

Access to Finance and Household Consumption

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Improving Access to Finance

- Improving access to finance helps boost consumption
 - Households may consume more and save less if they can borrow in the event of an adverse shock (alternative to self-insuring through savings)
- While an expansion of financing could help boost consumption, benefits must be carefully weighted vis-à-vis risks to financial stability

Plan of The Talk

- Cross-country analysis of household consumption
- Case Studies:
 - Payroll loans in Brazil
 - Mortgages in South Korea
 - Credit cards in South Korea
 - Automobile loans

Cross-Country Comparison of Consumption

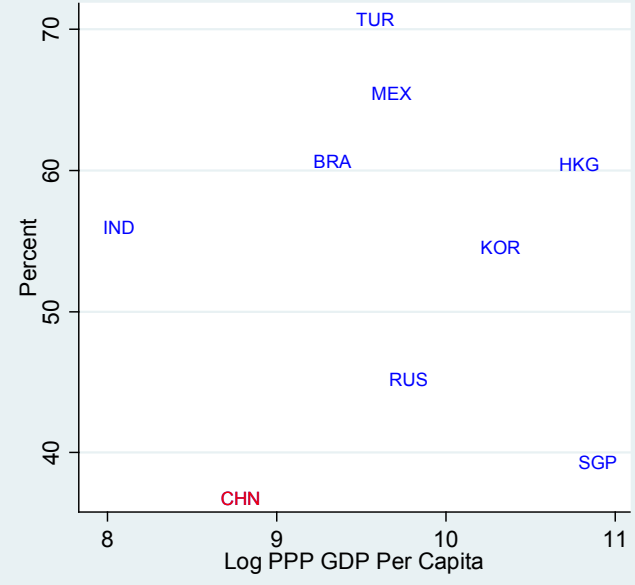
- Use national accounts data on household final consumption expenditure
- Estimate relationship between ratio of consumption to GDP and measures of financial development, controlling for standard determinants of consumption

Financial Sector Variables

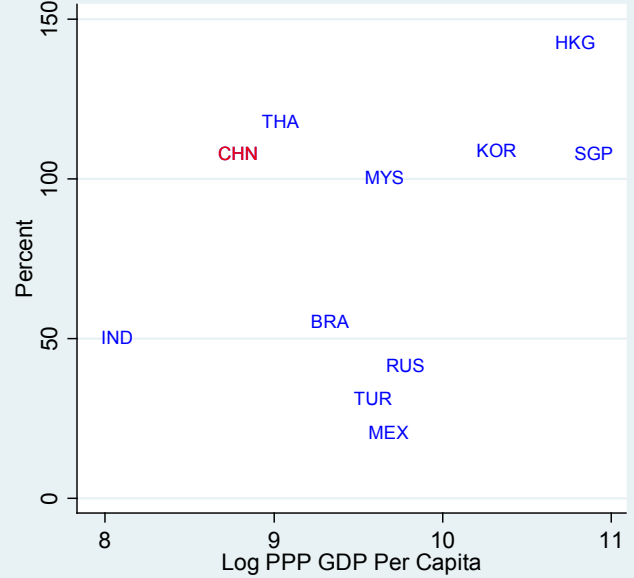
- Measures of financial development:
 - Private Sector Credit/GDP, M3/GDP
 - Financial reform variables considered include indices from Abiad, Detragiache and Tressel (2008) for:
 - Entry barriers (e.g. licensing requirements and limits in the participation of foreign banks)
 - Interest and credit controls
 - Privatization in the financial sector
 - International financial restrictions
 - Restrictions on security markets
 - Quality of banking supervision



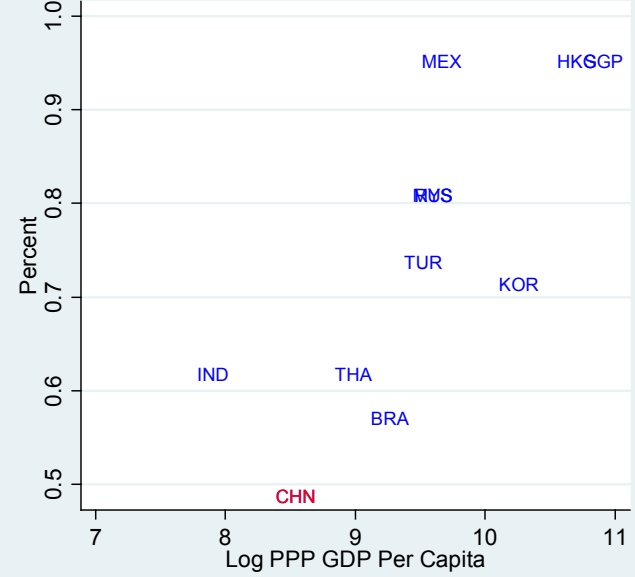
Household Consumption/GDP in 2008



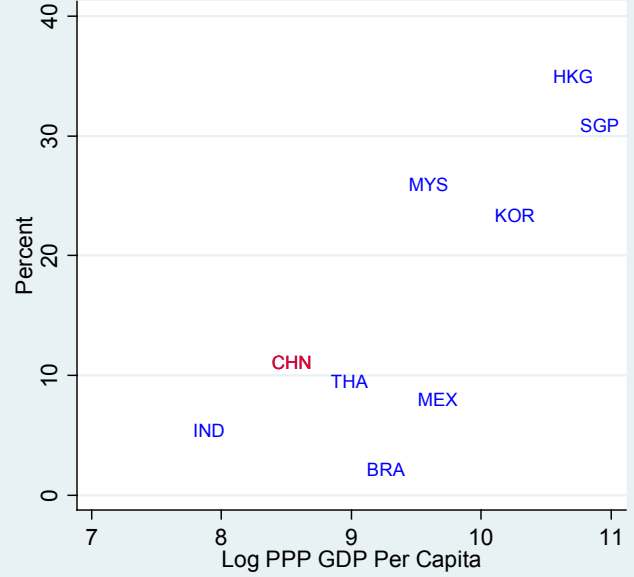
Private Sector Credit/GDP in 2008



Financial Reform Index in 2005



Mortgage Credit/GDP in 2008



Main Regression Results

- Financial reform increases household consumption:
 - Moving from China's financial reform index in 2005 to that of Korea (from 0.5 to 0.7) would raise Consumption/GDP by 2 percentage points, while moving to the average of G7 (1) would raise it by 5 percentage points
 - In comparison, a 1 percentage point increase in private sector credit-GDP ratio increases consumption-GDP ratio by 0.05 percentage points

Regression Results

- Taken at face-value, potential increase in consumption-GDP ratio from financial liberalization a significant step forward
- But the ground to cover is large
 - Actual is below model prediction (36 percent versus 50 percent in 2005)
 - Raising household income-GDP ratio from 60 percent to 70 percent (closer to international norm) would raise household consumption-GDP ratio by 7 percentage points

Case Studies: Payroll Loans from Brazil

- Payroll loans allow individuals to pledge a share of future wages (or pension) as collateral for a loan
 - Bank deducts loan repayments from wages or pension payments
 - Removes default risk
 - But subject to employment risk (mainly private sector workers) and longevity risk (mainly pensioners)
- Payroll loans existed in Brazil since early 1990s, but only took-off after a September 2003 law regulated this type of loan

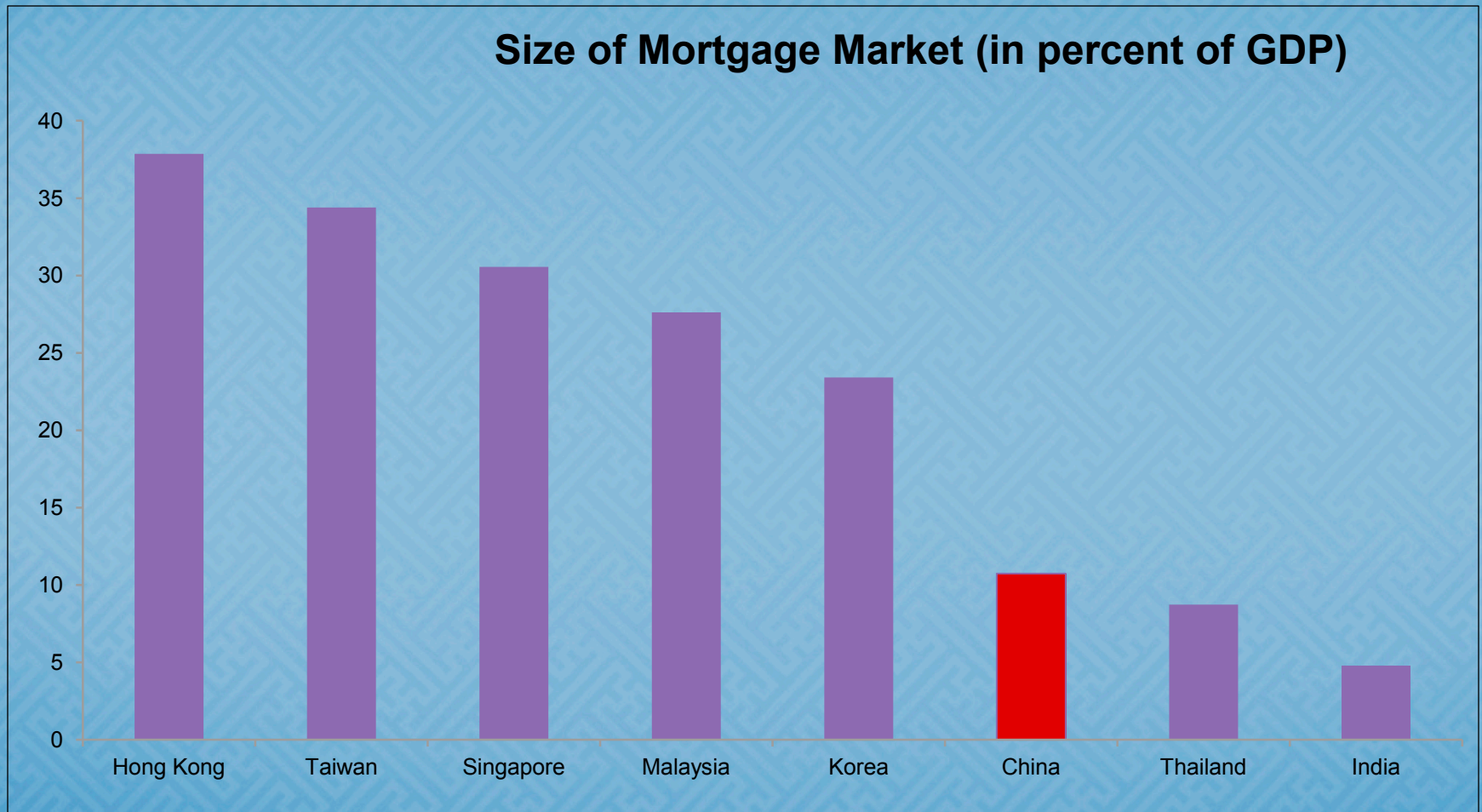
Case Studies: Payroll Loans from Brazil

- Within two years of regulation, payroll loans accounted for 20 percent of all loans to individuals in Brazil (2 percent of GDP).
- At present, stock of payroll loans account for about 3½ percent of GDP
- Average interest rate on payroll loans substantially lower than on other individual loans (30 percent per year, while a comparable non-payroll loan would charge 13 percentage points more)

Case Study: Mortgage Markets in Korea

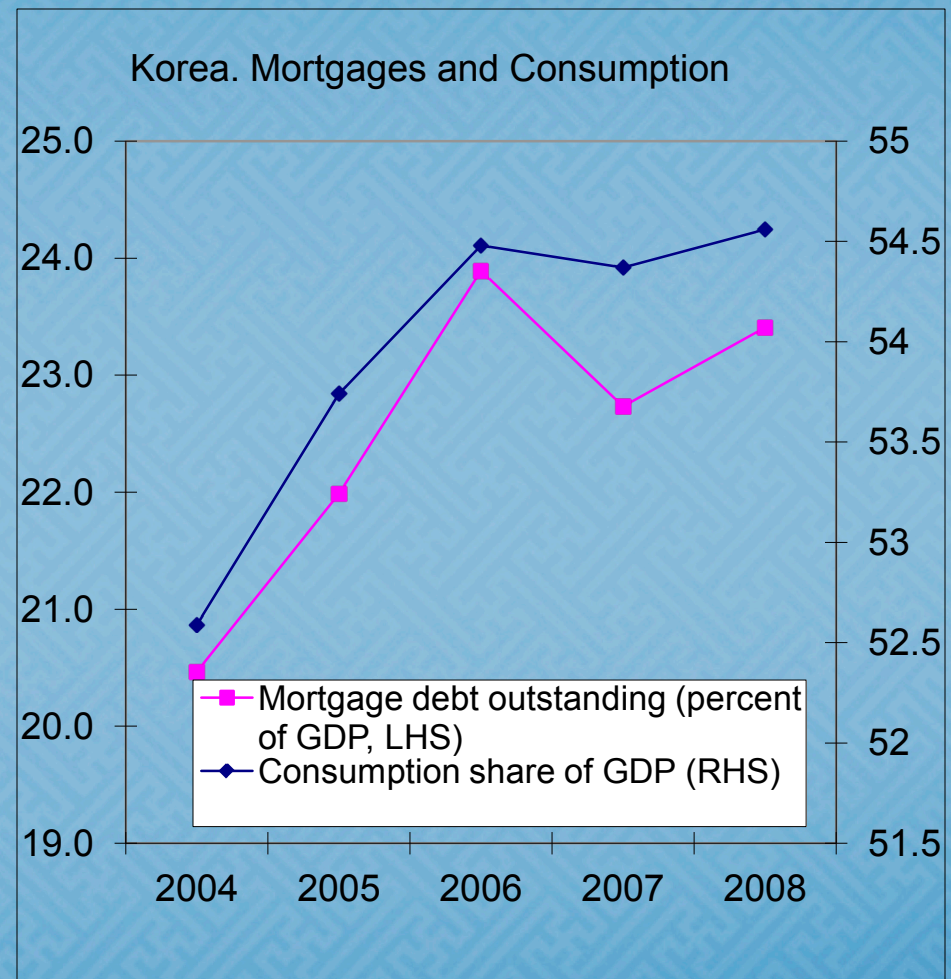
- Privatization of the dominant mortgage provider in 1997
- Reforms from 1999 onwards to securitize loans. Passage of a comprehensive asset backed securities law
- Since 2002, reforms focused on policies to curb rally in house prices, including tightening underwriting standards

Reforms have led to a large mortgage market in Korea



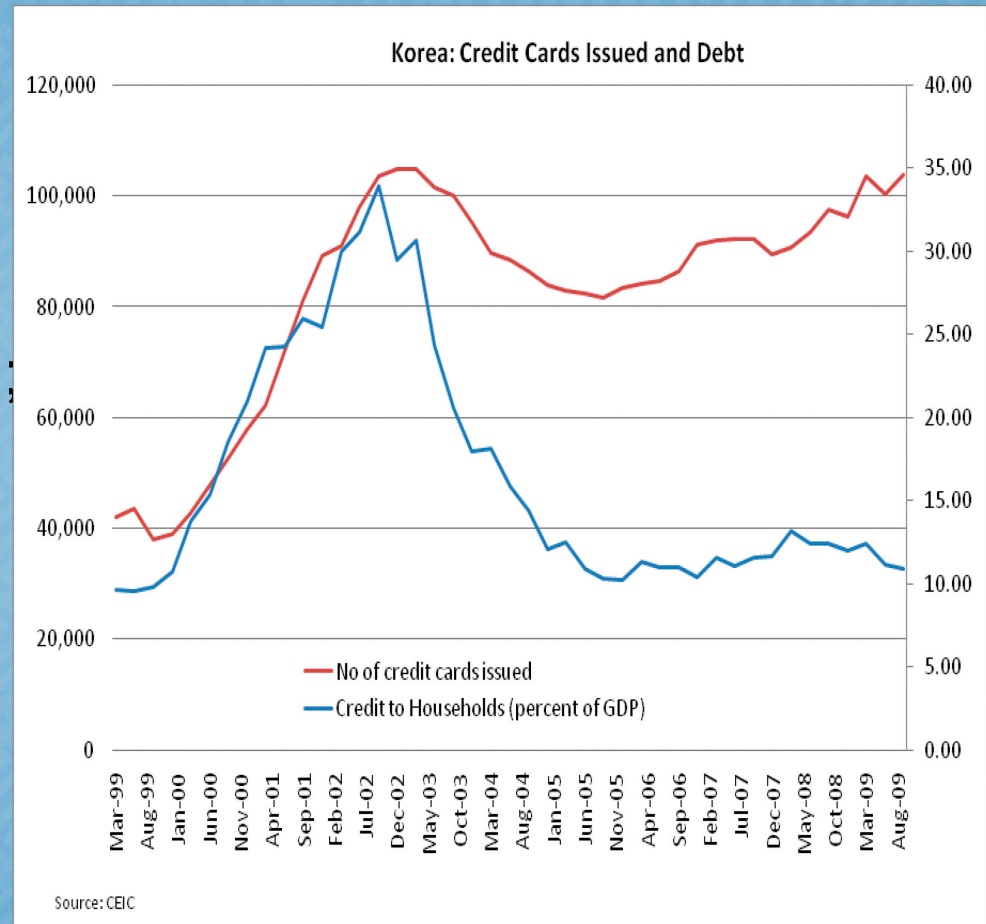
Impact on Consumption

- Consumption has risen in line with mortgages to almost 55 percent, one of the highest in emerging Asia
- Low loan to value requirements (60 percent) have not led to a dampening effect on consumption



Case study: Korean Credit Card Boom and Bust- A cautionary tale

- Rapid expansion from 1999 to 2002 owing to tax deductions, lack of income verification, aggressive marketing
- 4 cards for every Korean; “kiting” or revolving between cards prevalent
- 2002, rise in delinquencies
- 2003, collapse in market for CC company bonds
- Bail out of the largest CC company (LG Card)



Potential Role for Auto Financing

- Expansion of auto-financing could anticipate expected increase in demand for cars
 - There is a very stable relationship across countries between income levels and automobile ownership
 - Evidence from other countries' experience suggests China is at the onset of a rapid rise in car ownership.
 - Chamon et al (2008) project its car fleet to increase to over 50 million by 2010 and to 87 million by 2015

Potential Role for Auto Financing

- Auto-financing should be relatively safe to the lender given the presence of collateral
 - Improvements in the way cars are registered and liens recorded could promote auto-financing
- Expansion of car ownership brings other policy challenges that should also be weighted (e.g. environmental)

Conclusions

- Improvements in access to finance can help lift consumption
 - Expansion of mortgage credit and allowing households to borrow against housing collateral could have large effect, but not without risks
 - Other policies, such as payroll loans and auto financing, could also boost consumption

Thank you