Box 7 What does the loan-to-deposit ratio tell us?

Loan-to-deposit ratios[1] provide insights into imbalances between credit and deposits; availability of liquidity and reliance on credit; and shifts in liquidity preferences and demand for credit.

In South Africa, the total nominal stock of domestic private sector deposits (M3) generally exceeded the nominal outstanding balance of this sector's total loans and advances over the past 18 years. The domestic private sector's relatively stable loan-to-deposit ratio fluctuated around an average of 0.97 and mostly below the equilibrium ratio of one, indicating a marginal imbalance in favour of deposits. By contrast, and as could be expected, the loan-to-deposit ratios of households and companies displayed quite divergent levels and offsetting trends over this period. Generally, loan-to-deposit ratios indicate a smaller imbalance for corporates than households, with companies favouring deposits as opposed to households' reliance on credit. However, during the current downward phase of the business cycle, corporate credit growth exceeded deposit growth and household deposit growth exceeded credit growth. The shift in households' liquidity preferences and demand for credit has lowered their loan-to-deposit ratio to 2003 levels, reflecting an improved balance between deposits and loans.

Companies' loan-to-deposit ratio, which has been consistently below one since 2000, indicated a small imbalance between credit and deposits, in favour of deposits, and a general availability of liquidity from own sources for the sector as a whole. However, subtle shifts between growth in deposits (changes in liquidity preference) and loans (demand for credit) is observable from changes in the level of the loan-to-deposit ratio and its trend over the business cycle, and amid external shocks. Corporates' loan-to-deposit ratio trended lower since 2000 as growth in deposits mostly exceeded that of credit during the long upward phase in the business cycle, along with profit growth. Credit growth only briefly surpassed that of deposits towards the end of that economic upswing.

During the global financial crisis, corporate credit growth slowed more than deposit growth and the loan-to-deposit ratio receded further to a low of 0.55 in December 2010. Thereafter, corporates' loan-to-deposit ratio trended higher throughout the upward phase in the business cycle that followed the global financial crisis, and also during the subsequent downward phase. However, both corporate deposits and

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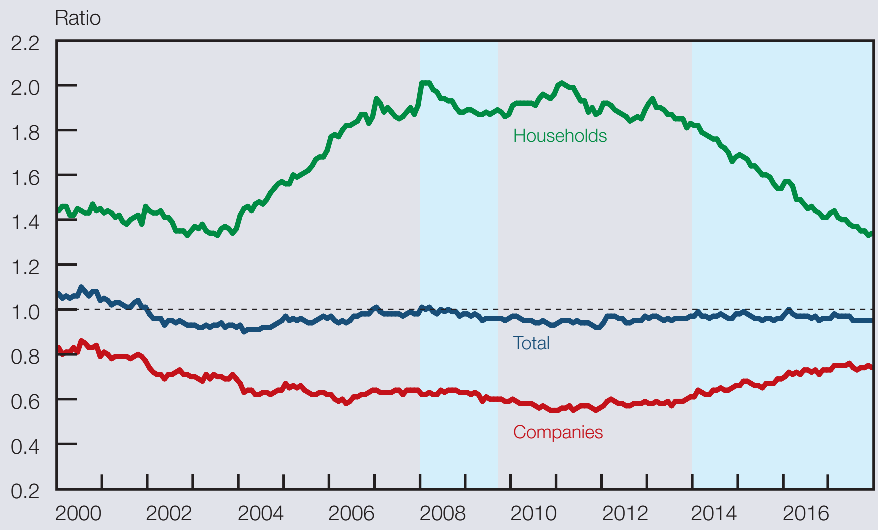
1 The loan-to-deposit ratio of the domestic private sector for the economy as a whole is calculated as the sum of the household and corporate sectors' outstanding balance of total monetary sector loans and advances (excluding indirect forms of credit extension such as the holdings of bills and bonds) divided by the broadly defined money supply (M3). At sector level, the ratio is derived as the specific sector's loans and advances received from monetary institutions divided by the sector's holdings of deposits.

Loan-to-deposit ratios



Downward phases of the business cycle

Source: SARB

credit grew at a much slower pace than during the preceding decade in an environment of relatively weak economic activity, with credit growth mostly exceeding deposit growth. Credit demand was boosted by an acceleration in mortgage advances on commercial property, general loans to fund renewable energy projects (although this has dwindled somewhat in the past two years), and cross-border expansion activities into Africa and the euro area in particular.

Companies

Downward phases of the business cycle

Source: SARB

Households' loan-to-deposit ratio mirrored that of companies and has been consistently higher than one since 2000, displaying a large imbalance between credit and deposits, in favour of credit, and a general reliance on funding by the sector as a whole. Changes in the level of the loan-to-deposit ratio and its trend over the business cycle and amid external shocks also reflect subtle shifts between growth rates in deposits (changes in liquidity preference) and loans (demand for credit).

The loan-to-deposit ratio of households increased rapidly from late 2003 to a high of 2.01 in March 2008, as growth in credit to finance household consumption expenditure greatly exceeded growth in deposits during the upward phase of the business cycle. Subsequently, the ratio fluctuated broadly sideways before receding rapidly from 1.94 in February 2013 to a low of 1.33 in November 2017, as household credit growth decelerated during the current downward phase of the business cycle and deposit growth accelerated, reflecting a clear shift towards a preference for the liquidity of deposits.

Households

Downward phases of the business cycle

Source: SARB