Interest rate hikes could affect micro-lending

By Saijil Singh

11 Dec 2012

Local banks could be heading for a micro-lending crisis if the extraordinary growth in unsecured micro-lending is not monitored closely. This is because over the past few years, South African banks have taken uncalculated risks in favour of higher premiums.

Micro-loans are easily accessible to the public and the demand is so high that banks can charge as much as 32% interest while the product remains attractive.

Previously, South African banks did not offer unsecured credit to lower income earners, who were forced to use other less regulated alternatives such as loan sharks for their credit needs, creating a demand for unsecured loans especially among low-income earners.

The National Credit Act set new rules that made large secured loans even less profitable. The Act also changed the rules for micro-lending, limiting the amount that could be charged for interest and administration. This eliminated many unregulated credit providers and left a gap in the market, making it feasible for banks to enter the micro-lending sector.

High risk or growth opportunity

The risk in this business is high, even though the lending base is vastly diversified. If the economy were suddenly to go into a downward spiral or interest rates were to rise, micro-lending banks would probably suffer significant losses due to a major domino-effect default.

Looking at future growth in the banking sector, if a micro-lending crisis is averted, the major South African banks will continue to deliver acceptable earnings in 2013. The earnings growth in 2012 is expected to be constrained by on-going elevated impairment charges and weaker revenue streams.

With the economic environment expected to improve over the coming years, overall levels of economic activity should begin to improve in 2013, driven by low interest rates and infrastructure spending by state-owned entities.

These improvements could be negatively affected by reduced export demand from the European markets. This in turn could affect the balance of payments and GDP. With low growth/low interest rates, in the context of relatively subdued levels of economic activity, banks will need to focus their attention on managing operational costs.

While there is evidence that loan growth may have returned after the global recession, long-term loans have remained at lower levels, but unsecured and short-term borrowings have escalated to meet the huge increase in demand.

ABOUT THE AUTHOR

Saijil Singh is lead analyst at Coface.