

Interest rate decision is a close call says Merrill Lynch, while funding for the NHI will slow rollout – Business Tech 30

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The South African Reserve Bank's (SARB) decision on interest rates is a close call at best, according to Merrill Lynch, who says that fiscal and global issues weigh on the central bank.

The Reserve Bank's Monetary Policy Committee lowered the repurchase rate to 6.5% from 6.75% in July.

And economists polled by Reuters suggest that the central bank is likely to keep main rate at 6.5%. All but two of the 20 economists surveyed suggested rates would stay on hold in September. The two expect another quarter-point cut to 6.25%.

Merrill Lynch noted that July inflation surprised to the downside at 4% year-on-year (vs. the market at 4.3%).

“Given the global backdrop and event risks, we see nominal rand depreciation continuing. However, the upside risks from rand depreciation are offset by weak growth – weighing on core inflation – and muted imported inflation – supported by weak growth driving global decline in commodity prices,” said a group economist, Ferhan Salman.

“We see average 2019 inflation at 4.2% and average 2020 inflation at 4.7% – end-2020 at 4.6%. We also see downside risks to our growth forecast for 2020 that suggest further downside to our 2020 inflation forecast,” said Salman.

Merrill Lynch said that the neutral rate model suggests about 65bp easing in rates with further downside if the global easing cycle is more aggressive. “This provides room for the SARB to ease rates. The calendar, fiscal risks and rand complicates any rate decision in upcoming meetings.”

Salman said that SARB feels that fiscal dominance is increasingly hampering monetary policy. Rising debt levels lead to higher real interest rates that induce capital inflows. Tighter policy by lowering inflation expectations provides a comfortable return for both local and international investors.

In the former, crowding out of investment in the real sector is more pronounced while in the latter real rates induce flight into South African assets.

“The September decision will be a close call between a hold and a cut of 25bp. We are of the view that SARB can introduce a 25bp cut to insure against staying behind the global easing cycle,” the economist said.

A hold, he added, would postpone easing into 2020 as November will be volatile due to local events, including the Budget statement, and Moody's ratings decision, and global noise including tariff wars.

Implementation of the National Health Insurance and debt relief

Merrill Lynch also commented on The National Health Insurance Bill, which was tabled earlier in August. The bill proposes free essential healthcare, regardless of employment status and the ability to make a direct monetary contribution to the NHI Fund.

It would take funds from the national health budget, private healthcare expenditure and higher personal income tax to be able to provide additional financing.

Citing Treasury, Merrill Lynch said that full implementation of the NHI would require R150 billion per year (a 7-8% increase in VAT) under conservative assumptions. "This makes its implementation difficult in the next 6-7 years," Salman said.

Legislation would allow the board and the NHI framework to be set up in the short term. However, funding constraints would lead to gradual implementation of the program over the medium term, Merrill Lynch said.

"Rollout is expected to begin by 2022 with full implementation by 2026. We see limited scope for tax allocations towards the NHI for now, given tight fiscal space, with delays to implementation likely," Salman said.

The National Credit Amendment Bill, which allows for the unsecured debts of over-indebted consumers to be rescheduled and in certain circumstances, cancelled, Salman said: "We think this will lead to an increase in bad debt provisions due to moral hazard, stricter lending requirements limiting loan growth and increased cost of credit for households."

The bill allows for the suspension of debt for up to two years and, if chances of rehabilitation don't improve, cancellation. Debt repayments can be rescheduled for periods of up to five years.

Locals are impatient on the pace of reforms

"There is broad acknowledgement of reform progress albeit at a slow pace and in less priority areas," said Salman.

"There have been positive changes at the cabinet level, leadership changes at tax administration, increased responsibilities for the auditor general, announcements around spectrum licensing / visa reform, investment announcements from Ford and Pepsi and a reconfirmation of SARB independence."

Merrill Lynch said that fiscal consolidation, restructuring state-owned enterprises, fighting corruption, and increasing security should be the priority.

"Nevertheless, government bureaucracy and technocracy are occupied with reforms like free health and debt relief that distract attention from priority reforms.

“We think recent moves by president Ramaphosa to address the ANC policy agenda should help him consolidate power and pave the way to implement reform in the medium-term. The downside is that fiscal risks are mounting and reforms will be difficult to implement into the next election cycle,” Salman said.