

## EVOLUTIONS AND TENDENCIES REGARDING THE POPULATION LIABILITY RATE

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**Abstract.** The paper analyzes the evolutions regarding the population liability rate and the implication over financial stability. The population confronts with an increase of the risks determined by the expansion of the liability rate with its significant growth rate in the past years. It is presented the weight of population liability in GIP (Gross Internal Product).

There are also explained the main factors of the population liability rate expansion, such as: the low level of population endowment with consumption goods, long term goods and real estates, the increase of people’s fortune and the available incomes, the improvement of macroeconomic conditions as well as the decrease of the interest rate in particular and in the last the role of funds transfer from residents who work abroad.

Those factors are analyzed and presented with examples from Romania.

At the end of the paper the conclusions relieved the impact of the increase of the population liability rate over financial stability.

**Keywords:** liability rate, financial stability, real estates

In the present the population faces a risk increase on both the asset and liabilities sides of the end of year financial statement. If the risks on the asset side are due to modifications in the placement structure, for the increase of the amount of assets with high volatility and efficiency, the risks that characterize the liabilities are determined by the expansion of the degree in people’s indebtedting.

The main factors of the population liability rate expansion refers to the low level of population endowment with consumption goods, long term goods and real estates, the increase of people’s fortune and the available incomes, the improvement of macroeconomic conditions as well as the decrease of the interest rate in particular and in the last the role of funds transfer from residents who work abroad [1].

These factors have a special importance from the point of view of financial stability and the attention must be focused towards the risks that may appear from the people’s liabilities rather than the assets.

This is due to the fact that the actual tendency of increase of the degree of people’s indebtedting enhances its vulnerability to the shocks in economy, affecting the possibilities to honour debts, which can generate negative effects on the

creditors’ end of year financial statement and the demand in economy. In fact, the concern is not the indebting degree but its significant growth rate.

As noted in the chart below, the weight of the population’s credit represented at the end of 2005 almost 5% of the Gross National Product, below the similar EU values.

On the other hand, the expansion of credits for the population was explosive compared to the European values, increasing almost 8 times (as amount of GNP) from 1996 to 2005 [2].

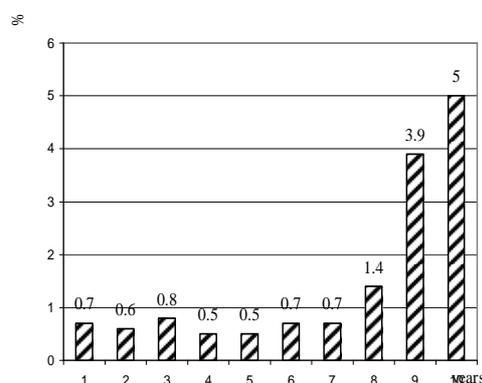


Figure 1. The weigh of people’s credit in the GNR in Romania

This expansion analysed in structure shows the fact that the population became indebted

through consumer credits. The structure of the indebtedting changed relatively slow (in 2005 the consumer credits represented 70.7% from the total credits, slowly decreasing from the level of 73.3% from 2004) [3].

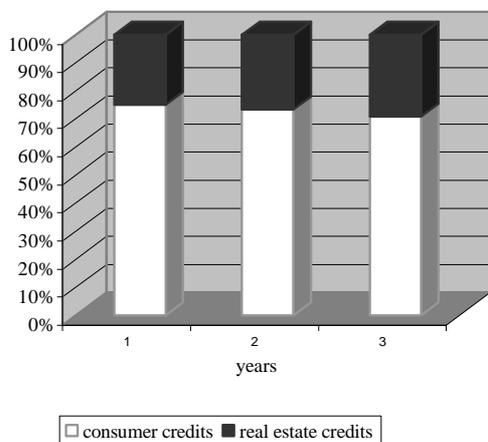


Figure 2. The structure of credits given to population in Romania

Considering the fact that in EU countries the structure of population credits is generally contrary to the present situation in Romania, it is possible that our country should see an increase in real estate credit rather than in consumer credits. Such an evolution, though it has positive elements, it can determine some concerns, regarding the financial stability point of view, when the increase in the demand for real estate leads to an even greater expansion of the price of these assets.

On the short term though, it is anticipated that the population would get indebted especially to satisfy the need for long-term consumer products, and as the available income increases, and the offer of real estate improves, there will be a transition of the indebtedting from the consumer credit to the real estate and mortgage.

In fact the credit providers are not interested in a major change in the population indebtedting structure, because consumer credits are guaranteed to a lower extent or not at all, and this risk, theoretically higher, is found in a higher profitability due to higher interest rates. Concerning real estate and mortgage, deemed less risky due to a real estate collateral, the least favourable scenario from the financial stability point of view is that where there is a significant positive correlation between the increase of interest rate, the decrease in real estate prices and the and the population's diminished ability to honour debts.

The main causes of the expansion of the population's degree of indebtedting were:

*The people don't own too many long term consumer goods and real estate.*

International statistics place Romania on one of the last places concerning the ownership of long-term consumer goods. As the economic climate improves, covering this type of necessities and the renewal of such goods will increase. The credit providers are already exploiting this segment for acquiring electronics/household items and cars, fully aware of the significant growth potential of the population's demand.

*The increase in population wealth and available income*

The population's net incomes have grown in the past two years, an important role having the effect induced by the price increase of financial assets, but especially of non-financial ones. These price variations influence the consuming and investment decision through the wealth effect and end of year financial statement effect.

The wealth effect is a decrease in saving motivation, as asset prices increase. The people feel more secure and want to consume more thus they resort to credits. In the future this effect could become important for the people of Romania considering the price increase of real estate assets and stocks.

Still, in Romania this wealth effect induced by the price increase of real estate assets is not significant because the owners benefit from the price increases but cannot change them into liquidities unless they sell the property. An improvement of this problem could come from the development of a liquid secondary market which would offer the owners the possibility to direct the earnings to the current consumption, requiring secondary mortgages or collateral credits with that property.

The end of year financial statement effect is felt by debtors that owe foreign currency. When the national currency is stronger there is an increase in the price of assets in the foreign currency and the debt in relation to the available income decreases, which gives the population a bigger indebtedting capacity. This effect is present in Romania too, generated by the national currency tendency to appreciate versus the USD and EUR.

*The improvement of macroeconomic conditions, in general and the reduction of interest rates, especially*

The active interest rate represents the cost of

the loaned funds and constitutes the main element in determining the indebted degree. The nominal interest rates specific for crediting the population have maintained at very high levels both in lei (including the inflationist component) and in foreign currency, the risk premium being considered significant.

When the inflation rate is high, it determines a high value for nominal interest rates. Thus the debt as amount of income, report which is higher at the beginning of the credit process when using a payment chart for equal instalments, will have higher values the higher the inflation rate gets. That's why the people's capacity for indebteding will increase as the inflation rate follows a descendent trend.

On the other hand, the increase of the real interest rate diminishes the incomes produced by the population's assets, but, on the other hand, it reduces the cost of indebteding and increases the up-to-date value of future income. If the demographic structure of Romania is considered, it can be estimated that the decrease of the real interests has a positive effect on the population because the number of older persons which live off incomes independent from pension money, those that have a significant net fortune and those about to retire is smaller than the number of young persons, those that have taken credits and those that are about to. Plus, the economic growth and the decrease in inflation acted on the people's trust in the improvement of life conditions. These evolutions took place during favourable work place conditions, representing another important factor that encouraged the increase of the consumption demand through indebteding, due to the people's lack of fear for losing their jobs.

*The role of the funds transfer of the residents that work abroad*

The volume of such transfers has increased continuously in the past years, being in 2005 of almost 2.5 billion EUR. The income sent by the residents that work abroad represents a stable source of capital entries. Empirical studies have shown that these transfers have the capacity to improve the life style of the recipients, leading to the increase in consumption of food, consumer products, some long term. Still, it can be appreciated that these transfers can lead to the increase in the degree of the people's indebteding, representing, for instance, the advance money for a credit. The volume and the dynamics of the transfers are important even from the financial

stability point of view due to the fact that significant and sustained entries of such funds, next to the benefic effects, can lead to negative aspects like the decrease of the will to work for the recipients of the transfers, the considerable appreciation of the exchange rate and the price increase of real estate.

Considering the fact that most transfers come from the income of residents that work in EU space and analyzing the demographic structure, the salary level and the increase rate in the EU, it is estimated that in the future the transfer volume may increase significantly, with the inherent risks and benefits.

The risks of the increase of the degree of people's indebteding

Not only value modifications of the population's credit determine concerns related to financial stability, but also structural ones. Thus it is important to bring forth the following tendencies:

- The significant amount of foreign currency credits over the national currency credits. This tendency may exist in the future too, due to low interest rates in foreign currency, but also the appreciation of the national currency over the main foreign currencies. This way the cost of the foreign currency credit diminishes. The concern is about eventual significant, long term national currency depreciation, which will increase proportionally the debt of the unhedged borrowers, and the more foreign currency credits increase, the more danger there is for problems in the system (for instance, for leasing societies the situation is even more severe because almost all credits are in foreign currency).

A separate analysis of consumer credits, real estate and mortgage shows that the largest number in foreign currency belongs to the latter, while the increase rate belong to consumer credits. Considering the long term for which real estate credits are given and the fact that around the years 2012-2014 Romania is to adopt euro as national currency, the result is that the unfavourable effect generated by unhedged borrowers is less visible than in the case of real estate credits towards the consumer goods credits.

- The expansion of credit maturity. Medium term credits (between 1 to 5 years) have known the greatest expansion, reaching, at the end of 2005 to almost 56% from the total of credits to population. In turn, long term credits (over 5

years) were a third of the total [4]. This increase on maturity next to the beneficial effects also brings certain risks. The lack of the banks' medium and long term resources to finance credits with higher maturities generates a mismatch of payment terms, with the inherent risks; the longer the payment terms, the stronger the possibility of not taking into consideration the medium and long term evolution of the interest rates and the unemployment rate; getting a longer maturity credit allows the borrowers to get even more into debt because the debt decreases. This behaviour of increasing the present consumption in the detriment of the future one can cause problems if a certain critical stage is reached.

- The amount of credit for the population in the total non-government credit is increasing continuously. The amount of credit for the population increased its importance in the total non-government credit, sometimes following an exponential curve. Thus, this amount increased, from a modest level of 4.8% in 2004 to almost 30% in 2005. Even if this evolution will approach the credit structure given by the Romanian banks to those of EU banks (where the credit for the population was, at the end of 2005, 54.7% from the total non-government credits), presently the financial force of the population is not comparable to that of the nonfinancial companies enough to justify such a quick alignment to the European characteristics [5].

The present tendency of increasing the degree of indebtedting determines a higher vulnerability of the population to the changes in the interest rate, of the available income and of the prices of financial and nonfinancial assets.

The expansion of the population's indebtedting can have long term beneficial effects over the financial stability; because of the very important social function that crediting has over the population, respectively its disciplining. Because of this, gradually, as the amount of people that get indebted increases, and the punitive mechanism of the credit bureaus amplifies, the population will be more concerned with identifying measures for maintaining or even increasing the available income (increase in work productivity, concerns about improving the professional development, finding a second job, etc.).

In the last years we can see a competition between banks. Traditionally banks have initially

moved into external markets with agency or a representative office because of the relative ease with which they can be established.

The most important factor affecting the choice of type of office is the attitude of the host country as reflected in its laws, regulations and policies towards financial institutions. Some countries prohibit foreign commercial branches; other prohibits foreign-held subsidiaries. And, of course, some governments exclude both foreign branches and subsidiaries. In some cases, policy of the home country of parent bank may determine or at least influence the type of office established abroad. In at least few instances, certain types of overseas office are not permitted by the government of the parent company.

Generally, branches are easier to establish than a subsidiary in a foreign country and they afford the parent company the greatest degree of control. Accordingly, as full service types of offices, branches play a key role in external operations. The type of office a bank establishes abroad also depends upon the extent of market participation desired by the bank, the amount that can be invested in the facility, and the availability of trained and talented staff.

These considerations were made to realize that the existence of foreign banks may increase the indebtedting of the population by increasing the alternative for one bank or another. This will amplify the process of increasing present consumption of the population, of course, in the detriment of the future.

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