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# Financial Fragility of Euro Area Households<sup>1</sup>

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## Abstract

Until recently, the lack of appropriate harmonised micro data covering both income and wealth has been the major obstacle in analysing financial vulnerability of the household sector in the euro area. This data problem has been partially circumvented by the dissemination of the Household Finance and Consumption Survey (HFCS). Based on this unique data set, we put forward a stress testing method of household balance sheets in a consistent manner across euro area countries. To this end, we put forward a metric of distress which takes into account both the solvency and liquidity position of the household and demonstrate that this metric outperforms the most common metrics used in the literature, which do not take into account the households' asset holdings. We calibrate this metric using the country level data on non-performing loan ratios and estimate stress-test elasticities in response to an interest rate shock, an income shock and a house price shock. We find that, albeit euro-area households are relatively resilient as a whole, there are large discrepancies in the impact of macroeconomic shocks across countries. Finally, we demonstrate that our framework could be used to assess some measures mitigating losses to the banks, such as engaging in the restructurings of loans that are at risk of defaulting.

JEL-codes: D10, D14, G21

Keywords: household indebtedness, stress testing, household finance, financial stability.

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