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PRESS RELEASE

The distribution of debt across euro area countries: The role of individual characteristics, institutions and credit conditions

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This paper presents an assessment of the differences across euro area countries in the distribution of various measures of debt depending on household characteristics. The analysis relies on the new Household Finance and Consumption Survey (HFCS), a harmonised survey that contains information on household demographics, debt, wealth and income across euro area countries.

The data reveal striking differences in the incidence, amount and cost of debt held by comparable households across countries in the euro area. In terms of explaining debt holdings within countries, income and education level of household members appear to be important demographic considerations. In this context, a hump-shaped profile of secured debt holding over age cohort groups is observed. Specifically, the propensity to borrow tends to peak for cohorts aged 35-44, before the income profile peaks, suggesting a role for secured debt in smoothing household consumption. Nevertheless, cross-country differences in the age, income and education profiles of borrowers are substantial.

The paper further examines the role of legal and economic institutions in accounting for the different impacts of household characteristics on debt patterns across countries, in particular the role of the legal enforcement of contracts, the tax treatment of mortgage repayments, regulatory loan-to-value ratios, the depth of information available about borrowers and credit conditions. Theoretical models have stressed the role of each of these institutions in shaping the distribution of debt outcomes among age or income groups. Findings suggest that among all the institutions considered, the legal enforcement of contracts - measured by the time needed to recover collateral - best explains the features of the distribution of debt. These results are robust to the inclusion of other institutions. Regulatory loan-to-value ratios, the taxation of mortgages and the prevalence of interest-only or fixed-rate mortgages also play a role but deliver less robust results. The findings could suggest that the supply of secured credit is affected by legal processes that delay the recovery of collateral in the case of non-repayment. In this case, banks react to expected losses due to longer repossession periods not only by rationing quantities or rejecting applications but also by pricing secured debt differently across income groups and charging relatively higher interest rates to low income households.

Finally, the paper documents substantial heterogeneity in the distribution of household debt across countries. Such diversity has implications for a wide array of outcomes including macroeconomic policy – the consequences of an interest rate increase, for example, depend on the fraction and the characteristics of indebted households – and financial stability – loan arrears depend on the income, age and household structure of indebted households. Those outcomes merit further research.

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