



## DEVELOPMENTS IN HOUSEHOLD LENDING AND INTEREST RATES ON NEW LOANS TO HOUSEHOLDS

Ing. Ján Beka, Národná banka Slovenska

The development of the credit market has in recent years been characterized by relatively dynamic growth in household lending.<sup>1</sup> This has also been reflected in a gradual increase in the indebtedness of Slovak households, as well as in interest payments as a share of household disposable income. Since loans for house purchase account for most of the growth in household lending and indebtedness, we will pay greater attention to them, in terms of both their growth and interest rates. Part of the article also focuses on the regional structure of lending growth.

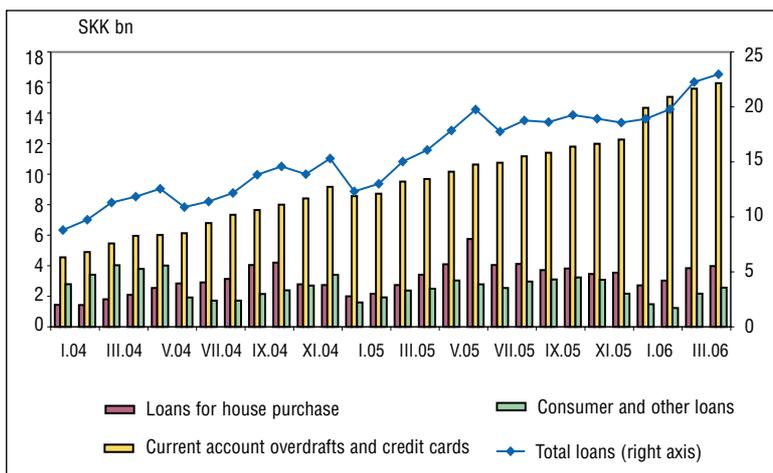
### The volume of loans provided to households is rising significantly

The dynamic development in household lending continued in the first four months of this year. Over that period, the banking sector provided almost SKK 84 billion household loans (the figure for the same period in the previous year was more than SKK 56 billion), and the largest lending volume was recorded in April (SKK 23 billion). These loans comprise mostly current account overdrafts and credit cards<sup>2</sup> (for the period January to April 2006, their share averaged 73%, compared with 65% for the same period of the previous year), which are mostly used either to bridge over a temporary shortage of household funds (current account overdrafts) or as interest-free household lending for a certain period (credit cards). A high share of current account overdrafts

<sup>1</sup> The credits evaluated in the text are all denominated in Slovak koruna except for the evaluation of credits according to region; likewise, interest rates are only given for Slovak koruna credits.

<sup>2</sup> In order to have better interpretation and consistency of the time series and to eliminate errors resulting from methodological changes in the reporting of individual loan types, loans were classified into five categories: 1) current account overdrafts and credit cards, 2) loans for house purchase, 3) consumer loans and other loans, 4) investment and operational loans (this category is not evaluated here given the specific use of such loans mainly by sole traders for business activities), and 5) non-performing loans (nor are these evaluated here – only "good" loans are analysed).

Chart 1 Monthly amount of new loans granted according to loan purpose



Source: NBS.

and credit cards was recorded mainly in the first two months of the year. The increase in the provision of these credit products is probably related to the relatively dynamic growth in household income and expectations that future economic development will be favourable. As a share of total lending in the first four months of 2006, consumer loans and other loans fell to below 10%. This development may indicate that the administratively-intensive and time-consuming process of obtaining consumer and other loans is giving ground to current account overdrafts and credit cards, although only in certain specific cases (relatively low amounts and more frequent payments). The volume of loans for house purchase shows a slightly rising trend and an element of seasonality, with fewer loans provided during the winter months. Their average share of total lending for the first four months came to 16% and declined slightly year-on-year.

### Loans with a floating rate and an initial rate fixation of up to one year continue to have a high share

There continues to be a preference for household loans with floating interest rates or with interest rates fixed for up to one year or up to five years. It is important to follow the fixing of interest rates, especially on loans for house purchase, given that the volume of

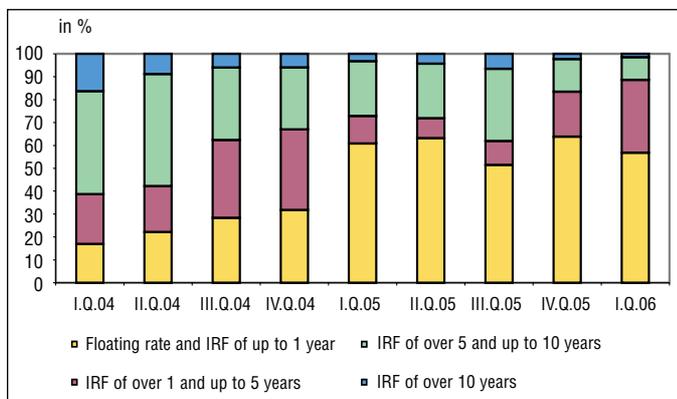


these loans is relatively high and is provided for a longer time period. This means that an interest rate change has, in nominal terms, a greater effect on the amount

of interest payments on loans for house purchase than on loans provided for consumption purposes. Since the beginning of 2005, more than half of the loans provided for house purchase have had a floating rate or an initial rate fixation (IRF) of up to one year. In the last two quarters, the share of loans with an initial rate fixation of over 1 and up to 5 years increased, which may also have been influenced by expectations of an increase in key interest rates of the NBS and/or by a slight increase in long-term rates (yield on 10-year government bonds).

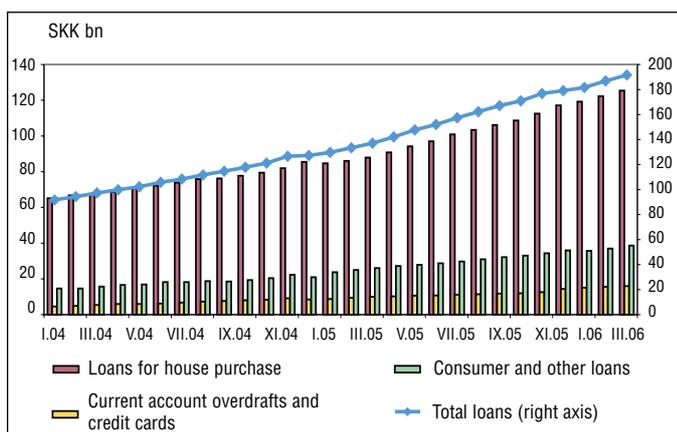
The trend in favour of floating rate household loans has been developing since 2000, mainly in EU countries. When a bank provides a floating rate loan, it transfers part of the risk to the client. For the bank, this is more advantageous than to provide a fixed rate loan and bear the entire risk over a long-term horizon.

**Chart 2 Shares of individual fixations of new loans for house purchase to households**



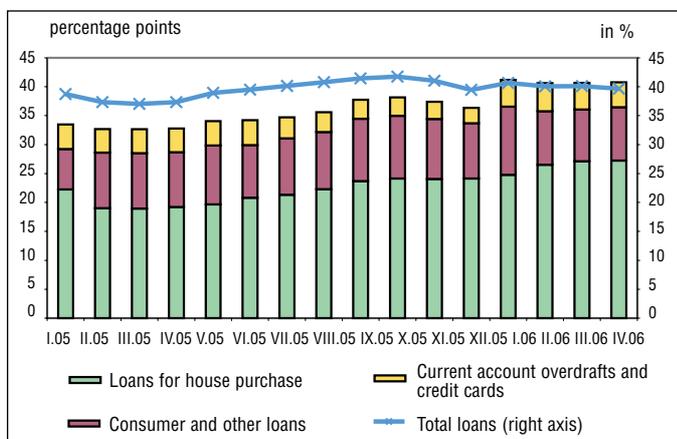
Source: NBS.

**Chart 3 Monthly outstanding amount of loans according to loan purpose**



Source: NBS.

**Chart 4 Year-on-year growth in household lending and the contribution of individual lending categories to overall growth**



Source: NBS.

Note: The difference between the year-on-year growth in total loans and the contributions to growth is accounted for by the category of investment and operational loans and non-performing loans.

### Outstanding loans continue to grow

The increasing volume of loans provided to households (new contracts concluded) is reflected in the amount of outstanding loans to households (and thus in the indebtedness of households). As at the end of April 2006, the outstanding loans to households denominated in Slovak koruna totalled almost SKK 192 billion, representing a year-on-year increase of 40%.

Loans for house purchase are recording the fastest growth (in April, they increased year-on-year by more than SKK 37 billion). Their share is relatively stable at approximately 65%. Consumer and other loans contributed to credit growth (a year-on-year increase of more than SKK 12 billion) as well as current account overdrafts and credit cards (their outstanding amount rose year-on-year by almost SKK 6 billion). The high volume of provided current account overdrafts and credit cards was not significantly reflected in the amount of outstanding loans.

### Lending dynamics the same as last year

Together with the relatively stable year-on-year growth in lending (40%), the contribution of loans for house purchase to the overall growth is rising slightly. Although loans used to finance consumer spending (current account overdrafts, credit cards, consumer loans and other loans) are increasing in absolute terms, their share in overall lending growth has not changed (between 12 and 16 percentage points in individual months).

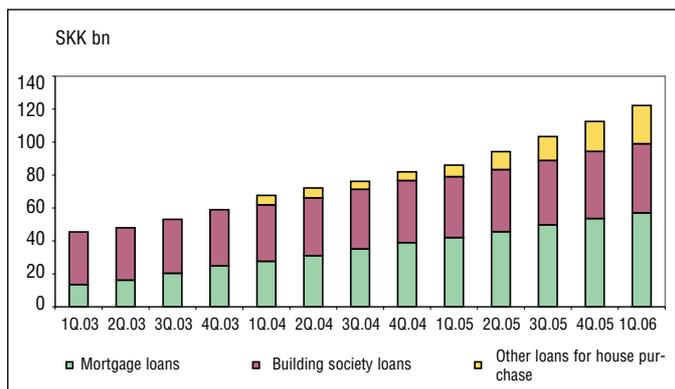


### Loans for house purchase to households

The development of loans for house purchase to households continues to be determined mainly by new products that certain banks are offering instead of mortgage loans (other loans for house purchase) and the continuing interest in mortgage loans. The outstanding amount of loans for house purchase increased in the

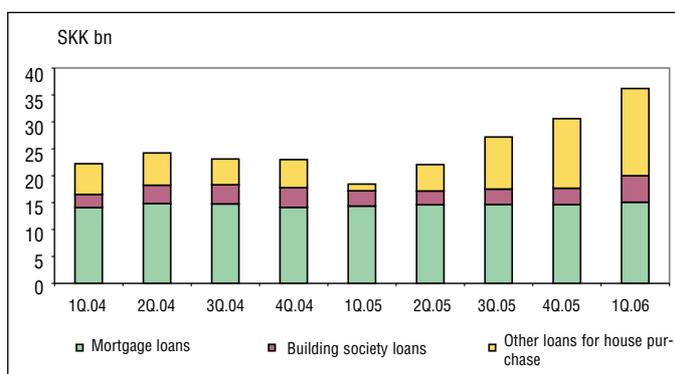
first quarter of 2006 by SKK 36 billion year-on-year with the category of other loans for house purchase rising by SKK 16 billion, mortgage loans by SKK 15 billion and building society loans by SKK 5 billion. The first quarter shows a slight increase in building society loans (especially intermediate loans) and dynamic growth in other loans for house purchase.

**Chart 5 Outstanding amount of loans for house purchase to households**



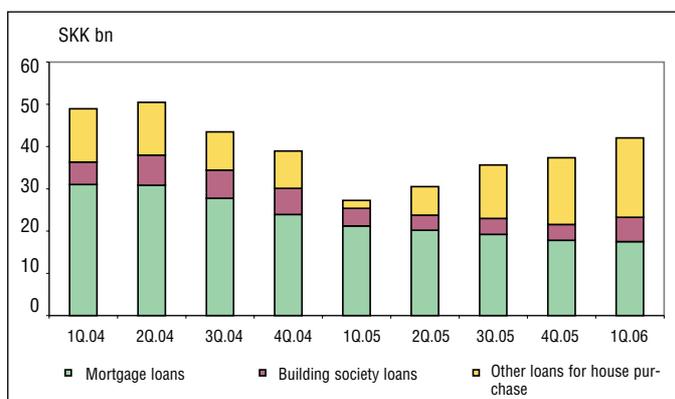
Source: NBS.

**Chart 6 Absolute year-on-year changes in individual types of loans for house purchase**



Source: NBS.

**Chart 7 Contributions of individual loan types to total growth in loans for house purchase to households**



Source: NBS.

Other loans for house purchase accounted for the largest share of the growth in house purchase lending to households in the first quarter of 2006; their contribution to total house purchase lending growth rose to almost 19 percentage points. Mortgage loans contributed with approximately 18 percentage points to the house purchase lending growth continuing a downward trend from 2004 and 2005. Building society loans in the first quarter recorded the largest contribution to total house purchase lending growth since 2004 (almost 6 percentage points).

### Household indebtedness

Household debt measured as a share of the outstanding loans to households and household disposable income increased by 4.6 percentage points in 2005 to stand at 21%. Although, on the one hand, the nominal disposable income of households rose in 2005 (by 9%), on the other hand, the rapid growth in household lending continued (it represented more than 40% year-on-year).

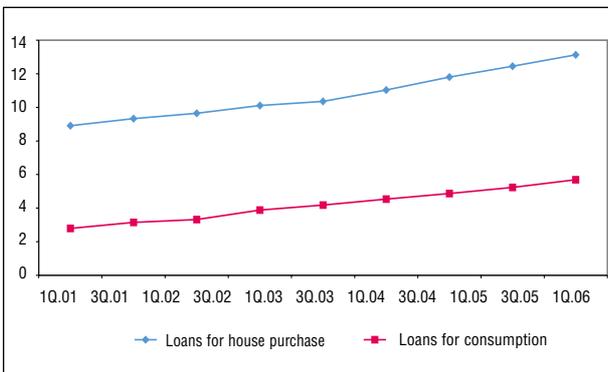
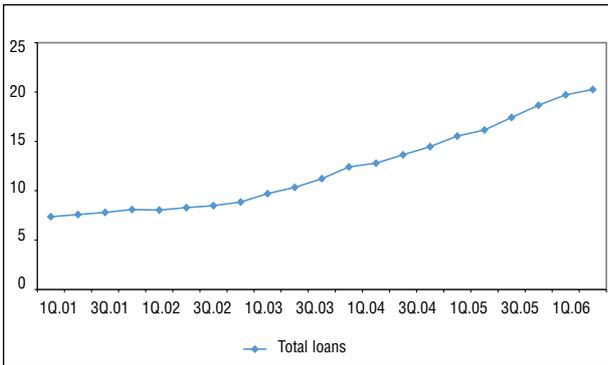
Household interest payments recorded a more substantial increase in 2005, caused mainly by the dynamic growth in lending, especially house purchase lending, in the context of a slight decline in interest rates. Interest payments as a share of household disposable income increased over the course of last year by 0.26 percentage points, to stand at 1.32%.

### Household lending in individual regions in 2005

As regards total lending in Slovakia broken down by region, Bratislava region maintained its dominant position in 2005 with a share of 60%, although this share fell by 3 percentage points over the course of the year. The high share, as well as absolute growth, of the balance of household loans in Bratislava region is related primarily to higher real estate prices (since house purchase lending makes up a majority of household lending) and to above-average incomes in comparison with other regions.

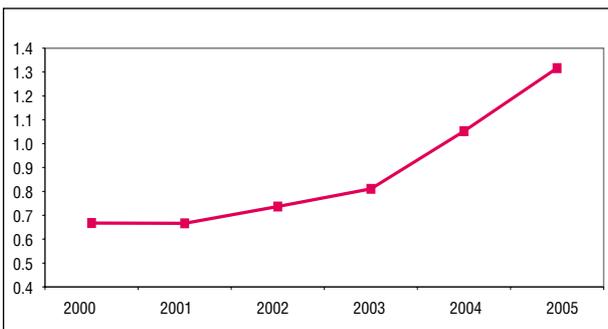


Chart 8 Outstanding amount of household loans excluding NISHs<sup>1)</sup> as a percentage of household disposable income



Source: NBS, Statistical Office of the SR.  
 Note: Loans for consumption include consumer loans, other loans, current account overdrafts and credit cards.  
 1) NISHs – non-profit institutions serving households.

Chart 9 Household interest payments as a percentage of household disposable income

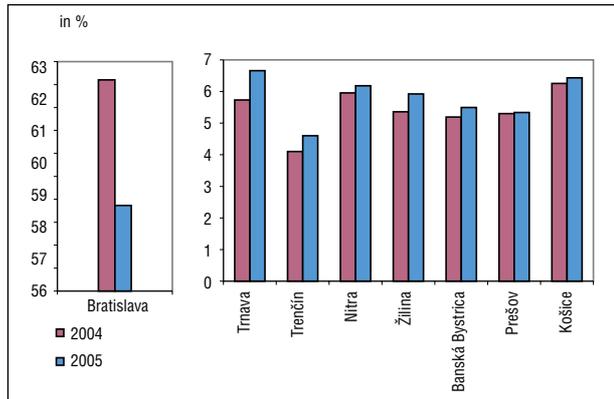


Source: NBS, Statistical Office of the SR.

The outstanding loans in Bratislava region increased by SKK 27 billion in 2005 (compared with an increase of approximately SKK 14 billion in 2004), which represented almost 53% of total lending growth in 2005 (39% in 2004). In other regions, the increase in the outstanding loans ranged from SKK 2.8 billion (Prešov region) to SKK 4.6 billion (Trnava region).

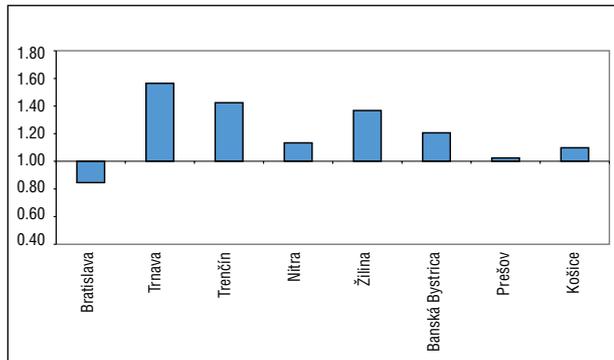
Another important fact is that in all regions except Bratislava, the increase in the outstanding loans was greater than the average for the whole of Slovakia. This is related, however, to the low credit base in individual

Chart 10 Share of household lending by region in 2004 and 2005



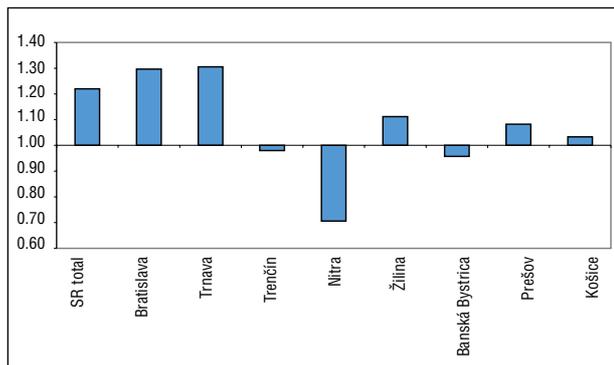
Source: NBS.

Chart 11 Household lending growth in individual regions in comparison with lending growth in Slovakia in 2005



Source: NBS.

Chart 12 Household lending growth in individual regions in ratio to its average growth in the years 2002 – 2005



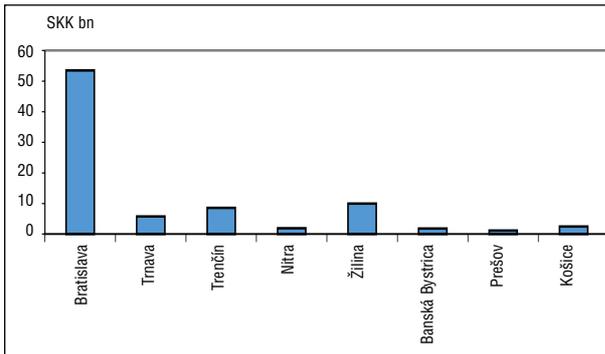
Source: NBS.

regions, where the scope for more dynamic lending growth is greater than in Bratislava region.

Comparing lending growth in individual regions in terms of the ratio to its average growth during the period 2002 to 2005, the largest increases were recorded in Trnava region (131% of the average level for the given period) and Bratislava region (130%). On the other hand, growth in the outstanding loans in compa-

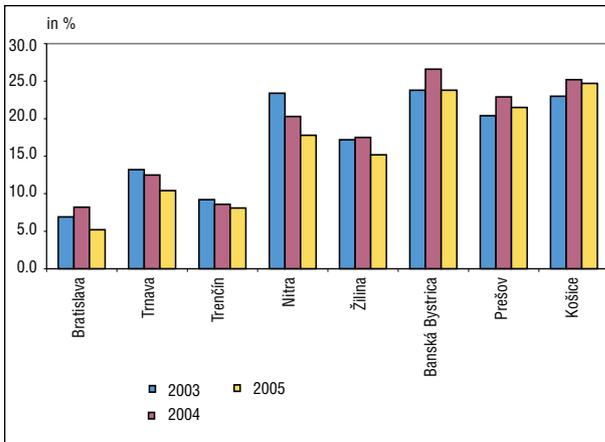


Chart 13 FDI inflow by region for the years 2003 to 2005



Source: NBS.

Chart 14 Unemployment rate by region



Source: Statistical Office of the SR.

risation with the average for 2002 – 2005 was slowest in Nitra region (71%).

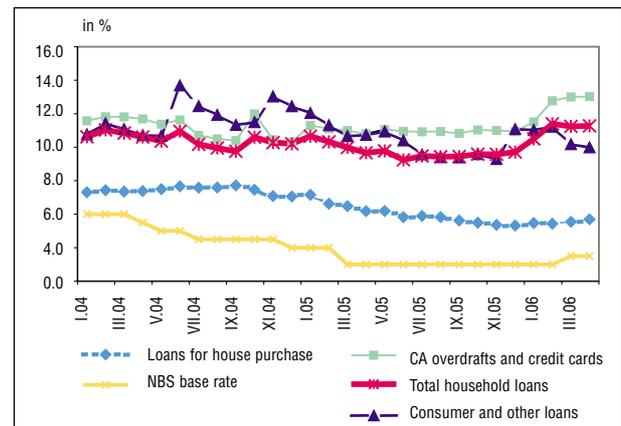
The high pace of lending growth in all regions except Bratislava continued the trend of 2004 though with not such intensity. Over the course of 2005, the balance of household loans increased most sharply in relative terms in Trnava, Trenčín and Žilina regions, i.e. in the regions which have in recent years attracted the most foreign investors. On the one hand, this development is probably related to the increasing disposable income of households and expectations for favourable future development; on the other hand, it may also be affected by the increase in real estate prices in these localities. The inflow of foreign direct investment (FDI) in these regions is creating new job opportunities, a fact that has started to be reflected in gradually falling unemployment (according to VZPS).

### Moderate rise in interest rates on household loans at the beginning of 2006

The long-term trend of cuts in NBS key interest rates and their lowest ever level in 2005 also affected the development of client interest rates and stimulated hou-

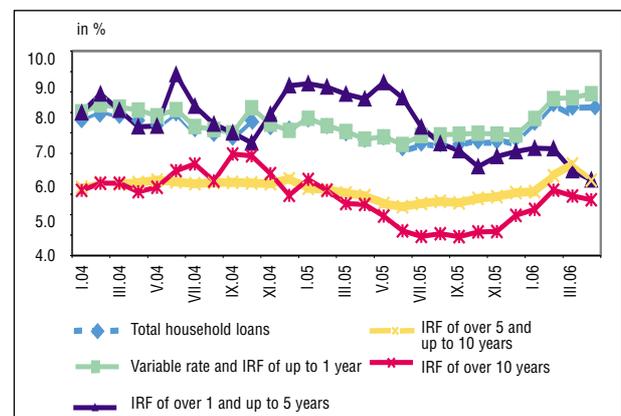
sehold demand for loans (especially loans for house purchase). Despite the slight increase in interest rates in the first two months of 2006 in particular owing to expectations for NBS key rate rises, household interest in credit products continued. With effect from 1 March 2006, the NBS raised key rates by 0.50 of a percentage point (the subsequent increase in NBS key rates at the end of May 2006 could not have affected the interest rates under review), and it is likely that this has already been passed through to client interest rates, in particular the rates on current account overdrafts and credit cards. Overall, the interest rate on household lending increased in April 2006 by 1.6 percentage points in comparison with December 2005 and also year-on-year. As regards individual loan types, the interest rate on current account overdrafts and credit cards recorded the most significant increase (by 2.1 percentage points in April in comparison with the end of 2005 and by 2.2 percentage points year-on-year). On the other hand, the interest rate in the category of consumer and other loans has been showing a noticeable trend of slight growth since the beginning of the year.

Chart 15 Interest rates on new household loans



Source: NBS.

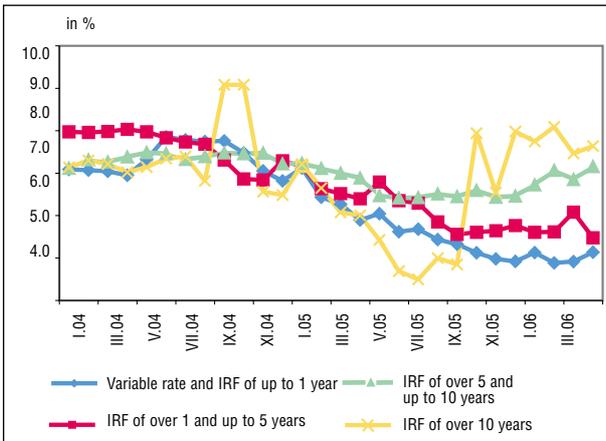
Chart 16 Interest rate on new household loans according to the initial rate fixation



Source: NBS.



Chart 17 Interest rate on new loans for house purchase to households according to the initial rate fixation



Source: NBS.

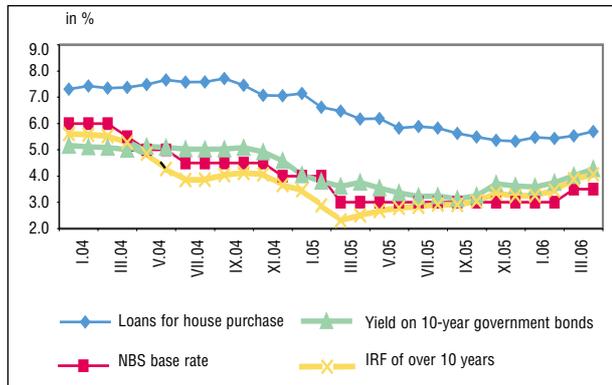
Despite expectations for an increase in NBS key rates at the beginning of the year and the subsequent rise in the rates, the reflection of these facts in interest rates on loans for house purchase and on consumption loans was very slight, probably owing to competition in the banking sector. It should be added, however, that the first months of 2006 saw interest rates on loans for house purchase come to the end of a more than year-long decline and record moderate rise.

### Increase in interest on loans for house purchase, especially with long-term fixed rates

Regarding the fixing of rates, the interest rate continued to increase on "short-term" loans (without fixing and with an IRF of up to 1 year) and on "long-term" loans (with an IRF of over 5 and up to 10 years and with an initial rate fixation of over 10 years) from the end of 2005. By contrast, interest on loans with an IRF of over 1 and up to 5 years declined. Mainly the loan purpose and loan volume affects the fact that loans with long-term fixed rates are subject to lower interest rates than loans without fixed rates. On the one hand, current account overdrafts and credit cards, which charge higher interest, are included among loans without fixed rates. On the other hand, low-interest loans for house purchase account for a high share of loans with long-term fixed rates.

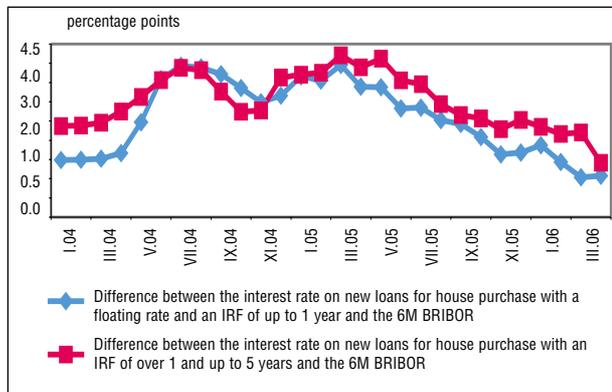
Among loans for house purchase to households, the interest rate for loans with an IRF of over 10 years increased markedly, reflecting expectations from the end of 2005 for interest rates rise. In the first quarter also saw smaller increase in the interest rate on loans for house purchase with an IRF of over 5 and up to 10 years. Interest rates on loans for house purchase without fixed rates, or with a short fixed rate period, have

Chart 18 Development of interest rates on new loans for house purchase to households, the NBS base rate, 6M BRIBOR, and the yield on 10-year government bonds



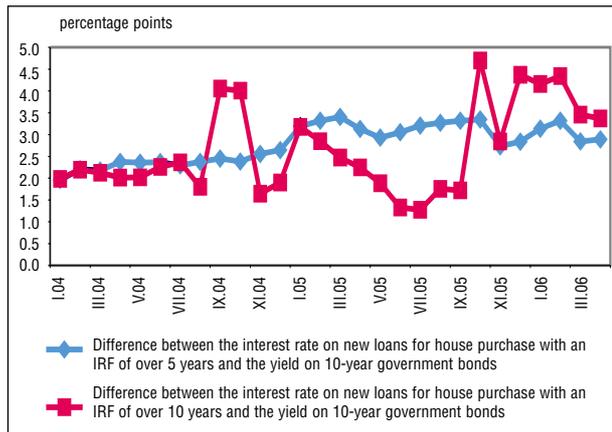
Source: NBS.

Chart 19 Risk premium on new loans for house purchase to households



Source: NBS.

Chart 20 Risk premium on new loans for house purchase to households

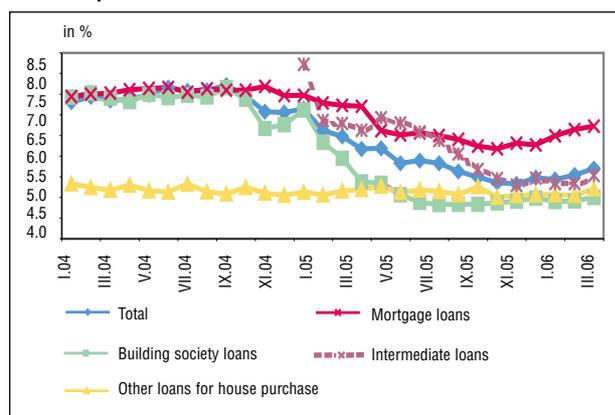


Source: NBS.

so far hardly changed at all, probably owing to the competitive environment in which banks are willing to provide loans for house purchase even at low interest and at the expense of their margin. Since these loans have a floating rate, or a short fixed rate period, banks may adjust the rate substantially following the expiration of



**Chart 21 Interest rate on individual types of new loans for house purchase**



Source: NBS.

the fixed rate period or according to the market conditions. Interest rates on loans for house purchase to households with an IRF of over 1 and up to 5 years did not increase significantly as a consequence of the low interest on fixed-rate intermediate loans.

The rise in NBS key rates and the expectations for their further development have been reflected in market rates. The increase in market interest rates (yield on 10-year government bonds and the 6M BRIBOR) from the end of 2005 and from the beginning of 2006 has so far been reflected only in interest rates on loans for house purchase to households with longer fixed rates.

An opposite trend has recently been prevailing in house purchase lending with various fixed rates. On the one hand, the risk premium<sup>3</sup> has declined for short-term rates (the difference between client interest rate for a loan with a variable rate and an IRF of up to 1 year, or of over 1 year and up to 5 years, and the 6M BRIBOR). On the other hand, the risk premium has increased for long-term rates (the difference between a loan with an IRF of over 5 and up to 10 years, or of over 10 years, and the yield on 10-year government bonds). As banks lure clients with various marketing offers of low interest rates on loans for house purchase, thus making credit conditions appear very favourable (especially for loans without fixed rates or with short-term fixed rates), there has already been a substantial tightening of credit conditions for loans with a longer fixed rate period.

The interest rate on loans for house purchase has increased slightly in recent months after a long down-

ward trend. Among individual types of loans for house purchase to households, the interest rise has been most notable with intermediate loans and other loans for house purchase. The interest rate on building society loans has also increased moderately, whereas the interest rate on mortgage loans continues to stagnate, though with an indication of slight growth.

## Conclusion

The long-standing dynamic growth in household lending also continued at the beginning of this year. This development reflects mainly the persisting environment of low interest rates. From the viewpoint of loan purpose, loans for house purchase are maintaining their dominant position. In comparison with the previous period, when mortgage loans were the main contributor to lending growth, other loans for house purchase have been assuming significance since the second half of 2005. Such loans are not tied to the issue of mortgage bonds and they may therefore be provided on a more flexible basis.

From the regional view, Bratislava region accounts for the largest share of lending. This is related mainly to the economic performance of the region, and also with the specific position of Bratislava as the capital city of Slovakia. Other regions, in particular Trnava, Trenčín and Žilina, are also recording dynamic lending growth. They are the regions that have in recent years been the destinations of the majority of FDI, and at the same time they are reporting the lowest rate of unemployment (after Bratislava region) and with a downward trend.

The favourable environment characterized by relatively low interest rates has stimulated lending developments. Since the end of 2005, however, there has been a gradual increase in lending rates – especially for current account overdrafts and credit cards. Consumer and other loans have also recorded a slight increase, as have loans for house purchase. As regards loans for house purchase, there is clear upward movement in interest rates, especially for longer fixed rates. The rates with short fixed rates, or with none at all, have not yet risen and their level represents an attractive option for clients. With these loans, however, the client must expect the risk of higher interest rates after the stipulated time.

<sup>3</sup> The risk premium represents the credit risk, which banks undertake within the credit relationship with clients (households); it may be approximated as the difference between the market rates provided to households and the market interest rate with a similar maturity at which the bank may obtain funds on the financial market.