Prepare for further interest rate increases

By Gary Palmer

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The Monetary Policy Committee's decision to increase the repo rate from 3.5% to 3.75% and subsequently the prime lending rate from 7% to 7.25%, is little surprise as rumblings of an increase have been in the market for some time. An increase impacts finances, affordability and how consumers should be thinking about the future, particularly as regards property.


Gary Palmer, CEO of Paragon Lending Solutions

In the previous high interest rate environment, more people were renting than buying residential property. When interest rates began to fall from around the start of the pandemic in 2020, everything shifted. Bond originators, banks and attorneys were negotiating 100% bonds, so naturally the rental market took a hit as people saw an opportunity to buy. Rental vacancies had previously stood at between 1%-5% but shot up to as much as 15% as more people could afford to buy instead of rent.

The cost of ownership was also about double the cost of renting prior to the pandemic. Then, when interest rates came down, the cost of ownership fell in line with renting. As the cost of ownership is set to become expensive again, it follows that the rental market will improve.

Reserve Bank's been more than fair

In South Africa, inflation currently stands at 5%, but the Reserve Bank's forecast reflects higher headline inflation for the fourth quarter, at 5.3% (from 5.0%). The Reserve Bank has been more than fair in lowering rates and doing what it can to ease pressure during these difficult times, but the global trend towards higher inflation called for adjustment.

Looking at another BRICS economy, Brazil has seen its biggest inflation increase in two decades, resulting in an interest rate hike, which is massively impacting the cost of fuel and providing a view into what the reality could be like locally.

Central banks in Europe, the US and UK have all experienced pressure to increase rates, and the world is watching the US particularly to see how their rates will rise, and what the knock-on effect will be. Meanwhile, JP Morgan has predicted that South Africa, Mexico, Poland, and Turkey will raise rates by 200 basis points over the next 12 months.

Repo rate hike disappointing for home buyers with mortgages
Dr Andrew Golding 18 Nov 2021

Beyond bond costs

South Africa was already in recession before the Covid-19 pandemic started, so further interest rate increases should be budgeted for, even before they arrive. With interest rates on the rise again, there will be distress, but this goes beyond people being able to afford to pay off their properties. It's not just a bond that needs to be considered, it's also all the other costs that must be factored in from municipal charges and maintenance, to levies in the case of a body corporate, and then inflation itself, which will obviously also impact many other costs.

For people thinking of buying now to get on or higher up the property ladder, while interest rates are still relatively low, they should create a large margin for error in calculating monthly expenses.

Some may have planned to renovate their new home once bought and these costs need to be calculated carefully, accounting for inflation on renovation materials. Keep in mind that shipping costs have increased for imported items and the pandemic has brought disruption to supply chains, so local suppliers may need to be considered instead. Everything will be going up in price and budgets need to provide for that realistically.

Cash squeeze is coming

This approach also applies to those who rushed for bonds as interest rates fell over the last two years. A cash squeeze is coming, so overextending should be avoided.

It's important for consumers to look at their credit card debt, motor vehicle costs and store cards, and not allow spending to get out of hand. Otherwise, they could find themselves suddenly trying to sell a property because they can no longer afford to live there, which means that the property market could depreciate collectively.

ABOUT THE AUTHOR

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