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Weekly Briefing

Slovenia economy briefing:

Bank of Slovenia applied stricter criteria for household loans

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Bank of Slovenia applied stricter criteria for household loans

Short summary

As of November 2019, The Bank of Slovenia changed its regulations for consumer loans provided by Slovenian banks. Two main changes were applied: caps were put on the maturity of consumer loans and the ration of the annual debt servicing costs to the net income was limited for consumer loans and for housing loans. The two measures caused a heated public debate, with even government representatives taking a position on it.

Background: The role of the Bank of Slovenia

The Bank of Slovenia is the Republic of Slovenia's central bank, established in 1991. It is fully owned by the state and is autonomous in finances and governance. When Slovenia joined the European Union in May 2004, the Bank of Slovenia became a member of European System of Central Banks (ESCB). After Slovenia joined the Eurozone in January 2007, the Bank of Slovenia has also been part of the Eurosystem., which took over the monetary policy. As a member of Euroystem, the tasks of the Bank of Slovenia are to implement the common monetary policy, to manage the official exchange reserves, to ensure the functioning of payment systems and to issue Euro banknotes.

In addition to these, the Bank of Slovenia has other responsibilities determined by Slovenian legal regulations. It supervises the banks and takes part in maintaining financial stability. It manages the Central Credit Register, namely, the national database of private and company debts. It also attends to the security of deposits and the resolution of banks and ensures the supply of cash in Slovenia. It manages accounts and provides payment services for the state, for the government bodies, for the public sector and for the banks. It collects, processed and discloses statistical data, which are important for the functioning of the monetary and financial system. (source of data: Bank of Slovenia)

The recent action of the Bank of Slovenia

In relation to the exceedingly fast growth in the consumer loan sector and increasing maturity of loans for consumer loans, together with the values of loan increasing too fast, the Bank of Slovenia already issued two previous measure in 2016 and 2018 to try to slow down this trend. In September 2016 the Bank of Slovenia introduced the non-binding macroprudential recommendation for the area of housing loans. Two instruments were part of this recommendation. The first was a cap of 80% ratio of the loan amount to the value of the real estate. The second was a cap on the ratio of annual debt servicing costs to the borrower's net income. This second measure had two subcategories: for those with net monthly income below 1700 euros, this ratio should not exceed 50% and for those with a higher income, the ratio should be below 67%. In a subsequent measure in November 2018, this recommendation was expanded to consumer loans as well.

In its analysis in summer 2019, the Bank of Slovenia assessed that its previous recommendation has not had a sufficient effect on lowering the risk associated with the growth in consumer loans. Yearly growth in consumer loans surpassed 10 %. The average value of consumer loans was also reported to have been increasing, making the year-on-year growth in consumer loans reach 11.7% in August. A large proportion of consumer loans that were given by banks were also discovered to have exceeded the recommended maximum ration of the annual debt servicing costs to the net annual income. Another trend that was identified by the Bank of Slovenia analysis, was that the average maturity of consumer loans has increased. In 2015 the average maturity was 5.6 years, while in august 2019 the average maturity was 7 years. The stock of the loans with long maturity also increased from 271 million at the ned of 2015 to 516 million in August 2019. (source of data: Bank of Slovenia). The recommendations of the bank of Slovenia were thus ignored by a quarter of all approved loans and recommendations of moderate growth were not followed. According to the Bank of Slovenia statement, such a situation could worsen further in the case of slow economic growth or even recession.

The Bank of Slovenia thus decided that as of November 2019 what was previously a recommendation now becomes a binding instrument for commercial banks, savings banks and branches of foreign banks. The measures are similar, but more specific and more restrictive in comparison to the previous recommendations. A cap is introduced on the ration of annual debt servicing costs to the yearly net income of the borrower. This should not exceed 50% if the person's income is less than twice gross minimum wage. In case the income is above the double gross minimum wage limit, the ratio can be up to 67%. Another additional criterion is added for borrowers who support family members, where the amount is raised accordingly. A limit of 7 years for the maturity of consumer loans was also put in place. The cap of 80% ratio of the loan amount to the value of the real estate has not been transformed into a binding instrument but remains a recommendation. Some deviations are permitted, but they have to be kept within no more than 10% of value of new consumer or housing loans for the cap on annual debt servicing costs to income ratio and no more than 15% of the value of new consumer loans for the maturity limit.

Reactions to the new restrictions

The decision of the Bank of Slovenia to put in place these new binding instruments was received with both criticism and support. Apart from many expressions of shock and surprise from the general public, serious criticism followed from the Association of the Banks of Slovenia. They warned that a limitation to the loans will have far-reaching consequences if the state will not instead provide alternative possibilities of financing. They also stressed that more than 300,000 people now became credit-shy and loans per month will be reduced by 70 million Euros. Both the association and retailers were also critical about the potential negative impact of these measures on GDP.

Governor of the Bank of Slovenia responded to this criticism by insisting that this measure is primarily intended to protect the population from the hazardous loan-giving practices of banks, especially to protect the vulnerable parts of the population from taking on debt they would never be able to pay off. A response followed also from the political side. Prime Minister Šarec made an explicit statement about his view on the new regulations. In his press release he warned that this measure is too haste and is primarily based on narrow accounting logic, while being damaging to the people and the state, i. e. its economic growth. He stressed that this measure is particularly difficult for the vulnerable groups, young families, people with lesser income etc. who will now never be able to afford to buy their housing. The criticism did not change the position of the Bank of Slovenia, but it also did not stop, especially after already first weeks showed a drastic fall in new consumer and housing loans.

Conclusion

After the Bank of Slovenia decided to transform the previous recommendations on loans into binding instruments and even make them more limiting, a lot of criticism followed, from the banks, the top of the government and the general public. The measures anyhow stay in place and resulted in an obvious decrease in loans in the past weeks. Supporters see this as successful attempt to tame the hazardous bank practices and protect the population from the effect of these loans. On the other hand, critics now fear that apart from the negative effect on the population, the economic growth and even the real estate market, it might also lead people to find crediting solutions outside of banks or in banks abroad.