Consumer credit in the Philippines

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Retail banking in the Philippines is still nascent, with consumer loans accounting for only about 10% of total bank lending and less than 5% of GDP. That said, the consumption-driven nature of the economy creates strong demand for consumer loans, with personal expenditure making up 77% of GDP (Fitch Ratings (2006)). In response, the banks have recently focused aggressively on retail lending, which is experiencing growth rates of more than 10% per annum (albeit starting from a low base).

However, high delinquency rates have accompanied the growth of retail lending, especially unsecured lending, where overextension of credit to low-income earners has resulted in a non-performing loan (NPL) ratio of almost 20%. Concerned about a general lack of familiarity with consumer credit and the absence of a credit culture, the Philippine authorities have tightened the rules on credit card lending while pushing for the establishment of a credit bureau. Although consumer lending in the Philippines is at an early stage, it is important that banks manage its rapid growth with sound credit judgment to avoid the high NPL ratio they are experiencing in their corporate loan book.

An important determinant of consumer spending is access to credit by consumers through various lending institutions. These institutions include banks, credit and employee associations, social security agencies, cooperatives and other non-banks and informal institutions. However, data on consumer or household indebtedness are available only in reports on credit cards and real estate and auto loans extended by banks that are monitored regularly by the Bangko Sentral ng Pilipinas (BSP). All other data are either not easily accessible or not available in organised formats. Hence, the data used in this paper are limited to those found in the reports submitted by banks to the BSP.

Credit card loans

Credit cards provided by the banking industry are an emerging source of household credit in the Philippines. Based on the results of the nationwide “Consumer expectations survey” for the first quarter of 2008,[2] about 3% of the 5,000 sample household respondents have a credit card and around 4% expect that a household member will apply for a credit card within the next 12 months. This is lower than the proportion of respondents with bank accounts, which is 20% on average.

Based on the data in the banking sector’s reports, the total credit card receivables (CCRs) outstanding of universal/commercial banks and thrift banks, inclusive of credit card subsidiaries, reached PHP 116.1 billion at end-December 2007. This represents an increase

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2 The survey is conducted quarterly by the BSP.

of 9.5% quarter-on-quarter and 16.5% year-on-year. Relative to the country's GDP, the proportion of credit card loans has grown gradually, from 1.52% in 2005 to 1.75% in 2007.

Of the total CCRs, PHP 16.518 billion, or 14.2%, was past due as of December 2007, compared with 14.3% (PHP 15.199 billion) in the third quarter of 2007 (Graph 1 and Table 1), although total past-due receivables actually increased by 8.7% quarter-on-quarter and by 1.1% year-on-year. The improvement in the ratio was attributable to the expansion in total CCRs, which outpaced the increase in past-due CCRs.

In December 2007, past-due CCRs represented 12.5% of the total non-performing loans of both universal/commercial banks and thrift banks, which came to PHP 132.68 billion, compared with 10.4% in September 2007 and 9.5% in December 2006.

The trend in past-due CCRs could mean that more credit cardholders are having difficulties making their payments on time. Accounts that were more than six months (180 days) overdue came to PHP 6.858 billion – almost half (48.6%) of total past-due credit card receivables in June 2007.[3] However, total past-due CCRs were decreasing gradually from their peak of PHP 10.426 billion in December 2005.

The rate of consumer credit defaults in the Philippines is almost triple the average in Asia (Malaya (2008)). Despite the risky market for credit cards, there is still intense competition among credit cards and personal loan providers. Interest rates have continued to slide, but credit card rates have been slow in adjusting to market forces as can be observed in the big gap between prevailing benchmark lending interest rates and the effective rates on credit card loans (Graph 2). On average, consumers end up paying a 3.5% rate per month, or 42% per annum, including the basic interest rate, fees and charges, although the weighted average lending rate of commercial banks ranged from only 9.84% per annum in the first quarter of 2006 to 8.6% in the fourth quarter of 2007. The current monthly interest rate of Citibank, for example, is 3.25% with an annual fee of PHP 2,500, while that of HSBC is 3.5%. Credit card interest rates in the Philippines are currently among the highest in the world. The regulations for non-bank financial institutions do not impose any ceilings on the rate of interest, including commissions, premiums, fees and other charges on loan transactions, regardless of maturity and whether the loan is secured or unsecured.

In effect, good borrowers are shouldering a significant portion of the premium on bad debts since, given the lack of credit data that would permit lenders to determine the quality of borrowers, high interest rates are levied on all credit card debt. The absence of credit bureaus impedes the provision of sound consumer debt data that would include, among other things, information on the creditworthiness of borrowers. Screening out borrowers with poor credit scores could reduce the default ratio to a low single digit and eventually lower average interest rates. Meanwhile, consumer groups are requesting that credit card issuers cap their annual rates at 18 to 20% or risk legislative intervention, amid intensifying lobbying for cheaper credit card loans.

The rules and regulations of the BSP that govern the credit card operations of the banks and subsidiary credit card companies are not enough to screen out delinquent borrowers. As a prudential measure to protect banks and subsidiary credit card companies, the BSP requires these institutions to set up an appropriate system for managing their risk exposures to credit card operations and to document these exposures in a complete and concise manner. Before issuing credit cards, banks and their subsidiary credit card companies must exercise due diligence by ascertaining that applicants have a good credit standing and are financially capable of fulfilling their credit commitments.

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[3] In the Philippines, loans that are six months overdue are considered bad debts, as defined in Subsection X136.1 of the BSP's *Manual of Regulations for Banks*.

At the same time, the BSP also ensures that the rights of consumers are protected in accordance with the section in the Consumer Act of the Philippines that covers consumer credit transactions with banks and other financial intermediaries.

Auto loans

As of end-December 2007, the automobile loans of universal/commercial banks and thrift banks reached PHP 86.2 billion (Table 1 and Graph 3), 3.8% higher than in the previous quarter and 19.4% higher than at end-December 2006, but trailing CCRs, which totalled PHP 116 billion, by PHP 29.8 billion.

Meanwhile, the share of auto loans in the total loan portfolio dropped to 4.1% in the fourth quarter of 2007, from 4.3% in the previous quarter. The ratio of past-due auto loans to total auto loans was maintained at 5.1% in the fourth quarter of 2007, little changed from the third quarter, as the 3.3% climb in past-due auto loans to PHP 4.4 billion nearly matched the growth in total auto loans. Nonetheless, the ratio was slightly lower in the first quarter of 2008 than in the first quarter of 2007 (5.2%), as the 17.6% hike in past-due auto loans was offset by the expansion in total auto loans outstanding. Meanwhile, the ratio of past-due auto loans to non-performing loans stood at 3.3% in the fourth quarter of 2007, compared with 2.9% in the previous quarter and 2.2% in the fourth quarter of 2006.

From March 2006 to December 2007, the ratio of past-due auto loans to total auto loans ranged from 4.69 to 5.17%, whereas the ratio of past-due CCRs to total CCRs for the same period ranged from 13.83 to 19.98%. The ratio of past-due auto loans to total auto loans indicates that auto loans have a much lower risk of default than credit card loans. The less risky environment in the car loan market allows auto distributors to offer an interest rate of 0% for up to 18 months on auto loans, in contrast with the very high interest rate on credit card loans. This could be due to the fact that auto loans are secured, with the car itself serving as collateral. By contrast, credit card loans are unsecured and tend to attract borrowers of lower quality. If the difference in risk is the reason rates are much higher on credit card loans than on car loans, regulators need to find an appropriate policy response in order to lower the risk in the credit card market, such as enhancing credit information and tightening rules on income requirements.

Housing loans

Housing loans are considered to be relatively less risky due to their collateralised nature (Fitch Ratings (2006)). Moreover, the Philippine government extends housing loans to households under its National Shelter Program, which is aimed at addressing the country's chronic housing shortage. While the BSP imposes a 20% overall limit on banks' real estate lending, to prevent universal/commercial banks from concentrating too heavily on commercial lending, it excludes from this prudential safeguard housing loans to individual households as well as loans extended to real estate developers for the construction of socialised and low-cost residential properties under various government housing programs. These loans, however, are subject to strict underwriting standards and prescribed limits on loan amounts relative to the value of the collateral.

Data provided by BSP-monitored banks on real estate loans granted for the acquisition of individual unit residential properties are readily available. Housing loans granted in 2007 totalled PHP 106.48 billion, compared with PHP 94.69 billion in December 2006, a year-on-year increase of 12.5%. The amount of past-due loans increased at a faster rate, however – 15.6% year-on-year. The level of past-due housing loans is slightly higher than that of auto loans, but the ratio of past-due loans to total loans is almost the same – 5% – in both markets.

Bank data exclude housing loans provided by government agencies, mostly to low-income groups. The state-controlled Home Development Mutual Fund (Pag-IBIG Fund), one of the leading government financial institutions in the Philippines and the biggest financier of the government's housing programs, granted a total of PHP 23.5 billion worth of housing loans in 2007, compared with PHP 16.09 billion in 2006. The Pag-IBIG Fund can provide financing for low-cost housing units at an interest rate of 6–7% for a term of up to 30 years. The average housing loan in 2007 was PHP 475,000.

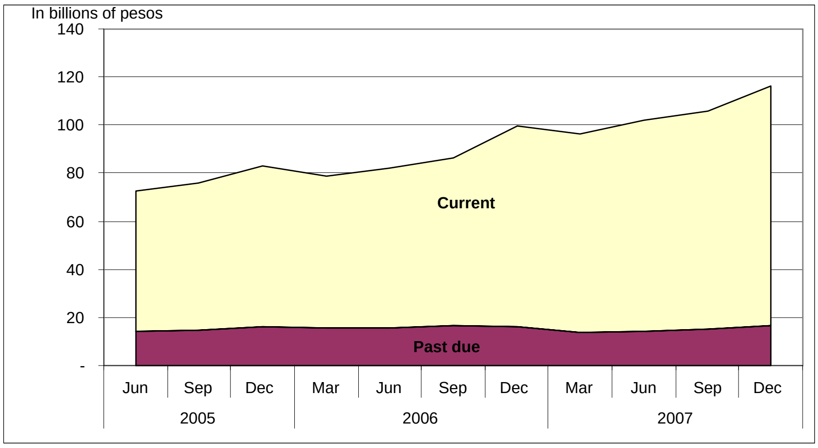
Consumer credit data gap: some measures

The loans discussed in this paper are only some of the many forms of credit available to consumers in the Philippines, including consumer loans provided by informal institutions, social security agencies, cooperatives, employee associations and non-banks. However, we are unable to discuss these other forms of consumer credit in this paper due to a serious dearth of data. In this regard, the BSP continues to lobby for the establishment of a central credit information system so as to improve discipline in the credit markets. The proposed credit bureau would be a reliable source of information allowing lenders to accurately evaluate risks and distinguish between creditworthy and poor-quality borrowers.

Another BSP initiative that addresses the data gap is the Consumer Finance Survey, which aims to generate, measure and analyse data on the wealth, indebtedness, savings and investments of Philippine households. At present, the BSP is completing a pilot consumer finance survey, and it will soon be conducting the full-scale survey in selected regions. This is one of the initiatives that could shed more light on the role of consumer credit in the development of the Philippines and in elevating the well-being of its people.

Graph 1

Credit card receivables of universal and commercial and thrift banks

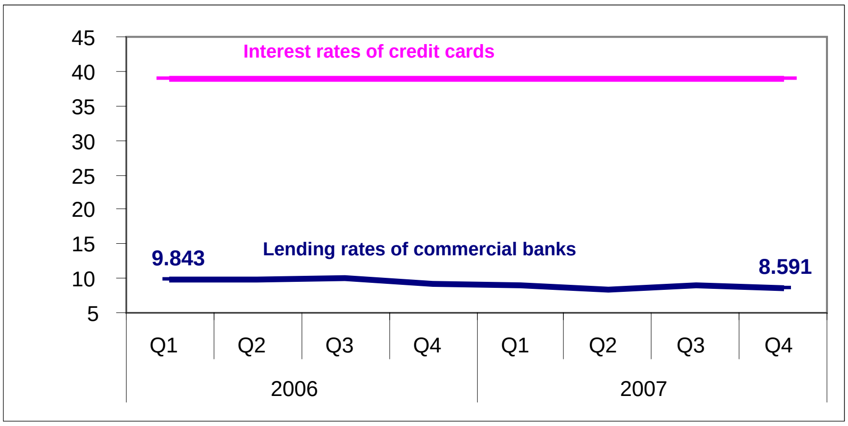


Source: Bangko Sentral ng Pilipinas.

Graph 2

Weighted annual average lending rates of commercial banks and credit card interest rates

In per cent



Graph 3

Current and past-due auto loans and ratio of past-due auto loans to total auto loans

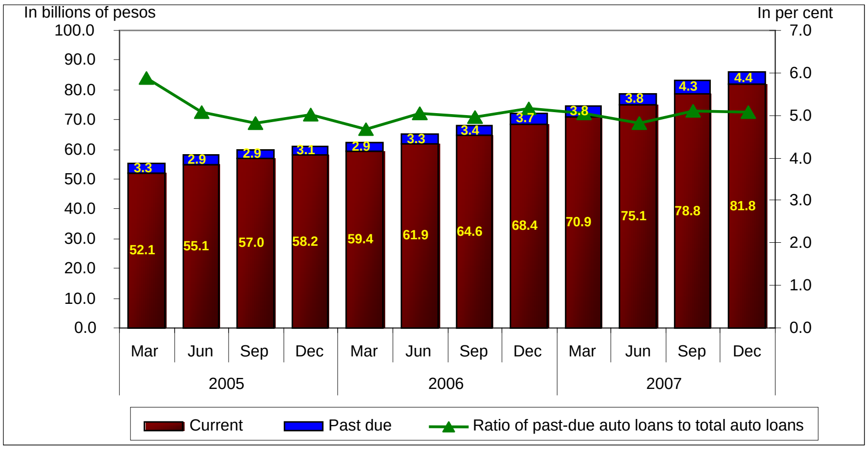


Table 1

Consumer loans of universal and commercial and thrift banks and subsidiaries

In billions of pesos

	2006				2007			
	March	**June**	**Sep-tember**	**Decem-ber**	**March**	**June**	**Sep-tember**	**Decem-ber**
Total loan portfolio (net of IBL)	1,758.33	1,815.71	1,848.11	1,931.69	1,925.23	1,886.71	1,915.54	2,130.06
Credit card receivables	**78.835**	**81.921**	**86.464**	**99.619**	**96.426**	**102.04**	**106.034**	**116.102**
Current	63.084	66.203	69.783	83.282	82.72	87.922	90.832	99.581
Past due	15.751	15.718	16.68	16.337	13.706	14.114	15.198	16.517
1–180 days	1.586	6.252	6.98	6.571	6.64	7.256	7.717	8.608
Over 180 days	9.974	9.466	9.7	9.766	7.066	6.858	7.481	7.909
Non-performing loans	191.53	184.11	185.8	171.96	154.67	151.62	145.98	132.68
Ratio of past-due CCRs to non-performing loans (in per cent)	8.22	8.54	8.98	9.5	8.86	9.31	10.41	12.45
Ratio of past-due CCRs to total CCRs (in per cent)	19.98	19.19	19.29	16.40	14.21	13.83	14.33	14.23
Total auto loans	**62.30**	**65.17**	**67.98**	**72.17**	**74.71**	**78.89**	**83.04**	**86.19**
Current	59.38	61.88	64.60	68.44	70.94	75.08	78.79	81.80
Past due	2.92	3.29	3.37	3.73	3.77	3.81	4.25	4.39
Non-performing loans	191.53	184.11	185.80	171.96	154.67	151.62	145.98	132.68
Ratio of past-due auto loans to non-performing loans (in per cent)	1.53	1.79	1.82	2.17	2.44	2.52	2.91	3.31
Ratio of past-due auto loans to total auto loans (in per cent)	4.69	5.04	4.96	5.17	5.05	4.83	5.11	5.09
Total housing loans	**78.34**	**82.49**	**86.35**	**94.69**	**97.17**	**99.18**	**101.90**	**106.48**
Current	74.09	78.28	82.10	90.06	92.69	94.80	97.18	101.13
Past due	4.25	4.21	4.24	4.63	4.49	4.39	4.73	5.35

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