PROPERTY BAROMETER – SARB RATE DECISION

While we had expected the Reserve Bank (SARB) to only hike again in January, a 25 basis point hike today is a positive development in terms of longer term consumer and residential market health.

19 November 2015

THE RATE HIKE DECISION

Although we had only anticipated the next interest rate hike in January, the Reserve bank (SARB) Monetary Policy Committee (MPC) decided today to hike its policy Repo Rate by a further 25 basis points to 6.25%, a move that will see Commercial Banks raise their Prime rates to 9.75%.

This brings the cumulative rate hiking in the current cycle to 1.25 percentage points. The Bank doesn't see major inflation problems in the near term, but nevertheless forecasts some deterioration from an average forecast CPI inflation rate of 4.6% in 2015 to 6% in 2016. Some years of Rand weakness, with possible 2nd round inflationary effects, were mentioned in the MPC statement as an upside inflation risk, along with sharp electricity tariff increases and possible drought-related food price increases. The SARB also remains concerned with high average wage increases

It was mindful of a bleak economic growth outlook, forecasting GDP (Gross Domestic Product) growth of only 1.4% in 2015 and 1.5% next year, but believes that even with the announced interest rate hike monetary policy remains accommodative.

THE MERIT OF THE DECISION – LITTLE URGENT PRESSURE ON THE SARB TO HIKE,….

Inflation very much contained

From a current inflationary point of view, there wasn't too much short term pressure on the SARB to raise interest rates in a hurry. CPI (Consumer Price Index) inflation for October was 4.7% year-on-year, only slightly up from the previous month's 4.6%, which is still just about in the middle of the 3-6% target range.

The main inflation drivers are not controllable by the SARB

In addition, if one looks at some of the most troublesome components of the CPI, they include Education, Electricity, Water and Municipal Rates. 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.

Lending rates positive in real terms

At the current Prime Rate of 9.5% and Repo at 6% (before today's announced hike), and given the prevailing CPI inflation rate, that translates into a positive Real Prime Rate of 4.8% and a Real Repo Rate of about 1.3%. That should already go some way to containing growth in consumer spend at a time when Consumer Confidence is very low, some would argue.

Prime rate levels don't really encourage housing speculation

Prime Rate is also above the average rate of house price inflation, 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.

From a Household Sector Credit growth point of view, too, there has been no urgent reason to hike interest rates. Household Sector Credit growth measured 4.3% year-on-year in September, which is probably still below Nominal Household Disposable Income growth, and should thus translate into further near term decline in the all-important Debt-to-Disposable Income Ratio.

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

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 tin 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, or otherwise put for South Africa to begin to live within its means. This is especially important at a time when the US Federal reserve is widely expected to begin to hike its own policy interest rates, a move which may exert additional pressure on Emerging Market capital inflows and currencies.

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 77.8% 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 4.3% Household Sector Credit growth rate in September was still slow, but it has been rising mildly since a low of 3.2% year-on-year back in May. 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 higher very slowly, possibly reaching a 10.5% Prime rate only towards 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.

HOUSEHOLDS WOULD DO WELL TO LOWER CONSUMPTION

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.

JOHN LOOS:
HOUSEHOLD AND PROPERTY SECTOR STRATEGIST
MARKET ANALYTICS AND SCENARIO FORECASTING UNIT: FNB HOME LOANS
Tel: 087-328 0151
John.loos@fnb.co.za