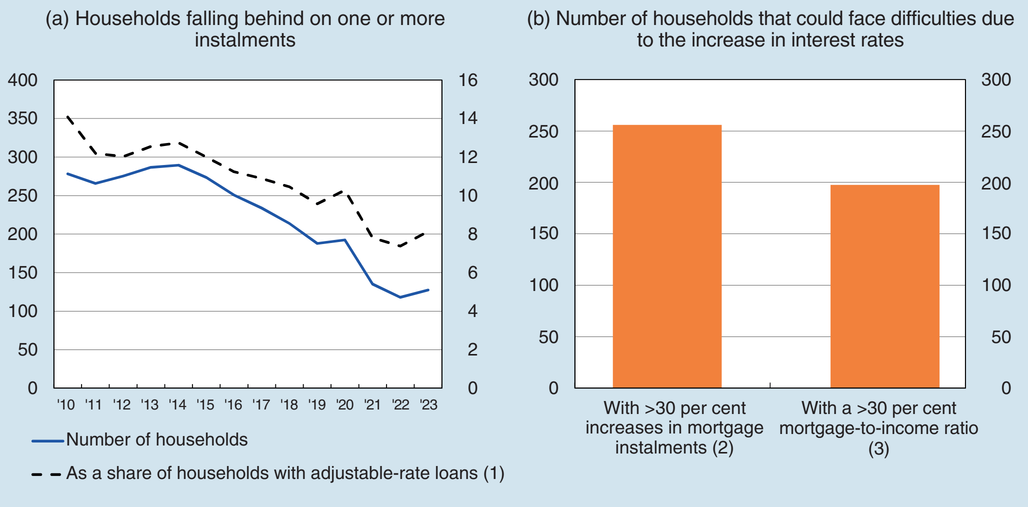
THE SUSTAINABILITY OF ADJUSTABLE-RATE MORTGAGE LOAN SERVICING

The policy rate hiking cycle initiated in 2022 by the ECB to ensure the return of inflation to the price stability target gradually passed through to the three-month EURIBOR, the most widely used benchmark for adjustable-rate mortgage (ARM) indexation, which went from negative territory to a positive 4 per cent in autumn 2023, to then remain broadly stable until May 2024. Monetary tightening helped bring down inflation from levels that were significantly reducing households' purchasing power and the real value of their savings (see the box 'The effects of inflation on the distribution of wealth among Italian households' in Chapter 14), but it also resulted in higher debt servicing costs for households with adjustable-rate loans.

Based on data from the Central Credit Register (CR), the number of households falling behind on one or more instalments of an ARM was approximately 127,000 in 2023, or 0.5 per cent of all Italian households and 8.1 per cent of those with this type of debt (see panel (a) of the figure).[1] These percentages are stable and slightly higher, respectively, compared with the previous year's historical lows (0.5 per cent and 7.4 per cent), but are still below the average figures for the pre-pandemic decade (1.1 per cent and 10.7 per cent).

Figure

Households with adjustable-rate mortgage loans by degree of difficulty in repaying instalments
(thousands and per cent)



Sources: Based on data from the CR and from the Bank of Italy's Analytical Survey of Lending Interest Rates, for panel (a); based on data from the Survey on Household Income and Wealth for 2022, for panel (b); see 'Households: Survey on Household Income and Wealth' in the Methodological notes in the Appendix (only in Italian).
(1) Right-hand scale. – (2) Number of households for which mortgage instalments increased by more than 30 per cent as a result of higher interest rates. – (3) Number of households for which mortgage instalments exceeded 30 per cent of their income between 2023 and May 2024.

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1 The focus is on adjustable-rate loans to Italian households for house purchase and/or home improvements. Other forms of household debt, such as consumer credit, are almost entirely fixed-rate.

However, this evidence makes no distinction between the households that fell behind on their mortgage payments due to the increase in interest rates and those that were late for other reasons (e.g. because of a reduction in their income). Based on preliminary data from the Survey on Household Income and Wealth for 2022,[2] it is possible to estimate the rate hike effect only, by calculating how many households overall (including those that did not fall behind on their payments) may struggle to cope with higher instalments. Our analysis uses two alternative criteria, which are based on the increase in cash payments and on their ratio to household income, respectively.[3]

According to our estimates, around 256,000 households saw an increase of over 30 per cent in their loan instalments due to higher interest rates and 198,000 had to pay more than 30 per cent of their income in loan instalments between 2023 and May 2024 (i.e. 1.2 per cent and 0.8 per cent of all Italian households, respectively; see panel (b) of the figure). These households hold, respectively, 11 per cent and 8 per cent of ARMs.

The probability of encountering difficulties in repaying instalments as a result of higher interest rates is greater for households with multiple lines of debt, while it is lower for those residing in Italy's South and Islands, where ARMs are less widespread.

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2 We have reconstructed the amortization schedule for households with adjustable-rate mortgage loans based on the assumption of an interest rate increase of 4 percentage points, for loans already outstanding in 2021 (before the start of monetary tightening), or of 1.8 percentage points (i.e. the increase recorded in the 3-month EURIBOR between end-2022 and end-2023), for loans taken out in 2022. The estimate has been adjusted for: (a) debt under-reporting, which usually affects sample surveys; (b) loan renegotiations, subrogations, refinancing (particularly, with switches from adjustable- to fixed-rate loans) or early repayments by a number of households as a way to hedge against rate increases. For more details, see A. di Salvatore, D. Loschiavo and A. Nunnari, 'Estimating the impact of interest rate hikes on the sustainability of adjustable-rate mortgages', Banca d'Italia, Notes on Financial Stability and Supervision, forthcoming.

3 Based on the first criterion, households for which mortgage payments are estimated to have increased by over 30 per cent are considered to be in a potentially critical position (the monthly instalment for the median household in that condition is estimated to have gone up from €600 to €780). The second criterion, on the other hand, identifies households for which mortgage instalments are estimated to have exceeded 30 per cent of their 2022 income between 2023 and May 2024, a threshold that conventionally signals a high risk of experiencing difficulties in debt servicing.