Box 5 Drivers of the recent growth in deposits and credit[1,2,3]

Growth in both bank credit extension[4] and deposits[5] accelerated recently with year-on-year increases almost doubling, though remaining in single digits. Growth in both money supply (M3) and total loans and advances slowed sharply in the wake of the global financial crisis of 2007/08, with credit extension contracting in the latter part of 2009 and early in 2010. Thereafter, both credit extension and deposits increased along broadly similar trajectories, but growth remained weak compared to pre-crisis levels.

This box analyses the drivers of the recent stronger growth in deposits and credit by looking at the contribution to growth from the type of deposit and credit as well as from institutional sector dimensions. Seemingly, the acceleration in credit growth in 2019 was mainly driven by general loans to companies, in particular, financial companies responding to political and financial market uncertainties, and not by non-financial companies usually affected by underlying economic activity. This supported growth in longer-term deposits of financial companies which, in addition to coupon payments on government bonds, supported growth in M3. Therefore, the recent acceleration in growth, in both deposits and loans, most probably reflects idiosyncratic short-term developments rather than an improvement in economic activity.

One of the drivers of growth in M3 is the change in deposit holders' *maturity preferences by type of deposit*. Cash, cheque, transmission and demand deposits, which reflect salaries and wages, among others, were the dominant contributors to overall growth in money supply from 2010 to 2017. Since then, their contribution declined as that of short- and medium-term deposits increased first, followed by that of long-term deposits. Long-term deposits already increased from the fourth quarter of 2018 amid heightened risk aversion in the

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1 Unless stated to the contrary, all the growth rates in this box for both calendar years and quarters reflect averages of monthly year-on-year rates.

2 The methodology to compile South Africa's monetary and financial statistics adheres to the guidelines of the Monetary and Financial Statistics Manual and Compilation Guide, 2016, of the International Monetary Fund, available at https://www.imf.org/~/media/Files/Data/Guides/mfsmcg-final.ashx

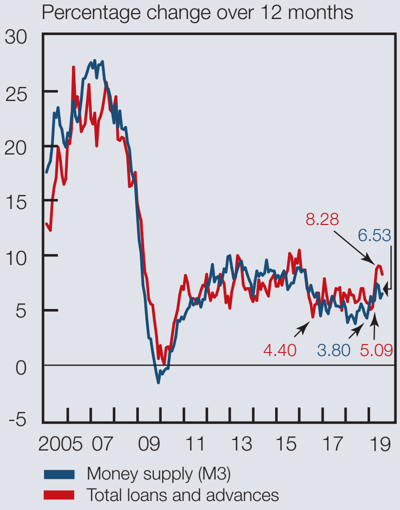
3 This box relates to money supply and credit extension statistics shown on pages S–22 and S–23 of this *Quarterly Bulletin*.

4 Credit extension includes total loans and advances of monetary institutions (banks) extended to the domestic private sector, with credit comprising instalment sales, leasing finance, mortgage advances, general loans, overdrafts and credit card advances.

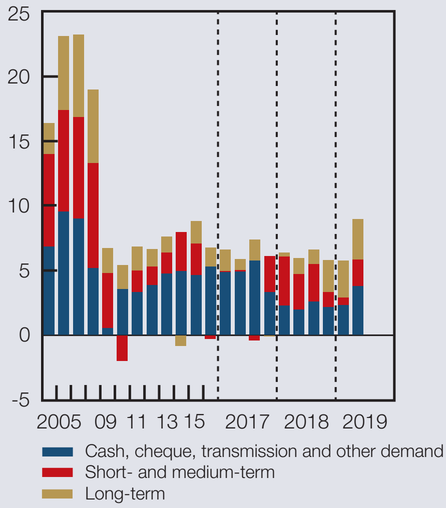
5 Deposits include M1 (bank notes and coin in circulation; cheque and transmission deposits; and other demand deposits) plus other short- and medium-term deposits (adding to M2) plus long-term deposits, adding up to the broadly defined money supply (M3).

run-up to the national elections. In 2019, deposit holders increased their holdings of both liquid short term and less liquid long-term deposits, amid continued political uncertainty and weak economic activity. This coincided with inflows related to equitable share transfers to local governments and the distribution of fuel levy allocations to metropolitan municipalities, as well as coupon payments on government bonds.

Growth in money supply and credit extension



Contribution to growth in M3 by type of deposit in terms of maturity



Source: SARB

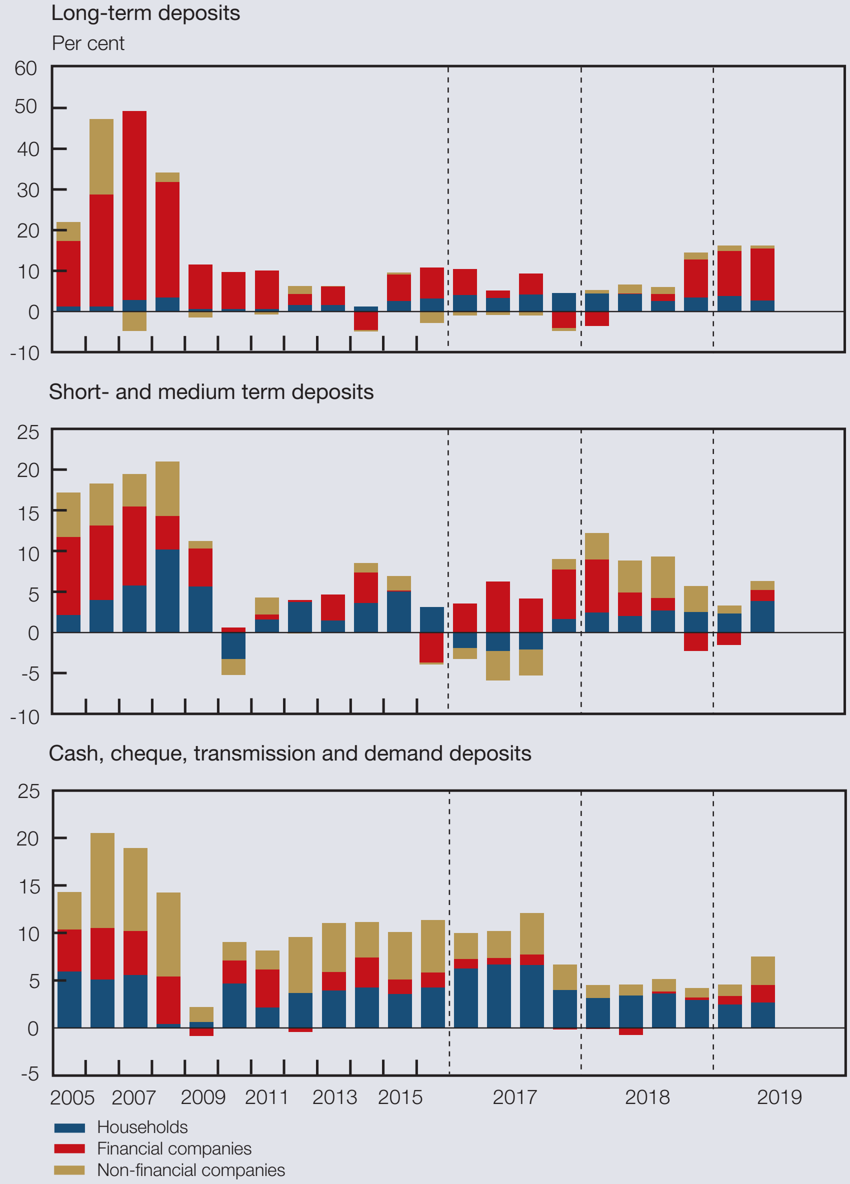
Households are the dominant contributors to growth in the most liquid part of money supply (M1) being significant holders of notes and coin, and recipients of salaries and wages. Households' contribution to long-term deposits has also increased over the years as banks succeeded in attracting such deposits, in line with Basel III[6] requirements.

Non-financial companies recently contributed more significantly to liquid deposits, along with occasional increases in short- and medium-term deposits, reflecting a build-up of cash balances amid weak gross fixed capital formation in an environment of low business confidence and subdued economic activity. However, their contribution to growth in overall M3 remained muted. Currently, non-financial companies hold slightly less than 30%, and financial companies around 37%, of total private-sector deposit balances.

Financial companies are usually the largest contributors to growth in short- and medium-term as well as long-term deposits. This applies to periods of heightened financial activity, such as from 2006 to 2008, and also to periods of subdued economic activity and weak growth in money supply. The contribution of financial companies to long-term deposits moderated somewhat during the course of 2017 and 2018, before again dominating from late 2018 and in the first half of 2019, in pursuit of stable returns amid financial market uncertainty.

6 Basel III is a comprehensive set of reform measures put forth by the Basel Committee on Bank Supervision, designed to improve the regulation, supervision and risk management within the banking sector. The Net Stable Funding Ratio requirement necessitates greater balance between banks' funding and lending profiles. This metric aims to promote resilience over a longer time horizon by creating incentives for banks to fund their activities with more stable sources of funding, on an ongoing basis.

Contribution to growth in money supply

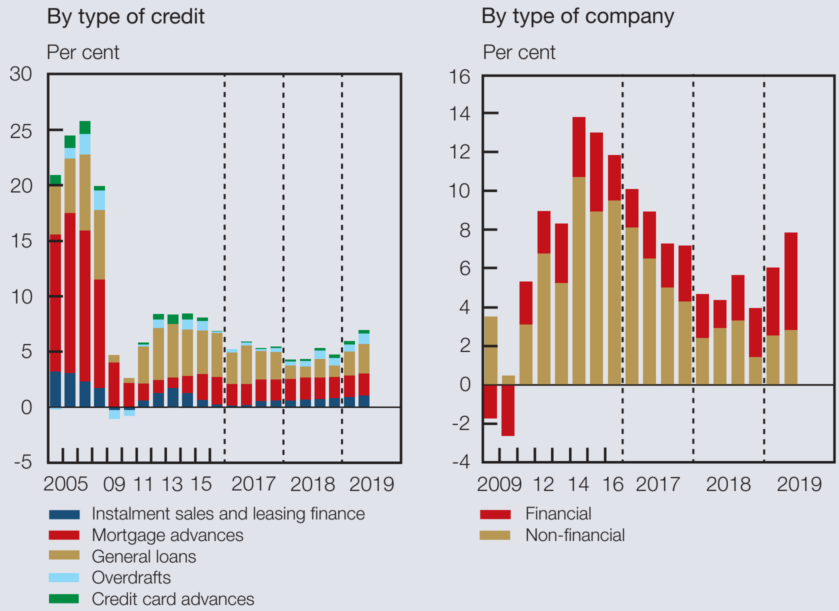


Source: SARB

By *type of credit,* the contribution of *mortgage advances* to growth in total loans and advances dominated before the global financial crisis, at around 50%, but diminished after 2008 to only 11% in 2013 and subsequently remained muted. After the global financial crisis, the contribution of *general loans* became more prominent. Nonetheless, the contribution of mortgage advances once again increased from 2014 – to more than 35% from 2016 onwards.

More recently, the contribution of general loans to growth in total loans and advances increased in the first two quarters of 2019, along with a moderate increase in such loans to households and a strong increase to companies. General loans – corporates' preferred source of funding – accounts for just more than 55% of all loans to companies. These loans are used to finance fixed investment and/or expansion, among others, and its growth normally tends to be aligned with that in overall economic activity. In contrast to these usual drivers, financial companies dominated the recent increase in general loans.

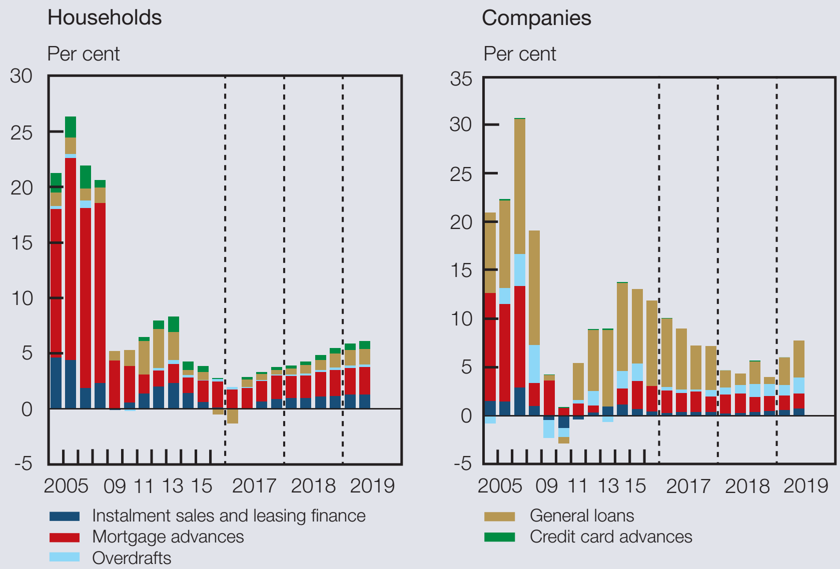
Contribution to growth in total loans and advances



Source: SARB

Historically, non-financial companies dominated credit demand, but this changed in the first two quarters of 2019 when fund managers and companies involved in securities trading, insurance and vehicle financing drove the demand for credit. The recent stronger growth in demand for credit by companies therefore does not necessarily indicate a recovery in gross fixed capital formation.

Contribution to growth in total loans and advances by type of credit to:



Source: SARB

The contribution of *mortgage advances* to growth in total loans and advances to both households and companies again became significant from 2014, with that of households increasing more than that of companies. The contribution of *credit card* advances, which is only a small portion of total loans and advances, is more relevant for households than companies. The contribution of credit card advances to growth in household credit increased to 11%, on average, in the first half of 2019, compared to less than 3% in 2016. The contribution of *overdrafts* to growth in total loans and advances to households remained subdued. By contrast, overdrafts contributed substantially to growth in credit to the corporate sector as its insignificant contribution in 2016 increased to 19% in the first half of 2019. The contribution of general loans to growth in overall loans to companies averaged around 65% from 2014 to 2017, before moderating sharply in 2018, affected by a technical adjustment related to the implementation of International Financial Reporting Standard 9, but reverted to previous levels a year later.