HOUSEHOLD SECTOR – MPC INTEREST RATE DECISION

SARB's keeps interest rates unchanged as expected, an appropriate decision from a consumer point of view.

21 July 2016

The SARB 's (South African Reserve Bank) Monetary Policy Committee (MPC) decided today to keep its policy Repo Rate unchanged at 7%, which will keep banks' Prime Lending Rates at 10.5%. This was in line with the general expectation.

- **We believe it to be an appropriate decision from an inflation point of view.** CPI inflation for June was indeed slightly above the 6.3% SARB upper target limit of its 3-6% target range, with a drought-driven food price inflation spike being the biggest single driver of CPI inflation. However, besides food price inflation being an area of inflation over which the SARB has no influence through monetary policy, this spike can be expected to pass through as the severe drought conditions lessen and as high base effects begin to impact on food's year-on-year inflation rate. In addition, we have seen the Rand behave slightly better in recent weeks, which improves the inflation outlook by lowering imported price inflation pressures.

  Furthermore, the current economic weakness implies little in the way of home grown "demand-side" inflationary pressures, further justifying an unchanged rate decision.

- **From a Consumer point of view, too, we are of the opinion that there was little need to hike interest rates.** It has been important, in our opinion, to contain the pace of Household Sector Credit growth to levels below that of recently mediocre Household Disposable Income growth, in order to further lower the Household Debt-to-Disposable Income Ratio from its still-high 1st quarter level of 76.6% as at the 1st quarter of 2016. A lower Household Sector Debt-to-Disposable Income Ratio is crucial in lowering the level of household vulnerability to economic and interest rate pressures in the longer run.

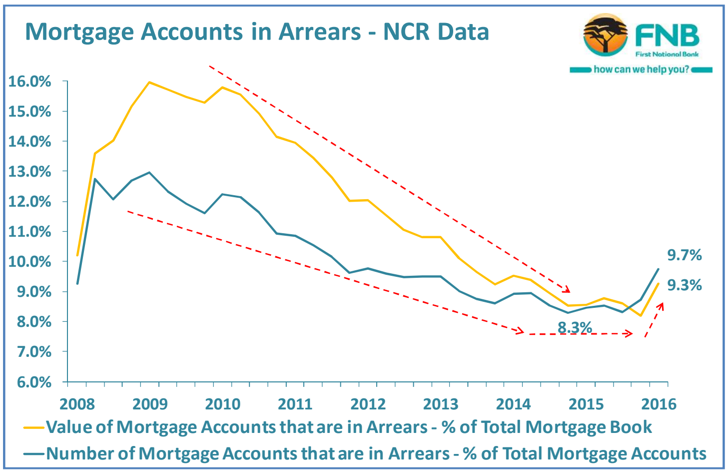
  However, we are of the opinion that, for the time being, the SARB's interest rate hiking to date is sufficient to sustain that declining Debt-to-Disposable Income Ratio trend in the near term, given the weak levels of consumer confidence currently prevailing as a result of major concerns around future economic performance of South Africa.

- **We are also of the opinion that the SARB's current monetary stance is appropriate from a housing market stability point of view, and that a rate hike was not necessary at this stage.** The average prevailing lending rates, marginally above Prime Rate of 10.5%, are significantly higher than single-digit average house price growth in most parts of South Africa, keeping the market largely away from "over-exuberance and large scale speculation.

- **From the point of view of the "desirable" speed of rate hiking, too, we believe that an unchanged decision was appropriate.** In other words, even should the SARB be intending to hike rates further, after 75 basis points' worth of interest rate hiking in the 1st quarter of 2016, pausing for some time thereafter is beneficial in order to allow the consumer significant time to absorb the rate hikes from earlier in the year and to adjust their finances. Such a slow approach to hiking, we believe, can significantly curb the rate of increase in financial stress, because households can take significant lengths of time to adjust spending habits.

Early in 2016, we saw a more noticeable uptick in Mortgage Arrears, as per the NCR (National Credit Regulator) data.

A pause in rate hiking in May and July may just slow any further potential rate of increase.



A POSSIBLE ARGUMENT IN FAVOUR OF HIGHER INTEREST RATES IN FUTURE

- **Savings remains weak though, but resolving that problem may just have to wait a while**

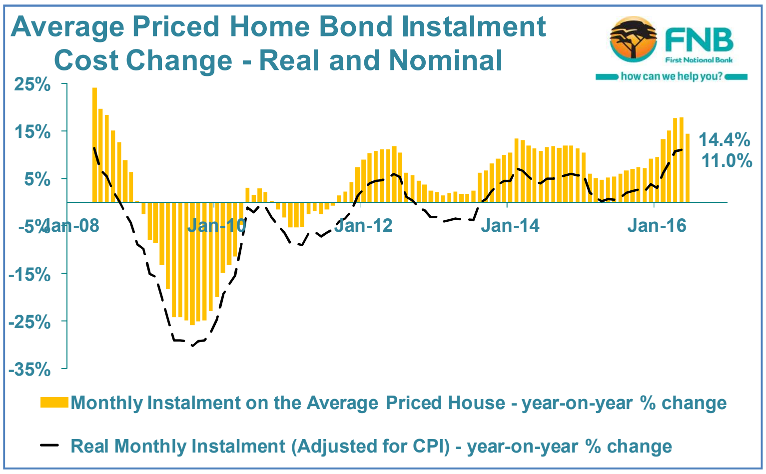
The dismal household savings rate still remains a major problem, languishing in net dissavings territory. Recently, the rate of dis-saving has begun to diminish, but the savings rate remains dire. Ultimately, we may need higher interest rates to meaningfully improve this situation. However, right now would probably not be a desirable time to push that agenda given the extent of economic weakness.

THE EXTENT OF THE INTEREST RATE HIKING TO DATE

On a R1 million bond at Prime Rate, the Rand value of the monthly instalment has increased by R1,306 from the beginning of 2014 (when Prime Rate was 8.5%) to the present day (Prime Rate 10.5%)

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%	Rise in monthly bond instalment from Begin 2014 (8.5% Prime) to the present
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 392
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 522
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 653
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 783
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 914
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 1 044
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 1 175
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 1 306
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 1 436
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 1 567
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 1 697
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 1 828
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 1 958
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 2 285
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 2 611
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 2 742
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 2 872
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 3 003
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 3 133
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 3 264
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 3 394
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 3 525
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 3 656
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 3 786
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	R 3 917

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



For those buying an average priced home as at June 2016 (according to the FNB House Price Index estimate of average price), the year-on-year rate of increase in bond instalment compared to those buying in June a year ago was 14.4%, taking into account both the bond instalment increase as well as the average house price inflation.

From the end of 2013, just before the start of interest rate hiking, the cumulative increase in the bond instalment on the average priced home has increased by 42.1% to June 2016. Home buying has thus become noticeably more costly over the past 2 and a half years.

OUTLOOK

We don't believe that the SARB is quite finished with interest rate hikes yet.

We are not expecting the latest CPI number to influence the MPC to raise interest rates this week. However, the abovementioned impact of lower commodity price base effects exerting mild upward pressure on CPI inflation later in the year leads us to expect one further 25 basis point Repo Rate hike late in 2016.

Thereafter, moving into 2017 we expect a lengthy sideways movement in interest rates as CPI inflation is forecast to slow to an average of 5.9% in 2017, back into the 3-6% target range after a forecast 6.6% average for 2016

CONSUMER SUGGESTIONS

It is important for consumers not to "drop their guard" based on widespread speculation from market commentators that interest rates may have peaked. The reality is that the future remains an uncertain place, and many inflation and interest rate forecasts depend on the always hazardous assumption of a reasonably well-behaved Rand. This, we know, can change at any time in these volatile times.

It is always good to be in a financial position to absorb a few percentage points worth of unwanted or unexpected interest rate hikes should they occur. If one can't, consider getting to work on either lowering the borrowing and spending and raise the rate of saving, because these adjustments take time. With South Africa's Gross Household Saving estimated to be insufficient to even cover depreciation on fixed assets, for many it is time to adjust, regardless of what interest rates are set to do in the near future. We believe that a rise in savings may well be starting to happen, but far more is needed.

Finally, while we do not advise people whether to fix or not to fix, if fixed interest rates are an appealing option to a person, now is probably not the time to stop looking for an "attractive" fixed rate. Should market expectations for interest rates begin to price in rate cuts at some stage, fixed rates on offer can be more attractive compared with times when the market expectation is for rate hikes, because fixed interest rates on offer are very much driven by market expectations of future interest rate moves. Fixing is very much a personal preference, however, determined by people's varying risk appetites.

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