



PRESS RELEASE

Mortgages: ABI, interest rates in the Euro area depend on the cost of deposits and the value of real estate

In the second issue of "Temi di Economia e Finanza" (Matters of Economics and Finance) of ABI's Study and Research Centre, the analyses of the main factors that influence the setting of interest rates on mortgages for the purchase of housing in Europe. The inefficiency of the civil justice system

The cost of deposits and the relationship between the amount of the loan and the value of the house are the main determinants of mortgage interest rates. At the same time, the inefficiency of the civil justice system is one of the other factors that explains the cost level of loans to households to buy a house.

This is what emerges from the second issue of "Temi di Economia e Finanza" of ABI's Study and Research Centre. The study, whose objective is to merge analyses of economic trends of banking and financial markets, through reflections of a structural nature, offers insight on assessments of the property market of particular importance to households. The study focuses on the Euro area market in the period between 2003 and 2009 and analyses, through econometric instruments, how macroeconomic factors, socio-cultural aspects and specific characteristics of the various bank and financial markets influence the setting of interest rates.

One of the most important aspects that emerges from the study is that the cost of deposits impacts the level of mortgage interest rates. This outcome seems to be able to explain why the process of convergence of mortgage interest rates in Euro area countries, which had lasted for several years, was interrupted after the Lehman default. Since then, in fact, the dispersion in the levels of interest rates on government bonds increased following the phenomenon of the "flight to quality" that has rewarded countries with the best financial conditions (*in primis* Germany).

Another factor that proved important in explaining the different interest rate profile is the relationship between the amount of the loan and the value of the house (loan-to-value): the higher riskiness of those loans for which the value of the guarantee is more contained actually worsens their economic conditions.

Another important outcome of the study regards the impact of the quality of intangible infrastructures. The inefficiency of the civil law system also appears to be important to explaining the level of interest rates: as the costs associated with the civil law procedures needed to assert credit claims rise, the economic conditions applied to mortgages become more onerous. In fact, when pricing them, banks appear to be discounting the potential costs that will be incurred if the party to whom the loan has been granted is unable to repay the same. On the basis of the empirical evidence gathered, it can be estimated how the intervention of European policymakers would benefit borrowers, if the former were to guarantee a more efficient justice system. On a par with the levels in Luxembourg, the most efficient European country from this aspect, the conditions applied to fixed-rate mortgages could considerably improve. In Italy, the resulting advantage would be around 50 basis points higher than the average of the other four major countries in the Euro area.

Lastly, the results of the empirical study do not appear to be able to confirm that the international financial crisis, in general, had a direct impact on the criteria applied by the European banking industry to define the economic conditions applied to mortgages.

The outcome of the analyses conducted provide a number of policy suggestions, which if put into practice would most probably enable European households to enjoy lower interest rates than those recorded in the period in question. First of all, and today, also as a result of the impact of the financial crisis, we need to maintain a rigorous and fundamentally balanced public finance structure, as the trend of long-term interest rates depends on this. Lastly, we need to reinforce and increase the role of public and private guarantee funds in order to allow parties assessed as creditworthy, but with scarce assets, easier access to the mortgage market.

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