NATIONAL ASSEMBLY

QUESTION FOR ORAL REPLY

QUESTION NUMBER: 160 [NO2407E]

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Ms J Tshabalala (ANC) to ask the Minister of Finance:

(1) Whether the recent announcement by the Governor of the Reserve Bank with regard to interest rate relief had any effect on (a) consumers and (b) business; if not, how did he arrive at this conclusion; if so, what are the relevant details;

(2) what has been its effect on the fiscal outlook?

NO2407E

REPLY:

(1) It is too early to assess the impact of the recent interest rate announcement on the economic activity of consumers and businesses. Interest rates affect economic activity with a lag – up to 12 months – but a more immediate impact should be seen in the next set of confidence figures. The consumer and business confidence indices for the third quarter will only be released on the 5th and 18th of September respectively.

Lower interest rates reduce the cost of new borrowing and in so doing encourage increased investment. But interest rates are not the only factor impacting on spending decisions. Households are affected by how rich they feel, which is influenced by how much quicker salaries are rising in relation to inflation, whether they feel secure in their jobs and by how much their investments or assets are appreciating in value (the wealth effect). Households may also decide to pay down debt more quickly when interest rates decline rather than spending more on goods and services.

For a typical household mortgage debt of R650 000, the rate reduction will imply a monthly saving of around R208 per month[1].

There is also a small, but important minority, such as pensioners, who suffer as interest rates fall, as they earn ever lower returns on their savings. These lower rates can also serve as a disincentive to save in cash and other similarly liquid products. However, on a total economy basis, given the small proportion of savers in the South African economy, this is unlikely to outweigh the benefits enjoyed by the larger number of South Africans who are indebted.

Businesses decide to invest and employ more people based on their assessment of how strong demand is going to be and whether they foresee opportunities to expand production. Since demand is determined by domestic and international factors, some businesses might be more affected by the turmoil in Europe and the generally weak global environment than by decisions on domestic interest rates. The most recent results from the RMB/BER Business Confidence Index illustrates this point, with roughly 70 per cent of surveyed manufacturing firms viewing external and internal demand as a constraint to business confidence, compared with just a third who saw interest rates as a constraint.

Corporate savings rates have been rather high as many companies hold back on investment decisions due to uncertainty. However, at the margin, we would expect there would be something of a boost to growth through higher business investment.

(2) Provided that lower rates are not associated with a higher risk of inflation, they will also lower the cost of borrowing for government, at least for short term debt. Following the SARB's interest rate announcement on 19 July, the rate at which government debt trades fell across most maturities. This means that the rate the market would expect to charge government for lending it money fell by between 0.2 and 0.3 percentage points. The lower rates have been sustained for bonds that are

[1] Monthly installment of R5,848 at 9 per cent on R650,000 house would fall to R5640 at 8.5 per cent on a R650,000 house.

due to expire in 2015 and beyond. Sustained lower rates should help to lower our cost of funding and limit the burden that our fiscal plans place on future generations

In the context of an uncertain global economy which presents significant downside risks to the Budget, the rate cut has also helped to reduce the downside risks to the forecast and will likely help to sustain tax revenue.