No. 36/2019

Outcome of the Joint Meeting between the Monetary Policy Committee (MPC) and the Financial Institutions Policy Committee (FIPC) on 5 July 2019

The Bank of Thailand announced the outcome of the joint meeting between the MPC and the FIPC on 5 July 2019 to assess risks to Thailand's financial stability. Key discussion points were as follows.

The committees concluded that Thailand's financial stability remained sound. Banks and insurance companies maintained high capital buffers, while external stability remained solid, which helped cushion the spillover from external factors notably the trade tensions between the US and China. **Nonetheless, financial stability risks had not abated in the recent periods, and a further build-up of risks was observed in some areas. The committees highlighted four key issues as follows.**

1) The household debt situation remained a pressing concern, especially for vulnerable households. Household debt accumulation stayed elevated and showed signs of picking up, mainly from auto-related loans. Meanwhile, banks and non-banks competed more aggressively in the retail loan market, exhibited looser underwriting standards, and had lending practices that encouraged excessive borrowing, which could add vulnerabilities to households' balance sheets. The committees thus urged banks and non-banks to lend responsibly by putting more weight on borrowers' debt serviceability in the loan approval process. Special attention should be given on vulnerable groups, such as low-income borrowers, first jobbers, and retirees, all of whom tended to be overly indebted and might not have enough residual income to cover living expenses.

The committees viewed household debt to be at the forefront of financial stability concerns. Barring prompt policy actions, the problem seemed poised to intensify in the coming years. Effective policy packages would require interagency collaboration and synchronized efforts on several fronts. These would include: (1) ensuring sound lending practices and consideration of borrowers' debt serviceability in the lending process, both for banks and non-banks; (2) restructuring of troubled loans; and (3) promoting financial literacy and use of microinsurance especially for farming products. Recently, the Bank of Thailand collaborated with banks in standardizing the calculation of debt service ratio (DSR), which could be used for monitoring the banking system's underwriting standards and informing policy decisions if needed in the future. **The committees also noted the need to stay vigilant on the spillover due to regulatory arbitrage**, as stricter regulations could push risky lending activities to unregulated entities outside the purview of regulators. So, effective policy packages must tackle the household debt issue in an all-inclusive manner without side effects.

2) The mortgage loan market still expanded in the first five months of 2019, despite the fact that new mortgage loans started to slow down in April and May following a surge earlier in the year. **Following the implementation of the revised loan-to-value (LTV) measure, adjustments in the real estate market turned out to be as expected.** (1) The decline in the number of new mortgage loan accounts came from borrowers servicing two or more mortgage loans, especially for high-rise mortgages, and this reflected reduced speculative demand. In contrast, new mortgage loans granted to first-time homebuyers (servicing one mortgage loan) still managed to grow at a pace close to that of the previous year. (2) Banks enhanced their underwriting standards, as reflected in a lower share of new mortgage loans with high LTV ratio, a lower loan-to-income ratio, and a shorter tenor on average. (3) Developers also delayed project launches and adjusted their investment plans to align with market conditions. **In the meantime, risks from oversupply continued to be present.** Foreign demand from many countries, notably China, showed signs of slowdown since the beginning of the year, while oversupply in the condominium market stayed high as reflected in declining rental yields. In light of these assessments, the committees would continue to monitor the impact of the LTV measure, adjustments in the real estate sector, and oversupply conditions in the periods ahead.

3) For savings cooperatives, their assets had grown over the years and their significance to financial stability had risen considerably. Thus, there was an urgent need to enhance the supervision of savings cooperatives to reflect their increased systemic importance. **While the new Cooperatives Act had already taken effect, the committees viewed that the enactment of the accompanying ministerial regulations remained delayed.** Relevant regulators must expedite the enactment of key parts of the regulations, especially those related to credit risks, liquidity risks, and households' leverage, so that the new regulations could be used promptly to mitigate existing risks in the savings cooperatives system. The committees would also remain vigilant on the search-for-yield behavior among savings cooperatives, as well as the increased interconnectedness within the cooperatives system due to cross-lending, which could act as the main channel through which liquidity shocks could propagate in the cooperatives system.

4) The search-for-yield behavior continued to persist in several areas, which could lead to underpricing of risks. Insurance companies invested in riskier bonds, while term funds' investment remained highly concentrated in a small number of countries and issuers. Meanwhile, large conglomerates expanded their investment into non-core areas and had complex organizational structures, which made it more difficult to assess their risks properly. In light of these conglomerates' significance in the loan and bond markets, monitoring their risks would require close collaboration among related regulators. With regard to households, their investment in risky assets seemed poised to continue on an uptrend. There also continued to be a need to monitor fraudulent investment schemes, such as those related to Ponzi schemes and fake digital tokens, which lured the public with abnormally high returns.

In the periods ahead, the committees viewed that financial stability risks would remain elevated. Further easing from G3 central banks could result in looser financial conditions globally, which would be conducive to a further build-up of risks in the global financial system. In addition, uncertainties surrounding the trade tensions and geopolitical risks would likely remain high. On the domestic front, the committees would continue to monitor developments in the four key issues discussed above, assess the effectiveness of the implemented measures, and explore further policy options to prepare for periods of heightened systemic risks in the future. The Bank of Thailand, the Office of the Securities and Exchange Commission, and the Office of Insurance Commission would continue to collaborate closely in assessing and monitoring risks to financial stability. The three regulators would also improve and enforce regulations to cope with emerging risks appropriately, with an aim to prevent the build-up of vulnerabilities that could undermine national financial stability.

Bank of Thailand
10 July 2019

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Annex: key points from the joint meeting between the MPC and the FIPC on 5 July 2019

- **In the recent periods, risks to financial stability had not abated and a further build-up of risks was observed in some areas.** Four key issues were highlighted by the committees:
    - **Household debt** stayed high and leverage showed signs of picking up, driven by all loan categories especially auto-related loans. Meanwhile, banks and non-banks competed more aggressively in the retail loan market, exhibited looser underwriting standards, and had lending practices that encouraged excessive borrowing, which could add more risks to vulnerable households.
    - For **the real estate sector**, after the revised loan-to-value (LTV) measure took effect in April 2019, households and banks' adjustments turned out to be as intended. This was reflected in reduced speculative demand and enhanced underwriting standards. However, there continued to be a need to monitor adjustments in the real estate sector and oversupply conditions going forward.
    - **The search-for-yield behavior** persisted in several areas. This could lead to underpricing of risks, as seen in households and insurers' investment in risky assets, as well as concentration risks especially those related to mutual funds and large conglomerates.
    - With regard to **savings cooperatives**, the enactment of the ministerial regulations accompanying the Cooperatives Act remained delayed. The committees stressed the need to expedite the enactment of key parts of the regulations, especially those related to credit risks, liquidity risks, and households' leverage.

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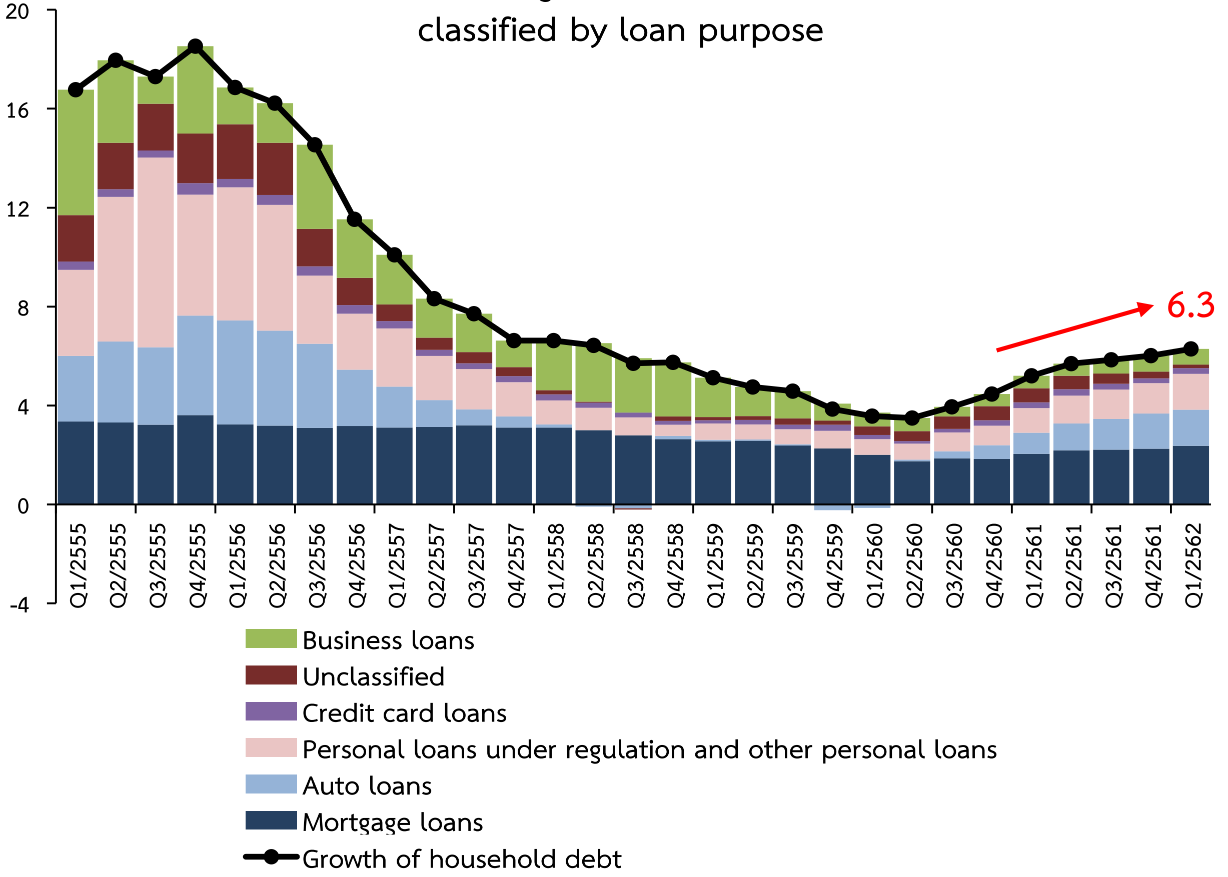
Household leverage showed signs of picking up in all loan categories. The key driver was auto-related loans, where commercial banks and leasing companies competed more intensely and showed looser underwriting standards.

Household leverage showed signs of picking up, driven by all loan categories especially auto-related loans.

Contribution to growth of household debt, classified by loan purpose

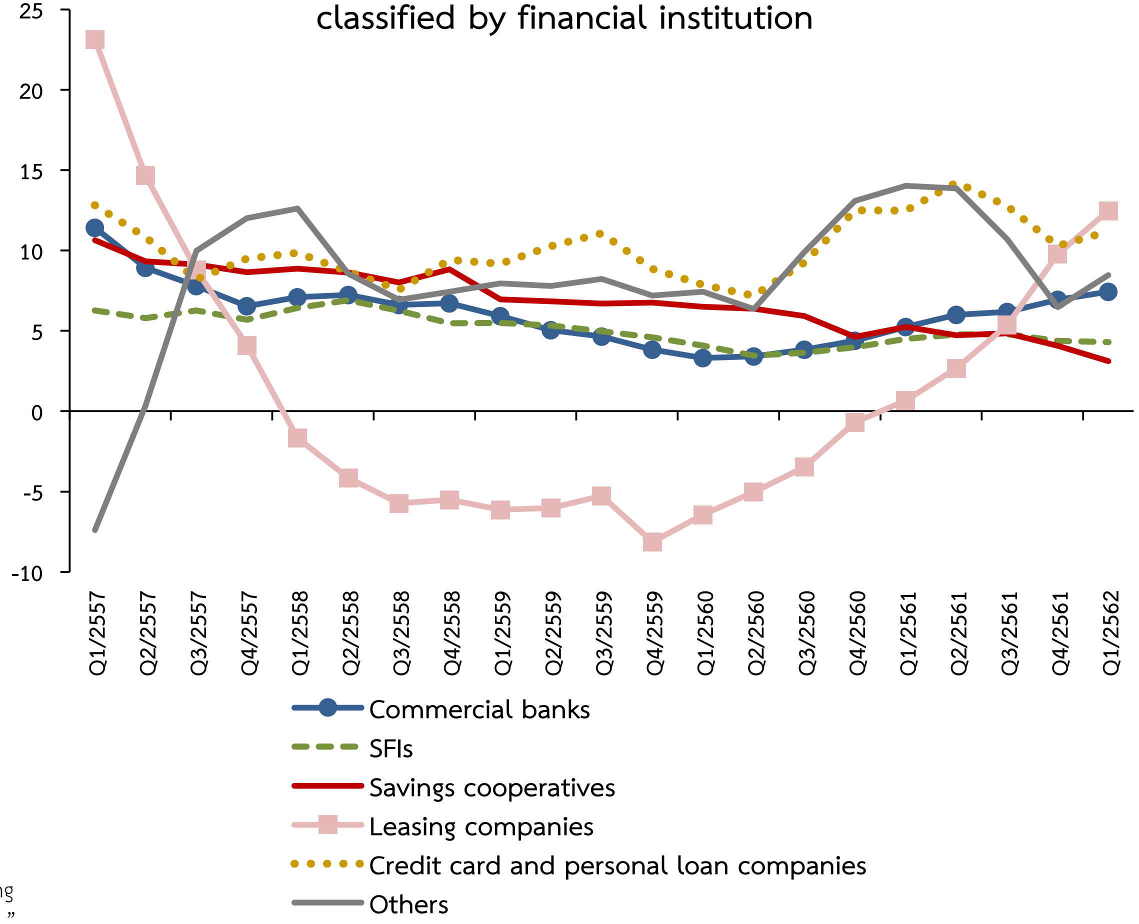


Note: In this figure, personal loans under regulation and other personal loans are combined into one group, since the new reporting scheme starting from February 2019 onward requires car-for-cash loans to be reported as part of "personal loans under regulation."

Source: Bank of Thailand

Commercial banks and leasing companies kept expanding their lending to households.

Growth of household debt, classified by financial institution



Source: Bank of Thailand

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After the LTV measure took effect, households and banks' adjustments turned out to be as intended. However, there continued to be a need to monitor adjustments in the real estate sector and oversupply in the periods ahead.

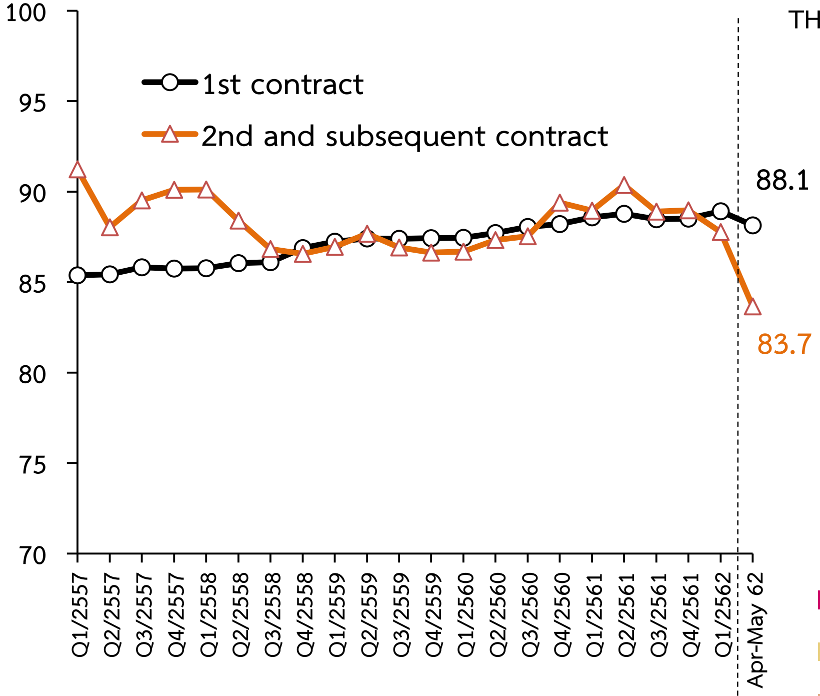
New mortgage loans still expanded in the first five months of 2019. But after the LTV measure took effect, some slowdown was seen especially in high-rise loans given to borrowers servicing the 2nd or subsequent contract.

New mortgage loan accounts	Growth (%YoY)
Jan–May 2019 (year to date)	14.8
Apr–May 2019	-4.6
1st contract*	0.2
- low-rise*	6.3
- high-rise*	-11.7
2nd and subsequent contract*	-36.0
- low-rise*	-21.9
- high-rise*	-45.3

Note: * Calculated from the database on loans that use new housing as collateral.
Source: Bank of Thailand

The average LTV ratio tended downward, especially for the 2nd and subsequent contract, which reflected banks' enhanced underwriting standards.

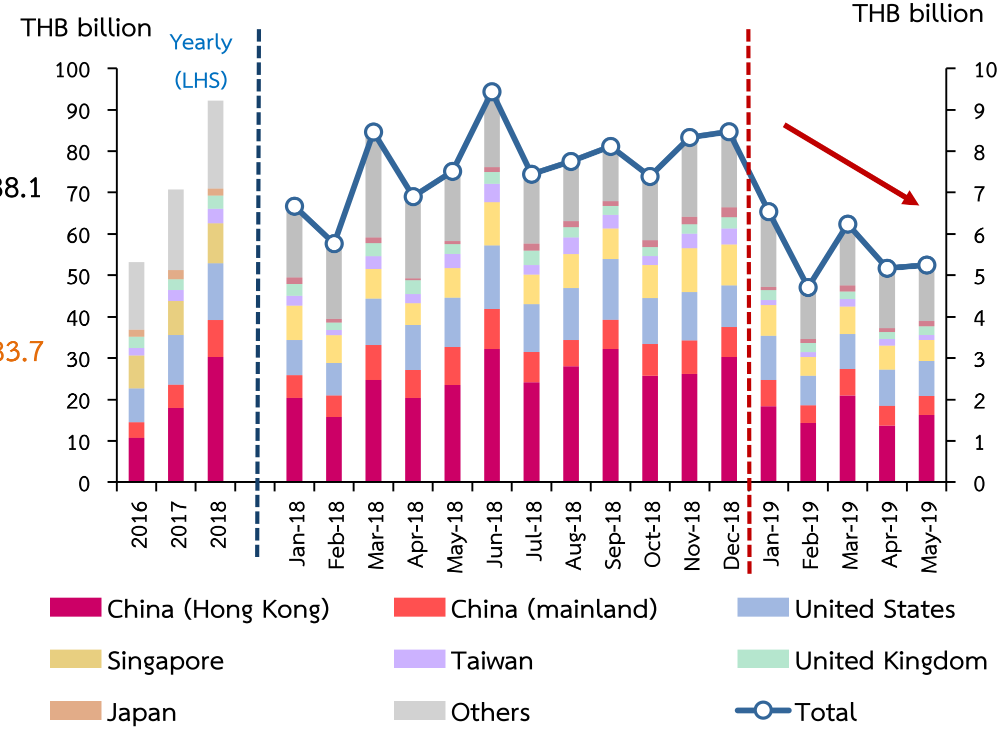
Average LTV ratio, classified by type of contract



Source: Bank of Thailand

There continued to be a need to monitor risks from oversupply, in the context where foreign demand showed signs of slowdown.

Non-residents' funds transferred for condominium purchases, classified by buyer's country of residence



Note: The value of funds transferred for condominium purchases by non-residents is estimated from (1) the amount of foreign currencies sold for down payments or purchases of condominiums and (2) the amount of funds withdrawn from baht-denominated accounts for condominium purchases by non-residents.
Source: Bank of Thailand.