quantec

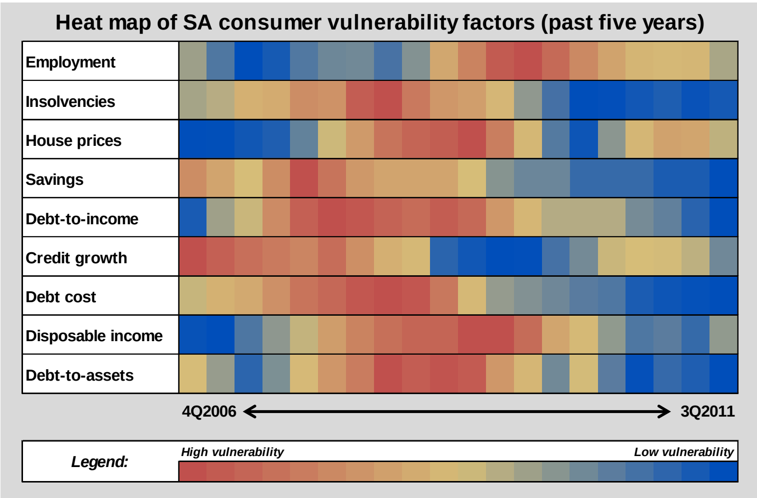
www.quantec.co.za

December 2011

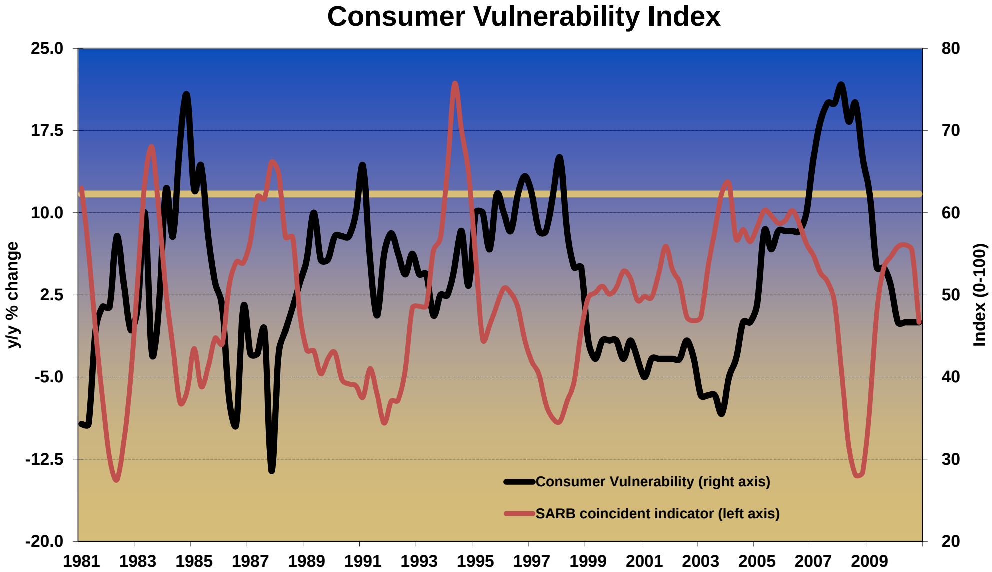
# Consumer Vulnerability Index

## CONSUMER VULNERABILITY REMAIN AT LOWER LEVELS

Quantec's Consumer Vulnerability Index (CVI) has recorded a stable pattern since the fourth quarter of 2010 at a level of 47 points. After reaching dangerously high levels during 2008, the the index had, by the end of 2009, dropped to around one standard deviation above its median value of the past three decades. During 2010 and 2011, the index showed some considerable improvement, dropping below its median value. Since reaching a high of 76 index points in the fourth quarter of 2008, there was a 38% decline in consumer vulnerability up to the third quarter of 2011.




Households' vulnerability improved over the past number of quarters mostly in the areas of indebtedness. Low interest ensured that debt servicing costs declined significantly, while households' savings efforts also showed some improvement. However, employment growth remained depressed while the lack of improvement in residential property values meant that households' net worth remained under pressure. Credit uptake by households did appear to be picking up by the end of 2010, but recent numbers suggest that this growth is again subsiding. The economy's performance and the extent to which employment growth will continue in 2012, will be very important determinants of households' ability to meet their debt obligations and further improve their financial vulnerability.




### In this issue:



*Quantec Research (Pty) Ltd is a South African based consultancy. We focus on the marketing, distribution and support of economic and financial data, country intelligence and quantitative analytical software. We also provide consultancy in custom economic and financial database solutions, economic analysis and forecasting, and market analysis and segmentation.*

*Author of this document:*
*Christo Luüs*
*christo@quantec.co.za*
*011 764 5620*

*In South Africa, as is the case in many other countries, there is a keen interest in the financial health or vulnerability of the consumer. Since bank asset growth depends heavily on mortgage demand and other forms of asset finance, this is clearly an area that needs to be monitored closely. Indeed, the credit crunch of 2008/2009, had its origins partly in lending to people who were not in a position to repay their loans.*
*Many international studies have been conducted over the years in an attempt to establish predictors of consumer vulnerability which could serve as a warning signal to the authorities and to aid banks in gauging the possible impact of household debt and borrowing on their profitability. In South Africa, a lack of data and insufficient occurrences of consumer crises, make the compilation of probability predictors more difficult.*
*For South Africa, nine indicators of consumer financial health or vulnerability were identified and combined into a single index which can be used as a measure of consumer vulnerability. For each of the nine indicators, the historical standard deviations are calculated and scores given as shown in the tables below.*

## Consumer vulnerability index composition (3rd Quarter 2011)

| | Historical period values[1] | | | Latest value[2] | Score 5 years ago | Score 3 years ago | Score 1 year ago | Score 3Q2011 | Outlook: next 6 months[3] |
|---|---|---|---|---|---|---|---|---|---|
| | Mean | Maximum | Minimum | | | | | | |
| Employment growth (y/y) | 0.7% | 2.8% | -6.3% | 1.7% | 10 | 10 | 15 | 10 | Negative |
| Insolvencies growth (y/y) | 9.9% | 137.8% | -45.3% | -33.4% | 10 | 25 | 5 | 5 | Stable |
| Real house price growth (y/y) | 2.3% | 35.3% | -21.5% | -0.7% | 10 | 15 | 15 | 15 | Negative |
| Saving to HDI [4] | 2.0% | 10.1% | -3.9% | 0.0% | 25 | 25 | 20 | 20 | Stable |
| Household debt to HDI | 59.5% | 82.7% | 44.3% | 75.0% | 20 | 25 | 20 | 20 | Stable |
| Real Credit growth (y/y) | 6.3% | 23.6% | -6.2% | -0.4% | 20 | 10 | 10 | 10 | Stable |
| Debt servicing cost | 9.4% | 15.4% | 5.1% | 6.8% | 10 | 20 | 10 | 5 | Stable |
| Real HDI growth (y/y) | 3.4% | 18.8% | -13.0% | 4.5% | 10 | 20 | 10 | 10 | Stable |
| Debt to financial assets [5] | 37.3% | 44.6% | 29.5% | 35.4% | 15 | 15 | 10 | 10 | Positive |
| Total average score (out of 100) | | | | | 58 | 73 | 51 | 47 | |

1) *Historical period under review starts in 1981 for most data series*
2) *Most of the official macro-economic data are available for 3Q2011*
3) *Expected score movement relative to the most recent quarter*
4) *HDI = Household disposable income*
5) *Long-term insurance data for recent quarter has been estimated*

### How scoring is done:

**For indicators where a bigger number would indicate less vulnerability**
***(eg real income, employment, savings, real house price growth)***

| Std deviations from mean | >2 | 2 to 1 | 1 to 0 | 0 to -1 | -1 to -2 | >-2 |
|---|---|---|---|---|---|---|
| Score | 25 | 20 | 15 | 10 | 5 | 0 |

**For indicators where a smaller number would indicate less vulnerability**
***(eg debt levels, growth in real credit, insolvencies growth)***

| Std deviations from mean | >2 | 2 to 1 | 1 to 0 | 0 to -1 | -1 to -2 | >-2 |
|---|---|---|---|---|---|---|
| Score | 0 | 5 | 10 | 15 | 20 | 25 |

*For each of the indicators, the most recent value is compared with the historical data. A score is then awarded depending on how many standard deviations this value is below or above the historical mean.*

*Source: Quantec*

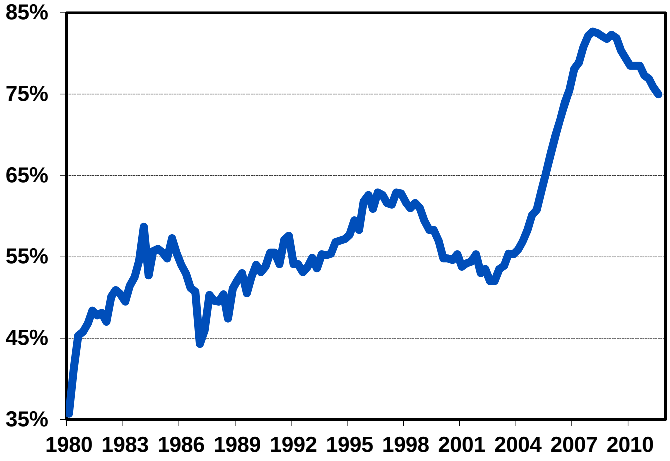
From the table it can be seen that there had been some improvement in South African households' financial position over the past five years, while a more significant improvement occurred during the past three years.

Savings were appallingly low and real credit growth dangerously high during the second quarter of 2006. The global credit crunch and ensuing recession of 2008/2009, impacted on employment and disposable income growth. Distress borrowing gave rise to even higher debt levels and caused a material rise in the number of insolvencies recorded.

The latest available figures (for the third quarter of 2011) show that only three of the nine indicators were still in the top half of the vulnerability scale. The other six indicators were showing lower vulnerability for various reasons. The lowest interest rates in three decades have had a remarkably positive effect on debt servicing costs. Credit uptake has continued to weaken owing to tighter lending criteria applied by banks and also because of households' relatively weak overall financial position. These factors have been limiting households' ability to take on additional debt. Household debt levels nevertheless remain elevated despite some moderate increases in household disposable income growth.

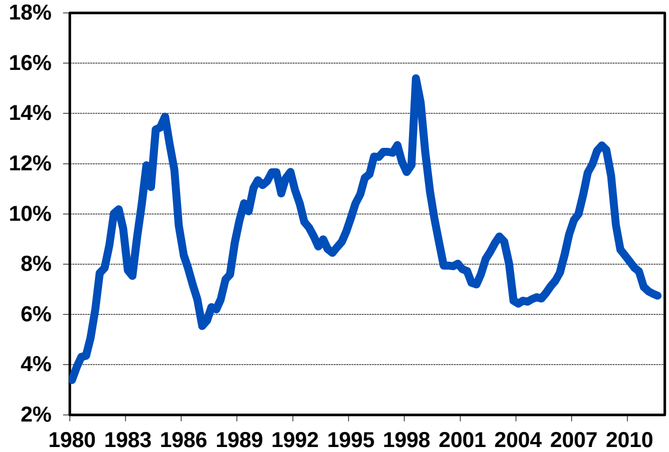
Meanwhile asset markets have remained under pressure which, together with the oversupply of properties in some areas, have kept real house price growth in negative territory.

## Household debt as a percentage of disposable income



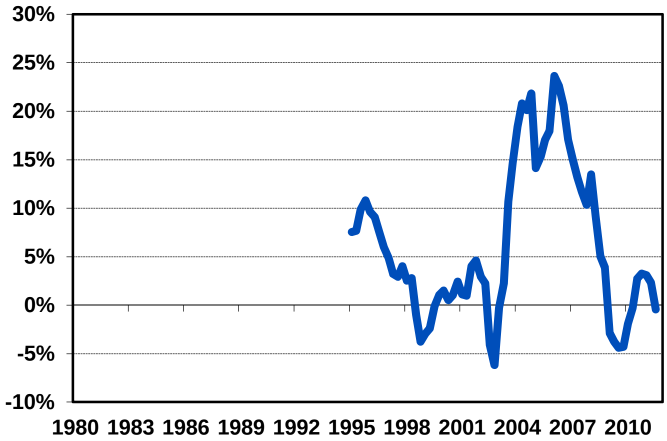

Whereas the household-debt-to-income ratio averaged 54% for about 25 years prior to 2005, the ratio moved up uninterruptedly during 2005 to 2008, going as high as 82,7%. Since then, household debt has relented somewhat, registering 75% of disposable in the third quarter of 2011. This level can still be regarded as unsustainably high, especially if interest rates should start rising again. The high debt level has proved to be an obstacle in the savings efforts of households and weakened their balance sheets, thus hampering the take-up of credit. This in turn has dampened the rises in certain asset prices.

## Household debt servicing cost as a percentage of disposable income



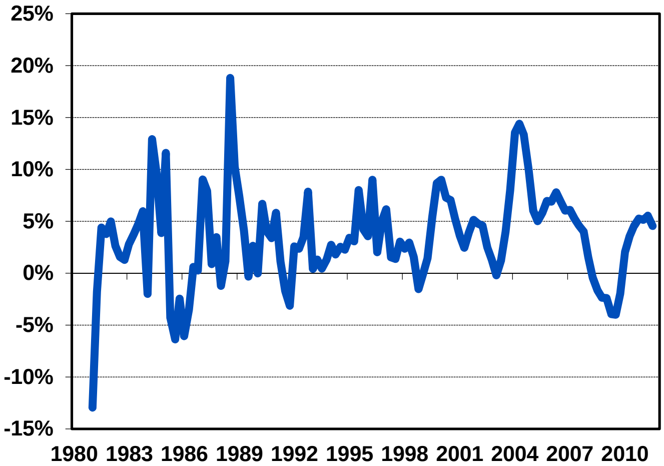

The latest number (third quarter 2011) of 6,8%, represents a meaningful drop from the level of more than 12% which prevailed during much of 2008 and 2009. (These figures only approximate interest costs and not principal repayments on debt.) The improved debt servicing cost ratio is of course mainly the result of the decline in interest rates since the end of 2008. The ratio is bound to show some further improvement in the first half of 2012 as the Reserve Bank is not expected to raise interest rates any time soon. In addition, disposable income growth should show further advances in the wake of above-inflation wage increases in many sectors.

## Real credit growth: Household sector




Real year-on-year growth in private sector credit extension was negative during 2009 and the first half of 2010. During mid-2010 to mid-2011, real credit growth was in positive territory but only to the tune of around 2,9% y/y on average. Real credit growth again declined by 0,4% in the tird quarter of 2011. For the past six months (up to end-September 2011), the average monthly y/y change for instalment sales and leasing finance was 4,8%; for mortgage advances it was 2,6%; and for other loans and advances it was 11,6%. Instalment and leasing finance's share as a percentage of total private sector credit fell from 12% five years ago, to 10,3% in September this year, while mortgage finance's share rose from 38,8% to 43,8%.

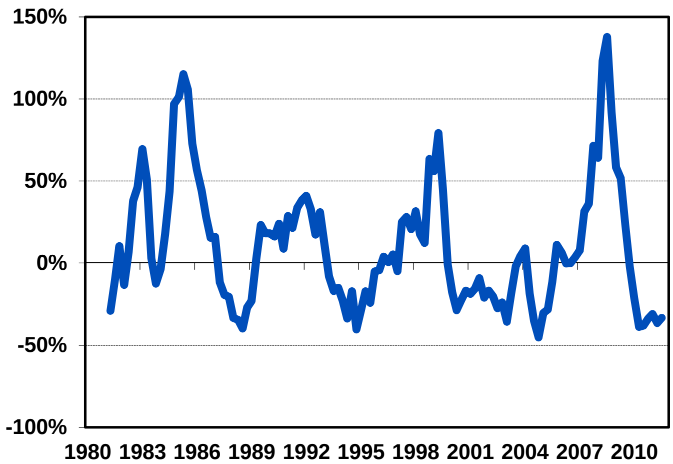
## Real household disposable income growth




Real household disposable income (HDI) increased by an average of 5,1% (y/y) over the past four quarters. This contrasts with six consecutive quarters in 2008-2009 during which real HDI declined by on average 3% y/y. Some of the main determinants of income still remain under pressure:

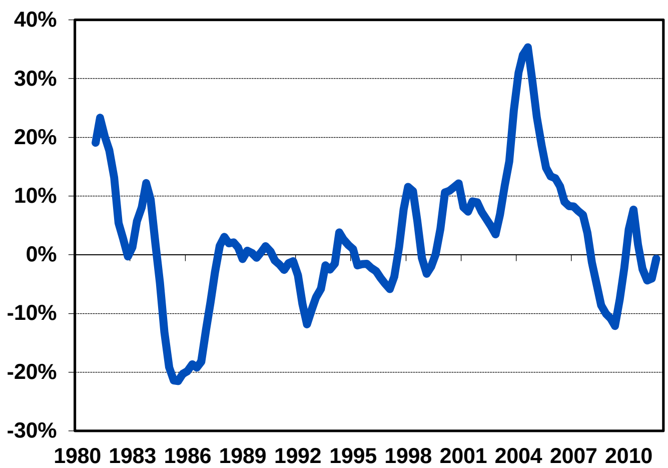
- Employment growth: Although positive growth is being recorded, unemployment is still rising while nearly half a million jobs have still not been recovered since the recession.
- Productivity growth: Labour productivity declined by 3,6% on a quarterly annualised basis during the second quarter of 2011.
- Inflation: Inflation is bound to remain at or above 6% during the next two to three quarters.
- Changes in taxes and subsidies: No tax relieve is foreseen over the next few years.

## Change in insolvencies



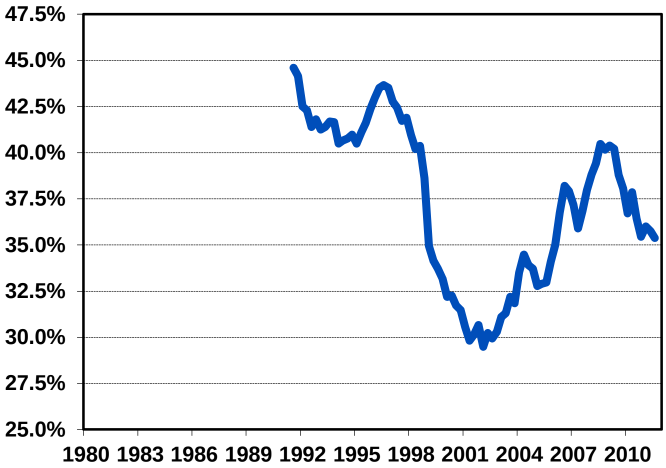

Rising insolvencies (of individuals) and liquidations (of enterprises) nearly always accompany any deterioration in economic conditions. Very often, a person can become insolvent when his / her income is no longer sufficient to finance expenditure, especially when such expenditure relates to the financing of debt commitments. During 2000-05, insolvencies had shown mostly a declining trend, averaging -18,4% per year during this period. However, insolvencies started to increase at the end of 2005, and by mid-2008, had escalated at a rate of more than 115% p.a. This involved around 1 200 insolvencies per quarter, compared with an average of some 560 insolvencies per quarter during 2007. The rate of growth in insolvencies started to moderate towards the end of 2008 and during the past seven quarters, insolvencies had shown a drop of 33,3% y/y on average (some 860 cases per quarter).

## Real house price growth



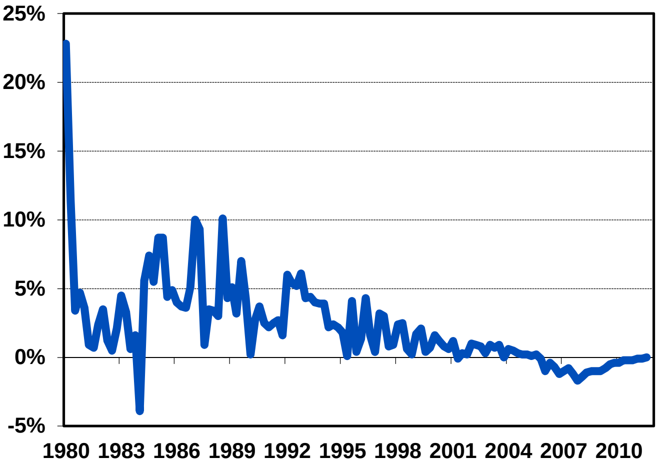

Any decline in residential property values usually relates to excess supply, relative to demand. Although the number of houses built escalated by on average 9,3% p.a. during 2003-2007, the decline in real house prices during 2008 probably had as much to do with deteriorating demand conditions than with an oversupply of properties. Steep increases in real house prices of more than 17% per year during 2003-2007 had made houses relatively expensive, while interest rate increases between mid-2006 and end-2008, as well as tighter credit conditions since mid-2007, caused many potential house buyers to buy smaller properties or to postpone purchases altogether. The drop in house prices during 2008 and early 2009 was the steepest since 1992, and by the second quarter of 2011, real house prices were back at roughly the levels that prevailed in 3Q2005.

## Household debt / financial assets



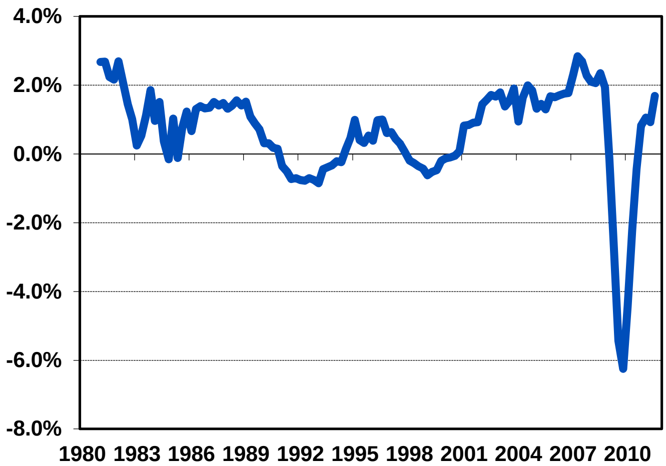

Household assets consist of tangible assets such as fixed property and durable goods, as well as financial assets. Reliable estimates for tangible assets of South African households are unfortunately not available. However, household assets held at banks in the form of deposits, at insurers in the form of unmatured policies, at pension funds and other financial assets in the form of financial securities, were added together to arrive at an approximation of household financial assets. During the period 2002-08 households accumulated debt at a faster pace than financial assets which caused the ratio to increase by more thyan ten percentage points. The situation has improved in the meantime, with the ratio reaching a level of just above 35% in the third quarter of 2011.

## Household net saving as % of disposable income




Household net saving in the national accounts is calculated as gross disposable income less final consumption expenditure and fixed capital formation. South Africa's net household saving, according to this measure, has been negative since the end of 2005. In essence, it implies that households are consuming more than they are earning, and this shortfall needs to be augmented from either accumulated savings, or through borrowing. Neither of these options are conducive for long-term wealth creation or ensuring sufficient funds at retirement and cannot be sustained indefinitely without affecting households' standard of living. Ways to encourage household saving would include sufficiently high real interest rates; low rates of inflation; measures to discourage excessive borrowing; economic policies to stimulate job creation; and low rates of taxation.

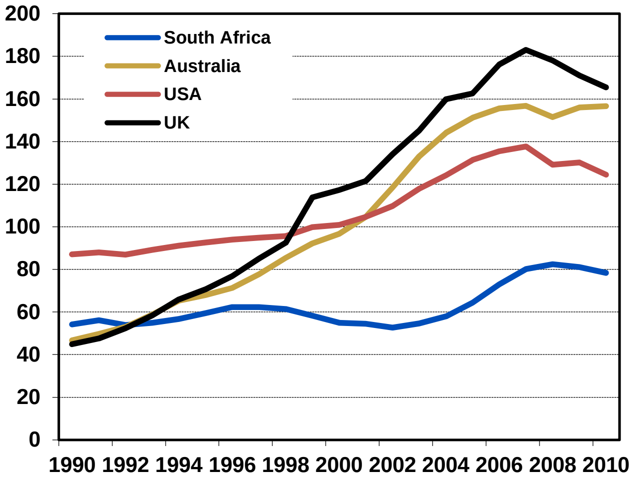
## Change in formal employment



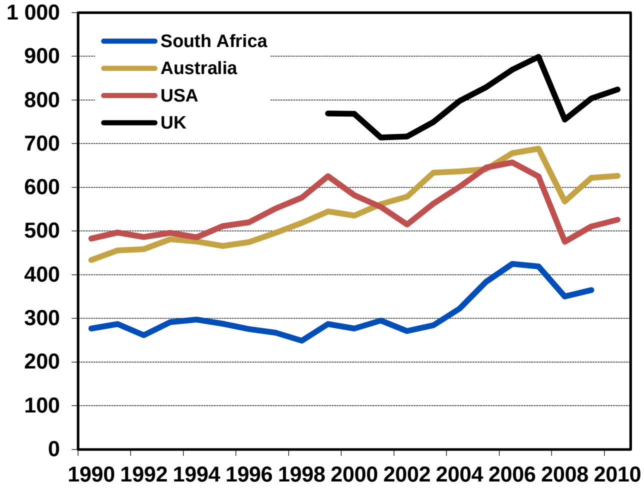

According to StatsSA's Quarterly Employment Survey and Quarterly Labour Force Survey (QLFS), formal employment started to rise (year-on-year) in the fourth quarter of 2010 after having recorded seven consecutive quarters of y/y declines. According to the latest surveys, formal employment growth amounted to 1,7% y/y in the third quarter of 2011 compared with average growth of some 1% during the previous three quarters. The latest QLFS (which includes informal sector jobs) showed that job losses in the third quarter were recorded in the utilities and transport sectors (-41 000), while the most significant increases occurred in Finance and other business services (+64 000) and trade (+68 000). The depressed construction sector aslo showed a gain (+43 000).

# International comparisons: Household net worth, debt and savings

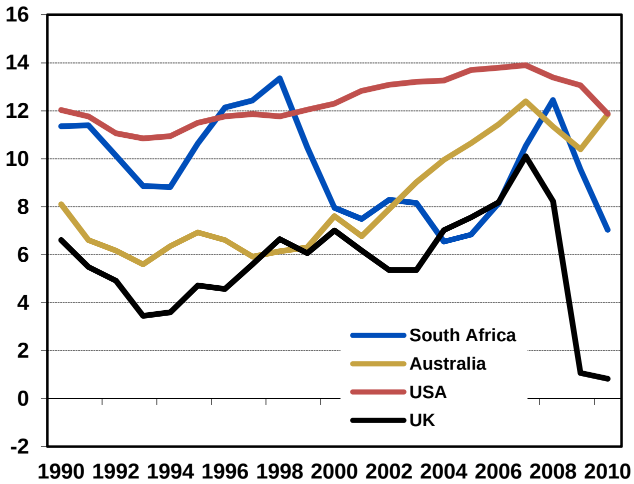
**Household debt / HDI (%)**



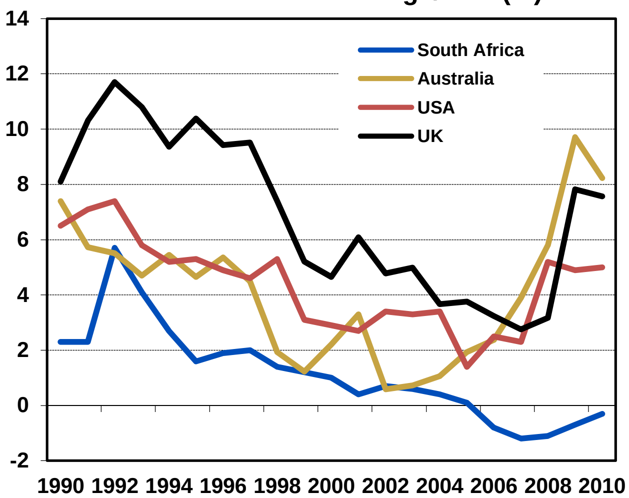

**Household net worth / HDI (%)**



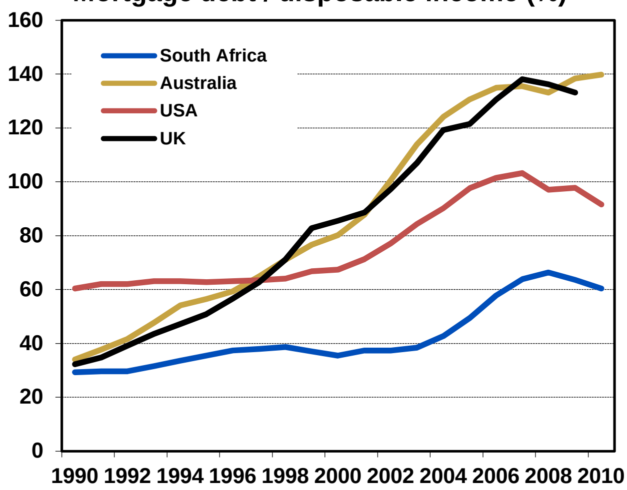

**Household debt servicing cost / HDI (%)**




**Net household saving / HDI (%)**




**Mortgage debt / disposable income (%)**




South African consumers are not the only ones who have been amassing debt over the past two decades or so. In Australia, the UK, and the US, debt levels had grown at an even more rapid pace, with mortgage debt having been responsible for most of the growth in household indebtedness.

The 2008/09 credit crisis and ensuing recession had also been responsible for a massive erosion in household wealth levels. From their respective peaks, household net wealth levels fell by 28% in the US, 18% in Australia, 17% in South Africa and 16% in the UK before recovering over the past year or so. Fortunately low borrowing rates have also caused significant declines in the debt servicing costs of households.

It would appear that savings levels have also benefitted from a renewed austerity drive amongst develop nations and although the process appears to have started in South Africa, household savings levels remained negative.