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

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25 November 2021

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Financial stability in November 2021

- The Czech **financial sector has increased its resilience** to adverse shocks this year.
  - **The capitalisation of the banking sector remains very robust** thanks to capital buffers and capital surpluses in excess of the regulatory requirements.

- **The level of uncertainty** about the future course of the pandemic and the economy **remains high**.
  - It **requires financial institutions to act very prudently** in the management of balance sheets, risks and capital and in dividend policies.

Financial stability in November 2021

- **Activity on the mortgage and property markets** has had an **upward tendency** since the second half of last year.
  - The **mortgage market** showed **significant signs of overheating** in 2021 Q2 and Q3.

- **The CNB Bank Board has decided to respond to the growth in systemic risks** associated with mortgage lending and housing market developments **using its new statutory powers**.

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Limits on mortgage loan ratios with effect from 1 April 2022

Mortgage lenders are required to comply with upper limits on:

DTI	Ratio of applicant's total debt to net annual income.	**8.5**	**9.5**
DSTI	Ratio of sum of applicant's monthly repayments to net monthly income.	**45%**	**50%**
LTV	Ratio of value of loan to value of collateral.	**80%**	**90%**

For applicants under 36 years if the loan is for the purchase of owner-occupied housing.

Lenders may in the current calendar quarter apply an exemption from compliance with the limits of up to 5% of the total volume of loans provided in the previous quarter.

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New rules for mortgage lending

- The CNB has set the specific levels of the upper limits on the credit ratios in a provision of a general nature, which will be published on 26 November 2021 and take effect on 1 April 2022.

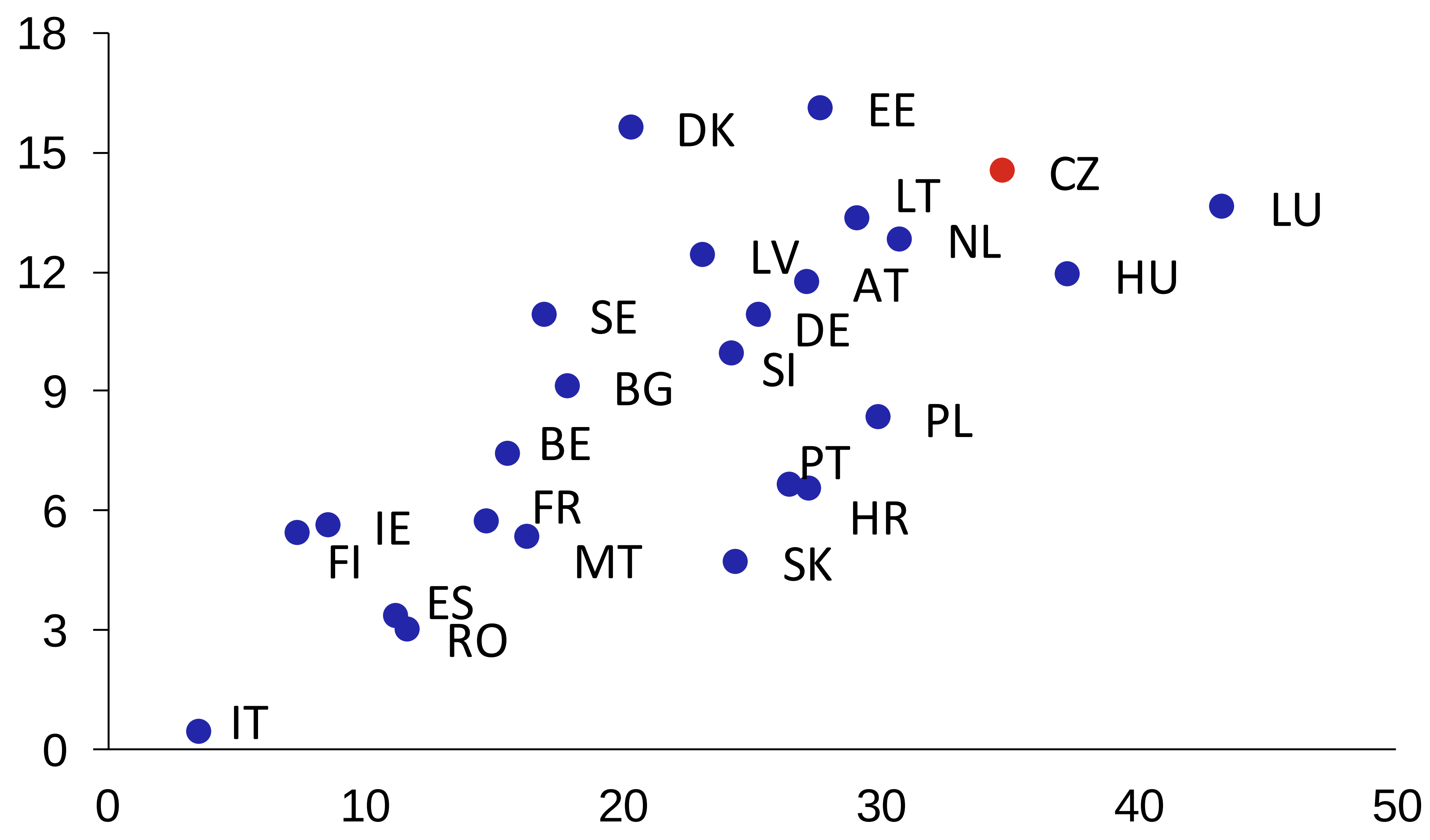
- The upper limits on credit ratios will represent a constraint on only a small proportion of mortgage loans, specifically those **with potentially the riskiest parameters**.

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

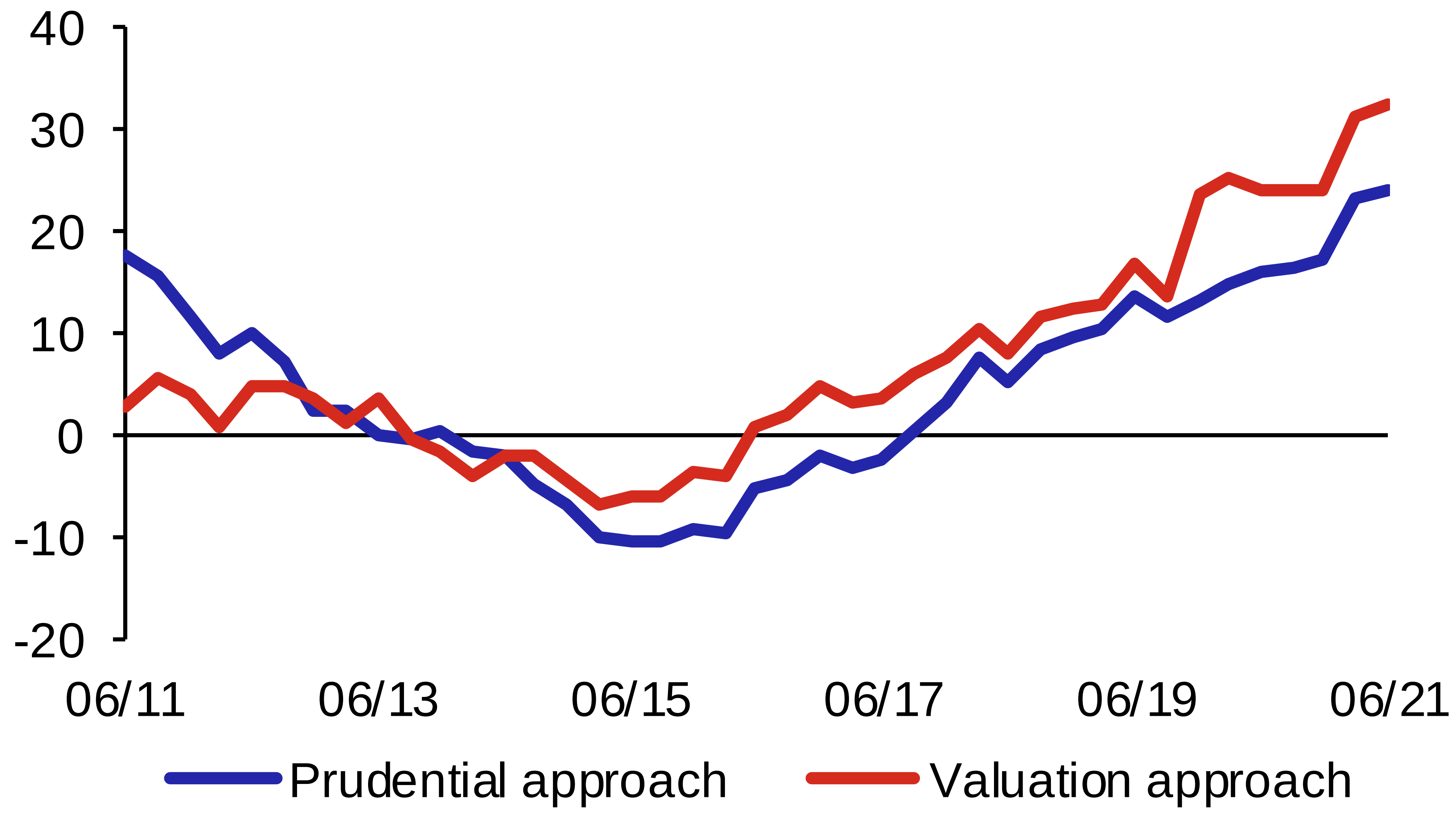
Property market and mortgage lending

- **House prices** have risen in all European countries in 2021, but **the rise in the Czech Republic is one of the largest in both one-year and three-year terms**.
- **The CNB estimates that apartments in the Czech Republic are overvalued by about 25% – and investment apartments by more than 30% –** for a median-income household (in both cases 5 pp more than half a year ago).

House price growth in selected EU countries
(%; x-axis: three-year growth; y-axis: one-year growth, end June 2021)



Estimated overvaluation of apartment prices
(%)



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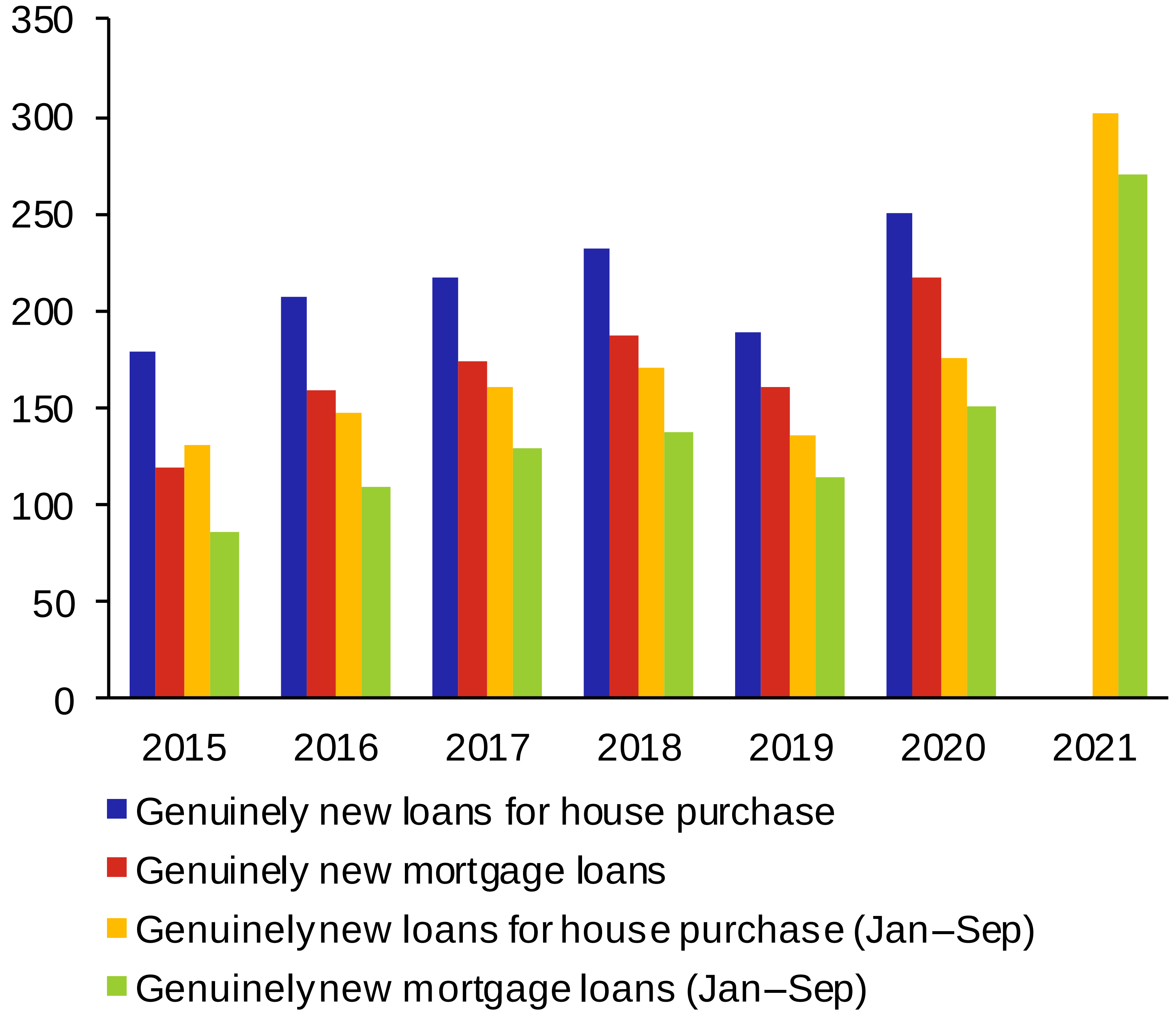
Property market and mortgage lending

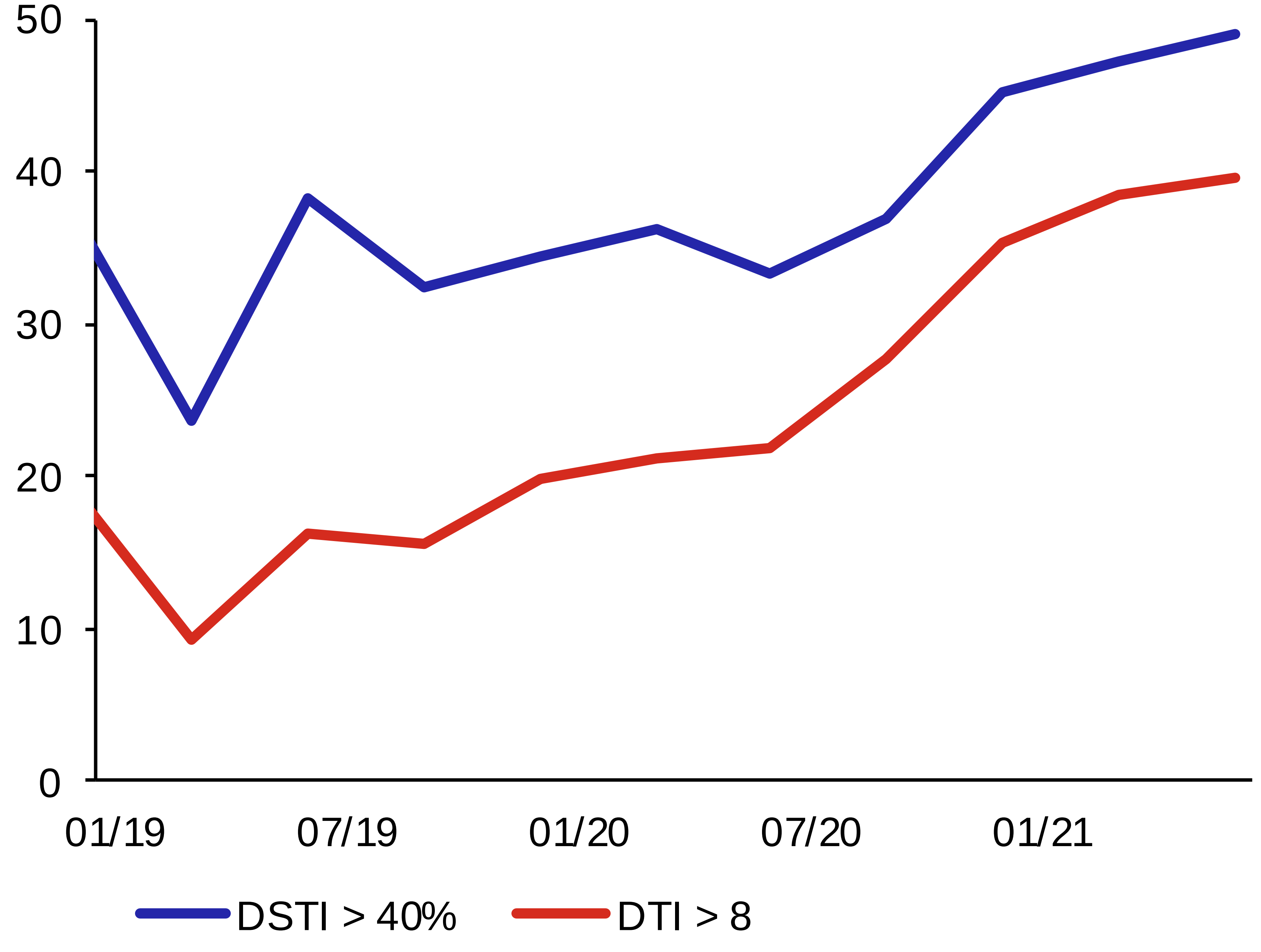
- **The volumes of genuinely new loans for house purchase and mortgage loans** will reach **record highs this year** despite a decline in activity from Q3 onwards.
- **Besides high demand, this is due to an easing of credit standards**.

Housing loans and mortgage loans
(CZK billions)



Property market and mortgage lending

Loans secured by residential property with a high DSTI or DTI
(% of reference volume)

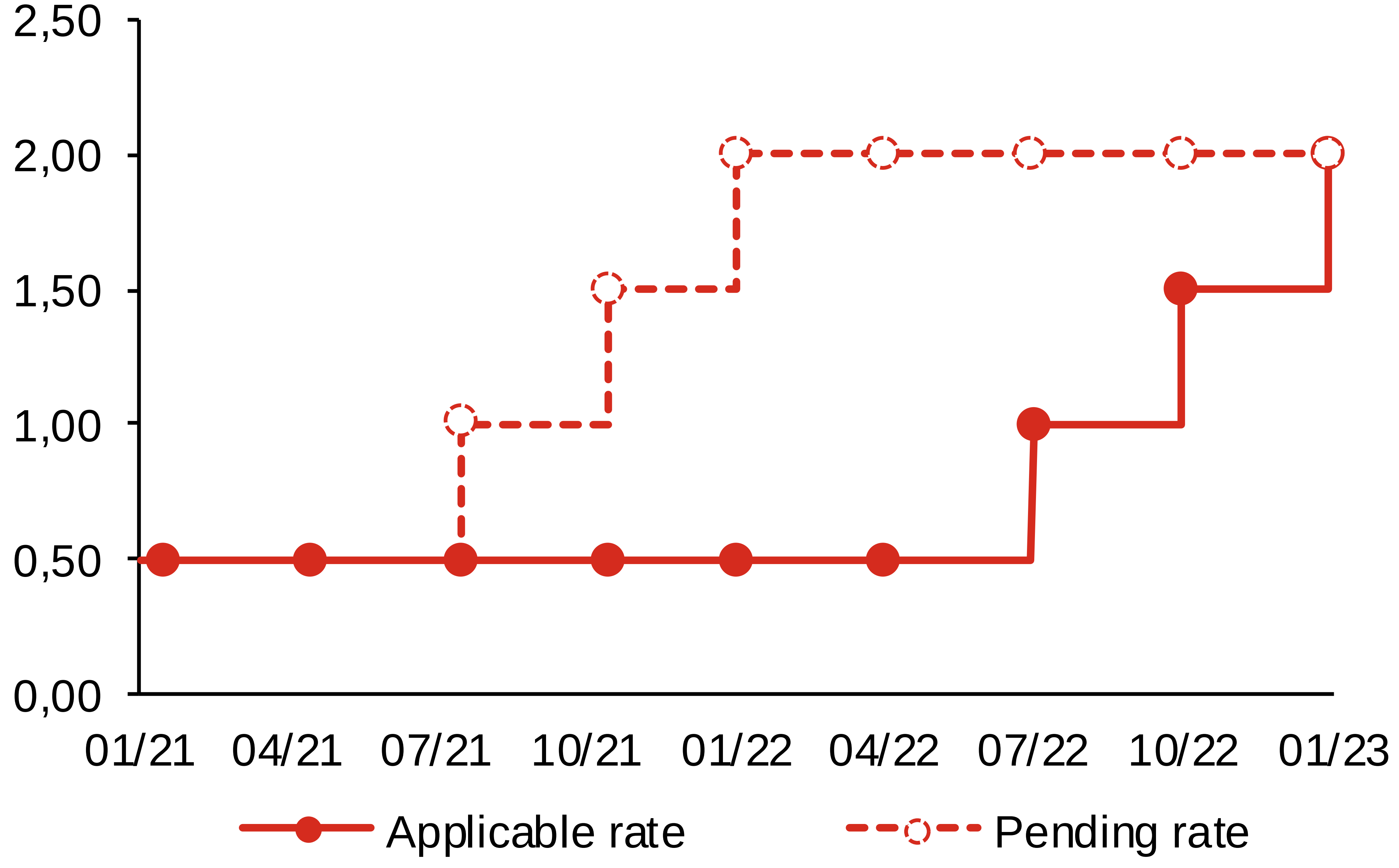


- **Mortgage lenders were compliant with the recommended LTV limit** of 90%.
  - However, the share of loans with LTVs of 80%–90% remained relatively high.

- **As for the DTI and DSTI ratios, lenders often did not abide by the levels representing increased risk** according to the CNB.
  - This year, the share of risky mortgages has exceeded the levels reached in the second half of 2018, when the CNB first introduced DTI and DSTI limits.

Decision on countercyclical capital buffer rate

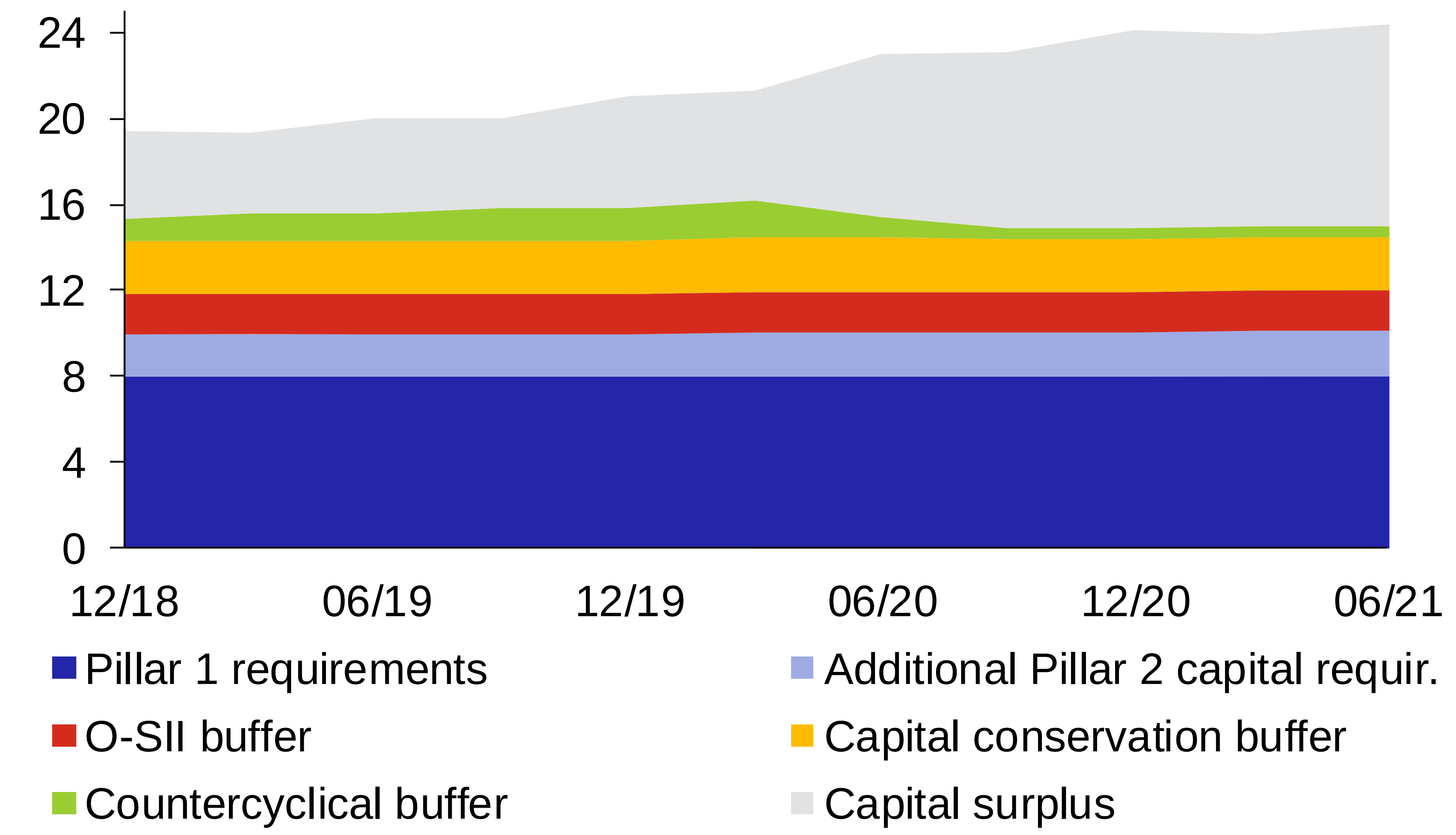
Applicable and pending CCyB rate in the Czech Republic
(% of total risk exposure)



- **The Bank Board also decided today to increase the countercyclical capital buffer (CCyB) rate to 2% with effect from 1 January 2023**.
    - In the event of a further acceleration of credit growth, increased taking on of risks in the banking sector's balance sheet, and rising vulnerability of the banking sector, the Bank Board is ready to increase this rate further.
    - By contrast, should the economic situation worsen substantially and risks materialise, it is ready to gradually lower the CCyB rate or release the buffer fully.

Decision on countercyclical capital buffer rate

Structure of capital requirements in the domestic banking sector
(pp)



- The **capital position** of the domestic banking sector is currently **very robust**.
- The aggregate capital ratio of the banking sector stood at 24.4% in the middle of this year.
  - The capital surplus in excess of the regulatory requirements accounted for more than one-third of the sector's capitalisation.
  - The capital ratio will decrease gradually in the years ahead due to an outflow of retained dividends.
- **Banks in the Czech Republic** currently **meet the overall capital requirement by a sufficient margin**.
- **Theoretically, the banking sector's current capitalisation would allow it to lend an additional roughly CZK 3.4 trillion**.

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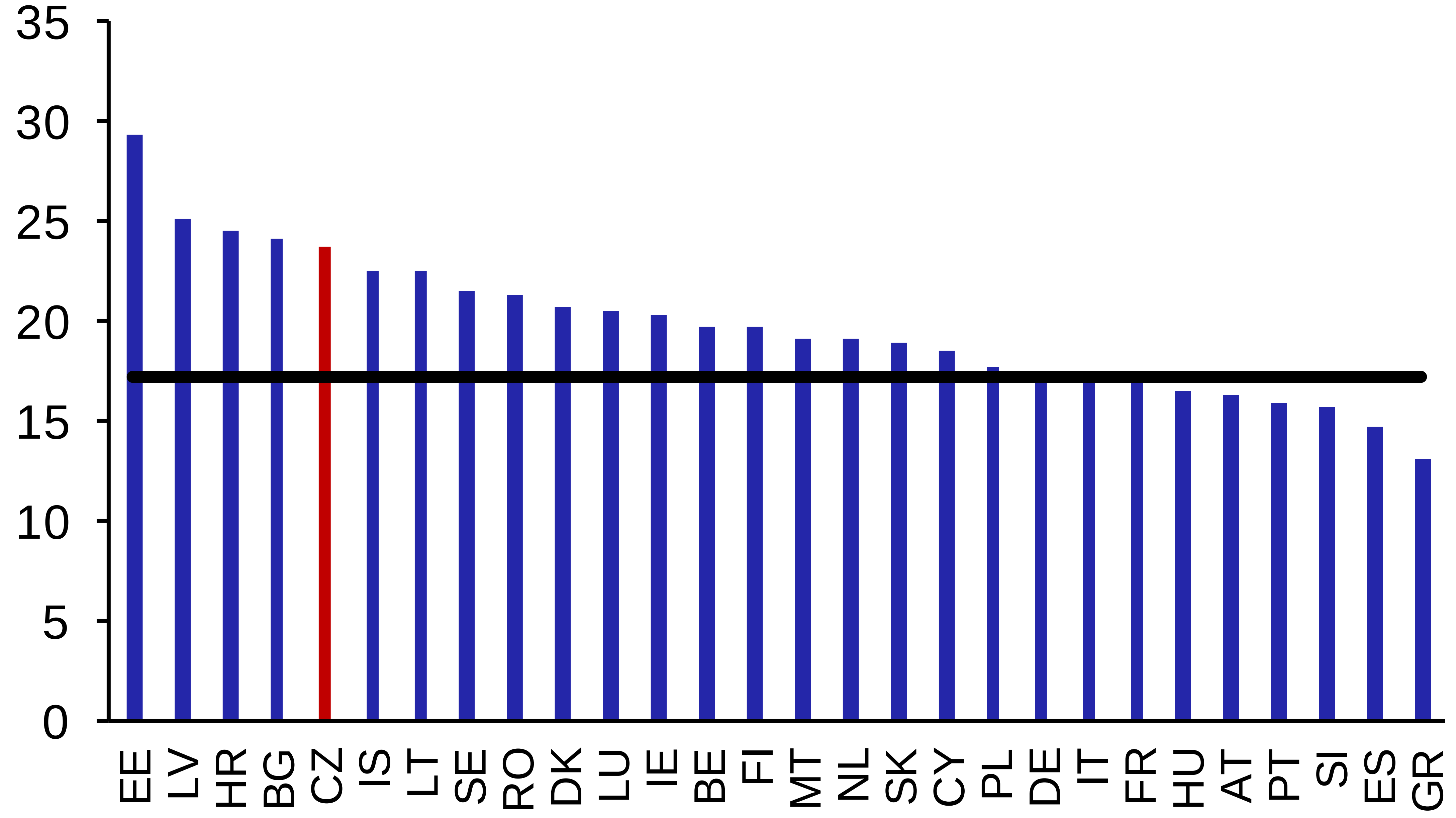
Domestic banking sector compared with other European countries

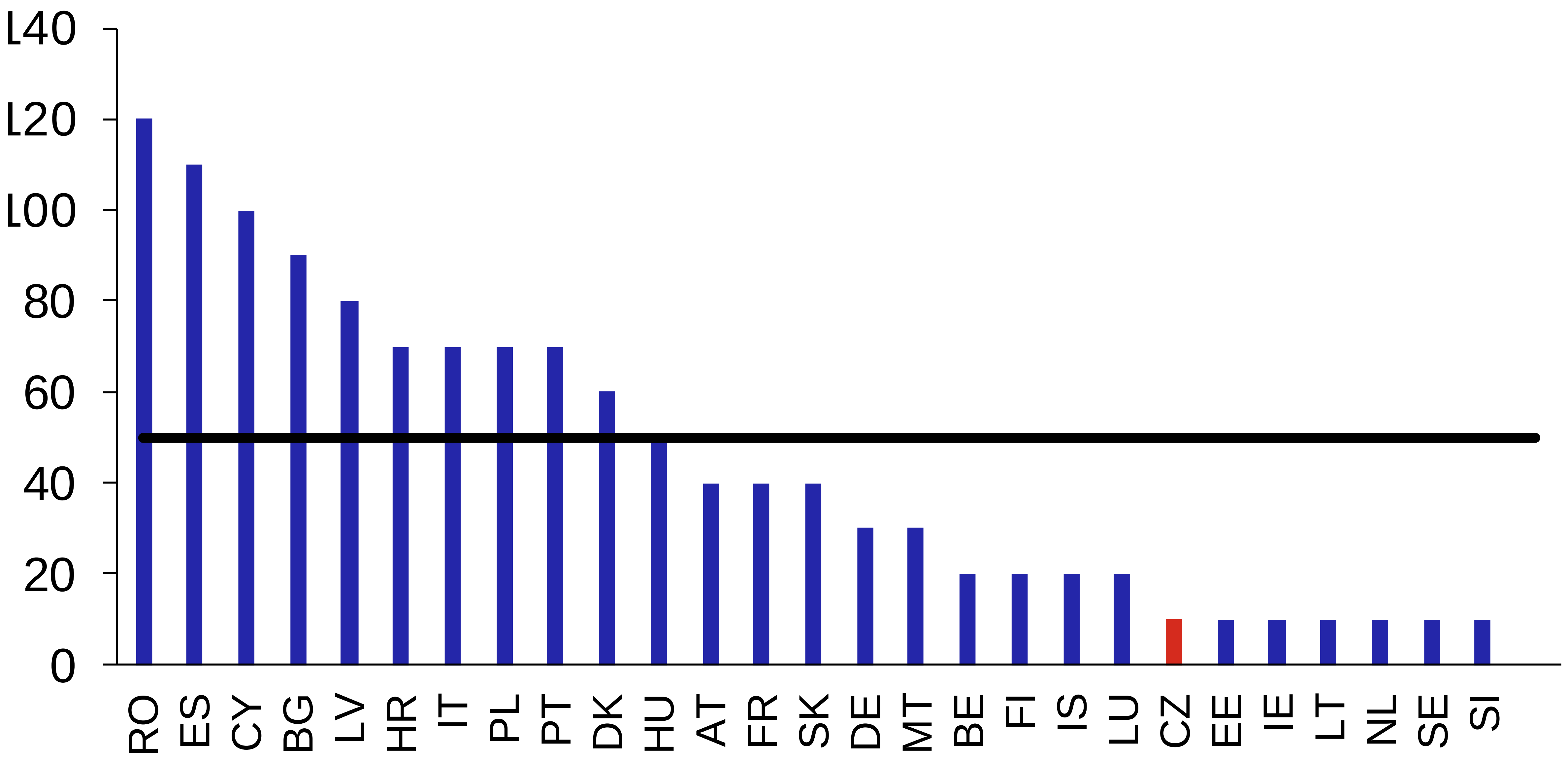
Tier 1 capital ratio as of 2021 Q2

(%)



Cost of risk comparison in the EU as of 2021 Q2

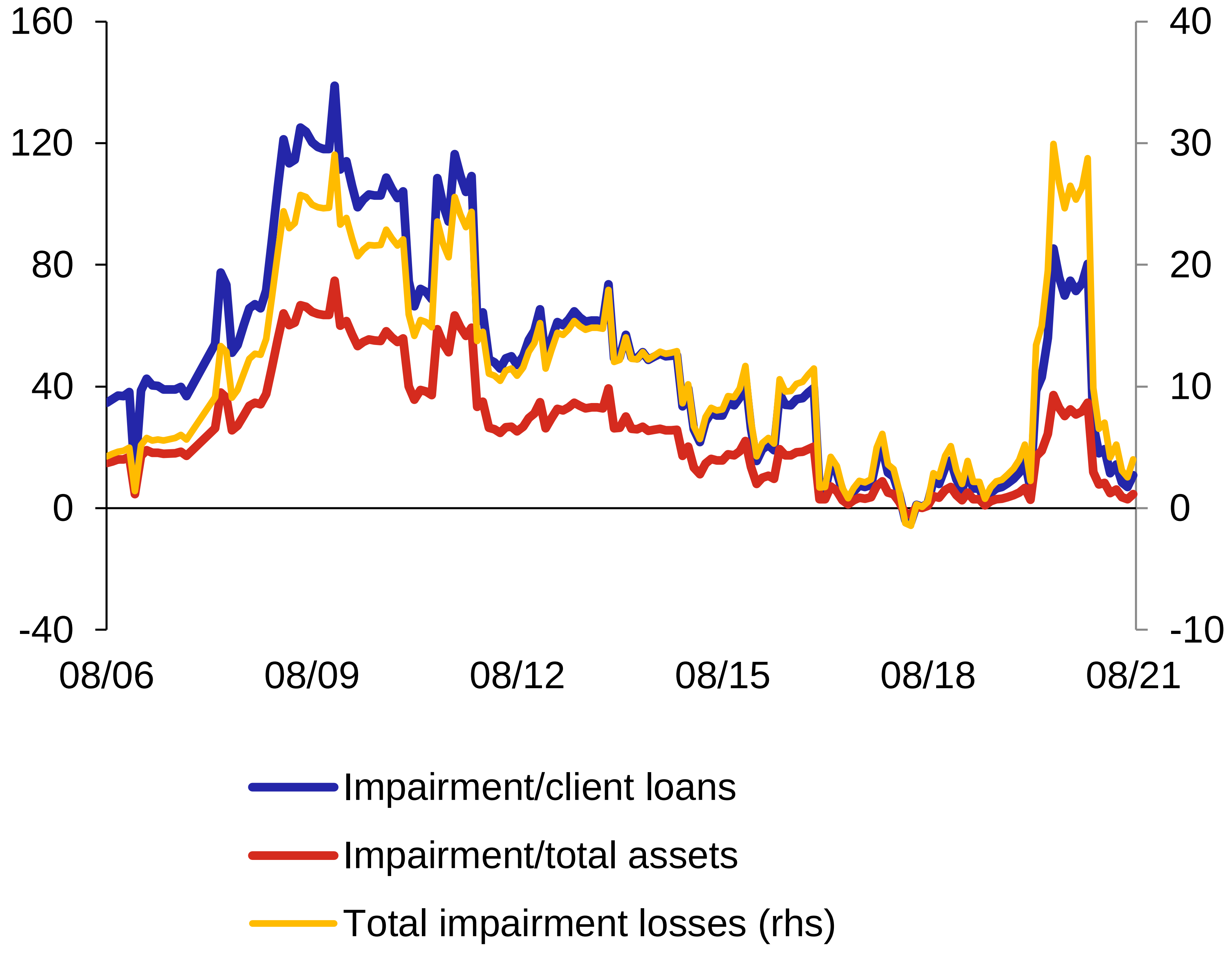
(bp)



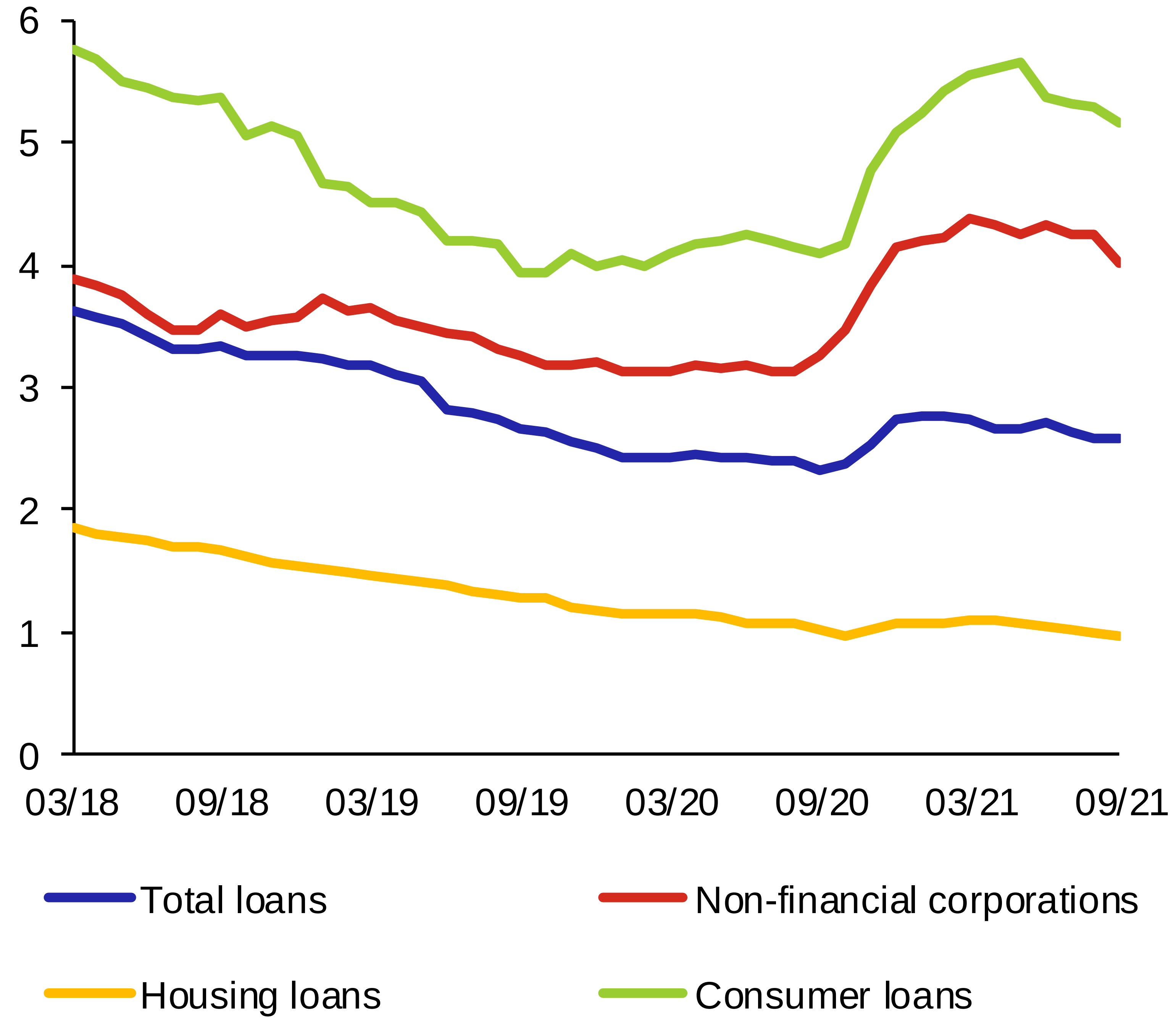
Credit risk in banking sector (1)

- Banks’ loan and asset impairment losses have returned to a very low level.
- The non-performing loan ratio has started to decrease.

Impairment losses
(annualised; bp; right-hand scale: CZK billions)

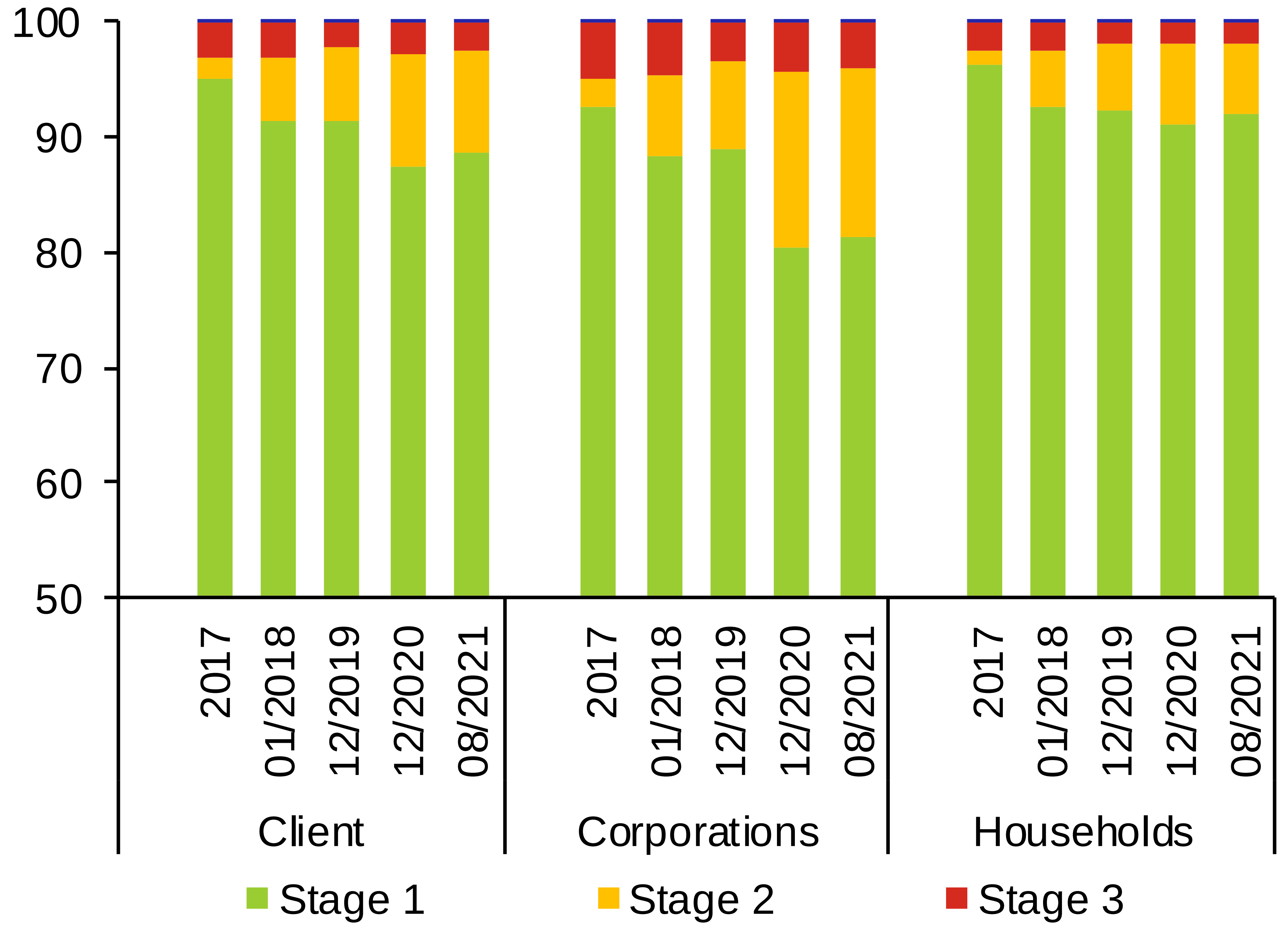


NPL shares in selected loan segments
(%)



Credit risk in banking sector (2)

Loan structure by portfolio
(%)



- The share of Stage 3 loans ("bad loans") has fallen slightly during the year.
- The share of Stage 2 loans ("loans at risk of default") has also declined.
- The decrease in the shares of Stage 2 and 3 loans does not necessarily mean that the actual level of credit risk has declined.
  - The continuing pandemic and the growth in energy prices may be reflected in renewed growth in the shares of Stage 2 and 3 loans.

Credit risk in banking sector (3)

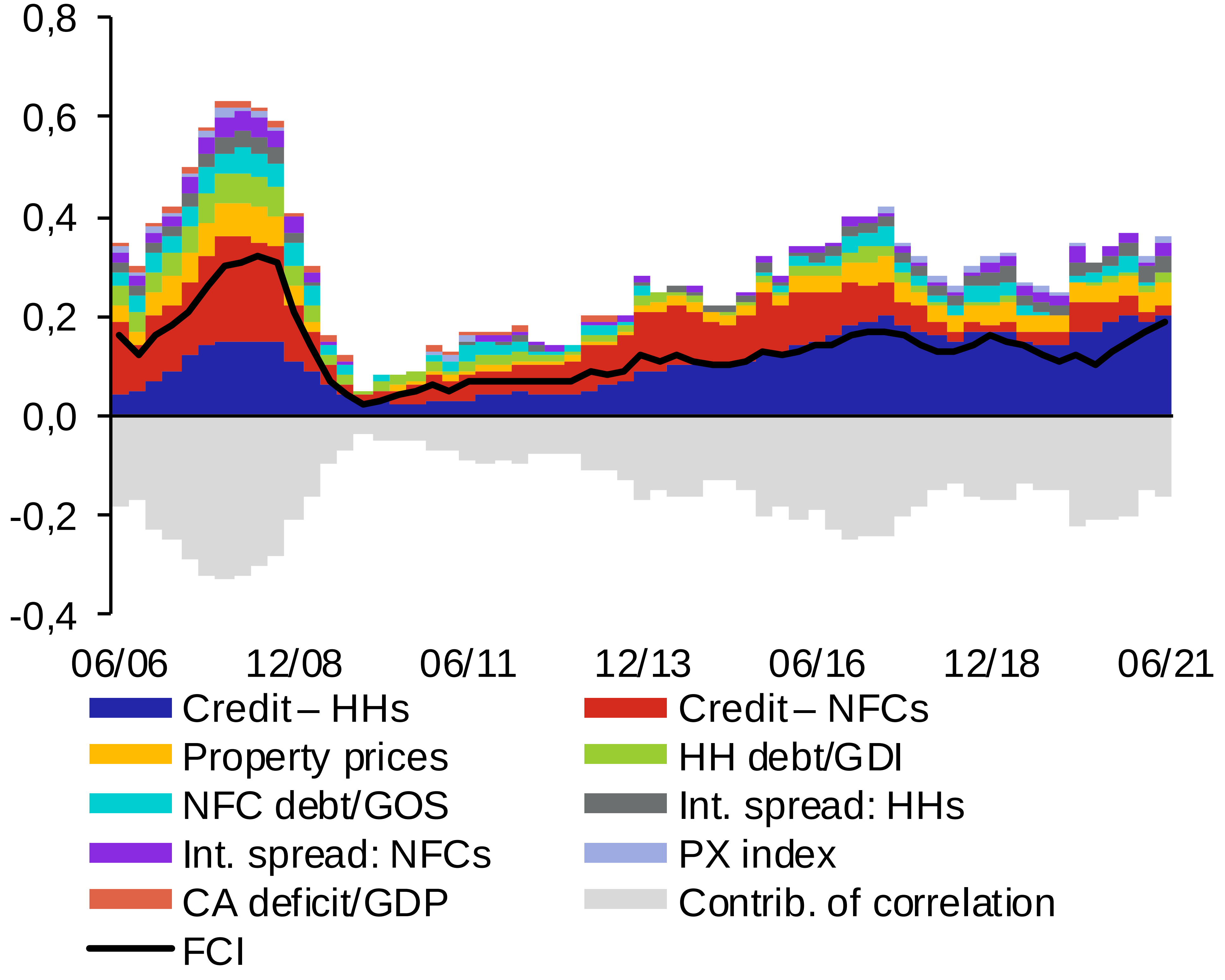
Exposures, provisions and coverage ratios by risk stage and portfolio

Stage	Date	Client exposures Volume (CZK bn)	Client exposures Change (%)	Provisions Volume (CZK bn)	Provisions Change (%)	Coverage ratio Share (%)	Coverage ratio Change (pp)
Total	12/2019	3371	8.3	58.00	-3.3	1.71	-0.24
	12/2020	3514		77.20		2.25	
	08/2021	3796		74.63		2.01	
S1	12/2019	3150	9.6	7.45	0.1	0.21	-0.03
	12/2020	3070		9.42		0.31	
	08/2021	3364		9.43		0.28	
S2	12/2019	215	-2.9	7.85	-11.5	3.32	-0.50
	12/2020	351		19.57		5.58	
	08/2021	341		17.32		5.09	
S3	12/2019	76	-2.0	44.17	-0.7	57.72	0.68
	12/2020	93		48.21		51.69	
	08/2021	91		47.88		52.37	

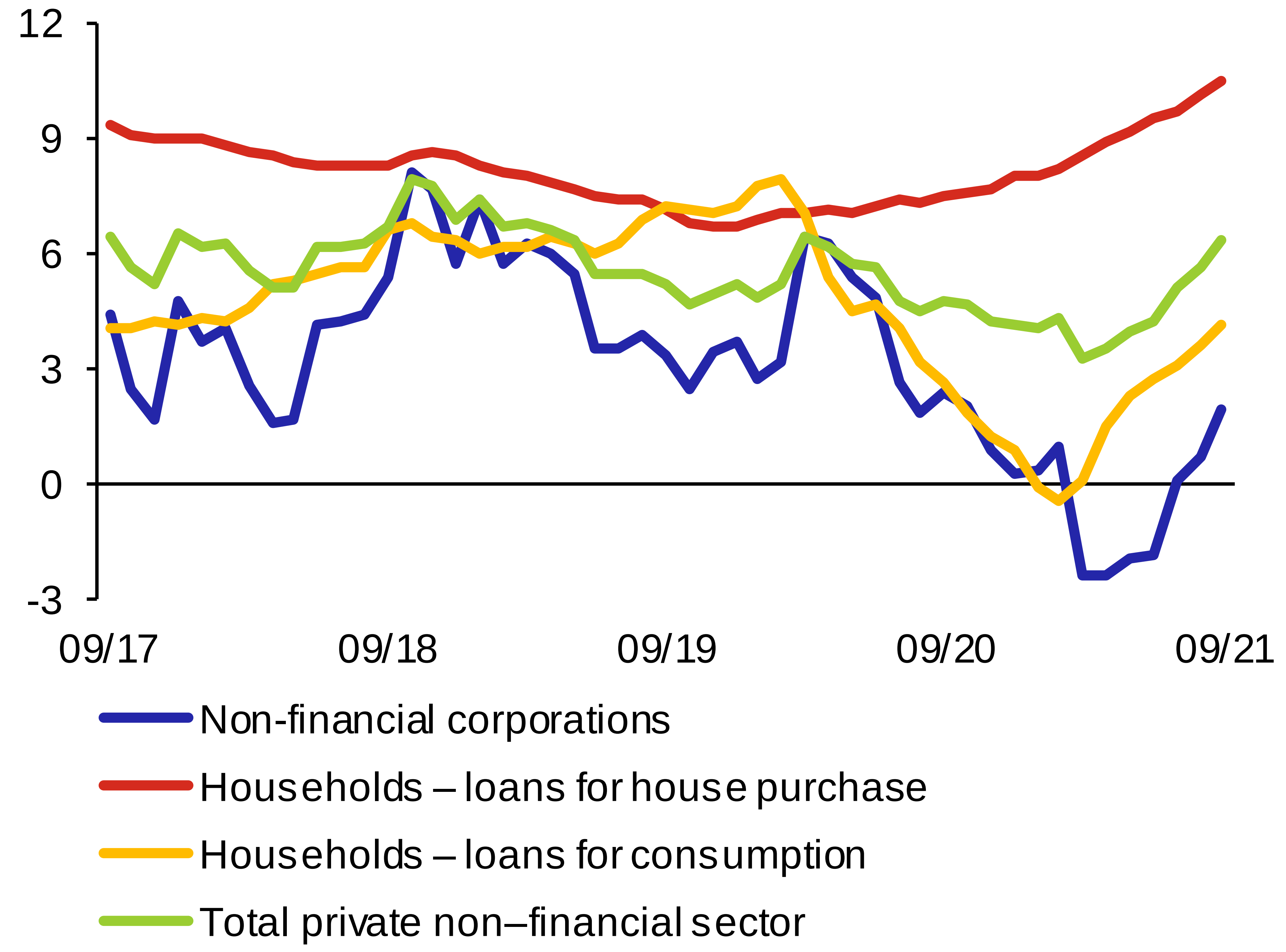
CCyB rate (1)

- The financial cycle indicator has risen further this year.

Financial cycle indicator
(0 minimum, 1 maximum)



Year-on-year growth in bank loans to the private non-financial sector
(%)



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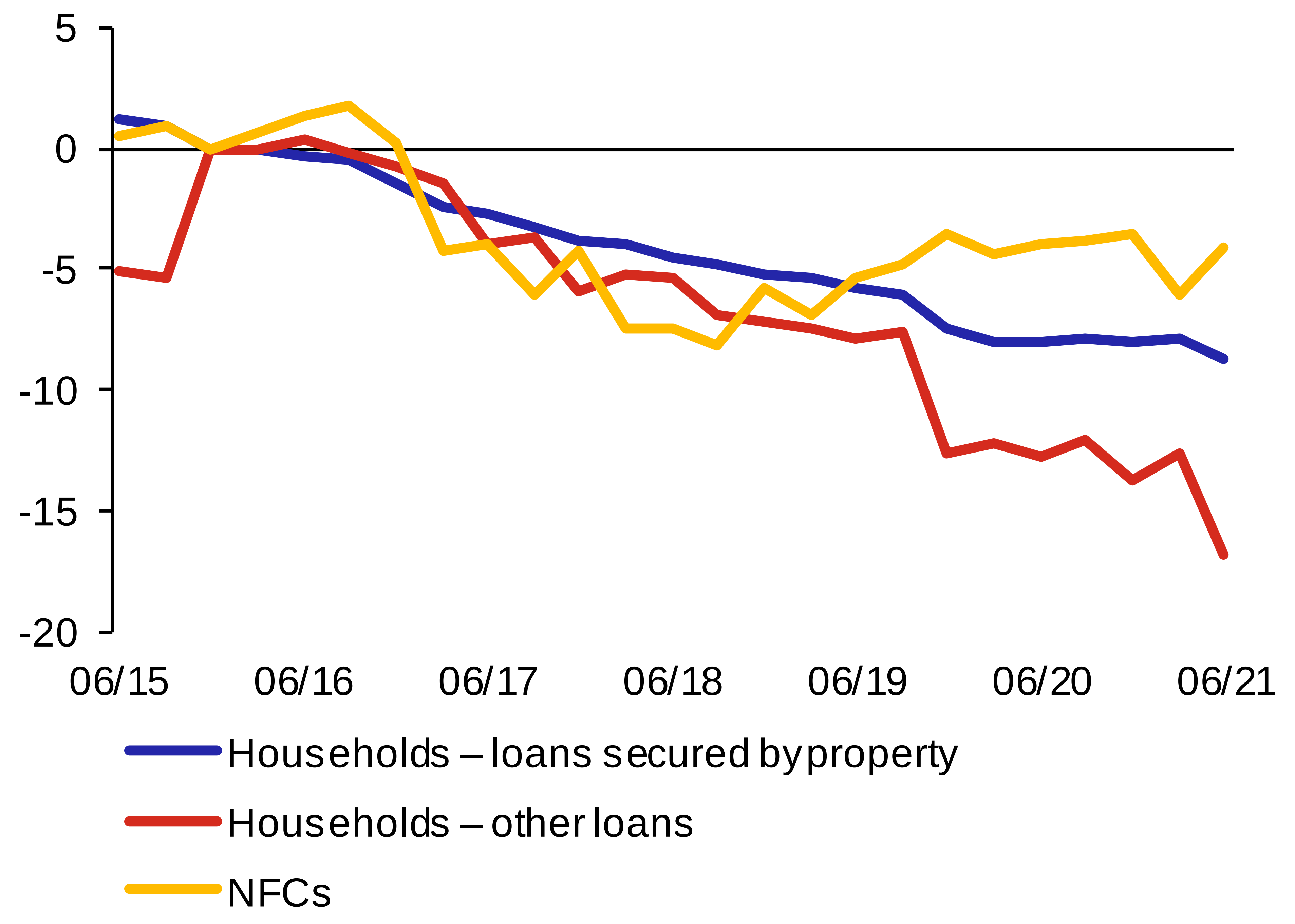
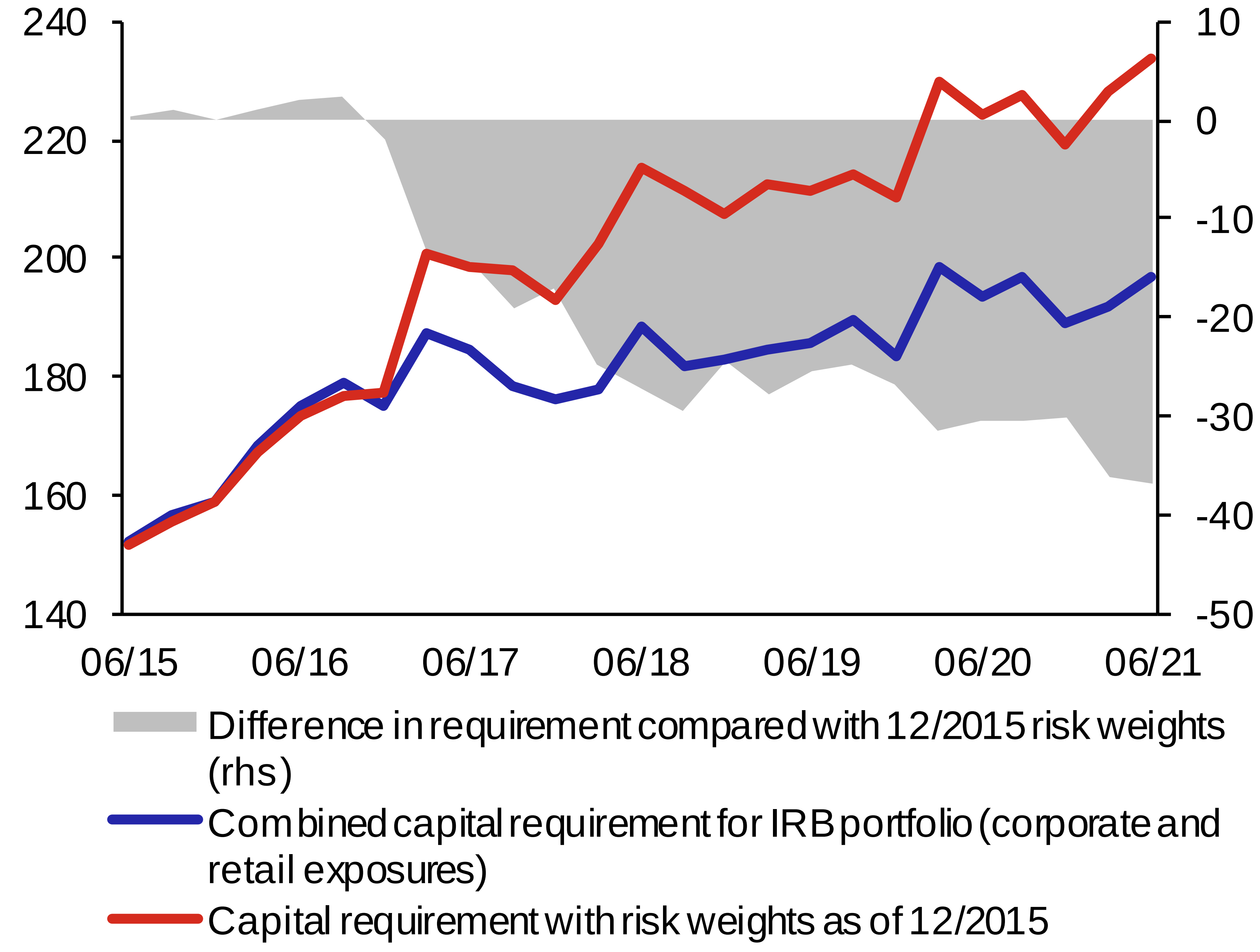
CCyB rate (2)

- A gradual decrease in risk weights is an important factor for the creation of the countercyclical buffer.

Change in risk weights compared with the start of the strongly expansionary phase of the financial cycle
(pp)



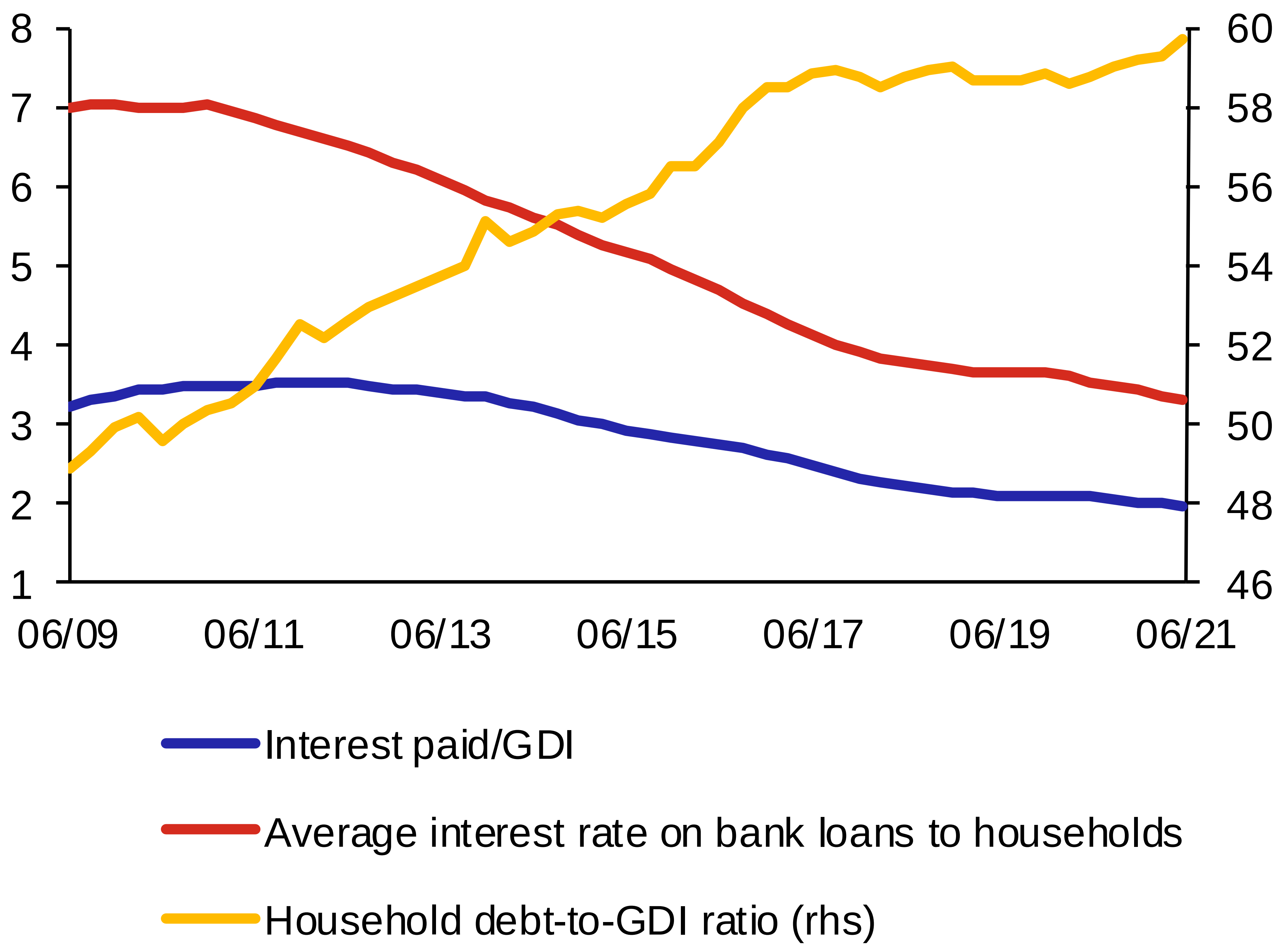
Actual and hypothetical capital requirements based on the application of the risk weights as of 12/2015
(CZK billions)



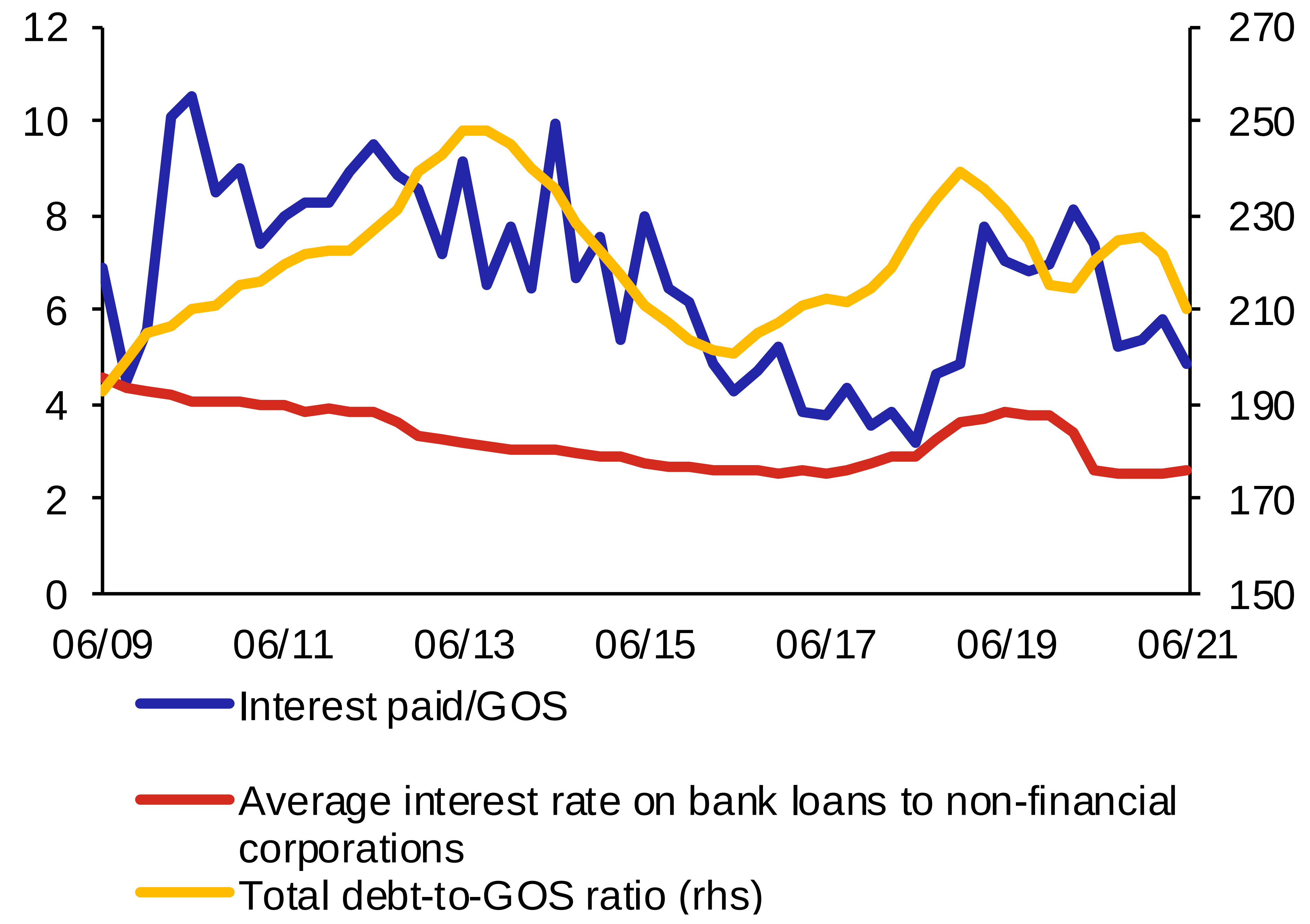
CCyB rate (3)

- Relative debt has risen only slightly for households and declined for NFCs.
- Relative interest paid has been very low.

Debt ratio and interest paid by households
(%)



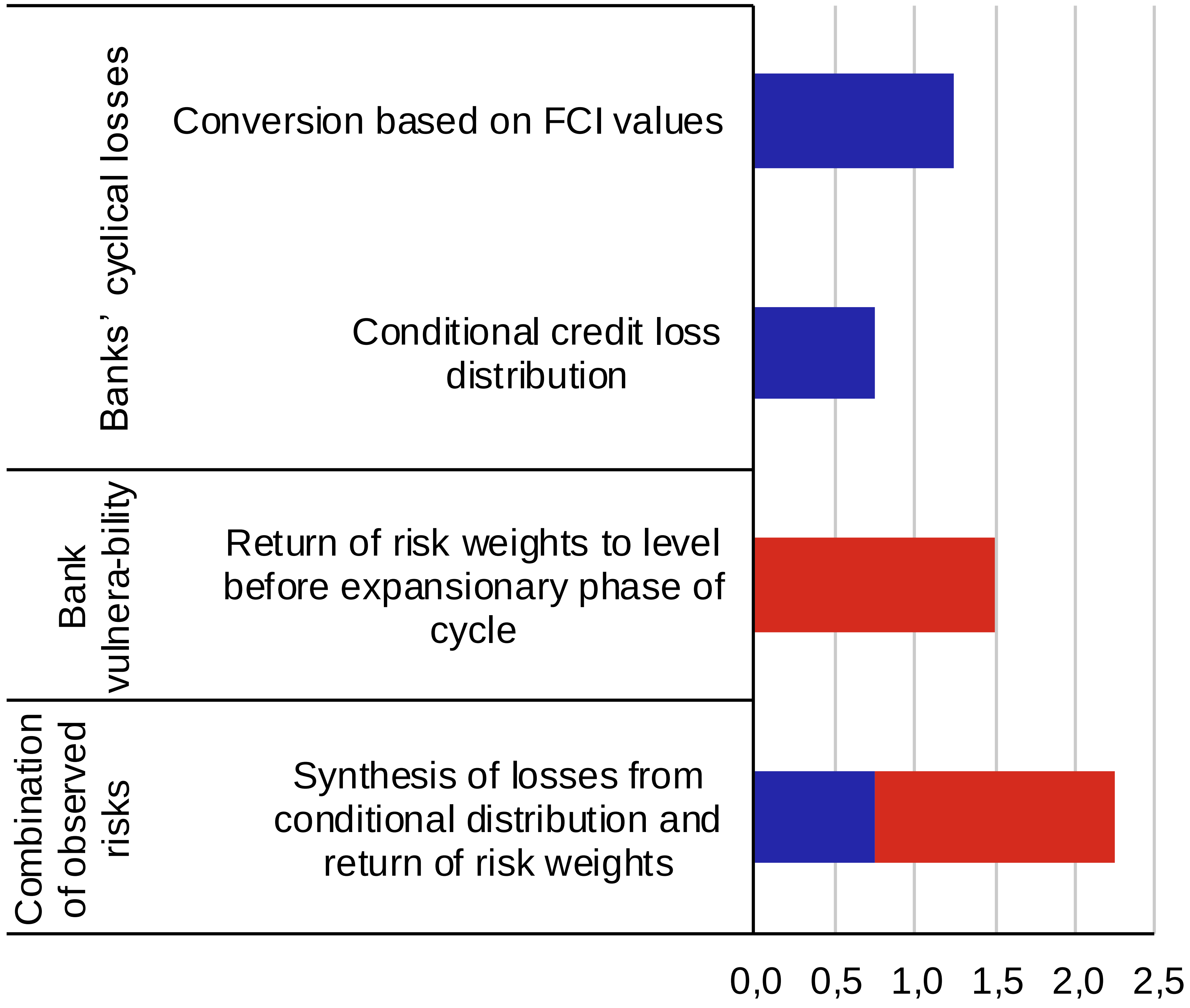
Debt ratio and interest paid by non-financial corporations
(%)



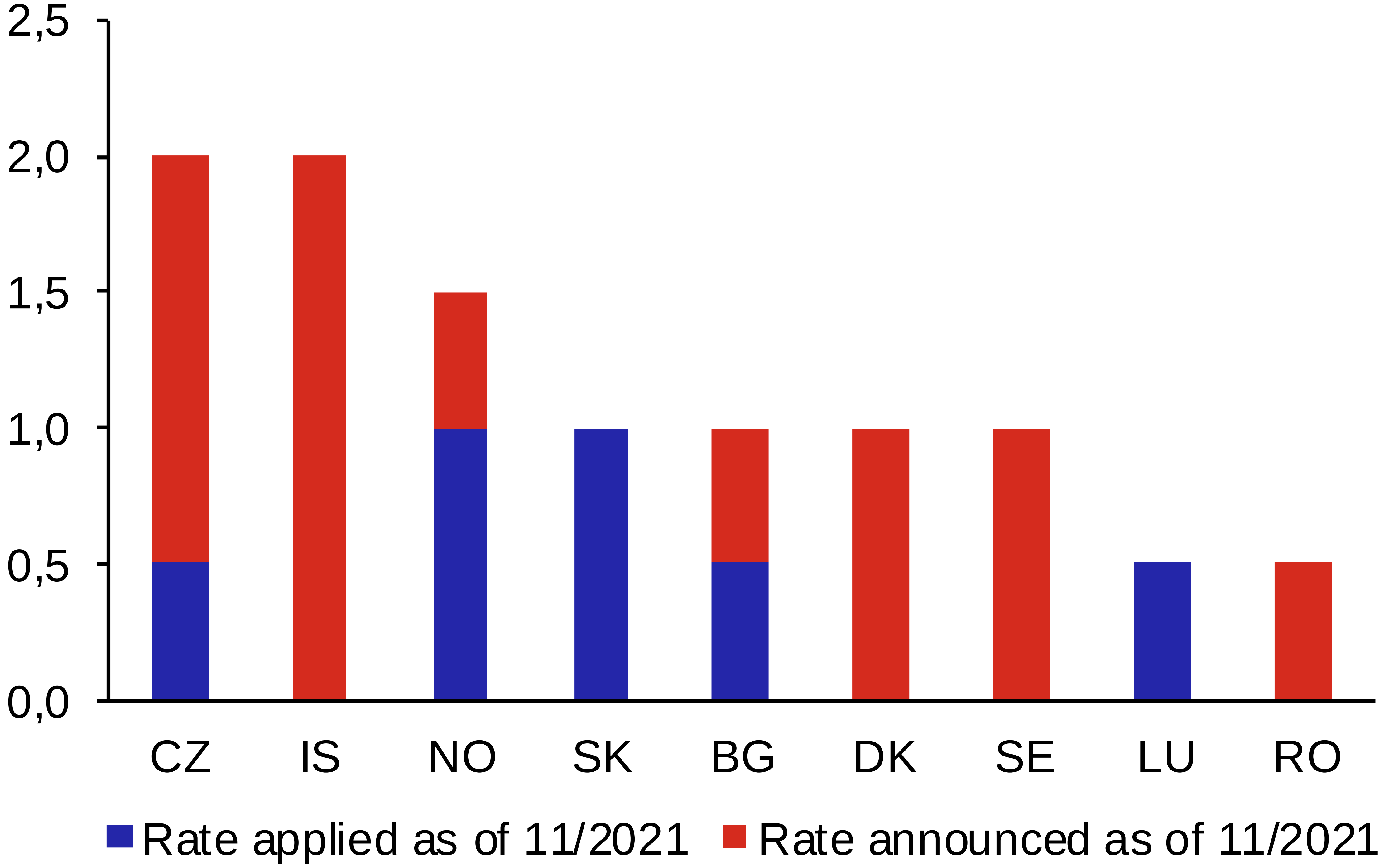
CCyB rate (4)

- Quantitative approaches “recommended” setting the CCyB rate at 2.25%.

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



CCyB rates in European countries
(% of total risk exposure)



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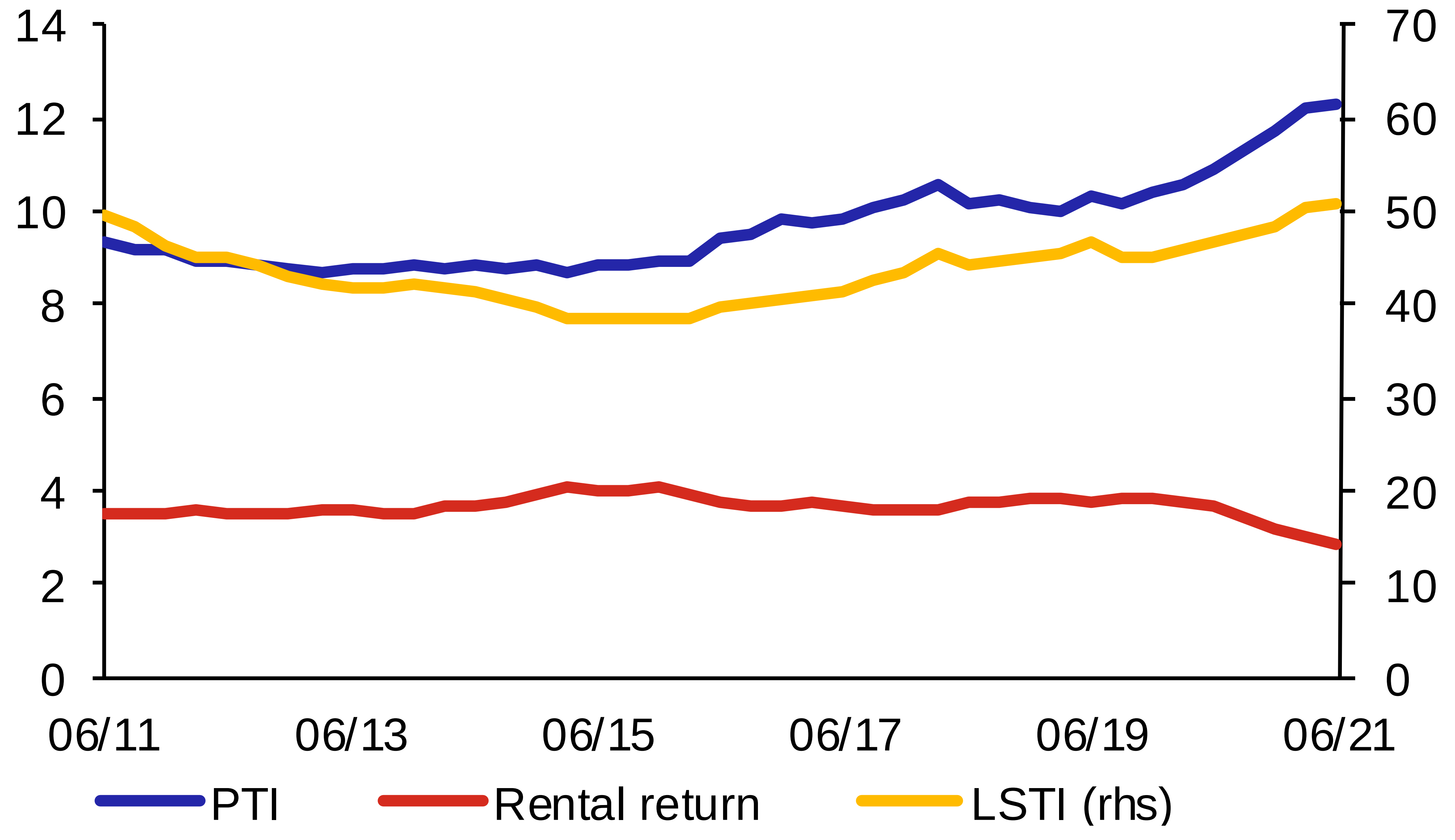
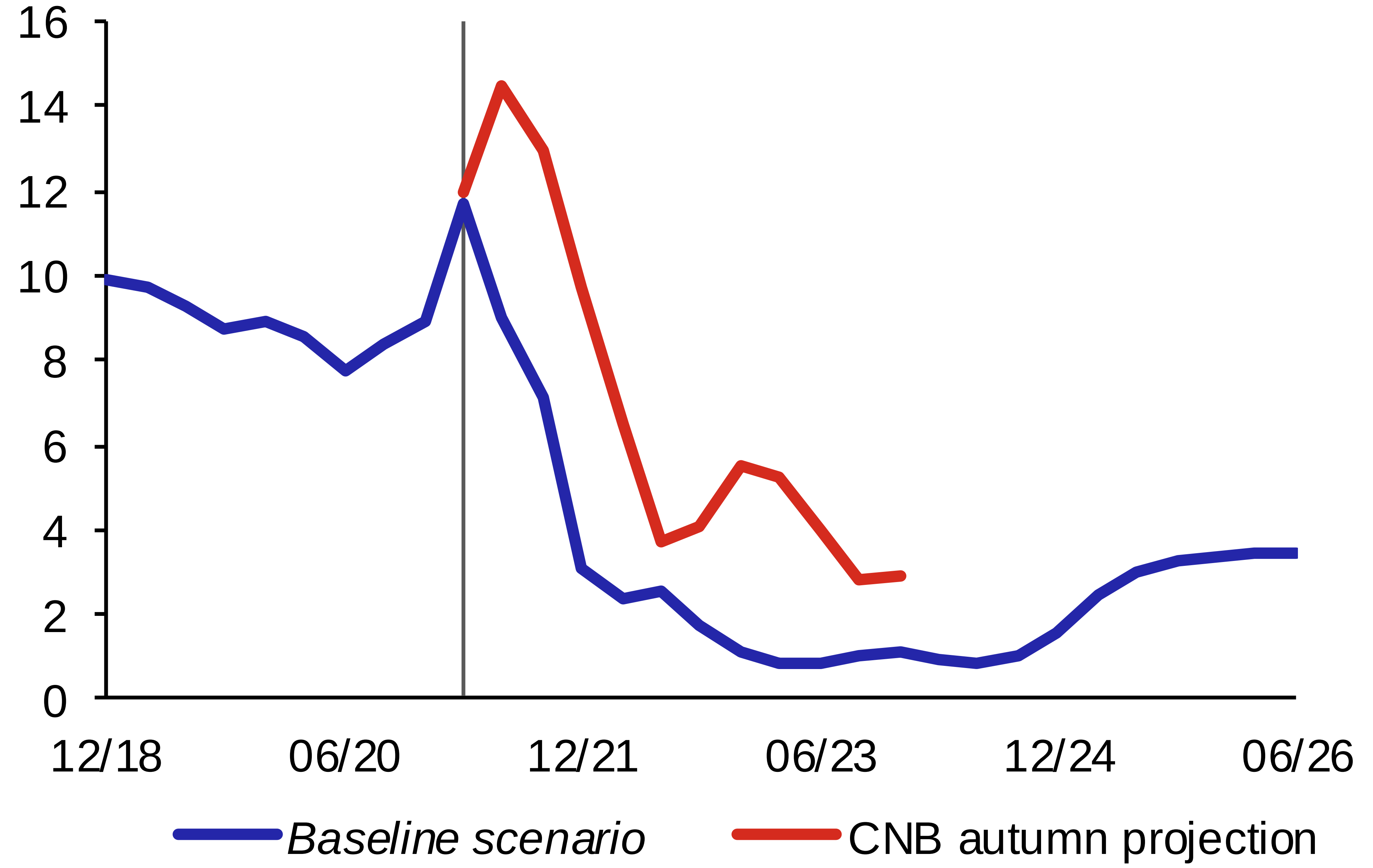
Residential property market

- Rental returns have dropped to a historical low amid rapid growth in house prices.
- The **Baseline Scenario** foresees continued growth in house prices, albeit gradually at a much slower pace.

Selected apartment affordability indicators
(PTI in years; yields in %; right-hand scale: %)



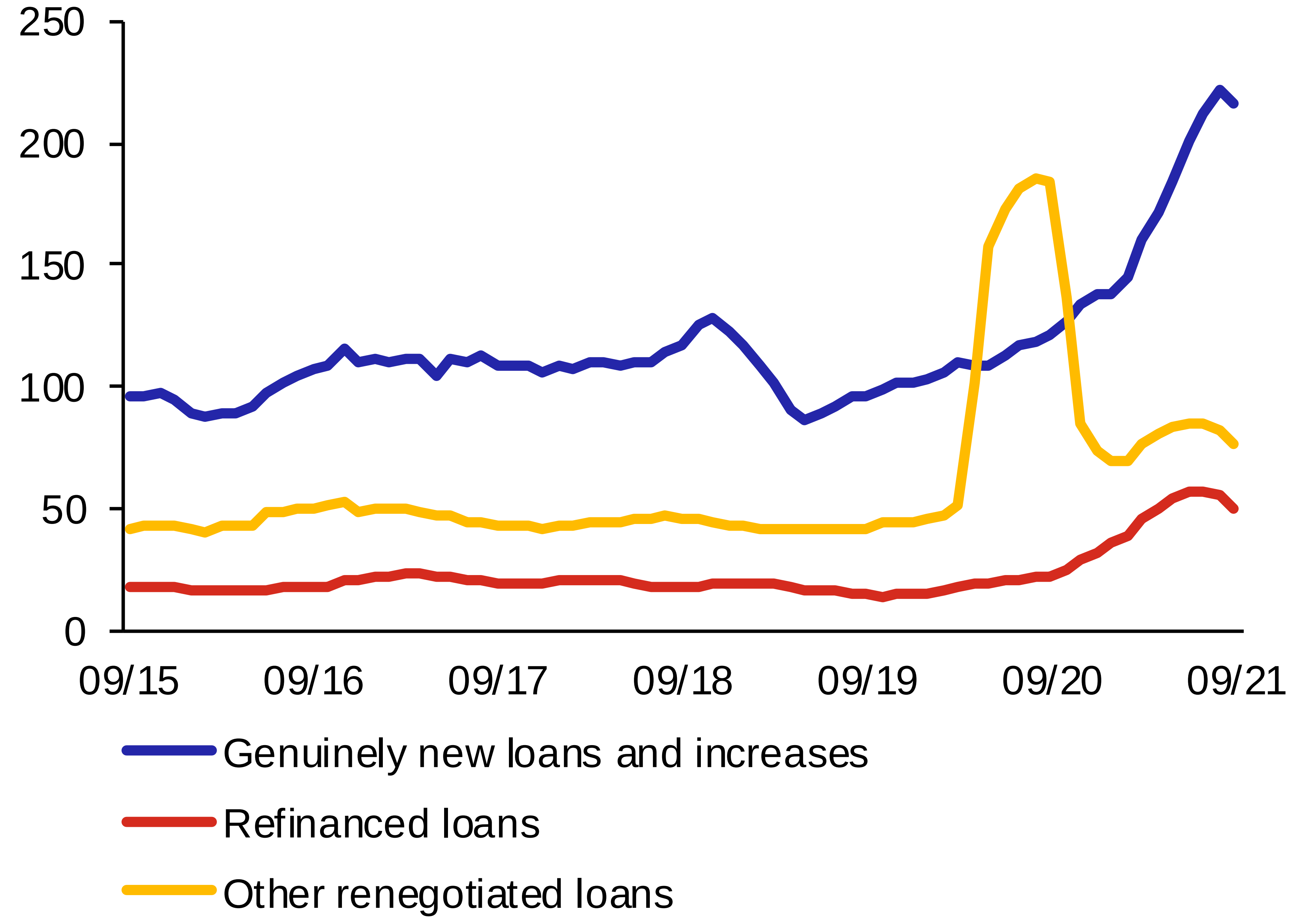
Scenarios for residential real estate prices
(year-on-year growth in %)



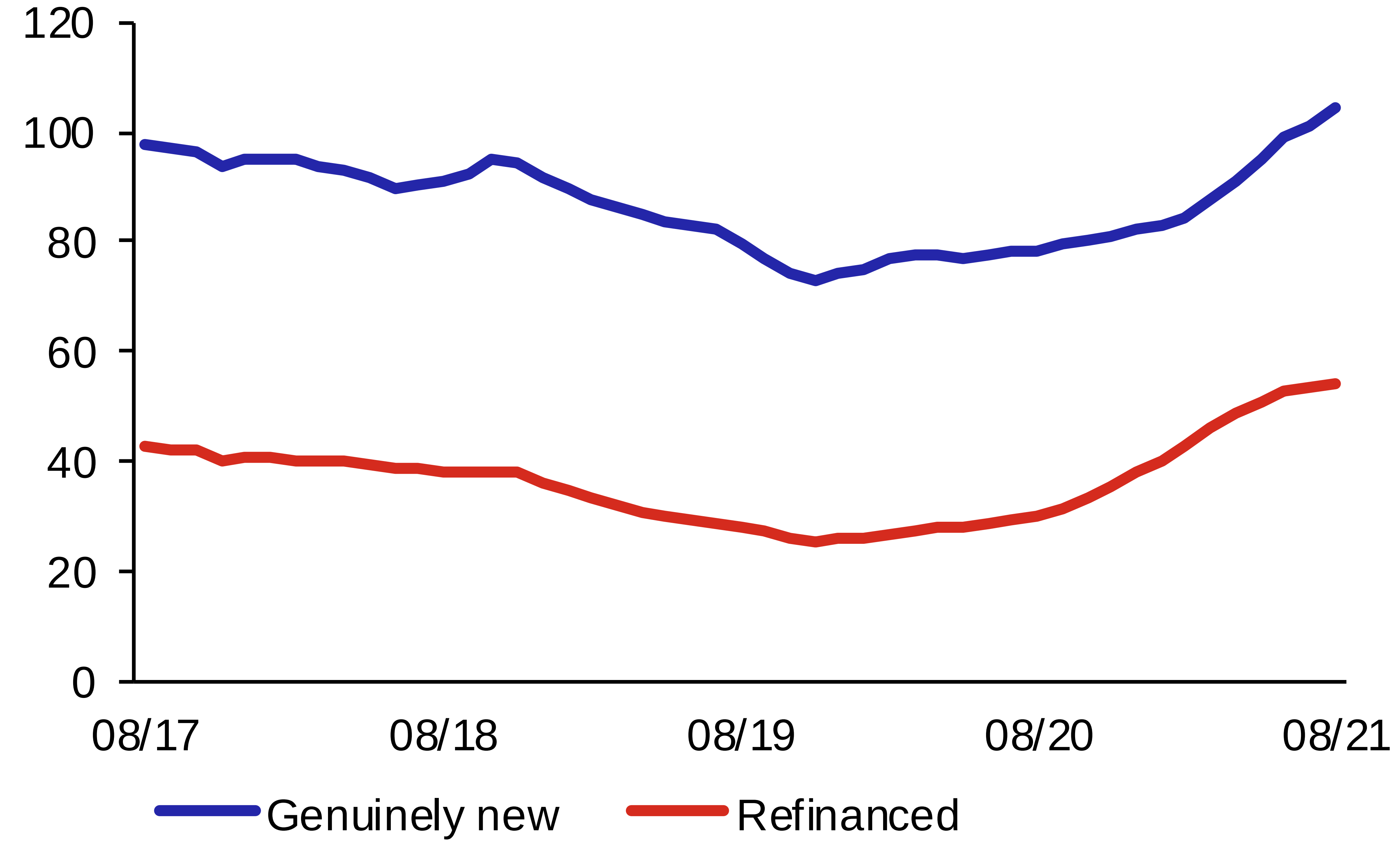
Mortgage loans (1)

- The high volumes of genuinely new mortgage loans are due not only to a rise in the average loan size, but also to growth in the number of loans.

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



New loans secured by residential property
(annual moving totals in thousands of loans)

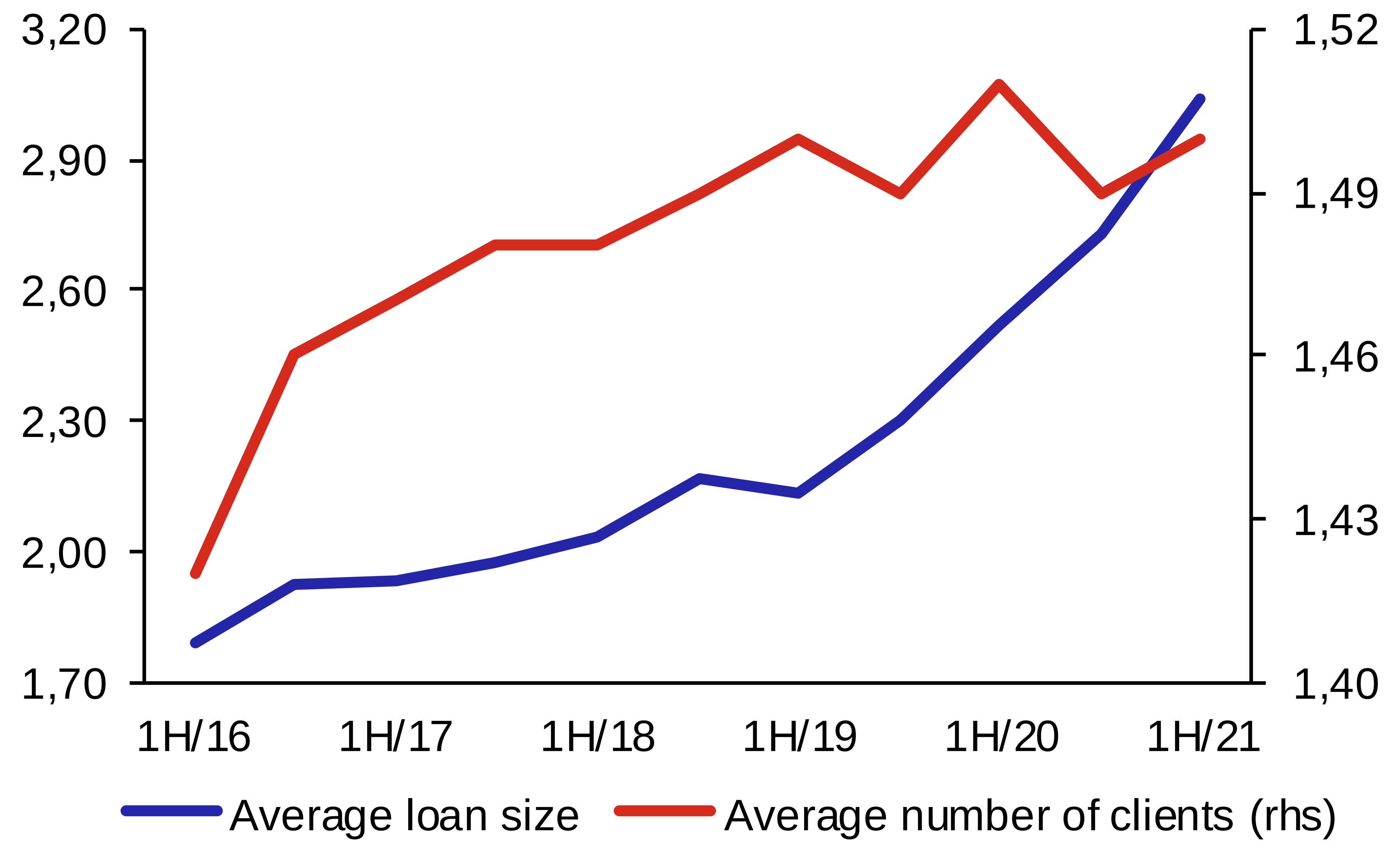


Mortgage loans (2)

- The rise in house prices has led to growth in the average size of new mortgage loans, which has increased by 60% in the last five years.

Average mortgage loan size and number of declared incomes

(CZK billions; right-hand scale: number of persons)



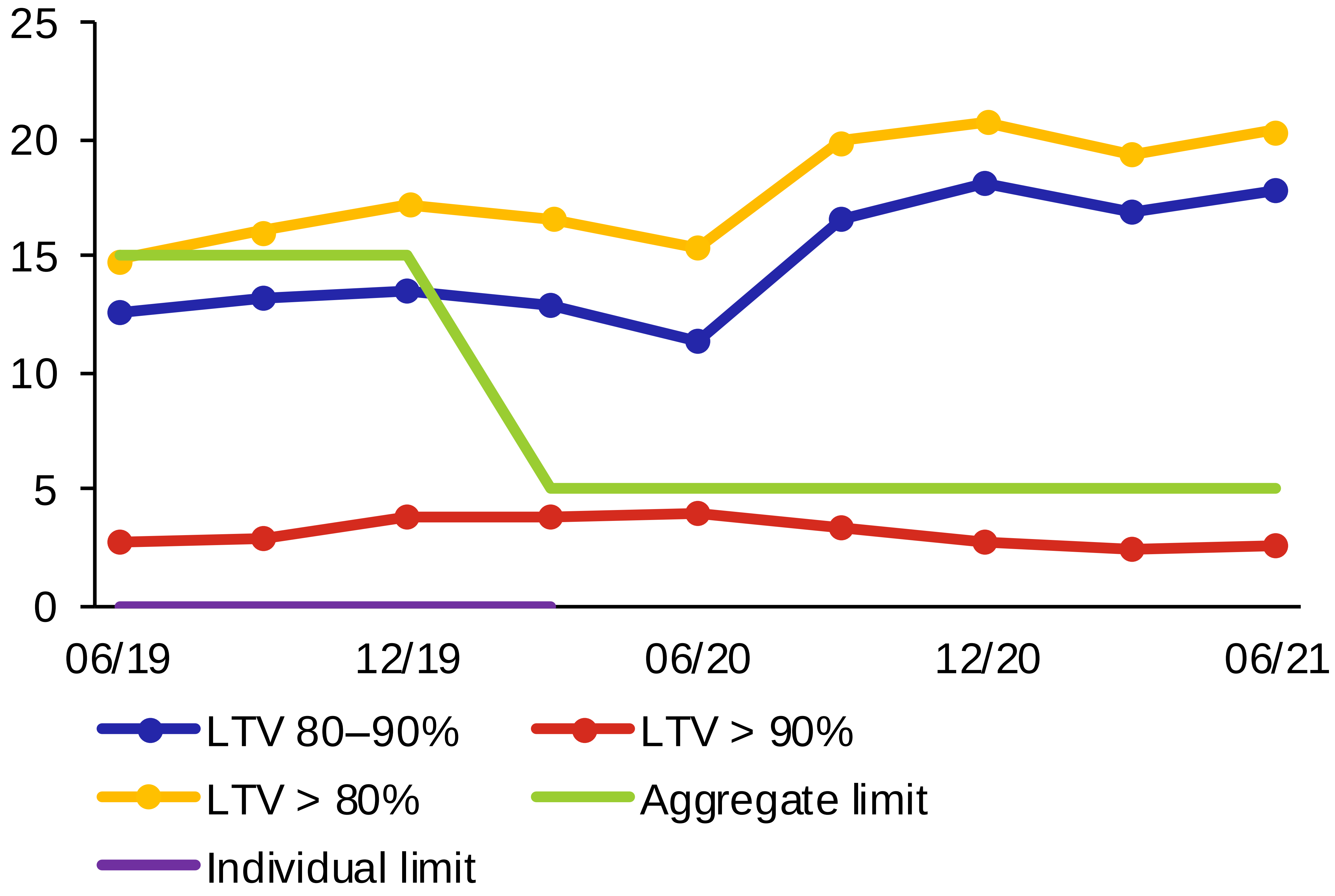
Median values of variables describing features of households when receiving mortgage loan

	2018 H1	2018 H2	2019 H1	2019 H2	2020 H1
Net monthly income (CZK thousands)	42,6	44,2	45,9	46,8	49,1
Year-on-year change (%)	8,8	9,1	8,0	6,0	6,8
Property purchase price (CZK thousands)	2 500	2 600	2 900	3 200	3 340
Year-on-year change (%)	4,6	9,2	16,0	23,1	15,2
Loan size (CZK thousands)	1 936	2 000	2 200	2 400	2 528
Year-on-year change (%)	7,6	2,0	13,6	20,0	14,9
Mortgage loan instalment (CZK thousands)	8,2	8,2	9,5	9,9	10,5
Year-on-year change (%)	14,7	6,7	15,0	21,4	10,3
Client's other debt (CZK thousands)	57,0	60,0	50,0	30,0	30,0
Year-on-year change (%)	90,0	78,0	-12,3	-50,0	-40,0

Compliance with LTV limit

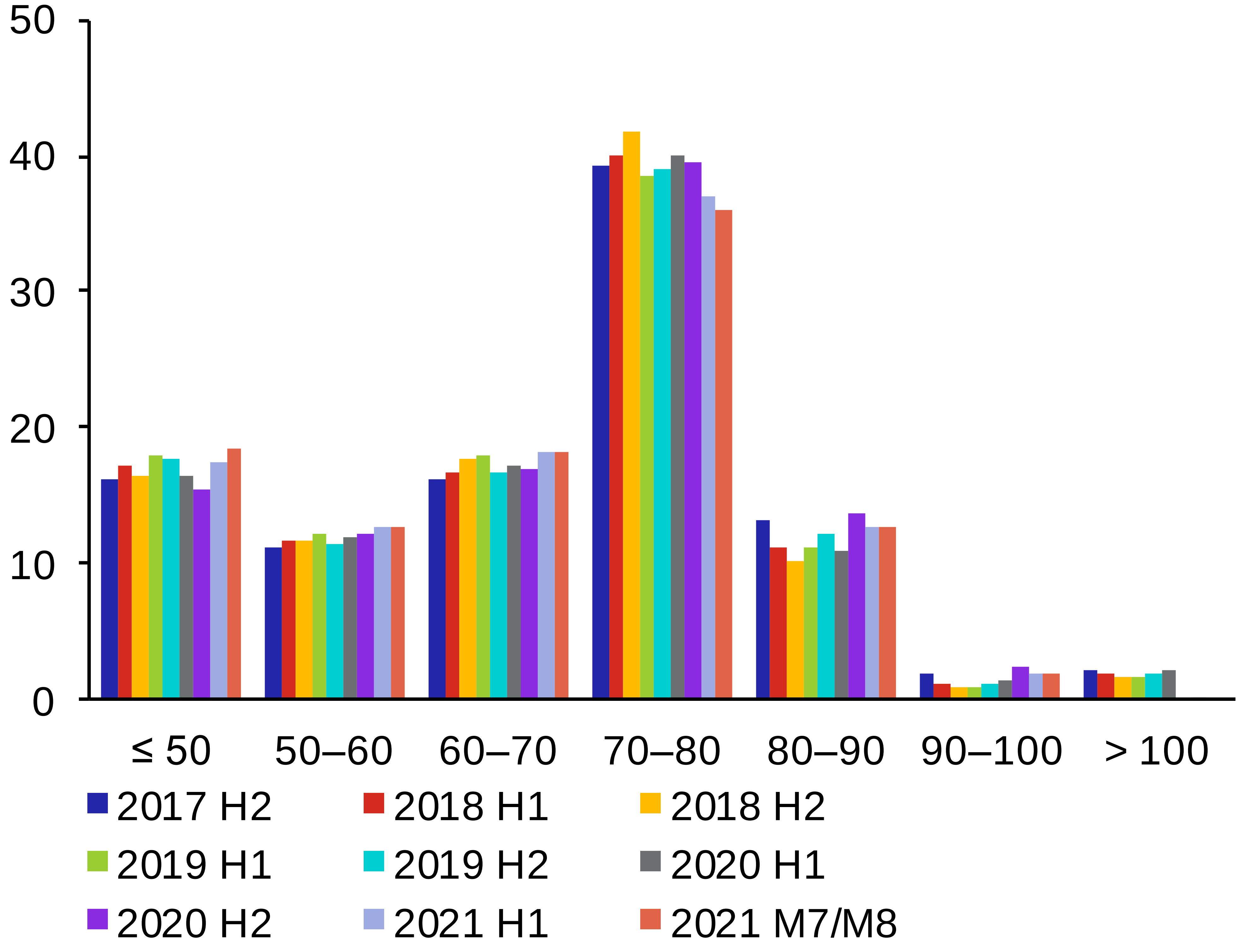
Fulfilment of the recommended LTV limits

(share of loans in reference volume in %)



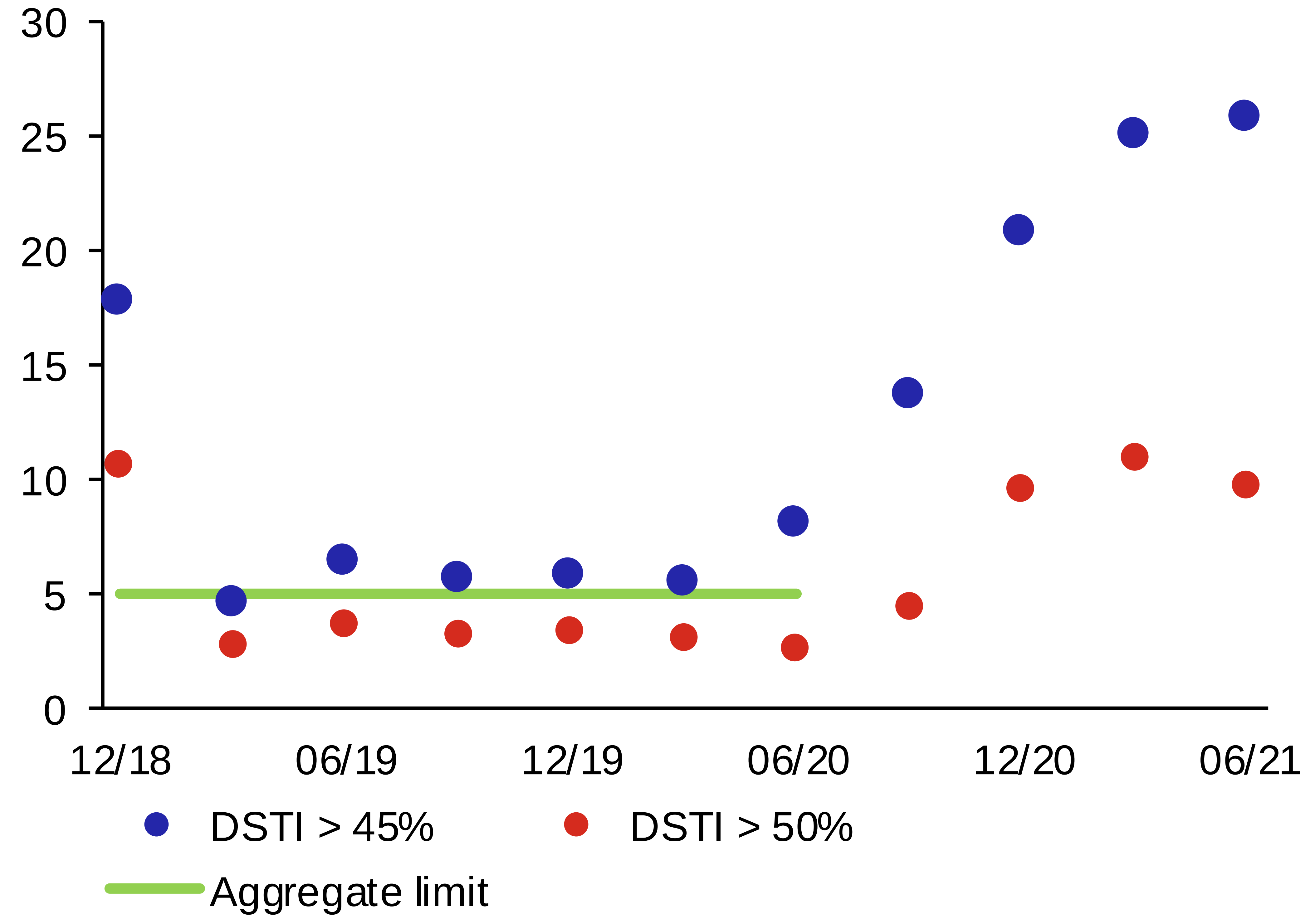
LTV distribution of new loans

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

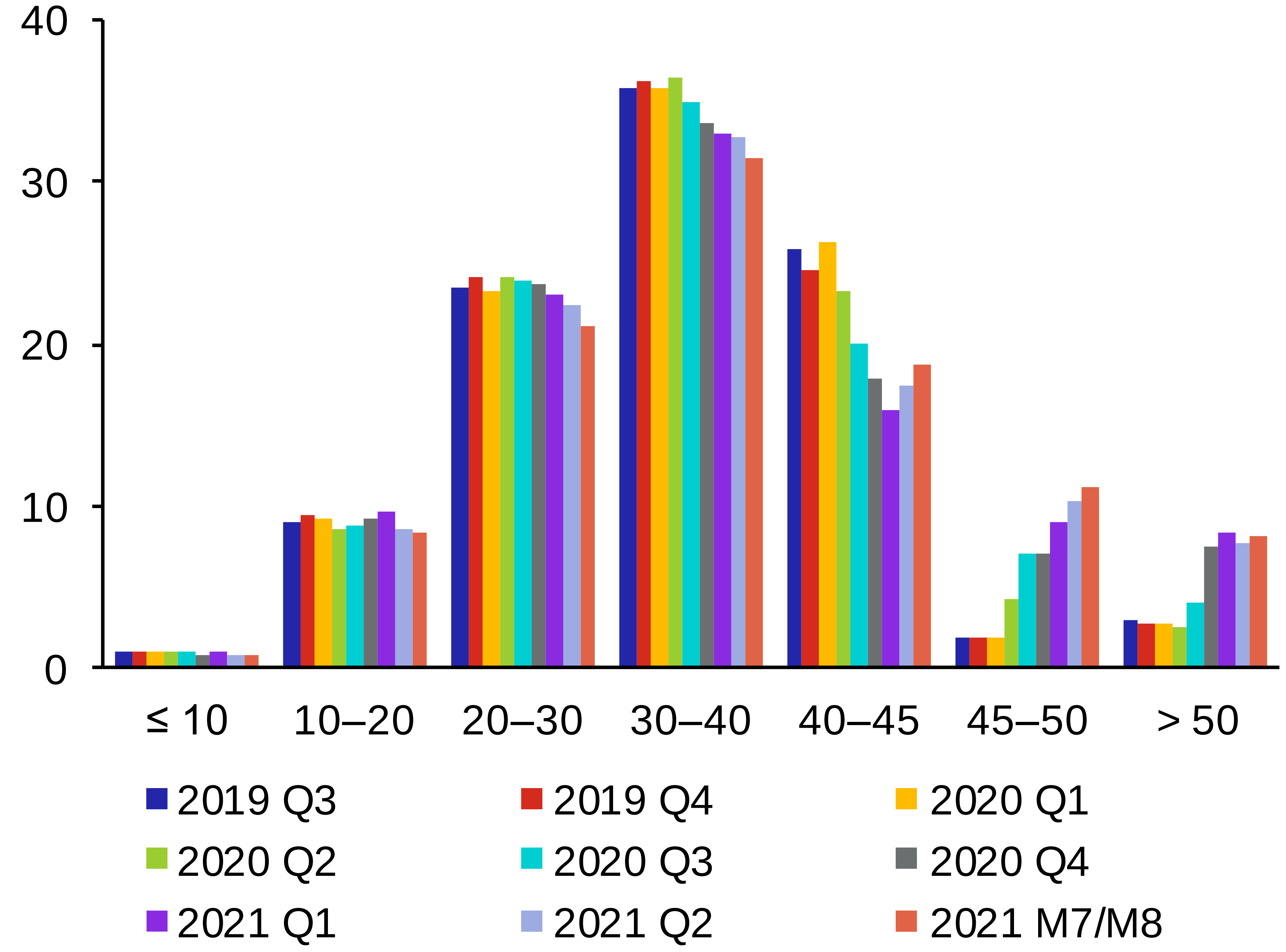


DSTI ratio

Loans with DSTI above previously recommended limits
(share of loans in reference volume in %)

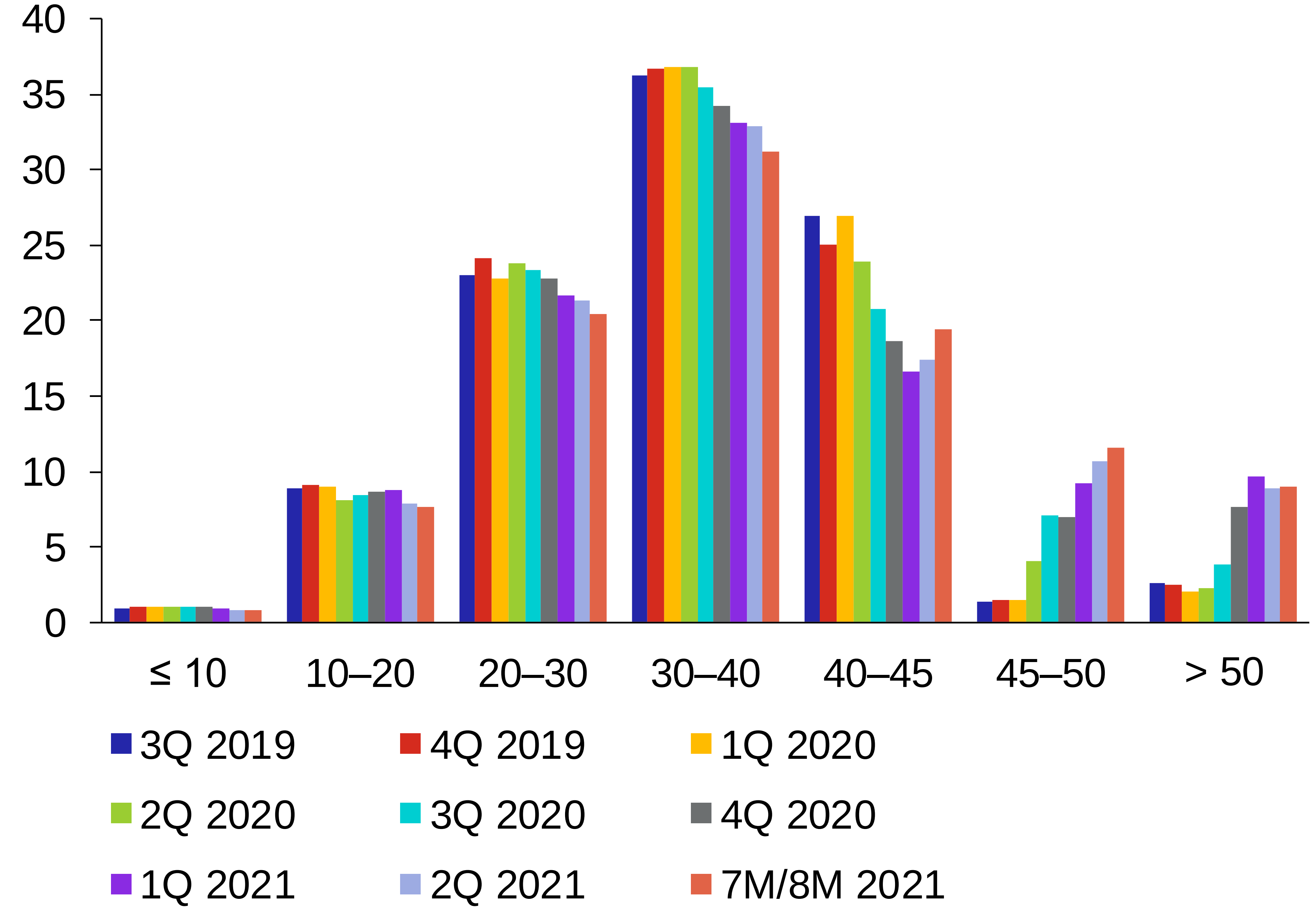


DSTI distribution of new loans
(share of loans in volume provided in %; x-axis: DSTI in %)

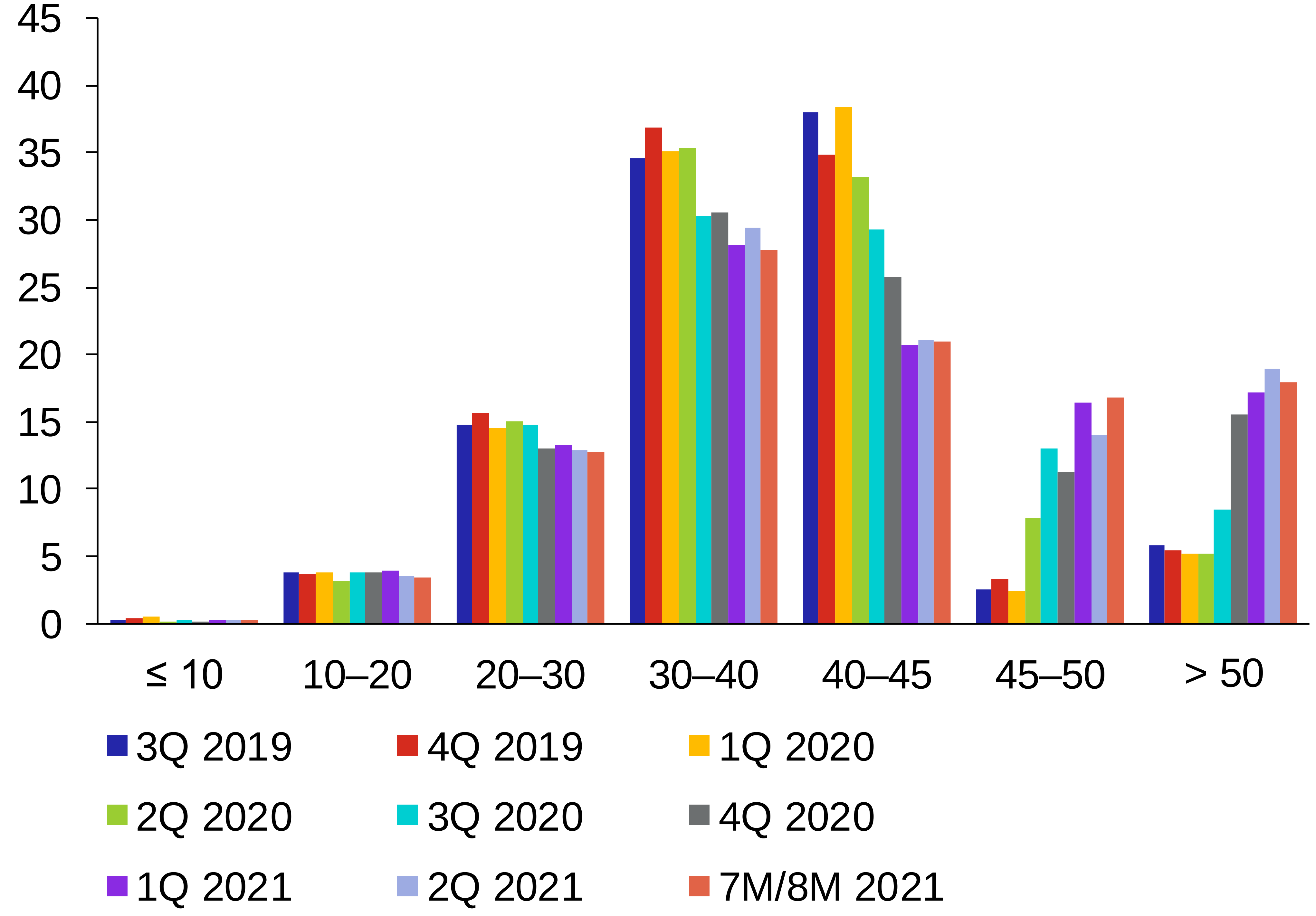


DSTI ratio

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

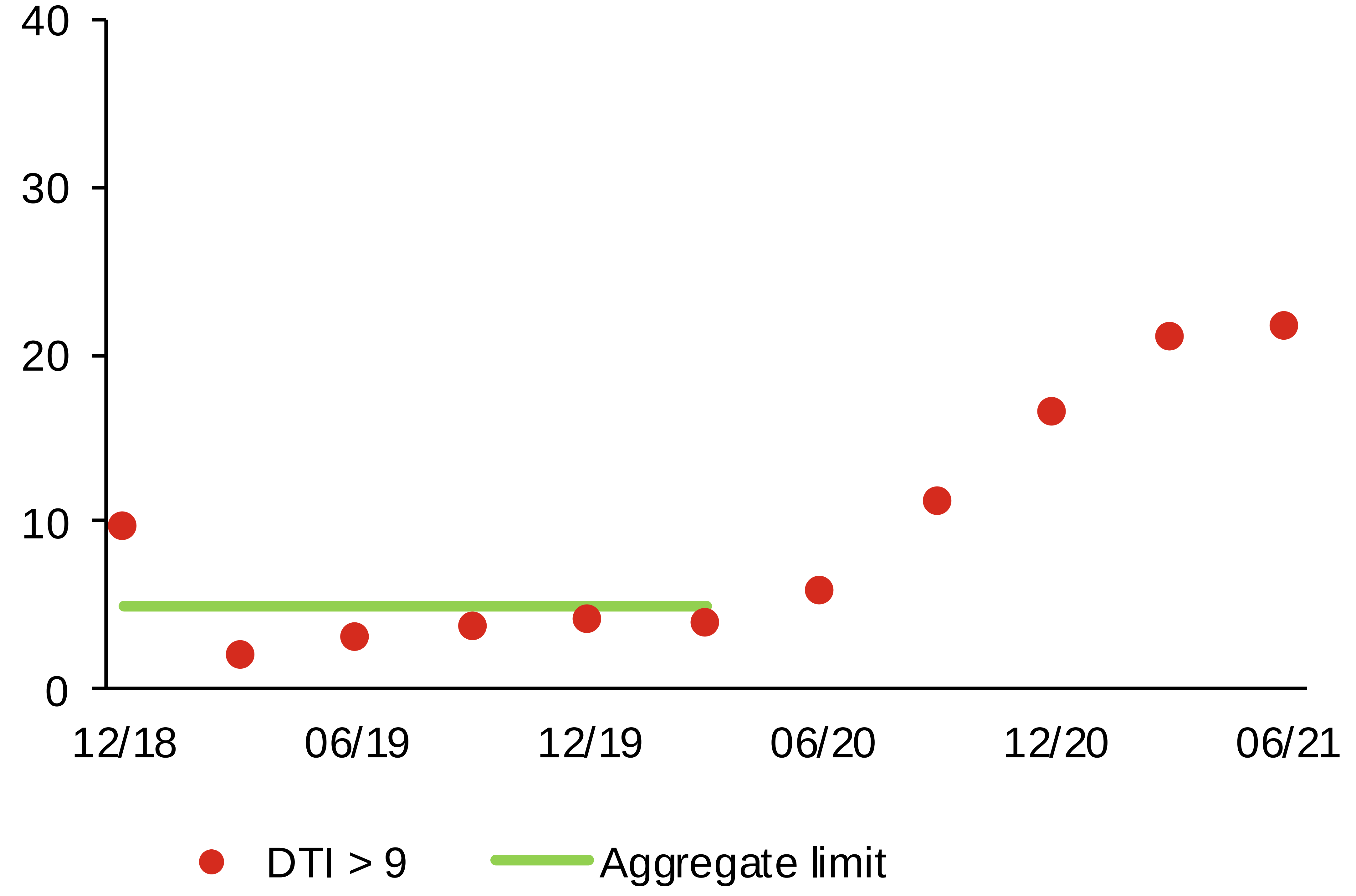


DSTI distribution of new second and subsequent loans
(share of loans in volume provided in %; x-axis: DSTI in %)

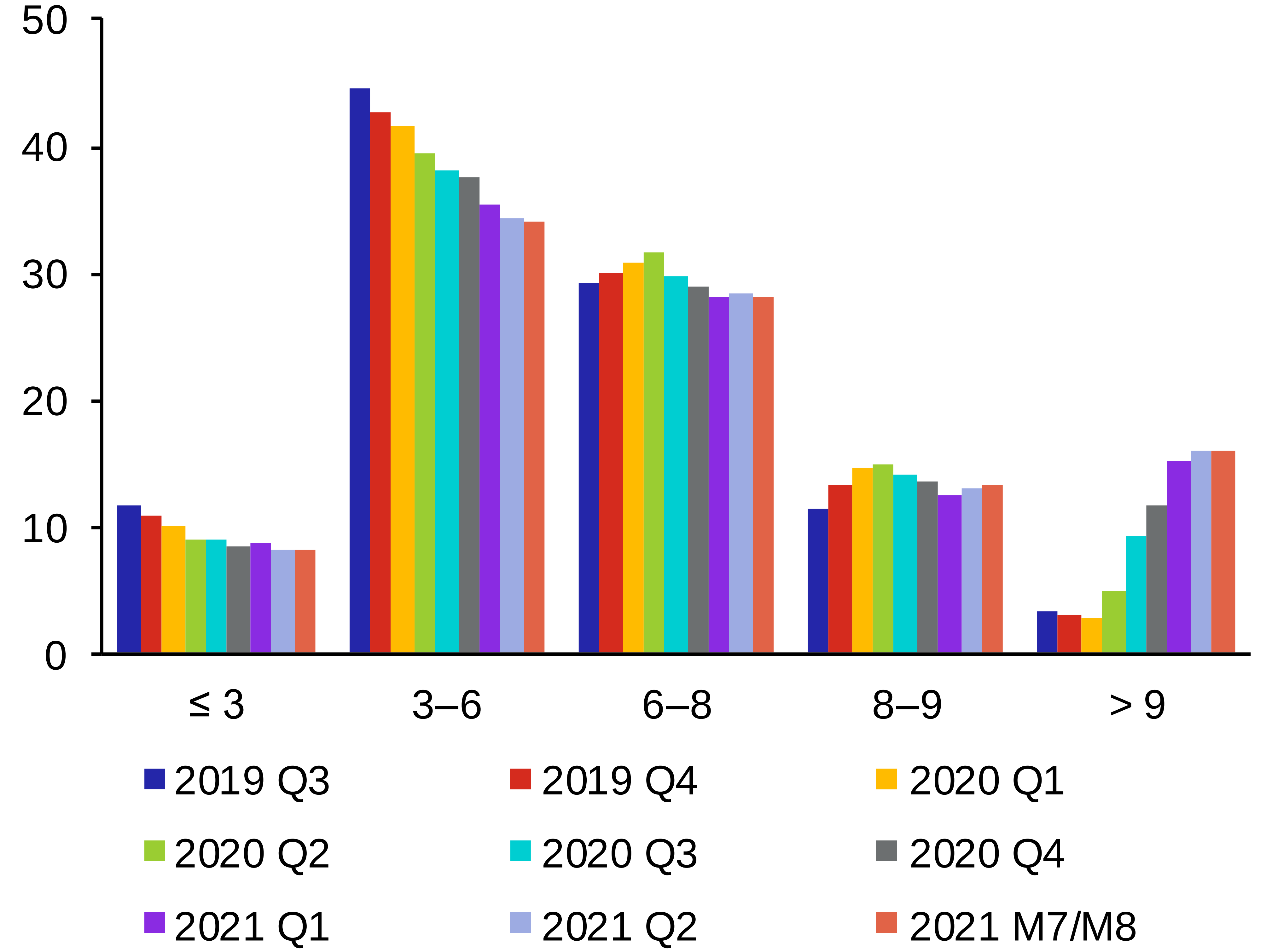


DTI ratio

Loans with DTI above previously recommended limit
(share of loans in reference volume in %)

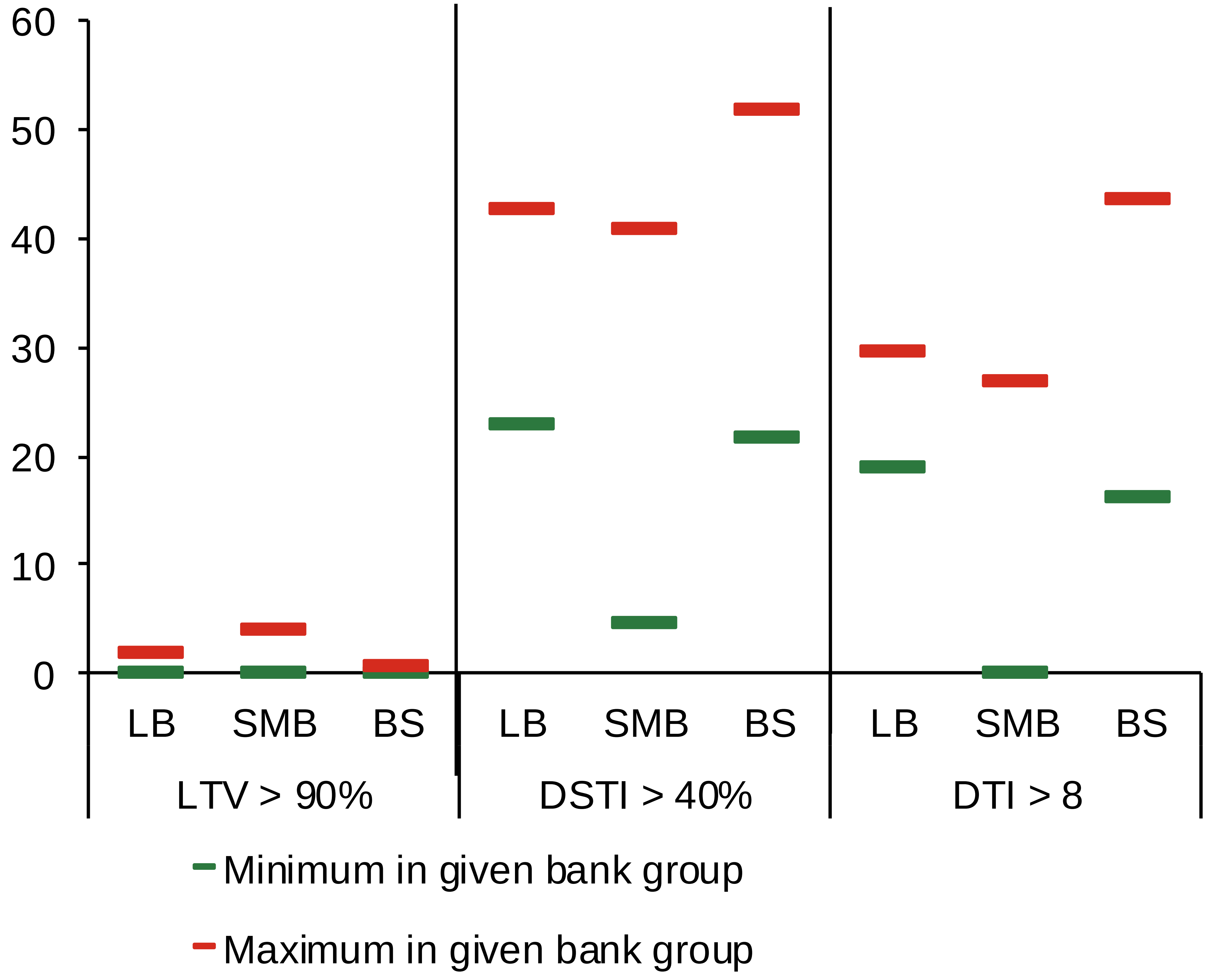


DTI distribution of new loans
(share of loans in volume provided in %; x-axis: DTI in years)



Higher risk profile of mortgages provided by some lenders

Shares of loans exceeding risky LTV, DSTI and DTI levels by bank group
(% of portfolio of loans for house purchase of given institution; 202(



- Credit standards differ across lenders; some lenders have eased them substantially.
- Data confirm the risk that previously cautious lenders are reacting to a potential loss of their market share by easing standards towards the levels applied by their more aggressive competitors.
- The CNB is responding to the fact that the share of new loans with highly risky DTI and DSTI ratios has increased markedly for some lenders using microprudential supervision instruments, such as an additional Pillar 2 capital requirement for risk management systems.

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New edition of Recommendation for mortgage lending

- The new version of the ***Recommendation on the management of risks associated with the provision of consumer credit secured by residential property*** will still contain a set of quantitative and qualitative parameters for prudent mortgage lending:
  - the LTV ratio should not exceed 100% for any loan,
  - the term of a loan should not exceed the horizon of economic activity of the client or the lifetime of the property (as a rule, it should not exceed 30 years),
  - the term of unsecured consumer credit should not exceed 8 years,
  - when refinancing a mortgage loan whose credit ratio levels they are not required to assess, lenders should not extend the final maturity of the loan beyond that agreed with the original provider,
  - lenders should stress test the applicant’s ability to repay the loan in the event of an increase in interest rates and under worse economic conditions, and conversely should not provide loans with a non-standard repayment schedule leading to a shift of the applicant’s commitments to a later period.

Thank you for your attention

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The following will be published on the CNB website on **10 December 2021**:

- *Risks to financial stability and their indicators – December 2021*
- The minutes of the Bank Board meeting on financial stability issues
- *Recommendation on the management of risks associated with the provision of consumer credit secured by residential property*

The following will be published on the CNB website on **26 November 2021**:

- *Provision of a general nature on setting upper limits on credit ratios I/2021*
- *Provision of a general nature on setting the CCyB rate IV/2021*