This box is part of the “Quarterly report on the Spanish economy”, 2017 Q1

Traditionally in Spain, households’ acquisitions of housing have predominantly been financed with variable interest rate loans. This means that the cost of funds changes periodically throughout the life of the loan, on the basis of the benchmark used (generally the 12-month Euribor). The attractiveness for banks of this option is that it ties the changes in the revenue obtained on loans granted to those in its funding costs, since the latter are habitually renewed with great frequency, in line with interbank market yields, given the prevalence of short-term operations. By being able to mitigate interest-rate risk, banks can offer very-long-dated maturities, with the subsequent reduction in the repayment instalments borne by borrowers. In fixed-rate lending operations, this risk can be covered in the swaps markets, but the horizon over which these contracts were available until very recently did not extend beyond 10 or 15 years. One advantage that is occasionally indicated as being favourable to borrowers under the variable-rate arrangement is that, under normal conditions, the expected average cost over the life of the loan is lower (see Chart 1), as no risk premium by term[2] is included. However, the fact that the cost of financing of variable-rate loans fluctuates throughout the life of the operation adds uncertainty as to its future course.

Within the euro area, Spain is among the group of countries in which the significance of variable-rate financing (in particular, with initial reset periods of less than one year) is greatest, along with Portugal, Italy and Ireland. This is unlike other European economies such as France, Germany and the Netherlands, where these operations are a minority option. Nonetheless, since early 2010, the weight of new loans in which the cost is reset before one year has elapsed (see Chart 2) has progressively diminished in Spain. In an initial phase, to mid-2015, there was an increase in the proportion of loans with initial rate fixation periods of between one and five years. Subsequently, the over-five-years segment – in which fixed-rate contracts are included – began to grow.[3] As a result, the segment with initial reset of up to one year has declined from accounting for 80-90% in 2010 to scarcely 50% at present. This tendency towards the lengthening of interest rate reset terms has also been observed in other euro area countries, with greater intensity in those economies in which operations up to one year were predominant, such as Italy and Portugal, although this has also been the case, albeit to a lesser extent, in other countries where initial rate fixation periods of over five years were more prevalent (see Chart 3).

The change observed in the structure of reset terms for new housing loans in Spain and in the other euro area countries has been accompanied, in the recent period, by a reduction in the spread between the interest rate applied to loans with an initial rate fixation of over five years and the initial cost where terms are reset in less than one year, which may have boosted borrowers’ demand for the first interest-rate type (see Charts 4 and 5). This development has been assisted by both the flattening of debt market yield curves, which has enabled banks to offer comparatively more attractive terms in fixed-rate operations, and the improvements in the infrastructure of derivatives markets, including most notably the growing use of clearing houses, which allow banks to hedge against longer-dated interest rate risk.

These changes in the structure of the mortgage market have some substantial consequences. The increase in the weight of transactions whose terms are reset at over five years, with higher interest rates than in those where reset is at less than one year, tends to translate into a rise in the synthetic cost of borrowing (which is calculated weighting the volume of new loans by their initial interest rates), irrespective of movements in yields in each segment. This development can be clearly discerned in Chart 6, which compares the observed value of this indicator with that which would have prevailed in the event of the term structure as at December 2010 having been maintained. It can be seen how, in the most recent period, this composition effect has meant that the synthetic indicator underestimates the improvement in financing conditions.

In the longer term, the most significant consequence of the change in the structure of the mortgage markets is that household financing costs will become less sensitive to interest rate movements, thereby limiting the scope of the effects associated with monetary policy decisions (in particular those that operate through the income effect of interest-rate changes). However, given the long-dated maturities of outstanding debt and how recent the changes in the composition of new lending business are, the impact on the overall credit portfolio is still very limited. Thus, in December 2016, 96.6% of the outstanding balance of loans for house purchase in Spain was at a variable rate, and 85.2% used the 12-month Euribor as a benchmark.

1 New loans include contracts formalised for the first time; renegotiated loans, provided that the borrower plays an active part; restructured loans, if they are at market interest rates; and those in which there has been a subrogation of the debtor.

2 The risk premium by term is the price paid for not incurring interest rate risk.

3 This tendency is observed not only in loans formalised for the first time but also in renegotiated loans

STRUCTURE BY INTEREST RATE RESET PERIODS ON NEW HOUSING LOANS (a)

Chart 1
INTEREST RATES ON NEW LENDING BY RESET PERIOD, SPAIN

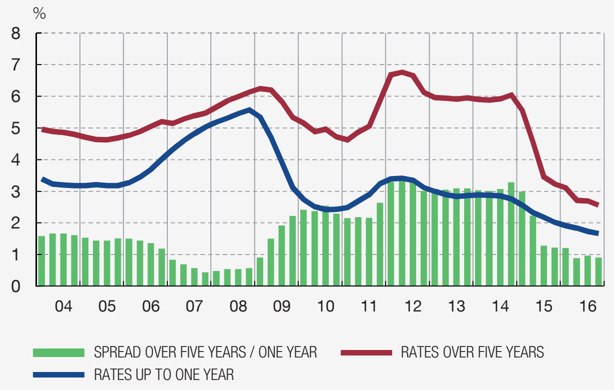


Chart 2
DISTRIBUTION BY RATE RESET PERIOD, NEW LENDING, SPAIN

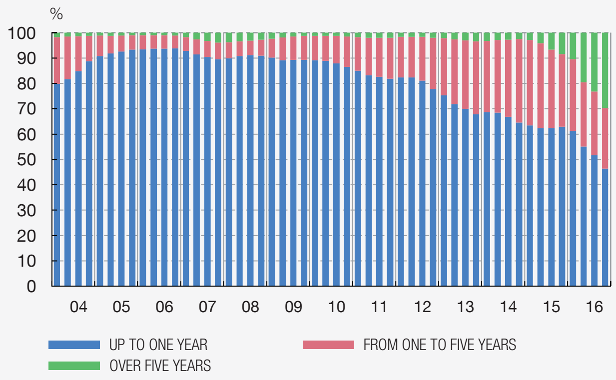


Chart 3
DISTRIBUTION BY RATE RESET PERIOD, NEW LENDING, COMPARISON EURO AREA COUNTRIES

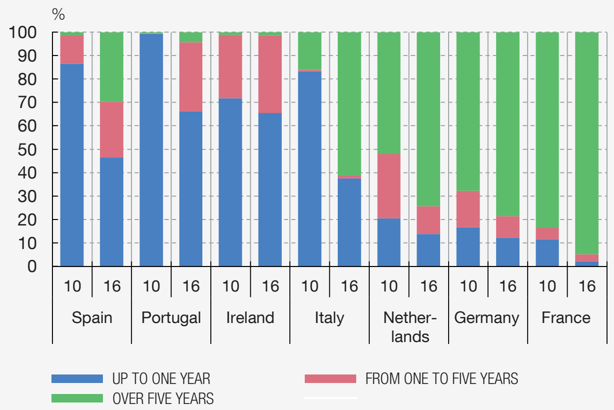


Chart 4
PERCENTAGE OF LOANS WITH RESET PERIOD AT MORE THAN FIVE YEARS AND SPREAD OVER FIVE YEARS / UP TO ONE YEAR, SPAIN

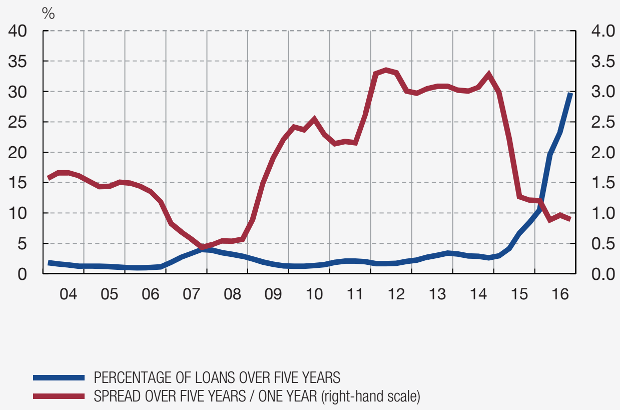


Chart 5
PERCENTAGE OF LOANS WITH RESET PERIOD OF UP TO ONE YEAR AND RATE SPREAD BY RESET PERIOD, COMPARISON EURO AREA COUNTRIES

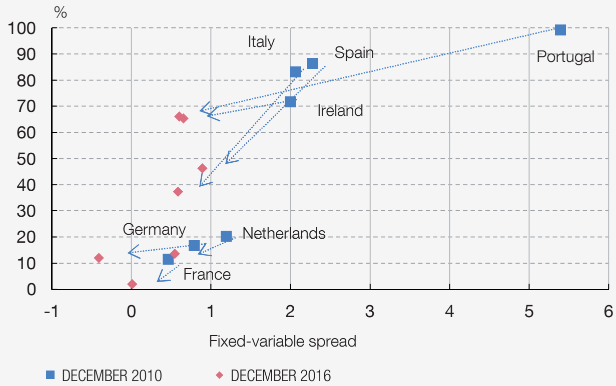
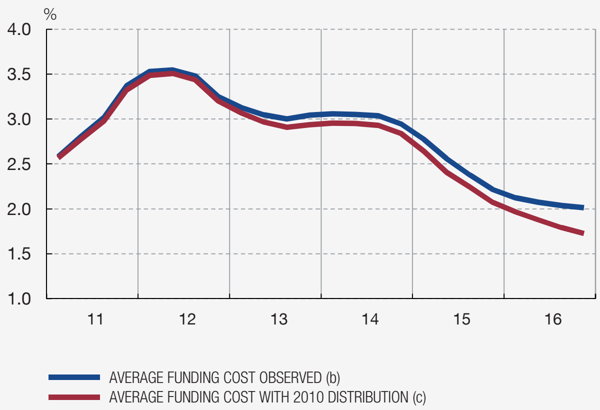


Chart 6
AVERAGE COST OF NEW HOUSING LOANS, SPAIN



SOURCES: ECB and Banco de España.

a The values depicted in the charts are a rolling average of the figures for the past twelve months of the year ending in each quarter; for loans, simple averages; and for interest rates, weighted averages (by lending volume). These data correspond to new loans approved in the month.
b Average cost with rate reset periods existing in each period.
c Average cost with rate reset periods as at December 2010.