



Press Release

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MEASURES TO IMPROVE STRUCTURAL SOUNDNESS OF HOUSEHOLD DEBT

BACKGROUND

As of the end of 2013, Korea's household debt amounted to KRW 1,021 trillion. The government has been taking a series of measures so far to improve the quality of household loan¹ and to rein in the pace of household debt growth.² As a result, the government significantly lowered a possibility that household debt issue might be worsened into a systemic risk.

Morgan Stanley(Oct. 2013) evaluated that Korea's household debt risk is manageable, citing grounds such as financially stable structure of household assets and mortgage rules on loan-to-value(LTV) and debt-to-income(DTI) ratios. The IMF stress test result (Jan. 2014) also shows Korea's household debt has a low possibility to pose a systemic risk in the event of economic shock.

Despite such achievement, the household debt issue still exposes vulnerability in some parts. The share of floating-rate and interest-only mortgages remains high.³ Low-income households' ability to repay debt deteriorated.⁴

The FSC and relevant ministries⁵ jointly announced today a package of measures to improve the structural soundness of household debt, as part of the government's follow-up measures to push forward the three-year plan for the next phase of Korea's economic growth.

¹ The share of fixed-rate mortgages significantly increased from 0.5% out of banks' total mortgages at the end of 2010 to 15.9% at the end of 2013. The share of amortizing loans also increased from 6.4% to 18.7% over the same period.

² Household debt growth rate (compared to the end of previous year, %): 9.4 (from 2005 to 2009), 8.7(2010), 8.7(2011), 5.2(2012), 6.0(2013). Household debt growth in 2013 was slightly higher than 2012 with an increase of loans taken out by first-time home buyers and household loans from the non-banking sector. However, the gap between household debt growth and nominal GDP growth in 2013 decreased to 2.0% (expected) from 2.2% in 2012.

³ As of end-2013, the share of interest-only mortgages in the banking sector is 69.7%.

⁴ According to a survey of households on financial welfare in 2013, debt per household increased 24.6% for the lowest-income quintile and 16.3% for the second-lowest income quintile in 2013 in comparison to 2012.

⁵ The Ministry of Strategy & Finance, the Ministry of Land, Infrastructure & Transport, the Financial Supervisory Service

Trend of household debt ratio and household debt amount (KRW trillion)

	Increase & Decrease('12)	% of Increase & Decrease('12)	Total Amount('12)	Increase & Decrease('13)	% of Increase & Decrease('13)	Total Amount('13)
Household Debt	47.6	(5.2%)	963.8	57.5	(6.0%)	1,021.3
- Housing Mortgage Loan (Jeonse Loan)	26.8	(5.7%)	497.1	30.5	(6.1%)	527.6
- Credit loan & etc.	5.5	(28.4%)	24.9	5.6	(22.5%)	30.5
- Sales Credit	17.8	(4.5%)	408.8	26.6	(6.5%)	435.4
	3.1	(5.6%)	57.9	0.5	(0.8%)	58.3

KEY CONTENTS

1. The government will set the ratio of households' debt to income⁶ as a key target indicator in managing household debt and lower the ratio by 5%p until the end of 2017.
2. The government will set new targets for banks to increase the proportion of fixed-rate and amortizing loans out of total mortgages, up to 40% by the end of 2017.

Banks' target to improve loan structure

Types of loan	end-2013	Banks' targets for each year			
		end-2014	end-2015	end-2016	end-2017
fixed-rate loans	15.9%	17.0%→ <u>20.0%</u> (adjusted target)	23.5%→ <u>25.0%</u> (adjusted target)	30%	<u>40%</u>
amortizing loans	18.7%	19.0%→ <u>20.0%</u> (adjusted target)	24.5%→ <u>25.0%</u> (adjusted target)	30%	<u>40%</u>

3. The government will prompt banks to offer a variety of loans tailored to consumers' debt repayment ability such as loans with a cap on floating rates or loans amortized over a mid-term maturity, for example, 5 to 10 years.
4. Borrowers with fixed-rate and amortizing loans will be granted a bigger tax exemption up to KRW 18 million, up from the current ceiling of KRW 15 million. For loans with a long-term maturity, ranging from 10 to 15 years, the government is considering offering tax incentives.
5. Mortgage-backed securities(MBS) issued by the Korea Housing Finance Corporation (KHFC) will be included to securities⁷ for the Bank of Korea(BOK)'s open market operation. The MBS will be issued with a single maturity, for example, in June or December.
6. The government will alleviate debt repayment burden for low-income borrowers such as self-employed, small business owners by helping them switch to lower-interest loans and debt restructuring.

⁶ Ratios of households' debt to disposable income (as of end-2012, %): 163.8(Korea), 172.1(Sweden), 154.3(Canada), 114.9(USA), 134.8(OECD average)

⁷ Korea Treasury Bonds(KTBs), Monetary Stabilization Bonds, and government-backed bonds, etc.

7. The government plans to launch a pilot project to help low-income households switch their short-term interest-only mortgages taken out from the non-banking sector to amortizing loans over a longer period of maturity.

EXPECTED OUTCOME

1. Spread out maturity structure of household debt over long-term period

The government will spread out maturity structure of household debt by increasing the share of fixed-rate and amortizing mortgages out of banks' total mortgages up to 40% by the end of 2017. The longer-term maturity is expected to reduce default risk of household debt and lower a possible systemic risk.

2. Reduce financial consumers' interest rate burdens

With tax incentives and increased demand for MBS, real interest rate on fixed-rate loans is expected to be lowered, which will push borrowers' preference towards fixed-rate loans. Household's risk resulting from a sudden rise in interest rate will be reduced when the proportion of fixed-rate loans increases.

3. Ease excessive demand for *jeonse*

By reducing the government's financial support provided for *jeonse*⁸ home owners with deposit exceeding KRW 400 million, the government expects to narrow the gap in housing costs among home owners, *jeonse* renters, and monthly renters. The government also expects excessive demand for *jeonse* to be shifted towards demand for home purchase or monthly rent with various policy measures and incentives.

4. Switch small business owners' loans to lower-interest loans

High-interest rate loans of a wider range of small business owners will be switched to lower interest ones. Total amount of the switched loans a year will be increased from the current KRW 140 billion to KRW 200 to 300 billion.

Standards for loans entitled to loan switching will be lowered from loans on annual interest rate of 20% to 15%. As a result, the amount of newly-benefited loans is expected to amount to KRW 2.7 trillion.

Debt burden of small business owners will be significantly eased as the interest rate on loans, which currently stands at 15% or higher, will be lowered to 8 to 12%.

⁸ *Jeonse* is a house leasing type unique in Korea. Instead of paying monthly rent, the renter makes a lump-sum payment for a leased house. At the end of the contract, usually two years, the landlord returned the money in its entirety to the renter.

5. Stabilize household debt structure and relieve repayment burdens

It is expected that systemic risk of household debt structure be reduced and household's repayment burdens be relieved as the proportion of fixed-rate and amortizing loans increases.

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