

The Continuing Debt Problem in Asia*

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The recent stress in “emerging market economies” is not only the result of the global slowdown that has adversely affected their exports and the capital outflows that have impacted stock markets. In many of these economies, the current difficulties are also the result of the internal debt cycle, as the excessive credit that powered the boom even during the phase just after the Global Financial Crisis gets wound down. Indeed, this problem is increasingly recognized by many observers of the global economy: a [recent report by Fitch Ratings](#) noted that “High and rapidly rising private sector debt can have a number of potential adverse effects on economic growth, the health of the banking system and sovereign creditworthiness” in emerging markets.

Nowhere is this more evident than in developing Asia. In a previous issue of MacroScan, we showed how recent growth in much of the region was reliant on ever-increasing piles of debt, dominantly taken on by the private sector in what can only be an unsustainable manner. Growing corporate debt is a concern throughout the region, as the debt overhang becomes one more reason for private corporations to shy away from new investment and therefore to add to the forces making for a deceleration of economic activity. However, household debt is also an important concern, and one that is likely to become of much more significance in the near future as the financial viability of many personal borrowers comes under question.

In this issue we consider the specific case of three Asian countries where this problem is particularly evident: China, Singapore and South Korea. All data are taken from the most recent debt database of the [Bank for International Settlements](#).

As Chart 1 indicates, in all of these countries, total credit to the non-financial sector grew sharply as percentage of GDP, particularly after March 2009. Furthermore, such debt has continued to grow even until the middle of this year, despite the evident slowdown of economic growth in these economies, with the ratio in the case of China continuing to increase at a relatively rapid rate.

Chart 1: The debts just keep on growing

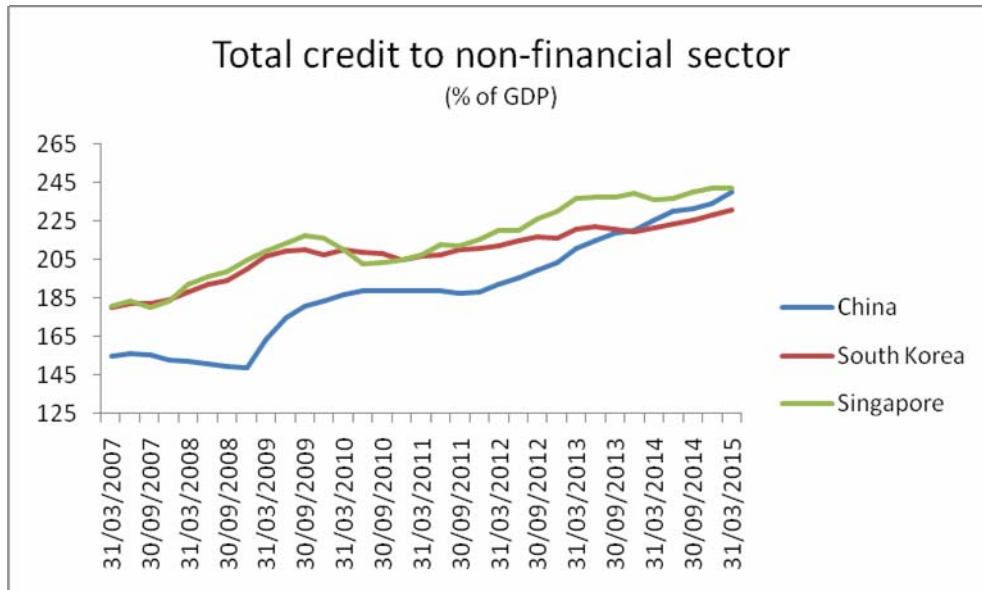
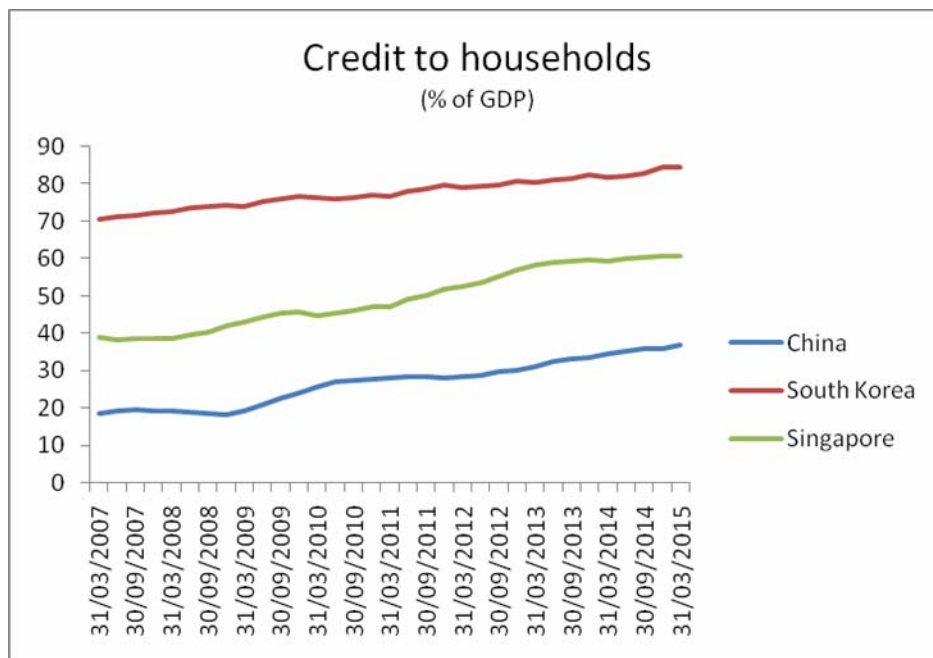


Chart 2: And more and more of it is taken on by households

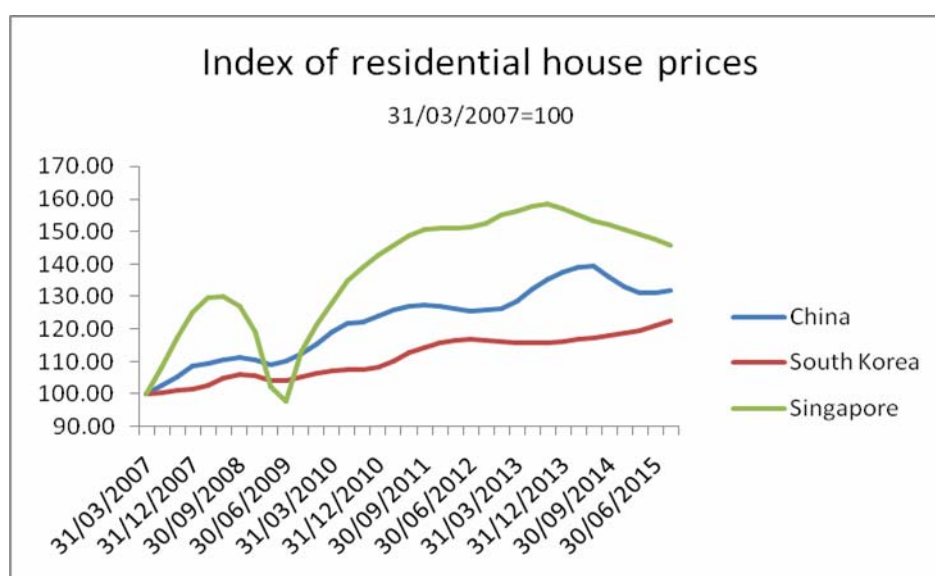


Household debt has been growing as a share of total debt, and therefore also has grown substantially in terms of GDP over this period. In China, for example, credit to households increased from around 15 per cent of total credit to the non-financial sector at the end of March 2007 to 18 per cent at the end of March 2015. In relation to GDP it has nearly doubled over the same period, more just below 19 per cent to 37 per cent. In Singapore and South Korea credit to households has moved more or less in tandem with total credit to the

non-financial sector, but the increase in relation to GDP has been even sharper. In Singapore it went up from 39 per cent of GDP at end March 2007 to 61 per cent at end March 2015. In South Korea the corresponding figures for household debt are even larger, and increased from 70 per cent to 84 per cent.

Obviously personal or household debt is incurred for a variety of reasons, including life cycle events, health spending, education (student loans and their sustainability have become a big issue in South Korea), and so on. The purchase of consumer durables such as cars is also one important source of incurring debt. But by far the single most important cause of household indebtedness, which dominates over all the others, is the purchase of residential real estate. Indeed, in many societies and certainly in developing Asia, it is also seen as a form of household saving, as a means of storing wealth even apart from the urge to own one's home, which is a major factor in any case.

Chart 3: But the credit goes to buy houses whose prices are now falling



This is what makes the evidence presented in Chart 3, of the indices of residential house prices in these three countries, of especial concern. (The data are from the [BIS database on real estate prices](#).) In all of these countries, house prices showed a dip – in the case of Singapore a severe dip – in the aftermath of the Great Recession. However, thereafter they recovered sharply, often actively aided and abetted by government policies that sought to create incentives for personal house purchases as a means of stimulating economic recovery and boost the construction sector.

As a result, real estate experienced a boom that was largely fuelled and financed by growing household debt, and construction became one of the most “dynamic” economic sectors in the growth of these economies. However, as we now know from the experience

of far too many countries, such debt-driven real estate bubbles eventually come to an end, often painfully.

The recent financial crises in the United States, the United Kingdom, Ireland, Spain and so on were all presaged by declining house prices, especially as some borrowers who could no longer service their debt were forced to default and so more houses started being sold in distress conditions. Once this process starts, the decline in value of the underlying collateral renders more such debt unviable, as other householders realize that selling the assets will not necessarily be sufficient to repay the loan. And this can then have a domino effect on financial institutions that have provided such credit.

So the downturn in house prices that is clearly evident in China and Singapore is obviously a cause of concern. In Singapore house prices peaked in the middle of 2013, and have been falling since then. In China the downturn occurred a year later, in the middle of 2014, but after falling for four quarters residential real estate prices appear to have stabilized, once again due to very active intervention by the Chinese government. In South Korea, house prices rose rapidly at first and then were stagnant, but recent policy moves have been designed to keep them rising – even if only to postpone the inevitable decline – because so much of household capacity to repay would be affected by major declines.

This is clearly a ticking time bomb that could have repercussions just as adverse as the excessive build-up of corporate debt that is typically more talked about. In the current context, this is one more reason to be worried about the strategies for economic revival that can be usefully adopted in such countries.

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