

Why Sluggish Credit Growth is Typical at This Recovery Stage

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ONE OF the concerns about the current economic recovery is that private credit growth continues to be subdued.

The October data showed that combined credit growth of commercial banks, finance companies, specialised financial institutions and cooperatives was 0.2 per cent year-on-year. The discomfort is over whether such muted credit growth is sufficient to support the recovery.

The usual explanation is that credit growth is a lagging indicator of economic growth. In other words, during a recovery, GDP starts to move up first and it takes a while for credit growth to catch up. That reflects usual business practice, because firms will normally first use up their slack, run down inventories and increase capacity utilisation before starting to acquire additional loans for new investment.

Another explanation for the muted credit growth is that some companies have been able to tap other sources of funds such as corporate bonds. According to the Thai BMA's bond issuance statistics, non-financial firms raised three times more funds through short- and long-term bonds in the first eleven months of 2009, compared with the same period last year.

Given the strengthening momentum of economic growth and consumer confidence, as well as the traditional seasonal upturn, credit growth is expected to pick up in the fourth quarter.

However, the anticipated pick-up will not compensate for the lackluster growth in the first three quarters, and total loan growth will end up in the red.

Moreover, credit demand remains sluggish, lacking a broad base. On the corporate loan side, the only place demand has picked up is in sectors such as hotels and utilities - particularly in the power-generation business, where the investment risk is restrained compared to other industries.

On the consumer loan side, only housing and auto loans register good growth (though still lower than the previous year's) while credit-card loan growth will end up flat at best.

How long will it take for credit growth to get back to normal levels? According to banking industry experts, credit demand in the first quarter 2010 is expected to speed up considerably in both business and household sectors.

A boost should come from an easing of credit standards. Financial institutions appear less worried about the risk of defaulted loans since there has been some improvement in the economic indicators. For instance, we have seen unemployment rates fall back to more normal levels, and the agriculture commodities price is expected to rally given the global supply-demand balance. These factors will likely lead to an increase in household spending and should further boost the supply side of the economy.

The upshot is that there is no need to worry about the lack of credit growth - it will happen in due course.

(The views expressed are the author's own.)

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