CNB CZECH NATIONAL BANK

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

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26 November 2020

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1. **Aggregate assessment of risks and overview of CNB's main measures**

2. Assessment of selected risks

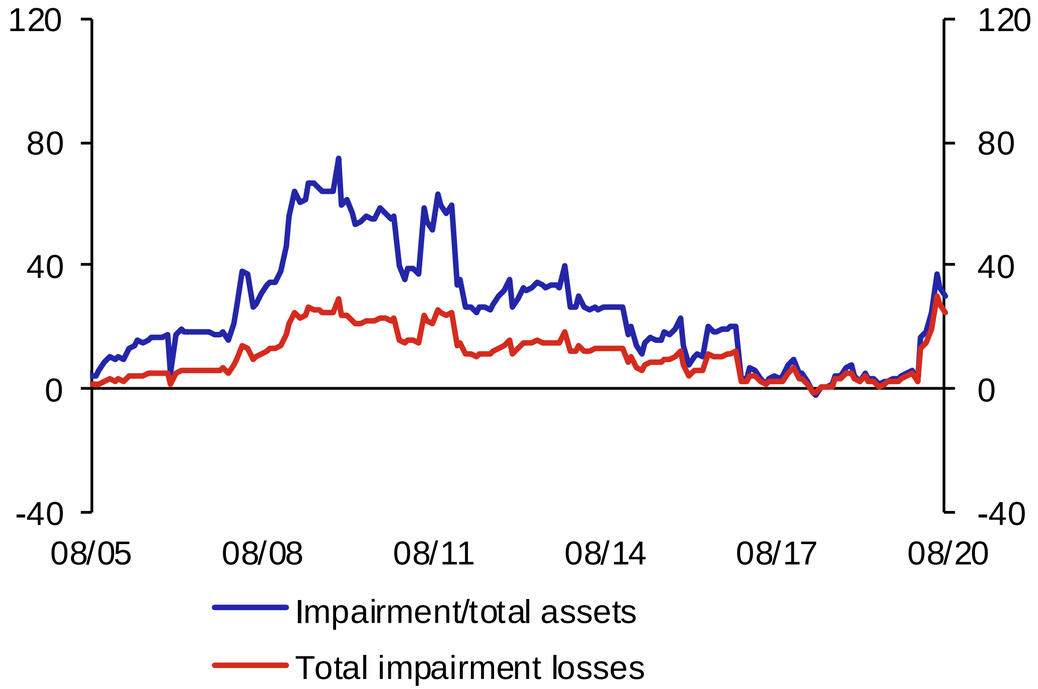
Financial stability in November 2020

- The Czech financial sector maintained high resilience to adverse shocks even during the coronavirus pandemic.
  - The government's stabilisation and support programmes provided liquidity to the real economy and prevented a precipitous wave of credit defaults.
  - The CNB's measures stabilised the debt service of the real sectors and supported the smooth operation of the financial markets.
- In view of the continuing pandemic, it must be expected that the income of many households and corporations will fall markedly. This will have a sizeable effect on their solvency and, in turn, the results of financial institutions.
- The banking sector will record a rise in credit risk costs connected with the October termination of the statutory loan moratorium, the gradual phase-out of stabilisation measures and weakened economic activity in the Czech Republic and abroad.
- Together with a high degree of uncertainty regarding future developments, this will require banks and other financial institutions to act very prudently in managing capital and in their dividend policies.

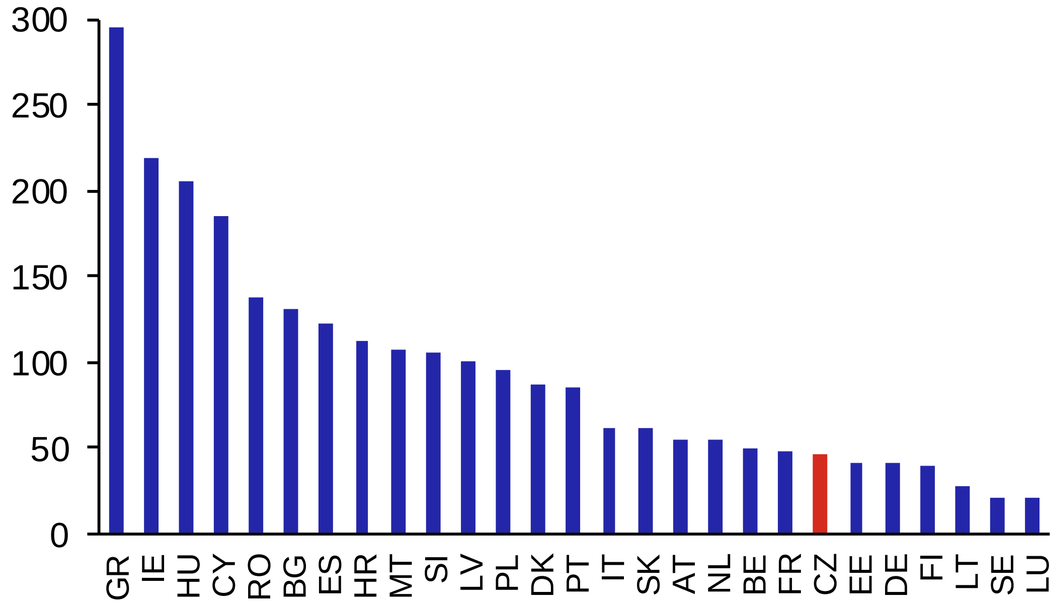
Credit risk in banking sector

- The government's stabilising measures and the flexibility of the accounting framework are reducing the materialisation of credit risk.
  - Loan impairment losses remain low compared with the global financial crisis.
  - Credit risk costs in the Czech Republic are among the lowest in the EU.

Asset impairment losses
(bp, annualized)

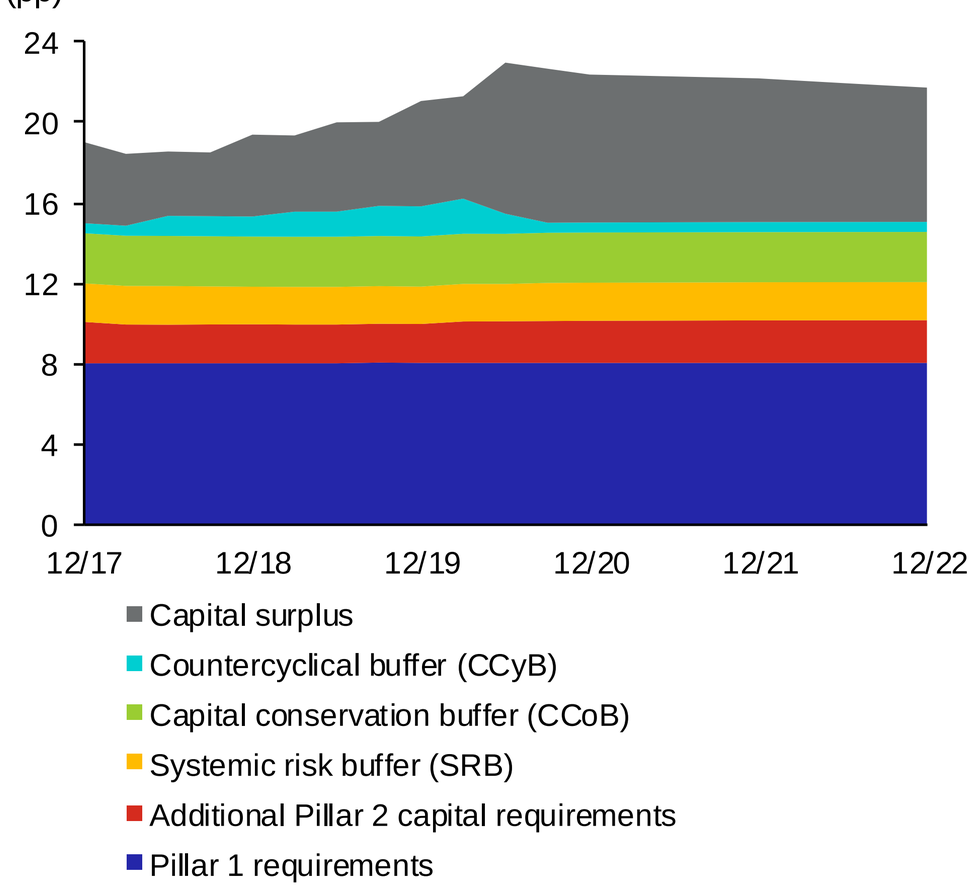


Comparison of cost of risk across the EU, end June 2020
(pb)



Decision on countercyclical capital buffer rate (1)

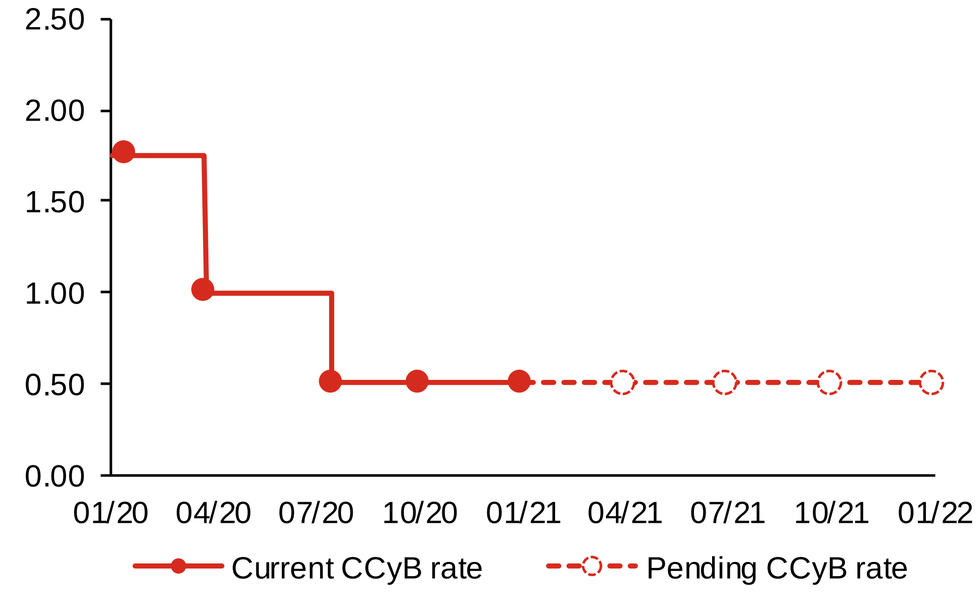
Structure of capital requirements in the domestic banking sector



- The capital position of the domestic banking sector remains robust.
- The aggregate capital ratio of the banking sector reached an all-time high of 23.2% at the end of June.
  - The capital surplus in excess of the regulatory requirements stood at CZK 200 billion, accounting for one-third of the sector's capitalisation.
- Most banks currently meet the overall capital requirement and have sufficient spare capital capacity for lending.
- Theoretically, the banking sector's current capitalisation would allow it to lend an additional more than CZK 2.5 trillion.

Decision on countercyclical capital buffer rate (2)

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

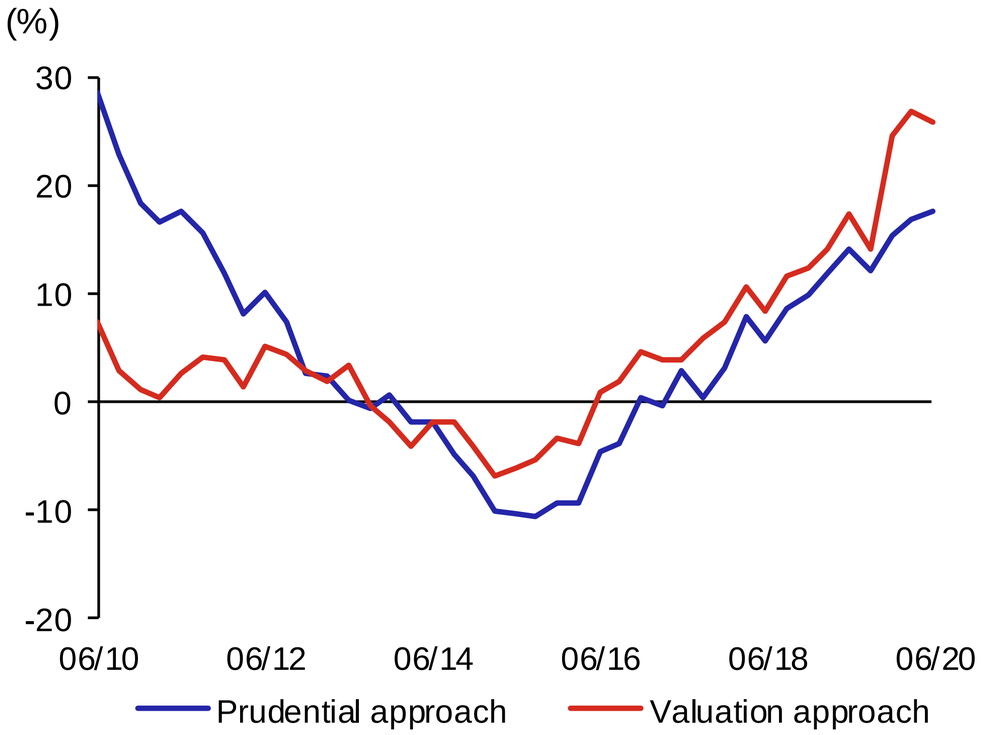


- The Bank Board decided to leave the countercyclical capital buffer (CCyB) rate unchanged at 0.5%.
- If a much more adverse scenario materialises, the CNB is ready to release the existing buffer fully.
- Conversely, if the pandemic-related risks subside, economic activity recovers and risks continue to materialise to only a limited extent, it will be desirable to gradually increase the buffer rate.

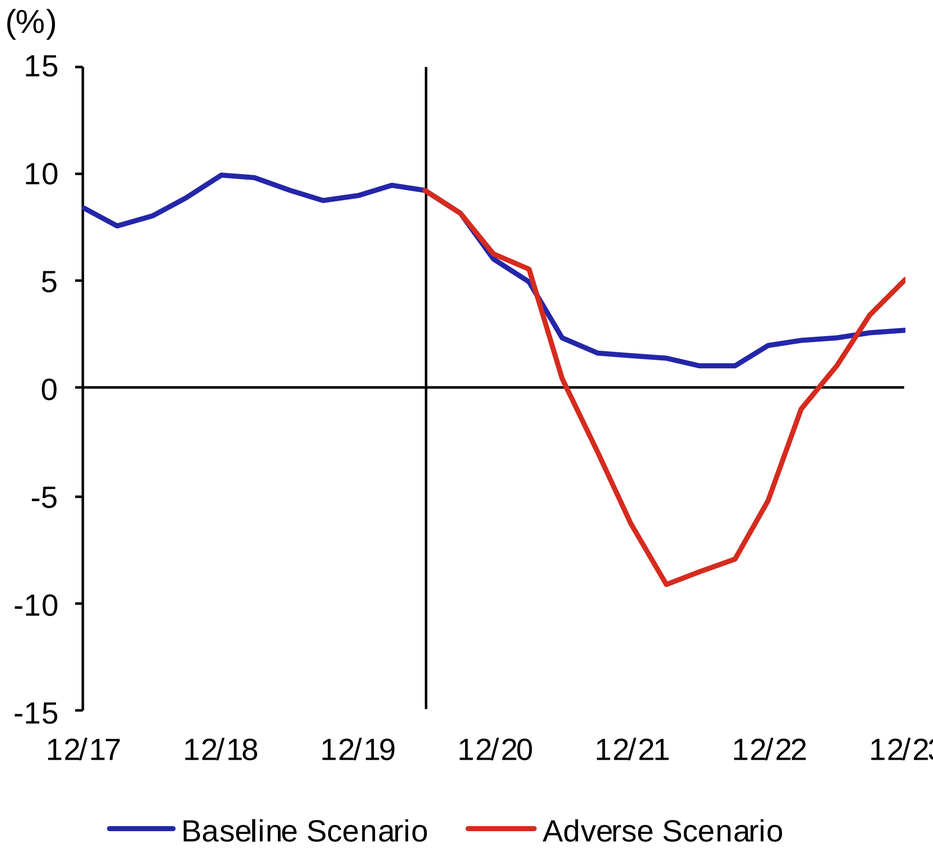
Property market and mortgage lending (1)

- The overvaluation of apartment prices stood at 17–25% at the end of 2019.
- The **Baseline Scenario** assumes continued housing price growth, only at a slower pace.
- But housing prices may fall in the event of highly adverse developments in the real economy.

Estimate of residential property overvaluation

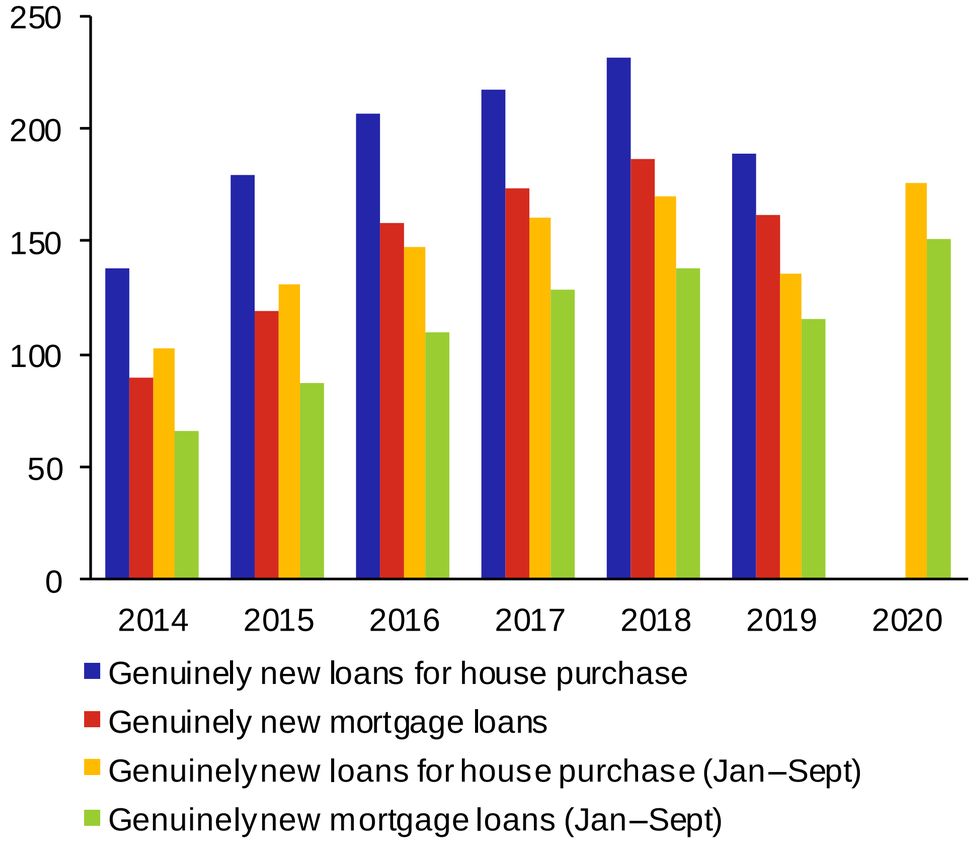


Year-on-year property price growth



Property market and mortgage lending (2)

Housing loans and mortgage loans
(CZK billions)



- The downturn in economic activity and gradually worsening labour market situation have yet to be reflected in the mortgage market.
  - On the contrary, the volume of genuinely new housing loans and mortgage loans (excluding refinanced and refixed loans) was at a record high in the first nine months of 2020 compared with the same period in previous years.
- A sizeable increase in the average loan size is one of the factors behind the high amounts of new mortgage loans.
  - This may be partly explained by the fact that mortgage loans were demanded to a greater extent by high-income households and loans were used increasingly to purchase new builds.
- It can be expected that the impacts of the coronavirus pandemic will manifest themselves over a longer time scale and lending for house purchase will weaken.

Property market and mortgage lending (3)

- In the first half of 2020, the majority of banks mostly followed the CNB Recommendation as regards LTV and DSTI limits (in both quarters) and DTI limits (in Q1).
  - However, the natural tendency of lenders to value collateral on the basis of current market prices, without taking significant account of the potential risk of overvaluation of the pledged property, is a risk factor.
- The Bank Board decided in the current situation to keep the LTV limit unchanged at 90%, with the option of applying a 5% volume exemption, and at this moment does not deem it necessary to set DTI and DSTI limits or tighten the other parameters of the current Recommendation.
- Nevertheless, the CNB continues to point out to lenders that mortgage loans can usually be regarded as very risky above certain thresholds (a DTI of 8 and a DSTI of 40%).
  - Lenders should therefore provide such loans only to applicants who are highly likely to repay without problems.
- The share of new loans with highly risky DTI and DSTI levels has increased markedly in the case of some lenders. The CNB will react to this using microprudential supervisory instruments, such as additional Pillar 2 capital requirements for risk management systems.

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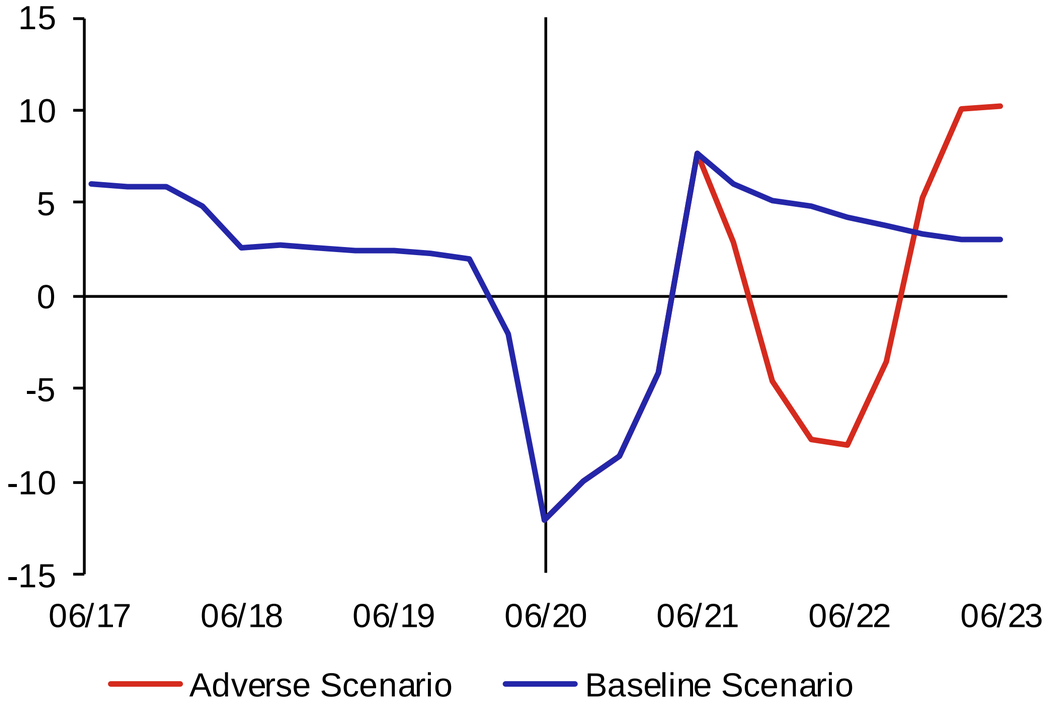
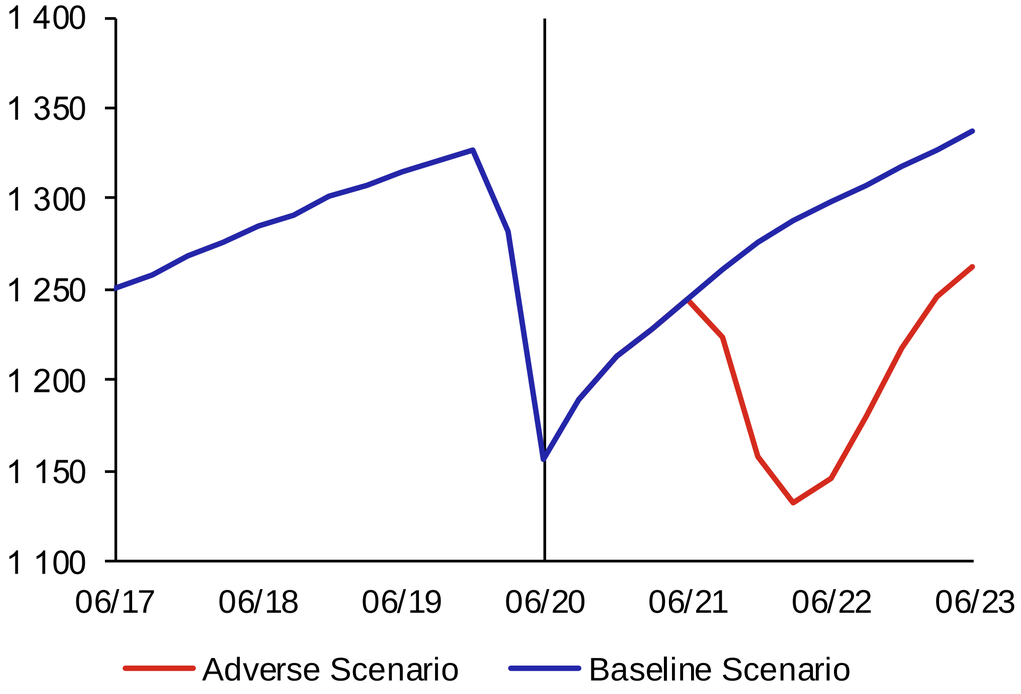
GDP in stress test

- The **Baseline Scenario** of the test is based on the CNB's August macroeconomic forecast, and the **Adverse Scenario** represents hypothetical adverse economic developments used to test the resilience of the domestic banking sector.

Alternative scenarios: real GDP growth
(year-on-year change in %)



Alternative scenarios: Real GDP level
(bn CZK, quarterly data)

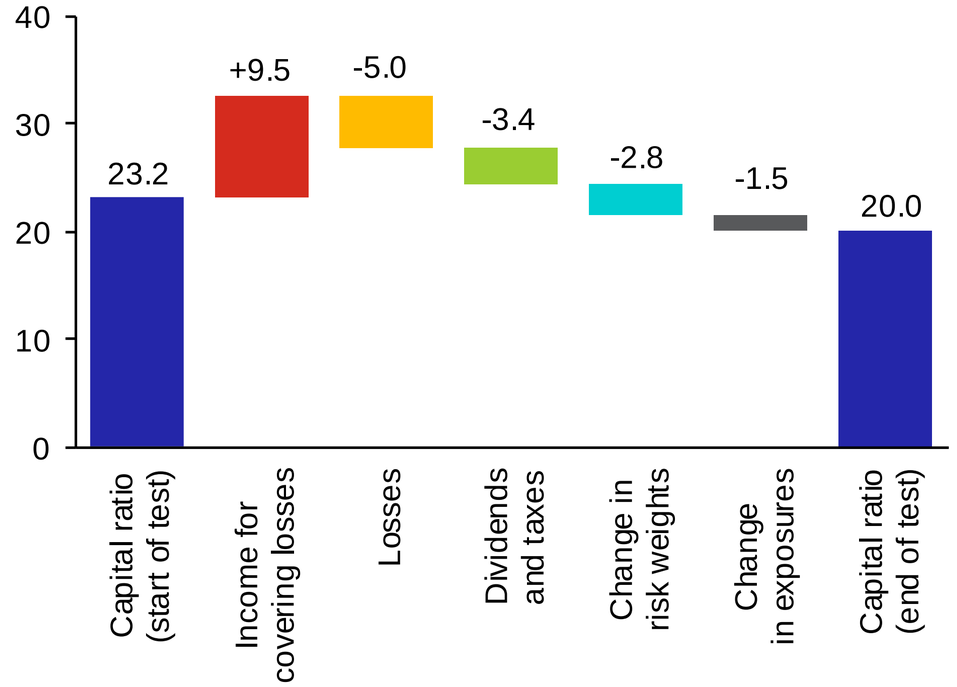


Main sources of stress

- In **both scenarios**, a decrease in the capital ratio is fostered by credit losses and a rise in risk weights.
- In the **Baseline Scenario**, this is complemented by dividend payouts and tax payments.

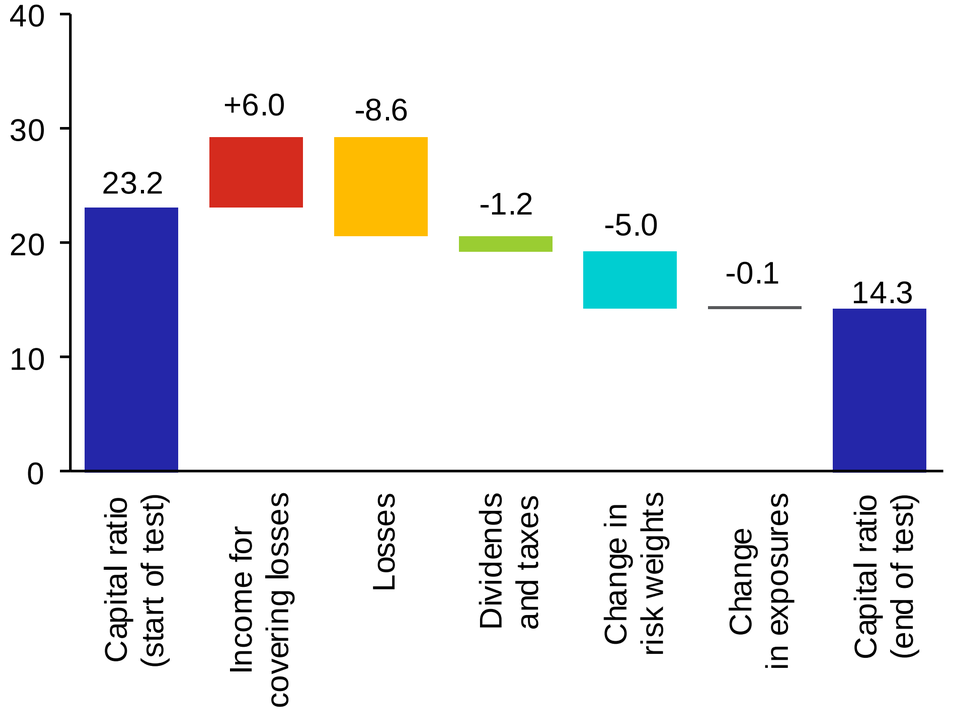
Decomposition of the change in the capital ratio of the banking sector in the *Baseline Scenario*

(pp)



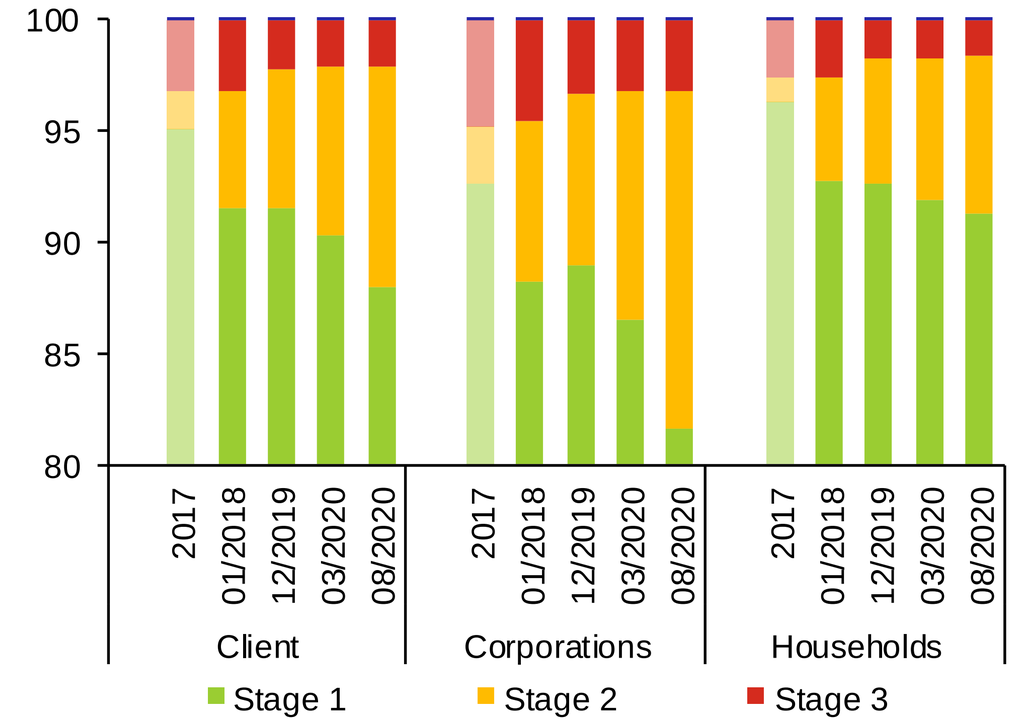
Decomposition of the change in the capital ratio of the banking sector in the *Adverse Scenario*

(pp)



Initial level of credit risk

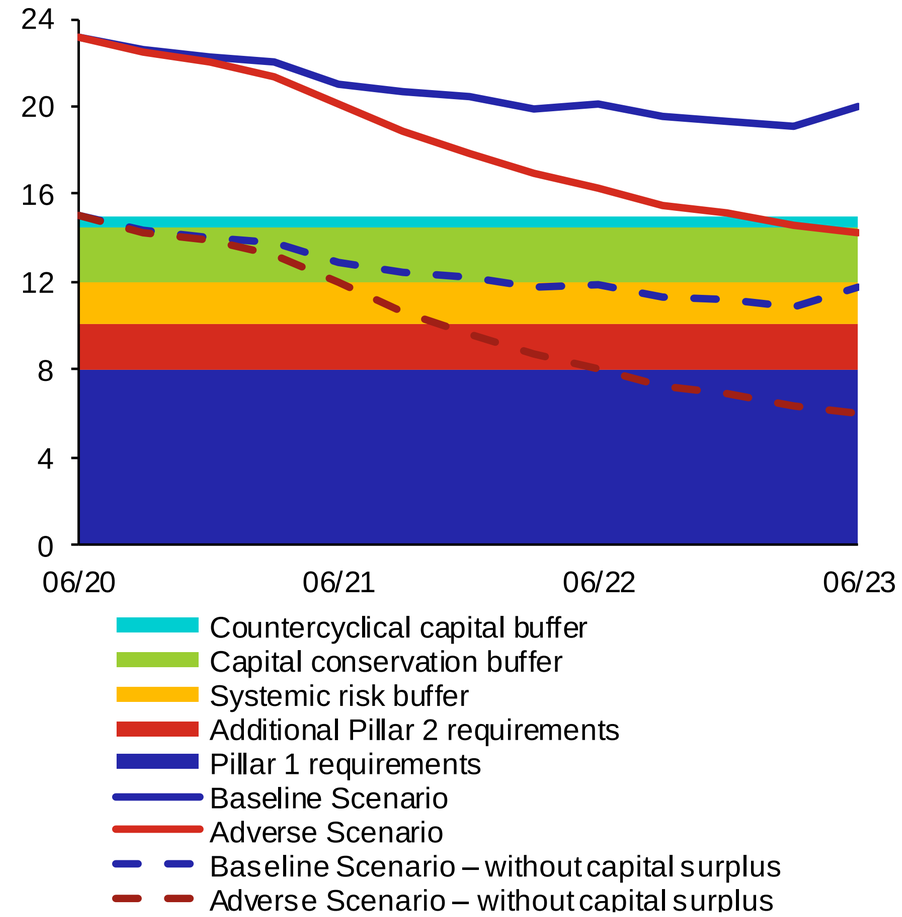
Loan structure by portfolio
(%)



- The share of loans in Stage 3 declined further during the year, but the share of Stage 2 loans rose steadily.
- At the end of September 2020, loans subject to the loan moratorium reached CZK 211 billion (16% of the portfolio) in the non-financial corporations (NFCs) sector and CZK 241 billion (15% of the portfolio) in the household sector.
- At the end of September 2020, banks were expecting 13% of loans to NFCs (CZK 27 billion), 7% of housing loans (CZK 13 billion) and 15% of consumer credit (CZK 9 billion) subject to the moratorium to become non-performing after the moratorium ends.
- According to the default rates assumed in the **Baseline Scenario**, 8.7% of loans to NFCs (CZK 122 billion), 1.6% of housing loans (CZK 25 billion) and 6.8% of consumer credit (CZK 35 billion) would be in the non-performing category at the end of 2021.

Outcome in *Baseline Scenario*

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



- 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 falls to 20% over the three-year test horizon.
- No bank should record a decline below the 8% regulatory capital minimum and no capital injections are needed.

Outcome in *Adverse Scenario*

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

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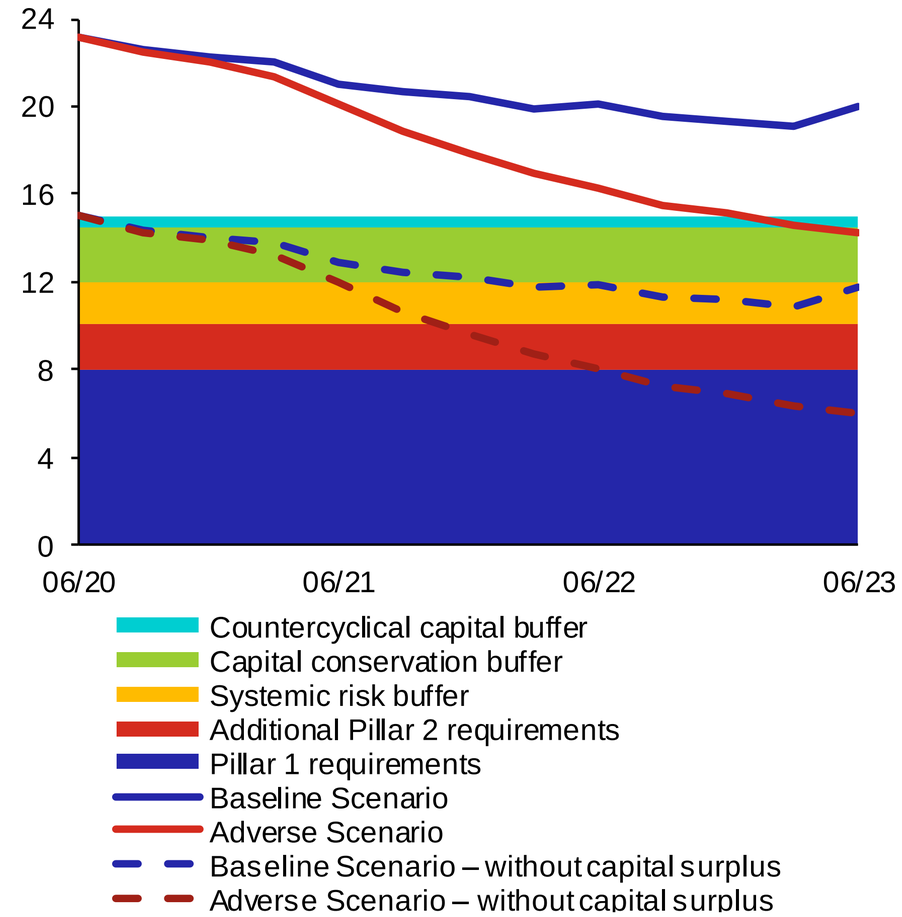
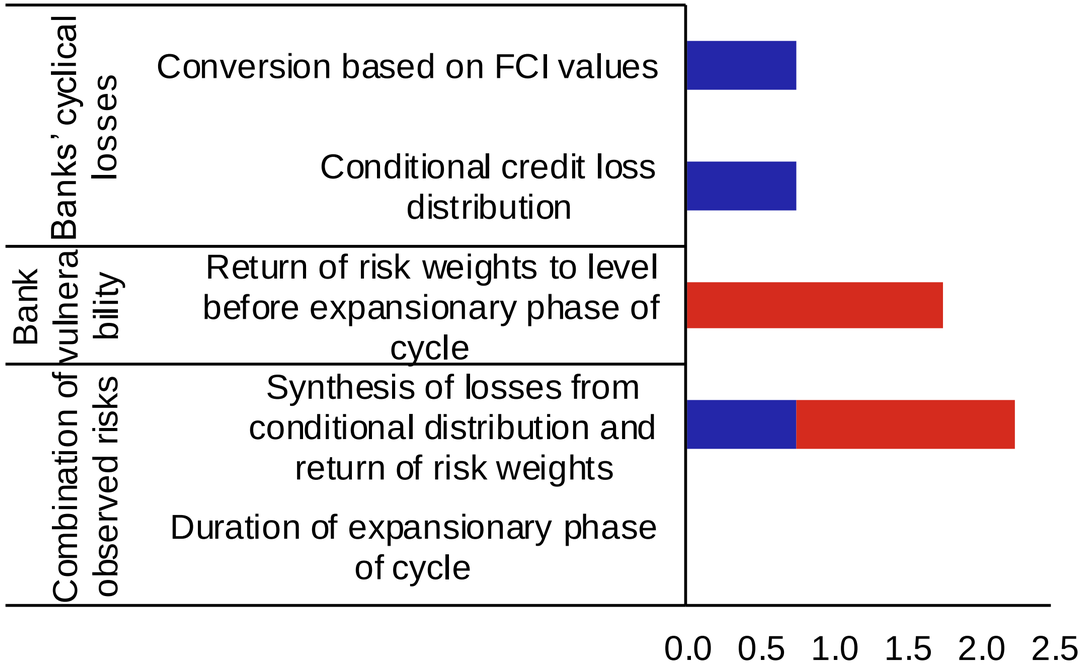


- The result of the **Adverse Scenario** shows that the extent of the losses under the given conservative assumptions leads to the use of part of the capital buffers (solid red line).
- The sector's aggregate capital ratio falls to 14.3% over the three-year test horizon.
- Negligible capital injections are needed in this scenario, too.
- However, if banks had no capital surpluses above the regulatory requirements at the start of the test (in mid-2020 they had a surplus of 8.2 pp), the capital ratio would drop below the regulatory minimum in the **Adverse Scenario**.
- The results thus confirm that a certain capital surplus is necessary to maintain banking sector stability in highly adverse conditions.

CCyB rate (1)

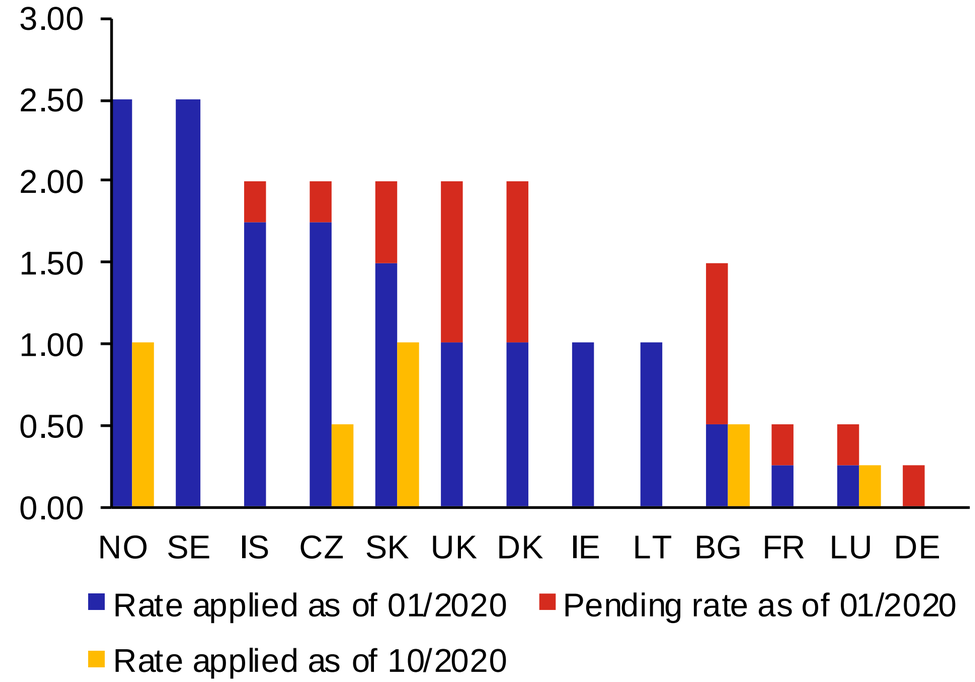
CCyB rate covering financial cycle effects monitored
(% of total risk exposure)



- The above quantitative approaches imply the need for a CCyB rate of 2.25%.
- The CNB lowered the CCyB rate to 0.5% this year in reaction to a marked rise in financial market tensions, a significant worsening of the outlook for the domestic economy and a higher probability of credit losses in the quarters ahead.
- The decisive signal for any further changes in the CCyB rate will be cyclical risks accepted earlier materialising or not materialising via credit losses and an increase in risk weights on credit exposures.

CCyB rate (2)

CCyB in European economies
(% of total risk exposure)

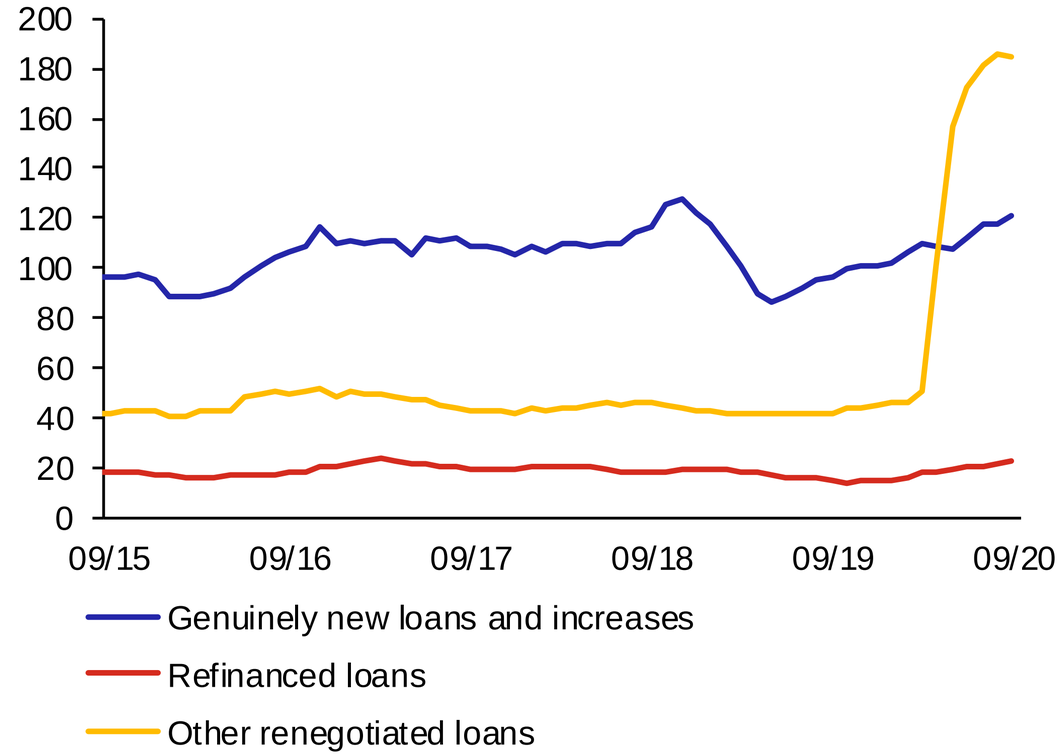


- In an effort to ease conditions and maintain sufficient supply of credit, other European countries also lowered the CCyB rate.
- All countries (except Luxembourg) cancelled CCyB rate increases planned at the start of 2020.
- Most of these countries also fully released their applicable CCyBs, albeit from lower rates than in the Czech Republic or with generally lower capital surpluses in their banking sectors.

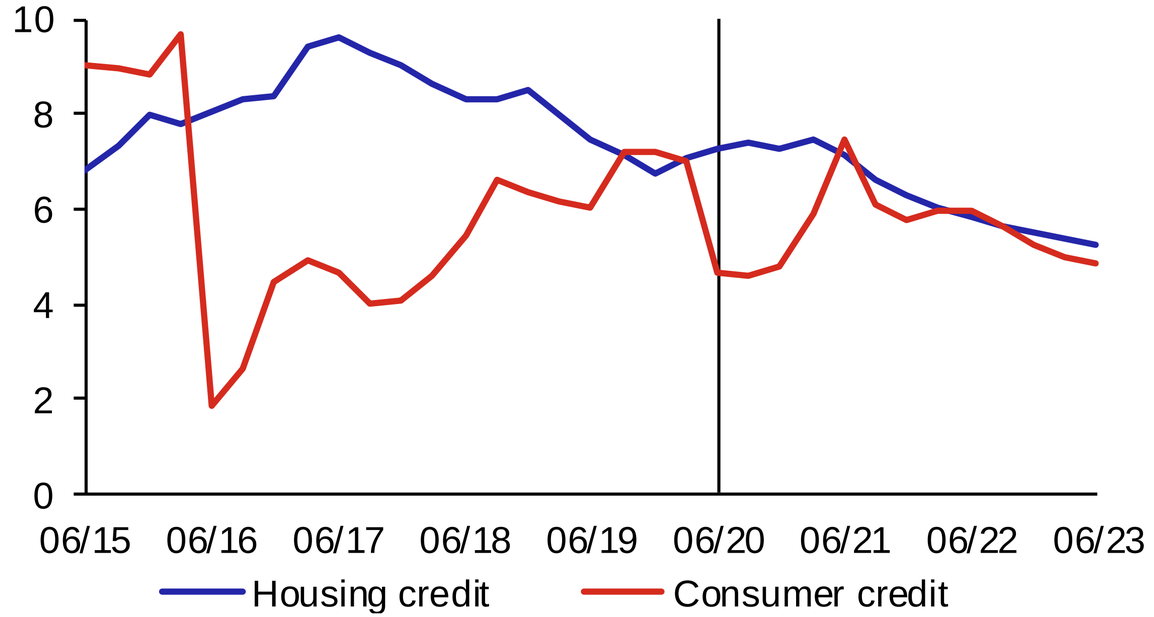
Loans for house purchase and their outlook (1)

- The **Baseline Scenario** assumes continued growth in the stock of loans for house purchase, but at a gradually slowing pace.

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



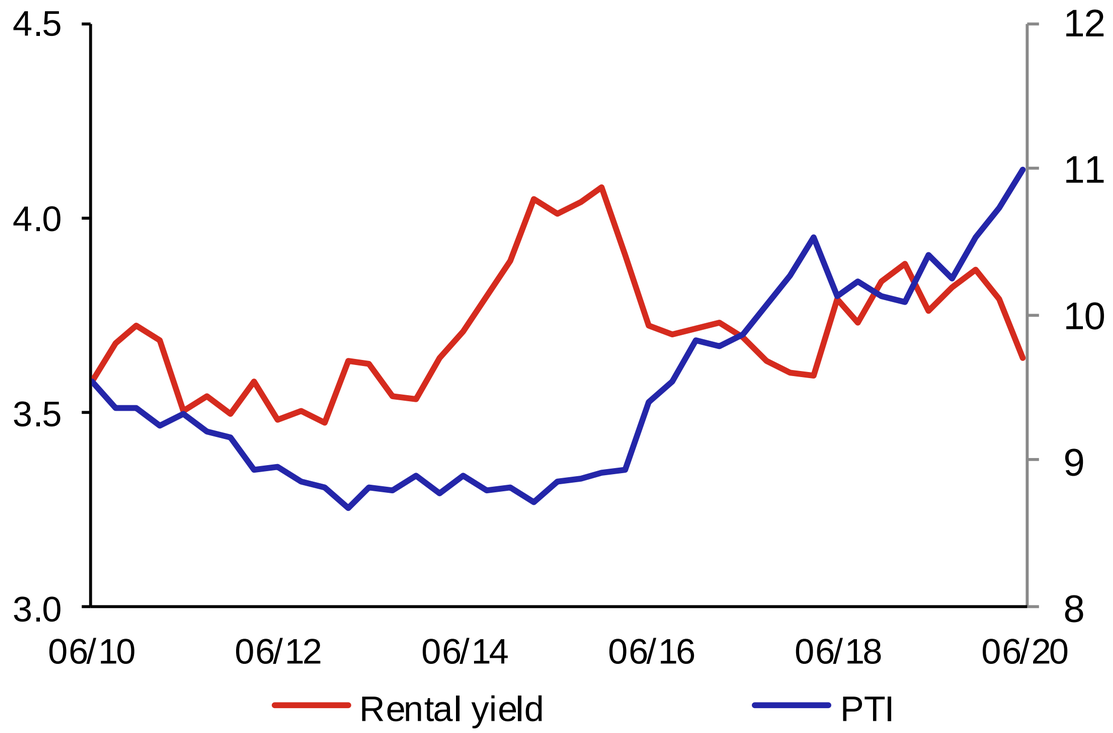
Household credit growth rates
(y-o-y, %)



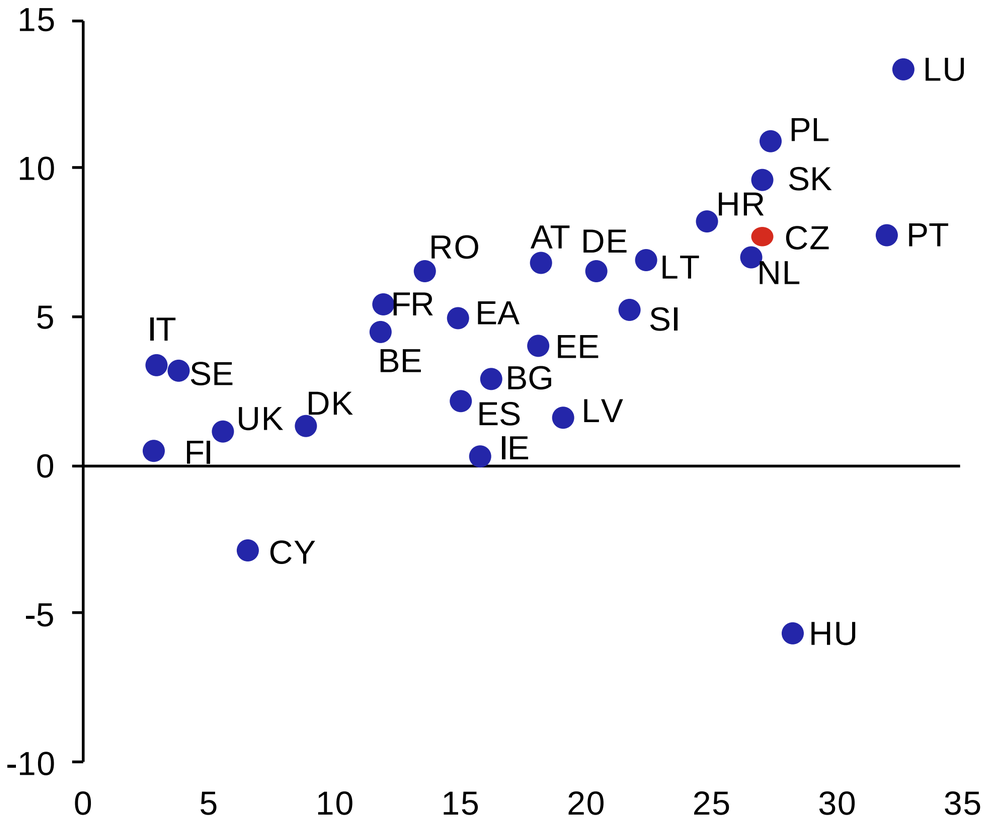
Loans for house purchase and their outlook (2)

- The rapid growth in the stock of loans for house purchase reflects increasing housing prices.
- Housing is becoming more expensive and less affordable in almost all European countries.

Indicators of apartment affordability
(PTI in years; rental yield in %)

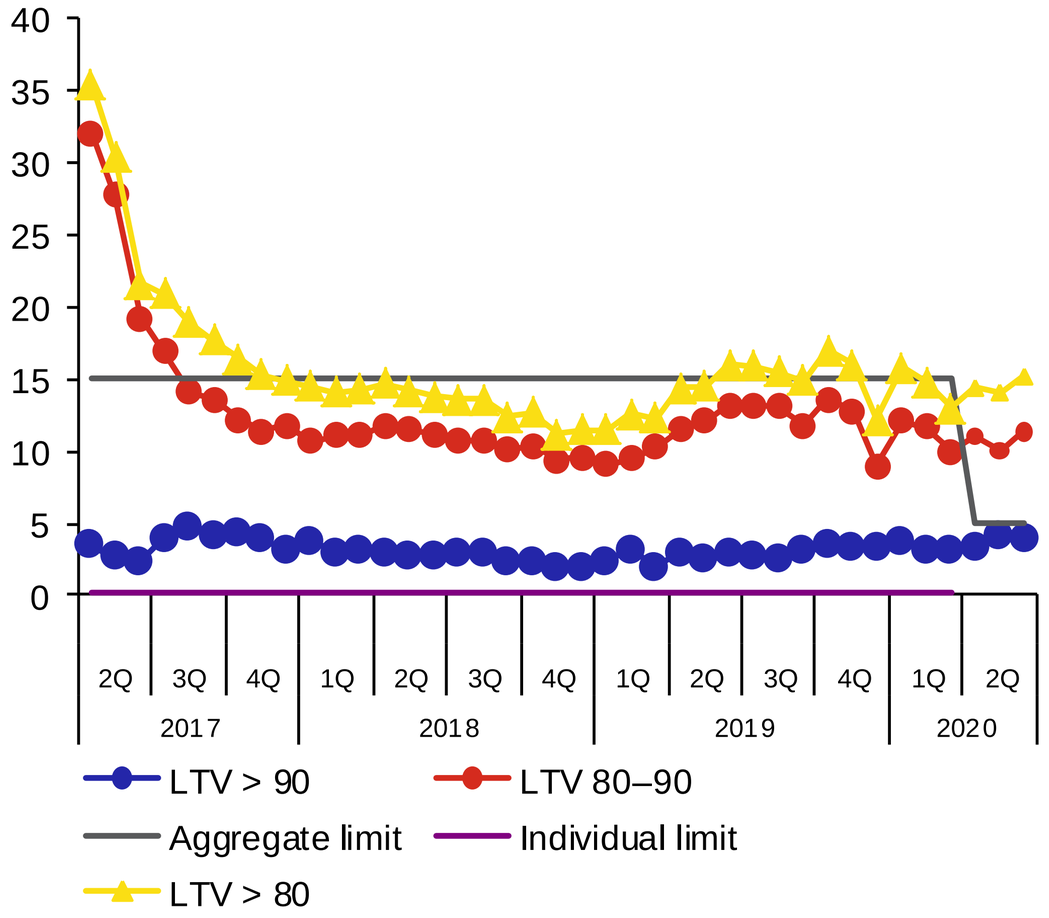


Property price growth in 2020
(%; x-axis: three-year growth; y-axis: one-year growth)

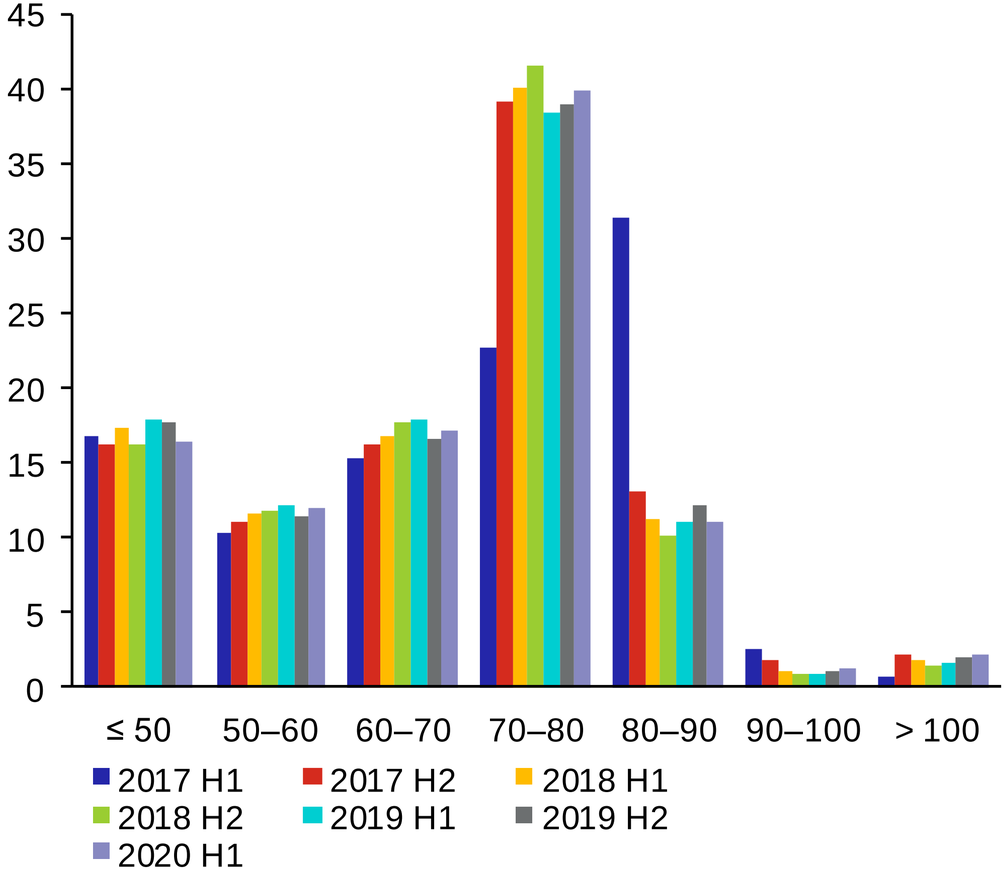


Compliance with LTV limit

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

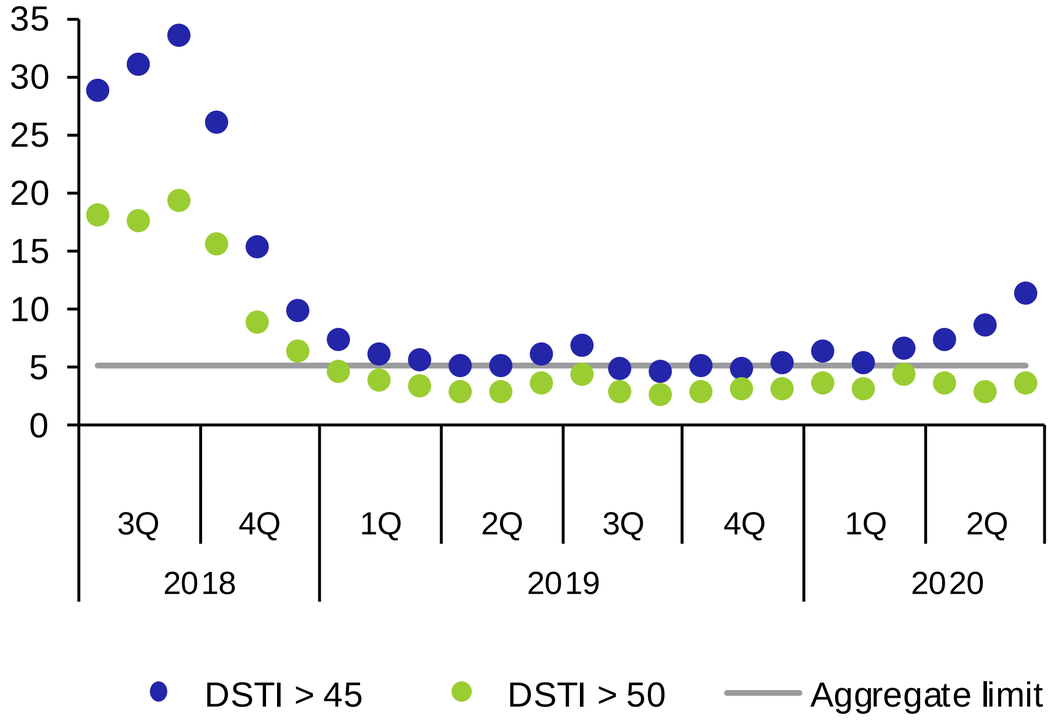


LTV distribution of loans
(x-axis: LTV in %; y-axis: share of loans in volume in %)

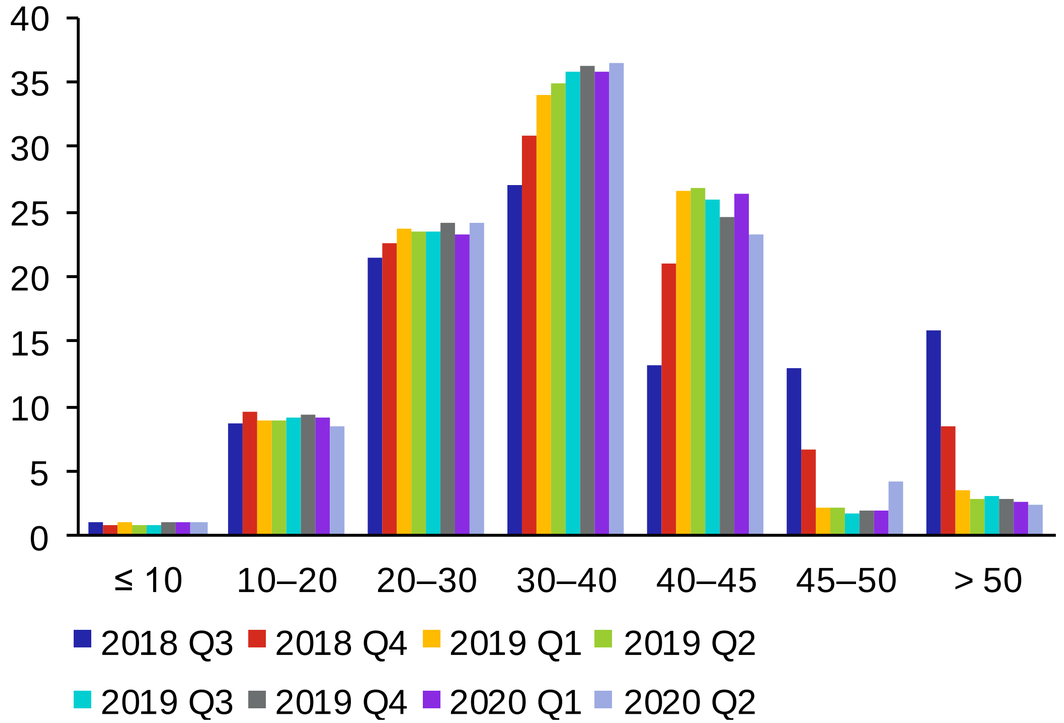


DSTI ratio

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

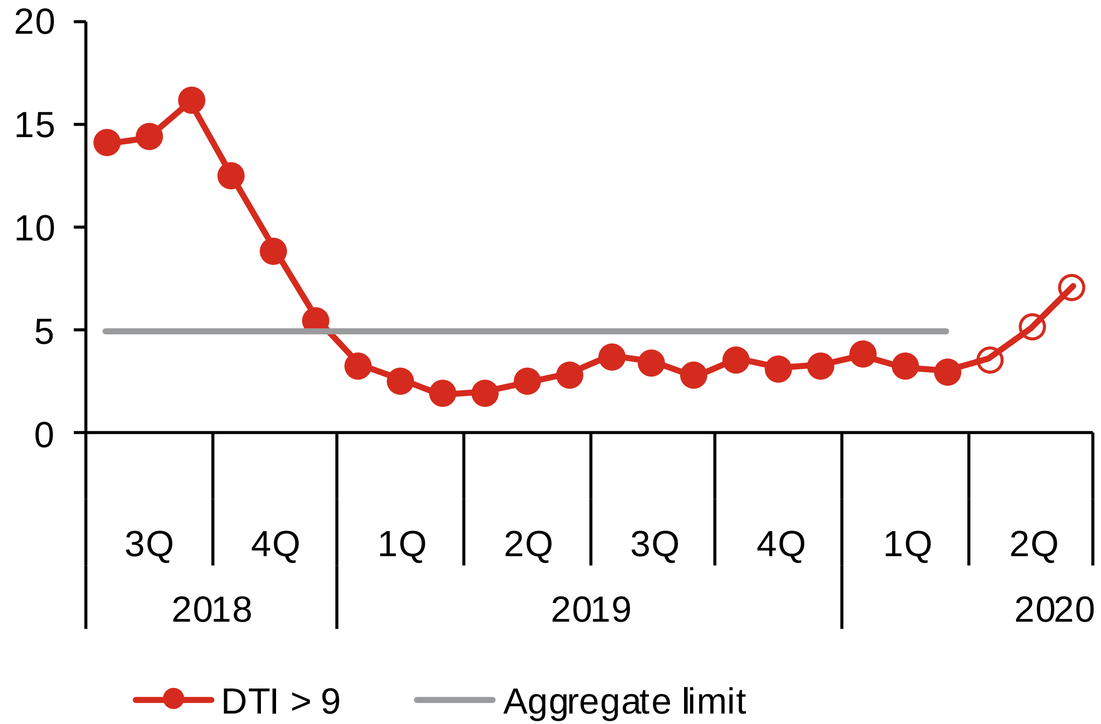


DSTI distribution of new loans
(x-axis: DSTI in %; y-axis: share of loans in volume in %)

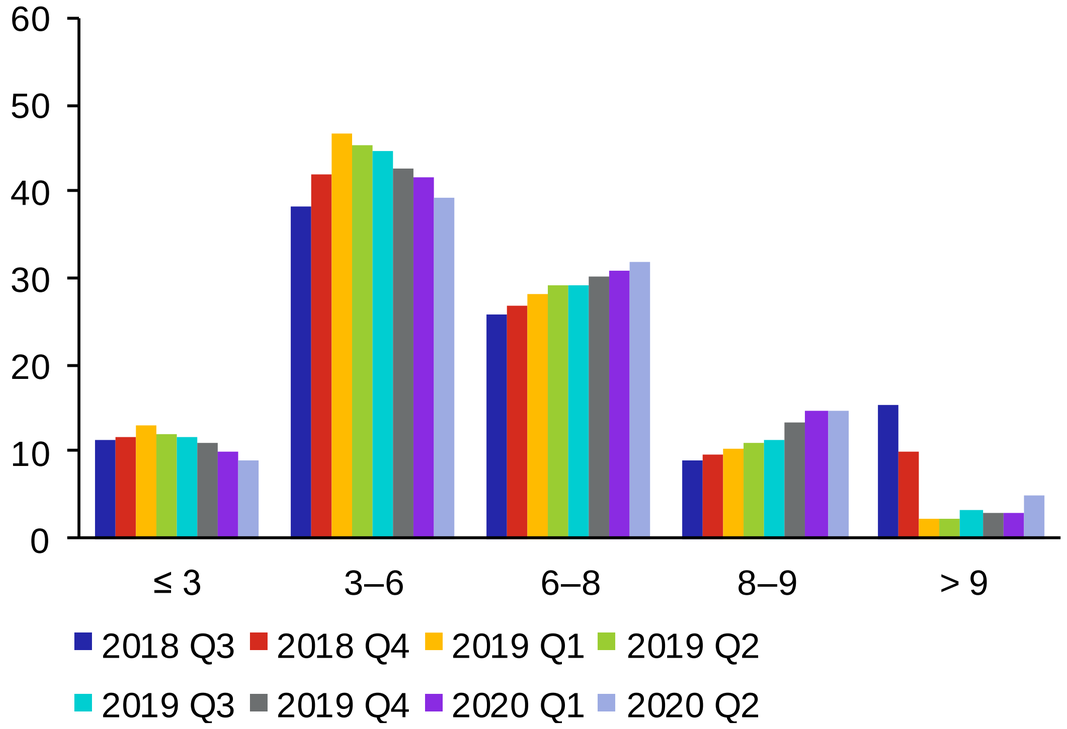


DTI ratio

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

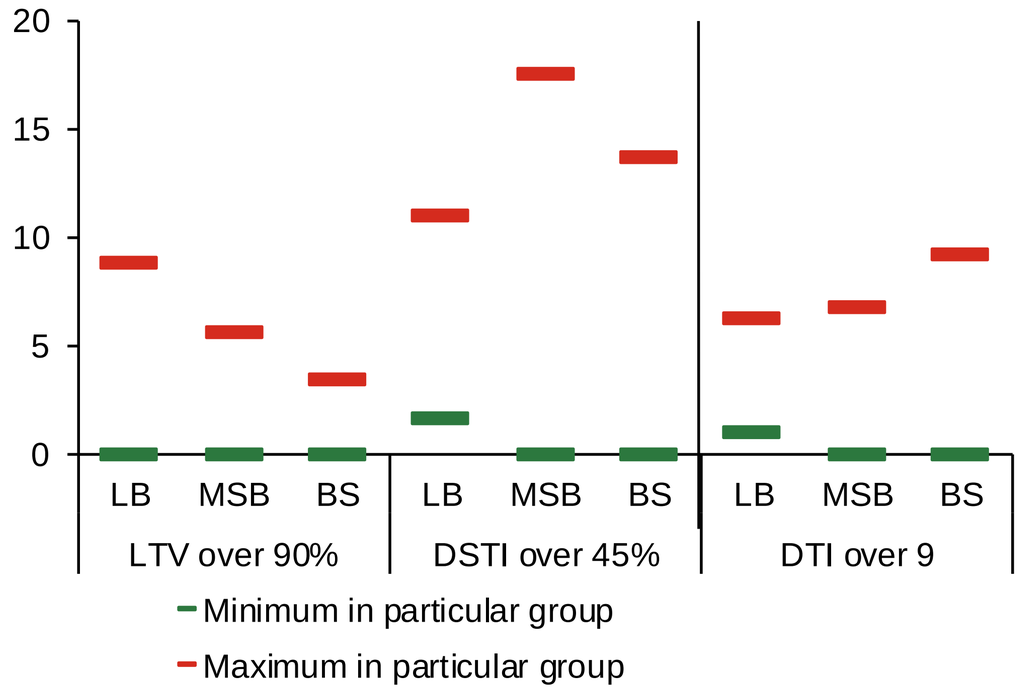


DTI distribution of new loans
(x-axis: DTI in years; y-axis: share of loans in volume in %)



Higher risk profile of mortgages provided by some lenders

Shares of loans exceeding risky levels of LTV, DSTI and DTI by type of banks
(% of housing credit of particular instiutions; 2020 Q2)



- Lenders differ in their credit standards; some relaxed them markedly, especially in Q2.
- More prudent lenders may react to the potential risk of losing market share by relaxing their credit standards to the levels of their less conservative competitors.
- The CNB would have to react to this using its macroprudential policy tools, though not immediately.

Thank you for your attention

The following will be published on the CNB website on 11 December 2020:

- *Risks to financial stability and their indicators – December 2020*
- The minutes of the CNB Bank Board meeting on financial stability issues
- *Provision of a general nature on setting the CCyB IV/2020*