

## Household Debt Burden and Changes in Interest Rates

Economic recovery, consumer confidence, low interest rates and easy credits environments, as well as government policies, are all important factors behind the rising household debt level. The latest data shows that household debt in the formal sector<sup>1/</sup> amounted to about 2.5 trillion baht at end-2003, increasing by 20 per cent from the previous year.

Foreign interest rates, for example in the US and the UK, have increased recently and are likely to rise further in the near future. This has caused some concern over the debt burden of Thai households should domestic interest rates follow suit and enter the upward interest rate cycle.

### Mortgage Debt: Non-Mortgage Debt

(per cent)	1998	2003 <sup>*</sup>
<b>Household debt in the formal sector</b>	<b>55:45</b>	<b>44:56</b>
- Financial institutions <sup>1/</sup>	66:34	56:44
- Specialized financial institutions <sup>2/</sup>	57:43	47:53
- Others <sup>3/</sup>	25:75	20:80

<sup>\*</sup> As of Q3 2003

<sup>1/</sup> Commercial banks, finance companies, and credit foncier companies

<sup>2/</sup> Only Government Saving Bank, Government Housing Bank, and Bank for Agriculture and Agricultural Cooperatives

<sup>3/</sup> Village funds, cooperatives, and non-bank companies

Looking at the composition of household debt, the ratio of mortgage debt to non-mortgage debt now stands at 44:56. In general, mortgage loans are subject to fixed interest rates for a certain period of time, whereas hire-purchase loans are mostly subject to fixed rates throughout the contract. While personal consumption loans, are subject to floating interest rates. The recent acceleration in other personal consumption loans thus suggests an increase in risk exposure of debtors to the fluctuation of domestic interest rates.

Consider a hypothetical case with the following assumptions: (1) household has debt of 1 million baht, (2) the mortgage interest rate is at 5.75 per cent per annum and non-mortgage interest rate at 10 per cent per annum, and (3) the ratio of mortgage to non-mortgage debt is at 44:56. If both interest rates adjust upwards by 25 basis points, the household's interest payment would increase from 6,775 to 6,983 baht per month, or an increase of 3.1 per cent. If both interest rates adjust upwards by 50 and 100 basis points, interest payment would increase by 6.2 and 12.3 per cent, respectively. This is an approximation for the maximum interest payment where all loans are subject to floating interest rates. In reality, however, hire-purchase loans are mostly subject to fixed interest rates throughout the contract period as mentioned earlier, while mortgage loans are mostly subject to fixed rates in the first three years.

### The effect of rising interest rates on interest payments

	Interest payment (baht/month)	Change from base case (baht/month)	Change from base case (%)
Base case	6,775	-	-
Increase in interest rates by 0.25%	6,983	208	3.1
Increase in interest rates by 0.50%	7,192	417	6.2
Increase in interest rates by 1.00%	7,608	833	12.3

From this example, an increase in interest rates by 1 per cent causes interest payment to increase by less than 12.3 per cent. In addition, total interest payment is expected to remain low at less than 2 per cent of household disposable income.<sup>2/</sup> Even though such increase in interest payment is neither high nor is likely to occur abruptly, households should recognise the risk and adjust their spending plan accordingly in order to prepare for the increased burden and avoid liquidity problems regarding their consumption and debt repayment should interest rates increase in the future.

<sup>1/</sup> Personal consumption loans (including mortgages) from financial institutions, non-bank companies, cooperatives, insurances, and village funds as of end-2003.

<sup>2/</sup> According to the NESDB, interest payment on non-mortgage debt is around 1 per cent of household disposable income. Since mortgage debt has a lower share as well as a lower interest rate than non-mortgage debt, total interest payment is approximated to be less than 2 per cent of disposable income.