Introduction

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This volume is a collection of the speeches and papers delivered at the seminar “Household debt: implications for monetary policy and financial stability”. The seminar was co-organised by the Bank of Korea (BoK) and Bank for International Settlements (BIS) under the BIS Asian Research Programme. It was held on 28 March 2008, in Seoul, Korea. Represented at the seminar were eleven central banks from Asia and the Pacific, Sweden and the United States. Governor Seongtae Lee of the BoK and Robert McCauley, BIS Chief Representative for Asia and the Pacific delivered opening speeches. President Eric Rosengren of the Federal Reserve Bank of Boston gave the keynote speech. Eli Remolona, BIS Head of Economics for Asia and the Pacific, wrapped up the seminar.

The theme of the seminar, chosen based on consultations between the BIS, the BoK and other central banks, turned out to be very timely, with the seminar being held even as the global financial turmoil continued to unfold. The seminar was divided along four topics: (1) mortgage finance; (2) consumer credit; (3) securitisation; and (4) policy challenges. Each session was introduced by three or four lead presentations to stimulate discussion on the floor. This introduction highlights some of the recent trends in the region’s household debt and the associated policy challenges as presented at the seminar.

Trends in household debt

Over the past decade, the region’s household debt grew significantly, but the speed of growth varied across markets. The level of household debt in many countries doubled and in some cases increased by nearly 50 times, albeit from a low base. The fast growth in lending to households has markedly increased the share of household loans in total bank loans: as of 2007, it ranged from 15% in China to 70% in Australia. In 2007 the level of household debt as a proportion of GDP ranged from a low of 7% in Indonesia to a high of 82% in Korea; in contrast, the share was more than 100% in both the United States and the United Kingdom.

In particular, many of the papers at the seminar reported household balance sheet information for several countries (Australia, Indonesia, Japan, Malaysia and Thailand). Such debtor information can complement creditor data for policy analysis and in monitoring the financial position of households.

Seminar participants identified several factors that contributed significantly to the strong expansion of household debt over the past decade. On the demand side, high economic growth, low and stable inflation, falling interest rates and demographic changes including urbanisation spurred household borrowing. On the supply side, financial deregulation, financial innovations, technological advancements and weak corporate demand for loans contributed to the increased availability of household lending. In some cases, other factors, such as government policies to promote lending to households via tax incentives and government-sponsored institutions, have been instrumental in the development of household

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finance. Asset prices, particularly housing prices, have often in turn further stimulated increases of household lending, although the latest global financial turmoil and resulting economic weakness have to some extent damped the rise.

The structure and composition of household debt exhibit similarities as well as diversity across markets in Asia and the Pacific. Mortgages have been by far the largest component of household debt for most of the markets, ranging in share from 50% to more than 80%. Mortgage debt has been dominant in part because collateralised lending tends to ameliorate the problems of adverse selection and moral hazard, and in part because many governments have promoted housing ownership. The only exception for the economies covered by this volume is the Philippines where the proportion of mortgage in total household debt is only about one third. Nevertheless, the fragmented provision of housing finance in the Philippines may lead to an understatement in the data on the overall mortgage burden there.

The remainder of the household debt category is consumer debt, which in the region consists mainly of loans for motor vehicles, credit card debt and education and personal loans. In Indonesia and the Philippines, motor vehicle loans have constituted a greater share of consumer debt and been of higher quality than elsewhere in Asia and the Pacific; in China, such loans were much more volatile in some recent years than elsewhere in the region. Regarding credit card lending, Korea recently experienced a boom-bust cycle in that market.

Rapid growth in household borrowing offers both opportunities and challenges. Household debt offers several advantages: better access by households to credit facilities for consumption smoothing, a new source of income for Asian financial institutions, and portfolio diversification for the banking sector. In the longer term, a healthy and vibrant household finance sector also facilitates a shift towards domestic demand that will help rebalance the export-oriented growth model of many Asian economies. However, high levels of household debt may heighten an economy's vulnerability to instability and crises. Such problems have been seen in the boom-bust cycles in some credit card markets, rapid house price increases in several economies and the ongoing global financial turmoil.

The securitisation of household debt has been a relatively new development in most markets in Asia and the Pacific. One notable exception is Australia, where a market in residential mortgage-backed securities has thrived for a number of years. In several Asian countries, government agencies have played an important role in the securitisation of residential mortgages and other consumer debt. However, the latest global financial turmoil has halted the region's growth in the securitisation of household debt. Indeed regional policymakers have been keen to draw lessons from the US experience to ensure that their own mortgage securitisation markets develop in a sound way.

Policy implications

The implications of rising household debt for monetary policy are explored in several papers. For instance, Norhana Endut and Toh Geok Hua, of the Central Bank of Malaysia, and Wimboh Santoso and Made Sukada, of Bank Indonesia, propose that a higher level of household debt increases the potency of monetary policy because it heightens the sensitivity of households to changes in interest rates. Hence, a case can be made for more-gradual changes in monetary policy. On the other hand, Kyuil Chung, of the BoK, argues that excess household indebtedness may constrain the effectiveness of monetary policy because fewer households are able to borrow for consumption smoothing. To alleviate output volatility in this case, monetary policy should respond more to inflation.

Although mortgages dominate household borrowing, evidence varies on how monetary policy affects house prices and thus on the external finance premium and wealth effect. Also, the mortgage market structure helps shape the effects of monetary policy. The dominance of variable-rate mortgages facilitates fast flow-through of a change in policy rates; but in today's global financial turmoil, the higher dependence on capital market funding entailed by such dominance increases the influence of non-monetary policy factors (see the paper by Michael Davis, of the Reserve Bank of Australia).

Most of the papers in this volume discuss the implications of higher household indebtedness for financial stability in terms of the need for monitoring the household sector's financial position and of the ability of market infrastructure and prudential regulation to provide a resilient financial system. Many authors point to the need for both aggregate and micro data on household borrowing and balance sheets if monitoring is to discover the build-up of stresses before they become excessive. As of this writing, data from most of the Asian markets show the financial condition of the household sector to be healthy, and loans to households remain among the best assets of financial institutions (for example, see the paper by Shinobu Nakagawa and Yosuke Yasui of the Bank of Japan). Most banks in Asia also appear well capitalised and less exposed to external funding stress. The infrastructure for sharing consumer credit information, centralised or otherwise, is being improved but has proven to be no panacea. Prudential regulations – such as strong write-off rules, minimum loan-to-value ratios for mortgages and minimum income requirements for credit cards – should be put in place and vigorously enforced to act as speed bumps in boom times (see the paper by Taesoo Kang of the BoK and Guonan Ma of the BIS).

Finally, a highly challenging question for regional policymakers lies in the complex interaction between monetary and financial stability. In particular, price stability may not always suffice to ensure macroeconomic stability, as highlighted by Andrew Filardo of the BIS. Much more still needs to be learned about the trade-offs facing central banks, the need to expand central bank mandates (as well as the possible scope for doing so) and the role of tail risks in setting monetary policy.