

2015-12-18

PRESS RELEASE

Macroeconomic determinants of non-performing loans

(Article published in the December 2015 Economic Review)

This article assesses realised (*ex-post*) credit risk in Belgium as measured by both non-performing loans (NPL) and payment arrears of households. It also examines the extent to which that risk can be explained by the macroeconomic environment and by structural variables, such as credit characteristics (e.g. the loan-to-value (LTV) and debt-service-to-income (DSTI) ratios) and features of the banks (e.g. their size).

Limited availability of data, for both credit risk and structural variables, made it necessary to focus on households and more specifically on mortgage credit risk. In spite of the further increase in the household debt ratio to 58.8 % of GDP in the second quarter of 2015, this risk is regarded as moderate, in view of high household net financial wealth. This is also confirmed by the relatively low NPL ratio (non-performing loans over total loans) in Belgium, which stood at 1.7 % for mortgage credit at the end of June 2015.

An analysis of the structural determinants of the default rate reveals a mixed risk profile for the outstanding mortgage debt in Belgium. Distribution aspects are important. There are "pockets of risk", as many Belgian households with mortgages spend a large proportion of their income on debt repayment (which tallies with a high DSTI). The analysis shows that these structural features of credit are informative for the credit risk incurred by banks on their loan portfolio. Banks with a relatively high NPL ratio also tend to have a relatively high proportion of loans with a high DSTI in their portfolio. Apart from the loan risk profile, banks' size also appears to be indicative for the credit risk. An analysis of the NPL ratio per individual credit institution shows that, on average, a higher NPL ratio is observed for the group of small banks.

An econometric analysis confirms the explanatory power of a number of these structural factors for credit risk in Belgium, and also indicates that this depends, albeit to a lesser extent, on the macroeconomic environment. Moreover, in some countries where very high NPL ratios are recorded, non-performing loans also appear to be having an impact on economic activity through a tightening of credit supply, especially via higher interest margins on new loans to businesses.

In these countries, it would be advisable to look for a solution to the problematic NPL level. On the one hand, efforts can be devoted to a better resolution of bad loans; on the other, preventive steps can be taken giving consideration to the relationships put forward in this article. In that respect, one positive factor is that a number of these countries are now recording a drop in their private debt ratio. Furthermore, accommodative monetary policy is also playing a supporting role via a considerable decline in interest charges. These countries need to make the most of these circumstances and get rid of the heavy legacy of the past (NPL) so that it does not constantly threaten to dampen the growth outlook.