Featured statistic

Development of household borrowing 2004-2007

Major changes in the mortgage loan market in recent years have caused a sea change in lending to households. The commercial banks' entrance into the mortgage loan market spurred competition, increased access to credit and caused changes in mortgage lending terms. The following is a brief overview of developments.

In July 2004, the Housing Financing Fund (HFF) changed the structure of the bonds that it issues to fund mortgage lending. Issuance of housing bonds with embedded call options was discontinued and replaced by HFF bonds in annuity format with fixed interest rates. As a result, HFF lending rates were soon lowered from 5.1% to 4.8% and eventually to a low of 4.15%. In autumn that year, the commercial banks, savings banks and several other credit institutions stepped up their profile in the mortgage loan market. Fiercer competition drove down interest rates and substantially increased households' access to credit. The commercial banks also reduced their housing mortgage rates to 4.15%. From 2006, HFF lending rates began to rise again and the banks followed suit. HFF rates (including a conceivable prepayment option) are currently 4.8%, 0.3 percentage points lower than before the banks entered the market.

These structural changes in the mortgage loan market had an impact on private consumption and household debt. Strict rules set by the HFF for loan ceilings and loan-to-value ratios had effectively capped house prices. This changed when the banks entered the market and the HFF eased its own lending rules. Lending is now more closely linked to the payment capacity of homebuyers, which together with the market value of the housing determines mortgage lending amounts. Properties may be mortgaged for up to 100% of their market value and loans are not required to be deployed entirely on residential purchases. Changes in the mortgage loan market are doubtless also responsible for the surge in house prices over this period.

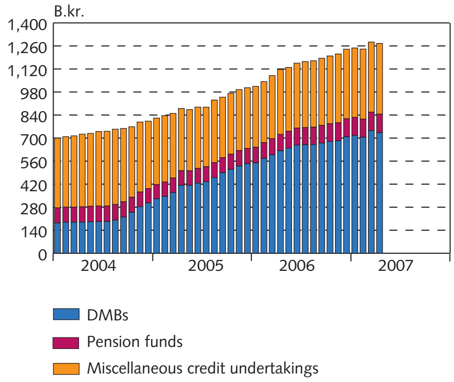
The main providers of household credit are miscellaneous credit undertakings,[1] deposit money banks (DMBs) and pension funds. Residential credit cannot be directly disaggregated from other lending, since mortgage collateral is generally insisted on for loans regardless of whether they are for housing purchases or other investment. Total lending to households amounted to 1,275 b.kr. in April 2007, up by 14% year-on-year from 1,117 b.kr.

DMB lending to households has soared, as Chart 1 shows. It amounted to 745 b.kr. at the end of May 2007, compared with 192 b.kr. in the corresponding month in 2004, a growth rate of 286%. By comparison, pension funds' loans to members increased by 22% from

Chart 1

Total household borrowing

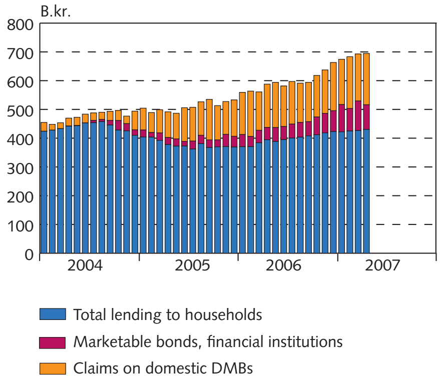
January 2004 - April 2007, end of month



Source: Central Bank of Iceland.

1. Miscellaneous credit undertakings comprise the Agricultural Loan Fund, Avant, Frjálsi investment bank, Greiðslumiðlun (VISA Iceland), the Housing Financing Fund, Kreditkort (Eurocard Iceland), Lýsing, MP investment bank, the Municipal Loan Fund, the Regional Development Institute, SP-Fjármögnun, Straumur investment bank and VBS investment bank.

Chart 2
Main assets of miscellaneous credit undertakings
January 2004 - April 2007, end of month



Source: Central Bank of Iceland.

April 2004 to April 2007. Residential mortgage lending accounted for almost 57% of total DMB lending to households in April 2007.

Total household lending by miscellaneous credit undertakings contracted from autumn 2004 until mid-2005 and remained broadly flat until March 2006, but has grown slowly since. The outstanding loan stock at the end of April 2007 was 430 b.kr., as against 442 b.kr. in April 2004. The HFF dominates household lending by miscellaneous credit undertakings.

Chart 2 shows the growth in claims on domestic DMBs and marketable securities portfolios of miscellaneous credit undertakings in recent years. Easier terms in the mortgage loan market have encouraged borrowers to refinance earlier loans which had carried less favourable terms. The bulk of lending by miscellaneous credit undertakings is long-term, as are claims on DMBs, but marketable bonds are mostly at short maturities. The HFF has amassed strong liquidity from prepayments, which it has invested in long-term claims on DMBs and short-term arrangements with financial undertakings.

Mortgage terms are easier in 2007 than they were in 2004. Interest rates are similar but credit access, loan amounts and loan-to-value ratios are more favourable for borrowers. Demand for residential credit has grown because potential homebuyers no longer need to reach a threshold of saving in order to climb onto the housing ladder, opening up the housing market to young people who would have lived with their parents for longer. Offsetting this, soaring house prices have increased the debt service burden, specially for first-time buyers.