PROPERTY BAROMETER – SARB RATE DECISION

The SARB hiked interest rates again today by a more significant 50 basis points, a bit more rapidly than our expectation as upside inflation risks mount. Best we tread carefully in volatile times.

28 January 2016

THE RATE HIKE DECISION

The Reserve bank (SARB) Monetary Policy Committee (MPC) decided today to hike its policy Repo Rate by a further 50 basis points to 6.75%, a move that will see Commercial Banks raise their Prime rates to 10.25%.

This brings the cumulative rate hiking in the current cycle to 1.75 percentage points (from a Prime Rate of 8.5% to 10.25%) since the start of rate hiking in January 2014. It means that, on a 20 year home loan of R1 million, the monthly instalment has risen by R1,138 per month since January 2014, while the most recent 50 basis point rate hike alone adds another R331 to the monthly payment.

To date, the Consumer Price Index (CPI) inflation rate has not been troublesome, with the December rate measuring 5.2% year-on-year. But it has been rising, and is expected to rise further to above the SARB's upper target limit of 6%, driven largely by drought related food price inflation and a sharply weakened Rand.

The Bank is mindful of a bleak economic growth outlook, forecasting GDP (Gross Domestic Product) growth of only 0.9% in 2016, but projects CPI inflation of 6.8% in 2016 and 7% in 2017, i.e. a rate outside the 3-6% target range for the next 2 years.

The SARB still believes that even with the announced interest rate hike monetary policy remains accommodative. Indeed, even after the series of rate hikes since early-2014, SA interest rates remain low relative to its general inflation rate.

THE MERIT AND IMPACT OF THE DECISION

Inflation figures still reasonable, but sharply weaker Rand and drought make near term surge likely.

From a recent inflation data point of view, there hasn't been major apparent pressure for a "rapid fire" approach to interest rate hiking. But inflationary pressures definitely have been on the rise of late.

The CPI inflation rate has risen from a low of 3.9% year-on-year in February 2015 to 5.2% by December. And the recent sharp further depreciation in the Rand late last year, along with a drought-driven surge in food prices, may speed this rise up in the near term. The Producer Price Inflation Rate for Agriculture is already above 10%, a sign of things to come in the food price inflation space.

The 50 basis point rate hike can thus be seen perhaps as more "forward looking" than backward looking at the historic inflation data.

Admittedly, the main inflation drivers are not controllable by the SARB

Admittedly, if one looks at some of the most troublesome components of the CPI, they include Education, Electricity, Water and Municipal Rates, along with Food. Interest rates have little real influence over the price setting process in these areas of the economy, so these inflation drivers are largely beyond the SARB's control.

However, the SARB looks to curb the 2nd round impacts from these factors, which can cause general inflation expectations to rise, thereby anchoring broader economy-wide price inflation at a higher rate in future. So we believe that rate hiking is justified even though the Bank doesn't have control over all sources of inflation.

Lending rates positive in real terms, and should slow consumption growth further

At the recent Prime Rate of 9.75% and Repo at 6.25% (before today's announced hike), and given the prevailing CPI inflation rate, that translated into a positive Real Repo Rate of about of about 1.05% and a Real Prime Rate 4.55%.

Given that the economy is weak, and Consumer Confidence extremely low, the further interest rate hike, at a time when rates are positive in real terms already, should further slow consumer spending growth, and keep the more credit-driven Durable Goods Consumption category firmly in negative growth territory.

Interest rate levels definitely don't encourage widespread housing speculation

Prime Rate is also above the average rate of house price inflation (recently around 7%), implying a positive real rate should one adjust Prime Rate to a real rate using the FNB House Price inflation rate. This implies little room for speculation in the housing market by speculators wishing to use cheap credit to make a quick capital gain. Rapid capital growth just isn't there at the moment.

Slower Housing Market to come

We have recently seen signs of slowing residential demand growth, and the further interest rate hiking is expected to sustain a slowing trend. We anticipate house price inflation to decline from recent levels of around 7% into lower single digit territory, below CPI inflation rates, through the course of this year.

Limited upside for Household Sector Credit growth

From a Household Sector Credit growth point of view, the ongoing increase in interest rates should contain it to within lower single digit growth rates, below nominal household disposable income growth, and as such we expect further decline in the all-important Household Debt-to-Disposable Income Ratio.

The most recent number for Household Sector Credit growth put it at 4.6% year-on-year in November, having risen slightly from prior months. This rise in growth may be short lived.

….BUT WE BELIEVE IT BEST FOR THE CONSUMER THAT THE BANK CONTINUES HIKING SLOWLY

We do believe, however, that gradual hiking by the SARB can assist in correcting certain Macroeconomic imbalances, and is thus desirable.

The domestic savings rate remains too low

The result of a low domestic savings rate, with Households and Government being the two main culprits here, has been a wide deficit on the Current Account on the Balance of Payments for some years.

This means a heavy reliance on net foreign capital inflows, which have been insufficient in recent years to prevent a multi-year rand slide. Viewing the Household Sector, a Net Dissavings rate means that their level of Gross Saving is insufficient to cover the depreciation on the fixed assets that they as a group own, let alone sufficient to create wealth.

There exists a need to contain the Current Account Deficit, especially given the recent years' weakness in global capital flows towards Emerging Markets. Higher rates are probably required for this purpose.

Household Debt remains too high

In addition, while Household Sector Credit growth remains low, it is important for the Bank to keep it that way. While this is not a core focus of the Bank, the gradual interest rate hiking is assisting in keeping this growth at a snails pace, and that in turn helps the Debt-to-Disposable Income growth rate to continue its gradual declining trend.

We view the 78.3% Household debt-to-Disposable Income Ratio as still being too high. Lower Household indebtedness will ultimately mean a less vulnerable Household Sector should later economic or inflation/interest rate shocks arise.

The 4.6% Household Sector Credit growth rate in November was still slow, but it has been rising mildly since a low of 3.2% year-on-year back in May 2015. Another interest rate hike will hopefully contain this growth, translating into further debt-to-Disposable Income Ratio decline

Housing Market to remain "rational".

"Normalising" interest rates is key to healthy functioning of not only the South African, but many other countries', residential property markets. Property "bubbles" across the world have been driven largely by cheap credit. Withdrawing this massive stimulus in an orderly way should serve to keep "irrational" behavior in the housing market contained.

OUTLOOK

Our expectation is that the SARB will continue to nudge rates slowly higher, possibly reaching a 11% Prime rate towards end-2016/early-2017. The idea will continue to be to "normalize" rates from abnormal lows, but at a pace that will do minimal harm to an ailing economy.

The behavior of the Rand will be key as to whether the SARB is allowed to hike gradually, or whether it has to "speed it up" as it has done today perhaps.

HOUSEHOLDS WOULD DO WELL TO LOWER SPENDING

Lowering consumption expenditure, containing borrowing growth, and raising savings, as tough as it may be, would be our suggestion for many regardless of whether interest rates rise further or not.

The reality is that a weaker global and domestic economic performance has slowed Net Wealth growth in recent quarters, and it is important that the weak level of SA's Household savings be adjusted accordingly, to compensate for a possible lack of asset price growth looking forward.

When buying homes, it would be sensible to buy well within one's means. Households should not only have "financial space" to absorb more interest rate hikes should they materialize, but it is also important to consider a higher price inflation rate and how it eats into disposable income, notably high inflation on housing related costs such as Municipal Rates and Tariffs bills.

Economic times are getting tougher. We have been warned

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Bond Value (20 years)	Monthly instalment value according to interest rate charged on a 20-year bond											
	15.00%	14.00%	13.00%	12.00%	11.50%	11.00%	10.75%	10.50%	10.25%	10.00%	9.75%	8.50%
R 300 000	R 3 950	R 3 731	R 3 515	R 3 303	R 3 199	R 3 097	R 3 046	R 2 995	R 2 945	R 2 895	R 2 846	R 2 603
R 400 000	R 5 267	R 4 974	R 4 686	R 4 404	R 4 266	R 4 129	R 4 061	R 3 994	R 3 927	R 3 860	R 3 794	R 3 471
R 500 000	R 6 584	R 6 218	R 5 858	R 5 505	R 5 332	R 5 161	R 5 076	R 4 992	R 4 908	R 4 825	R 4 743	R 4 339
R 600 000	R 7 901	R 7 461	R 7 029	R 6 607	R 6 399	R 6 193	R 6 091	R 5 990	R 5 890	R 5 790	R 5 691	R 5 207
R 700 000	R 9 218	R 8 705	R 8 201	R 7 708	R 7 465	R 7 225	R 7 107	R 6 989	R 6 872	R 6 755	R 6 640	R 6 075
R 800 000	R 10 534	R 9 948	R 9 373	R 8 809	R 8 531	R 8 258	R 8 122	R 7 987	R 7 853	R 7 720	R 7 588	R 6 943
R 900 000	R 11 851	R 11 192	R 10 544	R 9 910	R 9 598	R 9 290	R 9 137	R 8 985	R 8 835	R 8 685	R 8 537	R 7 810
R 1 000 000	R 13 168	R 12 435	R 11 716	R 11 011	R 10 664	R 10 322	R 10 152	R 9 984	R 9 816	R 9 650	R 9 485	R 8 678
R 1 100 000	R 14 485	R 13 679	R 12 887	R 12 112	R 11 731	R 11 354	R 11 168	R 10 982	R 10 798	R 10 615	R 10 434	R 9 546
R 1 200 000	R 15 801	R 14 922	R 14 059	R 13 213	R 12 797	R 12 386	R 12 183	R 11 981	R 11 780	R 11 580	R 11 382	R 10 414
R 1 300 000	R 17 118	R 16 166	R 15 230	R 14 314	R 13 864	R 13 418	R 13 198	R 12 979	R 12 761	R 12 545	R 12 331	R 11 282
R 1 400 000	R 18 435	R 17 409	R 16 402	R 15 415	R 14 930	R 14 451	R 14 213	R 13 977	R 13 743	R 13 510	R 13 279	R 12 150
R 1 500 000	R 19 752	R 18 653	R 17 574	R 16 516	R 15 996	R 15 483	R 15 228	R 14 976	R 14 725	R 14 475	R 14 228	R 13 017
R 1 750 000	R 23 044	R 21 762	R 20 503	R 19 269	R 18 663	R 18 063	R 17 767	R 17 472	R 17 179	R 16 888	R 16 599	R 15 187
R 2 000 000	R 26 336	R 24 870	R 23 432	R 22 022	R 21 329	R 20 644	R 20 305	R 19 968	R 19 633	R 19 300	R 18 970	R 17 356
R 2 100 000	R 27 653	R 26 114	R 24 603	R 23 123	R 22 395	R 21 676	R 21 320	R 20 966	R 20 615	R 20 265	R 19 919	R 18 224
R 2 200 000	R 28 969	R 27 357	R 25 775	R 24 224	R 23 461	R 22 708	R 22 335	R 21 964	R 21 596	R 21 230	R 20 867	R 19 092
R 2 300 000	R 30 286	R 28 601	R 26 946	R 25 325	R 24 528	R 23 740	R 23 350	R 22 963	R 22 578	R 22 195	R 21 816	R 19 960
R 2 400 000	R 31 603	R 29 844	R 28 118	R 26 426	R 25 594	R 24 773	R 24 365	R 23 961	R 23 559	R 23 161	R 22 764	R 20 828
R 2 500 000	R 32 920	R 31 088	R 29 289	R 27 527	R 26 661	R 25 805	R 25 381	R 24 959	R 24 541	R 24 126	R 23 713	R 21 696
R 2 600 000	R 34 237	R 32 332	R 30 461	R 28 628	R 27 727	R 26 837	R 26 396	R 25 958	R 25 523	R 25 091	R 24 661	R 22 563
R 2 700 000	R 35 553	R 33 575	R 31 633	R 29 729	R 28 794	R 27 869	R 27 411	R 26 956	R 26 504	R 26 056	R 25 610	R 23 431
R 2 800 000	R 36 870	R 34 819	R 32 804	R 30 830	R 29 860	R 28 901	R 28 426	R 27 955	R 27 486	R 27 021	R 26 558	R 24 299
R 2 900 000	R 38 187	R 36 062	R 33 976	R 31 931	R 30 926	R 29 933	R 29 442	R 28 953	R 28 468	R 27 986	R 27 507	R 25 167
R 3 000 000	R 39 504	R 37 306	R 35 147	R 33 033	R 31 993	R 30 966	R 30 457	R 29 951	R 29 449	R 28 951	R 28 456	R 26 035

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