HOUSEHOLD SECTOR– HOUSEHOLD SECTOR FINANCES

Ironically, perhaps, tougher economic and financial times are more likely to bring about a higher savings rate than the good times, despite it being theoretically tougher to save during these times

17 June 2016

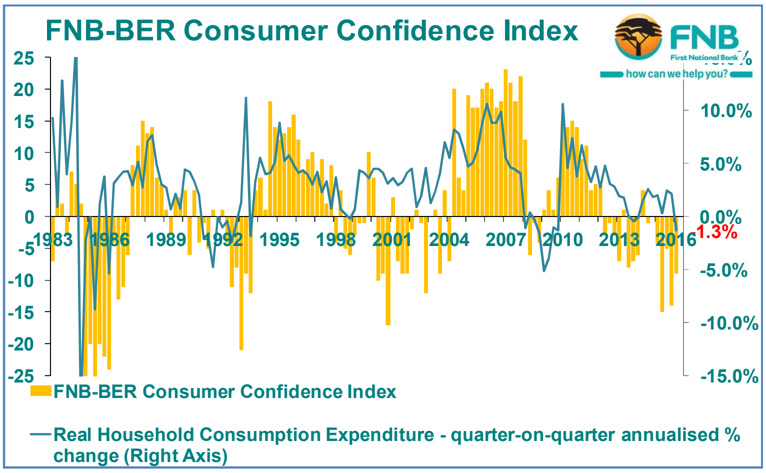
SIGNS EMERGING OF A "DELIBERATELY" MORE CONSERVATIVE CONSUMER

In the Residential Property Market, we have seen signs of a "deliberately" more conservative Household/Consumer emerging for a while. More recently, it would appear that Household Sector Income, Debt and Consumption Expenditure numbers are also starting to point to this.

When we use the term " deliberately more conservative", we refer to a Household Sector that may be starting to intentionally curb its spending and borrowing habits as opposed to a situation where slower income growth merely forces this behavioral change upon households.

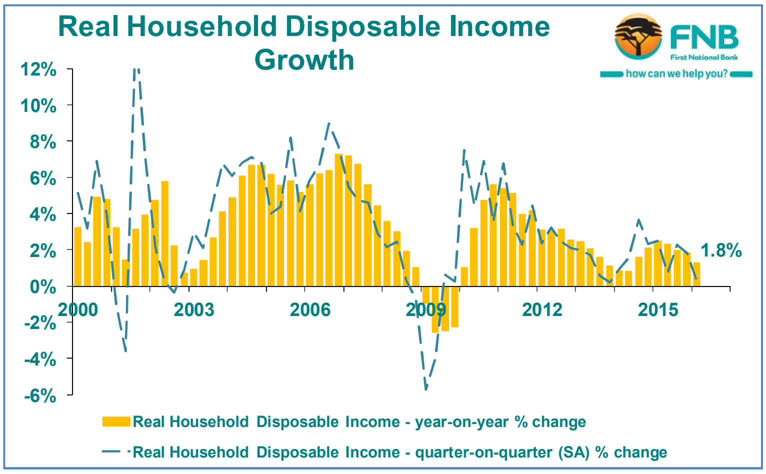
2 observations in the Residential Property Market led to the initial assertion that households as a group may gradually be becoming more cautious, or conservative. Firstly, we have seen a gradual decline in the percentage of home sellers selling in order to upgrade to a better property. This is by and large the non-essential side of property trading, which in tougher times can normally be put on hold. Secondly, we have seen some shift in demand towards the lower end of the Residential Market, with the higher priced Luxury Home Segment having seen its activity levels slow first of the major segments.

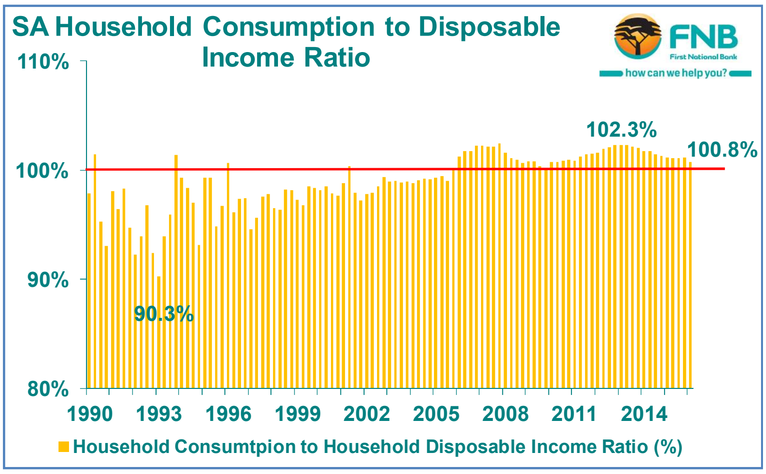
Such trends, however, did not point conclusively to a voluntary change in Household Sector mindsets necessarily. Such greater levels of conservatism could merely be forced upon households by a deteriorating economy of recent years, which has curbed employment and income growth. And, of course, there have been the gradual interest rate hikes since 2014 along with a steadily rising trend in Tax and Tariff rates coming from General Government and its Parastatals.

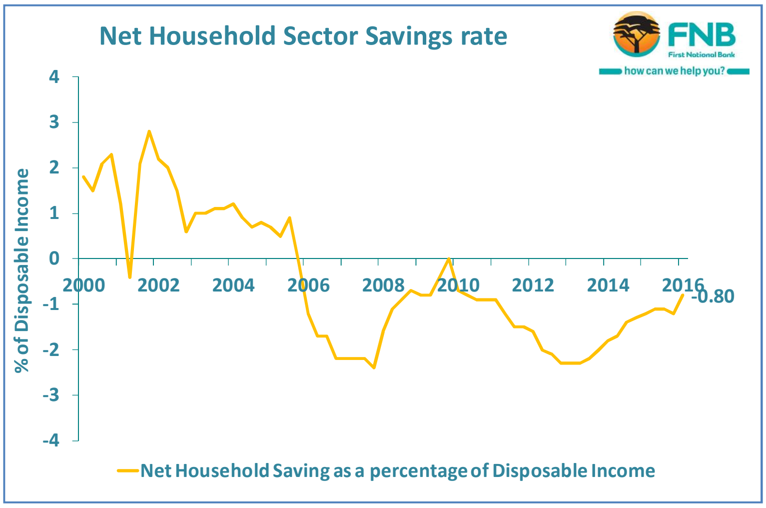


But what had led us to expect a little more than merely a Household Sector adhering to its current financial constraints, i.e. one that would start to adjust its savings and borrowing behavior deliberately too, was when we examined the drivers of weak consumer confidence. Here, we saw consumers' expectations for the economy over the next 12 months being more negative than their experience of their own financial position at the time. In other words, it is the broader environment, and the future, that concerns them more. There were numerous reasons for this, much related to the global economic slowdown and commodity price slump, but also to local factors including interest rate hiking, and heightened political and future policy uncertainty.

So what we had really expected to ultimately see was a more noticeable divergence between Real Household Consumption Expenditure growth and Real Household Disposable Income growth, and it appears that we are starting to see more signs of such a divergence. This in turn would translate into a long overdue improvement in the Household Sector Savings Rate as well as perhaps to slower Household Sector borrowing growth.







Real Household Sector Disposable Income growth has slowed. From 2.5% year-on-year in the 1st quarter of 2015, it has slowed to 1.5% year-on-year as at the 1st quarter of 2016.

However, Real Consumption Expenditure growth has slowed even faster of late, recording a mere 0.8% year-on-year as at the 1st quarter of 2016, with the quarter-on-quarter annualized growth rate turning negative to the tune of -1.3%.

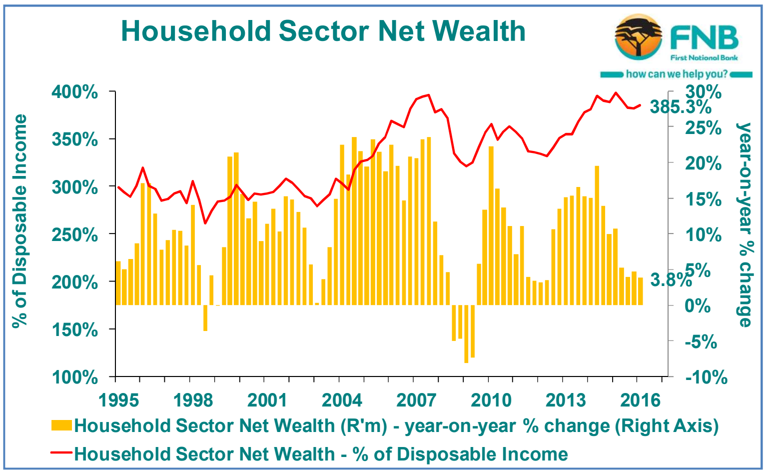
The result is a further decline in Household Consumption Expenditure when expressed as a percentage of Household Sector Disposable Income, to 100.8% of Disposable Income. This reflects some positive progress in returning Household Consumption to more sustainable levels relative to Disposable Income levels, from a 102.3% high around 2013.

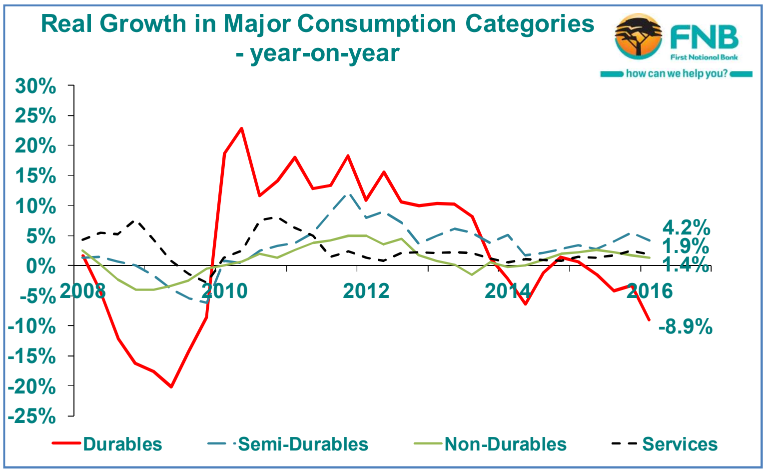
This translates into a further shrinking in the revised Net Dis-Savings Rate to -0.8% of Disposable Income, continuing the improving trend in the still-dismal net savings rate from a negative -2.3% of Disposable Income low point reached in 2012.

Net Saving/Dis-Saving refers to Gross Saving net of Depreciation on Fixed Assets owned by households. The Net Dis-savings rate means that what gross savings takes place is still insufficient to cover all depreciation in fixed assets owned by the Household Sector.

But this may soon be about to change as the Net Dis-savings rate heads nearer to zero.

This savings rate improvement is typically what we would expect to see during tougher economic times and times of rising interest rates. The Household Sector has become less confident of the economic future, and by implication of its own future financial situation.





The "natural" response should be to become more conservative in its spending habits.

The response appears justified if one examines Household Sector Net Wealth trends. While at 385.3% of Disposable Income the Household Sector's Net Wealth remains relatively high, its growth in value has slowed dramatically from 19.5% year-on-year in the 2nd quarter of 2014 to a mere 3.8% by the 1st quarter of 2016. This growth rate has become negative in real terms (i.e. is below CPI inflation), with slowing in growth in various asset markets, so the expected response should be a higher savings rate in order to grow wealth where weak asset price growth falls short.

Leading Real Household Consumption Expenditure growth slower has been the Durables category, declining by -8.9% year-on-year in real terms by the 1st quarter of 2016. Durables are often expenditures which can be postponed in tougher times, or times of rising cost of credit, for instance the purchase of new vehicles or furniture.

So what does all of this mean? On the positive side the sustained economic weakness, over a number of years to date, along with weak consumer expectations of the economic future, looks to be starting to drive an improving trend in savings behavior. We don't regard a net – dis-saving rate as "good" or "sustainable". A change is overdue, and indeed we expect a return to a positive net savings rate later in 2016 for the 1st time since 2005.

On the negative side, however, while the Household Sector is shifting towards a more cautious way of managing its finances, including higher levels of savings, the further dampening effect on consumer spend growth, over and above the dampening effect of slow economic growth, can be a further "growth negative" for retailers and the economy alike. In the longer term, however, a significantly higher savings rate could become "growth positive", contributing much needed domestic funding for Fixed Investment.

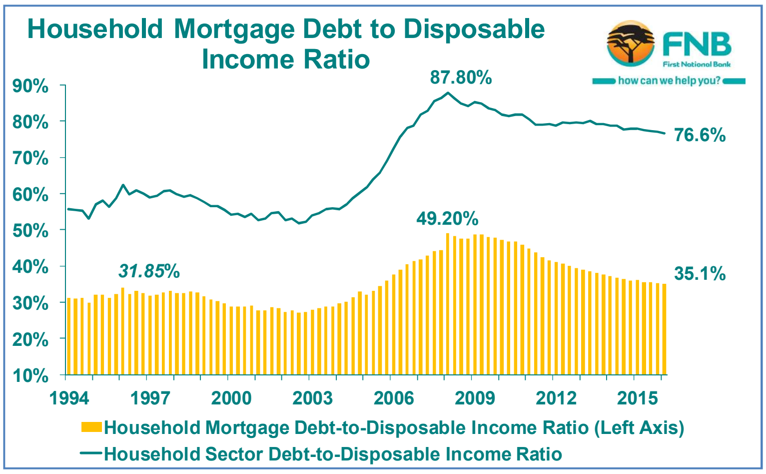
Ironically, perhaps, tougher economic and financial times are more likely to bring about a higher savings rate than the good times, despite it being theoretically tougher to save during the tougher times.

HOUSEHOLD SECTOR INDEBTEDNESS

Mortgage lenders are the key contributor to the much-needed lowering in the Household Debt-to-Disposable Income Ratio

The good news continued in the 1ST quarter of 2016 in the form of a further mild decline in the all-important Household Debt-to-Disposable Income Ratio. The reduction in this ratio is crucial to lowering the level of vulnerability of South Africa's Household Sector to unwanted economic and interest rate "shocks".

The June 2016 SARB (Reserve Bank) Quarterly Bulletin shows the 1st Quarter Household Debt-to-Disposable Income Ratio as declining slightly further, from a previous quarter's revised 77.0%, to 76.6%. Although this is a very slight decline, it extends the cumulative progress made since 2008 to an 11.1 percentage point reduction. The all-time revised high of 87.8% in this ratio was reached in the 1st quarter of 2008.



A key contributing factor to this decline remains the significantly more conservative approach by mortgage lenders subsequent to the pre-2008 boom period. This has resulted in a crucial "normalization" in the size of mortgage books relative to disposable income. So, from a high of 49.2%, reached in the 1st quarter of 2008, the Household Sector Mortgage Debt–to-Disposable Income Ratio has declined even more significantly than the overall Household Sector Indebtedness ratio, to 35.1% by the 1st quarter of 2016.

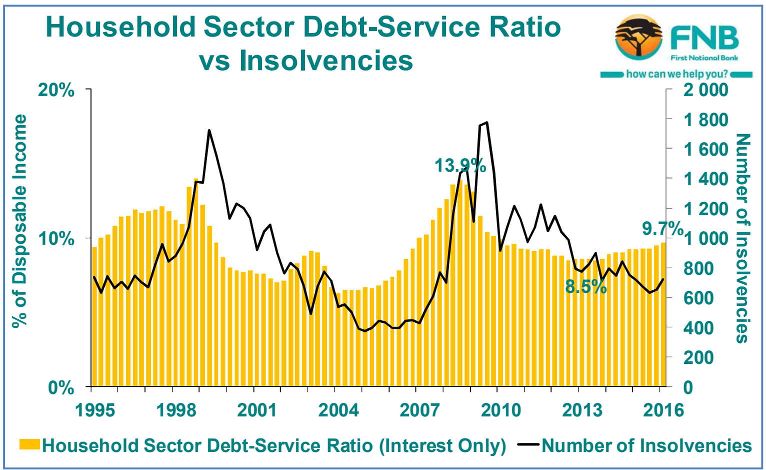
This most recent level of the Mortgage Debt-to-Disposable Income Ratio remains above the pre-boom levels of the late-1990s, suggesting that further real contraction in Household Sector Mortgage Credit may still be appropriate, but the level is no longer that significantly higher than the pre-boom levels.

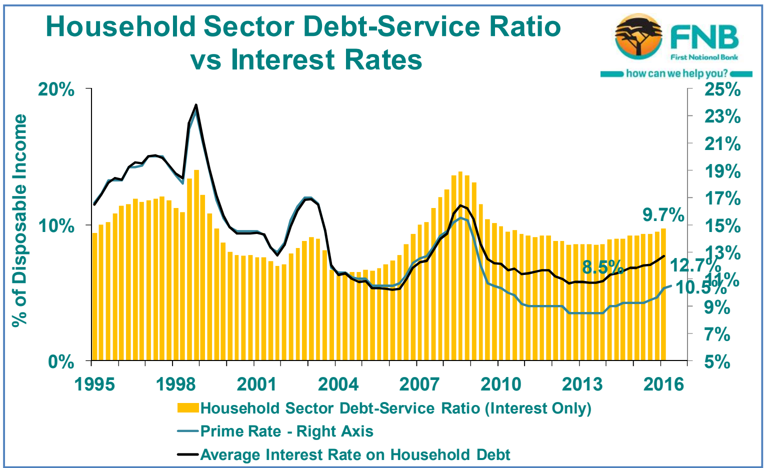
A weak economy and slow income growth continue to make a slow pace of household credit growth necessary.

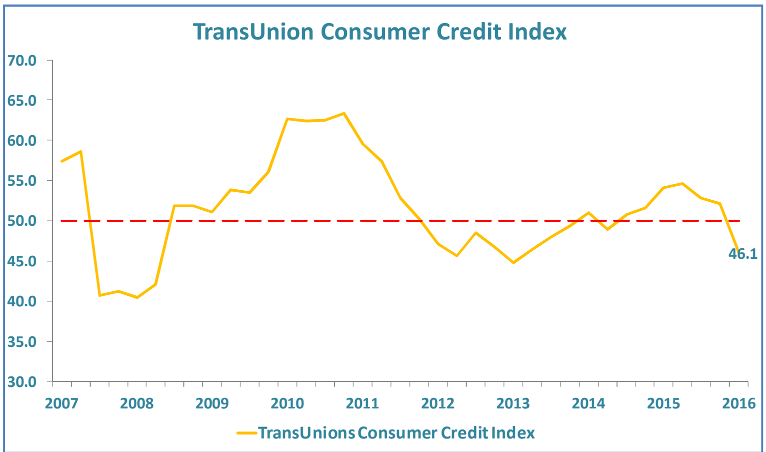
Important, though, is that non-mortgage credit also decline as a percentage of Household Sector Disposable Income in order to reduce the Debt-to-Disposable Income Ratio meaningfully further.

DEBT SERVICE RATIO CONTINUES TO RISE DESPITE A DECLINING INDEBTEDNESS RATIO

The decline in the Household Debt-to-Disposable Income Ratio over the past 8 years has been crucial, and its positive impact has arguably being felt when viewing various statistics relating to credit health. We frequently make the claim that the Household Sector has been experiencing mounting financial constraints in recent years, with Disposable Income growth under pressure and interest rates rising, but has not yet experienced a significant mounting of financial stress.







This is despite rising costs of servicing debt-relative to disposable income. Rising interest rates have contributed to a rising Household Debt-Service Ratio (The interest cost on the Household Debt Burden expressed as a percentage of Disposable Income), from 8.5% at the end of 2013 to 9.7% by the 1st 4th quarter of 2016.

Prime rate rose from 8.5% to 10.5% over the period. And the Average Interest Rate on Household Debt remains at a higher level than Prime Rate, averaging 12,7% in the 1st quarter of 2016, due to the higher priced non-mortgage credit having become a more significant part of overall Household Debt since the end of the pre-2008 housing boom. In addition, the Residential Mortgage Market was significantly "re-priced" upwards post-2008.

However, despite the positive development of a declining Debt-to-Disposable Income Ratio since 2008, ultimately we would expect rising interest rates and a rising Debt-Service Ratio to have some negative impact in Consumer Credit Health.

And indeed, after a considerable lag time from when interest rate hiking commenced back in early-2014, this appears to be the case.

The TransUnion Consumer Credit Health Index provides a useful view of the overall Consumer Credit Health trend, and it dropped to below the 50 level to 46.1 (Scale of 0 to 100) during the 1st quarter of 2016. Below 50 implies the onset of deteriorating credit health.

In short, although the Household Sector Debt "fundamentals" have turned for the better, the short term negative impact on credit health emanating from interest rate hikes is unlikely to be avoided entirely. And after a considerable lag time, there are indications of some moderate deterioration in Household Sector Credit Health.

However, had the Debt-to-Disposabe Income Ratio not have declined significantly since 2008, the negative impact of rate hikes would likely have been significantly worse.

CONCLUSION

We expect the result of a lengthy period of weak consumer confidence to be a "deliberate" move by the Household Sector towards more conservative spending and borrowing habits. By "deliberate", we mean moves over and above merely curbing consumer spend in line with slowing disposable income growth. We mean moves to curb spending growth over and above that, which would translate into a rise in the Household Sector Savings Rate.

Indeed, it would appear that the savings rate has been starting to improve, even if for the time being this has only meant less of a net dis-savings" rate. However, looking ahead, with little sign of the economic weakness ending any time soon, we would expect ongoing weakness in consumer confidence to translate into a rise in net savings back into positive territory (meaning that gross savings levels would once again be enough to cover estimated depreciation on fixed assets owned by the Household Sector) for the 1st time since 2005.

In line with the theme of a shift towards greater "conservatism" by the Household Sector, we would also expect further decline in the all-important Household Sector Debt-to-Disposable Income Ratio to continue.

While these improving savings and indebtedness trends are to be welcomed in the longer term, they can add an extra "negative" to retail sales and economic growth in the short term over and above the already lengthy list of "economic negatives".

JOHN LOOS:
HOUSEHOLD AND PROPERTY SECTOR STRATEGIST
087-328 0151
John.loos@fnb.co.za