Financial Services Commission
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Press Release

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ANALYSIS OF KOREA'S HOUSEHOLD DEBT AND POLICY RESPONSE

BACKGROUND

Korea's household debt has grown rapidly since the Asian financial crisis compared to the growth rate of Korea's GDP and income, posing a potential risk to our economy. It has been also pointed out that Korea's household debt is structurally vulnerable as household loans are mostly composed of floating-rate, lump-sum payment, and interest-only loans.

Against this backdrop, the government took a set of measures to take the household debt growth under control.

Last year, the ceilings on debt-to-income (DTI) ratios, temporarily eased, were reinstated in March. In June, the government took measures to curb household borrowing in the non-banking sector, while strengthening microfinance programs in order to ensure low-income households' accessibility to financial services.

Building on such measures, the government came up with a comprehensive package of measures in June 2011 to ensure a "soft landing" for the household debt risk, which includes properly managing total liquidity, improving households' ability to repay their debt, strengthening financial institutions' soundness, and reinforcing microfinance programs.

With the recent economic slowdown and slow recovery of household income, there are limitations in taking drastic measures to curb household debt growth. There are also concerns raised about low-income or elderly borrowers' ability to repay their loans.

ANALYSIS OF HOUSEHOLD DEBT TRENDS

1. Overview

In 2011, Korea's household debt grew at 8.1%, slower than 8.7% in 2010; however, household debt-to-GDP ratio and household debt-to-disposable income slightly rose[1] as GDP and disposable income did not grow sufficiently in 2011.

[1] Korea's household debt-to-GDP ratio rose from 86.6% in 2010 to 89.2% in 2011.
Korea's household debt-to-disposable income ratio rose from 158% in 2010 to 163.7% in 2011.

However, since the second half of 2011, the growth rate of household debt has slowed down.[2] In the first quarter of 2012, outstanding household loans decreased for the first time in three years since 2009.

The structural weakness of household debt has also been quite improved. The ratio of fixed rate loans by banks rose from 5.1% at the end of 2010 to 12.5% in March 2012. Over the same period, the ratio of lump-sum payment loans fell from 41.3% to 37.6%.

Given that Korea's household debt grew KRW 8 trillion in the first half of this year and KRW 2.5 trillion to KRW 3.5 trillion in April to May this year, it is estimated that the annual household debt growth this year will be about KRW 27 trillion to KRW 34 trillion, or 2.9 to 3.7% increase.

To evaluate the overall soundness of Korea's household debt, we see it currently at a manageable level. Financial institutions are sound enough to absorb losses, and the fact that 69.1% of household debt held by high-income-range individuals provided additional assurance. The ratio of financial assets to debts remains stable.

The household default rate slightly rose this year; however, it remains low compared to those in early 2000s.

2. Self-employed entrepreneurs & their debt level

The number of the self-employed continuously increased since August 2011. As of May 2012, there are 5.85 million self-employed entrepreneurs, representing 23% of the workforce. In particular, the elderly self-employed increased in wholesale/retail or restaurant businesses.

Against this backdrop, banks' loans to such small business owners rapidly increased from the second half of 2011. The loan default rate of the self-employed is quite high particularly in wholesale/retail and restaurant businesses. The self-employed are considered more vulnerable to default risk than employed individuals.

As more baby boomers retire, the number of the self-employed will also increase. As such retirees engage in small businesses, already saturated, it is likely that profitability would worsen, driving up their loan default rates.

3. Housing market & household debt

As housing prices continue to fall in Seoul and near cities, the default rate of group lending has risen up to 1.72%, higher than the default rate of mortgage loans, 0.85%.

[2] Household debt growth rate (y-o-y, %) : 9.1 (2Q2011), 8.8 (3Q), 8.1(4Q), 7.0(1Q2012)

However, high default rate of group lending is not because home buyers are unable to repay their loans. Rather, many default cases are relevant to disputes over housing prices in which home buyers file a lawsuit against construction companies, refusing to pay an intermediate payment.

To evaluate the overall soundness of mortgage lending, the loan-to-value (LTV) ratio[3] of mortgage loans remains sound. The recent fall in housing prices in Seoul and near cities is considered moderate compared to a sharp rise of 30% in house prices from 2006 to 2008. Therefore, there is a low possibility that decrease in house prices will lead to a rapid deterioration of financial institutions' soundness.

The high default rate on group lending seems to have a limited impact on banks' soundness. The total amount of defaulted loans stands at KRW 1.6 trillion, mostly defaults on loans to pay an intermediate payment, and 75.6% of the defaulted loans are guaranteed by construction companies and Korea Housing Finance Corporation (KHFC).

4. Low-income borrowers & their debt level

If the current economic slowdown or slow recovery of household income continues, it is likely that low-income households will have difficulties in repaying their debt. The household debt-to-disposable income ratio for those in the first quintile of income is relatively high.[4] The number of borrowers in the first quintile of income is increasing, which is becoming a concern.[5]

Also, seniors in their 50s have a high debt to income ratio. Although these individuals have been borrowing money increasingly, their real estate asset will offset the risk.

Low-credit individuals borrowing from multiple secondary financial institutions have been on the rise. However, their delinquency rate and the amount of loans have stabilized.

Overall, there is limitation of financial supports for the socially vulnerable groups. What is in need is more comprehensive policy responses on expanding income bases and tightening expenditures.

[3] The loan-to-value (LTV) ratio (%) : 48.0 (2007), 47.1 (2008), 47.5 (2009), 48.0 (2010), 48.1 (2011), 48.5 (March 2012)
[4] Household debt-to-disposable income ratio (%): 179.3 (1st quintile), 94.5 (2nd quintile), 79.6 (3rd quintile), 79.8 (4th quintile), 76.3 (5th quintile)
[5] As borrowers in the first quintile rose from 15.3% in March 2009 to 16.6% in March 2012, their debt service ratio (DSR) also increased from 18.1% in March 2009 to 23.3% in March 2012.

POLICY RESPONSES

The government will continue to implement the comprehensive measured announced on June 29, 2011. In order to ensure the soundness of financial institutions, the government will increase its investment in the Korea Housing Finance Corporation (KHFC) and establish statutory rules for issuing covered bonds, thereby encouraging banks to extend more fixed-rate and long-term loans. Financial institutions are also encouraged to reserve sufficient loan-loss provisions.

In order to support the self-employed, the government will provide business consulting programs, prevent them from starting businesses in overly saturated sectors, and help retirees utilize their careers. We will also strengthen risk management of financial companies which extends loans to small business owners in highly saturated sectors such as wholesale/retail and restaurant businesses.

In order to prevent the impact of housing market slump on the soundness of financial institutions, the government will continue to implement measures to boost the housing market as announced on May 10, 2012. For mortgage borrowers who have difficulties in repaying their debt due to falling housing prices, we will consider providing extension of debt maturity.

MICROFINANCE FOR LOW-INCOME HOUSEHOLDS

Microfinance programs will be strengthened to cover those who are financially excluded such as wage workers and small merchants. The size of funds for microfinance programs will increase from KRW 3 trillion to 4 trillion a year.

- Sunshine loans: KRW 500 billion → KRW 700 billion
- New Hope loans: KRW 1.5 trillion → KRW 2 trillion
- Smile microcredit loans: KRW 200 billion → KRW 300 billion
- Microcredit loans by credit recovery program: KRW 100 billion → KRW 150 billion
- Comprehensive and easy-to-access microfinance services through 16 microfinance service centers and a call center (to be launched at the end of August)

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