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South African Consumer

Not much relief from the credit cycle

Miyelani Maluleke
+27 11 895 5655
miyelani.maluleke@absa.co.za

Peter Worthington
+27 21 927 6525
peter.worthington@absa.co.za

Sello Sekele
+27 11 895 5685
Sello.Sekele@absa.co.za

www.absa.co.za

- **The South African consumer has been under pressure for some time due to a multitude of headwinds, including weak labour markets and tight credit conditions**. Our analysis of the recent consumer credit market data shows that although conditions remain generally tight with willingness to lend still weak, lending growth has increased, mainly supported by a reorientation of unsecured lending to higher-income households, while positively, arrears on outstanding debt also appear to have stabilised.

- **On lending growth, the SARB data show that bank consumer credit extension has increased in recent months, mainly driven by unsecured credit**, which reached 10.4% y/y in June, while secured credit growth has remained broadly stable just below 5%. National Credit Regulator data, which broaden the credit landscape to all registered credit providers, also broadly mirror the divergence in secured and unsecured lending.

- **Growth in unsecured lending appears to be mainly driven by higher-income households.** The NCR data show that growth in new unsecured credit for consumers with incomes >ZAR15k/per month increased by 29.3% y/y in Q1 19, while it fell across all other reported income groups. The shift to higher-income households is also reflected in the number of new unsecured transactions, with a proportion of new transactions flowing to higher-income households rising to 46.8% in Q1 19 from 36.8% just three years earlier.

- **Unsecured loan sizes are getting larger, while the terms also appear to be getting longer**. In Q1 19, the number of new unsecured credit where loans sizes were greater than ZAR15k accounted for all 52.4% of all unsecured transactions in Q1 19, up from 44.9% a year earlier and 37.4% in Q1 2016. Unsecured loan terms also appear to be getting longer, with unsecured credit transactions of terms longer than five years accounting for 38.8% of the total in Q1 19 compared with 28.6% three years earlier. **We are skeptical of the sustainability of the recent pick up in unsecured lending growth.**

- **Arrears on outstanding debt appear to have stabilised across all credit types in Q1 19**. Fresh arrears in the mortgage book stood at 3.9% of the total in Q1 19, just up from 3.8% in Q4 18. In the unsecured book, the proportion of the book that was reported overdue by 90+ days fell slightly to 17.8% in Q1 19 from 18.4% in Q4 18.

- **Notably, rejection rates on new credit applications remained elevated at 55.8% in Q1 19,** albeit slightly lower from 56.1% in Q4 18. Without a meaningful decline in arrears, these rejection rates are likely to remain high, keeping credit extension growth muted.

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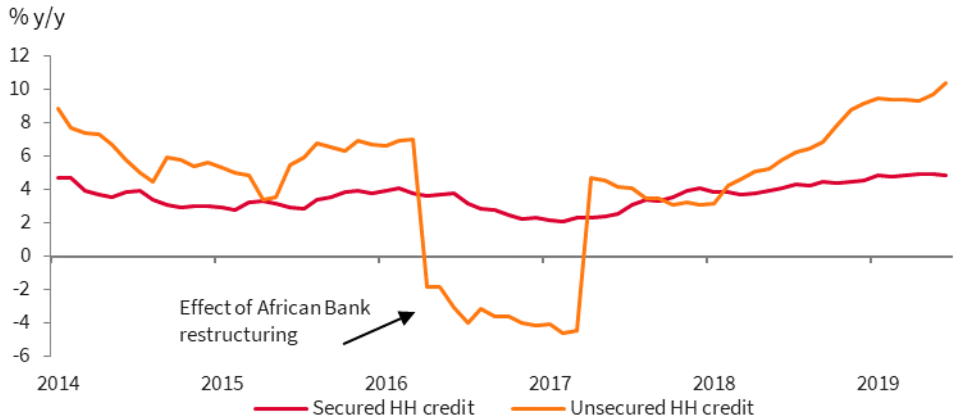
Given the recent focus on Eskom and the linked fiscal and credit rating risks, the outlook for the consumer has taken a backseat somewhat in the macroeconomic discourse. However, as the single largest driver of domestic demand, a clear read of the consumer is critical for assessing growth prospects over the foreseeable future. In this report, we focus on the consumer from a credit perspective, with help from two recently published datasets - one is the monthly private sector credit extension (PSCE) data from the SARB, while the other is the Consumer Credit Market Report (CCMR) from the National Credit Regulator (NCR).

Household credit extension has picked up, but mainly in the unsecured space

Credit extension data are showing a divergence between secured and unsecured lending growth

We begin by examining recent trends in credit growth, starting with the SARB's data on bank lending to households. The SARB publishes data on outstanding stock of household debt across different categories on a monthly basis. These debt data are of course somewhat narrower than the NCR's data since banks only account for about 82% (as of 31 March 2019) of outstanding consumer credit. The SARB data show a gradual acceleration in bank credit extension to households in recent months. In June, bank household credit extension growth reached 6.2% y/y, the highest level since late 2013, compared with 5.6% y/y at end-2018 and 4.5% y/y in mid-2018. However, it is the underlying drivers of this gradual improvement that are more interesting. Specifically, this rise has been driven largely by unsecured credit, which has been rising much faster than secured credit (Figure 1). At an aggregate level, unsecured borrowing by households reached double-digit growth of 10.4% y/y in June for the first time in nearly six years. Meanwhile, secured credit extension has remained broadly steady, just below 5% y/y by June.

Figure 1: Secured and unsecured household credit extension showing a clear divergence



Source: SARB, Absa Research

Bank secured credit extension to households has been broadly stable across different categories…

Within the secured part of the bank household debt book, growth has been fairly stable across two major categories i.e., mortgages and installment sales credit (Figure 2). Mortgages, which account for 58% of total household debtors' book, have grown at a steady pace of around 4% for several quarters, which is consistent with the weakness in the housing market. At 17% of the total debtors' book, installment sales credit, the bulk of which is vehicle finance, showed some improvement from the start of this year, but growth rates now appear to have stabilised at around 7.5% y/y.

…but unsecured credit extension to households has risen, driven by credit cards and general loans and advances

Meanwhile, unsecured credit growth has demonstrated a fairly broad-based increase. 'General loans and advances', the largest category of unsecured credit, accounting for 14% of the total debtors' book in the SARB data, grew 11.0% y/y in June, the strongest pace of growth since 2013. Outstanding balances on credit cards, which are roughly 7% of the total bank debtors' book, also hit double-digit growth for the first time in five years at 11.3% y/y in June compared with 7.6% y/y at end-2018 and 5.6% y/y in mid-2018. Overdrafts, which are a fairly small proportion of total household credit, have shown more volatile growth rates, but overall, have not picked up as strongly as 'general loans and advances' and credit cards.

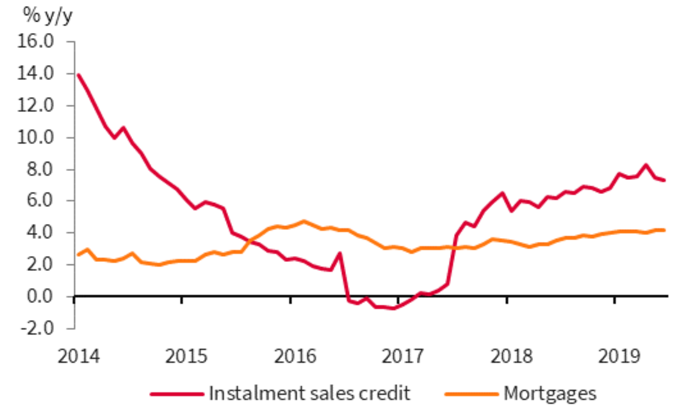
There could be several explanations for the divergence between secured and unsecured lending growth

The apparent divergence between growth in secured and unsecured credit is somewhat puzzling. However, in the context of financially constrained households, which have seen a marked slowdown in nominal income growth, the development may be an indication of households tapping into unsecured credit to supplement current consumption. However, we believe it may also reflect lenders' changing preferences, with loans in the unsecured space generally enjoying a much higher interest premium.

NCR data also show a sharp 16.4% y/y increase in unsecured credit during Q1 19

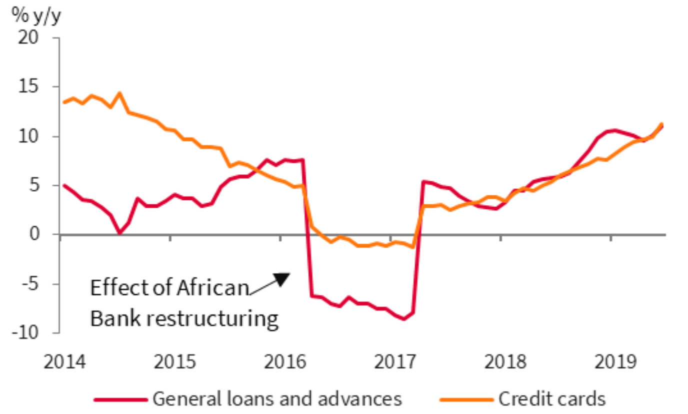
To get more clues, we looked at the recently released Q1 19 CCMR data from the NCR. Although these are not as timely as the SARB data, they provide a more detailed read of the consumer credit landscape in two ways. Firstly, they broaden the scope of analysis to include all registered non-bank providers of consumer credit, as well as banks. Secondly, they provide more detailed data on borrower incomes, loan sizes and repayment behaviour on existing credit. As regards to credit extension, we find the NCR data's growth rates to be broadly consistent with the SARB's reported growth rates, even if the magnitudes of debt outstanding are somewhat different. The debtors' book data as reported by the NCR (reported as stock data similar to the SARB data) show that growth in unsecured credit reached 16.4% y/y in Q1 19, up from 14.7% y/y in Q4 18. Meanwhile, the mortgage and (non-mortgage) secured parts of the debtors' book grew 3.8% y/y (Q4 18: 3.9%) and 4.8% y/y (Q4 18: 5.1%), respectively in Q1 19.

Figure 2: Secured credit extension growth broadly stable…



Source: SARB, Absa Research

Figure 3: …but unsecured credit extension is rising



Source: SARB, Absa Research

Unsecured credit increasingly driven by higher-income consumers

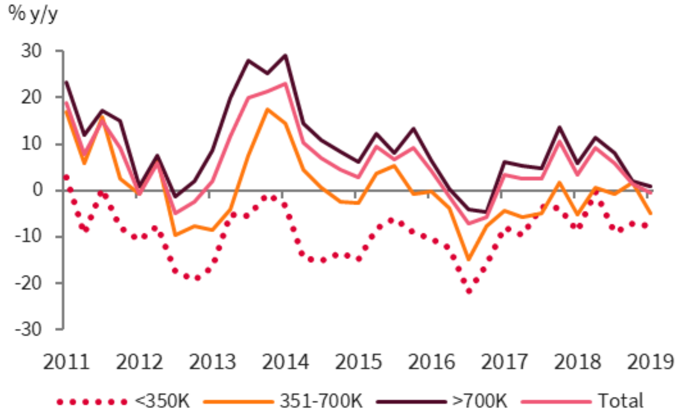
Secured credit growth is weak across income groups and loan sizes…

Although the sluggish timing of the release of the NCR data leaves the analysis with a backward-looking tilt, the level of disaggregation in its data does help to shed more light on the divergence in secured and unsecured credit. In this respect, the NCR supplements its gross debtors' book data with flow data on new credit extended on different categories (i.e., mortgages, unsecured lending, etc.) across different income groups, loans sizes, and in some cases, loan terms. According to these data, total new mortgage credit extended fell by 0.4% on a y/y basis in Q1 19, the first y/y contraction since 2016 and after growth of just 1.6% y/y in Q4 18. In terms of loan sizes, the largest categories in this book are unsurprisingly the ZAR701k+ and ZAR351-700k sizes, accounting for 81.5% and 15.1% of all new mortgage credit, respectively. Growth in larger loans (i.e., ZAR701k+) remained marginally positive in Q1 19 at 0.8% y/y, but slowed from 2.0% in Q4 18. However, the ZAR351-700k mortgages fell by 4.9% y/y in Q1 19 after growth of 1.7% y/y in Q4 18.

…but the highest income threshold in the NCR data may be too low to analyse the bulk of secured lending across different income groups

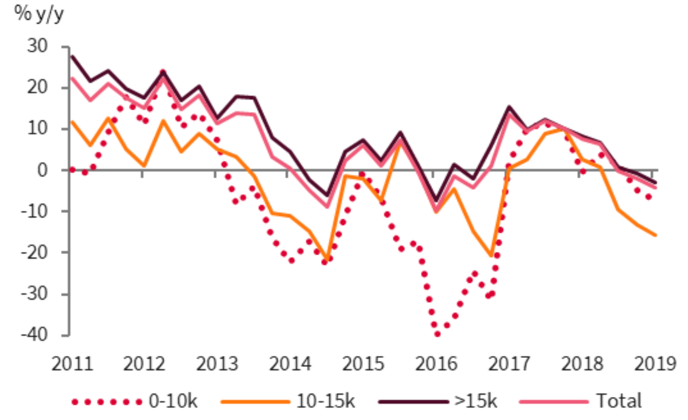
The mortgage data by income category showed that 99.2% of the rand value of all new credit went to consumers with monthly income of more than ZAR15k. Arguably, the NCR's highest income threshold of over ZAR15k is too low to disaggregate and analyse the bulk of mortgage lending in South Africa, in part because the NCR was set up to protect consumers, particularly low-income households. Thus, the data it gathers by income category are not strongly oriented towards providing useful income breakdowns for broad macroeconomic analysis. Those with monthly incomes between ZAR10k and ZAR15k accounted for just 0.7% of the rand value of new mortgage loans in Q1 19. The (non-mortgage) secured credit data also showed falling y/y growth across all income groups (Figure 5). But similar to mortgages, the highest-income threshold in this category is too low to analyse the bulk of the lending activity, with 90.4% of all new credit granted in this category in Q1 19 flowing to consumers with income higher than ZAR15k per month. That said, the slowdown in the growth of all forms of secured credit, even in higher-income households, perhaps suggests that some of it could be related to low consumer confidence and heightened caution about committing to large-ticket durable goods such as new houses or new vehicles. This is also evident in the BER's consumer confidence data, where the metric measuring consumers' 'rating of the present as a time to buy durable goods' fell to -10 in Q2 19 from -8 in Q1 19. We note however that the NAAMSA data show some acceleration in car sales in Q2 from Q1, so it will be interesting to see if the NCR data show any pick-up in non-mortgage secured lending in Q2 19.

Figure 4: Growth in new mortgage credit is weak across all loan sizes



Source: NCR, Absa Research

Figure 5: New secured (non-mortgage) loans across income groups

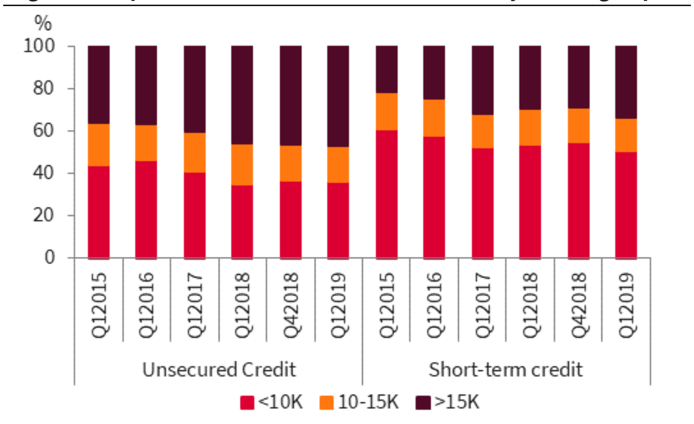


Source: NCR, Absa Research

Unsecured credit extension is also increasingly reoriented towards higher-income households

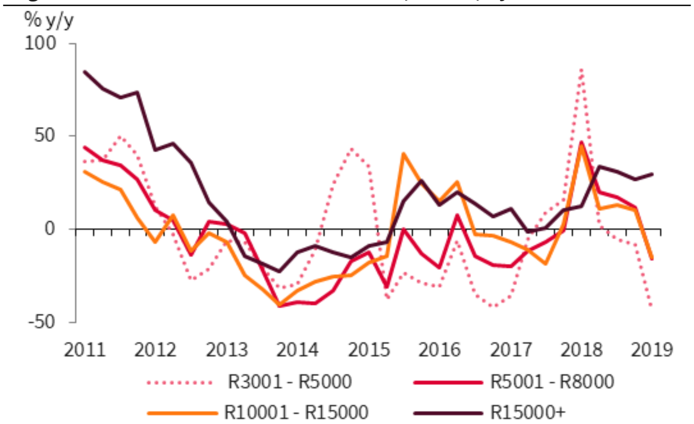
As with the SARB data, the trends in new unsecured credit loans in the NCR data are a bit more interesting. The increase in unsecured credit in Q1 19 was mostly driven by higher-income consumers. The data also show that loan sizes in unsecured credit are getting larger, while the loan terms are also getting longer. New unsecured credit to households with monthly income higher than ZAR15K/per month increased by 29.3% y/y in Q1 19, after growth of 26.6% y/y in Q4 18. Consumers with income higher than ZAR15k/per month are also now an increasingly larger share of the actual number of unsecured credit transactions. In Q1 19, 46.8% of all new unsecured credit transactions went to consumers with income of more than ZAR15k/per month (Figure 6). This compares to just 36.8% as recently as Q1 16. Meanwhile, unsecured credit growth for all other lower-income groups fell in Q1 19. For households within the ZAR10-15k/ per month income band, unsecured credit extension fell by 15.2% y/y in Q1 19. The declines were even larger for lower-income households. The reorientation of unsecured lending towards higher-income households could possibly be an indication of a deterioration in credit risk among lower-income households, such that lenders find it increasingly unattractive to lend to extend new credit to these consumers.

Figure 6: Proportion of new unsecured transactions by income group



Source: NCR, Absa Research

Figure 7: Growth in new unsecured credit (in rand) by loan sizes



Source: NCR, Absa Research

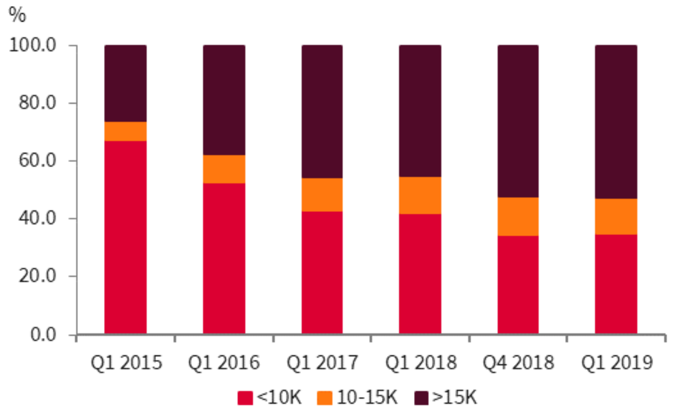
Larger-sized loans are a growing share of new unsecured credit transactions

With respect to loan sizes, unsecured loans of more than ZAR15k grew by 29.3% y/y in Q1 19 after several quarters of similarly strong growth (Figure 7). However, unsecured credit loans of smaller sizes all fell in Q1 19 on a year-on-year basis, although generally off higher bases in Q1 18. New unsecured loans below ZAR3K were down by 40.1% y/y in Q1 19, while those between ZAR3-5k were also down by more than 40% on a year-on-year basis in Q1 19. However, trends in low-size loans are so much more volatile, possibly because low amount loans are typically made to low-income consumers, and these could perhaps be more sensitive to credit risk-on versus credit risk-off by lenders. But more broadly, smaller-sized loans are a falling share of new unsecured transactions. The number of new unsecured transactions where the loan amount was ZAR10k or less accounted for 35% of all new transactions in Q1 19, down from 52.7% in Q1 16.

The terms of new unsecured credit are also increasingly getting longer

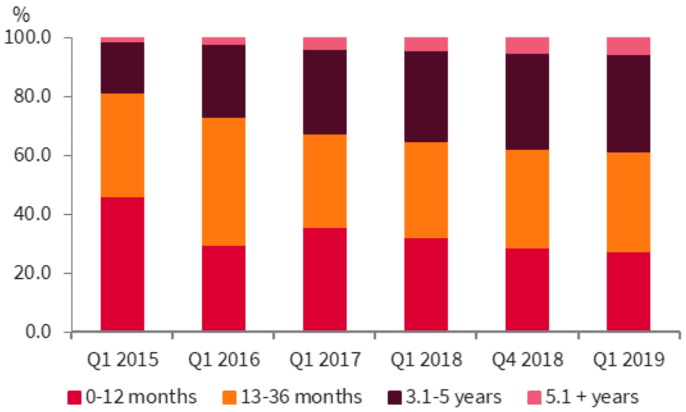
The terms of new unsecured loans are also gradually getting longer. In Q1 19, the number of new unsecured credit transactions of more than five years accounted for 38.8% of all loans compared with just 26.8% in the first quarter of 2016 (Figure 9). We did not investigate closely the details of short-term credit, given that it is a relatively small category but the high level data also show that higher-income households account for an increasing share of these loans. In the absence of employment and income growth, we are skeptical of the sustainability of the strong growth evident in unsecured credit categories in the recent quarters, as increased indebtedness amongst households will ultimately make lenders more cautious.

Figure 8: Proportion of new unsecured transactions by loan sizes



Source: NCR, Absa Research

Figure 9: Proportion of new unsecured transactions by loan term



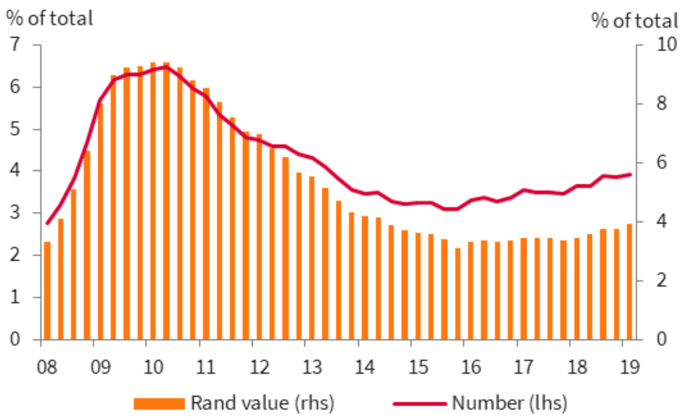
Source: NCR, Absa Research

Positively, arrears appear to have stabilised in Q1 19

Arrears appear to have stabilised in Q1 19

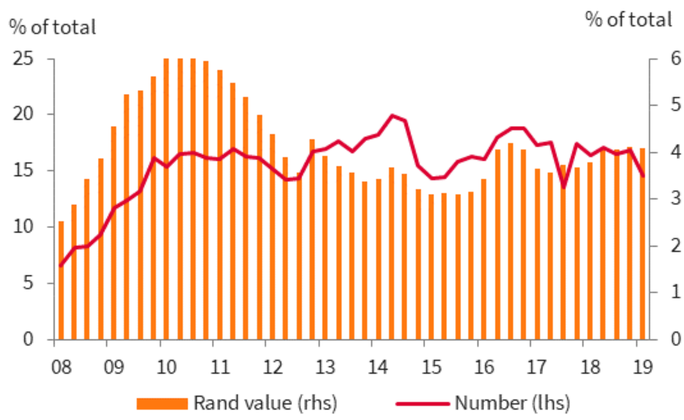
The second main theme we explore in the NCR data is the issue of credit quality. Despite ongoing narratives of increasing financial strain on households, the NCR's data did not show further deterioration in arrears. Unsurprisingly, higher-quality debt (i.e., secured debt) continued to perform better than lower-quality debt (i.e. unsecured credit) in terms of consumer repayment behaviour. In the mortgage book, the proportion of the rand value of the book that was reported as 'current' (i.e., where repayments are up-to-date) stood at 91.4% in Q1 19, unchanged from Q4 18. Looked at differently, the proportion of the mortgage book reported as overdue by 90+ days was only marginally higher at 3.9% of the total book in Q1 19 compared with 3.8% in Q4 18. In the (non-mortgage) secured credit book, repayment behaviour improved in Q1 19, as the proportion of the rand value of the book that was reported as current increased marginally to 89.5% in Q1 19 from 89.1% in Q4 18. The proportion of the book in rand terms that was reported as overdue by 90+ days fell to 10.5% in Q1 19 from 10.9% in Q4 18. A similar picture emerges in these data when viewed from the proportion of accounts. Generally, the secured credit data showed no further deterioration in repayment behaviour in Q1 19 (Figures 10 and 11).

Figure 10: Mortgage arrears of 3+ months unchanged in Q1 19…



Source: NCR, Absa Research

Figure 11: …while the non-mortgage secured book is showing the same

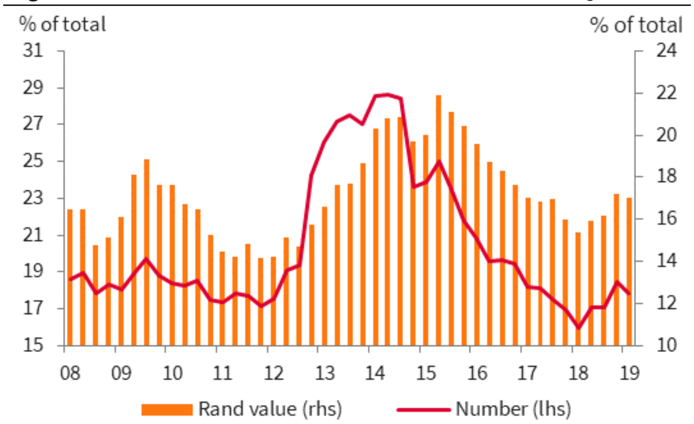


Source: NCR, Absa Research

Arrears in the unsecured debtors' book also remained stable in Q1 19

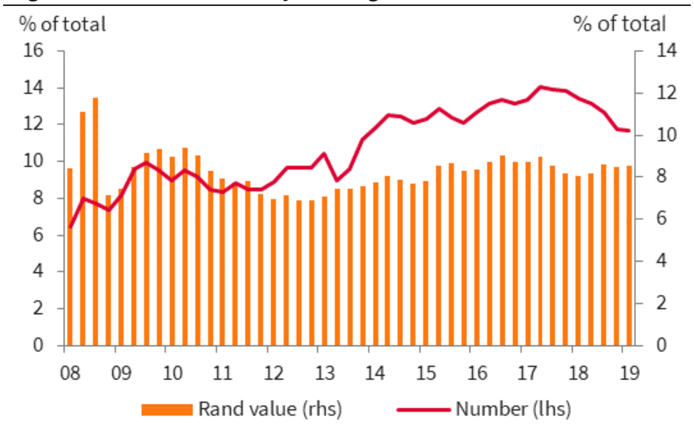
In the unsecured credit book, arrears also stabilised somewhat after rising for three consecutive quarters. The proportion of the outstanding book in rand terms that was reported to be overdue by 90+ days fell slightly to 17.8% in Q1 19 from 18.4% in the final quarter of 2018. Including arrears of longer periods, total arrears were down marginally by 0.3pp to 27.0%. In the credit facilities book, fresh arrears (or arrears of three months +) were at 11.7% in Q1 19, unchanged from Q4 18. Thus, similar to the more secured forms of credit, the unsecured credit data showed little signs of increasing strain in Q1 19. Of course, what could partly explain this is that credit providers have increasingly reoriented their crediting lending to higher-income, and presumably more credit-worthy, consumers.

Figure 12: Arrears of 3+ months in the unsecured book fell in Q1 19…



Source: NCR, Absa Research

Figure 13: …and were broadly unchanged in credit facilities



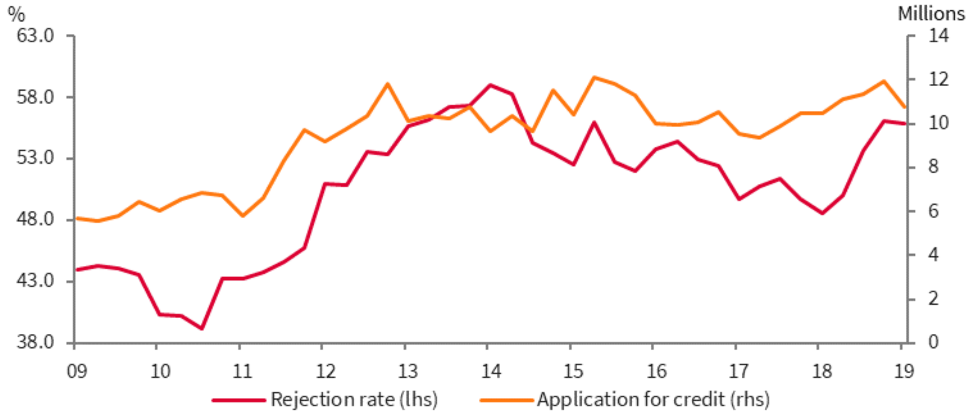
Source: NCR, Absa Research

Rejection rates on new credit applications are still elevated

The number of new credit applications fell in Q1 19, with the rejection rate also easing slightly to 55.8%

In the final main theme from the NCR data, we consider new credit application and rejection rates. Unfortunately, the NCR does not publish these data across different credit types or different income groups, which is a great lacuna, since such a breakdown would provide exceptionally valuable insights into the dynamics of South Africa's credit markets. The data are still interesting nonetheless. Rejection rates on new credit applications rose markedly during 2018, rising from 48.5% in Q1 18 to 56.1% by Q4 18. However, these high rejection rates appear to have discouraged some consumers in Q1 19, with the number of new credit applications falling by 10.1% q/q to 10.8mn in Q1 19 (Figure 14). The rejection rate also declined, albeit to a still elevated level of 55.8%, a level that clearly still indicates that lenders remain fairly cautious, possibly due to strained consumer balance sheets. The fact that the credit extension data also clearly show a growing bias towards higher-income households suggests that lower-income households are bearing the brunt of credit application rejections. Without a meaningful decline in arrears as a result of improved repayment behaviour, we believe rejection rates are likely to remain elevated, keeping credit growth fairly subdued.

Figure 14: Rejection rates on new credit applications were down slightly in Q1 19



Source: NCR, Absa Research

The consumer credit cycle is unlikely to be supportive of consumer spending in the near-term and the recent rate cut is unlikely to make a big difference

As we argued in the *South Africa Quarterly Perspectives: Fiscal slippage and policy drift (16 July),* the consumer credit cycle seems unlikely to provide a significant and sustained boost to consumer spending in the near term. The recent interest rate cut of 25bp by the SARB will likely only make a marginal difference to consumer borrowing, particularly in an environment where consumer confidence is probably tenuous, despite seemingly elevated reading of the BER Consumer Confidence Index (CCI). To put in context, using the NCR data that show total consumer debt stock of ZAR1.9tn in Q1 19 and assuming that about 75% of this debt is on variable interest rates, a 25bp interest rate cut reduces households' debt servicing costs by ZAR3.5bn over a 12-month period. This is only about 0.1% of total nominal household consumption expenditure in 2018. That said, we find it encouraging that the recent credit data are not showing any further deterioration in arrears across secured and unsecured debt, suggesting some stabilisation in consumer financial strain. This is also supported by the TransUnion Consumer Credit Index, a measure of consumer credit health, which improved marginally to 49 in Q2 19 from 48 in Q1 19.

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