Opening speech

Robert McCauley[1]

Governor Lee, President Rosengren, ladies and gentlemen:

First of all, I would like to welcome all the participants, some of whom have travelled far from home to attend this seminar. Second, I wish to commend the superb efforts of the staff of the Bank of Korea who, along with my colleagues from the Bank for International Settlements, have organised this seminar.

Indeed, this joint seminar is an expression of active and close cooperation between the Bank of Korea and the BIS. It will showcase the fruits of our collaboration in policy research – namely, the work of Tae Soo Kang and Guonan Ma on episodes of credit card lending distress in Asia. This seminar also draws on the widening cooperation between the BIS and central banks in Asia and the Pacific. We welcome the familiar faces of Michael Davies of the Reserve Bank of Australia and Tientip Subhanij of the Bank of Thailand, important contributors to the Asian research programme of the BIS. Both have worked on aspects of the housing market as research fellows at the BIS Asian Office and published studies jointly with BIS staff economists. We look forward to learning more from them today.

Given the ongoing turmoil in the global financial markets, a seminar on the implications of household debt for monetary policy and financial stability is especially timely. Excessive global liquidity, excessive leverage of financial institutions and excessive complexity of structured finance products all set the stage for the current financial market turmoil. And all of these forces contributed to the housing finance boom that occurred in many mature economies during the past several years. A big challenge for central banks, supervisors and other policymakers is to identify the proper policy responses when the aforementioned financial excesses build up. What should the authorities do in the face of excessive leverage and risk-taking on the one hand, and rapid diffusion of financial innovation on the other?

This joint seminar is very apt because the Bank of Korea and the BIS have, in different ways, taken the lead in addressing this question. In this century, the BIS has been a strong proponent of paying more attention to the relationship between credit growth and asset prices and putting greater emphasis on the macroprudential approach to monetary and financial stability. Policymakers in Korea, for their part, have been at the forefront in deploying a range of instruments to respond to emerging signs of financial imbalances and excesses in the Korean economy. In particular, in the face of a housing boom amid strong inflows of capital in recent years, they have responded not only with monetary policy but also with prudential regulation, credit rules, capital outflow liberalisation and supply measures. In particular, the authorities sought to reinforce norms for down payments (or equivalently, to limit the rise in loan-to-value ratios) in the mortgage market.

The seminar today is also an occasion for policymakers at central banks in Asia to come together and share their thoughts and experiences in handling the policy issues posed by household debt. One can postulate a kind of Kuznets curve whereby a higher level of personal income is associated with higher household debt in relation to income. At the upper right on this curve are the mature markets of Australia and Japan with relatively high debt

[1] Senior Adviser in the Monetary and Economic Department of the BIS. He was Chief Representative of the BIS Representative Office for Asia and the Pacific at the time of the seminar. The views expressed are those of the author and not necessarily those of the BIS.

levels. At the lower left are the less mature markets of China, India and Indonesia. In the middle, we find Korea, Malaysia, Taiwan (China) and Thailand.

In general, convergence to mature market levels of household debt is a welcome sign of improvement in consumer welfare and in the efficiency of the financial sector. This is particularly the case in economies like Korea, where banks for many years neglected household lending in favour of corporate lending. Under these circumstances, it is easy to be complacent when household debt grows very quickly: a stock adjustment process is under way, it is said. However, the catching-up process might not prove to be a smooth asymptote to the Kuznets curve. Instead, a painful boom-bust cycle may occur, as the episode of credit card lending distress in Korea in 2003 demonstrated. Even from a very low base, too fast an adjustment in the stock of consumer debt can overwhelm the capacity of risk management and market infrastructure.

The authorities thus need to work to upgrade risk management and the market infrastructure. In addition, experience shows that at times the authorities may need to encourage the widening of margins of safety, such as limits on leverage or debt service in relation to income and minimum repayment terms. This is particularly so during a transitional period marked by structural changes such as deregulation, intensified competition and increased penetration by global firms. In response to the Korean 2003 credit card lending debacle, Thai policymakers tightened income tests in the fast-expanding local credit card business and avoided a hard landing. By contrast, Taiwanese policymakers relied on the local consumer credit reporting system and suffered a crash of credit card lending in 2006. The recent turmoil in the mature markets testifies to the potential for problems when market participants lose track of basic prudential norms regarding leverage in relation to assets, and debt service in relation to income.

If Asia can manage a deepening of household credit without booms and busts, consumer welfare, economic growth and financial stability will be well served in the region over the coming decades. For some of the biggest Asian markets, such as China, India and Indonesia, this process is at an early stage. Therefore, it is my hope that this joint Bank of Korea/BIS seminar will help central bankers in the region learn from each other about policies related to household debt.

Thank you very much and I wish you all a successful seminar.