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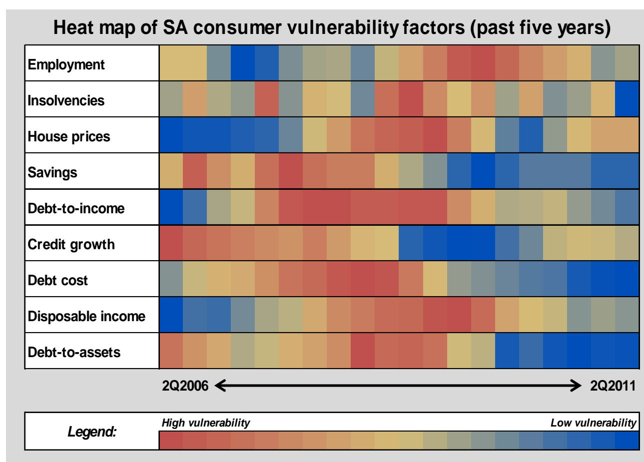
Consumer Vulnerability Index

CONSUMER VULNERABILITY IMPROVEMENT HALTED

Quantec's Consumer Vulnerability Index (CVI) has shown consistent improvement since reaching dangerously high levels during 2008. By the end of 2009, the index had dropped to around one standard deviation above the median value of the past three decades, and during 2010 and the first quarter of 2011, the index showed considerable improvement. In fact, since reaching a high of 144 index points in the fourth quarter of 2008, there was a 41% decline in consumer vulnerability up to the first quarter of 2011.

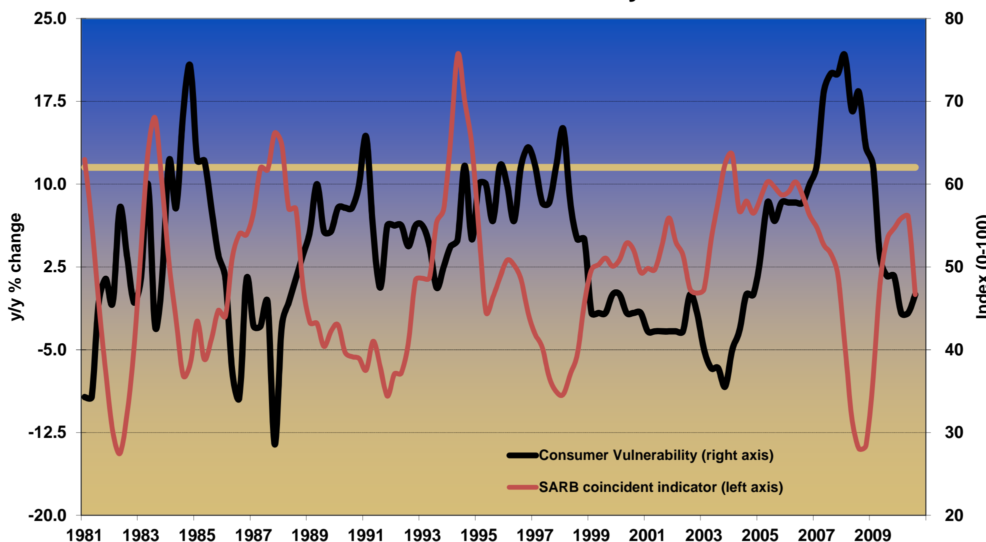
Unfortunately the improvement in consumers' financial position appears to have faltered, with the index slipping from 85 to 89 index points in the second quarter of 2011.



Although scores for most of the indicators have remained flat during the past three quarters, employment growth has disappointed in the second quarter of the year and has caused the uptick in consumer vulnerability.

Household saving, as a ratio of disposable income, remained negative at -0,2%, while the household debt ratio eased marginally to 75,9% in the second quarter. However, both these variables still indicated high levels of consumer vulnerability compared with their historical values.

Despite the uptick in consumer vulnerability during the second quarter of 2011, households nevertheless appear in a much better position to withstand a deterioration in economic conditions than had been the case in 2007-2008.



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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.

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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 (2nd Quarter 2011)

	Historical period values[1]			Latest value[2]	Score 5 years ago	Score 4 years ago	Score 3 years ago	Score 2Q2011	Outlook: 2nd half 2011[3]
	Mean	Maximum	Minimum						
Employment growth (y/y)	0.6%	2.8%	-6.3%	-0.5%	10	10	10	15	Negative
Insolvencies growth (y/y)	10.1%	136.6%	-45.3%	-36.4%	10	10	20	5	Stable
Real house price growth (y/y)	2.3%	35.3%	-21.5%	-4.3%	10	10	15	15	Negative
Saving to HDI[4]	2.0%	10.1%	-3.9%	-0.2%	25	25	25	20	Stable
Household debt to HDI	59.3%	82.0%	44.3%	75.9%	20	20	25	20	Stable
Real Credit growth (y/y)	6.4%	23.6%	-6.2%	2.3%	25	20	15	10	Stable
Debt servicing cost	9.4%	15.4%	5.1%	6.8%	10	15	20	5	Positive
Real HDI growth (y/y)	3.4%	18.8%	-13.0%	5.1%	10	10	15	10	Stable
Debt to financial assets[5]	47.7%	57.4%	36.7%	36.7%	10	10	15	5	Positive
Total average score (out of 100)					58	58	71	47	

1) *Historical period under review starts in 1981 for most data series*
2) *Most of the official macro-economic data are available for 2Q2011*
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

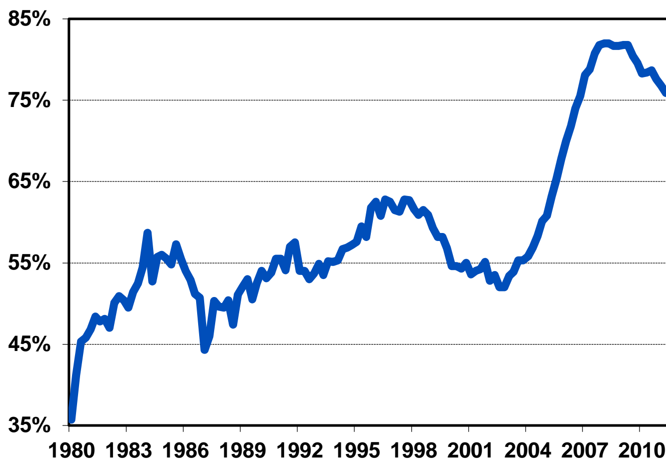
From the table it can be seen that there had been some improvement in South African households' financial position over the past five years, while a more significant improvement occurred during the past three years.

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 second quarter of 2011) show that four of the nine indicators were still in the top half of the vulnerability scale. The other five 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.

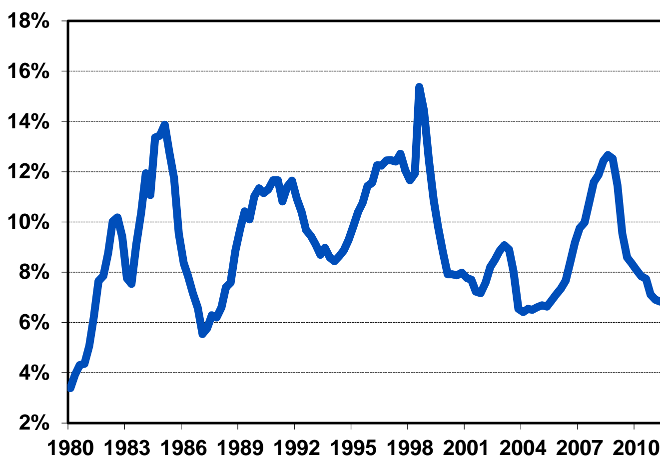
Meanwhile asset markets have remained under pressure which, together with the oversupply of properties in some areas, have kept real house price growth in negative territory.

Household debt as a percentage of disposable income



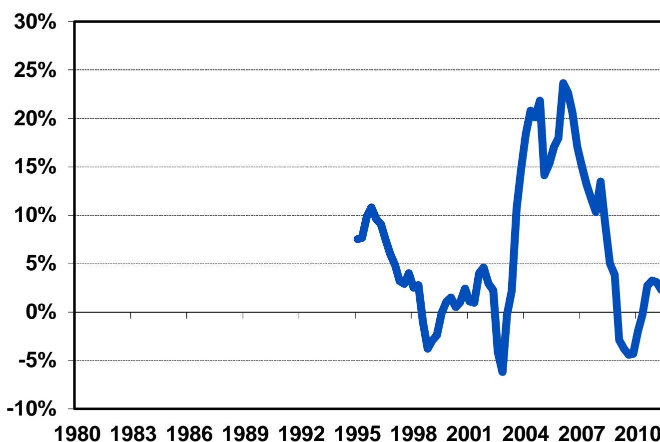
Whereas the household-debt-to-income ratio averaged 54% for about 25 years prior to 2005, the ratio moved up uninterruptedly during 2005 to 2008, going as high as 82%. Since then, household debt has relented somewhat, registering 76% of disposable in the second quarter of 2011. This level can still be regarded as unsustainably high, especially if interest rates should rise 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



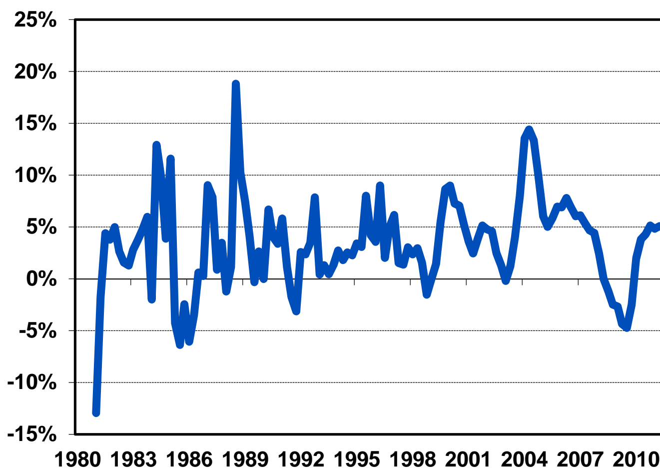
The latest number (second quarter 2011) of 6,9%, represents a meaningful drop from the level of more than 12% which prevailed during much of 2008 and 2009. (These figures only approximate interest costs and not principal repayments on debt.) The improved debt servicing cost ratio is of course mainly the result of the decline in interest rates since the end of 2008. The ratio is bound to show some further improvement in the latter half of 2011 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. Since the middle of last year real credit growth has been in positive territory but only to the tune of around 2,8% y/y on average. For the past six months (up to end-June 2011), the average monthly y/y change for instalment sales and leasing finance was 4,1%; for mortgage advances it was 3,2%; and for other loans and advances it was 10,6%. Instalment and leasing finance's share as a percentage of total private sector credit fell from 12,4% five years ago, to 10,6% in June this year, while mortgage finance's share rose from 37,8% to 44,9% over the same period. Banks' provisions rose from only 0,9% to 2,3%.

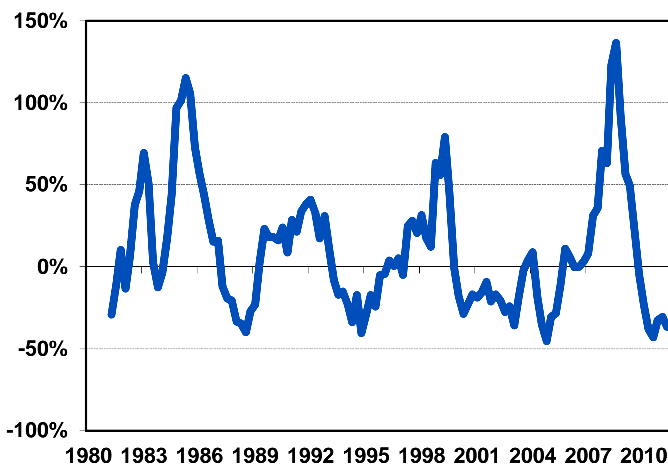
Real household disposable income growth



Real household disposable income (HDI) increased by an average of 4,8% (y/y) over the past year. This contrasts with six consecutive quarters in 2008-2009 during which real HDI declined by on average 3% y/y. Meanwhile some of the main determinants of income remain under pressure:

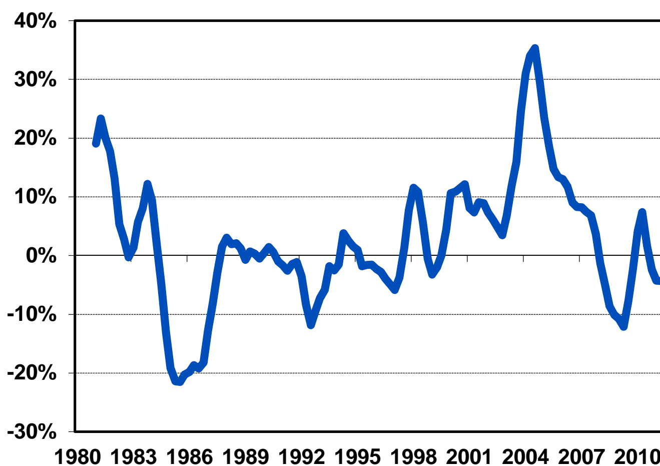
- Employment growth: After only tentative increases in the final quarter of 2010 and the first quarter of 2011, employment levels appear to be dropping again.
- Productivity growth: Labour productivity growth was only around 1% y/y for the first quarter of 2011, while no growth was recorded on a quarter-on-quarter basis.
- Inflation: Inflation is bound to remain at or above 5,5% during the remainder of 2011 and in 2012.
- Changes in taxes and subsidies: With pressure on the fiscus mounting, no tax relieve is foreseen over the next few years.

Change in insolvencies



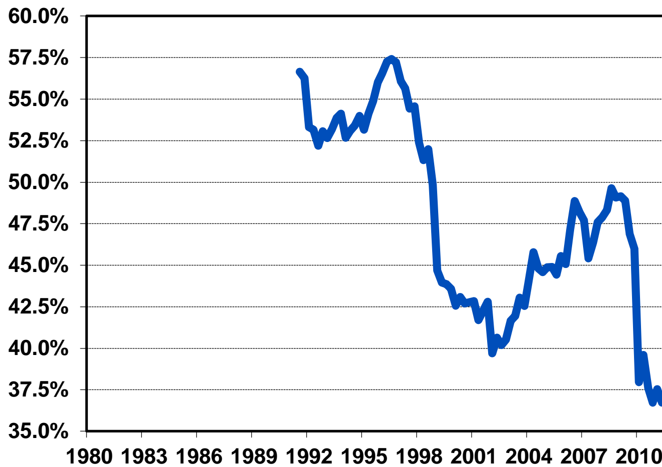
Rising insolvencies (of individuals) and liquidations (of enterprises) nearly always accompany any deterioration in economic conditions. Very often, a person can become insolvent when his / her income is no longer sufficient to finance expenditure, especially when such expenditure relates to the financing 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 1200 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 18 months, insolvencies had in fact shown a drop of 34% y/y on average (850 cases per quarter).

Real house price growth



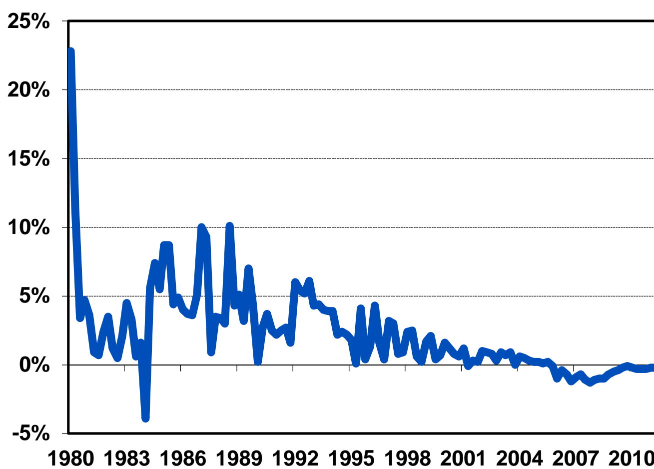
Any decline in residential property values usually relates to excess supply, relative to demand. Although the number of houses built escalated by on average 9,3% p.a. during 2003-2007, the decline in real house prices during 2008 probably had as much to do with deteriorating demand conditions than with 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



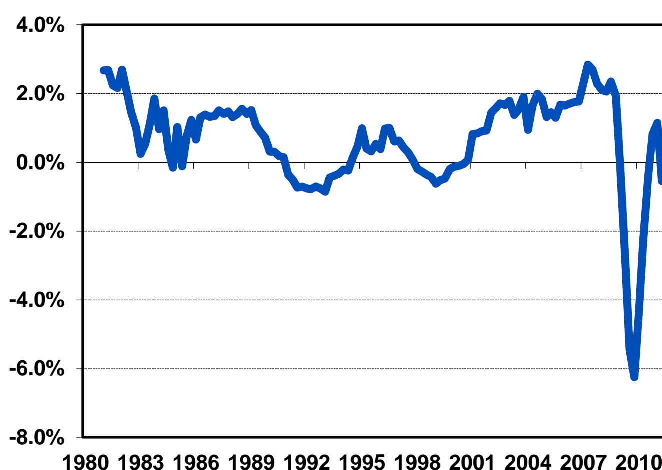
Household assets consist of tangible assets such as fixed property and durable goods, as well as financial assets. Reliable estimates for tangible assets of South African households are unfortunately not available. However, household assets held at banks in the form of deposits, at insurers in the form 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 nearly nine percentage points. The situation has completely reversed in the meantime, and the ratio reached an all-time recorded low of 36,7% in the second quarter 0f 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 increased in the fourth quarter of 2010 and first quarter of 2011 by respectively 0,8% and 1,2% y/y. However, according to our estimates, formal employment growth was again negative to the tune of around -0,5% y/y in the second quarter of 2011. The latest QLFS (which includes informal sector jobs) showed that job losses in the second quarter were recorded in most sectors compared with a year ago. Finance (-218 000) and construction (-71 000) were the worst affected, while community and social services have managed a gain of 165 000 since a year ago. Total formal and informal sector employment have dropped by 118 000 since June 2010.