

Household over-indebtedness with micro-financial institutions

The German Economic Team Moldova together with the National Commission for Financial Markets has collected data on household over-indebtedness with micro-financial institutions. Although the data in our sample is probably only an approximation of the actual situation, it is closing an information gap.

Our analysis shows that over-indebtedness of households through loans from micro-financial institutions has increased since 2016. At the same time, it does not represent a consistent trend as the market in Moldova is very heterogeneous. The increase is primarily related to irresponsible lending by a handful of institutions that are growing strongly. This has increased the volume and the number of non-performing loans - an indicator of over-indebtedness - for the whole sector.

Based on our analysis, we recommend stronger supervision of micro-financial institutions whose business model is based on irresponsible lending. If necessary, a stricter regulation should also be considered. At the same time, the social function of micro-financial institutions – access to credit for certain groups that would otherwise not have access – should be maintained.

Over-indebtedness by micro-financial institutions

There are many reasons why private households become over-indebted. These include poverty, unexpected events, lack of financial education and lack of transparency in lending. Currently there is an intensive public discussion in Moldova on over-indebtedness. The background is the increasing number of loans from micro-financial institutions (MFIs), the inability of some borrowers to pay their debts and the associated negative consequences.

The weak point of this discussion so far has been the lack of information, as there was no data on the indebtedness of private households with micro-financial institutions.

In order to analyse this situation, the German Economic Team Moldova together with the National Commission for Financial Markets, the supervisory authority for micro-financial institutions, developed a questionnaire and collected a sample from micro-financial institutions. We focus on the share of non-performing loans as the most important indicator for the over-indebtedness of private households. Although this data is only a rough approximation of reality, they provide a unique insight into MFI lending.

Results from our sample

There was strong growth in MFI lending between the end of 2014 and the third quarter of 2018. Lending increased from MDL 2.4 bn to MDL 5.5 bn, an increase of 127%.

For a similar period – from the end of 2014 to the first half of 2018 – the data we collected shows an increase in the volume of non-performing loans from 4.7% to 7.1%. The number of non-performing loans increased from 4.2% to 13.8% at the same time. This implies that many small loans cannot be repaid. Therefore, there is increasing over-indebtedness in lending with micro-financial institutions to private households.

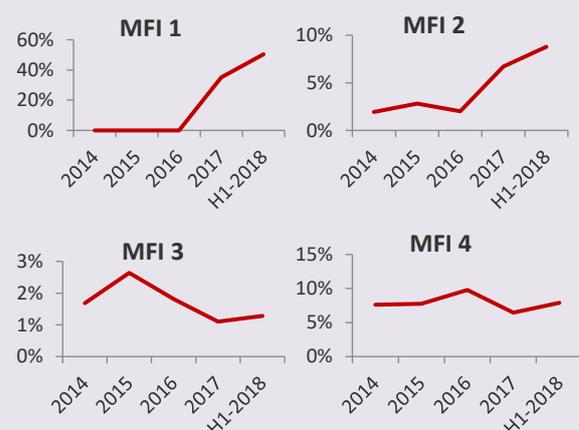
Share of non-performing loans in our sample



Source: Data based on a sample 20 micro-financial institutions; includes consumer and mortgage loans; NPL: PAR>30

In order to shed more light on the background to this development, we examine the development at the level of individual MFIs.

Share of non-performing loans of individual MFIs



Source: Own survey

This analysis shows a very mixed picture. Some MFIs have a very high and rising share of non-performing loans. For others, it hardly changed since 2014 or even decreased.

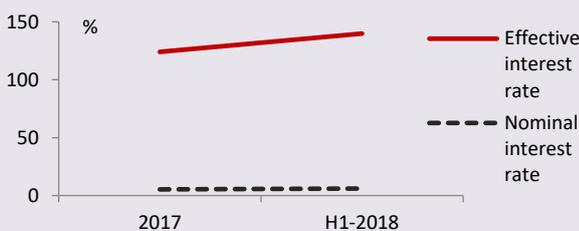
The overall increase in the share of non-performing loans is therefore not systematic and does not represent the sector as a whole. Instead, it can be traced back to the growth of a few MFIs. For example, in our sample, two MFIs account for two thirds of the volume of non-performing loans and for over 90% of the number of non-performing loans. The overall increase in the share of non-performing loans can, thus, be attributed to a few institutions.

For instance, one micro-financial institution has a very high share of non-performing loans which rose to over 40% in 2018. This development goes hand in hand with a fast growing loan volume. This institution mainly grants very short-term loans of less than 30 days. The average loan is MDL 3,000 (equivalent to about EUR 150) and has an effective annual interest rate of 140%. A large part of these loans is granted to customers with a very low official income of less than MDL 2,000, i.e. the monthly payments are in some cases higher than the official income.

Business model: Irresponsible lending

The increase of the share of non-performing loans and the connected over-indebtedness of households can be explained at least in part by increased irresponsible lending by some institutions. Creditworthiness is not or not sufficiently checked. As a result, many loans are provided to individuals who are unable to repay them. One indication of the lack of transparency of these loans is the high difference between the nominal and the effective interest rate.

Average interest rate of an MFI



Source: Own survey

This difference arises when a substantial part of the costs are charged as fees, with the result that the actual costs tend to become more difficult to understand and compare.

This business model is profitable because losses are financed by very high interest rates and overdue loans are sold to collection companies. However, these companies still account for only a small – albeit growing – part of the market.

Although the non-performing loan rate of around 7% that our data shows is not alarming by international

comparison, the data also shows a clearly negative trend.

At the same time, the use of non-performing loans as an indicator of household over-indebtedness underestimates the problem. The information was provided by MFIs themselves and cannot be verified. Moreover, these institutions usually do not hold non-performing loans for long, which diminishes their informative value.

Recommendations

The problem of household over-indebtedness with MFIs is only roughly covered by our analysis. A household survey as carried out in other countries in the region would be desirable in order to provide a sharper picture of the situation.

In our view, when supervising MFIs, it makes sense to better supervise MFIs with an irresponsible business model and to strictly punish violations of the law. If stronger supervision does not lead to improvements, changes of regulation may be advisable. At the same time, however, it must be stressed that MFIs also have an important social function, namely access to credit for groups of the population that would otherwise not have access. This function should be maintained.

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A more comprehensive analysis is provided by our Policy Briefing PB/05/2018 [“Household over-indebtedness with micro-financial institutions in Moldova: Results based on a questionnaire”](#)

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