Survey-based assessment of household borrowers' financial vulnerability

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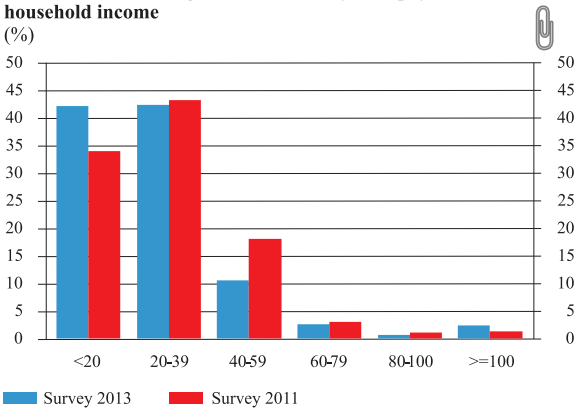
In 2013 Latvijas Banka carried out a survey of household borrowers (a sample of 1 002 households which had at least one housing loan) to get an insight into their financial situation. A similar survey was also conducted in 2011. Based on survey data, household financial vulnerability and ability to cover household expenses and loan payments have been assessed using the financial margin methodology. The financial margin shows a household's remaining income after the deduction of debt servicing costs and basic living expenses. Households are considered solvent (SHs) if the financial margin is nonnegative and vulnerable (VHs) if it is negative.

According to the survey, 10.2% of household borrowers can be considered VHs (the household has solvency problems) and the share of liabilities of these households constitutes 12.7% of the credit portfolio for house purchase. Part of household borrowers still find it very difficult to balance their expenses and income, but overall household income has increased over the past two years. Slow improvements are observable compared to the first survey – 11.2% of household borrowers could be considered VHs in 2011. Furthermore, in 2011 the average ratio of monthly loan payments to total income was 31%, while in 2013 it was 29%, indicating that the household debt burden had decreased (see Chart 1).

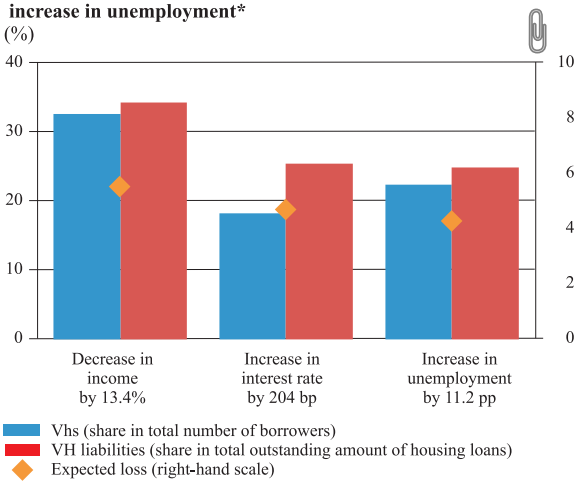
Chart 1
Distribution of average ratio of monthly loan payments to total household income



Source: Latvijas Banka.

Although household borrowers are rather vulnerable to various unfavourable macroeconomic shocks and this vulnerability has decreased only slightly during the last two years, the possible losses related to their solvency have become more moderate for lenders. This has been facilitated both by the real estate price growth over the past years and a decrease in the housing loan stock. Household borrowers can still be considered as rather vulnerable to shocks of declining income and increasing interest rates but less vulnerable to shocks of rising unemployment rates (see Chart 2). A relatively minor decrease in income or an interest rate rise would cause a faster expansion of the share of VHs than a minor increase in unemployment. Moreover, it would cause a need for credit institutions to increase provisions for delinquent loans. Nevertheless, credit institutions' expected losses due to shocks would still be limited.

Chart 2
Household sensitivity to income decline, interest rate increase and increase in unemployment*



* The chart shows household sensitivity to isolated shocks that are equivalent to maximal changes in the respective variables that have been observed (over a year).
Source: Latvijas Banka.

The rise in interest rates has a more pronounced effect on households with large credit. This is supported by the fact that the growth rate of the share of loans of VHs in the total outstanding amount of housing loans is faster than that of the share of the number of VHs, with interest rates increasing. Meanwhile, household sensitivity to an increase in unemployment within a year is moderate due to the assumption that in the event of a loss of job all persons employed receive unemployment benefits.

For further information see the discussion material "Survey-based assessment of household borrowers' financial vulnerability" on the website of Latvijas Banka:

http://www.bank.lv/images/stories/pielikumi/publikacijas/petijumi/DM_1-2014-arins-sin-laube_final_062014.pdf.