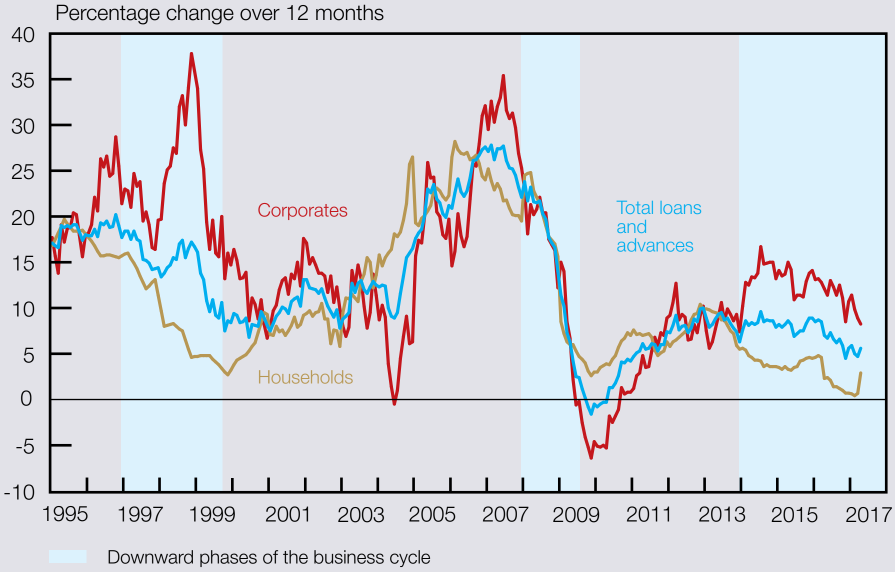
Box 4 Long term trends in credit extension to households and corporates

Credit extension to households and corporates experienced several periods of divergent growth over the business cycle. Growth in credit extension to households tends to start decelerating ahead of peaks in the business cycle. By contrast, growth in credit extension to corporates on occasion continues to accelerate beyond peaks in the business cycle into the early stages of the subsequent downward phase. This delayed response indicates that corporates tend to be less sensitive to weak economic conditions than households. Credit growth to corporates also generally displays a higher amplitude than that to households. During the current business cycle (the most recent upward and downward phase) growth in credit extension to both the household and corporate sectors has been significantly more moderate than during previous business cycles.

Total loans and advances to the household and corporate sectors



Source: SARB

The divergence between growth in credit extension by banks to households and corporates reveals credit standard differentiation among economic sectors, especially during times of slower economic growth. This reflects the more flexible and relatively stronger financial positions of corporates compared to the household sector. Some of the factors that contribute to corporates' ability to obtain credit more easily than households include their ability to:

– pass the effect of rising costs on to consumers;
– retrench staff to cut costs in times of tough trading conditions;
– source income from offshore activities and to benefit from a depreciation in the exchange value of the rand, which may contribute to and support cash flow and savings;
– benefit from a wide range of tax deductions and the write-off of previous losses from taxable income; and
– source funding at lower interest rates than the household sector due to favourable credit risk profiles and relationships with banks.

In the aftermath of the East Asian crisis in 1998, growth in total loans and advances decelerated to an annual average of 8.5% in 2000 from an average of 17% between 1995 and 1998. This period was also marked by disparate growth in credit extension to the household and corporate sectors. The downward phase of the business cycle from late 1996 to 1999 had a marked impact on credit extension to the household sector, while credit extension to the corporate sector maintained strong growth. Growth in loans and advances to the household sector plummeted to rates of below 3% in late 1999, at which stage credit to the corporate sector still grew at around 15%. Year-on-year growth in credit extension to the corporate sector only reached a lower turning point of 6.7% in December 2000.

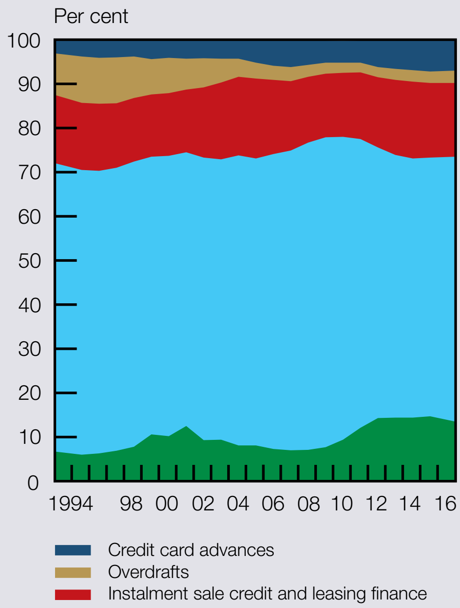
During the subsequent upward phase of the business cycle, growth in credit extension to the household sector accelerated steadily to average 26% in 2006, while growth in credit extension to the corporate sector only peaked in mid-2007. This upward phase was noted for a boom in consumption expenditure and fixed investment. Throughout most of this period, robust growth in loans and advances extended to the private sector was supported by favourable lending and borrowing conditions, rising real disposable income, strong growth in domestic consumption expenditure, high levels of consumer and business confidence, and a buoyant real-estate market. Growth in credit extension was also supported by relatively low interest rates, a rebound in the corporate sector's demand for bank-intermediated funding and wealth effects associated with the rapid rise in domestic real estate prices.

In the wake of the global financial crisis, the end of the pre-2008 property boom saw an almost sudden stop in mortgage advances extended to the corporate sector. Although there was a slowdown in almost all types of corporate credit, demand for general loans by the corporate sector slowed quite sharply. Growth in total loans and advances to the corporate sector slowed from rates in excess of 30% prior to the global financial crisis to negative rates in 2009.

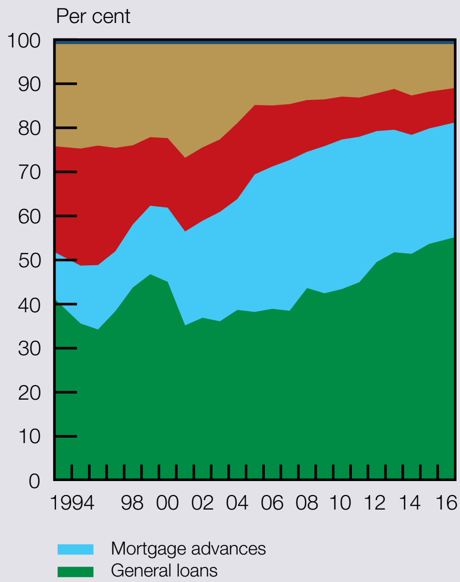
Growth in credit extension to the household sector decelerated to less than 3% by the end of 2009. Household credit growth was further constrained by, among other factors, the introduction of the National Credit Act (NCA) in 2007 which led to tighter lending criteria by banks, increased international regulatory requirements, slower global and domestic economic growth, and weak consumer and business confidence. These factors, together with the progressive tightening of monetary policy up to mid-2008, contributed to a general slowdown in demand for bank credit.

The prolonged period of weak economic conditions following the global financial crisis impacted the credit risk profiles of households to the extent that a credit amnesty was introduced in 2014 to provide relief to many indebted consumers. The difficult economic environment resulted in household consumption expenditure growth moderating to 0.8% in 2016 from 1.7% in 2015, along with a sharp decline in spending on durable goods. In recent years, the balance sheets of households have been quite strained due to rising living costs, high levels of indebtedness limiting access to new credit, higher interest rates as well as insufficient employment creation.

Changing composition of loans and advances to the household sector



Changing composition of loans and advances to the corporate sector

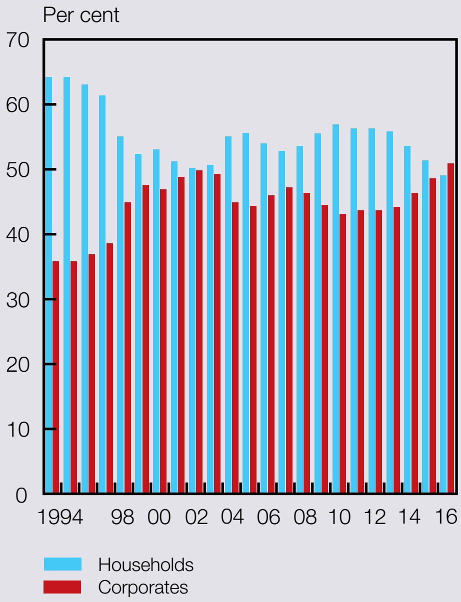


Source: SARB

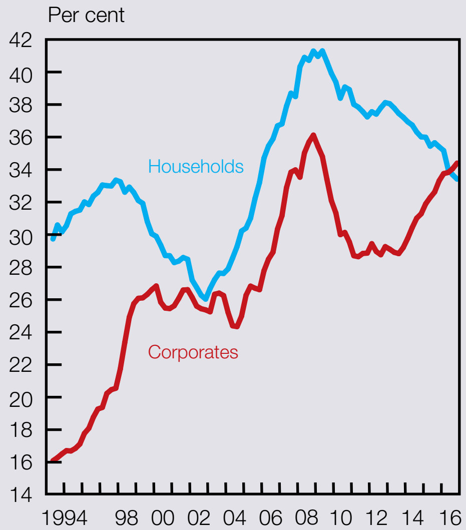
Growth in credit extension to the household sector decelerated across various types of credit from the start of 2013. Mortgage advances, the largest component of household credit, was the main driver behind the subdued growth. General loans to households (mostly unsecured loans) gained in popularity from 2009 with growth accelerating to just less than 40% in 2011, before closer regulatory scrutiny resulted in it decelerating from 2013 onwards. General loans to households currently account for less than 14% of all loans extended to households. Growth in instalment sale credit and leasing finance (predominantly used for the funding of vehicles) also started to decelerate from 2013. This, together with a contraction in new vehicle sales at the time confirmed the effect of challenging economic conditions on consumers and the business sector over a wide front. Growth in credit extension to corporates started to slow gradually from mid-2014, as the increasingly tough economic and trading conditions eventually also impacted the corporate sector.

In recent years, growth in credit extension to the corporate sector was supported by firm growth in general loans and mortgage advances on commercial property. General loans are the largest category of credit utilised by corporates and include term loans and structured loan funding. General loans as a ratio of the total outstanding balance on corporate credit have increased from less than 44% in 2009 to more than 55% since early 2016, making it the fastest-growing component of credit extension to the corporate sector. The revival in general loans to companies was supported by an increased number of private-sector companies involved in renewable energy projects making use of this type of finance. Furthermore, the provision of equity bridging finance to assist companies undertaking expansion activities as well as corporate expansions into Africa, boosted this type of finance. The growth in general loans occurred at the expense of mortgage advances to corporates, as its share of total corporate credit diminished in the aftermath of the financial crisis, despite its growth rate accelerating up to 2015.

Total loans and advances: changing distribution of outstanding balances



Total loans and advances as a ratio of gross domestic product



Sources: Stats SA and SARB

The importance of the ratio of private sector credit extension to gross domestic product (GDP) was highlighted when the Basel Committee on Banking Supervision proposed that banks hold additional capital at times when the ratio exceeds its long-run trend. By separately displaying the ratio of loans and advances of the household and corporate sectors to GDP, it is possible to distinguish which of these sectors have recorded the strongest relative growth in credit extension.

As a ratio of GDP, credit extended to, and owed by, the household sector has exceeded that of the corporate sector in recent decades. However, the persistent slowdown in credit growth to the household sector, together with robust growth in demand for credit by the corporate sector, is unsettling this historic trend. Subsequent to the global financial crisis, the gap between the ratios of credit extended to households and corporates to GDP widened as the sectoral composition of credit changed. Growth in mortgage advances, the largest component of credit extension and predominantly taken up by the household sector, decelerated notably while the uptake of general loans increased. Initially, this was due to an acceleration in growth of general (unsecured) loans to households, but after 2013 the corporate sector increased their demand for funding through general loans. The brisk growth in general loans to companies that were supported by growth in mortgage loans on commercial property then brought the ratio of credit to GDP of households and corporates closer together. However, on aggregate, the recent trends probably reflect banks' preference to provide credit to the more financially sound corporate clients rather than to households, given subdued economic growth. Credit conditions could remain relatively tight for the household sector in the foreseeable future as unemployment remains high and as a significant proportion of credit active consumers are struggling to service their existing debt.