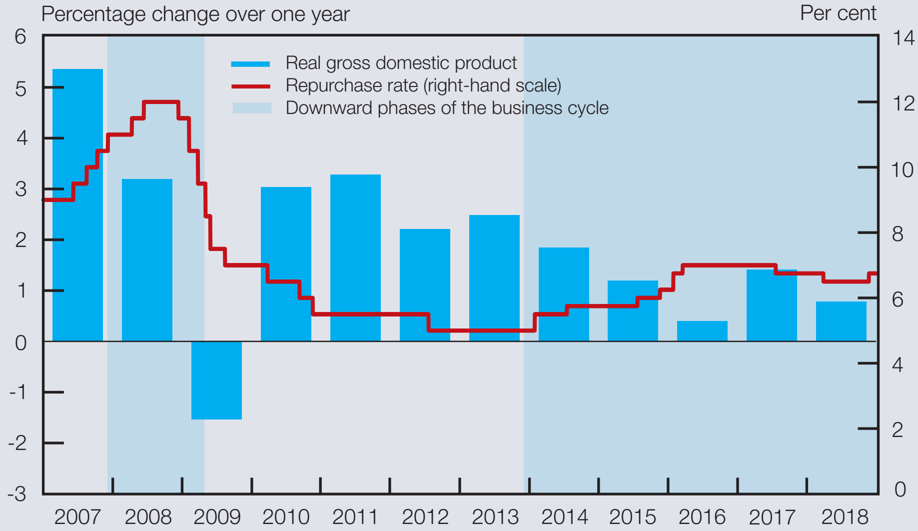
Box 4 Drivers of households' borrowing and deposit rates[1, 2]

Fairly persistent weak domestic economic activity in the wake of the global financial crisis tightened credit standards and the international regulatory regime. The change in the composition of bank credit to households towards more expensive credit contrasted with higher deposit rates. Borrowers have not always benefitted from a lower repurchase rate but, on balance, households' net interest burden declined.

The level and trend of interest rates, and the changes therein, reflect economic conditions and associated policy responses as well as regulatory requirements – all of which affect the demand and supply of credit and deposits. Credit extension is further influenced by banks' willingness to lend and households' ability to repay debt. The lending rates charged by private sector banks on loans and advances extended to households reflect the continued reassessment of borrowers' credit risk profiles relative to banks' appetite for credit, liquidity and interest rate risk, all of which influence the risk premium added to the funding cost. Interest rates on different types of loans also differ due to, among other factors, dissimilar term structures and underlying collateral.

Credit standards tightened in the wake of the global financial crisis and the 2008-09 recession in South Africa, which was followed by a relatively weak upward phase of the business cycle that turned into a protracted downward phase at the end of 2013. This was accompanied by relatively accommodative monetary policy[3] while regulatory requirements exerted upward pressure on costs as banks geared up to comply with Basel III requirements.[4] This increasingly changed banks' focus towards more stable sources of funding and compliance with more stringent liquidity requirements. Some of these adjustments and higher interest rates from tighter credit standards discouraged long-term mortgage lending, while gradually higher deposit rates encouraged household deposits.

Economic activity and monetary policy



Sources: Stats SA and SARB

Since the global financial crisis, the composition of bank credit extended to the household sector changed noticeably as growth in general unsecured loans and instalment sale credit accelerated and that of mortgage advances slowed. This not only changed the composition of banks' and households' exposure to different types of loans, but also increased households' exposure to loan categories with higher interest rates, increasing the interest burden. This is reflected by the trends in the weighted average interest rates[5] charged on the different categories of loans.

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1 The analysis is based on data collected from the South African Reserve Bank BA930 surveys of registered South African banks.

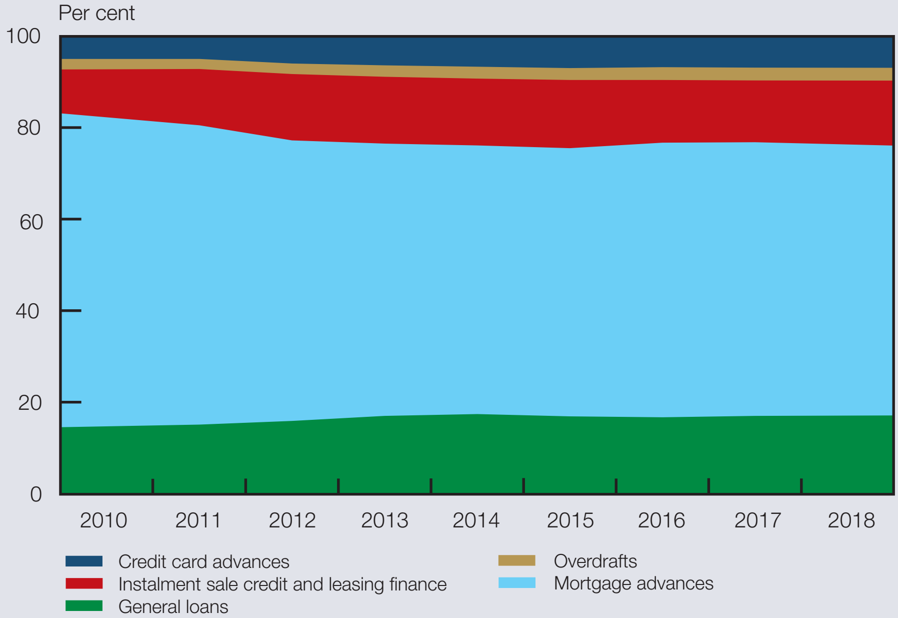
2 This box reflects selected statistics of interest rates on deposits as well as loans and advances published in the tables on page S–30 of this *Quarterly Bulletin*.

3 The repurchase rate initially declined from a peak of 12.00% per annum in November 2008 to a low of 5.00% in 2012, and then remained unchanged until early January 2014 before increasing by a cumulative 175 basis points to its current level of 6.75%, effective November 2018 – inclusive of 25 basis points decreases in both June 2017 and March 2018.

4 The Basel Committee on Banking Supervision developed Basel III as a comprehensive set of reform measures to strengthen the regulation, supervision and risk management of the banking sector. Actual implementation was scheduled from January 2013 to January 2019.

5 Weighted average interest rates are reported by banks on both new and existing loans for each credit category.

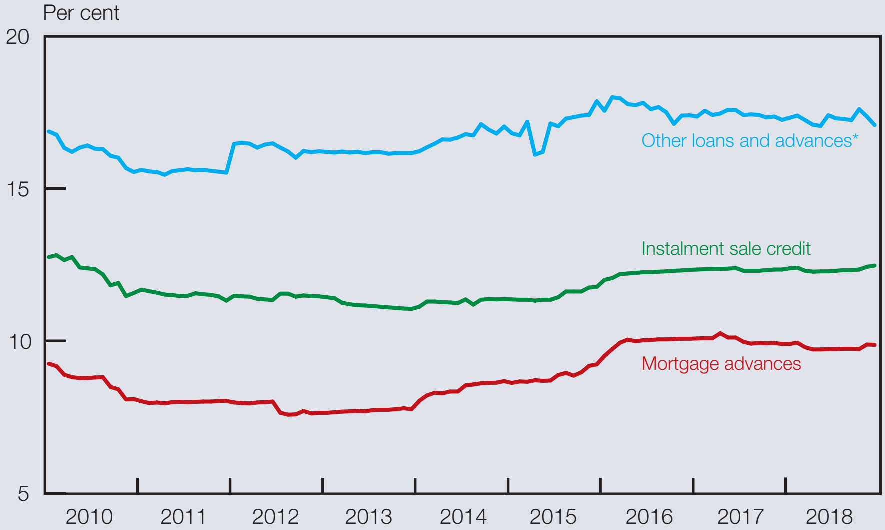
Composition of household sector loans



Source: SARB

The weighted average interest rate on mortgage loans is significantly lower than that on other types of loans, such as general unsecured loans, due to underlying real estate collateral and repayment periods of up to 30 years. However, since the end of the property boom in 2008, banks' credit standards have tightened and the weighted average interest rates on mortgage advances have increased while remaining relatively stable on most other types of loans.

Weighted average interest rate on household loans

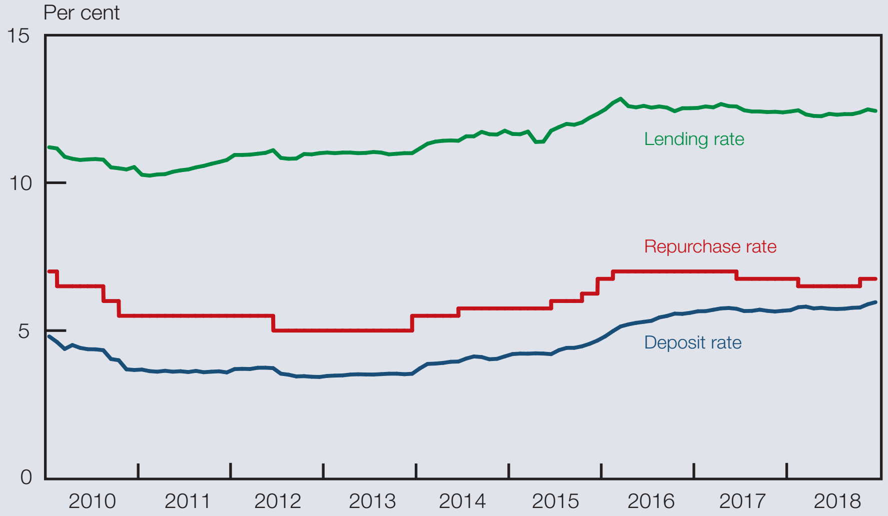


* Includes credit card advances, overdrafts and general loans

Source: SARB

Households' overall weighted average lending rate[6] trended higher from 10.24% in February 2011 to 12.59% in April 2016, and levelled off thereafter. This reflects the structural change in exposure towards loans with higher risk premiums, whereas banks' quest for more stable funding drove up households' weighted average deposit rate.

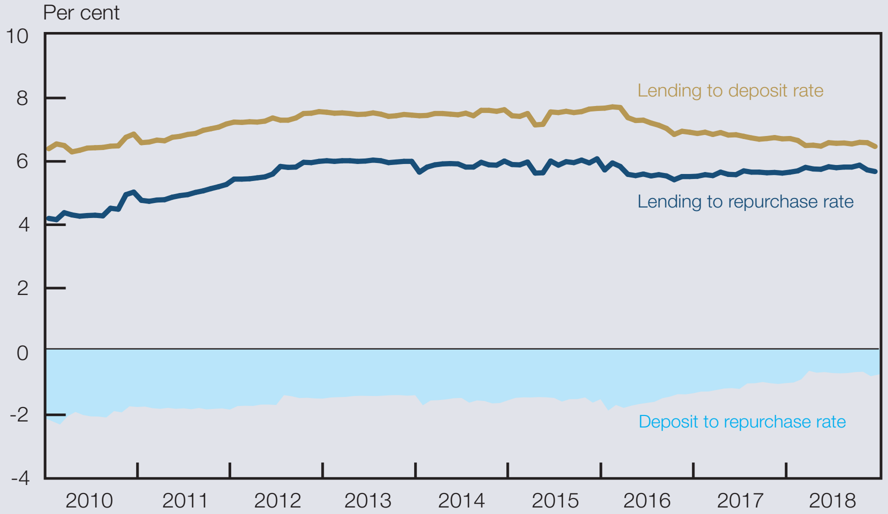
Households' overall weighted average lending and deposit rates and the repurchase rate



Source: SARB

The drivers of interest rates at times pushed lending rates higher when monetary policy became more accommodative, and lately caused deposit rates to move against the trend in the repurchase rate. This is reflected by changes over time in the difference between both lending and deposit rates relative to the repurchase rate. As borrowers, households therefore did not always benefit fully from a lower repurchase rate. However, more recently, households benefitted from the narrowing of the difference between lending and deposit rates as this, on balance, reduced their overall net interest burden, with the outstanding balance of loans exceeding the outstanding balance of deposits.[7]

The difference between household lending and deposit rates, and the repurchase rate



Source: SARB

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6 Households' overall weighted average lending (deposit) rate is derived by applying the weighted average rates to each credit (deposit) category. While each bank reports its own weighted rate per category, these rates are then aggregated and weighted across the various banks using outstanding balances.

7 See 'Box 7: What does the loan-to-deposit ratio tell us?' in the *Quarterly Bulletin, No. 287, March 2018:* p. 58–60. Pretoria: South African Reserve Bank. Also available at http://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/8361/07What%20does%20the%20loan-to-deposit%20ratio%20tell%20us.pdf