HOUSEHOLDS' FINANCIAL DISTRESS AND UNEMPLOYMENT

The capacity of households to repay their debts has been hampered by the economic downturn that took place in the course of 2008 and the first half of 2009. Indeed, with some lag with respect to the economic cycle, delinquency rates are still increasing markedly in some euro area countries, forcing banks to provision funds to cover for possible losses and, in some cases, leading to write-offs on loans on their balance sheets.

This box addresses households' financial stress at its earliest stage, i.e. when households start to face problems in servicing their debts. It focuses on the answers provided by households holding mortgage debt on "whether the household has been in arrears on mortgage payments in

the last 12 months", as polled in the EU Survey on Income and Living Conditions (EU-SILC). The indicator is defined as the percentage of households with late payments (on mortgage debt) in the total number of households holding mortgage debt. As the EU-SILC started to be conducted only in 2004, the indicator has been prolonged with the answers to the same question collected in the European Community Household Panel (ECHP) between 1995 and 2001 in order to cover a longer time span.[1]

The chart below indicates that arrears have shown a cyclical pattern between 1995 and 2007. Indeed, the indicator has been subject to some downward and upward movements, reaching peaks in 1996 and 2004, and troughs in 2000 and 2006. The most recent developments point to a slight increase in 2007 in comparison with the year before, to around 4%, which can be seen as close to the average historical level (available country-specific information indicates that it may have increased to 4.5% in 2008). It is also noteworthy that the overall euro area picture hides a high dispersion across countries. In particular, in 2007 the range moved between a minimum of 0.8% and a maximum of 18.3% (see table below).

The chart also illustrates the close link between the indicator of arrears and the overall unemployment rate (lagged by one year) – the correlation between both indicators being 0.76 (and 0.66 in first differences). This close and direct link can be expected, as the labour market situation is a key determinant of household income. An increase (decrease) in the unemployment rate implies an increase (decrease) in the proportion of households seeing a reduction in their income levels and, given a level of debt commitments, an increase (decrease) in the proportion of those facing problems in servicing their debt payments. This direct link between arrears and unemployment is confirmed by a micro-data approach, according to which households in which the head is unemployed are those showing a higher probability of facing debt servicing problems. Indeed, it is estimated that the probability of reporting late payments is more than 40 percentage points higher when the head of household is unemployed than in the case of heads of household with a permanent employment contract.[2]

Percentage of households holding a mortgage facing problems in servicing their mortgage debt and the overall unemployment rate

(1995 – 2010; percentage of households and percentage of the labour force)

- arrears (left-hand scale)
- unemployment rate (lagged one year; right-hand scale)

Country variation	1995	1997	1999	2001	2004	2005	2007	2008
Average	4.5	4.4	3.7	3.1	4.1	3.7	3.9	*4.5*
Min.	0.9	0.5	0.2	0.5	0.3	0.4	0.8	*0.7*
Max.	23.7	20.7	20.0	17.3	15.1	18.3	18.3	*13.7*

Sources: Eurostat and ECB calculations.
Notes: Arrears on mortgage debt based on micro-information derived from the European Community Household Panel (ECHP) up to 2001, and from the EU Survey on Income and Living Conditions (EU-SILC) from 2004; 2002 and 2003 are obtained by simple interpolation. Unemployment rate lagged one year; green dots indicate forecasts derived from Consensus Forecast. The figure for 2008 is an estimate based on available country-specific information.

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1 Estimates for the years 2002 and 2003 were obtained by simple interpolation. Euro area figures are based on country estimates obtained by means of household cross-sectional weights reported at the survey, which are then weighted by using country GDP at purchasing power parity (PPP) exchange rates.
2 This results from a probit estimate of late payments on working status, controlling for income, age, education level, household size, marital status, gender, migration status, durable goods own, employment rate in the region and country dummies, for the year 2007.

Looking at the level of the indicator together with the unemployment rate indicates that in 2007 it may be assessed as having been relatively high in historical terms, as it coincided with a record low in the unemployment rate. In fact, a similar level of this indicator was observed in 1998 when the unemployment rate was more than 2 percentage points higher. Nonetheless, long-term developments in arrears are also linked with other trends. In particular, new financial instruments offered to the general public and changes in consumer habits have led to a trend increase in the level of households' indebtedness, taking together mortgage and consumer debt. At the same time, there is evidence that such an increase has translated, in recent years, into a higher debt burden for households at the lowest income levels, which should have fostered debt servicing problems. On the other hand, there are also some offsetting factors in place. For instance, lending institutions – sometimes supported by government programmes – have developed tools to introduce flexibility in mortgage contracts, such as the possibility of delaying part of or all debt service payments temporarily in the case of spells of unemployment.

Looking forward, the ongoing downward adjustment in labour markets is expected to lead to a further increase in the number of unemployed and, as a result, it could extend and prolong its negative impact on households' income. In that respect, assuming a broadly unchanged institutional framework, the possibility of a further increase in the proportion of late payments close to or above the maximum reached in 1996 cannot be ruled out.