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Consumer spending – solid as a rock?

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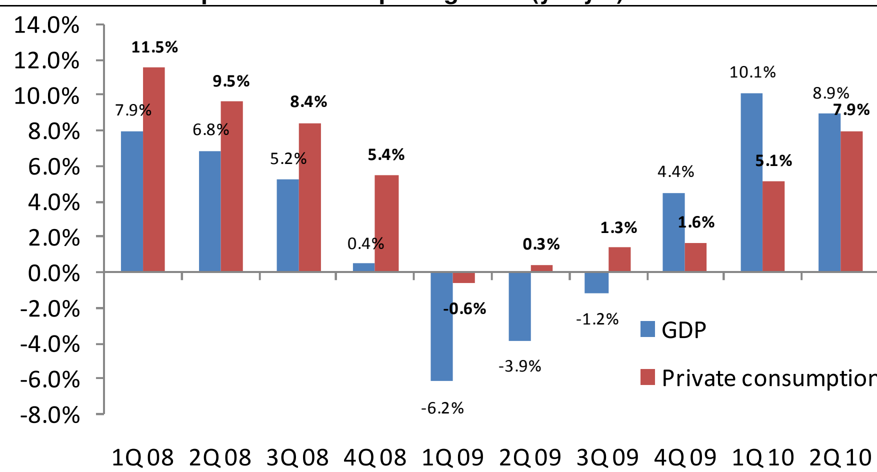
Consumer spending – solid as a rock?

Introduction

Economic recessions are generally associated with high unemployment, loss of purchasing power and a decline in consumer spending. The Great Recession in the United States, for example, has caused the unemployment rate to surge to around 10%, resulting in a sharp decline in consumer spending and dragging the economy since December 2007. Malaysia also experienced a recession that was accompanied by high job losses and a reduction in consumer spending in 2009. However, statistics suggest that during last year's downturn, consumer-spending patterns differed slightly from the recessions experienced in 1998 and 2001.

Anecdotal evidence suggests that while Malaysian consumers were cautious about their spending in the wake of last year's recession, they did not fully react to the gravity of the economic contraction. In other words, their spending habits were not significantly altered, especially for those in the services sector. This intriguing finding, in our view, will have important policy implications at a time when the nation is striving to sustain respectable growth rates amidst lethargic private investment. An important question now is whether a consumption-led growth strategy should continue to be used to drive economic growth in a country such as Malaysia along with measures to boost investment in order to achieve our aim of becoming a high-income nation in the next decade.

Chart 1: GDP and private consumption growth (y-o-y%)

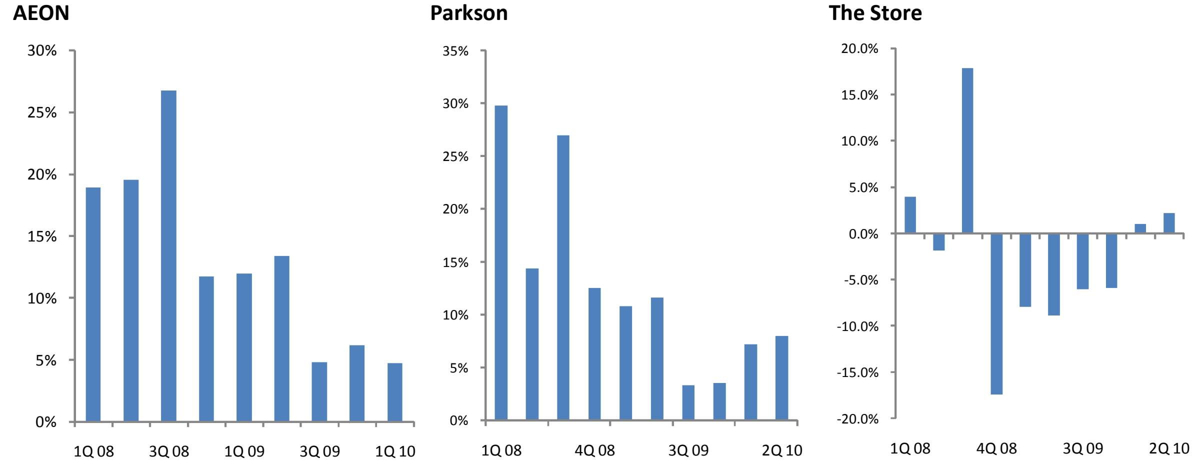


Source: CEIC

Malaysians just love to spend! The evidence…

To gauge the strength of consumer spending, we started by looking at the trend of retail sales at selected retail outlets by obtaining the relevant statistics of three listed companies – AEON (M) Berhad, Parkson and The Store – from Bursa Malaysia's website (http://www.klse.com.my). We found that retail sales were much higher in 1H2009 for AEON and Parkson compared with 2H2009. The Store, for some reason, continued to register negative sales growth in most of 2009, which led us to preclude it from our inferences about the general trend. Judging by the trend, the lag effect on consumer spending is quite obvious. Although the economy contracted considerably in 1H2009, retail sales continued to record positive growth throughout the year.

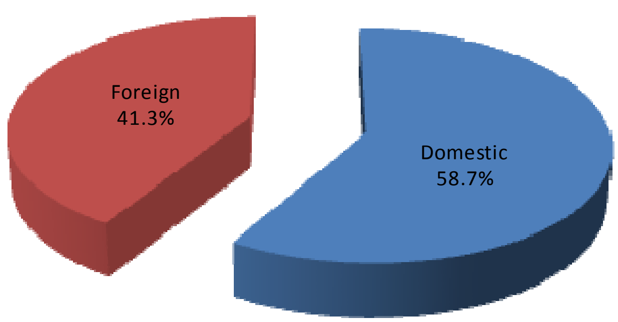
Chart 2: Retail sales in Malaysia (y-o-y%)



Sources: Bursa Malaysia and respective companies' announcements

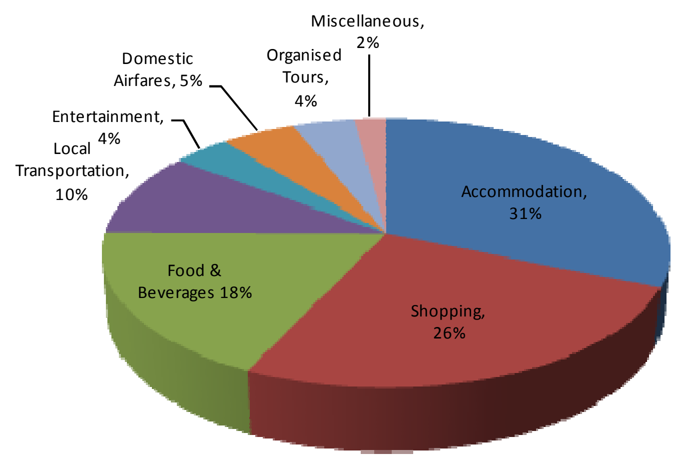
Tourism is a key sector that has a significant impact on the retail sector, as shopping forms the second-largest type of expenditure incurred by tourists after accommodation (see chart 4). Looking at the trend of tourist arrivals – an important gauge for the tourism sector – one can conclude that tourism activities were less affected by the global recession in 2009 as it continued to register positive growth rates throughout 2009. In addition, domestic tourists play a crucial role in driving up expenditure, given that more than half of hotel guests are Malaysians. This is another important reason for the strength of the retail sector during last year's recession.

Chart 3: Hotel guests in Malaysia (5-year median) (% of total)



Sources: CEIC & MARC Economic Research

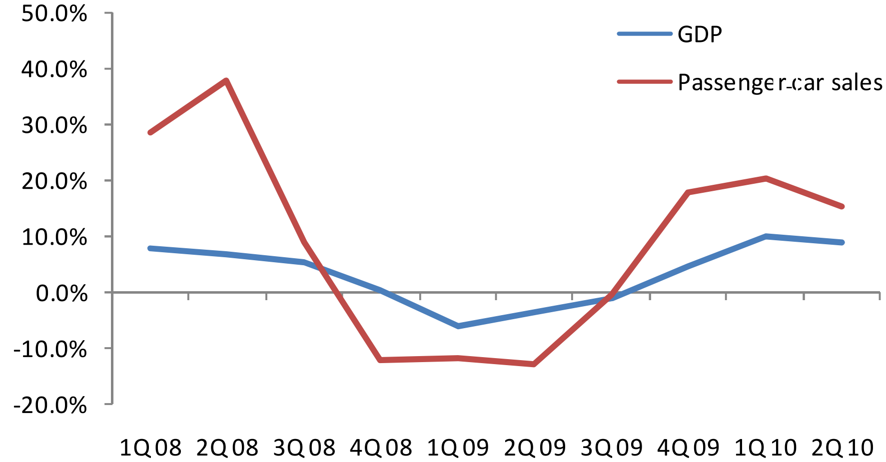
Chart 4: Tourist expenditure (5-year median) (% of total)



Sources: CEIC & MARC Economic Research

On the contrary, expenditure on cars was more affected by the downturn, as evidenced by the trend in car sales which mirrored Malaysia's economic performance in 2009. Notably, passenger-car sales fell at a double-digit pace in 4Q2008, 1Q2009 and 2Q2009 before recovering in 2H2009. This trend could probably be explained by the fact that car-sale transactions take longer to complete as they are normally financed by banks, while retail sales generally do not require financing. As such, car purchases depend more on approvals by financiers. And since the recession had caused loan approvals for passenger-car purchases to decline significantly in 2009, passenger-car sales slumped in 1H2009 in tandem with the overall economy.

Chart 5: GDP vs. passenger-car sales (y-o-y%)

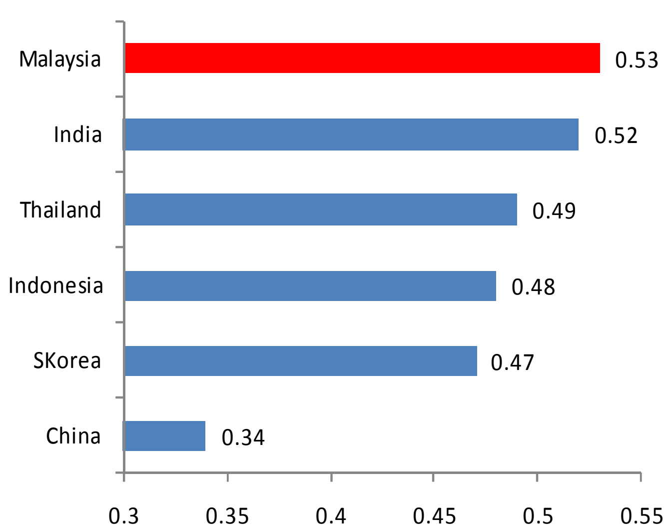


Source: CEIC

The above statistics prove that Malaysia's consumer spending has been resilient amidst slower external demand. In fact, our estimate of Malaysia's marginal propensity to consume (MPC), standing at 0.53 presently, suggests that Malaysians have a tendency to spend more than consumers in other Asian countries for every unit increase in their income. For instance, for every additional RM1 of income, Malaysians spend about RM0.53. This compares with 0.48 in Indonesia, 0.47 in South Korea and 0.34 in China.

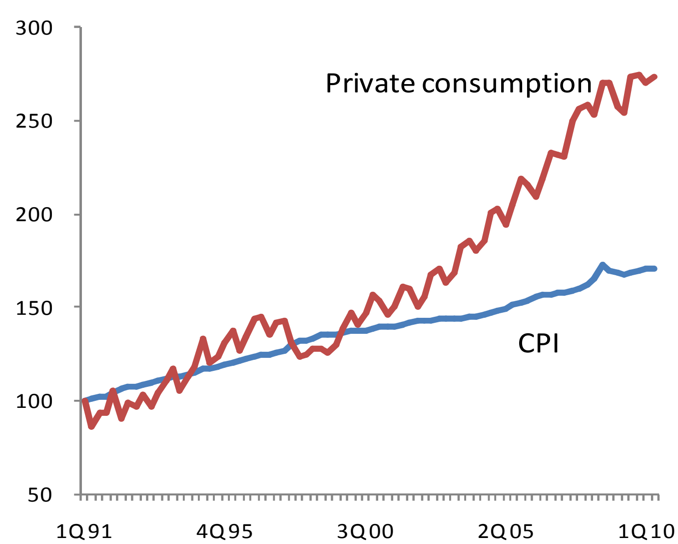
Another interesting finding is that Malaysians have continued to spend rigorously, even when prices of goods and services are generally high. For instance, from chart 6, we can see the pace of private consumption increased significantly and surpassed the speed of the increase in the consumer price index (CPI) since early 2000. This suggests that consumer spending has been relatively inelastic in the past several years.

Chart 6: Marginal propensity to consume



Source: MARC Economic Research

Chart 7: Private consumption vs. consumer price index (1991 = 100)



Sources: CEIC & MARC Economic Research

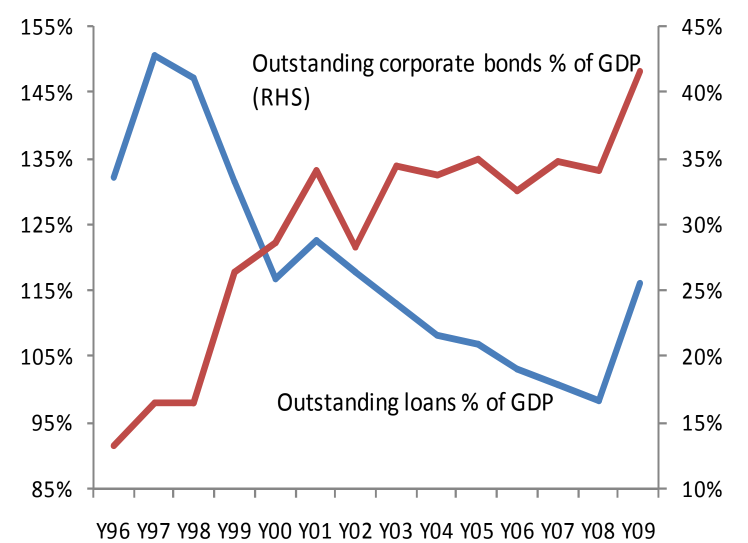
What explains the trend?

We believe that there are two factors that contribute to this behaviour. The first is obviously the income level. Malaysia's income per capita has risen to USD6,950.5 in 2009 from USD4,029.7 in 2000 and this, to some extent, has powered the consumer sector in recent years. However, without proper measures of income disparity (i.e. Gini coefficient), such a conclusion may have to be supported by other explanations. In our view, a more important reason for the exceptional strength in consumer spending in recent years has been consumers' easy access to credit.

It is a well-known fact that after the Asian Financial Crisis in 1997/98, Malaysian banks have been focusing their lending activities on the consumer sector (also known as the retail sector) as many companies turned to the bond market to meet their long-term financing requirements. As a result, the ratio of outstanding corporate bonds to GDP surged to 42% in 2009 from as low as 13% in 1996, while outstanding loans to GDP have dwindled to around 116% in 2009 from 132% in 1996.

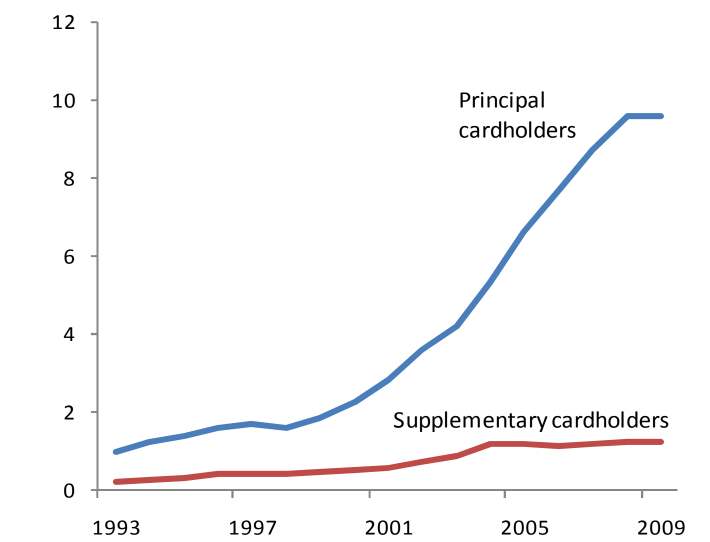
During this period, banks aggressively strove to expand their shares in the markets for mortgages, hire-purchase loans, personal financing and credit cards. Not surprisingly, some banks are now offering personal financing of up to RM200,000 with repayment periods ranging from 15 years to 20 years. Similarly, the number of credit cards in circulation rose rapidly by 15.4% per annum, with total purchases surging from RM2.0 billion in 1992 to RM59.9 billion in 2009, a hefty 2,895% jump in 17 years!

Chart 8: Outstanding corporate bonds and loans % of GDP



Sources: CEIC & MARC Economic Research

Chart 9: Credit cards in circulation (million units)

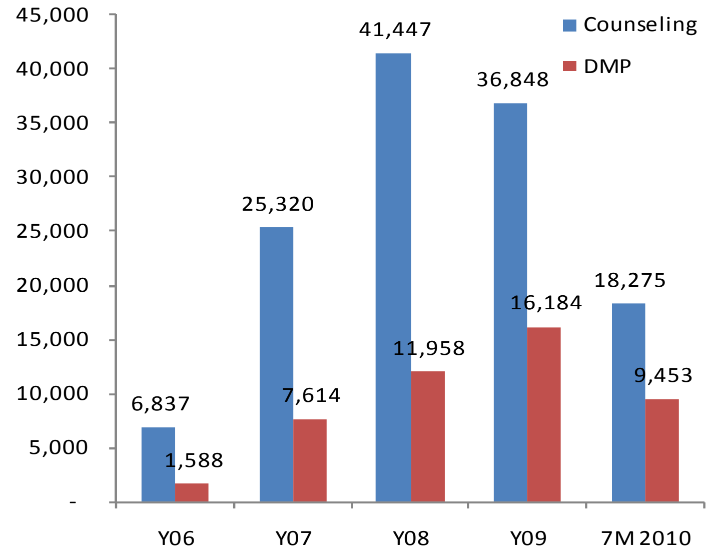


Sources: CEIC & MARC Economic Research

The price we have to pay

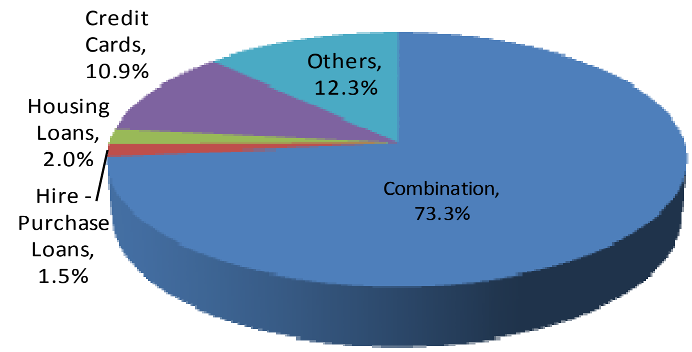
The massive amounts of loans given out to consumers who later face difficulties repaying their debts have caused a steep rise in Malaysian household debt in recent years (household debt as a percentage of GDP grew to 77% in 2009 from less than 50% in 2000). Difficulties faced by some borrowers in settling their debts have led Bank Negara Malaysia (BNM) to establish in April 2006 the Credit Counseling and Debt Management Agency (AKPK), a body responsible for promoting financial wellness among Malaysians through consumer educational programmes, providing credit counseling and a debt-management programme (DMP). Thus far, the public's response has been quite heartening: since inception, AKPK has received a total of 128,727 cases, of which 46,797 (or 36.4% of total cases) were placed under the DMP. In our view, the DMP service is critical, as it allows borrowers to reschedule or restructure their borrowings to regain financial control. Indeed, we believe that the 2009 recession could have been worse in the absence of the agency.

Chart 10: Number of cases received by AKPK (nationwide)



Source: AKPK

Chart 11: DMP – Categorised by credit facility (nationwide) (2006 – July 2010)



Source: AKPK
Note: Combination (housing & hire-purchase loans, credit cards)
Others (Term loans/personal loans/share margin financing)

Policy implications

Malaysians are indubitably big spenders. The positive thing about this is that it supports private consumption and the economy as a whole, as evidenced by Malaysia's private consumption which contributed a hefty 3.7 percentage points out of the 5.4% average growth recorded between 2000 and 2008. In addition, Malaysian consumers' high marginal propensity to consume will keep the economic engine humming along as there is ready demand for goods and services. However, this consumption-led growth strategy comes with a side effect - high household indebtedness, which as a percentage of GDP has risen to nearly 80% in 2009.

The problem of high household debt must be addressed, and not surprisingly, the BNM has taken an important step towards that goal by reducing the loan-to-value ratio to 70% for purchases of three properties and above. More caps for mortgage financing (especially for high-end properties) will also help prevent a property bubble in the country. Other measures, such as higher income requirements for new credit-card applicants and central credit limits for credit-card users, will be helpful to prevent the consumers' abuse of credit.

While all these initiatives should logically be undertaken to address the worrisome household-debt conundrum, one must remember that cold-turkey measures to quickly reduce the level of consumer indebtedness can be potentially disruptive and may even result in high non-performing loans in the banking sector. We opine that measures such as excessive removal of subsidies and the implementation of the goods and services tax (GST) should be carefully studied, as they can affect disposable incomes and lead to a significant drop in consumer spending. In this light, we think that the move to defer the GST should be viewed positively as the government is aware of its ramifications on consumers' purchasing power, especially when they already have to cope with another fuel-price hike of 5 sen (for RON 97) on November 2 after July's increase.

Another important implication is related to interest rates. Due to high household indebtedness, drastic increases in interest rates are probably not the best way to deal with inflationary pressures, should they emerge in the economy in the near future. Indeed, a sharp rise in interest rates could affect consumers by way of higher monthly installments, potentially leading to higher non-performing loans. This, however, does not imply that interest rates should not be increased at all. In fact, our estimate of a neutral rate for the Overnight Policy Rate (OPR) of between 3.25% and 3.50% suggests that rates may have to go up by 50 to 75 basis points if the economy continues to recover. However, such an adjustment should be made in the context of policy normalisation, and not as a means to curb inflationary pressures.

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