Chapter 11

HOUSING AND CONSUMER CREDIT IN THE PHILIPPINES:
RECENT TRENDS AND IMPLICATIONS ON
FINANCIAL STABILITY

By
Veronica B. Bayangos ¹

1. Introduction

This paper analyses the developments and policy implications of the rising housing and consumer credit extended by banks to households in the Philippines. There are two areas in which this paper can be applied: First, components of private sector loans for production and household consumption are regularly monitored by the Bangko Sentral ng Pilipinas (BSP, Central Bank of the Philippines) in the conduct of monetary policy. Year-on-year growth of outstanding loans of banks rose from 4.5% in end-December 2006 to 10.0% in end-December 2009 and to 14.2% in end-August 2013.² In recent years, loans for productive activities, mainly to real estate, renting and business services as well as to construction and transportation, storage and communication sectors, led the rise in loans extended by banks to productive activities. Meanwhile, loans for consumption purposes rose steadily starting in 2009, driven mainly by borrowings for residential real estate and credit card receivables. This paper examines the factors driving the loans extended by banks for household consumption.

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². Based on the BSP-DES Selected Economic and Financial Indicators as of 11 October 2013. The data refer to loans outstanding of universal and commercial banks, thrift banks and rural banks, net of reverse repurchase and net of interbank transactions.
Second, the Financial Stability Committee (FSC) of the BSP periodically evaluates movements of loans to households from the financial stability perspective. The household sector is a significant driver of the Philippine economic growth. The share of household final expenditure to nominal Gross Domestic Product (GDP) has averaged 73.7% from 1998 to 2012, while year-on-year growth has averaged 4.6% during the same period. In the latest BSP Flow of Funds Report, the household sector remained the prime saver in the economy for 2011. This finding could be attributed to the sustained inflow of remittances from overseas Filipinos, positive outlook for the economy as revealed in the Consumer Expectations Survey, and the relatively favourable labour market conditions. Moreover, the household sector has been the biggest accumulator of capital since 2009. Accounting for 42.8% of the economy’s capital accumulation in 2011, the household sector continued to build up capital, mainly on dwellings. Housing and consumer credit are the major financing channels for household spending.

The BSP monitors developments in household debt. In many empirical studies, the increase in household debt can have both positive and negative aspects. On the one hand, higher indebtedness suggests that the financial system is accomplishing one of its basic roles, that is, acting as an intermediary of financial resources and facilitating households’ access to credit. It has also been noted in many studies that facilitating financial access has positive impacts on welfare as it allows households to smooth consumption, both over the life cycle and during business cycles (Alvarez and Opazo, 2013). On the other hand, the growth of debt and the resulting increase in debt service can be a source of concern with regard to household payment capacity, especially in the face of income shocks. Some literature on these issues suggests that with higher debt, households are more sensitive to shocks to income, interest rates and exchange rates. Such shocks may affect households’ default on bank loans and consumption, and hence affect both price and financial stability.

This paper observes that Philippine household debt has gained importance in recent years, both in absolute terms and relative to the size of the economy. But, compared with selected countries, the Philippine household debt relative to GDP appears to be modest. Several factors have contributed to the strong growth in consumer credit. The principal factors include, from the demand side, the relatively lower interest rates in the Philippines, deepening financial sector, optimistic outlook not only on the real estate sector but on macroeconomic fundamentals, improvements in employment situation and consumer confidence and expectations by the public of rising residential real estate prices. From the supply side, the effect of the increase in households’ borrowing capacity has
been reinforced by an increase in the availability of housing construction and finance, including the government initiatives to continue with the National Shelter Programme in the urban and rural areas and buoyant retail market developments.

Moreover, as a first approximation, this paper finds that the rising housing and consumer credit in the Philippines from 1999 to 2012 can be reasonably explained by fundamentals and that there is a stable long-run relationship between prices and value of housing and consumer credit. Hence, the expanding housing and consumer loans especially in recent years do not pose any threat on financial stability. This finding follows the general approach by Yiu and Jin (2012) in identifying episodes of bubble formation in housing credit by using unit root and cointegration analysis.

This paper is part of a growing literature covering different aspects of household sector dynamics, such as consumption, debt, portfolio allocation, retirement decisions, and default risk, among others (Alvarez and Opazo, 2013). This paper analyses the steady rise in outstanding household debt and offers possible implications on financial stability in the Philippines from 1999 to 2013. Throughout this paper, household debt includes outstanding housing (mainly residential real estate loans) and consumer credit (mainly auto loans and credit card receivables) extended by the banking system. The Philippine banking system is composed of universal and commercial banks, thrift banks, rural and cooperative banks.

This paper is organised as follows: Section 2 discusses the trends in housing and consumer credit and the reasons why Filipino consumers keep on borrowing. Section 3 surveys related local and international literature on household debt dynamics. Section 4 examines the risks in the steady rise in housing and consumer credit and implications on financial stability while Section 5 discusses some policy recommendations. Section 6 concludes.

2. Why Do Filipino Households Keep on Borrowing?

2.1 Data Description

In the Philippines, the household sector sources credit from the formal financial intermediaries, which are basically composed of banks regulated by the BSP, other financial institutions and the informal credit market. While household debt data can be sourced from the BSP through banks, loans from other financial institutions may include loans from key shelter agencies (KSA), such as the Home Development Mutual Fund (HDMF) and Social Housing
Finance Corporation (SHFC) and government institutions, such as the Government Service Insurance System’s Social Insurance Fund (SIF) and Social Security System’s (SSS). However, official data series on outstanding loans to member households by these financial institutions are currently unavailable.

Another important source of household debt data is the Flow of Funds (FOF) report. The BSP compiles the FOF which serves as a basis for the analysis of the link between saving, capital accumulation and financial flows for the whole economy and for each of the institutional sector. Households include all resident households both as consumers and as entrepreneurs of household-based businesses such as small-scale stores and farm operations. Also included are non-profit institutions serving households, such as the non-governmental organisations. However, due to some limitation in compiling the FOF, this paper uses data on household debt coursed through banks. A comparison between the FOF data and bank data on household debt shows that data based on the FOF are relatively lower than data from banks. As a proportion of nominal GDP, household loans climbed from 0.8% in 2005 to 1.5% in 2009 and further to 2.2% in 2011. As indicated in the previous section, banks are further classified into universal banks and regular commercial banks, thrift banks, rural and cooperative banks. Data are limited to housing and consumer loans extended by banks to Filipino households.

2.2 Trends in Household Borrowing

The latest data show a steady rise in household debt in recent years, both in absolute terms and relative to the size of the economy, based on consumer loans extended by banks. Outstanding household debt, as indicated by housing and consumer loans by banks, rose from PHP 66.0 billion in December

3. Total loans financed by the SIF consist of consolidated loans, salary loans, restructured salary loans, summer one-month–salary loans, policy loans, real estate loans, e-card cash advance loans, e-card plus cash advance loans, deeds of conditional sale, private loans, emergency/calamity loans, pension loans and emergency loan. Meanwhile, SSS loans cover member loans and housing loans.

4. Estimates on household loans using the FOF are based on available data from counterparties’ financial statements. The estimates include entrepreneurial activities of households as well as all other unaccounted transactions in the domestic economy; also covers non-profit institutions serving households.

5. Consumer credit extended by banks includes auto loans, credit card receivables, residential real estate loans and other personal loans. For purposes of classifying household loans into housing and consumer credit, we reclassified consumer credit to include auto loans and credit card receivables only.
1997 to PHP 226.5 billion in December 2005 to PHP629.3 billion in December 2012 (Table 1). As of end-March 2013, the outstanding household debt settled at PHP647.1 billion. Between 1999 and March 2013, the outstanding household debt rose, on average, by 16.3%. As a proportion of total banking portfolio, residential real estate and consumer loans rose from 6.3% in 1999 to 13.1% in 2005 and to 16.5% in March 2013. In terms of proportion to nominal GDP, the household debt steadily inched up from 2.9% in 1999 to 4.0% in 2005 and to 6.0% in March 2013 (Figure 1). In terms of national disposable income, the outstanding household debt rose from 3.8% in December 1999 to 5.7% in December 2005 and to 7.9% in December 2012.

Meanwhile, 43.2% of the outstanding household debt as of end-March 2013 was residential real estate loans. From 2001 to 2012, year-on-year growth in residential real estate loans of banks has averaged 16.2%, with particularly strong growth in 2004 to 2006, 2008, and 2010 to 2012. This is slightly faster than the annual growth in auto loans, which has averaged 15.9% during the same period. However, outstanding credit card receivables by banks grew faster than auto loans and residential loans. The year-on-year growth in credit card receivables has averaged 19.6% since 2001, with the highest growth recorded at 103.4% in 2002. As of end-December 2012, the bulk (or 67.0%) of the total loan portfolio of the banking system is extended by universal and commercial banks, while around 39.0% by thrift banks.
A closer look at the year-on-year growth of consumer loans by universal and commercial banks suggests that their lending operations have consistently been rising at double-digit rates since its peak at 76.3% in 2008 and have outpaced auto loans and credit card receivables. From a modest year-on-year growth of 1.4% in 2009, the growth of residential real estate loans outstanding by universal and commercial banks swelled to 27.0% in 2010 and further to 32.7% in 2012. By contrast, the growth of residential real estate loans outstanding by thrift banks dropped from its peak at 33.4% in 2000 to 21.8% in 2005 and further down to 3.3% in 2012.

Table 1
Philippines: Housing and Consumer Loans Extended by Banking System in Billion Pesos

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Banking Loan Portfolio</th>
<th>Total Household Loans</th>
<th>Consumer Credit</th>
<th>Housing Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>of which:</td>
<td></td>
<td>Auto Loans a)</td>
<td>Residential Real Estate Loans b)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Credit Card Receivables b)</td>
<td></td>
</tr>
<tr>
<td>1997</td>
<td>1,713.6</td>
<td>66.0</td>
<td>18.3</td>
<td>14.8</td>
</tr>
<tr>
<td>1998</td>
<td>1,646.1</td>
<td>73.2</td>
<td>27.3</td>
<td>19.7</td>
</tr>
<tr>
<td>1999</td>
<td>1,478.4</td>
<td>92.8</td>
<td>25.9</td>
<td>18.8</td>
</tr>
<tr>
<td>2000</td>
<td>1,578.1</td>
<td>95.0</td>
<td>28.4</td>
<td>21.8</td>
</tr>
<tr>
<td>2001</td>
<td>1,556.9</td>
<td>112.2</td>
<td>34.5</td>
<td>28.6</td>
</tr>
<tr>
<td>2002</td>
<td>1,589.4</td>
<td>151.6</td>
<td>42.2</td>
<td>52.4</td>
</tr>
<tr>
<td>2003</td>
<td>1,643.9</td>
<td>166.9</td>
<td>46.8</td>
<td>59.0</td>
</tr>
<tr>
<td>2004</td>
<td>1,704.1</td>
<td>189.8</td>
<td>49.9</td>
<td>69.3</td>
</tr>
<tr>
<td>2005</td>
<td>1,730.7</td>
<td>226.5</td>
<td>61.2</td>
<td>82.8</td>
</tr>
<tr>
<td>2006</td>
<td>1,912.2</td>
<td>272.7</td>
<td>72.2</td>
<td>99.6</td>
</tr>
<tr>
<td>2007</td>
<td>2,112.0</td>
<td>313.0</td>
<td>86.2</td>
<td>116.1</td>
</tr>
<tr>
<td>2008</td>
<td>2,576.2</td>
<td>363.2</td>
<td>78.6</td>
<td>130.7</td>
</tr>
<tr>
<td>2009</td>
<td>2,719.9</td>
<td>413.1</td>
<td>94.5</td>
<td>115.5</td>
</tr>
<tr>
<td>2010</td>
<td>2,960.1</td>
<td>472.6</td>
<td>117.6</td>
<td>120.3</td>
</tr>
<tr>
<td>2011</td>
<td>3,483.6</td>
<td>545.9</td>
<td>139.2</td>
<td>132.2</td>
</tr>
<tr>
<td>2012</td>
<td>3,938.9</td>
<td>629.3</td>
<td>159.9</td>
<td>148.7</td>
</tr>
<tr>
<td>2013 (March)</td>
<td>3,929.8</td>
<td>647.1</td>
<td>167.2</td>
<td>143.7</td>
</tr>
</tbody>
</table>

1/ Values for 1997-1998 refer to total loan portfolio of the Philippines Banking System. Values from 1999-2008 were computed as sum of UCBs and TCBs. The total loan portfolio, gross, net of amortization into IBL. Values for 2009 onwards were from SBC’s schedule on consumer loans.

2/ Inclusive of auto loans, credit card receivables, real estate loans (residential) and other consumer loans.

3/ Inclusive of UCBs banks subsidiaries of universal and commercial banks.

4/ Data on real estate include bank property only.

Source: Supervisory Data Center, Supervision and Examination Sector, BSP.

A closer look at the year-on-year growth of consumer loans by universal and commercial banks suggests that their lending operations have consistently been rising at double-digit rates since its peak at 76.3% in 2008 and have outpaced auto loans and credit card receivables. From a modest year-on-year growth of 1.4% in 2009, the growth of residential real estate loans outstanding by universal and commercial banks swelled to 27.0% in 2010 and further to 32.7% in 2012. By contrast, the growth of residential real estate loans outstanding by thrift banks dropped from its peak at 33.4% in 2000 to 21.8% in 2005 and further down to 3.3% in 2012.
Meanwhile, compared with selected countries\(^6\), the Philippine household debt relative to GDP appears to be modest. For developed economies such as the US and the UK, the household debt represents more than 100% of GDP (Debelle, 2004; Girouard, et al., 2006; Karasulu, 2008; Ma, et al., 2009). The growth of indebtedness in the household sector is attributed to financial innovation and decreases in nominal and real interest rates (Debelle, 2004). In selected Asian economies, South Korea’s latest household debt with GDP recorded the highest at 89.0% in 2011, although the figure covers not only banks but other financial institutions. At the lowest end of the range are the Philippines at 6.0% in March 2013, followed by Indonesia at 7.4% in 2008. It can be noted that both Philippines’ and Indonesia’s data only cover banks.

2.3 What is Driving the Steady Rise in Banking Systems’ Housing and Consumer Credit?

*Demand-side and supply-side factors reinforce the steady rise in household debt.* Several factors have contributed to the strong growth in consumer credit over recent years, the principal factor being the relatively lower interest rates in the Philippines which stimulated households to borrow more.

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\(^6\) These economies include Indonesia, Mongolia, Cambodia, Nepal, Thailand, Malaysia, Singapore, Chinese Taipei and South Korea.
This pushes up the size of new loans and, over time, the size of loans outstanding. Between 1997 and 2012, the average bank lending rate (all maturities) fell from 16.2% in 1997 to 10.2% in 2005 and further down to 5.8% in January to June 2013. The fall in bank lending rates was due mainly to the decrease in inflation – and hence in nominal interest rates – but also to the appreciation of the average peso-dollar rate from PHP55.09/US$ in 2005 to PHP43.31/US$ in 2011 to PHP41.24/US$ in January to June 2013. Over the last few years, the steady increase in labour productivity, stemming from the IT revolution and the progress of globalisation, has kept prices relatively stable.7 Defined as GDP per employed person, year-on-year growth labour productivity increased from 0.5% in 2002 to 3.7% in 2007 and to 5.6% in 2012.

The relatively low interest rates were accompanied by deepening of the financial sector as seen in the rise in domestic liquidity, driven largely by continued increase in remittances from overseas Filipinos as well as the financial sector reforms initiated after the currency crisis in 1997 to 1998. Between 2005 and 2012, year-on-year growth of domestic liquidity averaged 11.9% while overseas remittances grew by an average of 12.3% during the same period. In terms of nominal GDP, the domestic liquidity rose from 41.2% in 2005 to 49.0% in 2012.

Following the decline in the country’s unemployment rate from 7.3% in 2007 to 6.9% in 2012, per capita household final expenditure (in real terms) grew, on average, by 3.0% from 2007 to 2010.8 As a result, consumer and housing credit rose, on average, by 15.0% from 2007 to 2012. While outstanding consumer and housing loans had increased, loan repayments as a share of household disbursement schedule slightly edged up from 2.5% in 2003 to 2.8% in 2009, based on the Family Income and Expenditure Survey.9

Middle-class growth in Southeast Asia, including the Philippines, has been among the most rapid in Asia and has boosted consumption growth (OECD, 2013). Middle-class development is affecting the structure of demand in Emerging Asia. Middle-class households, particularly those in the higher portion of the

7. Based on data from the Philippine Institute for Development Studies (PIDS).
8. Based on the PIDS database. For data on unemployment rates, start of the new series is 2007 while the latest available data for per capita household final expenditure (in real terms) is 2010.
9. The Family Income and Expenditure Survey (FIES) is the main source of income and expenditure data in the Philippines. It is a nationwide survey of households conducted regularly by the National Statistics Office (NSO).
middle-income range, tend to devote a larger portion of their income to the purchase of automobiles and other major consumer durables. Middle class households also tend to spend a higher portion of their income on education and health services, and to purchase more sophisticated services. A study by the OECD (2011) projected the share of spending by the middle class in various regions. By 2030, the middle class of Asia Pacific countries, including the Philippines, will account for 59% of the world’s consumption spending (compared with 28% and 23%, respectively, in 2009). The same study also projected that the role of the middle class in Asian countries will capture 54% of the world’s middle class by 2020 and further to 64% by 2030.¹⁰ There is also the growing number of foreign-educated youth who are bringing in skills, capital and new ideas to their home countries, and contributing to the economic and social welfare of their nations. From these individuals will eventually rise a new generation of companies that will embody modern entrepreneurial ideas and insights. As the middle class becomes more educated, they begin demanding more from themselves and the government.

Related to the rise in middle-class is the view that the Philippines has entered the second demographic dividend phase (Mapa, et al., 2010). This dividend results when individuals accumulate savings in their working years to serve as buffer during their retirement years. While accumulation of capital can be used to deal with the lowering of income in the older ages, this capital also influences economic growth, funded by the increase in private household expenditure.¹¹

From the supply side, the effects of the increase in households’ borrowing capacity have been reinforced by an increase in the availability of housing credit. Property analysts and developers agree that the boom in the real estate sector will remain strong in the medium term due to the strong growth prospects in remittances and business processing outsourcing units and the relatively lower interest rates offered by banks and other financing institutions. This positive sentiment is also echoed by consumers. Based on the BSP’s 2013 Second Quarter Consumer Expectations Survey¹², more respondents considered

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¹¹ As Mason (2007) pointed out, it is when society increases its savings rate that more rapid economic growth results — creating the second demographic dividend. Mason estimated that the first and second demographic dividends account for 37.7% of the yearly average per capita growth rate of Japan from 1950 to 1980.

¹² The Consumer Expectations Survey (CES) is a quarterly survey of a random sample of 5,000 households in the Philippines. Results of the CES provide advance indication of consumer sentiments for the current and next quarters and the year ahead as reflected in the overall CI, as well as in selected economic indicators.
2013 as the best time to spend, particularly for big-ticket items such as real property, followed by consumer durables and motor vehicles. Easy installment terms contributed to consumers’ favourable buying conditions outlook in the current quarter of 2013 and for 2014. The overall improvement in buying intentions is consistent with the more favourable consumer sentiment on family income and family financial situation for the near term.

Government initiatives to continue with the National Shelter Programme (in rural and urban areas) and availability of affordable housing to underprivileged citizens in the urban centres and resettlement areas as well as to beneficiaries of overseas Filipino workers contributed to the rise of housing loans from government and private social security. It can be noted that public housing finance institutions account for a significant share of aggregate home financing loans, broadly matching the share of housing credit provided by banks. However, as of end-December 2011, housing backlog in socialised, economic and low cost housing was reported at 3,919,566 units. This means that we can see an increase in construction of residential units in the next 18 years, based on the Philippine Housing Industry Plan: 2012-2030.13

In anticipation of real estate price increases due to abundant global liquidity towards the emerging economies, including the Philippines, residential real estate lending expanded rather sharply (Figure 2). The real estate sector highly benefits from remittances as more overseas Filipinos and their beneficiaries are purchasing residential units, particularly condominium units in urban areas. According to Metro Manila property agents, 60% to 70% of their sales are from overseas Filipinos and their beneficiaries.14 Most industry players and market watchers claim that about 30% of remittances are spent in the real estate sector, either to buy a property or to spend on home improvement.15

13. The Philippine Housing Industry Plan of 2012 to 2030 is reported by the Sub-division and Housing Developers Association, Inc. (SHDA) in cooperation with the Centre for Research and Communication (University of Asia and the Pacific -CRC-UAAP); HUDCC, SHFC 2011 Annual Report.
Figure 2 shows the behaviour of the year-on-year growth of Implicit Price Index of Real Estate, Renting and Business Activities (price index on a national basis and based on National Income Accounts) and outstanding residential real estate loans of banks. For the period 2000 to 2012, the year-on-year growth of the implicit price index of real estate, renting and business services averaged at 5.1%, lower than the average growth of outstanding residential real estate loans extended by banks at 14.4% during the same period. However, there are indications that average land values in high-end residential areas have been rising especially during the last two years (2011 to 2012).

Favourable population dynamics in terms of one of the fastest growing working age populations within Asia should provide a “demographic dividend” to GDP growth. Beginning in 2015, the Philippines’ “home” market will expand by a factor of ten as the ASEAN Economic Community comes into full existence (Singh, 2013). The Philippines has vast deposits of mineral wealth and responsible extraction of these natural resources can contribute to growth for decades. The more than 7,000 islands, 35,000 kms of shoreline, coral reefs and natural beauty make the Philippines a natural tourist destination. Finally, the large English-speaking
youthful workforce can help sustain the phenomenal growth in BPOs and large remittances from overseas Filipino workers in the context of an ageing population elsewhere.

Meanwhile, based on the Report by the Housing and Land Use Regulatory Board (HLURB), the total licenses issued by HLURB for condominiums across the country increased, on average, by 19.0% from 2002 to 2011, translating to an annual average growth of 25.4% in units. Moreover, based on the 2013 First Quarter Report by Colliers International, the overall residential licences issued by the HLURB from November 2012 to January 2013 increased significantly by 157%. The latest figures indicate that 70,566 units were licensed during the period, up by 43,112 units compared from the year-ago level. The increase was mainly driven by the growth of licences issued in the high-rise segment which reached 36,140 units. Moreover, with a growth of 104%, the number of socialised housing units has shown signs of sustainability against its double digit contraction in 2011. Meanwhile, the number of licences in the middle-income housing segment has consecutively dropped for the last two years, registering a 9.7% drop in 2012. Licences in the same sector are expected to continually decrease in number as more middle-income developments are targeted to the high-rise residential segment.

In tandem with a boost in real estate sector, the retail market is expected to grow significantly in the near term based on the 2012 Euromonitor International Report on the Philippine retail market. The Report also highlighted that Filipino consumers have become more discriminating. 16 Aside from hunting for the lowest bargains and biggest discounts, customers increasingly demand an overall great shopping experience. This put pressure on retailers into competing by differentiating themselves through an assortment of higher quality merchandise, specific value services, better ambiance, and more convenient payment schemes. In addition, the creation of a wider pool of middle-income customers in urban areas drove growth of non-grocery retailing enabling it to overtake grocery retailing’s growth. Supported by the boom in residential developments, consumers’ purchase of electronics and appliances, furniture and furnishings, and home care significantly improved.

16. With more money to spend, Filipino consumers have become more discerning, opting for convenience and picking branded goods in modern retail chains, based on Nomura (2013) Research Notes. In its latest research note, Nomura indicated that the consumer sector has seen major developments in the last two years, giving consumers a wider array of options from which to choose.
Although dominated by traditional, independent retailers, the Philippine retailing landscape continued to see the aggressive moves of chained players trying to carve out greater share. The emergence of fast growing cities encouraged chained players to move outside Metro Manila to tap key cities in the provincial areas through smaller brand formats, such as supermarkets and discounters in the case of SM Investments Corp and Puregold Price Club, Inc. Customers have welcomed the outlet expansion of chained players as these promise shopping convenience, assortment of products, and specific services compared to those offered by independent stores.

This section highlights the growing importance of consumer and housing credit in recent years as major financial channels for household spending. In many cases these developments reflect financial sector deepening. As mentioned in Section 1, rapid growth in household borrowing offers both opportunities and challenges. Household debt offers several advantages: better access by households to credit facilities for consumption smoothing, a new source of income for Asian financial institutions, and portfolio diversification for the banking sector. However, the rise in household debt also may come with a downside. Excessive household indebtedness makes households vulnerable to shocks which may lead to financial instability. On the whole, the country’s household debt remains manageable. However, given the uncertain pace of the global economic recovery, possible decline in household income and savings especially from those households dependent on overseas remittances may ensue. Under such a scenario, the household sector’s earning and debt-servicing capacity may weaken, thus, the situation warrants close monitoring since a continued increase in the households’ credit accumulation can affect the balance sheet of the banking system as well as the overall stability of the financial system.


The findings from the empirical studies so far point to the growing role of private sector bank credit to support economic growth. For instance, Bayangos (2010) examined the role of bank credit channel in transmitting impulses to the real economy in the Philippines by estimating a bank credit behaviour that takes into account not only the monetary variables but also specific banking indicators to monetary policy actions, such as bank capital and non-performing loans. The results indicate a feedback loop from the aggregate demand to bank credit through the financial accelerator and wealth effects. This latter finding underscored the need to look further into the behaviour of credit channel in the Philippines to include banking conditions.
Studies on the impact of Filipino household debt on financial stability remain relatively scant. In the Philippines, the empirical studies focus on the contribution of the household sector to economic growth (Dakila, et. al, 2013). However, only few studies have focused on the impact of household indebtedness on economic growth. One of these studies is the paper by Tan (2008), which discussed consumer credit developments in the Philippines. In his paper, Tan (2008) noted that the growth of retail lending in the country, especially unsecured lending, has been accompanied by high delinquency rates which could be, in part, due to the extension of credit to low-income earners.

Meanwhile, Samarita (2010) observed that despite the increase in credit card and residential real estate loans extended by banks, the BSP measures on credit accumulation and consumer spending were able to help maintain the stability of the Philippine financial system in terms of better loan quality, improved credit environment and increased financial awareness of the household sector. These measures helped maintain the overall stability of the country’s financial system during the 2008 global financial crisis.

Nakornthab (2010) analysed the evolution of household debt and its potential consequences on financial stability in the SEACEN economies (Cambodia, Malaysia, the Philippines, Chinese Taipei and Thailand). The findings of this study suggested that the threat of a household-debt-induced instability in Southeast Asia is remote. Most importantly, the levels of aggregate household indebtedness in SEACEN economies did not appear excessive relative to their economic fundamentals. A large part of the developments in household indebtedness in SEACEN economies can be explained by countries’ stages of economic development and the contemporaneous macroeconomic and financial environments. At the same time, the shares of household loans in total bank loans were found to be low to moderate in general. Finally, there appears to be no signs of significant stress on either household balance sheets or financial institutions’ household credit portfolios. The majority of household loans are in collateralised residential mortgages which have low risk in the absence of a property price bubble. Nevertheless, regional policymakers cannot afford to be complacent, but need to remain vigilant against increases in household indebtedness and financial institutions’ household credit risk.

Meanwhile, several approaches have also been used to analyse the role of household debt on growth and financial stability. For instance, Fang (2010) examined Chinese Taipei’s household debt to relevant macroeconomic variables usable by policymakers for scenario analysis and stress tests. In essence, Fang’s paper constructed two error-correction models for household debt and the NPL
ratio of household loans, respectively, which are linked to the relevant macroeconomic variables. In addition, given the importance of the real estate for financial stability, Fang (2010) conducted stress tests to assess the impact of a fall in real housing prices on the NPL ratio of household loans.

Djoudad (2012) emphasised that the rising level of household indebtedness has created concerns about the vulnerabilities of households to adverse economic shocks and the impact on financial stability. To assess these risks, Djoudad (2012) presented a formal stress-testing framework that uses micro data to simulate how various economic shocks affect the distribution of the debt-service ratio for the household sector. Djoudad introduced a combined methodology where changes in the probability of default on household loans are used as a metric to evaluate the quantitative impact of negative employment shocks on the resilience of households and loan losses at financial institutions.

On a macro scale, Kaufmann and Valderrama (2004) investigated the relationship between interest rate and demand variables to household loans and in particular the asymmetry of the reaction of lending to these variables over the business cycle within a Markov-switching Vector Autoregressive Model. They concluded that spending and interest rate variables have marginal effects on lending. Moreover, Kaufmann (2001) revealed the asymmetric effects of monetary policy on bank lending over the business cycle in Austria. During the economic recovery from Q2 1993 to Q2 1998, the effect of interest rate changes on bank lending was modest, while from Q2 1990 to Q1 1993 interest rate changes had significant, albeit counter-intuitively positive effects on bank lending.

However, a number of econometric studies of other countries’ credit variables have been conducted. Papers by Calza, et al. (2003a and 2003b) both estimated a vector error correction model (VECM) for the euro area with the log of the real credit stock, the log of real GDP and cost variables (both a long-term and a short-term real interest rate in the former study and a constructed composite real interest rate in the latter). Meanwhile, Calza, et al. (2003a and 2003b) showed, in line with other studies, that the development of private sector loans in the euro area have been reasonably explained by aggregate macroeconomic variables and that a stable long-run relationship between real loans, GDP and real interest rate variables has been found. Calza, et al. (2003a and 2003b) employed log-linear relationships between a credit variable and its determinants. In their paper they found weak evidence for a log-linear cointegration relationship in econometric specification. Hence, they did not conduct a threshold cointegration analysis accounting for possible nonlinearities in lending.
In a recent work, Lindquist (2012) suggested an operational definition of household debt-sustainability within a broader financial stability perspective. Data at the household age-group level are used to test debt sustainability within a counter-factual history approach. Since the interest rate is the primary policy instrument of an inflation targeting central bank, and since macro prudential policy is aimed at mitigating systemic risk by smoothing credit growth through the cycle and making the banks more resilient, it is particularly relevant to look at the vulnerability to increases in the interest rate and how close to a maximum manageable debt level households are.

The survey so far reveals that the role of household debt on economic growth has risen in recent years. The studies suggest that household leverage can be an early and powerful predictor of crisis. Overall, our findings suggest that focus on household finance may help elucidate the sources of macroeconomic fluctuations.

4. Implications of the Rising Housing and Consumer Credit on Financial Stability

4.1 Preliminary Estimation Suggests Formation of Housing and Consumer Credit Bubble to be Remote

Section 3 suggests that household debt can be an early and a significant indicator of a crisis. As a first approximation, this section attempts to detect possible bubbles in housing, auto loans and credit card receivables using annual data from 1999 to 2012. A bubble occurs when the price of an asset rise sharply at a sustained rate such that it exceeds the valuation justified by macroeconomic fundamentals. A real estate bubble or property bubble, in particular, is characterised by rapid increases in valuations of real estate property, such as housing, until they reach unsustainable levels and then decline. Recognising when a bubble may occur is difficult. However, there are perceived signs or indications in the areas of lending and spending.

Following the general approach of Yiu and Jin (2012), this paper uses unit root and cointegration tests of the prices and values of housing credit by banks as a preliminary step to detect formation of housing bubble. This study modifies the coverage employed by Yiu and Jin (2012) to include auto loans and credit card receivables. This study assumes that when asset prices and their fundamental values are stationary and are found to be cointegrated, the null hypothesis of no bubble is confirmed. The results are presented in Table 2. To check the robustness of results, the trend component of the variables are similarly
evaluated for unit root and cointegration tests to determine possible formation of bubble episodes. The results are shown in Scenario 2 in Table 2.

The use of unit root and cointegration tests to determine the possibility of a bubble episode is a matter of judgment. We can use regression analysis to determine the bubble formation. However, in the absence of longer time series, this study uses unit root and cointegration techniques as reasonable options which will help examine the initial relationship between prices and value of housing, auto loans and credit card receivables. It should be emphasised that the use of cointegration test in this paper is meant to check for robustness of the results of stationarity test due to relatively shorter time series.

It can be recalled that the standard unit root test and cointegration test on the price series and fundamental value series have been widely used for detecting asset bubbles because of their ease of implementation. The unit root and cointegration tests have been applied to detect property market bubbles in different economies for the past two decades. For example, Drake (1993) used this method to study the price boom in the mid-1980s in the UK property market while Arshanapalli and Nelson (2008) employed cointegration test to verify the housing bubble in the mid-2000s in the US housing market. For Hong Kong, Peng (2002) used this method to detect the 1997 bubble in the residential property market. The test has also been extended in different ways over time, such as using panel data and regime switching techniques.
Table 2  
Results of Unit Root and Cointegration Tests

<table>
<thead>
<tr>
<th>Variables/Pair</th>
<th>Scenario 1</th>
<th>Scenario 2 (Trend Component Only)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Unit Root Test (Levin, Lin &amp; Chu, using 5% critical value)</td>
<td>Co-Integration Test (Johannsen System, using 5% critical value)</td>
</tr>
<tr>
<td>Implicit Price Index of Real Estate and Residential Real Estate Loans</td>
<td>Stationary</td>
<td>Co-integrated</td>
</tr>
<tr>
<td>Implicit Price Index of Financial Intermediation and Credit Card Receivables</td>
<td>Stationary</td>
<td>Co-integrated (at 10% CV)</td>
</tr>
<tr>
<td>Implicit Price Index on Financial Intermediation and Auto Loans</td>
<td>Stationary</td>
<td>Co-integrated (at 10% CV)</td>
</tr>
</tbody>
</table>

Source: Author’s estimates.

Unit root and cointegration group tests are conducted for three pairs of indicators:

(1) Year-on-year growth in Implicit Price Index for Real Estate, Renting, and Business Services and Outstanding Residential Real Estate Loans by Banks scaled to Nominal GDP;
(2) Year-on-year growth in Implicit Price Index of Financial Intermediation and Outstanding Auto Loans by Banks scaled to Nominal GDP; and
(3) Year-on-Year Growth in Implicit Price Index of Financial Intermediation and Outstanding Credit Card Receivables by Banks scaled to Nominal GDP.

The scope and coverage of Implicit Price Index for Real Estate, Renting and Business Activities (RERBA) include ownership of dwellings, real estate, renting and business activities and business process outsourcing (BPOs), other business activities (Non-BPOs; including Renting of Machineries and Equipment, etc.). In an earlier run, this paper included data on Capital Values of Luxury Residential Units and Residential Real Estate Loans to determine whether there is a bubble brewing in the luxury residential units.18 However, due to shorter

17. Refers to Implicit Price Index of Real Estate, Renting, and Business Activities.
18. In pesos per square meter. Consistent data on Capital Values of Luxury Residential Units started in 2001 only, hence, the results are not that robust.
time series, the results are not that conclusive. In the absence of a concrete price index for auto loans and credit card receivables, this paper uses the Implicit Price Index on Financial Intermediation (IPFI). IPFI covers measures through the financial intermediation services indirectly measured (FISIM). FISIM is derived by the difference between the reference rates, the actual interest rate charged on loans and actual interest rate offered on deposits by banks.

The results of the exercise show that all the series in growth and in ratios are stationary at 5% level of significance. The results further suggest that the variables under investigation are integrated of order one, I(1). There are cases when auto loans and credit card receivables and their assumed prices are cointegrated at 10% level of significance (Scenario 1 in Table 2). However, when the trend component is examined, auto loans and credit receivables and their prices become cointegrated at 5% level of significance.\textsuperscript{19} On balance, these findings suggest that formation of housing, auto loans and credit card bubble episodes seems to be remote and that banks’ exposure to these types of loans do not pose any major threat to financial stability.

It should be noted that the results from the tests need to be interpreted with caution. The presence of a rational bubble may be one of the many possible reasons in the behaviour of indicators. Other possible factors include, for example, the non-stationarity nature of unobservable variables. Moreover, because the method utilises a linear model to detect any non-linear growth of the bubble component, the method’s power of detecting explosive bubble behaviour and identifying the origin and collapse of a bubble, particularly the collapse, is limited.

4.2 Banking System’s Exposure to Household Sector Appears to be Modest

From a financial stability perspective, observations in the previous section reveal that Filipino households pose minimal threat to the banking system. Figure 3 shows that the banking system’s NPL ratios (defined as the ratio of non-performing loans to banking system’s total loan portfolio) dropped from 1.4% in March 2009 to 1.2% in September 2011 and further to 1.0% in March 2013 (Figure 3). It can also be seen in Figure 3 that residential real estate loans, auto loans and credit card receivables exhibited decelerating NPL ratios since March 2009. In particular, the NPL ratios dropped from 0.5% in March 2009 to 0.3%

\textsuperscript{19} Cyclical components are derived using HP filter.
in September 2011 and to 0.2% in March 2013. This means that housing and consumer loans, in general, do not pose any significant threat to the banking system and that there is still scope for the financial institutions to market their products to households.

**Figure 3**

**Philippines: Non-Performing Loans (Residential Real Estate, Auto Loans, Credit Card Receivables) to Total Loan Portfolio of the Banking System (%)**

It can be recalled that a risk weight of 150% on non-performing loans was imposed when Basel II was implemented in 2007, higher than the 125% risk-weight implemented under the BSP Circular 475, dated 14 February 2005. A higher risk weight of 100% (from 75% under the BSP Circular 475) on NPLs for housing purposes, fully secured by first mortgage on residential property, was also implemented in 2007. These measures kept the non-performing loans of the banking system under manageable levels (Samarita, 2010).

It has also been observed that during periods of risk aversion, which usually coincides with a marked increase in NPLs, banks could resort to credit tightening. During the recent global financial crisis, residential real estate loans decreased markedly while the volume of transactions of 364-day Treasury bills in the primary market went up during the same period. These developments reflected the risk-averse behaviour of banks during the period, such that they reduced their loan...
exposure to the household sector and, instead, shifted more of their portfolio to the safer government securities, particularly the longer-term 364-day Treasury bill (Samarita 2010).

4.3 Household Sector Debt Service Ability Remains Firm

The observations in the previous sections so far point to the relatively sound debt service ability of Filipino households. Empirical studies reveal that employment typically affects households’ ability to repay loans. A household with unstable stream of income and with insufficient income buffer is expected to experience difficulty in repaying debt obligation which can eventually lead to loan default. Moreover, people may also consider the outlook in employment. This is especially true when new job entrants start to apply for loans on the expectation that they will be able to service their loan obligation by having a stable source of income.

As discussed in Section 2, the Philippine employment rate has remained stable at about 7.0%. In its latest Business Expectations Survey (BES), the BSP revealed that the employment outlook for the next quarters of 2013 remains optimistic. The BSP Survey noted that firms in the services sector are the most optimistic in their employment outlook, consistent with their bullish outlook in the second quarter of 2013. Business sentiment across employment size improves in the quarter ahead. Large-sized firms’ business confidence for both the current and next quarters was the most buoyant, followed by those of medium- and small-sized firms. Moreover, firms with expansion plans are broadly steady. The percentage of businesses with expansion plans for the next quarter of 2013 grew by about 30%.

There are also indications that difficulty in debt servicing may be rather limited. Based on the latest Consumer Finance Survey (CSF), many households considered their home as the most important asset they hold in 2009. About 68.8% of households are homeowners (38% own/co-own their house and lot and 30.8% own/co-own their house only). The rest (31.2%) are broken down as follows: renting (13.0%), neither owned nor rented their housing unit (18.0%),

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20. Based on the latest Labour Force Survey, the country’s unemployment rate in July 2013 was estimated at 7.3%.

21. The First Quarter 2013 BES was conducted during the January 3 to February 8, 2013. There were 1,555 firms surveyed nationwide. Respondents were drawn from the Securities and Exchange Commission’s Top 7,000 Corporations.
and did not respond (0.2%). This finding indicates that a significant number of families lived with relatives or are part of extended families. Most households that owned their house/house and lot acquired the property through cash payment (64.8%) and inheritance/gift (29.6%). Only 6.7% of households borrowed money for their housing. Almost one-half of households with outstanding loans paid their monthly amortisation either ahead of or on schedule, while the other half were behind schedule.

In addition, interest rates and bank lending are effective channels for transmitting monetary policy impulses to the real economy in the Philippines, even in the presence of significant sources of foreign exchange such as overseas remittances (Bayangos 2012). This highlights the potency of monetary policy in enhancing the effectiveness of the transmission mechanism. This underscores the importance of carefully calibrated policy rate adjustments so as not to erode the debt servicing capacity of households. On the other hand, it can be argued that excess household indebtedness may constrain the effectiveness of monetary policy because fewer households are able to borrow for consumption smoothing.

4.4 The Household Sector is Seen as Vulnerable to Interest Rate and Exchange Rate Shocks, Based on the 2011 Income and Outlay Schedule

Given the continued uncertainty in the global economic recovery, possible decline in household income and savings especially from those households dependent on remittances may ensue. Based on the NSCB’s latest Household Income and Outlay Schedule, about 73% of household sector’s total income in 2011 came in the form of compensation, of which 38% originated from the rest of the world, while 35% was sourced from the domestic economy. This finding suggests that the household sector is vulnerable not only to interest rate shocks but also to exchange rate shocks. Under such a scenario, the household sector’s earning and debt-servicing capacity can weaken, thus, the situation warrants close monitoring since a continued increase in the households’ credit accumulation can affect the balance sheet of the banking system as well as the overall stability of the financial system.

This section finds that the rising housing and consumer credit in the Philippines from 1999 to 2013 can be plausibly described by fundamentals and that there is a steady long-run relationship between prices and value of housing and consumer credit. Hence, the increasing housing and consumer loans extended by banks especially in recent years do not pose any major threat to financial stability. This finding underscores the relatively firm ability of households to
service its debt and a modest record of banks’ non-performing loans on housing and consumer credit. However, the findings in this section imply that the household sector can be exposed to interest rate and exchange rate shocks based on the 2011 Income and Outlay Schedule.

5. **Insights for Policy Going Forward**

The results in Section 4 indicate that, on the whole, the Philippine household debt remains manageable. However, given the uncertain pace of the global economic recovery, possible decline in household income and savings especially for those households dependent on overseas remittances may ensue. Under such a scenario, the household sector’s earning and debt-servicing capacity may weaken. Since a continued increase in the household sector’s credit accumulation can affect the balance sheet of banking system as well as the overall stability of the financial system, close monitoring of tail events becomes reasonable.

For its part, the BSP has taken significant stride to pursue measures that will address the possible excesses in financial system’s exposure to household sector. Following the Joint Center for Housing Studies and Harvard University’s Symposium Proceedings on “Moving Forward: The Future of Consumer Credit and Mortgage Finance,” this section discusses the areas where the BSP has taken initiatives to strengthen the surveillance of household debt dynamics and looks at areas where intervention may be considered. These initiatives fall into two areas: (a) BSP’s role in supporting further initiatives in housing and consumer credit; and (b) support for regulatory reform measures, including improvements in transparency through enhanced information disclosure (Table 3). These reform measures are expected to deepen further the BSP’s tool kit in identifying and assessing key challenges and potential risks to financial stability.
In view of the possible impact of increasing household loans on the stability of the financial system, the BSP implemented several measures to address the risks posed by the banking system’s loan exposure to the household sector, particularly through credit card and residential real estate loans.

On credit card receivables, the BSP issued various regulations aimed at protecting both the public and banking industry. The BSP issued on 27 August 2002, Circular No. 349 which significantly tightened the rules on credit card and other lending operations by requiring banks and their subsidiary credit card companies to ascertain that cardholders are capable of fulfilling their commitments and by setting credit limits based on their net take-home pay. On 23 August

### Table 3
**Policy Initiatives Taken and Possible Areas for Improvement**

<table>
<thead>
<tr>
<th>A</th>
<th>Policy Initiatives Taken</th>
<th>Possible Areas for Improvement</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>BSP prudential measures</td>
<td>Include lower loan-to-value (LTV) ratios for second/subsequent purchases</td>
</tr>
</tbody>
</table>
| 2 | Expanding economic and financial learning campaigns, including consumer education programme | • More frequent financial learning campaigns in remote areas and countries with large overseas Filipinos  
• Consumer Protection Framework for the Philippines |
| 3 | Stronger data surveillance on household debt dynamics                                      | • More frequent release of Consumer Finance Survey  
• Construction of Residential and Commercial Real Estate Price Indices, housing affordability measures like price-to-income ratio  
• Compilation of micro data on consumer credit and real estate loans |
| 4 | In-depth research/studies on housing and consumer credit                                  | • Conduct studies on vulnerability of household sector, including bank stress tests  
• Assessment of shadow banking activities in the Philippines |

<table>
<thead>
<tr>
<th>B</th>
<th>Support for Regulatory Reforms</th>
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</thead>
</table>
| 5 | Credit Card Industry Regulation Act                                                      | • Support for faster deliberation of the Credit Card Industry Act at the Lower and Upper House of Representatives  
• Tighten rules on credit card disclosure through Implementation of the Truth in Lending Act (Republic Act No. 3765) |
| 6 | BSP Charter Amendments                                                                    | • Faster deliberation of the BSP Charter Amendments at the Lower and Upper House of Representatives  
• Monitoring of non-banks’ loan exposure to household sector |
2003, through Circular No. 398, the BSP required that the development of consumer credit through innovative products such as credit cards, shall be under the conditions of fair and sound consumer credit practices. Meanwhile, the BSP issued Circular No. 454 on 24 September 2004 and required the alignment of the credit card operations of banks in the country and their subsidiary credit card companies, including affiliates, with global best practices.

With regard to real estate loans (RELs), the BSP has tightened the regulations on real estate lending since June 1997. The prescribed ceiling on commercial bank’s loan to the real estate sector is 20% of a bank’s total loan portfolio (TLP), exclusive of loans to finance the acquisition or improvement of residential units amounting to not more than PHP 3.5 million. Inclusive of these loans, however, aggregate RELs should not exceed 30% of the bank’s TLP.

In addition, the allowable loan value of the real estate used as collateral for commercial bank loans has also been reduced to not more than 60% (from 70%) of the appraised value of the real estate property, except the following which shall be allowed a maximum loan value of 70%, (a) any loan not exceeding PHP 3.5 million to finance the acquisition or improvement of residential units; (b) housing loans extended or guaranteed under the government’s National Shelter Programme; and (c) loans extended to housing developers for socialised and/or low-cost housing under the government’s National Shelter Programme. Given the recent rise in demand for real estate loans, subsequent purchases of real estate (or second purchases) may be given lower loan-to-value requirement. This measure is meant to discourage borrowers from purchasing real estate properties for investment or for speculation.

On 17 January 2008, the BSP approved the rationalisation of limits on the exposure of universal/commercial banks to the real estate industry by imposing a single 20% overall limit on their real estate lending. The new limit, which primarily serves as a prudential safeguard against over-concentration of credits of universal/commercial banks to commercial lending, is expected to provide these banks with more flexibility in delivering credit to high priority areas, such as infrastructure development and construction of residential properties.

Meanwhile, loans for the construction of public infrastructure are now excluded from the definition of RELs and consequently from the 20% loan limit. Housing loans to individual households, regardless of amount have also been excluded from the limit, as well as loans extended to real estate developers for
the construction of socialised and low cost residential properties under the various government housing programmes. This measure is meant to sustain the government’s National Shelter Programme aimed at addressing the country’s housing shortage. Meanwhile, RELs to the extent guaranteed by the Home Guarantee Corporation (HGC) or collateralised by non-risk assets shall continue to be excluded from the said limit.

In September 2012, the BSP expanded the coverage of real estate exposures of banks which now includes loans as well as investments in debt and equity securities to finance real estate activities. It should be noted that the BSP imposes a 20% overall ceiling on U/KBs’ real estate lending (i.e., 20% of TLP, net of interbank loans). This limit will continue to be implemented during the duration of the observation period of the enhanced real estate exposure of banks. The new guidelines also require the reporting of real estate exposures as share of adjusted capital. Meanwhile, the regulations on real estate exposures will be revisited after sufficient data is gathered from this expanded report to determine any further need to regulate banks’ exposure on real estate activities. The expanded report on banks’ exposure to real estate activities started with the reporting period last 31 December 2012.

The BSP has taken a proactive stance in embarking on a consumer education programme that aims to improve the basic financial literacy of the public. In line with this programme, the BSP approved in January 2004 the creation of the BSP Consumer Education Committee. The Committee initially addressed the basic financial literacy needs of consumers of financial products and services. This involved familiarising the public on the various banking products and services that they usually encounter in ordinary financial transactions. Moreover, the BSP promotes consumer rights awareness and protection through its linkage with an inter-agency group, ConsumerNet. ConsumerNet is a group of national government agencies that have banded together to facilitate the resolution of consumer complaints and disseminate information regarding consumer rights. The BSP also created the Financial Consumer Affairs Group (FCAG) of the

22. Under the new guidelines, real estate activities shall refer to the construction and development of real estate projects as well as other ancillary services, such as buying and selling, rental and management of real estate properties. This covers a broader scope compared to the definition specified under Circular No. 600 dated 4 February 2008, which limits real estate activities to the acquisition, construction and improvement of real estate property.

23. This is embodied in the BSP Memorandum No. M-2012-046, dated 21 September 2012.
Supervision and Examination Sector (SES) to ensure protection of depositors and investors and enabling the smooth and orderly functioning of the entire financial system.

Consistent with the BSP’s objective to raise the public’s understanding of economic and financial issues, the BSP launched the Economic and Financial Learning Programme (EFLP) on 28 July 2010.24 In the same year, the EFLP campaigns were conducted in six key areas of the country: Pampanga, Legazpi, Davao, Bacolod, Dagupan, and General Santos. These activities coincided with the re-launching of the Economic and Financial Learning Centres (EFLCs) in these areas.25 In 2011, the EFLP campaigns were also held in the following cities: Tuguegarao, Dumaguete, Naga, Zamboanga, Cabanatuan, and Tacloban. In 2012, similar programmes were conducted in Ilocos Norte and in the cities of Roxas, Ozamiz, Lucena, Cagayan de Oro, Iloilo, Cotabato, and Tarlac. Four key component programmes of the EFLP include Public Information Campaign (PIC) on the Role of the BSP in the Economy, Financial Education Expo (Fin-Ed Expo)26, Financial Learning Campaign (FLC) for overseas Filipinos and beneficiaries. There are also other EFLP component programmes such as the Users’ Forum on BSP-produced Statistics.

Stronger data surveillance on household debt dynamics is equally important. Given the limited data on Filipino household’s balance sheet, the BSP needs to continuously support the more frequent release of a national survey to obtain a broader picture of the financial sector risks posed by households as well as those to which these households are exposed to. In 2012, the BSP released the first Philippine Consumer Finance Survey (CFS). The CFS generates data on the financial conditions of households, including what they own (financial and non-financial assets) as well as from whom and how much they borrow (sources

24. The EFLP embodies the BSP’s thrust to promote inclusive and proactive economic and financial education among its stakeholders, the underlying philosophy of which is that a citizenry that is well informed in economics and finance is a more effective partner of the BSP in maintaining the effectiveness of monetary policy as well as in ensuring a stronger and safer banking and payments system.

25. The EFLC aims to provide information services, programmes, and materials to introduce the work of the BSP and its role in the Philippine economy and to promote greater understanding of the essential economic and financial concepts and issues.

26. The Fin-Ed Expo aims to instill awareness about the availability and accessibility of financial education programmes to all Filipinos, increase personal financial consciousness on the values and benefits of being financially empowered, and orientate the public about available financial tools that will help in the promotion of their financial well-being.
of credit and level of indebtedness). It also generates data on the income, spending and insurance coverage of households residing in the National Capital Region and in areas outside the National Capital Region. An indicator that can be particularly relevant for ensuing surveys is the extent of households’ non-performing loans to total household loans.

Studies on the vulnerability of the household sector, including banks’ stress tests on household income, are priority research areas of the BSP. The BSP is also supporting the construction of a residential real estate property price index for the Philippines. Residential property prices are used to assess and value properties. Valuations of residential real properties are typically used for acquisition and disposal, mortgages, taxation, land and property management, among others. However, there are shortcomings/weaknesses in the compilation of housing statistics. In view of the significant contribution of the sector to economic growth, there is a need to develop a system that will generate an official residential real estate price index for the Philippines which can help the BSP in assessing trends in asset prices and the risk of bubbles in the housing prices.27

Regular estimates of housing affordability measures such as price-to-income ratio can be considered. The price-to-income ratio is the basic affordability measure for housing in a given area. It is generally the ratio of median house prices to median disposable incomes of families, expressed as a percentage or as years of income. It is sometimes compiled separately for first time buyers.

Micro data on mortgage finance and consumer credit are important indicators in assessing the build-up of stress before it becomes excessive. There are pockets of data on mortgage finance in the Philippines but the data are unorganised. In most empirical literature, the impact of household indebtedness in the financial sector is assessed using aggregate data. While aggregate data typically give us a useful first approximation, micro data on distribution of debt among household members provide important indicators in determining the financial risk of a given amount of household debt (Dey, et al., 2008; Herrala and Kauko, 2007; Faruqui, 2008). With this in mind, several countries have developed surveys at the household level with the purpose of analysing risk in the household sector. The BSP may also consider gathering data on debt distribution among household members.

27. Moreover, the availability of data on property prices is one of the information gaps identified in the Group of Twenty (G-20) report following the financial crisis, and was also included in the proposed Special Data Dissemination Standard (SDDS) Plus categories under Financial Soundness Indicators.

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The need to bring shadow banking activities more firmly into the regulatory system has been raised in the empirical literature as well as in dialogues/consultations with the public, but specific aspects of how this should be done are yet to be firmed up. Another specific point raised in the literature is the need for a regulator to have responsibility for overseeing systemic risk. The BSP has taken a crucial role to strengthen the connection between monetary policy and addressing systemic risk. The BSP has established the Financial Stability Committee (FSC) in September 2010 to provide broad directions in identifying and assessing the key challenges and potential risks to the stability of the financial system. The FSC is tasked with monitoring developments and market vulnerabilities which have potential systemic implications on domestic financial markets. The FSC is also in the process of identifying tools and indicators to address macro prudential issues.

To ensure financial stability across a broader spectrum, the Financial Stability Coordinating Council (FSCC) was convened in April 2012 and is composed of the BSP, the Securities and Exchange Commission, the Philippine Deposit Insurance Corporation, the Insurance Commission and the Department of Finance. The FSCC serves as a collaborative venue for discussing financial stability issues and taking necessary actions/steps to address the build-up of system-wide risks.28

Support for regulatory reform measures by the BSP is crucially important. Currently under deliberation at the Lower and Upper House of Representatives, the Credit Card Industry Regulation Act is expected to establish fair and transparent practices relating to the extension of credit under an open end consumer credit plan, and for other purposes. In the Upper House, Senate Bill (SB) No. 602, or the Credit Card and other Access Device Act was proposed and filed in August 2013 to regulate the interest rate charged by credit card companies so that a healthier environment will prevail for the benefit of the credit card holders and credit card companies. SB 602 requires credit card companies to provide additional information regarding repayment of the outstanding balance of the credit card holders, accompanied by information on the minimum payment, the number of years and months it will take to repay the balance under a monthly minimum-payment scheme, and total cost to the consumers, broken down as principal and interest payments, of paying the balance in full if no further advances are made. The proposed SB 602 bill imposes a cap on

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28. The FSCC has identified the following areas which have systemic implications: (a) corporate leverage; (b) non-bank sources of credit; (c) managing capital flows; (d) financial crisis management; and (e) reforms relevant to the capital markets.
interest rates at 1% per month, or 12% per annum without compounding, and a monthly ceiling of 1% on surcharges or penalties.

Meanwhile, the rules on the Implementation of the Truth in Lending Act (Republic Act No. 3765) were updated in 2011 to ensure consistent and comprehensive application of disclosure rules and a uniform method of computing interest charges for compliance by all banks, non-banking financial institutions and credit granting entities (Circular No. 730 dated 20 July 2011; Circular No. 754 dated 17 April 2012; and Circular No. 755 dated 20 April 2012). These regulations seek to address the transparency and disclosure practices of the entire credit-granting industry that will lead to a more level and robust competitive environment among credit providers and ensure better informed and protected consumers.

In line with its advocacy on consumer protection, the BSP now takes a closer look at covered institutions’ compliance with the updated rules implementing the “Truth in Lending Act” (RA No. 3765). Covered institutions refer to banks, non-banking financial institutions and BSP-registered credit-granting institutions that engaged in lending activities. To ensure a level playing field among the credit providers, other regulatory bodies such as the Securities and Exchange Commission (SEC), the Cooperative Development Authority (CDA) and the Insurance Commission (IC) issued parallel regulations mandating institutions under their respective jurisdictions to observe the updated implementing rules and regulations of the “Truth in Lending Act”.

For its part, the BSP will continuously monitor covered institutions’ compliance to ensure that the updated rules on loan transparency are observed, including the credit card activities of banks. In fact, the BSP tightened watch on credit card operations of banks anew to ensure that consumers are protected amid the increasing use of credit cards. Starting in October 2013, all banks (banks and quasi-banks and their subsidiaries and affiliates with credit card businesses) will be required to submit reports on the scope of their credit card operations, the number of issued and type of cards, fees and charges for transactions and credit limits for the average user. The data will be included in the credit card business activity reports (CCBAR) to be submitted to the regulator every month. These new reporting requirements are part of the BSP Circular No. 812-2013 which was published during the last week of September 2013. In particular, reports

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29. The Effective Interest Rate (EIR) calculation models for all types of loans for the guidance of all NBFIs and entities with credit-granting facilities were issued under Memorandum Nos. M-2012-018 dated 19 April 2012 and M-2012-020 dated 25 April 2012.
on credit card issuers and acquirers, cardholders and complaints will have to be submitted monthly, while data on the usage location of credit cards will be submitted quarterly. By following these requirements, banks will disclose the number of cards per network or brand, the types of cards issued, approved applications and the number of cards based on credit limits.

Meanwhile, the BSP is fully supporting amendments to its Charter. The explicit mandate of financial and payments system stability for the BSP merely formalises the practice being adopted by the BSP in recognition of the fact that monetary stability is deeply intertwined with financial stability and that the conduct of monetary policy and financial policy are completely rooted in the stability and soundness of the payment and settlements system. It can be noted that the proposed amendments to the BSP Charter cover the areas of monetary policy and enhancing the BSP’s access to information from the non-banking sector. Specifically, the BSP proposes the following amendments:

- Explicit objective of financial stability and payment system stability;
- Removal of the limitation on monetary growth;
- Removal of the restriction on the issuance of securities;
- Authority to create reserve accounts to smoothen the impact of financial losses on its balance sheets;
- Symmetric distribution of gains and losses;
- An increase in its capitalisation; and
- Expansion of the authority of the BSP to obtain data from the non-banking sector.

The primary motivation for the amendments is the maintenance of effective monetary control. Monetary control is a means of achieving the final policy objective of the BSP, which is price stability. Inflation cannot persist without sustained increases in the money supply. It follows then that for the objective of price stability to be achieved, the BSP has to be able to issue effective constraints on monetary expansion. The proposed amendments are sought in order to grant BSP the flexibility to fully utilise the monetary tools at its disposal and to adopt best practices used by other central banks.

With respect to greater power to access data from the non-banking sector, the proposed change is likely to expand and enrich the information set upon which the BSP bases its policy decisions as well as further improve the quality
of research done by the BSP. Moreover, the proposed amendments are expected to strengthen the financial stability function of the BSP by expanding its supervisory function to include additional categories of financial institutions such as credit card companies and money changers. Meanwhile, the proposed creation of reserve accounts and a more symmetric distribution of net income combined with an increase in capitalisation will help to insulate the credibility of monetary and financial policy from the implications of losses to its financial position.

6. Conclusion

This paper examines the developments and policy implications of the rising housing and consumer credit extended by banks to the household sector in the Philippines from 1999 to 2013. Throughout this paper, household debt includes outstanding housing (mainly residential real estate loans) and consumer credit (mainly auto loans and credit card receivables) extended by the banking system. The Philippine banking system is composed of universal and commercial banks, thrift banks, rural and cooperative banks.

The household sector’s role has consistently been robust as a driver of the Philippine economy. In recent years, household debt has gained importance in recent years, both in absolute terms and relative to the size of the economy. However, compared with selected countries, the Philippine household debt relative to GDP appears to be modest.

Several factors have contributed to the strong growth in housing and consumer credit, the principal factors include, from the demand side, the relatively lower interest rates in the Philippines, government initiatives to continue with the National Shelter Programme in the urban and rural areas, including the underprivileged citizens and beneficiaries of overseas Filipino workers, optimistic outlook not only on the real estate sector but on macroeconomic fundamentals, and some improvements in employment situation. From the supply side, the effect of the increase in households’ borrowing capacity has been reinforced by an increase in the availability of housing construction and finance, buoyant retail market developments and improved consumer confidence.

Moreover, as a first approximation, this paper finds that the rising housing and consumer credit in the Philippines from 1999 to 2013 can be reasonably explained by fundamentals and that there is a stable long-run relationship between prices and value of housing and consumer credit. Hence, the expanding housing and consumer loans especially in recent years do not pose any major threat on financial stability. This finding is reinforced by the relatively firm ability of
households to service its debt and a modest record of banks’ non-performing loans on housing and consumer credit. However, the household sector is seen as vulnerable to interest rate and exchange rate shocks based on the 2011 Income and Outlay Schedule.

In general, the Philippine household debt remains manageable. However, the rise in household debt may come with a downside. Given the uncertain pace of global economic recovery, possible decline in household income and savings especially from those households dependent on remittances may ensue. Under such a scenario, the household sector’s earning and debt-servicing capacity can weaken. Since a continued increase in the household sector’s credit accumulation can affect the balance sheet of banking system as well as the overall stability of the financial system, close monitoring of tail events becomes reasonable.

For its part, the BSP has taken significant and comprehensive stride to pursue measures that will address possible excesses in the financial system’s exposure to the household sector. These measures include BSP’s prudential measures and reporting requirements, expanding economic and financial learning campaigns, including consumer education programme, stronger data surveillance, and in-depth studies on housing and consumer credit. In the area of regulatory reforms, the BSP supports faster deliberation of amendments to its Charter and the Credit Card Regulation Act. These two reform measures are expected to deepen further the BSP’s tool kit in identifying and assessing the key challenges and potential risks to financial stability.
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