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Invest with the times

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Lower interest rates on the cards

The Monetary Policy Committee of the Reserve Bank (MPC) will probably continue to lower interest rates for at least the next year or two.

The start of a more relaxed monetary policy – also known as the dove era – was introduced last month when the MPC reduced the repo rate (rate at which commercial banks borrow money from the SA Reserve Bank) by 25 basis points (0.25%) from 7% to 6.75%.

This reduced the prime rate (rate at which banks lend money to consumers) from 10.50% to 10.25%, a step that will encourage capital spending and boost consumer confidence.

It is the first of at least three rate cuts expected in South Africa this year and next year which could result in the repo rate dropping to 6.25% (primary rate at 9.75%) within a year!

The new era of lower rates and softer monetary sentiment emphasises the importance of fixed rates with investors who are expected to start looking for more fixed investment options. Ecsponent's Class A preference shares, for example, provide a fixed gross interest rate of 10% per annum, paid monthly, and a fixed capital growth rate of 11.2% on its Class B preference shares. These rates will not ease if the repo or prime rate continues to decline.

The advantage of fixed rate investments is that you are not subjected to declining returns. You know exactly what your return will be and can budget accordingly.

Which factors promote the further easing of interest rates?

Inflation must decrease

Inflation and expectations around it will play a major role in the MPC's decision to continue reducing interest rates. Inflation has been below 6% since late 2016 and in June inflation stood at 5.1%, which means that prices were 5.1% higher than in June 2016. The inflation rate is expected to fall below 5% in July. The closer inflation moves towards the middle of the target band between 3% and 6%, the greater the possibility of lower interest rates. The fall in the international oil price may also lead to lower inflation rates in countries such as South Africa. Expectations are that the price of petrol and diesel will decrease by 68c and 60c respectively. Another positive note is that the drought which resulted in higher inflation and subsequent rising food prices, has been broken in the northern parts of the country.

Rand must strengthen further

Despite the downgrade of our foreign credit, the rand has performed stronger against most currencies in recent months. In June the rand was on average 12% stronger than in June 2016. The rand will, however, continue to fluctuate until we have achieved some stability on the political front.

More credit lending

Credit lending to the private sector has also shrunk in recent months, and an interest rate cut is the appropriate step to increase money in circulation. If the repo rate is reduced by 50 basis points, and if all debt repayments are similarly reduced, consumer spending will increase by R15 billion within a year. The easing in rates obviously provides the ideal opportunity for consumers to reduce their debt.

Lower current account deficit

The current account deficit (difference between imports and exports) also declined as a percentage of gross domestic product (GDP) from 4.4% in 2015 to 3.3% in 2016. This year's deficit may be as low as 2.5.%, benefiting the exchange rate and reducing the pressure on local savings.

Lower interest rates in the US

Interest rates in the US may start to decline again. This follows the slowing down of inflation in the USA, increasing the possibility of lower interest rates. It will be good news for South Africa where lower rates will support the rand and improve capital flow to the country. Lower US rates may mean that money can start flowing back to emerging countries.

South Africa does, however, remain very vulnerable to international investment sentiment. Credit downgrades should subsequently be taken seriously, as a further downgrade of South Africa's rand debt may weaken the rand.

Lower interest rates, however, will not necessarily promote economic growth, as a wide range of structural changes is required to give impetus to the economy.

Corruption, state capture and Pres. Zuma's poor governance is destroying our economy and it is important that these factors be addressed.

The political uncertainty does not create a favourable investment climate and without investments no jobs will be created. About 34.4% or 9.3 million people are currently unemployed in South Africa and this will rise as political risks increase.

Ecsponent is well aware of the need for a fixed rate of return and is currently designing additional financial products with fixed rates to be released soon.

Hone your investment skills

Knowledge could make a huge difference to your financial future. The best investment you can ever make is to invest in yourself. As the old adage goes "An investment in your own expertise always pays the best dividends".

Being financially informed, enables you to evaluate conflicting financial advice and ensures that your investment decisions suit your unique life stage, goals and preferences.

Even if you delegate investment decisions, the final responsibility rests with you. You are the one who appoints an advisor, and if something goes wrong, you are the one who will bear with the consequences.

Spot a good deal

Most investment advice is generic and not tailored to serve your personal circumstances.

That's why it can be highly confusing when you receive conflicting advice. One expert might advise you to diversify, while another maintains it would render minimal returns. One expert might insist that you should first pay your debt, while another would want to persuade you that certain clever types of debt serve as the opening gambit of wealth creation. One might say shares are the way to prosperity, while another might recommend property as the key. How do you know what is best when even the experts shower you with conflicting advice?

You are unique with your own abilities, background and experience and you need your own solution that will work for you and differ from the rest. The same monetary shoe does not fit all. You understand your own needs better than anyone else and you have to make the final decisions.

Learn to separate the wheat from the chaff and create lifelong financial security, rather than making wrong investment decisions and jeopardising your chances to create wealth.

Invest in yourself

People often say that they do not have the time or money to invest in their own financial expertise. If you think it's too expensive, you might want to ask yourself what the price of ignorance is.

It is hazardous to take a million rand investment decision with only one thousand rands worth of financial intelligence. Your financial intelligence determines the ceiling of your fiscal wealth. The more and longer you invest in both your money and in yourself, the greater your financial options and prosperity.

Learn from your mistakes

Even informed people can, from time to time, make investment mistakes. You cannot avoid every pitfall, but you can learn from your mistakes and manage them properly if you have the necessary financial insight. This is education you do not gain at school or at university. In a recent radio chat with a young BCom Accounting graduate, for example, his first employer asked whether his pension fund contributions should be paid into a unit trust. The young man did not know what a unit trust was.

The employer also wanted to know which asset classes he preferred. Once again the young man had no clue which asset classes were available, except "cash". Hence his pension was put into cash for months before he realised how much he had been losing.

This is the story of many people. The ignorance of our youth often continues, leading to a lifelong journey of financial failures and setbacks.

Your first investment

Young people who have just started working, are often swamped by agents who want to sell funeral policies and life insurance. However, few of them make a meaningful investment which will create prosperity for their future. The duty lies with parents and schools, but also with the employer to guide and educate young employees to ensure they understand the importance of savings and of investing from early on.

Lifelong journey

To remain financially informed is a lifelong commitment. It involves investing from early on, maintaining financial discipline and continually expanding one's knowledge of personal finance and experiencing various financial products.

Ecsponent is actively involved in programmes to promote financial expertise among people and to teach them about financial matters and the value of investments.

Our latest programme, "Jy Geld" can be viewed on Sundays at 18:00 on Kyknet (Channel 144). It focuses on women and their personal finances and offers tips on how to deal with money through life. The first instalments dealt with the merits of investing, the dangers of debt and how to manage one's salary.

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