The Effect of Household Debt on Consumption in Thailand

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The views expressed in this paper are those of the author and do not necessarily represent those of the BOT.

Abstract

This paper describes the quantitative influence of household debt and wealth on total consumption in Thailand during the recession and recovery periods after the 1997 financial crisis. The analysis of the consumption function was based on the Life-Cycle and Permanent Income Hypotheses and used household survey data in Thailand. This empirical study found that debt positively influences consumption similar to wealth effect with greater impact of the latter. Moreover, positive debt effect can be observed in each type of consumption classified by durability, especially in durable goods. By contrast, positive wealth effect can be observed considerably on services consumption but not for durable consumption that was affected adversely from wealth. In terms of consumption classified by purpose, transportation, communication, and education spending are more heavily influenced by the positive debt effect than any other purposes. On the other hand, households desire more services consumption when they become richer in line with the positive wealth effect. In all, these findings are consistent with the perception that being in debt is not bad for households because it could help them finance their asset accumulation and smoothen their desired level of consumption over time. Although the study found that the current debt level is not harmful to the economy on a large scale, it is necessary to ascertain the rising household debt will not deteriorate sustainable consumption in the future. This paper proposes a set of policy recommendations to enhance the consumer credit market as well as to educate people to better manage their ability to service debt and not over-borrow. Furthermore, the paper emphasizes how important asset data is for analyzing household’s financial strength on the basis of balance sheet analysis.

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