

Nontechnical summaries in English

Mapping financial vulnerability in CESEE: understanding risk-bearing capacities of private households is key in times of crisis

Nicolás Albacete, Pirmin Fessler, Maximilian Propst

A crisis of the real economy – like the current crisis caused by the COVID-19 pandemic – can have dramatic consequences for the financial sector if debtors become unable to pay back their debt. Since Austria's banks are heavily exposed to Central, Eastern and Southeastern Europe (CESEE), potential loan defaults in the region may affect financial stability in Austria.

The Household Finance and Consumption Survey (HFCS), whose third wave was published in March 2020, enables us to estimate at the microlevel the potential loss given default (LGD) of financially vulnerable households for Austria and eight CESEE countries. We show that the risk of CESEE households with collateralized debt defaulting on their loans is fairly small even though homeownership in the region is more common than in Austria. However, we see that the structure of uncollateralized debt varies strongly across CESEE.

LGD is lower in Slovakia, Poland and Estonia than in Slovenia and Hungary. This finding also holds when we consider differences in household composition across countries.

Since the COVID-19 crisis only started to unfold as we finished this study, we were unable to include simulations of income losses caused by the crisis and their impact on potential LGDs. Still, we show that the increase in the share of potentially vulnerable households is nonlinear across countries. The share of households that may run into difficulties repaying their debt does not rise proportionately with potential income losses, with the increase in critical values differing from country to country.

Austrian banks' lending risk appetite in times of expansive monetary policy and tightening capital regulation

Stefan Kerbl, Katharina Steiner

The past decade was marked by historically low interest rates and favorable economic conditions. Against such a backdrop, concern was mounting worldwide that banks might be overly willing to lend to borrowers whose ability to repay their debt is doubtful. Together with rising indebtedness, worsening credit quality can be a threat to financial stability. We therefore evaluate how the credit quality of Austrian banks' loans was shaped by low interest rates, tightening capital regulation for banks and the benign economic environment. We cover the period from 2008 to 2019. We use data from the Austrian credit register that provide loan-by-loan information on banks' own estimates of credit quality, in particular the probability of default, expected loss and the share of risky customers receiving additional funds. We combine this large dataset with data on banks that granted the individual loans with a view to assessing which factors drive banks' risk appetite in lending. Banks' risk appetite captures how much risk banks actively take on in their loan portfolio given their strategic objectives.

The results indicate a profound and, to our knowledge, as yet unreported decrease in bank-assessed riskiness of loans until 2019. We explore to what extent this development was attributable to borrowers' improved financial performance. Our tentative analysis shows that firms' financial statements did not improve to the same extent as did banks' credit risk estimates. The improvement in banks' estimates of credit quality rather went hand in hand with the generally improved economic conditions. Concerning risky customers' ability to access additional funding, we find that expansive monetary policy encourages risk taking by banks via a "search for yield." We confirm that, compared with large banks, this effect is stronger for deposit-financed banks that are particularly confronted with squeezed profit margins. We relate the overall decrease in bank-estimated credit risk to improved economic conditions but also to capital requirements that were tightened over the same period. This way, we corroborate research that indicates that better capitalized banks have reduced risk-taking incentives and tighter capital regulation can encourage banks to shift to less risky customers.

In light of the COVID-19 pandemic and the related economic shutdown, we zoom in on the credit risk developments over the past decade of service industries hit particularly hard by the coronavirus fallout (see annex 2). Research has shown that the situation at the beginning of a crisis is one key factor in how severely financial stability and the real economy are hit. For the industries currently most affected, we find that the credit quality as assessed by banks had

improved markedly over the past years. As a result, banks have assigned lower risk weights and have entered the crisis with lower loan provisions. Importantly, the macroprudential capital buffers applicable to banks in Austria will help absorb the shock. Such buffers, which are intended to cushion severe shocks, will need to be replenished after the crisis in order to rebuild financial stability. This is to safeguard that banks will have renewed absorbing capacity for future shocks.