Commercial Banks and Other Deposit Taking Institutions Household Indebtedness Survey Report

November 2018

Executive Summary

This survey measures the level of household indebtedness using data collected from all domestic commercial banks and deposit taking statutory banks, namely Botswana Savings Bank (BSB) and BBS Limited.

It is envisaged that the findings of this survey will guide the implementation of the Bank's macro-prudential policy as well as determine the extent of vulnerability of the financial system to the household sector. In this survey, the term debt means loans taken by households, differentiated into housing loan, motor vehicle loan, credit card loan and personal or unsecured loan; the types of loans that are normally associated with household debt.

The findings indicate that about 59 percent of the loans to the household sector financed unsecured personal lending, while around 34 percent was for residential property. The rest was for motor vehicles (5 percent) and credit cards (2 percent). The higher ratio of total household loans to total bank loans in 2017 (64 percent) is an indication that the distribution of credit is more skewed towards consumer borrowing. This is a worrisome situation given that there are concerns about the level of household indebtedness.

The survey also finds that men take up more loans from banks than their female counterparts, both in number of customers and outstanding balances. The proportion of borrowing by youth is low, suggesting that youth have limited access to bank lending and/or signalling the high level of youth unemployment (hence they have low or no income).

The study concludes that since the majority of borrowers have formal employment, the potential threat to financial stability that could stem

from the sector is lessened significantly. However, monitoring of the sector's levels of indebtedness will continue.

A limitation of the study is the exclusion of non-bank financial institutions that extend credit to households, which was beyond the study's scope. Future surveys will focus on this sector as well.

1. INTRODUCTION

1.1 In the last decade, global and domestic economic developments have led to modest wage increases, while price increases have also been modest. Domestically, annual average cash earnings increased by 5.1 percent in 2017, while inflation was 3.2 percent. Generally, the effect suggests a positive net increase in purchasing power. However, in order to smoothen expenditure, households increasingly use debt, thus leading to elevated levels of indebtedness. These developments provided the motivation for this survey.

1.2 This survey measures the features of household debt, including debt service capacity and the alternative sources of funding. The debt service ratio is a key parameter for assessing the capacity of households to service their debt obligations. The analysis makes use of information gathered from all deposit-taking financial institutions except Savings and Credit Cooperative Societies (SACCOs).

1.3 The survey focuses on annual data only. By the end of December 2017, total outstanding loans to households amounted to P38 billion, constituting about 64 percent of banks' total loans (including statutory banks). The amount translates to a ratio of 20.9 percent for household debt to gross domestic product (GDP). Compared to other countries, this ratio remains low. For example, in 2007, Malaysia reported a ratio of 65 percent while South Africa's ratio was 33.1 percent. Total bank lending to households in Botswana increased by 6.5 percent in 2017, lower than the 8.3 percent recorded in 2016. This compares with respective total credit growth rates of 5.1 percent and 6.7 percent in 2017 and 2016.

2. DATA AND METHODOLOGY

2.1 The survey seeks to identify the level of indebtedness of domestic households. The survey covered all domestic commercial banks and the two statutory banks. It was conducted for the three-year period from 2015 to 2017. In order to achieve the objective of the survey, primary data was collected using a questionnaire and from statutory returns previously reported to the Bank of Botswana. The questionnaire consisted of eleven items and questions that measure the capacity of households to service their debt, and banks' strategies on sectoral lending, looking ahead.

2.2 In this survey, the term debt refers to loans taken by households (individuals or persons representing themselves or their families). Simply put, debt is a credit facility that can allow people to smooth out their spending throughout their life. The loans are categorised into housing or mortgage loans, unsecured personal loans, motor vehicle loans and credit card loans. The definition of each type of loan is consistent with definitions used by the financial institutions when compiling their financial accounts for submission to the Bank. Housing (mortgage) loans refer to loans allocated for the purchase or construction of a house or residential property; unsecured personal loans are those taken for personal use without need to disclose purpose of loan to the lender. Motor vehicle loans are self-explanatory and are asset-backed, while credit card loans refer to the used-up balances that are charged interest on a credit card.

3. FINDINGS

(a) Demography

3.1 Table 1 shows the demographic profile of the household borrowers at banks as at the end of December 2017. There were 277 762 household borrowers comprising 121 869 (43 percent) female and 155 893 (56 percent) male. Around one percent could not be categorised. The aggregate borrowers translate to 68 percent of the total number of formal sector paid employees in the country. In terms of age, 12 percent of the borrowers are less than 30 years of age; 68 percent are aged between 31 - 50 years and 20 percent are above 50 years. With regard to employment status, most of the members of households who obtained loans from banks were employed (94 percent), one percent self-employed and 2 percent unemployed, while 3 percent were unclassified.

3.2 The survey also requested the breakdown of households by level of income. The results showed that 19 percent earned less than P3 000 per month; 71 percent earned between P3 001 and P20 000 monthly, while 9 percent of the borrowers earned above P20 000 per month. In terms of categorisation of amount outstanding by gender, more males (56 percent) borrowed from banks than females (43 percent).

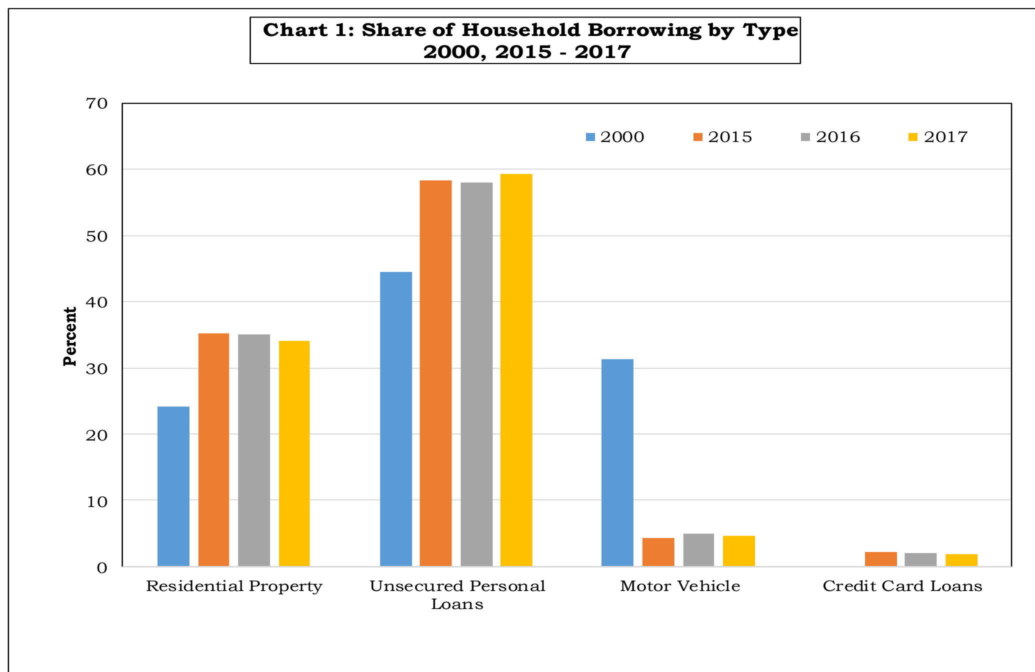
Table 1: Demographic Profile of Household Borrowers– December 2017		
	Number of Borrowers (Percent)	Amount Owing (Percent)
Gender		
Male	56	56
Female	43	43
Unclassified	1	1
Age		
Less than 30	12	8
31 - 50	68	77
Above 50	20	14
Employment		
Employed	94	91
Self-Employed	1	1
Unemployed[1]	2	3
Unclassified[2]	3	4
Income		
Less than P3 000	19	13
P3 001-P20 000	71	57
Above P20 000	8	28
Unclassified	2	2

[1] Most of these received loans from banks while still employed, but left employment before the loan reached its maturity.

[2] Unclassified information indicates that appropriate details on customers were not captured at the time of account opening.

(b) Types of Household Loans

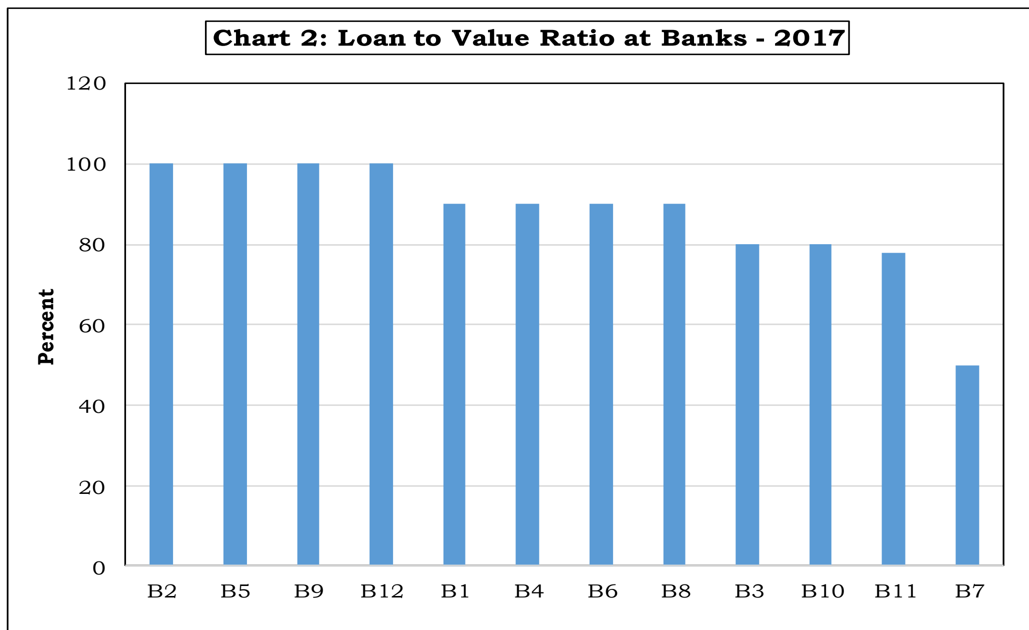
3.3 As shown in Chart 1, most of the households' debt is in the form of unsecured personal loans (59 percent in December 2017). The second largest debt is for residential property at 34 percent, followed by motor vehicle loans (5 percent) and credit cards (2 percent). A long-term comparison shows that, in December 2000, unsecured personal loans dominated household loans at 45 percent, followed by loans for motor vehicles at 31 percent. Loans for acquisition of residential property stood at 24 percent.



(c) Loan to Value Ratio

3.4 Loan to value (LTV) ratio is used by lenders to assess recoverability before approving a loan for an asset purchased. It shows how much is borrowed against collateral, usually mortgages. The higher the LTV ratio, the less "equity stake" in the property, hence the riskier the loan is to the lender. During the three-year period under review, most banks maintained the

same ratios, ranging from 50 percent to 100 percent (Chart 2). Four banks indicated an LTV ratio of 100 percent required for mortgage loans. This renders banks susceptible to the risk of not recovering the full loan amount from the property sale to pay off the outstanding loan balance should there be foreclosure on the property. For this reason, loans with high LTV ratios have much more strict requirements, including the requirement for borrowers to obtain insurance cover, which increases the cost of the mortgage.



(d) Cost of Household Loans

3.5 The interest rate paid on most of household loans is linked to the prime lending rate (and therefore, the Bank Rate). The prime lending rate decreased from 7.5 percent in December 2015 to 6.5 percent in 2017, reflecting a more accommodative monetary policy stance by Bank of Botswana. As such, the cost of credit has generally been declining. By type of loan, credit card loans are the most expensive followed by unsecured personal loans

across all banks that have these facilities. Mortgage and motor vehicle loans are generally cheaper in comparison.

3.6 Besides the interest rate charged on loans, there are additional costs levied on customers for obtaining loans. Across banks that responded to the questionnaire, additional costs of borrowing include administration/arrangement fees, legal and valuation fees and insurance cover. Some have early repayment penalty and credit reference/clearance fees. These fees are either proportionate to the loan amount (ad valorem) or fixed. Since these charges are not linked to interest rates, they had not varied much during the three-year period under review. This development was partly due to the Bank's decision to impose a two-year moratorium on any upward adjustment of bank charges and fees with effect from January 1, 2014. This meant that no bank was allowed to make any upward adjustment of banking tariffs (bank charges, commissions, and other non-interest fees) for a period of two years.

(e) Debt Service and Debt to Income Ratios of the Households

3.7 In addition to credit scores for borrowers, banks use the debt to income (DTI) ratio and the debt service ratio (DSR) to evaluate the credit worthiness of applicants. DTI ratio compares the periodic instalment to periodic earnings, while the DSR is the share of a borrower's income allocated to loan repayments over a given period, say one year (total loan repayments/total income). A low DTI or DSR reduces the repayment burden for the borrower, raising the capacity to repay. On the other hand, a higher DTI or DSR (particularly, above certain thresholds) raises the likelihood of challenges in meeting debt obligations and, therefore, default.

3.8 On average, banks reported debt-to-income ratios ranging from 40 percent to 70 percent between 2015 and 2017. The banks' average DTI for the households was 56 percent in 2017 compared to 55 percent in 2016. Based on international standards, the ideal DTI should be 40 percent or below.

3.9 The debt-service-ratio could not be calculated because data on household income was not readily available. Some banks could not provide data on repayments (principal and interest), which is needed for computing the ratio. However, banks indicated that when they assess loan applications, they consider basic salary, standing allowances and rental income as part of a borrower's income which could be allocated to servicing a loan.

(f) Data Challenges

3.10 Data compiled from banks had some flaws, which should be attended to in future surveys. There were some data inconsistencies between data submitted on the regular statutory returns and information provided in the questionnaire. Different methods of capturing customer details at banks resulted in some information not being available. This led to issues of data integrity and quality. In addition, understanding the distribution of stock of debt is important for analysis (for example, across regions and by economic sector of employment). For this reason, examining household indebtedness using micro data could be helpful, particularly when analysing the LTV and DTI alongside economic developments.

4. Banks' Strategies on Household Lending

(a) Lending Strategies

4.1 Since 2015, most banks' strategies focussed on increasing lending to the household sector, particularly encouraging ownership of property for first time buyers. Banks with large proportions of unsecured loans were accelerating growth in the more secured loan segment. Some banks indicated that they would focus their lending on customers with whom they have existing relationships and known financial habits. The strategies for lending to households undergo regular reviews to ensure responsible lending by banks.

(b) Effectiveness of the Strategies

4.2 Most banks cited prevalence of very strong competition among market players, which led to marginal growth. However, there have been increased profit margins from the household segment, despite market shocks, such as the job losses witnessed in 2016. Profitability was not only attributable to growth in lending business, but also to new products and services, and enhancements to existing products and services. Therefore, banks were able to get most of their non-funded income from existing customers.

(c) Risk Mitigation Measures

4.3 In order to mitigate risks associated with lending to the household sector, banks engage in financial literacy campaigns and lend to select creditworthy customers with known financial habits. Banks also conduct regular reviews of credit scoring parameters for loan applicants using independent credit

bureaus. They apply low DTI ratios, as well as low LTV ratios in their lending mechanism, and lending caps based on the geographical location of the property financed. Loan applicants are also required to receive their salaries through the lending banks to reduce probabilities of default by ensuring that the income used to repay the loan is paid directly to the lender. In addition, banks enter into agreements with employers to deduct repayment of loans from the employer's payroll. Some banks have introduced insurance products to relieve customers of servicing their debt obligations during financial distress periods; for example, the retrenchment insurance cover.

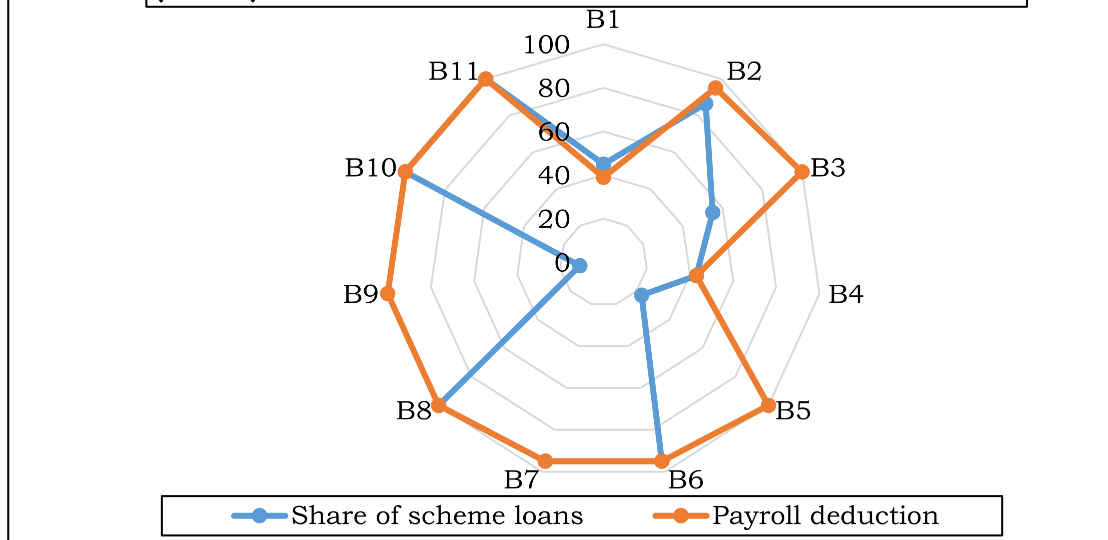
(d) Anticipated Changes in Strategies

4.4 The survey findings also showed that any changes in strategies would aim to improve on consultants' and relationship managers' knowledge of products and services to increase efficiency. Banks would also consider reducing lending to the household sector (given its associated riskiness), particularly the unsecured segment and focus more on mortgage lending.

5. Scheme Loans and Payment from Employer Payroll Arrangements

5.1 On average, 65 percent of total household loans are accessed under the scheme or group arrangement with either the employer or labour unions. About 87 percent of these loans are repaid using the deduction from the employer payroll arrangements (deduction codes). As shown in Chart 3 almost all banks have scheme loans with household customers. Only four banks have less than 50 percent of scheme loans as the share of their total household loans.

Chart 3: Proportion of Scheme Loans to Houldhold Loans and Share under Payroll Deduction Plan (2017)



5.2 In order to mitigate the risk associated with deducting from payroll, the following measures have been put in place:

(i) Memorandum of Understanding with employers to continue deductions post termination of the arrangement for existing loans until a loan is fully settled;

(ii) Encouraging loan applicants to open transaction accounts with banks to enable direct deduction;

(iii) Engaging debt collectors and filing of law suits to recover arrears;

(iv) Obtaining customers' bank account details to allow for stop order or debit order to collect from customers' accounts; and

(v) Providing retrenchment and disability insurance cover.

6. CONCLUSION

6.1 The general findings of this survey are suggestive of a balanced exposure of the banks to household debt. Although the bulk of banks' lending is taken up by the household segment of the credit market, most of which is unsecured lending, the possible risk is dampened by the fact that the majority of borrowers are employed (94 percent). However, any unforeseen adverse economic developments that can negatively affect banks' asset quality through increased retrenchments warrants continuous monitoring of indebtedness of the households.

6.2 Risks to global growth reflecting negative effects of the escalation of trade tensions could spark further deterioration in risk sentiment, with adverse growth implications, especially given the high levels of public and private debt. Such negative effects could adversely affect domestic economic activity, heighten financial risks and weigh on domestic demand. The banks' risk mitigation strategies to reduce excessive lending to households, particularly from unsecured loans to secured loan segments such as property, bodes well with the need for banks to extend loans for economically productive investments.

6.3 Data challenges remain a major constraint in undertaking some vital household indebtedness analysis, in particular, data inconsistencies and incomplete data capturing at banks. To address these challenges, banks are encouraged to use advanced automated data management systems and train staff in order to improve quality and accuracy of information.

6.4 Going forward, subsequent surveys will widen the scope and encompass other institutions extending credit to the households, as a way of improving coverage and sector completeness.

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