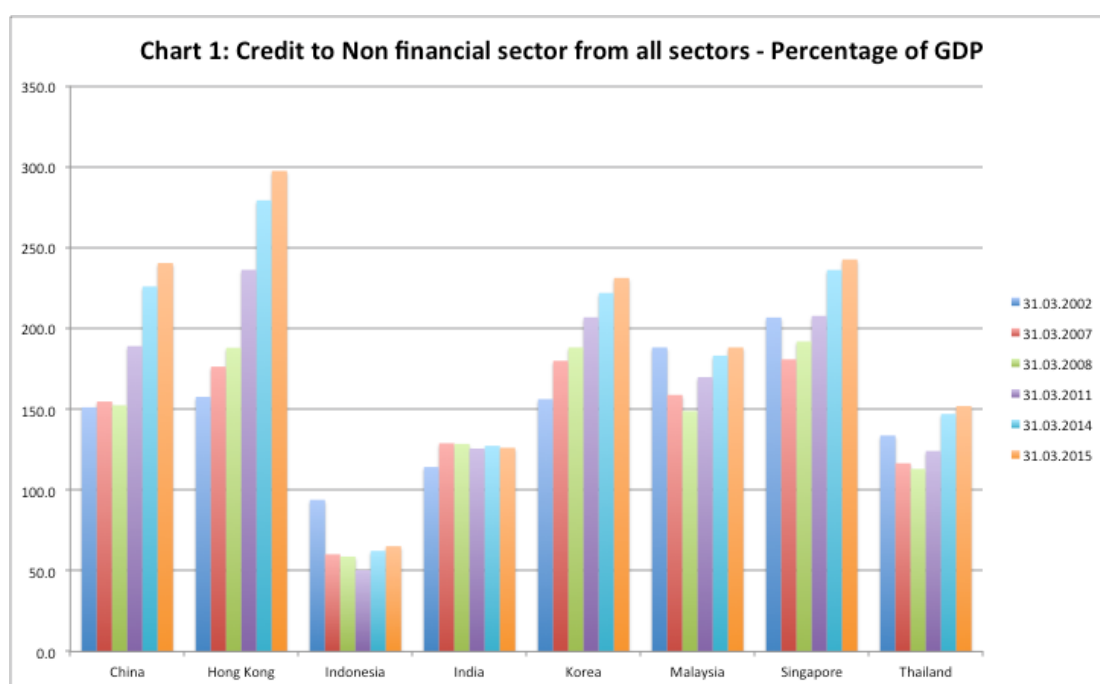


Debt and Asia's Success*

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Slowing growth in Asia is focusing attention on a characteristic of most of the region's economies (though not of them alone). This is the huge debt pile that burdens the private non-financial sector in these countries—firms, households and individuals, all with different degree of debt exposure in different contexts. There are two features of this debt that defines its sustainability. The first is how large the debt is relative to an economy's size, measured by the debt to GDP ratio. Though there is no absolute level of the debt-to-GDP ratio that separates the debt volume into one that is sustainable and one that is not, high ratios point to the need to set aside more income to meet debt service commitments. The second is the pace at which that ratio has increased over time. Rapid debt build up is often taken as an indicator of potential vulnerability to a financial crisis.

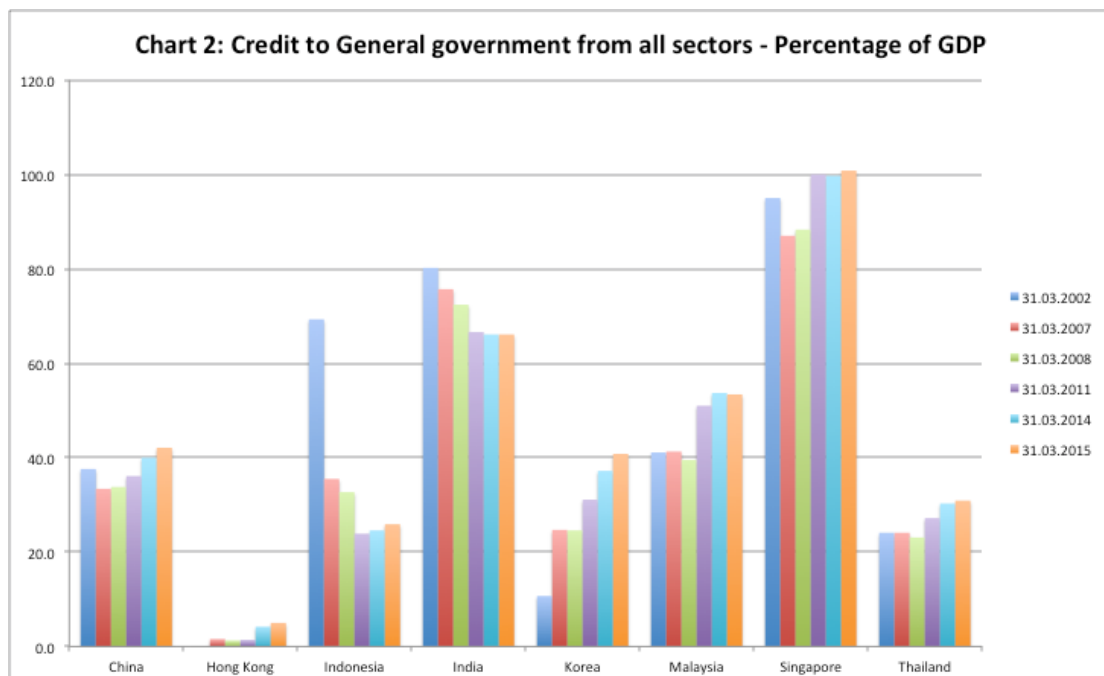


The recently refurbished and expanded database of the [Bank of International Settlements \(BIS\)](#) allows for a comparison of debt trends in some of the potential growth frontrunners in Asia. The countries chosen for analysis here are China, Hong Kong, Indonesia, India, South Korea, Malaysia, Singapore and Thailand. Chart 1 presents the movement of credit provided by all sectors to the non-financial sector in these countries. There are a number of obvious pointers in that evidence. To start within this cross-section of “emerging” Asian countries, other than for India and Indonesia, all countries registered a sharp spike in the aggregate debt of the non-financial sector in the period after the 2008 crisis. The increase are from 155 to 240 per cent in China, 176 to 297 per cent in Hong Kong, 180 to 231 per cent in Korea, 159 to 188 per cent in Malaysia, 181 to 243 per cent in Singapore, and 117 to 152 per cent in the case of Thailand. Only in

India has the ratio stagnated around 127 per cent and in Indonesia the rise is from 60 to just 65 per cent.

There are two factors that could possibly explain the trends in and the variations across countries. First, the spike in credit provision must have been partly driven by the need to provide a countercyclical stimulus to the economy in the wake of the global financial crisis. In the era when the stress is on holding down government fiscal deficits and on fiscal consolidation, this required relying on an increase in credit provision to spur investment and consumption demand. The Chinese post-crisis stimulus was a typical example of this. Second, the smaller rise in the credit to GDP ratio in India and Indonesia may be accounted for by the fact that these countries were less dependent on world markets and therefore not as adversely hit by the collapse of the world economy as the others were, necessitating much weaker stimuli than in the latter. And third, this was also the period when the massive infusion of liquidity into the system by central banks in the developed countries resulted in a large flow of capital into equity and debt assets in the emerging markets. To the extent that domestic regulations and local appetites encourage exposure to debt over equity, a spike in the debt to GDP ratio would follow.

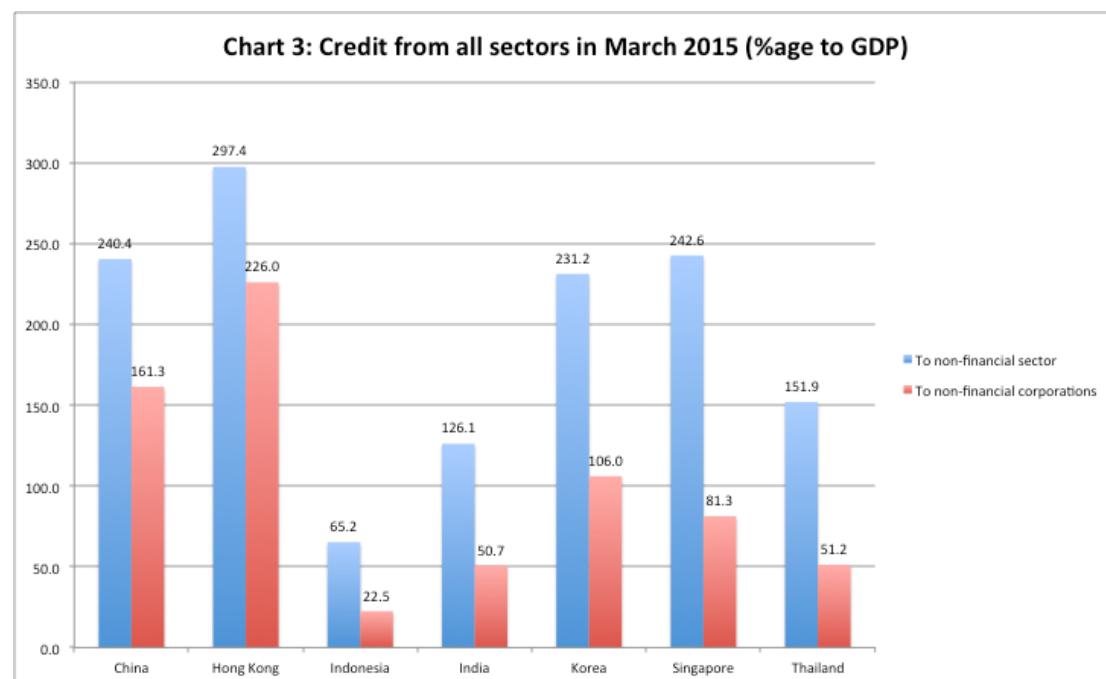
A second feature revealed by Chart 1 is the relatively high levels that the credit to GDP ratio had reached in some countries by 2015—close to 300 per cent in Hong Kong, above 240 per cent in China and Singapore, around 230 per cent in Korea. These were levels that prevailed in the US (239 per cent) and the UK (269 per cent) and significantly higher than that in a more conservative Germany (192 per cent).



Third, these high levels were reached through a rapid rise in the ratio in a short span of time between 2007 and 2015—86 percentage points in the case of China, 121 in the case of Hong Kong, 51 for Korea and 62 for Singapore. This amounts to annual average increases of 11, 15, 6 and 8 percentage points respectively.

According to a J P Morgan analyst quoted by the *Financial Times* (August 11, 2015), the IMF had in an empirical study found that an increase in the ratio of credit to GDP of five percentage points or more in a single year signals a heightened risk of an eventual financial crisis.

The credit spike occurred in a context where, given the emphasis on fiscal consolidation, credit flow to the government *per se* was restricted. The BIS dataset captures core debt, that is, (i) loans; (ii) debt securities; and (iii) currency & deposits, of “general government”, which consists of central, state and local governments and social security funds and excludes public enterprises. As Chart 2 shows, the ratio of credit to general government relative to GDP did not change very much between 2007 and 2015 in most countries, and even fell in some like India. Where it did increase, as in South Korea, the increment was much less than the overall increase in credit to the non-financial sector.



The question that arises is: to which activities was credit channelled within the non-government non-financial sector? If a rising credit to GDP ratio goes to financing productive investment, the resulting increase in GDP should help stabilise the ratio, unless of course excess investment results in excess capacities being created that remain unutilised. Assessing this from the BIS dataset is difficult. However, the database provides information on the flow of credit to non-financial corporations. Chart 3 compares the overall credit to GDP ratio of the non-financial sector with the credit to GDP ratio of the non-financial corporations at the end of March 2015 and shows the substantial difference between the two, excepting for China and Hong Kong. Overall credit to the non-financial sector in Indonesia, India, South Korea, Singapore and Thailand is significantly higher than credit to non-financial corporations. One obvious reason for this is lending to the households sector or individuals, substantially, though not exclusively, in the form of mortgage or housing loans.

South Korea is a country where the explosion of household debt almost precipitated a crisis. The ratio of household debt to disposable income exceeded 160 per cent at the end of 2014, which was among the highest among developed countries. Not surprisingly, the ratio of overall non-financial sector credit to GDP is well over double the ratio of credit to non-financial corporations to GDP. The government had to intervene with measures such as conversion of floating rate “bullet loans” (in which a lump sum is payable at maturity) to fixed rate, routinely amortised mortgages, to address the household debt problem.

But the problem is severe not just in South Korea. Across Asia, the post-crisis trajectory of development has been one in which the accumulation of debt was crucial to sustaining growth rates, which were on average higher than elsewhere. Since spiralling debt drove growth, that growth now seems unsustainable. Fears about the end of the China boom, because of the global ripple effects that could have, are partly explained by the recognition that this trajectory is not sustainable.

There is one issue that remains. While in India there is much concern about the non-performing assets of the banking system and the unsustainable burden of corporate debt, the comparison here seems to present the country as one not affected as much by the debt accumulation syndrome. This divergence in perception is partly explained by the fact that fiscal conservatism in a period of high growth has brought down the ratio of “general government” credit to GDP from 76 per cent in 2007 to 66 per cent in 2015. It is also explained by the fact that the stressed assets problem afflicting banks in India is the result of a few corporations, in a few sectors being exposed hugely to debt, and individual banks being excessively exposed to a few such borrowers. That might keep the problem from surfacing in the aggregate figures as much as they should.

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