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CONSUMER BANKING BAROMETER

Consumer Credit Environment

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Consumer credit health doesn't appear bad yet, but the Household Sector remains vulnerable, and much of its financial frailty continues to be masked by low interest rates.

KEY POINTS

Focus: Consumer Credit Health is not nearly as bad as some believe.....But.....

- *We're just not seeing the "chronic" credit health situation that is some times reported...yet.....but.....*
- *Indicators of credit health actually appear relatively good. The release earlier this week of insolvencies data showed another year-on-year decline in the number of insolvencies, to the tune of -5.7% year-on-year. And the TransUnion Consumer Credit Index has moved back up to a level above 50 in recent quarters, which signals a return to improving credit health.*
- *But we are definitely not saying that the consumer isn't vulnerable. Low interest rate hide many "frailties". The level of consumer vulnerability remains high, because the level of outstanding household debt expressed as a percentage of Disposable Income's remained high at 78.4% early in 2015.*
- *1st prize is for consumer credit to grow very slowly, and for the SARB to raise interest rates gradually. Slow credit growth will hopefully drive further decline in the Debt-to-Disposable Income Ratio, and gradual rate hiking by the SARB can give households the time to "prepare their finances" for an ultimately more "normal" interest rate environment*
- *But the key question is whether global and local economic risks will force the SARB to raise interest rates faster. South Africa's wide current account deficit on the balance of payments exposes the Rand to volatility. Does a China "hard landing" cause severe pressure on Emerging Market currencies, including the Rand, or will US interest rate hiking have that effect, or both?*
- *So, while the Household Sector does not currently experience high levels of financial stress, it remains vulnerable. Any severe rand weakening can cause a surge in imported inflationary pressures, pressuring the SARB into a more rapid pace of interest rate hiking. These are the risks that the still highly-indebted Household Sector of South Africa lives with.*

Data: June Household Sector Credit

- *June Household Sector Credit recorded year-on-year growth of 3.5%. Whilst this is slightly higher than the 3.2% for the previous month, the pace of growth remains "pedestrian.*

FOCUS: CONSUMER CREDIT HEALTH IS NOT NEARLY AS BAD AS SOME BELIEVE......BUT....

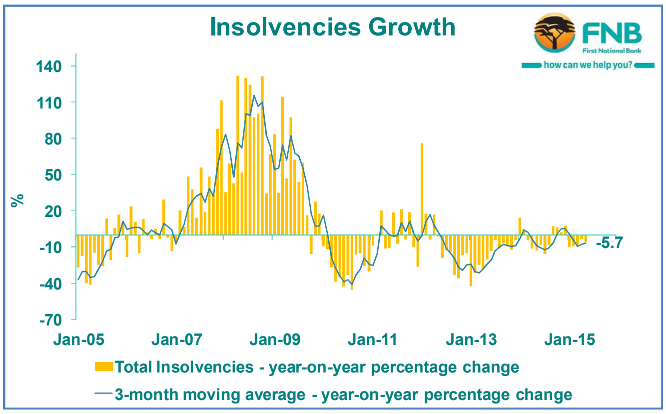
- ***We're just not seeing the "chronic" consumer credit health situation that is some times reported***

Frequently, one reads reports painting a dire consumer credit situation...one in which arrears and non-performing loans are spiralling "out of control". However, we find very few indications of this at present. To the contrary, the performance of households with regard to servicing of debt appears fairly good at present, and the level of indebtedness relative to disposable income has been broadly declining in recent years. But this is not to say that all is entirely "safe" yet.

- ***Indicators of credit health actually appear good***

Examining various indicators regarding the state of Household Sector Debt, the impression is that a relatively good period of credit health continues, with households benefiting from "abnormally low" interest rates by South African standards. The release earlier this week of insolvencies data showed another year-on-year decline in the number of insolvencies, to the tune of -5.7% year-on-year. For the 1st 5 months of 2015, StatsSA insolvencies data averaged 230 insolvencies per month, dramatically better (lower) than the 451/month average for the corresponding months of 2009, just after the 2008 peak in Prime Rate at 15.5% and as South Africa experienced recession.

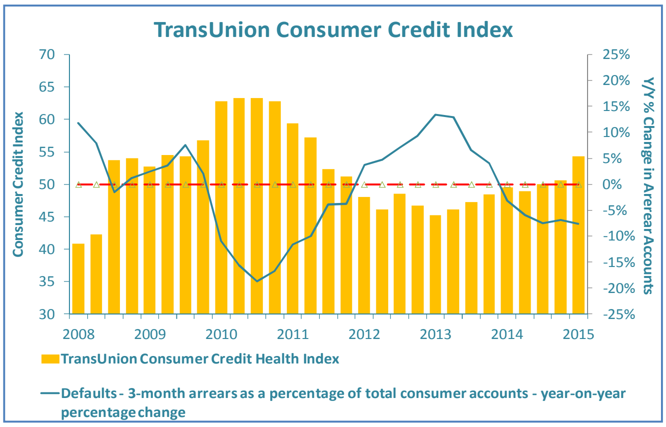
Admittedly, in recent times the rate of change in insolvencies had popped briefly up into positive growth territory at stages of 2014, before returning to decline once more, and admittedly the year-on-year rates of decline of late have been small relative to earlier sharp declines back around 2010 as interest rates were being cut.



So at the current time it would probably be more correct to see consumer credit health as "good", although one could say that the multi-year improving trend since around 2010 has perhaps run out of steam.

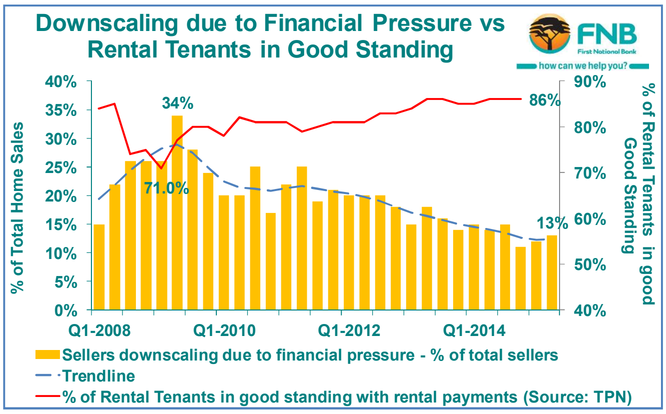
Certain other data, notably the TransUnion Consumer Credit Index, points to a similar picture.

The TransUnion Consumer Credit Index has moved back up to a level above 50 in recent quarters, which signals a return to improving credit health. As this has happened, TransUnion has reported a return to decline in arrears accounts expressed as a percentage of total consumer accounts.



Delving into residential property data we see a similar picture. In the FNB Estate Agent Survey, 13% of total sellers were believed to be selling in order to downscale due to financial pressure in the 2nd quarter of 2015. This percentage has hovered at between 11 and 14% over the past 2 years or so, and remains far below the 34% peak estimate back at a stage of 2009.

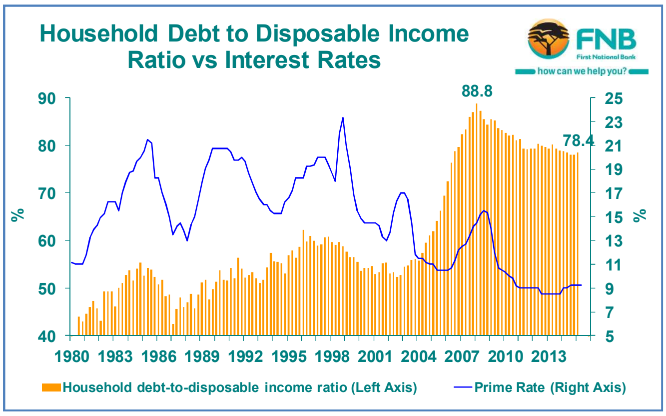
And while the percentage of financially stressed sellers declined from 2009 to 2014, in the rental market we saw the percentage of tenants "in good standing", with regard to rental payments to landlords, rise from a low of 71% in mid-2009 to 86% by the end of 2014.



Most data therefore points to a relatively positive picture for consumer credit health in recent years, and we don't yet get the sense that there has been a noticeable deterioration.

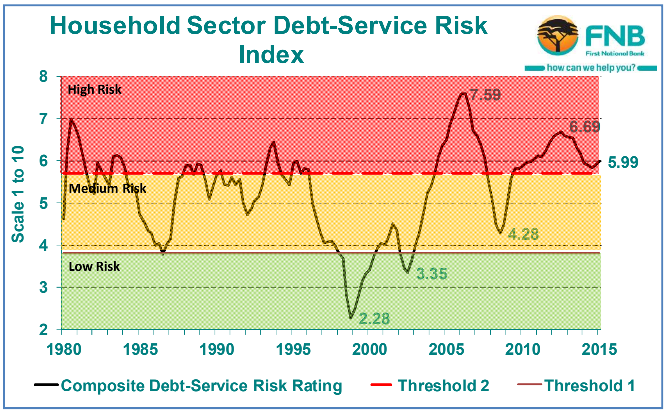
- ***But we are definitely not saying that the consumer isn't vulnerable. Low interest rates hide "frailties"***

However, this is not to say that the consumer is not vulnerable. To the contrary, the level of vulnerability remains high, because the level of outstanding household debt expressed as a percentage of Disposable Income's remained high at 78.4% early in 2015. The low level of bad debt in recent years is thus largely attributable to the SARB's aggressive interest rate reductions of a few years ago, to multi-decade lows, and to a lesser extent attributable to a more conservative borrowing/lending approach since the end of the 2000-2007 consumer and housing booms.



The good news is that this ratio is down on the all time high of 88.8% back early in 2008.Every time this debt-to-disposable income ratio declines it reduces the vulnerability of the household sector to interest rate "shocks" a little bit more, and slowly we can make our way back to lower levels of vulnerability.

We attempt to rate consumer vulnerability when it comes to debt and future ability to repay.



Our Household Sector Debt Service Risk Index is compiled using the level of the Debt-to-Disposable Income Ratio, its trend direction as well as Real interest rate levels (with lower real interest rate levels being seen as a higher risk period, because that's the time when worse lending/borrowing decisions are made on average than when rates are high).

The Index puts Household Debt-Service Risk at 5.99 on a scale of 0 to 10, markedly improved on the 2006 all time high of 7.59, but still in the "High Risk" zone.

- ***1st prize is for consumer credit to grow very slowly, and for the SARB to raise interest rates gradually***

Important, therefore, is that Household Sector Credit growth remains at recent "pedestrian" levels, which would hopefully be generally slower than disposable income growth, in order that the Debt-to-Disposable Income Ratio continues to decline. Our subjective view is that a level below 70% of Disposable Income at the very least would be a desirable outcome.

And the current approach of the SARB, lifting interest rates at a "snail's pace" appears the most desirable. The hiking of rates promotes a more conservative approach by the consumer towards borrowing growth, thus keeping credit growth slow, whilst simultaneously giving ample time for consumers to "prepare their finances" for what appears to be "the inevitable".

- ***But the key question is whether global and local economic risks will force the SARB to raise faster***

The key risk, though, is that the SARB's hand is forced by global economic conditions. South Africa's wide current account deficit on the balance of payments makes it highly dependent on volatile foreign capital inflows, making the Rand constantly exposed to volatility. Does a "hard landing" in China cause more severe pressure on Emerging Market currencies, including the Rand, or will US interest rate hiking have that effect, or both?

Any severe rand weakening can cause a rise in imported inflationary pressures, pressuring the SARB into a more rapid pace of interest rate hiking.

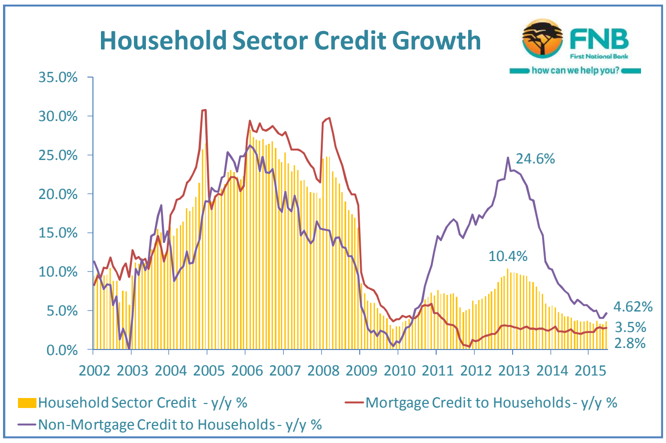
These are the risks that the still highly-indebted Household Sector of South Africa lives with.

So, currently, Household/Consumer credit health appears good, contrary to what we sometimes hear. But interest rates are rising, albeit mildly, and this should cause some mild credit health deterioration in the near future. Households remain vulnerable, with not enough improvement (decline) in the levels of indebtedness relative to income to date. The hope must be that the SARB continues to hike interest rates at its current slow pace, containing credit growth but not doing significant damage. But some key global economic risks suggest that we cannot take this for granted.

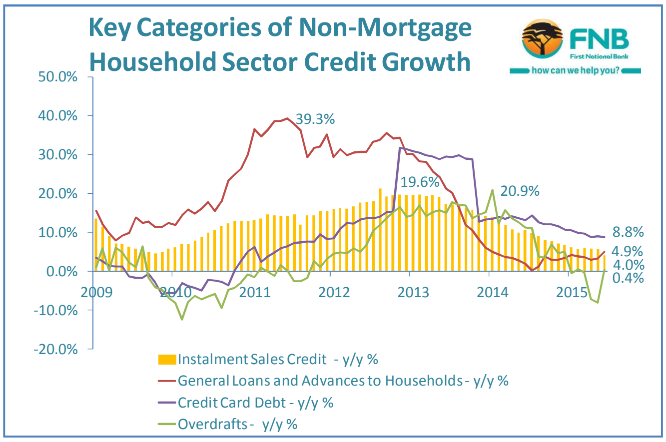
DATA: JUNE HOUSEHOLD SECTOR CREDIT

June Household Sector Credit recorded year-on-year growth of 3.5%. Whilst this is slightly higher than the 3.2% for the previous month, the pace of growth remains "pedestrian.

Non-mortgage credit remains a stronger driver of overall credit growth than mortgage credit. Total Non-Mortgage Household credit growth was 4.6% year-on-year in June, while Mortgage Credit to households was a lesser 2.8%.



Within the non-mortgage component, it was the Overdrafts category that had the most noticeable turnaround, from a previous month's -8.2% year-on-year decline to slightly positive growth of 0.4%. The General Loans and Advances category also showed accelerated growth from 3.2% previous to 4.9% in July. However, Instalment Sales credit growth continued to slow, from 5.5% previous to 4%, reflective of weak demand growth for the highly cyclical durable goods, especially motor vehicles. Credit card debt growth also slowed very slightly from 8.9% to 8.8% over the two months.

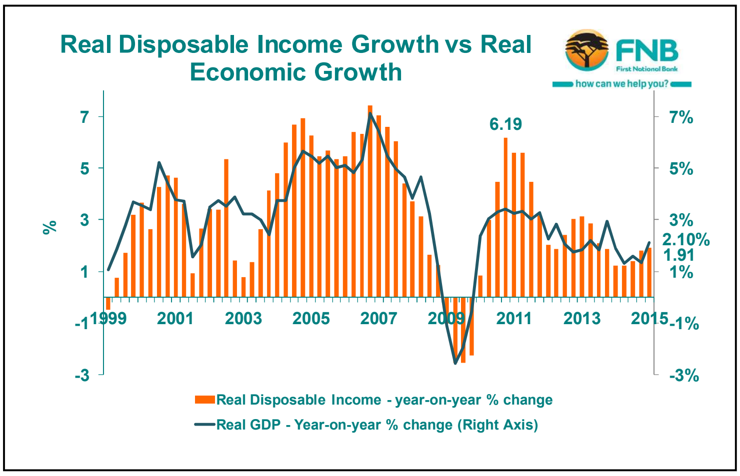


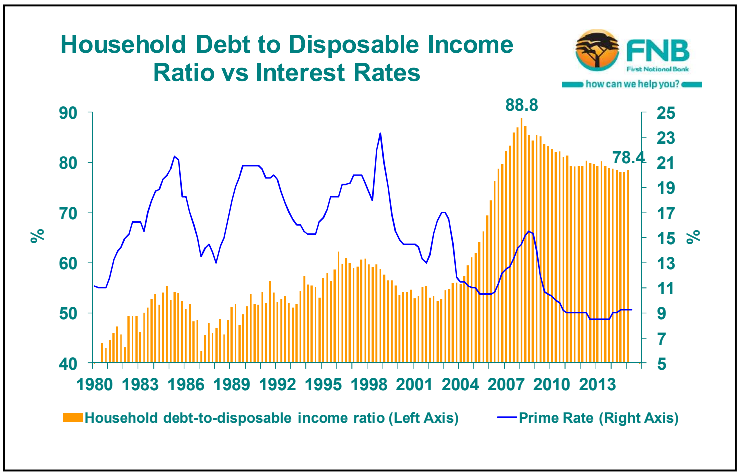
The slight uptick in Household Sector Credit growth from May to June is not expected to turn out to be the start of any noticeable accelerating trend. Rather, we expect the pace of growth to remain rooted in the lowly 3-4% range. The SARB resumed its interest rate hiking in July, which should elicit a more cautious approach by consumers in the near term. In addition, we anticipate a further 25 basis point rate hike before the year is over. Furthermore, we have seen the FNB BER Consumer Confidence Index drop to a 15-year low in the 2nd quarter, and this, too, is expected to put a dampener in credit demand. This sharp drop in consumer confidence is reflective of a very weak economic growth.

Despite this slight rise in credit growth in June, we continue to expect household credit growth to be slow enough to cause the resumption of the broad declining trend in the Household Debt-to-Disposable Income Ratio, crucial in order to reduce household vulnerability to interest rate hiking over time.

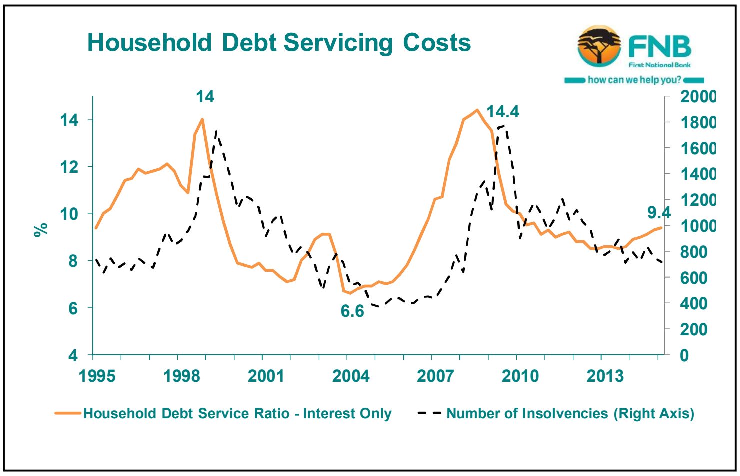
GRAPHICS: HOUSEHOLD SECTOR CREDIT ENVIRONMENT

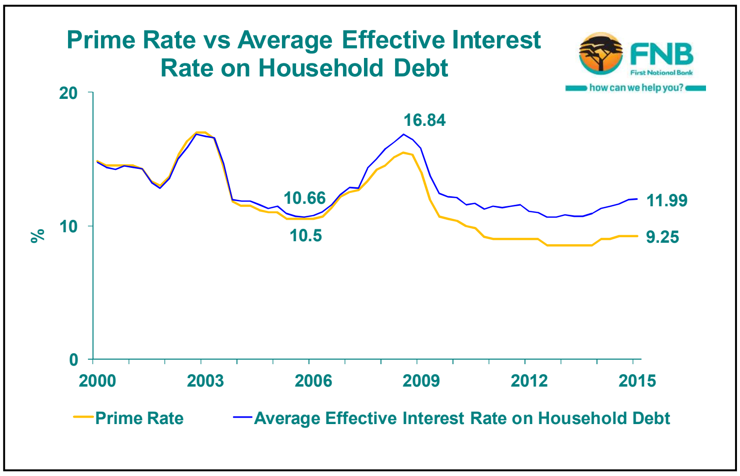
Household Sector Debt and Disposable Income Growth



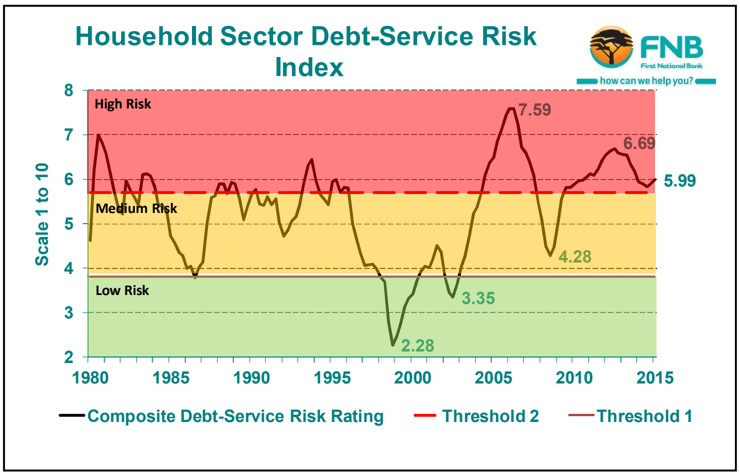


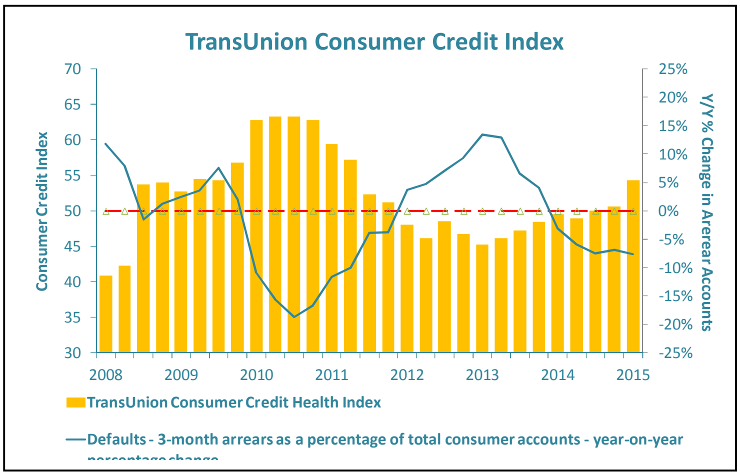
Debt-Service Cost



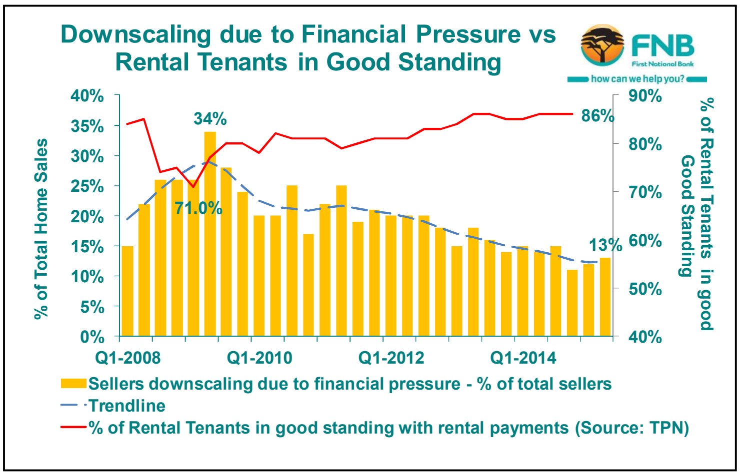


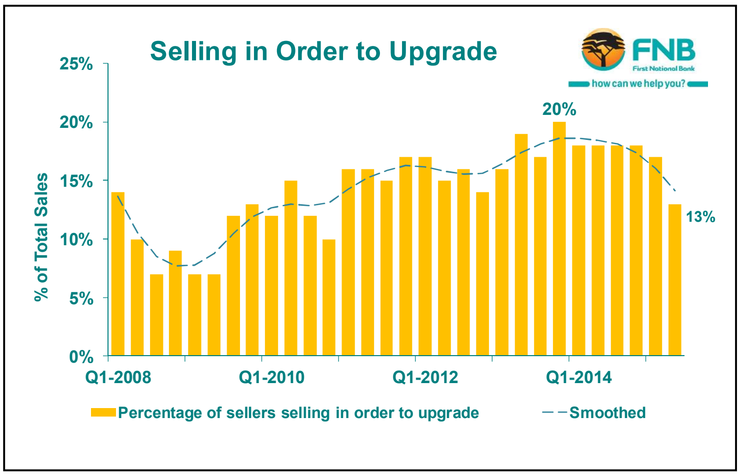
Household Credit Risk and Credit Health Indices



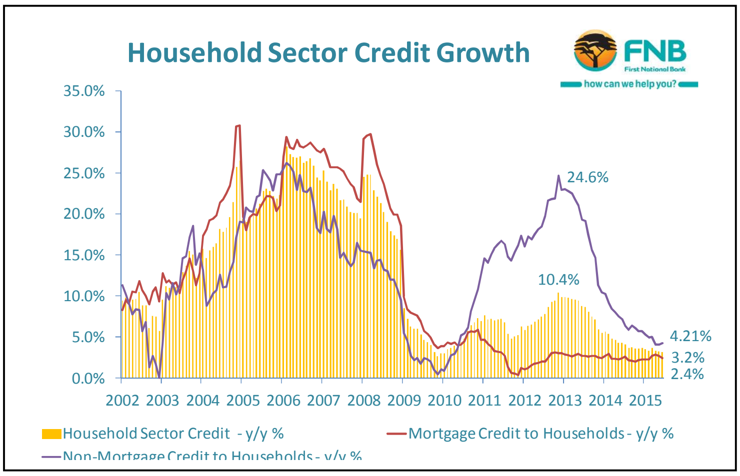


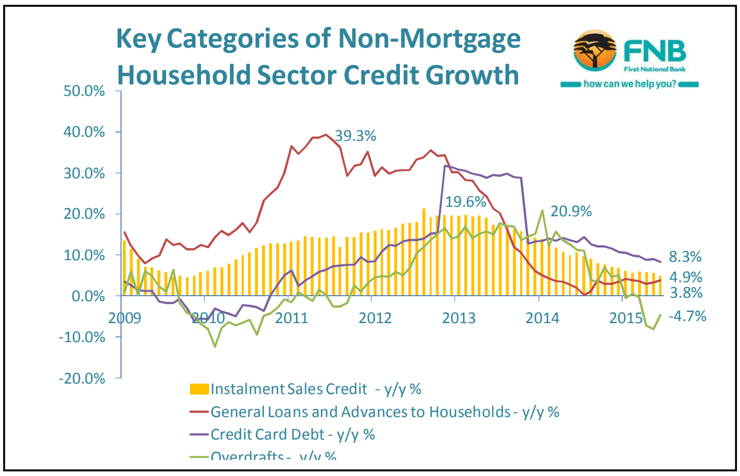
Housing Market Financial Strength-Related Indicators





Household Credit





Household Credit category Splits