

PROVISION OF A GENERAL NATURE
of 25 November 2021
on setting upper limits on credit ratios No. I/2021

Pursuant to Article 45b(1) of Act No. 6/1993 Coll., on the Czech National Bank, as amended by Act No. 219/2021 Coll. (hereinafter the “Act on the Czech National Bank”), the Czech National Bank as the competent administrative authority hereby issues the following provision of a general nature:

I. The upper limit on the ratio of the consumer’s total debt arising from consumer credit secured by the same residential property to the value of the collateral (hereinafter the “LTV ratio”) shall be set at

- a) 90% for consumer credit secured by residential property for financing the purchase of owner-occupied residential property of an applicant who is under the age of 36 at the time the loan is granted, or applicants living in a marriage or registered partnership, at least one of whom is not yet 36 at the time the loan is granted,**
- b) 80% for consumer credit secured by residential property other than that referred to in subparagraph (a).**

II. The upper limit on the ratio of the consumer’s outgoings arising from the consumer’s total debt to the consumer’s income (hereinafter the “DSTI ratio”) shall be set at

- a) 50% for consumer credit secured by residential property for financing the purchase of owner-occupied residential property of an applicant who is under the age of 36 at the time the loan is granted, or applicants living in a marriage or registered partnership, at least one of whom is not yet 36 at the time the loan is granted,**
- b) 45% for consumer credit secured by residential property other than that referred to in subparagraph (a).**

III. The upper limit on the ratio of the consumer’s total debt to the consumer’s income (hereinafter the “DTI ratio”) shall be set at

- a) 9.5 for consumer credit secured by residential property for financing the purchase of owner-occupied residential property of an applicant who is under**

the age of 36 at the time the loan is granted, or applicants living in a marriage or registered partnership, at least one of whom is not yet 36 at the time the loan is granted,

- b) 8.5% for consumer credit secured by residential property other than that referred to in subparagraph (a).**

IV. Entities authorised to provide consumer credit shall proceed pursuant to this provision of a general nature from 1 April 2022.

Justification

1. When setting upper limits on credit ratios, the Czech National Bank shall, pursuant to Article 45b(2) of the Act on the Czech National Bank, take into account factors giving rise to systemic risk.

The total *volume of consumer credit* has increased significantly year on year. At the end of September 2021, its year-on-year growth rate was well above the long-term average.¹ This was due mainly to recent growth in *new consumer credit secured by residential property*.²

Growth in *transaction prices of residential property* rose further in the first half of 2021. Available market data suggest that it did not slow in subsequent months either.³ The degree of overvaluation of apartment prices reached around 25% in the second quarter of 2021 by the CNB's estimation. The observed trend reflected optimistic expectations of future growth in the value of property in an environment of insufficient supply, increased motivation of some debtors to maintain the purchasing power of their financial reserves amid rising inflation and low returns on alternative assets, and still relatively favourable debt financing conditions.

The record-high volume of new consumer credit secured by residential property provided in 2021⁴ in an environment of continued growth in residential property prices is fostering growth in *the ratio of household debt to disposable income*. *The ratio of residential property prices to household income* is also rising.⁵ Average apartment prices are currently safely affordable for only around 15% of households.

The trend of easing credit standards has been intensifying during 2021.⁶ It has been reflected in an increase in the share of new consumer credit secured by residential property with significantly risky characteristics. In the second quarter of 2021, banks provided over 48% of the relevant reference amount of loans with a DSTI of over 40%, 26% of loans with a DSTI of over 45%, and 10% of loans with a DSTI of over 50%. Similar tendencies could be seen for the DTI ratio. Loans with a DTI of over 8 accounted for almost 40% and loans with a DTI of over 9 for almost 22% of the reference volume of loans in the second quarter of 2021. These trends intensified

¹ The year-on-year growth rate of bank loans provided to households for house purchase was around 11% at the end of September 2021 (five-year average: around 8%). Total consumer credit provided by banks was up by around 9% (five-year average: around 7%).

² The year-on-year growth rate of new consumer credit secured by residential property was around 80% in the second quarter of 2021.

³ Transaction prices of residential property were up by around 15% year on year at the end of June.

⁴ New consumer credit secured by residential property amounted to CZK 322 billion in the first eight months of 2021.

⁵ The debt-to-income ratio has reached 60% and the price-to-income ratio 12.

⁶ See also Bank Lending Survey IV/2021, https://www.cnb.cz/export/sites/cnb/en/statistics/bank-lending-survey/.galleries/Bank-lending-survey/2021_q3_BLS_en.pdf.

further in July and August 2021. The numbers of vulnerable debtors in lenders' balance sheets are thus growing. At the same time, banks' balance sheets still contain risks taken on in previous years, the materialisation of which may have been delayed by the economic policies adopted during the pandemic. Combined with adverse shocks from the real economy (such as a sharp rise in energy prices), this is causing systemic risks to increase. At the same time, credit standards have differed significantly across lenders. This is creating a risk of more conservative lenders reacting to a potential loss of market share by easing their standards to the levels of their less conservative competitors. Mutually enforced relaxing of credit standards would be reflected in more rapid accumulation of systemic risks.

2. In view of the aforementioned factors indicating systemic risks to financial stability, the CNB Bank Board has set an upper limit on the LTV credit ratio of 80% or 90%, an upper limit on the DSTI ratio of 45% or 50% and an upper limit on the DTI ratio of 8.5 or 9.5. The combined effects of the factors requires that upper limits be set on all credit ratios. This will enhance the long-term stability of providers of consumer credit secured by residential property⁷ and reduce the provision of consumer credit secured by residential property to potentially vulnerable households.

The setting of upper limits on credit ratios may, under certain conditions,⁸ lead to a decrease in the volume of new loans secured by residential property, even taking into account the 5% exemption set out in Article 45a(1) of the Act on the CNB. However, experience with the application of previously recommended credit ratio limits shows that applicants are able to adjust to new conditions without the volume of loans provided falling significantly in the given macroeconomic conditions.

The potential effect of the measures on the volume of new loans, which, by the CNB's estimation, will not exceed one-tenth of the amount of loans that would hypothetically be provided if the measures did not exist, will be offset by a more conservative risk profile of new loans.

3. The Czech National Bank will review the reasons for the issuance of this provision of a general nature at least once every six months and will assess them with regard to the existence and expected further evolution of the factors referred to in Article 45b(2) of the Act on the Czech National Bank. If there has been a material change in these factors, the Czech National Bank will issue a new provision of a general nature or will amend or abolish the existing one.
4. When calculating the credit ratios, entities authorised to provide consumer credit shall proceed in accordance with Decree No. 399/2021 Coll. of 25 October 2021.
5. Pursuant to Article 45c(1) of the Act on the Czech National Bank, the Czech National Bank may impose a measure to remedy a shortcoming detected on an entity which provides consumer credit in contravention of Article 45a(1) of the Act on the Czech National Bank. The Czech National Bank will specify a reasonable time limit for the entity to remove the shortcoming detected. If the entity fails to comply with an obligation imposed by the decision to impose a remedial measure, it

⁷ Such stability provides for smooth provision of financial services to the economy even in adverse phases of the financial cycle.

⁸ In cases where the portfolio of future applicants for consumer credit secured by residential property exhibits similar credit ratio levels as in January–August 2021.

shall be deemed to have committed an offence pursuant to Article 46(4)(b) of the Act on the Czech National Bank, for which the fine specified in Article 46(5)(a) of the Act on the Czech National Bank may be imposed.

6. Pursuant to Article 45b(3), this provision of a general nature will be issued without a procedure on a proposal of a provision of a general nature.

Effect

This Provision will take effect on 1 April 2022.

Tomáš Nidetzký
Deputy Governor

(signed electronically)

Jan Frait
Executive Director
Financial Stability Department
(signed electronically)

imprint of official stamp

This provision of a general nature was published on 26 November 2021.