

ASSOFIN- CRIF- PROMETEIA

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INTRODUCTION

The Survey analyses the whole of the household credit market, paying particular attention to the consumer credit business, with insights into the type of product and financial service provider.

Calculations have been made on the basis of official information available as of 31st May 2007.

This edition of the survey maintains its characteristic contents, focusing on the Italian finance world, but has a new set of graphics and offers a new way of reading it, making it easier for the reader to access the multitude of different contributions it contains. Therefore, the beginning of each chapter has highlighted guidelines that emerge from the studies carried out, which are then explored in more detail in the paragraphs that follow. These paragraphs also aim to give greater visibility to the different elements that are the focus of the study.

The Survey is divided into six chapters, each of which addresses different aspects of the household credit market. These and are as follows:

The first chapter describes the Italian and international macroeconomic scenario, paying particular attention to the trends in *drivers* of the demand for credit expressed by households.

The second chapter contains an analysis of the trends in overall household credit and compares the pattern of development that has characterized the main financial players in the market (general banks and specialized banks and financial institutions). Compared to the official information available, the special focus of the study is based on an estimate of the overall performance of the household credit market, divided into consumer credit, mortgages and other technical form sectors. In particular, the first part of the chapter (Para.2.1) is dedicated, in general, to family debt and to the overall historic trends. The study then focuses on the consumer credit market as a whole (Para.2.2) and looks at the two sectors of market operators separately: general banks on one hand (Para.2.3) and financial institutions and specialized banks on the other (Para.2.4). Finally, there is an in-depth look at trends in the family mortgage market (Para.2.5) though a study of the characteristics of mortgages granted, in terms of amount and average length, type of interest applied and the channels through which they are distributed.

Chapter 3 deals with a study of risk and trends in the consumer credit and mortgage markets, on the basis of data updated in December 2006. Risk analysis is carried out through static indexes, such as write-off, serious insolvency and slight insolvency rates, and dynamic indexes, such as the level of default rates and of mortality. In particular, the first section of the chapter analyses the trends in risk in the consumer credit market for operators as a whole (Para.3.1) and separately for the two sectors of general banks and financial institutions and specialized banks (Para 3.2). The in-depth analysis dedicated to household credit for Italian families continues with a study of trends in default levels, calculated in terms of the amount given, the length of the loan and mortality rates (Para.3.4). The second and last part of the chapter (Par.3.5) is, however, dedicated to the quality of credit on the mortgage market, whose trends are also analyzed through risk indicators that appeared in the section dedicated to consumer credit.

The fourth chapter illustrates the scenario predicted for the household credit market at an international level. The chapter is divided into two parts. The first, (Para.4.1) is dedicated to

an analysis of the trends and forecasts for the consumption of goods (by product sector), with special focus on the durable goods sector, the component most affected by the demand for household consumer credit. The second part is dedicated to a forecast of the loans scenario. This is an analysis of market trends, which is first carried out in relation to credit as a whole given to households by banks and specialized financial institutions, (Para.4.2) then in relation to the whole of the consumer credit market (Para.4.3) also by type of operator (Para.4.3.1 and Para.4.3.2) and, finally, in relation to the mortgage market. (Para 4.4). The illustrated forecast scenario ends with an interpretation of trends in the quality of household credit through some market risk indicators (Par.4.5).

Chapter 5 offers an analysis of future trends in the household credit market based on different macro areas. In particular, it looks at trends in the main macro economic parameters that characterize trends in the developing scenario in different territorial sectors (Para.5.1). After having highlighted the main territorial characteristics of the household credit banking market (Para.5.2), it outlines trends and future dynamics of the overall consumer credit market (Para.5.3) differentiated by type of operator and by the mortgage market (Para. 5.4). Finally, it analyses the main differences in credit quality between different macro areas through trends in write off rates (Para.5.5).

The sixth chapter of this edition of the Survey features a monographic investigation of the household credit market in some of the new European countries. The study focuses on two areas: one is macro economic and is linked to an analysis of the development of demand and of the household credit market (also in terms of the different morphology of credit-finance systems and of the macro economic context of the countries under examination). The other is more clearly micro economic and looks at the behaviour of financial intermediaries and at the policy of household credit supply. Its final aim is to analyze determining factors in the development of household credit, evaluate the growth potential of individual markets and identify possible gaps in the demand and supply of credit.

With the aim of offering as complete a picture as possible of the different characteristics of the consumer credit market in the individual regions, the final part of the Survey includes a series of regional data. The contents have been expanded compared to previous editions and contain a detailed analysis, on a regional basis, of the main parameters that specifically characterize the consumer credit and mortgage markets and their trends over time

As always the Survey relies on:

- The CRIF Credit System installment credit database as well as CRIF's expertise in processing data on credit risks and on the performance of this market.
- The information structure and forecasts of Prometeia, both in terms of development in the external environment and in terms of specific trends in household credit in different business sectors at a territorial level.
- The contribution of ASSOFIN, the Italian Association of Consumer and Real Estate Credit, which represents the most important financial institutions operating in the consumer credit and real estate mortgage markets and is thus the most accredited source of statistics pertaining to this market.

1.1 REPORT TOPICS

2007 opened with a trend towards growth in the economic activity of the EMU that was more than double that of the USA, even though it had slowed in both areas, compared to the intense growth rhythms achieved in the second half of 2006. In the course of 2007 the Italian economy should consolidate the recovery seen in the previous year, with a growth in GDP of around 1.8%, only slightly less than that of the 1.9% of 2006. Household spending should also slow down, moving from 1.5% in 2006 to 1.3% in 2007, but it will nevertheless be supported by the positive trend in occupation and disposable income.

In 2007 the Italian economy should consolidate last year's recovery

In 2006 the household credit market showed a lively growth, even though it has slowed down compared to recent growth in all territorial sectors. When looking at operators as a whole, by the end of 2006 the market had shown an increase of 10.8%, compared to the 12.4% growth registered in 2005. The demand for credit has been affected by the more reflective trends in the real estate market and the more restrictive monetary policy implemented by the ECB, while it has been supported by an improvement in the economic cycle and by the continued innovation and flexibility in supply, which have favored overall conditions of household credit.

In 2006 the household credit market showed lively, if slightly slower, growth

The consumer credit component has shown the liveliest trends, compared to other technical forms, even though it has also undergone a moderate slow down in growth rhythms: there has been a 17% increase in the sector, compared to the 20.8% seen at the end of 2005, thus stabilizing the incidence of overall household loans at 19% with a 90 billion euro volume. The incidence of household consumer credit to GDP has risen from 5.4% in 2005 to 6.1% in 2006.

The most dynamic sector was that of consumer credit ...

Recourse to consumer credit by households continues to be tied to mid-term structural factors, both in terms of demand and supply. In particular, the demand of households is supported by some socio-demographic aspects; for example, the simplification of the family group and increased work mobility. Furthermore, greater flexibility, visibility and access to credit have contributed to increasing the recourse to this credit, especially in families with a better household financial culture. On one hand, supply has consolidated the focus of operators on direct credit, in particular personal loans and loans on salary, favoring an increase in the customer pool, a gradual increase in the average sum borrowed and a lengthening of loan durations.

...mainly supported by mid-term structural factors

The growing attention given to the household credit sector by financial intermediaries has progressively generated a worsening of the pressure from competition, which has manifested itself, on one hand, in the reduction of unitary margins and, on the other, in a gradual reinterpretation of business models by sector operators. In 2006, the reorganization carried out by financial groups seems to have favored a growth in consumer credit, also through bank distribution networks, and has generated a further increase in the market shares of specialized operators, which has increased to 76.5% from the 75.5% of 2005.

The growing competition has led operators to re-evaluate their business models...

The supremacy of specialized operators is reinforced both in the customer credit sector (where the level of credit given by financial institutions and specialized banks has increased further – even if the trends in flows have seen an acceleration in the general banks sector, which also reflects the absorption of effects linked to the movement of larger portfolios towards specialized companies that has taken place in recent years), and in the mortgage sector, which continues to show livelier flows in mortgages granted by specialized banks (often foreign banks), with a trend in acceleration compared to 2005.

...when faced with a further increase in the activity of companies specialised both in credit and mortgages

Three factors have caused the slow down in the growth of mortgages: the housing market, monetary policy and the recourse to securitization and credit assignment...

The household mortgage market saw an increase of 12.5% in 2006. This has slowed compared to the 17.4% of the end of 2005 and, in terms of value; it has reached approximately 244 billion euros. In particular, the slowing down in the growth of stock is mainly due to a less lively property market, which still shows overall growth indicators, but ones that are lower than the previous two years. Moreover, the increasingly restrictive monetary policy may have, in part, limited the demand for new mortgages. The downturn in the growth rhythm in mortgages is also partially due to credit policies adopted by operators and put into action through securitization and the assignment of land mortgages, which were particularly intense in 2006, reaching a value of 17 billion euros in terms of the value of securitized stock.

...this has been contrasted by increased flexibility in supply and a widening of the client pool

Also in 2006, a trend continued as a response to the weakening of *driver* trends to increase the sums granted, lengthen expiry dates and re-evaluate percentages for variable-rate mortgages, which lost ten percentage points compared to 2005. Pressure from the competition and greater innovation in supply policies in terms of flexibility of financial solutions for repayment have also favored the extension of the demand pool to those with atypical jobs, foreigners, the young and the elderly. In particular, the demand to purchase housing on the part of immigrants grew by 12.9% in 2006 (according to studies by *Scenari Immobiliari*), especially in the North of the country, where buying and selling by these clients segment is concentrated.

The use of distribution through third party networks has increased

There is also a growing use of indirect distribution channels for real estate mortgages through the intermediation of third parties, brokers, financial promoters, agents and via the Internet. In fact, in 2006, 40% of total flows came via these channels, compared to 35% in 2003. The growth in this indirect channel has been favored by the entry of specialized banks on the market, which have used it for 78% of their mortgages granted and has been further established through partnerships with specialized sales networks spread over the territory.

The gradual reduction in credit risk has been consolidated

In 2006, the household credit market consolidated its trend of the previous two years towards a gradual reduction in overall risk. The total of number of defaults and insolvency, both major and minor, had by the end of 2006 a value that was lower than that of 2005 and 2004. This is true of intermediaries, general banks, financial institutions and specialized banks, and for both components of household credit: residential mortgages – the main part of their debt – and consumer credit. Greater market stability has been confirmed (the result of the behaviour of both intermediaries and families) and so has the gradual containment of risk.

The write-off rate is more sensitive to market trends and, after the increase recorded in the first half of last year, the second half saw once again levels that were similar to those of the previous two years. Also in this case, what is striking is the extraordinary uniformity and stability of relative temporal profiles, both in the different categories of intermediaries and in the two household credit components. The danger feared by some was that the long recession of the previous ten years would have produced, after a certain time, critical situations. This, however, does not yet seem to have materialized.

In coming years the demand for credit will be more selective and there will be a more flexible supply...

In coming years the demand for household credit should show further development, which reflects the peculiarities of local markets.

With the weakening of support derived from the property market and from interest rates being at historic lows, the household credit market should register some changes that will support its growth, even though this will occur with a gradually slower rhythm. In this context, the demand for credit will become increasingly selective and attentive to different offers on the part of operators and will increasingly respond to structural drivers, while supply will fo-

cus on increasing its client pool and on product innovation and flexibility (supported by trends in competition and developments in norms).

Overall, the growth in loans to families given by banks and specialized financial institutions should be around 9.7% by the end of 2007 and 8.3% and 7.5% respectively in 2008 and 2009.

...that will support further lively, but more contained growth in credit volumes destined for households

The growth in the market will mainly involve the consumer credit component, which should show livelier trends than other technical forms during the whole period under study. At the end of 2009 the quota of loans to households represented by consumer credit should be around 21.6% (after the 19% seen in 2006), while mortgages should have an incidence of over 52% in the whole three month period being studied.

Consumer credit should grow with a rhythm of 14.5% during 2007 and a 12.5% average in 2008-09, supported by the strengthening of structural drivers like the financial behaviour of households. The tendency towards forms of direct financing, both for specialized and general operators, should continue. The liveliest growth will be seen in the North East sector, in line with greater potential demand, highlighted by lower pro capita values than those of the national average.

Consumer credit should grow notably, especially in the non finalized sector...

The competitive advantage of specialised operators (who are more capable of handling the entire credit lifespan cycle) over traditional banks, should continue in coming years. However, collaboration between specialized companies and commercial banks should increase and these should sustain market growth, by mainly focusing their distribution networks on this business activity. Recent regulations to abolish commission on maximum overdrafts (which are still under discussion) could also provide further impetus to banks to favor the reorganization of the use of overdrafts and consumer credit.

... confirming in coming years the competitive advantage of specialized operators compared to an increase in bank distribution

In 2007 the land mortgage sector should confirm the slow down seen in the first three months of the year, where there was a growth of 10.6%. This trend is forecast to continue in the next two years and should be around 8.7% in 2008 and 7% by the end of 2009. The evolution of the market will continue to favor the regions of the South, which will however maintain its structural gap compared to the rest of the country.

The land mortgages sector should confirm its trend to slow down ...

Market growth will be mainly linked to product innovation and aided by trends in norms, which should lead to increased flexibility in offers and the spread of new products such as home equity loans and life-long home equity loans, aimed at meeting the need for immediate cash flow. The market will also expand towards foreigners; those with atypical jobs, the young and the elderly.

...but there will be innovative products and a greater trend towards segments that are today still marginal

The development of the household credit market is characterized by the maintenance of good credit levels. In the consumer credit sector this may be due to the combined effect of reorganized portfolios towards deadlines and higher amounts, together with riskier technical forms and, in part, to the increase in market interest rates and the gradual improvement in scoring and collection processes.

The quality of the market as a whole will be maintained under control

The in-depth monograph is dedicated to an analysis of the household credit market in New European countries, such as the Czech Republic, Hungary, Poland, Slovakia, Slovenia, Bulgaria and Romania. The study focuses on two fields: one is macro economic and is linked to the evolution of demand in the household credit market, also in terms of the different morphology of credit-loan systems. The other is more clearly micro economic and is inherent to the behaviour of financial intermediaries and to household credit policy. The main objective is to analyze the determining factors in the development of the household credit market, to evaluate growth potential for single markets and to identify possible gaps between credit demand and supply.

The in-depth monograph is dedicated to an analysis of the household credit market in the following countries in New Europe

The macro economic analysis highlights how household financial behaviour in these countries tends to follow a special trend cycle: in the first phase it satisfies consumer needs and later, with an increase in earnings and economic stability, it satisfies the need to buy a home. This behaviour and some other economic characteristics allow us to divide the countries into two groups:

- The first, made up of the Czech Republic, Hungary, Poland, Slovakia and Slovenia, has a greater use of credit with a larger demand for loans to buy homes, compared to consumer credit. Families have more disposable income and more financial wealth, which allows them to invest in residential property.
- The second, made up of Bulgaria and Romania, uses credit less and has a greater demand for consumer loans than mortgages. These families have lower incomes and tend to use credit to acquire durable goods.

All the countries studied have a notable potential for future growth in the demand for household credit, supported both by macro economic evidence and by trends in demographic characteristics and social organization. This potential regards not only the demand for loans but also for investment services, insurance and savings management.

The demand for credit has also been aided by the development of the financial system, which has increased credit availability, improved the quality of services offered and reduced the cost of loans. Foreign banks and operators have contributed significantly to this development and they are currently market leaders in many countries. In recent years retail clientele and, more specifically, households have become more important to the balance sheets and profit structures of banks.

Reflections on business opportunities in these countries can also be extended to other developing European markets. There are, therefore, concrete possibilities for the expansion of the activity of Italian operators who are able to reproduce their own business models and export their expertise in household credit. These opportunities are not exclusively for large banking groups, as in some of the countries studied there are still small banks that can be a target for new, smaller operators.