Evolving Household Balance Sheets and Implications for Private Consumption

Introduction

The household balance sheet in Malaysia has evolved significantly over the recent decade. The size of the balance sheet has grown substantially over the years, as reflected in rising household assets and debt. The composition of the balance sheet has also changed, with higher holdings of financial and property assets. This article explores the changing structure of the household balance sheet and discusses the key drivers behind it. It also examines the effects of these changes on private consumption and outlines the policy implications going forward.

The Evolving Nature of the Household Balance Sheet[1]

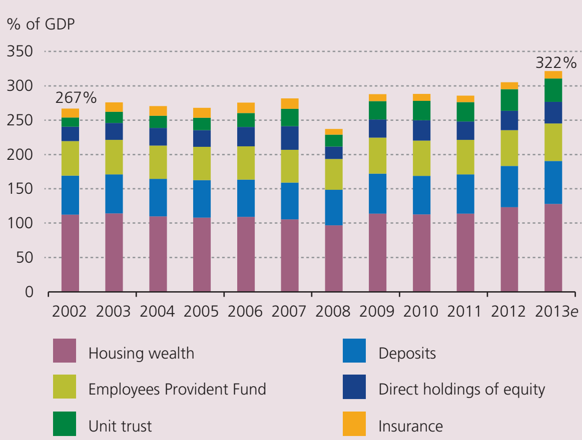
The household balance sheet provides a snapshot of assets and liabilities, and reflects households' financial health. Assets reflect resources for future spending, and can be both liquid[2] (for example deposits, unit trust funds and direct investments in the stock market) and relatively illiquid (for example housing wealth[3] and mandatory contributions to the Employees Provident Fund). Household debt represents liabilities that need to be repaid in the future, comprising of loans to purchase property and securities, and to finance consumption[4].

Two key trends in Malaysia's household balance sheet can be observed. First, the size of the balance sheet has grown since 2002. Total household assets grew at an average annual rate of 10.4% from 2003-2013 to 321.6% of GDP at end-2013, while household debt grew annually by 12.7% to 86.8% of GDP at end-2013 (Chart 1 and 2). In level terms, household assets continue to exceed debt by 3.7 times. This trend is mainly attributable to rising household income, which facilitates asset accumulation through an increase in savings and borrowings.

Second, the composition of household assets has become more diversified. While the level of deposits continues to grow, its share of total assets has been on a moderating trend. At the same time, the accumulation of assets in unit trust funds and equities has been on the rise (Chart 3). This trend

Chart 1

Composition of Household Assets

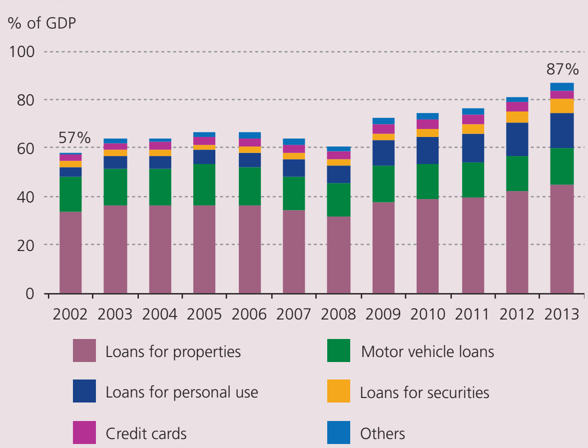


e Estimate, housing wealth data is only available up to 3Q 2013

Source: Bank Negara Malaysia estimates

Chart 2

Composition of Household Debt



Source: Bank Negara Malaysia

[1] Only domestic assets and liabilities are included in the analysis. This is due to the unavailability of a breakdown by economic agents in the International Investment Position statistics on holdings of assets abroad and external liabilities.

[2] Liquid assets are assets that can be converted into cash quickly and with minimal loss of value.

[3] Housing wealth is estimated by multiplying the average national house price with the total number of residential properties excluding unsold units.

[4] Loans for consumption comprise of motor vehicle loans, personal loans and credit card facilities.

not only reflects more developed domestic financial markets offering a wider range of products and services, but is also attributable to households' growing financial sophistication and improving awareness of alternative savings instruments. Housing wealth, meanwhile, continues to be the largest component of household assets[5].

From a distributional perspective, much of this wealth accumulation can be accounted for by higher-income households who are able to save a larger proportion of their income. Chart 4 illustrates the distribution of households by income groups and proxies of asset ownership based on flow data across income brackets[6]. Relative to lower-income households, those with monthly income above RM5,000 (accounts for a share of 33.7% of total households) assume a larger share of spending that is channelled to the accumulation of financial assets (65.8%) and earnings from rental income[7] (60.1%).

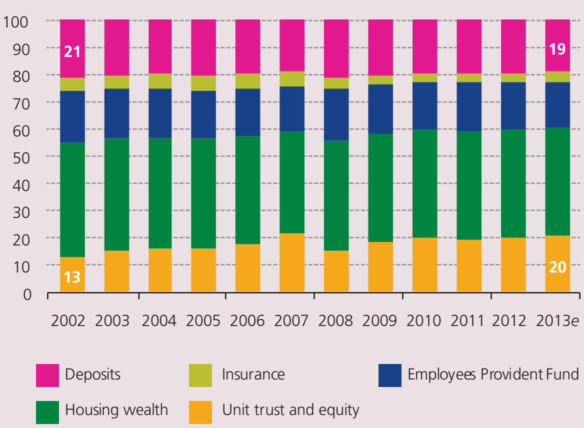
The Implications for Private Consumption

The changing size and structure of the household balance sheet has important implications for private consumption. On the assets side, the accumulation of property and financial assets has enabled Malaysian households to benefit from the recent asset price increases, supporting private consumption. Conceptually, asset prices affect spending by asset-owning households through three main channels (Skudelny, 2009). First, households are able to sell their assets to finance spending. This channel is stronger for more liquid financial assets, in which capital gains can be realised more quickly. Second, when assets serve as retirement savings, an appreciation in the value of these assets reduces the perceived need to save at present to finance future spending. Finally, assets can serve as collateral, enabling households to borrow against the value of the asset. While the three channels benefit asset owners, higher asset prices, particularly for property, increases the need for debt accumulation among house buyers. This reduces the disposable income of these households going forward, which may partially offset the positive wealth effect on private consumption.

On the liabilities side, borrowings to finance consumption have allowed households to adjust their spending patterns. Households with access to credit can borrow to facilitate purchases of durable goods as well as

Chart 3

Total Household Assets by Components

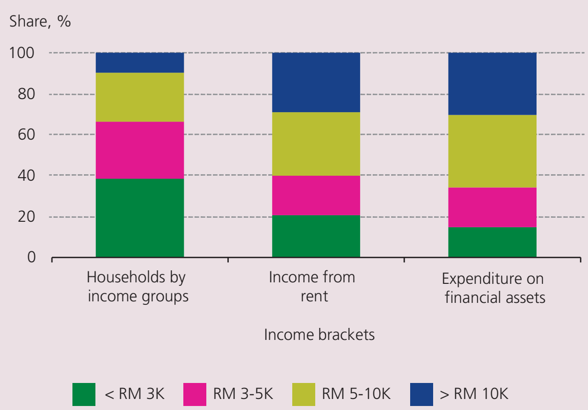


e Estimate, housing wealth data is only available up to 3Q 2013

Source: Bank Negara Malaysia estimates

Chart 4

Income from Rent and Expenditure on the Accumulation of Financial Assets Across Income Brackets



Source: Household Expenditure Survey 2009/10 and Household Income Survey 2012, Department of Statistics, Malaysia

[5] For household liabilities, loans for the purchase of properties remain the largest component. Personal loans accounted for an increasing share since 2002, although its growth moderated in 2013. Refer to the Financial Stability and Payment Systems Report 2013 for a detailed analysis of household liabilities.
[6] Statistics on stocks of household assets by income groups are not available.
[7] Rental income, however, constitutes only a small fraction of total income for all income brackets.

to support consumption during times of lower income. Nonetheless, a portion of income must be devoted to the repayment of debt going forward. Consumption is not increased permanently but rather brought forward, hence limiting future increases in consumption. The sustainability of private consumption thus requires that households' future repayment capacities are in line with their debt obligations.

To understand the role of these channels for private consumption, an aggregate consumption function for the Malaysian economy was estimated[8]. The determinants considered are income, housing wealth, financial wealth[9], consumption credit disbursements and repayments. The contribution of each determinant to private consumption is quantified and illustrated in Chart 5.

The findings show that income is the most important driver of private consumption, accounting for an average of 67.4% of private consumption growth during the period. This result reflects the fact that private consumption has been consistently supported by stable labour market conditions and sustained income growth. Since 2005, housing and financial wealth have been supportive of private consumption, accounting for 14.5% and 13.7% of private consumption growth, respectively. The contributions have increased in the post-global financial crisis period. Consumption credit disbursements, while on average playing a small role, contributed significantly to private consumption during certain periods[10]. This reflects the fact that consumption credit cannot permanently increase spending, but rather helps households redistribute consumption over time or purchase durable goods[11].

The econometric findings relate to aggregate private consumption. Across income groups, the determinants of private consumption are likely to differ. Income likely contributes a larger share to private consumption growth for lower-income households, given that they have higher marginal propensities to consume

Table 1

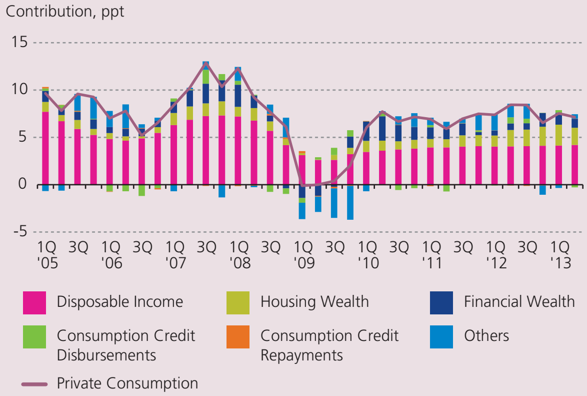
Average Contribution of the Determinants of Private Consumption Growth (2005-2Q 2013)

Determinant	Contribution (%)
Disposable income	67.4
Housing wealth	14.5
Financial wealth	13.7
Consumption credit disbursements	0.3
Consumption credit repayments	-0.2
Others	4.3

Source: Bank Negara Malaysia estimates

Chart 5

Drivers of Private Consumption Growth



Source: Bank Negara Malaysia estimates

[8] An error correction model (ECM) was used. Housing and financial wealth are estimated as the value of wealth net of the outstanding value of loans used to purchase them (e.g. financial wealth minus loans outstanding for the purchase of securities).

[9] Financial wealth refers to household holdings of unit trust funds. Direct holdings of equities are excluded due to the unavailability of reliable quarterly data.

[10] For example, between 2Q and 4Q 2009, consumption credit disbursements contributed an average of 0.6ppt. to overall private consumption growth of 1.0%. This coincided with the reductions in the Overnight Policy Rate by the Bank to support the economic recovery during this period.

[11] Loan repayments do not have a significant impact on private consumption in this model. This likely reflects the fact that there have been no episodes of widespread deleveraging on household balance sheets in the sample period. Repayments are expected to adversely affect consumption during such a deleveraging episode. For example, Dynan (2012) found that highly-leveraged homeowners in the United States experienced larger falls in consumption between 2007 and 2009, after accounting for the wealth effects of lower house prices.

(Murugasu, Ang and Tng, 2013). Improving the distribution of household income is thus likely to support overall private consumption. Meanwhile, wealth effects are probably larger for high-income households as they tend to hold more housing and financial assets.

Policy Implications

The findings suggest that balance sheet developments have become an increasingly important consideration for policy analysis for two key reasons. First, asset price movements have an important effect on household spending. For example, a reversal of the asset price gains in recent years is likely to reduce wealth, which may cause households to scale back on their spending. Thus, policy would need to focus on the sustainability of asset prices and the spillovers to the economy. This effect is, however, partially mitigated by the fact that a larger proportion of housing and financial wealth is held by higher-income households with larger savings buffers. Households with monthly income above RM5,000 save approximately a fifth of their income and are better able to support their consumption amid adverse asset price movements. Nonetheless, ensuring that asset prices are reflective of economic fundamentals remains a policy priority, given the potentially significant adverse implications of sharp corrections in asset prices for macroeconomic and financial stability.

Second, changes in household income may now pose significant implications for the real economy and financial stability. It not only affects households' ability to consume in a given period, but also to service their debt obligations. For example, if an income earner of an indebted household becomes unemployed, the household may be forced to further cut back on spending to manage debt repayments or face default. These concerns are, however, partially alleviated by holdings of assets. Liquid financial assets of households are 1.6 times outstanding debt, sufficient to cover their liabilities in the event of income shocks. In addition, 52% of the household debt is utilised for property purchases, and hence, is backed by physical assets. From a distributional perspective, however, the Bank continues to closely monitor lending to lower-income households. Households earning below RM3,000 a month have higher leverage positions than those in other income groups and hence are more susceptible to income shocks. The policy imperative, therefore, is to continue to ensure that households only borrow within their means.

Taking all these into consideration, the Government and the Bank have undertaken pre-emptive policies to prevent household balance sheets from becoming a source of systemic risk. In the 2014 Budget, the Government raised the real property gains tax (RPGT) and the minimum price of properties that can be purchased by foreigners. These measures are aimed at curbing speculation and ensuring that property prices grow in line with fundamentals. The Bank has also introduced macroprudential measures in stages since 2010, to prevent excessive household indebtedness and to ensure responsible lending practices. These measures are part of a broader trend of more active use of macroprudential policies to manage risks related to financial imbalances and excessive leverage. PR China, Chinese Taipei, Hong Kong SAR, Singapore and Indonesia have introduced macroprudential measures to manage either property prices or mitigate unsustainable increases in household indebtedness.

Conclusion

The household balance sheet has evolved over the recent decade. It has grown in size, both in terms of assets and debt, and has become more diversified. These developments have helped to support private consumption in recent years. Going forward, the household balance sheet will continue to evolve and have implications on household welfare, private consumption and economic growth. Nonetheless, it is recognised that over-leveraging which is not commensurate with income will make households more vulnerable to adverse shocks, and subsequently, pose a risk to household spending and sustainable growth. Therefore, there is a need to continuously evaluate financial developments and undertake pre-emptive action to mitigate the build-up of imbalances when appropriate.

References

Dynan, K. (2012), `Is a Household Debt Overhang Holding Back Consumption?´ Brookings Papers on Economic Activity, (Spring 2012), pp. 299-362.

Murugasu, D., Ang, J.W. & Tng, B.H. (2013), `The Marginal Propensity to Consume Across Household Income Groups´, Bank Negara Malaysia Working Paper Series, WP2/2013.