HOUSEHOLD SECTOR – JULY HOUSEHOLD CREDIT GROWTH

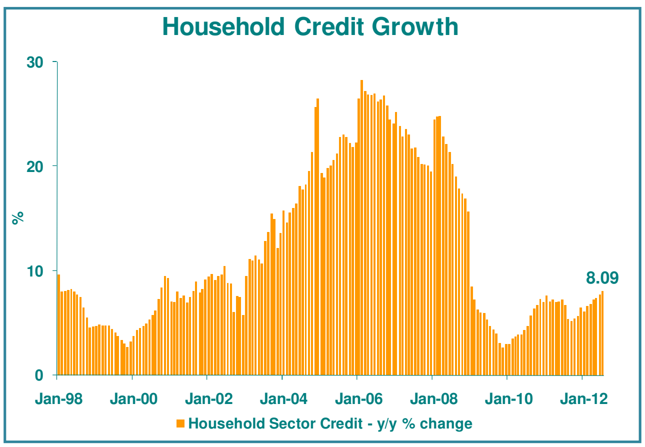
Household sector credit growth is gradually becoming more troublesome, due to very strong growth in non-mortgage household borrowing.

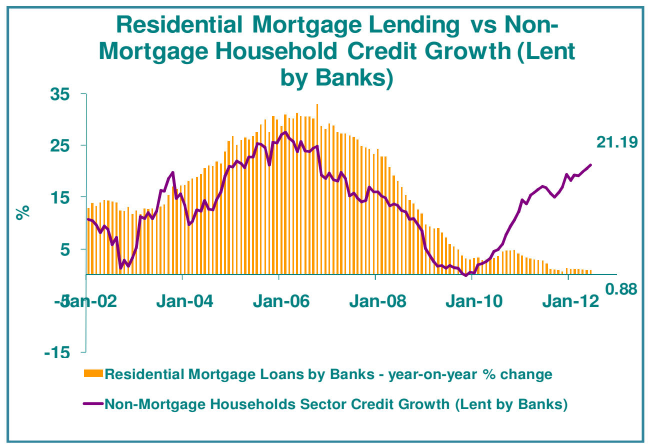
30 August 2012

The Reserve Bank (SARB) today released the figure for total household credit outstanding as at July, and further acceleration in household credit growth in that month should lead to be increasing concern around household sector financial health.

On a year-on-year basis, household credit outstanding rose by 8.09% in July, a further acceleration from the previous month's 7.7%.

The troublesome sources of upward pressure on household credit growth lie firmly outside of the mortgage lending area at present. Using bank BA900 data (only available up until June but good enough to illustrate where the pressures lie), we see total "non-mortgage household sector lending" growth at 21.2% year-on-year in June. This would appear extreme given the current mediocre state of the economy. In contrast, residential mortgage lending growth is at a lowly 0.88% year-on-year, and is now the key credit component in preventing overall household credit growth from becoming extreme.





*And indeed, comparing the July overall household credit growth rate with levels not far short of 30% back in 2006, it wouldn't appear extreme. **Why then the concern?** The point is that those high credit growth rates back in the boom years led the country's household debt-to-disposable income ratio up to around 83% by early-2008. What an appropriate upper limit should be for the debt-to-disposable income ratio should be is debatable, but we now know that the 2008 peak did cause severe financial pain for the household sector as interest rates peaked, and the financial frailties from the 2008/9 recession and interest rate peak are still witnessed today.*

I therefore believe it crucial that the household sector reduces the debt-to-disposable income ratio significantly before the next interest rate hiking cycle. So far, the ratio had come down to 74.7% by the 1st quarter of 2012, but this remains a high level for South Africa, and my admittedly subjective opinion is that it should at least move to below 70% before interest rates rise again.

Therefore, it was concerning to see almost no further progress in the reduction of the debt-to-disposable income ratio from the 4th quarter of 2011 to the 1st quarter of this year (74.8% to 74.7% from quarter to quarter). While concerning, though, that was not surprising given the gradual rise in household sector credit growth. In addition, the growth in SA's domestic wage bill for the 1st and 2nd quarters of 2012 were 7.6% was 8.1% year-on-year respectively, growth rates significantly lower than a year or two before, due to moderation in average wage growth as well as a struggling economy.

The July 8.09% household credit growth is now reaching a level very close to the slower wage bill growth rates, implying that it may be increasingly difficult for nominal disposable income growth to outpace household credit growth, a requirement for the debt-to-disposable income ratio to decline further.

There exists thus a real possibility that the debt-to-disposable income ratio starts to rise again in the near future, something I would deem to be undesirable at the current stage when widespread household underlying financial weakness still exists (much of ithe weakness "masked" only by abnormally low interest rates). Although consumer price inflation is the key focus for the SARB, from a household sector perspective I believe it is important that interest rate policy moving forward should also aim at containing household sector credit growth to lower single-digit growth rates, until such time that the debt-to-disposable income ratio is significantly lower than current levels.

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