M R Pridiyathorn Devakula: Consumer finance

Opening address by Mr M R Pridiyathorn Devakula, Governor of the Bank of Thailand, at the “FITCH Rating’s Annual Conference 2004 an Consumer Finance”, Bangkok, 16 September 2004.

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Distinguished Guests, Ladies and Gentleman

I would like to welcome all of you to this highly relevant conference an consumer finance and securitization appropriately organized by FITCH Ratings Thailand. I would also like to show my appreciation to FITCH for inviting me to give today’s opening remarks.

Ladies and Gentleman

Although consumer finance has long been a staple of banking in the west and developed economies, it is still a relatively new and open frontier for Thailand. As I thought of my opening remarks, I am reminded of two stories that can capture the reality and the impact of this new world in the context of Thailand’s dual economy. It is not all from my memory since as you may agree I am still too young for historical anecdotes.

As a university student some 30 ycars ago, I met two fellow classmates that came from completely opposite family backgrounds. The first came from a well-off family that supplied him with cars, expensive clothes and a lot of disposable income. Tbe second one was from a poor family and had just enough money for food and public transportation. The wealthy friend did not graduate from college and was later sent to the US to finish his bachelor’s degree, while the second successfully earned his bachelor’s degree and won a scholarship for graduate school also in the US.

Neither man changed his ways while living abroad. The first continued his unencumbered spending spree with cars, expensive apartment, and credit cards. The second, more studious and frugal of the two, worked long and hard and was able to bring home his Masters degree on time. His hard work ethic stuck with him as he got older, and today he is one of Thailand’s successful business entrepreneurs.

The other person however, left the States without any degrees but with a trail of unpaid credit card bills for his parents to repay. He started working in Bangkok but could not stay in any place for long. He started his own small business which loss money and ultimately failed. Unable to change his spending habits, he had to sell his assets and house in order to make good on his debts. To this day, he has no stable income, and must rely on the kindness of people around him for help.

One of the lessons that 1 have drawn from the story is that immature adults, when presented with easy access to credit, may form the habit of spending beyond their means until they themselves become a burden on their community and society.

A more recent story that comes to mind involves two factory workers who earn approximately 6,000 baht per month. Both were invited to apply for a credit card but only one signed up for the offer. This worker first used his credit card to purchase a TV set, which he could easily finance with his salary. Nevertheless, the TV was followed by a washing machine and a motorcycle, which eventually pushed his monthly debt payment to exceed his income. As he exhausted all of his savings, and could no longer borrow from family and friends, his belongings were repossessed by the creditors, and finally he had to quit his job in hopes of running away from his remaining creditors.

The story highlights a dangerous combination in the fabric of Thai society and that is low-income earners who lack financial literacy, or the ability to effectively manage their finances, but yet have very high marginal propensity consume. They in turn are more susceptible to unknowingly consume beyond their means, and like my previous story, become a burden an society. That burden is further intensified by the difficulty in finding and obtaining new employment. This probable risk demands that stakeholders take a more cautious approach to ensure quality growth in Thailand’s consumer finance market.

Ladies and Gentleman,

In reality there are more than one type of savings behavior in the world, but most importantly the savings behavior should be appropriate for the developmental needs of each country. In a developing economy such as Thailand, the customary savings behavior is to save first and spend later.

Developing economies can and should benefit from this type of behavior since it allows for vital investments to be madc using domestic savings, thereby lessening reliance on extemal capital inflow, while at the same time promoting an economically viable savings-investment gap.

On the other hand, the savings behavior of the west and developed economies tend to lean toward spend now save later. This type of behavior is practicable in western countrics due to many factors that can be summed up under the heading of high level of economic development. The existence of social welfare systems, mature capital markets, diversified economy, and highly educated workforce are a few factors that allow such countries to be able to grow under a relatively low savings environment. Without such factors, a country could find it difficult to grow and develop without straining its finances.

Coming back to Thailand, it is possible to say that with more widespread usage of credit cards and other types of consumer loans, we can expcct Thailand's savings behavior to become more in line with those of the developed economies. This trend is a double-edge sword that if not managed carefully can cause a severe negative savings-investment gap. Such predicament will worsen Thailand's dependence an extcrnal capital inflow that historically has shown its ability to change direction rapidly and jeopardize macroeconomic stability. It is thus with the need for further economic and social development that consumer finance should expand in line with domestic savings.

Ladies and Gentleman,

Once again we are back at the regulator's dilemma of regulating without dampening the exuberance and vitality of the market. Consumer finance need not be damaging as long as we can be sure that the individual or household have the prerequisite responsibility, maturity and financial literacy to manage their finances.

Both the service provider and regulator must share the task of addressing these concerns and issues. lt is hoped that service providers will not only focus on improving their bottom line but to also consider the social impact of their business model. Through the use of gimmicks, service providers risk enticing under-qualified and immature applicants whose inability to manage their finances will only exacerbate social costs and NPLs.

As such, if social impact considerations become embedded in the process of determining business strategy for consumer finance, service providers could easily address the social concerns previously mentioned, while at the same time securing quality growth in the consumer finance market.

However, it is understood that competition may pressure service providers to leave behind these social concerns. Thus it is the duty of the regulators to issue rules and guidelines that will level the playing field in order to prevent consumer finance from causing an unsustainable bubble. The industry has already seen the Bank of Thailand's forays into the credit card market with rules governing minimum monthly incomc, interest rate ceiling, fees etc. Going forward, we may come out with social impact rules such as minimum age, or rules to limit the number and types of gimmicks currently being used by somc service providers to attract new customers.

Maintaining Thailand's cconomic growth and vitality is a goal that all of us in this room share, and it is my hope that we all will work together towards preserving Thailand's existing savings culture, in order to keep it an integral part of Thailand's economic development for tomorrow and beyond.

Thank you.