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The Household Sector Economy

Some will be disappointed with SARB decision to hike interest rates, some even arguing for rate cuts to provide relief for consumers and the economy. But that would have questionable longer run benefits.

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Last week's 25 basis point interest rate hike by the South African Reserve Bank (SARB) will likely have caused some disappointment amongst many consumers, industries whose demand for their product is heavily credit driven, and other role players in the economy. Some would argue that fuel prices, the key driver of higher inflation of late, cannot be controlled by interest rates. Some might even argue that the SARB should rather be focused on the economic growth, lowering rates to provide consumers with much needed financial relief, boosting credit-driven demand in order to drive higher economic growth and job creation.

Such "short-term growth-focused" thinking on interest rates, while having some merit in the very short run, is questionable in the longer run. This is because interest rate cutting changes household (and other) behavior in ways not always conducive to driving longer term economic growth. By this, I mean that lower interest rates often fuel strong borrowing, much of it for consumption purposes, with arguably insufficient savings for investment (savings and investment being much needed for long term growth). Given the high propensity of South Africa households to consume and borrow in times of low interest rates, in the longer run low interest rates typically lead to higher levels of household indebtedness and stagnating growth once the short-term stimulus impact has been felt, with little else to show.

LET'S CONSIDER THE HISTORY OF HOUSEHOLD DEBT SERVICE COSTS

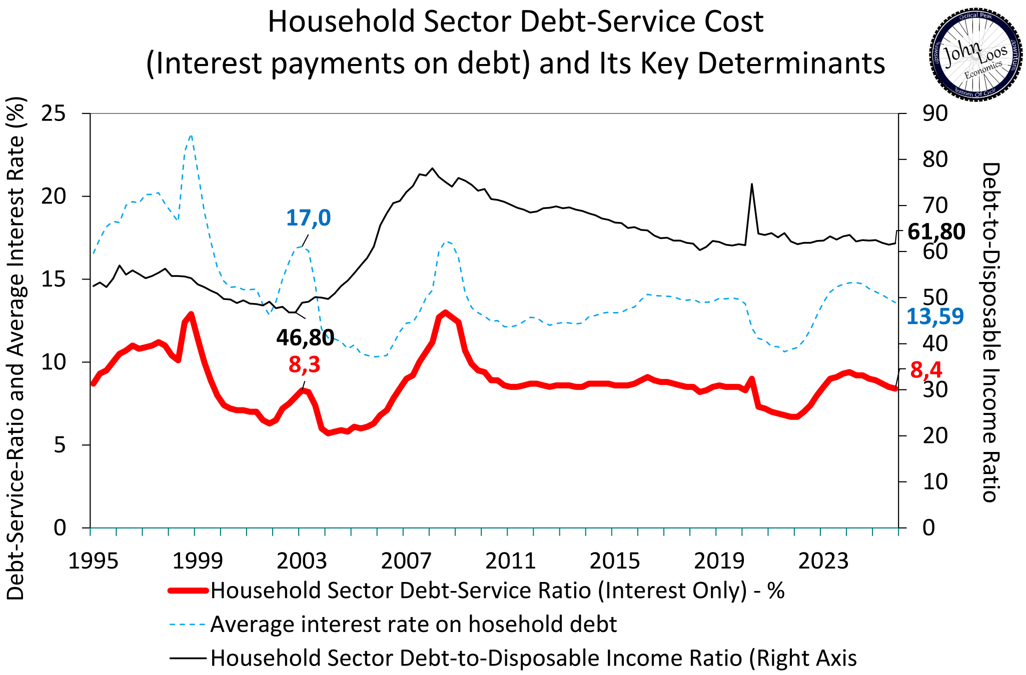
In the final quarter of 2025, after some interest rate cutting by the SARB, the SARB household debt-service ratio (interest cost on all household debt outstanding expressed as a ratio of household sector disposable income) was 8,4. In other words, an estimated 8,4% of household sector disposable income went toward interest payments on debt.

A comparable point in history was in early-2003, where the debt-service ratio reached a very similar level of 8,3 at its cyclical peak.

But the similarity in the household debt-service ratio between late-2025 and early-2023 was the only number thing was comparable. South Africa at that time had just undergone a seemingly severe 400 basis point interest rate hiking cycle through 2002 in response to a currency and food price-driven inflation surge. The average interest rate on household debt peaked at an estimated 17% (prime rate also peaked at 17% in that year), well higher than the late-2025 estimated average interest rate on household debt of 13,59%. But still, the debt-service ratio in 2003 didn't quite reach the late-2025 level.

And in 2003, strong housing and consumer spending at the time hardly slowed.

This was because the level of indebtedness in 2002/3, as measured by the household sector debt-to-disposable income ratio, was very different today compared with back then. Late in 2002, the household debt-to-disposable income ratio was only 46,8. In late-2025 it was far higher at 61,8. Household indebtedness is far higher today.



The key problem is that debt-servicing costs are not only determined by interest rates on the debt. The value of the debt outstanding is also crucial, and lower interest rate levels typically drive levels of borrowing and indebtedness higher over time. That is why the 400 basis point rate hiking cycle of 2002 saw the debt-service ratio peak at a lower level than the ratio of late-2025, even though the average interest rate was significantly higher back then, and even though by late-2025 the SARB had already cut interest rates mildly.

Taking 2 other points in history, a sharply higher level of indebtedness by the end of the pre-2008 consumer and housing boom, compared with that of 1998, was the reason why a prime rate peak of 15,5% in 2008 caused arguably more severe financial pain for the household sector than a far higher prime rate peak of 25,5% a decade earlier in 1998.

THE BOTTOM LINE

If we could be confident that household sector behaviour would tend towards paying down debt in times of lower interest rates, the lower interest rate argument for providing financial relief to households would have a lot of merit. But very often the opposite is true, i.e., lower interest rates fuel increased borrowing and higher levels of indebtedness for the household sector as a whole. This is a key reason why interest rates that are far lower today, and rate hiking cycles that are far less severe, compared with a few decades ago, seem to feel just as painful financially as the more extreme interest rate hiking cycles a few decades ago, if not worse

Higher indebtedness levels today make households, and the entire economy for that matter, more sensitive to interest rates compared with a few decades ago, and with an economic growth rate significantly worse today than back then.

The solutions to longer term economic growth, employment and stronger household sector income growth in South Africa lie largely elsewhere, in the myriad of required structural reforms, in fixing and increasing investment in human and physical capital, and redesigning the set of economic incentives.

Interest rate policy is better focused on creating the environment for long-term macro-economic stability, of which price stability is an important component and levels of indebtedness are another.

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