Household debt, wealth and saving

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Introduction

Household debt ratios are important analytical tools because they allow policy makers, analysts, economic researchers and others to evaluate households' financial situation and to forecast final consumption expenditure. Households' consumption expenditure currently represents more than 60 per cent of South Africa's gross domestic product. Consequently, fluctuations in households' expenditure patterns affect the economy's output performance. Rising levels of consumption expenditure by households generally stimulate the economy, whereas slower growth or declines in aggregate consumption expenditure by households have a dampening effect on economic growth.

In general, the spending and saving behaviour of individuals is determined by various factors such as their material and social needs, tradition, standard of living, existing indebtedness, net worth and disposable income. Consumption expenditure by households is therefore determined to an important degree by the extent of and the actual and anticipated changes in the income of consumers, as well as their ability to spend future income now by making use of credit.

Credit extension is also an important link in the transmission mechanism that relays changes in monetary policy to changes in the total demand for goods and services and the rate of inflation. A change in interest rates by the monetary authority could have an effect on credit extended to households, and this would ultimately influence aggregate demand. The availability of credit from reliable financial institutions could help channel resources into their most productive uses and so increase economic growth and prosperity. In addition, greater access to credit makes it easier for business enterprises to initiate new capital formation projects, augment stock levels and expand their activities. The availability of credit also makes it easier for households to spend. An increase in credit could entice consumers to buy now instead of postponing buying for the future. Therefore, it is important to measure household debt appropriately in order to evaluate consumer spending behaviour.

The purpose of this article is to analyse household debt and other relevant aspects, particularly those related to wealth and saving. Consequently, the objective of the first section is to define household debt. The section after that reviews the structural developments in household debt with specific emphasis on the relative importance and composition of household debt. This is followed by an analysis of the household sector's indebtedness. Further sections discuss household debt relative to real and financial assets, and an analysis of household debt and its relationship to wealth and saving. The last section encompasses a summary and concluding remarks.

Defining household debt

Generally debt (including household debt) refers to an obligation or liability arising from borrowing money or taking goods or services "on credit", i.e. against an obligation to pay later. Usually a debt contract is an essential part of the debt agreement between one person or organisation and another. A debt contract states the terms of borrowing,

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the interest and redemption payments that the borrower must make and what collateral the borrower has to provide. In addition, secured debt refers to debt where the borrower provides collateral, which the lender is entitled to take over if the borrower does not make the promised payments. One kind of secured debt is mortgage debt secured on houses, other buildings or land. By contrast, if debt is unsecured the lender has no special claim on any particular part of a defaulting borrower's assets.

Households may, in practice, be willing to enter into credit transactions for various reasons. The use of consumer debt is mainly related to consumers' eagerness to consume now rather than later. Households surrender future consumption because they will use the income earned at a later stage to settle debts and meet interest commitments. Consequently, they will have less money to spend at that later stage, even if they do not further increase their commitments relative to income growth.

The two major components of household sector debt are customarily classified into household credit and mortgage advances. Household or consumer credit is, in turn, subdivided into open accounts, personal loans at banks, other personal loans, credit card facilities, instalment sale transactions and lease agreements.

According to national accounts practices the household sub-account reflects all current transactions of private households, unincorporated business enterprises (proprietors and partnerships) and non-profit institutions. Consequently, household sector debt includes the credit extended to unincorporated business enterprises and the debt commitments of non-profit institutions serving households. Empirical data show, however, that consumer debt (private household debt) in South Africa accounted on average for more than 93 per cent of total household debt. At this level it is clear that a correlation between private consumption expenditure and predictable consumer credit will mainly be subject to consumers' borrowing behaviour.

Credit extended to the household sector

As mentioned in the previous section, there are five methods or types of credit facilities which the household sector can use for borrowing money for current consumption expenditure. These facilities are discussed in more detail in the following paragraphs.

Open account

Open accounts of households include all outstanding debits to dealers, and also those amounts payable to buy-aid associations for the purchase of goods and services from dealers.

Financing by way of open accounts is generally used for the purchase of durable and semi-durable goods and the rendering of consumer services. The period of credit extension is short and outstanding balances are normally payable within one calender month of the date of the transaction. However, instalments over periods of up to six months are common, especially where semi-durable goods are involved.

Personal loans at banks

Personal loans granted by banks consist of overdraft facilities made available by banks to their clients and other advances granted to individuals. Overdraft facilities are available to the holders of current accounts at banks, enabling clients to withdraw funds from such accounts over and above the amounts deposited into the clients' accounts. Only that part of the overdraft facility that is actually drawn by the consumer is included in consumer credit. The conditions for the repayment of overdrawn accounts at banks are particularly flexible and are arranged at the discretion of the banks and with the client's needs and financial capabilities in mind. "Other bank advances" to individuals may be made even though these individuals may not necessarily be holders of current or deposit accounts at that particular bank. The repayment of such debt is usually more precisely scheduled than the repayment of overdrawn accounts, and repayment is normally required within a fixed period.

Other personal loans

Other personal loans consist of loans granted to individuals by long-term insurers where the surrender value of a policy serves as security for the loan (called "loans against policies"). Loans made to farmers to finance consumption expenditure are, irrespective of the institution granting the credit, also classified as personal loans. However, loans entered into by farmers for the sole purpose of financing farming activities are not regarded as part of outstanding consumer credit.

Credit cards

Banks make credit card facilities available to consumers, offering a convenient method of making purchases and deferring the payment of the purchase price. Debit balances on credit card accounts are usually payable within one calendar month after the cardholders receive their accounts, but "budget" facilities are also provided to postpone the payment over longer periods. The outstanding debit balances at the end of each calendar month, and not the total credit available, are taken into account in calculating total consumer credit.

Instalment sale and lease agreements

An instalment sale agreement (hire-purchase agreement) is a transaction in terms of which goods or services are provided to the buyer, but where the purchase price is paid in instalments over a period in the future. Although the buyer takes possession of the goods, he or she does not become the owner and the seller is entitled to repossess the goods if the buyer does not comply with the provisions of the agreement. Instalment sale transactions are used almost exclusively to finance the purchase of durable consumer goods with prices that are high in relation to the income of the buyer, and where the expected economic lifetime of the goods is long, for instance three to five years or longer.

Lease agreements are transactions in terms of which goods are leased but where there is no arrangement that the debtor will become the owner of the goods at any time during or after the expiry of the lease period. As the credit-taker or debtor does not acquire ownership in terms of the agreement, the outstanding commitments can perhaps strictly speaking not be regarded as consumer debt. The Statement of Generally Accepted Accounting Practices, however, lays down guidelines according to which the commitments of persons in terms of finance lease transactions are included in consumer debt. The finance lease agreement is regarded as an alternative to a credit sale transaction and all the risks and remuneration involved in the right of ownership of the asset concerned are transferred from the lessor to the lessee. However, the same considerations do not apply in the case of operating lease transactions, and the commitments in terms of these agreements should accordingly not be included in the estimates of total consumer credit.

Mortgage advances

Mortgage advances come into play when households enter into loans (home mortgages) to buy homes and other fixed property and provide the property concerned as security for the loan. One feature of such loans is that the borrowers (mortgagees) will, under normal circumstances, have to pay off a certain portion of the price of the property themselves before the lender (mortgagor) makes the remaining portion of the purchase amount available. The size of the loan is usually determined according to the annual income of the borrower and the value of the pledged property. The loan is repaid over a long period that ranges from 20 to 30 years, although shorter periods may also be arranged.

In South Africa the interest on mortgage loans is normally determined at a variable rate and the lender may adjust the interest rate after giving one month's notice. Recent developments also allow for a fixed-rate option that protects the mortgagee against sharp increases in mortgage rates. The maximum period that the banks are prepared to lock into such a fixed-rate agreement depends mainly on the expected change in interest rates. The mortgagee may redeem the mortgage debt at any stage without being penalised, but repayment usually takes place in monthly instalments. The amount repaid each month may vary in accordance with interest rate movements, if a variable rate was chosen.

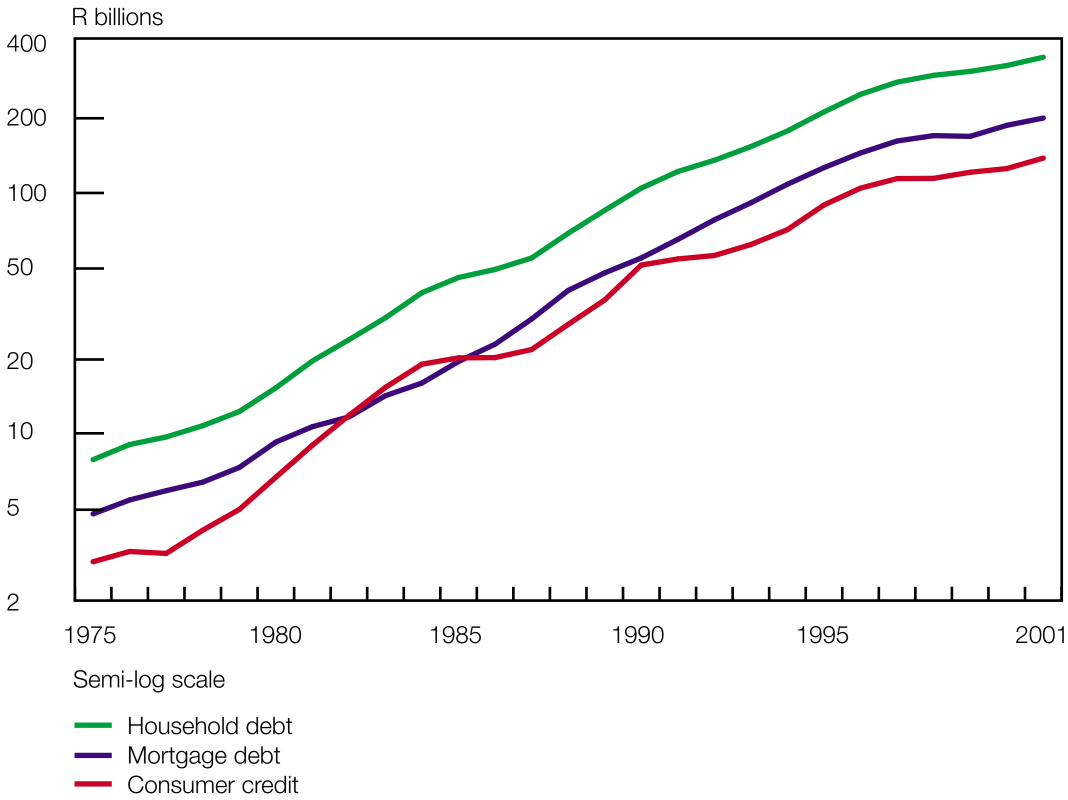
The South African retail credit markets changed markedly during the 1990s. Consequently, the retail finance sector has seen new developments, particularly in private-label credit cards and unsecured loans. As part of these developments, households enter into mortgage loans to acquire funds for purposes other than the purchase of fixed property. In such a case the fixed property owned by a household is pledged as security for the loan. The keen competition among the various financial institutions in South Africa since the first half of the 1980s has caused mortgage advances to be promoted increasingly for purposes other than the financing of transactions in fixed property.

Structural developments in household debt

Total lending to households by financial institutions continues to rise, but the pace slowed down towards the end of the 1990s and the beginning of the new millennium (see Graph 1). The year-on-year rate of increase in total household debt declined from an average of about 20 per cent in 1995 to approximately 3½ per cent during 1999 before it rose again to 9½ per cent for the first half of 2002. At the beginning of the 1980s and again between 1989 and 1990 increases in excess of 30 per cent and 25 per cent, respectively, were recorded. Rapid growth in borrowing has always been associated with a deterioration in the saving ratio – a development also clearly manifested in South Africa's saving history.

The more pronounced slowdown in the growth of both secured (mortgage debt) and unsecured borrowing in the South African economy since 1997, also brought to an end the big differences between the growth of these two aggregates prevailing during the mid-1980s and the beginning of the 1990s. Prudent monetary policy and sharp increases in interest rates during the second half of the 1990s made consumers less inclined to incur debt. Consequently, the demand for secured and unsecured debt declined. Households' desired debt levels will always depend partly on interest charges on borrowing. Accordingly, that part of secured lending not used to fund investment in housing, but to buy other durable consumer goods, became less attractive in the second half of the 1990s as the interest rates on mortgage loans for dwelling units peaked in 1998.

Graph 1 Household debt



The relative importance of household debt

To analyse the importance of household debt it is necessary to distinguish between the components of household debt, namely consumer credit and home mortgage debt, and the movement of these aggregates relative to total credit extended to the domestic private sector by banks.

The broadening of banks' lending activities to households, particularly during the 1980s, caused consumer credit to expand at a much faster pace than bank lending to the private sector. During the 1970s consumer credit extension by banks and other monetary institutions, as a percentage of total credit extension by these institutions to the domestic private sector, amounted to about 19½ per cent. This ratio rose rapidly between 1980 and 1984 to reach a level of 29½ per cent in the latter year, but this strong rise ended during the recession of 1984 – 1986. However, at the beginning of the 1990s this ratio rose again to reach its most recent high of 26½ per cent in 1996. In the subsequent years it has declined progressively to 20½ per cent in 2001.

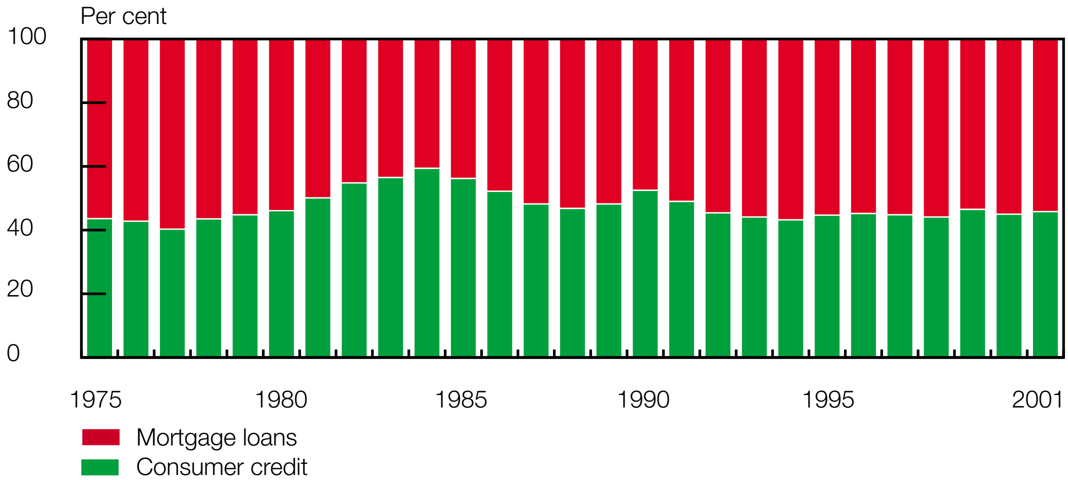
By contrast, the share of mortgage advances to households relative to total credit extended to the private sector by banks declined from a level of about 33 per cent at the beginning of the 1970s to a low of 24½ per cent in 1984. In the subsequent years this ratio increased again to a high of 38 per cent in 1994 and 1995, before it gradually declined to 29 per cent in 2001.

In addition, total household debt, i.e. mortgage lending to households plus consumer credit, as a percentage of total credit extended by banks to the private sector, amounted to an average of 51½ per cent in the 1970s. During the 1980s this ratio moved higher to an average of 53 per cent, before accelerating in the 1990s to reach a high of 64 per cent in 1996. This was the net result of sharp increases in consumer credit and mortgage advances to households. Total household debt as a percentage of total credit extended by banks to the private sector had declined again in the past three years to reach the relatively low level of 49½ per cent in 2001.

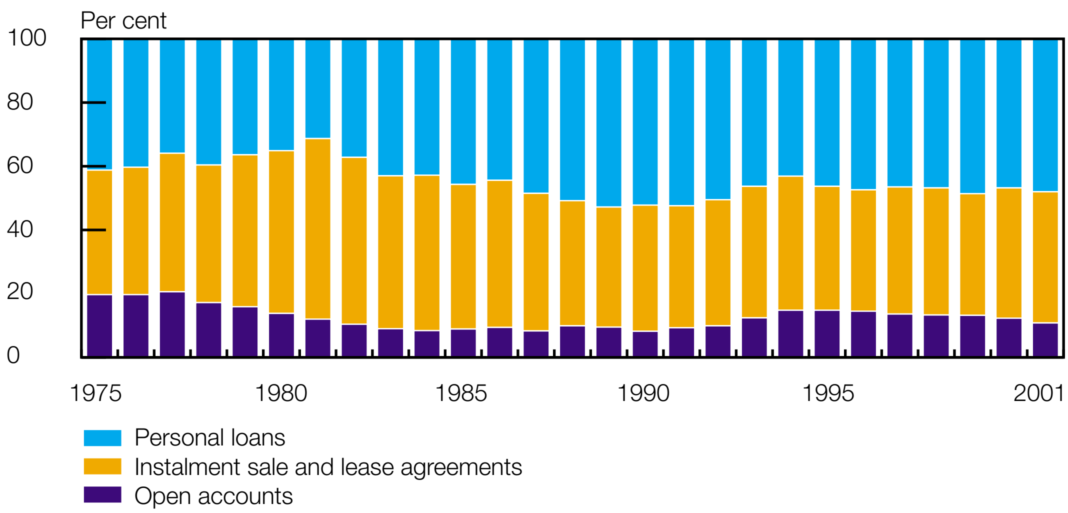
The composition of household debt

An analysis of the components of total household debt shows that mortgage advances accounted, on average, for 57 per cent of aggregate household debt during the 1970s (see Graph 2). Since the beginning of the 1980s the relative importance of mortgage debt has decreased, as reflected in the ratio of consumer credit to total household debt rising to a high of 59½ per cent in 1984. This could mainly be attributed to sharp increases in consumer credit at an annual rate of 31½ per cent from 1979 to 1984 compared with only 17½ per cent in the case of mortgage debt. These developments were mainly associated with the deregulation

Graph 2 Composition of household debt



Composition of consumer credit



of the financial sector in the beginning of the 1980s, the general buoyancy in economic activity during the heyday of the gold price boom at the end of the 1970s and the beginning of the 1980s, coupled with the upswing phases of the business cycle from 1978 to 1981 and again from 1983 to 1984 when negative real interest rates prevailed for most of the time.

From 1985 the importance of consumer credit changed substantially as several factors such as the high level of nominal interest rates, the depreciation in the value of the rand, adverse socio-political developments and the debt “standstill” agreement with foreign banks impacted negatively on consumer confidence and caused a slowdown in the expansion of consumer credit. The net result of these developments was an increase in mortgage debt relative to total household debt, reaching a level of 53 per cent in 1988. This ratio decreased again to 47½ per cent in 1990, but the relatively buoyant demand for mortgage advances since 1991 has again resulted in a sharp increase in the share of mortgage debt in aggregate household debt. In 1994 mortgage advances relative to total household debt reached a recent high of about 57 per cent. Although this ratio came down to an average of 54½ per cent in 2001 it is still high, compared with some periods in the past.

The composition of outstanding consumer credit has changed substantially over the past three decades. The relative importance of credit extended by way of open accounts in total consumer credit decreased over the period 1970 to 2000. Since the beginning of the 1970s the relative share of open accounts in total consumer credit has declined from more than 20 per cent to about 8½ per cent in the mid-1980s. In subsequent years the aggressive marketing of open accounts and the ready availability of such financing throughout the 1990s to a broader spectrum of consumers helped to increase the share of open-account balances in total consumer credit to an average of about 13½ per cent in the second half of the 1990s.

In contrast to the declining relative share of open accounts in total consumer credit, the importance of instalment sale and lease transactions increased considerably. At the beginning of the 1970s approximately 33½ per cent of all consumer credit extended to households was in the form of instalment sale and lease transactions. This ratio increased to a high of 56½ per cent in 1981, reflecting the buoyancy in households' consumption demand and the fact that meeting the increasing demand for consumer credit has been facilitated by the lifting of direct control over credit extension in August 1980 and adopting a more market-oriented system of monetary policy making since 1981. Since 1984 the relative importance of instalment sale credit and lease transactions has varied along a downward trend to a level of 39 per cent in 2001.

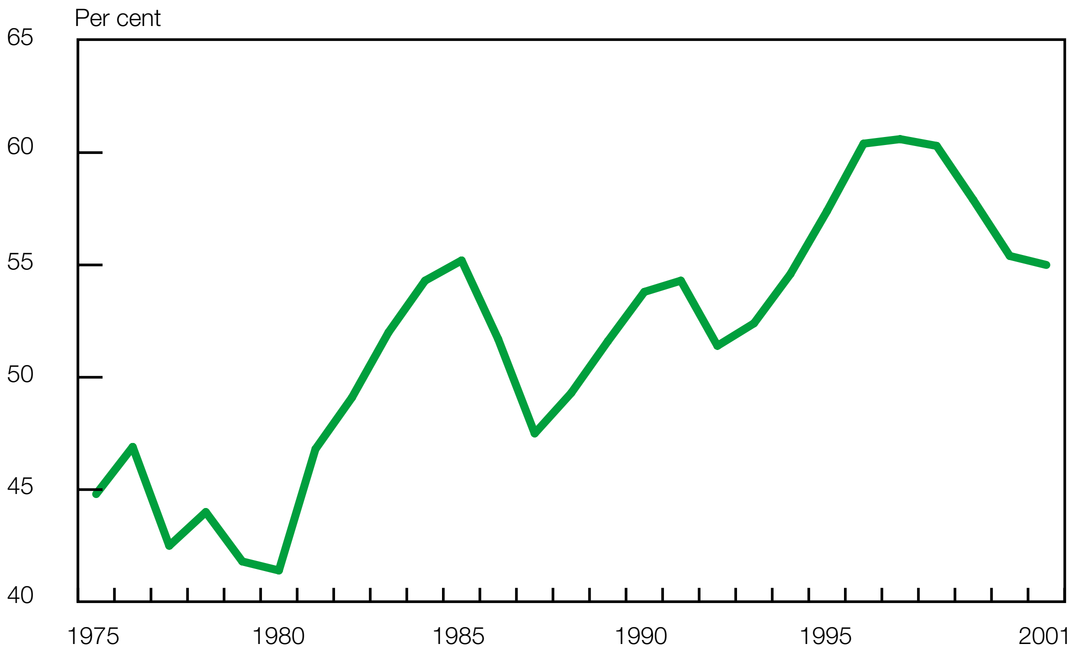
Credit granted to households by way of personal loans grew at a far slower pace between 1970 and 1980 than total outstanding consumer credit. As a result the relative importance of personal loans declined from 45 per cent in 1970 to 31½ per cent in 1981. Since 1982, however, personal loans have increased more rapidly than total consumer credit. Between 1989 and 1991 personal loans constituted about 52½ per cent of total consumer credit, but more recently this ratio fell back to an average of about 49 per cent.

Structural changes in the composition of consumer credit reduced the relative importance of open accounts to total consumer credit from 22 per cent in 1970 to 11 per cent in 2001. By contrast, the importance of personal loans (including overdraft and credit card facilities), instalment sale credit and leasing rose from 78 per cent to 89 per cent in the corresponding period. This increase may have strengthened the effects of monetary policy changes on aggregate demand, because the impact of interest rate changes is evidently more directly linked to personal loans, instalment sale and lease agreements than to open accounts.

Household sector indebtedness

As shown in Graph 3, it is clear that during most of the 1970s the household sector's indebtedness rose at a rate that more or less corresponded with the rate of increase in the disposable income of households. Consequently, the ratio of outstanding debt to the disposable income of households remained virtually unchanged and varied around an average rate of approximately 45 per cent. Indebtedness rose even slower than disposable income between 1978 and 1980. However, this trend was reversed in the period 1980 to 1985, when aggregate household debt, as a percentage of disposable income, rose from an average of 41½ per cent in 1980 to 55 per cent in 1985.

Graph 3 Household debt as percentage of households' disposable income



Because of the slowdown in consumer credit extended during 1985 and 1986, when monetary policy measures were decisively tightened, the ratio of total household debt to personal disposable income receded sharply to an average of 47½ per cent in 1987. However, in subsequent years the use of consumer and mortgage credit accelerated again and at the beginning of 1994 the ratio of household debt to disposable income exceeded the high levels of the mid-1980s. In addition, the strong growth in credit demand in the mid-1990s was underpinned by the introduction of private-label credit cards. Leading retail outlets in partnership with banks and through an aggressive marketing campaign, encouraged the use of private-label credit cards to a broad spectrum of clients and consumers. Partly as a result of these developments, household debt as a percentage of personal disposable income surged to an all-time high of more than 61 per cent in the first quarter of 1998. Subsequently, however, credit demand has weakened because private-label credit cards became unpopular during 1997 when a stringent monetary policy and rising interest rates left households with historically high levels of indebtedness. The lower growth in credit demand relative to the growth in households' disposable income since the middle of 1998 has led to a decline in households' debt ratio, amounting to an average of 55 per cent in 2001 and 53½ per cent in the first half of 2002.

An international comparison shows that although South Africa's ratio of household debt to disposable income increased strongly in the 1980s and again in the first half of the 1990s, it is lower than most of the Organisation for Economic Cooperation and Development (OECD) countries, and significantly lower than in the United States of America, Japan, Canada and the United Kingdom, where household debt ranges between 100 and 120 per cent of disposable income.

Another development related to household debt has been the growth in the micro-lending industry since the beginning of the 1990s. The exponential growth of the micro-lending industry in South Africa, especially during the 1990s, firmly established the role that micro lenders have played in increasing access, particularly by low-income households, to credit extension in South Africa. The expansion of the micro-lending industry was also partly responsible for growing concern about the levels of indebtedness of the household sector. Micro loans are targeted at the middle to low-income section of households, whereas cash lenders are more active among households with minimum living standards.

South Africans were in debt to micro lenders (gross loans outstanding) to an amount of R13,5 billion in 2001. Relative to total household debt outstanding, estimated at a level of about R322 billion at the end of 2001, the debt extended by micro lenders amounted to less than 5 per cent. In addition, very little of the gross loans granted by the micro-lending industry can be added to the existing level of household debt. This can be explained by the fact that 52 per cent of the debt granted by micro lenders comes from banks and is consequently already measured as part of household debt. Another 3 per cent of the loans extended by micro lenders comes from co-operations and trusts, which are essentially part of the household sector. The remaining 45 per cent of debt granted to individuals comes from close corporations, and public and private companies and should be added to aggregate household debt. However, this component of household debt is negligible and cannot significantly affect the current indebtedness of the household sector.

Household debt and capital gearing

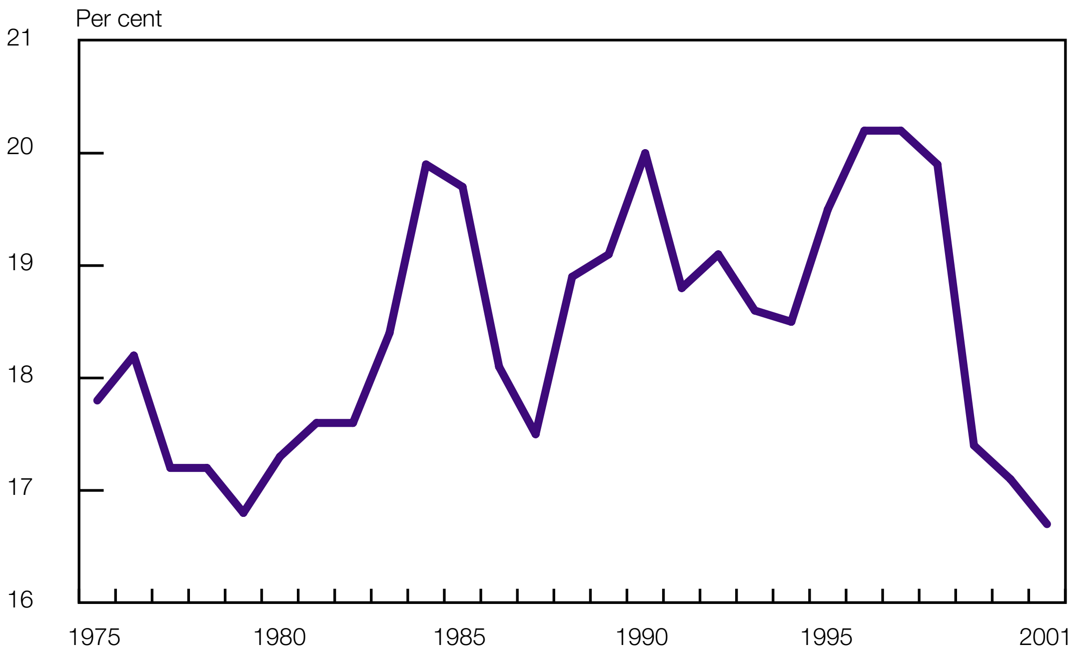
The deterioration in households' indebtedness since the early 1980s is also discernible in their "capital gearing", i.e. the ratio of household debt to the total assets of the household sector (see Graph 4).

Household debt relative to fixed assets for the period 1974 to 1984 fluctuated around an average of 44 per cent, but subsequently rose faster, reaching a high of 98 per cent in the first quarter of 1997. Since then this ratio has declined to an average of 83 per cent in the calendar year 2001.

By contrast, household debt relative to financial assets reacted much more favourably, improving from an average ratio of approximately 29 per cent between 1975 and 1984 to an average of 24½ per cent in the second half of the 1990s. In 2001 this ratio receded to an average of 21 per cent. These developments can mainly be attributed to the fact that an increasing share of personal saving has gone into acquiring financial assets, especially during the 1990s. The high level of inflation in South Africa over the long term caused distortions which encouraged people to concentrate their personal saving in risk-avoiding institutions and financial assets in preference to riskier undertakings and fixed assets. This is probably an indication that the general public has increasingly become financially sophisticated over the past decade or so, allocating income to tax-immune types of assets and consequently requiring larger borrowing to support ordinary consumer spending. The recent introduction of capital gains tax (CGT) and the 25 per cent tax on income from retirement funds are likely to change the saving and investment behaviour of households once again as they reduce the attractiveness of financial assets somewhat.

The total capital gearing of households deteriorated slightly from an average of 17½ per cent in the 1970s and the beginning of the 1980s to an average of 20 per cent in 1996 and 1997. However, this ratio declined to about 16½ per cent in 2001, as consumers became less inclined to incur debt.

Graph 4 Capital gearing of households



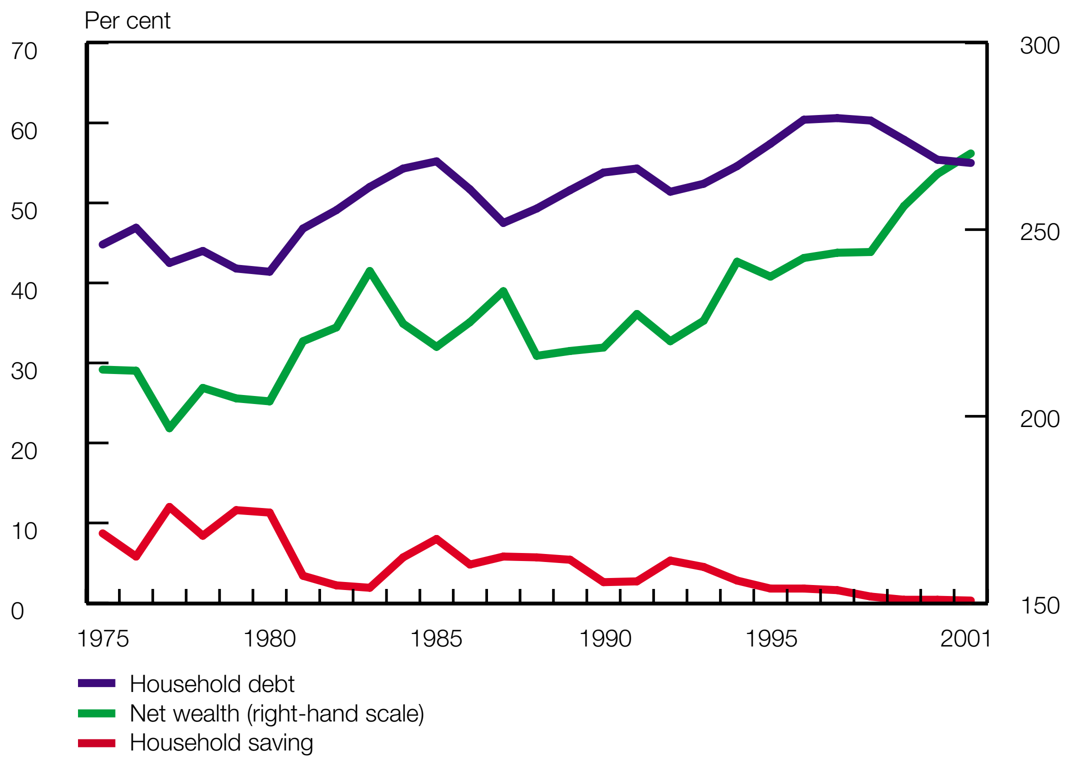
There are several reasons for the growth of indebtedness since the mid-1980s. One is the deregulation of financial institutions, which is believed to have encouraged an expansion of personal debt. Another is the strong demand for residential mortgage loans, spurred by inflation and the relatively high level of house prices as well as other factors, such as the aggressive marketing of sectional title units and the government initiative to boost owner-occupied dwelling units among certain lower-income communities. More recently, households' fear for their safety and security has also contributed to an increasing demand for residential development in security complexes. In addition, the household sector's indebtedness, particularly in the form of mortgages, rose much faster than disposable income in the second half of the 1980s. This ratio continued to increase during the 1990s and reached a high of 33½ per cent in 1998, before declining to 29½ per cent in 2001 and the first half of 2002.

Household debt, wealth and saving

Saving by the household sector is defined as that part of current income, after the payment of direct taxes, that is not consumed or transferred as part of household current expenditure. Dissaving occurs when current expenditure exceeds current income. In terms of standard accounting practices, the saving of a household or of any other organisation will be equivalent to the increase in the net asset value of the household or organisation. Increases in the credit commitments of households will accordingly lead to a decline in their saving, unless this is counteracted by similar or stronger increases in the assets of households. Generally speaking, an inverse relationship can be expected between increases in the utilisation of consumer credit and the saving of private households over time.

In South Africa a clear inverse relationship can be discerned from the beginning of the 1980s between the ratio of household debt to personal disposable income and between household saving in relation to the personal disposable income of households. The deterioration in the saving ratio of households at the beginning of the 1980s coincided with the greater use of credit by households. Alongside these developments, there was an increase in the net wealth of households relative to their personal disposable income (see Graph 5).

Graph 5 Household debt, saving and net wealth as percentage of personal disposable income



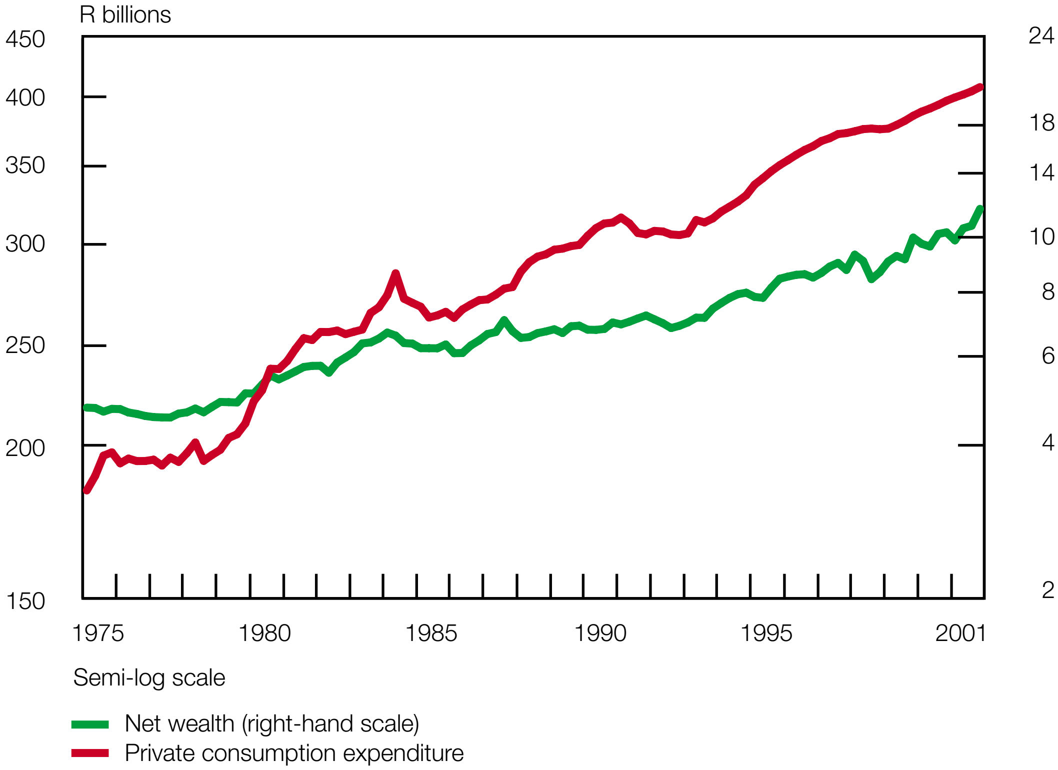
Though there is no scope in this analysis to identify and discuss the determinants of households' saving behaviour, it suffices to state that most studies rely on some variant of the life-cycle, or permanent-income, hypothesis. These theories assert that households maximise the benefits of consumption over their lifetime, subject to the constraints of expected lifetime income and initial wealth. Interest rates indicate the terms of the trade-off between current and future consumption, whereas demographic variables and wealth are accordingly singled out as the potential causes of changes in consumer behaviour. Other determinants that may influence households' decisions about saving include changes in average income levels, the distribution of income among households, tax policies, government saving, corporate saving and the ability to save through the corporate sector rather than directly, unemployment, and financial deregulation.

Major financial policy and institutional changes, including the liberalisation of financial markets during the 1980s, created many new lending opportunities for the financial sector. Financial institutions such as banks found that they could fund new lending in a less constrained way than had previously been the case. These changes enabled households to increase their borrowing in relation to their income. The changes also whetted financial institutions' appetite for household lending. Although it is not possible to quantify the direct effect that the general deregulation of the financial sector has had on saving over the past two decades, it has undoubtedly contributed to the rapid rise in outstanding credit and the concomitantly high level of household debt, resulting in a lower rate of household saving.

Another fundamental cause of the decline in households' saving is that consumers, at least to a certain extent, have rationally decided to lower their saving rates or alternatively to keep consumption expenditure at a relatively high level. The deterioration of households' saving in 1993/94 and the very low level of saving during 1999/2000 were accounted for by lower growth in real personal disposable income relative to growth in consumption expenditure by households – an indication that other factors have supported consumption growth. If it is assumed that at any particular time, consumption by households should also reflect their perceptions of the "wealth effect", then ultimately what households care about is their net worth – total assets minus liabilities. Household wealth has risen sharply since the mid-1980s, but more specifically from 1993 onward. This rise was driven by increases in both equity and house prices. Consequently, households' low saving rate is a sign that consumers feel comfortable with the evolution of their net worth and that they see little reason to curtail consumption as a way to increase their net worth even further. The positive correlation between an increase in the real net wealth of households and real consumption expenditure by households is illustrated in Graph 6. The higher rate of growth in household wealth since 1993 was closely followed by accompanying increases in private consumption expenditure.

The effect of any wealth revaluation remains difficult to quantify. Changes in asset prices can have a powerful impact on household consumption through wealth effects. For example, owner-occupiers of dwellings may perceive higher house prices as an addition to their wealth, and reduce their saving out of current income. However, individuals planning to purchase their own houses may reduce their consumption in the wake of higher house prices as they will have to save more for higher deposits and repayments. For these reasons, the impact of the wealth effect is uncertain. In addition, the changes in house values may influence household consumption, even if wealth effects are absent, to the extent that they influence the borrowing capacity of households. Households' ability to borrow will, in practice, depend strongly on their capacity to supply collateral as security for repayments, and real estate is the most widely used collateral asset. Consumers can withdraw part of the increase in housing equity by increasing their borrowing secured on rising property values, and use part of the proceeds to finance additional consumption.

Graph 6 Households' real final consumption expenditure and net wealth



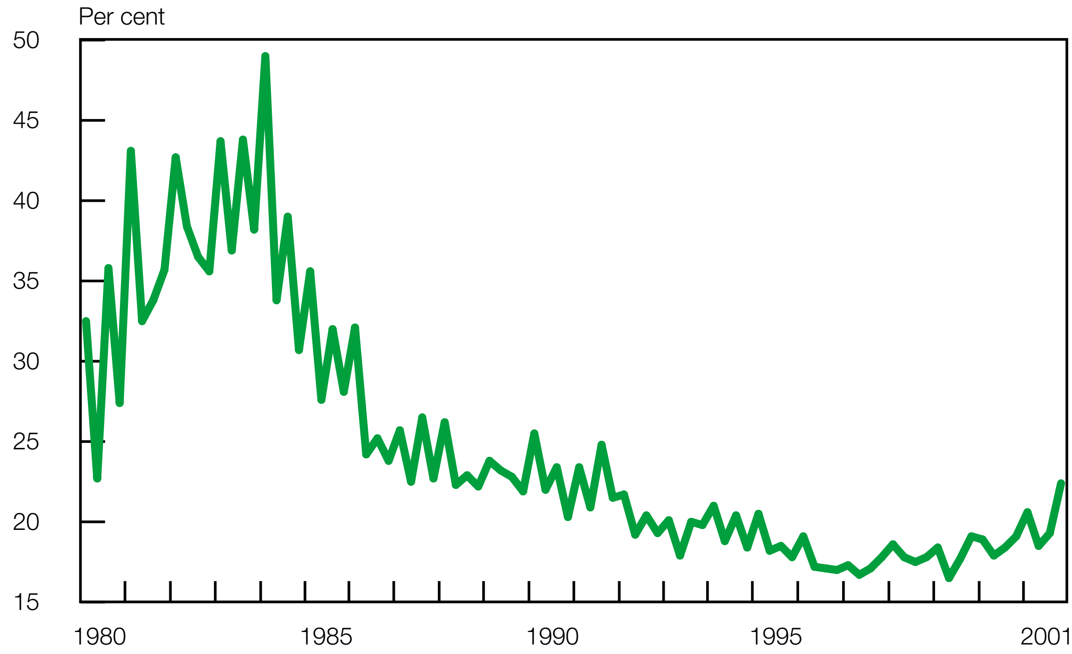
In the real-estate sector, residential equity probably plays the most important role in the transmission mechanism of monetary policy. Although the share of fixed assets in total household wealth has declined over the past 15 years as a result of financial deregulation, financial innovation and the strong rise in equity prices, it still accounts for more than 20 per cent of total household assets.[2]

2 In the United States of America this ratio is around 20 per cent and in Europe it is more than 30 per cent.

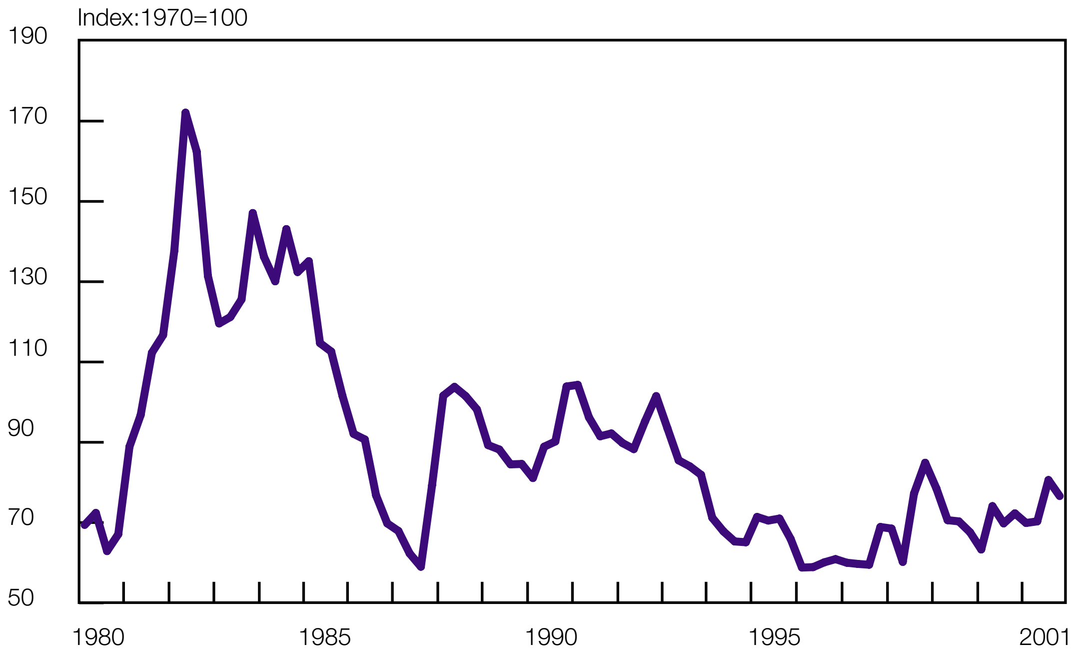
Equity markets have experienced some volatility in recent years, but house prices continued growing at a solid pace. An analysis of average house prices in South Africa relative to disposable income *per capita* shows a persistent upward trend since the beginning of 1997 (see Graph 7). Although the ratio of house prices to disposable income *per capita* rose from a low base towards the end of 1996, it is still far below the average level recorded at the beginning of the 1990s – and there is no evidence that residential property is repeating the bubble conditions that prevailed in the early 1980s. As a result of these developments, the wealth effects of rising property prices have supported economic activity in South Africa during the recent downturn from December 1996 to August 1999, as the wealth effect induced the growing number of property owners to raise their consumption. In addition, the relative strength of house prices compared to equity prices bottomed out towards the end of 1995 and has risen since then (see Graph 8). Part of this probably reflects a shift of flows away from equity towards real estate.

The relatively strong increases in households' consumption expenditure over the past two to three years and the concomitant subdued performance of saving by households, could, on balance, be partly ascribed to the net effect of a number of factors, such as the steady increase in real-estate prices, the underlying strength in equity values, the increase in owner-occupied dwellings among a broader spectrum of the population (which increased the borrowing capacity of households) and a sustained high level of consumer confidence.

Graph 7 Average house prices relative to personal disposable income *per capita*



Graph 8 Average house prices relative to equity prices



Summary and conclusion

The empirical estimates presented in this overview indicate that household borrowing patterns have changed substantially over the past three decades. After having varied only slightly around an average of approximately 45 per cent in the

1970s, the ratio of household debt to personal disposable income increased sharply to 55 per cent in 1985. During the ensuing period until 1993 the debt-to-income ratio of households varied around an average of 51½ per cent, before rising to a new high of 60½ per cent during the period 1996 to 1998. Over the past two-and-a-half years, the debt-to-income ratio of households has gradually declined to an average level of 53½ per cent in the first half of 2002.

Likewise, the composition of household debt was also subject to change. Mortgage advances to households relative to total household debt declined from an average of 57 per cent in the 1970s to a low of 40½ per cent in 1984. A mirror image of this development was that the importance of consumer credit as a portion of household debt increased to a high of 59½ per cent in the corresponding period. In the mid-1990s mortgage advances relative to total household debt increased again and reached a level of 57 per cent in 1994 – recently this ratio slipped back to 54½ per cent. The growing popularity of mortgage debt can partly be attributed to an increase in the use of mortgage equity withdrawals, facilitated by the more flexible mortgage advance procedures created by the banks.[3]

3 Mortgage equity withdrawal represents borrowing that is secured on the housing stock but not invested in it. Hence it makes additional funds available (at a lower cost than unsecured loans) for reinvestment in financial assets or to finance consumption expenditure.

The increased importance of bank-intermediated credit to households in the first half of the 1980s and the greater flexibility in household mortgage advances since the beginning of the 1990s seem to indicate that the rising household debt burden was partly caused by financial deregulation and the liberalisation of financial markets during these periods. In general, increased competition in credit markets probably contributed to the lower cost and wider availability of consumer credit. Accordingly, these developments may have allowed some households that had previously been credit-constrained, to move closer to their "optimal" consumption levels, contributing to the underlying strength of borrowing and consumption growth.

In recent years the impact of rising asset prices on household wealth has probably contributed substantially to the subdued performance of households' saving ratio and the prevailing high level of household debt. An important source of the perceived wealth of households was the steady rise in house prices in recent years and households also benefited by the capital gains from rising equity prices. These developments, coupled with a decline in the rate of inflation, have probably allowed households to achieve a given level of wealth with less saving over the past three years.

Though monetary policy can influence real economic activity in several ways, changes in households' balance sheets may have implications for the way that a change in policy-controlled interest rates (the interest rate on repurchase transactions) affects output and the Reserve Bank's ultimate objective, namely price stability. Monetary policy affects the economy "directly" through the impact of market interest rates on expenditure. However, changes in the repurchase rate can have additional effects through the movements induced in asset values and balance sheets. When long-term interest rates decline in response to a change in the monetary policy stance, this will result in an increase in asset values and, accordingly, in household wealth. Consequently, a higher level of wealth should enable households to reduce their saving and increase their consumption.

Although the household debt and wealth estimates provide valuable information about the changes in the balance sheet of households, full balance sheets are not currently compiled for the South African economy. This area provides an opportunity for further research that will undoubtedly improve the analysis of the links between monetary policy changes and the saving and spending decisions of households.

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