CNB press conference on the results of the autumn meeting on financial stability issues

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I.

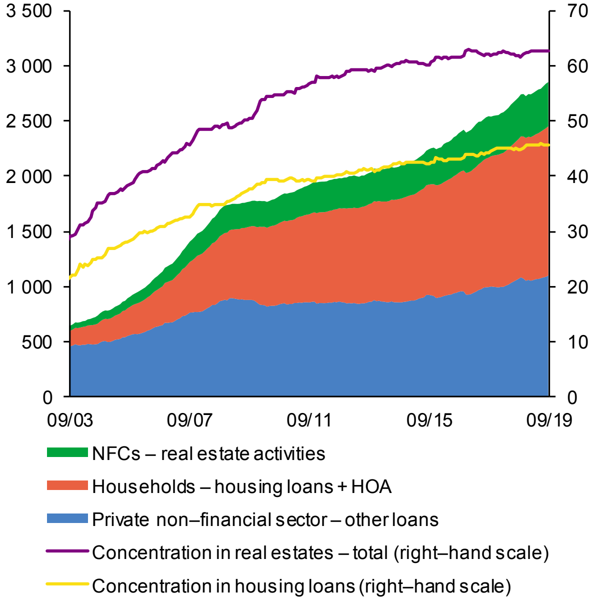
Aggregate assessment of risks and overview of CNB’s main measures

- **Developments since spring meeting (FSR 2018/2019):**
  - Banks remain resilient to potential adverse shocks but should maintain adequate capital buffers and capital surpluses and pursue reasonable dividend policies for the potential case of the economy cooling.

- **Potential sources of future risks:**
  - Prices of residential and commercial property may be overvalued and unsustainable in an adverse scenario.
  - Banks' credit risks may not be fully covered by interest margins, provisions and capital.
  - Gradual growth in structural risks (e.g. concentration of loans for house purchase) is continuing.
  - The risk scenario of sustained low interest rates is beginning to materialise in advanced countries, especially the euro area.

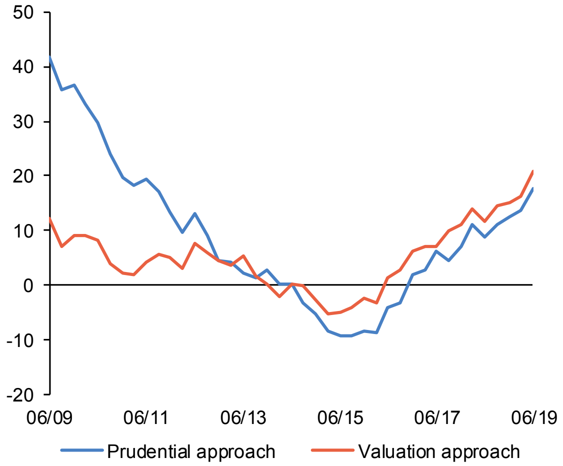
- The **share of housing-related loans** in loans to the private non-financial sector is gradually **approaching 50%**.
- The methods used by the CNB indicate that **house prices are overvalued by 15%–20%**.

Bank loans concentration in real estate segment
(CZK billions; right-hand scale: %)



Source: CNB
Note: HOA = Homeowners' Association

Estimated overvaluation of apartment prices
(%)



Source: CNB
Note: The methodology of the indicators is described in detail in Plašil, M., Andrle, M. (2019): *Assessing House Price Sustainability.* Thematic Article on Financial Stability 1/2019, CNB.

Property market and mortgage lending (2)

- The Bank Board **currently does not deem it necessary to change the existing recommended LTV, DTI and DSTI limits**.
- Most banks were broadly **compliant with** the currently applicable CNB Recommendation as regards **LTV limits** in the first half of 2019.
  - However, the proportion of loans with LTVs of 80%–90% increased, and loans with LTVs of over 90% were provided, contrary to the Recommendation.
  - Overall, the share of loans with LTVs of over 80% exceeded the recommended 15% in June 2019, which means some providers were not compliant with the Recommendation.
  - This confirms that legally binding LTV limits are necessary.
- With regard to its increasing estimate of house price overvaluation, the CNB regards the current LTV limits as **upper bounds**.
  - Continued growth in house price overvaluation could necessitate a reassessment of the current limits.

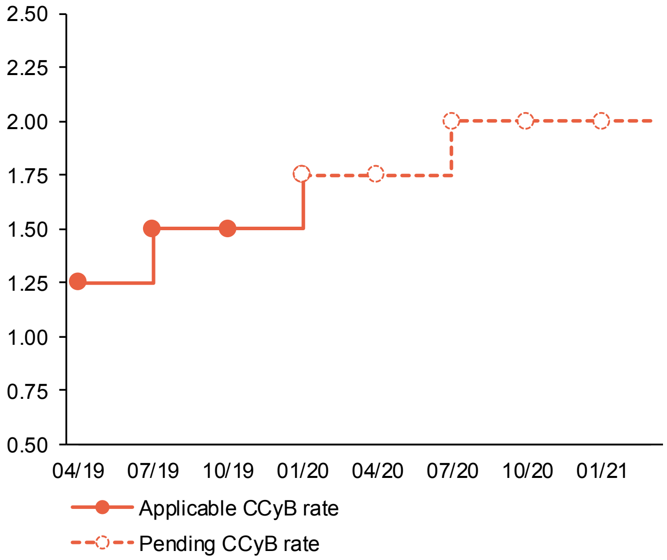
Property market and mortgage lending (3)

- Since October 2018, lenders should not exceed a debt-to-income (**DTI**) ratio of **nine times annual income** and a debt service-to-income (**DSTI**) ratio of **45%**, according to the CNB's Recommendation.
- In the first half of 2019, **almost all banks were compliant with the DTI and DSTI limits** and the share of loans in excess of the limits did not exceed the 5% exemption for either indicator.
  - Credit supply to highly indebted applicants was restricted.
  - There was a continued upward trend in multiple borrowers applying for a single loan in order to jointly report a higher income and thus meet the income criteria.
- The provision of loans **simultaneously exceeding all three credit indicators monitored** (LTV, DTI and DSTI) was reduced.
- Lenders reflected the higher risks of some loans in interest rates on these loans to a greater extent than in the past.

Decision on countercyclical capital buffer (CCyB) rate

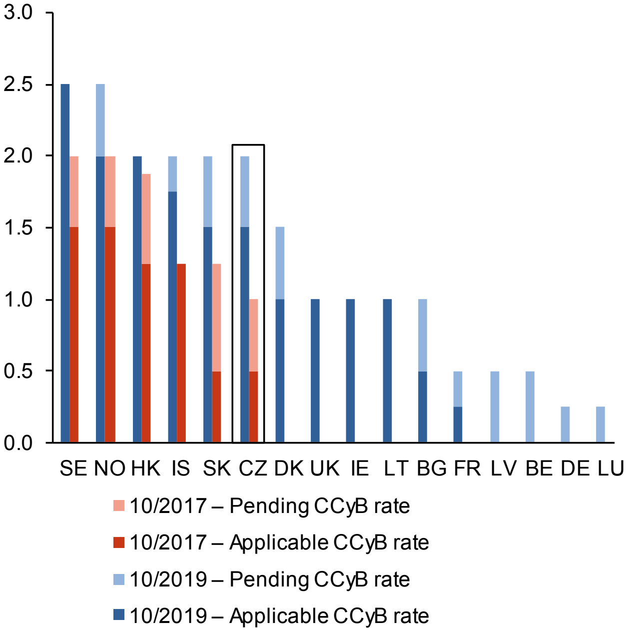
- The CNB Bank Board decided to **leave the countercyclical capital buffer rate unchanged** at **2.0%**.

Applicable and pending CCyB rate in the Czech Republic
(% of total risk exposure)



Source: CNB

Countries with a non-zero CCyB rate
(% of total risk exposure)



Source: ESRB, BCBS
Note: Data updated in October, 2019

Reasons for leaving rate at 2.0%

- The domestic economy is probably **close to the peak of the financial cycle** and cyclical risks are not increasing further.
  - The CNB expects the CCyB rate to stay the same for the near future.
  - In the event of a renewed acceleration in credit growth, for example due to a decrease in mortgage interest rates, a renewed upward shift in the financial cycle or further growth in the vulnerability of the banking sector, the CNB stands ready to increase the CCyB rate further.
- Considerations of lowering the CCyB are unjustified at the moment, as **credit risks accumulated in previous years** remain in banks' balance sheets.
  - Most banks meet the overall capital requirement by a sufficient margin and have room for further growth in lending.
- The CNB stands ready to gradually lower the CCyB rate, or even zero it in a single step, in the event of a sudden turnaround in the financial cycle.
  - Increased credit losses and growing tensions in financial markets jeopardising banks' ability to lend to the real economy will be the key signal for a potential lowering of the CCyB rate.

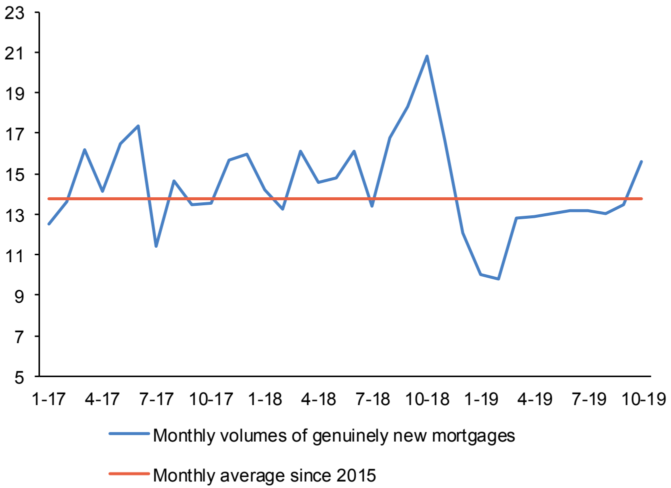
II.

Assessment of selected risks

Fluctuations on mortgage loan market

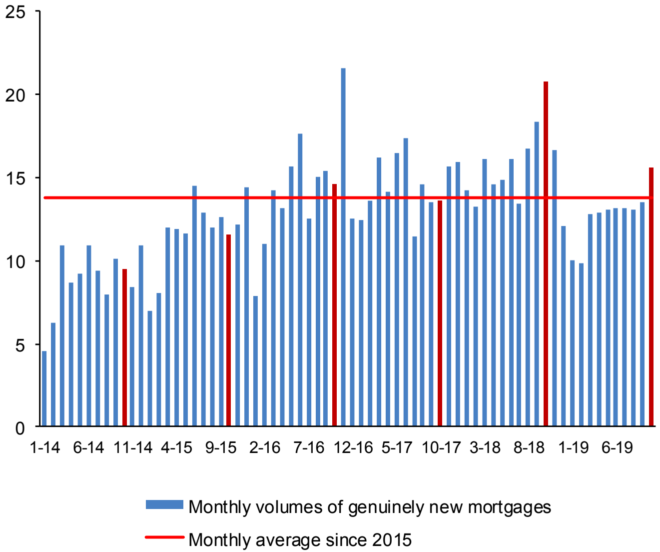
- The volumes of newly provided mortgage loans stabilised following fluctuations in the second half of 2018 and the first quarter of 2019.
- The amount of genuinely new mortgage loans was relatively high in October.

Monthly volumes of genuinely new mortgages
(CZK billions, since 2017)



Source: CNB

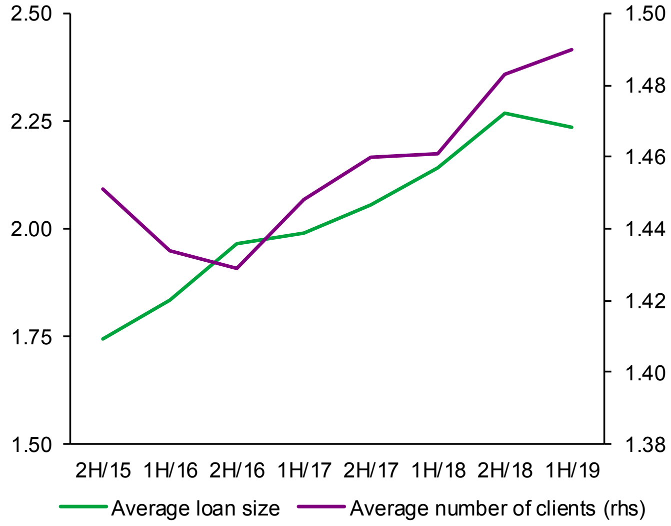
Monthly volumes of genuinely new mortgages
(CZK billions, since 2014)



Source: CNB

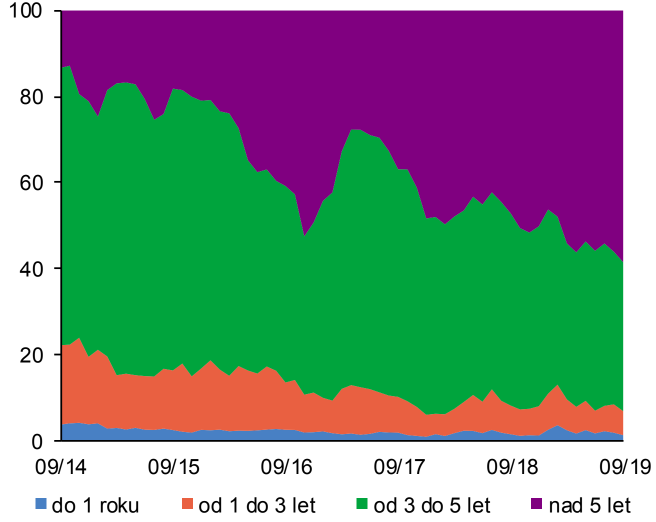
- Growth in the average mortgage loan size came to a halt.
- The upward trend in the average rate fixation period continued.

Average mortgage loan size and number of declared incomes according to the Survey
(CZK billions; right-hand scale: number of persons)



Source: CNB

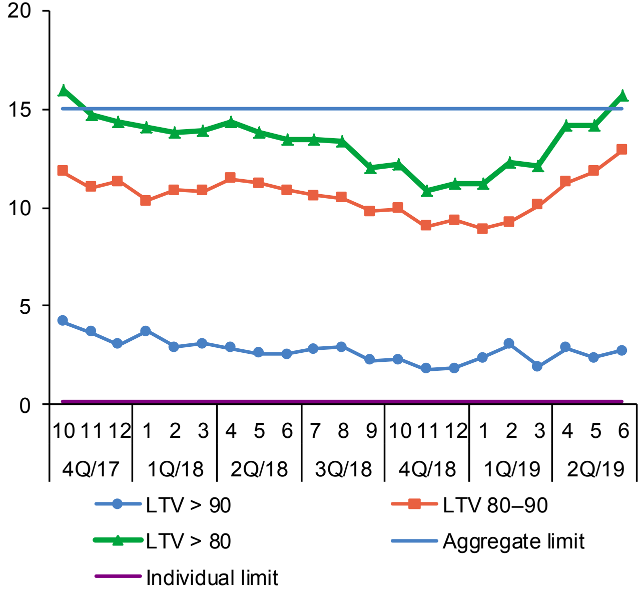
New mortgage loans by rate fixation period
(share in %)



Source: CNB

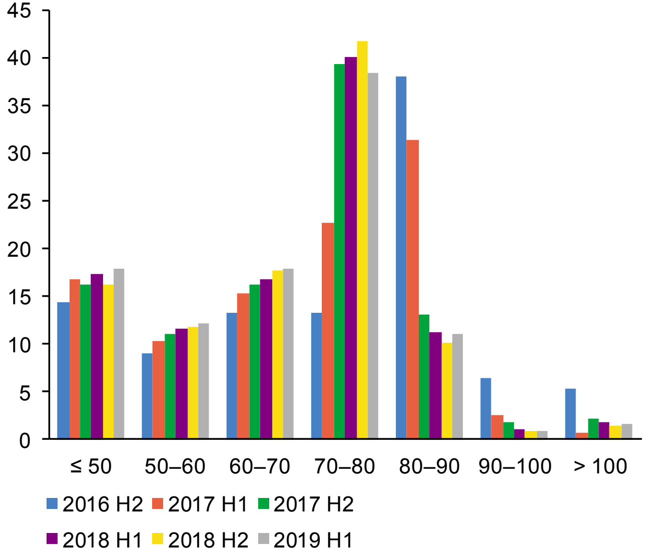
- The volume of loans with LTVs of over 80% exceeded the 15% limit in June 2019.
- The CNB reacts to insufficient compliance with the Recommendation and the macroprudential rules by setting an additional capital requirement.

Fulfilment of the recommended LTV limits
(share of loans in volume provided in %)



Source: CNB

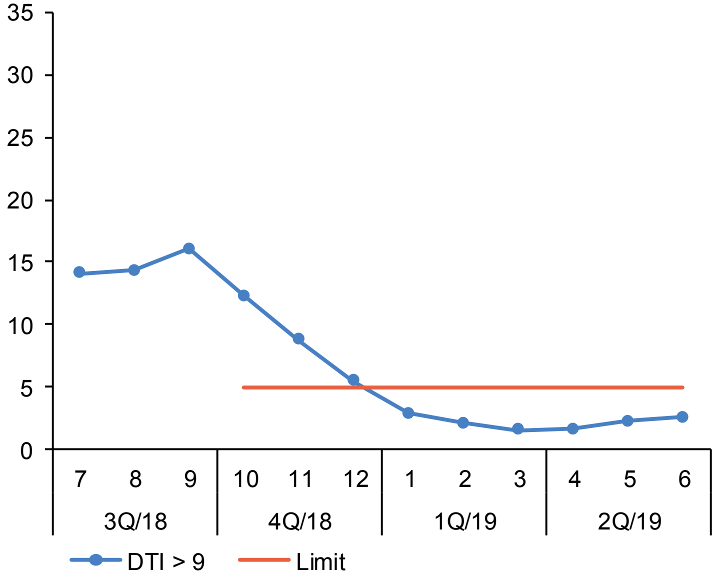
LTV distribution of loans
(x-axis: LTV in %; y-axis: share of loans in volume in %)



Source: CNB

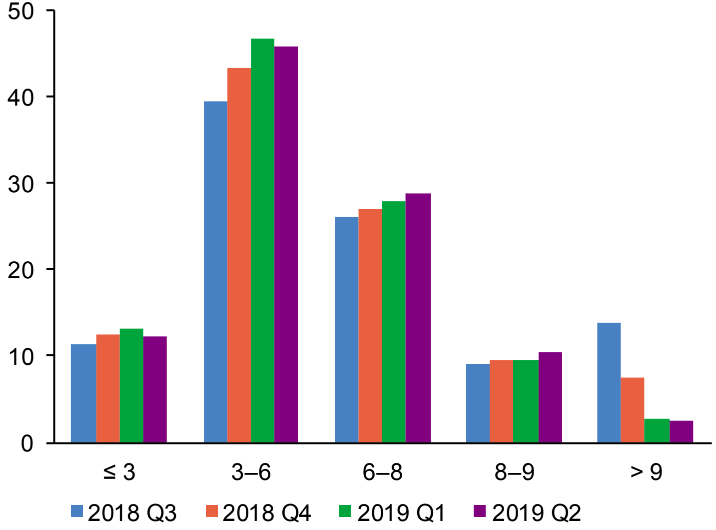
- Banks have no problem complying with the DTI limit.

Fulfilment of the recommended DTI limits
(share of loans in volume provided in %)



Source: CNB

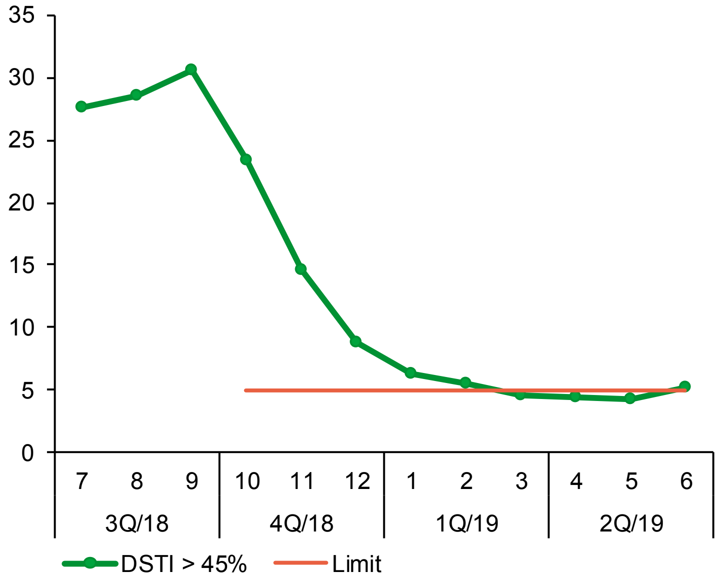
DTI distribution of new loans
(x-axis: DTI in years; y-axis: share of loans in volume in %)



Source: CNB

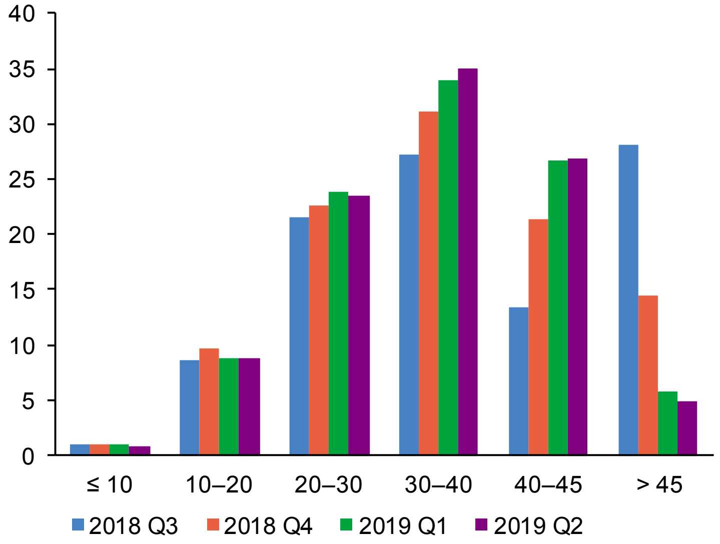
- The DSTI limit remains a major constraint on applicants despite the gradual decrease in interest rates on new mortgage loans.

Fulfilment of the recommended DSTI limits
(share of loans in volume provided in %)



Source: CNB

DSTI distribution of new loans
(x-axis: DSTI in %; y-axis: share of loans in volume in %)



Source: CNB

"Investment" ("additional") mortgages

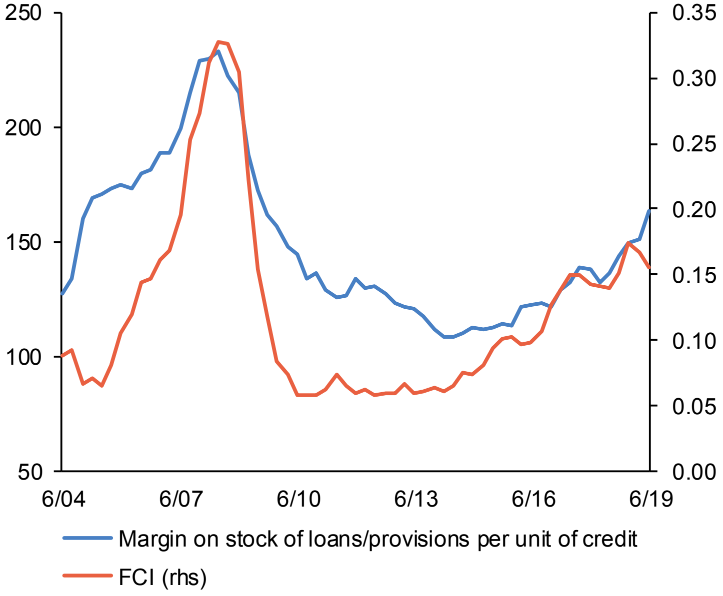
- The share of mortgage loans for which clients declare **rental income as part of their declared income** is very low (below 5%).
- However, newly provided mortgage loans to clients who **already have a mortgage loan account for almost one-third** of the total volume of loans provided (32.4%).
  - It is likely that such loans are mostly of an investment nature and some of them are provided to clients who will rent out the property but do not need to declare the rental income as part of their income.
- The shares of **loans exceeding the DSTI and DTI limits** in all new "investment" mortgages were 6.8% and 2.8% respectively. Their shares in the volume of all above-limit mortgages was 60% and 72.8% respectively.
  - These "investment" mortgages show higher DSTI and DTI values but cannot be regarded as riskier overall.
- In view of the potential **weaker incentive to repay an "investment" loan** in an adverse situation by comparison with mortgages for owner-occupied housing, the CNB today adjusted its Recommendation.

Partial adjustments and clarifications in Recommendation

- In Article IX, the CNB recommends that providers should:
  - in addition to **loans to purchase buy-to-let residential property** (loans where expected income from renting out residential property is included in net income for the assessment of the DTI and DSTI ratios), as monitored now,
  - **newly monitor loans to purchase additional residential property** (loans provided to clients who already have one or more mortgage loans when submitting the application and for whom expected rental income is not included in net income) and use all available information to assess the purpose of such loans.
- Since 2015, banks should apply an **LTV limit of 60%** to **loans to purchase buy-to-let residential property with a higher risk level**.
  - The CNB today clarified the definition of "higher risk level of indicators of the client's ability to service the loan from their own resources" for loans to **purchase buy-to-let residential property**: a DTI of over 9 or a DSTI of over 45%.
- A provision enabling **compliance with exemptions at the lender group level** has been added.

- The domestic economy is now close to the peak of the financial cycle (the cyclical evolution of credit conditions and credit growth) with no clear trend in either direction.

Ratio of the interest rate margin to provisions and the FCI
(%; right-hand scale: 0 minimum, 1 maximum)



Source: CNB
Note: The margin on the stock of loans is the difference between the client lending rate and the client deposit rate.

Sources of banking sector vulnerability

- The **risks** of some loans provided in the growth phase of the financial cycle **are not materialising so far**.

- The models used by banks to set **risk weights** for loans are still influenced by “good times”.
  - The decrease in risk weights during the growth phase of the financial cycle corresponds to a decline in the capital requirement of about CZK 25 billion.

- **Banks’ models** of expected losses also **lead to low provisioning**.

List of other systemically important institutions

- The CNB is required to specify a list of "other systemically important institutions" (O-SIIs) every year based on the methodology of the European Banking Authority.
  - According to the new assessment, the J & T financial group will be excluded from the O-SIIs list; its systemic importance score has been falling over the long term to levels below the threshold.
  - Therefore, **only six financial groups** instead of seven will operate as O-SIIs in the domestic financial sector in 2020 (Československá obchodní banka, Česká spořitelna, Komerční banka, UniCredit Bank, PPF FH B.V. and Raiffeisenbank).

- The change has no impact on the institutions' capital requirements.

- **The following will be published on the CNB website on 13 December 2019:**
  - The report *Risks to financial stability and their indicators*
  - The minutes of the CNB Bank Board meeting on financial stability issues
  - Official information – *Recommendation on the management of risks associated with the provision of retail loans secured by residential property*
  - *Provision of a general nature on setting the countercyclical capital buffer rate IV/2019*