The effect of the interest rate cut explained in real terms

By Adrian Goslett

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The recent announcement of the interest rate cut was a mini triumph for all South Africans. The unfortunate reality, though, is that too few individuals fully understand exactly how this affects them, which means that they are unlikely to reap the full rewards of this decision.

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To begin with, the difference between the repo rate and the prime lending rate is left a mystery to most. While this distinction is unlikely to affect you directly, it is helpful to understand if you want to grasp the broader concepts. The repo rate is the rate at which the South African Reserve Bank lends money to commercial banks. These banks then add their own mark-up on this rate which results in the prime lending rate: the rate at which banks lend money to consumers. Simply put, a cut in the repo rate will mean that the interest you owe on your debt will automatically decrease. This is exactly what happened at the MPC meeting late last month.

To put this in real terms, the monthly repayment on a R1m bond with no deposit, calculated at the new interest rate over 20 years amounts to R9,650. Based on the previous interest rate, the monthly repayment for the same bond amounted to R9,816. This totals a saving of R166 per month on bond repayments.

Potentially cut a year off your lending term

If you choose to channel the money you're saving right back into your monthly bond repayment, thereby keeping the repayment at the rate before the interest cut, you can potentially cut a whole year off of your lending term, provided you are right at the beginning of your 20-year lending period. If you are halfway through your 20-year bond, you will only be able to cut about two months off the lending term. The power of compound interest is largely to thank for this. When stretched over 20 years, this small R166 per month (plus the interest it accumulates) turns into 12 months' worth of bond repayments. However, the amount saved when limited to just the second half of your bond lifespan, amounts to only two months' worth of repayments. Still, two months off your total repayments amounts to a saving of close on R20,000.

Now is also the perfect time for first-time buyers to enter the market. Their monthly repayments will be less, which in turn lowers the overall amount owed by the end of their lending term. Before the interest rate cut, a R1m house would have ended up costing you R2,355,944 at the end of the 20-year loan period. At the current interest rate, the same house will end up costing you R2,315,664 at the end of a 20-year period. If you purchase property at the current interest rate, you are saving R40,280.

Off the back of the interest rate cut, South Africans have two options: either enjoy the short-term pleasure of having an extra R166 to spend each month, or invest that money in a way that results in long-term financial relief.

ABOUT ADRIAN GOSLETT

Adrian Goslett is CEO and regional director of RE/MAX Southern Africa. He joined RE/MAX Southern Africa in 2005 as a franchise development consultant, supporting various regions and offices. Throughout his career at RE/MAX he has held various positions. In 2010, after successfully leading 160 offices and over 1500 agents in six countries through the worst years real estate has ever seen in South Africa in 30 years, Goslett was appointed as CEO of RE/MAX Southern Africa.

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