Opening address

Seongtae Lee[1]

I bid a sincere welcome to central bankers participating in this seminar held jointly by the Bank for International Settlements (BIS) and the Bank of Korea. Let me also express my deep gratitude to our keynote speaker, Dr Eric Rosengren, President of the Federal Reserve Bank of Boston.

This seminar has been organised under the BIS's Asian Research Programme to allow central banks to share their experience and opinions with regard to major monetary policy issues. The theme, "Household Debt: Implications for Monetary Policy and Financial Stability", is very closely related to the current international financial market turmoil generated by the US subprime mortgage meltdown and should therefore be of great interest to us all.

Growth of household debt: background

As you are all well aware, household debt in many countries has increased quite sharply since the early 2000s. In the United States, the ratio of household debt to GDP rose from 75% in 2000 to 104% in 2007, led largely by an expansion in mortgage lending. According to an analysis by the IMF, household debt in 12 Asian countries, including Korea, Japan and China, grew by 15% per year, on average, between 2002 and 2006. Mortgage debt accounted for about two thirds of this growth.

There are a number of reasons for this rapid build-up of household debt. First, it is due, to a certain extent, to demographic changes. The ageing of the baby boom generation, together with urbanisation, has fuelled a steady increase in housing demand. Second – and to my mind an even greater factor in the increase in household debt – has been the persistence of low inflation and low interest rates. Over the last few years, heightened productivity stemming from the IT revolution and the progress of globalisation has kept prices relatively stable. Accordingly, central banks in every country maintained policy rates at low levels. This resulted in low lending rates, which further boosted demand for household loans. Third, as anticipations of real estate price increases formed owing to abundant global liquidity, mortgage lending for the purpose of speculative housing purchases expanded sharply. Fourth, in the United States and other advanced countries, mortgage securitisation and the transfer of credit risk, made easier by the development of advanced financial techniques, were also a factor in rising household debt.

Assessment of the increase in household debt

This great increase in household debt did have positive effects on household welfare and financial institutions, as well as on the macroeconomy overall. Expanded borrowing opportunities helped to improve the quality of life of many households by making consumption-smoothing over the life cycle and house purchases easier.

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Household lending and transactions in credit derivatives whose underlying assets were household loans broadened the range of profit opportunities available to financial institutions. The total outstanding volume of credit derivatives worldwide is estimated to have expanded by a factor of 110, from US$ 180 billion in 1997 to US$ 20 trillion in 2006. In Korea, the share of household lending in banks' total loans rose from 28% in 1996 to 50% in 2006. With corporate demand for funds drastically reduced after the 1997 financial crisis, Korean banks turned to household lending to increase their profit bases.

Increased household lending helped to heighten housing market vitality, stimulate consumption and enhance banks' profitability. In these respects, it is considered to have contributed to the improvement of the macroeconomy in terms of business activity and employment trends.

Having said this, however, I should point out that if household debt rises to an excessive level, there is a greater likelihood of households' being unable to repay the principal and interest on their loans when interest rates rise or housing prices fall. This, of course, may result in financial institution insolvency and generate financial market turmoil, which in turn have a negative impact on the real economy, as has been dramatically demonstrated by the US subprime mortgage meltdown. When lenders extended the subprime mortgages now in difficulty, they often neglected to screen borrowers thoroughly to verify their ability to repay. Credit risk then spread through the financial system by way of mortgage-backed securities and collateralised debt obligations. For these reasons, the weakening of economic conditions aggravated the problems posed by non-performing mortgages, with a correspondingly severe impact on financial markets.

In Korea, however, there have been no signs as yet of household debt turning sour, although it has increased very rapidly since the early 2000s. The delinquency rates on banks' household loans stood at only 0.6% at year-end 2007.

Future policy tasks

In many countries, housing loans account for a large proportion of household debt. To maintain household debt soundness, therefore, the absolutely crucial thing is to avoid a housing boom and bust cycle. This requires micro policy initiatives targeting the supply of and demand for housing and the tax regime. Even more important, however, are macroeconomic policies that keep the overall economy on a stable course.

What is more, given that financial innovation can amplify financial unrest, central banks and financial supervisory authorities should redouble their efforts to construct effective systems for the monitoring and supervision of financial derivatives.

Closing remarks

I expect this seminar will be a forum for policy debate, involving in-depth and constructive discussions about household debt issues.

In closing I should once more like to voice my deep thanks to all of you for taking part. I hope you will be able to spare some time to gain a taste for Korean culture and the beauty of spring here. Thank you.