Implications of household debt on the Thai economy and financial system stability

Household debt has received much attention from the public for the past decade as it accelerated significantly since 2011. This is reflected in the ratio of household debt to GDP that increased from 60.3 percent at the end of the first quarter of 2011 to 80.8 percent at the end of the fourth quarter of 2015. Although households have begun to slowly deleverage since the beginning of 2016, the ratio of household debt to GDP remains high (Chart 1) and is at the top of the rankings among the region (Chart 2). As a result, this has led to rising concerns that Thailand’s elevated household debt might affect private consumption and derail economic growth in the long run. Moreover, it might have an impact on debt serviceability of households and also increase financial stability risks. This article thus focuses mainly on two issues including implications on the Thai economy and financial system stability.

Implications on the Thai economy:
Household debt causes private consumption to expand at a lower rate than it should be

Households play an important role in driving and supporting economic growth by acting as “savers,” passing on their savings through financial institutions to those who need funds, which are firms that borrows money to invest in the production of goods and services as well as households in need of funds. At the same time, households also play a role as “consumers” of goods and services that are produced by firms. In terms of value, private consumption accounts for about half of Thailand’s GDP (Chart 3). However, such ratio has been declining

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12 Household debt in this article covers only debt extended from financial institutions to residents. Financial institutions, hereby, refer to (1) depository institutions such as commercial banks, specialized financial institutions accepting deposits, savings cooperatives, and (2) other financial institutions such as credit card companies, leasing companies, personal loan companies, insurance and life insurance companies, and pawnshop.

13 There are several reasons such as a better access to borrowing sources in the system, innovation and diversified financial products, debt accumulation to fix damages after the flood disaster in 2011, debt accumulation following the first-time car buyer scheme, debt accumulation by farmers due to severe droughts.

14 Most studies use the ratio of debt to GDP as a reflection of a ratio of debt to income because GDP data are comparable across countries and released before household disposable income data.

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Monetary Policy Report  September 2018  28
especially since 2016. This is due to factors related to both the business cycle and structural changes\(^{15}\) such as labor migration out of the manufacturing sector to the services sector with relatively lower wages, a transition toward aging society that has prompted households to save more for retirement, and elevated household debt.

Debt creation allows households to increase spending in the short run and is an alternative way for consumption smoothing in case of economic fluctuations. On the contrary, debt creation increases debt burden which might decrease households’ ability to spend in the future should such debt accumulation is not used for income-generating activities. Nevertheless, a recent study on impacts of household debt on Thailand’s private consumption\(^{16}\) suggested that the rise in household debt helped boost consumption in the short run but was found to be a factor holding down growth in the long run, which is defined in this study as four years later.

Net cash flow generated from debt creation, assuming no changes in net cash flow from income, can be calculated from the difference between the value of new debt and the value of existing debt that is repaid. It is found that net cash flow generated from household debt creation was still negative in the first quarter of 2018 (Chart 4, grey area), meaning less money for households to spend. This is one of the reasons why private consumption has expanded at a lower rate than it should be. However, such effect has started to be lessen since the previous year as households increase debt accumulation. This is particularly observed in auto leasing, driven by demand for new cars as the impact from the first-car buyer scheme, where auto possessions needs to be maintained for five years, gradually dissipated. However, although debt creation helps boost household spending, if accelerated, it would have implications for financial stability in the household sector.


Implications on financial system stability
Households are subject to risks from heavy debt burden, deteriorating debt serviceability, and limited capacity to cope with shocks

Debt creation is one of risk management tools, for instance, to cope with a severe drought. However, excessive debt creation can create vulnerabilities to households' balance sheets should households with debt burden have lower income due to various reasons such as economic slowdown and natural disasters. As a result, households might not be able to repay debt as scheduled, leading to higher non-performing loans (NPLs) of financial institutions and eventually an impact on overall financial system stability.

Analysis of the impact of household debt on Thailand’s financial system stability consists of three aspects: (1) level and speed of leverage, (2) debt serviceability, and (3) ability to cope with income and interest rate shocks.

First, although the ratio of household debt to GDP slowly declined since early 2016 (Chart 1), the ratio remains high and there are signs of acceleration in household debt since the beginning of 2017. This is particularly observed in consumer loans for all spending categories especially auto leasing. Meanwhile, household income has not sufficiently increased in a broad-based manner, with only medium- and high-income households in the manufacturing and tourism sectors being the first group to see improvements in income. On the contrary, farm income recovers only gradually, with the majority of farmers having low income but substantial debt. In addition, a decrease in the ratio of household debt to income is concentrated only in households in certain regions, namely the central and southern regions. Meanwhile, other regions see the ratio of household debt to income increases (Chart 5).

Second, debt serviceability of some households continues to deteriorate and that warrants monitoring. The NPL ratio of consumer loans extended by commercial banks trended up since 2013 to 2.2 percent at the end of the second quarter in 2018, driven mainly by a continue rise in mortgage NPLs (Chart 6). Moreover, when classified by income and occupation, the debt service ratio (DSR) is found to increase for some groups, particularly the low-income and agricultural households (Chart 7).

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17) Considering a quarter-on-quarter growth of household debt after seasonal adjustments
Third, households have lower capacity to cope with economic and financial shocks. In particular, household financial positions become more susceptible to interest rate shocks as well as income shocks. Households have less cushion to cope with financial risks given high debt relative to savings, as reflected in the ratio of debt to financial assets (savings) that increases for all income and occupation groups (Chart 8). Moreover, the household sector is found to be slightly more sensitive to interest rate shocks, as reflected in the marginal increase in the ratio of debt with floating rates in comparison to 2014 (Chart 9).

However, higher interest rates in the period ahead are expected to have limited impact on monthly debt repayment of households. This is because, first, installment loans, whereby borrowers pay a fixed monthly payment with a flexible repayment period, account for 43.2 percent of total household debt. Furthermore, both installment loans and fixed-rate loans account for 65.7 percent of total household debt. Second, non-installment loans, whereby borrowers would bear greater monthly burden if interest rates were to rise, constitute only 34.3 percent of total household debt.
Regarding income shocks, indebted households are found to be liquidity constrained in order to meet debt repayments. Liquidity constraint here is defined as a situation when net household income, after deducting consumption and tax expenses, is below monthly debt burden. The proportion of household debt that is subject to such liquidity constraint is found to be as high as 46.8 percent of total household debt. In a stress test analysis, whereby household income falls by 20 percent and consumption is assumed to remain unchanged, the ratio of debt with liquidity constraint reaches 72.5 percent of total household debt, with all occupation groups suffering greater liquidity constraints (Chart 10). In the case of severe shocks, households might begin to adjust by reducing consumption and defaulting on their debt, and these could impact overall economic growth.

In summary, although private consumption has been supported in part by a recent pickup in the pace of leveraging, such debt creation could undermine household financial positions. While the impact of higher interest rates on monthly debt burden is found to be limited, income shocks could put indebted households at risk. Therefore, if households as borrowers and financial institutions as lenders could change their behavior to become more financially disciplined, such endeavor could help reduce household debt as a share of GDP and consequently debt could become a driver of consumption without putting financial stability at risk in the future.

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18\(1\) The ratio of debt with liquidity constraints may be lower than the abovementioned figure due to reporting error of the data collected in the socio-economic survey (SES).