

MUTUAL CAUSAL RELATION BETWEEN INDEBTEDNESS AND NUMBER OF EXECUTIONS IN YEAR 2010-2016

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Abstract: *The purpose of the following article is to explain the process of continuous growth of indebtedness of Czech households and to find a potential correlation to the development of the number of ordered executions. The time period of our research is framed by the years 2010-2016. The characteristic and relevant events of the period we would like to point out: a change in debt perception by Czech households, dynamic growth of indebtedness and related increase of the number of executions in the years 2011 and 2014, and last but not least, the progress of indebtedness growth in the households of the Czech Republic becoming a political theme, which reflected for example in the amendment of the Consumer Loan Act, the more stringent rules of the Czech National Bank for mortgage and other loan provision or the new decree of the Ministry of Justice on remunerations and compensations for court executors (as at 1 April 2017).*

Keywords: *Payment discipline, household, indebtedness, bank, loan, execution*

JEL: *A14, E21, E16, H31, J40*

1 INTRODUCTION

Household consumption may be seen as an important GDP determining factor. Households as economic entities significantly contribute to important macro data by their consumption. The question is how the households finance their own functioning and consumption. In 1990s the source of household financing was still largely represented by periodic income in the form of wages and potential savings. As the time passed, the finance product portfolio extended and advertising and offer of finance products developed priorities changed radically in terms of consummation preference over saving. Individuals and households have become a strong credit potential for financial institutions. The philosophy of household economy has changed, leading to dramatic increase of the relatively low indebtedness of 1990s in the recent two decades.

2 TIME PERIOD 2010 - 2016

The period selected for our research is a recent past of the indebtedness increase trend characterising Czech households. The characteristic feature of this particular period is slow-down of the year-on-year growth of overall indebtedness, showing some attenuation of the initial indebtedness boom. Thanks to the favourable atmosphere after the turn of the millennium encouraging indebtedness loans became a frequently used source of financing of more or less important household needs. This often led to temporary increase of the living standards of families financed by foreign resources.

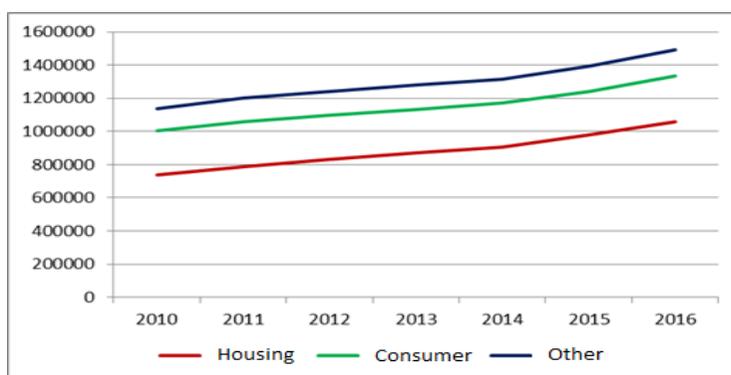
2.1 Overall Indebtedness of Czech Households

The below diagram (Fig. 1) shows development of overall indebtedness of Czech households divided by debt structure. The shown development of this indicator reflects slow indebtedness growth with year-on-year increments keeping a low level, on average ranging around 4.5 %. This confirms the assumption expressed above that the rapid increase of overall indebtedness, caused by the atmosphere encouraging indebtedness, as well as by the beneficial conditions offered and also by a certain lack of knowledge of the consequences of an impetuously accepted loan, has really been mitigated. The value of total debt of Czech households at the beginning of the period of interest, the year 2010, was CZK 1.1 billion. That year was also marked by the lowest indebtedness in-crease in the year-on-year comparison, by the mere 2.5 %. In the years that followed the indebtedness growth rate increased slightly, with the year-on-year increase not exceeding 3-5 %, though, which does not represent alarming data in the light of the situation in the previous decade. At the end of the studied period, i.e. in the years 2015 and 2016, household indebtedness grew most significantly, in particular by 5.8 and 7.13 %, respectively. The final value of total household debt was CZK 1.49 billion. Thus total indebtedness of Czech households increased across the period in question by more than CZK 354 milliard.

The period of the previous seven years was marked by another relaxation of the atmosphere, as the Czech Republic was recovering from the financial crisis affecting the world markets and debts were becoming part of (not only) public debate as one of its hot themes. With it also the negative side of indebtedness began to be manifested, for example when many of the debtors, unable to assess their ability to repay their debts, faced the merciless enforcement methods of non-bank credit institutions, including forced executions. Thanks to the financial crisis putting the actual creditworthiness of debtors at test, the huge

potential seen in the household sector was reduced considerably, and the debtor register was extended. Every day people are exposed to a flood of advertisements of the growing number of non-bank entities providing seemingly beneficial loans “overnight” and extending the already wide offer of loan products. Individuals with low financial literacy and economic education are unable to properly assess this offer and benefits or disadvantages of the individual loans and the related costs. Comparison of the individual offers should be facilitated by the amended consumer loan act, introducing a fixed structure of information about loan costs with the aim to increase transparency of the loan offers and facilitate their assessment.

Fig. 1 Total household debt at banks and financial institutions including debt structure in the period 2010-2016 in CZK million:



Source: Data of the Czech National Bank

2.2 Structure of Czech Household Debt

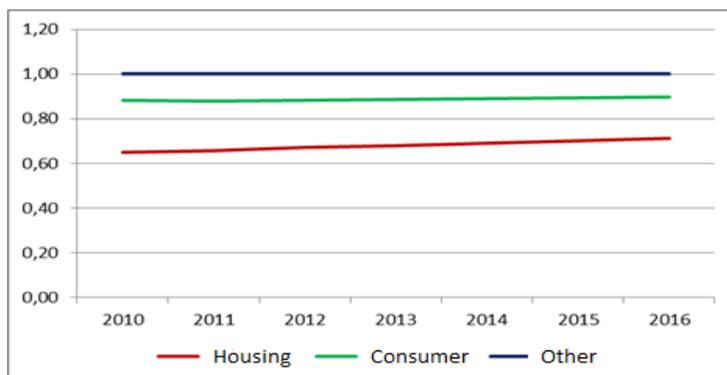
The below diagram (Fig. 2) shows development of the percentages of the individual components of household indebtedness. The progress of all the curves is relatively stable, without significant breaks across the period of interest.

The highest percentage is represented by housing loans in the long run, given by the high amounts provided for this purpose, which makes it impossible to witness any change in this proportion. The diagram shows that the proportion of housing loans slightly increased across the studied period at the expense of consumer loans, the latter rather showing a year-on-year decrease in virtually all years of the period. You can see then that after the years of uncertainty caused by the financial crisis people again began to increasingly use other resources for financing their housing needs. This trend was certainly further enhanced by the historically lowest interest rates of mortgage loans, stabilised real estate property prices and last but not least the expected increase of the

VAT rate since 2012 (partners.cz, 2013). The total value of housing loans is partly biased, though, for it also includes mortgage loans used for refinancing. This fact could mainly be manifested in 2011, marked by the end of the fixation period of mortgage loans provided in 2008 with the accompanying decrease of interest rates, making refinancing beneficial for many debtors. In the latter half of the period of interest the increase of the mortgage loan number continuously decreased despite the continuing decrease of mortgage loan interest rates, in 2014 even ranging around 2.5 % p. a. Another significant increase only came in 2015 and 2016, when the interest rates even dropped below 2 % p. a. (hypindex.cz, 2016). The percentage of mortgage loans attacked the level of 70 % at the end of the period, showing the main reason why households use foreign resources and risk uncertain future under the long-term repayment liability.

The shares of the other loan types in overall household indebtedness did not change, ranging around 11 % all the time. Only in 2012 and 2014, for the first time in history, the volume of other loans received dropped year-on-year. This included cash loans without purpose specification or financial leasing.

Fig. 2 Shares of individual loan types in total household debt in the period 2010-2016:

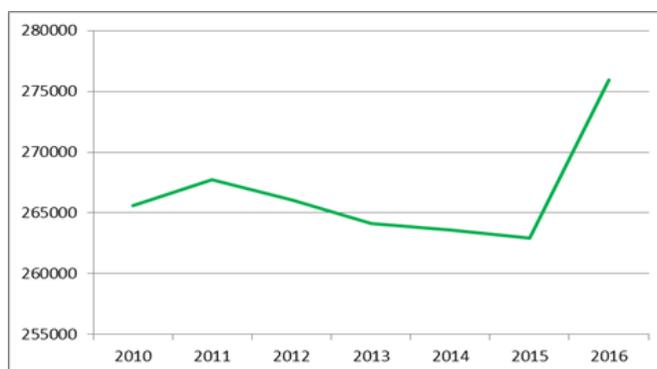


Source: Data of the Czech National Bank

The following diagram (Fig. 3) shows a detailed development of the consumer loan volume provided in the years 2010-2016. At the beginning of the period a growth in the number of consumer loans can be seen, in particular by 2 milliard in comparison to the previous year, with the reason including the current drop of interest rates (hypindex.cz, 2014), but also the extended bank offer of loan consolidation and refinancing. These products reduce monthly instalment amounts and thus overall loan costs. Beginning with the following year consumer loan indebtedness of households began to decrease. In 2012 the year-

on-year decrease amounted to CZK 1.7 milliard and in the following year even CZK 1.9 milliard. The cause of this drop was the decreasing demand for non-bank loan products, for consumer loan indebtedness in the bank sector only slightly dropped in those years. The end of the studied period was marked by resumed growing trends with a relatively significant increase of consumer loans. The main cause is probably represented by the continual drop of interest rates in the years 2015 and 2016, which reached their historic minimum, thus increasing accessibility of these loans for the general public. The above mentioned decrease of consumer loans provided by non-bank institutions might be a signal of a certain lesson learned by the households manifested by a potential diversion from this source of finance. However, the year 2014 reversed this assumption by another increase of household indebtedness in relation to the non-bank sector by CZK 3.2 milliard year-on-year. Thus the drop of indebtedness in the non-bank sector again appears accidental. The amount of the increment is not alarming, but shows that households still consider non-bank loans a solution to their lack of finances and do not forsake them, at least for the time being. Non-bank loans may be for them a solution of their financial emergency when a bank loan is not possible for a debtor not meeting the conditions for the loan provision.

Fig. 3 Household indebtedness with consumer loans received from banks and financial institutions in CZK million in the years 2010-2016:



Source: Data of the Czech National Bank

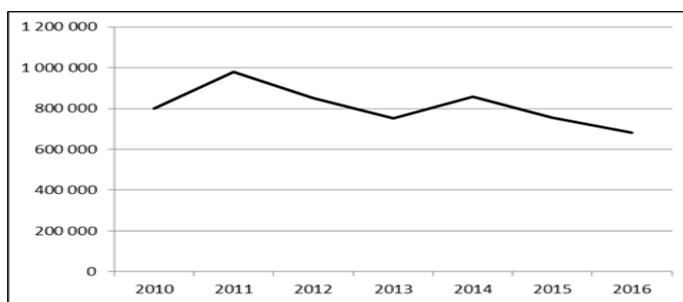
2.3 Ordered Executions

The below diagram (Fig. 4) shows development of the number of ordered executions in the years 2010-2016. At the beginning of the period the numbers of executions decreased like in the previous years, with signs of revival of Czech economy. As the bank criteria for client creditworthiness assessment

became more stringent, risk groups indebtedness decreased, including low-income families with the relatively high risk of inability to repay the loan in the case of unfavourable future financial development. The number of ordered executions in 2011 exceeded 978,000, with year-on-year increase by nearly 179,000 orders, after 2008 the second highest increment since 2003. In the following two years, on the other hand, the number of ordered executions decreased, in 2012 even by nearly 127,000 which is 13 % in comparison to the previous year, and in 2013 by 98,000 executions year-on-year. Another turning point in this trend was brought by the year 2014 when the number of ordered executions again increased by 104,000. At the end of the period of interest the number of newly ordered executions decreased and the total number of executions at the end of the period was lower as well.

A problem that has intensified recently is represented by over-indebtedness of individuals. A number of debtors have become permanent debtors, often falling into the debt trap. On the basis of data of the Czech Chamber of Executors (2015) up to 50 % of the newly ordered executions apply to debtors with 10 or more executions, with a rapid decrease of the number of debtors with 1 – 3 executions, and only 4 % of executions concerning individuals with only one execution.

Fig. 4 Total numbers of ordered executions in the years 2010-2016:



Source: Data of the Ministry of Justice of the Czech Republic

A detailed view of year-on-year changes in the number of ordered executions in the years 2010-2016, offered by the following diagram (Fig. 5) suggests a changeable development trend, in 2012 for the first time in the period with a negative change in the year-on-year figure of ordered executions. The highest increase in the number of ordered executions was recorded in 2011, when together with earlier executions the total number of ordered executions reached the record 978,409, with year-on-year increase by nearly 179,000. The reasons for the enormous increase of the number of newly ordered executions included the still existent, albeit fading financial crisis, but also and above all the

amendment of the Rules of Execution, with effect since March 2012 reducing potential costs of attorneys charged for debt enforcement (Chamber of Executors of the Czech Republic, 2013). Creditors thus repeatedly petitioned years old receivables for the proceeding to be still held under the original conditions and the executors could still receive the high remunerations and cost compensations in connection with the debt enforcement. Creditors also began to increasingly use services of court executors at the expense of the sometimes illegal ways of debt enforcement.

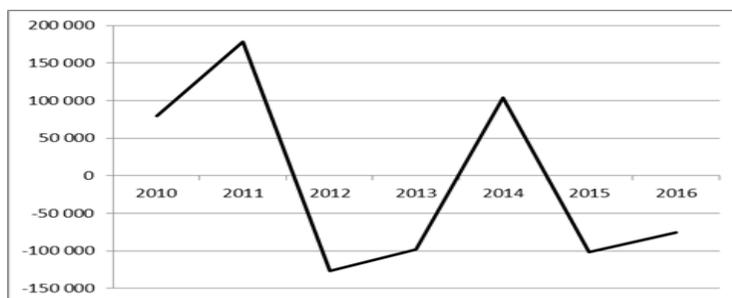
In 2012 and 2013 the numbers of ordered executions decreased year-on-year, first by nearly 129,000 and then by another 98,000, showing a decreasing trend. Considering the situation and the reasons for the rapid increase of executions in the previous year one can assume that the execution number was decreased by these very older receivables submitted for court enforcement under the original conditions and the number of ordered executions increased again in comparison to year 2010. The following decrease of executions in 2013 was certainly affected by the above mentioned amendment of the Rules of Execution and the Rules of Civic Court Proceeding, thanks to which different executions against the same individual managed by a single execution office could be merged into one. Debtors thus could avoid the high costs of every individual execution proceeding significantly increasing the amount due. In comparison of the number of executions to the situation in 2010, preceding the period of legislative changes and the related highest year-on-year increase, the year 2013 really shows a decrease in the absolute number of ordered executions.

The year 2014 reversed the existing trend by another increase of the number of ordered executions. The reason stated by the Chamber of Executors of the Czech Republic (2015) was above all low responsibility of debtors related to fulfilment of minor liabilities, such as fines imposed by city transport companies or the police, with the carelessness or lack of finances for the fine payment resulting in ordered executions. Although currently more and more debtors, often with the help of the State and authorities, show interest in increasing their financial literacy, this is a long-term matter and its results may only be expected within a long-time horizon.

The last two years of the period under investigation the numbers of ordered executions decreased year-on-year. According to the Chamber of Executors of CR (2015), on the other hand, the number of individuals with 4 and more executions increases steeply. Thus executions concentrate within a narrow

sector of the society with the mean number of executions per individual being 5, 8. Most executions can be found in the age group of 28-47 years (Chamber of Executors of CR 2017). The growing number of executions per person, however, decreases the probability of their successful enforcement and the executors, only paid for receivables successfully enforced, thus have about 60 % of their work unpaid. The increasing number of multiple executions per individual together with increasing costs of enforcement represent one of the main reasons for the worsening economic situation of court executors. The total debt being enforced currently amounts to around CZK 302 milliard, making one fourth of the state budget, meaning that the drop of enforceability connected with the decreased income of court executors might unfavourably affect the whole national economy. The main reason for the current development, according to the Chamber of Executors of CR (2015) is abuse of court executor service. For creditors court execution is always free of charge, even if is unsuccessful. For that reason some creditors behave irresponsibly and file new and new execution petitions, although the debtor is long-term insolvent and thus enforcement of the debt is virtually impossible. The only solution might therefore be to motivate creditors to consider beforehand whether filing a petition for court execution makes sense or not, to avoid destabilisation of debt enforcement. One of the preliminary suggestions is introduction of territorial competence. Executions would thus be allocated to executors according to the place of permanent residence of the liable party, which would reinforce independence of court executors and open ways towards increased financial participation of creditors in the costs of executions.

Fig. 5 Year-on-year changes in numbers of ordered executions in years 2010-2016:



Source: Data of the Ministry of Justice of the Czech Republic

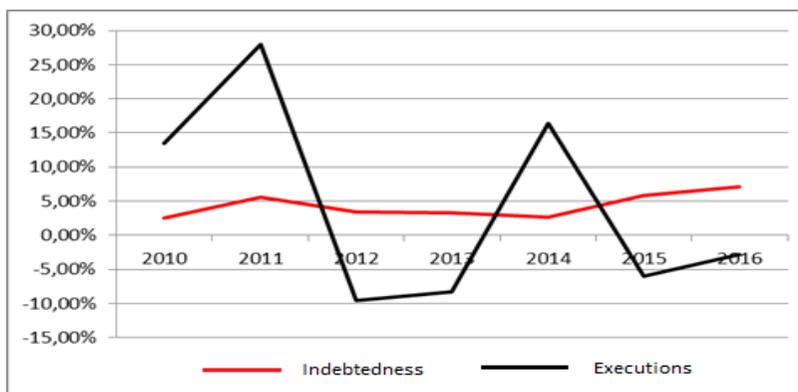
The below diagram (Fig. 6) shows year-on-year percentage changes of overall indebtedness of Czech households and numbers of newly ordered executions in the period in question. The diagram shows a differing progress of the two

curves. In 2010 and 2011 both indicators showed year-on-year increments. As already mentioned, the increase in the number of executions was partly caused by the amendment of the Rules of Execution, but still the number of ordered executions was high, pointing to worsened payment morals of the households, which according to the Czech National Bank (2015b) also confirms increasing numbers of failed loans. The amended Rules of Execution will thus not be the main reason for the enormous number of the newly established executions.

Subsequently, in 2012, the curves began to show a difference in their development. While the number of newly ordered executions decreased by 13 % year-on-year, household indebtedness continued to grow, albeit very slowly. Loan products ceased to be a tempting new development in financing of household needs from foreign resources and the beneficial conditions accompanying the origin of the extensive indebtedness of Czech households provided with the aim to indebt the greatest possible number of clients ceased. Banks changed their strategy and began to check applicants for loans more profoundly. Suitable candidates for a loan ceased to be nearly all individuals with stable income like before. Regardless the year 2011 with the enormous number of newly ordered executions, for the reasons mentioned above, the payment morals of the households, in comparison to 2010, worsened again, for the number of ordered executions again increased. According to the Czech National Bank (2015b) this assumption is confirmed by the increased number of failed loans.

A similar trend in indebtedness of Czech households continued through to 2013, only the increment was slightly lower than in the previous year. The number of ordered executions continued to decrease, which might reflect a slight improvement of the ability of the households to cope with their financial liabilities. The decrease was evident in comparison to both the previous year and year 2010 and according to the Czech National Bank (2015b) the number of the failed loans increased only slightly.

Fig. 6 Year-on-year changes in indebtedness and numbers of ordered executions in the period 2010-2016:



Source: Data of the Ministry of Justice of the Czech Republic

3 DISCUSSION AND CONCLUSION

The beginning of the period of interest (2010) was characterised by slowed-down year-on-year growth of overall household indebtedness, but at the same time by continuous relaxation of the atmosphere with the Czech economy recovering from the consequences of the previous financial crisis. Household indebtedness became a widely publicly discussed theme for already in 2008 the total debt exceeded the limit of 1 billion CZK and a growing trend could be expected also in the following years in the environment of extending portfolios of finance products and loan advertising campaigns. Also the legislative changes in household crediting may contribute to further growth. Their primary aim is to provide increased protection to debtors an easier orientation in the individual offers of loan providers. This assumption is confirmed by the above diagrams of overall development of household indebtedness in the past 7 years.

The structure of Czech household indebtedness across the period of interest was marked by a high share of housing loans, ranging between 60 and 70 % of the total household debt. While at the beginning of the period under investigation the markets recovered from the past financial crisis and the year-on-year increments were low, the end of the period in question is connected with the biggest increase of the volume of the provided mortgage loans. The year 2016 is generally considered by economist as a turn-ing point which can be summarised - for it is marked with a number of major events and changes in the mortgage loan market. In the very year 2016 the psychological barrier of 2% interest rates of mortgage loans was broken. Continual decrease pushed the interest rates down to the historic minimum of 1.77 %. The mean rate then

amounted to 2.12 %, which, together with the very favourable economic situation and effectiveness of the consumer loan act, enormously increased interest in mortgage loans. The volume of the provided mortgage loans increased in 2016 year-on-year from CZK 184 milliard to CZK 225 milliard. At the same time the mean amount of the loan in-creased by up to 10 %. The LTV also continued to decrease, which should mean a higher proportion of the client's own resources and restriction of excessive burden on the debtor. The question is whether this is to result in additional financing of mortgage loans by monies from other loan types or not. A similar increase towards the end of the studied period could also be seen in the case of consumer loans, supported, in addition to the low interest rates, by the growing consumption by Czech households following from increasing wages and dropping unemployment rates.

The development of the numbers of ordered executions across the period under investigation was very changeable with a first historic negative year-on-year change. Significant increases of executions were recorded in the years 2011 and 2014. The main reason was not only the poor payment morals of debtors but also and above all the above mentioned legislative changes concerning remuneration of executors and later, in 2014, carelessness of debtors in fulfilment of minor payment liabilities following from fines. In the last two years there is a decreasing trend in the number of ordered executions. The biggest problem however continues to be over-indebtedness of individuals, which in effect reduces probability of debt enforcement. Although more and more people show interest in increase of their financial literacy, the results will only be manifested after years.

Although statistical methods are able to prove existence of a correlation between indebtedness and the number of executions, the question is the extent of the correlation and also to what extent the calculation will affect for example legislative changes. In the context of the scope and needs of this article the mutual causality between the dynamics of the growing household indebtedness and the number of ordered executions may also be proved by a qualitative assessment. As the increase is more or less expectable in both cases, let us look in more detail on the antagonistic (positive) movements.

In general two recent positive social trends may be characterised. The first successful development is that despite the growing household debt the number of the performed executions has dropped (2012-2016, except for years 2011 and 2014). The second positive phenomenon is represented by the fact that the

number of non-payers with a low number of debts decreases and in the same way the number of new indebtedness cases of notorious debtors will decrease (recording of debtors, careful approach of institutions, more profound review of applicants...). Let me remind that still in 2014 the whole 50 % of new executions were represented by case of multiple debtors. Both trends represent a positive signal for the future. Notorious debtors access to new loans (and debts) has been made more difficult by the current legislative amendment and the number of executions of “singular” debtors has been decreasing. A significant contribution to these positive trends can be seen in the financial “education” of the society, the growing numbers of financial advisors, the increasing numbers of financial literacy courses and of course the younger generation’s increased interest in their own financial positions.

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