CREDIT EXTENSION TO HOUSEHOLDS

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F E A S ibilitY

Financial Economic Analysis Strategy

A report by:

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1. Executive summary

1. According to data by the South African Reserve Bank (SARB), credit extension to the private sector by banks amounted to R1.2 trillion as at September 2006. This equates to a growth of 67% between January 2004 and September 2006. Credit extended to households accounts for 51% of this credit, or around R680 billion, with the rest to the business sector. Mortgages currently account for 65% of credit to households while instalment sales account for 13% and overdrafts and other loans 11%. Leases and credit cards debt each account for 5.5%.

2. Growth in all the categories of household credit, including mortgages, overdrafts and other loans, instalment sales, leases and credit cards was positive between January 2004 and September 2006. The fastest growth occurred in credit cards (138%) and leases (123%), followed by mortgages (87%) and instalment sales (81%) growth. Growth in overdrafts and other loans (36%) was the lowest relative to the other categories of household credit. In terms of value, household credit increased by R305 billion over the period, of which mortgages accounted for R206 billion and credit cards R20.5 billion. Since April 2006 however, growth in all categories of credit has flattened off.

3. Growth in credit extended to households since January 2004 has exceeded growth in household consumption, nominal GDP growth and growth in formal employment.

4. In June 2006 the ratio of household debt to disposable income stood at 70%, its highest level since figures were published in 1991 Nevertheless the decline in interest rates and increase in average real incomes have contributed to the affordability of this debt. The debt service cost, calculated by the SARB, has increased from its lows in 2003, but remains lower than the highs of 2002, and has remained flat since the beginning of 2006.

5. Interviews were conducted with 10 key household credit providers with a view to gauge whether or not the growth in credit extension has overburdened consumers. Other areas of concern included the sustainability of credit extension.

6. These providers indicated that there had been growth in the value of advances and number of accounts in recent years. The economic boom was a key contributor to this, as were favourable interest rates.

7. Half of the providers acknowledged that their strategy over the last two years had been to grow or regain market share. In some cases, this was linked to the introduction of a product, or new alliance, which offered lower entry criteria, such as credit cards offered to consumers with a monthly income of only R1500. The result has been an aggressive account growth in this area and is a source of potential competition to micro lenders. Providers were at pains to point out however, that they had neither lowered their scoring criteria nor deliberately adjusted their scoring card parameters to allow riskier offerings.

8. Over the past two years, alliances between the banks and retailers have become more evident and are clearly a part of the corporate strategy of the major commercial banks and the retail sector, particularly in the credit card segment. Providers see the credit card stream as particularly competitive. A number of the providers dated the change in attitude towards greater profitability and hence greater risk in the credit card market to the Barclaycard joint venture with Standard Bank, in 2003. Providers saw the more aggressive marketing stance of credit card providers as typical of the US credit card market, and possibly even a world-wide trend. In the view of some, what we have experienced over the past 18-24 months is somewhat inevitable.

9. The change in marketing stance and the lowering of income thresholds in the credit card segment in particular has led to the expansion of the numbers of consumers with credit cards, with some indications that this includes previously under-serviced low-middle income consumers. One retailer that services low to middle income consumers pointed out that whereas in 2004 only 5% of its customers had credit cards, that number has now increased to 12%. In the case of appliance and furniture retailers, credit cards are being used to pay monthly instalments and for smaller household appliances, while accounts are still being opened for “big ticket” items. For clothing retailers, there appears to have been some substitution of credit card usage for store accounts. There are indications that the credit thresholds on many of the recently-issued credit cards are relatively low.

10. Growth in advances and accounts appears to have peaked in 2005, and 2006/7 is likely to be a period of consolidation, with several providers seeing their growth in advances and accounts as relatively modest, given the boom times. Such providers indicated they had not undertaken any targeted account acquisition drives over the past two years, but acknowledged that the scramble for good clients in the market had not left them unaffected.

11. The scramble for good customers has meant that at least two providers saw themselves as being on the receiving end of these market trends, in spite of their own restraint, with delinquency creeping into the payment behaviour of previously good performing customers, who are now over-indebted.

12. The hierarchy of payment appears to affect the payment behaviour of clients. Certain types of accounts are more likely to be paid even when the household is under financial pressure. In general, if a client has a mortgage and asset based finance, these will have priority, followed by the household budget, credit card and other store account debt. Where clients do not have a mortgage or asset based finance, a furniture account may have priority over any other debts, including micro-loans.

13. While the average size of loan has remained relatively flat among all categories of credit, since the beginning of 2006, there is some evidence of demand for longer term products. In the credit card market, there has been an effective extension of term through the adoption of smaller minimum repayments on outstanding balances (some suggest that the current minimum payment is as low as 3.5% of the outstanding balance - compared with 10% or 7.5% in the past).

14. While some retailers have pointed to an increase in collections arrears, this is generally not regarded as being unexpectedly high or outside thresholds for this stage of the cycle. Providers all point to the fact that 2005 was an exceptional year, with historically low levels of bad debt. They point out that they had expected arrears and bad debts to rise from these levels.

15. Overall indebtedness of clients is evaluated at the time of loan application. Such indebtedness is reflected in the acceptance rates of new applicants. While some providers suggested these rates had dropped off slightly, this was not seen as a cause for alarm, and a number have reported that there has been no change in their

acceptance rate. Evaluation of over-indebtedness levels for existing clients is not explicit, but essentially derived from payment behaviour or collection rates. As has been mentioned before these have risen marginally, but not to unexpected levels.

16. While the growth in the credit card segment has received much attention of late, the growth in mortgages is probably more important, given its high weighting in the budget of households.

17. While an element of uncertainty in terms of the impact of the National Credit Act, 2005 (Act No. 34 of 2005) (the NCA) may have encouraged pre-emptive action on the part of some credit providers, this is not seen as the predominant motive for the current credit extension.

18. All the providers expect that as the business cycle progresses, there will be an increase in bad debts and arrears – although this will also be influenced by the time elapsed following aggressive new account acquisitions. None of the providers indicated that they expect a "hard landing", although most confess that it is too soon to tell.

19. Once the NCA comes into effect, credit facilities (whether or not they have been fully utilised) need to be taken into account when assessing levels of indebtedness. This may lock consumers into existing credit providers. There are indications that, in anticipation of the NCA era, credit providers have been actively marketing revolving credit facilities in an attempt to capture market share. It may be necessary to clarify the method and measures that would be used to determine overall levels of indebtedness and to set in place mechanisms to make it easier for consumers to cancel existing facilities that have been paid up.

20. The National Credit Regulator should consider instituting a regular monitoring process that incorporates a statistically valid sample reflecting all parts of the household sector, and the entire range of incomes. Total indebtedness levels of this sample should be tracked over time, and some method should be determined for updating income levels.

2. Introduction

2.1 Calls for proposals from the NCR

Official statistics and an increasing number of queries by consumers suggest that widespread, unsolicited offers of credit are being made to individuals by most of South Africa's major financial institutions. This may imply that certain financial institutions may be engaging in lending practices which are designed to pre-empt provisions of the National Credit Act. The National Credit Regulator appointed FEASibility (Pty) Ltd to assess the growth in credit extension and certain related questions as detailed below.

(a) Overall trends in personal credit extension since January 2006, both in terms of secured and unsecured credit. This should include an assessment of mortgages; vehicle finance; credit cards/store cards; personal overdrafts; micro finance; furniture credit and clothing credit.
(b) Specific factors that have contributed to the current growth in credit extension.
(c) The method of client identification (in terms of marketing to new clients).
(d) The overall trend in the incidence of adverse and bad debt accounts related to different credit products.

2.2 Method

The research was conducted by way of interviews with selected credit providers and a review of data sources including statistical information from SARB, financial results and other public announcements of banks and retailers.

The interviews conducted included main stream banks, credit card issuers, clothing and furniture retailers and micro lenders.

3. Evaluation of credit extension data

This section provides an analysis of the publicly available credit extension data, with a view to identifying trends and possible shifts in credit granted to the private sector and to the household sector in particular. The section commences with an analysis of credit extension to households and firms and then proceeds to analyse credit extension to households only.

The source of data is the SARB Quarterly Bulletin and DI900 returns from registered banking institutions. Retail credit, funded by retailers themselves is excluded from such data. There is currently no reliable source for data on retail credit. The credit extension due to alliances between retailers and banks will be included in the data presented here.

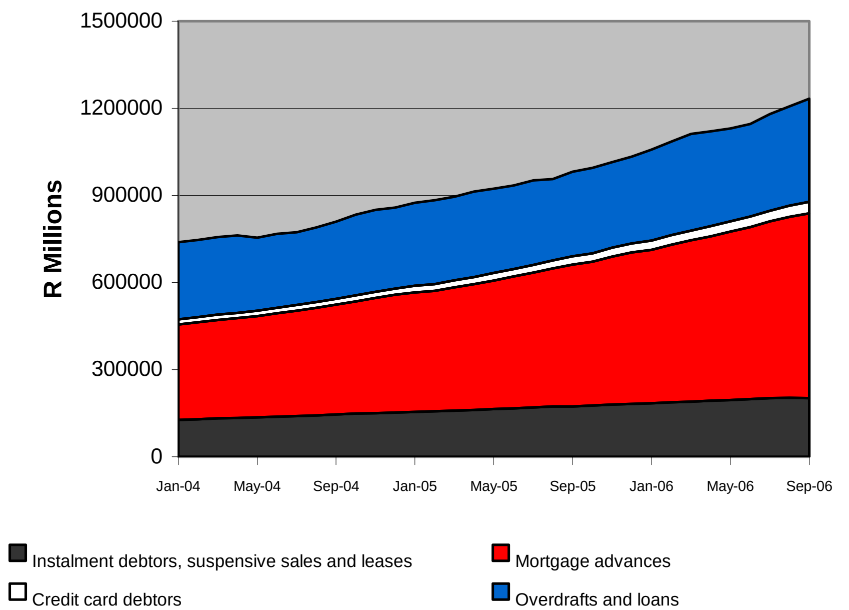
3.1 Credit extension to the private sector

An analysis of the levels of accumulated private sector credit[1] extended primarily – but not exclusively - to individuals by banks in South Africa grew from R739 billion in January 2004 to R1 233 billion in September 2006. This equates to a 66.9% increase over the period. However, this overall growth was accompanied by notable shifts in the composition of credit extended. Such shifts probably reflect structural changes in both South African society, and the financial sector itself.

Figure 1 indicates changes in the value of specific categories of credit between January 2004 and September 2006. The mortgage category makes up over 50% of all credit to the private sector, and is the most significant of these credit classes, followed by overdrafts and loans (28.8%) and instalment sales and leases (16.4%). Credit card debtors account for a relatively small share (see Table 1).

[1] As reflected by net changes in the value of certain asset classes of the South African banking sector that most closely relate to credit extension to individuals. Measured by the accumulated outstanding installment sales and leases, mortgage advances, credit card debtors and overdrafts and loans of South African banks

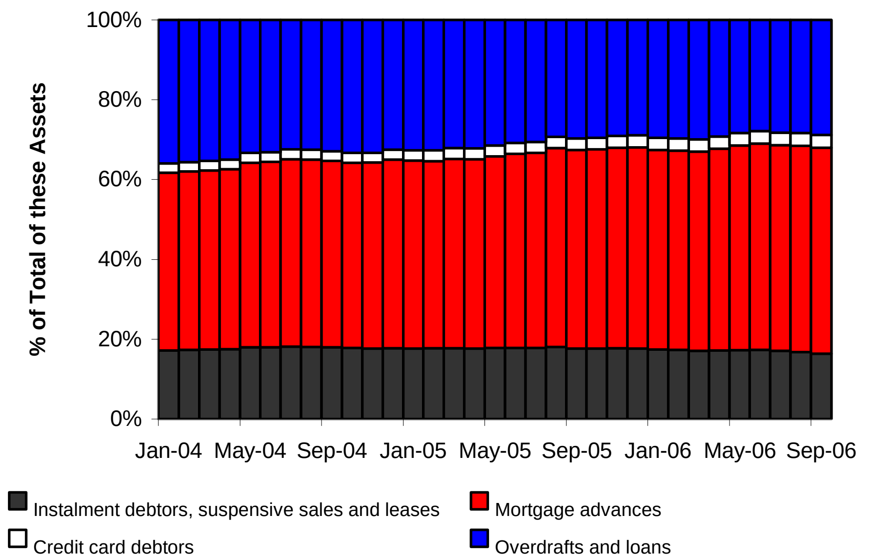
Figure 1: Bank assets by type



Source: SARB Quarterly Bulletin and DI900 returns

The relative share of each of the above banking asset classes of the cumulative total of these four classes combined is indicated in the figure below.

Figure 2: Bank assets – share of the total of these assets



Source: SARB Quarterly Bulletin and DI900 returns

Figure 2 and Table 1 indicate that the relative importance of overdrafts and loans, and instalment sales and leases has declined, while that of mortgage advances and credit card debtors has increased.

Table 1: Value and share of asset classes to the private sector

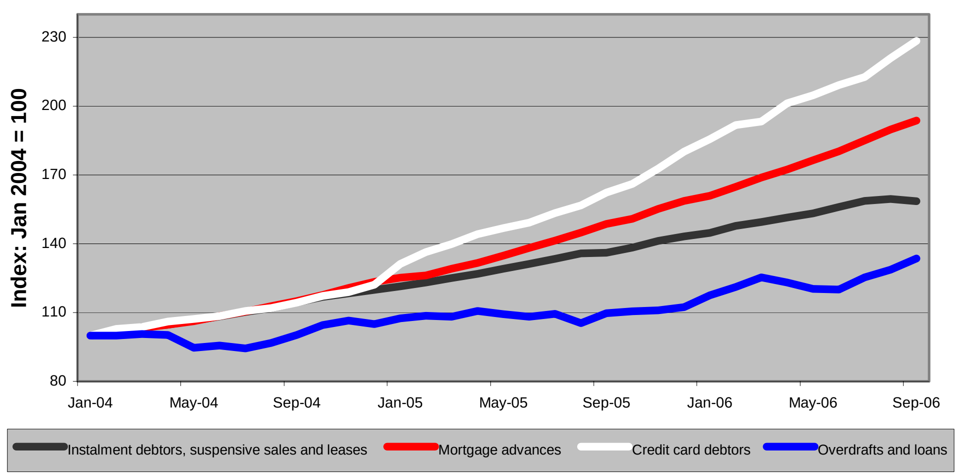
Asset class	September 2004		September 2005		September 2006	
	Value (Rm)	Share of total (%)	Value (Ram)	Share of total (%)	Value (Rm)	Share of total (%)
Instalment debtors, suspensive sales and leases	145 525	18.0%	173 167	17.6%	201 716	16.4%
Mortgage advances	377 886	46.7%	488 736	49.8%	636 782	51.6%
Credit card debtors	19 801	2.4%	28 113	2.9%	39 570	3.2%
Overdrafts and loans	266 312	32.9%	291 560	29.7%	354 975	28.8%
Total	809 524	100.0%	981 576	100.0%	1233 043	100.0%

Source: SARB Quarterly Bulletin and DI900 returns

The shifting contribution of these types of bank credit is apparent over the study period. The figure below indicates that the growth in credit card debtors has been significantly greater over the period than other forms of credit.

Between January 2004 and September 2006, the value of credit card debt increased by 128%, compared with growth of 93.7% in mortgage advances, 58.6% in instalment debtors, suspensive sales and leases, and 33.6% growth in overdrafts and loans.

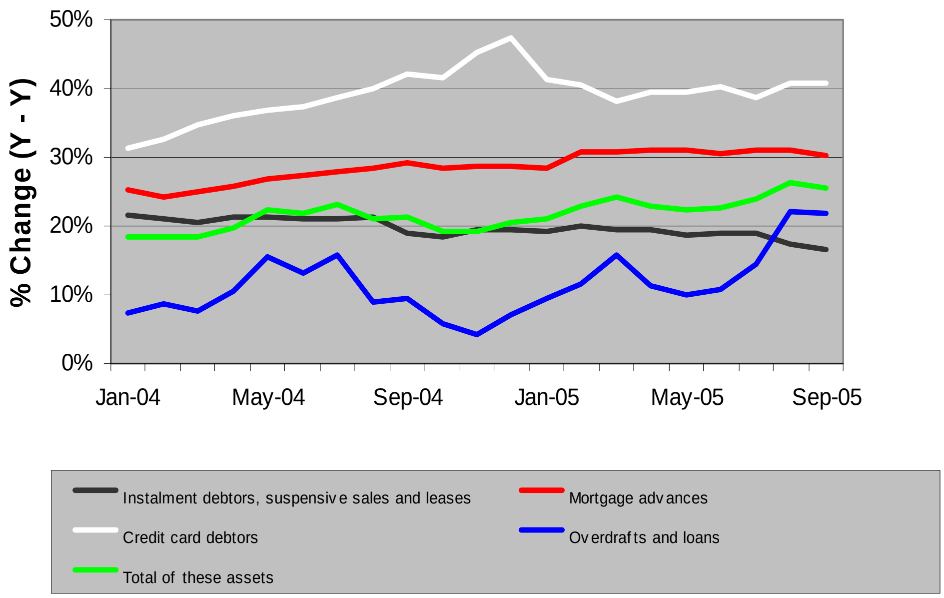
Figure 3: Relative growth in bank assets



Source: SARB Quarterly Bulletin and DI900 returns

The annual growth rates in these categories of credit are shown in the figure below. It is apparent that while there has been some levelling-off of growth rates in relation to credit cards and mortgage advances, and a decline in the growth of instalment sales and leases, overdrafts and loans growth has accelerated in the last three months for which the data was available at the time of research (July to September 2006).

Figure 4: Growth in types of bank assets



Source: SARB Quarterly Bulletin and DI900 returns

3.2 Credit extension to households

Credit extended to households accounts for 51% of the credit extended to the private sector, the other 49% being, of course, accounted for by the business and corporate sector. This is a growing share (in 2002, households accounted for 47% of private sector credit). However, this is not the highest it has been: in 1996, households accounted for 57% of credit extended to the private sector (SARB, Quarterly Bulletin).

The analysis now shifts from a broader overview of the private sector, to the household sector.

Table 2: Credit extension by banks

Loan category	Jun-02		Jun-06	
	Total Amount: Private sector extension (businesses and households) R millions	Household share	Total Amount: Private sector extension (businesses and households) R millions	Household share
Mortgages	268,245,411	70.0%	590,482,093	70.2%
Overdrafts & other loans	223,104,915	23.6%	309,817,712	23.7%
Leases	31,598,301	32.5%	55,736,701	61.7%
Installment sales	70,310,729	55.2%	142,595,536	58.6%
Credit Cards	14,066,298	95.4%	35,909,369	95.7%

Source: DI900 returns, SARB Website[2]

The table above provides a snapshot of the credit extension by banks to the private sector and shows the relative share attributed to the household sector, as compared to the corporate and business sector.

The data are taken from the DI900 returns provided by banks to the SARB, which warns that banks do resubmit data from time to time, which would affect the categories of assignment here. The period of analysis spans an economic growth phase and the growth in credit extension is perhaps then not notable in itself, but it does show shifts in the composition of credit.

There has been little change in the share of mortgage, overdraft and credit card debt attributable to households, but the household share of leases and instalment sales has grown relative to businesses. The latter categories generally refer to asset finance for vehicles, and reflect the boom in car sales over the past four years. One of the major banks noted that whereas five years ago, they were financing five second-hand vehicles for each new one, that ratio has now dropped to two second-hand vehicles for each new vehicle financed. This could indicate that consumers are taking advantage of the positive phase in the cycle and low real interest rates.

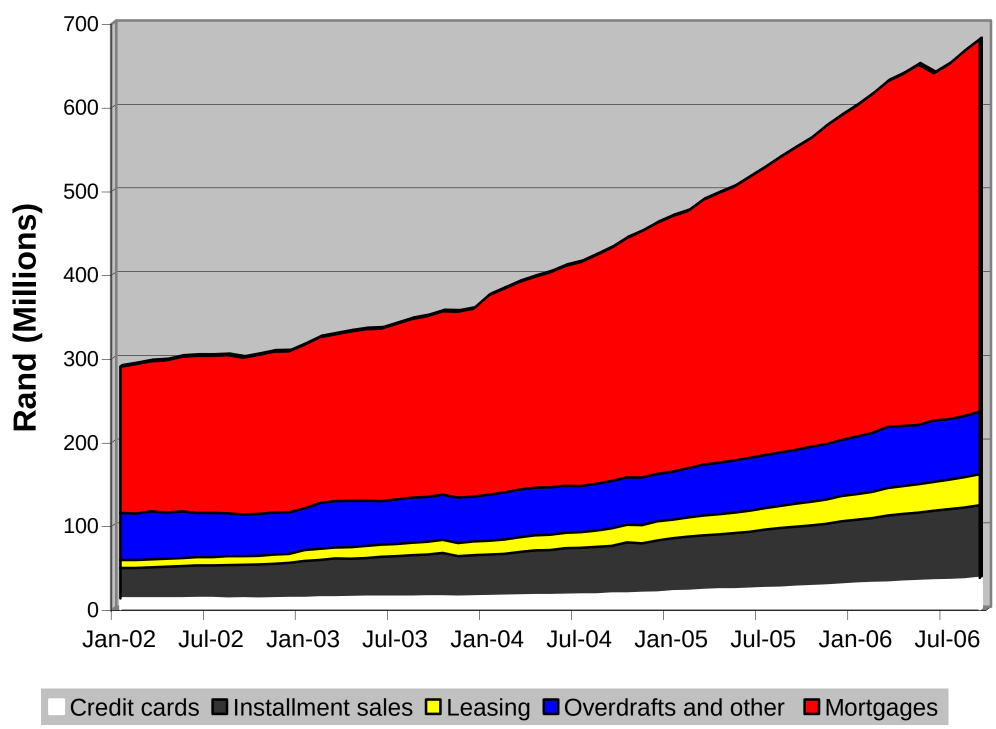
[2] Note these data differ from the data in the SARB Quarterly Bulletin S-8 and S-9 as they exclude the public sector and the foreign sector. These data originate from the DI900s, Table 8 and Table 10 which are reported on a monthly basis by the banks.

Table 3: Credit extension to households

Loan category	Jan-02 Amount R millions	Sep-06 Amount R millions
Mortgages	174,691,837	444,832,706
Overdrafts & other loans	56,348,917	74,453,434
Leases	9,332,163	37,186,331
Installment sales	36,454,703	86,702,797
Credit Cards	13,020,853	37,526,087
Total	289,848,473	680,701,355

Table 3 and Figure 5 indicate changes in the value of specific categories of credit to households between January 2002 and September 2006. For households, mortgages are the most significant of these credit classes amounting to almost R445bn in September 2006. Over the period shown, instalment sales superseded overdrafts and other loans in terms of importance as a category of credit to households. By September 2006, credit card debt and leasing finance to households both accounted for around R37bn.

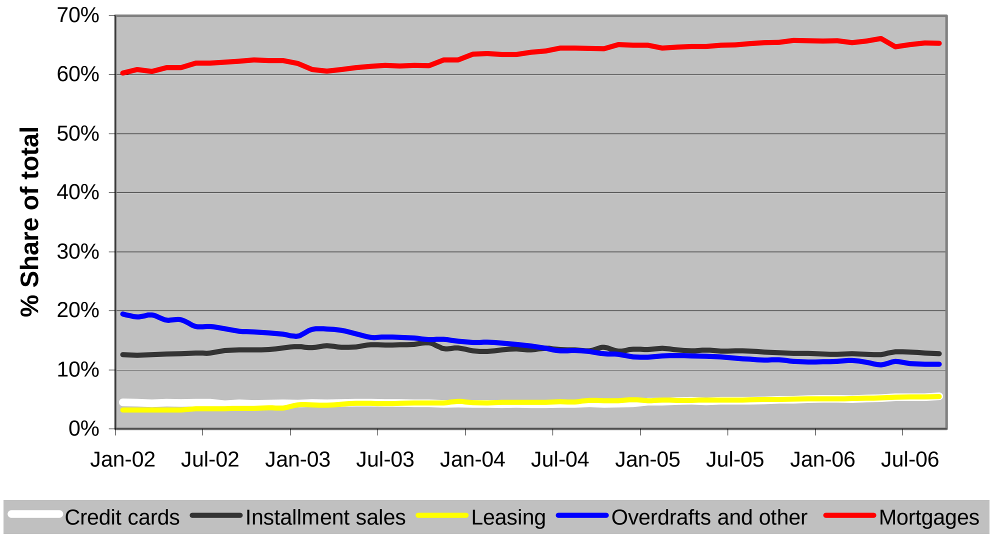
Figure 5: Credit extension to households by type



Source: DI900 returns, Tables 8 and 10

The relative share of each of the above banking asset classes of the cumulative total combined is indicated in the figure below.

Figure 6: Share of bank credit extended to households by type



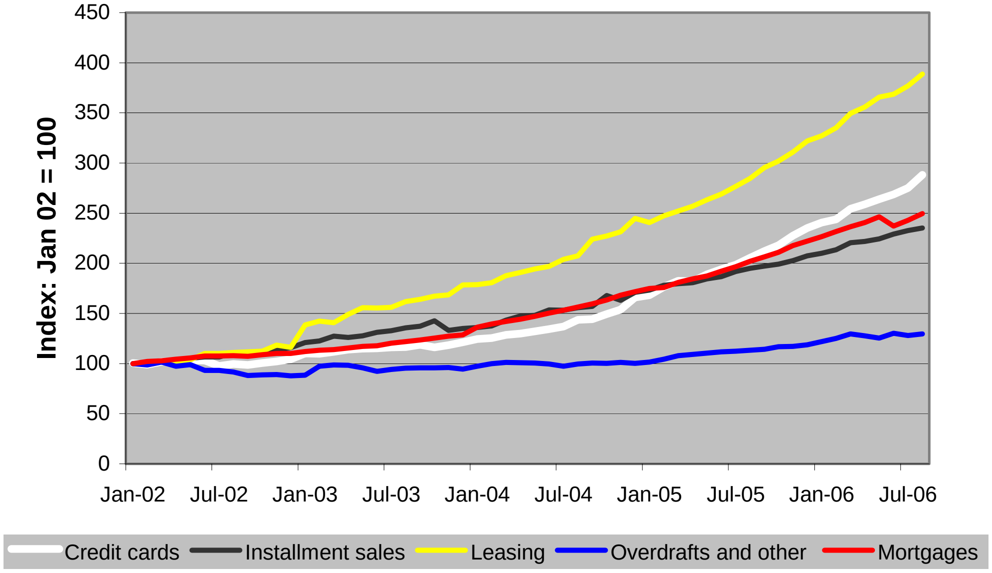
Source: SARB Quarterly Bulletin and DI900 returns

The previous figure illustrates that the relative importance of overdrafts and other loans for households has declined, while that of mortgage advances, credit card debtors and leases has increased. Possible reasons for this are discussed below.

Mortgages account for 65% of credit extended to households. Overdrafts and other loans accounted for around 20% of the credit extended to households in January 2002, it now accounts for around 11%. Instalments sales share of household credit has remained at around 13%. As a share of the bank credit extended to households, leases accounted for just over 3% of credit extended to households at the beginning of 2002, now it accounts for 5.5%. The share of credit card debt has grown to 5.5% of household debt, from 4.5% in 2002.

The relative growth performance of the different categories of credit is apparent over the period under review. Figure 7 indicates that from the perspective of households, credit card and leasing finance has growth faster than other forms of credit.

Figure 7: Relative growth of household credit by type



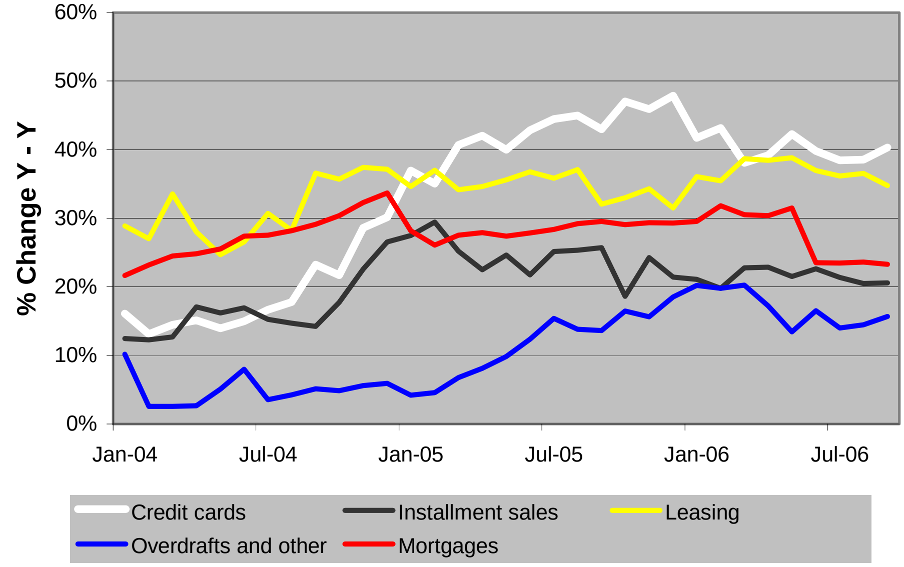
Source: DI900 returns

Growth in credit card finance since January 2004, (refer to the figure below) has been in the order of 138% and leases have growth by 123% in terms of value of advances. In both cases, these types of credit represent a small share of household credit, so this growth is from a low base.

Leases and credit card finance growth may have outstripped the other categories of credit, but mortgages and instalment sales growth, which account for a far more substantial weighting in terms of household debt have also shown substantial growth (87% and 81% respectively). Relative to these growth rates, it is only growth of overdraft and other loans that has languished at around 36% for the period under review.

The lower growth in overdrafts and loans may, in part, reflect a rational shift on the part of consumers away from comparatively expensive unsecured overdraft and loan facilities towards comparatively less expensive secured credit facilities such as access bonds. Factors such as high explicit bank charges and cheque fraud may also partly account for the increased usage of credit cards in preference to traditional overdraft-linked cheque accounts. All the interviewees in the sample reported a growing preference by consumers for debit and credit card as a means of payment.

Figure 8: Year-on-Year growth of credit categories



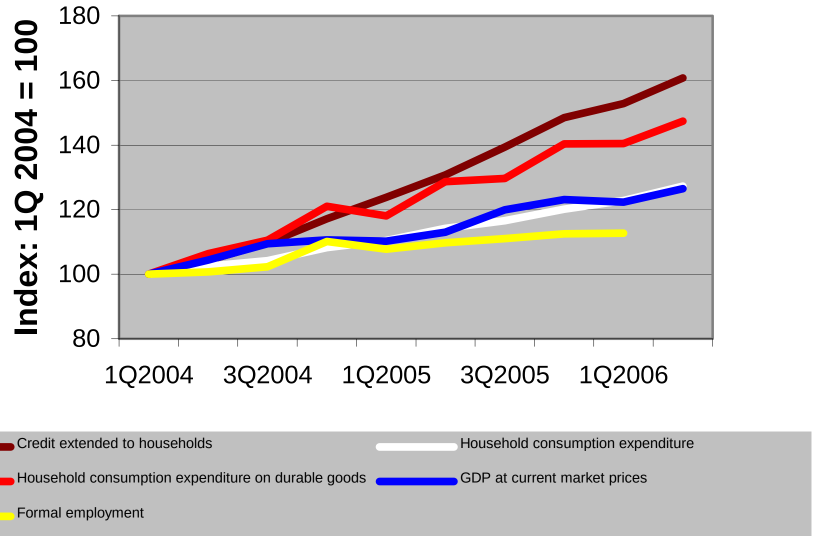
Source: SARB Quarterly Bulletin and DI900 returns

The annual growth rates in these categories of credit are shown in the figure above (with a base year of January 2004). Between the second half of 2004, and July 2006, the best performers were credit cards, leases and instalment sales and mortgages. The outlier is overdrafts and other loans, where the growth rate remains below 10% until the middle of 2005. Annual growth in mortgages peaks in December 2004 and in instalment sales in February 2005. In the case of credit cards, annual growth peaks in December 2005 and in the case of overdrafts, March 2006. Growth in leasing finance peaks in March 2006 remains at these levels until June 2006, and then the annual growth falls off slightly.

3.3 Macroeconomic context of household data

The growth in household credit should also be seen in the context of broader, macroeconomic trends, including aspects such as overall growth in the value of economic output, growth in household expenditure, growth in household expenditure on durable goods and changes in formal employment. We can construct indices for each of these five series, and set them all equal to 100 in the first quarter of 2004, Figure 9 indicates the relative movement of such indices.

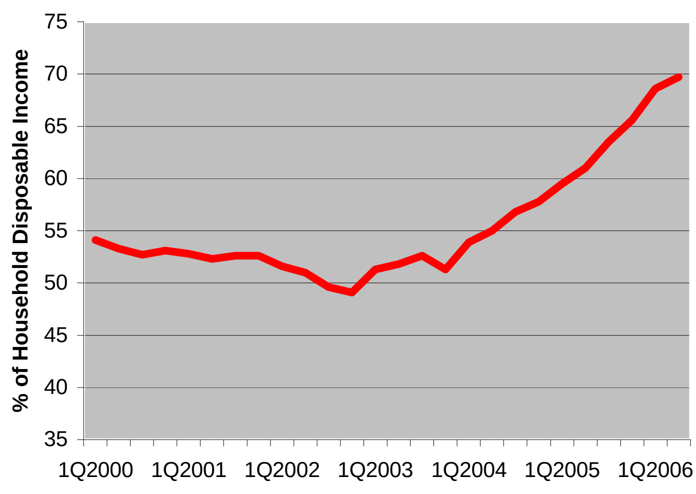
Figure 9: Comparative performance of various indicators



Source: SARB Quarterly Bulletin

Figure 9 indicates that credit extended to households over the period has increased substantially more than household consumption, nominal GDP and the growth in formal employment. There is a slightly closer correlation between credit extension and household consumption expenditure on durable goods.

Figure 10: Ratio of household debt to annualised household disposable income

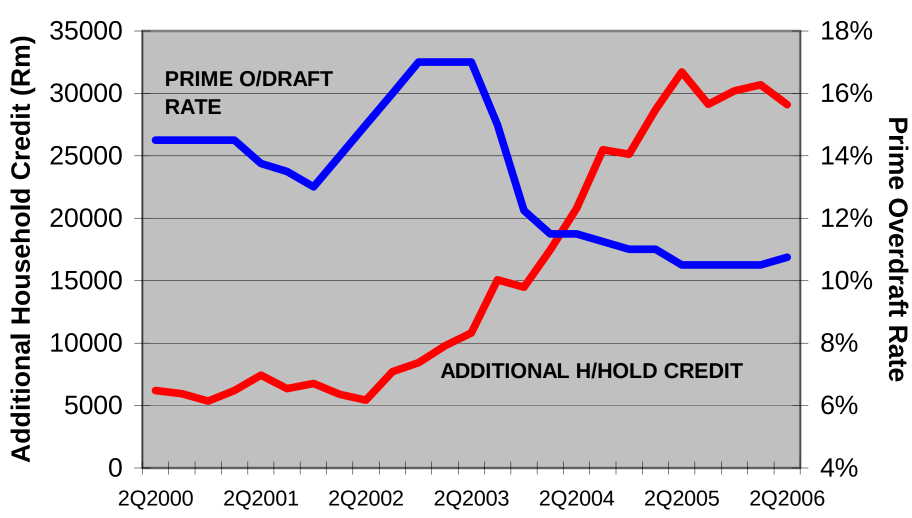


Source: SARB Quarterly Bulletin

The ratio of accumulated household debt to household disposable income provides some indication of overall levels of indebtedness. The figure above indicates a steady increase in this measure since the beginning of 2004. The current level of almost 70% (June 2006) of annual disposable income is substantially higher than the 53.5% experienced in 1997 (the previous cyclical highpoint), and represents the highest level of household indebtedness since data reflecting credit extension to households began to be published in 1991. However, due to the decline in interest rates and increase in average real incomes, the affordability of servicing these higher levels of debt may have ameliorated the impact of the significant growth in cumulative household debt levels.

The following figure indicates the relationship between changes in money market interest rates (represented by the average prime overdraft rate of commercial banks) and the levels of net additional credit extended to households[3]. It is apparent that while there was no noticeable response to the interest rate spike in 2001/2, there are early indications of some slowdown in the growth in household credit in response to recent increases in interest rates. The growth in credit from the second quarter of 2005 suggests that something other than the prime rate of interest is driving credit extension. The discussion in section 4 suggests a number of factors may have contributed to this.

Figure 11: Growth in household credit and interest rates



Source: SARB Quarterly Bulletin

3 The absolute change in the net value of accumulated credit extended to the domestic household sector by all monetary institutions in relation to the preceding quarter.

3.4 Conclusion

Credit extension to the private sector by banks amounted to R1.2 trillion as at September 2006. This equates to a growth of 67% between Jan 2004 and September 2006. Credit extended to households accounts for 51% of this credit. Mortgages made up 65% of these, overdrafts and other loans 11%, and instalment sales 13%. Leases and credit cards debt each account for 5.5% of credit extended to households.

Growth in different categories of household credit since 2004 has been fastest in credit cards and leases, followed by mortgages and instalment sales. While growth in overdrafts and other loans has been positive, it has experienced the lowest relative growth of all categories of household credit. Since April 2006, growth in all categories of credit has flattened off.

Growth in credit extended to households since January 2004 has exceeded growth in household consumption, nominal GDP growth and growth in formal employment, but at the same time, the cost of servicing this debt has remained at historically low levels.

4. Themes from interviews with providers

A number of themes were explored in the interviews and are explored here. The detail from the interviews is contained in a confidential report to the National Credit Regulator.

4.1 Factors leading to growth of credit extension

- **Economic boom**

The decline in money and capital market interest rates to historically low levels and the acceleration of growth in the South African economy in recent years has impacted on the consumer credit market in a number of ways.

Firstly, it has become more affordable to service debt. Mortgages – which account for roughly 65% of total household debt – are still[4] significantly cheaper to service at current interest rates than they were in 1998 and 2002. In 1998, mortgage repayments[5] amounted to R1 917 per month for every R100 000 borrowed. In 2002, monthly repayments of R1 467 per R100 000 were required, while at current rates, repayments amount to only R1 066 per R100 000. This means that someone with a mortgage of R500 000 in 1998 could now afford to service a mortgage bond of almost R900 000 with the same nominal monthly repayments. In addition, average nominal disposable incomes per capita rose by almost 80% between 1998 and 2005, and average real disposable income per capita increased by more than 16% over the same period.

The increase in the value of property over this period (which the reduction in interest rates helped facilitate) has also improved the balance sheets of property-owning households – making them more credit-worthy in many cases. Since the bulk of household credit is secured, this has provided the financial sector with an additional rationale for re-gearing the household sector by raising the levels of credit extended to it.

In addition, formal non-agricultural employment is estimated to have increased by 819 000 between the first quarter of 2004 and the first quarter of 2006. This has meant that more than R2 billion worth of additional nominal spending power[6] is being injected into the economy each month. This has also helped to increase the number of credit worthy households.

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[4] Even after account is taken of the interest rate increases announced in the latter half of 2006.

[5] Based on a term of 240 months (20 years)

[6] We are assuming average monthly income of R2 500 per month

- **The strategy of companies providing financial services and their attitude to growth**

The financial services sector has been under considerable pressure for some time to extend banking and other financial services to previously excluded segments of the South African population.

This, together with a more conducive macroeconomic environment and the entry of new participants has resulted in a more aggressive approach towards credit extension – which accepts higher average rates of bad debts over the course of the business cycle.

For the most part, it appears that aggressive new account acquisition and efforts to regain market share in certain credit markets peaked in 2005, and that credit providers have viewed 2006 as a period of consolidation. Going forward, the principal strategy for the remainder of 2006 and 2007 appears to be consolidation of existing accounts, and "customer value management" through the cross-selling of additional products to existing and "group" clients.

There is little doubt that levels of competition in the sector have increased over the past year – particularly in the credit card market. While the major competitive differentiator has been around loyalty programmes attached to cards, pricing is also starting to play a role. There has also been a marked increase in the micro lending activities of the "Big 4" banks.

This increase in competition is to be welcomed, and the long-term effects on consumers and the economy should be positive. However, in the short term there is a tendency for providers to cherry pick, and scoring systems and lists are likely to result in more credit worthy individuals being saturated with offers of credit. Since it appears that at least 18 months is required before a provider is able to adequately assess the performance and risk associated with a newly acquired book, it is likely that bad debt and impairment levels will peak between now and mid-2007 (given that most aggressive account acquisition was done in 2005).

- **Role of alliances**

Alliances have become more evident and are clearly a part of the corporate strategy of the major commercial banks and the retail sector. The principal reasons for entering into an alliance are:

- o To expand a "footprint" by accessing a market segment that is under-represented, or has not traditionally been part of the client base. Retailers, cellular service providers, and healthcare funders with large, established customer bases are important potential alliance partners for banks (eg Standard Bank and MTN).
- o To broaden, and change, the brand image of traditionally conservative institutions by partnering with brands which have different appeal and which allow access to different markets without having to dilute or change the values associated with existing brands (eg ABSA with Virgin).
- o To access branch and distribution networks in order to expand a geographical presence in a cost-effective manner (e.g. FNB and Edcon).

- **Normalisation / expansion of credit market**

A number of factors have contributed to a growing trend towards the integration and normalization of the credit market away from its previous segmented nature. These include the gradual effects of democracy and the associated change in wealth distribution, the emergence of a Financial Sector Charter and a number of studies and legislation (including that of the NCA) which have highlighted the earlier disparities in terms of the distribution of credit.

Associated with these pressures has been the growing awareness of potential growth associated with servicing lower income clients and a sense of the aspirational demand of new entrants to the labour market. Hence the forces of demand and supply have allowed for the re-design of scoring models associated with lower income groups and the development of products more suited to those previously excluded from a range of formal credit products.

The substantial growth in credit extension in recent years is not purely a cyclical phenomenon linked to a decline in interest rates. It also reflects a structural shift that seeks to accommodate large parts of the population that were historically excluded from accessing the formal credit market. This view is supported by customer profiles in the retail sector, which indicate a shift towards younger, black, increasingly female applicants with little job experience. Purchases on credit of residences, vehicles and other items such as furniture and clothing for this market segment are probably relatively more interest inelastic than the historically established market because they are aimed at satisfying aspirations that have – in many cases – been frustrated for an extended period.

- **Customer numbers**

One of the perplexing questions around the data analysed here is the inability to assess with any sense of certainty the growth of the customer base relative to the number of accounts.

While the number of accounts has grown - in some cases substantially - it is very difficult to assess the number of customers in the system – even within institutions, as typically account numbers, rather than customer numbers are given.

The extent to which the clientele of banking groups and other financial entities overlap is unknown. It is worth noting that the vast majority of bank account holders simply have savings and/or transmission accounts, and rarely qualify for bank credit facilities.

One of the retailers that serves low to middle income consumers gave us permission to provide the information in the table below which is based on a statistically significant sample of their customer base. The aim was to establish their customers' exposure to other credit categories and from other credit providers. Of the 140000 customers who had an account with the clothing retailer 5% had a credit card, 45% an apparel account, 28% had a furniture account elsewhere, 3% had vehicle finance, 1% had a mortgage and 27% had a personal loan.

As can be seen in the data below, while the share of customers with credit cards in the client base is growing (from 5% in 2004 to 12% in 2006), the proportion remains small. In addition, the vast majority of their clients do not have vehicle finance or mortgage loans, but they do have clothing accounts and furniture accounts.

Hence this customer base appears to have facilities with other non-bank providers (such as clothing and furniture retailers) but not necessarily with banks (home loans and vehicle finance).

Table 4: Customer exposure to other credit categories

Customers with	Sample Size		
	140 000 Customers	141 000 Customers	100 000 Customers
	2004	2005	2006
Bank Credit Cards	5%	8%	12%
Credit Apparel account	45%	46%	46%
Furniture account (excluding this retailer)	28%	29%	29%
Vehicle Finance	3%	3%	4%
Home Loans (Mortgage)	1%	1%	1%
Personal Loans	27%	33%	37%

Source: Retailer submission

4.2 Changes in trends since Jan 2006

- **Size of loan and terms**

Most of the ten parties interviewed indicated that the average size of loans has remained flat during 2006. In some cases, market segments that are perceived as riskier have been accommodated by the extension of repayment terms. In the retail sector, there has been greater demand for longer term products and in the credit card market, there has been an effective extension of term through the adoption of smaller minimum repayments on outstanding balances. Some suggest that the current required minimum payment is as low as 3.5% of the outstanding balance, compared with 10% or 7.5% in the past.

- **Change in repayment behaviour: Collections**

Some increase in collections arrears has been noted. This tends to be more evident among consumers accessing the retail credit market. It is assumed the typical in-store cash repayment requirement and “back of wallet” position of retail credit means customers are more likely to allow these arrangements to go into arrears than credit cards and commercial bank facilities. The increase in collections arrears is generally not regarded as being unexpectedly high or outside thresholds for this stage of the cycle.

- **Tightening of credit thresholds**

Most of the firms interviewed indicated that there had been a decrease in approval rates over the course of 2006 – especially since June. However, the higher rate of rejections is not necessarily indicative of a tightening of credit scoring thresholds – although some providers have started to tighten in relation to higher risk market segments.

It is primarily the result of poorer quality applications – which may support the view that overall indebtedness levels for some groups have increased to levels that are not viewed as sustainable.

- **Over-indebtedness and arrears of clients with microloans**

Data provided by some of the six providers who offer micro loans suggest there has been an increase in overall indebtedness amongst the micro-lending client base, as discussed in the section on tightening of credit thresholds above.

However, information from other providers shows a relatively constant debt to gross income ratio amongst the micro-lending client base since the end of 2005, at around 33%. This latter group of credit providers stressed that they do not experience the 70% household debt ratios so often quoted in the press.

In general, providers only check overall indebtedness levels for new applicants, so assessments of over-indebtedness are manifest in approval rates of new applicants. One provider indicated that approval rates had fallen from 56% to 48% since the beginning of 2006. Other providers said that while debt levels have been rising – this has not been in a manner that is unexpected or a-typical for this stage of the cycle. In addition, a number of providers re-iterated that the higher levels of debt are relatively more affordable than in other recent cyclical peaks.

4.3 Trends in the market

- **Substitution of one credit product for others**

There are clear indications of some substitution of revolving credit products (mainly credit cards) for term loans, overdrafts and installment sales. This may simply be an indication of a maturing market, but it also appears to have been influenced by the impending implementation of the NCA.

The change in marketing stance and lowering of income thresholds in the credit card segment in particular has led to the expansion of the numbers of consumers with credit cards, with some indications that this includes previously unserviced low-middle income consumers. While it is clearly impossible to provide definitive information from a study such as this, there are indications (such as those shown in the Table 3 above) that the growth in credit cards has not simply meant the proliferation of many cards in the hands of a few.

In addition, there appears to have been a shift in the relative shares of cash vs. credit customers in retail outlets. In this instance cash includes cash and payment by debit and credit card. In the case of appliance and furniture retailers, credit cards are being used to pay monthly installments and smaller appliances, while accounts are still being opened for big ticket items. For clothing retailers, there appears to have some substitution of credit card usage for store accounts.

The fact that credit cards are not being used to purchase larger items of furniture or electronic goods suggest that credit limits on the cards remain relatively low. One furniture retailer confirmed that on average those clients that do have credit cards have limits of around R1500.

- **"Land-grabbing" prior to the NCA**

Although none of the parties interviewed were prepared to acknowledge it as an explicit strategy on their part, more than one noted a trend towards what has been described as "land grabbing" prior to the imposition of the NCA.

Once the NCA comes into effect, credit facilities (whether or not they have been fully utilized) need to be taken into account when assessing levels of indebtedness. Since it will probably be quite onerous for facility holders to cancel existing credit facilities (even if they are fully paid up), it is likely that they will tend to become locked in to existing credit providers. There are indications that, in recognition of this fact, credit providers have been actively marketing revolving credit facilities in an attempt to capture market share for the post NCA implementation.

- **Early signs of distress**

There are a number of possible signals of household distress in terms of indebtedness. These include a shift in approval or rejection rates, payment delinquency and collection arrears. These have been discussed above.

In addition, slowing of client acquisition may also suggest saturation of the market. There is evidence that this has already started to occur. In particular, one retailer with a particularly aggressive marketing strategy has not achieved its forecast growth in accounts, as although it substantially increased its account base, the vast majority of these were closed due to inactivity. This suggests that there may be self-correcting mechanisms in the market.

4.4 Conclusion

The interviews with providers indicate that while there has been significant credit extension growth in the past two years or so this has been a consequence of a number of interrelated factors:

- The economic boom and the relatively low debt serving costs.
- A change in strategy amongst key players in the market to extend credit to new segments and adopt a less risk-averse strategy in the case of certain categories of credit.
- New alliances and new entrants – which have predominantly been in the credit card area.

These points suggest a relatively well-functioning and increasingly more competitive market. At the same time, an element of uncertainty in terms of the impact of the NCA may have encouraged pre-emptive action on the part of some credit providers, but this is not seen as the predominant motive for the current credit extension.

Further, while there are some indications that there may have been many credit offers to good clients, there are also indications that some of these options have been extended to low-middle income groups who may have had less choice in the past.

The pre-emptive action discussed under the section on "land grabbing" above could result in an effective locking–out of potential competitors once the NCA becomes fully effective in mid-2007 – since access to existing credit facilities could preclude the household sector from taking up alternative sources of credit on the grounds that such lending would be deemed reckless. There is merit in clarifying the method and measures that would be used to determine overall levels of indebtedness so as to make it easier for consumers to cancel existing facilities that have been paid up.

While there are indications that the level of payments delinquency and arrears has ticked up, the levels reported in the 2005/6 financial years were generally historically low levels and there has been an expectation that these low levels are not sustainable as the business cycle progresses. However, none of the providers indicated that the data to date suggest a hard landing, although most confess that it is too soon to tell.

Because of the diversity of data sources, it has not – apart from the limited sample provided by one financial institution – been possible to assess trends in overall levels of indebtedness. While the SARB figures reflecting the ratio of household debt to disposable income do reflect a rising trend, the National Credit Regulator should consider instituting a regular monitoring process that incorporates a statistically valid sample reflecting all parts of the household sector, and the entire range of incomes. Total indebtedness levels of this sample should be tracked over time, and some method should be determined for updating income levels. This would provide an early warning system for the Regulator, and may also assist the monetary authorities.

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