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Economics Group

Special Commentary

Central Banks in Brazil and South Africa Up Next

Executive Summary

- Central banks have eased monetary policy aggressively over the past few weeks as the COVID-19 virus continues to spread and disrupt economies and financial markets. As a result of easier monetary policy from the Fed and other major central banks, central banks in emerging economies have started pursuing lower interest rates as well.
- We expect the trend to continue as the Brazilian Central Bank (BCB) and South African Reserve Bank (SARB) are set to make monetary policy decisions this week. As of now, we expect both central banks to cut interest rates 50 bps, with risks tilted towards even more aggressive easing, as the effect of the virus is likely to weigh on each economy.

Easier Policy Reaches Emerging Economies

COVID-19 has created volatility across global financial markets. The selloff in equity markets has been severe, while volatility in currency markets has skyrocketed over the last few months. In addition, global bond yields continue to fall, with two-year yields in the United States currently sitting at 0.45% as the Fed has aggressively cut policy rates over the last month in an effort to limit the economic fallout from the virus. The Fed has not been the only developed market central bank to ease monetary policy as the virus has intensified, with the Bank of England, Bank of Canada, Reserve Bank of Australia and Reserve Bank of New Zealand also lowering interest rates.

With the Fed and other major foreign central banks cutting interest rates, this has placed pressure on emerging central banks to ease monetary policy as well. Of course the potential economic impact of the virus has also contributed to the decision to lower interest rates, but rate cuts from G10 central banks typically provides a significant incentive for emerging economies to cut rates. As of now, central banks in Turkey, Chile and Korea have all reduced their respective main policy rates, while policymakers in the Philippines and Indonesia have signaled they are likely to ease monetary policy in the next few days. In addition to these emerging economies, over the next two days the Brazilian Central Bank (BCB) and South African Reserve Bank (SARB) will make rate decisions, and given the current backdrop, we expect both central banks to cut rates at least 50 bps.

Brazilian Central Bank on the Move Again

While Latin America has not seen COVID-19 infection rates rise as quickly as other parts of the world, it is still likely that an economic impact will be felt across the region. In order to offset the slowdown, most central banks will likely look to lower policy rates and we think the Brazilian Central Bank is next in line to cut interest rates. Utilizing our assessment of which emerging central banks have room to cut interest rates, our model suggests that BCB still has space to lower interest rates. As of now, the BCB’s Selic rate is 4.25%, the lowest it has ever been, with inflation still relatively low and the domestic economy still struggling to gain momentum and downward pressure on global interest rates building, we believe the BCB will opt to cut rates another 50 bps at today’s meeting. While we believe the BCB will cut 50 bps today, we believe risks around this view are tilted towards even more aggressive easing. Some central banks within emerging markets have already cut more than economists or investors had expected, and we believe it is possible the BCB could also move rates by more than currently anticipated.

We expect the BCB and SARB to each cut interest rates 50 bps this week.

We believe risks around the BCB’s policy meeting are tilted towards even more aggressive easing.

Together we’ll go far

This report is available on wellsfargo.com/economics and on Bloomberg WFRE.
In addition to the BCB, the South African Reserve Bank (SARB) is scheduled to assess monetary policy this week. Similar to the BCB, we also expect the SARB to cut rates 50 bps at its meeting currently scheduled for tomorrow. Assuming SARB moves ahead with a 50 bps cut, this would mark the second time the central bank cut rates this year, which is relatively significant given SARB is typically quite conservative when it comes to making adjustments to monetary policy. Utilizing our same monetary policy space model, we also believe the SARB has adequate room to lower policy rates. In addition to the likely economic impact the South African economy will come under as a result of the virus, inflation is also low by historical standards, while positive real rates give the SARB room to lower rates.

Source: Bloomberg LP and Wells Fargo Securities

We believe the SARB has adequate room to lower policy rates.