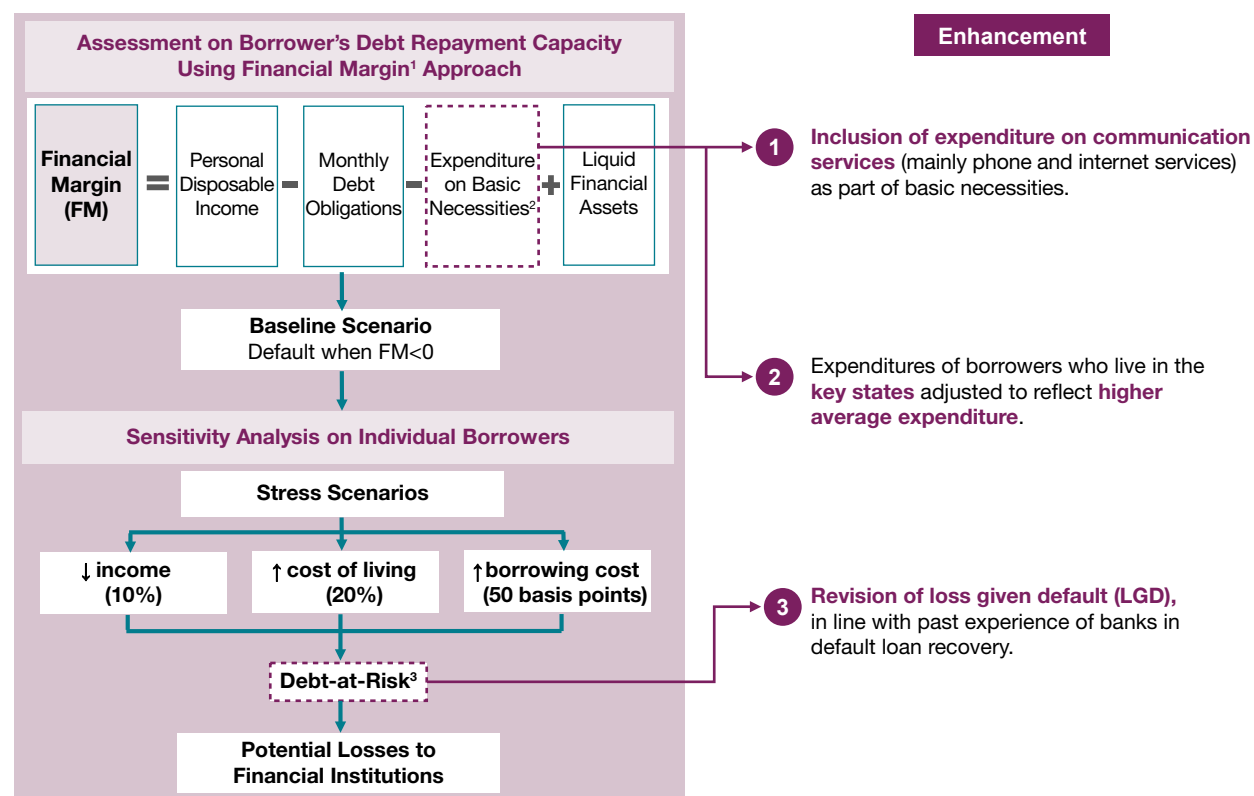


An Enhanced Financial Margin Framework for the Household Sector

This info box summarises recent enhancements to the financial margin (FM) framework,⁹ which uses individual-level income and credit information to identify and assess risks to financial stability from the household sector. The motivation for these refinements is twofold – first, to ensure that the components of borrowers’ FM continue to be reflective of their monthly spending and financial obligations, and second, to derive a more plausible estimation of DAR and potential losses to banks.

As evidenced by the high internet penetration rate of 87%¹⁰ in 2018, expenditure by households in Malaysia on communication services has become much more of a necessity than a luxury. Therefore, in calculating the FM of an individual borrower, expenditure on communication services, which accounts for about 3% of monthly income, is now included under basic necessities (Diagram 2). Further, recognising the higher living costs in Kuala Lumpur, Selangor, Penang and Johor, the enhanced framework also incorporates higher relative expenditure levels for borrowers in these key states.

Diagram 2: Enhancement to the Financial Margin Framework



¹ Residual monthly disposable income and liquid financial assets, after deducting debt repayments and expenditure on basic necessities

² For this study, basic necessities are defined as: (i) food and non-alcoholic beverages; (ii) housing rental and maintenance; (iii) water, electricity, gas and other fuels; (iv) transportation; (v) education; (vi) healthcare; and (vii) communication services

³ The proportion of debt of borrowers with negative FM to total household debt after taking into account the potential LGD

Source: Bank Negara Malaysia

⁹ Financial Stability and Payment Systems Report (2016). 'Looking Beyond Headline Household Debt Statistics'. Bank Negara Malaysia, page 41-46 and Financial Stability and Payment Systems Report (2017). 'Indebted to Debt: An Assessment of Debt Levels and Financial Buffers of Households'. Bank Negara Malaysia, page 39-48.

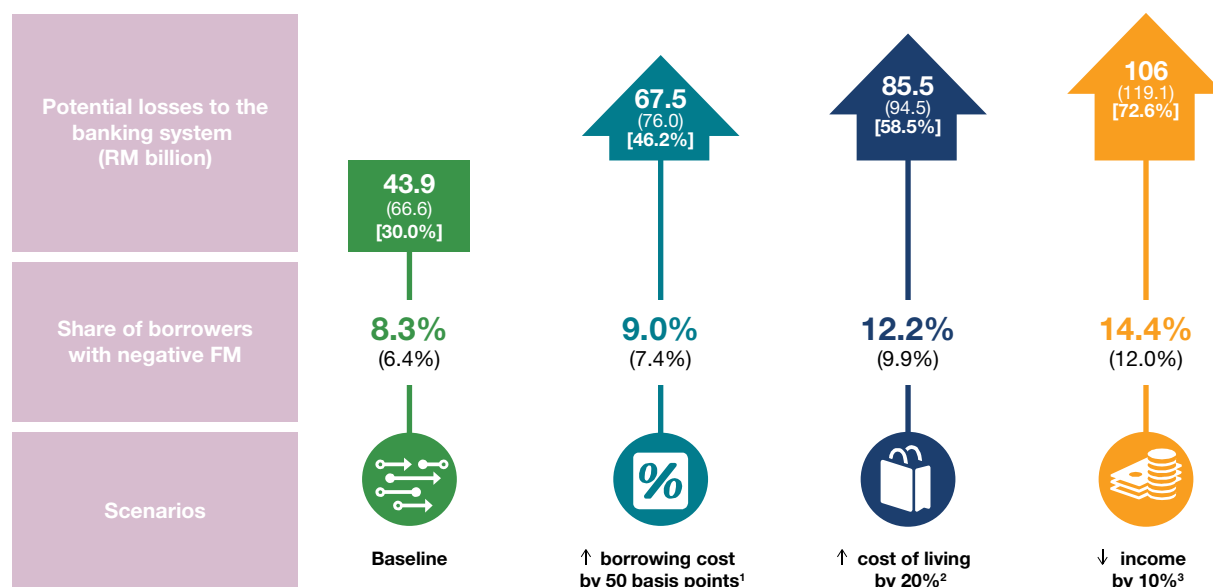
¹⁰ Department of Statistics, Malaysia (2018). 'ICT Use and Access by Individuals and Households Survey Report', Putrajaya.

The DAR under the baseline and stress scenarios have also been re-estimated with a more plausible set of LGD data derived from the historical experience of domestic banks (Baseline scenario: 17% – 66%; stress scenarios: 23% - 76%).¹¹ Notable differences are mainly in LGDs for loans for the purchase of non-residential properties and securities which are significantly lower given the availability of collateral.¹² These LGDs are also in line with that assumed under the Bank’s multi-year solvency stress test.

With these refinements, the share of borrowers with negative FM is higher at 8.3% (pre-enhancement: 6.4%) (Diagram 3), driven mainly by the inclusion of expenditure on communication services. While the number of distressed borrowers has increased, overall DAR has declined to 5.2% of total household debt (pre-enhancement: 7.8%) given the lower LGDs (DAR for the banking system: 4.4%; pre-enhancement: 6.6%). The distributions of DAR by loan purpose and income group remain broadly unchanged with the refinements. Personal financing accounted for the largest share of DAR (42%), the bulk of which was attributed to borrowers earning less than RM5,000 per month. While residential property loans comprised more than half of total household debt, this segment accounted for only about a quarter of DAR as risks are largely mitigated by collateral values that exceeded balances on outstanding loans. Potential losses to the banking system under the baseline scenario stood at RM43.9 billion, or 30% of banks’ excess capital buffers.¹³

In assessing borrowers’ debt repayment capacity under stress scenarios, borrowers continued to be most susceptible to income and cost of living shocks, with a smaller impact from an increase in borrowing costs. The corresponding increase in potential losses to the banking system under stress scenarios remains within banks’ excess capital buffers of RM146.1 billion as at end-June 2019.

Diagram 3: Results of Sensitivity Analysis on Potential Losses to the Banking System



(..) denotes estimate based on the pre-enhancement framework
[. %] denotes ratio of potential losses to banks’ excess capital buffers

¹ Based on the increase in the average lending rate following two consecutive increases in the Overnight Policy Rate in 2006

² Close to triple that of 2009 - 2016 compounded annual growth rate (CAGR) of 7.3% for expenditures on basic necessities

³ Larger than the decline in aggregate household disposable income of 8.7% during the Asian Financial Crisis in 1998

Source: Bank Negara Malaysia, Department of Statistics, Malaysia

¹¹ Previously, the estimation of LGDs only considers housing loans as having underlying collateral and imposes a 40% haircut on the collateral value in the event of a default. Other loans were assumed to have an LGD of 100%.

¹² Bulk of loans for the purchase of securities is invested in fixed-price unit trust funds.

¹³ Above the regulatory minimum of 8%.