Another contraction in European household credit markets

Sylvain Bouyon, Filippo Boeri, 12 August 2014

Summary

The ECRI Statistical Package 2014 Lending to Households reveals that the total amount of outstanding household real debt at end-2013 contracted for the third consecutive year in both the EU member states (EU27) and the euro area (EA17). All in all, indicators point to less divergent growth patterns across member states in 2013, as the standard deviation of the sample in domestic currency recorded its lowest value in more than 15 years. Still, pronounced corrections continued in a few countries, especially in Slovenia, Portugal, Spain, Hungary and Latvia.

The successive yearly contractions in the EU27 occurred despite significant easing in interest rates in many markets over the last few years. Gross disposable income of households, which is one of the main drivers behind households’ demand, and housing prices, which can affect both demand and supply of loans, have had strong effects on the dynamics of household debt since 2007.

Considering household debt-to-GDP ratios, long-term comparisons between the different groups of countries composing the EU27 show that no convergence was observed across these groups and across EU27 countries in the years preceding the financial crisis. However, partly as a result of the 2008-09 financial crisis and its long-lasting effects, strong convergence was registered across EU27 countries between 2007 and 2013.

Regarding non-financial corporation (NFC), the outstanding debt decreased again in 2013 in both the EU27 and the euro area. In 2013, the correction intensified in nominal terms in both the EU27 and the EA17, but slowed down in real terms in comparison with 2012. At end-2013, outstanding NFC real debt in the EA17 and the EU27 was respectively 12.2% and 13.4% below the pre-crisis level of end-2007.
1. **Another yearly contraction in the EU household real debt in 2013**

At end-2013, in real terms, the total amount of outstanding household debt contracted for the third consecutive year in both the EU27 and the euro area (-1.1% and -1.2%, respectively). All in all, indicators point to less divergent growth patterns across member states in 2013, as the standard deviation of the sample in domestic currency recorded its lowest value in more than 15 years. Still, pronounced corrections continued in a few countries, especially in Slovenia (-4.4%), Portugal (-4.6%), Spain (-5.8%), Hungary (-5.8%) and Latvia (-7.9%) (see Chart 1).

**Chart 1.** Total outstanding household real debt in 2013  
(in domestic currency, annual variation, in %)

Sources: ECRI and CEPS.

Some sectors in specific countries registered significant variations in 2013 and their evolution noticeably affected the development in total EA17 household credit. Regarding consumption credit, significant contractions occurred notably in France, Germany, Italy and Spain, whose cumulative contribution to the total household real debt in the EA17 stood at -0.5 pps in 2013. Within the housing loans segment, deleveraging dynamics were observed in Italy, Portugal, the Netherlands and Spain, contributing -0.9 pps to total EA17 household debt. By contrast, housing loans in Belgium, France and Germany remained robust positive contributors.

Over the 2007-13 period, total household debt trends varied widely across countries and over time (see Chart 2). Retail markets grew markedly in five new member states (Cyprus, the Czech Republic, Malta, Poland and Slovakia) and in two EU15 member states (Luxembourg and Sweden) and, to a lesser extent, in Austria, Belgium, Bulgaria, Finland, France, Italy, Romania and Slovenia. On the other hand, household real debt contracted in Denmark, Estonia, Germany, Greece, Hungary, Ireland, Lithuania, the Netherlands, Portugal, Spain and the UK.

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1 “pps” stands for percentage points.
Chart 2. Total outstanding household real debt in 2013 (in domestic currency, 2007 = 100)

Sources: ECRI and CEPS.

2. Convergence of European household debt-to-GDP ratios since 2007

In line with 2012, in the EU27, the total household debt to household disposable income ratio (DIR), which partially mirrors the sustainability of household debt, the total debt to GDP ratio (GDR) and the total debt to final consumption expenditure of household ratio (FCR) decreased somewhat in 2013. Once put in an historical context, the three ratios were slightly above their 2007 levels in the euro area; however, in the EU27, the (DIR) and the (FCR) stood below their value recorded in 2007, reflecting primarily the marked decreases recorded in the UK over the 2007-13 period.

Chart 3. Household debt-to-GDP ratios (in %, unweighted averages)

Notes:
EA Periphery: Greece, Ireland, Italy, Portugal and Spain.
EA Core: Austria, Belgium, France, Germany and the Netherlands.
EU27: All EU27 member states excluding Cyprus, Hungary, Latvia, Lithuania, Slovenia, Slovakia and Sweden.
NMS12: All new member states excluding Cyprus and Latvia.
Source: ECRI.
Long-term comparisons between the different groups of countries composing the EU27 reveal that the GDR observed in the pre-crisis years moved along strong upward paths in the NMS12, the euro-area periphery and the group including Denmark, Sweden and the UK (see Chart 3). GDR also increased in the euro area, albeit at a much slower pace. Overall, no Beta-convergence\(^2\) or Sigma-convergence\(^3\) was observed across these groups or across EU27 countries\(^4\) in the years preceding the financial crisis.

However, partly as a result of the 2008-09 financial crisis and its long-lasting effects, strong Beta-convergence and Sigma-convergence were registered across EU27 countries between 2007 and 2013. The majority of the economies with very high GDRs in 2007 (i.e. above 55%), such as Germany, Ireland, the Netherlands, Spain and the UK, recorded significant contractions in their GDRs in 2013, while most countries with moderate levels in 2007 (i.e. between 25% and 55%) have observed rising GDRs in 2013: Belgium, Finland, France, Greece, Italy, Luxembourg and Malta.

Regarding non-EU economies, the US GDR has been much above the EU27 over the last 16 years, especially before the financial crisis of 2008-09. The (GDR) differentials between the US and the EU27\(^5\) peaked in 2007 to reach 46 pps. However, the transatlantic (GDR) gap has narrowed significantly since 2007, due notably to the GDP growth gap between both economies, as the US economy grew by about 4.5 pps. more over the period (2007-13), and the higher charge-off rates in the US.\(^6\)

### 3. Contraction in household debt in recent years despite significant easing in interest rates

Different macroeconomic factors could explain the evolution of retail loans for households in recent years. The amounts of consumption loans, housing loans and other loans are the result of a confrontation between the demand for retail loans from households and the availability of these financial products on the banks’ side. Gross disposable income of households is likely to be one of the main drivers behind demand, while the level of interest rates typically reflects the availability of retail loans.

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\(^2\) Beta-convergence refers to a process in which the lower the GDR in the initial point of time for a given country, the higher is its rate of growth. As a result, countries with low GDRs should catch up with countries with high GDRs in the long run. The methodology used here to measure Beta-convergence estimates a simple growth equation in the following form:

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\Delta y_t^\gamma = \alpha + \beta y_0^\gamma, \text{ where } \Delta y_t^\gamma \text{ is the growth in pps in the (GDR), } y_0^\gamma \text{ is the initial value of the (GDR), } \alpha \text{ is an intercept and } \beta \text{ indicates the speed of convergence. A negative relationship between the growth rate } \\
\Delta y_t^\gamma \text{ and the initial level } y_0^\gamma, \text{ i.e. } \beta \text{ is significant and negative, which is the sign of a convergence process.}
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\(^3\) Sigma-convergence is the decrease of the dispersion of (GDR) between the economies considered. A necessary condition for the existence of Sigma-convergence is the existence of Beta-convergence, not necessarily the opposite, meaning Beta-convergence could be found without finding Sigma-convergence.

\(^4\) The EU27 sample contains all EU27 member states, excluding Cyprus, Hungary, Lithuania, Latvia, Slovenia, Slovakia and Sweden (these countries have been excluded due to a lack of data)

\(^5\) These differentials are based on the weighted average of the EU27.

\(^6\) The US recorded higher charge-off rates as a result of the flexibility of their bankruptcy laws which combine ‘no recourse’ mortgages and faster bankruptcy procedures.
Last but not least, housing prices can affect retail loans through the demand and the availability of loans, since both borrowers and lenders will consider housing prices when getting involved in a loan. Rising house prices are likely to boost the average value of housing loans and to affect consumption and other loans through diverse channels: since housing is a major component of households’ wealth, rising house prices may stimulate consumption by increasing households’ perceived wealth, or by relaxing borrowing constraints.

In 2013, in the EU27, there was no significant correlation between the outstanding value of household debt and the different potential economic factors. However, by considering the 2007-13 period, disposable income of households and housing prices did have a strong effect on the value of households’ loans, with correlations of 29% and 34%, respectively.

Regarding the availability of loans, the representative interest rates of each credit market did not seem to have any noticeable effect on the corresponding market dynamics in the long run. The continuous cuts in retail interest rates in recent years in numerous markets could not reverse downward trends in outstanding values of retail loans.

4. Significant deleveraging continues in the non-financial corporation segment

Outstanding non-financial corporation (NFC) debt decreased again in 2013 in both the EU27 and the euro area. In 2013, the correction intensified in nominal terms: the debt contracted by -4.4% in the euro area and -4.3% in the EU27, up from respectively -3.9% and -3.1% in the previous year. The decrease slowed down in real terms in comparison with 2012 (-5.0% in 2013 vs. -6.0% in 2012 in the euro area and respectively -4.6% vs. -5.6% in the EU27). Nevertheless, at end-2013, outstanding NFC real debt in the euro area and the EU27 was respectively 12.2% and 13.4% below the pre-crisis level of end-2007. In 2013, real contractions in domestic currency were recorded in 20 EU27 member States, down from 24 in the previous year.

In line with 2012, most new member states recorded a real contraction in 2013. Among the five largest markets, Italy, Spain and the UK heavily dragged down the EU27 real stock, with a cumulative negative contribution of -3.4 pps. Compared with 2007, the levels registered in 2013 differed substantially across member states and the contributing countries can be roughly divided into three groups. The first group includes five countries with NFC real debt much above their 2007 levels in 2013 (above +15%): Bulgaria, Cyprus, Finland, Poland and Romania. Within the second subclass, moderate variations were recorded over the 2007-13 period (between -15% and +15%): Austria, Belgium, the Czech Republic, Denmark, France, Germany, Greece, Italy, Luxembourg, Malta, the Netherlands, Portugal, Sweden and Slovakia. Finally, the third group contains countries with significant corrections (more than -15%): Hungary, Ireland, Latvia, Slovenia, Spain and the UK.

The EU27 breakdown of NFC real debt by remaining maturity shows that the overall decrease of NFC real debt between 2009 and 2011 mainly reflected the sharp contraction in short-term funding, while long-term funding contributed to the continuous decrease in the total debt only from 2012 (see Chart 4). Short-term funding is typically more sensitive towards the economic cycle than long-term loans and, therefore, it does not come as a surprise that the loans with short maturities declined abruptly as a response to the economic recession of 2009.

Although the gross fixed capital formation of NFCs, which is partly funded through long-term loans, also declined significantly in 2009 and fluctuated at low levels in 2010-11, outstanding long-term loans were maintained at broadly the same level, perhaps owing to significant
refinancing. However, long-term funding declined noticeably in 2012-13, partly as a result of the lagged effects of the sovereign debt crisis, continuous tightening of lending standards (as confirmed by the results of the ECB Bank Lending Survey) and growing alternative sources of funding.

**Chart 4.** Credit to non-financial corporations in the EU27, by maturity
(in euros, in real terms, 2007 = 100) (in euros, in real terms, in billions of euros)

*Note:* The sample for the EU27 contains Austria, Belgium, the Czech Republic, Germany, Denmark, Estonia, Greece, Finland, France, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, the Netherlands, Poland, Portugal, Romania, Sweden, Slovenia and Slovakia (i.e. 76.9% of the total in the EU27 in 2013)

*Source:* ECRI.