The growth of consumer credit in Asia

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Hong Kong Monetary Authority

March 2005

FEATURE ARTICLE

The growth of consumer credit in Asia

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Consumer credit has shown strong growth in emerging and newly industrialised Asian economies in recent years. While credit card lending has helped smooth consumer spending and improved the profitability of financial institutions, it also represents a new source of risk.

Preventing financial and macroeconomic instability associated with consumer lending requires policy makers to be confident that lenders have proper risk management systems in place and consumers have sustainable debt burdens. Public policy also needs to ensure that essential infrastructure for consumer credit is available and set up properly, such as credit information bureaux and personal debt workout systems.

Corporate and financial sector restructuring in the aftermath of the 1997-98 Asian financial crisis has led to a marked turnaround in the balance sheets of financial institutions in Asia. The significance of household lending has increased sharply. In particular, non-secured credit card debt has been growing exceptionally fast, albeit from a low base. These developments raise a number of issues, such as the implications for financial stability due to a rapid rise in consumer credit, whether risk management systems and supervisory practices should be strengthened in response to the new risks involved, and whether governments need to look at new requirements in financial sector infrastructure. This paper attempts to address these issues. It focuses on the growth of non-secured credit card debt instead of mortgages, which have been dealt with extensively elsewhere. It will first provide an overview of consumer credit in various Asian economies, and then focus on Hong Kong's experience and the lessons learnt.

Recent developments in Asia

Household credit grew strongly in emerging and newly industrialised Asian economies in the past few years (Table 1, Table 2 and Table 3). As banks and non-bank lenders suffered large losses from their

TABLE 1

Growth of household credit

(year on year)

%	1999	2000	2001	2002	2003	H1 2004
China[1]	206.1	205.4	63.9	n.a.	50.0	n.a.
Hong Kong[2]	2.6	4.4	3.3	-1.4	-3.9	-1.3
Korea[3]	16.5	24.7	28.0	28.5	1.9	4.3
Malaysia[4]	5.4	17.2	17.0	16.8	13.9	14.5
Philippines[5]	-11.7	2.2	-1.9	0.2	-1.1	10.8
Singapore[6]	5.2	11.0	6.0	2.9	11.4	12.4
Taiwan[7]	4.3	6.6	-0.3	4.1	13.5	18.4
Thailand[8]	-7.5	-5.9	1.0	16.2	30.2	29.1

Source: CEIC, Bank Negara Malaysia, Bank of Thailand & authors' estimates.

1. Data from People's Bank of China.
2. Loans of authorized institutions to private and professional individuals, except those for business purposes.
3. Data from Bank of Korea.
4. Loans of commercial banks, merchant banks and finance companies for residential properties, personal uses and purchases of consumer durables and cars.
5. Loans of commercial banks to individuals.
6. Commercial banks' housing loans and loans to professional and private individuals, and finance companies' housing loans and hire purchase loans for cars and consumer durables.
7. Consumer loans of commercial banks.
8. Personal consumption loans of commercial banks and finance companies and housing loans of government housing bank, government savings banks and credit foncier companies.

corporate loan portfolios during the Asian financial crisis, many turned to the household sector as a new source of loan growth and profits. In some cases, governments encouraged financial institutions to lend to the household sector to boost the role of domestic consumption as a source of growth and to reduce reliance on external demand. In addition, economic recovery in the region generated higher income and improved consumer confidence. Together with the low interest rate environment that reduced the cost of borrowing, younger households with prospects of higher income have become more willing to borrow in order to smooth their consumption.

TABLE 2
Total household credit as a percentage of GDP

%	1999	2000	2001	2002	2003	H1 2004
China[1]	1.7	4.8	7.1	n.a.	n.a.	n.a.
Hong Kong[2]	58.3	58.9	61.7	62.0	60.9	58.9
Korea[3]	40.4	46.1	54.9	64.2	62.0	61.0
Malaysia[4]	37.5	38.5	46.3	50.0	52.2	52.4
Philippines[5]	7.1	6.4	5.7	5.3	4.9	5.4
Singapore[6]	45.9	44.6	48.9	49.1	54.3	54.1
Taiwan[7]	41.6	42.6	43.2	43.8	49.2	52.5
Thailand[8]	19.6	17.4	16.8	18.4	22.0	22.6

Source: CEIC, Bank Negara Malaysia, Bank of Thailand & authors' estimates.
1. Data from People's Bank of China.
2. Loans of authorized institutions to private and professional individuals, except those for business purposes.
3. Data from Bank of Korea.
4. Loans of commercial banks, merchant banks and finance companies for residential properties, personal uses and purchases of consumer durables and cars.
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6. Commercial banks' housing loans and loans to professional and private individuals, and finance companies' housing loans and hire purchase loans for cars and consumer durables.
7. Consumer loans of commercial banks.
8. Personal consumption loans of commercial banks and finance companies and housing loans of government housing bank, government savings banks and credit foncier companies.

In most economies, the dominant household credit has been mortgage lending against residential properties (Table 4). Commercial lenders have been eager to enter the residential mortgage market because such loans are typically viewed as low risk.

TABLE 3
Total household credit as a percentage of total loans

%	1999	2000	2001	2002	2003	H1 2004
China[1]	1.5	4.3	6.2	8.0	10.0	n.a.
Hong Kong[2]	25.8	30.8	35.9	37.2	36.5	35.6
Korea[3]	42.7	46.7	55.1	58.0	56.3	56.2
Malaysia[4]	28.6	31.8	35.8	40.0	43.4	44.5
Philippines[5]	15.5	14.8	15.0	14.7	14.0	16.4
Singapore[6]	39.4	41.9	43.1	45.1	48.5	50.3
Taiwan[7]	34.2	34.3	34.7	36.9	39.8	41.6
Thailand[8]	16.0	16.7	17.7	19.0	23.4	24.4

Source: CEIC, Bank Negara Malaysia, Bank of Thailand & authors' estimates.
1. Data from People's Bank of China.
2. Loans of authorized institutions to private and professional individuals, except those for business purposes.
3. Data from Bank of Korea.
4. Loans of commercial banks, merchant banks and finance companies for residential properties, personal uses and purchases of consumer durables and cars.
5. Loans of commercial banks to individuals.
6. Commercial banks' housing loans and loans to professional and private individuals, and finance companies' housing loans and hire purchase loans for cars and consumer durables.
7. Consumer loans of commercial banks.
8. Personal consumption loans of commercial banks and finance companies and housing loans of government housing bank, government savings banks and credit foncier companies.

TABLE 4
Components of household credits

(end of June 2004)

%	Mortgage	Credit card	Others
Hong Kong	83.0	6.4	10.6
China*	80.1	n.a.	19.9
Thailand	65.9	7.3	26.8
Singapore	61.9	2.7	35.4
Taiwan	59.8	8.5	31.7
Malaysia	56.5	5.8	37.7
Korea#	55.1	9.5	35.4
Philippines^	38.4	45.5	16.1

* Figure for China as of end 2001.
\# Commercial and specialised banks only.
^ Only includes mortgages, credit card receivables and auto loans of commercial banks.
Source: CEIC, Bank Negara Malaysia, Bank of Thailand & authors' estimates.

This activity has helped finance booming construction industries and rising housing markets (Table 5).

TABLE 5
Growth of mortgage loans

(year on year)

%	1999	2000	2001	2002	2003	H1 2004
China	218.6	148.7	65.8	n.a.	n.a.	n.a.
Hong Kong	3.2	2.9	3.3	-0.8	-4.0	-1.9
Korea	n.a.	n.a.	59.4	52.7	15.7	15.5
Malaysia	8.1	17.9	17.3	16.5	16.1	15.4
Philippines	20.7	-23.2	12.3	2.6	0.0	4.1*
Singapore	8.5	6.9	5.5	6.1	14.9	15.9
Taiwan	4.6	4.5	-1.0	5.3	10.1	15.5
Thailand	-7.4	-4.0	0.0	11.8	14.3	15.6

* March 2004 figure.
Source: CEIC, Bank Negara Malaysia, Bank of Thailand & authors' estimates.

Although quantitatively less significant, non-secured credit card debt has been growing faster than mortgages (Table 6). The growth of credit card debt reflects a number of factors. First, there appears to be a cultural shift, particularly among Asian youth, in favour of borrowing for consumption. The low interest rate environment also facilitated such a cultural shift. Secondly, credit card borrowing to some extent replaced previous borrowing from the "curb market" and "loan sharks". Government incentives, such as tax deductions, also encouraged the use of credit cards, as was the case in Korea.

TABLE 6
Growth of credit card receivables

(year on year)

%	1999	2000	2001	2002	2003	H1 2004
Hong Kong	7.2	30.1	12.8	-6.3	-3.7	0.7
Korea	n.a.	78.5	122.9	39.3	-31.6	-36.1
Malaysia	n.a.	36.9	19.7	20.2	15.5	14.0
Philippines	12.5	15.6	16.8	41.4	16.2	16.1*
Singapore	23.2	25.8	21.8	15.5	2.8	-0.3
Taiwan	22.3	34.6	26.4	21.7	26.4	31.1
Thailand	-25.2	-3.4	26.3	76.7	30.1	29.7

* March 2004 figure.
Source: CEIC, Bank Negara Malaysia & authors' estimates.

Credit card debt has helped to improve the profitability of banks in the region, but it also represents a new source of risk. There are a number of channels through which the risks of credit card lending can affect financial and macroeconomic stability. First, since both lenders and borrowers have little experience in these new products, it is difficult for lenders to price the risks correctly. There is also likely to be high volatility in borrower behaviour patterns, particularly when the external economic environment changes. Thus credit risks associated with credit cards are likely to be high, at least in the beginning.

Secondly, although credit card loans represent a small part of the lending portfolio of major financial institutions in Asia, their potential influence on system fragility can be much larger than commonly assumed, in part because the distribution of the credit card portfolio can be concentrated in a number of lenders (for example, specialised non-bank financial institutions). The failure of these lenders can disrupt financial markets, as they are typically funded in the wholesale markets, such as bond and inter-bank markets. Thirdly, the consequences of consumer delinquency on private consumption growth can be larger and more protracted than expected, as many defaulters are young and jobless and have to rely on their parents for debt workout. In other words, the family tradition in Asia may exacerbate the negative shock to household sentiment.

Owing to inadequate information on the creditworthiness of households, many financial institutions in Asia have been poorly prepared to manage risks associated with consumer lending. A number of economies have seen a sharp rise in non-performing loans in their consumer loan portfolio (Table 7). Over-borrowing by some households has also led to an increase in personal bankruptcies. An example is Korea where household delinquencies reached 3.8 million at the end of 2003, about 17% of the economically active population, and distressed credit card debt rose from 7.5% of total credit card receivables in 2000 to 34% in 2003. Economic growth turned negative in the first half of 2003 due to a credit squeeze in the household sector, and the government was under pressure to provide relief to both lenders and borrowers. Concerned with systemic risks in the bond market, the government stepped in to arrange the rescue of the largest credit card company, LG Card, and set up a government-backed "bad bank" to reschedule distressed credit card debt.

TABLE 7
Distressed credit cards debt

(in percentage of total receivables)

%	1999	2000	2001	2002	2003	H1 2004
Hong Kong	4.8	3.9	8.6	13.5	8.2	5.4
Korea	n.a.	7.5	7.3	11.8	34.0	n.a.
Malaysia	5.2	5.1	4.6	4.1	4.7	4.2
Philippines	22.6	22.0	21.6	18.7	19.4*	n.a.
Singapore	2.7	2.0	2.6	1.7	3.5	3.2

* September 2003 figure.
Source: CEIC, IMF Korea Selected Issues 2003; authors' estimates.

In response to the rapid growth of consumer credit, supervisory authorities in a number of economies tightened lending standards and raised provisioning requirements. Some economies (for example, Malaysia, Singapore, and Thailand) introduced minimum eligibility criteria on credit card applications. In Thailand, the Bank of Thailand issued regulations requiring a minimum monthly income for credit card applicants in 2002. The central bank tightened the rules in March 2004 and capped the outstanding debt to five times the monthly income of cardholders. Some authorities also revised the legal and regulatory framework to ensure better credit information reporting by, and sharing among, financial institutions. Credit reference agencies have been formed in a number of economies, including Mainland China, Thailand, Taiwan and Hong Kong.

Experience of Hong Kong

Hong Kong's experience in credit card lending provides useful lessons for managing risks to financial stability arising from consumer credit. Banks in Hong Kong are highly exposed to the household sector, with household credit[1] accounting for 36.5% of total loans in 2003. Of this, mortgage loans and credit card advances accounted for around 83% and 6% of total household debt respectively. Although credit card advances accounted for a relatively small share of total loans in Hong Kong, rising delinquencies led to high levels of charge-offs.

The growth of credit card lending

Following the Asian financial crisis, loan growth slowed significantly in Hong Kong as the weak economy curbed corporate loan demand, and the correction in the property market dampened the demand for mortgages. Because of keen competition, net interest margins of banks also narrowed. To maintain profits, banks moved enthusiastically into the credit card business, leading to a rapid increase in both the amount of credit card receivables and the number of credit cards (Table 8). Between 1998 and 2001, credit card advances expanded at an average annual rate of 16%. Outstanding credit card receivables increased by more than 50% from HK$40.2 billion at the end of 1999 to HK$62.1 billion at the end of 2001. During this period the number of credit cards increased by around 60%.

[1] Household credit includes all loans to professional and private individuals, except those for business purposes.

TABLE 8

Credit card lending survey of selected authorized institutions*

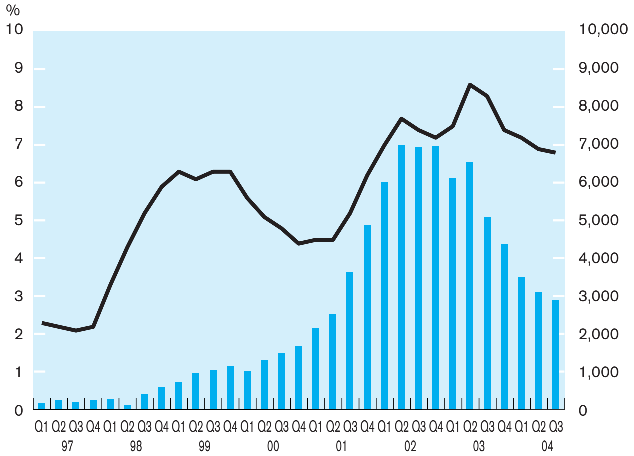
	Outstanding credit card receivables (HK$ bn)	Number of credit cards ('000)	Rollover ratio# (%)	Delinquency ratio## (%)	Annualised charge-off ratio### (%)
1998 Q4	n.a.	n.a.	n.a.	1.16	4.13
1999 Q4	40.2	5,776	54.3	0.76	4.83
2000 Q4	51.2	7,159	54.3	0.92	3.88
2001 Q4	62.1	9,217	53.2	1.28	8.55
2002 Q4	59.2	8,865	54.1	1.28	13.45
2003 Q4	56.3	8,784	49.3	0.92	8.19
2004 Q3	54.2	9,119	46.0	0.55	4.51

* The survey covered 23 AIs before Q4 2001 and 27 AIs from Q4 2001 onward.
\# The rollover ratio is defined as the rollover amount of credit card receivables over total credit card receivables.
\## The ratio of credit receivables overdue for more than 90 days to total credit card receivables.
\### Charge-off policies vary from institution to institution. Normally, an account will be written off when the receivable has been overdue for more than 180 days or when the ultimate repayment of the receivable is unlikely (e.g. the cardholder is bankrupt or cannot be located).

Lending standards began to loosen when banks started competing for a share of the credit card market. As the banks could not check borrowers' overall indebtedness, some borrowers were able to obtain several credit cards from different banks and the credit limits they were granted far exceeded their repayment capability. With economic growth remaining negative for five consecutive quarters in 2001-02, the unemployment rate rose to over 7%. Credit card receivables also declined between September 2002 and March 2004 as a large number of cardholders could not service their credit card debt and went into bankruptcy (Chart 1). The number of personal bankruptcy petitions increased sharply from under 1,000 a quarter in 1998 to around 7,000 a quarter in 2002. Credit card charge-offs also rose from 4.1% at the end of 1998 to a peak of 14.6% at the end of September 2002 (Chart 2). Despite the increase in the charge-off ratios, the rollover ratio remained stable from 1998 to 2002, demonstrating that around half of the

CHART 1

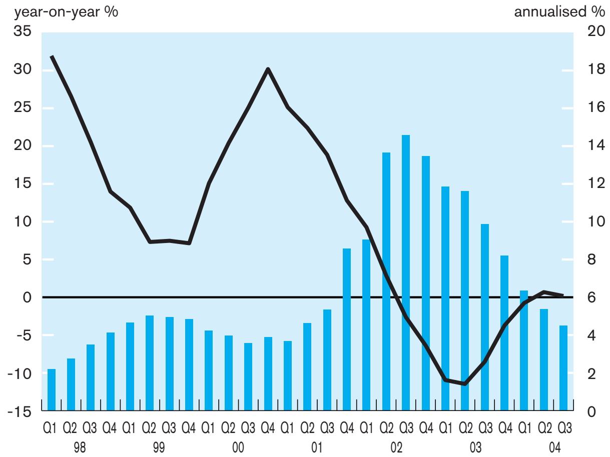
Unemployment rate and personal bankruptcy petitions



Source: Census and Statistics Department, Official Receiver's Office.

CHART 2

Credit card receivables growth and charge-offs



Source: HKMA.

outstanding receivables would be paid off monthly even when the economic conditions deteriorated.

Supervisory response

In response to rising credit card charge-offs, the Hong Kong Monetary Authority issued the *Best Practices for Credit Card Operations* (the Best Practices Guide) in 2002. The Guide sets out the best practices for credit card operations in different aspects, including policies and procedures, marketing, approval process, credit risk management and delinquency management. On the approval process, the guidelines state clearly that authorized institutions must establish prudent underwriting criteria, which should include

- income level
- employment and length of service
- acceptable credit record
- asset requirement (especially for high risk customers or customers with no stable income source)
- acceptable age range
- residence type, and
- permanent residence.

In addition, the Guide requires that credit limits be set on the basis of the credit profile of individual customers and their monthly income. For risk control purposes, the Guide requires a maximum unsecured credit limit to be set for each customer, with sub-limits for each credit card. In September 2004, the HKMA issued letters to remind authorized institutions of the importance of obtaining proper income proof to accurately estimate the credit risk level of customers. The letters warned against accepting income surrogates in place of proper income proof as a standard practice.[2] The banks were also asked to set up guidelines for handling applications from customers who do not have a stable income source, including how the repayment ability of these customers should be assessed and how to set the credit limit.

Credit information sharing

One reason for the high credit card delinquencies was the inability of banks to accurately assess the financial position of individual borrowers. Although lenders in Hong Kong had been sharing credit data through a private credit bureau[3] since 1985, a comprehensive database failed to develop, partly because participation in the credit bureau was not compulsory and there was a lack of co-operation among banks. In 1998, the banks finally reached consensus on the sharing of consumer credit data. But at that time, they were restricted by the Code of Practice on Consumer Credit Data to share only negative information, such as defaults. Positive data, including the level of debt and repayment records, could not be shared.

The sharp increase in credit card delinquencies in 2001 highlighted the need for positive credit data sharing. In March 2002, relevant industry organisations, including the Hong Kong Association of Banks, the Deposit Taking Companies Association, the Licensed Money Lenders Association and the Finance Houses Association submitted joint proposals on the issue to the Privacy Commissioner for Personal Data. After

[2] Income surrogates are acceptable only if they provide reliable data to enable an authorized institution to accurately estimate the income level of the applicant. A lower credit limit may be granted to cater for additional risk where income surrogates are used.

[3] The credit bureau, Credit Information Services Limited (CIS), was established in 1982 by 12 finance companies to collect information on vehicle and equipment financing. In 1985, the CIS database was expanded to include default data and the number of shareholders rose from 12 to 16 with the joining of credit card issuers and banks. In 1999, TransUnion International, one of the biggest credit reference agencies in the US, acquired a majority stake in CIS. By the end of 2002, the size of the CIS database grew to more than two million records, with contributions from nearly 90 members. In 2003, CIS was renamed TransUnion Information Services Limited.

consultations, the Commissioner revised the Code to allow lenders to share positive consumer credit information from June 2003, while putting in place adequate safeguards to protect the access to, and use of, such data.

The revised Code allows the sharing of data of all types of consumer credit, except residential mortgage loans. Because of the industry's concerns over a possible credit crunch caused by positive data sharing, access to positive data in the first two years (June 2003 to May 2005) is only permitted for assessing new credit applications from customers, facilitating the restructuring of an existing loan, reviewing existing credit facilities to put in place a scheme of arrangement at the request of customers, or setting up a loan restructuring arrangement where there is a default in excess of 60 days. Access will not be allowed for ordinary credit review or renewal during the transition period.

To ensure that authorized institutions comply with the new Code, the HKMA issued statutory guidelines in May 2003 on the minimum standards that authorized institutions should observe in the sharing and use of consumer credit data. The guideline requires

- authorized institutions to have clear and comprehensive policies and procedures designed to

    i. ensure the security, confidentiality and integrity of consumer credit data; and

    ii. guard against unauthorised access to or use of such information that could result in a breach of the Code and the data protection principles and relevant provisions under the Personal Data (Privacy) Ordinance;

- all authorized institutions involved in the provision of consumer credit to participate as fully as possible in the sharing and use of consumer credit data through a credit reference agency within the framework laid down by the Code.

Debt workout scheme

The same guideline also deals with the issue of personal workout. It provides that at times when credit information reveals that a customer has an unmanageable level of indebtedness and might have genuine difficulty in repayment, authorized institutions should follow the guidelines set out in the *Hong Kong Approach to Consumer Debt Difficulties* issued by the Hong Kong Association of Banks and endorsed by the HKMA. The Approach consists of formal, but non-statutory guidelines, on how members of the Association are expected to deal with personal customers who have genuine difficulty in repaying consumer loans. The principles include the following points.

i. Financial institutions (FIs) should abide by the guideline and the spirit of the Code of Practice on Consumer Credit Data issued by the Privacy Commissioner under the Personal Data (Privacy) Ordinance.

ii. When the FIs are aware of any financial problems of customers, the FIs should discuss the matter with the customer to find a solution that is mutually beneficial to both the customer and the FI. Possible solutions may range from extending the repayment schedule to rescheduling the debts, or to offering partial relief (Debt Relief Plans).

iii. FIs should work out a mutually acceptable solution with the customer as far as possible, instead of hastily demanding immediate repayment of loans, reducing credit lines or recommending transfer of the balance. The industry will best serve the interests of Hong Kong by adopting a common approach to consumer debt problems.

iv. FIs should endeavour to follow (but not limit their endeavours to) the framework and procedures that are laid down in the Agreement on Debt Relief Plans (DRP Agreement).[4] Under the DRP framework, when negotiating a restructuring plan for unsecured consumer debts of not less than HK$100,000, a creditors' committee will be convened to decide whether there is a viable case and, if so, a Lead Creditor will be appointed. When the Lead Creditor starts the negotiation, there is a standstill period of 30 days and all creditors are expected to act in a co-operative and timely manner to agree expeditiously on a DRP. The debt restructuring agreement needs a 75% majority.

Following the introduction of positive credit data sharing and the more recent economic recovery, credit card charge-offs have begun falling. At the end of September 2004, the figure stood at 4.5%, compared with the peak of 14.6% at the end of September 2002. The economic recovery may have helped lower credit card defaults, but the benefits of positive data sharing are increasingly being realised. A number of banks have launched tiered interest rate products based on the creditworthiness of individual borrowers. This will benefit borrowers with good credit standing. Positive data sharing has also strengthened banks' credit risk management systems and enabled them to offer better terms to customers.

Lessons learnt

Hong Kong's experience in credit card lending over the past few years has shown that policy makers need to be confident that credit risks are properly managed and the household sector has sustainable debt burdens to prevent financial and macroeconomic instability associated with consumer lending. In addition, public policy needs to make certain that essential financial sector infrastructure for consumer lending is properly set up. Accordingly, the authorities need to

- ensure that banks have proper risk management systems for consumer credit and establish guidelines on prudent lending criteria and credit approval processes;
- facilitate data collection (for example, data on household debt level and debt service burdens) by allowing financial institutions to share both positive and negative credit data of customers through credit reference agencies, while providing adequate protection for the privacy of customers;
- educate consumers (particularly the youth) and raise public awareness about the dangers of over-borrowing; and
- strengthen the statutory or non-statutory frameworks for personal debt workout.

[4] In June 2002, the HKAB, DTC Association, Finance Houses Association and HKSAR Licensed Money Lenders Association endorsed the DRP Agreement. The FIs active in consumer finance signed the Agreement to signify their willingness to offer DRPs to qualified customers.

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