EFFICIENT GROUP

ECONOMIC COMMENTARY

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Newsletter

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LOWER LOCAL INTEREST RATES AND STIMULUS IN THE UNITED STATES

More good news for indebted households in South Africa as the South African Reserve Bank (SARB) announced another interest rate cut. Although the governor of the SARB, Lesetja Kganyago, explained that rates would only be cut by 0.25%, interest rate have in total been reduced by 2.75% this year. To illustrate how this will benefit indebted households, let us consider the following example: According to TransUnion, the average South African owes about R20 000 on his/her credit card, a total of R40 000 for two adults in a traditional household setup. Furthermore, the average outstanding home loan is about R500 000, and the average amount outstanding for vehicle finance is R190 000. That is once again a total of R380 000 for two adults. Finally, the average outstanding amount for personal loans is R37 000, R74 000 in total. Of course, not every household looks the same, but if we assume these amounts, then the total household indebtedness is nearly R1 million. By cutting interest rates with 2.75%, the average household will pay just over R27 000 less on interest over 12 months; or R2 280 less per month.

That is a staggering amount and the aggregate household debt, which is currently around R2.3 trillion, is even more so. Reducing interest rates by 2.75% has reduced the servicing cost households must pay on their debt by R63 billion; given that these rates are sustained for a year. That is R63 billion that can be consumed in these troubling times to assist struggling households. For corporate debt, the numbers are of course, substantially larger. But this helps to illustrate how a reduction in interest rates can help an indebted South Africa. However, there is one consideration to keep in mind; although indebted households enjoy interest rate cuts, investors, and those living off their savings, do not benefit from interest rates cuts. By cutting interest rates, the SARB reduces the returns of many of these investors. Cutting interest rates, therefore, also makes South Africa less competitive in the market for global liquidity. Luckily though, most comparable markets are also cutting interest rates, which is why the rand did not depreciate against other currencies. In fact, one might conclude that markets consider the reductions necessary and growth-friendly in the short-term. In the long-term, however, our rates should be kept attractive to both local and global investors, to convince them to invest their short- and long-term capital. Only these investments can create an environment of long-term sustainable growth, and although higher levels of consumption are necessary, it is not sufficient.

In other news this week, the United States Federal Reserve (Fed) will conclude their monetary policy meeting on Wednesday. Analysts do not expect another interest rate cut but do expect more guidance in terms of additional stimulus, even though the Fed has already cut rates to zero, and pledged to buy an unlamented quantity of government debt to push liquidity into the financial system. We are also expecting to hear more about the second round of the fiscal stimulus which policymakers have planned for Americans. As part of the Democrats' Hero Act, they want individuals earning less than $77,000 (that's R500 000 compared to Purchase Parity Power-dollars) to each receive $1 200 (R7 800), and additional support of $500 (R3 250) for each dependent. As a result, the second round of fiscal stimulus will cost around $3 trillion. Of course, Republicans do not want to hear anything about it and would limit the second-round stimulus to $1 trillion.

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