HRVATSKA NARODNA BANKA

Interest rate risk in the household sector and CNB measures

Boris Vujčić, Governor

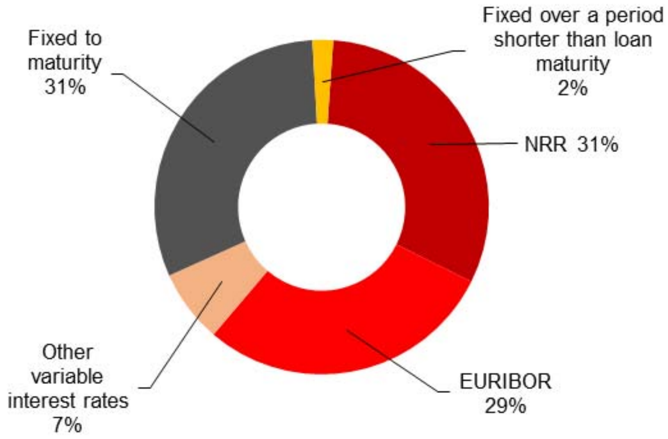
Press conference, 26 September 2017

Content

- Interest rate risk in the household sector
- CNB measures to mitigate this risk:
  - Information list of offered consumer loans
  - Recommendation to mitigate interest rate and interest rate-induced credit risk in long-term consumer loans
  - Changes to the regulatory framework for monetary policy operations

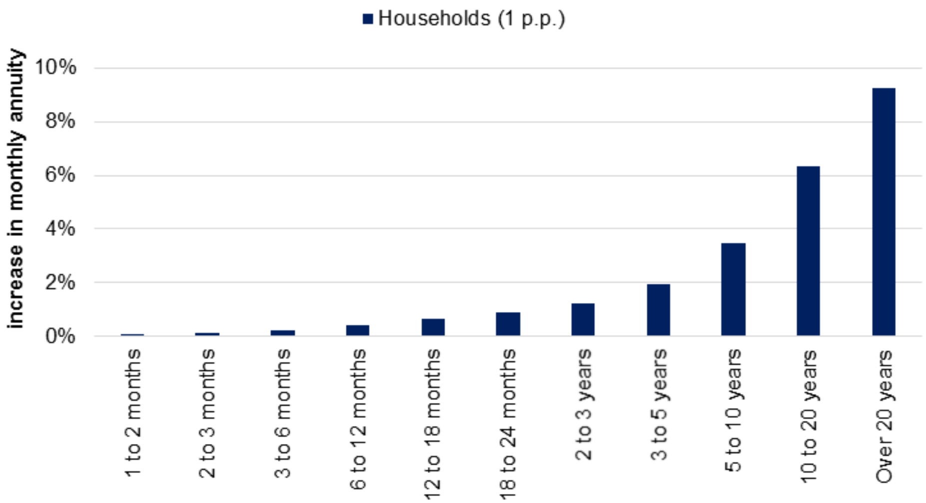
Interest rate risk is significant for some households

Households (31 March 2016)



Source: CNB, Survey on interest rate variability.

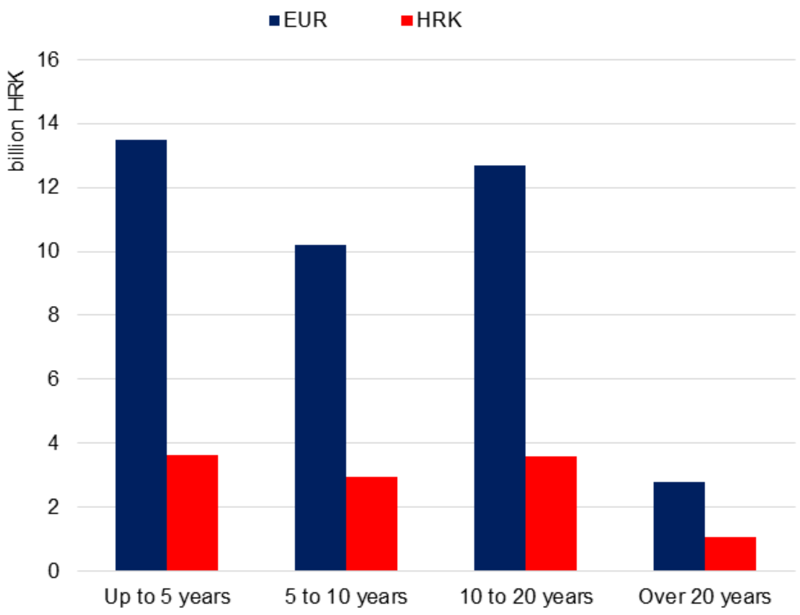
Increase in the amount of monthly loan annuity in the event of a one-percentage-point increase in interest rates



- The Survey on interest rate variability confirmed that households are mostly financed at variable interest rates (which accounted for 67% of all household loans at end-March 2016).
- This largely exposes them to interest rate risk that is **most pronounced in loans with longer remaining maturities**:
  - around 20% of all household loans have a remaining maturity of over 10 years;
  - around 42% of all household loans have a remaining maturity of over 5 years.

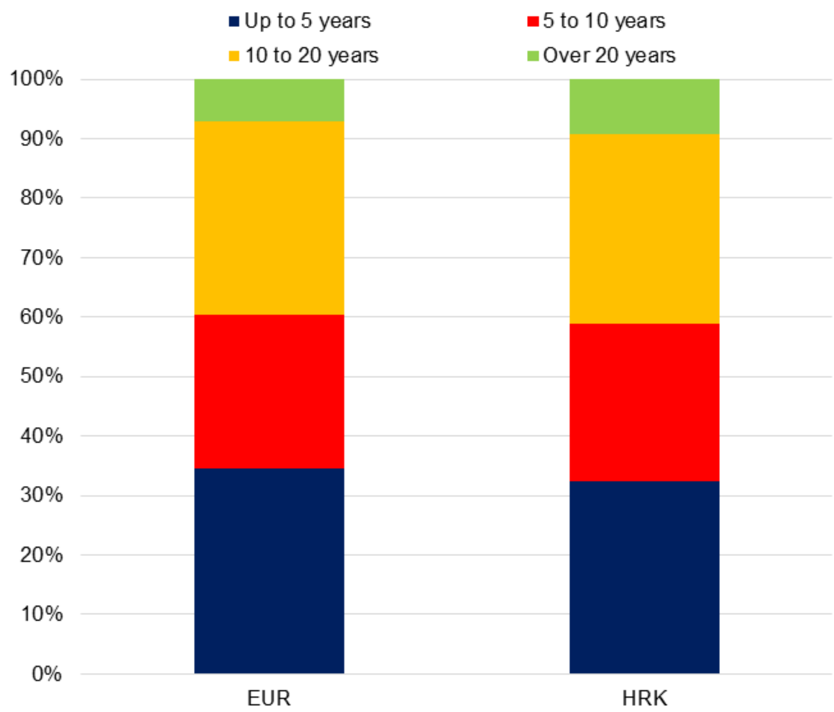
Housing loans: more than 65% of loans have a remaining maturity of over 5 years

Housing loans by remaining maturity, currency breakdown



** Balance as at 31 March 2017*

Relative share by remaining maturity, housing loans

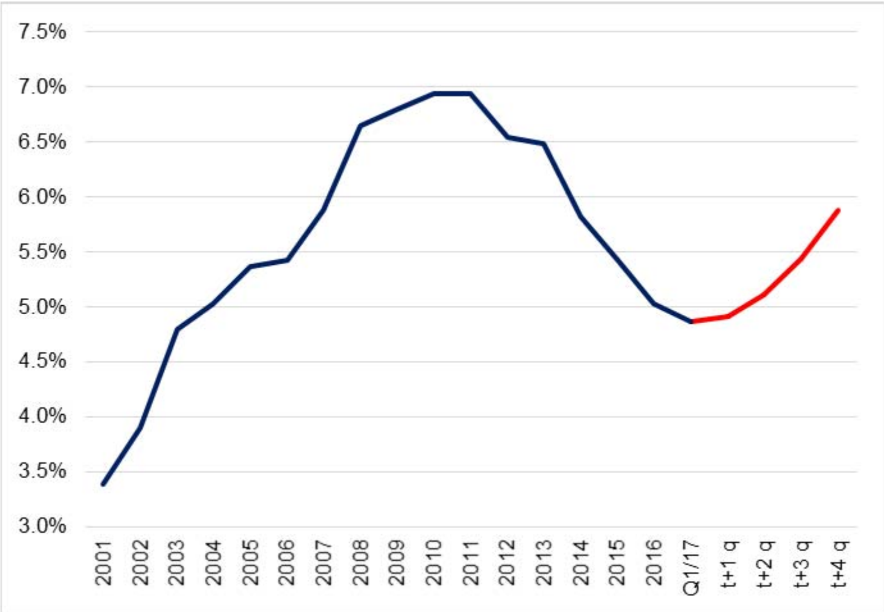


** Balance as at 31 March 2017*

Source: CNB.

Materialisation of interest rate risk would reduce the disposable income of indebted households

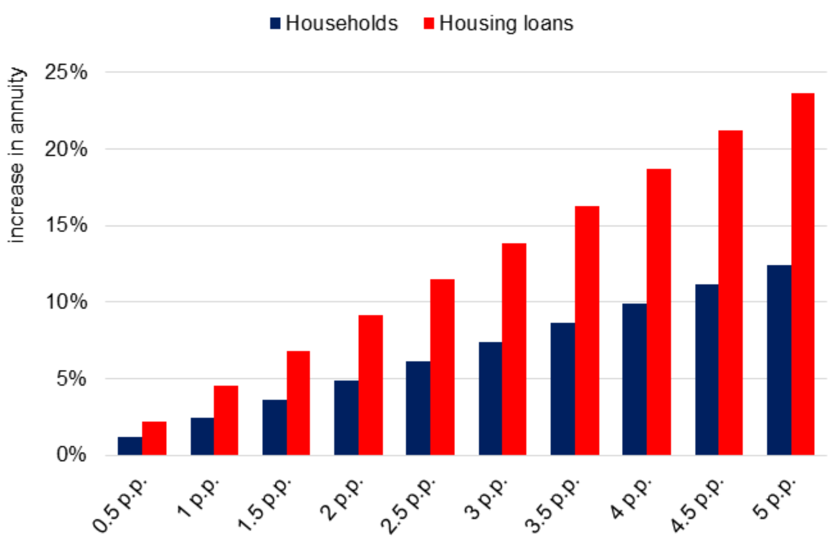
Increase in the interest burden to disposable income ratio due to the gradual increase in interest rates



Note: The calculation is informative in nature and assumes the structure of household loans as established in the Survey on interest rate variability (Figure 2): EURIBOR 29%, NRR 31%, other variable interest rates 7% and 33% fixed interest rates. EURIBOR is assumed to grow gradually by a total of 2%, while, in line with estimated long-term relations between the implicit NRR3 and EURIBOR, the NRR would grow by 1.26% in the observed period.

Source: CNB (CNB calculations).

Expected increase in aggregate annuity of the household sector due to an interest rate increase

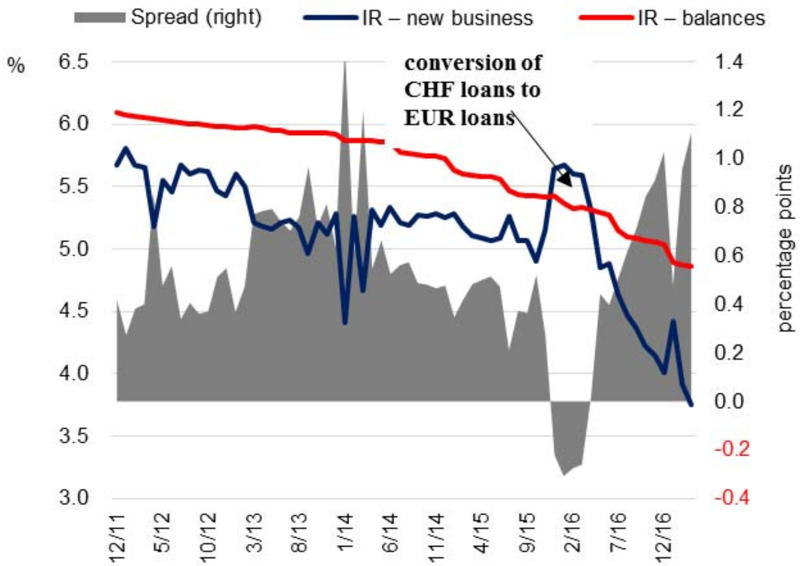


Note: The calculation was made on the aggregate of loans taking into account the outstanding total amount of all loans as a single loan.

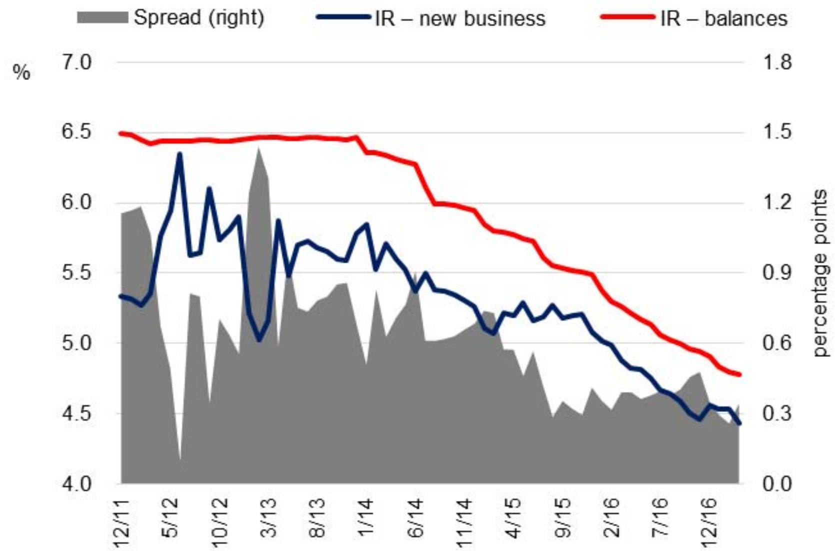
Source: CNB (CNB calculations).

Due to the interest rate decrease, interest rates on newly-granted loans are on average lower than those on existing loans

EUR



HRK



Source: CNB.

The interest rate spread that on average goes in favour of newly-granted loans opens up the possibility of loan refinancing without increasing the interest expense for loans granted before the recent fall in interest rates.

Information list of offered consumer loans

Information list (1)

- Objective – improve awareness of individuals about offered loans

- Information list on kuna loans and euro-indexed loans (based on the data obtained from credit institutions)

- It contains the main information (**not all**) on the following selected types of loans mostly used by consumers:

  - cash general-purpose loans
  - loans for motor vehicle purchase
  - education loans
  - mortgage loans
  - loans for house/flat purchase
  - loans for house/flat renovation.

Information list (2)

- Information by selected types of loans:
  - *Largest loan amount (in kuna and indexed to the euro)*
  - *Longest loan maturity (in months)*
  - *Designation of whether the loan has a variable, fixed or combined interest rate*
  - *Level of the effective interest rate*
  - *Reference parameter (variable and combined interest rates)*
  - *Fixed margin (variable interest rates)*
  - *Maximum fee for early loan repayment in full (all loans – broken down by loans granted before and after 2010)*
- helps in browsing through current offers and narrowing down the choice
- enables a comparison of various offers of selected loan types at all credit institutions
- has additional functionalities (e.g. it can narrow down the choice of credit institutions and make a comparison of the terms and conditions for particular loan types at a few credit institutions)

Information list (3)

- **Important**: In addition to those published, credit institutions impose additional terms and conditions (e.g. collateral instruments, client status, etc) – the final offer is also influenced by information on the consumer himself.
- HNB – web link

Recommendation to mitigate interest rate and interest rate-induced credit risk in long-term consumer loans

Content of Recommendation

- Recommendation has six parts that refer to replacing variable interest rate loans by fixed interest rate loans.
- It recommends banks to offer consumers the possibility of fixing interest rates on the loans that are the most exposed to interest rate risk:
  - It targets loans with a remaining maturity longer than 7 years.
  - It requires a clear and transparent comparison of the existing and newly offered loan, which enables consumers to better understand the costs and benefits of interest rate fixation.
  - It requires that costs for consumers are reduced to a minimum, i.e. avoidance of fees, such as those for early repayment.
  - It requires that banks do not charge early loan repayment fees even for loans granted before 2010.
  - It is expected that, in offering a fixed interest rate, banks do not depart from the rate they currently offer or, if they have not offered fixed interest rates before, from the market interest rate.
  - It is expected that banks expand the offer of loans with fixed interest rates and that contracts for new loans do not contain provisions on early loan repayment fees.
- The CNB shall require credit institutions to regularly submit the information on actions related to this Recommendation and shall notify the public thereof.

Consumers and fixed interest rates

- A change in the interest rate may significantly influence the amount of annuity for loans with longer maturities.
- However, the final decision is on the consumer!
  - The consumer – loan user has the most information to asses the risk associated with a pending loan agreement.
  - Depending on future movements in interest rates, a loan may turn out to be more favourable or more expensive at the end of the repayment period.

		Types of interest rates		
		Fixed interest rate	NRR / interest rate on household deposits	Other reference interest rates
Remaining loan maturity	up to 1 year			
	1 to 5 years			
	over 5 years			

Note: Green colour denotes low risk, yellow and orange, medium risk, and the shades of red denote higher risks.
NRR – national reference rate

Banks and fixed interest rates

- Interest rate fixation is expected to be beneficial for banks as well:
  - primarily due to the reduction in interest rate-induced credit risk.

- In addition, the CNB will ease banks' access to (structural) operations, which will facilitate favourable long-term financing.

Changes to the regulatory framework for monetary policy operations

Changes in monetary policy implementation of the CNB

- Decision on monetary policy implementation of the CNB
  - Unification of CNB regulations governing monetary policy operations – open market operations and standing facilities, as well as instruments for their implementation.
  - Introduction of a system of collateral management by means of a pool of eligible assets for all credit operations of the CNB.

Characteristics of a pool of eligible assets (1)

- A bank creates a pool of eligible assets with the CNB by transferring securities to the CNB accounts with securities depositories.
- A bank may replace, add and withdraw the securities in the pool of eligible assets.
- Assets in the pool of eligible assets are not earmarked for a specific transaction, but the total value of the pool of eligible assets represents the maximum permissible amount that a bank may borrow from the CNB under all credit operations.

Characteristics of a pool of eligible assets (2)

- The CNB uses the eligible assets pooling system for collateralisation of all CNB credit operations.
- Collateral management by means of a pool of eligible assets provides for the use of short-term securities for long-term credit operations of the CNB.
- Increase in the potential amount for long-term lending to around HRK 38bn

Thank you for your attention!