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Recent credit growth trends in Korea's private sector and its implications

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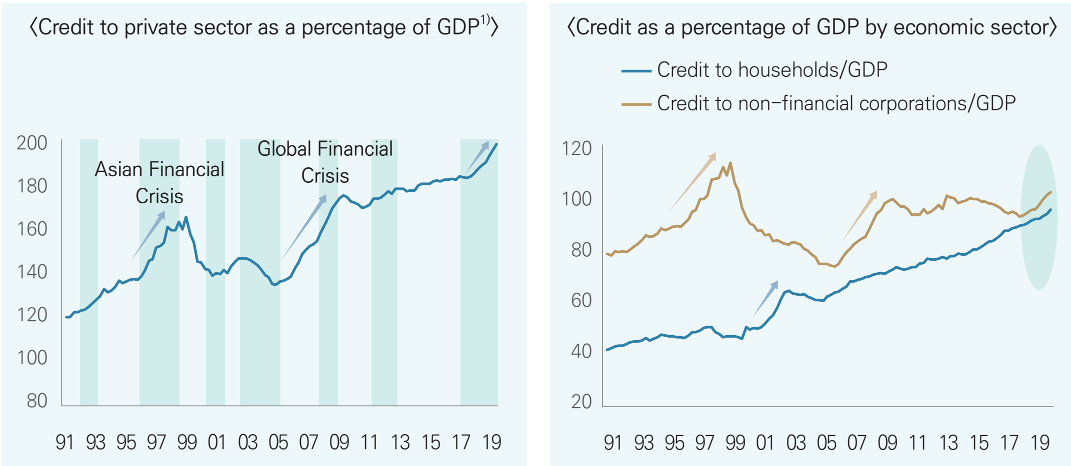
Recent credit trends in Korea's private sector

● According to the Bank for International Settlements(BIS), the ratio of private sector credit(household credit +corporate credit) to the GDP in Korea is currently experiencing the steepest increase since the 2008 Global Financial Crisis

- BIS data regarding the private sector credit of major countries shows that Korea's domestic credit-to-GDP ratio was 197.6%, up 10.0% from the previous year (187.6%) at the end of 2019.
  - By sector, the ratio of household credit and corporate credit to GDP increased by 3.6%p and 6.4%p, respectively, to 95.5% and 102.1%, respectively, year-on-year.
- Compared to the past, the recent growth trend is the steepest trend since the 1998 Asian Financial Crisis and the 2008 Global Financial Crisis.
  - After the Global Financial Crisis, the growth trend showed a modest rise; increasing by 15.5% (182.1% → 197.6%) in the eight quarters in the period from Q4 of 2017 to Q4 of 2019.

[Figure 1] Korea's private sector credit as a percentage of GDP

(Unit: %)



Note: The figure above represents quarterly data
1) The shaded section represents the economic contraction period in the business cycle according to Statistics Korea.

Source: Bank for International Settlement(BIS)

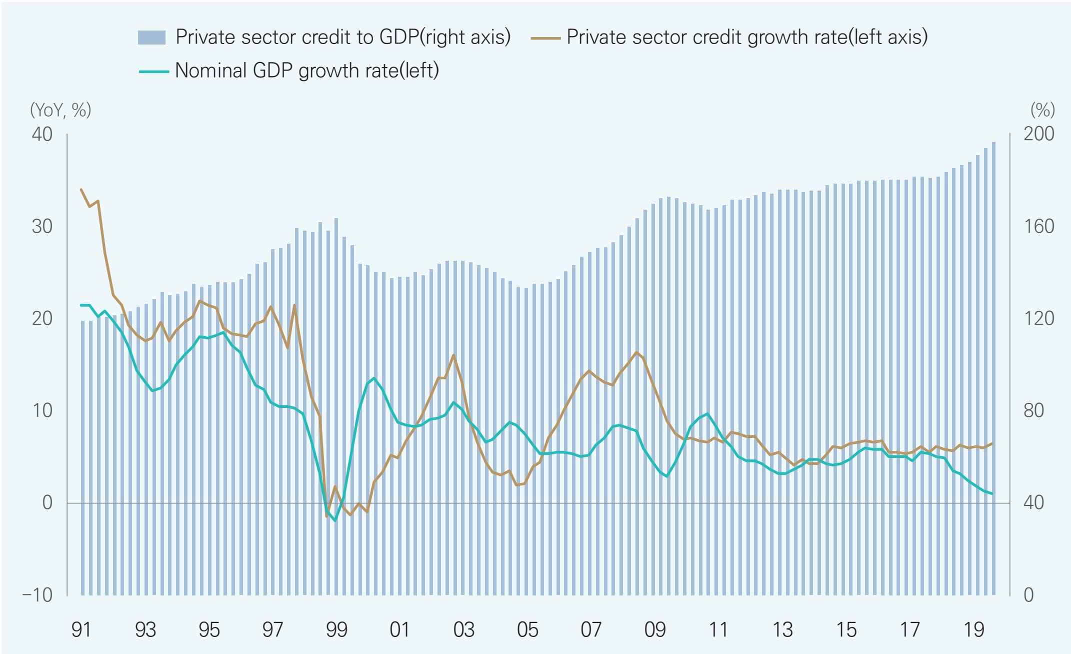
1) The private sector credit level can be evaluated using various indicators such as credit growth rate by sector and debt repayment burden; however, in Korea, the private-credit-to-nominal-GDP ratio, which is a common reference guide for international comparison recommended by the BIS, is used.

The recent increase in the private-credit-to-GDP ratio can be mainly attributed to the decline in the nominal GDP growth rate and the consistently high growth rate of private sector credit, particularly corporate credit.

- Since Q1 of 2018, the private credit growth rate has maintained a year-on-year average of 6.1%, while the nominal GDP growth rate for the same period has rapidly slowed from 3.9% in Q1 of 2018 to 1.5% in the Q4 of 2019, which influenced the private-credit-to-GDP ratio.
  - According to the Bank of Korea's estimates(「Financial Stability Report」, June 24), the private credit growth rate in Q1 of 2020 increased to 7.6% year-on-year, while the nominal GDP growth rate slowed to 1.0%, increasing the private-credit-to-GDP ratio to 201.1%.

- By sector, household credit experienced relatively slow growth, while corporate credit growth increased. However, household credit growth has started expanding in 2020.
  - Household credit growth slowed from 7.8% in Q1 of 2018 to 5.0% in 2019 due to the stabilization of the housing market and strengthened household loan regulations; however, the corporate credit growth rate increased from 4.6% to 7.9% in the same period.
  - In Q1 of 2020, the household credit increased again to 6.5% due to the increase in capital demand for housing transactions while corporate credit increased to 8.6% since companies were able to secure liquidity in response to the COVID-19 shock.[2)]

[Figure 2] Korea's private-sector-credit-to-nominal-GDP growth rate



Note: The figure represents quarterly data.

Source: Bank for International Settlement(BIS)

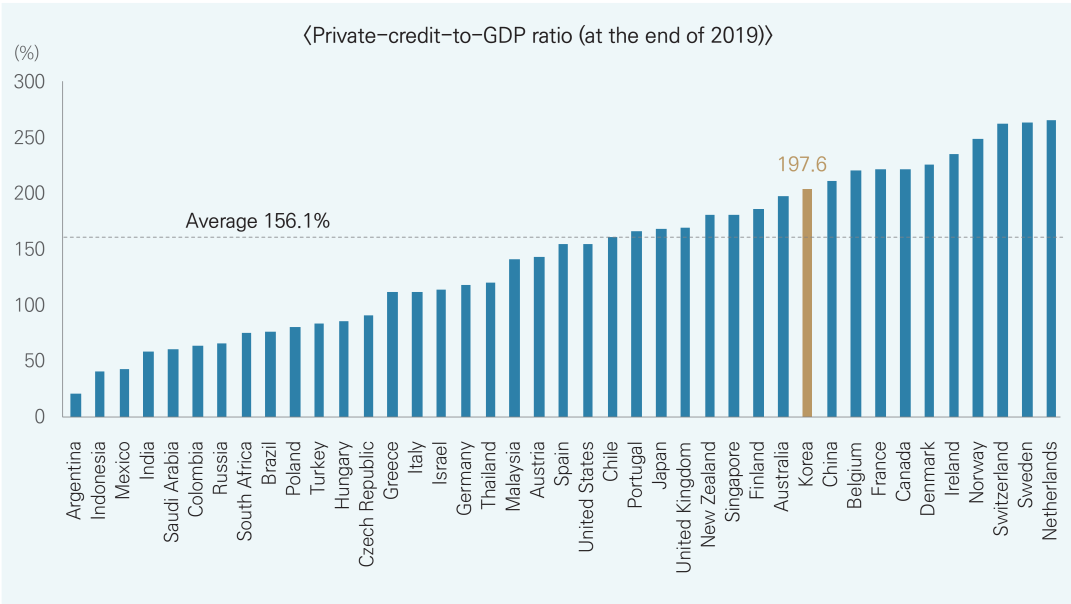
2) Bank of Korea "Financial Stability Report" (June , 2020), p.163

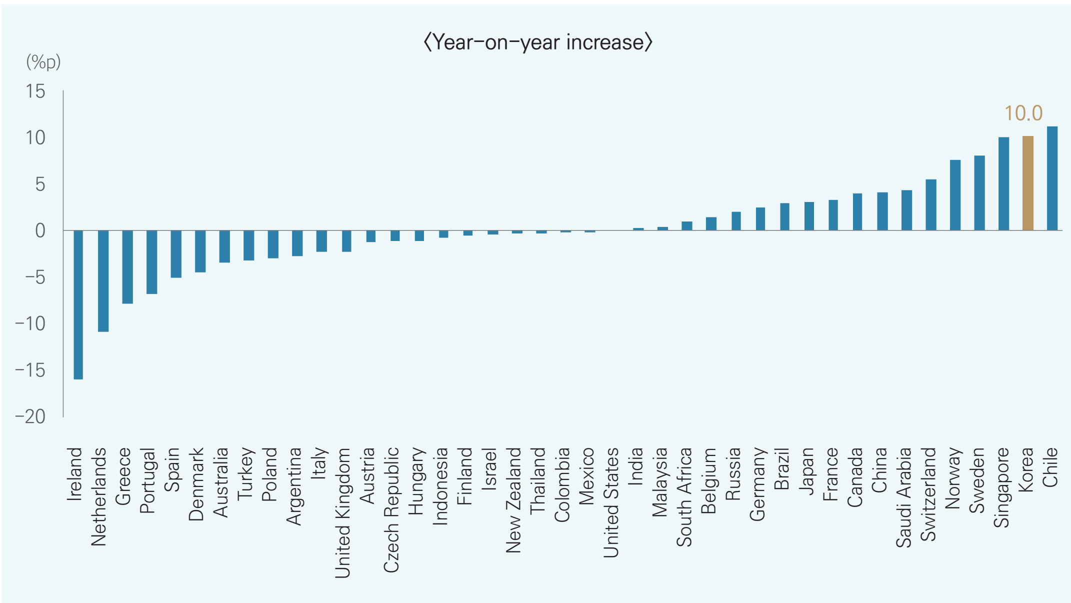
Comparison of the private sector credit of major economies

● Korea's private-credit-to-GDP ratio is higher than that of other major countries and showed a relatively steep increase recently.

- At the end of 2019, Korea's private-credit-to-GDP ratio(197.6%) was 41.5% higher than the average ratio for 43 major countries(156.1%) and 29.0% higher than the average ratio for developed countries(168.6%).
  - In particular, based on the increase at the end of 2018, Korea showed a steep year-on-year growth of 10.0%, following Chile(11.1%).

[Figure 3] Comparison of major countries' private-credit-to-GDP ratio[1] level and year-on-year[2]





Note: 1) At the end of Q1 of 2019;
2) Increase from the end of Q4 of 2018

Source: Bank for International Settlements(BIS)

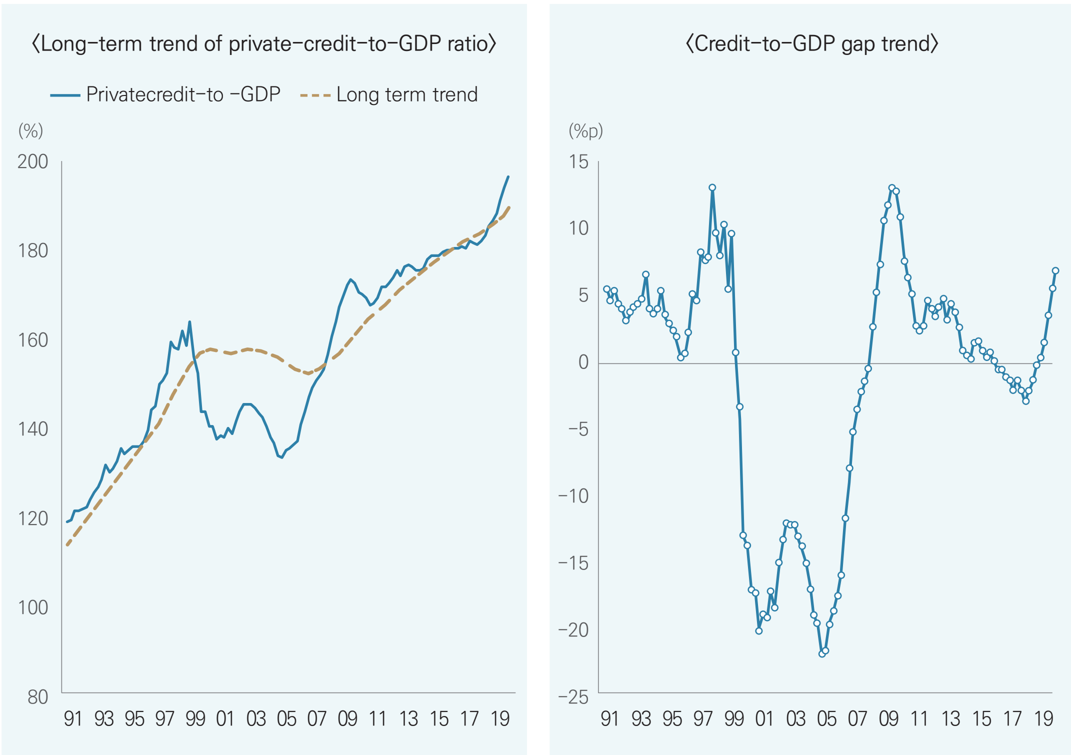
3) A total of 43 countries submitted credit data to the BIS

Korea's credit-to-GDP gap

● **As the private-credit-to-GDP ratio increases rapidly, the credit-to-GDP gap, an indicator of creditrisk, rises rapidly and enters the "caution" stage**

- The BIS credit-to-GDP gap indicates the extent to which the private-credit-to-GDP ratio has deviated from the long-term trend and is used as an indicator of the capital buffer to respond to economic crises.
  - In other words, as the credit-to-GDP gap increases, the ability to mobilize capital in response will decrease if the economic condition is worsened by a shock. Thus, the risk of causing a credit crisis also increases.
  - If the credit-to-GDP gap, an indicator of credit risk, is less than 2%, it is classified at the "normal" level. If it exceeds 2~10%, it is classified at the "caution" level and if it exceeds 10%, it is classified at the "alarm" level.
- At the end of 2019, Korea's credit-to GDP gap had risen by 6.6%, compared with gap at the end of 2018(0.4%), to 7.0%, thus entering the "caution" stage.
  - The credit-to-GDP gap exceeded 10% during the 1998 Asian Financial Crisis and 2009 Global Financial Crisis, and the latest level is the highest since Q2 of 2010(6.8%), just after the financial crisis.

[Figure 4] **Long-tern trend of the private-Credit-to-GDP ratio[1] and the Credit-to-GDP gap in Korea**



Note: The above figure represents quarterly data.
1) BIS calculates the long-term trend of private-credit-to-GDP ratio by applying the HP filter
Source: Bank for International Settlement(BIS)

Implications

● **It is important to note that the rapid growth of private credit amid deteriorating economic conditions at home and abroad will increase the financial vulnerability of the private sector and thus, pose a burden on the real economy in the future.**

- The private-credit-to-GDP ratio is expected to rise even more rapidly if the economic growth rate continues to decline while the low interest rate prolongs[4)] due to the easing of the monetary policy in response to the COVID-19 shock.
  - It should be noted that, the recent increase is mainly due to a decline in the nominal GDP growth rate, which is highly likely to lead to a decline in household income and corporate profitability.
  - With the private credit growth rate consistently maintained at the average rate of the last two years(6.1%) and a nominal GDP growth rate of 0.8%(based on the National Assembly Budget Office's estimate) in 2020, the private-credit-to-GDP ratio is estimated at 208%, which is a 10% year on year increase.

- If the credit-to-GDP gap extends beyond the long-term trend and rises excessively, there is a risk that the financial vulnerability of the private sector will increase due to economic or interest rate fluctuations.
  - If economic recovery is delayed due to the prolonged COVID- 19 situation and a financial crunchenvironment is created, the financial soundness of households and small and medium enterprises(SMEs) with poor debt-repayment capacity may deteriorate.

- Amid deteriorating economic conditions at home and abroad, the expansion of private credit may cause a slowdown in investment and consumption by the private sector due to the increased debt burden, which may impose a burden on the real economy.

▶ For more details, please refer to "NABO Economic/Industrial Trend & Issues(Vol. 6)"

4) While maintanining an expanding monetary policy stance to mitigate the COVID-19 shock, the goverment bond(three-year) annual interest rate fell from 1.53% in 2019 to 0.88% in may 2020

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