

Consumer Lending in South Africa

H2 2020

November 2020

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The state of the South African consumer

Overview

The South African market in Q3 has seen the Level 1 lockdown conditions remain in place despite grandstanding from lower-level politicians and a slight increase in infection rates. Critical sectors of the economy remain under pressure, especially tourism given the limited border openings and the closure of large parts of Europe amid concerns of a second wave of infections.

A recent McKinsey survey has shown that South African consumers have a higher expectation of the economy recovering in the next 12 months than some of more developed economies, although with a more pessimistic view than developing economies such as India.

Consumers seen as optimistic expect a recovery in the next 3 to 6 months, those unsure in the next 6 to 12 months and those with a pessimistic outlook expecting no short-term recovery with a high likelihood of a prolonged recession.

This is further borne out in the assessment of household income, where 79% of respondents indicated an improvement or at least the maintenance of the status quo, up from 32% in June, during the earlier stage of lockdown.

From the perspective of the lending sector, consumer repayment remained poor in Q3 with the number of accounts in default increasing by 16% y/y. This coupled with the increase in credit utilisation over the same period points to an increased level of lending distress that needs to be closely monitored over the next few quarters.

While there was some anticipation of increasing defaults as a result of the end of payment holidays provided by banks and lenders for most of Q2, this has been offset by the reduction in interest rates.

Caution is still the watchword – it will take a while for defaults to cycle through the system and the lead indicators for Q4 (October performance) show an increase in 1 month in arrears statistics.

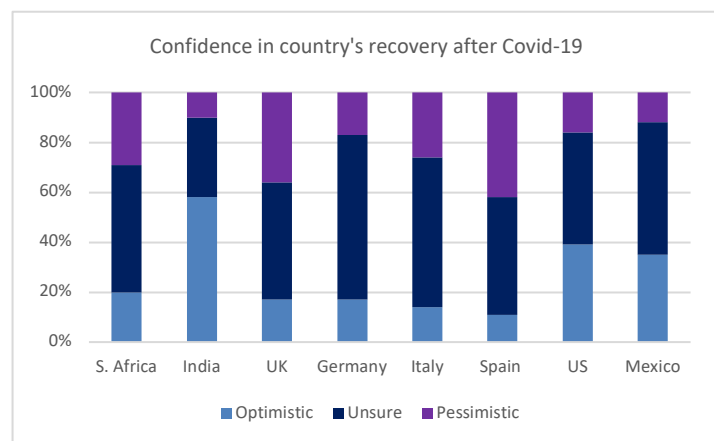


Figure 1: Source: McKinsey Covid-19 Report 2020

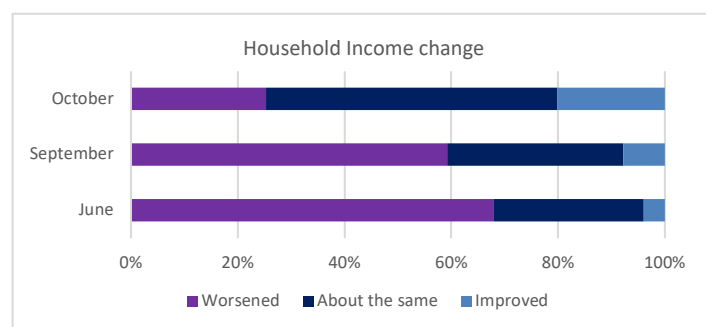


Figure 2: Source McKinsey Covid-19 Report 2020

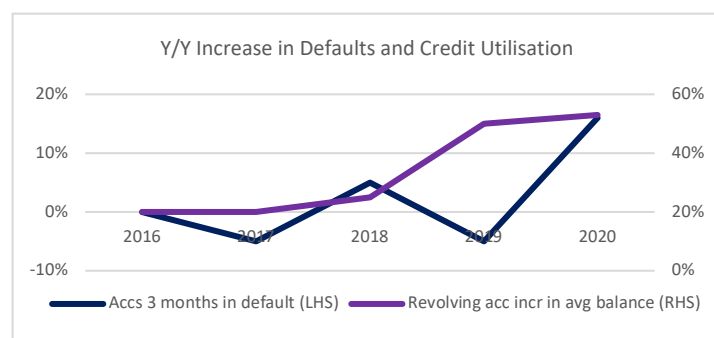


Figure 3: Source: Transunion CCI Q3 2020

Lending - Originations

The second quarter of 2020 saw a significant, and some would say catastrophic decline in the level of lending as a direct result of the the Level 5 lockdown imposed in March 2020.

There was substantial contraction across all categories while lenders, especially those dependent on brick-and-mortar distribution were forced to shutter a significant part of their branch infrastructure for two to three months resulting in sales reductions of between 60% and 80%.

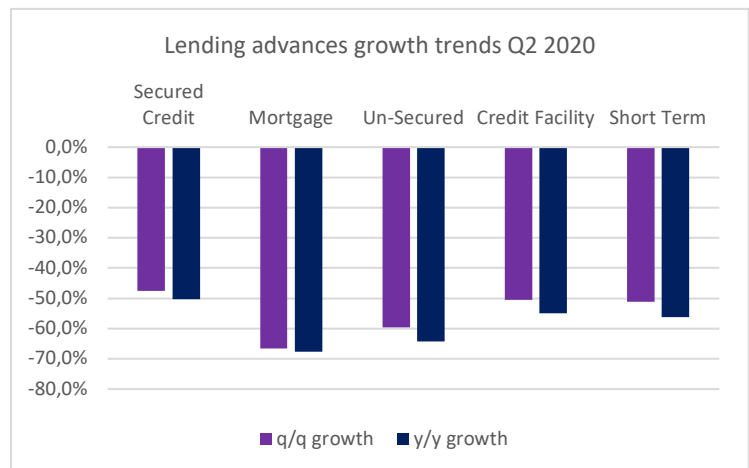


Figure 4: Source: NCR Q2 2020

Overall, total debt reduced by c. R 18bn (c. 1%) from Q1 to Q2 2020 to end Q2 at c. R 1.9trn. The largest reduction came in credit facilities, down c. R 6.9bn quarter on quarter, the first quarter on quarter reduction in facilities since the introduction of the NCA in 2007. Unsecured lending saw it's first reduction since the months after the curatorship of African Bank in late 2014 which caused a material contraction of the unsecured lending categories.

While some of this was undoubtedly the tightening of criteria by lenders, the larger contributor was a significant reduction in access and a reduction in the number of clients that applied for credit during the early stages of lockdown. Total applications reduced by c. 42% from Q1 to Q2 with approved applications falling by c. 53% over the same period. Year-on-year the approval rate fell from 45% to 33%. Based on initial market feedback for Q3 and the early part of Q4 we do expect this to recover to somewhere between these two levels and expect industry approval levels to settle at around c. 38% for the second half of 2020.

In the unsecured lending industry, the average term of new advances decreased to 10 months for Q2, down from 35.2 months in Q2 2019. This should be viewed in the context of the fact that the majority of lenders with strong online capabilities typically offer a shorter-term loan product and remained amongst the more active credit providers during the early stages of lockdown.

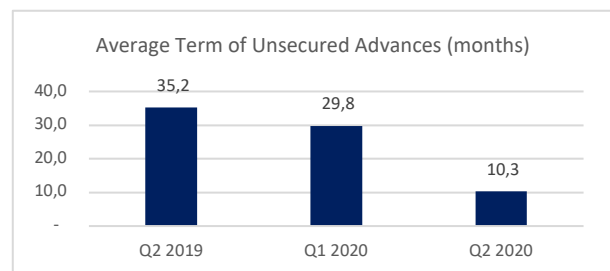


Figure 5: Source: NCR Q2 2020 Report

We expect these average terms to normalise at around the level seen in Q1 2020 for the remainder of the year as well as the average loan size of unsecured loans granted to remain relatively constant at c. R 38k, a level it has held at since early 2019.

Lending - Performance

There was an interesting webinar at the start of the Level 5 lockdown in South Africa that compared a lending portfolio to a “huge bag of uncertainty” and I think that all lenders took this view as we entered a period where there were limited data points available to be able to predict the actual experience that would be observed.

There was a visible increase in the level of Non-Performing Loans (NPL’s) across the industry during the first four months of the lockdown.

The increase in mortgage defaults from 3.9% to 5.1% represents a c. R 11bn (or 31%) increase in defaults over the past 12 months.

The increases in the facilities, secured credit and unsecured lending segments was expected, even in the absence of Covid-19, and can be seen to be an acceleration of “bubble” we saw in the unsecured and vehicle finance markets and predicted in our H2 2019 report.

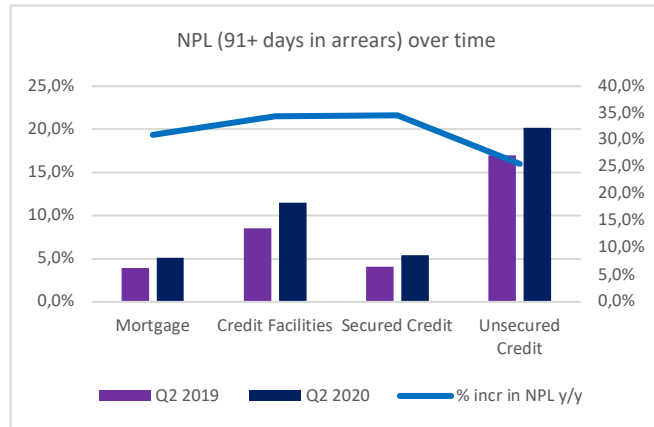


Figure 6: Source NCR Q2 2020

The trend in mortgages is more concerning however given the willingness of the banks to enter into payment arrangements with clients through the lockdown period. We will closely monitor this to see if defaults normalise at this level or whether we observe some form of recovery over the second half of 2020.

Judgements and Adverse listings declined over the same period (the courts were closed for lockdown and only reopened at the end of June).

Industry collection (the amount of payments successfully collected through the industry payment mechanisms versus what was expected to be paid) fell sharply through the early stages of lockdown (March to May)

From June onwards there has been a steady recovery to September 2020 to end in line with the seasonal trends that we have historically observed.

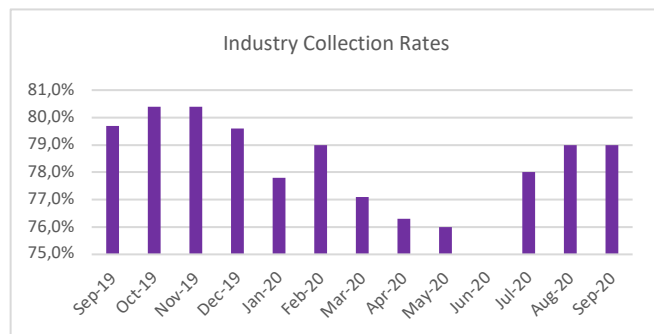


Figure 7: Source PASA Industry Report Sep 2020

We expect the traditional seasonal experience to continue into early 2021.

GetBucks through the lockdown

The business had already taken a significant amount of corrective action on the loan portfolio in 2019 as we reshaped the credit risk approach, the loan process, and our position in the market that the loan portfolio entered the lockdown in a significantly more insulated state than those of other providers.

Heading into the initial phases of lockdown we also made the following changes to our risk assessment criteria,

- 1) We retrained our credit scorecards to remove characteristics that might create a false positive based on the change in data (e.g. consumers that received payment holidays from other providers appeared to have much better cash-flow on their bank statements than was actually the case)
- 2) We reviewed our sector and risk exposures and reduced exposures to sectors that were more highly impacted by the lockdown than others (e.g. hospitality)
- 3) For our payroll portfolio, we restructured payments for impacted employees to align with their lower salaries and have slowly increased their repayments as their salaries have recovered to normal levels.

While this initially impacted sales levels, with advances falling to 50% of their pre-Covid-19 levels, there was a sharp recovery to the point where we are now trading at a consistent level in line with the sales levels in H2 2019.

We closed our 1-month and 2-month term product lines (part of our strategy to move away from being perceived as a microlender) and increased our maximum loan amounts for returning direct debit and payroll clients to R 12k and R 30k respectively which has contributed to the recovering sales levels.

Our collection rates have consistently outperformed the industry during lockdown and remained consistent through the harder stages of lockdown before trending sharply positive in September and October.

We have already implemented strategies to manage the seasonally higher risk collection months of December and January to ensure that the portfolio remains insulated over the period.

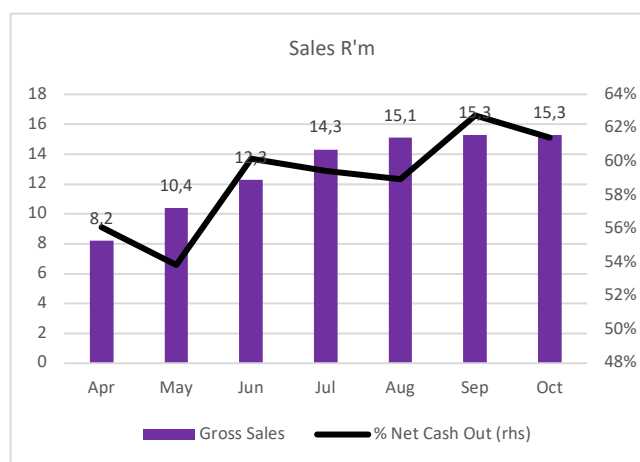


Figure 8: GBSA Gross Monthly Advances

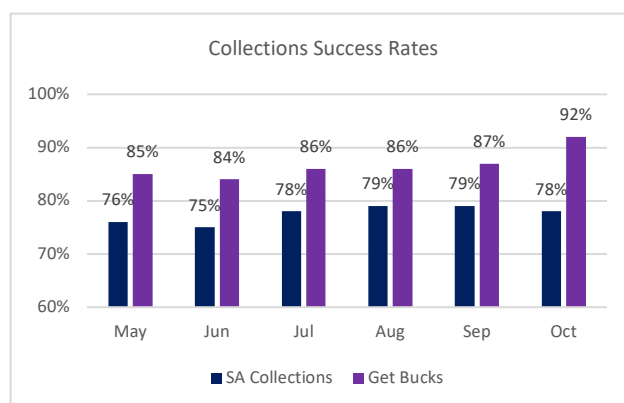


Figure 9: Source PASA and GBSA

Our NPL rates reflect this improving performance, reinforcing the benefits of a strong origination process, a focus on a quality portfolio supported by risk focused operational processes.

We have managed to maintain an improving NPL rate while at the same time growing our approval rates in the second half of the year.

We were extremely conservative through H1 as we strove to understand the shifts in consumer data. This allowed us to recover exponentially in the second half of the year while still maintaining a high level of quality advances.

This quality is further evidenced in our First Payment Missed metric, a strong lead indicator of portfolio quality which has been running at less than 1% for the past six months, compared to 5%+ in 2018 and against an industry benchmark of 3%.

In closing

While the lending sector will remain under pressure in the first quarter of 2021, some of this pressure is driven by the historical “growth at all costs” strategies of certain credit providers. We are cautiously confident of our ability to continue to scale what has become a materially better-quality loan portfolio over the first half of 2021, as we grow into new market segments.

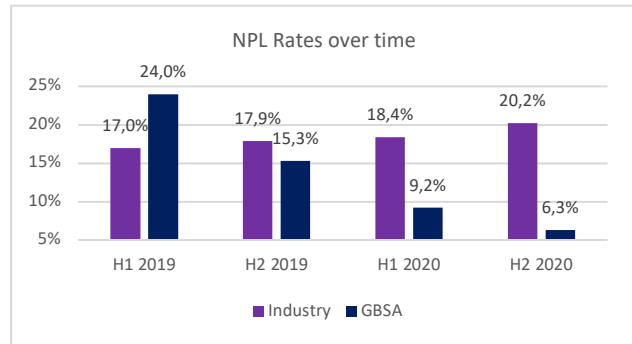


Figure 10: Source NCR and GetBucks

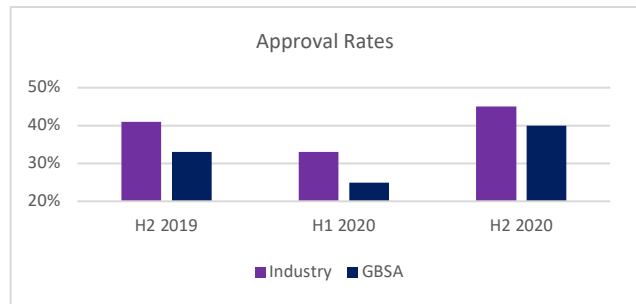


Figure 11: Source: NCR and GetBucks