The Wealth and Debt of Thai Households: Risk Management and Financial Access

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Executive Summary

Risk pervades everyday life. Risk, whether in the form of the weather, price fluctuations, or illness, has been part of human society since time immemorial. However, risk is often associated with many beneficial economic ventures. Rather than eschewing risky economic ventures altogether, households have often chosen to pursue risky economic ventures.

The challenge for households is therefore not to avoid risk altogether, but rather how to live with risk that arises either from providence or from their own choosing. To this end, households have learnt how to live with risk not through blithe acceptance but through managing risk by mitigating its consequences. Risk can be managed through self-insurance or cross-insurance. Self-insurance refers to the precautionary accumulation of buffer stocks and savings, which can be drawn during times of economic hardship. Cross-insurance refers to implicit or explicit arrangements for households with positive income shocks to send resources to households with negative income shocks. A common example is that of the tendency for households with bountiful harvests to send remittances to those less fortunate.

The financial sector can play a key role in augmenting the ability of households to both self-insure and cross-insure. Although a well-functioning financial sector helps households manage risk and accumulate wealth, rising financial access itself brings new types of risks to households. Innovative saving and debt instruments are expected to bring opportunities to households, but they may also bring a greater variety of risks. Excessive borrowing may weaken household balance sheets and expose households to various shocks. Given sufficiently weak balance sheets and strong enough shocks, households may face cash-flow problems, loan default, insolvency and foreclosure. The surge in Thai household debt over the past few years and the recent US sub-prime turbulence have brought this concern to the forefront of the policy debate.

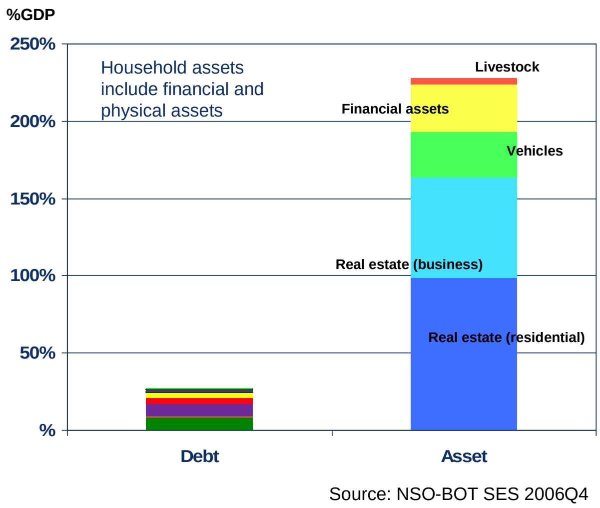
In order to better inform the policy debate, **this paper pursues two main research objectives designed to take advantage of new household data**. The first objective is the measurement of the household balance sheet at the macroeconomic and microeconomic levels and the determination of whether households are unduly exposed to certain economic shocks given rising financial access. The paper uses household survey data from the National Statistical Office (NSO) from a joint project between the Bank of Thailand and NSO fielded with the Socioeconomic Survey in the

fourth quarter of 2006. This survey is a first attempt to measure household debt and assets across Thailand in order to obtain representative balance sheet at the microeconomic and macroeconomic levels. The survey also measures various dimensions of financial access and financial literacy. **The second objective** is the conceptualization of household financial access and the measurement of the current breadth and depth of financial access among households.

The research contributions of this paper are three-fold: first, the measurement of the household balance sheet at the macro and micro levels; second, the measurement of financial access; and third, an understanding of the relationship between household fragility, the household balance sheet, economic shocks, and financial access.

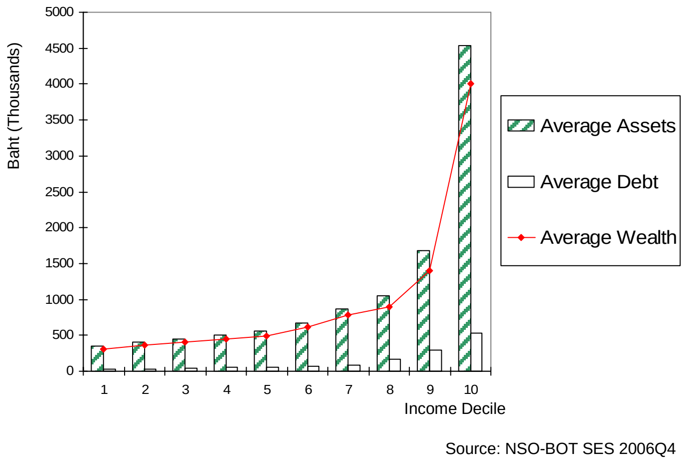
The paper finds that household balance sheets appear to be strong although certain households in the low income deciles exhibit high leverage. Financial access is found to benefit household resiliency although excessive leverage increases household exposure to interest rate hikes. It finds that low-income rural households lack access to basic financial services due to income and collateral constraints and low financial literacy. Approximately five percent of households are severely savings constrained and lack access to basic savings services. Middle-income have access to basic services but show low depth of usage and portfolio diversification similar to low income households.

Figure 1. Aggregate Household Balance Sheet



It may seem paradoxical that financial access helps household stability while high leverage weakens it. After all, high leverage is the apparent outcome of financial access and high debt. It is not immediately apparent that high financial access is a sufficient condition for high leverage, as high wealth households, which have high financial access, exhibit low leverage due to large accumulation of assets. It may lead to higher leverage for households in the short run. In the long run, financial access helps households to accumulate wealth as shown by the experience of the developed economies.

Figure 2. Thailand's Aggregate Household Balance



Financial access can be a double-edged sword, if not well-implemented. It can help and hurt household stability. The key for policymakers is not to restrict the rise in the financial access; but to develop a financial sector that is able to provide opportunities to all households that have adequate ability to use financial services in the appropriate manner, enabling households to effectively use financial services to manage risk, generate income and accumulate wealth. We discuss **policy implications** below**.**

Financial access can be broadened by encouraging a wider range of financial products and innovation to lower transaction costs. The entry of new market players can bring innovation and close the gap in financial access.

Financial literacy can be enhanced through initiatives from partnerships between the government sector, the private sector, and educational institutions.

Better information provision, regarding financial services, in a simple and comprehensive manner can help households to understand and make more informed financial decisions.

Credit data provision is crucial to a vibrant and competitive financial sector that can share risk and provide access. The role of the credit bureau can be broadened to cover main financial institutions in the formal, semi-formal and informal sectors.

A financial consumer protection agency can help offer advice and suggestions on financial and investment decisions to households regarding opportunities and risks involved may help to empower households.

Households will become increasingly sensitive to the effects of interest rate changes as amplified by leverage. **Monetary policy transmission** may become more effective or more potent. Effective communication on the part of the central bank will become more important in shaping household expectations and preparing households for future interest rate changes.