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## *Malaysia: Loans and Household Debt - An Assessment*

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## In a nutshell

- In its Monetary Policy Committee statement released on 8 May 2014, Bank Negara Malaysia (BNM) hinted that stronger monetary measures would likely need to be imposed to address the persistent financial imbalances in the economy. The message was in our view related to the need to further address the rising household debt which continued to accelerate to 86.8% of gross domestic product (GDP) as of the end of 2013 following strong loan growth in certain segments of the economy, although various macroprudential measures introduced by the BNM have somewhat moderated the increase in household indebtedness. The issue of rising household debt is also amplified by the resilient pace of growth in private consumption (+7.1% year-on-year) in 1Q2014 which partly fueled the overall economic growth to a robust 6.2%.

- In the banking system, credit growth continued to remain strong. The acceleration in credit growth which is taking place in some Asian countries – Malaysia included – has raised concerns as it could potentially give rise to systemic risks to these economies. In Singapore and Malaysia, credit-to-gross domestic product (CTG) climbed from 101.7% and 109.9% respectively in 2009 to 155.2% and 124.5% respectively in 2013. However, in the case of Malaysia, BNM has elaborated its view in the recent Financial Stability and Payment Systems Report 2013 that while CTG has surpassed its long-term trend (derived using the Hodrick-Prescott filter), the trend does not imply signs of credit excessiveness (BNM Financial Stability and Payment Systems Report 2013, page 23). This is based on the fact that CTG has not reached certain critical thresholds defined as: (1) being more than 1.5 times its long-term standard deviation (SD); and (2) a CTG growth rate of above 10% per annum (p.a.).

- Notwithstanding this, credit growth has picked up in recent years with loans in the banking system rising at a resilient pace following a swift recovery of the economy after the Great Recession in 2009. This is evidenced by the CTG which has surpassed its long-term trend since 2012, the first time this has happened since the early 1990s, although it has not reached the threshold of 1.5 SD above the long-term trend. Experiences in other countries tend to indicate that without stronger measures, such a situation may lead to either further stress in the household balance sheets or a deterioration of the banking system's asset quality, although in the case of Malaysia, the latter is less likely due to strong capital buffers and high impairment provisions. A good example is the experience in South Korea in the early 2000s where a credit card boom finally led to an implosion of household debt which caused the economy to slow significantly in 2003.

- In Malaysia, both loan applications and approvals in the banking system have rebounded since mid-2013, thanks to the improving prospects of the global and domestic economy. Breaking it down, on a 6-month moving average (6-mma) basis, growth of loan applications rebounded from -7.5% in March 2013 to 11.7% in March 2014 while growth of loan approvals improved from -6.4% in December 2012 to 4.2% in March 2014. The improvements in the overall applications and approvals were primarily attributed to the sharp rebound in the applications and approvals of loans for the purchase of residential properties. On the other hand, stricter lending guidelines by banks have reversed the trend of unsecured loans (i.e. personal loans) in the past one year, evidenced by its approvals which continued to contract by 35.5% in March 2014.

- Outside the banking institutions, lending by Non-bank Financial Institutions (NBFI) (including Development Financial Institutions (DFI)), despite representing a small fraction of total household loans (12% in 2012), became a concern as the pace of consumption credit component extended by DFIs grew at a robust pace prior to the Great Recession, hitting a peak of 35.4% p.a. in 2008. Even after the Great Recession, consumption credit grew at a relatively strong pace, averaging 15% p.a. between 2010 and 2012 before moderating to 8.5% p.a. in 2013. Recent developments, however, have been encouraging as growth rates continued to moderate. In addition, the establishment of the Financial Services Act (FSA) in 2013 has somewhat eased concerns as the BNM now has a supervisory role over non-bank financial institutions.

- The robust expansion of loans to the household sector has led to a rising household debt-to-GDP ratio in Malaysia to 86.8% in 2013 – one of the highest in the Asia Pacific region. Malaysia's household debt-to-GDP ratio has been above 60% of GDP since the early 2000s and has been on the uptrend since then. The stable labour market, rising income level and the relatively accommodative monetary stance have partly contributed to the rising household debt. In addition, the increasing number of civil servants taking loans through automatic salary deduction schemes provided by some financial institutions have bolstered loans given for personal use.

- Fortunately, Malaysia's household financial assets have also grown in tandem with the nominal GDP, providing some buffer against the rising household debt. Between 2002 and 2013, while household debt grew at a compound annual growth rate (CAGR) pace of 12.1% p.a., household financial assets expanded by 12.3% p.a., slightly faster than nominal GDP which grew by 9% p.a. This provides some comfort as borrowers' ability to pay is cushioned by the amount of financial assets that can be drawn down whenever needed. Notwithstanding this, since the Great Recession of 2009, household assets have increased at a slower pace of 10.8% p.a. on a CAGR basis (2010-2013), compared with household debt which grew by 12.9% during the same period. Prior to the Great Recession, financial assets grew at a more robust pace of 12.4% p.a.

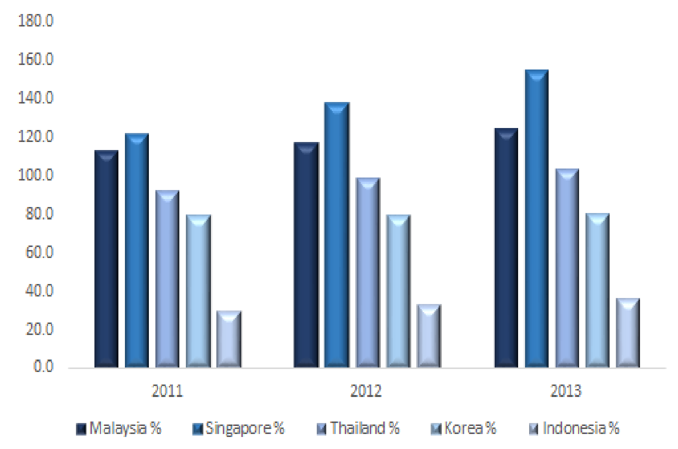
- While the financial asset-to-household debt ratio remained stable in 2013 at 2.2 times (2012: 2.2 times), it has moderated from a peak of 2.7 times in 2007, implying that growth of financial assets has not kept pace with the increase in household debt. In addition, while financial assets provide some buffer against the increase in household debt, their values are strongly correlated with Malaysia's equity market performance. Fortunately, favourable equity market performance since the Great Recession has supported the value of financial assets, although a deep correction in Malaysia's stock market, if it happens, may adversely affect its value. As such, if there is another economic downturn (when the equity market normally drops), the value of financial assets will also take a hit. Also, as the amount of household debt will usually remain the same or increase during an economic downturn, the financial asset-to-household debt ratio will likely decline.

- As a whole, the ratio of household financial assets to household debt tends to move in tandem with the economy and the slower expansion of nominal GDP since the Great Recession (7.3% p.a. versus 12.3% between 2002-2008) has exerted downward pressure on the household financial assets-to-debt ratio. The good news, however, is the brighter prospects of the global economy which have boosted Malaysia's trade performance since 2H2013 and will likely push up the headline growth rate in 2014 more than expected. As such, household financial assets will likely rise in tandem with a stronger pace of nominal GDP growth this year.

- The positive aspect of Malaysia's household debt is that it is mainly backed by strong assets as they are largely comprised of residential property loans. And the positive outlook of the property market (due to favourable demographics and strong demand) helps mitigate some of the risks. Past experiences suggest that Malaysia's property market has been relatively resilient, slowing or contracting only in one or two years during the bad times and rebounding quickly following economic recoveries. Secondly, different stress tests conducted by BNM indicate that financial institutions have sufficient capital buffers and are capable of absorbing losses if an economic turndown happens.

- A point of caution, however, is that the household debt-service ratio (DSR) has also risen to about 43.5% in 2013 from the cyclical low of 39.1% in 2006, suggesting an increasing burden on Malaysian households. While it was noted that the DSR has slowed to below 40% for new loans, according to BNM in its Financial Stability and Payment Systems Report 2013, the low-income group (income below RM3,000 per month) remained overstretched with a leverage position of up to seven times their income in 2013. Against this backdrop, we expect the BNM to introduce more macroprudential measures to scale back the over-leveraged position of the household sector or even consider tougher policies through a tighter monetary stance which could lead to an increase in its policy rate in an effort to keep financial imbalances in check.

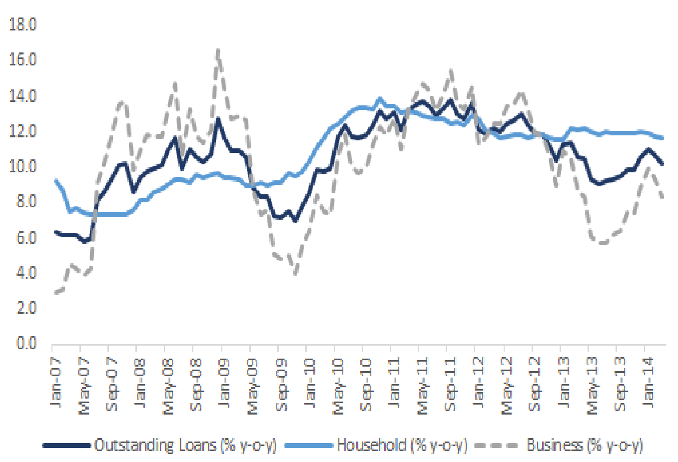
**Chart 1: Loans-to-GDP by selected countries**




*Source: CEIC, MARC Economic Research*

- As a percentage of GDP, loans in the banking system in many Asian countries have grown over the years since their economies recovered from the Great Recession in 2009. In Singapore and Malaysia, credits in the banking system were up from 101.7% and 109.9% of GDP respectively in 2009 to 155.2% and 124.5% of GDP respectively in 2013.
- The rising level of credit in the banking system has raised concerns as strong credit growth for an extended period signifies an increasing pace of leveraging which, if not properly contained, may lead to either stress on household balance sheets and/or a deterioration of the banking system's asset quality, which in turn may affect future lending capacity, business activities and private consumption.

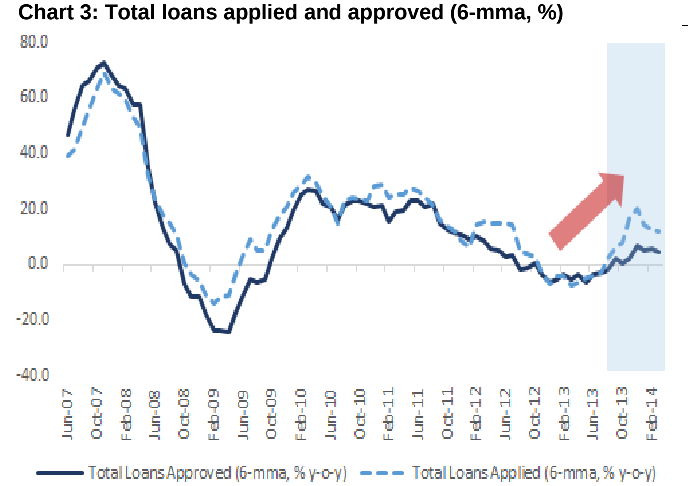
**Chart 2: Malaysia's loan growth – household and business**




*Source: CEIC, BNM, MARC Economic Research*

- In Malaysia, loan growth tapered off from a cyclical high of 13.8% in September 2011 to a low of 9.1% in June 2013 before edging up to 10.2% in March 2014.
- The decline in growth from September 2011 to mid-2013 was primarily due to the impact of macroprudential measures imposed by the BNM to avert further overlending by financial institutions to certain segments of borrowers that could lead to financial imbalances such as escalating home prices and overstretched household balance sheets.
- BNM, while acknowledging that Malaysia's CTG has surpassed its long-term trend in the past 7 quarters, opines that there are no strong signs of credit excessiveness as the ratio has not reached the critical threshold of 1.5 times the SD above the trend line.

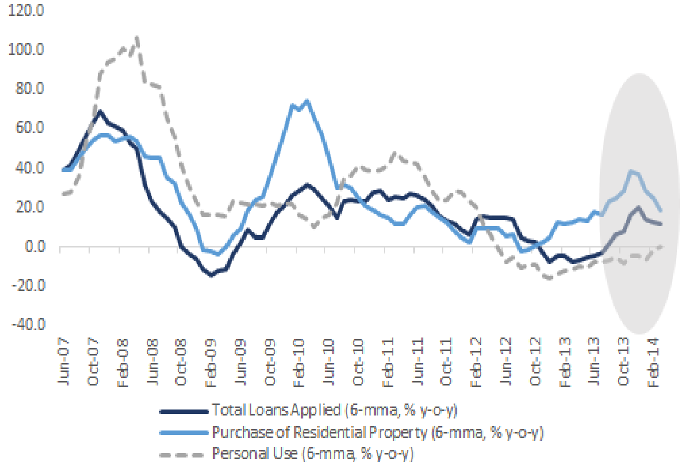
**Chart 3: Total loans applied and approved (6-mma, %)**




*Source: CEIC, BNM, MARC Economic Research*

- By mid-2013, as the prospects of global economy improved, evidenced by a stronger United States (US) economy and a steady recovery of the Euro economies, Malaysia's loan applications and approvals picked up in tandem with stronger GDP growth posted in 2H2013.
- On a 6-mma basis, the growth of loan applications rebounded from -7.5% in March 2013 to 11.7% in March 2014 while the growth in loan approvals improved from -6.4% in December 2012 to 4.2% in March 2014.
- Breaking it down, the improvements in the overall applications and approvals were primarily due to sharp rebounds in the applications and approvals in loans for the purchase of residential properties.

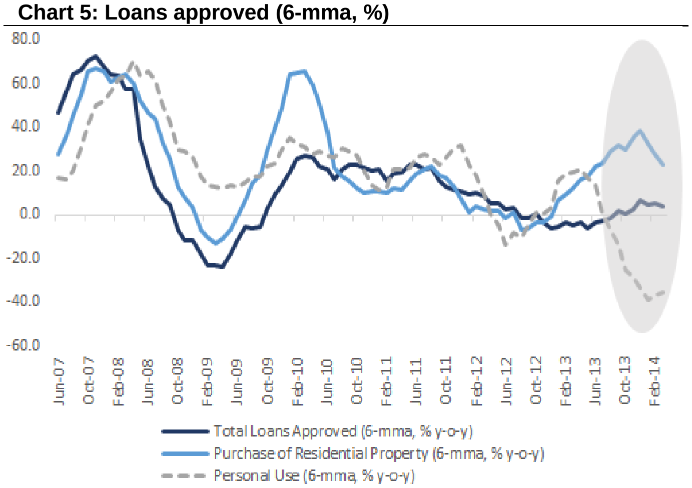
**Chart 4: Loans applied (6-mma, %)**




*Source: CEIC, BNM, MARC Economic Research*

- The amount of loan applications which contracted prior to the 2009 recession rebounded by mid-2009 when the economy started to recover from the Great Recession, led by loan applications for the purchase of residential property which surged 109.4% y-o-y by January 2010. By 3Q2010, however, the growth in loan applications lost its momentum after hitting a peak of 47%.
- However, by mid-2013, loan applications picked up again as the prospects of the global and domestic economies improved. By November 2013, its 6-mma growth rate accelerated by a double-digit pace of 16.7%, before moderating to 11.7% in March 2014. The recovery was again led by a surge in loan applications for the purchase of residential properties (+60.2% in November 2013).

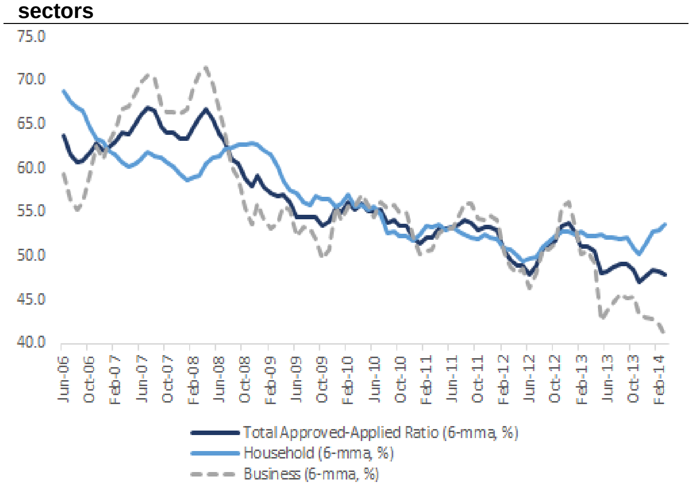
**Chart 5: Loans approved (6-mma, %)**




*Source: CEIC, BNM, MARC Economic Research*

- A similar trend was seen in the amount of loans approved in the banking system. The amount of loan approvals which contracted from September 2008 – May 2009 prior to and during the Great Recession rebounded, and its growth hit a peak of 44.8% in March 2011 before starting to moderate. Subsequently, it weakened significantly by the end of 2012 with its 6-mma growth registering ten consecutive monthly contractions between November 2012 and August 2013.
- Similar to the trend in loan applications, loan approvals started pick up again by mid-2013 as lenders anticipated improvements in business and consumer sentiment. However, the pace of increases lagged behind the surge in loan applications.

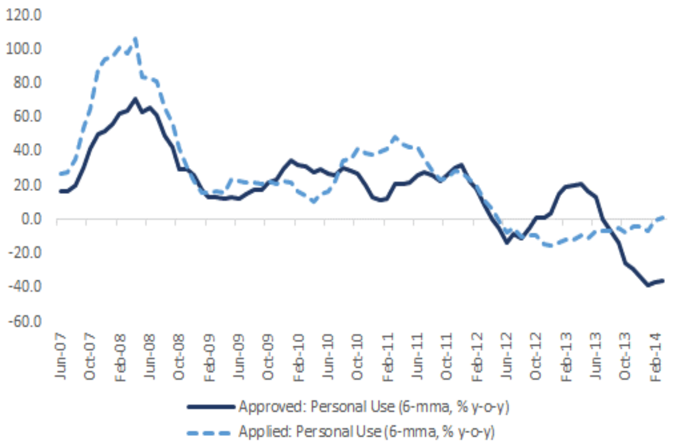
**Chart 6: Approved-applied ratio by household and business sectors**




*Source: CEIC, BNM, MARC Economic Research*

- Notwithstanding the recent pick-up in loan approvals, its 6-mma ratio to loan applications has continued to slide, suggesting that the growth of approvals has not kept pace with the increase in loan applications.
- However, there is a divergence between the approval-to-application ratios of the household and business sectors which shows an upward trend in the former as opposed to the downward trend in the latter. Going forward, we foresee this trend to continue in the near term as approvals for household-related loans (i.e. purchase of properties) rebound on favourable prospects of the residential housing sector.

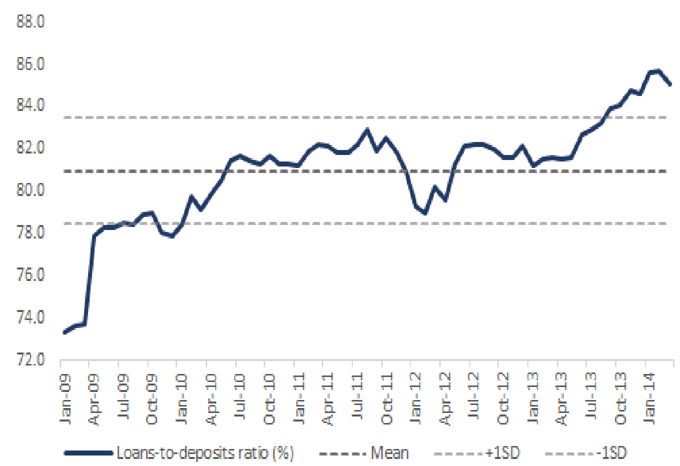
**Chart 7: Loans applied and approved for personal use (6-mma, %)**




*Source: CEIC, BNM, MARC Economic Research*

- Stricter lending guidelines by banks have reversed the trend of unsecured loans (i.e. personal loans) in the past one year. While the 6-mma growth in applications rebounded to 0.8% in March 2014, approvals continued to contract by 35.5% in the same month.
- Going forward, with greater focus on reducing the leverage position of households, especially with regard to the amount of unsecured loans, loan applications and approvals for personal loans will likely continue to remain anemic. Instead, banking institutions will likely keep their focus on lending to the property sector.

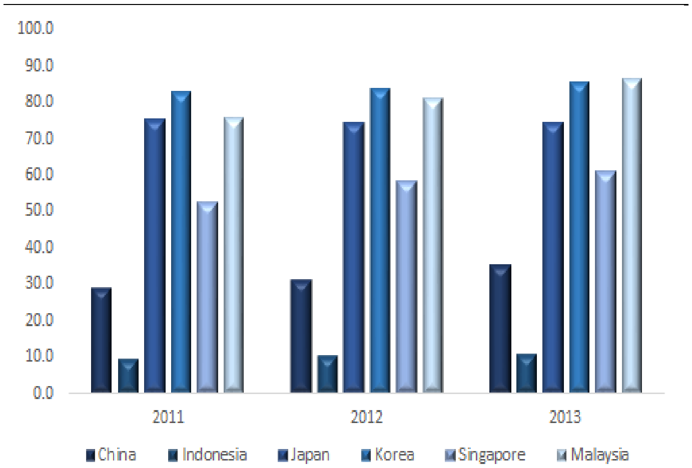
**Chart 8: Loans-to-deposit ratio**




*Source: CEIC, BNM, MARC Economic Research*

- The overall strong increase in the amount of loans extended by the banking system vis-à-vis the increase in deposits following the Great Recession has led to a continued rise in the loans-to-deposits (L/D) ratio.
- Based on its trend since 2009, the L/D ratio climbed to above its mean in mid-2012 and surpassed one SD above the mean since 3Q2013.
- The robust growth in loans led to the introduction of several macroprudential measures by the BNM which include: lower loan-to-value (LTV) ratio for the purchase of third properties, abolishment of Developer Interest Bearing Schemes (DIBS), shorter repayment period for personal and housing loans, and the use of net income to determine the eligibility for loans.

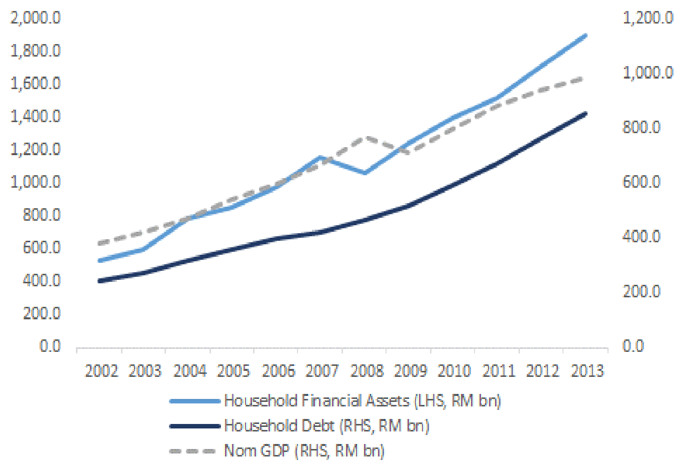
**Chart 9: Household debt-to-GDP of selected countries**




*Source: CEIC, MARC Economic Research*

- The robust expansion in loans for the household sector led to a rise in Malaysia's household debt-to-GDP ratio to 86.8% in 2013 – one of the highest in the Asia Pacific region save for Australia, Taiwan, New Zealand and South Korea. Malaysia's household debt-to-GDP ratio has been above 60% of GDP since the early 2000s.
- Declining interest rates after the Asian Financial Crisis helped to support private consumption which became a major pillar of growth, replacing private investment which dropped significantly in the 2000s. However, the relatively low levels of interest rates and increasing competition among banks led to not only a strong recovery of the economy but also contributed to higher household debt.

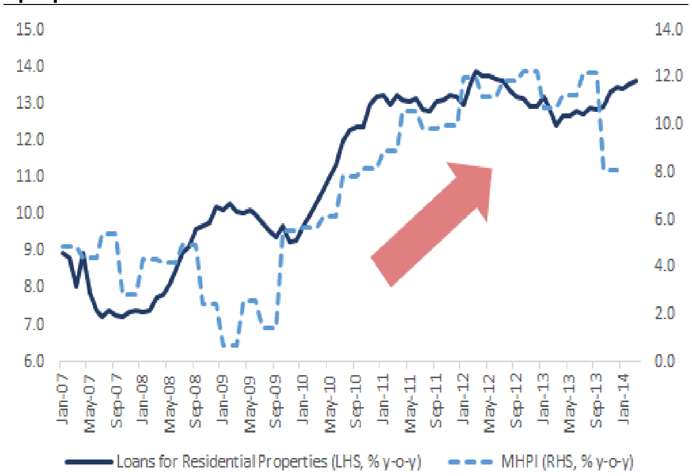
**Chart 10: Household debt, financial assets and nominal GDP**




*Source: CEIC, BNM, MARC Economic Research*

- Malaysia's household debt and financial assets have grown in tandem with the nominal GDP. Between 2002 and 2013, household debt has grown at a CAGR pace of 12.1% p.a. while household financial assets expanded by 12.3% p.a., slightly faster than nominal GDP which grew by 9% p.a.
- BNM's findings suggest that credit expansion in Malaysian economy (i.e. lending to the property sector which largely contributed to the household debt) is attributed to (1) the amount of deposits; (2) nominal and real GDP; and (3) house prices. If house prices remain elevated, lending to the households sector will not likely decline significantly in the near term.

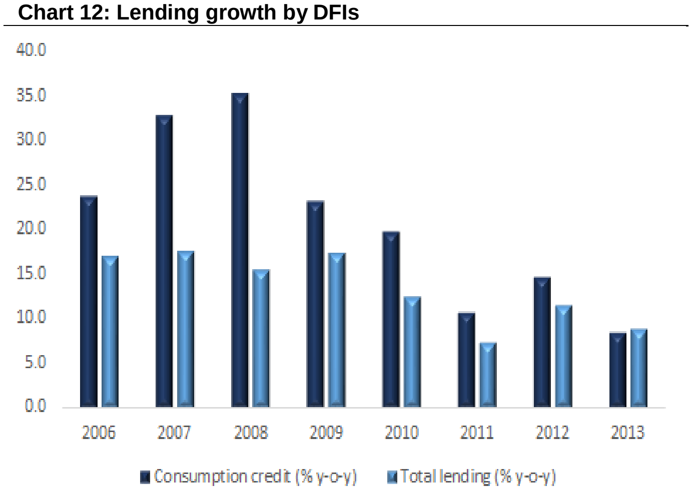
**Chart 11: Malaysia's House Price Index and loans for residential properties**




*Source: CEIC, NAPIC, BNM, MARC Economic Research*

- Loans for the purchase of residential properties have risen in tandem with Malaysia's House Price Index (MHPI) which has continued to accelerate since the economy recovered from the Great Recession. The MHPI has climbed by 51.5% since its cyclical low in 1Q2009. In 2013 alone, the MHPI climbed by 11.6% (2012: 11.8%).
- The rapid increase in home prices is evidenced by the double-digit growth in the annual MHPI for eight consecutive quarters since 4Q2011. This matches the strong growth in lending for the purchase of residential properties which expanded by a double-digit pace every month since February 2010.

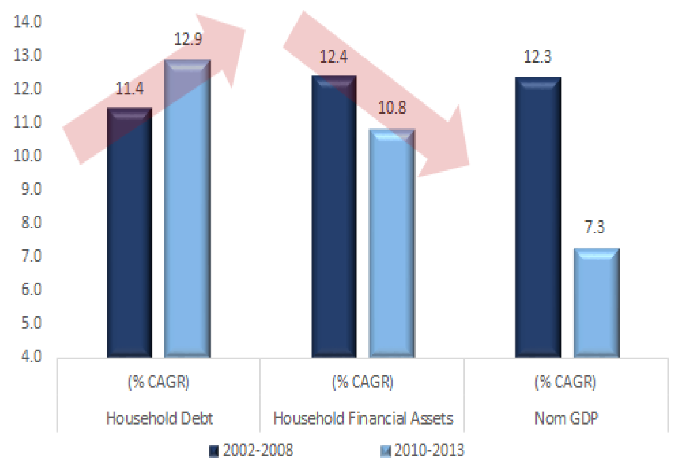
**Chart 12: Lending growth by DFIs**




*Source: BNM Financial Stability and Payment Systems Report (various issues)*

- Outside the banking institution, lending by NBFIs, including DFIs, which despite representing a small fraction of total household loans (12% in 2012) became a concern as the pace of consumption credit component extended by DFIs grew at a robust pace prior to the Great Recession, hitting a peak of 35.4% p.a. in 2008, more than double the overall loan growth of 15.5% p.a. in that year.
- Even after the Great Recession, consumption credit grew at a relatively strong pace, averaging 15% p.a. between 2010 and 2012 before moderating to 8.5% p.a. in 2013. Recent developments, however, have been encouraging as growth rates continued to moderate and the establishment of the FSA in 2013 has somewhat eased concerns as the BNM now has a supervisory role over NBFIs.

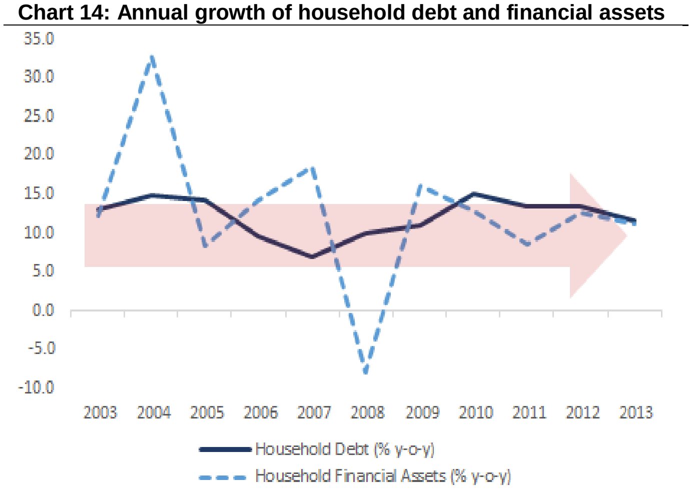
**Chart 13: Household debt, financial assets and nominal GDP (% CAGR)**




*Source: CEIC, BNM, MARC Economic Research*

- A comparison between the period prior to and post the Great Recession (2002-2008 versus 2010-2013) shows the difference in the household debt and financial asset profiles.
- Worth noting is the rising growth of household debt from 11.4% p.a. on a CAGR basis in 2002-2008 to 12.9% p.a. post Great Recession (2010-2013). The increase was primarily fueled by strong lending to the household sector as a result of (1) lower borrowing costs and rising property prices; and (2) rising competition among bank and NBFIs.
- Household assets have also increased but at a slower pace, expanding by 10.8% p.a. on a CAGR basis between 2010 and 2013, compared with 12.4% p.a. prior to the Great Recession (2002-2008).

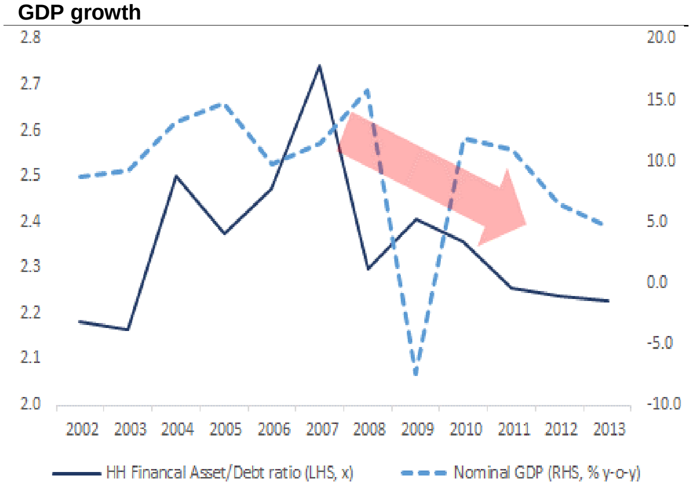
**Chart 14: Annual growth of household debt and financial assets**




*Source: CEIC, BNM, MARC Economic Research*

- Since the early 2000s, the growth of household financial assets has been more volatile, ranging from over 30% p.a. to -8% p.a. in line with asset prices, especially equities.
- On the other hand, household debt, although it has been growing between 6% and 15% p.a., has expanded significantly since 2008, a year before the Great Recession. While its growth has moderated since 2010, the robust performance of the residential property sector (as evidenced by a double-digit increase in MHPI in 2013) will likely increase demand for loans in this segment, thus limiting the slowdown of household debt-to-GDP ratio in the near term.

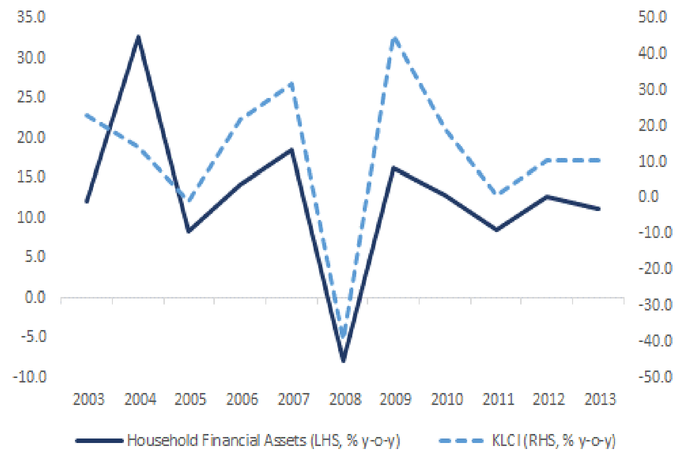
**Chart 15: Household financial assets-to-debt ratio and nominal GDP growth**




*Source: CEIC, BNM, MARC Economic Research*

- The household financial assets-to-household debt ratio remained stable in 2013 at 2.2 times (2012: 2.2 times). However, household financial assets have been rising at a slower pace when compared with household debt. As a result, its ratio to household debt has declined from the peak of 2.7 times in 2007.
- As a whole, the ratio of household financial assets to household debt tends to move in tandem with the economy and the slower expansion of nominal GDP since the Great Recession (7.3% p.a. versus 12.3% between 2002-2008) has exerted downward pressure on the household financial assets-to-debt ratio. Notwithstanding this, the rebound in the GDP growth momentum seen in 1Q2014 may alleviate concerns for this year as the rising growth will generally increase the value of financial assets.

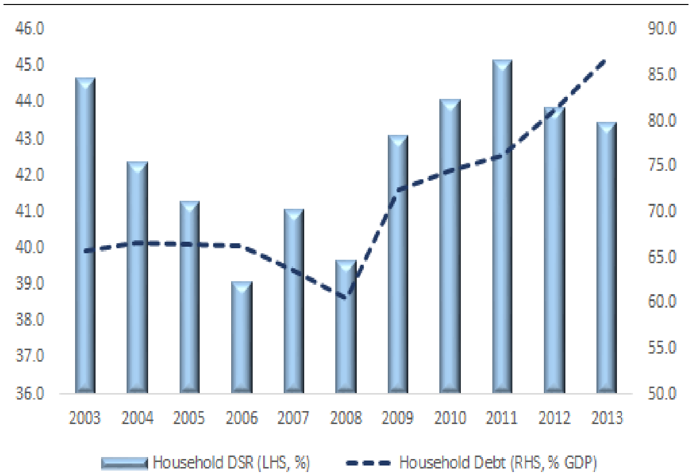
**Chart 16: Annual growth of household financial assets and KLCI**




*Source: CEIC, BNM, MARC Economic Research*

- While financial assets provide some buffer against the increase in household debt, the value of financial assets is highly correlated with Malaysia's equity market performance. This is hardly surprising as financial assets comprise not only deposits but also financial instruments like unit trusts and shares.
- As such, during an economic downturn (when the equity market normally drop) the value of financial assets also decline. But at the same time, as the amount of household debt normally remains the same or increases during economic downturns, the household financial assets-to-household debt ratio will decline. Under such circumstances, the amount of the financial buffer needed to support the rising household debt will be automatically reduced.

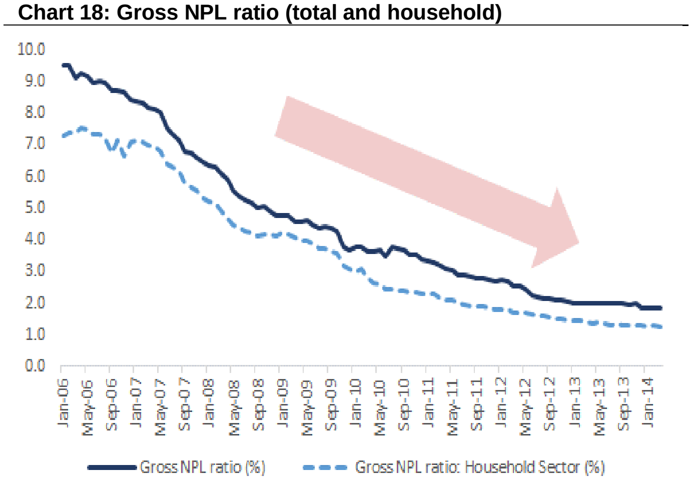
**Chart 17: Household debt-to-GDP and debt-service ratio**




*Source: CEIC, BNM, MARC Economic Research*

- The positive point: Malaysia's household debt is mainly backed by assets as they are largely comprised of residential property loans. The positive outlook of the property market (due to favourable demographics and strong demand) helps mitigate some of the risks.
- A point of caution: The household DSR has also risen to about 43.5% in 2013 from the cyclical low of 39.1% in 2006, suggesting an increasing burden on Malaysian households. The low-income group (income below RM3,000 per month) is also overstretched with leverage positions of up to seven times their income in 2013.
- Given this, we expect the BNM to introduce more macroprudential measures or even consider tougher policies through a tighter monetary stance to keep financial imbalances in check.

**Chart 18: Gross NPL ratio (total and household)**




*Source: CEIC, BNM, MARC Economic Research*

- Another comforting point is that the overall ratio of impaired loans has continued to decline over the years. The gross non-performing loans (NPL) ratio fell to 1.8% by March 2014 (Mar 2013: 2.0%; Mar 2012: 2.6%) while gross NPLs from the household sector dropped to 1.2% (Mar 2013: 1.4%; Mar 2012: 1.7%).
- In addition, BNM's vintage analysis for housing loans has exhibited lower default rates for new loans originated in the later periods since 2004, in line with declining housing loans-in-areas of between one to three months to 1.6% of total housing loans in 2013 (2012: 1.9%).

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