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The credit card report

Credit card use and debt in Hong Kong
August 2004



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Welcome

On behalf of Visa International, I am pleased to present *The Credit Card Report*, a detailed analysis of a wide variety of issues relating to credit card usage in Hong Kong.

The convenience provided by payment cards in general, and credit cards in particular, have made their use widespread and this will continue to grow as cardholders and businesses choose to use them in new ways, for example in the rapidly expanding e-commerce markets.

This increased popularity has also led to concern in some quarters about irresponsible use of cards and unsustainable levels of personal debt. Such concerns are naturally heightened in periods of economic difficulty so that credit card debt has in recent years been erroneously cited as a main cause of personal bankruptcy.

As the leading payment brand, Visa takes community concern about sustainability of credit card debt very seriously. In making the information in this report widely available, we believe that community concerns and public policy will benefit from a better understanding of cardholder behavior, of the industry and of its relationship to the wider economy.

Visa and its members in Hong Kong are strongly committed to the continuing development of an efficient, modern payments system and to the economic benefits that it brings to the individuals, businesses and institutions that use it.



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Highlights

The take up of credit cards in Hong Kong increased strongly until the end of 2001, but has since stabilized. Hong Kong's credit card market appears to be quite mature, with every household having on average four credit card accounts. Approximately 71 percent of credit card accounts in Hong Kong carry the VISA brand.

The state of the economic cycle appears to have a strong influence on credit card use. Weaker economic growth from 2001 saw the number of transactions and spend levels slow noticeably. More recently, with GDP up 6.8 percent in the year to Q1 2004, the number of transactions and, especially, the level of spend using credit cards, have surged while credit card debt has reduced. In the year to Q1 2004:

- The number of VISA credit card transactions increased by 7.7 percent to around 41 million transactions per quarter
- VISA credit card spend increased by 28 percent in inflation-adjusted terms to HK\$35 billion per quarter
- Industry figures depict a 1.6 percent decline in credit card debt in inflation adjusted terms

Since there has been little movement in credit card penetration over the past year, these movements in aggregate figures have been primarily driven by commensurate movements in credit card usage on an individual account basis.

Fluctuating economic conditions have also had a strong impact on various indicators of affordability. Taken as a whole, these indicators imply that Hong Kong's cardholders, on average, are managing their accounts comfortably:

- Over the year to Q1 2004, for every HK\$100 spent using credit cards, almost HK\$110 was repaid
- This has contributed to a drop of 1.6 percent in the average level of credit card balances per account over the same period, leaving average outstanding balances of HK\$5,901 per account
- Credit card debt represents only seven percent of total household debt in Hong Kong
- Default rates, defined as outstanding balances for more than 90 days plus outstandings that have been written off as a proportion of total balances expressed as a percentage, have fallen from five percent in Q2 2002 to slightly more than two percent in Q1 2004.
- Visa data indicates that delinquency rates, from have fallen from four percent in Q1 2002 to less than two percent in Q1 2004





1 | Introduction

The Hong Kong economy has experienced a broad recovery since mid-2003. However, this growth follows several difficult years where the economy had to adjust to the severe misalignment in asset markets, political and economic uncertainties in its relationship with mainland China, the outbreak of severe acute respiratory distress syndrome (SARS), and flow-on effects of the bird flu crisis.

Despite these challenges, the vast majority of Hong Kong credit cardholders have been able to manage their accounts sensibly, as evidenced by a range of affordability indicators. Average credit card balances today are around the same as they were in 1998, but the percentage of financial statements, including financial charges, has almost halved from 1998 levels. Repayments have, in recent years, consistently outpaced spending and default rates, at their long run average levels, are comparable with other economies in Asia Pacific.

Hong Kong's economic outlook appears encouraging and should underpin continued orderly patterns of credit card use:

- The *Economist Intelligence Unit* has forecast GDP to expand by 6.5 percent in 2004 and by a further 4.6 percent in 2005.
- The tone of The Hong Kong Monetary Authority's (HKMA) latest Quarterly Bulletin indicates that it has become increasingly confident that some of the major risks that the economy has faced are waning.

The positive, albeit cautionary, outlook for credit card use and affordability is supported by comments from HKMA Deputy Chief Executive William Ryback:

The improvement in the asset quality of the credit card portfolio is not unexpected in light of the improving economic and labor market conditions. Banks' efforts in helping their customers reschedule their card receivables continued to be steady and appear to be paying off.¹



Visa has commissioned this report to build broader knowledge of the Hong Kong credit card market within public policy circles and the wider community. It draws on data published by the HKMA, the Department of Census and Statistics Hong Kong and the IMF as well as Visa data. The Visa data is based on reports provided by its Hong Kong members on a quarterly basis according to a set format.

The report is presented in seven sections. Sections 2 and 3 investigate recent trends in credit card take-up and use. Section 4 examines credit card spend, while Section 5 explores credit card repayment behavior. Section 6 reviews trends in credit card debt and debt affordability. The final section presents a summary of the key issues for the future.

¹ See the HKMA's press release that accompanied the *Credit Card Lending Survey Results For First Quarter 2004* at http://www.info.gov.hk/hkma/eng/press/category/credit_index.htm



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2 | Credit card take-up in Hong Kong

This section describes recent trends in credit card issuing in Hong Kong. The HKMA provides statistics on the number of credit card accounts for the industry as a whole. Visa statistics are available for a longer time period for both the number of credit cards and the number of credit card accounts. Both sources of data are reported here.

Key points

After a period of strong expansion in the take-up of credit cards until end-2001, credit card penetration in the market has declined slightly over the two past years.

There were 8.8 million credit card accounts in Hong Kong at the end of Q1 2004.

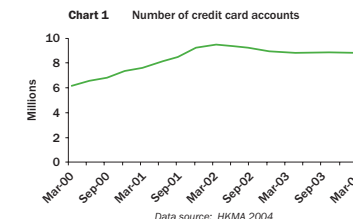
At the end of Q1 2004, 71 percent of the credit card accounts in Hong Kong were VISA credit card accounts.

2.1 Number of accounts

Households typically manage their credit card spending and debt on an account rather than on a card basis. A credit card account is set up in order to record the value and date of credit card transactions, details about the merchant who has accepted the credit card transaction, the value of the outstanding balance, and any financial charges imposed on holders of the account.

Where there is more than one card issued per account, cardholders typically coordinate and make joint decisions about their level of spend, repayments and revolving debt. Thus, an increase in the number of cards issued to existing accounts has no impact on the level of credit these households can access. This report, where possible, concentrates on the use of credit cards on a per account rather than per card basis.

After significant increases in 2000 and 2001, the number of credit card accounts has since stabilized (see Chart 1). In Q1 2004, there were 8.8 million accounts, virtually the same number of accounts as the previous year.²



The slowdown in the take up of credit cards appears to reflect the weaker economy between 2001 and the first half of 2003 (with the outbreak of SARS impacting the more recent period). GDP growth fell to just 0.6 percent in 2001, unemployment rose significantly in 2001 and 2002, asset prices fell sharply and a period of mild deflation persisted. Personal bankruptcy levels were high. During this period, interest rate deregulation also influenced the card payment market.³

² HKMA data.

³ Citigroup, Smith Barney "Banks: HKMA Cards Survey 4Q03: Charge-offs fall to 8.2 percent, volume up 4.3 percent qoq aided by seasonality." February 2004.

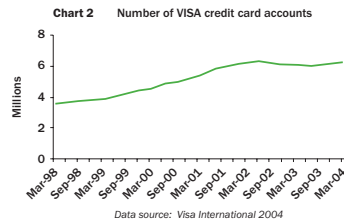


Approximately
64,000 merchants
in Hong Kong
accept VISA

The stabilization in account numbers also reflects a maturing of the credit card market in Hong Kong. During Q1 2004, households held, on average, four credit card accounts, which was unchanged from three years previously.⁴

Both VISA and total market account numbers increased through 2001. Since then, while the market edged slightly down, the number of VISA accounts was initially stable and then began to increase from the second half of 2003. The number of VISA credit card accounts expanded by 2.6 percent in the year to Q1 2004. (see Chart 2)

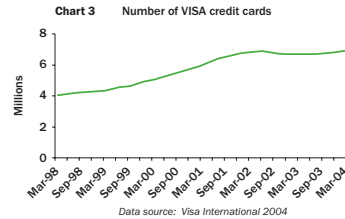
At the end of Q1 2004, 6.2 million credit card accounts in Hong Kong carried the VISA brand. This is equivalent to 71 percent of the market total of 8.8 million credit card accounts.



2.2 Number of cards

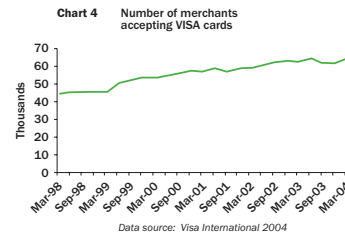
Along with the data on accounts, Visa has also collected data on the number of credit cards issued by member financial institutions in Hong Kong since the beginning of 1998. On average during Q1 2004, there were 1.1 VISA credit cards in circulation per account. The number of VISA cards per credit card account has remained quite steady at this level since Q1 1998.

As a result, the number of VISA cards in circulation has moved in a very similar pattern to the number of accounts (see Chart 3). Between 1998 and mid-2002, the number of accounts increased each quarter by around three percent year-on-year. After a period of stagnation, the number of cards in circulation increased from the second half of 2003 to show year-on-year growth of 2.3 percent for Q1 2004.



2.3 Number of merchants accepting VISA credit cards

Generally, growth in the number of credit card accounts and cards in circulation positively correlates with growth in the number of opportunities to use a credit card. At the end of Q1 2004, there were approximately 64,000 merchants in Hong Kong accepting VISA cards (see Chart 4), 2.7 percent more than the previous year.



⁴ HKMA and Department of Census and Statistics, Hong Kong data.



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3 | Credit card use in Hong Kong

This section profiles the frequency of credit card use in Hong Kong in terms of the number of credit card transactions. It draws only on Visa data as the HKMA does not report data on transactions.

Key points

Visa data indicates a doubling in the number of credit card transactions in Hong Kong since 1998.

Over the year to Q1 2004, the number of transactions rose by 7.7 percent. This increase was attributed to a five percent rise in the average number of transactions per VISA account and to a 2.6 percent rise in the number of accounts.

The average VISA credit card account holder made approximately 6.5 transactions per quarter.

3.1 Number of credit card transactions

During the year to Q1 2004, the total number of transactions on VISA credit card accounts increased by 7.7 percent to 40.6 million (see Chart 5). This growth represents a continuation of what has been a steady expansion in transactions since 1998. The increase in the number of transactions over the past year has been supported by the strong 6.8 percent growth in GDP in Q1 2003 and Q1 2004.



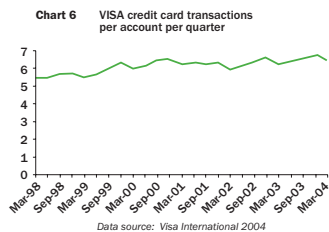
On average, the total number of transactions increased by 13.7 percent per year since 1999. Chart 5 illustrates that this trend was strongest between 1999 and 2001, but growth has continued since then despite difficult economic circumstances. Note that there tends to be a seasonal decline in the number of transactions in the first quarter of each year.

VISA cardholders make on average 6.5 transactions per quarter

3.2 Average number of credit card transactions per account

Given that the rate of growth in the total number of transactions over the past year (Section 3.1) has been stronger than the growth in the number of accounts (Section 2.1), the number of credit card transactions per account must have increased. This indeed has been the case with a five percent increase in the average number of transactions per VISA credit card accounts over the past year (see Chart 6).

The average VISA credit card account holder made approximately 6.5 transactions during Q1 2004.



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4 | Credit card spending in Hong Kong

The section analyses the value of credit card spending in Hong Kong. It draws on Visa data only, as the HKMA does not report credit card spend data. All time-series comparisons of spending make adjustment for the impact of inflation over the relevant period.

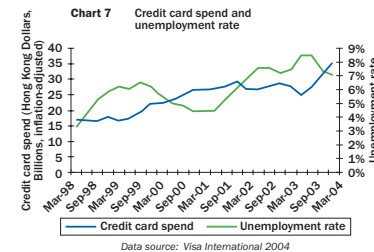
Key points

Total spending on VISA credit cards has doubled over the past five years, influenced by both increased card penetration and increased spending by existing cardholders.

Until 2001, increased card penetration was the dominant factor leading to higher credit card spend. Since then, fluctuations in average spend per cardholder have been the dominant influence.

According to Visa data, average spend per credit card account was HK\$5,677 during Q1 2004.

Credit card spend as a proportion of total household consumption has increased over the past five years.



4.1 Total spend on credit cards

As Chart 7 demonstrates, VISA credit card spend has expanded considerably over the period Q1 1998 to Q1 2004, although the pattern of the growth has been influenced by the prevailing economic conditions. During Q1 2004, VISA credit card account holders collectively spent HK\$35.4 billion on their credit cards.⁵ This was 28 percent higher than the level of credit card spend in Q1 2003, after adjusting for the impact of inflation.

The influence of economic trends on credit card spend is illustrated in by its inverse relationship with the rate of unemployment. Reduced unemployment between 1999 and 2001 was matched by a period of very strong growth in credit card spend. As the unemployment rate subsequently increased, credit card spend leveled off, only increasing again in the second half of 2003 as economic conditions began to improve.

⁵ Visa International data 2004.

4.2 Average spend per account

Average spend per account can reveal the extent to which growth in credit card spend is due to increased spend by existing cardholders rather than any increase in the number of credit card accounts. While the statistics may also be affected by the number of accounts held by each household, it is reasonable to assume that patterns in spend per account will provide useful information on changes in the use of credit cards by people already using cards.

In Hong Kong, the take-up of credit cards expanded strongly until 2001 and has since been quite stable. The increase in credit card penetration was the dominant influence on total spend until 2001.

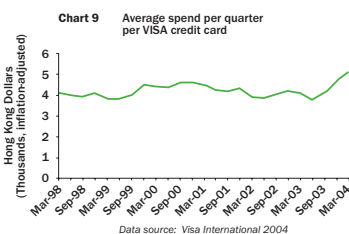
Since then, changes in spend per account have had more pronounced effects. During the period of economic adversity between 2001 and early 2003, spend per account declined noticeably. The economic recovery that has occurred since mid-2003 has produced a surge in spend per account (see Chart 8).

In the year to Q1 2004, average spend per VISA credit card increased by 25 percent to HK\$5,677 per account per quarter - the highest level recorded in inflation-adjusted terms.



4.3 Average spend per card

VISA spend per card closely mirrors VISA spend per account, as one would expect given the close relationship between the number of cards and the number of accounts (see Chart 9). Average spend per VISA credit card also reached a new high in Q1 2004. During Q1 2004, VISA credit cardholders spent HK\$5,142 per card, up from HK\$4,680 during Q4 2003. In inflation-adjusted terms, average spend per VISA card increased by 25 percent over the year to Q1 2004.



4.4 Average spend per transaction

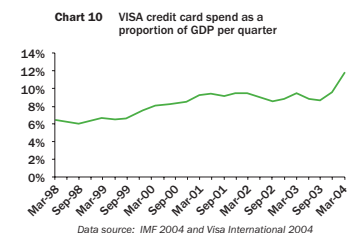
According to Visa data, the average spend per transaction during Q1 2004 was HK\$871. During the year to Q1 2004 average spend per transaction on VISA credit cards increased by 19 percent in inflation adjusted terms.

In 2003, average spend per VISA credit card increased by 25 percent

VISA credit card spend accounts for approximately 20 percent of household consumption

4.5 Credit card spend relative to GDP

The combination of higher card penetration and, more recently, the jump in spend per account has been also seen a marked increase in VISA credit card spend relative to GDP (see Chart 10). In Q1 2000, VISA credit card spend was equivalent to around 7.9 percent of GDP for the quarter. Four years later it was equivalent to around 11.9 percent of GDP.



The ratio of VISA credit card spend to GDP in Hong Kong is high relative to that in other countries in the region. In particular, VISA credit card spend as a share of GDP in Q4 2003⁶ was eight percent for Taiwan, five percent for Singapore and four percent for both Malaysia and Thailand.

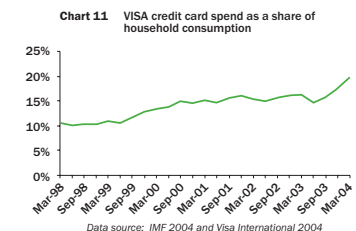
In part, this reflects Visa's high market share in Hong Kong. National credit card use will provide more comprehensive comparisons although, for some countries, the national data is not available. However, where national data is not available, estimates can be obtained by dividing the Visa spend-to-GDP ratio by Visa market share in credit card take-up.

After making these adjustments where necessary, we find that the ratio of spend-to-GDP for Hong Kong is approximately 17 percent. In comparison, during Q4 2003, Thailand's national credit card spend-to-GDP ratio was four percent, Malaysia's was eight percent, Singapore's was nine percent and Taiwan's was 13 percent.

4.6 VISA credit card spend relative to household expenditure

Credit card spend relative to household expenditure has increased noticeably, as households have made greater use of cards as a payment method.

In Q1 2000, VISA credit card spend accounted for around 13.4 percent of household consumption for the quarter (see Chart 11). Four years later in Q1 2004, it accounted for around 20 percent of household consumption.



⁶ Latest Visa data available.



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5 | Credit card repayments in Hong Kong

This section examines trends in credit card repayments. It draws only on Visa data, as the HKMA does not publish national credit card repayment data.

Key points

In recent years, Hong Kong credit cardholders have consistently repaid more than they spent each quarter on their cards.

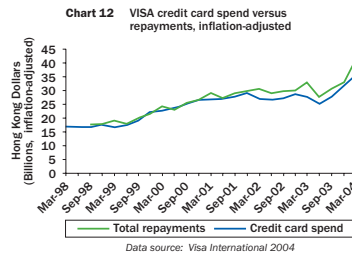
During the 12 months to Q1 2004, for every HK\$1,000 spent using credit cards, cardholders repaid an average of HK\$1,097.

5.1 VISA credit card repayments

Credit card repayment patterns can provide a useful indication of how well households are managing their credit card spend and debt. However, the data needs to be considered in the context of the broader environment. For example, a decline in the ratio of repayments to spend may be a sign of concern in times of financial stress. Equally, in a period of growth and strong underlying spending, it may reflect growing confidence in households' ability to meet borrowing obligations. Repayment data is therefore best viewed alongside other indicators including the data for outstanding balances (see Section 6).

Visa data suggests that Hong Kong credit cardholders have a healthy credit card repayment record.

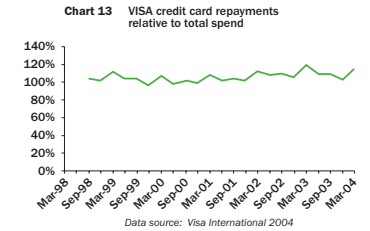
Chart 12 indicates that inflation-adjusted repayment figures have increased between Q1 1998 and Q1 2004. Repayments to VISA credit card accounts during Q1 2004, which totaled HK\$41 billion, were 24 percent higher than in Q1 2003 in inflation-adjusted terms.



Credit card repayments in Hong Kong

Repayments have exceeded spending in every quarter since the beginning of 2001 in all but a few instances since 1998, with the ratio of repayments to spend averaging approximately 106 per cent during this period (see Chart 13). This has contributed to a reduction in average credit card debt levels.

During the 12 months to Q1 2004, repayments represented an average of 109.7 percent of the total spending. That is, for every HK\$1,000 spent, Hong Kong's credit cardholders repaid HK\$1,097.



For every
HK\$1,000 spent on
credit cards, Hong
Kong cardholders
repaid HK\$1,097



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6 | Credit card debt in Hong Kong

This section examines recent trends in credit card debt, drawing on HKMA and Visa data. It identifies the proportion of balances that is revolving debt and also examines the affordability of credit card debt. All time-series comparisons of debt make adjustments for the impact of inflation over the relevant period.

Key points

In Q1 2004, total credit card outstanding balances were HK\$55 billion, a decline of 1.6 percent from Q1 2003 in inflation-adjusted terms.

Average debt levels per account also decreased by 1.6 percent over 2003, in inflation-adjusted terms. With incomes increasing over this period, credit card liabilities became less onerous over the year.

Credit card debt accounted for only seven percent of total household debt at the end of Q1 2004.

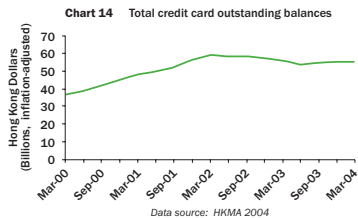
Credit card default rates and delinquency rates have fallen considerably over the past two years. The default rate has declined from a peak of just over 5.3 percent in Q3 2002 to 2.4 percent by Q1 2004.

In addition, the delinquency rate on VISA accounts has declined from four percent in Q1 2002 to 1.8 percent in Q1 2004.

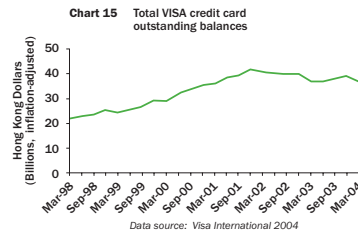
Trends in default rates are closely related to the economic cycle.

6.1 Total outstanding balances

Total outstanding balances in Hong Kong were HK\$55 billion at the end of Q1 2004 (see Chart 14). Outstanding balances have decreased over the last few years – balances were 1.6 percent lower in Q1 2004 than in Q1 2003, in inflation-adjusted terms.



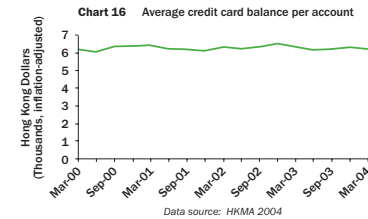
Visa data reveals similar movements over time in outstanding balances. VISA credit card outstanding balances decreased by 0.3 percent over the year to Q1 2004 in inflation-adjusted terms (see Chart 15).



Credit card debt in Hong Kong

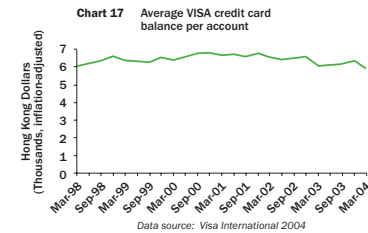
6.2 Average balance per account

The HK\$55 billion national credit card debt figure translates to an average balance of HK\$6,243 per account. Average balances per account decreased by 1.6 percent in inflation adjusted terms over the year to Q1 2004 (see Chart 16).



Average VISA credit card balances have decreased in recent years

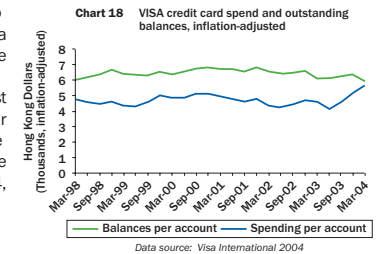
Outstanding balances on VISA credit card accounts display some small differences to the market figures. Whereas the market data displays little trend in balances, the average VISA credit card balance per account has consistently edged slightly lower over the past few years with a fall of 2.8 percent in the year to Q1 2004 in inflation-adjusted terms (see Chart 17). The average outstanding balance per VISA account was HK\$5,901 at Q1 2004, a little more than five percent below the market average.



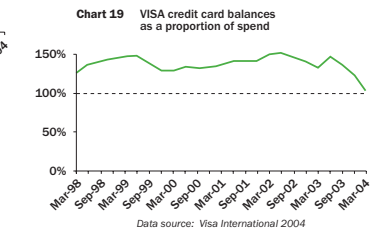
6.3 Credit card balances relative to spend

The ratio of credit card balances to spend will reflect how households time their repayment decisions. An increasing ratio of credit card balances to spend would suggest that households are paying off their credit card balances more slowly over time.

In Hong Kong, total Visa outstanding balances have exceeded total spend since Q1 1998 (see Chart 18). The gap between the levels of spend and outstanding balances tended to gradually drift apart between 1998 and 2002, but over the last 12 months the gap has narrowed substantially. Presumably, the better economic conditions have stimulated spending while allowing cardholders to reduce their debt levels marginally.



The ratio of outstanding balances to spend had been broadly stable until mid-2003. The recent surge in spending, however, has translated into a sharp drop in this ratio to 104 percent in Q1 2004 (see Chart 19).

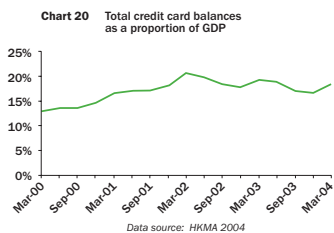


Note that balances tend to adjust more smoothly than spending. This produces a cyclical pattern in the ratio between the two. Also, the jagged pattern in the ratio of balances to spend over 2003 primarily reflects the drop in consumer spending associated with the SARS outbreak followed by the recovery in spending in the second half of the year.

Hong Kong's Q1 2004 Visa outstanding-to-spend ratio at 104 percent was above those in Singapore (100 percent) and Thailand (102 percent), but below those in Malaysia (126 percent), Taiwan (194 percent) and Australia (198 percent) at the end of 2003.

6.4 Credit card balances relative to GDP

The scale of credit card balances can also be tracked in relation to GDP to provide a sense of the economy's reliance on credit cards as a source of financing. Total credit card balances in Hong Kong were equivalent to 18 percent of quarterly GDP during Q1 2004, equating to 4.5 percent of annual GDP. Credit card balances as a proportion of quarterly GDP have been in decline since Q1 2002 (see Chart 20).



When compared with other countries in Asia Pacific, Hong Kong has a relatively high level of balances as a proportion of quarterly GDP. At the end of 2003, the proportion was five percent in Thailand, and 10 percent in Malaysia.

6.5 Credit card debt relative to limits

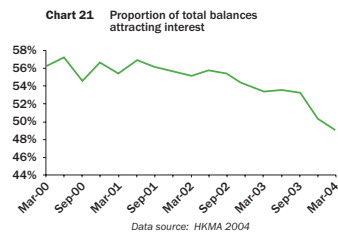
The HKMA does not report total credit card limits data. In some other countries, this data facilitates investigation of the extent to which cardholders are accumulating debt up to card credit limits. For instance, in Australia, limits data reveals that credit card debt is consistently less than 38 percent of total card credit limits. As such, this suggests that factors other than limits are influencing cardholder spending decisions.

If the HKMA is able to report limits data in the future, it would help to reveal the extent to which Hong Kong consumers make their debt decisions in relation to credit card limits.

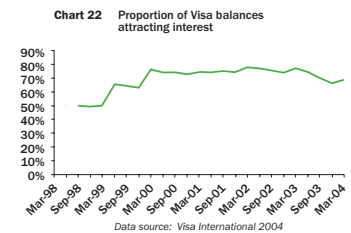
6.6 Balances attracting interest

Credit card debt refers to the total amount that cardholders owe to their issuing institutions. This includes both amounts that attract interest - 'revolving debt', and amounts that do not - 'non-revolving debt'.

HKMA data shows that, at the end of Q1 2004, HK\$27 billion of the HK\$55.0 billion in outstanding balances incurred interest charges, which is around 49 percent of the total. The proportion of balances attracting interest has been steadily declining since Q2 2000 when it was at 57 percent (see Chart 21).



In contrast, Visa data shows that a noticeably higher proportion of its outstanding balances attract interest charges. The Visa data shown here is available for a longer time period and has been sourced from the top five banks in Hong Kong.⁷ They show that the proportion of balances incurring interest charges has declined from 77 percent in Q1 2002 to 69 percent in Q1 2004. The HKMA ratio for rollover balances as a proportion of total outstanding balances is lower than the Visa estimate possibly due to the fact that the HKMA data includes outstanding balances relating to charge cards, which require their cardholders to repay their balances in full and do not contribute to balances attracting interest.

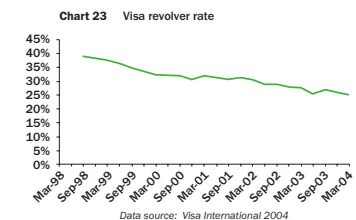


The percentage of credit card debt that attracts interest in Hong Kong is higher than that in some other countries in the region. At the end of 2003, based on Visa data only, the proportion was 62 percent for Singapore, 69 percent for Malaysia, 44 percent for Taiwan, and 43 percent for Thailand. Based on national figures, the proportion of credit card debt attracting interest in Australia was around 70 percent at the end of 2003.

6.7 Transactors and revolvers

Cardholders can be split into two broad groups. The first group is referred to as 'transactors' - those cardholders who pay their cards in full and do not pay interest charges. The second group is referred to as 'revolvers' - cardholders who do not pay their cards in full and therefore incur interest charges. Individual cardholders may migrate between the two groups.

The data published by the HKMA does not include any information on the ratio of transactors versus revolvers. However, Visa collects this information as set out in Chart 23. This data shows that since Q3 1999, the percentage of revolvers has consistently declined to approximately 25 percent. That is an average 7.5 accounts out of every 10 being repaid in full each month and not incurring interest charges. The remaining accounts are incurring interest charges.



⁷ This ratio is calculated using data only from the five banks reporting the largest outstanding balances in Hong Kong in order to provide as accurate picture as possible given the advanced reporting systems in place at these institutions.

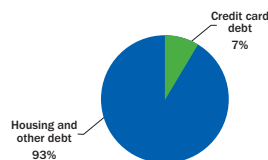
Credit card debt represented seven percent of total household debt in Q1 2004

6.8 Credit card debt relative to total household debt

Credit card debt is one component of household debt. The other components include money borrowed to buy property and for other personal purchases, such as cars or other durable goods and services. All debt needs to be serviced from future income and wealth.

Total household debt in Hong Kong at the end of Q1 2004 totaled HK\$744 billion.⁸ As indicated earlier, credit card debt represented seven percent of total household debt at the end of Q1 2004. Over the past five years, credit card debt in Hong Kong has ranged between 5.5 and 8 percent of total household debt.

Chart 24 Credit card debt as a proportion of household debt in Q1 2004



Data source: HKMA 2004

By comparison, credit card debt accounts for around five percent of total household debt in Australia and four percent in Thailand. In each of these markets, if there is any concern about the sustainability of household debt levels, it is evident that the principal source of that concern should relate to the non-credit card components of debt.

6.9 Affordability of credit card debt

Most of the available indicators of credit card affordability suggest that the majority of Hong Kong credit cardholders are able to manage their credit card debt very well.

Delinquency, default rates and net credit losses as a proportion of total outstanding balances are three indicators that measure the extent to which cardholders have difficulties in repaying their credit card liabilities.

The delinquency figure is the broadest of the measures, encompassing all cardholders who are overdue in paying their credit card liabilities by 30 days or more.

The indicators of default rate and net credit loss as a proportion of total outstanding balances are narrower measures that focus on those cardholders in real difficulty. The default figure encompasses all those cardholders who are overdue in paying their credit card liabilities by 90 days or more, plus those cardholders who have been deemed unable to repay their credit card debt (net of any monies collected from those cardholders).

The net credit loss figure (expressed as a proportion of total outstanding balances) is the narrowest of the measures, focusing only on those credit cardholders who have been deemed unable to repay their credit card debt (net of any monies collected from those cardholders) and the debt that has been written off.

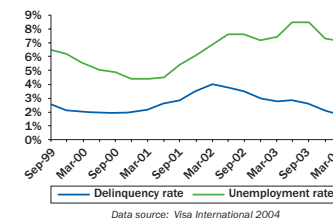
⁸ HKMA 2004.

Credit card default rates have declined sharply since September 2002

6.9.1 Delinquency rate

According to Visa data, delinquency rates have fallen to their lowest level for the period for which data is available. In Q1 2000, the Visa delinquency rate was two percent, and after rising in line with the deterioration in economic conditions, the delinquency rate has fallen again to around 1.8 percent in Q1 2004 (see Chart 25).

Chart 25 Visa delinquency rate versus the unemployment rate

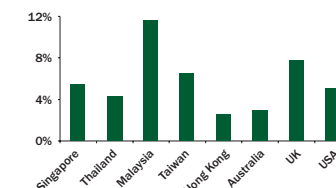


Data source: Visa International 2004

The delinquency rate has fluctuated in line with the unemployment rate since September 1999 (see Chart 25). This relationship between delinquency and unemployment rates is not surprising. As more people become unemployed, they face greater difficulties meeting obligations on all liabilities, including those on credit cards. The observed correlation between the two time-series indicates that the upward surge in the delinquency rate in previous years in Hong Kong is not the result of unsustainable credit card use and debt accumulation, but unforeseen changes in the employment status of credit card users in Hong Kong.

The latest delinquency rate compares favorably with those in other countries. (see Chart 26)

Chart 26 Average delinquency rate for 2003 across countries

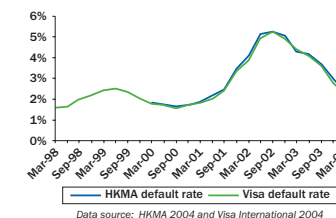


Data source: Visa International 2004

6.9.2 Default rate

Credit card default rates – measuring balances that are outstanding for more than 90 days plus balances that have been written off as a proportion of total balances – have almost halved since Q3 2002 (see Chart 27). Default rates using Visa data track the market figures very closely.

Chart 27 HKMA and Visa default rate

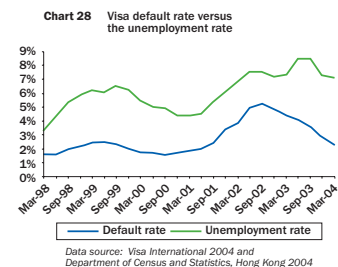


Data source: HKMA 2004 and Visa International 2004



Hong Kong's default rate compares favorably with most countries in Asia Pacific

As with the delinquency rate, the default rate is heavily influenced by the state of the economic cycle (see Chart 28). The improvement in the default rates over the past two years has been better than one would expect based on the relationship evident in previous years.



The default rate in Hong Kong has traditionally been quite low. In Q3 2002, the default rate hit a peak rate of slightly more than five percent. By Q1 2004, it had fallen to slightly more than two percent. Default rates have remained under 5.3 percent in Hong Kong since Q1 1998 and have only risen above three percent between Q4 2001 and Q3 2003.

This compares favorably with some of the other countries in Asia Pacific, particularly Thailand and Malaysia, which had default rates of over 20 percent in the late 1990s. Chart 29 shows the average default rates for 2003 for Asia Pacific countries. Hong Kong's rate compares favorably with most countries. The average figures for 2003 were for Hong Kong four percent, Taiwan four percent, Singapore four percent, Thailand three percent, Malaysia seven percent, and Australia two percent.

Chart 29 Average default rate for 2003 across countries



6.9.3 Net credit losses

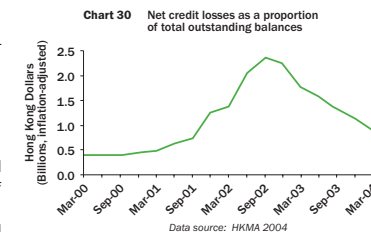
After a period of time, credit card balances that are not repaid are "written-off" by financial institutions. The amounts written off are called gross credit losses. Some of the amounts that are written-off are subsequently recovered from cardholders. Subtracting these recovered amounts from gross credit losses gives us net credit losses.

Net credit losses important indicators for several reasons:

- They influence the profitability of the credit card business
- They are an indicator of the efficiency of the collections process which is an important part of the overall management of the credit card business
- They are an indicator of the overall financial position of the debtor.

Chart 30 presents HKMA data on net credit losses per quarter between Q1 1998 and Q1 2004 expressed as a proportion of total outstanding balances. Unsurprisingly, the state of the economic cycle has a strong impact on net credit losses.

During Q1 2004, net credit losses amounted to around HK\$871 million, or 1.6 percent of total outstanding balances, a substantial reduction of 50 percent in inflation adjusted terms from a year earlier. Visa data followed the same trend over this period. Visa net credit card losses were HK\$515 million, or 1.4 percent of total Visa outstanding balances, down 56 percent in inflation adjusted terms from the previous year.



7 | The way forward

The increased level of consumer debt and default rates that were associated with the economic slowdown particularly in 2001, resulted in a heightened focus by policymakers on the use of credit cards. Since then, the HKMA has been instrumental in major reforms aimed at improving credit management in the credit card industry. In February 2002, it sent best practice guidelines to card issuers and made these public. Areas included in the guidelines were:⁹

- Underwriting criteria
- Credit checking
- Credit limit assignment
- Account management
- Portfolio management
- Delinquency management

The HKMA also played a major role in the formation of Hong Kong's 'positive' consumer credit bureau. It was able to work through sensitive issues related to protecting consumer rights with the Commissioner for Privacy. The bureau, which became fully operational in August 2003, has more than 90 members including banks, deposit-taking institutions and card companies.

Although credit bureaus existed in a more limited form prior to this date, they focused only on negative data. The establishment of the bureau is expected to contribute to improving the quality of credit management in coming years.

The credit card debt affordability indicators show that credit cardholders have encountered few problems managing their accounts over the past two years. Default and delinquency rates and the rate of debt turnover are declining and by the beginning of 2004 were at the lowest levels since 1998 for which data are available. As discussed throughout the text, the primary influence behind these improvements appears to have been Hong Kong's improving economy.

Data limitations constrain our capacity to undertake more comprehensive analysis of credit card take-up, use, spend, limits, repayments and debt in Hong Kong. If the HKMA were to collect and publish market data relating to numbers of accounts, numbers of transactions, total limits granted, total repayments, and balances attracting interest, it would facilitate a broader understanding of these issues by interested parties and a higher standards of decision-making by the industry as a whole.

⁹ Information on regulatory activities supplied by Visa 2004.

Glossary of key terms

Indicator/Term	Definition
Balances	The amount owing on a credit card at the end of a billing cycle, both interest and non-interest bearing. This is the outstanding balance from the previous billing cycle plus total charges on a credit card during a billing cycle less repayments within the billing cycle.
Balances accruing interest	Includes any part of total balances on which the customer has been or will be charged interest.
Credit card	A plastic payment card that can be used at a wide variety of merchants to make purchases and which offers a wide range of credit facilities and other benefits to cardholders. The card usually offers an interest-free period and a revolving line of credit.
Credit card account	An account held with the card issuer to which one or more credit cards are linked.
Credit card limits	Refers to the sum of credit card limits approved on all credit card accounts in Hong Kong.
Credit card spend	Credit card spend includes all amounts spent on bank-issued credit cards during the quarter. This includes transactions on accounts with and without an interest free period. It includes cash advances and payments for goods and services.
Credit card transactions	All transactions made using a credit card including cash advances and other payments for goods and services. This does not cover charge cards.
Default rate	Balances that are outstanding for more than 90 days plus outstandings that have been written off as a proportion of total balances, expressed as a percentage.
Delinquency rate	Calculated as delinquent balances divided by total outstanding balances, expressed as a percentage. Delinquent balances are balances that are over 30 days due.
Disposable income	Disposable income is the total of income received minus income tax and minus other income payable. This was taken from page 12 of Euromonitor Report "The Market for Financial Cards in Hong Kong" December 2001.
Gross Domestic Product (GDP)	Is the total market value of goods and services produced in Hong Kong within a given period after deducting the cost of goods and services used in the process of production but before deducting allowances for the consumption of fixed capital. Thus gross domestic product, as here defined, is 'at market prices'. It is equivalent to gross national expenditure plus exports of goods and services less imports of goods and services.
Household consumption	All forms of consumption by households as recorded in the International Financial Statistics Service as supplied by the IMF.
Household debt	All forms of debt accrued by households including housing-related debt, and other personal debt.
Inflation adjusted	An adjustment (using a local price index) to a time series' nominal values to remove the impact of inflation.
Nominal	Value expressed in terms of its current price.
Rate of debt turnover	Total balances divided by annual credit card spend.
Repayments	Captures all payments to credit card accounts including payments of interest, fees and other charges billed to the account.

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