PRUDENTIAL
INVESTMENT MANAGERS

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4 ways SA's interest rate cuts impact you as an investor

Coming amid the Coronavirus pandemic shutdown in South Africa, you may not have paid as much attention to the recent interest rate cuts by the South African Reserve Bank (SARB) as you would have under more normal conditions. The two cuts, totaling a substantial 2.00%, took the economy's base interest rate from 6.25% to a record low of 4.25%. This will likely have some significant effects on most people's investment choices and portfolios going forward, so it's important to take the new environment into consideration.

Here are four ways the rate cuts are likely to impact you:

1. Less interest on your cash deposits

If you've got money in a bank deposit account, money market account or other "cash-type" vehicle, your interest rate earned will fall by a full 2%. So if you're saving or investing towards a goal, it will take you longer to reach it unless you're able to boost the amount you're saving.

2. Lower real earnings on cash over time

According to Prudential's calculations, cash-related investments are now only likely to return around 0.2% p.a. more than inflation over the next three to five years. With its potential returns so much lower, the cash holdings in your portfolio could now be too high if you have a medium- to longer-term investment timeframe, acting as a drag on future returns.

Following the sharp sell-off in SA equities and bonds in March, the value of these assets in your investment portfolio is likely to have fallen compared to cash. It's probably wise to look at your latest asset allocation to see if it is still appropriate to meet your investment goals.

3. Less income for conservative investors

If you're retired and drawing down a fixed income, your portfolio is likely to be positioned relatively conservatively, with more cash and other shorter-term assets than the average investor. Consequently you will very likely be earning less money going forward. This means you should consider whether you could draw down less income to avoid. The good news is that the government has proposed to allow investors with living annuities to adjust their drawdowns as necessary to cope with the current difficult conditions.

4. Lower home loan costs

If you have an outstanding bond on your home, it is very likely to feature an adjustable interest rate that moves in line with the SARB's base interest rate. As such, you'll be paying less going forward, which is a big positive for your finances. You could take advantage of this monthly windfall by continuing to pay the same total amount monthly, thereby repaying your bond more quickly and saving a substantial amount of money down the line. This option has an extra but unquantifiable benefit, which is the psychological relief of carrying a lower debt burden. An even better alternative could be to pay down any outstanding high-interest credit card debt more quickly. Or, if you instead decided to save and invest the extra monthly cash, it would need to earn a return that is higher than your credit card and bond interest rates to make it worthwhile.

So from the above it's easy to see that the SARB's interest rate cuts will have a mixed impact on investors, depending on their individual circumstances. Borrowers will benefit from lower costs and a rare opportunity to improve their finances going forward, while savers have lost out to a certain extent. Whatever your circumstances, market conditions have changed substantially in the past few weeks, so it makes sense for everyone to step back, assess how you've been impacted by the lower interest rates, and adjust your investments or financial arrangements accordingly.

For more information, speak to your financial adviser or contact our Client Services Team on 0860 105 775 or email us at query@prudential.co.za.