Missing the Boat

THE SA RESERVE BANK'S balancing act on the matter of interest rates is puzzling not a few noted economists while disappointing many business sectors desperately seeking stimulae for growth. The latest decision by the Bank was again to hold the repo rate at 5,5%, which is more or less level with inflation. Throughout this year this has been the monetary authorities' formula for keeping interest rates unchanged at 35-year lows.

The Bank is concerned, rightly, about the volatile global picture, particularly the Eurozone situation. But Greece and Italy have fallen into line (it appears) and the global picture is proving less threatening. US growth has improved since the first quarter this year, with no evidence of recession, while China appears to be maintaining it's growth momentum. There is reason to expect more progress next year. First National Bank's chief economist Cees Bruggemans asks whether or not this is sufficient for the SARB to become less insistent on "keeping its powder dry" and be guided more by domestic needs and cut interest rates by another notch, as did the Australian Central Bank that same week.

Bruggemans comments that the SARB's policy stance is unusual when considering insufficient demand is keeping the economy below par and the output gap large which, he avers, argues for lower interest rates. Inflation is a threat but is expected to remain around the 5%-6% band through next year and into 2013 (even 2014).

There is little evidence of profligate consumer spending; tight bank credit is ensuring that. Says Bruggemans: "There are no signs of reckless business expansion or speculative excesses in the economy; instead both business and consumer confidence came off in the course of the year, signalling the economy's performance to be modest – also confirmed by the stagnating SARB leading indicator."

The South African economy remains consumer-led – especially new car sales, up almost 17% on a year ago. But retail sales have slowed and fixed investment is sluggish, both private and public. Output in mining and manufacturing is barely 2% higher year-to-date, building and construction activity is low and property is subdued.

An interest rate cut of 50 basis points, which appears to be the SARB's favoured tool, would not excite much demand in the economy, nor would it greatly stimulate the residential property in a direct sense. It would, however, be a very welcome confidence booster and would help reduce household indebtedness while bolstering business cash flows.

So has the SARB missed the boat in terms of stimulating consumer demand and the economy as a whole? Iraj Abedian, chief economist at Pan-African Investment and Research Services, certainly believes so. He says: "Once again the monetary policy committee has lost the opportunity to take its own analysis to its logical conclusion. This is increasingly inexplicable. In the midst of declining global growth rates, and the inevitable worsening business conditions, the MPC has failed to lower the repo rate. Clearly this prolonged procrastination in cutting interest rates will cost the economy dearly."

"Whilst the mining sector has been and remains in recession, the delayed interest rate cuts will deepen the malaise in the real estate sector and will worsen conditions in the retail sector. This combination is bound to undermine overall growth considerably."

Abedian continues: "Ironically, whilst the world over central bankers go out of their way to boost growth, the SARB appears to be on a journey of its own with its decision totally disconnected from its analysis, or from the business realities at home and elsewhere – and, importantly, out of line with all central bankers of South Africa's major trading partners."

Household indebtedness remains a huge hangover. Although household debt to disposable income has fallen from its peak of 82% peak in 2008 to 76% currently, it is still too high. But the signs that the household sector is slowly improving its debt situation are encouraging. This ratio needs to be much lower if it is to absorb any future interest rate hikes. However, the slow rate of household and private sector borrowing, helped along by the National Credit Act, could help encourage the SARB to keep interest rates as low as they are. There was concern last year when growth in the value of new household credit granted peaked in the third quarter at 42%. But this started slowing, reaching 26% y/y in the second quarter of this year, according to the National Credit Regulator.

Looking ahead, there is always the spectre of inflation. Property analyst John Loos recalls the situation which arose at the end of 2007 and into 2008. In mid-2006 the prime rate was 10,5%. Inflation was bumping along just above 4,5%. At mid-2008 the prime rate had risen to 15,5% and CPI inflation peaked shortly afterwards at a massive 13,7% in August that year. Warns Loos: "The rest was history and the results were disastrous for a highly-indebted household sector and for the housing market.". ▪▪▪

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Repo Rate