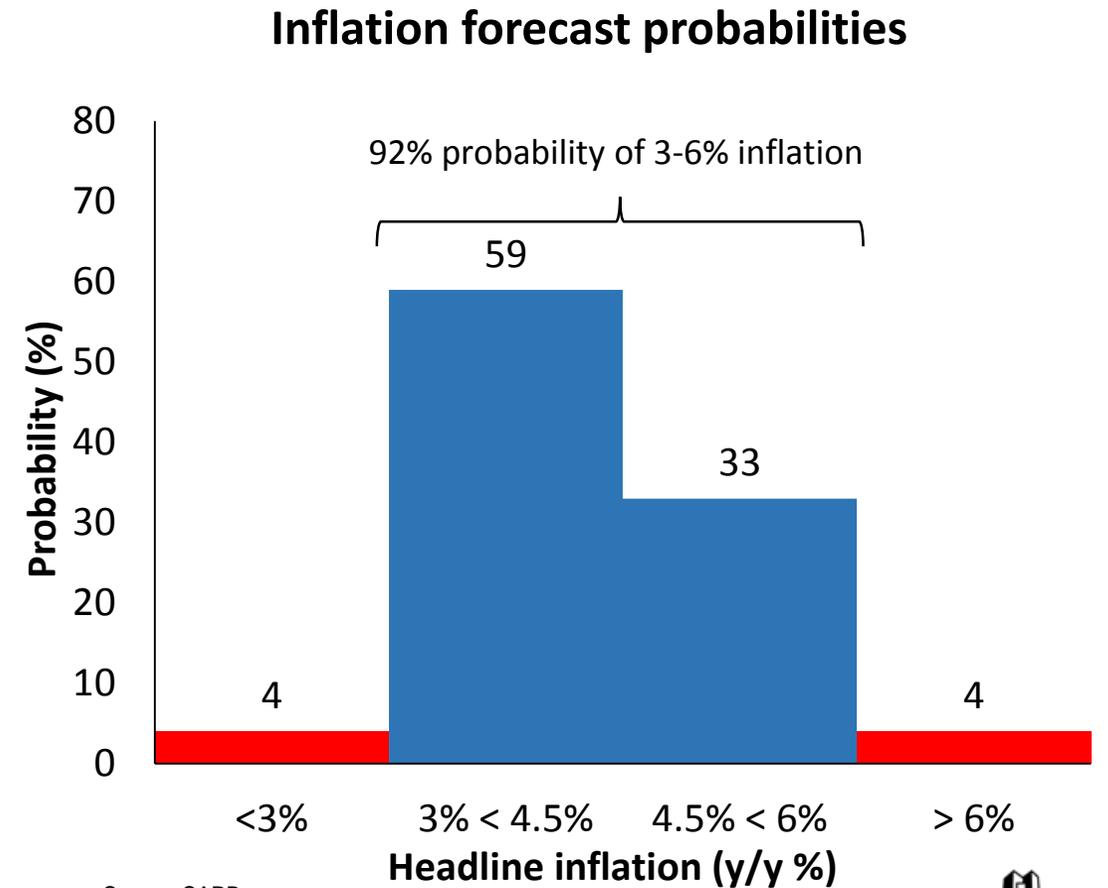


Inflation likely in the bottom half of target this year, but stable



* The shaded bands show confidence intervals of 10%, 30%, 50% and 70%.

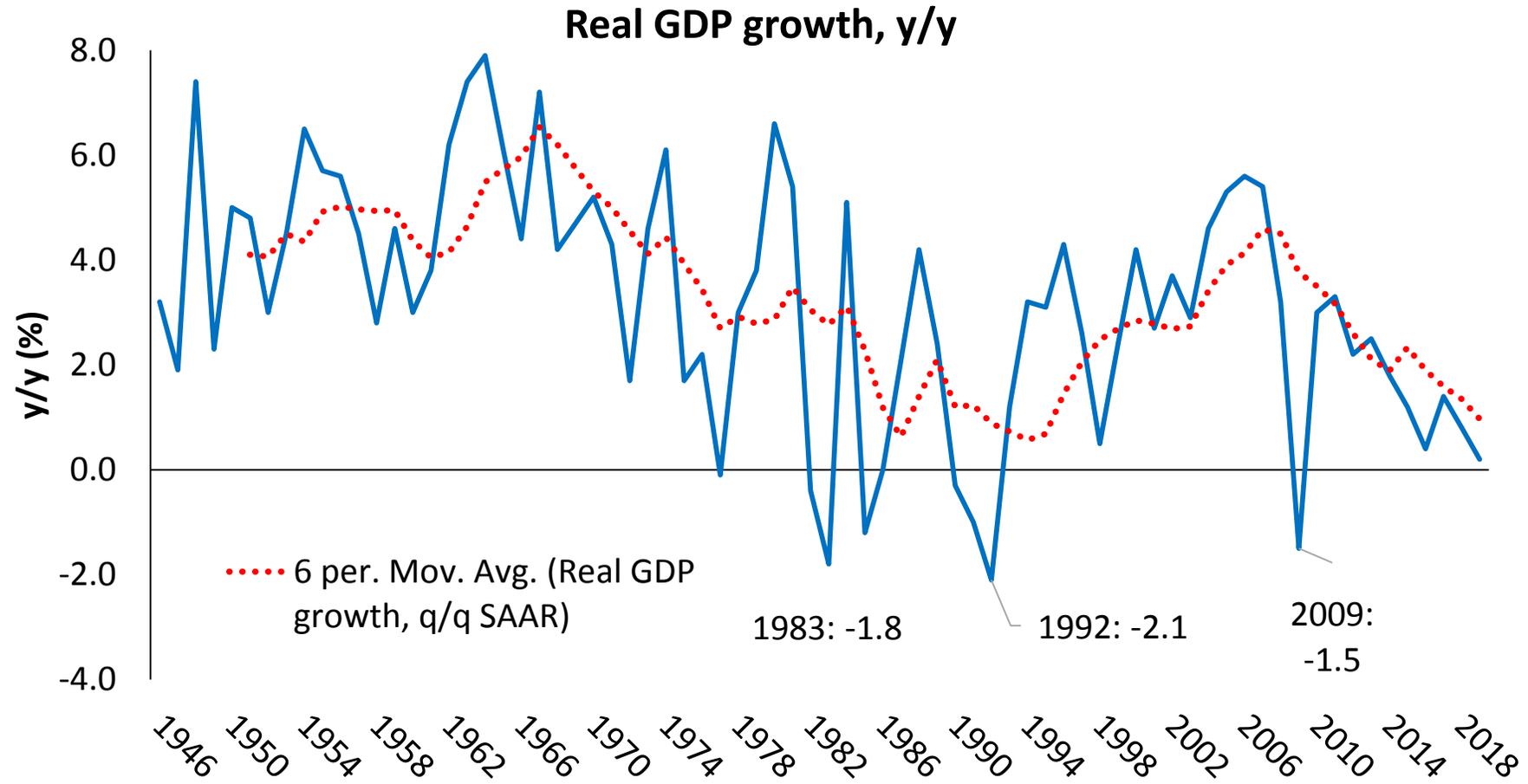
Sources: Stats SA and SARB



Source: SARB

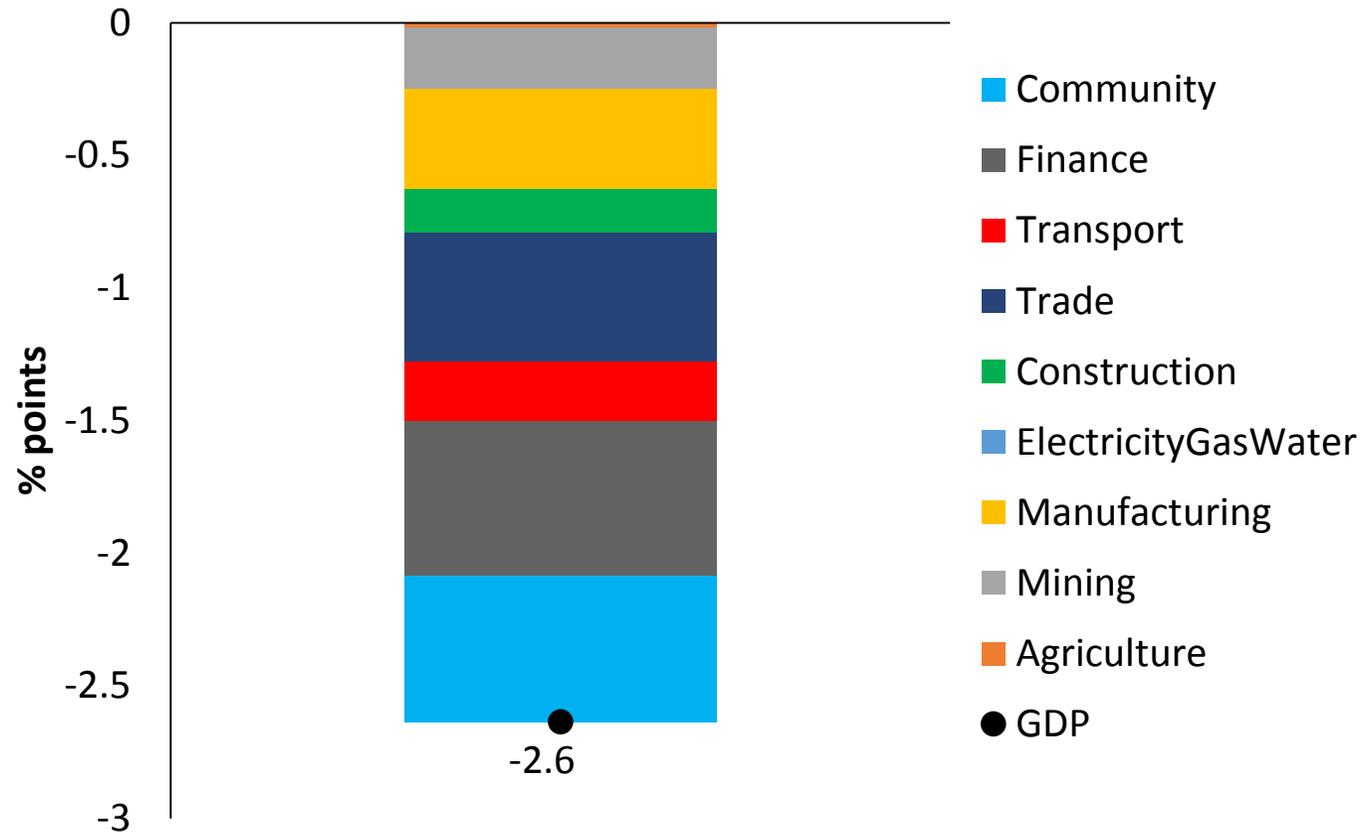


SA economy expected to contract in 2020

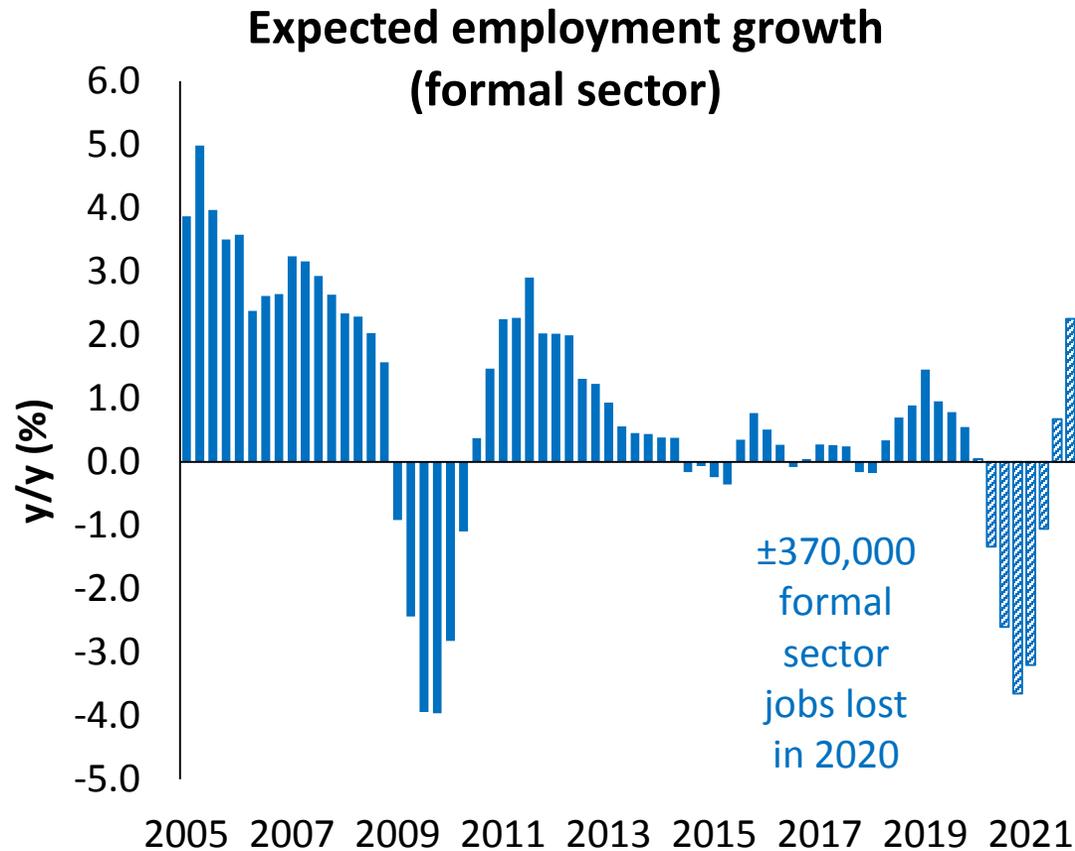


Direct effects of shutdown detract from annual growth

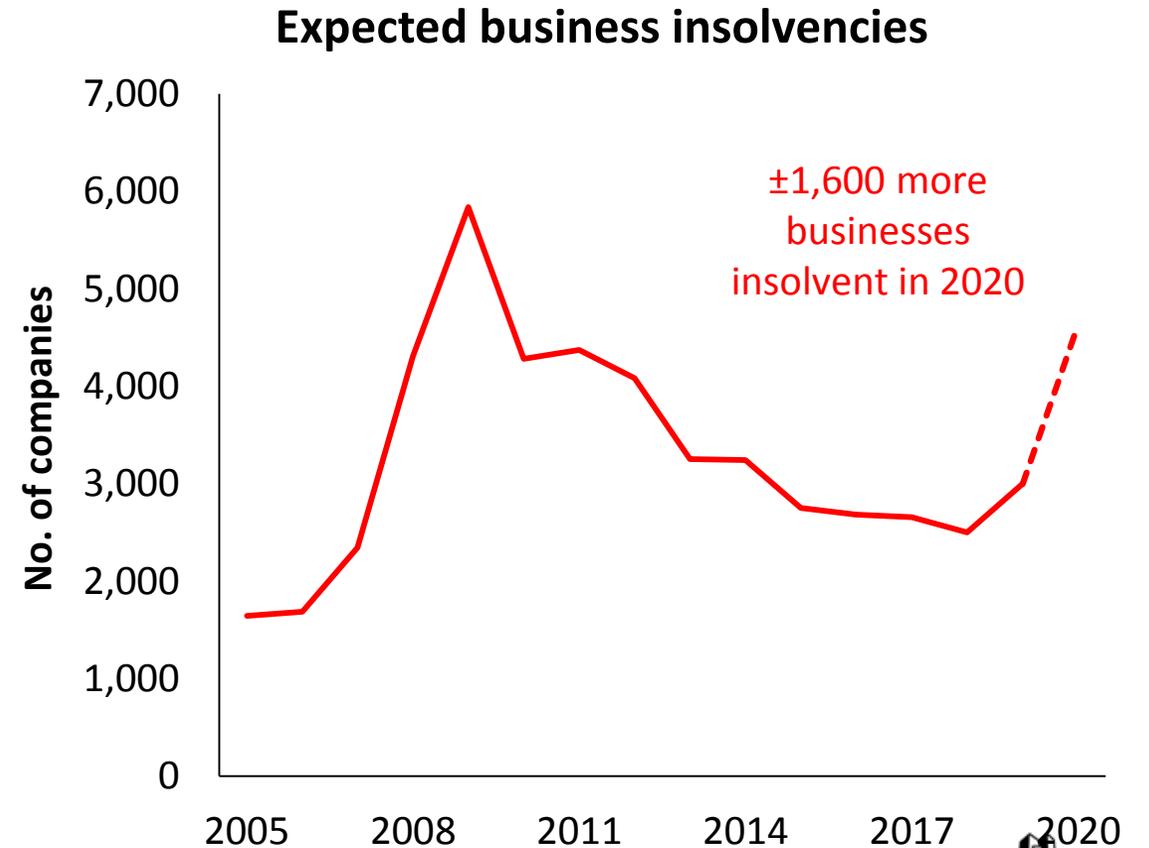
Direct costs of 21 day shutdown on 2020 growth



Partial rebound post-shutdown, but offset by job losses, business failures



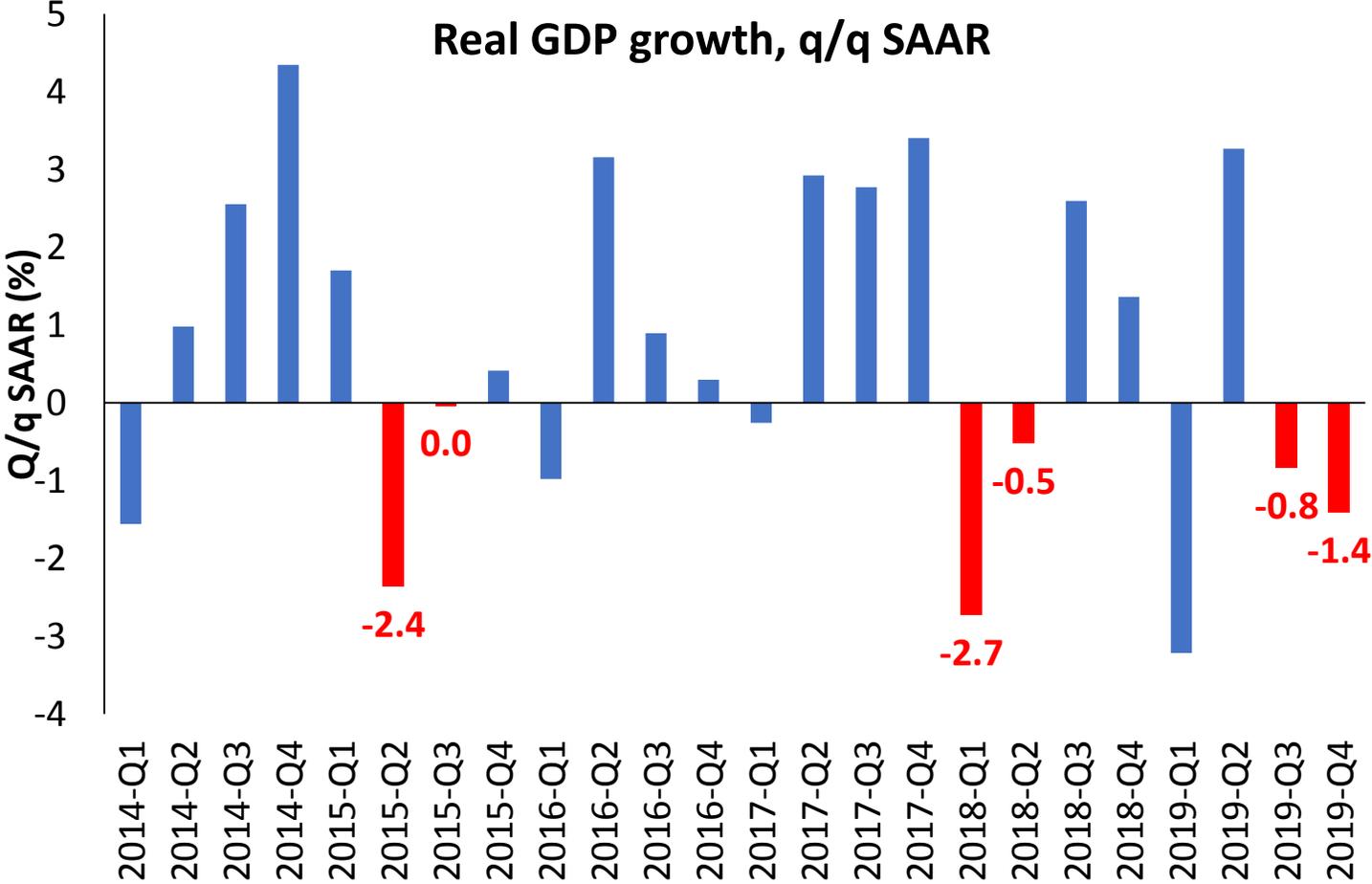
Sources: Stats SA and SARB



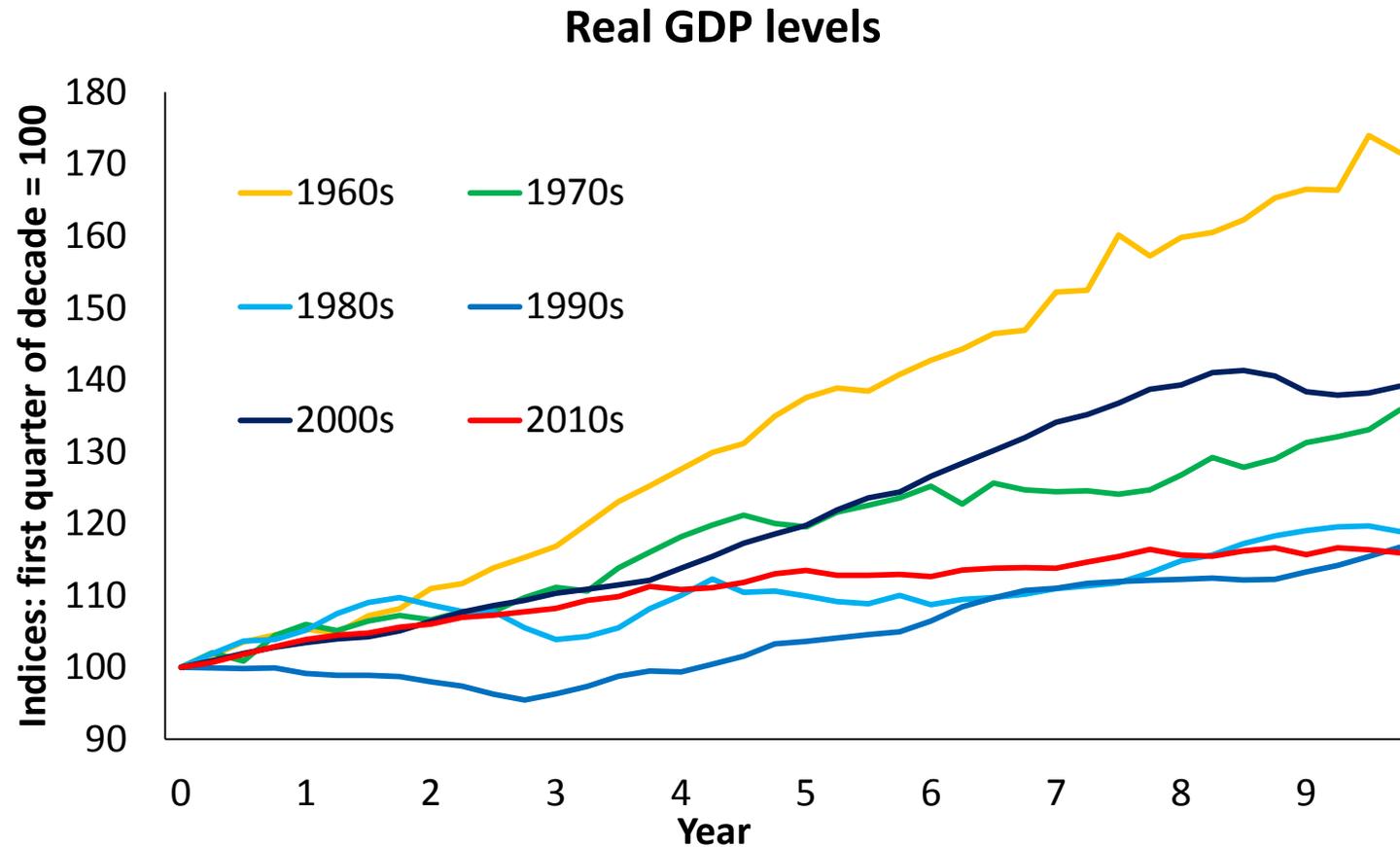
Sources: Stats SA and SARB



The economy was in recession before COVID-19



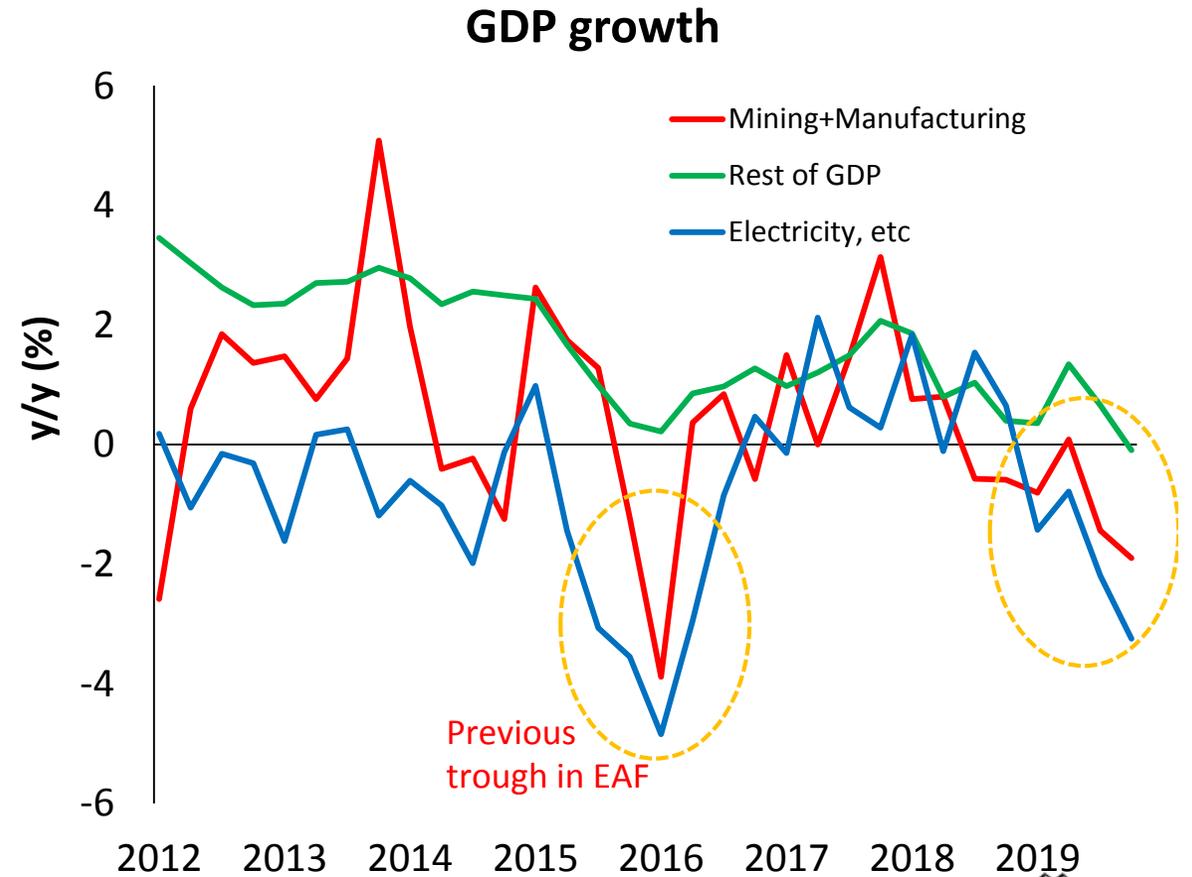
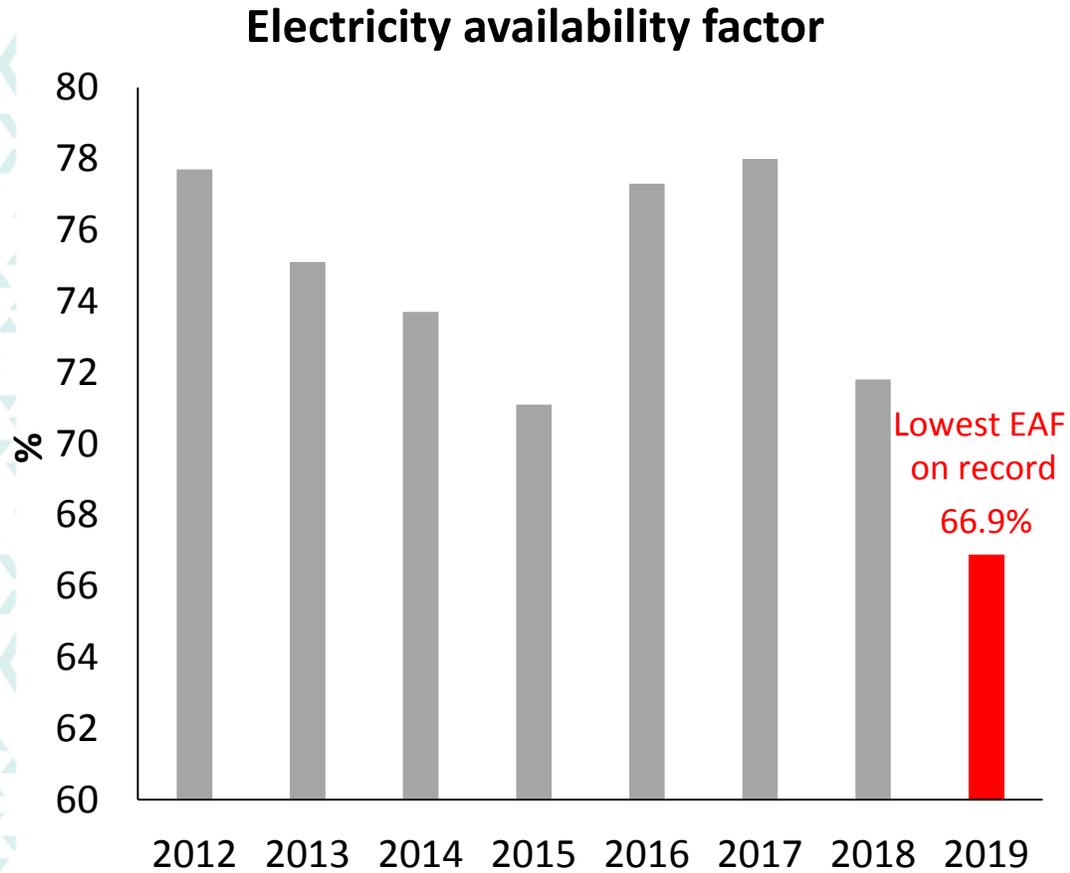
Past decade the worst for growth on record



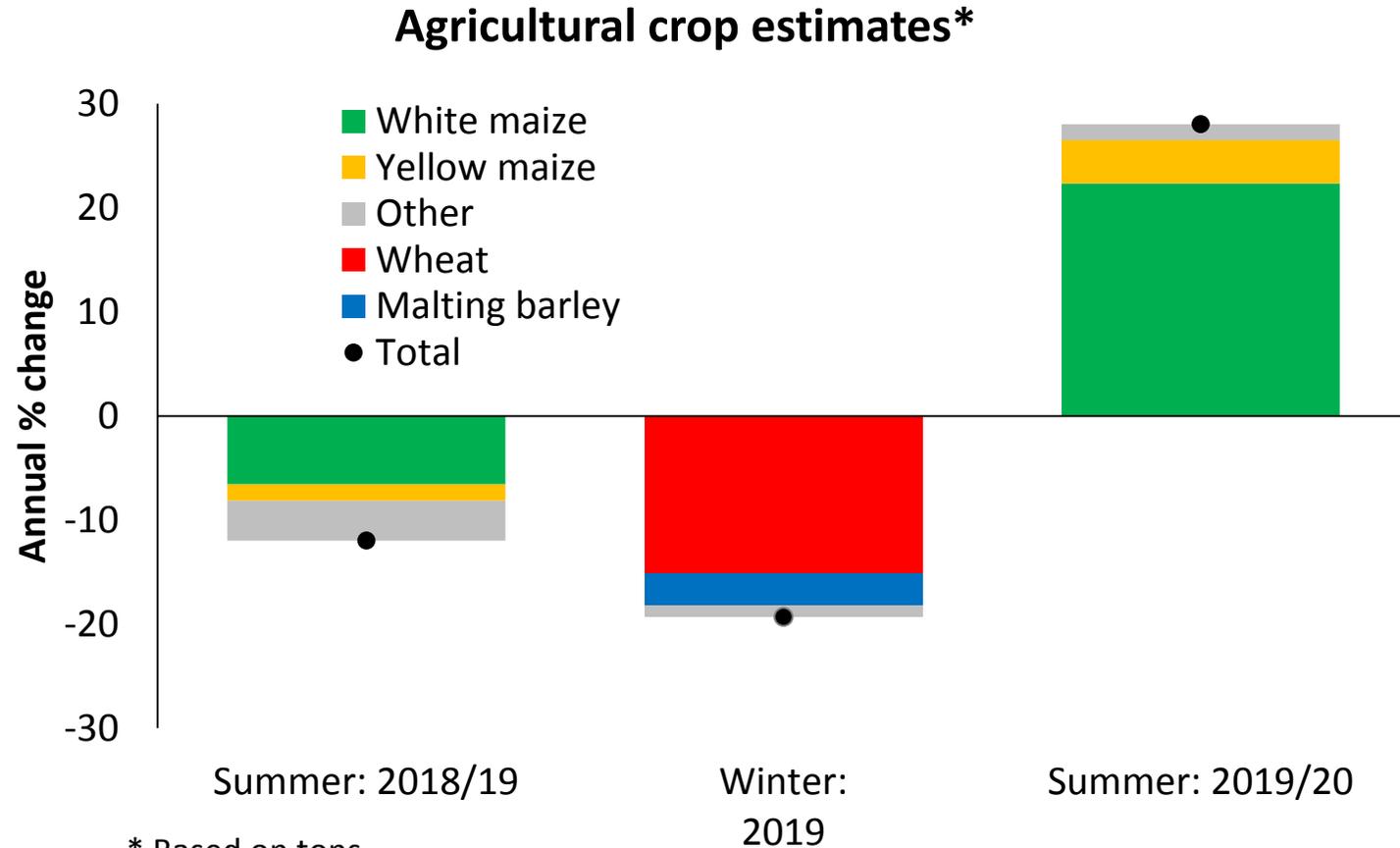
Sources: Stats SA and SARB



Electricity shortages became more acute



Also a difficult year for agriculture

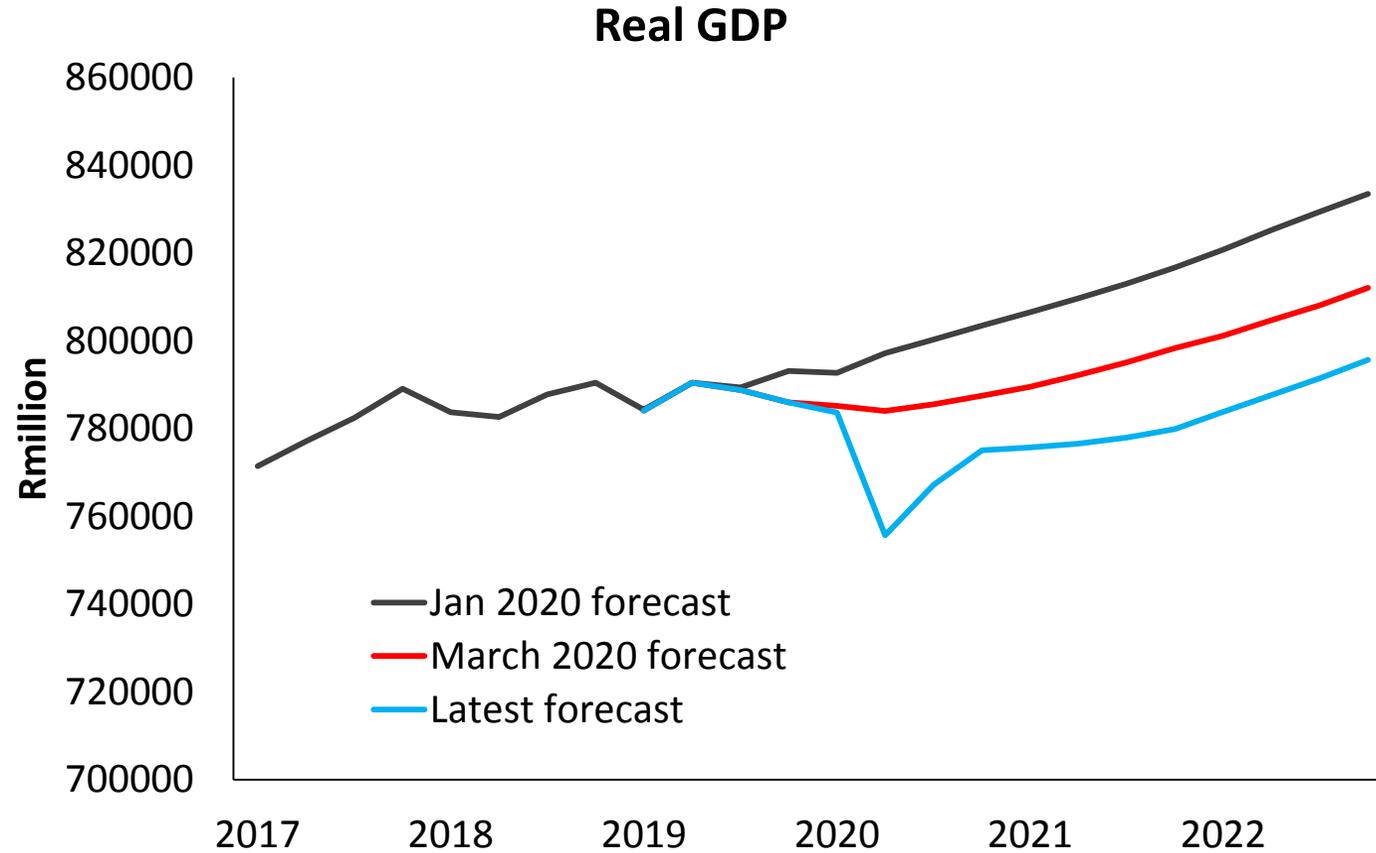


* Based on tons

Source: DAFF



Growth outlook uncertain into 2021 & 2022

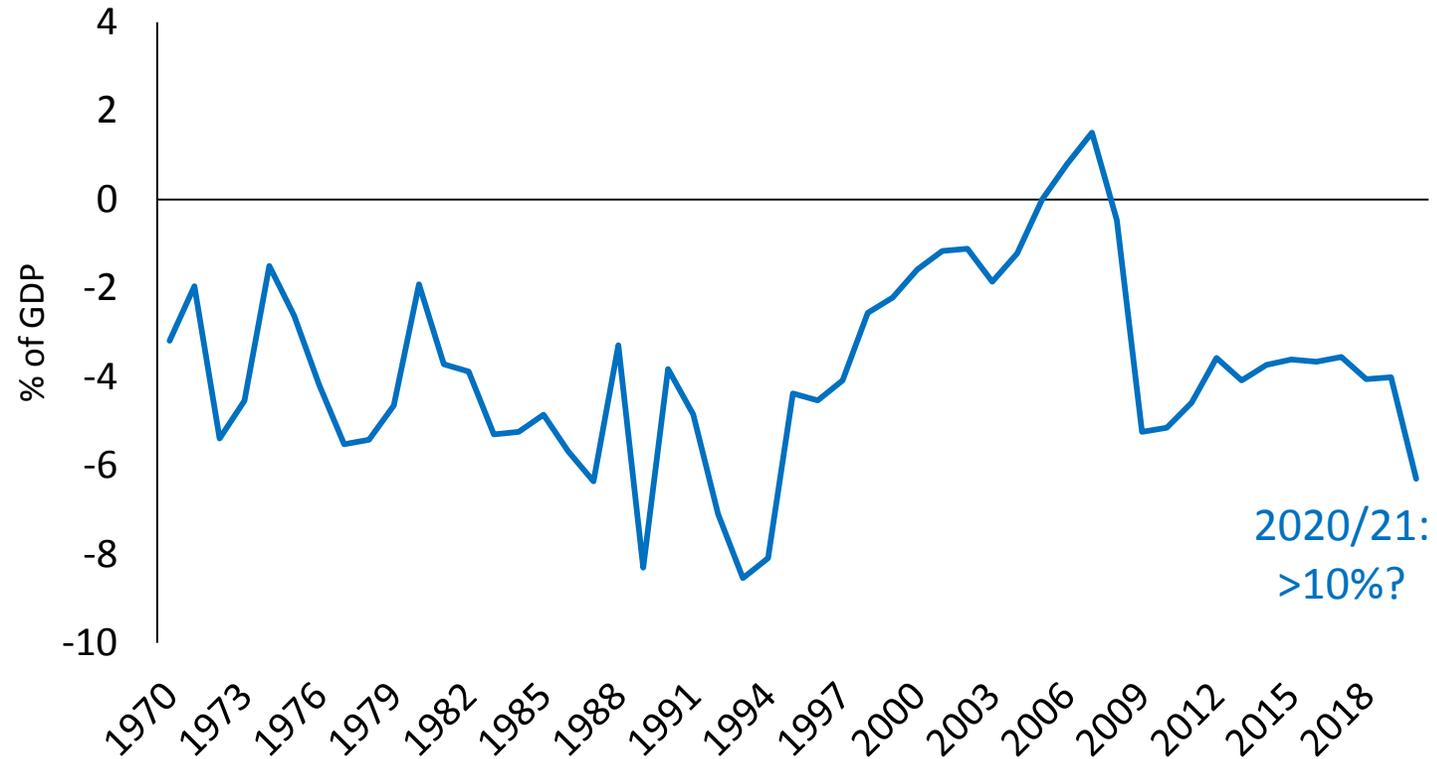


Source: SARB



Despite hyper-extended fiscal position

Budget balance

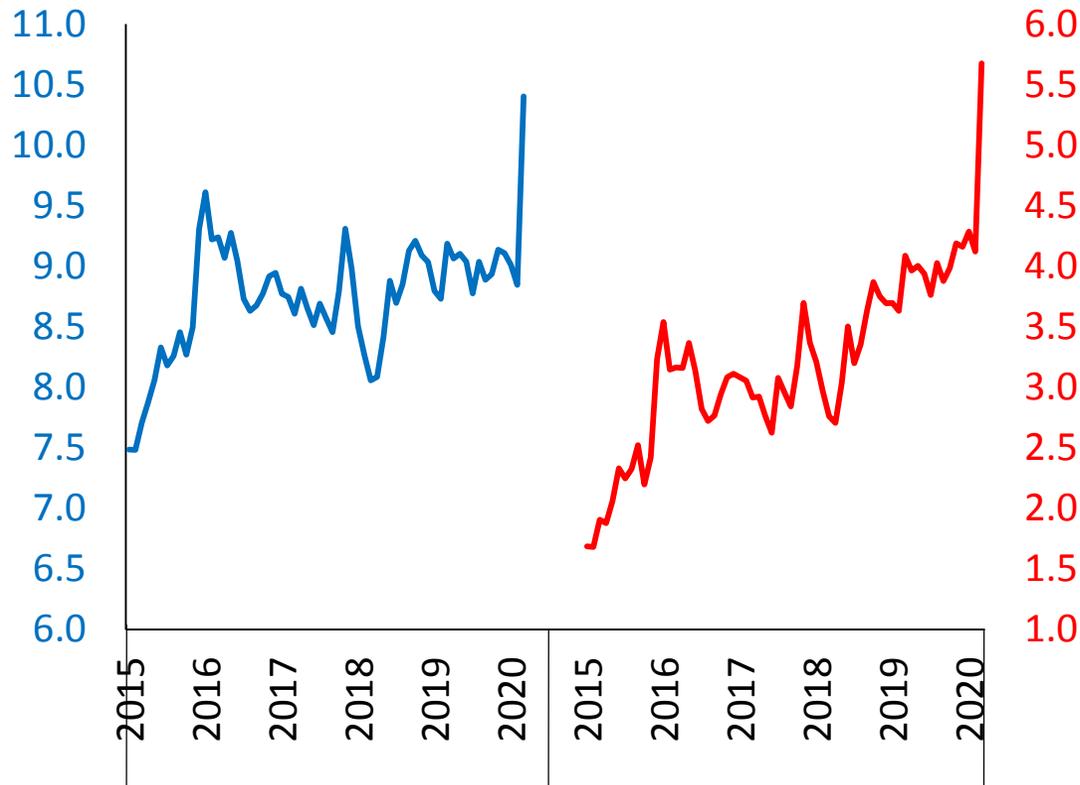


Sources: Mauro et al., National Treasury



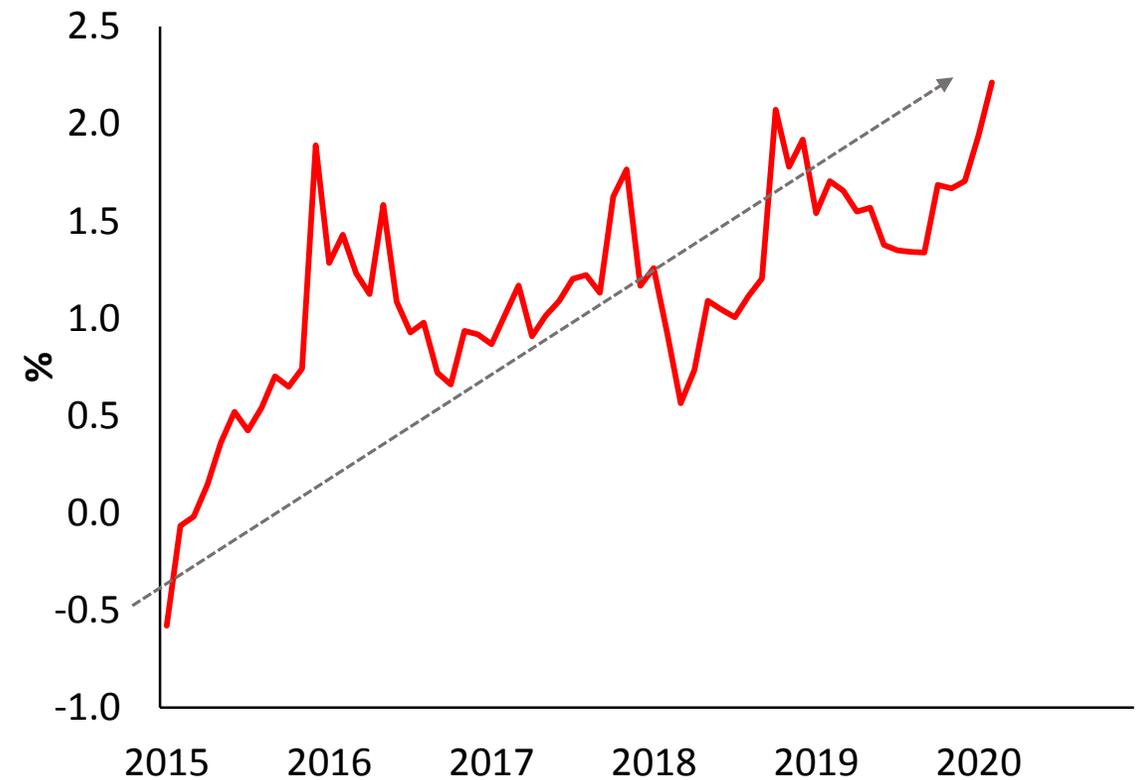
Long-term lending cost rising

SA ten-year bond yields



Source: Haver. *Real yields deflated using BER 5-yr inflation expectations

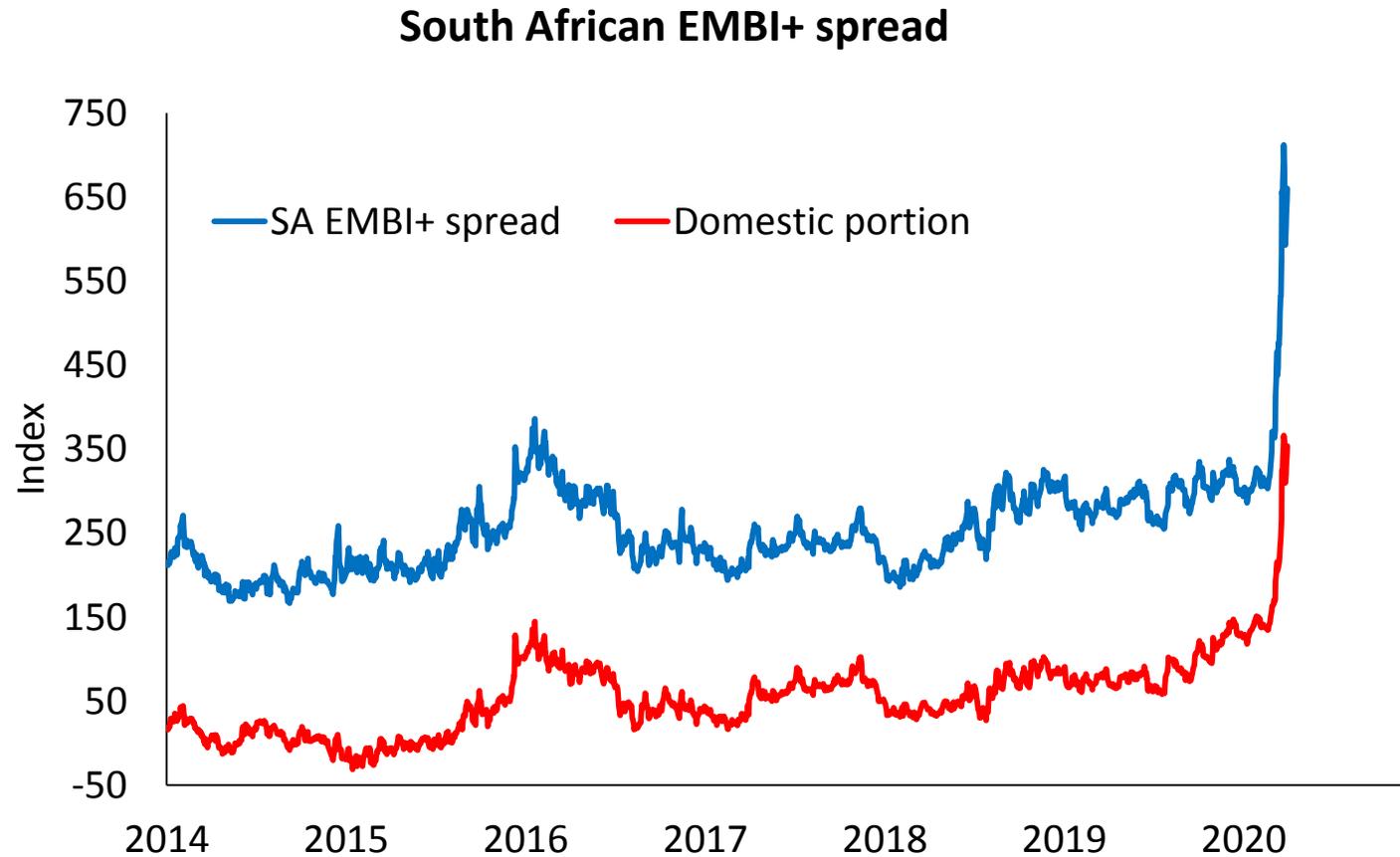
Term premium on SA 10-year bond



Sources: Bloomberg and SARB



EM risk generally up, but SA higher

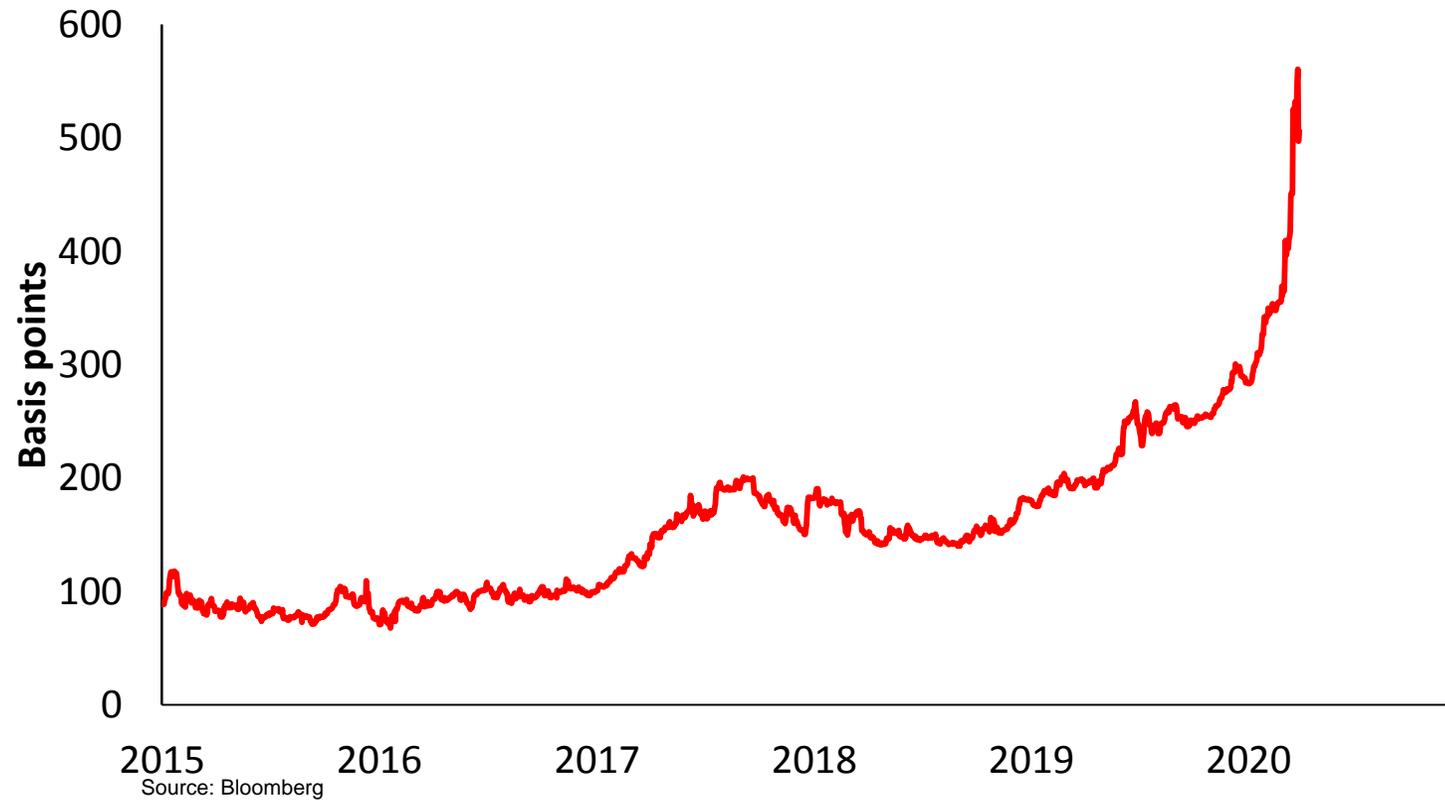


Sources: Bloomberg and SARB

This chart shows a decomposition of the SA EMBI+ spread, a measure of sovereign SA risk, into its general (blue) and idiosyncratic (red) drivers. General drivers are common to emerging markets; the idiosyncratic ones are SA-specific.

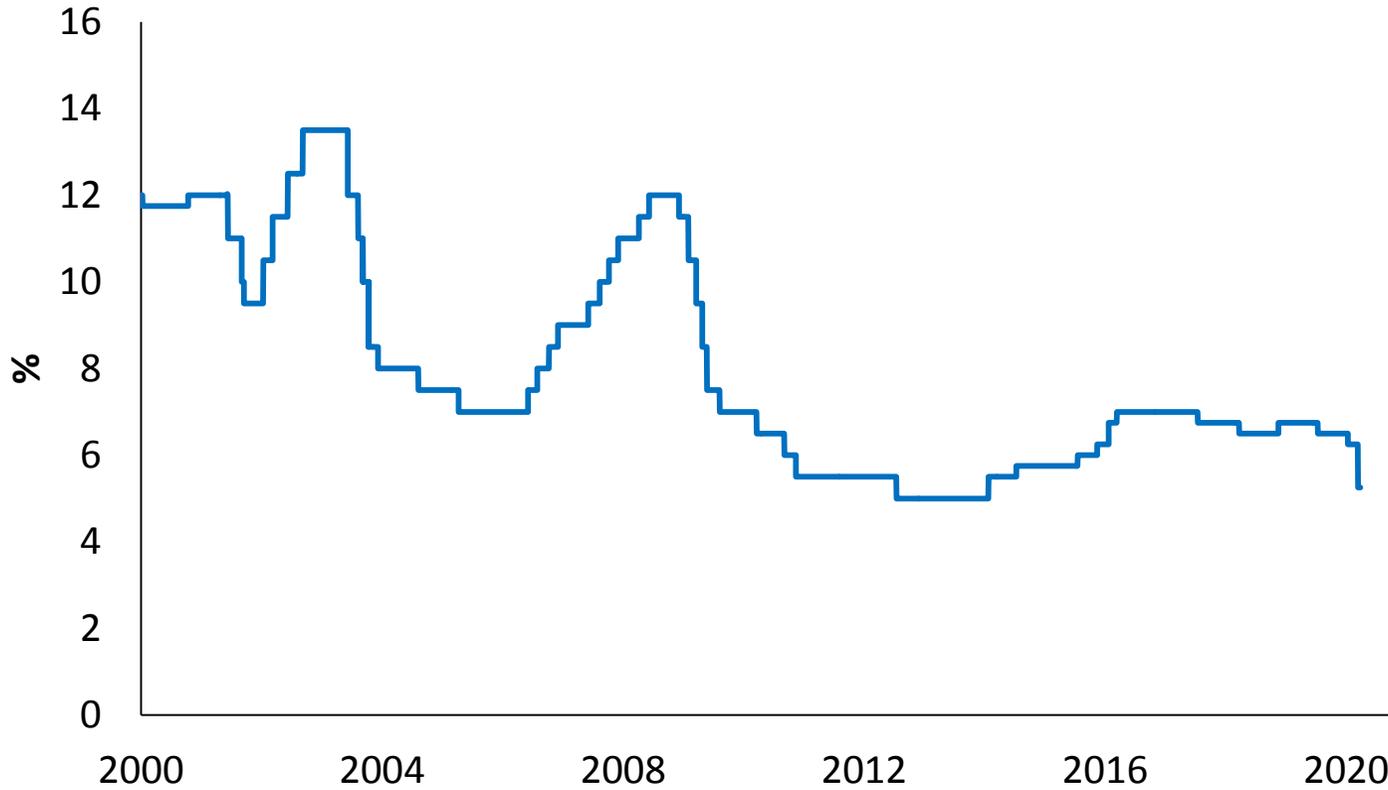
Yield curve now very steep... weakening policy impact

Spread: 2-year versus 30-year bond



Repo rate down to 5.25%, lowest rate since 2014

Repurchase rate



Source: SARB



...frees up cash for households and businesses, less impact on growth

Private sector credit from banks			
R billions	Corporations	Households	Total
Stock of debt: Feb 2020	R 1,795.6	R 1,744.7	R 3,540.3
Implied financing costs: Feb 2020*	R 159.5	R 155.0	R 314.5
Implied financing costs: Mar 2020**	R 143.2	R 139.1	R 282.3
Savings from March 2020 cut p/a	R 16.4	R 15.9	R 32.3
Share of GDP	0.32%	0.31%	0.62%

*Assumes simple interest loan at prime

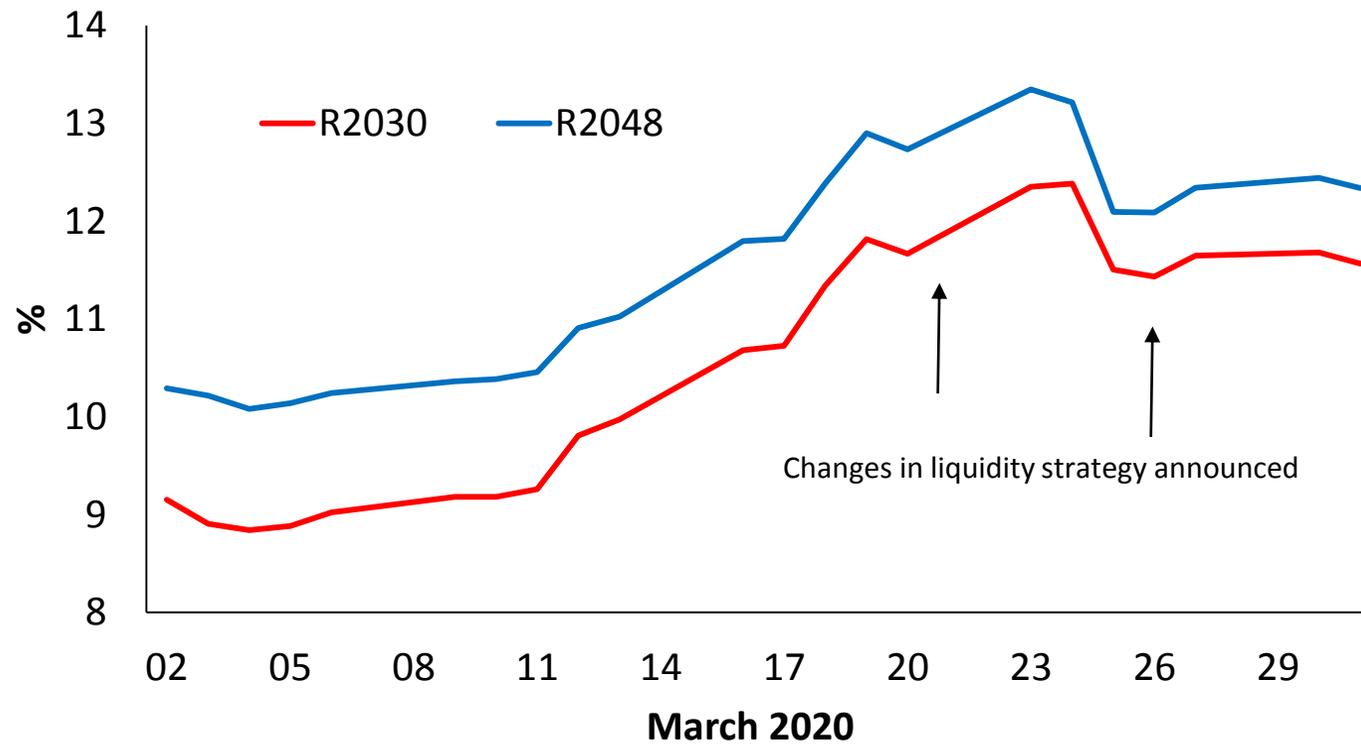
**Assumes capital increases in new loans offset repayments of existing loans

Note: All figures are seasonally adjusted and denominated in R billion, unless otherwise specified



Liquidity supporting financial market functioning

Selected government bond yields



Source: Bloomberg



Conclusions

- COVID-19 a major shock to already weak economy
- Monetary policy space opened, despite currency weakness
- Ease the cost of adjustment, “bridging” to recovery
- Broader reforms crucial for improving growth

