theSundaily

Will more fall into household debt trap?

WHILE many Americans are trying to rebuild their financial buffers through various sources of income, a rapid adjustment of the federal funds rate (FFR) has vanished their hope to recover (back to pre-pandemic times).

The US Federal Reserve (Fed) has not only failed to contain the inflationary pressure, with inflation coming down to 8.5% only in July despite the easing of the pump price resulting from lower West Texas Intermediate crude oil price as well as from commodities.

At the same time, the FFR rate hikes have also "exported" inflationary pressures to countries such as Malaysia, with the strengthening of the dollar vis-à-vis the local currencies concerned such as the ringgit while threatening the servicing capability of countries with dollar-denominated debt as in Latin America (evoking memories of the notorious impact of the infamous Volcker shock in that region).

It would seem that included in the inflationary pressures is the "exporting" of recessionary pressures too, with the US experiencing a technical recession from the first two consecutive quarters of this year.

The Fed raised its FFR for the fourth consecutive time – 0.25% in March, 0.5% in May, 0.75% in June, and an additional 0.75% in July – bringing the target range to between 2.25% and 2.5%.

If the Fed increases its policy interest rate by another 50 to 75 basis points in September, will other countries who are highly dependent on the US market fall into recession and be at the risk of "stagflation" eventually?

As alluded to, recession is a significant and broad decline in the gross domestic product (GDP) for two successive quarters, i.e, typically running for six months back-to-back.

Whereas stagflation is an economic condition characterised by stagnant economic growth, accelerating inflation and high unemployment.

In addition to the US, the UK economy also has already fallen into recession as the cost-of-living crisis has negatively impacted household incomes, according to a prominent think tank National Institute of Economic and Social Research (NIESR).

With a continuing rise in grocery price inflation by 1.6% (from 8.3% in June to 9.9% in July, based on the data from retail research firm Kantar), families nowadays are facing a £454 (equivalent to RM2,450.21, as of Aug 15) increase in average annual grocery bills.

Butter, milk and pet food are food items that experienced the most price hike over the past year.

As a result, the UK's food inflation has risen by 1.2%, from 8.6% in May to 9.8% in June.

A higher food inflation rate also translates to a 0.3% increase in the UK's Consumer Price Index (CPI), which measures the rate of change in the cost of purchasing a constant basket of goods and services by households in a specific time period, from 9.1% in May to 9.4% in June.

Although the unemployment rate witnessed a declining trend between December 2020 to May 2022 (from 5.2% to 3.8%), does this imply financial stability and wage gains in the UK during this high inflation period?

If the UK eventually undergoes stagflation as forecasted by NIESR, which projected that the CPI will go up to almost 11% by year-end and the unemployment rate to be above 5%, more households will experience a fall in average real disposable income by an unprecedented 2.5% and remaining at 7% below the pre-Covid level until 2026.

The NIESR also expected that the number of UK households living from paycheck to paycheck will almost double to seven million by 2024, including the 5.3 million who have no savings.

They will be forced to go into debt or arrears as soaring energy and food prices eat into families' financial gains.

Although the situation in Malaysia is not as bad since we have the subsidies (with petrol subsidy the macroeconomic "centrepiece") and price control measures, our households are facing comparable challenges as Malaysians too, are being squeezed by lower/weaker purchasing power, stagnant wages and a cost-of-living crisis in its own right.

As more money is required to purchase the same/lesser goods, does this mean more Malaysians will fall into a household debt trap?

The household debt trap is understood as the inability to continue servicing the loan, resulting in an even lower/weaker financial position accompanied by a decline in living standards or even bankruptcy.

As of the first quarter (Q1) 2022, South Korea, Hong Kong and Thailand recorded the top three highest household debt-to-GDP ratios at 104.3%, 95.3% and 89.7%, respectively.

Similarly, Malaysia recorded an 89% of household debt-to-GDP ratio as of end-2021, which is relatively higher than the developed economies such as the US (80% as of Q4 2021) and the UK (86.4% as of Q4 2021).

Of the RM1.375 trillion worth of household debt, 58% were housing loans, 14% for other debts, 13% for personal loans, 12% for car loans and the remaining 3% for credit card debts.

Although there is no latest figure on the amount of household debt as of June 2022, it has already exceeded the amount of federal government debt at RM1.045 trillion.

Hence, there is an increasing concern that more lower M40, B40 and hardcore poor Malaysian households would not be able to cope with paying for basic expenses and bills such as food, utilities (including water and electricity), car or housing loan instalments and children's education during this cost-of-living crisis.

The **Department of Statistics Malaysia** revealed sustained inflationary pressures in the food and non-alcoholic beverages category for three consecutive months from 4.1% in April to 5.2% in May and 6.1% in June.

This has translated to a higher CPI in Malaysia in June compared with previous months from 2.3% year-on-year in April to 2.8% and 3.4% in May and June, respectively.

As of June 30, the EPF's special withdrawal facility comprising i-Lestari, i-Sinar, i-Citra and the special one-off withdrawal of RM10,000 has recorded a total of RM145 billion in funds withdrawn by members.

Out of the 12.78 million Malaysians who contribute to the EPF, a total of 6.62 million members (or 52%) under 55 have less than RM10,000 in savings.

Of that number, 4.99 million members (or 75%) were bumiputra members.

At the same time, there were 3.2 million members below age 55 at a very critical low savings level of less than RM1,000, of which 2.58 million (or 81%) were bumiputra members.

When EPF contributors exhaust all of their savings, they will apply for loans from financial institutions to pay off their owing expenses.

When they cannot access bank loans, their last resort is to borrow money from moneylenders with high or exorbitant interest rates.

This means that many Malaysians now are struggling to recover from their financial woes over the past two years of the pandemic (2020 to 2021).

Recent findings from the global market analysis firm Ipsos have revealed that Malaysians worry over inflation and poverty (as the top anxieties) compared with the Covid-19 pandemic.

When the survey was conducted between May 27 and June 10, 23% of Malaysian respondents said they struggled financially, with 45% feeling they were just getting by.

The proportion of Malaysians having a comfortable life has also dipped to 29%, compared with the global average of 49% from all 28 countries surveyed.

Will the overnight policy rate (OPR) hike from Bank Negara Malaysia (BNM) for the second time in July lead to more Malaysians becoming even more financially vulnerable?

Malaysians are now having to face the risk of financial crimes which are now on the rise based on media reports.

In light of the recently known iPay88 cybersecurity breach incident that may compromise the data of credit/debit card users, there is an increasing fear that more Malaysians will experience unauthorised withdrawals from banking accounts without proper authorisation or consent.

According to the Director of the Personal Data Protection Department Mazmalek Mohamad, there have been 3,699 reports of personal data breaches in Malaysia since 2017.

A total of 51,631 online fraud cases were reported in Malaysia from 2019 to 2021, involving a total loss of RM1.61 billion.

If those who unexpectedly fall into a personal data breach or financial scam are low-income individuals, wouldn't this imply that they will be even more stuck in the household debt trap?

From a cost-of-living crisis to a household debt crisis, we would also be seeing a retirement crisis in the future (as highlighted above).

The government must recognise the critical nature of the problem and take appropriate measures to contain the triplex of cost-of living, household debt and retirement crises.

EMIR Research has the following policy measures to recommend the current administration:

1. Cost-of-living crisis

BNM, as a consolidated arm of the government, should no longer hike the OPR. Instead, it should prepare to reverse gear next year in view of the prospects of recession (as admitted even by Finance Minister Datuk Seri Tengku Zafrul Abdul Aziz).

2. Household debt crisis

The stalling of the intention to hike the OPR and preparation to lower it would also enable households to (better) manage their debt.

3. Retirement crisis

The government should consider a state-pension fund for EPF members whose savings have been depleted by the withdrawals. This scheme will run in parallel with the EPF. There will be monthly deductions, accordingly, but without employers' contribution.

Given that at its height, 6.1 million members have withdrawn the money contributed to the pension fund to be invested in special government bonds that provide high yields (returns).

This would obviate the challenge of having a tiered-system in the EPF, i.e, higher interest returns for the low savings group.

Aside from these proactive government measures, among others, Malaysians will need to be prudent in their daily expenditure and finances.

https://www.thesundaily.my/home/will-more-fall-into-household-debt-trap-KX9671873