Financial Stability Report 2019/2020

CNB press conference

on the results of the meeting on financial stability issues

Jiří Rusnok, Governor
Jan Frait, Executive Director, Financial Stability Department

Contents

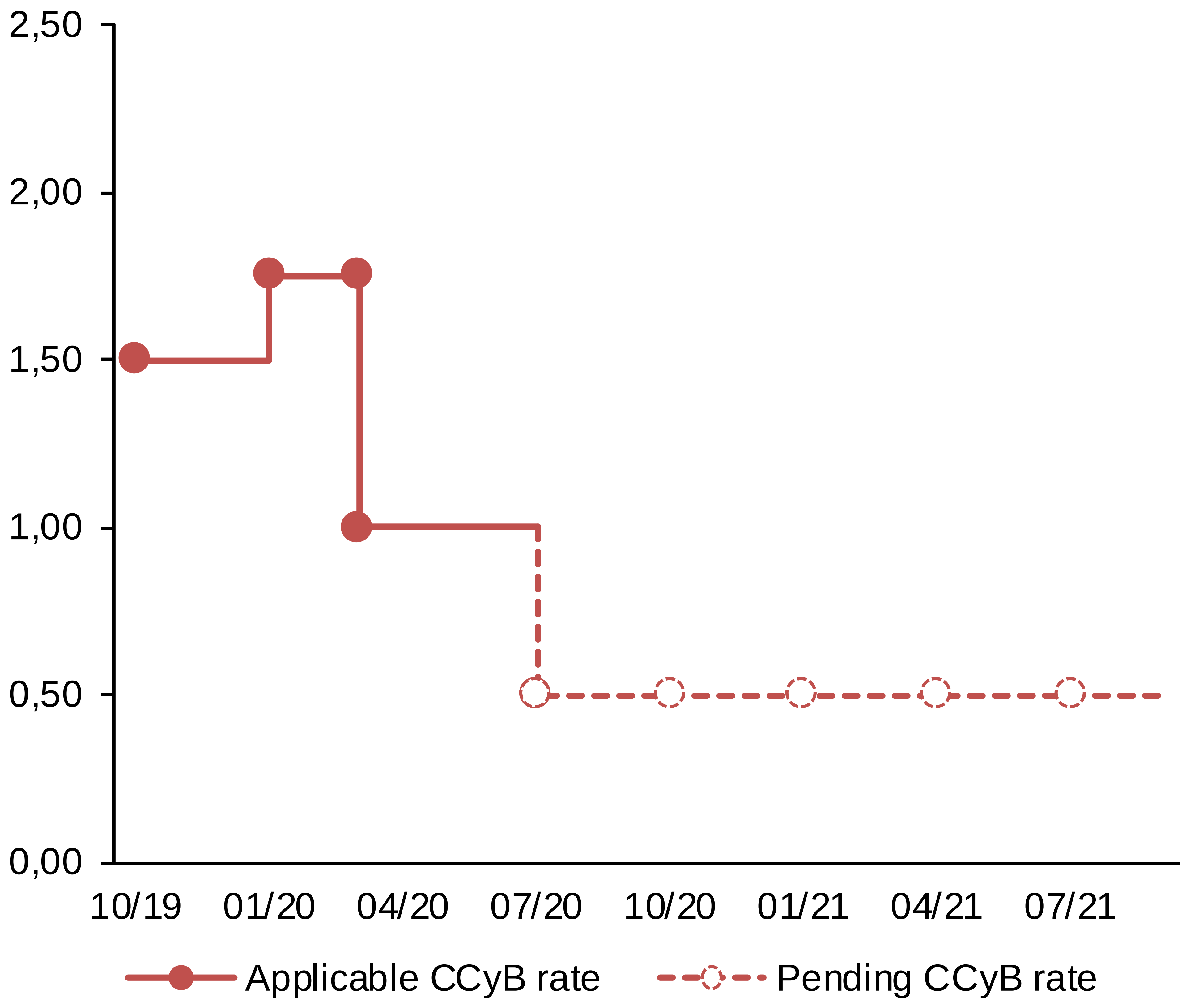
Financial stability in June 2020

CNB CZECH NATIONAL BANK

- The Czech financial sector developed highly favourably from spring 2019 onwards.
  - The banking sector maintained high resilience to potential adverse shocks and entered the coronavirus crisis in good shape.
- The disruption to economic activity due to the COVID-19 pandemic poses a risk of sizeable credit losses and a marked reduction in lending by banks.
  - The government's stabilisation and support programmes are providing liquidity to the real economy and preventing a precipitous wave of credit defaults.
  - The CNB's measures are stabilising the debt service of the real sectors and supporting the liquidity of financial institutions in a preventive manner.
- Risks that built up in the previous growth phase of the financial cycle are very likely to materialise gradually.
  - After the loan moratorium ends, households and firms with higher debt levels are especially at risk of becoming insolvent.
  - This will be reflected in a rise in credit losses on banks' balance sheets.
- Banks are tightening their credit standards, so the extent of newly accepted risks on their balance sheets will decline.

Decision on countercyclical capital buffer rate (1)

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



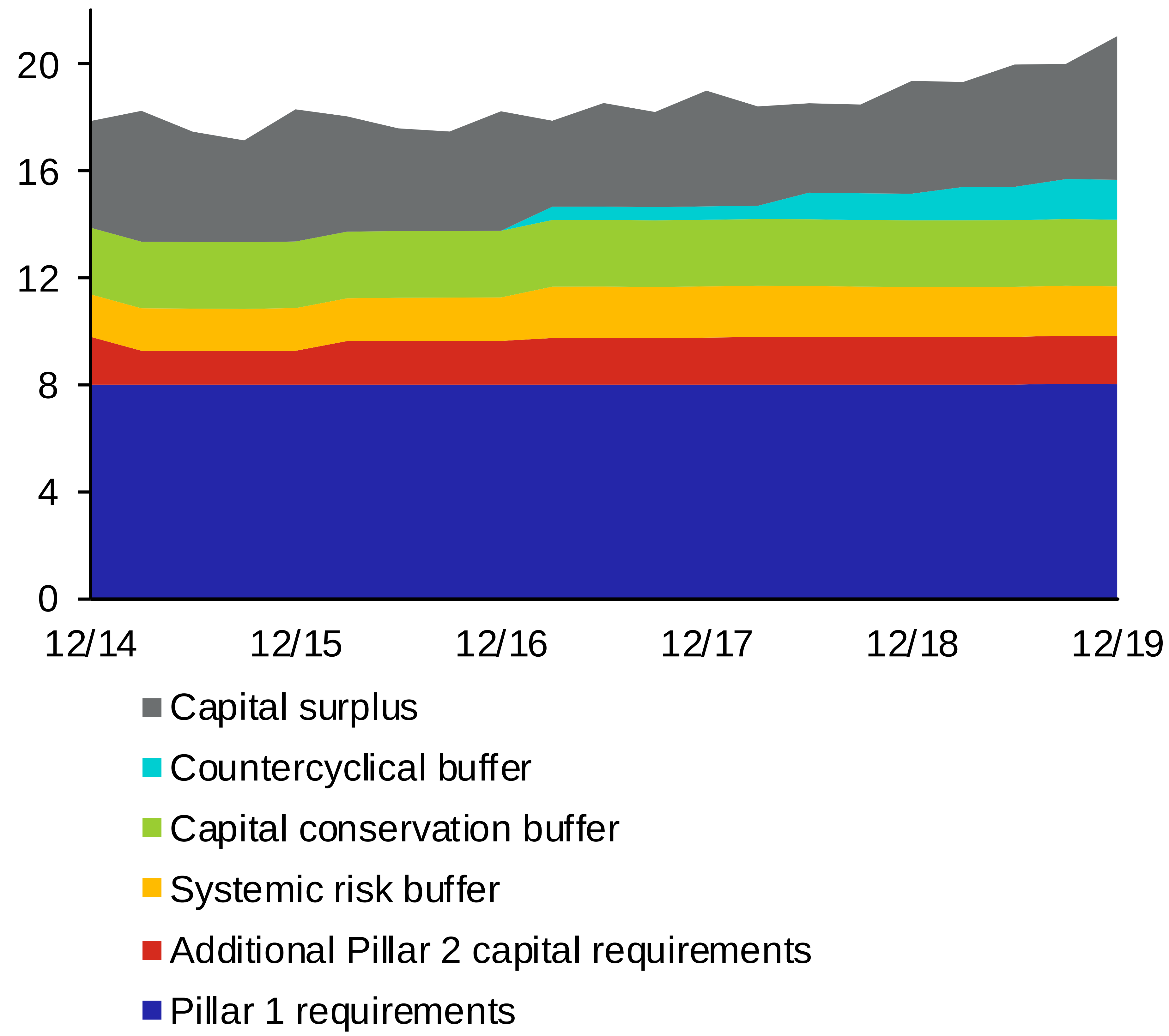
Source: CNB

- The Bank Board lowered the countercyclical capital buffer (CCyB) rate to 0.5%.
- The CNB is ready to release the countercyclical capital buffer fully were banks' credit losses to rise markedly, in order to support their ability to provide credit to non-financial corporations and households without interruption.
- The CNB considers it natural that, following the potential full release of the CCyB, banks will also use the capital conservation buffer and possibly also the systemic risk buffer in order to be able to continue providing services to their clients in the event of strongly adverse developments.

Decision on countercyclical capital buffer rate (2)

CNB CZECH NATIONAL BANK

Structure of capital requirements in the domestic banking sector
(pp; right-hand scale: %)



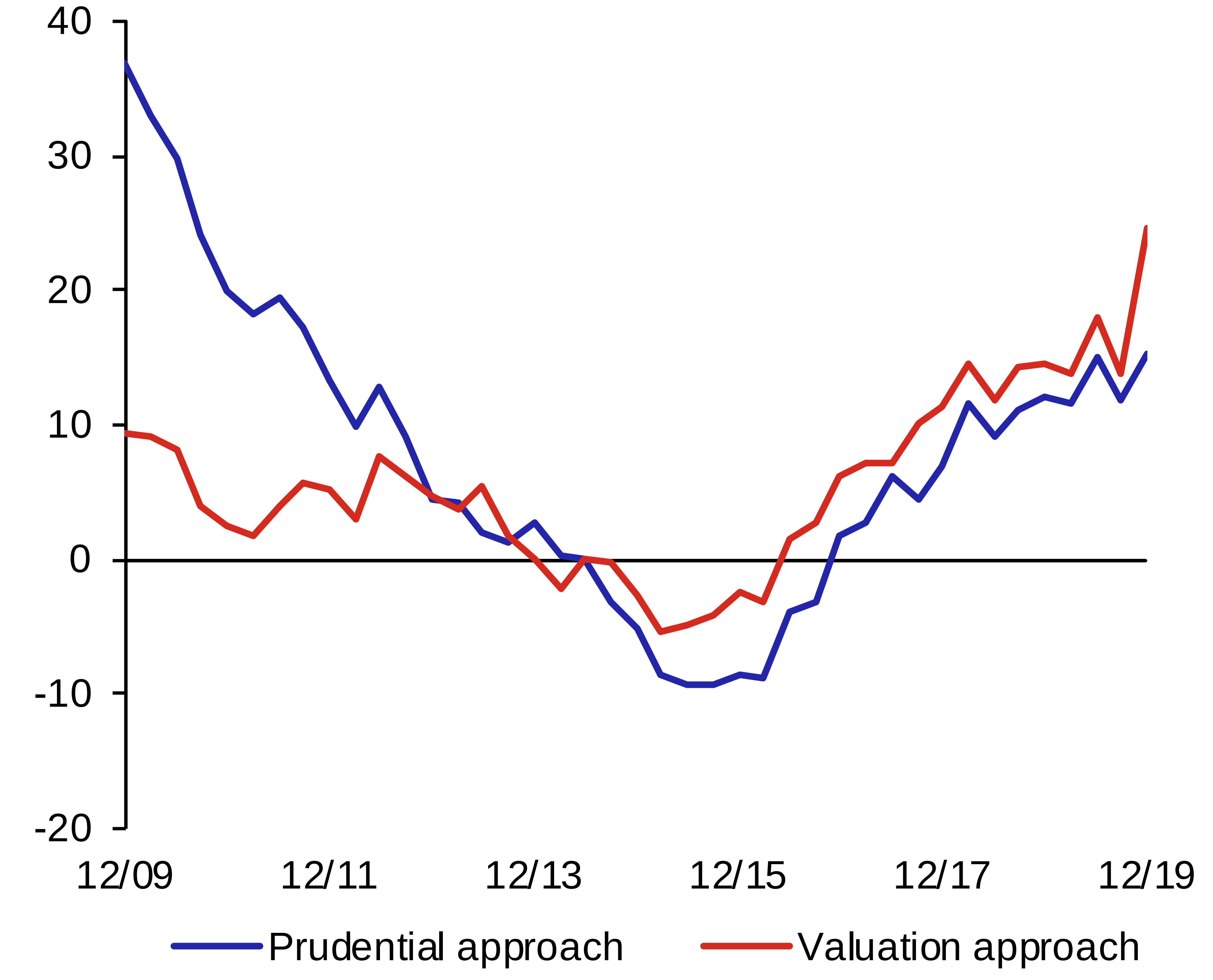
Source: CNB

- The capital position of the domestic banking sector is currently robust.
- The aggregate capital ratio of the banking sector was 21.3% at the end of last year, with
  - the combined capital buffer requirement at 5.9% (CZK 158 billion) on average,
  - the capital surplus in excess of the regulatory requirements at 5.6% (CZK 148 billion).
- Most banks currently meet the overall capital requirement and have sufficient spare capital capacity for lending thanks to the capital surplus and earnings retained in line with the CNB’s recommendation.
- The CNB stands ready to use all its supervisory and regulatory instruments to maintain this situation.

Property market and mortgage lending (1)

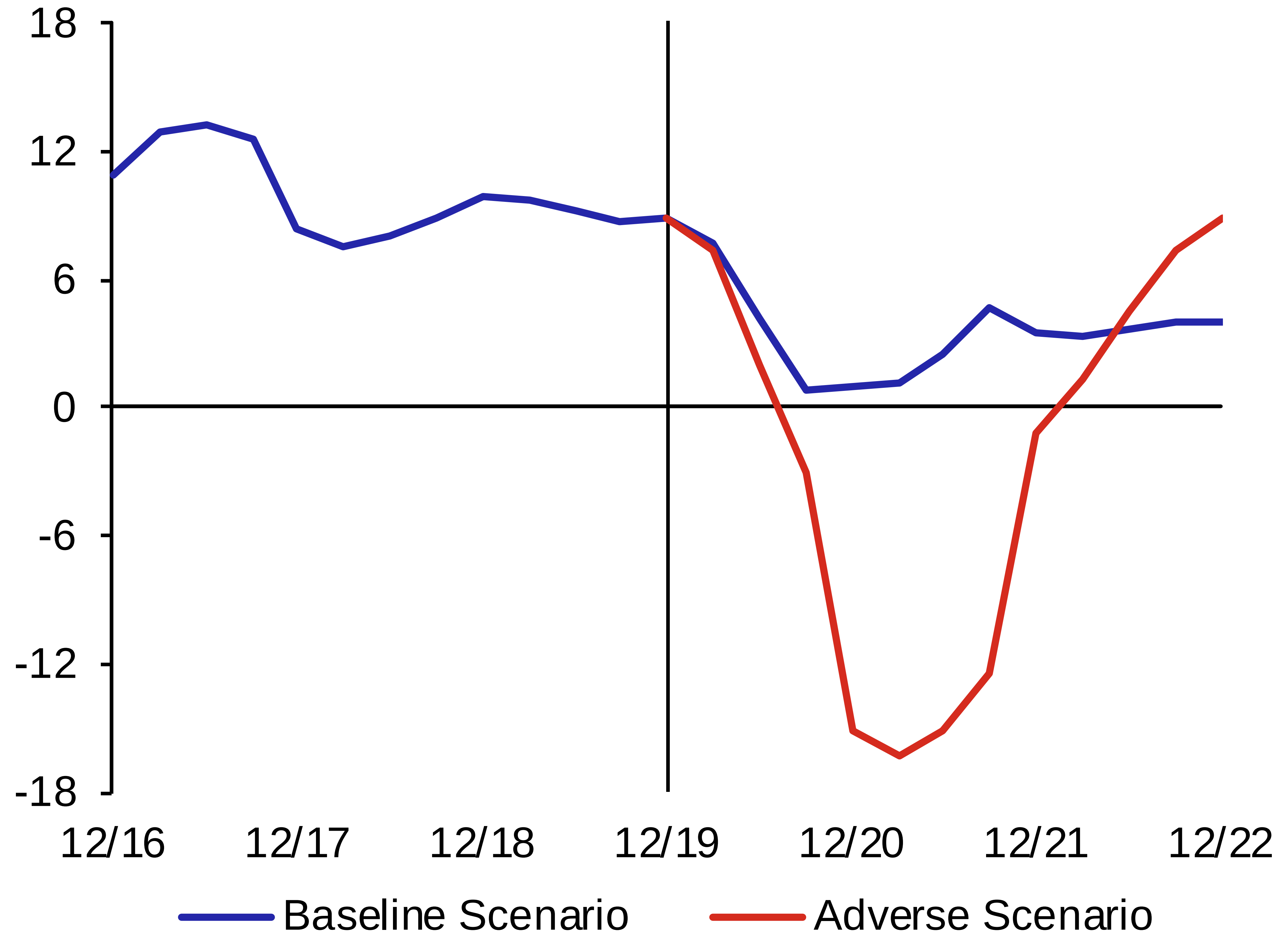
- The overvaluation of apartment prices stood at 15–25% at the end of 2019.
- In the event of very adverse developments in the real economy, housing prices may fall.

Estimated overvaluation of apartment prices
(%)



Source: CNB.

Year-on-year property price growth
(%)

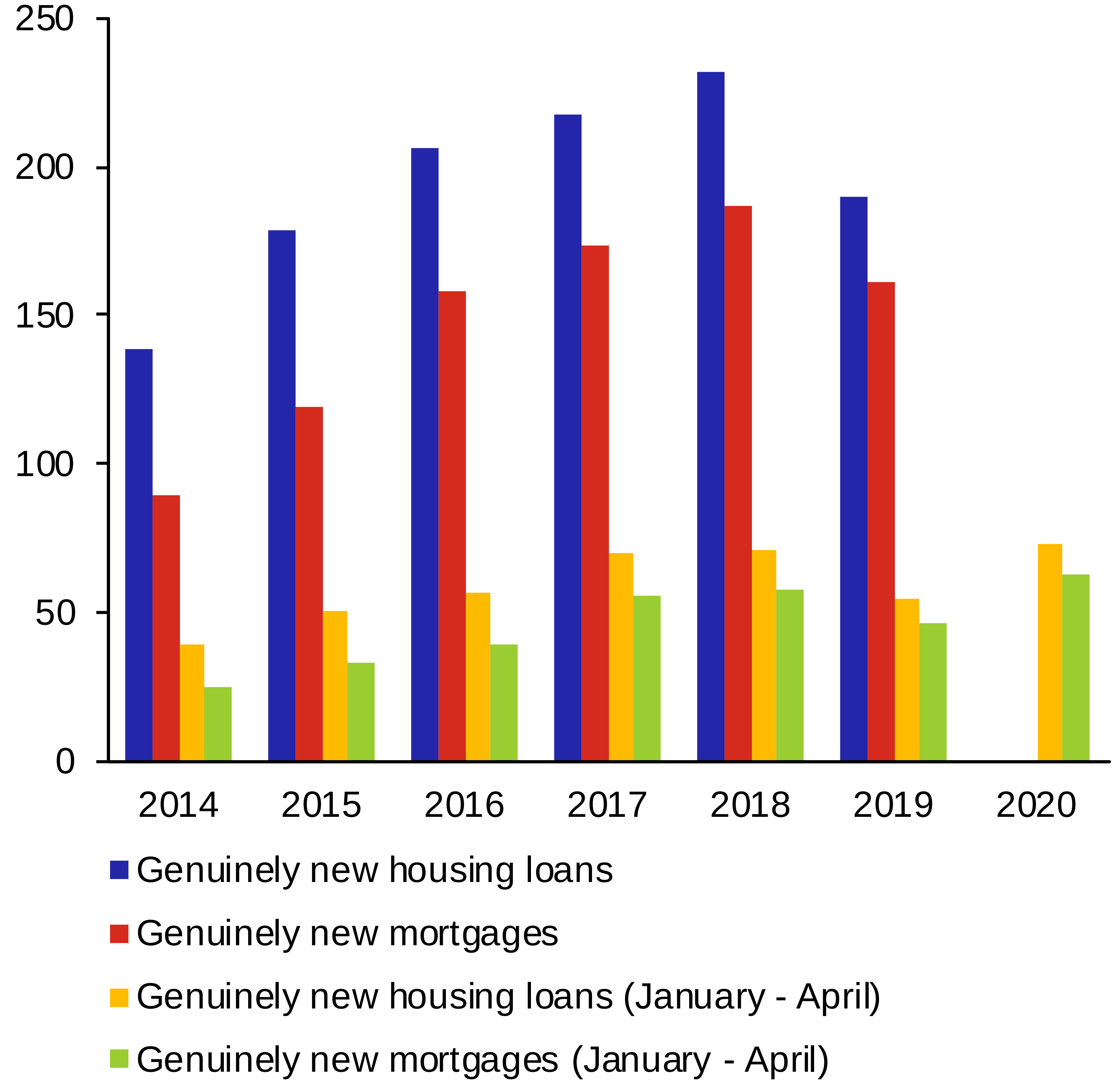


Source: CNB.

Property market and mortgage lending (2)

CZECH NATIONAL BANK

New housing loans nad mortgage loans
(CZK billions)



Source: CNB

- In the first four months of this year, the volume of genuinely new loans for house purchase and mortgage loans reached record highs compared with the same period in previous years.
    - It can be expected that the impacts of the coronavirus crisis will manifest themselves in the months ahead and lending for house purchase will decrease.
    - The development of the spiral between debt funding of property and optimistic expectations regarding future property price growth should therefore come to a halt.

Property market and mortgage lending (3)

- In the second half of 2019, the majority of banks mostly followed the currently applicable CNB Recommendation in the area of compliance with the LTV, DTI and DSTI limits. In the case of DSTI, some were only very slightly above the recommended limits.
- The Bank Board decided that, given the persisiting overvaluation of housing prices, it is currently not desirable to change the current recommended LTV limit of 90% (with a possible 5% exemption).
- Given the expected economic consequences of the COVID-19 pandemic for risk perceptions among banks and their clients, the Bank Board decided to abolish the recommended upper limit on the DSTI ratio with effect from July 2020.
  - It can be assumed that lenders and their clients will be well aware of the risks and will act in a very conservative way.
- However, the CNB continues to point out to lenders that loans can usually be regarded as very risky above certain thresholds (LTV 90%, DTI 8 and DSTI 40%).
  - Lenders should provide such loans with great caution and only to applicants who are highly likely to repay without problems.

Contents

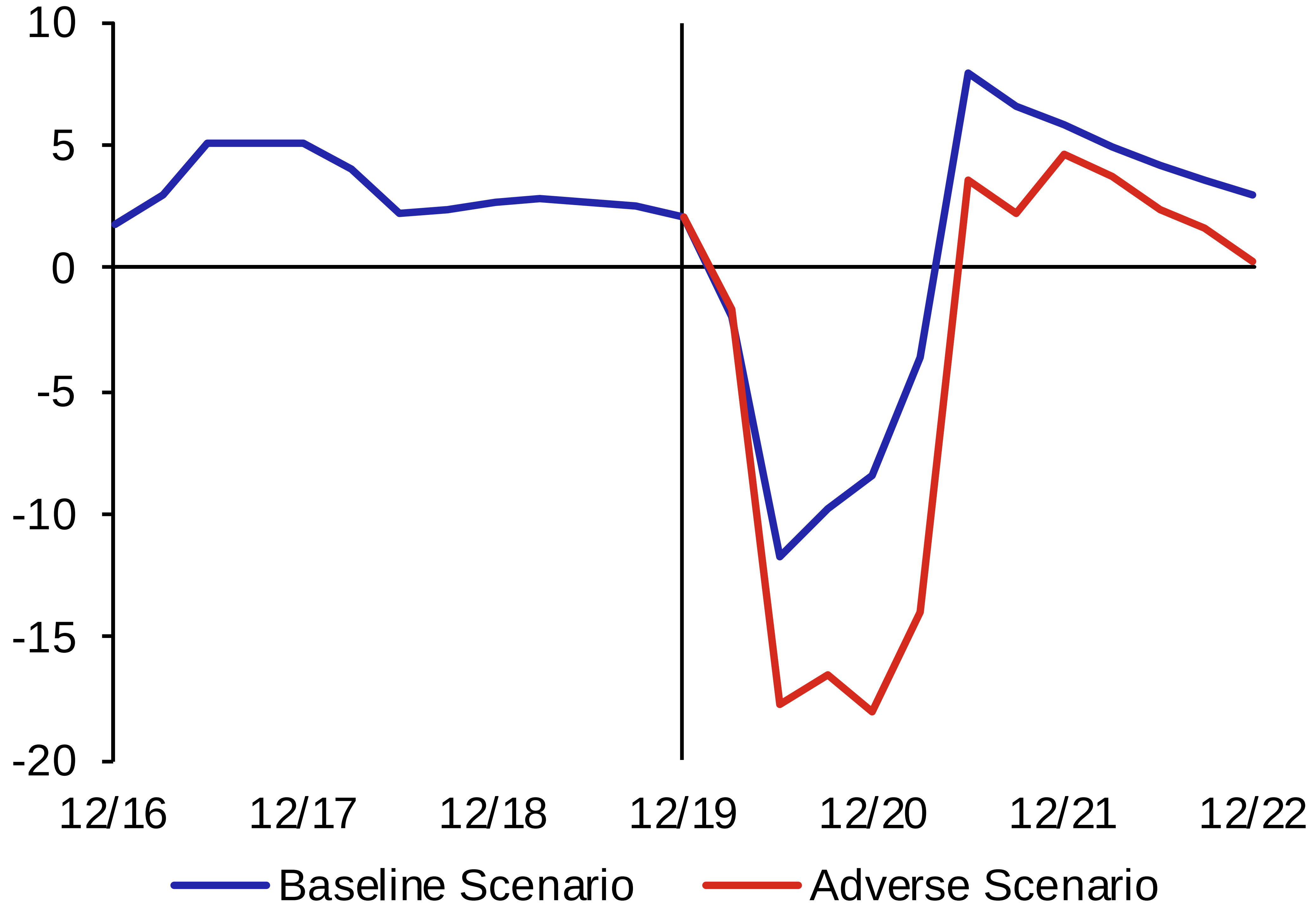
GDP in stress test

CZECH NATIONAL BANK

- The **Baseline Scenario** is characterised by a pattern usually attributed to adverse scenarios. It involves a sharp temporary decline of the economy in the first year of the test.
- The **Adverse Scenario** assumes that the coronavirus crisis will persist due to a resurgence of COVID-19, which will hit Europe, including the Czech Republic, at the end of 2020.

Real GDP growth

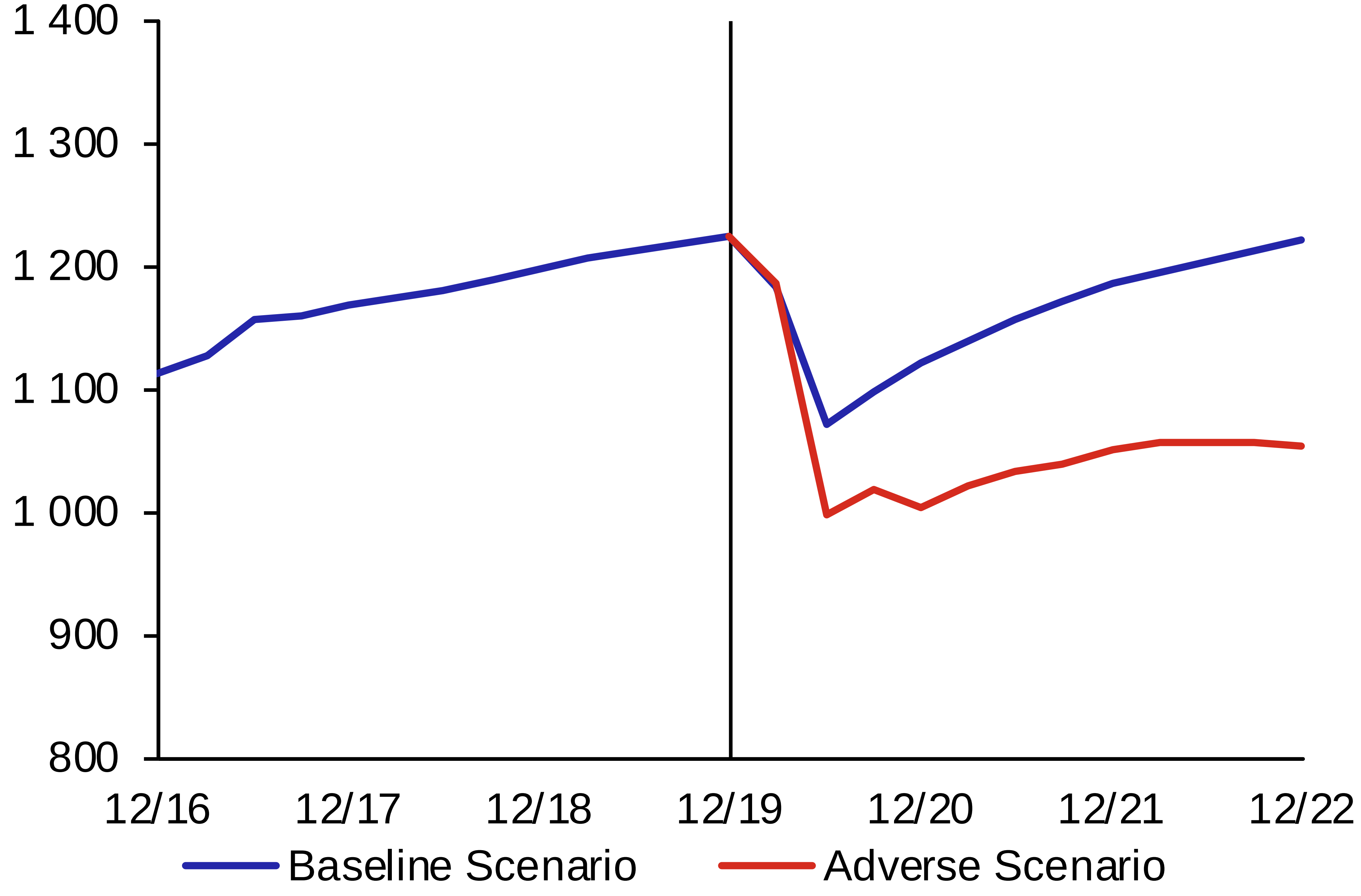
(year-on-year in %)



Source: CNB.

Real GDP

(CZK billions; quarterly)



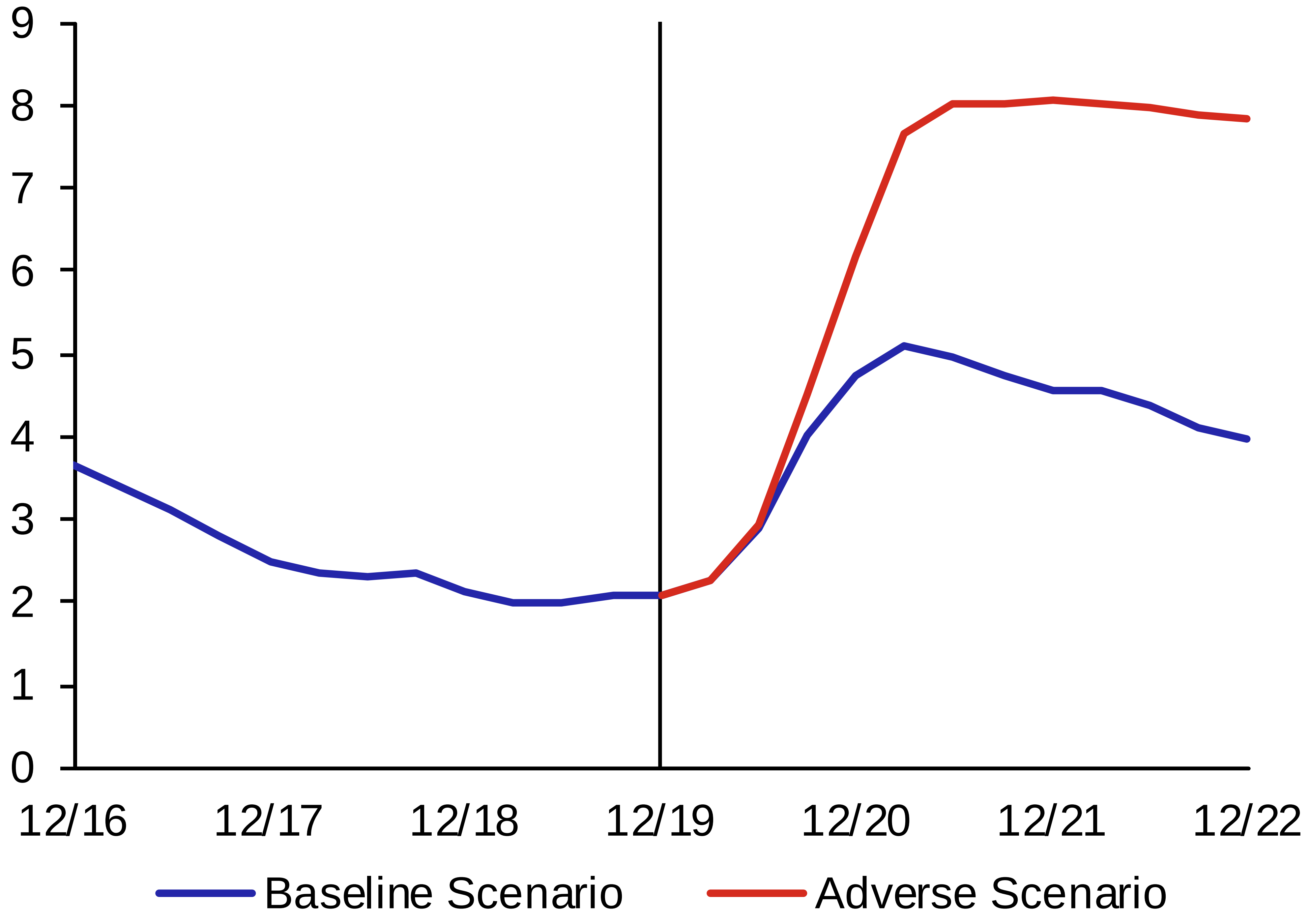
Source: CNB

Unemployment and GB yields in stress test

- The **Baseline Scenario** is characterised by a pattern usually attributed to adverse scenarios. It involves a sharp temporary decline of the economy in the first year of the test.
- The **Adverse Scenario** assumes that the coronavirus crisis will persist due to a resurgence of COVID-19, which will hit Europe, including the Czech Republic, at the end of 2020.

Unemployment

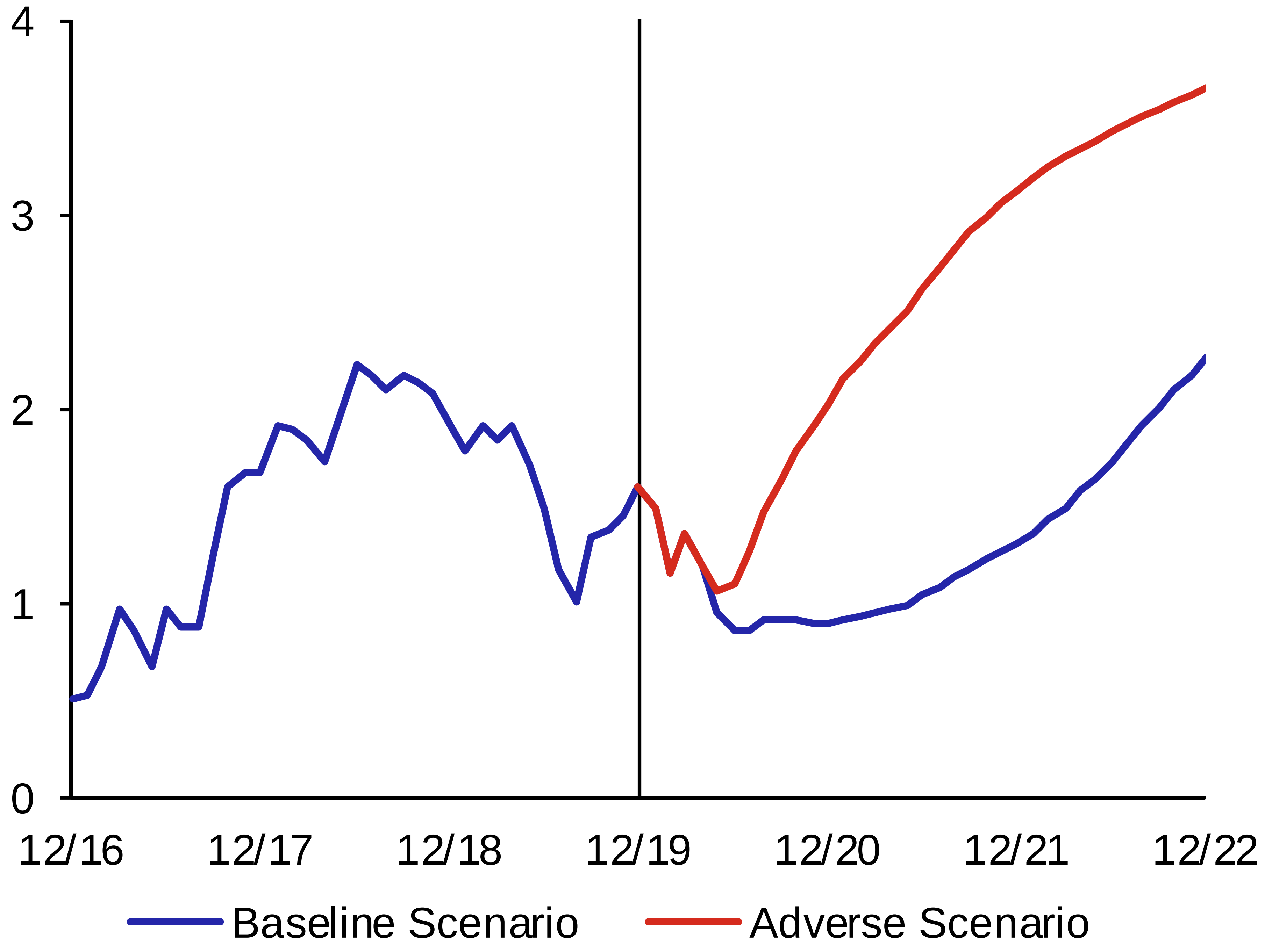
(%)



Source: CNB.

10-year CZ government bond yield

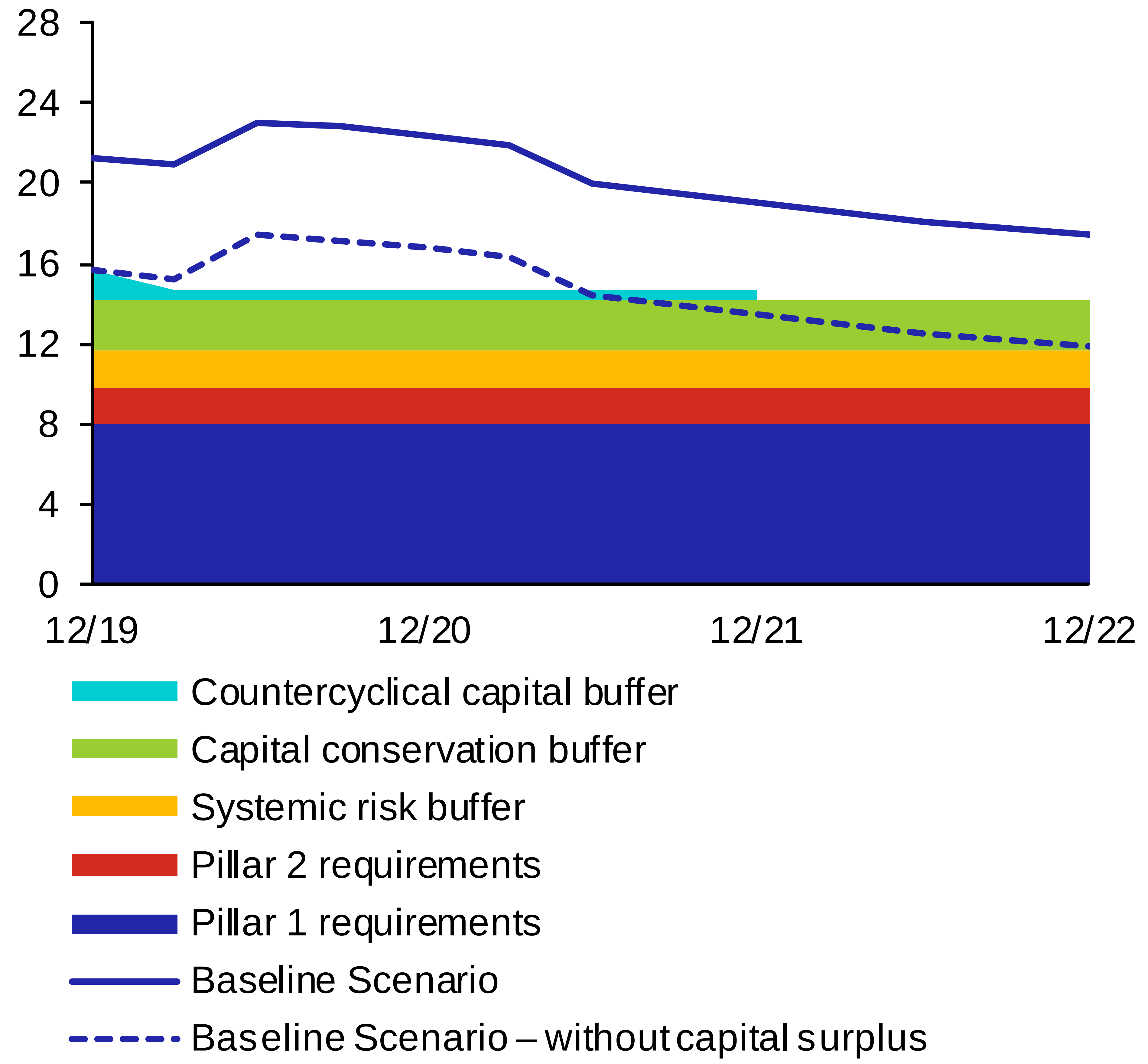
(v %)



Source: CNB.

Outcome in *Baseline Scenario*

Impact of the alternative scenarios and interactions with the capital requirements of the banking sector
(pp)



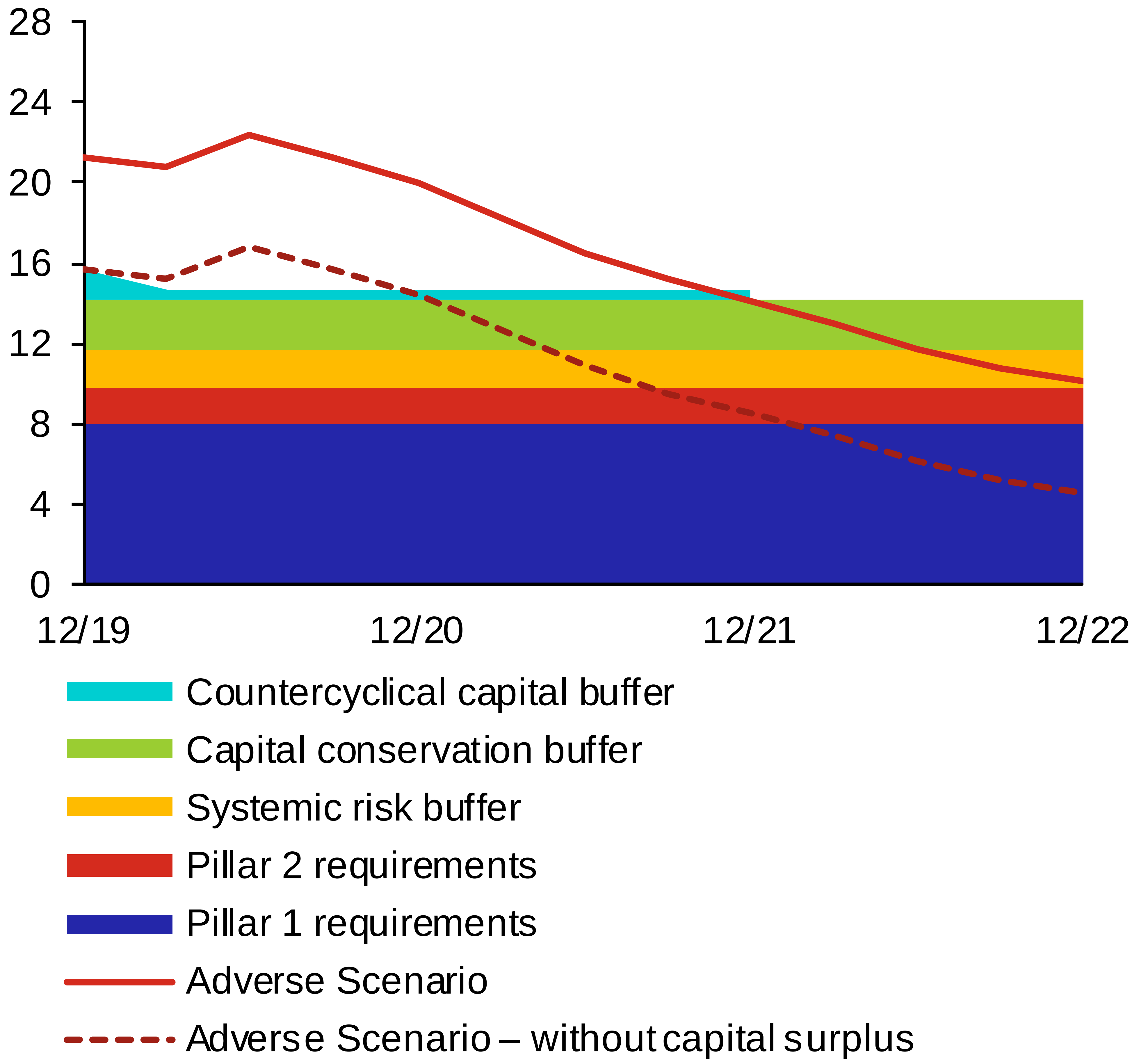
Source: CNB

- The result of the macro stress tests of banks in the **Baseline Scenario** shows that banks are able to withstand the stress without major problems (solid blue line).
- The sector's aggregate capital ratio (21.3% in 12/2019) falls by 3.7 pp to 17.5% over the three-year test horizon.
- No bank should record a decline below the 8% regulatory capital minimum.
- However, the capital ratios of three banks could drop below the total capital requirement (TSCR, the sum of the Pillar 1 and Pillar 2 requirements), implying a need to top up capital by CZK 0.6 billion.

Outcome in *Adverse Scenario*

CNB CZECH NATIONAL BANK

Impact of the alternative scenarios and interactions with the capital requirements of the banking sector
(pp)



Source: CNB

- The result of the **Adverse Scenario** shows that the extent of the losses under the given conservative assumptions leads to the use of all capital buffers (solid red line).

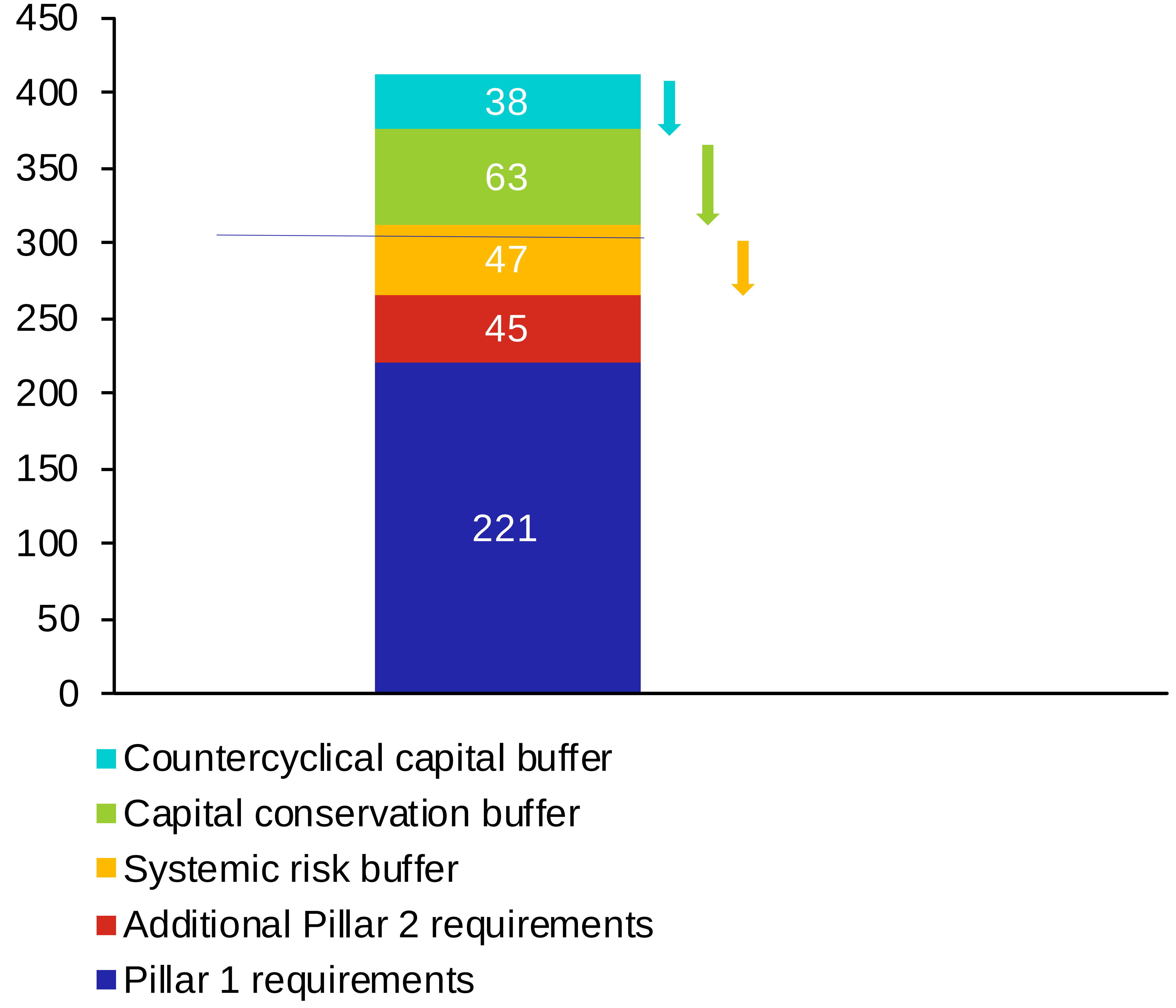
  The sector's aggregate capital ratio falls by 11.2 pp to 10.1% over the three-year test horizon.

  Thirteen banks would not comply with the 8% regulatory minimum, implying a need to top up capital by CZK 28 billion (0.5% of GDP, or 5.2% of the banking sector's current capital).

  The capital ratios of 17 banks would fall below the total capital requirement (TSCR, the sum of the Pillar 1 and Pillar 2 requirements), implying a need for a capital injection of CZK 62 billion (1.1% of GDP).

Absorption capacity of capital and capital buffers

Order of use of capital reserves of the banking sector
(CZK bilions, end 2019)

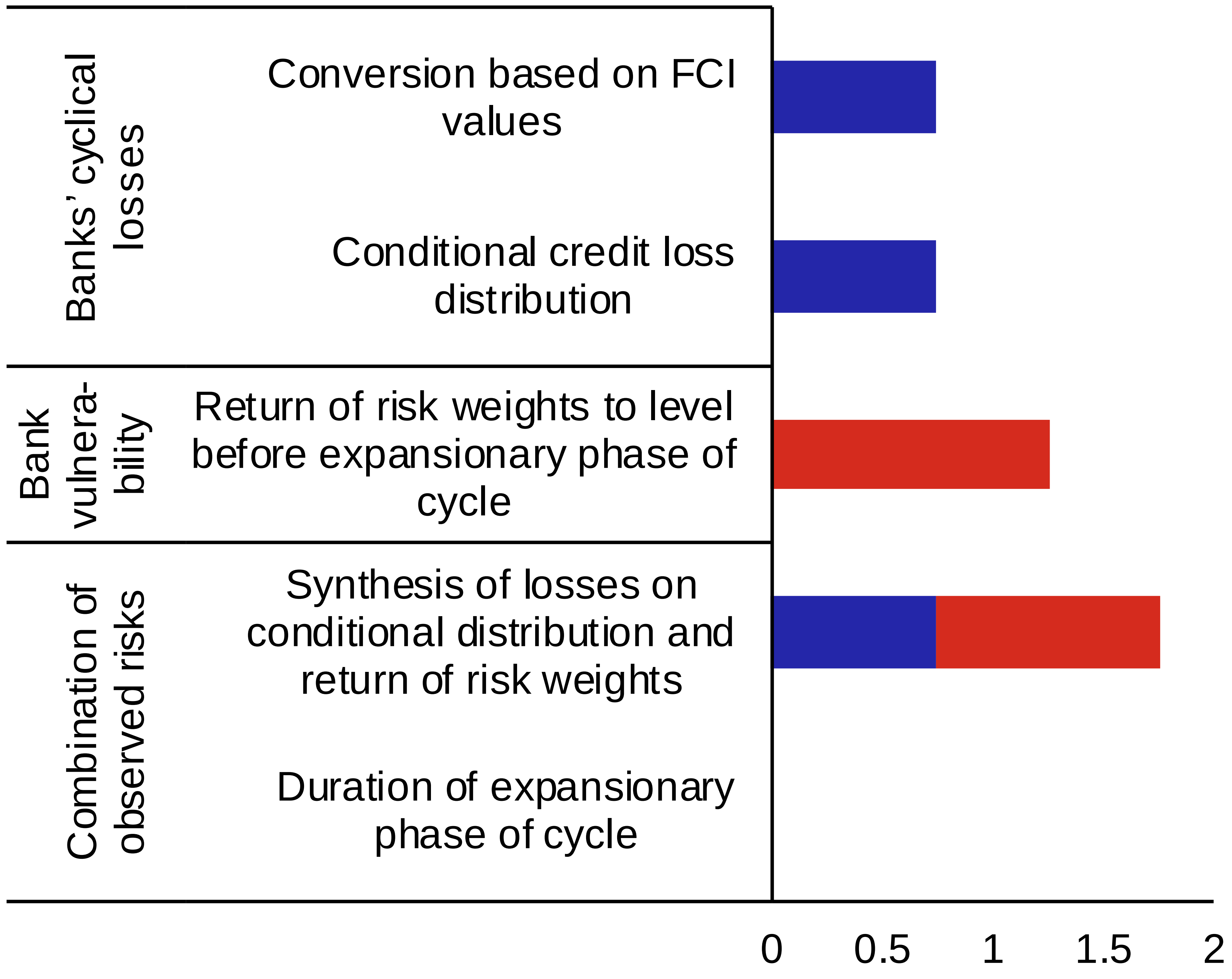


Source: CNB

- Step 0: Losses are absorbed by undistributed profits and the capital surplus (almost CZK 250 billion).
- Step 1: Increased credit losses may reach a level where the CNB will fully release the CCyB.
- Step 2: An escalation of credit losses may lead to the use of the CCoB by some institutions in order to cover losses and/or prevent a credit crunch.
- Step 3: Five systemically important banks have the systemic risk buffer (SRB) at their disposal; the SRB can be used as a capital buffer of last resort so that credit can continue to be provided to the real economy even in a very adverse economic situation.
- The renewal of these capital buffers (CCoB, SRB) may be gradual.

CCyB rate

Implied CCyB rate based on various approaches
(% of total risk exposure)

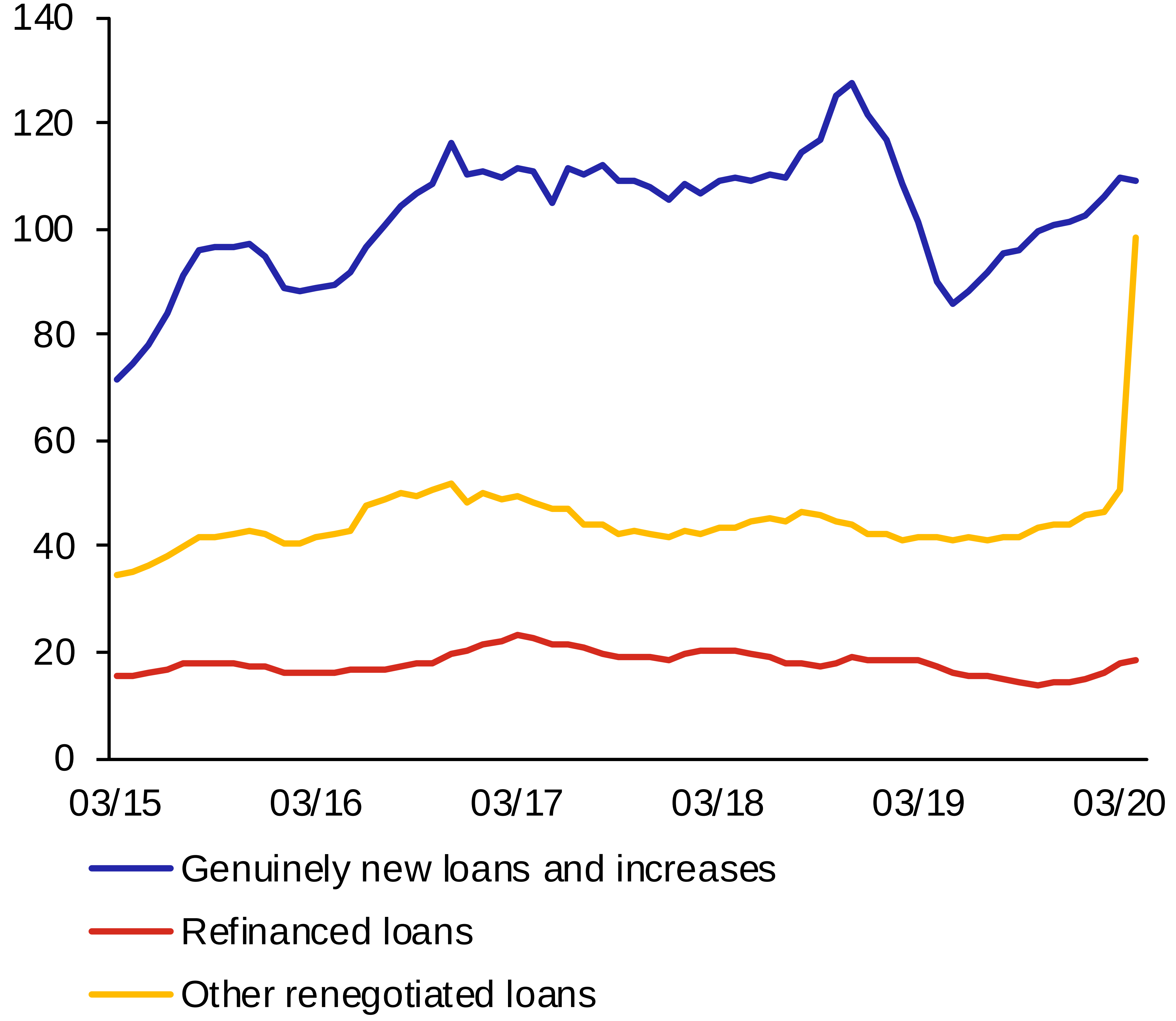


Source: CNB

- The indicators used for decision-making currently imply a CCyB rate as high as 1.75%.
- The reduction of the CCyB rate to 1% with effect from the start of April 2020 was a forward-looking reaction to expected adverse economic developments.
    - It made almost CZK 20 billion available to banks to absorb part of the credit losses that are very likely to occur in the quarters ahead.
- The decisive signal for a potential further reduction of the CCyB rate will be cyclical risks accepted earlier materialising as credit losses and an increase in risk weights on credit exposures.

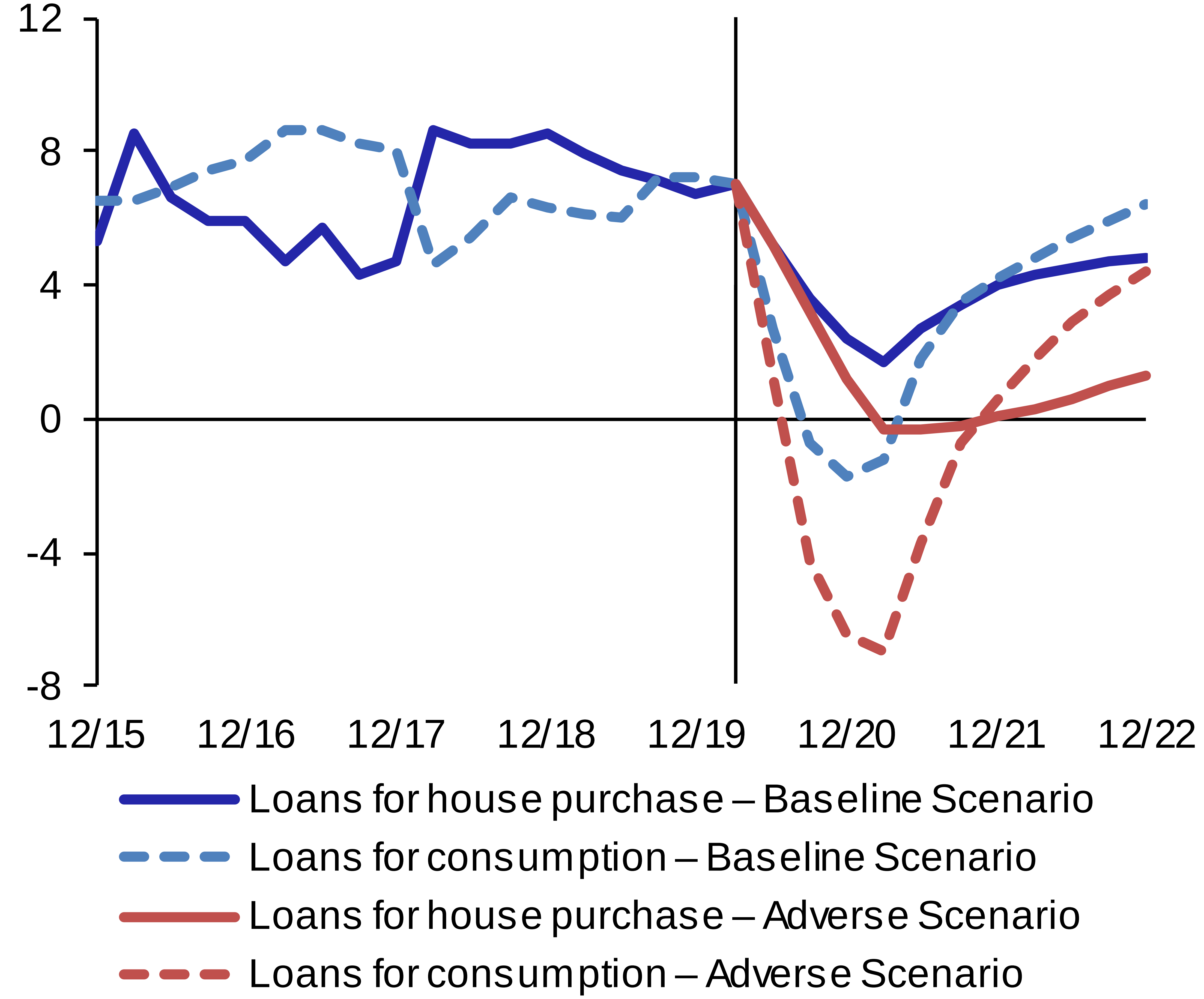
Loans for house purchase and their outlook

Six-month totals of components of new loans for house purchase
(CZK billions; moving six-month totals)



Source: CNB

Year-on-year growth in bank loans to households
(%)

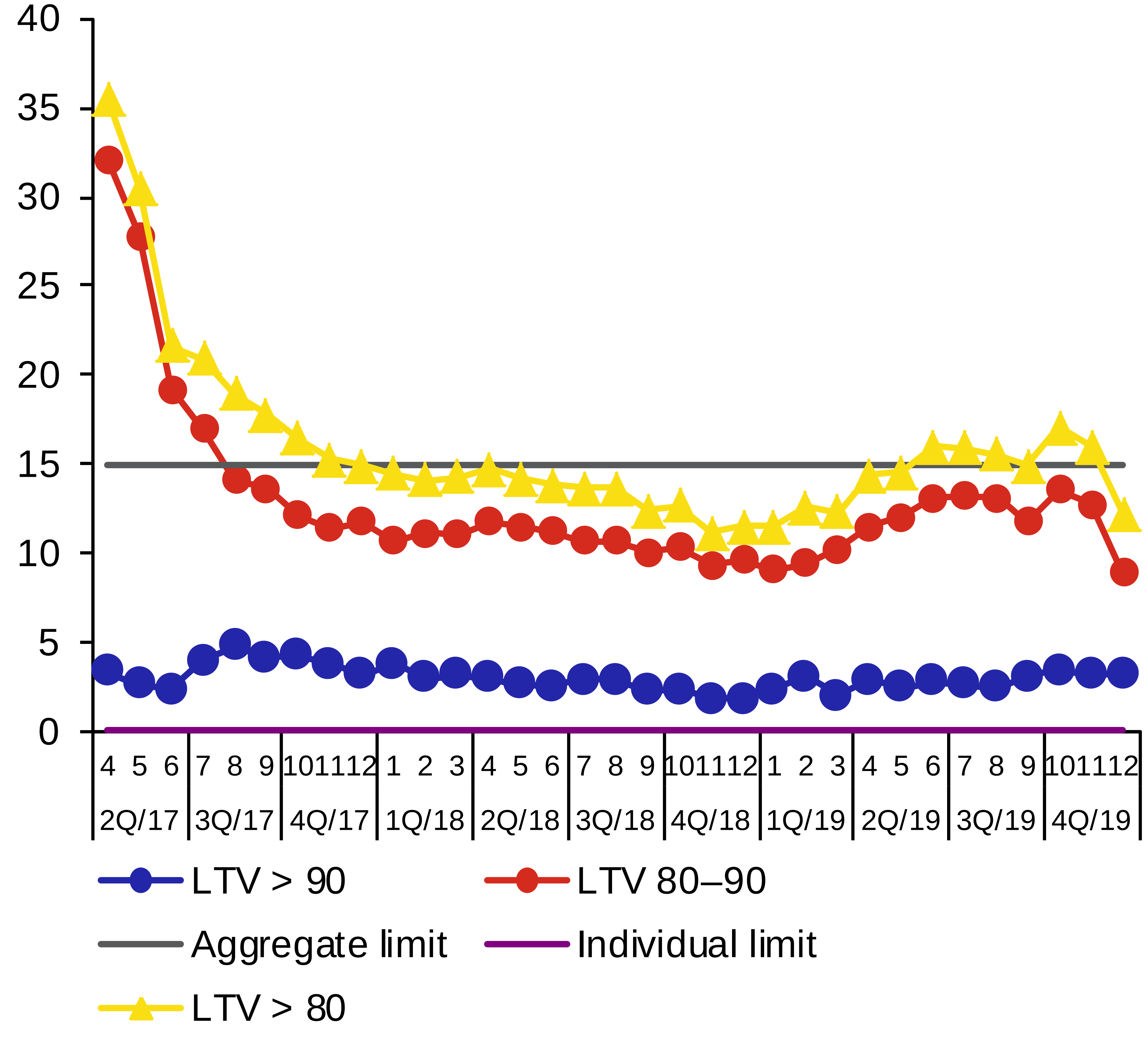


Source: CNB

Compliance with LTV limit

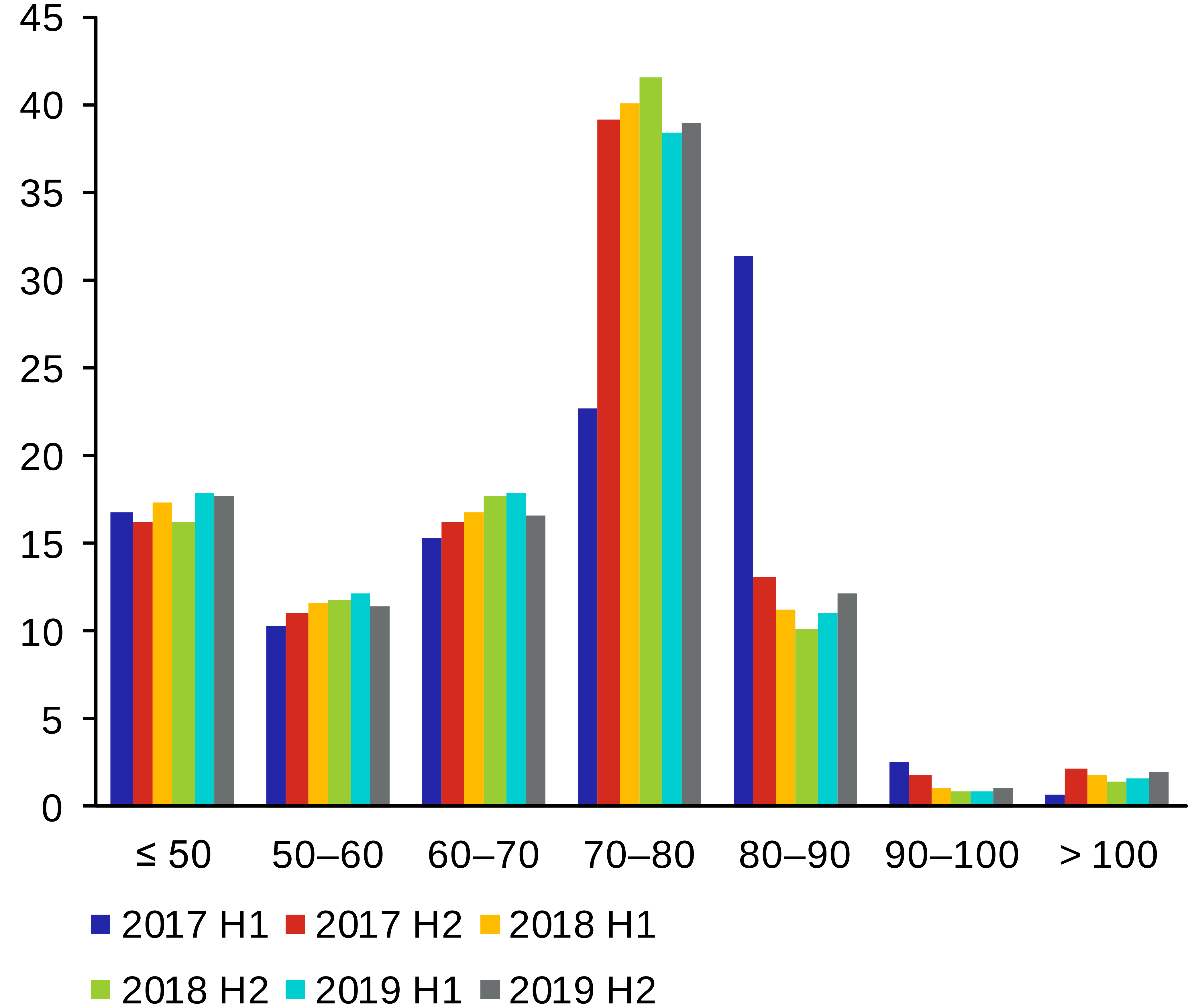
CNB CZECH NATIONAL BANK

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 %)



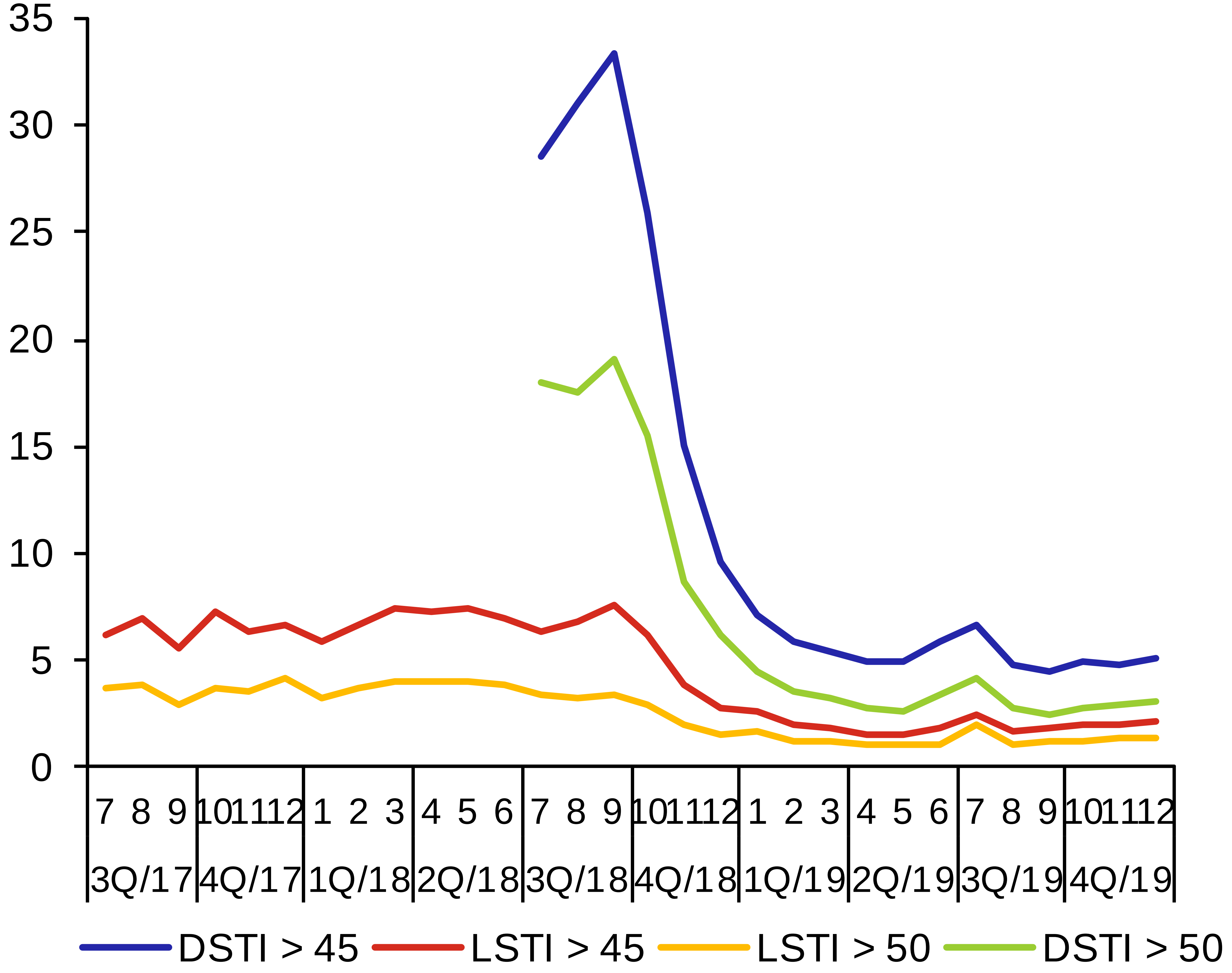
Source: CNB

Compliance with DSTI limit

CZECH NATIONAL BANK

Fulfilment of the recommended DSTI limits

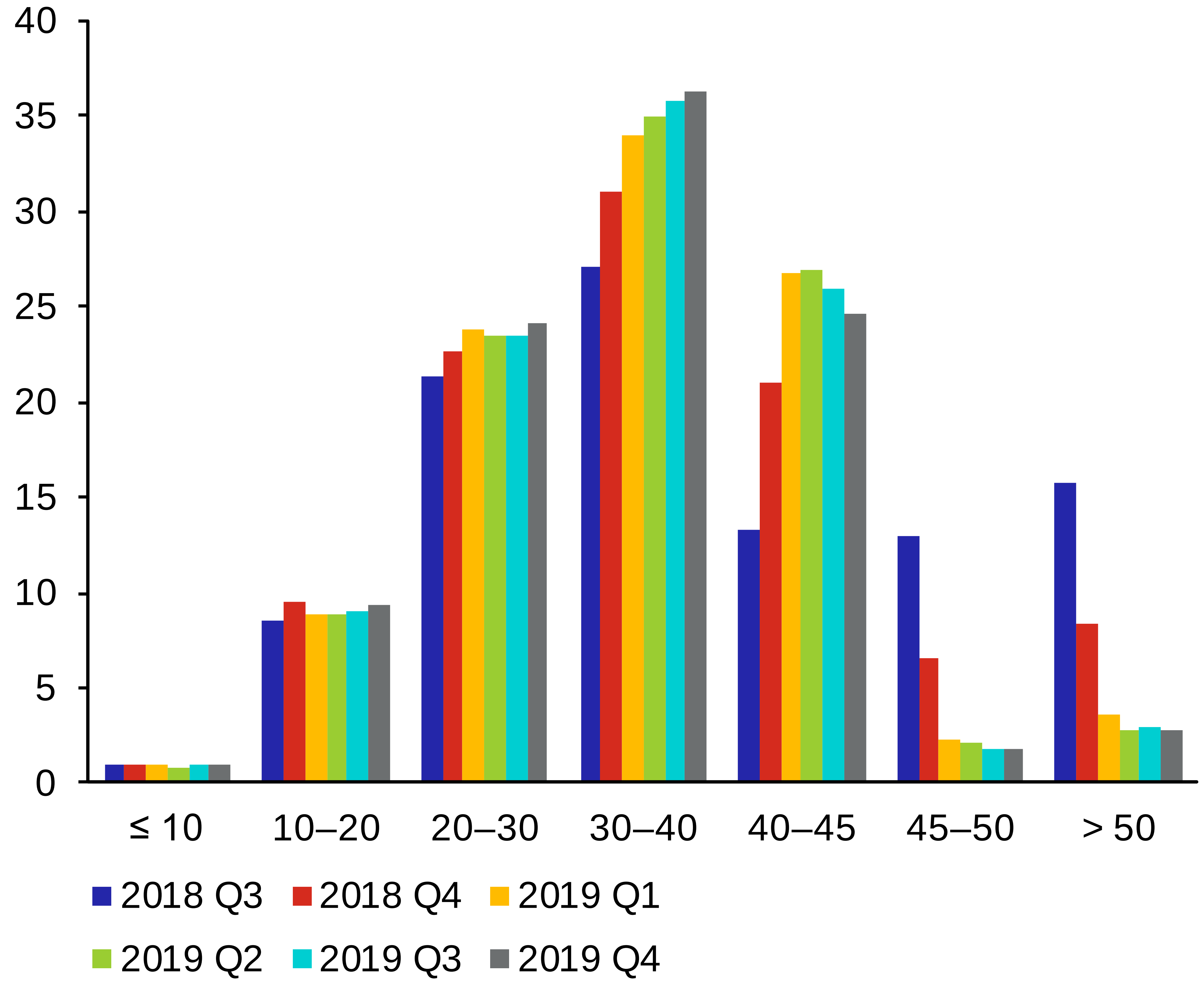
(share of loans in volume provided in %)



Source: CNB

DSTI distribution of new loans

(x-axis: DSTI in %; y-axis: share of loans in volume in % in given quarter)

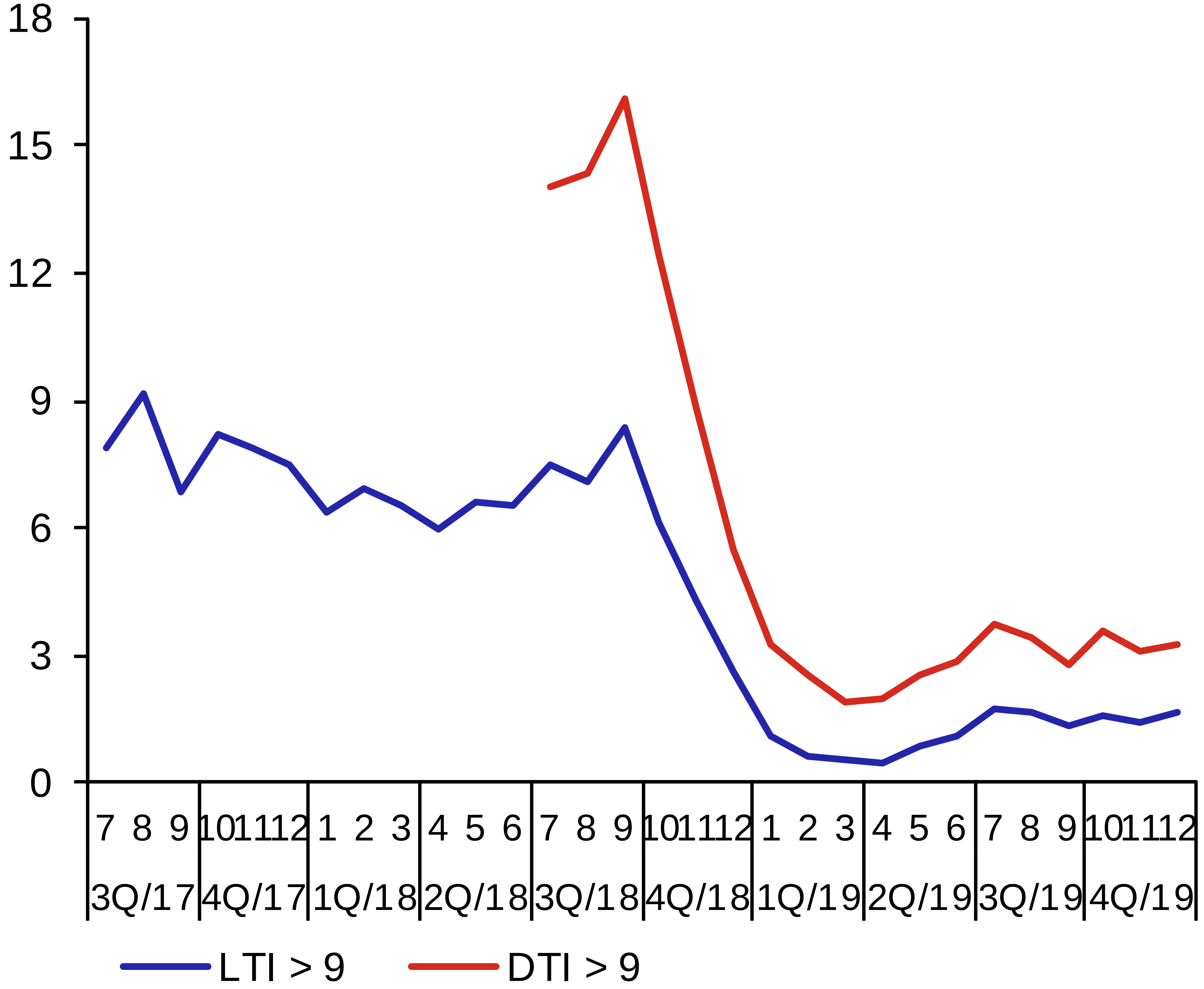


Source: CNB

Compliance with DTI limit

Fulfilment of the recommended DTI limits

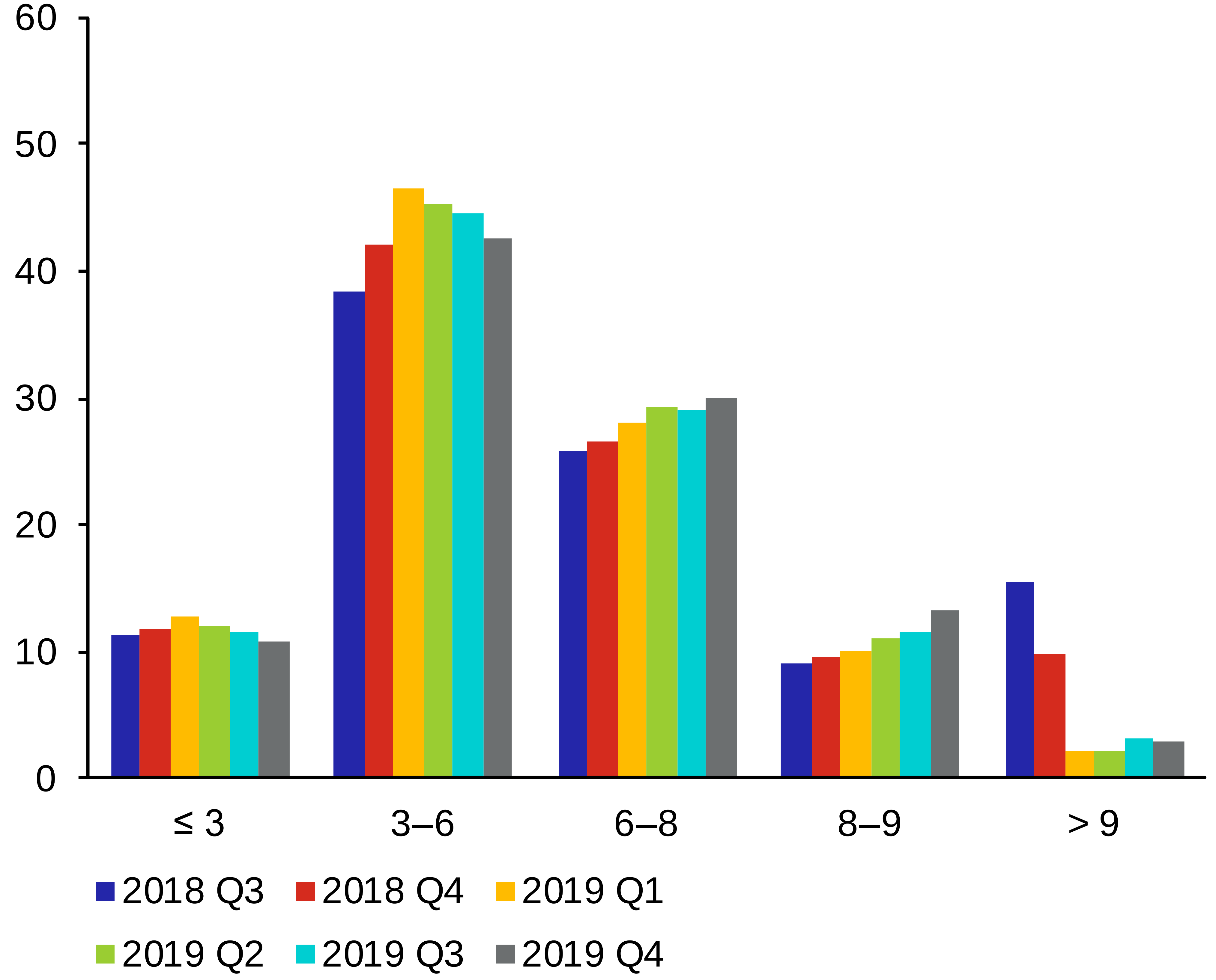
(share of loans in volume provided in %)



Source: CNB

DTI distribution of new loans

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



Source: CNB

Thank you for your attention

CNB CZECH NATIONAL BANK

The following documents will be published on the CNB website on 8 July 2020:

- Financial Stability Report 2019/2020
- 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