Discussion note

NÁRODNÁ BANKA SLOVENSKA
EUROSYSTÉM

What is behind the recovery of consumer loans?

The consumer credit market experienced a significant recovery in the past period. Although the portfolio of consumer loans began to gradually grow from the beginning of 2022 after a two-year decline (2020 - 2021), the growth rate accelerated in 2023. While in 2022 it was mainly a post-pandemic recovery, in 2023 the production of new loans even exceeded the pre-pandemic level. In the context of rising interest rates, this may sound somewhat paradoxical. In this note, we will therefore take a closer look at what is happening in the consumer credit market today.

Although consumer loans are accelerating their growth, their risk characteristics are not getting worse. The increase in production is mainly due to higher inflation, which motivates people to speed up their purchases.[1] Households also perceive that after two years of falling real wages, their situation is starting to improve again, which increases this motivation even more.

Let's look at some facts first:

- **The growth rate of consumer loans[2] gradually accelerated during 2023, reaching 7.4% as of December.** The last time we saw such growth in consumer loans was over five years ago.[3] If current gains are maintained, it will not be a surprise if growth exceeds 9% in the coming months.
- **Production of new debt increased by 11% year-on-year,** mainly due to an increase in the volume of new consumer loans. The top-up of refinancing loans increased only slightly.

The increase in production was the main, but not the only, factor in the acceleration of the growth rate of consumer loans. An important role was also played by the lower rate of refinancing of consumer loans into mortgage loans, the so-called consolidation into mortgages. Its volume in 2023 was approximately a third lower than the long-term average (for 2019-2022). A lower volume of net write-offs and sales of bad loans also contributed to the faster growth of the consumer loan portfolio, although compared to the previous two factors, this factor was less significant.[4]

The production of new loans increased mainly due to a larger number of newly granted loans. Although a natural reaction to higher inflation could be a growing average amount of loans provided, we do not see such a trend in the data. On the contrary, the average amount of consumer loans granted in 2023 decreased slightly compared to 2022. This means that demand for consumer finance is growing, which is reflected in more loans being granted.

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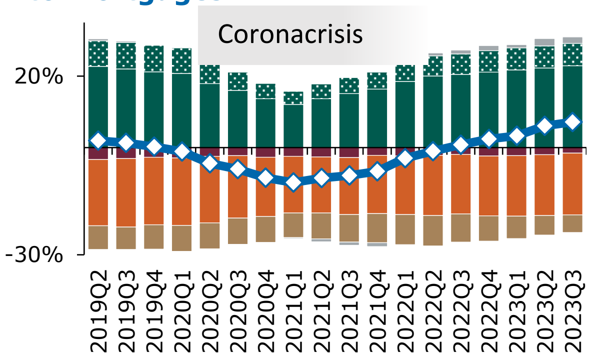
[1] This influence of inflation is also confirmed by the conclusions published in the article Marenčák, M. (2023): "State-dependent inflation expectations and consumption choices", Working paper 10/2023, Národná banka Slovenska.

[2] In this note, we consider consumer loans to be loans granted by banks to finance consumption, i.e. j. loans that are not intended to finance the purchase or construction of real estate, nor are they secured by real estate. Current account overdrafts, credit cards, bridging loans and loans provided by non-banking companies (including leasing) are also not included. However, the development of the volume of overdrafts and credit cards shows similar trends - their volume began to grow from the second quarter of 2021, although during 2023 they showed a rather slight decrease.

[3] The last time the year-on-year growth of consumer loans was above 7% was in October 2018 (7.4%).

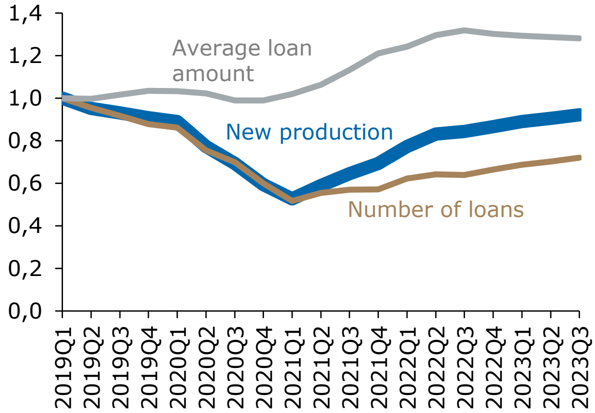
[4] The share of individual factors contributing to the increase in the average growth of the consumer loan portfolio for 2023 compared to 2022 is as follows: an increase in the production of new debt contributed by 45%, a decrease in the volume of consumer loans refinanced with mortgages contributed by 37%, and a decrease in write-offs and sales contributed by 22%.

Chart 1 The growth of consumer loans accelerated thanks to higher production, but also lower consolidation into mortgages



Source: NBS.

Chart 2 The increase in production in 2023 was mainly associated with the growing number of newly granted loans



Source: NBS.
Notes: The values in each quarter show the average for the period of the previous four quarters. The chart shows the index, with the value for the 1st quarter of 2019 corresponding to the value of 1.

An opposite trend to mortgages

The increase in the production of consumer loans contrasts sharply with the development of mortgages, where production fell by a third. While the demand for mortgages decreased, it remained stable for consumer loans, and even increased, according to several banks.

Interest rates increased for both types of loans, but clients felt it much less for consumer loans.[5] While for a representative newly granted mortgage the repayment increased by almost half, for consumer loans only by approximately 6%.[6]

As a result, consumer loans now account for almost a third of the increase in the retail portfolio,[7] the highest share in the past 10 years. It is true that in the past, some consumer financing could also be realized by top-ups of existing mortgages at the time of their refinancing. With the decrease in demand for mortgages, and especially for their refinancing, this way of financing consumption also faded away. Hence, to a certain extent, the current growth in consumer loans may also be due to the fact that consumers finance their consumption more with traditional consumer loans than by topping up their mortgages.[8] The difference between the interest rates on consumer loans and mortgages has decreased significantly,[9] so clients are more considering the additional administrative costs when increasing the mortgage (e.g. for valuation and mortgaging the real estate collateral). Topping up a mortgage before the refixation date, which was common in the past, would also today lead to an increase in the interest rate on the entire mortgage, which would make the additional loan significantly more expensive. Overall, however, the current recovery in the consumer credit market cannot be directly considered as compensation for the slowdown in mortgage top-ups, as the structure of clients is different.[10]

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[5] Interest rates on new consumer loans rose from 7.9% to 9.7% from January 2022 to December 2023.

[6] If a client applied for a consumer loan of € 5 000 (the average amount of newly granted consumer loans) with a maturity of 7.5 years (the volume-weighted average of the maturities of newly granted consumer loans), the increase in the interest rate from 7.9% to 9.7% meant an increase in the monthly installments from €74 to €78 (i.e. by 6%). On the other hand, if the client applied for a mortgage in the amount of € 90 000 (the average amount of newly granted mortgages) with a maturity of 24 years (the volume-weighted average of the maturities of newly granted mortgages), an increase in the interest rate from 1.0% to 4.5% meant an increase in the monthly payment from €352 to €512 (i.e. by 45%).

[7] The share of consumer loans in the overall increase in the retail portfolio reached 31% in the period from August to November 2023. The share of consumer loans in new production was even higher (for the third quarter of 2023: 36%).

[8] In some cases, it can also be a compensation for lower demand for new mortgages.

[9] While in March 2022, the difference between the average interest rate when increasing mortgages and the average interest rate on consumer loans in the amount corresponding to a normal increase in mortgages (€10,000 to €50,000) was at the level of 5.4 p.p., by September 2023 this difference was reduced to 4.0 p.p.

[10] The highest contribution to the increased production of new consumer loans is made mainly by loans granted to clients who already have certain debts, but in a relatively small amount (not exceeding twice their annual income, i.e.

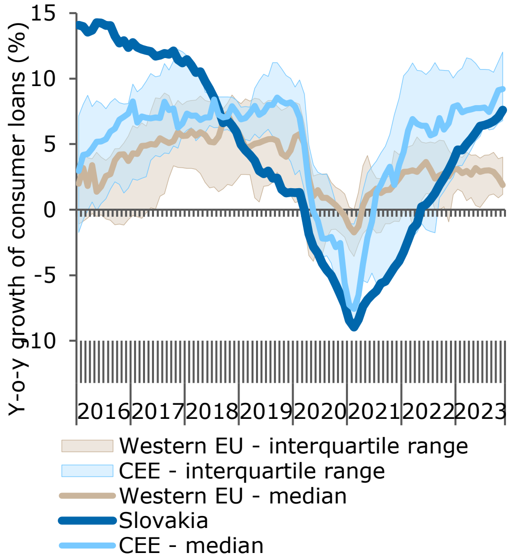
How is it elsewhere in Europe?

If we look at other countries, the said growth is nothing special. This is especially true in the Central and Eastern EU (CEE) region, where most countries are growing even faster.

Faster growth is generally associated with higher inflation. Consumer loans are growing faster in the CEE region than in the Western EU. However, this difference also corresponds to the different levels of inflation, which has been higher compared to the Western EU.

However, in the CEE region itself, the differences between countries in the growth of consumer loans are quite significant. For example in the Baltics, consumer loans are growing relatively quickly, although interest rates there are higher than elsewhere in the region. In Hungary and Poland, on the other hand, growth is lower, despite higher inflation. Different specificities of individual countries may be behind these differences. For example, in some countries, lower compensations for the increase in energy prices could lead to a higher need to finance investments in increasing energy efficiency.

Chart 3 The revival of the consumer credit in Slovakia is significant, but the growth rate continues to lag slightly behind the CEE region



Source: ECB.

Two stories

There could be two distinct motivations behind the higher growth of consumer loans in Slovakia. They differ significantly especially in terms of their impact on financial stability.

- The first of them can be described as **"buy before it's too late"**. As inflation has exceeded interest rates on new consumer loans over a prolonged period, there is an increasing incentive to buy some types of goods sooner with credit, rather than later without credit but at a higher price. In addition, the demand for consumer credit is reinforced by the development of the financial situation of households, which has picked up again in recent months.
- The second motivation could be **"if your income is too low, take a loan"**. Consumers who faced a decline in real incomes could seek to partially offset this shortfall through consumer financing. However, unlike the previous one, this motivation can lead to an increase in the riskiness of consumer loans provided.

The better of the two options

It seems that although both of these stories can be behind the revival of consumer credit production in Slovakia, the first one seems to prevail. This is good news from a financial stability perspective for the riskiness of the consumer loan portfolio.

The risk parameters of newly granted consumer loans are not deteriorating. This is particularly evident in the following three areas:

- **Rising interest rates do not increase the repayment burden on households.** While the share of new loans with a debt service to income ratio close to the regulatory limit has doubled for mortgages over the past two years, it remains stable for consumer loans.[11]

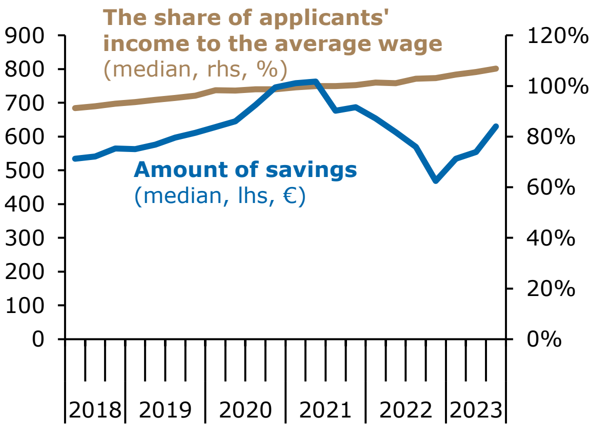
the DTI (debt-to-income) indicator does not exceed the value of 2). The share of new consumer loans granted to clients with a DTI > 2 is approximately a quarter, while the share of clients with a DTI > 2 is up to two-thirds for mortgage top-ups.

[11] The share of new loans or loans for refinancing with a top-up with debt service to income ratio exceeds 55% (the regulatory limit is 60%), increased from 18% to 37% for mortgages from December 2021 to September 2023, but has remained stable for consumer credit for a long time at approximately 34%. The maturity of new consumer loans also has remained stable (on average approximately at the level of 5 years).

- **The share of debtors with a lower income is not growing.** On the contrary, the median income of clients is growing faster than the average wage in the economy. In the recent period, this growth has accelerated even more. Today, most consumer loans are granted to clients with an above-average income. It can be assumed that the growing share of clients with a higher income is related to the effort to speed up their purchases, while the opposite trend would point to the effort to maintain necessary consumption with a lower income. The share of middle-aged and older clients is also growing.
- **Loans were not increasingly provided to clients with low savings.** On the contrary, in 2023, loans were granted to clients with increasingly higher savings. While in 2022 the savings of applicants were lower than in the past, in 2023 they returned to their long-term average.

Moreover, the increase in the production of consumer credit is happening at a time when average real household incomes are starting to grow again. [12] **This development is also reflected in expectations of a more favorable financial situation on the part of the households themselves.** According to the household survey, during 2023 the ability to finance essential expenses has improved significantly. At the same time, households are gradually increasing their interest in large purchases. Higher demand for loans due to the purchase of durable goods was also identified by some banks.

Chart 4 In 2023, consumer loans were provided to clients with increasingly higher incomes and higher savings



Source: NBS.
Notes: The chart shows a moving average for a period of three quarters of seasonally adjusted values. Savings express the amount of funds held only in the bank that granted the loan.

Chart 5 Households perceive an improvement in their financial situation and increase their interest in large purchases

Source: European Commission.
Note: The values are in p.p.

Conclusion

Behind the acceleration of the growth rate of consumer loans is not only higher production, but also a lower rate of consolidation of consumer loans to mortgages. The increase in production is primarily motivated by higher inflation, i.e. j. the need to finance the purchase of goods that are becoming more expensive as soon as possible. **From the point of view of financial stability, it is important that the revival of consumer loans comes at a time when the financial position of households begins to gradually improve again.**

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[12] While real household income fell by 4.0% between June 2021 and September 2023. According to the NBS winter medium-term forecast, it should return to the level before this decline by the end of 2024. Behind the positive development of real income is not only the favorable development of wages on the labor market, but also several supporting fiscal policy measures.