II FINANCIAL BEHAVIOUR OF COMPANIES AND HOUSEHOLDS AND THEIR RISKS

COMPANIES

Financial position and saving

According to the financial accounts analysis (see also the background information "Compilation of financial accounts in Eesti Pank"), corporate financial investment exceeded savings in 2005. As **financial deficit** still decreased, the negative **net financial position** of companies improved by 2 percentage points by the end of 2005 compared to 2004, i.e. to −117% of GDP (see Figure 2.1).

Although generally companies invest most of their funds in fixed assets, some funds are also placed in financial assets in order to maintain liquidity, hedge risks and earn income. Approximately half of Estonian corporate **financial assets** are comprised of stocks and holdings in other companies (44%). The share of cash and deposits amounts to 15% and also the share of issued loans is the same. Last year, corporate deposits grew the most. In addition, more shares and holdings in other companies were acquired than in 2004. Besides domestic investment some financial funds also find their way out of Estonia, for example through the expansion of a company's activities abroad.

The growth rate of domestic corporate **deposits** started increasing again in October 2005, rising even to 68% in December. All the same, the growth of deposits was very volatile, referring to a possibility that part of that could be attributed to short-term investment of funds received from e.g. company sales or external funds attracted from abroad. The share of time deposits in total deposits increased, reaching a semi-annual average of 30% in March, which is 5 percentage points higher than six months before. This was caused by short-term deposits with maturities of up to two months. Companies have become more active in managing their liquid assets and have found more profitable ways to allocate them. This shows in the growth of the share of overnight deposits to 38% in total deposits, which is 4 percentage points higher than a year ago.

More than a half of corporate **financial liabilities** are shares and other equities and over a quarter are loan commitments. Few companies have issued bonds. Besides loan commitments, also the amount of stocks, shares and bonds issued increased in the past year. Due to the strong growth of deposits the coverage of corporate loan and bond commitments by liquid financial assets

Figure 2.1. Corporate financial assets and liabilities (EEK bn and % of GDP)

(cash, deposits, securities and granted loans) has increased from 56% at the end of 2003 to 62% at the end of 2005.

From among European countries, Estonia had one of the greatest financial deficits in 2004 which can also be said about Slovenia (see Figure 2.2). Generally, the corporate sectors of new EU Member States suffered a financial deficit, while older Member States had a lower deficit or even a financial surplus. At the end of 2004, net financial assets in all countries were negative, reaching from 134% of GDP in Sweden to –62% in Poland.

In countries involved in the analysis of financial accounts, the largest share of corporate financial assets were comprised of stocks and holdings in other companies and other financial assets, including trade credit issued (see Figure 2.3). The share of currency and deposits in financial assets was the greatest among the companies of the United Kingdom and Greece (30% and 39%, respectively) and also Lithuania's indicator was high (27%). The coverage of corporate loan commitments by liquid financial assets varied greatly by countries, reaching from 31% in Italy to 97% in Belgium (see Figure 2.4).

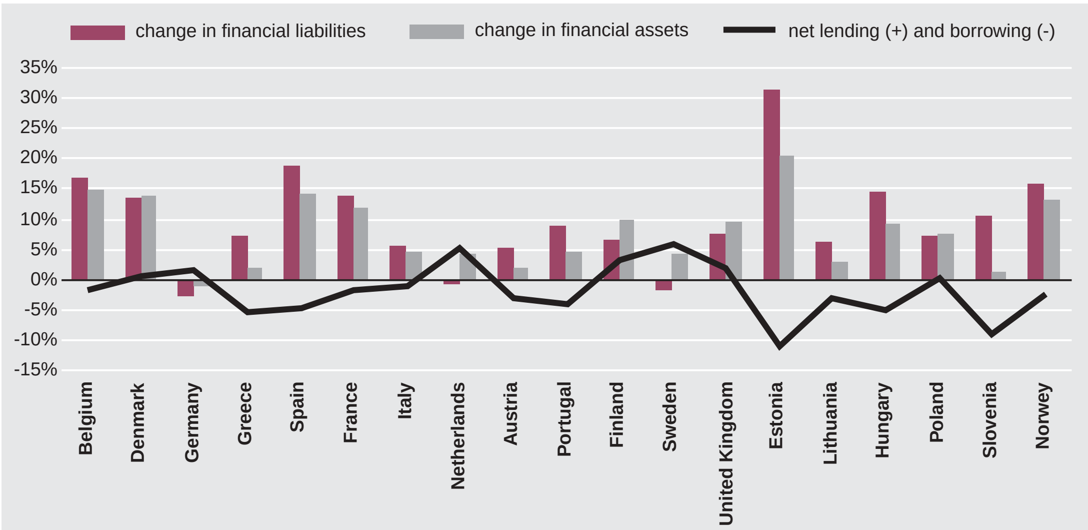

Figure 2.2. Corporate sector net lending and borrowing by countries in 2004 (% of GDP)

Source: Eurostat

Figure 2.3. Corporate financial assets and net financial position by countries at end-2004 (% of GDP)

Source: Eurostat

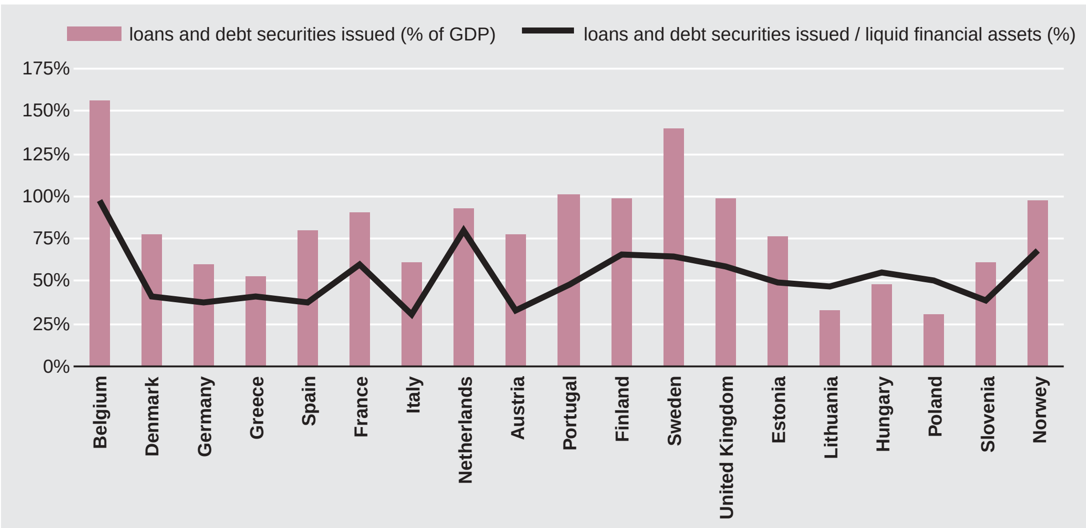

Figure 2.4. Volume of corporate loans and debt securities issued and their ratio to liquid financial assets at end-2004 (%)

Source: Eurostat

COMPILATION OF FINANCIAL ACCOUNTS IN EESTI PANK

In 2004, Eesti Pank commenced preparations for the compilation of quarterly national financial accounts. By today, the Financial Stability Department has completed the balance accounts as at the end of 2003, 2004 and 2005, and the transaction accounts of 2004 and 2005 by quarters[1]*.*

The financial accounts of the national accounts system describe the state of financial assets and liabilities as well as respective transactions between different economic sectors. *Financial accounts include crucial financial information, which can be used for the analysis, forecasts and international comparison of the influence of the economic sectors' financial behaviour and economic policy decisions.*

During the past few years the use of financial accounts has become extensive. For instance, the time-series created on the basis of financial accounts are essential for the European Central Bank (ECB). The ECB uses quarterly euro area data concerning financing and financial investment in the analysis of the economic situation of companies and households[2]*, and these serve as the basis for making monetary policy decisions.*

Eesti Pank also discovered the need for a more complete approach to financial indicators. In addition, we must be ready to meet the requirements of the European Central Bank regarding the compilation of statistics upon becoming a full member of the Economic and Monetary Union (EMU). Timeliness and high quality in submitting the time-series of financial accounts calls for lengthy preparations and experience in preparing the accounts, and thus the central bank started early. Thirdly, a financial account enables to coordinate the activities of different statistics compilers and improve the overall quality of statistics, as the entire economy is under scrutiny instead of single sectors.

In the compilation of quarterly financial accounts Eesti Pank proceeds from the European System of Accounts (ESA 95) and uses its concepts, definitions and classifications. Such an approach meets the needs of analysts as well as the requirements of forwarding data to the European Central Bank and is methodically compliant with the national annual accounts system.

Data from a variety of sources are used in the compilation of the financial accounts; there are no separate studies or surveys conducted for that purpose. The primary data sources are the following: the statistics of credit institutions; Estonia's balance of payments and international investment position data; the balance sheet data of Eesti Pank; the statistics of leasing companies; the reports of investment funds; the reports of savings and loan associations; the statistics on securities (data of the Estonian Central Depository for Securities); the reports of investment firms; fund managers' reports; insurance statistics; the reports of other financing institu-

[1] National annual accounts (incl. financial accounts) are compiled in the Statistical Office. Quarterly financial accounts are compiled in Eesti Pank, which are completed approximately four months after the end of the respective period.
[2] Euro area countries have been submitting financial account time-series to the European Central Bank pursuant to the "Guideline on the statistical reporting requirements of the European Central Bank (ECB) in the field of quarterly financial accounts" as of 21 November 2002.

tions and financial auxiliaries (quarterly survey of the Statistical Office); the survey concerning the annual statistics of companies and quarterly financial indicators of major enterprises (the Statistical Office); the quarterly and annual statistics of the general government, etc. In addition, other survey results (e.g. TNS EMOR surveys) and also indirect estimations are used.

The Estonian economy has been a net borrower during the past two years (see Figure 2.5). The greatest source of the financial deficit has been the business sector whose deficit has reached a maximum of 18.2% of GDP. While traditionally households are regarded as a sector with financial surplus, Estonian households have shown a deficit throughout all quarters in the past two years – primarily due to the drastically increasing loan commitments. The general government has contributed to offsetting the deficit, usually posting a surplus in the first three quarters of a year and a deficit in the final quarter.

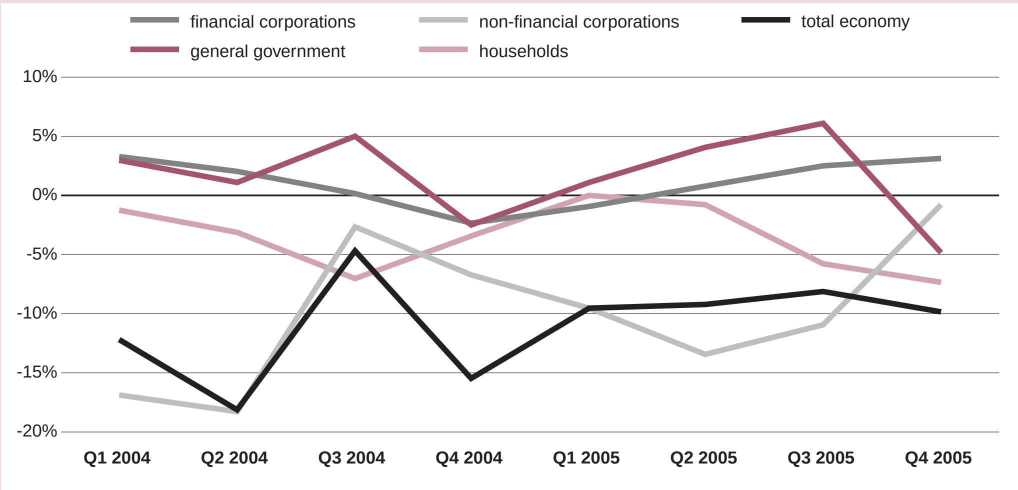

Figure 2.5. Net lending and borrowing (% of GDP)

Corporate debt

The **growth of corporate debt**, which started accelerating in the first half of 2005, sped up even more in the following quarters. By the end of the year, debt growth reached a record level of 26% (see Figure 2.6).

The structural development characteristic of recent years continued in 2005: the share of corporate external borrowing decreased and that of domestic borrowing increased. Compared to the end of 2004, the stock of corporate external debt even shrunk (see Figure 2.7). Meanwhile, the growth rate of domestic debt reached record levels (46%). This indicates that the relative advantage of external borrowing will fade, if the role of domestic financial intermediaries in financing companies increases owing to the decrease in interest margins and better availability of loans. Structural changes are expected to take place in the near future as well.

The remarkable acceleration of debt growth brought along an **increase in the corporate indebtedness**. Corporate debt in ratio to GDP reached 67% by the

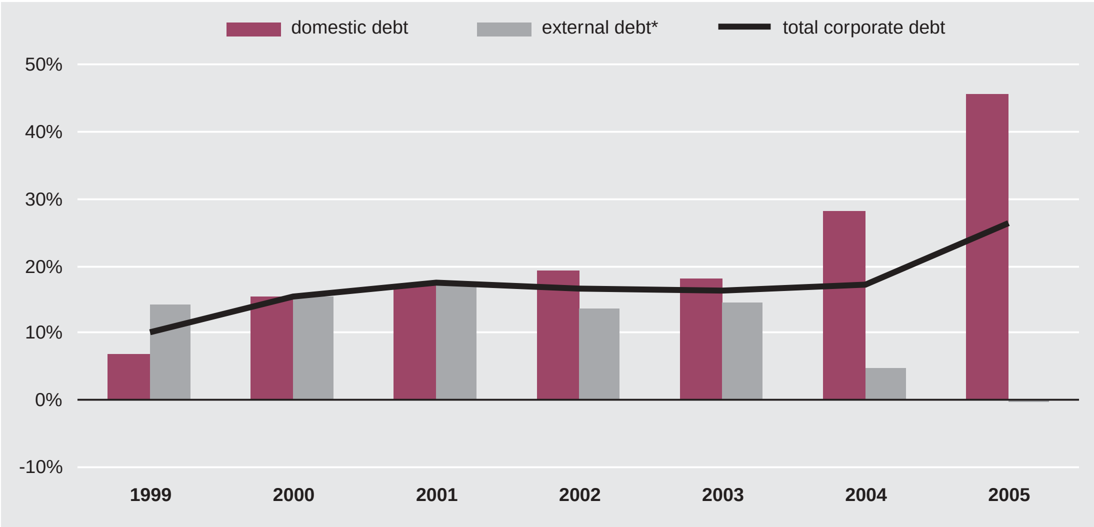

Figure 2.6. Corporate debt growth

* intragroup claims subtracted

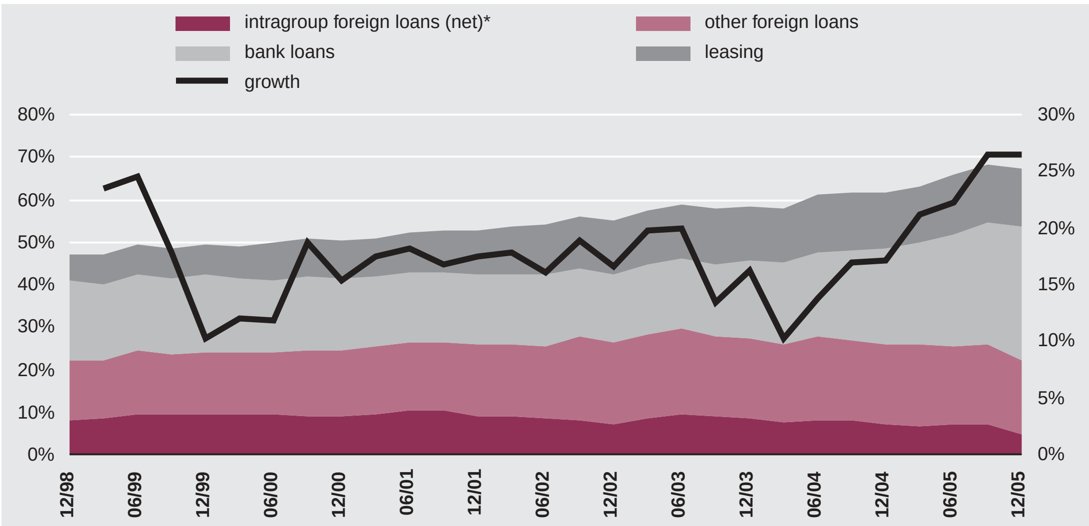

Figure 2.7. Corporate debt (% of GDP; left scale) and growth rate (right scale)

* intragroup claims subtracted

end of 2005, having grown by over 5 percentage points within a year.

As for **economic sectors** in 2005, real estate and construction companies were again the most active to attract debt, being the destination for 43% of the total debt acquired by non-financial companies during the last year (see Figure 2.8). Debt grew quite modestly in transport, storage and communications, where financing was probably based more on own funds during this period.

The growth of domestic debt at the beginning of 2006 was expectedly faster in the fields of real estate and trade. Compared to the beginning of the previous year, the credit to construction and agricultural companies increased faster (the annual growth rate of the stock of loans and leasing stood at 71% and 58%, respectively).

Real estate financing by domestic banks

At the end of March 2006, 59% (30.5 billion kroons) of corporate loans were purposed for acquiring real estate (incl. for own use as well as for commercial purposes). 54% of that accounted for loans granted to real estate companies.

Other sectors borrowed a total of 14 billion kroons for financing real estate, whereas the year-on-year growth was virtually double. Real estate loans comprised 44% of the debt of non-real estate companies, i.e. proportionally as much as in 2005 (see Table 2.1). By sectors the differences are quite remarkable: as to hotels and restaurants, for instance, the share of real estate loans in total debt reaches 82%, whereas the respective ratio is 30% in the transport sector, 39% in trade, and 44% in manufacturing.

In terms of loan purposes, the acquisition of real estate for own use prevails for both real estate and other companies (see Figure 2.9). However, it cannot be ruled out in any field that instead expanding or improving production, storage, trading or office spaces, the loan decision might have been spurred by the desire to earn additional income from real estate development. By adding household housing loans and leasing to the stock of corporate real estate loans, the real estate portfolio of banks has grown to 76 billion kroons (45% of GDP).

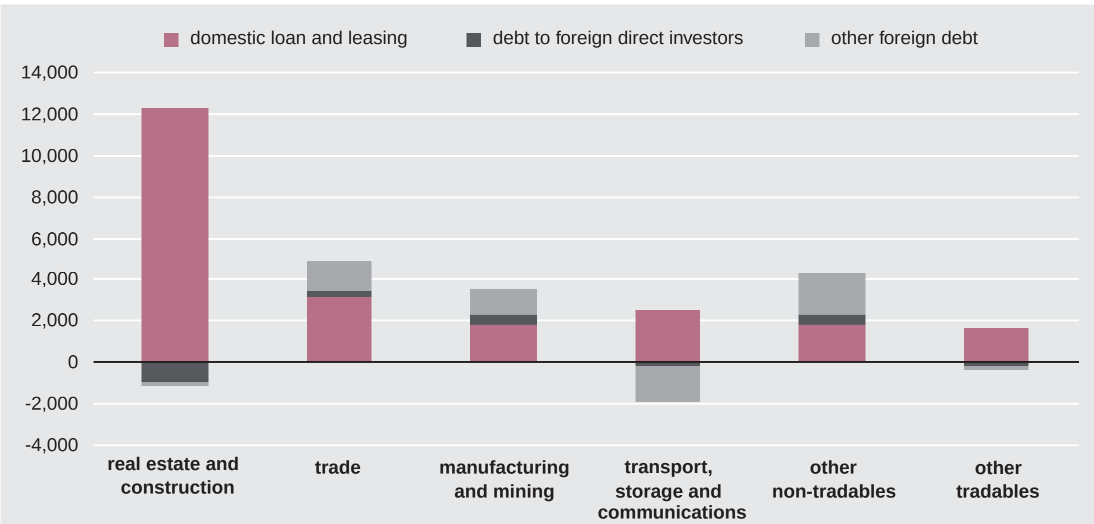

Figure 2.8. Net borrowing of corporate sector in 2005 by fields of activity (EEK m)

Tabel 2.1. Stock of corporate real estate loans

	2003*	2004*	2005	Q1 2006
Real estate sector				
real estate for own use (EEK m)	3,130	5,106	8,629	9,681
commercial real estate (EEK m)	3,225	3,860	6,348	6,654
share of real estate loans in total loan volume	87%	78%	87%	87%
Other sectors				
real estate for own use (EEK m)	4,996	6,711	10,941	11,929
commercial real estate (EEK m)	368	688	2,011	2,237
share of real estate loans in total loan volume	43%	45%	44%	44%

* Business services included; real estate activities distinguished as of July 2005.

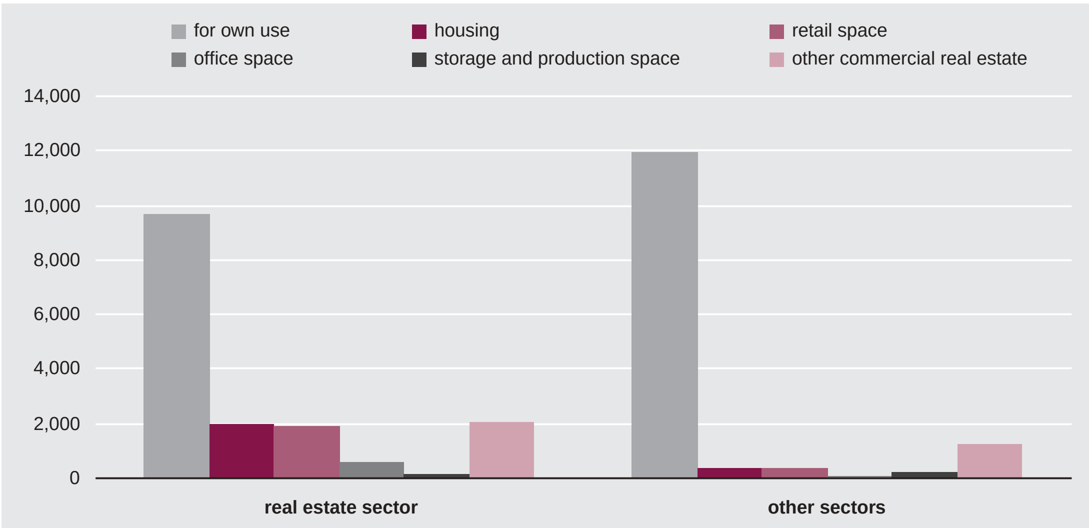

Figure 2.9. Corporate real estate loans (EEK m; as at 31 March 2006)

HOUSEHOLDS

Financial position and saving

Contrary to previous years, the financial investments of households have exceeded savings in 2004 and 2005, resulting in a **financial deficit** (3.8% and 3.3% of GDP, respectively). Due to the rapid debt growth the **net financial position** of households weakened by 3 percentage points during 2005 to 17% of GDP (see Figure 2.10).

Households' **financial assets** are primarily kept as currency and deposits (44% of total financial assets). Shares and holdings in investment funds comprise 39%, of which investment fund shares account for 3% of total financial assets. So far, insurance and pension products are not yet a popular form of investment in financial assets, but they are expected to grow fast as the volume of pension assets increases. In 2005, household pension assets stood at 6.2 billion kroons, i.e. at 7% of the total volume of financial assets.

Last year, financial assets experienced an increase mainly in currency and deposits as well as resources held in pension funds. However, the volume of listed

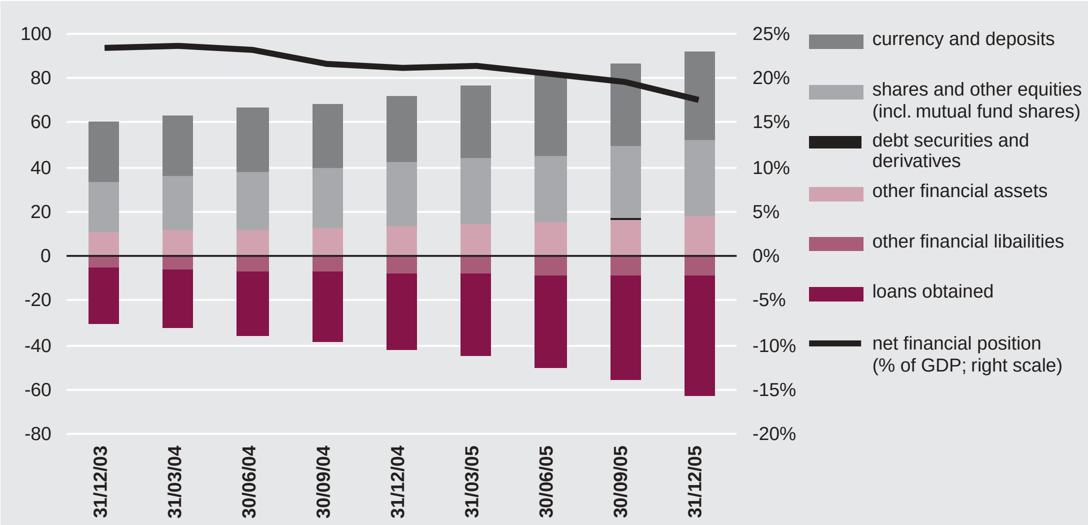

Figure 2.10. Household financial assets and liabilities (EEK bn and % of GDP)

shares held by households decreased in the last two quarters of 2005, partly as a result of the sales of Hansapank's shares in respect to the takeover of Hansapank.

The growth rate of household **deposits** has remained over 30% in the past half-year (see Figure 2.11). Though the share of time deposits in total deposits stayed near 40%, increasingly more short-term deposits are being used as time deposits and the share of long-term deposits has been constantly decreasing.

The growth of households' **financial liabilities** was outstanding both in 2004 and 2005. Therefore, the net financial position as well as the **coverage of liabilities by liquid financial assets** deteriorated.

From among European countries in 2004, the Estonian household sector displayed the greatest financial deficit, though also the households of Denmark, Finland, Spain and the United Kingdom invested more than they saved (see Figure 2.12). In all the European countries observed, the net financial assets of households were positive, reaching from 206% in Belgium to 21% of GDP in Estonia (see Figure 2.13). Generally, it appears that the ratio of households' net financial assets to GDP in the new EU Member States was lower compared to older Member States.

Similarly to Estonia, the financial assets of other European households have also been analysed mainly in terms of currency and deposits, shares and other equities. In some countries, insurance products also play an important role in household assets (the United Kingdom, Germany and France). The importance of these assets mainly depends on the structure of the pension system and the volume of assets placed in pension insurance.

Household debt and loan-servicing ability

Debt level and growth

The **year-on-year loan and leasing growth** of households has been accelerating since the beginning of 2005. By the end of March, the growth rate exceeded 60% (see Figure 2.14).

Similarly to recent years, the rapid loan growth mainly stemmed from the strong loan demand on

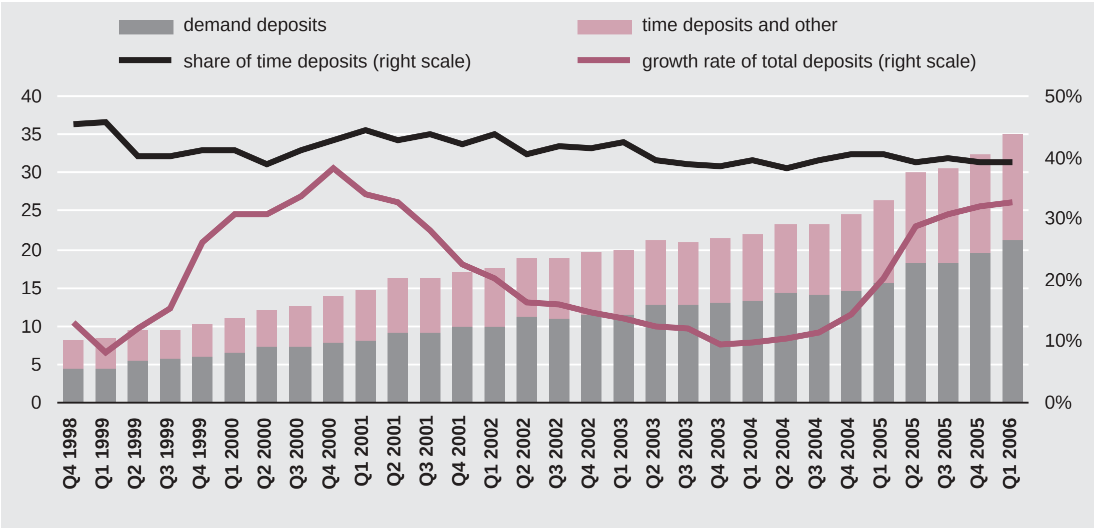

Figure 2.11. Household deposits in domestic banks (EEK m) and deposit growth

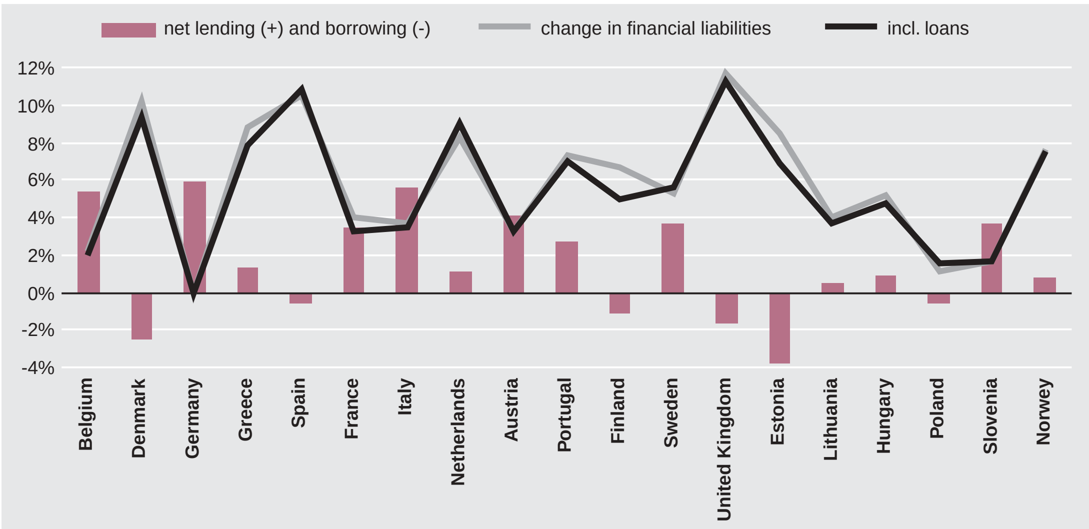

Figure 2.12. Net lending and borrowing of the household sector in European countries in 2004 (% of GDP)

Source: Eurostat

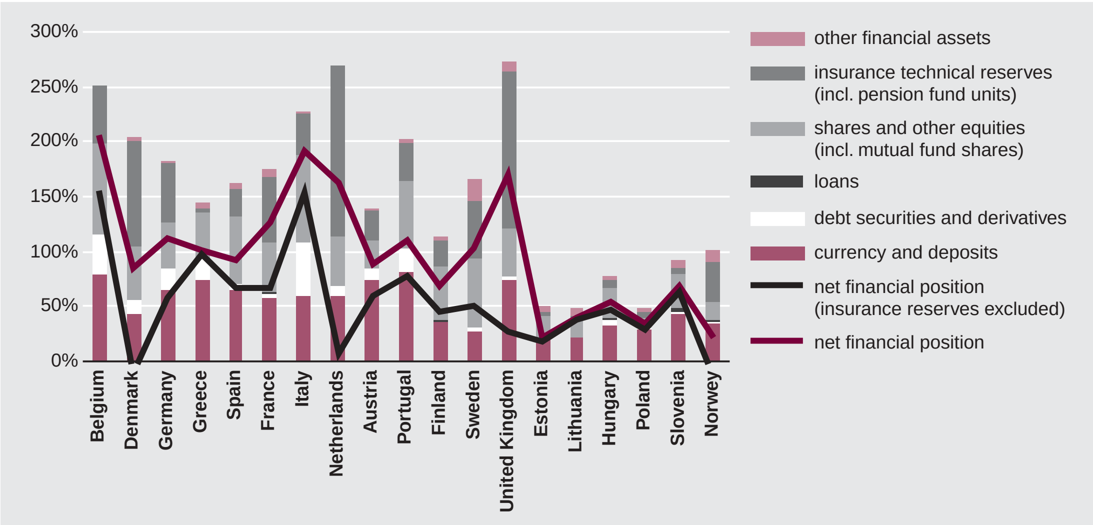

Figure 2.13. Household financial assets by countries as at end-2004 (% of GDP)

Source: Eurostat

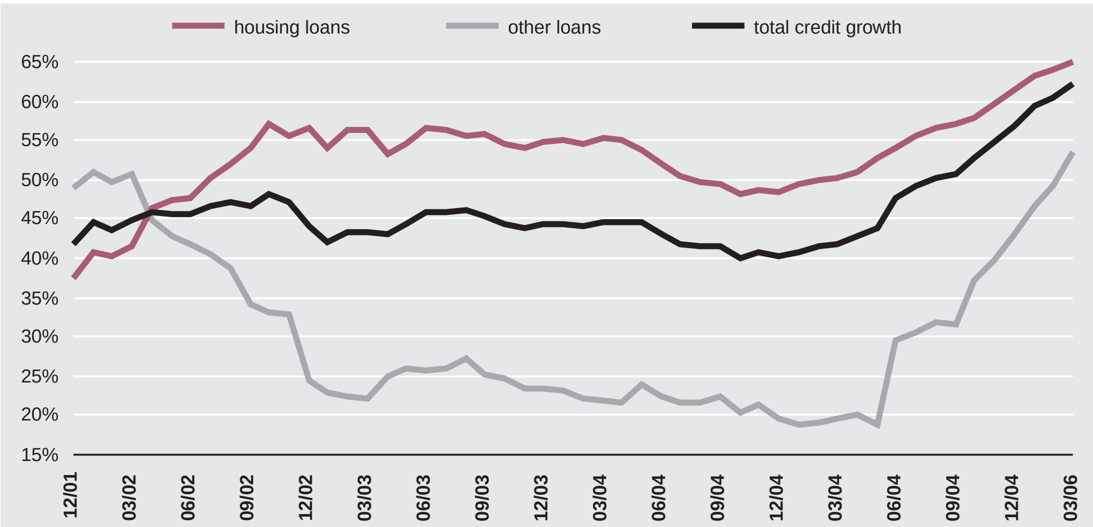

Figure 2.14. Annual growth of domestic credit to household sector

the housing loan market. Though the share of other loans (incl. consumer credit) in household debt has decreased from 23% to 22% over the year, this market segment has also revived in light of general economic activity.

Household indebtedness, which comprised 57% in ratio to the real disposable income at the end of March 2006, has shot up by more than 15 percentage points within the past year (see Figure 2.15). The debt level continues to be low in comparison to the more advanced economies of Europe (e.g. at the end of 2005, the ratio of debt to real disposable income amounted to an estimated 225% in Denmark, 150% in the United Kingdom, 130% in Sweden, and 89.5% in Finland)[3]. As for the indebtedness growth, however, Estonia is in the forefront of European countries (see the background information "Household loan growth in European countries").

Housing loans

The **stock of housing loans** reached 46 billion kroons at the end of March, increasing by over 18 billion kroons, i.e. 65%, within a year. Within the last six months, the number of housing loan customers has grown by approximately 11,400 households and has raised the share of households with the respective long-term loan commitment to 17.5%[4]. If the next few months witness a similar rise in the number of new customers as the first quarter (an average of 1,600 new clients per month), the share of households with a housing loan may increase to 20% by the end of the year.

Due to the rise in real estate prices, the **share of large loans** in the banks' loan portfolio has increased. In March 2006, loans in the sum of over 1 million kroons accounted for about 32% in the turnover of new loans; only half a year ago they comprised 16%, i.e. half the volume (see Figure 2.16). Quite a number of loans are also taken for renovating housing.

Low interest rates have played a substantial role in the housing loan market activity (see Figure 2.17). From the end of September 2005, when EURIBOR started to recover from its long-term low, the key interest rate (6-month EURIBOR) increased by approximately 80 basis points by the end of March 2006. The relatively modest rise of EURIBOR could not cool off the borrowing frenzy: the growth of housing loans accelerated instead. The impact of the rise of EURIBOR rates on household budgets was the largest for those who had borrowed at the time the key interest rates were at their lowest level, i.e. from June 2003 to October 2005. At the same time, acknowledging the potential interest rate increase helps new loan customers make their loan decisions more deliberately, taking into account the potential risks.

Households have enjoyed low interest rates owing to low interest margins of banks. The average interest margin reached 1% in March 2005 and has remained at that level throughout the year.

The **maturities** of housing loans have been **extended** further in the last six months. In case of high real estate prices, longer loan maturities are among the most crucial factors determining access to borrowing. In March 2006, loans granted with maturities of over 25 years comprised 54% of the turnover of new housing loans (37% of the total number of loans issued). In September 2005, their share amounted to 41% (27% of total loans; see Figure 2.18). Also in international comparison, the maturities of loans in Estonia are relatively long. For instance, in Finland where loan maturities have also extended, the typical housing loan maturity is 20 years. Only larger loans (over 150,000 euros) have longer maturities

[3] Source: national central banks.
[4] In comparison to other European countries, this ratio is rather low. For instance, in Finland which also has a relatively low debt level, 29% of households have taken a housing loan (source: The Finnish Bankers' Association, *Säästäminen ja luotonkäyttö*. Tutkimusraportti, April 2006).

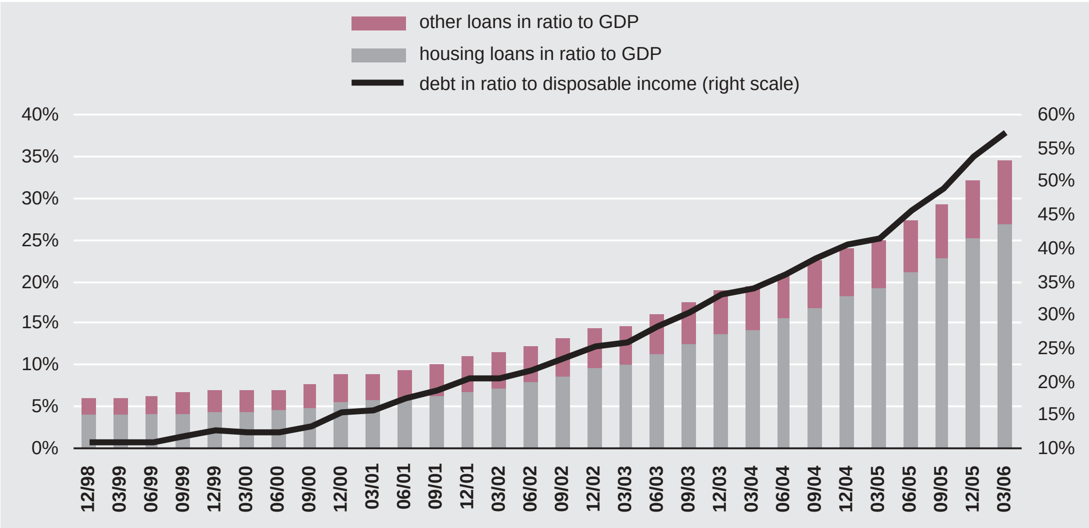

Figure 2.15. Household indebtedness

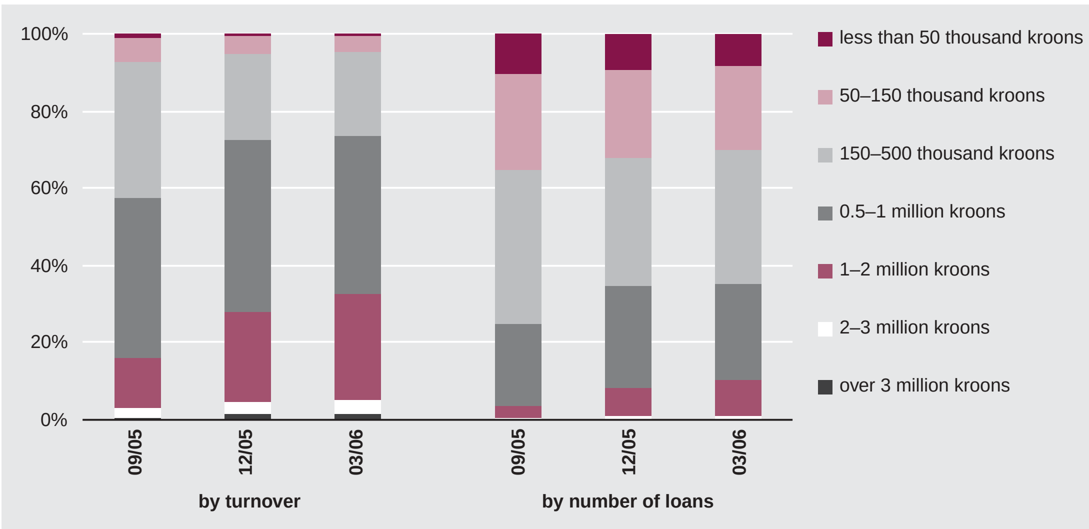

Figure 2.16. Breakdown of housing loans per month by loan size

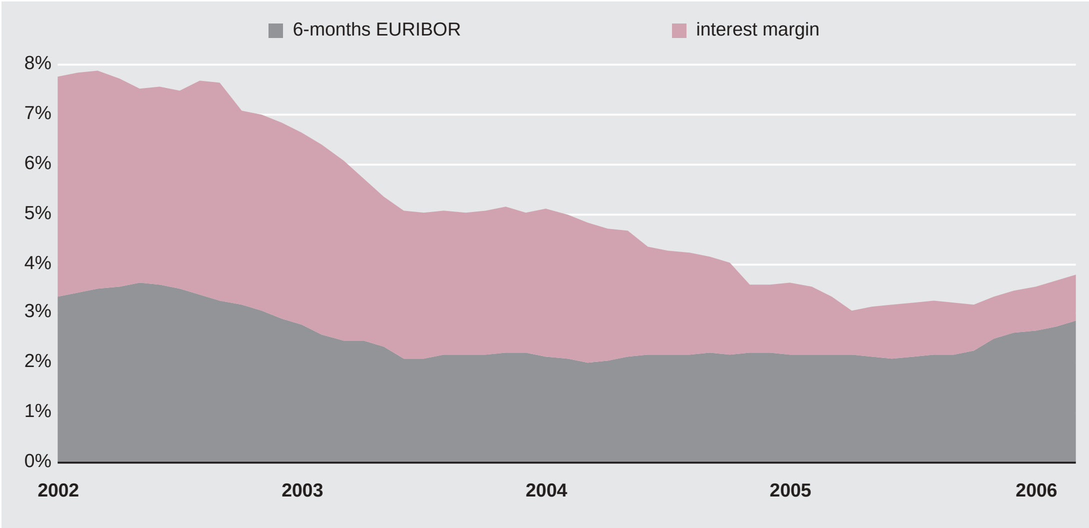

Figure 2.17. Development of housing loan interest rates

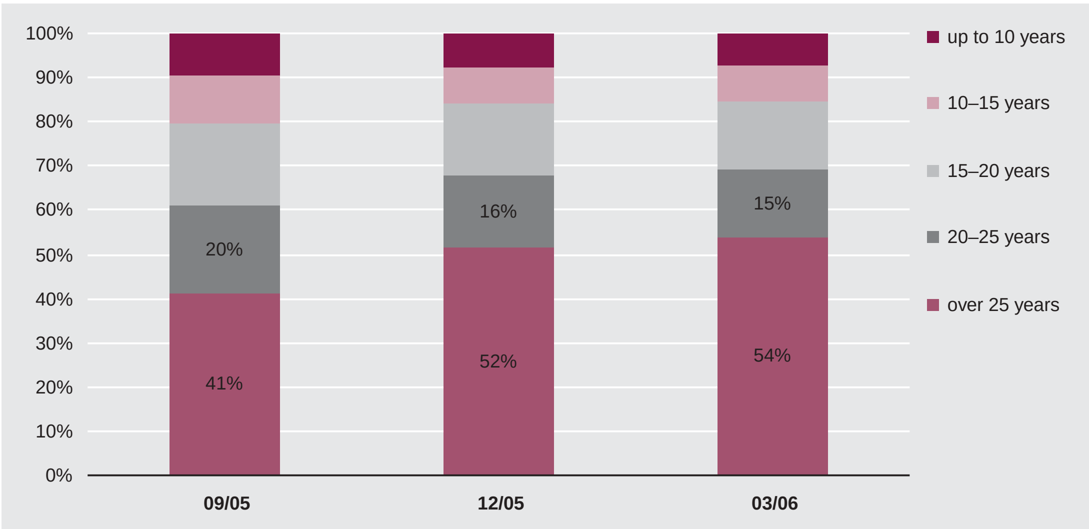

Figure 2.18. Maturity structure of new housing loans

(25–30 years), but also in their case the average loan maturity is 22 years.[5]

The housing loan growth rate stayed in line with price changes on the housing market, though remained more inert. While in the final quarter of 2005 the **housing market growth** reached record levels both in terms of prices and transactions, in the first quarter of 2006 the Tallinn apartment market gave an indication of stabilisation.

The average value of housing-related notarial transactions performed in the second half of 2005 increased 41%, year-on-year, and the number of transactions grew even 50% (see Figure 2.19). In the most active segment of the real estate market – the apartment market – demand significantly exceeded supply, enabling sellers to experiment with increasingly higher price peaks. Hence, according to the Statistical Office, the annual price growth of a two-room apartment in Tallinn reached even 57% in the fourth quarter of 2005. In the first quarter of 2006, the supply on the secondary market of apartments in Tallinn increased and sales periods lengthened, indicating a potential deceleration of price growth.

Due to the extraordinary developments of the housing market, apartment prices have achieved another record level also in ratio to the average gross wages. In Tallinn one square meter of a two-room apartment costs already two and in Tartu one-and-a-half average gross wages of the respective region (see Figure 2.20). Such a high level of real estate prices in ratio to incomes might obstruct the labour mobility and therefore the entire country's economic development. Meanwhile, an increase in real estate prices in relation to disposable income also limits the number of potential investors entering the housing market and thus has a negative effect on credit demand.

Consumer credit

As expected, rapid economic growth has also fostered the increase in **loans not directly related to financing housing** (see Figure 2.21). The year-on-year growth in the stock of non-housing loans and leasing accelerated to 54% by the end of March 2006. Consumer credit[6] grew the fastest (annual growth 125%). Such robust growth can be largely explained by the addition of a market participant not previously reflected in the analysis, although the growth rate would have been anyhow extraordinary (108%). Compared to the relatively modest growth of 2005, the beginning of 2006 also witnessed the acceleration of car leasing growth, which reached a year-on-year level of 40% by the end of March.

The volume of **consumer credit** reached nearly 5 billion kroons by the end of March 2006, remaining rather small in ratio to nominal GDP (3% of GDP). The average volume of consumer credit in the European Union was 8.5% in 2004. Sweden, the United Kingdom, Austria, Greece, Malta, and Ireland stood out with higher levels (over 10%).[7]

In addition to the demand-side factors (e.g. income growth, stronger confidence, active real estate market), consumer credit growth accelerated also owing to better loan terms and conditions. The **interest rates** on loans obtained for consuming products and services started declining already in 2004. A steeper fall took place in the summer of 2005 and the downward trend lasted until the end of the year (see Figure 2.22). Despite the rise in the money market interest rates in the euro area, the average interest rate on consumer credit stabilised at the level of 6% in the first quarter of 2006. The interest rate drop was probably supported by the increasing use of real estate as collateral. The share of consumer credit collateralised by mortgage increased

[5] Source: The Finnish Bankers' Association, *Säästäminen ja luotonkäyttö*. Tutkimusraportti, April 2006.
[6] Consumer credit is regarded here in narrower terms as the acquisition of products and services without instalments and the use of credit cards. Therefore, car leasing and study loans have not been included under consumer credit.
[7] Source: European Central Bank, "EU Banking Structures", October 2005. The definitions of consumer credit may vary greatly across countries.

Figure 2.19. Notarised purchase-sale contracts of dwellings and residential buildings as movable assets and real estate, average contract value and price of a 2-room dwelling in Tallinn

Source: Statistical Office of Estonia

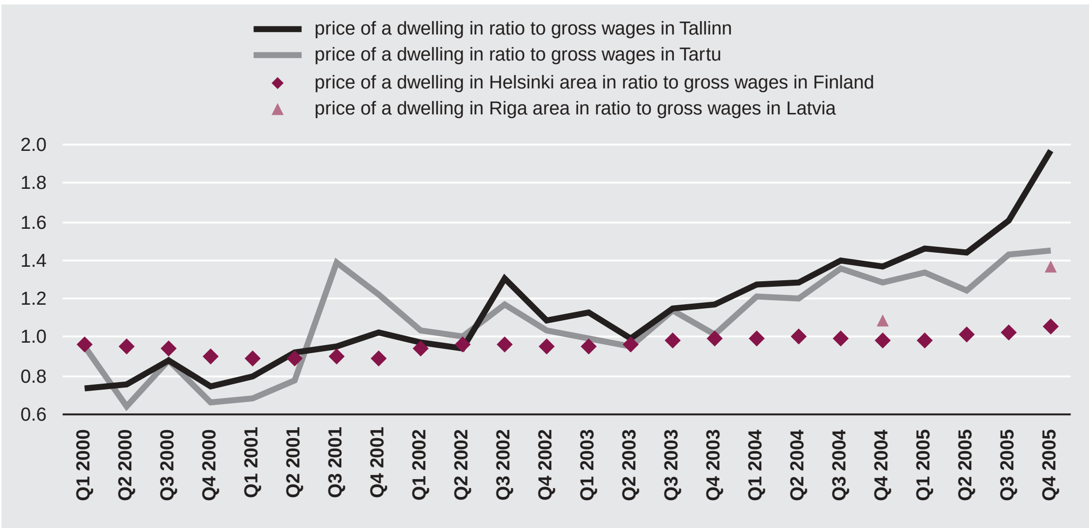

Figure 2.20. Ratio of the price of a two-room dwelling to gross monthly wages

Sources: Statistical Office of Estonia, Central Statistical Bureau of Latvia, Statistics Finland

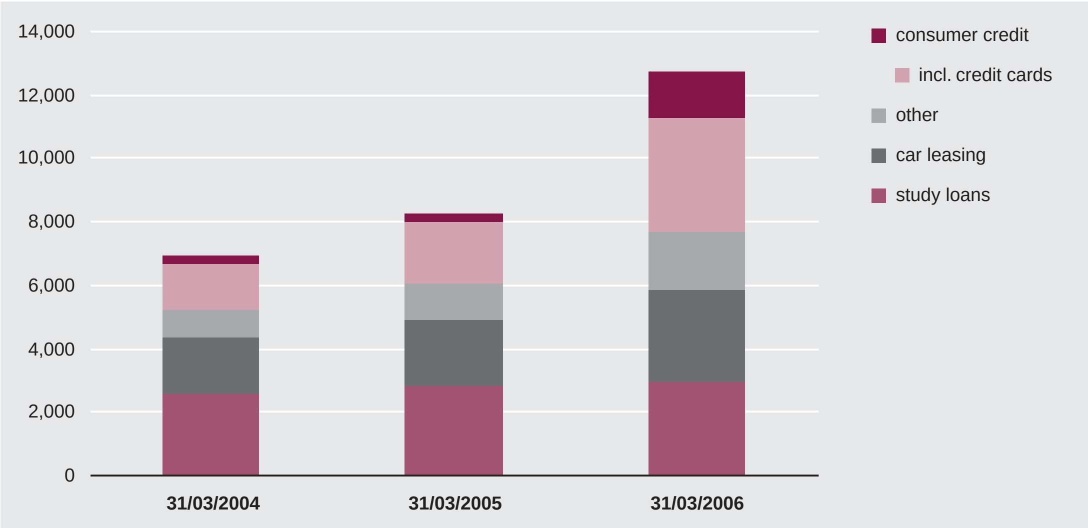

Figure 2.21. Stock (EEK m) and structure of non-housing household loans/leasing

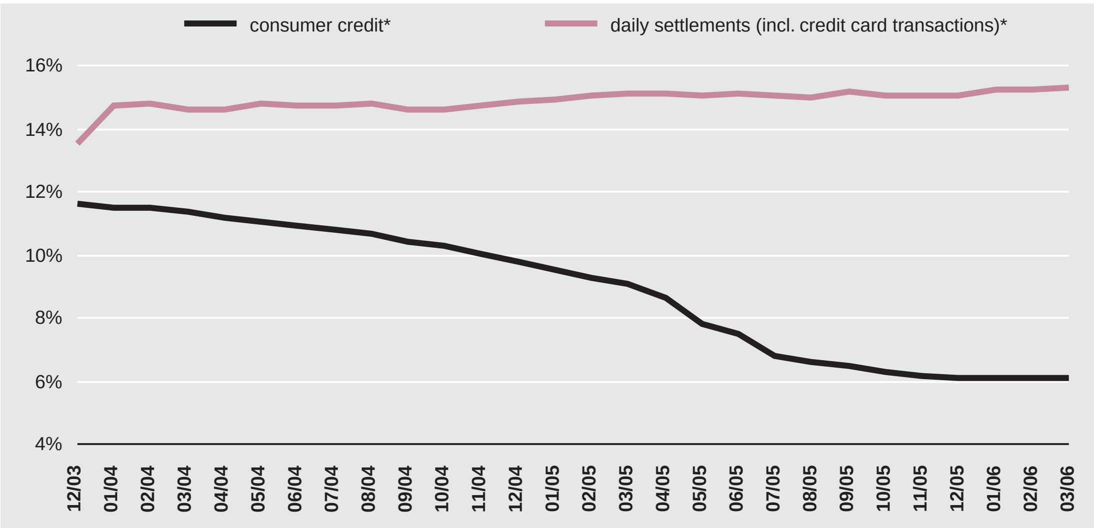

Figure 2.22. Consumer credit interest rates

* without the data of BIG

to 64% by the end of March 2006 (50% at the end of September 2005).

The **maturities** of consumption loans have become substantially longer within the past half-year. The most significant structural change was the rise in the share of loans with maturities of over ten years in the stock of consumer credit, climbing to 33% by the end of March 2006 (19% at the end of September 2005; see Figure 2.23). The share of loans with maturities of up to three years has remained quite stable at the level of 12%.

The increasingly widespread use of mortgages for obtaining consumer credit points to the increased use of the housing equity withdrawal among Estonian households. Meanwhile, the consumption portfolio of the last half-year shows an increase in the amount of loans with parameters (such as long maturity, low interest rate, large sums) more pertinent to housing loans.

Households' loan servicing ability and risks

In 2005, households' loan servicing costs increased further in ratio to disposable income. Households' **interest rate burden**[8] rose to 2.4% at the end of the year (see Figure 2.24). Similarly to 2004, the rise in the interest burden was primarily affected by the significant increase in loan volumes. On the other hand, the sharp indicator boost concerning the beginning of 2006 can also be explained by the rise in the average interest rate. By March 2006, the interest burden of households reached approximately 2.7%; excluding the influence of the interest rate increase it would have stood at 2.5%.

Rising interest rates might weaken the loan servicing ability in the coming years. Though the income forecasts for the near future are rather optimistic, it is possible that households' expectations regarding income growth have been higher than fears arising from the interest rate rise.

This is confirmed by the high level of (housing) loan contracts concluded with a **floating interest rate**. At the end of March 2006, housing loans with floating interest rates comprised 99% of the total volume of household loans[9].

The resolute upward trend of EURIBOR slightly increased households' motivation to fix housing loan interest rates as of November 2005. Generally, the share of housing loan contracts with a fixed interest rate has remained modest. Fixed interest rate housing loan contracts comprised only 2.4% of the housing loans granted in March 2006. Therefore, Estonian households, whose loan history is brief and who have not experienced an upward interest rate cycle so far, have not yet acknowledged the interest rate risk or do not consider risk covering worthwhile.

In conclusion, though the modest increase in EURIBOR may curb the borrowing enthusiasm slightly, it will not entail a significantly lower loan servicing ability. The net wage rise caused by wage pressures as well as tax changes helps to offset the negative impact of the interest rate increase. At the same time, in addition to the estimates concerning the financial behaviour of the so-called average person, it is important to assess the loan servicing ability and financial buffers on the level of single households. The loan servicing reserve might become exhausted faster than expected. For now, the good loan quality indicators of banks show no sign of major problems.

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[8] Interest burden is the ratio of household interest payments to disposable income.
[9] Loans with floating interest rates are loans with the initial period of fixation of the interest rate below 5 years.

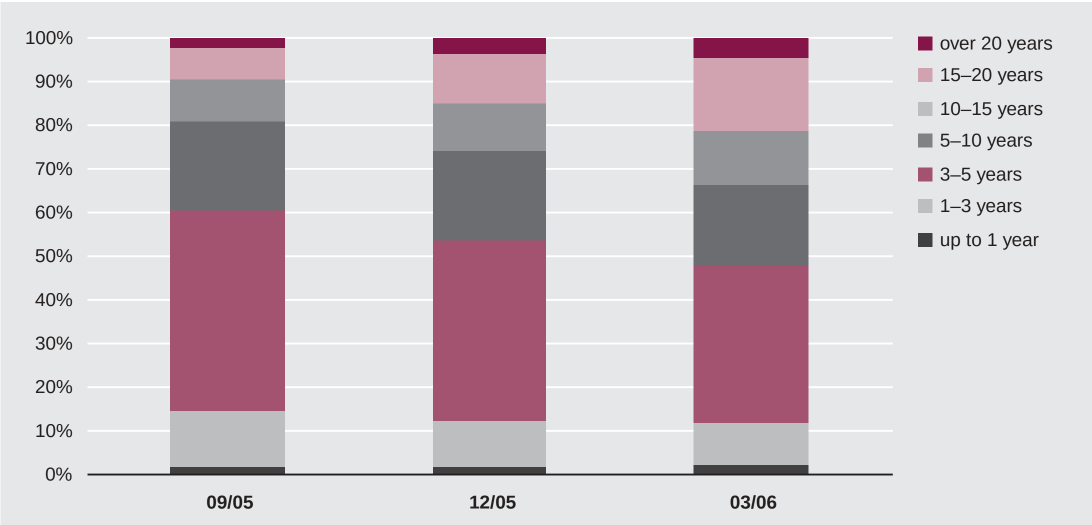

Figure 2.23. Maturity structure of new consumer loans

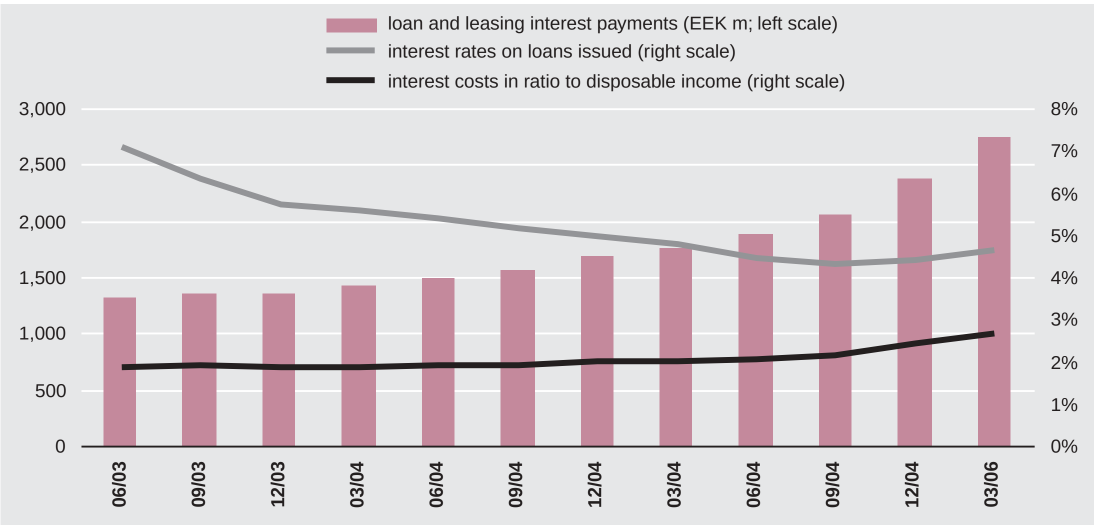

Figure 2.24. Households' loan and leasing interest payments during a year, interest rates on outstanding loans and interest costs in ratio to disposable income

HOUSEHOLD LOAN GROWTH IN EUROPEAN COUNTRIES[10]

*Estonia posted a nearly 60% household **loan growth rate** in 2005, being among the fastest growing countries in Europe (see Figure 2.25). Growth was faster only in other Baltic States and the new EU Acceding States, Romania and Bulgaria. As for old Member States, at the end of 2005 the growth rate was faster than average in Ireland, Spain and Finland (28.5%, 21% and 15%, respectively).*

*The **household indebtedness in ratio to income** in the new Member States and Acceding States is still relatively low (see Figure 2.26). This is also the main reason why the developing financial markets have faced such drastic loan growth in recent years.*

*Comparing countries in terms of loan growth rate or debt level, however, does not provide sufficient clarity in estimating the pace of financial deepening. The easiest way would be to achieve appropriate comparability through various flow indicators (e.g. the ratio of loans obtained during a certain period to income or indebtedness growth), which would help alleviate the base effects. **Indebtedness growth** allows for a more explicit interpretation of loan growth intenseness, i.e. showing how many percentage points the debt-to-GDP ratio increased during a certain period.*

In 2005, on the basis of this indicator financial deepening was most noticeable in Iceland, where households' indebtedness increased by 13 percentage points in light of the loan growth rate reaching 23%. From among the Baltic States, Latvia experienced the fastest growth with the indebtedness growing by approximately 10 percentage points within the year (see Figure 2.27). In Lithuania, the increase in the debt level remained much more modest (5.2 percentage points) despite rapid loan growth, just as in Bulgaria and Romania (5.1 and 2.6 percentage points, respectively).

A fascinating trend of 2005 was the acceleration of indebtedness growth in Denmark and the Netherlands, where the debt level is already one of the highest in Europe. In Denmark, for instance, indebtedness growth accelerated as much as in Estonia (by 8 percentage points) and reached its highest level since five years in the Netherlands (6.1 percentage points). Indebtedness grew briskly also in Ireland (by 9.6 percentage points) and Spain (by 7.8 percentage points). In several European countries, the debt level increased faster in earlier years (e.g. in Norway, 6–8 percentage points in 2002; in the United Kingdom, 6–7 percentage points in 2003-2004; in the Netherlands, 5–7 percentage points in 1997 and 7–8 percentage points in 2002).

Great differences in the level and growth of debt by countries give rise to the question whether these are the most appropriate indicators for assessing the loan behaviour or just as well the vulnerability of households. A general overview and simplified methodology is not enough to determine the appropriate convergence rate for new Member States.

*Besides considering the debt level in assessing the vulnerability of households, it is essential to analyse the amount and changes of loan servicing costs. To this end, the **interest***

[10] Sources: central banks, Eurostat, EcoWin.

burden *indicator is used. A comparison with the Nordic countries (4.5% in Norway, 3.4% in Sweden, 2.7% in Estonia) shows that Estonian households use a slightly smaller share of their net income to pay interest rates. At the same time, it should be mentioned that in Estonia this indicator is low in ratio to the total number of households, but probably quite high in ratio to borrowers. Therefore, it is logical to conclude that given the growing number of households that have taken a loan the interest burden of the total household sector will also continue to rise.*

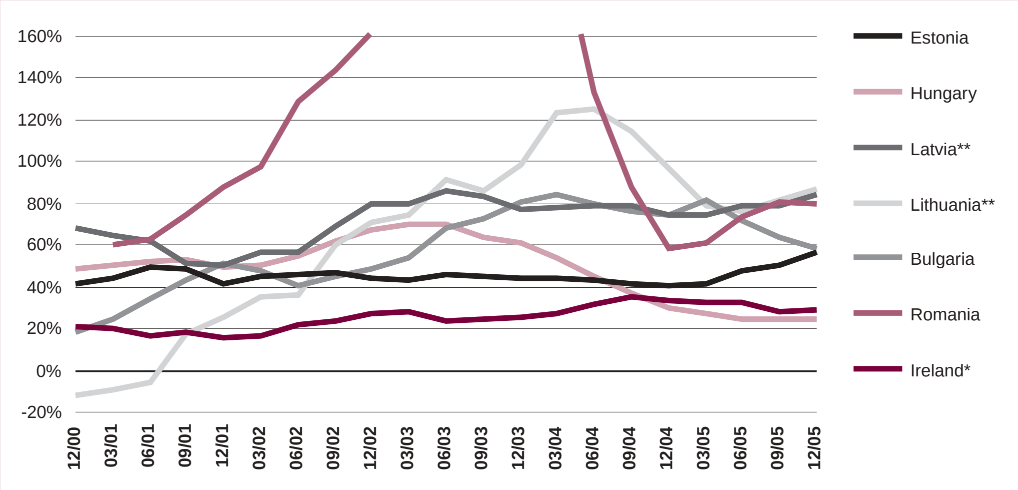

Figure 2.25. European countries with fastest loan growth rate in the last five years

* real estate loans
** leasing excluded

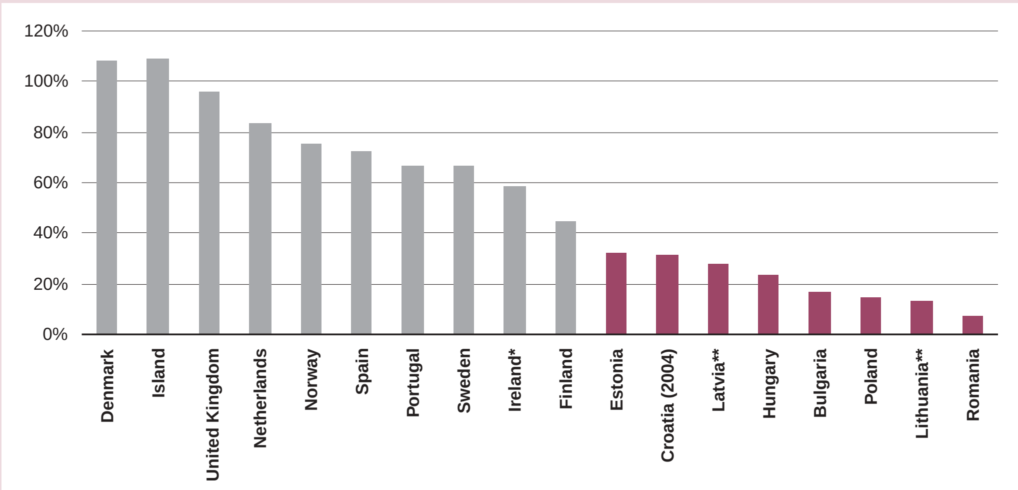

Figure 2.26. Households' indebtedness in ratio to GDP as at end-2005

* real estate loans
** leasing excluded

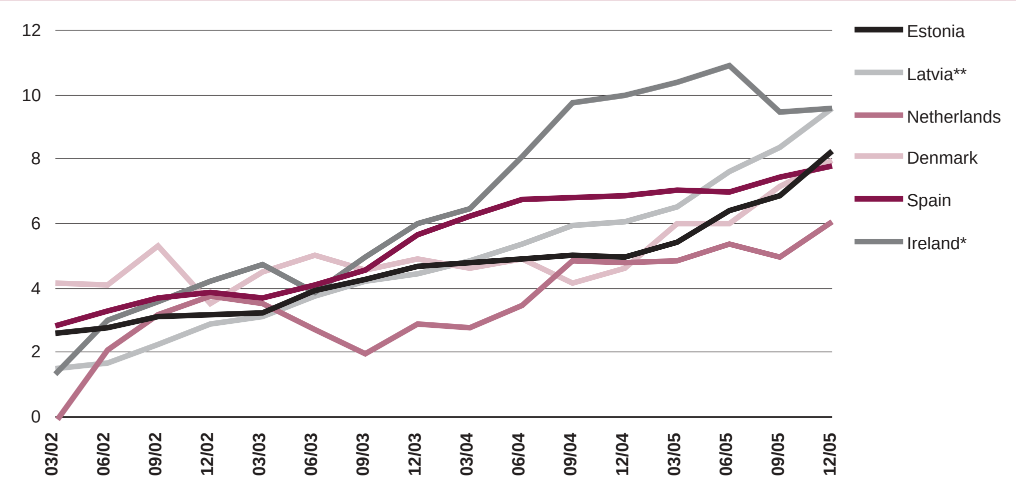

Figure 2.27. European countries with largest indebtedness growth in 2004-2005 (percentage points)

* real estate loans
** leasing excluded