HOUSEHOLD SECTOR –JANUARY INTEREST RATE DECISION

Today's interest rate hike puts bets on further residential market strengthening off, but will at the same time serve to keep market behaviour healthy and free of speculative behaviour.

29 January 2014

THE CRUX OF THE MESSAGE FROM THE MPC (MONETARY POLICY COMMITTEE)

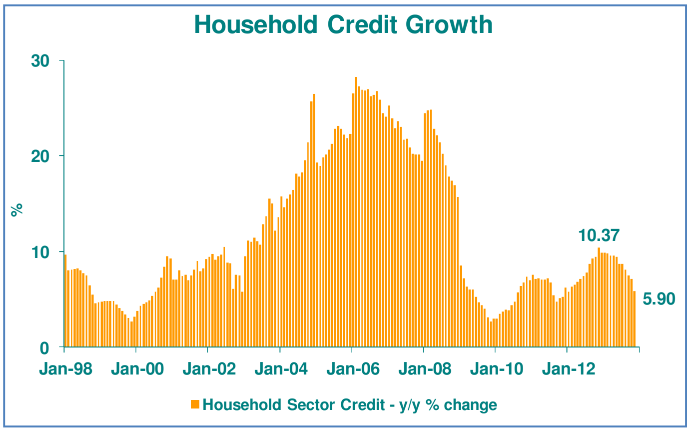
The Monetary Policy Committee (MPC) of the Reserve Bank (SARB) served up something of a surprise today by raising its policy repo interest rate by half a percentage point to 5.5%, which will in turn cause commercial banks to raise their prime lending rates from 8.5% to 9%.

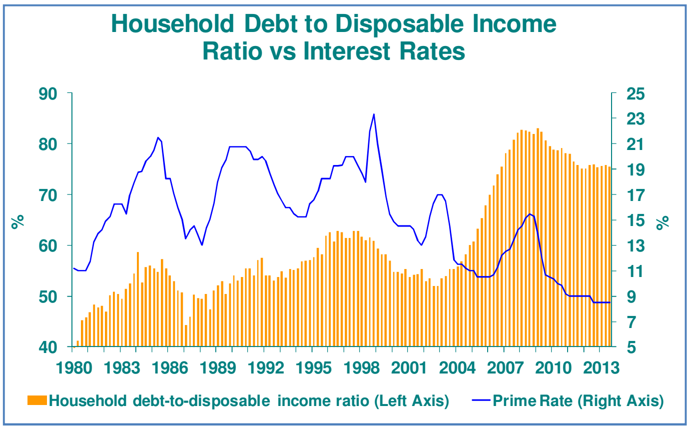
The decision appeared largely Rand driven, following a sharp currency depreciation in recent times, with key changes to the SARB's Rand assumptions now causing its CPI inflation forecasts to move outside the target range for an "extended period". The decision was in spite of the SARB having lowered its economic growth forecasts for 2014 and 2015. It appears to be a decision that cannot have been taken lightly, but at the end of the day the SARB does have an official 3-6% inflation target, and must be seen to be responding to severe inflationary pressures should it wish to maintain credibility.

IMPLICATIONS FOR THE HOUSEHOLD/ CONSUMER SECTOR

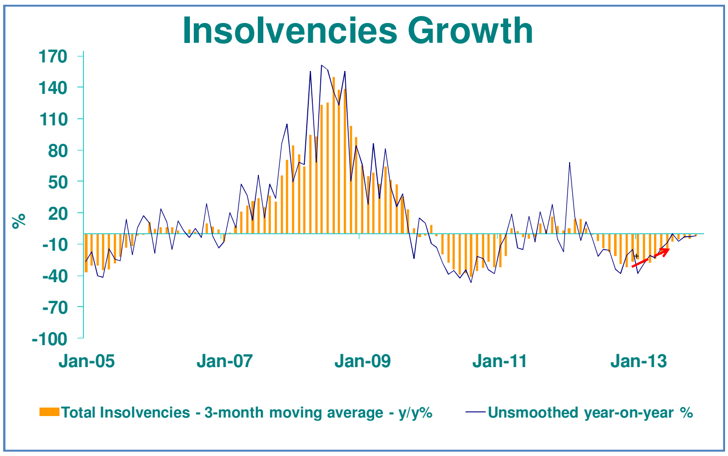
- *The impact should be seen as "negative" from a short term consumer point of view. As the positive impact of the big interest rate cuts has been gradually wearing off through 2012/13, both real household sector disposable income growth and real consumption expenditure growth have been slowing. By now, we anticipate that these variables' growth rates are not far from 2%, and we anticipate average real consumption growth for 2014 more likely to move down into the 1-2% range for 2014. This would be down from the average growth rate of nearer to 2.5% estimated for 2013 as a whole.*
- *The rate hike would further serve to contain household sector credit growth, whose November 2013 year-on-year rate had already slowed to 5.9%, from a high of 10.4% as at November 2012. We would expect further slowing in this growth in the near term.*

  This probably implies further containment of the household sector's debt-to-disposable income ratio in the near term. This ratio was 75.5% as at the 3rd quarter of 2013. That level represented a decline on the prior quarter's 75.8, and the most recent pace of growth in household sector credit is expected to remain below nominal household disposable income growth of nearer to 7%, thus bringing about a further decline in the household debt-to-disposable income ratio in the near term. This would be a positive development in terms of reducing household vulnerability to future interest rate hiking.





- *The rate hike may however serve to raise the level of bad debts slightly. Taking insolvencies as an indicator of bad debt trends, we have already seen a healthy declining trend of recent years virtually coming to an end in recent months, and the rate hike may well once again push insolvencies growth into slightly positive territory. However, one lone interest rate hike would not have an extreme impact.*



- *Finally, a rate hike may have a very slight impact in encouraging household savings although we would not expect "miracles" in this regard, as the savings problem is a longer term structural issue that can't be solved that easily. Household savings is very weak by historic standards, with the net savings/disposable income ratio stuck at around zero, implying that what little gross saving exists is just sufficient to cover the depreciation on fixed assets.*

IMPLICATIONS FOR THE RESIDENTIAL PROPERTY MARKET

- *For the residential property market, this interest rate hike is seen as a negative for growth in demand, thus likely to have a containing impact on house price growth. All bets are off regarding any noticeable rise in house price growth compared to recent levels, and single-digit price growth is expected to remain a characteristic through 2014.*
- *The new repo rate level, which leaves the prime rate percentage at 9%, slightly above house price growth, does not promote unhealthy short term speculative buying on a large scale, because it is not easy to borrow money at prevailing rates and make quick capital gains. From a point of view of preventing major speculative activity in the residential market, therefore, this level of interest rates would appear appropriate.*

MORTGAGE LOAN INSTALMENT TABLE

To give an example of the direct impact of the cost of the interest rate hike on mortgage loans, we take a R1m 20 year mortgage loan at prime rate. A rise from 8.5% to 9% would imply a R319/month increase in the instalment value. This is not extreme for most people. But it important to realize that interest rate hikes often take place in a series, and are not usually confined to one isolated hike. It is thus always prudent to make provision for a few percentage points' worth of interest rate hikes.

Bond Value (20 years)	**Monthly instalment value according to interest rate charged on a 20-year bond**											
	15.5%	15.0%	14.0%	13.0%	12.0%	11.0%	10.0%	9.5%	9.0%	8.5%	8.0%	7.5%
R 300 000	R 4 062	R 3 950	R 3 731	R 3 515	R 3 303	R 3 097	R 2 895	R 2 796	R 2 699	R 2 603	R 2 509	R 2 417
R 400 000	R 5 416	R 5 267	R 4 974	R 4 686	R 4 404	R 4 129	R 3 860	R 3 729	R 3 599	R 3 471	R 3 346	R 3 222
R 500 000	R 6 769	R 6 584	R 6 218	R 5 858	R 5 505	R 5 161	R 4 825	R 4 661	R 4 499	R 4 339	R 4 182	R 4 028
R 600 000	R 8 123	R 7 901	R 7 461	R 7 029	R 6 607	R 6 193	R 5 790	R 5 593	R 5 398	R 5 207	R 5 019	R 4 834
R 700 000	R 9 477	R 9 218	R 8 705	R 8 201	R 7 708	R 7 225	R 6 755	R 6 525	R 6 298	R 6 075	R 5 855	R 5 639
R 800 000	R 10 831	R 10 534	R 9 948	R 9 373	R 8 809	R 8 258	R 7 720	R 7 457	R 7 198	R 6 943	R 6 692	R 6 445
R 900 000	R 12 185	R 11 851	R 11 192	R 10 544	R 9 910	R 9 290	R 8 685	R 8 389	R 8 098	R 7 810	R 7 528	R 7 250
R 1 000 000	R 13 539	R 13 168	R 12 435	R 11 716	R 11 011	R 10 322	R 9 650	R 9 321	R 8 997	R 8 678	R 8 364	R 8 056
R 1 100 000	R 14 893	R 14 485	R 13 679	R 12 887	R 12 112	R 11 354	R 10 615	R 10 253	R 9 897	R 9 546	R 9 201	R 8 862
R 1 200 000	R 16 247	R 15 801	R 14 922	R 14 059	R 13 213	R 12 386	R 11 580	R 11 186	R 10 797	R 10 414	R 10 037	R 9 667
R 1 300 000	R 17 600	R 17 118	R 16 166	R 15 230	R 14 314	R 13 418	R 12 545	R 12 118	R 11 696	R 11 282	R 10 874	R 10 473
R 1 400 000	R 18 954	R 18 435	R 17 409	R 16 402	R 15 415	R 14 451	R 13 510	R 13 050	R 12 596	R 12 150	R 11 710	R 11 278
R 1 500 000	R 20 308	R 19 752	R 18 653	R 17 574	R 16 516	R 15 483	R 14 475	R 13 982	R 13 496	R 13 017	R 12 547	R 12 084
R 1 750 000	R 23 693	R 23 044	R 21 762	R 20 503	R 19 269	R 18 063	R 16 888	R 16 312	R 15 745	R 15 187	R 14 638	R 14 098
R 2 000 000	R 27 078	R 26 336	R 24 870	R 23 432	R 22 022	R 20 644	R 19 300	R 18 643	R 17 995	R 17 356	R 16 729	R 16 112
R 2 100 000	R 28 431	R 27 653	R 26 114	R 24 603	R 23 123	R 21 676	R 20 265	R 19 575	R 18 894	R 18 224	R 17 565	R 16 917
R 2 200 000	R 29 785	R 28 969	R 27 357	R 25 775	R 24 224	R 22 708	R 21 230	R 20 507	R 19 794	R 19 092	R 18 402	R 17 723
R 2 300 000	R 31 139	R 30 286	R 28 601	R 26 946	R 25 325	R 23 740	R 22 195	R 21 439	R 20 694	R 19 960	R 19 238	R 18 529
R 2 400 000	R 32 493	R 31 603	R 29 844	R 28 118	R 26 426	R 24 773	R 23 161	R 22 371	R 21 593	R 20 828	R 20 075	R 19 334
R 2 500 000	R 33 847	R 32 920	R 31 088	R 29 289	R 27 527	R 25 805	R 24 126	R 23 303	R 22 493	R 21 696	R 20 911	R 20 140
R 2 600 000	R 35 201	R 34 237	R 32 332	R 30 461	R 28 628	R 26 837	R 25 091	R 24 235	R 23 393	R 22 563	R 21 747	R 20 945
R 2 700 000	R 36 555	R 35 553	R 33 575	R 31 633	R 29 729	R 27 869	R 26 056	R 25 168	R 24 293	R 23 431	R 22 584	R 21 751
R 2 800 000	R 37 909	R 36 870	R 34 819	R 32 804	R 30 830	R 28 901	R 27 021	R 26 100	R 25 192	R 24 299	R 23 420	R 22 557
R 2 900 000	R 39 263	R 38 187	R 36 062	R 33 976	R 31 931	R 29 933	R 27 986	R 27 032	R 26 092	R 25 167	R 24 257	R 23 362
R 3 000 000	R 40 616	R 39 504	R 37 306	R 35 147	R 33 033	R 30 966	R 28 951	R 27 964	R 26 992	R 26 035	R 25 093	R 24 168

**Note: The above rates are indicative only. Actual instalment values can differ mildly depending on the method of calculation applied by a lending instituion*

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