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THE EXPANSION OF CONSUMER CREDIT IN ITALY AND IN THE EURO AREA: WHAT ARE THE DRIVERS AND THE RISKS?

by Silvia Magri*, Valentina Michelangeli*, Sabrina Pastorelli*, Raffaella Pico*

Abstract

Since 2015 consumer loans have been rising fast in France, Germany, Italy, and Spain. Credit demand, specifically for consumer durables, has played a crucial role; the easing of supply conditions has been relevant only in Italy and Spain, which experienced stronger credit tightening during the past crises. Risks stemming from the growth of consumer credit are mitigated by its lower incidence, compared with mortgages, on households' total debt and income; exposure to interest rate risk is also decreasing due to the high share of fixed-rate contracts. There is wide risk heterogeneity across countries, with Italy and Spain having the highest share of delinquent households (even for less than 90 days). In Italy, however, debt is increasingly concentrated among more affluent households, which are better able to withstand negative economic shocks; this trend is sustaining the drop in the ratio of *new* non-performing consumer loans.

JEL Classification: D12, D91, E32, G21, I32.
Keywords: consumer loans, credit demand and supply, non-performing loans.

Contents

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1. Introduction

Since 2015 consumer credit has been increasing at a remarkable pace in the euro area. During 2018 the annual growth rate exceeded 7 per cent and was very similar to that observed in 2005-06, before the financial crisis. The vigorous expansion was common to the main euro-area countries, namely France, Germany, Italy, and Spain. In the second part of the year signs of deceleration appeared.

Consumer credit expansion has been analysed in European Central Bank reports (ECB Economic Bulletin 2017, ECB Financial Stability Review, 2017 and 2018), mainly focusing on the aggregate trends observed at the euro-area level. This study aims to investigate consumer credit dynamics in distinct euro-area countries where consumer loans are increasing fast, with specific focus on Italy.

In the first part of the paper, the analysis focuses on the drivers of credit growth by evaluating the relative weights of credit demand and supply. Risks arising from consumer credit expansion are then assessed using both macro and micro indicators. Whenever possible, comparable data across euro-area countries are presented; as for risk indicators, a measure of delinquencies taken from the European Union Statistics on Income and Living Conditions (EU-SILC) survey is adopted.

In all countries analysed, consumer loan expansion has been driven mainly by credit demand, specifically for consumer durables expenditure. The larger variations in consumer durables consumption are reflected in those in consumer credit, which is therefore highly procyclical, i.e. its changes tend to be wider than those observed for households' income and consumption through the economic cycles.

The easing of supply conditions played a role only in Italy and Spain, where the credit tightening was by far stronger during the past crises. In these two countries, where interest rates are higher than in other euro-area countries, banks also increased the share of consumer loans relative to total loans granted to the private sector. More specifically, in Italy consumer credit has increased fast mainly among banks with better asset quality.

Risks stemming from consumer credit expansion are mitigated by its lower incidence, compared with mortgages, on households' total debt and disposable income. Exposure to interest rate risk is also decreasing thanks to a larger share of fixed-rate contracts. There is wide risk heterogeneity across countries, with Italy and Spain ranking as the ones with the highest share of delinquencies, even for less than 90 days, according to EU-SILC data. Nonetheless, in Italy there is a clear trend towards an increasing share of consumer credit granted to more affluent households, better able to service their debts; this trend contributed to the reduction in the *new* non-performing consumer loan ratio.

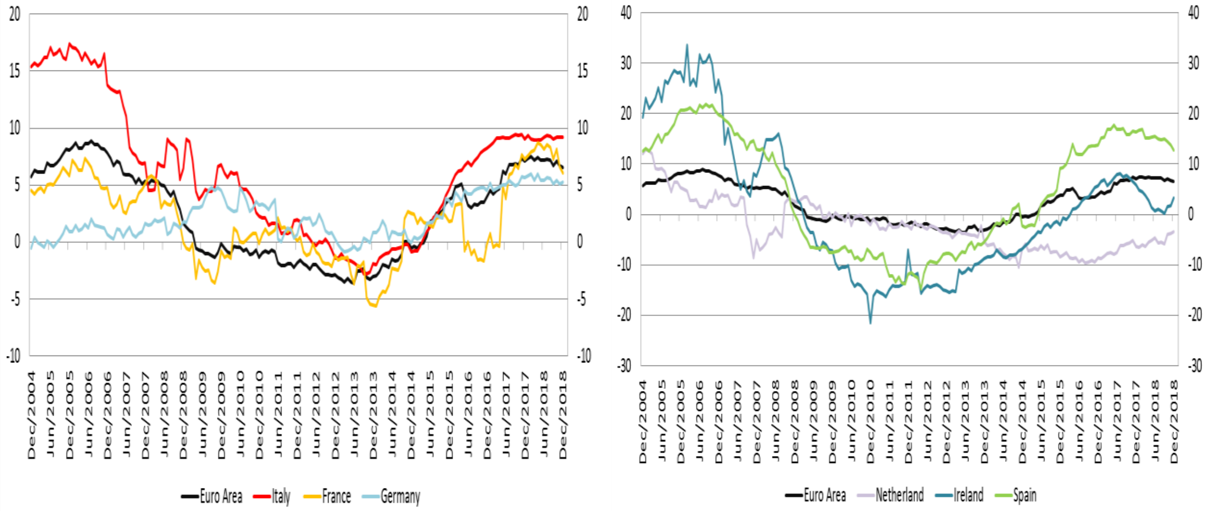
The paper is organized as follow. Section 2 analyses consumer credit dynamics and its drivers at country level. Section 3 is devoted to changes in the supply side of the market, while Sections 4 and 5 evaluate the risks connected with consumer credit expansion. Section 6 focuses on Italy and Section 7 discusses the main findings.

2. The consumer credit expansion and its drivers in the main euro-area countries

The outstanding amount of consumer credit granted by banks has been growing fast in the euro area since 2015.[1] In December 2018 the annual growth was about 7 per cent, very similar to the growth rates observed in 2005-06, before the financial crisis. The expansion was even stronger in Italy and Spain (9 and 13 per cent respectively in December 2018; Figure 1), albeit in these two countries the growth rate was lower compared with the pre-crisis period. In the second part of 2018 signs of deceleration appeared.

Figure 1 – Consumer credit granted by banks

(outstanding amounts, annual percentage changes)



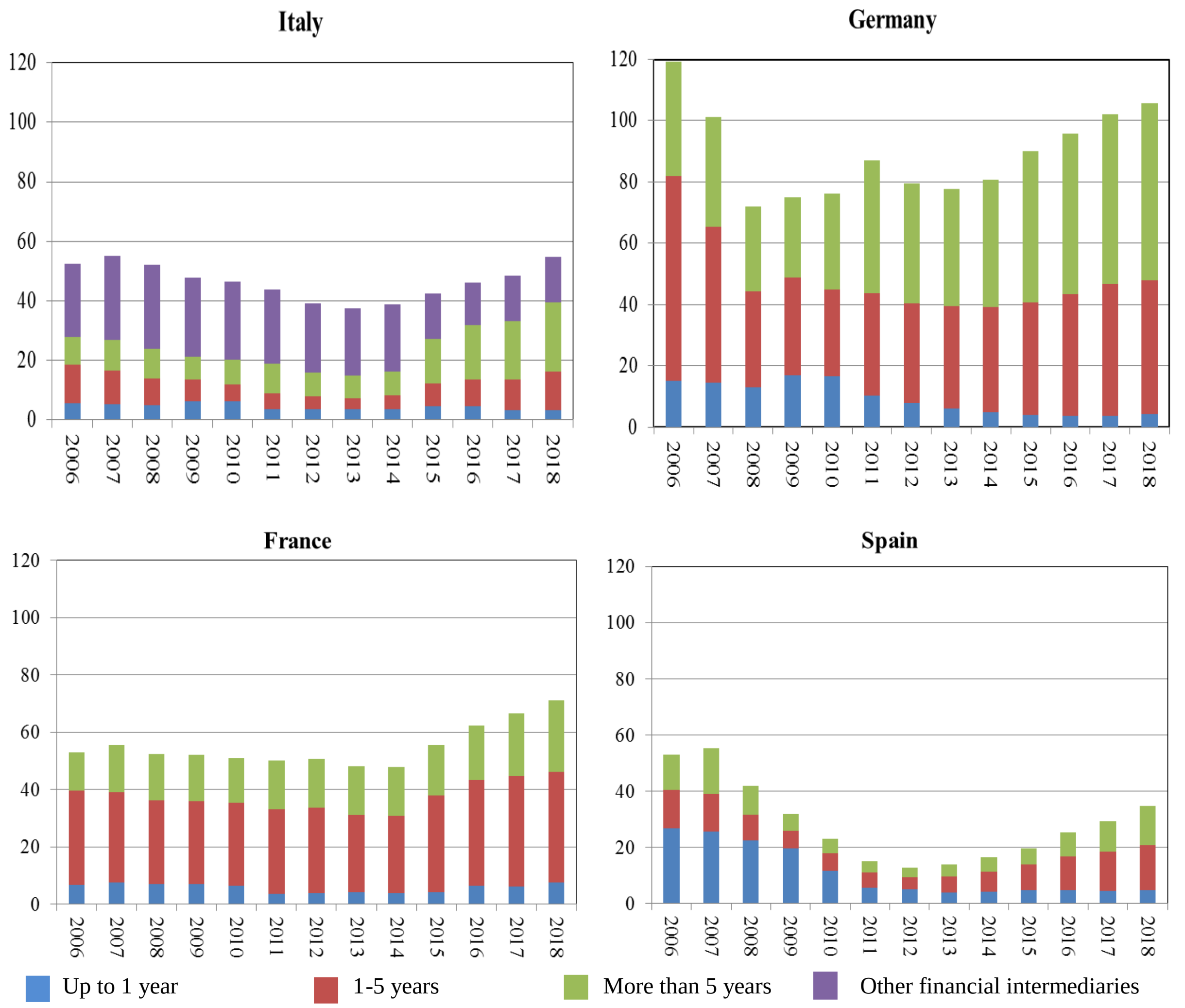
Source: ECB Statistical Data Warehouse. Latest data refer to December 2018. For Italy data include securitized loans and exclude credit granted by financial intermediaries other than banks, which represents about 30 per cent of the market.

The expansion was also strong when looking at the flows of new consumer loans granted by banks. After a lengthy period of contraction (Italy and Spain) or halt (France and Germany), since 2015 new loans have increased markedly in all countries; with the sole exception of Spain, in 2018 they were almost in line with or even above those recorded before the financial crisis, in 2006-07 (Figure 2).

According to the ECB Bank Lending Survey, the expansion in demand for consumer credit (blue line in the left panels of Figure 3) has been an important driver of its growth in all countries analysed. Specifically, consumer durables expenditure and sentiment indicators were the key factors in supporting the demand for consumer loans (Figure A1 in the Appendix). In Italy and Spain supply effects (red line in the left panels of Figure 3) were also at work in sustaining the growth: after a long period of tightened credit conditions, since 2015 financial intermediaries have eased the terms for consumer loans. This trend is much less noticeable in France and Germany.

[1] Consumer loans are granted almost entirely by banks in the main euro-area countries. One exception is Italy, where financial companies play an important, though decreasing, role (see Section 3.2).

Figure 2 – New consumer loans granted by banks by period of interest rate fixation (1)
(EUR billion)



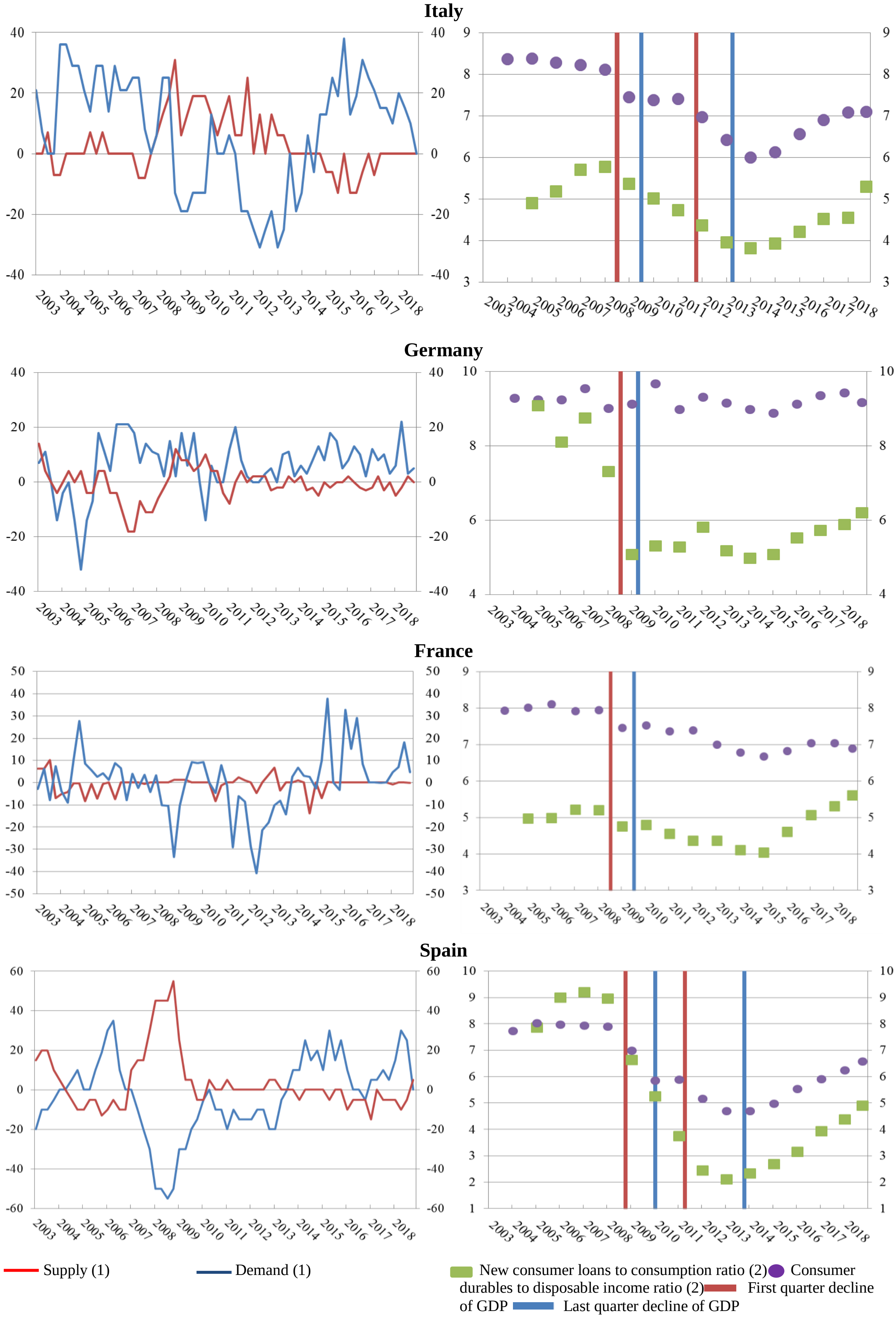
Source: ECB Statistical Data Warehouse, supervisory reports for Italian financial intermediaries. 1) For Italy data refer to new consumer loans granted by banks and other financial intermediaries.

Consumer credit is also strongly procyclical: this is evident when looking at the trend for new consumer loans in comparison with that of households' consumption (Figure 3, right panel green dots; Fig. A2 in the Appendix). In the past years of economic growth, new consumer loans have increased much more than households' consumption in all countries analysed. At the euro-area level, the ratio of new consumer loans to household consumption has risen to 4.6 per cent in September 2018 (3.7 per cent in 2012); this trend has been more pronounced in Spain, where the increase from the trough of 2012 has been almost equal to 3 percentage points. In September 2018, the value of this ratio is similar to the one observed in 2008 for Italy, while it is higher for France and Germany. Only for Spain the new consumer loans-to-consumption ratio remains much lower than the average reached before the financial crisis.

To deepen the analysis on procyclicality, the right panels of Figure 3 show the ratio of new consumer loans to household consumption with that of consumer durables expenditure to household disposable income for each country along the economic cycles.

Figure 3 – Credit demand and supply conditions (left panel) and durable goods and consumer credit during the economic cycle (right panel)

(quarterly and annual data; diffusion indexes and percentages)



Source: Eurostat, ECB Statistical Data Warehouse, Bank Lending Survey. 1) For the demand index, values above (below) zero indicate expansion (contraction); for the supply index, values above (below) zero indicate tightening (easing). 2) Data refer to the end of the year.

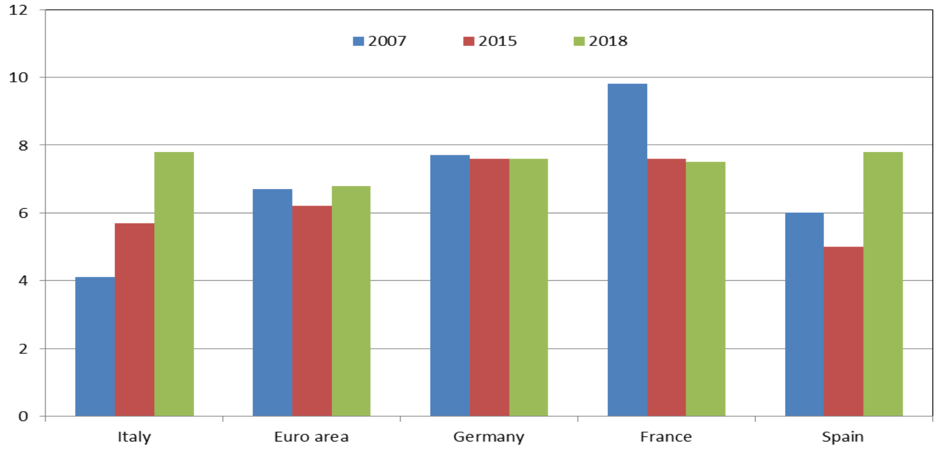
In France, Italy and Spain, the procyclicality of consumer credit (green dots in Figure 3) was mainly due to the large variability in consumer durables expenditure whose changes through the cycles tend to be wider than those of household disposable income (purple dots). Spending on durable goods is hence at the heart of consumer credit dynamics.[2] Households prefer or need to cut these expenditures during negative economic junctures and boost them when the economic cycle turns positive and sentiment indicators improve (Crossley et al., 2013; Dossche and Saiz, 2018). Consumer credit, which is largely used to buy durable goods, moves accordingly, recording remarkable variations.

3. The supply side of the market

3.1 The euro-area countries

In Italy and Spain the easing of supply conditions for consumer loans has mirrored in a significant increase of their share of total bank lending granted to the non-financial private sector. In Italy this ratio, after hovering around 4 per cent for a decade, rose to 7.8 per cent in 2018, above the euro-area average (6.8 per cent) and the level recorded in Germany (7.6 per cent) and France (7.5 per cent; Figure 4);[3] Spain shows a similar trend.

Figure 4 – Ratio of consumer credit to non-financial private sector total loans
(percentages)



Source: ECB Statistical Data Warehouse.

Italian and Spanish banks were attracted to the consumer loan market by the high return on this asset class (Banco de Espana, 2018). Though decreasing, the annual percentage rate applied to new consumer loans is still around 6 per cent in the euro area, with significant differences across the main countries: in Italy and Spain this rate is above 8 per cent, in Germany and France, 6 and 4 per cent, respectively (Figure 5).

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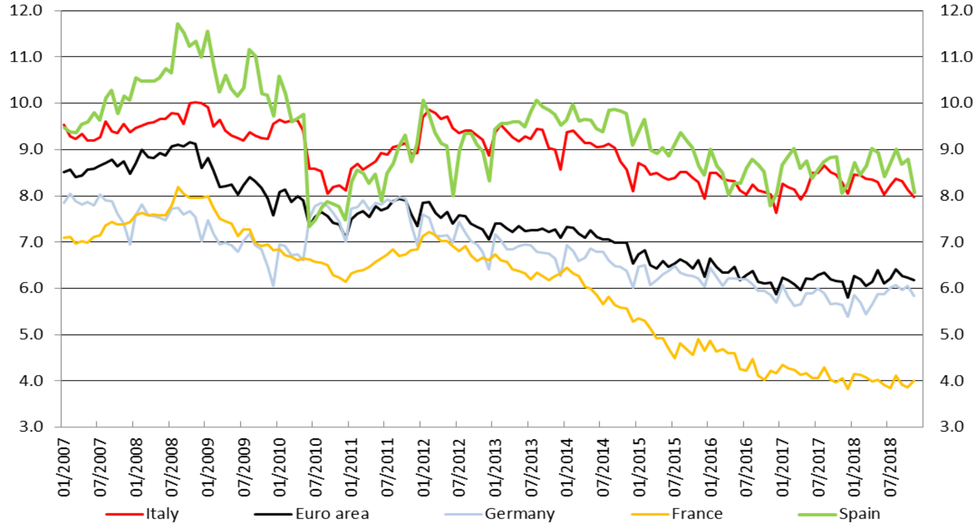
[2] Bertola, Disney and Grant (2006) in reviewing the theory concerning consumer credit devote significant attention to the extension of the basic model to durable goods. Other studies find that procyclical durable consumption expenditures are an explanation for the procyclicality of consumer debt (Iacoviello, 2008; for a review, see Claus and Claus, 2016).

[3] In Italy, by contrast, the share of loans for house purchases, though increasing steadily over the last decade, has remained far below the level recorded on average for the euro-area countries (29 versus 43 per cent of loans to non-financial private sector).

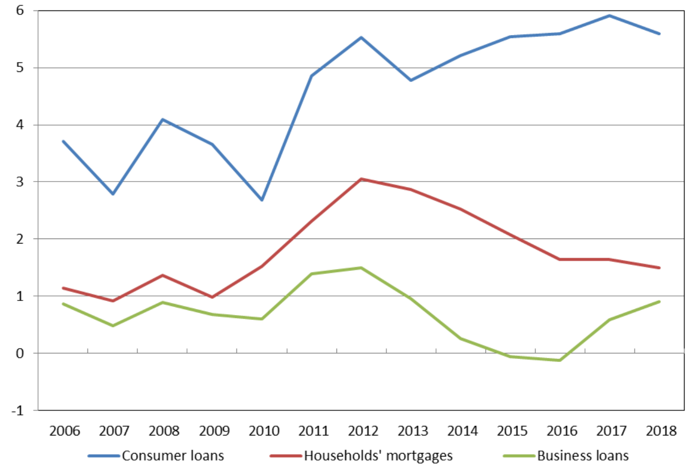
Figure 5 – Annual percentage rate of charge on new consumer loans
(monthly data; percentages)



Source: ECB Statistical Data Warehouse. Annual percentage rate of charge (APRC) includes fees.

As for Italy, we are also able to calculate a credit risk-adjusted interest rate, measured with the new bad loan rate. The evidence is striking: even adjusted for the higher risk of this asset class, partly explained by the absence of collateral, the return on consumer loans is still much higher than those obtained on household mortgages and business loans (Figure 6).

Figure 6 – Risk-adjusted returns on different assets for Italian banks
(annual data; percentages)

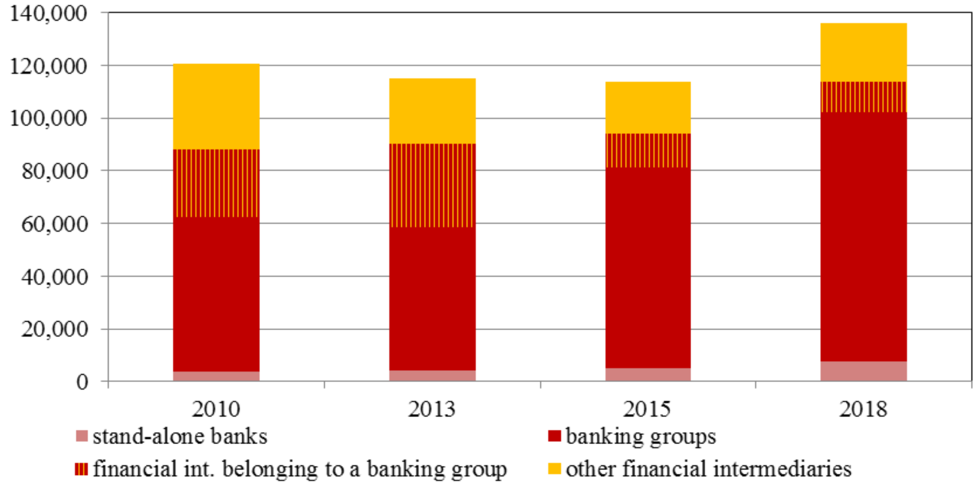


Source: Bank of Italy. The credit risk-adjusted return for the different types of loans is calculated as: APRC – benchmark interest rate – (default rate*loss given default).The default rate is the new bad loan rate for each type of loans.

3.2 The Italian market

The increasing share of consumer loans relative to total loans granted by banks to the private sector in Italy is partly explained by their larger role in this segment of the credit market. During the last five years, banks expanded at the expense of financial companies, raising their market share from 50 to 75 per cent (Figure 7).

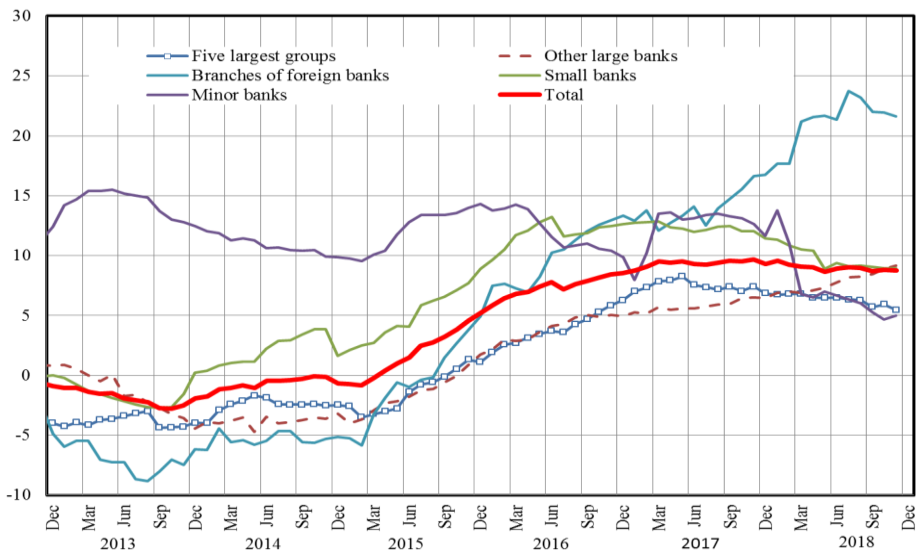
Figure 7 – Consumer credit market in Italy: breakdown by banks and financial companies
(outstanding amounts, EUR million)



Source: Bank of Italy, Supervisory reports.

This structural change is mainly due to the merger by incorporation of consumer credit subsidiaries into bank holding companies and the conversion of financial companies into banks. Factors that fuelled this change include modifications to prudential regulation, reducing the regulatory advantages of financial companies over banks, and greater funding opportunities for banks through access to central bank liquidity-providing operations. Cost savings achieved through the simplification of group governance may have also played a role. Moreover, the opportunities stemming from new information and communication technologies could have increased the incentives for banks to provide a whole package of services (cross-selling) rather than single specialized products, more often offered by financial companies.

Figure 8 - Consumer credit market in Italy: breakdown by bank size
(quarterly data; 12-month percentage changes)

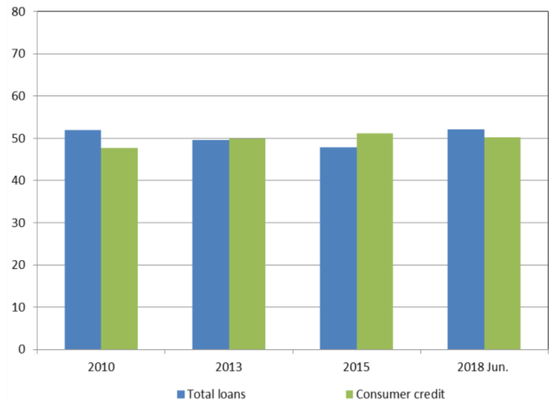


Source: Bank of Italy, Supervisory reports.

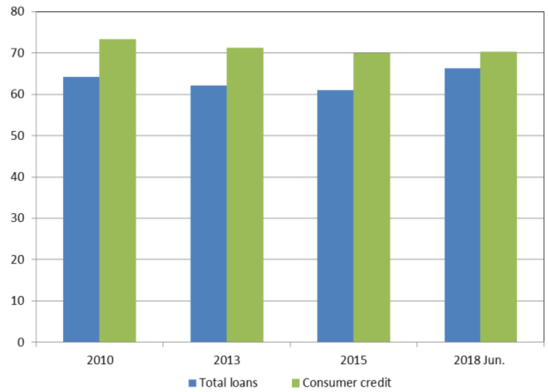
Not all banks contribute at the same rate to the increase in consumer loans. While in 2015-17 growth rates were much higher for smaller banks and branches of foreign banks (more than 10 per cent), in the second part of 2017 and during the first part of 2018 this trend changed. Loans granted by the branches of foreign banks further accelerated, showing double digit growth (more than 20 per cent, Figure 8), while a significant deceleration was observed for smaller banks. For large banks, the rate of expansion has been more stable, less than 10 per cent since 2016: the two major banking groups rank among the top five players in the consumer credit market. Market concentration has remained virtually unchanged over the last five years (Figure 9).

Figure 9 - Consumer credit: market shares of top players
(percentages)

a) Top 5 players



b) Top 10 players

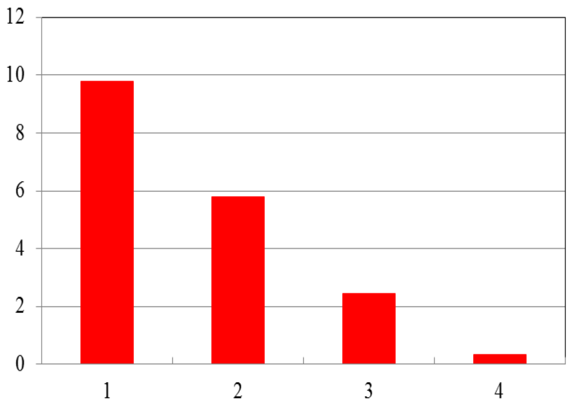


Source: Bank of Italy, Supervisory reports.

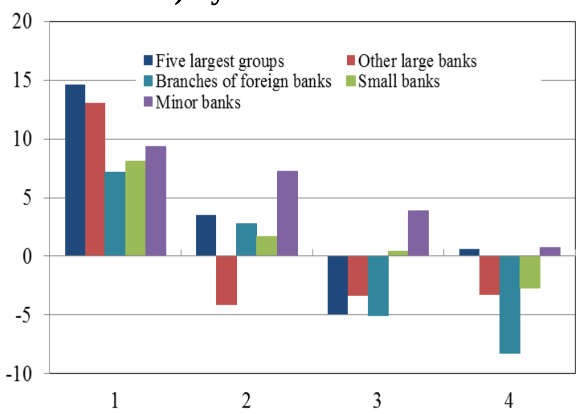
The high margins earned from consumer credit have not attracted the weakest banks into this market. As shown in Figure 10, the highest growth rate in consumer credit is observed for banks with the lowest share of total non-performing loans.

Figure 10 - Consumer credit growth by relevance of total non-performing loans
(median values across quartiles of NPL ratios)

a) total



b) by bank size

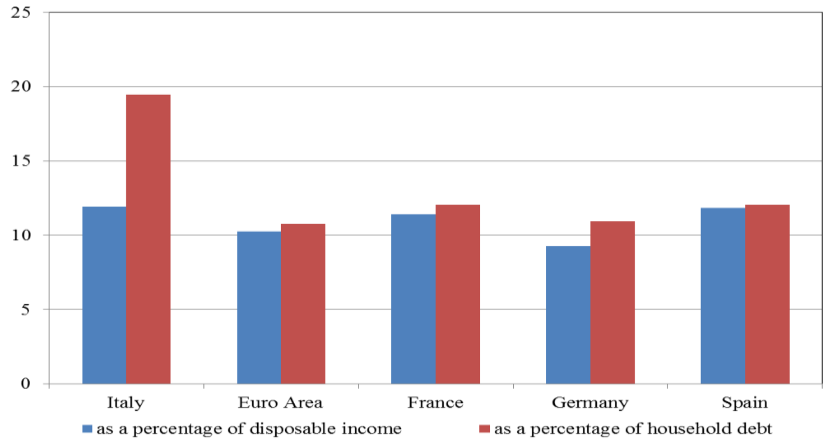


Source: Supervisory reports.
NPLs refer to total loans and NPL quartiles are calculated using data referring to the years 2012 and 2013; consumer credit growth rates are those observed from January 2014 to June 2018.

4. The risks in consumer credit expansion: evidence from macrodata

The vigorous consumer credit expansion has raised concerns about the riskiness associated with this type of credit. In this section, we assess different risk indicators based on macrodata. At macro level one of the mitigating factors most frequently mentioned is that the incidence of consumer credit on household total debt and income is smaller compared with mortgages. Figure 11 shows that for the euro area consumer credit as a percentage of household debt was around 10 per cent in 2018; in Italy it was higher (around 20 per cent) as mortgages are less common here than in other countries. The incidence of consumer loans on disposable income in 2018 was 10 and 12 per cent in the euro area and Italy respectively.

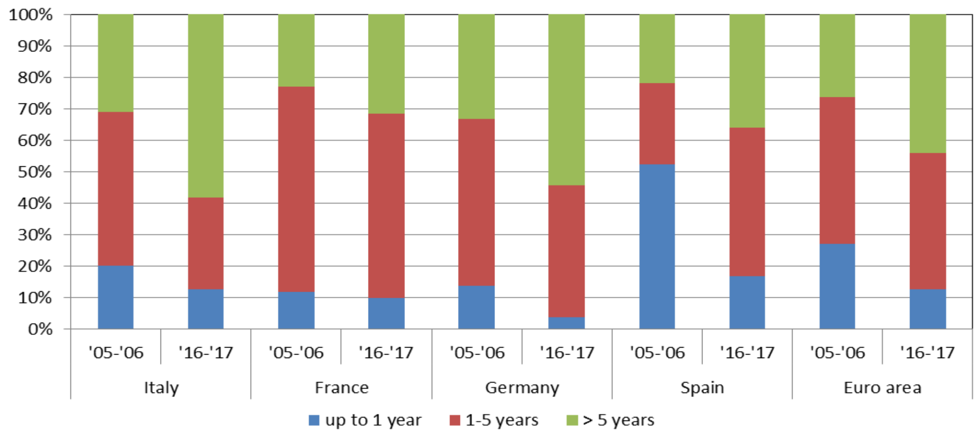
Figure 11 – Relevance of consumer credit
(percentages; 2018)



Source: ECB Statistical Data Warehouse and National Financial Accounts.

Another relevant issue is interest rate risk. The interest component of the monthly repayment of a consumer loan is sizable due to the high interest rates and the lower average loan amount compared with mortgages. In years past, euro-area households exploited the low interest rate environment to reduce their exposure to the risk of future increases in interest rates (Figure 12). In the period 2016-17, the share of new consumer credit with an adjustable rate was around 10 per cent in the euro area (almost 30 per cent in 2005-06); the share was similar in Italy, which also had the highest fraction of loans with rates fixed for a period longer than 5 years (60 versus 43 per cent in the euro area).

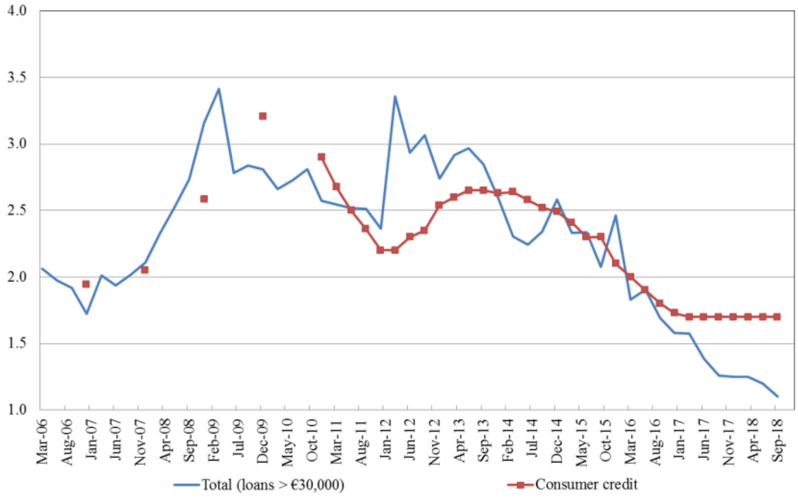
Figure 12 – New volumes in consumer credit by initial period of interest rate
(percentages)



Source: ECB Statistical Data Warehouse, Eurostat.

The ratio of the *stock* of non-performing loans (NPLs) for consumer credit is another synthetic indicator of credit quality. Unfortunately no comparable data are available for distinct euro-area countries, though we can rely on some figures at the euro-area level referring only to the consolidated data of significant banks. In the euro area, the NPL ratio for consumer credit decreased from 10 per cent in 2014, in the aftermath of the financial and sovereign crises, to around 7 per cent in more recent years (ECB, Financial Stability Review, May 2017).

Figure 13 – New non-performing loan rate for the household sector (1)
(percentages)



Source: Credit register for loans to households; Crif Spa for consumer credit.
1) Quarterly inflow of new non-performing loans as a percentage of performing loans in t-4.

For Italy, we are also able to calculate a ratio of *new* non-performing loans (Figure 13), a better indicator of the *current* risk inherent with consumer credit expansion. Unfortunately, this indicator is not harmonized at the euro-area level. In Italy, this ratio has been decreasing since 2014; in September 2018 it was equal to 1.7 per cent, lower than the level recorded before the crises (around 2 per cent). The ratio for loans to households larger than EUR 30,000 shows a similar trend, though it more so captures the dynamic for mortgages.

5. The risks in consumer credit expansion: evidence from microdata

Useful insights into the risks arising from consumer credit can also be obtained using microdata from the EU Statistics on Income and Living Conditions (EU-SILC). We focus on 2008 and 2016 surveys to assess the changes before and after the crises. The analysis is based on the evolution of participation in the consumer credit market, specifically for low-income households, and of delinquency rates in the main European countries.

Table 1 - Households with consumer credit
(percentages)

	Germany		Spain		France		Italy		United Kingdom	
	2008	2016	2008	2016	2008 (2)	2016	2008	2016	2008	2016
Total Sample (1)	22,2	20,8	26,7	19,3	35,3	32,5	14,8	8,4	46,1	41,2
Poor-income HHs	13,8	12,1	19,7	15,8	22,4	22,1	11,3	5,7	33,0	26,9
Poor-income HHs with consumer credit as a % of HHs with consumer credit	11,8	12,1	15,4	17,0	8,4	8,8	14,8	14,1	15,1	11,4
age										
<35	25,0	24,9	35,2	22,6	45,5	36,4	21,0	9,6	54,1	47,6
35-44	31,7	31,9	35,1	26,6	46,7	44,6	21,7	11,5	57,5	53,2
45-54	30,1	27,2	32,8	23,3	45,3	43,1	19,8	11,6	54,2	47,0
55-64	21,9	20,1	24,6	19,9	37,2	34,1	15,0	10,5	43,9	38,1
>65	8,7	9,5	8,4	9,7	13,1	16,7	4,4	3,3	26,5	24,7
education										
middle school or less	16,1	18,2	24,7	17,0	25,2	23,0	12,3	6,5	27,1	34,0
high school	22,7	20,1	32,5	22,6	41,3	35,5	18,5	10,5	51,3	44,7
university	22,8	22,0	26,9	20,8	42,0	36,5	16,9	9,6	52,9	47,6
income quartiles (3)										
1	15,0	12,7	20,2	16,8	25,2	25,0	11,7	6,2	33,6	28,1
2	20,7	19,1	28,5	19,3	35,0	32,4	14,3	7,6	41,8	37,3
3	26,2	25,2	29,7	20,7	40,7	36,5	16,6	10,1	53,3	47,4
4	26,9	26,1	28,4	20,5	40,3	36,1	16,7	9,6	55,7	52,1
household size										
1	15,6	14,0	16,2	12,2	22,3	20,8	7,4	4,8	34,1	28,7
2	20,8	20,7	20,7	16,4	33,8	32,2	12,1	7,2	45,0	39,5
3	32,0	29,8	29,2	22,5	49,6	41,2	19,0	11,6	53,3	50,5
4	35,8	32,5	36,2	28,5	51,7	49,2	24,3	12,9	58,6	58,1
5 or more	33,1	39,3	40,3	27,2	49,1	49,7	24,0	11,0	61,3	52,4

Source: EU-SILC dataset.
Statistics calculated using sample weights. (1) First row reports percentages of households with consumer credit on total households; second row shows percentages of households with consumer credit among poor-income households; third row shows percentages of poor-income households with consumer credit on households with consumer credit. (2) Data for France refer to 2007. (3) Equivalent disposable income.

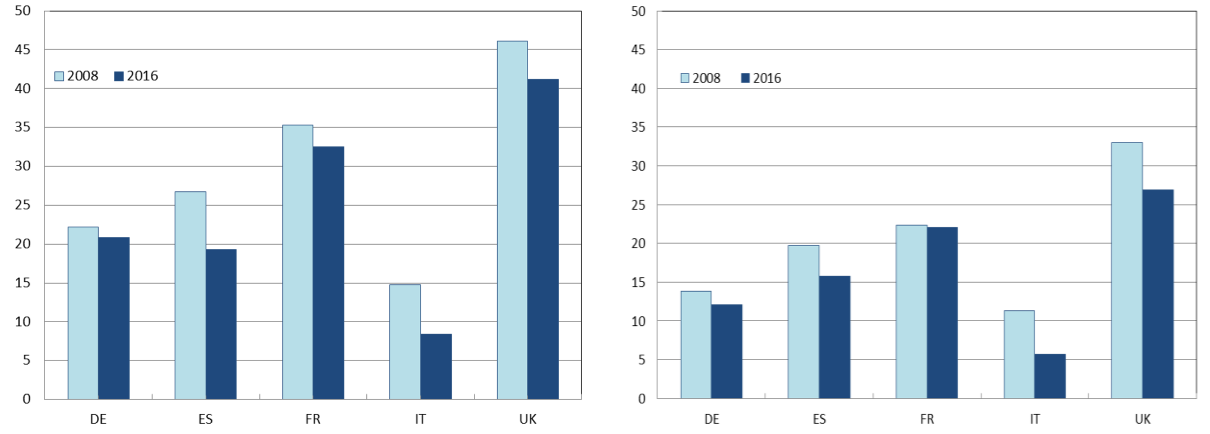
Wide heterogeneity in participation persists over time: in 2016 the percentage of households with consumer credit on total households ranges from 8 per cent in Italy to 41 per cent in the United Kingdom (15 and 46 per cent in 2008, respectively; Table 1, first row). Participation has decreased over the period in all selected countries (Figure 14, left panel), though more strongly in Italy and Spain. As in 2008, Italy has the lowest frequency of households relying on this type of loan; since the crisis the percentage has nearly halved.[4]

[4] Compared with the 2016 Bank of Italy Survey of Household Income and Wealth (SHIW), analysed in the next Section, the share of households with consumer credit in Italy is lower in the EU-SILC data, where it is indirectly identified by asking households whether they are able to meet repayment commitments on this type of loan or by assessing the burden of loan repayment. The two shares are similar when excluding from the SHIW data overdrafts and credit cards, which are less likely to be perceived as a debt by households.

Figure 14 - Households with consumer credit

(percentages)

a) total sample **b) poor-income households**



Source: EU-SILC dataset.
Share of total households in the left panel (Table 1, first row) and on poor-income households in the right panel (Table 1, second row).

Reliance on consumer credit is substantial also for households with a very low level of income (Figure 14, right panel). Poor-income households, defined, according to the European Commission, as those with an equivalent income below 60 per cent of the national median income, range from 9 to 17 per cent of total households with consumer credit, on the rise compared with 2008 (8 and 15 per cent, respectively; Table 1, third row). Spain and Italy exhibit the highest percentages (17 and 14 per cent, respectively), despite a decline in Italy over the period.

Table 2 - Households in arrears on consumer credit repayments

(percentages relative to households with consumer credit)

	Germany		Spain		France		Italy		United Kingdom	
	2008	2016	2008	2016	2008 (2)	2016	2008	2016	2008	2016
Total Sample (1)	7,8	5,5	8,4	10,0	5,9	4,1	10,5	12,1	2,3	5,0
Poor-income HHs	24,9	13,4	13,5	20,9	12,8	12,8	20,5	28,6	6,9	15,0
Poor-income HHs in arrears as a % of HHs in arrears	36,0	32,9	23,3	37,6	18,2	29,3	28,9	33,4	45,1	34,1
age										
<35	11,0	6,5	13,2	14,0	9,4	6,7	10,9	17,3	4,3	6,3
35-44	8,6	6,2	8,5	9,1	5,4	3,4	11,2	11,9	2,4	5,4
45-54	7,5	5,6	5,5	11,5	4,1	4,9	8,8	11,4	2,1	5,8
55-64	4,5	4,4	7,2	8,0	4,8	2,7	10,2	13,3	1,3	3,6
>65	5,7	3,7	2,4	8,3	4,0	2,8	12,7	7,4	0,4	1,7
education										
middle school or less	13,5	11,2	9,3	12,3	7,6	6,1	13,2	16,6	3,0	7,1
high school	9,5	4,4	9,7	8,7	6,8	4,3	9,0	11,0	3,3	5,7
university	5,6	5,3	5,9	8,6	2,9	2,7	6,7	5,6	1,3	3,0
income quartiles (3)										
1	20,9	12,5	12,8	20,5	10,5	10,2	18,7	25,1	6,3	13,5
2	8,8	7,3	10,3	11,6	7,2	4,4	14,5	10,9	2,8	6,0
3	5,2	3,9	7,8	9,7	5,8	2,3	8,6	10,7	1,3	3,3
4	2,4	2,3	4,1	1,4	2,1	1,5	3,3	5,9	0,6	1,2
household size										
1	9,4	7,1	11,9	14,3	8,9	4,4	17,4	15,5	2,5	6,8
2	7,5	3,7	6,6	8,9	4,7	3,3	5,9	9,8	1,6	3,0
3	7,7	4,6	7,7	9,6	4,4	4,6	9,8	12,8	2,8	3,9
4	5,3	8,0	7,3	7,9	5,9	4,6	9,4	9,5	2,1	5,4
5 or more	9,6	5,4	16,5	13,7	6,3	4,6	16,2	17,1	3,7	11,0

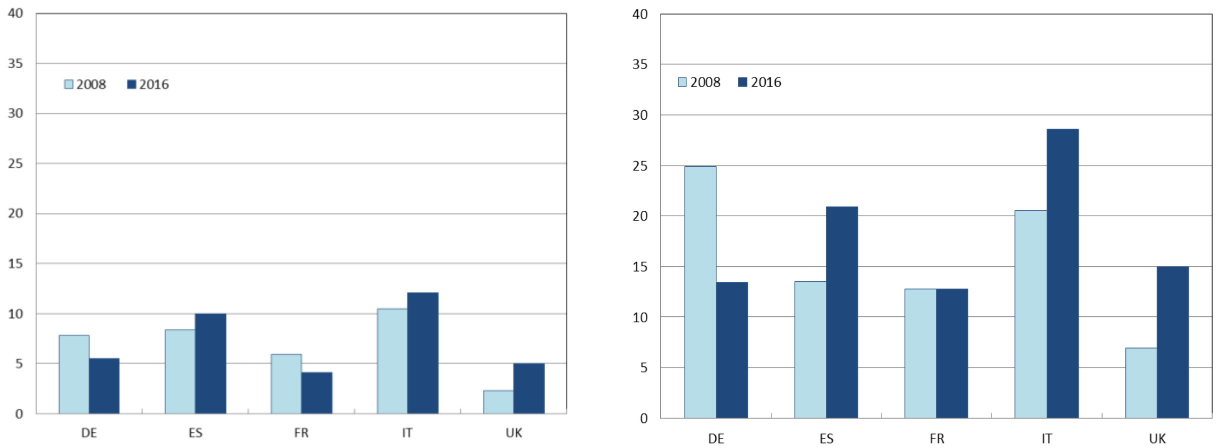
Source: EU-SILC dataset.
Statistics calculated using sample weights. (1) First row reports percentages of households in arrears on consumer credit on total households; second row shows percentages of households in arrears among poor-income households; third row shows percentages of poor-income households in arrears on households in arrears. (2) Data for France refer to 2007. (3) Equivalent disposable income.

Participation is spread more evenly among age classes: the shares are similar in the first three (<35, 35-44, 45-54) and shrink sharply only for households with the oldest heads (>65). In Italy the participation of households in the first age class (< 35) has more than halved over the period (from 21 per cent in 2008 to 10 per cent in 2016)[5] and is particularly low compared internationally. This trend is stronger than in other countries and is consistent with more selective lending policies, as arrears remain the highest for the youngest age class (Table 2).

When assessing the risks stemming from consumer credit, the non-negligible share of poor-income households relying on this type of loan should not be overlooked as it could translate into a higher frequency of delinquencies. The EU-SILC survey also measures households with at least temporary repayment difficulties in the previous 12 months.[6] In 2016, between 4 and 12 per cent of all borrowers were in arrears (2 and 11 per cent, respectively, in 2008; Table 2, first row and Figure 15, left panel); the same percentage among the poor ranges from 13 to 29 per cent and markedly increased over the period (7 and 25 per cent, respectively, in 2008; Table 2, second row and Figure 15, right panel). More than one third of households in arrears are income poor in Spain; the percentage is slightly lower in the other countries surveyed (Table 2, third row).

Figure 15 - Households in arrears on consumer credit repayments
(percentages of households with consumer credit)

a) total sample **b) poor-income households**



Source: EU-SILC dataset.
Share of total households in the left panel (Table 2, first row) and on poor-income households in the right panel (Table 2, second row).

In Italy the legacy of the crisis and the slower pace of economic recovery have significantly affected households' ability to discharge their obligations: Italy has the highest percentage of households in arrears (12 per cent), also among the poor-income group (29 per cent; Figure 15). When considering only arrears longer than 90 days, included in the non-performing loans statistics, the share of delinquent households in the total sample is, however, much lower, around 2 per cent (see next Section).

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[5] See Magri et al. (2011) for a description of the characteristics of households with consumer credit in nine European countries in the period 2005-08.

[6] Unlike the Bank of Italy Survey of Household Income and Wealth, which takes into account only payments more than 90 days overdue, the EU-SILC survey does not indicate a time threshold for defining arrears, resulting in higher percentages of delinquencies. We rely on EU-SILC data for comparison with other countries.

Delinquencies correlate to some extent with interest rates, while the most important part of the differences in interest rates across euro-area countries is explained by unobserved country factors, fixed over time. In an estimation from aggregate data for the main euro-area countries analysed in this paper, after controlling for a country fixed effect, a time dummy for the period after the crisis and the size of the consumer loans market, delinquencies are positively correlated with interest rates on new loans in the period 2003-17, but their economic impact is limited.[7] All in all, the larger frequency of delinquencies seems to explain only partially the higher interest rates on consumer loans paid by Italian households (Figure 5).

6. Insights from microdata on the Italian consumer credit market

6.1 Aggregate dynamics and heterogeneity across households in different income classes

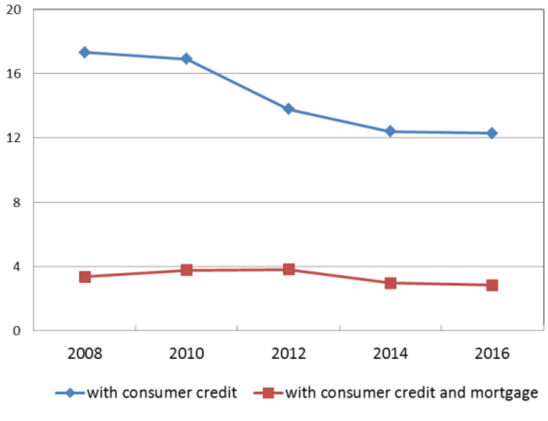
As seen from the previous section, microdata enable a deeper analysis of risks through evaluation of the heterogeneity in trends across different groups of households, specifically by income classes. As for Italy, we could rely on further data gathered from the Survey of Household Income and Wealth (SHIW): the most recent release refers to the year 2016 and is able to capture the initial phase of consumer credit expansion. This analysis cannot be extended to the other main euro-area countries as the Household Finance Consumption Survey, collecting harmonized surveys in the euro area, was last updated to 2014.[8]

The share of Italian households participating in the consumer credit market remained essentially unchanged between 2014 and 2016 at 12 per cent (Figure 16, left panel); similarly, the share of households with both consumer credit and mortgage was stable, at around 3 per cent. However, the average loan amount increased and this mirrored in a rise of the total amount of consumer credit, in line with the evidence from the macrodata.

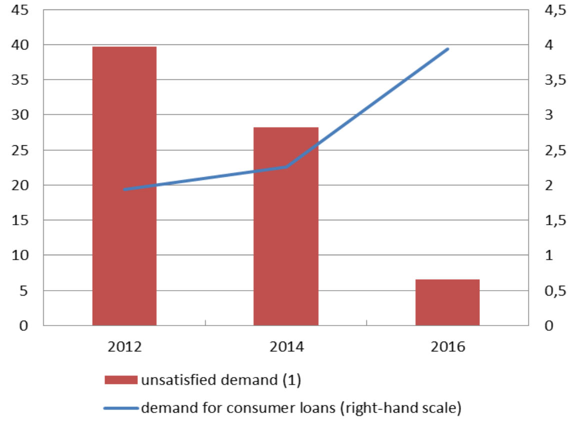
Figure 16 – Consumer credit in the SHIW

(percentage of households)

a) participation



b) demand and supply



Source: Survey of Household Income and Wealth. (1) Percentage of households with unsatisfied demand among those that apply for a consumer loan.

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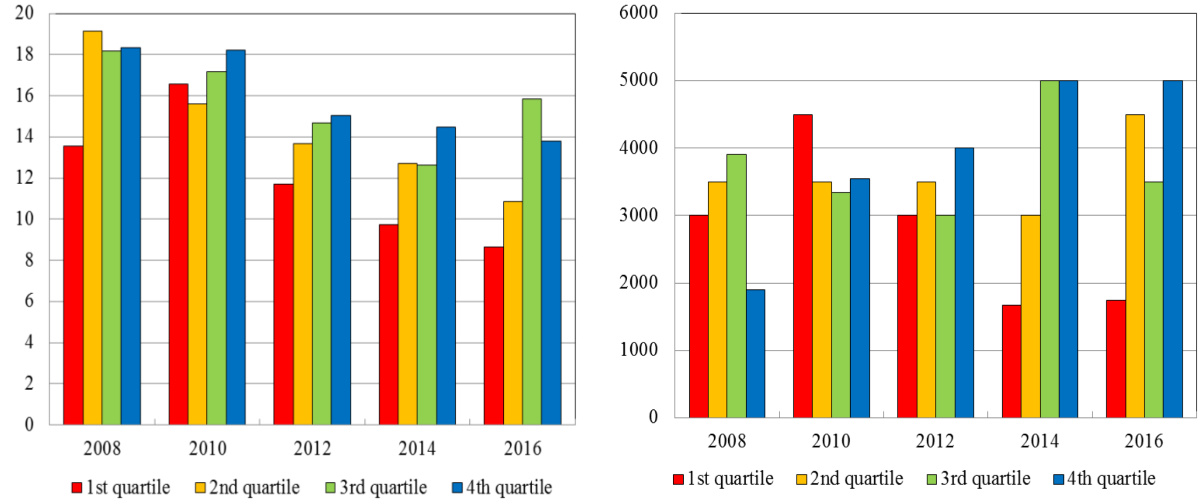
[7] When the frequency of delinquencies increases by one standard deviation (3.9 percentage points), interest rates on new loans rise by roughly 0.5 percentage points, around one third of one standard deviation of the interest rate distribution. The differences in interest rates across the main euro-area countries are largely explained by the contry fixed effect, which is a kind of black box that can capture different country features (estimations available upon request).

[8] Data referring to 2016 will be released in 2020.

Consistently with the findings of the Bank Lending Survey, the increase in consumer credit has been driven by demand and supply factors. Between 2014 and 2016, the demand for consumer loans in the SHIW (measured as the fraction of households that submit a loan application) increased (from 2 to 4 per cent), while the share of applications for consumer credit that have not been granted, in full or in part, sharply decreased (from 27 to 6 per cent; Figure 16, right panel).

Figure 17 - Consumer credit by income quartiles

a) participation *(percentage of households)* **b) median loan** *(EUR)*



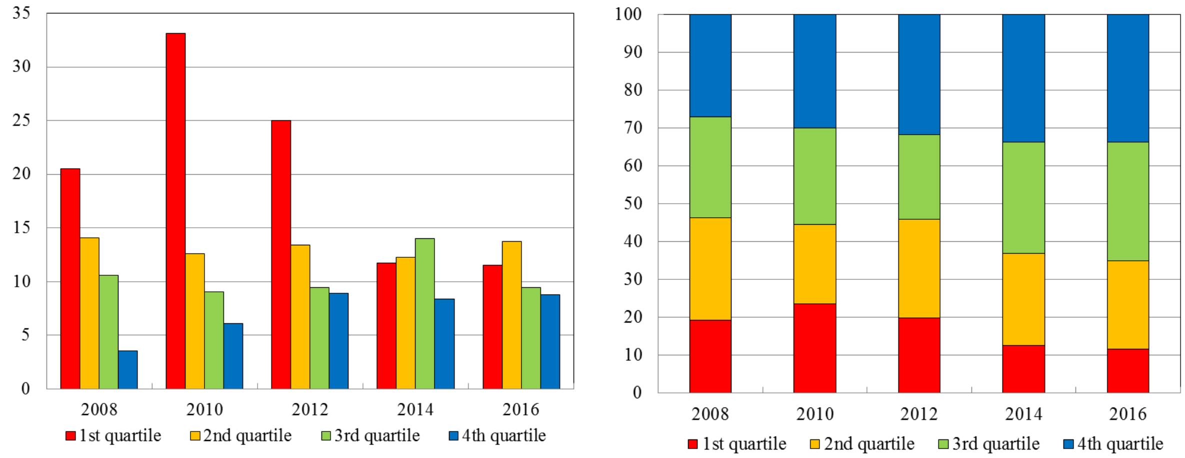
Source: Survey of Household Income and Wealth. Income quartiles refer to equivalent income.

Similarly to what is observed in the EU-SILC data, in 2016 the percentage of households with consumer credit has decreased since 2008 (from 17 to 12 per cent); the reduction has been stronger among those with income lower than the median value (Figure 17, left panel). Furthermore, the median amount of debt has halved for households belonging to the lower income quartile, while it has almost tripled for those in the upper quartile (Figure 17, right panel).

Figure 18 – Consumer credit and risk

(*percentages*)

a) consumer debt to income ratio **b) distribution of consumer debt**

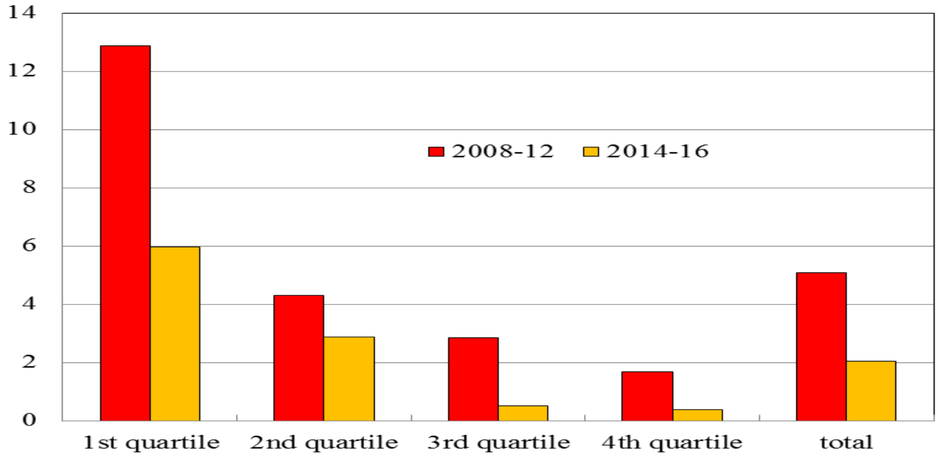


Source: Survey of Household Income and Wealth. Income quartiles refer to equivalent income.

In line with the evidence on income,[9] we find that the decrease in the share of households with consumer credit is particularly pronounced among young households, i.e. those whose head of the family is younger than 35; on the other hand, the participation in the consumer credit market among households whose head is aged over 55 is almost unchanged. Furthermore, while for the youngest the median loan amount has almost halved between 2008 and 2016, for the other age classes it has increased or remained stable.

The trends in the median loan amount are mirrored in a decrease in the ratio of consumer credit to income for households belonging to the lower income quartile and in an increase in the same ratio for households in the upper quartile (Figure 18, left panel).

Figure 19 - Households in arrears for more than 90 days by income quartiles
(percentage of households among those with consumer credit)



Source: Survey of Household Income and Wealth. Income quartiles refer to equivalent income.

Overall the share of consumer credit held by households in the two highest income quartiles has increased from 54 per cent in 2008 to 65 per cent in 2016 (Figure 18, right panel). The higher concentration of debt among households that are better able to withstand negative economic shocks helps to explain the reduction in new non-performing consumer loans, observed in Figure 13.

Households in the two upper income quartiles are indeed characterized by a much lower frequency of arrears longer than 90 days in paying back their consumer loans. This frequency has decreased further since 2008-12 (Figure 19). This statistic for Italy refers to arrears longer than 90 days, consistently with the NPL definition used in banking supervisory reports; as argued, it is therefore much lower compared with delinquencies analysed in the previous section (EU-SILC), the only one available for international comparison, but for which there is no threshold on the length of the arrears.

6.2 Why do the most affluent households need a consumer loan?

Another issue that the SHIW helps to explain is why households in the upper income quartiles are willing to pay high interest rates to get credit to satisfy their consumer needs. In the following figures, the focus is on liquid assets held by households with consumer credit.

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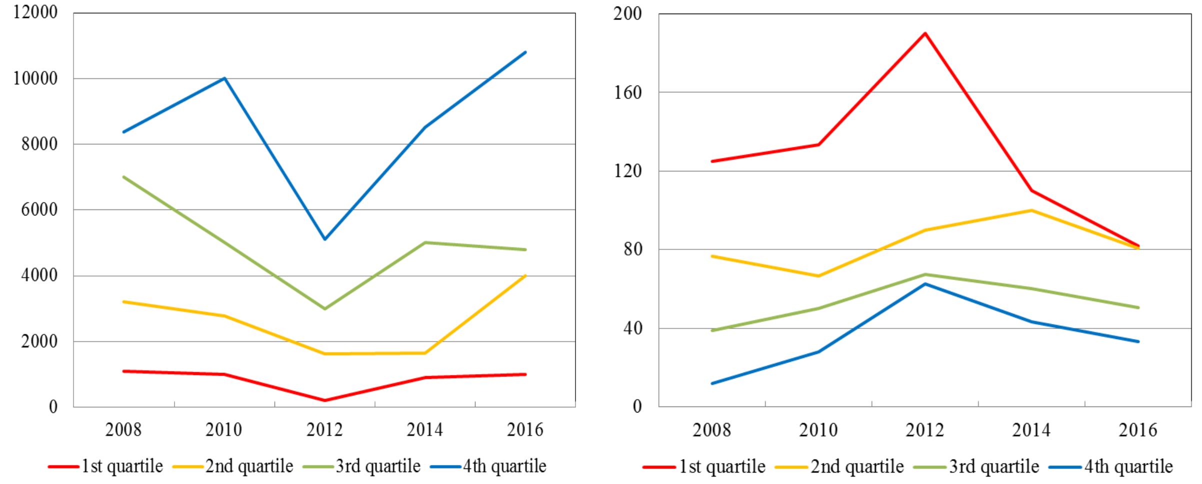
[9] A large share of young households belong to the lower income quartiles, while a large share of older households (aged 55-64) belong to the upper income quartiles.

Figure 20 - Liquid assets of households with consumer debt by income quartiles

a) liquid financial assets
(median values, EUR)

b) consumer debt to liquid financial assets ratio
(percentages)



Source: Survey of Household Income and Wealth.

Even among the most affluent households (third and fourth income quartiles), the median value of liquid assets is around EUR 5,000 and 10,000 respectively (Figure 20, left panel); this amount may not be enough to buy some durables, such as cars or pieces of furniture.[10] Therefore even these households could need a consumer loan, whose amount is on average between 40-60 per cent of their liquid assets (Figure 20, right panel). Lower income households are, as expected, more financially constrained: given their lower amount of liquidity, the incidence of consumer loans relative to liquid assets is much higher (80 per cent).

7. Discussion of results

Credit demand, specifically for consumer durables expenditure, has been an important driver of the consumer credit expansion in the main euro countries analysed in this paper. The easing of supply conditions played a relevant role only in Italy and Spain. In these two countries, where interest rates are higher than in other euro-area countries, banks also increased the share of consumer loans relative to total loans granted to private sector.

Consumer durables are also at the heart of consumer credit procyclicality: households prefer or need to cut spending on durable goods during negative economic junctures and boost them when the economic cycle turns positive and sentiment indicators improve. Consumer credit, which is used to buy durable goods, moves accordingly, recording much stronger variations than those observed for household income and consumption.

Overall, risks connected with consumer credit expansion are decreasing. Households' exposure to interest rate risk is falling in all countries; the non-performing loan ratio is also on a downward path at the euro-area level. There is wide risk heterogeneity across countries, with Italy and Spain ranking as the ones with the highest share of delinquencies, even for less than 90 days, according to EU-SILC data. However, the higher concentration of debt among

[10] Most affluent households may choose to borrow because they are wealthy hand-to-mouth, i.e. they hold little liquid wealth (cash, checking, and savings accounts), despite owning sizable amounts of illiquid assets (Kaplan et al., 2014).

more affluent Italian households, better able to withstand negative economic shocks, is sustaining in our country the reduction in the ratio of *new* non-performing consumer loans, which is currently lower than before the crises. Delinquencies correlate to some extent with interest rates, while the most important part of the differences in interest rates across euro-area countries is explained by unobserved country factors, fixed over time. All in all, the larger frequency of delinquencies seems to explain only partially the higher interest rates on consumer loans paid by Italian households.

In Italy we observe a strong reduction in consumer loans granted to low-income households and, also, to young households. This evidence is consistent both with a lower fraction of more vulnerable households asking for a consumer loan and with a high selectivity of banks in granting them (Assofin, Crif, Prometeia, 2018).[11] The drop in the frequency of young households using consumer credit is common to other euro-area countries, but it has been stronger in Italy. As a consequence, only about 10 per cent of young households rely on consumer credit in Italy, much less than around one fourth in Germany and Spain and more than 30 per cent in France. This gap has likely reduced the role of credit in smoothing consumption during a person's lifespan in our country. Young households are indeed more in need of obtaining credit to anticipate their future income increases and face the expenditures connected with buying or renting a new house and raising children (Magri, 2002; Barnes and Young, 2004; Del Rio and Young, 2006; Rothstein and Rouse, 2011; Avery and Turner, 2012).

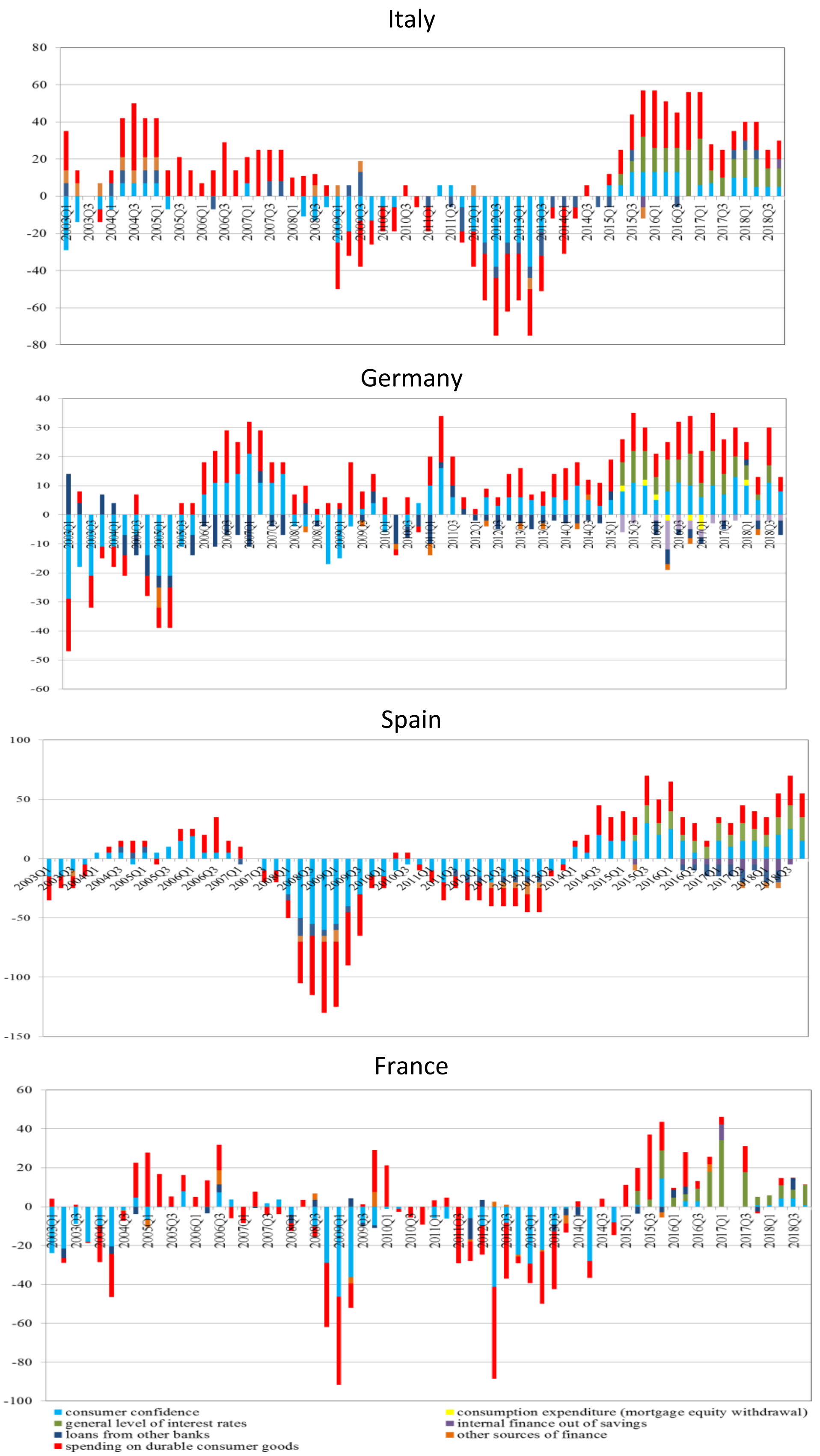
Consumer credit could also be used to smooth consumption in case of abrupt changes in income along the economic cycle (Christen and Morgan, 2005; Karlan and Zinman, 2009; Wilson et al., 2010; Zinman, 2010; Morse, 2011; Cavalletti et al., 2011). For Italy, by using the SHIW we are able to evaluate the role of consumer loans to help those households facing important negative income shocks: since 2010 for this group of households, those relying on consumer credit were better able to protect their consumption than those without consumer credit.[12] The difference was larger and statistically significant in 2010, when indeed household consumption increased while their income dropped (Figure A.3 in Appendix), and more recently in 2016. All in all, even though household spending on durable goods and loans used to buy them are highly procyclical, some Italian households hit by negative income shocks were able, in the past, to avoid important reductions in their total consumption by using credit. The role of consumer credit in smoothing consumption in the next years will be the subject of future analysis.

[11] In their Report, Assofin, Crif and Prometeia underline that the share of high-risk households asking for a consumer loan has decreased in the past years. Meanwhile, banks have been very selective in evaluating applications: vintage analysis shows that since 2012 new consumer loans have lower default rates.

[12] Since 2010 households have been asked in the SHIW whether they had a significant drop in their income. In this group of households (15 per cent of total households), among those using consumer credit 14 per cent also had an important reduction in consumption, a lower share than that observed for those without consumer credit (20 per cent).

Appendix

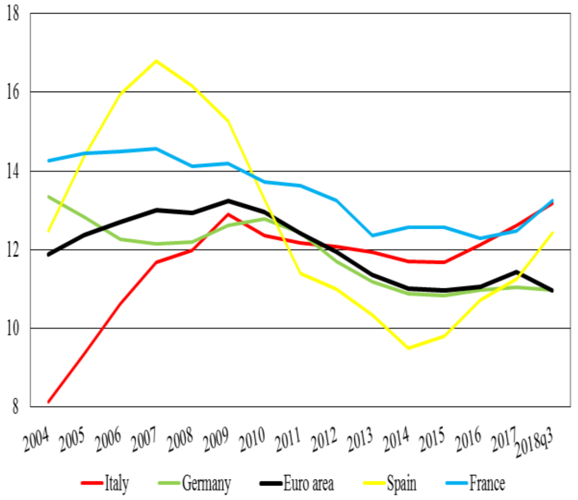
Figure A.1 – Consumer credit demand: drivers of growth



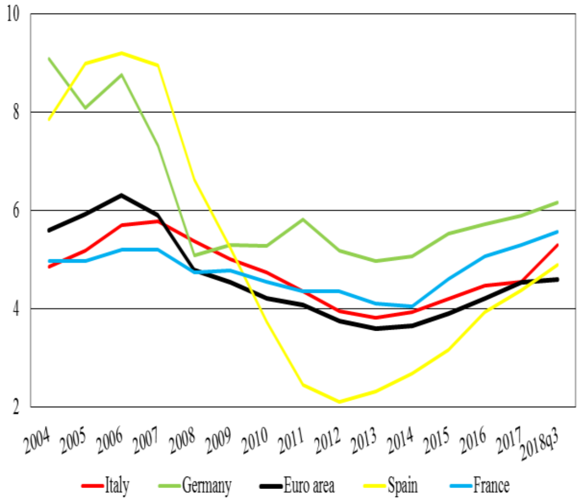
Source: ECB Bank Lending Survey.

Figure A2 – Consumer credit and households' consumption
(percentages)

a) stock of consumer credit as a percentage of consumption (1)

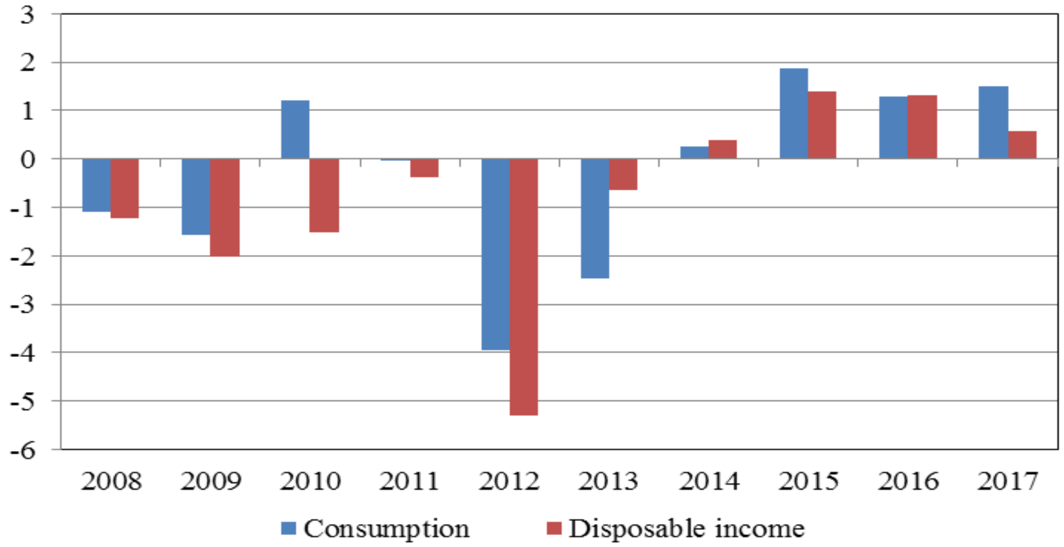


b) new consumer loans as a percentage of consumption (2)



Source: ECB Statistical Data Warehouse, Eurostat.
(1) Consumption data are annualized. - (2) Figures for 2018 refer to the flows in the first nine months of the year.

Figure A3 – Consumption and disposable income in Italy
(percentage changes on previous year)



Source: Based on Istat data.

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