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Debt servicing costs leap as cash-strapped consumers turn to unsecured loans

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Rising reliance on unsecured debt saw cash-strapped SA consumers facing a sharp rise in their debt service burden in the third quarter of this year.

The Reserve Bank's hiking cycle drove borrowing rates on unsecured debt to an eight-year high, according to DebtBusters' latest index.

DebtBusters' index for the third quarter shows that the total debt level for SA consumers seeking debt counselling has improved over the past eight years, rising by only 8% — which is below inflation.

While the result has been a falling debt to income ratio, the ratio of debt servicing costs to incomes rose significantly, particularly in recent months.

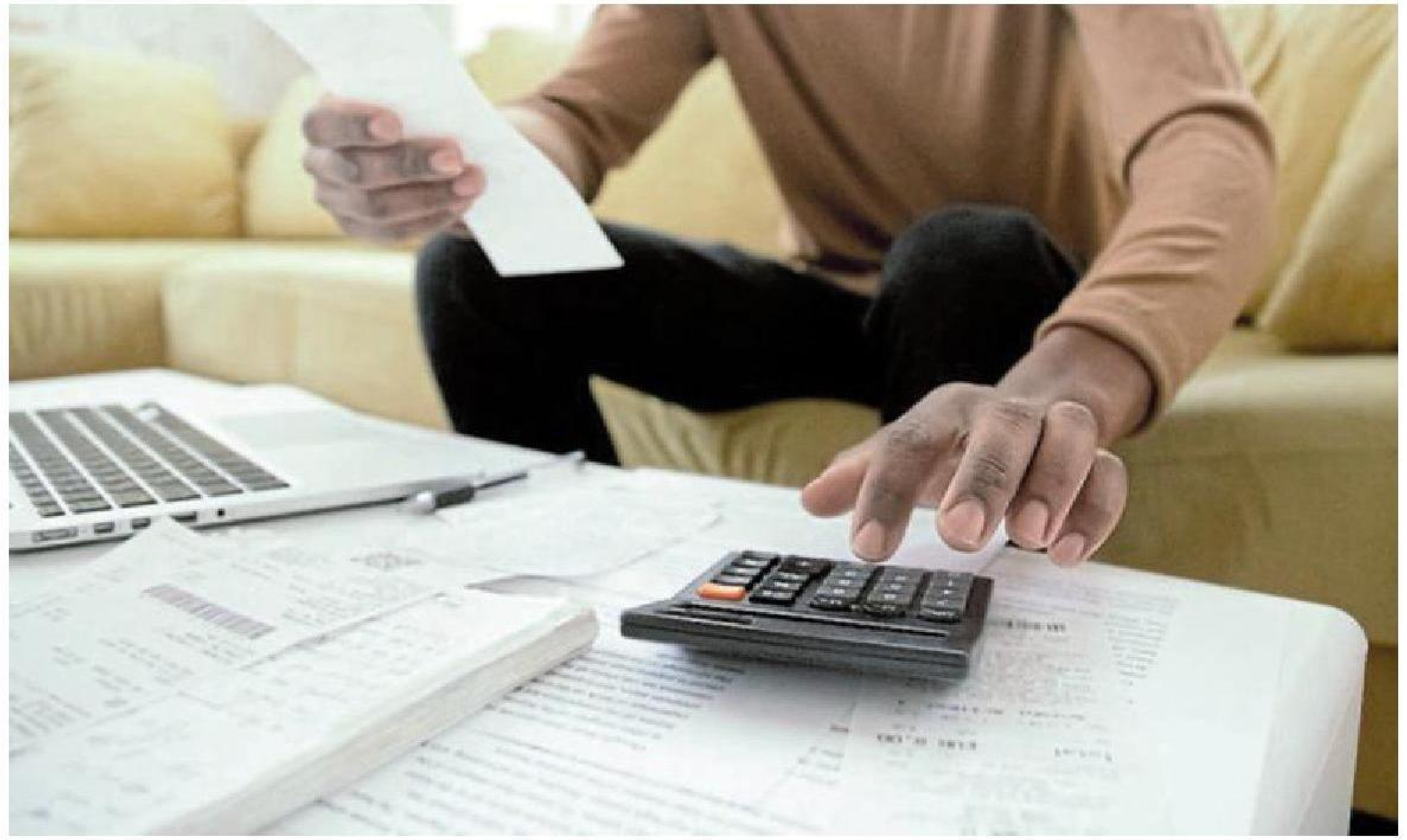
On average, consumers who applied for debt counselling in Q3 required two thirds of their take-home pay to service their debt.

This reflects a sharp increase in debt servicing burdens compared to the past several quarters and the highest level since 2017, said DebtBusters' executive head Benay Sager — and is a particular concern for SA's most vulnerable income bracket, with those paid R5,000 a month or less using three-quarters of take home pay to service their debt, the highest level yet recorded by the survey.

The sharp rise in debt servicing costs was driven mainly by an increase in the average annual interest rate on unsecured debt, which was recorded at an eight-year high of 26.7% in the period.

The maximum allowable rate on this kind of debt — which includes credit card debt, overdraft facilities, personal loans, retail cards and store cards — is only 29%.

This had a significant effect on debt burdens, as consumers continued to supplement their income with short-term, unsecured credit in the period. Of the consumers seeking debt counselling, 82% had personal loans, while more than half had one-month "payday" loans.



The Reserve Bank's hiking cycle drove borrowing rates on unsecured debt to an eight-year high, according to DebtBusters' latest index. Picture: 123RF

"The prevalence of personal loans, one-month loans and credit cards indicate SA consumers continue to be under significant cash flow pressure," said Sager.

Additionally, unsecured loans are increasingly concentrated on a small number of borrowers. While the average unsecured loan size had increased by 57% since 2016, the volume of new unsecured loans fell 30%, suggesting that larger personal loans are being granted to a smaller set of people.

While unsecured debt was less common among high-income earners taking home R35,000 or more each month, this group had the highest debt to income ratio across all income bands, at 176%.

This was due mainly to elevated bond rates, which are sensitive to changes in the Bank's lending rate, as well as higher vehicle financing debt, indicating more consumers with financed vehicles are seeking financial assistance.

"During the most recent quarter, there have been many positive developments for consumer finances and sentiment," said Sages — including reduced inflationary pressures on the back of lower petrol prices, access to two-pot retirement funds, the absence of load-shedding, a new coalition government and the first interest rate cut at the end of the quarter.

But Sager said the high debt service burdens were unsurprising, given that income growth for SA consumers has not kept up with the primary indicators of living costs.

Since 2016, electricity tariffs rose 135%, petrol prices nearly doubled and inflation had a compounded impact of 46%.

While nominal incomes rose 2% in the period, the cumulative effect of inflation means SA consumers now have 44% less purchasing power in real terms than they did eight years ago.

Amid the sharp rise in debt servicing costs, DebtBusters reported a 6% year-on-year increase in demand for debt counselling in the third quarter, while the demand for online debt management was up 10%.