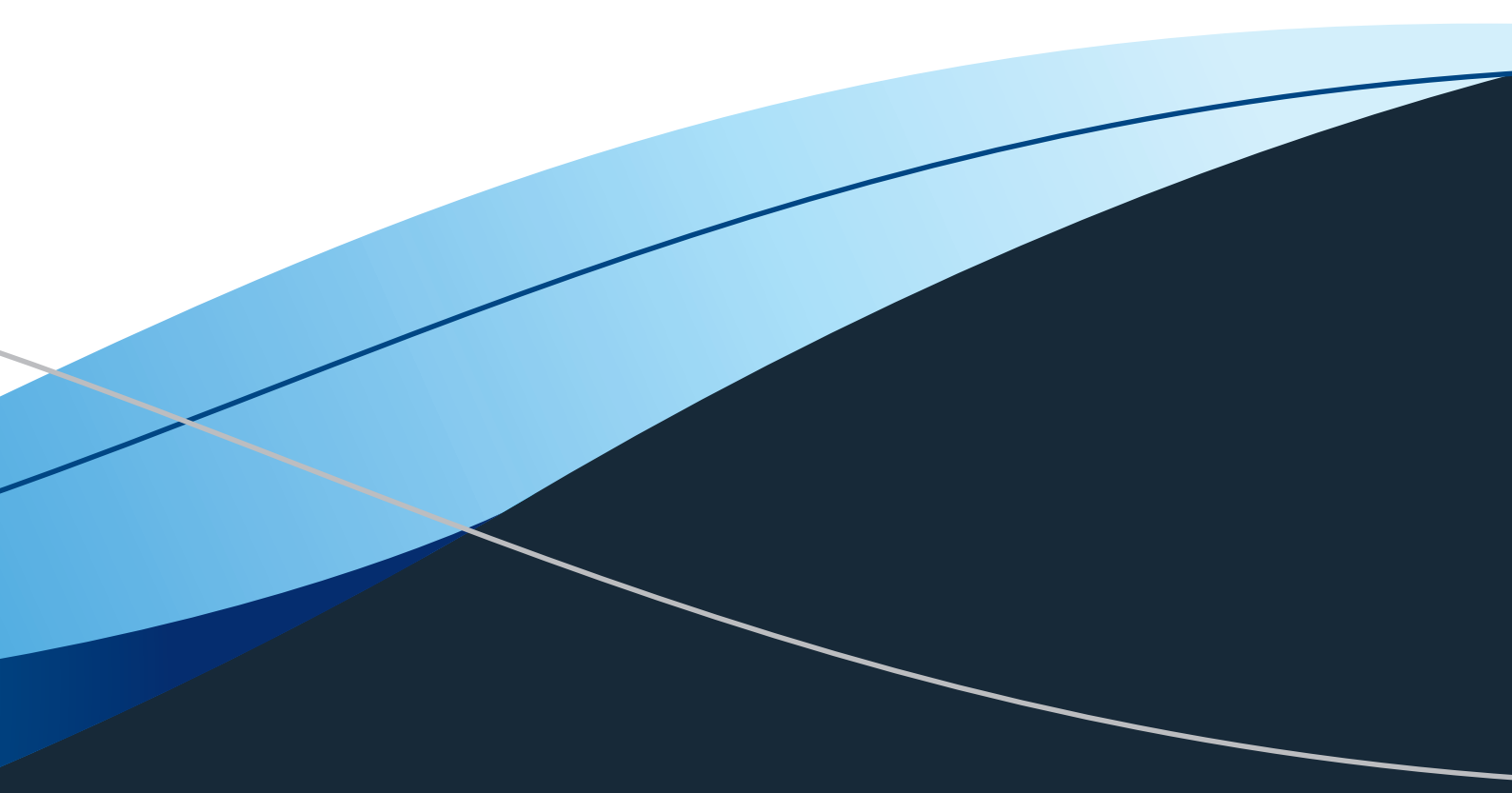




# Consumer Financial Vulnerability Index

QUARTER 4, 2015 RESULTS



# TABLE OF CONTENTS

|   |           |
|---|-----------|
| <b>CFVI foreword</b>  | <b>4</b>  |
| <b>MMI Unisa consumer financial vulnerability index</b>   | <b>5</b>  |
| What is consumer financial vulnerability?   | 5         |
| The CFVI and its sub-components   | 6         |
| How is consumer financial vulnerability measured?   | 6         |
| A tale of two Ideologies: analysis of results CFVI Q4 2015  | 7         |
| Movement in the CFVI and its sub-components during 2015   | 9         |
| The CFVI and macro-economic performance   | 11        |
| Debt servicing and savings key vulnerabilities and the underlying factors   | 12        |
| <b>Addressing high levels of consumer financial vulnerability: what did everyone expect from the budget and what does the budget actually entail?</b> | <b>14</b> |
| How will changes in the budget impact the levels of consumer vulnerability going forward?   | 16        |
| <b>Concluding remarks</b>   | <b>17</b> |
| <b>Appendix</b>   | <b>18</b> |

## CFVI Foreword

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At MMI Corporate and Public Sector our aim is to be the preferred and trusted lifetime Financial Wellness partner, with a reputation for innovation and excellence.

Financial Wellness is a virtuous circle whereby people who feel in control of their lives will be more effective workers. This, in turn, brings reward for them and prosperity for the company which results in increased cash flow. This ultimately generates more consumption in the economy, which then turns the same wheel with an increased tempo.

The MMI Unisa Consumer Financial Vulnerability Index is the first in a series of indices that MMI Corporate & Public Sector is presenting that will enhance a business' financial wellness, through engaging on and solving together for the impact of a range of variables.

The MMI Consumer Financial Vulnerability Index serves as a robust indicator of consumers' perceptions about their financial position (which is also a main driver of GDP), and with this insight into the South African consumer, businesses are able to use this as a tool to enhance their own financial wellness.

At MMI Corporate & Public Sector, the division within MMI Holdings that services large and medium sized businesses, we exist to increase business Financial Wellness by helping our clients to grow their income statements, protect their balance sheets and enhance their sustainability throughout the business life cycle. As part of this, we have a responsibility to conduct and present research that enables us to enter into meaningful and relevant conversations around what is driving company growth, employee effectiveness and corporate longevity with our clients – the same businesses that are impacted by consumers' financial vulnerability. We are committed to delivering quality research such as this for the betterment of all South Africans.



**HERMAN SCHOEMAN**  
**CEO: MMI HOLDINGS CORPORATE & PUBLIC SECTOR**



## MMI Unisa Consumer Financial Vulnerability Index

Since its inception nearly six years ago, the Consumer Financial Vulnerability Index (CFVI) has told a meaningful story for policymakers, financial institutions, retail businesses and many others. This story resonates one to two quarters later in their experience of the state of the macro economy. The Index is a powerful window into the psyche of consumers and how vulnerable they are feeling in relation to their income, expenditure, savings and debt servicing.

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*“The CFVI fills an important information gap in South African data on consumer finances.”*

As a quarterly indicator, the CFVI fills an important information gap in South African data on consumer finances as viewed by consumers in the sense that it regularly provides updates as to the state of consumers’ financial vulnerability. CFVI results provide business and consumer intelligence and actionable information to users of the data. In addition, once a

year the CFVI provides distributional and demographical information of consumers categorised according to their levels of financial vulnerability.

Insights into consumers’ financial positions are vital to determine the extent to which economic growth and government programmes translate into improved consumer financial positions. In essence, the CFVI is a cash flow index that identifies the specific financial sub-component/s that consumers on average feel are causing stress on their financial situations. The results of this release of the CFVI stem from research conducted by Unisa on behalf of MMI.

### **WHAT IS CONSUMER FINANCIAL VULNERABILITY?**

Consumers live in a world of financial uncertainty. There are both positive and negative shocks occurring to consumer income, basic expenditure requirements and the environment in which consumers live, giving rise to financial vulnerability. These shocks include consumers becoming unemployed, being impacted by rising interest rates or taxes (national monetary and fiscal policy decisions) and living through periods of lower economic growth. Furthermore, consumers may find themselves over-in-

debted and struggling to keep up with payments for a number of reasons. Sudden changes in their personal circumstances, such as the loss of a job, illness or family breakdown may also cause financial difficulties. As consumers are the backbone of the South African economy, regular information on their perceptions of their financial situations and the causes of their vulnerability provides valuable insights that assist decision makers in their planning, strategies and policy decisions.

The term ‘Consumer Financial Vulnerability’ refers to the fact that consumers experience a sense of financial insecurity or an inability to cope financially. This manifests in the degree to which the income and savings security of consumers is low or under threat, while they struggle to cope with high consumption expenditure and high debt servicing burdens. Consumer financial vulnerability can therefore be viewed as the financial vulnerability of consumers resulting from perceived threats to their income statements or balance sheets brought about by changes in both macro- and microeconomic factors and their own behaviours.

### THE CFVI AND ITS SUB-COMPONENTS

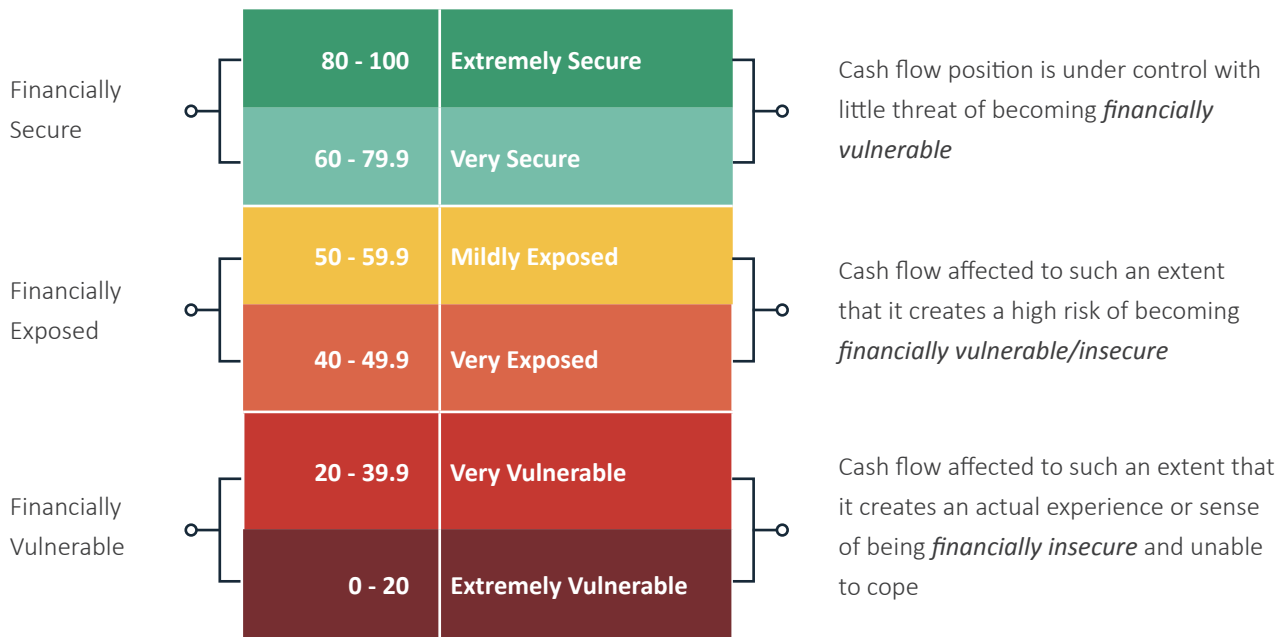
Financial vulnerability depends on various factors, both beyond a consumer’s control, such as adverse local and international economic conditions, and those over which consumers have some degree of control, including levels of savings or debt. When assessing a consumer’s financial vulnerability, the following aspects need to be taken into consideration in order to obtain a holistic view of consumers’ perceptions of their financial vulnerability:

| Component                         | Possible influences   |
|-----------------------------------|---|
| <b>Income vulnerability</b>       | Job security, income growth, social grants and the ability to access transfers from family and friends      |
| <b>Savings vulnerability</b>      | The levels of savings and assets that a person can access when times are tough                              |
| <b>Expenditure vulnerability</b>  | Whether a consumer is able to deal with rising costs of food and transport, or is living within their means |
| <b>Debt service vulnerability</b> | Cost of servicing debt and the level of debt a consumer has accumulated                                     |

### HOW IS CONSUMER FINANCIAL VULNERABILITY MEASURED?

The Index scores are interpreted on a 100 point scale as outlined in Figure 1. An index score between ‘0’ and ‘100’ provides an indication of the degree to which consumers feel vulnerable with regards to their cash flow position. Mean scores between ‘0’ and ‘39.9’ indicate that consumers are feeling *financially vulnerable*. A mean score between ‘40.0’ and ‘59.9’ indicates that consumers are *financially exposed*, while a mean score between ‘60.0’ and ‘100’ is indicative of consumers feeling *financially secure*.

Figure 1: Measurement scale of consumer financial vulnerability



#### A TALE OF TWO IDEOLOGIES: ANALYSIS OF RESULTS CFVI Q4 2015

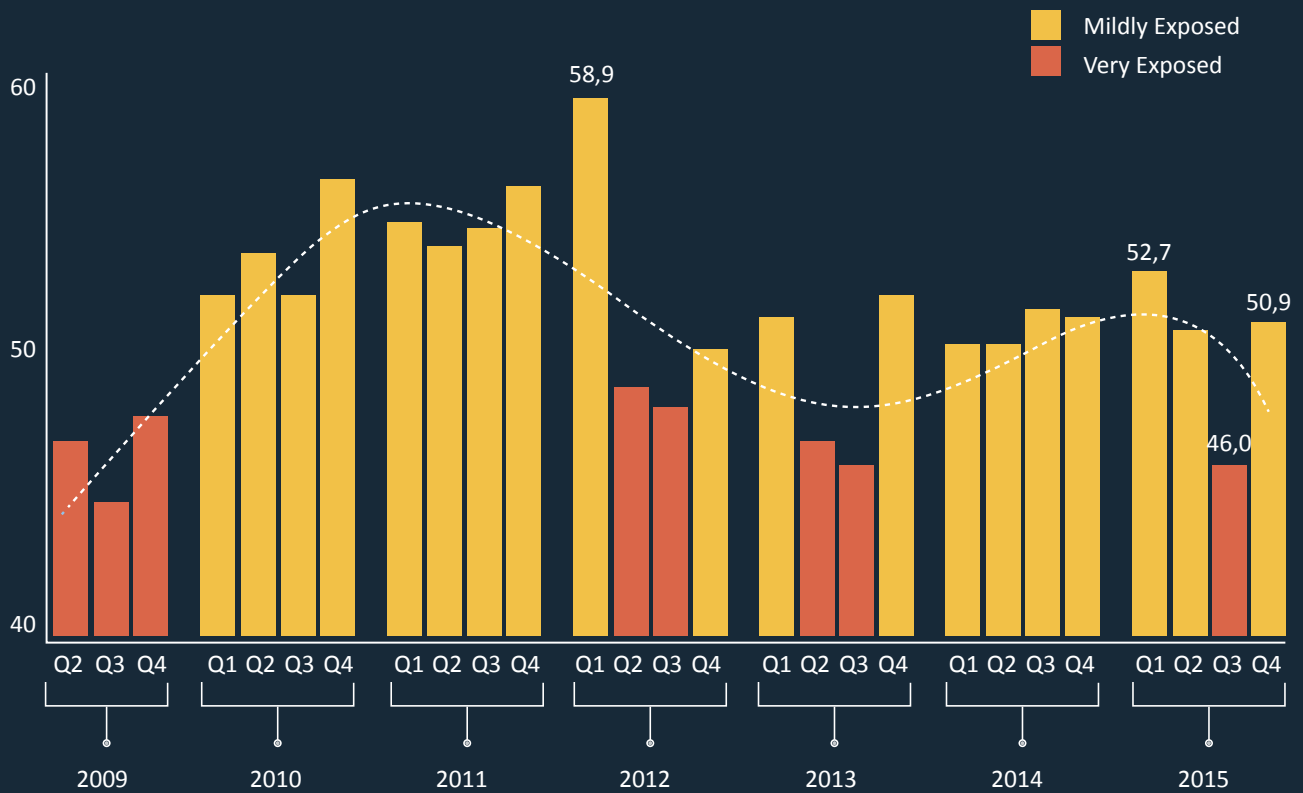
Charles Dickens wrote in his well-known work, *A tale of two cities*: “It was the best of times; it was the worst of times; it was the age of wisdom; it was the age of foolishness; it was the epoch of belief; it was the epoch of incredulity; it was the season of light; it was the season of darkness; it was the spring of hope; it was the winter of despair; we had everything before us; we had nothing before us; we were all going direct to Heaven; we were all going direct the other way...”.

This is an excellent description of the current state of the South African consumer landscape. Some consumers are extremely *financially vulnerable* while others are not *financially vulnerable* at all. Some consumers manage their personal finances very well while other are imprudent in that regard.

The average South African consumer experienced a heavy burden on their cash flow during Q4 2015. The MMI Unisa (CFVI) recorded a value of 50.9 index points in Q4 2015, which is down from 52.7 points recorded for Q1 2015. The CFVI has shown a downward trajectory since Q1 2012 when it was 58.9 index points. According to the CFVI measurement scale, consumers in general still perceived their financial situation to be *mildly exposed* during Q4 2015, although just barely as the Index was on the brink of being classified as financially *very exposed*. When seen in conjunction with prevailing circumstances in the local economy, there is a real risk that consumers may become *very exposed* during 2016.

*“There is a real risk that consumers may become very exposed during 2016”*

Figure 2: Consumers' financial vulnerability levels since 2009



It is clear from the trend line provided in figure 2 that the state of consumers' cash flow remains under pressure. The historical CFVI scores for the third quarters tend to be somewhat below that of the general trend line. Results for these quarters are based on household surveys, while that of the remaining quarters are based on key informant surveys. Further details concerning the survey methodologies are provided in the appendix.

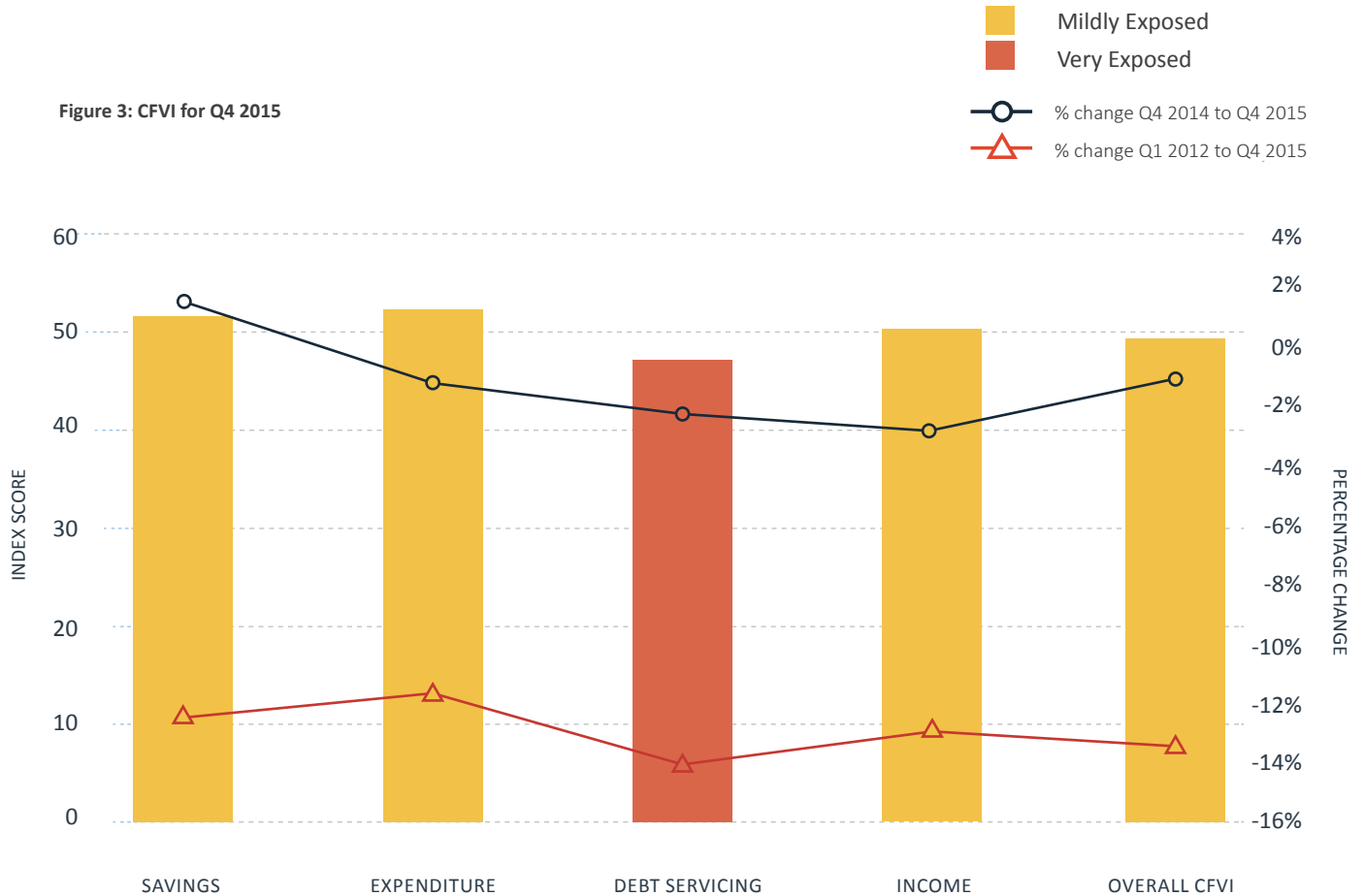
Consumers remained on the brink of being financially *very exposed* at the end of 2015. The possible causes of this are summarised below.

**FINANCIALLY EXPOSED CONSUMERS CAUSED INTER ALIA BY:**

- Very low levels of real **economic growth**
- Anaemic formal sector **job creation**
- Low real personal **income growth**
- High debt** to disposable income ratio
- Low levels of **financial literacy**

### MOVEMENT IN THE CFVI AND ITS SUB-COMPONENTS DURING 2015

The CFVI reflects consumers' sense or experience as to the state of their cash flow positions. The Index scores for each of the different sub-components and what contributed to consumers feeling financially *mildly exposed* during Q4 2015 as well as comparisons to other periods, are provided in the figure below.

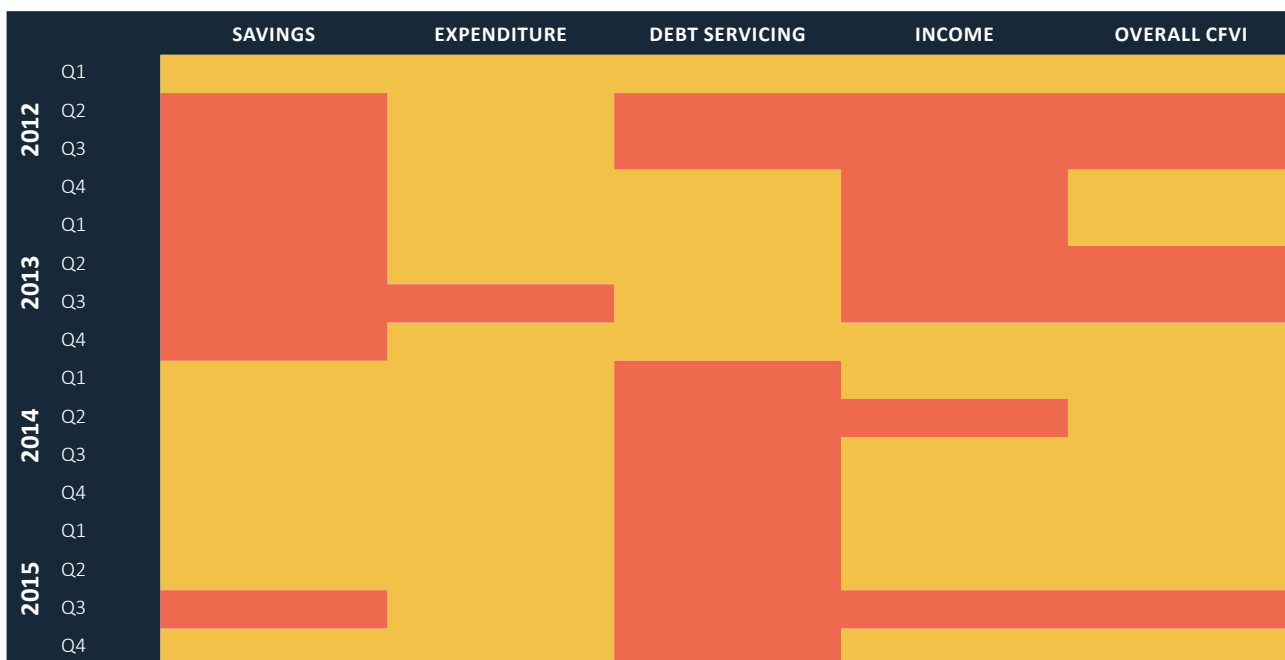


Considering the individual sub-components, there were increasing levels of expenditure vulnerability while there were slight improvements in income, debt servicing and income vulnerability during the period Q3 2015 to Q4 2015. Over a longer period of time, there is a clear trend of increasing consumer financial vulnerability as reflected by the fact that during the period Q4 2014 to Q4 2015 expenditure vulnerability worsened from 53.5 to 53.2 (0.65% increase in vulnerability score), debt servicing vulnerability worsened from 49.6 to 48.7 (1.73% increase in vulnerabil-

ity score) and income vulnerability worsened from 51.4 to 50.2 (2.32% increase in vulnerability score). During the period Q1 2012 to Q4 2015, the increase in consumer financial vulnerability was even more pronounced as reflected by a 12.13% increase in savings vulnerability, an 11.52% increase in expenditure vulnerability, a 13.92% increase in debt servicing vulnerability and a 12.77% increase in income vulnerability. Overall, consumer financial vulnerability increased by 13.47% during the period Q1 2012 to Q4 2015.

Table 2 below shows a “heat map” of quarterly consumer financial vulnerability per index sub-component since 2012.

**Table 2: Categorisation of Vulnerability Levels Since 2012**



A summarised view, focusing on the average annual consumer financial vulnerability (see table 3), reveals similar trends. South African consumer finances remain under immense pressure as witnessed by the fact that debt servicing vulnerability increased further during 2015, while income, expenditure and savings vulnerability remained at similar levels compared to 2014. More specifically, consumers felt *mildly exposed* towards their income, expenditure and savings, while remaining *very exposed* towards their debt servicing capability. The average for the debt servicing sub-index is the lowest since the introduction of the Index in 2009. Though the overall CFVI remained in the *mildly exposed* category, it is on the verge of the *very exposed* category with the score bordering on 50 points.

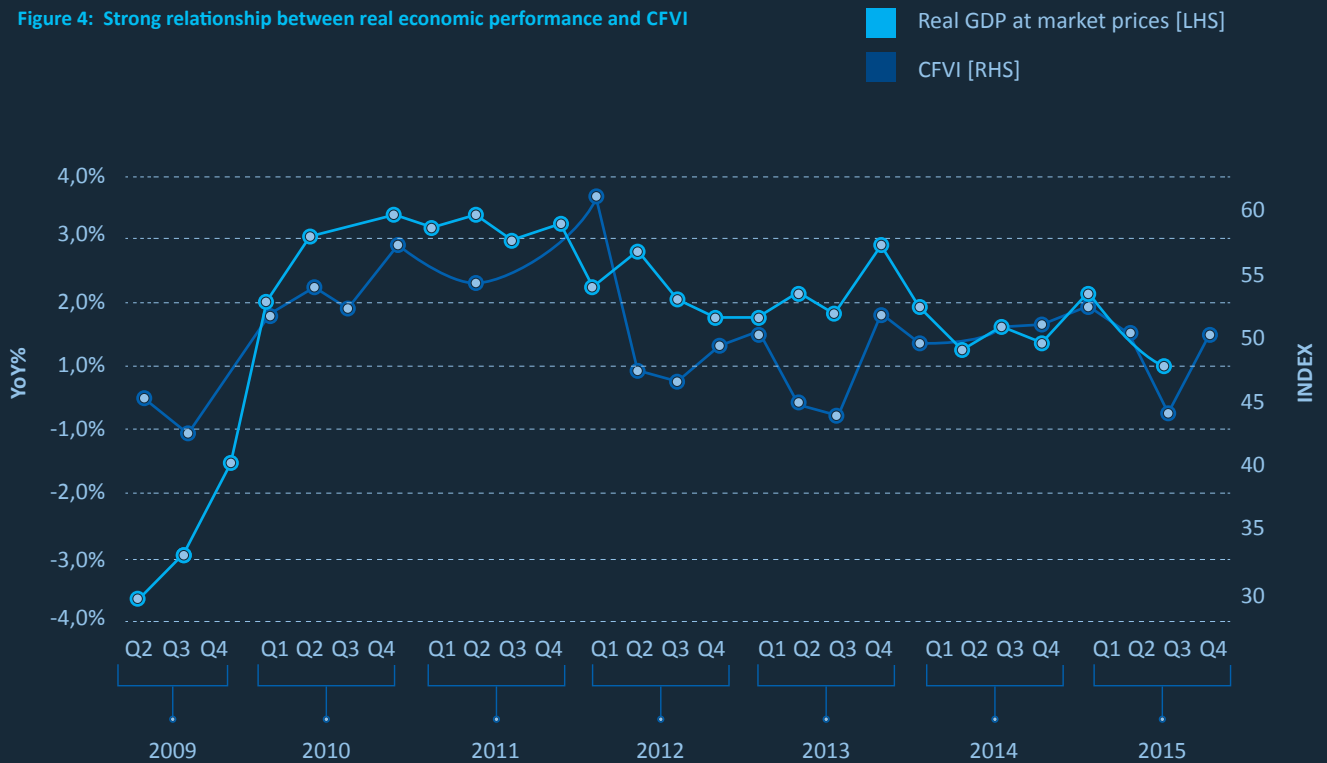
**Table 3: Annual CFVI Scores 2009 to 2015**

|      | SAVINGS | EXPENDITURE | DEBT SERVICING | INCOME | OVERALL CFVI |
|------|---------|-------------|----------------|--------|--------------|
| 2009 | 43.36   | 45.85       | 54.74          | 41.82  | 46.37        |
| 2010 | 52.97   | 50.51       | 58.27          | 51.38  | 53.28        |
| 2011 | 49.41   | 54.43       | 59.61          | 54.63  | 54.52        |
| 2012 | 49.26   | 55.13       | 51.17          | 49.10  | 51.35        |
| 2013 | 47.18   | 50.53       | 53.29          | 46.61  | 48.92        |
| 2014 | 51.12   | 53.82       | 48.39          | 50.28  | 50.74        |
| 2015 | 51.08   | 54.33       | 48.35          | 50.41  | 50.10        |

## THE CFVI AND MACRO-ECONOMIC PERFORMANCE

Long-term trends show that CFVI scores were very similar in 2014 and 2015, but significantly less positive than the CFVI scores obtained during 2010 and 2011. These results closely follow the trends visible in the macro-economy. This correlation is visible when comparing real economic growth to the Index scores over time as in figure 4.

Figure 4: Strong relationship between real economic performance and CFVI



During the period 2009 to 2011, income vulnerability improved, after which it started to deteriorate. Major reasons for this included slow economic growth, minimal employment creation, as well as low levels of real income growth.

Increased income vulnerability impacted on the ability of consumers to spend, save and service their debt, resulting in higher vulnerability levels in each of these components following initial improvements.

# 50%

**DEBT SERVICING ARREARS  
RATE IN SA HOUSEHOLDS**

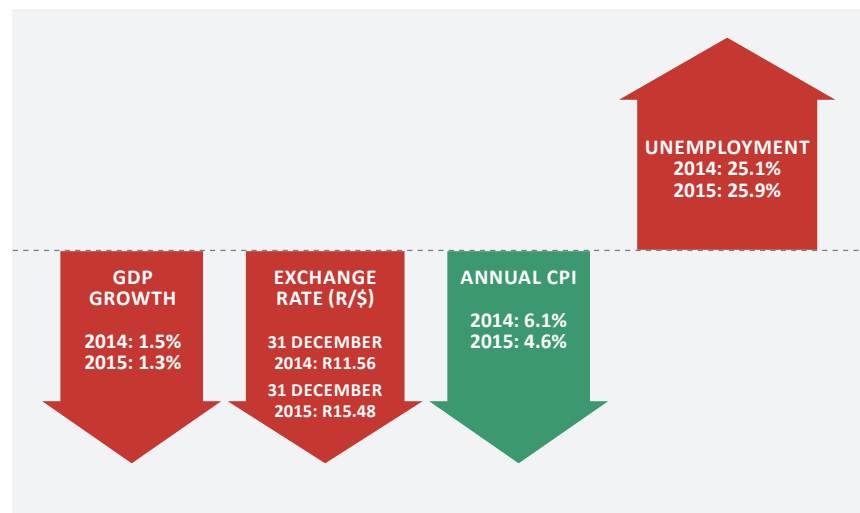
*“The increasing interest rate environment adds additional pressure to the finances of those consumers with debt.”*

## **DEBT SERVICING AND SAVINGS KEY VULNERABILITIES AND THE UNDERLYING FACTORS**

Since 2010, the strongest increases in consumer financial vulnerability were experienced with respect to debt servicing and savings vulnerability. These two aspects appear to be the “Achilles heel” of the South African household sector with negative savings rates and nearly 50% debt servicing arrears rates experienced in this sector.

The long-term trend with regards to higher debt servicing vulnerability is of serious concern. While income, expenditure and savings vulnerability are mainly driven by macro-economic performance, debt servicing capabilities are also impacted by institutional dynamics and consumer practices, such as low levels of financial literacy and debt spirals in which millions of consumers find themselves. The increasing interest rate environment adds additional pressure to the finances of those consumers with debt.

### **Macro-economic factors contributing to high levels of Financial Vulnerability in 2015**



There were various macro-economic factors that give rise to high levels of financial vulnerability during late 2015. These factors include inter alia,

- GDP growth which was according to the Economist Intelligence Unit only 1.3% for 2015 as a whole;
- gross fixed investment which slowed down to 0.6% in 2015;
- a significant weakening of the rand against major currencies (i.e. the rand was 34.6% weaker against the dollar at the end of 2015 compared to the end of 2014);
- consumer price inflation (CPI) which is slowly but surely picking up pace; and
- the official unemployment rate which increased from 25.1 % in 2014 to 25.9% in 2015.

**Institutional factors contributing to high levels of financial vulnerability in 2015**



The negative impact of these factors on consumer financial vulnerability is being exacerbated by a large number of institutional factors, such as high levels of inefficiency at national, provincial and local government levels, electricity supply constraints, policy uncertainty and low profitability levels in the private sector as well as a looming downgrade by ratings agencies.

In figure 5, a breakdown of the top 10 reasons for financial vulnerability during Q4 2015 as reported by key informants

is provided. It appears from this figure that the major reasons for financial vulnerability all relate to financial ill-discipline and low levels of financial literacy, namely; (1) bad financial planning, (2) consumers obtaining too much debt and (3) consumers spending more than they earn. These main reasons remain similar to those reported for Q4 2014, with rising interest rates and unforeseen expenses becoming greater concerns for consumers.

**Figure 5: Top 10 perceived reasons for financial vulnerability in Q4 2015**





## Addressing high levels of consumer financial vulnerability: what did everyone expect from the budget and what does the budget actually entail?

In order to address the high levels of consumer financial vulnerability by ensuring higher levels of economic and employment growth as well as a capable state, which could address the plight of the poor, the budget should provide a facilitative platform. It is clear from the budget expectations expressed by a large number of analysts and institutions that a variety of actions were expected from the budget, which could ensure efficient government to do its job to the benefit of all consumers.

The first set of budget expectations pertain to reductions in government expenditure. The number one candidate for expenditure cuts by analysts and institutions alike is the public sector wage bill. It is recognised that in order to ensure fiscal consolidation, the large public sector wage bill has to be targeted. However, the problem is that government conducted a three-year wage deal binding it to relatively high wage increases over this period. At present, consumer financial vulnerability levels among public sector workers is relatively low compared to the broad consumer populace. Tinkering with their income growth rates could potentially increase the levels of financial vulnerability among public sector workers while the resulting fiscal consolidation will in the long-run be very positive for realising higher

levels of economic growth. This will be achieved because fiscal consolidation will enhance government efficiencies and will free up investment funds for infrastructure, education, incentives for new investment and job creation programmes. It appears from the actual budget speech that the expectations of analysts in this regard were broadly correct with Minister Gordhan indicating that his budget is “focused on fiscal consolidation. We cannot spend money we do not have”.

A second expectation from analysts and institutions with respect to the budget was the privatisation of some state-owned enterprises and/or phasing out some of the state-owned enterprises. Privatisation of this nature as well as fiscal austerity could potentially be of great importance in averting a further down grade by the major credit ratings agencies. By averting such a downgrade direct investments into the economy are being encouraged which will have a range of positive spin-offs for the household sector in terms of higher economic growth giving rise to higher business income and compensation growth, higher levels of job creation and the reduction of poverty by increasing the labour absorption capacity of the economy. The privatisation of some state-owned enterprises will also free up money for the fiscus to

spend on infrastructure and job creation to the benefit of the broader economy and the household sector in particular. Minister Gordhan indicated in this regard that state-owned entities which are no longer necessary should be phased out. Also in cases where entities have overlapping mandates, rationalization options will be pursued. However, he clearly states that full-scale privatisation of state-owned entities is not on the cards.

A third widely held expectation was

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*“There is little scope for raising additional revenue from personal taxes.”*

that the marginal personal income tax rate will be increased although studies by the Davis Committee have shown that there is little scope for raising additional revenue from personal taxes and that the introduction of a wealth tax will not make a significant contribution to overall revenue. Despite the views expressed by the Davis Committee on the desirability of a wealth tax, the ANC’s National Executive Committee (NEC) is of the opinion that wealth redistribution is

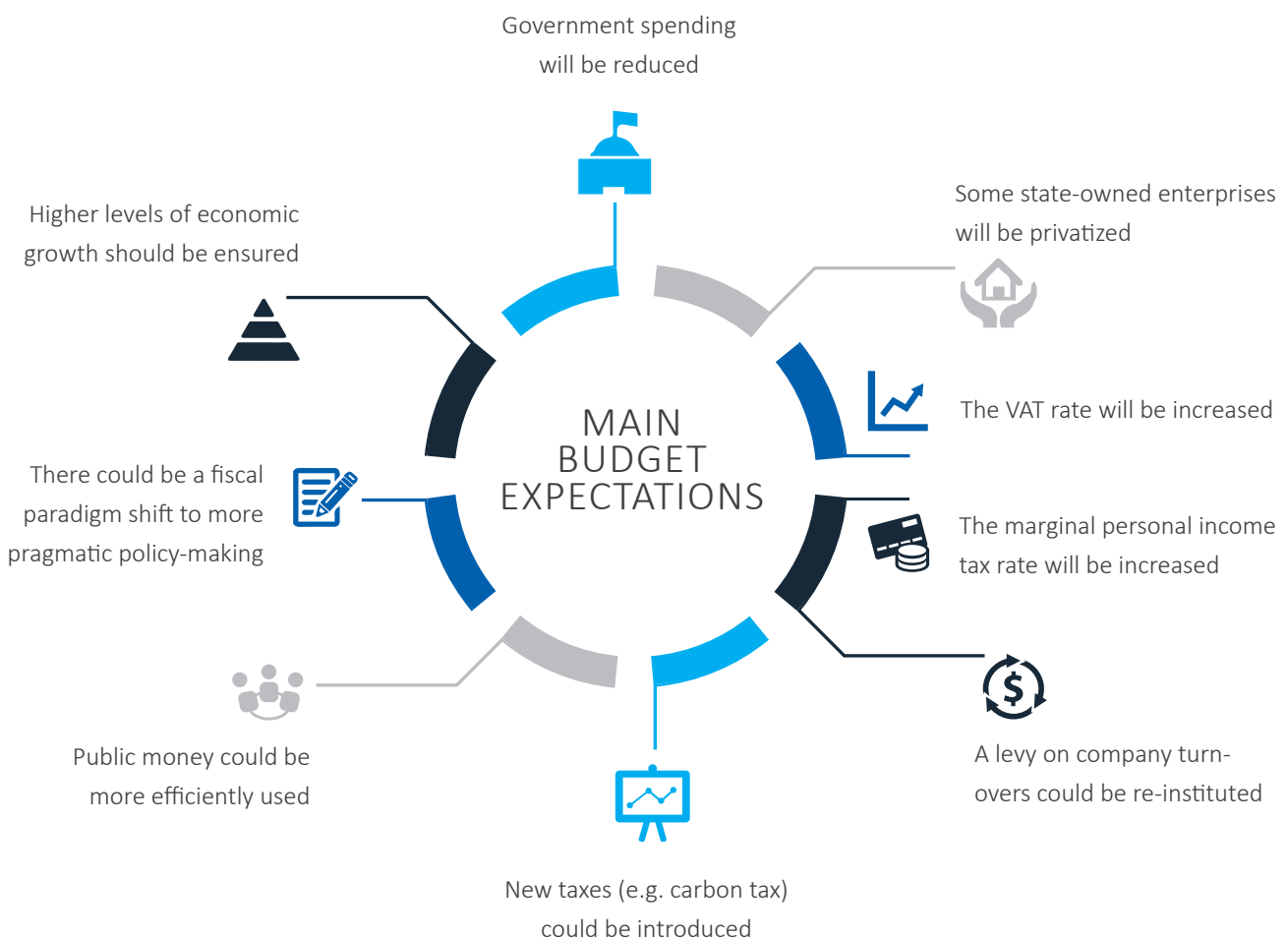
“both a moral and economic imperative”. Analysts believed that there was a great likelihood that some form of wealth tax would be introduced which would have been specifically aimed at the so-called ‘super rich’. Contrary to the predictions, the Minister did not increase the marginal personal income tax rate but did focus on obtaining more tax revenue from the rich via increased capital gains tax. By doing so, the Minister provided some personal income tax relief to taxpayers to address bracket creep.

A fourth expectation was that new taxes might be introduced of which

carbon taxes were the prime suspect. The Davis committee recommended that a carbon tax be introduced with zero liability initially. A tax of this nature will have little positive impact on consumer financial vulnerability. The Minister did not introduce a carbon tax but surprised everyone with the introduction of a new tax on sugar-based beverages.

Another expectation was that there will be a fiscal paradigm shift toward brutal fiscal management for longer term benefit. It is clear from recent pronouncements by government that such a paradigm shift will in the me-

dium to long-term be very positive towards consumer finances. Slower growth in government consumption expenditure will contribute to possible smaller tax hikes in future, leaving more money in the pockets of consumers which could be used for expenditure, savings and debt servicing purposes. The Minister emphasized a fiscal paradigm shift throughout his presentation. He said inter alia in this regard: “These budget proposals signal governments commitment to a prudent sustainable fiscal trajectory...”



# 2016

**“CONSUMER FINANCES WILL MOST LIKELY REMAIN UNDER PRESSURE.”**

*“For the economy and consumer finances to improve, quite a number of economic policies, programmes and acts should be amended.”*

## HOW WILL CHANGES IN THE BUDGET IMPACT THE LEVELS OF CONSUMER VULNERABILITY GOING FORWARD?

Although certain parts of Mr Gordhan’s budget may reduce consumer financial vulnerability, other parts of the budget may give rise to increased levels of consumer financial vulnerability. The question could be asked whether the budget on balance will be expansionary with respect to the economy (and consumer finances), neutral or contractionary. Given that the various components making up aggregate demand in the economy, such as household consumption expenditure, government expenditure, investment and the external sector are all under pressure and given that the Budget is less non-expansionary, it will not add significantly to aggregate demand in order to provide a badly needed fiscal stimulus to the economy.

It is clear from the CFVI time series provided in this report as well as the discussion of the economy (at macro-and micro-levels) and budget realisations that relatively high levels of consumer financial vulnerability will still be with us for the short to medium-term. The cascade path from government and household expenditure to economic growth to job creation to household incomes remains under pressure and will in all likelihood remain that way for the remainder of 2016 with little hope that the economy and consumer finances will show a marked improvement during 2017.

In order for the economy and consumer finances to improve, quite a number of economic policies, programmes and acts could be amended to ensure that the triple challenge of poverty, unemployment and inequality is addressed head-on to ensure substantially lower levels of consumer financial vulnerability. Such changes at macro- and micro-economic levels are as follows:

### MACRO-ECONOMIC:

Future budgets should ensure the growth of the tax base, decreasing taxes and a more efficient use of tax payers’ money. Government needs to adopt pro-growth policies and should ensure a flexible labour market allowing maximum absorption of labour market entrants and the unemployed.

### MICRO-ECONOMIC:

Levels of financial literacy should be increased, savings should be encouraged (e.g. by not taxing incomes resulting from savings) and broad-based education and re-education of labour market required skills should be ensured.

## Concluding Remarks

Consumers remained *mildly exposed* towards their finances during Q4 2015, but on the verge of falling into the *very exposed* category. Similar results were realised in 2015. Consumer finances were specifically hampered by financial pressures on their income generation and debt servicing capabilities during this quarter. Consumers remain *very exposed* in terms of their debt servicing vulnerability levels. The likelihood of consumers slipping on average into the *very exposed* category during most of the quarters of 2016 is very high given that an economic growth rate of 0.6% (or lower) is expected for 2016, private consumption expenditure growth will only be about 0.7%, the official unemployment rate will increase to about 26.6% in 2016 and that CPI will average about 6.2% during 2016.

Consumers remain highly indebted and growth in real disposable income is likely to be suppressed by the rise in food prices, electricity tariff hikes and possible increases in petrol prices due to a weak exchange rate. Consumer access to additional credit, which temporarily alleviates vulnerability in times of emergencies, may be further hampered by the implementation of the new affordability assessment criteria in March 2015 as part of revisions to the National Credit Regulations. Adding to this, the psychological influence of talks of further hikes in the repurchase rate by SARB during 2016; it is unlikely there will be an improvement in consumer's perceptions regarding the control over their finances during the remainder of 2016. Despite this rather gloomy outlook, if consumers make a concerted effort to improve their financial skills, adjust their financial behaviour and take responsibility for their own futures, a brighter picture may start to emerge. To quote the Minister,

*“If consumers make a concerted effort to improve their financial skills, a brighter picture may start to emerge in the future.”*

“Let us **unite** as a team, sharing our skills and resources ... and **developing our economy** inclusively.”

# Appendix

## INDEX HISTORY HIGHLIGHTS

- The Index was started in the second quarter of 2009 (Q2 2009) and is conducted on a quarterly basis. This relatively long Index history provides a sufficient number of data points to enable any statistical analysis (more than 20 observations).
- The Index is based on solid methodology as the results of the CFVI are obtained either from annual Finscope surveys among South African consumers, customised CFVI household surveys, or from a quarterly selection of approximately 100 key informants in relevant industries (including credit industry institutions, retailers providing credit and municipalities) able to gauge consumers' financial perceptions.
- The fact that the Index analysis and calculations are conducted by an independent and credible academic institution, namely Unisa, adds to the reputational value of the Index.
- The CFVI has attracted the attention of a wide spectrum of analysts including policy makers, private sector companies, consumer market analysts, labour unions and academics. In addition to the Reserve Bank's use of the Index information, other institutions such as the Association of Debt Recovery Agents and the National Credit Regulator make use of these research findings.
- The Index has been referenced or formed the subject of various academic studies and articles.

## INDEX SURVEY METHODOLOGY OVERVIEW

The results of the CFVI are obtained either from annual Finscope surveys among South African consumers, or from a selection of approximately 100 key informants in relevant industries (including credit industry institutions, retailers providing credit and municipalities) able to gauge consumers' financial perceptions. Results based on annual Finscope consumer surveys are for Q4 2010, Q3 2011, Q3 2012, Q3 2013, Q3 2014 and Q3 2015, while the BMR conducted a consumer survey in Q1 2013. The remainder of the results are based on surveys conducted amongst key informants. However, in order to ascertain and ensure that key informant results remain a good indicator of consumer financial vulnerability during the other quarters (non-Finscope survey quarters) the results of the key informant surveys are, from time to time, benchmarked to those of the Finscope surveys by conducting a key informant survey simultaneous with a Finscope survey.

## KEY APPLICATIONS OF INDEX FINDINGS TO DATE

### Planning and decision making

As consumers are the backbone of the South African economy, regular information on their perceptions of their financial situations and the drivers of these perceptions assists decision-makers with their planning, strategies and policy decisions. For instance, the Index is a useful tool for the National Treasury to refine their tax policies (such as when the income sub-component is under pressure it points to less income tax collections) as the Index is used as an input when making fiscal policy decisions affecting individuals. Meanwhile, the South African Reserve Bank gains a better understanding of the impact of interest rate decisions on specific consumers as well as having access to an overall measure of financial stability in the country. The Reserve Bank already includes the CFVI in their measurement of financial stability of consumers as published in recent Financial Stability Reviews.

The sub-components of the CFVI also provide information to retailers as to what they can expect in terms of consumer demand, whilst banks and lenders can gain an understanding regarding granting, repayment and affordability of debt, as well as consumers' arrears. More specifically companies that rely on consumers to conduct business such as retailers, insurance companies, local banks, municipalities and retail analysts may use the Index to determine the state of consumer financial health for strategy and planning purposes.

### Predictor of trends in economic variables

Analysis through correlations shows that the CFVI and its sub-components have strong linear relationships with certain economic variables (or leads thereof) and therefore have some predictive power for trends in certain economic variables. The CFVI has been found to be a strong leading predictor of nominal economic growth.

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