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# CNB press conference on the outcome of the spring meeting on financial stability issues

## Financial Stability Report – Spring 2023

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**Libor Holub**, Executive Director, CNB Financial  
Stability Department

1 June 2023



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# Contents

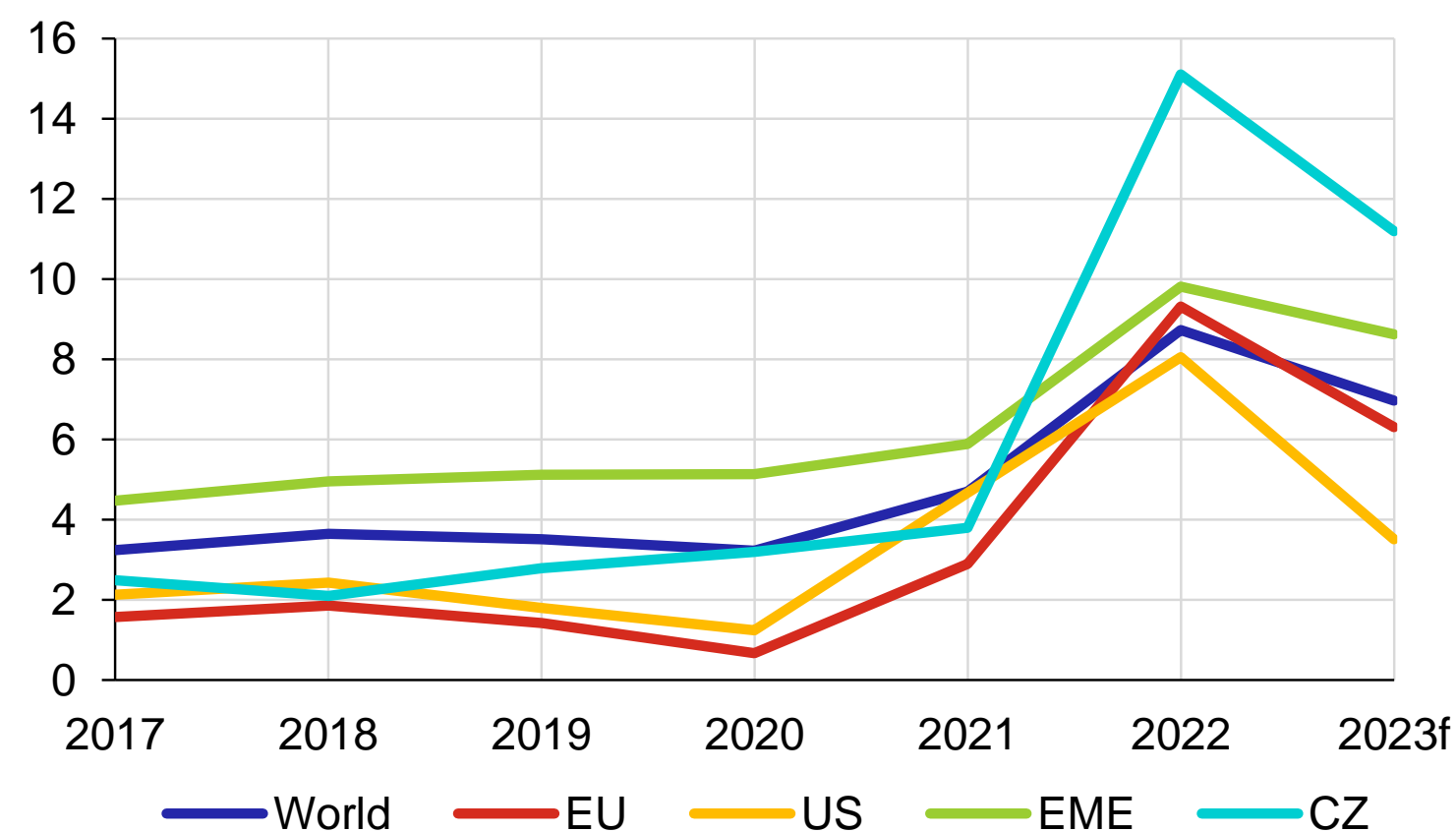
- 1. Aggregate assessment of risks and overview of CNB's main measures**
2. Assessment of selected risks



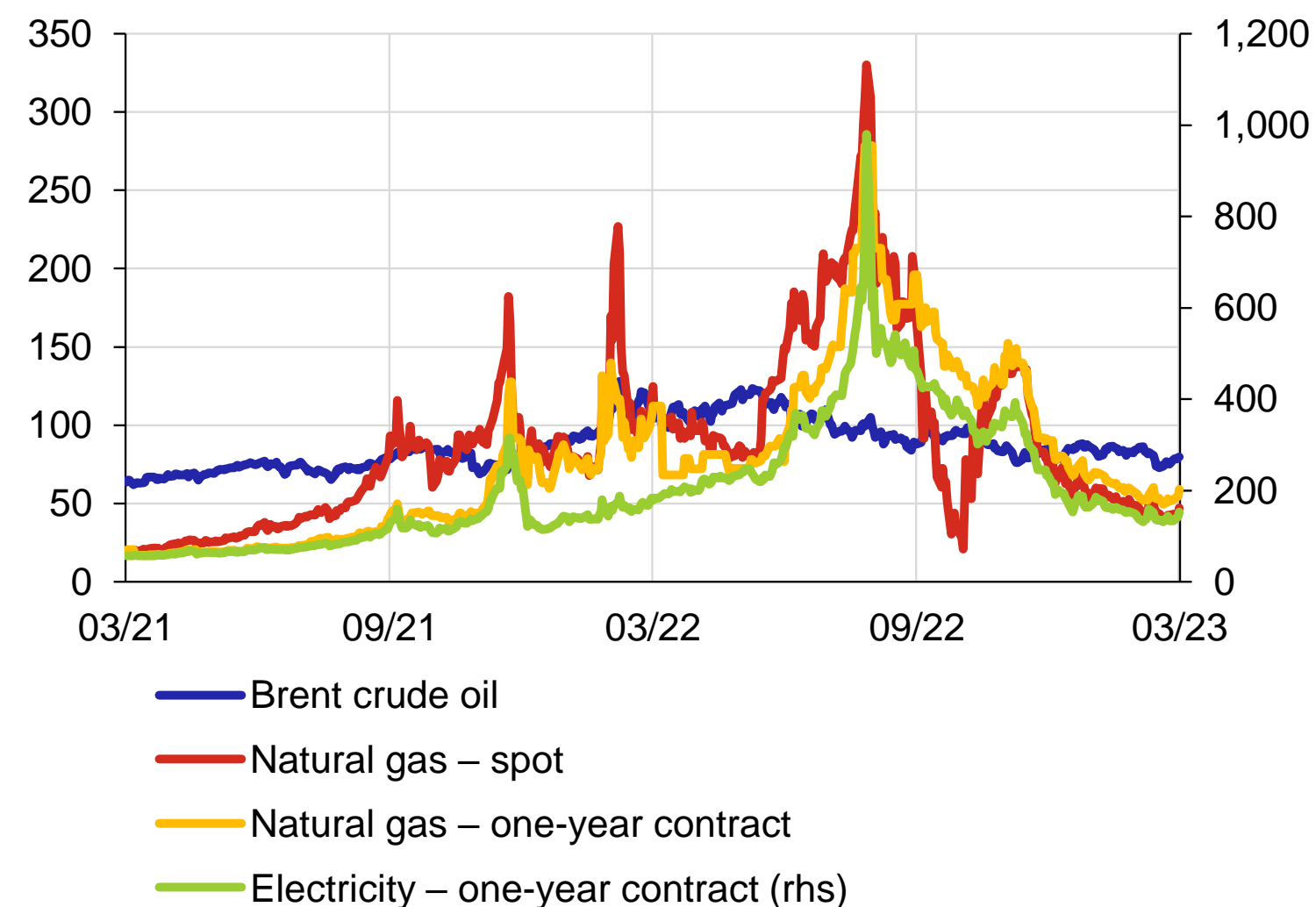
# Economic environment, aggregate risk assessment (1)

- Global economic growth has slowed in an environment of high inflation and rising interest rates:
  - The global supply-side inflation pressures, linked mainly with the rise in energy and food prices, are now weakening.
  - The European economy is recovering gradually, but geopolitical uncertainties are still weighing on it.
  - The asset price correction on financial markets is not deepening but cannot be completely ruled out going forward.

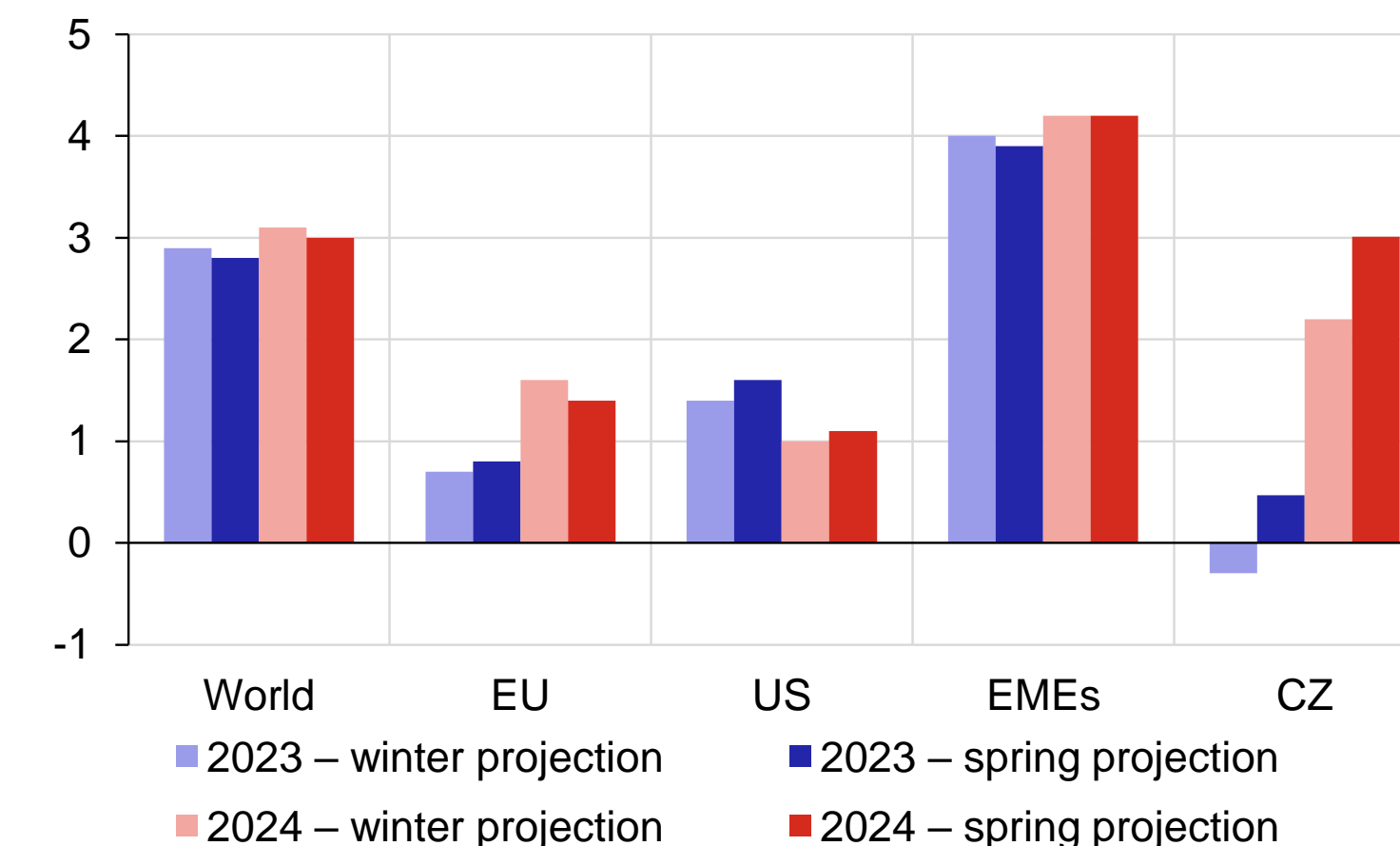
**Inflation in selected regions**  
(annual inflation rates in %)



**Selected commodity prices**  
(oil in USD/barrel; natural gas and electricity in EUR/MWh)



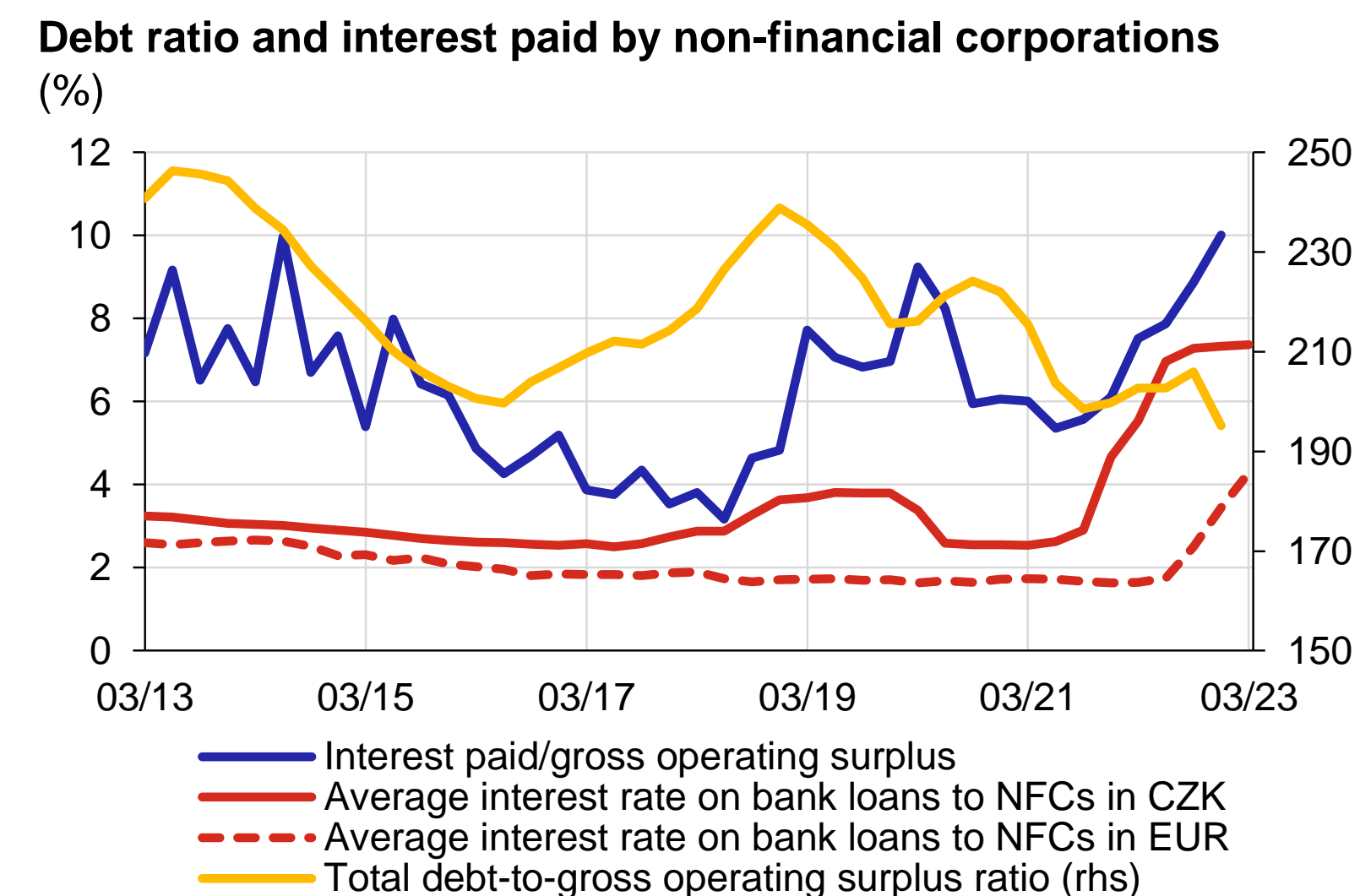
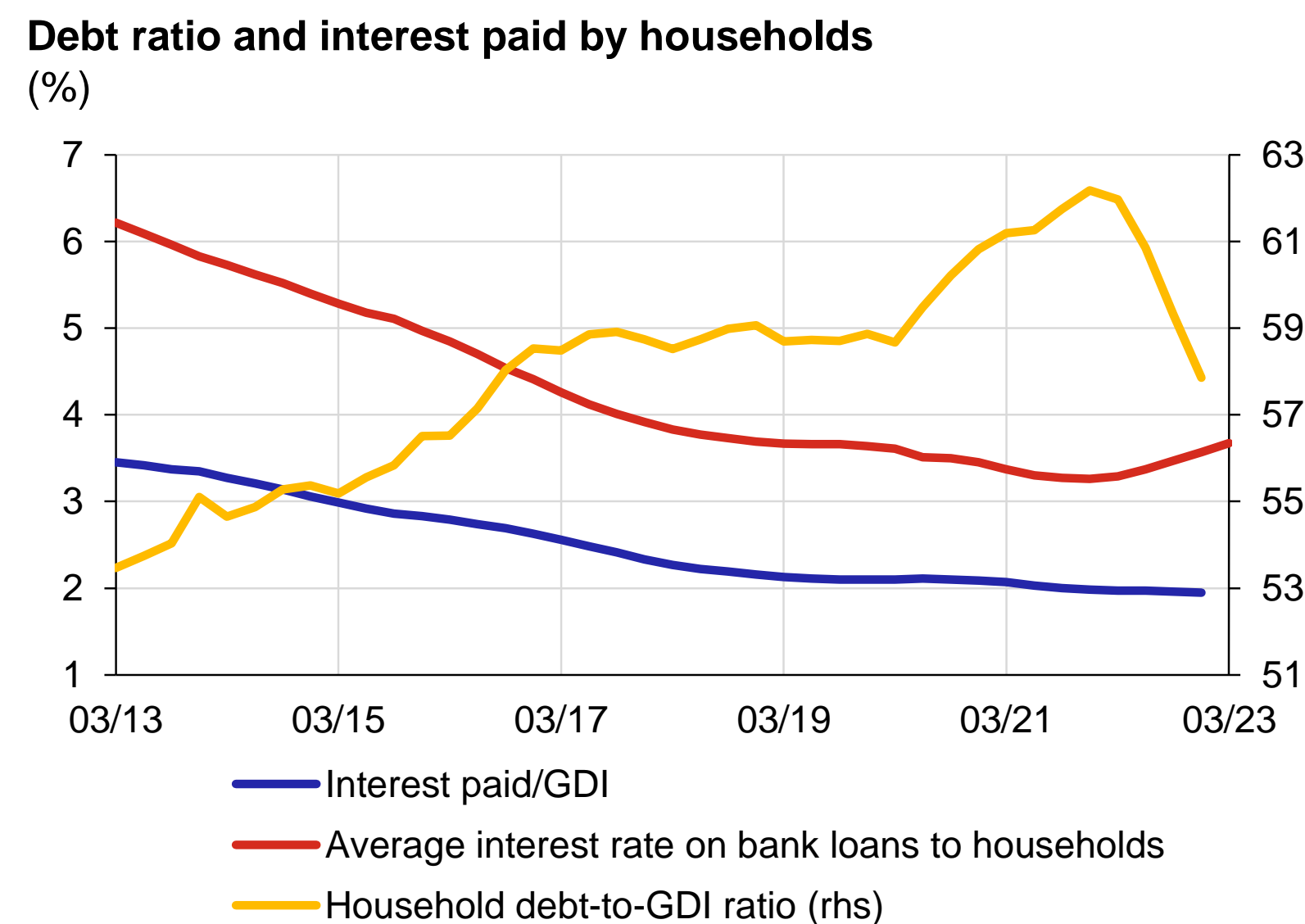
**Economic growth forecasts for selected regions**  
(annual real GDP growth in %)





# Economic environment, aggregate risk assessment (2)

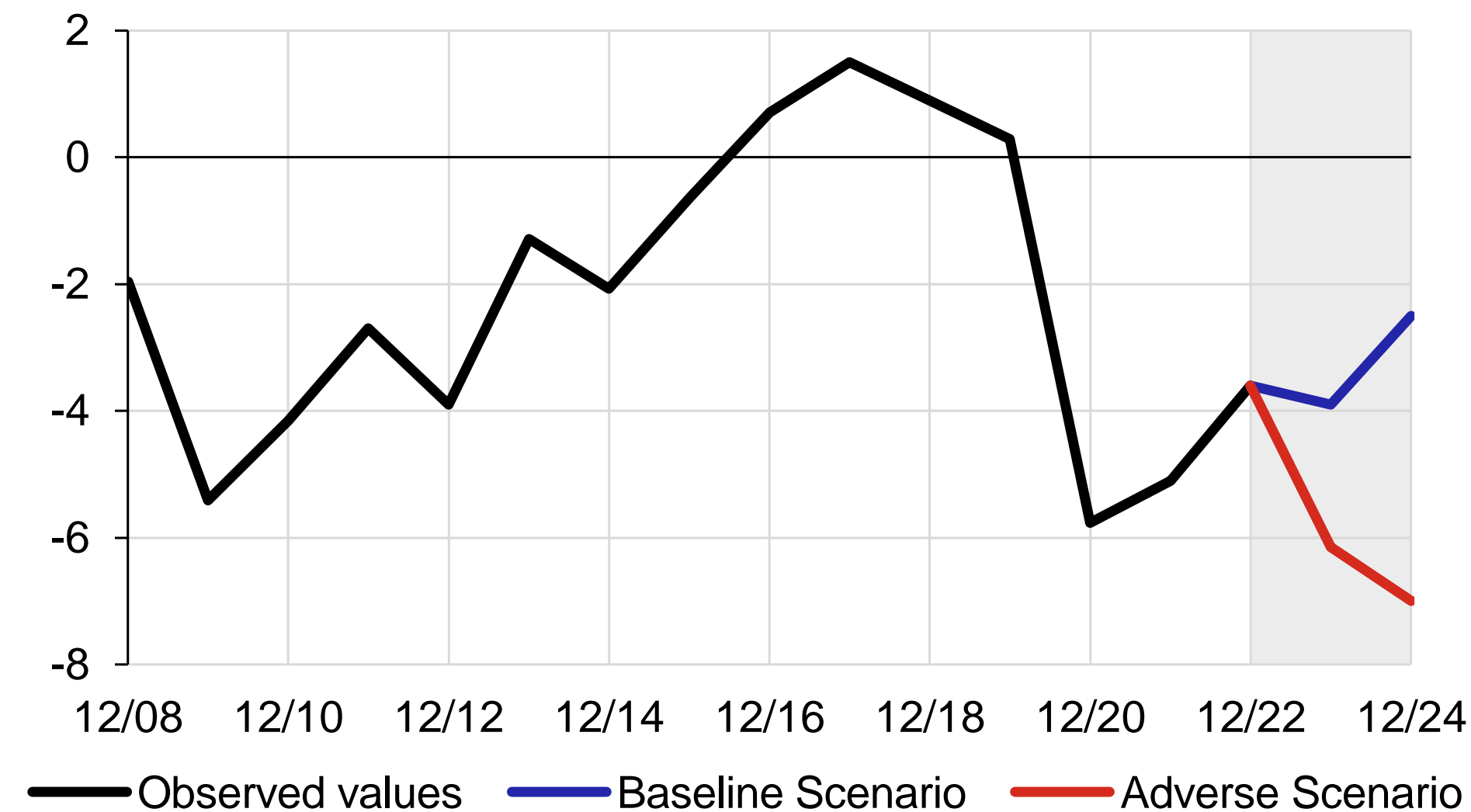
- Against a background of subdued economic growth, elevated inflation and tighter financial conditions, the Czech economy is facing risks to economic activity and to price and financial stability in the downward phase of the financial cycle:
  - The debt servicing costs of non-financial corporations and households have gradually been growing.
  - This, together with a rise in corporations' input prices and households' living costs, is putting pressure on the financial soundness of these sectors.
  - However, credit risk has not increased significantly so far and the risks are likely to lessen gradually amid subdued materialisation of credit losses.



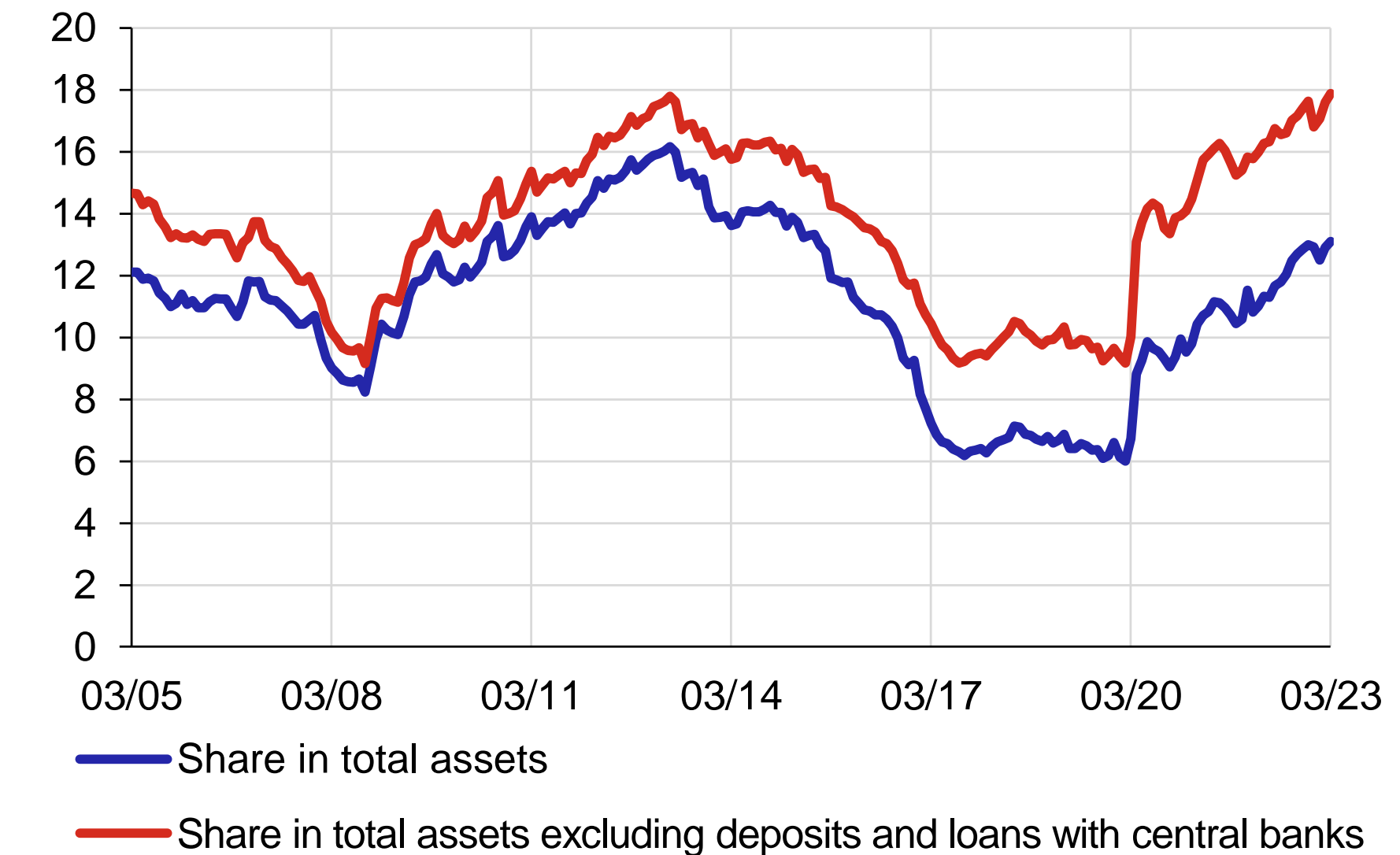
# Economic environment, aggregate risk assessment (3)

- Persisting general government deficits are increasing the sovereign exposures of domestic banks and the related risk of concentration in their balance sheets.

**General government balance**  
(% of GDP)



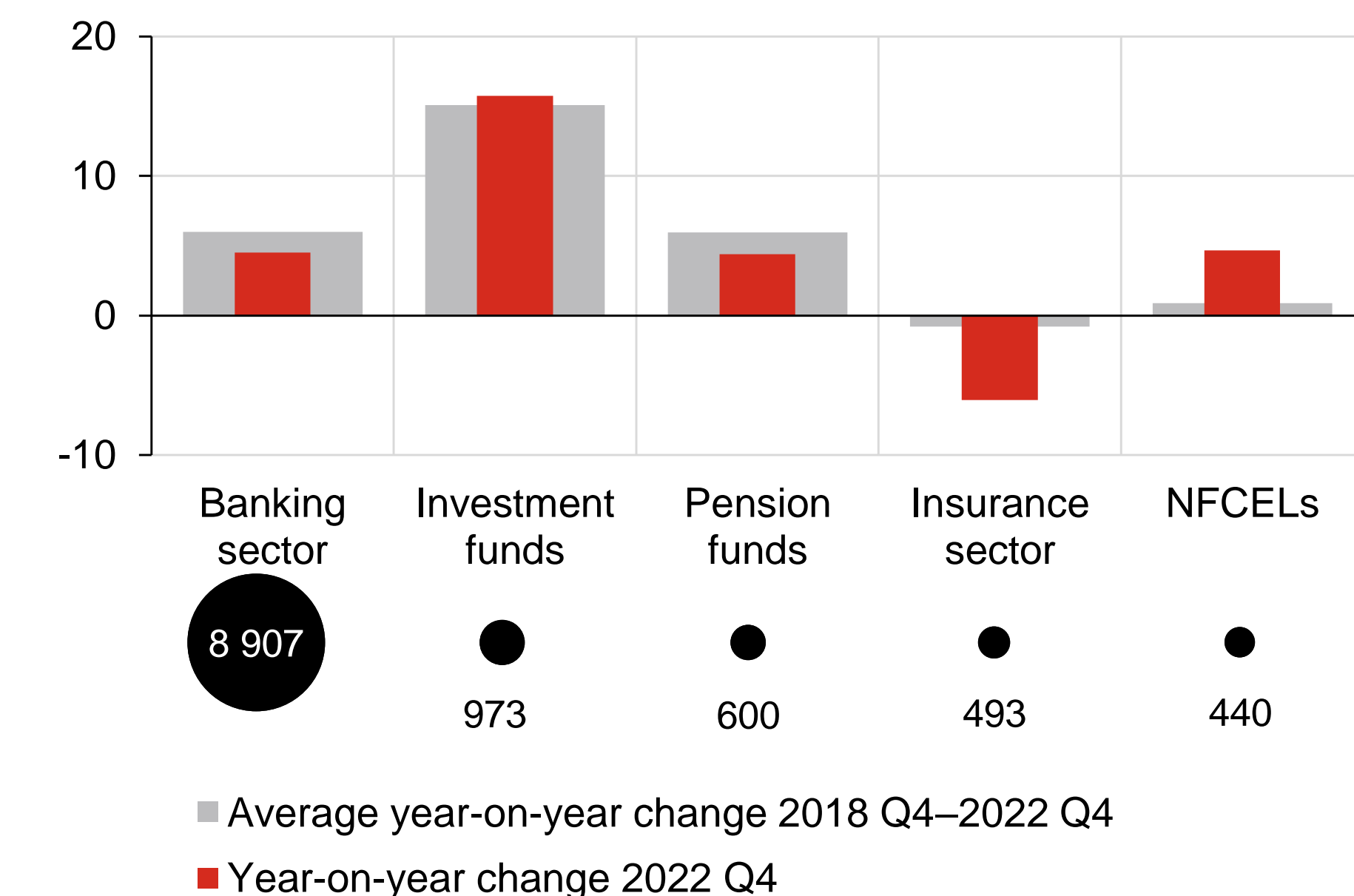
**Share of general government debt securities**  
(%)



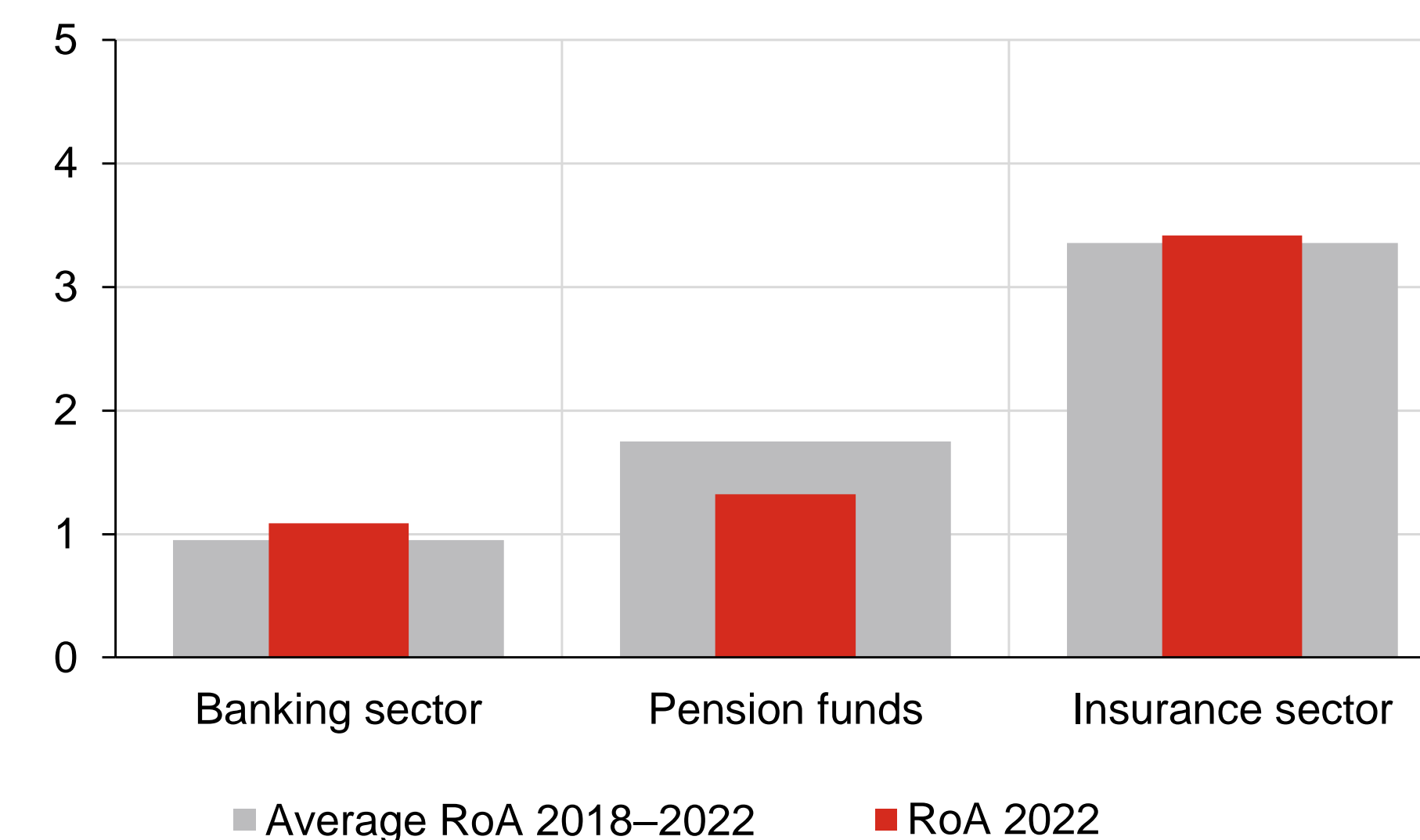
# Financial stability in May 2023 (1)

- The Czech financial sector showed favourable trends in 2022.
- Most of its segments recorded growth in total assets and profitability.
  - Their resilience to shocks is based on a strong capital and liquidity position.
  - In particular, the investment fund segment continues to expand rapidly.

Rates of growth of segments of the financial sector (%)



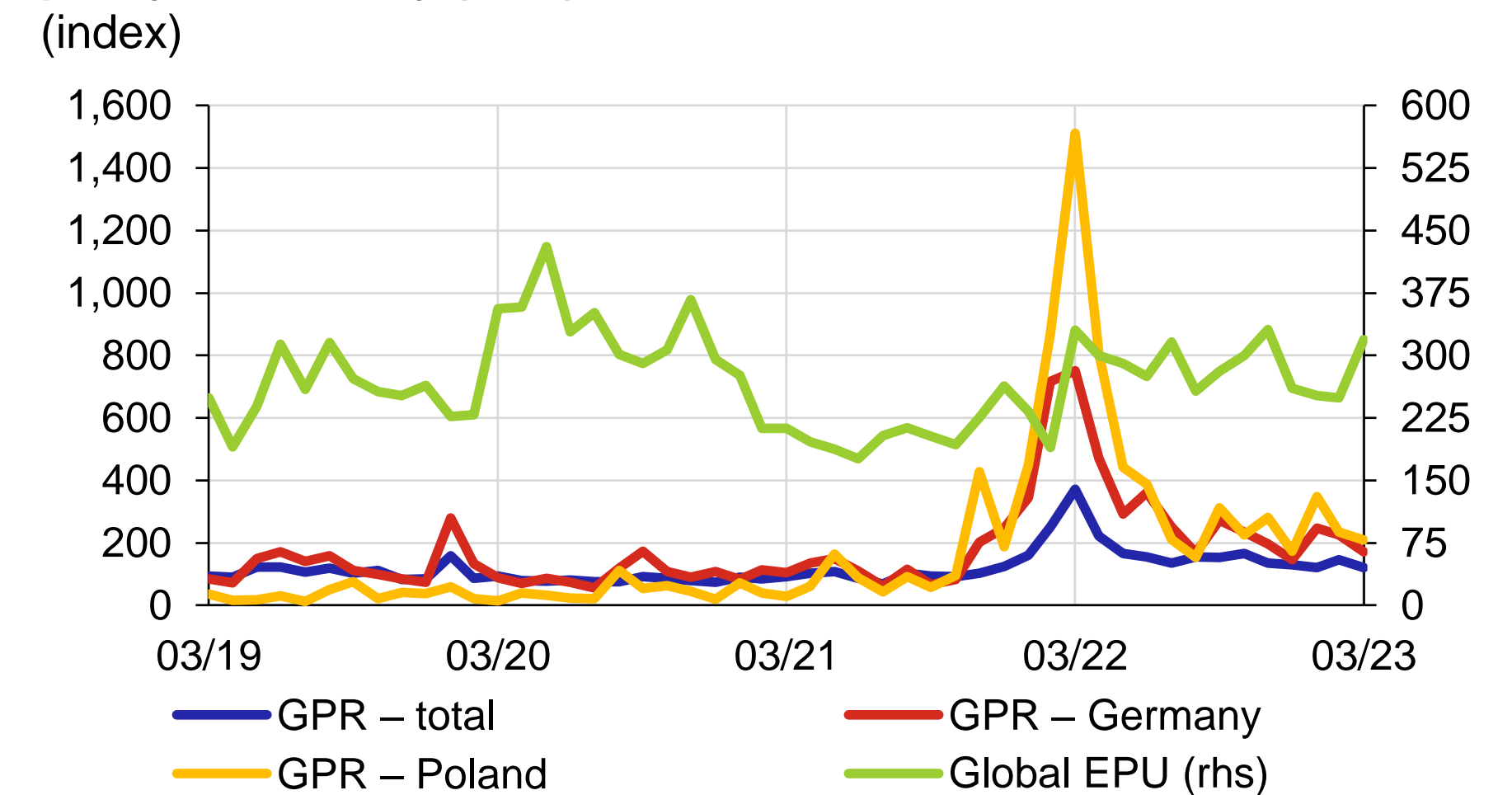
Profitability of individual segments of the financial sector (%)



# Financial stability in May 2023 (2)

- The banking sector recorded its biggest-ever profit, and credit portfolio quality stabilised in early 2023 following a period of deterioration.
- A gradual recovery in economic activity and subdued lending are reducing the risk of sudden and large credit losses in the banking sector:
  - Some stabilisation of geopolitical tensions is helping to reduce the potential of this threat...
  - ...as is the CNB's long-standing active policy in the area of capital buffers and credit ratio limits:
    - Capital buffers are strengthening banks' ability to cover credit losses.
    - The LTV, DSTI and DTI limits were reducing the accumulation of risks in banks' mortgage portfolios and enhancing households' ability to service their debt.

Indicators of perceived geopolitical risk (GPR) and economic policy uncertainty (EPU) (index)

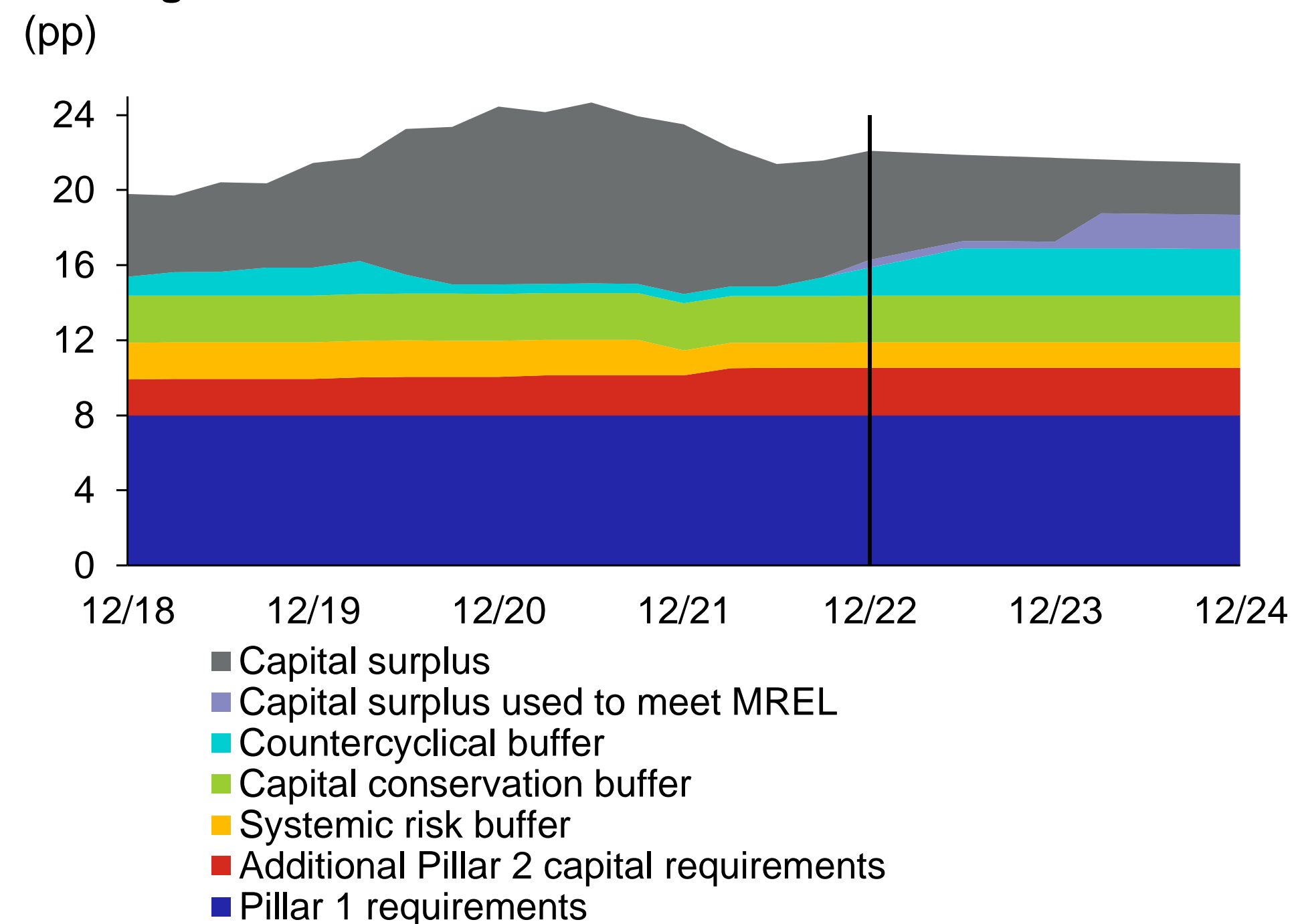


Source: Websites – Matteo Iacoviello and Economic Policy Uncertainty

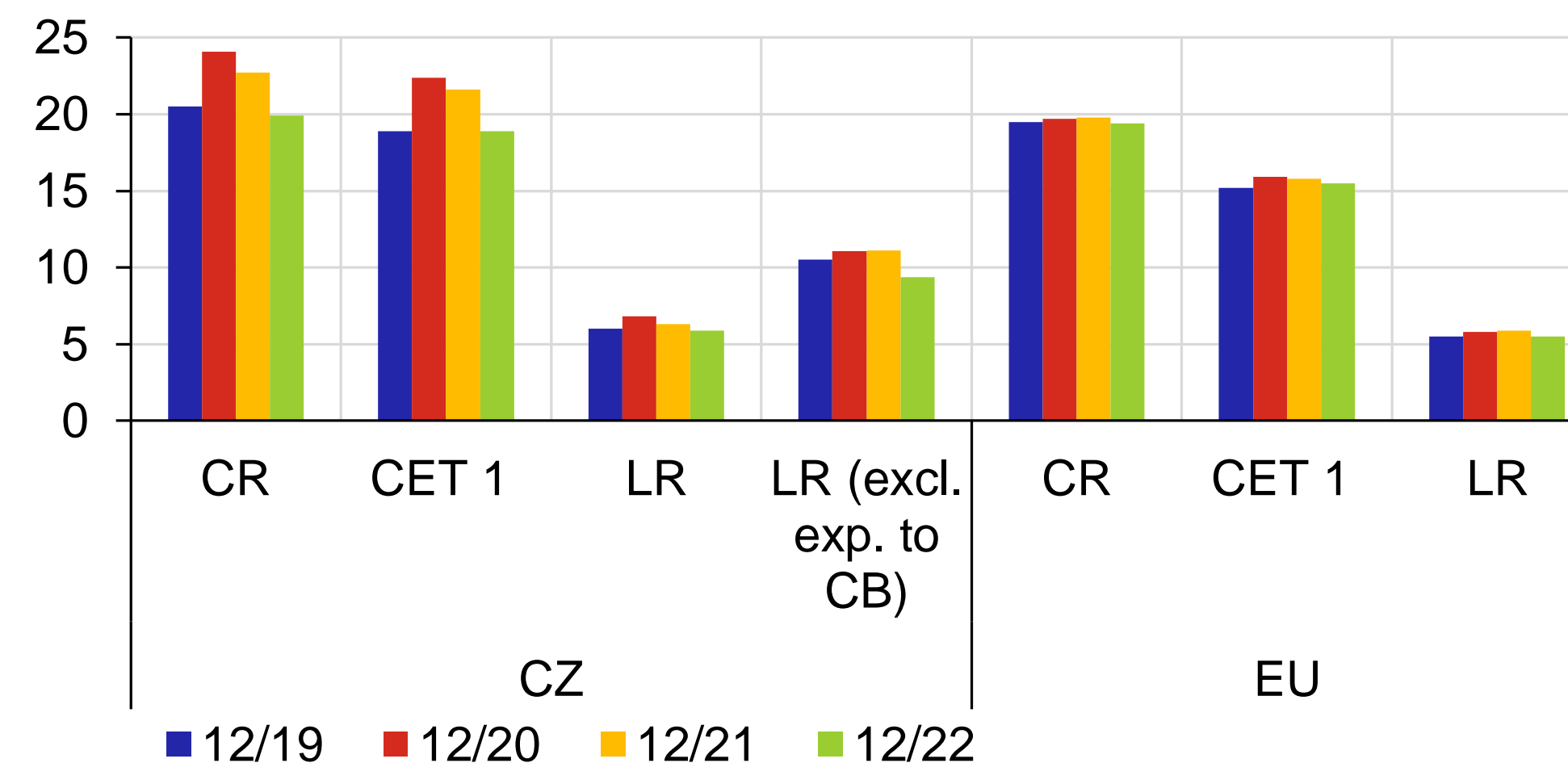
# Financial stability in May 2023 (3)

- The **crucial banking sector** is highly resilient to adverse shocks.
  - Capitalisation remains very robust thanks to capital buffers and capital surpluses in excess of the regulatory requirements.
  - A gradual build-up of resolution capacity (MREL) is also playing a stabilising role.

Structure of capital and capital requirements in the domestic banking sector



Capitalisation in the domestic and European banking sectors (% of RWE)

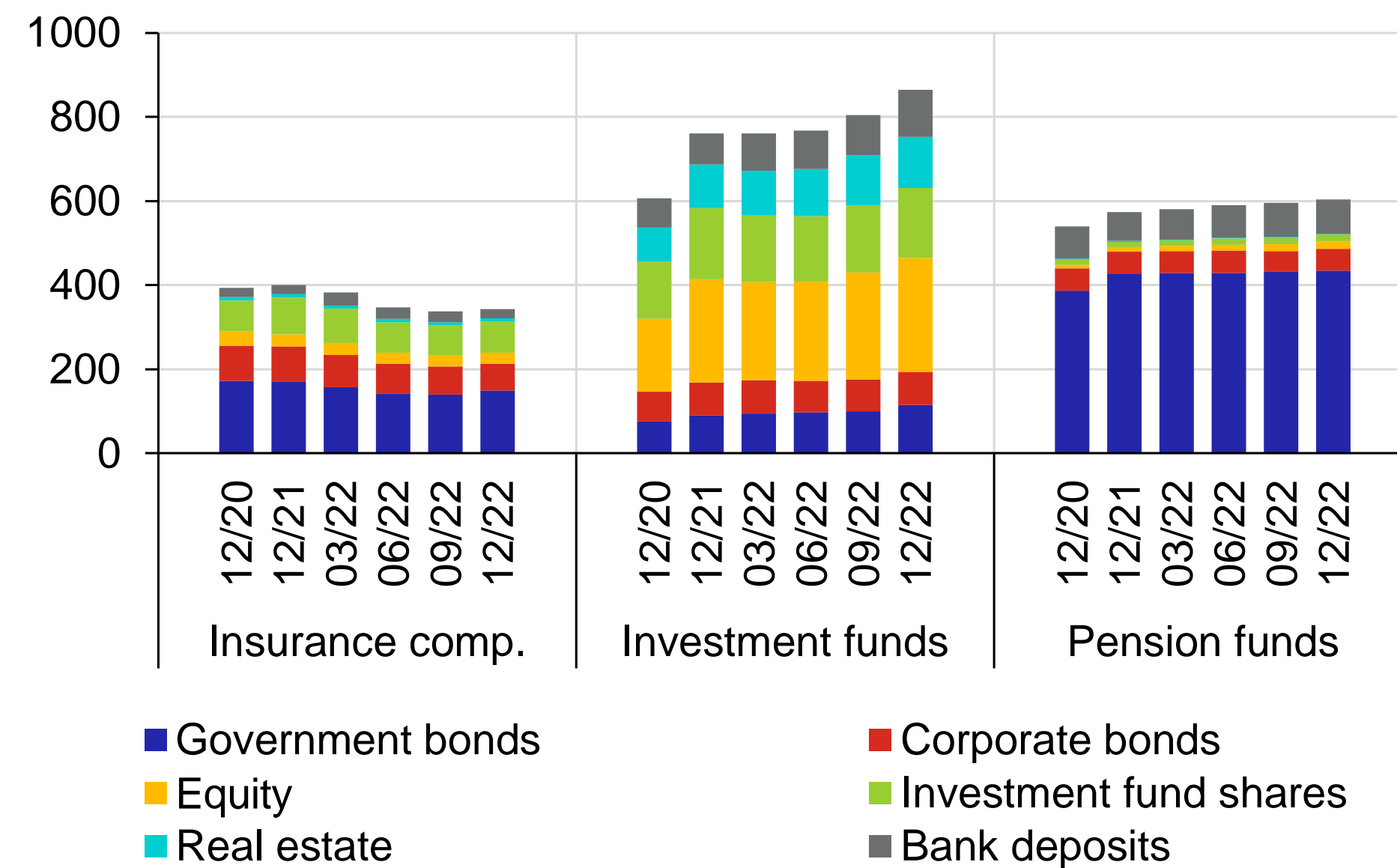




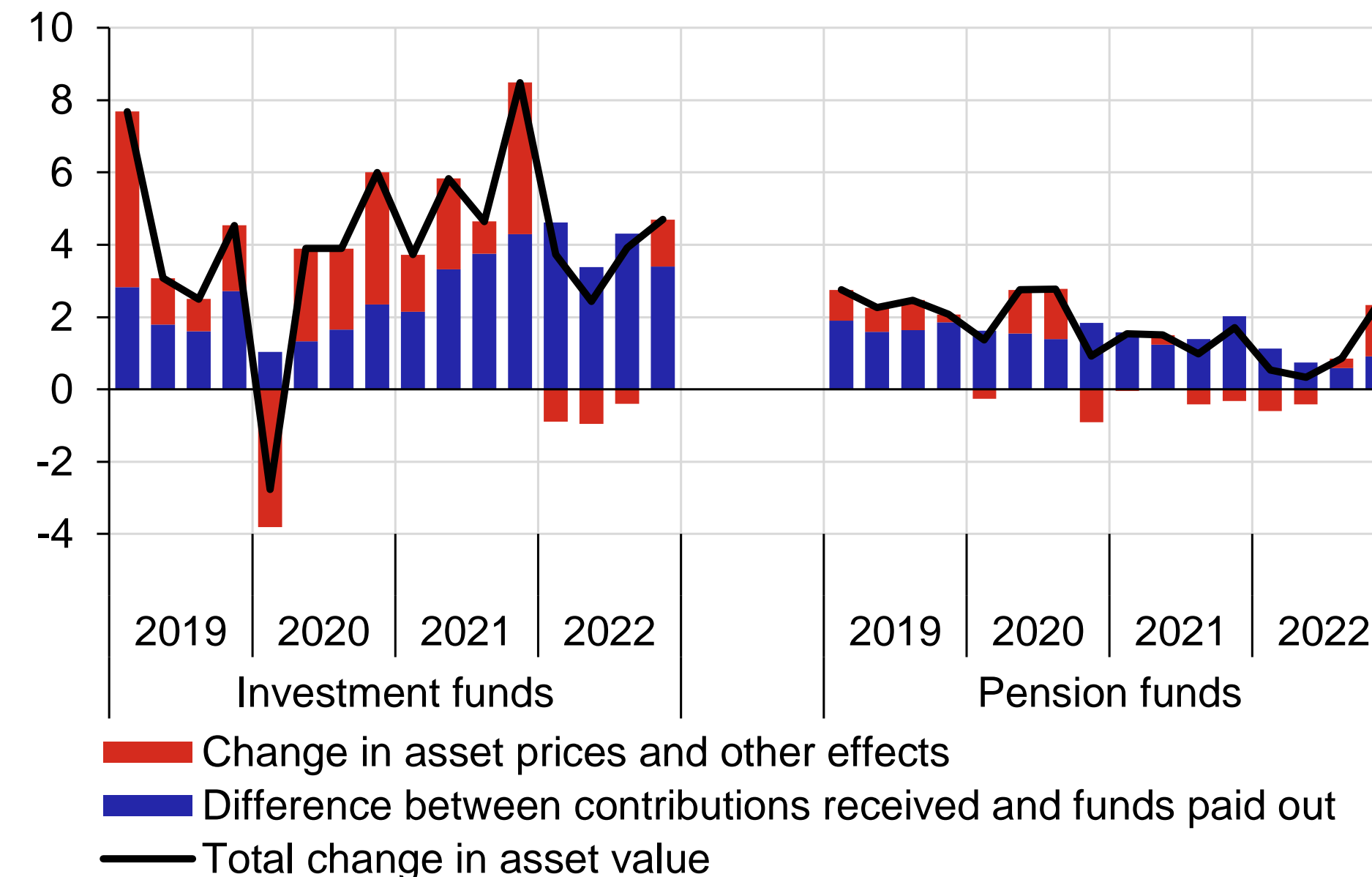
# Financial stability in May 2023 (4)

- The domestic **non-bank financial sector** is stable and resilient.
  - Uncertainty on global financial markets and a related risk of a sudden decline/increased volatility of financial asset prices persist.

**Main components of domestic institutional investors' investment assets**  
(CZK billions)



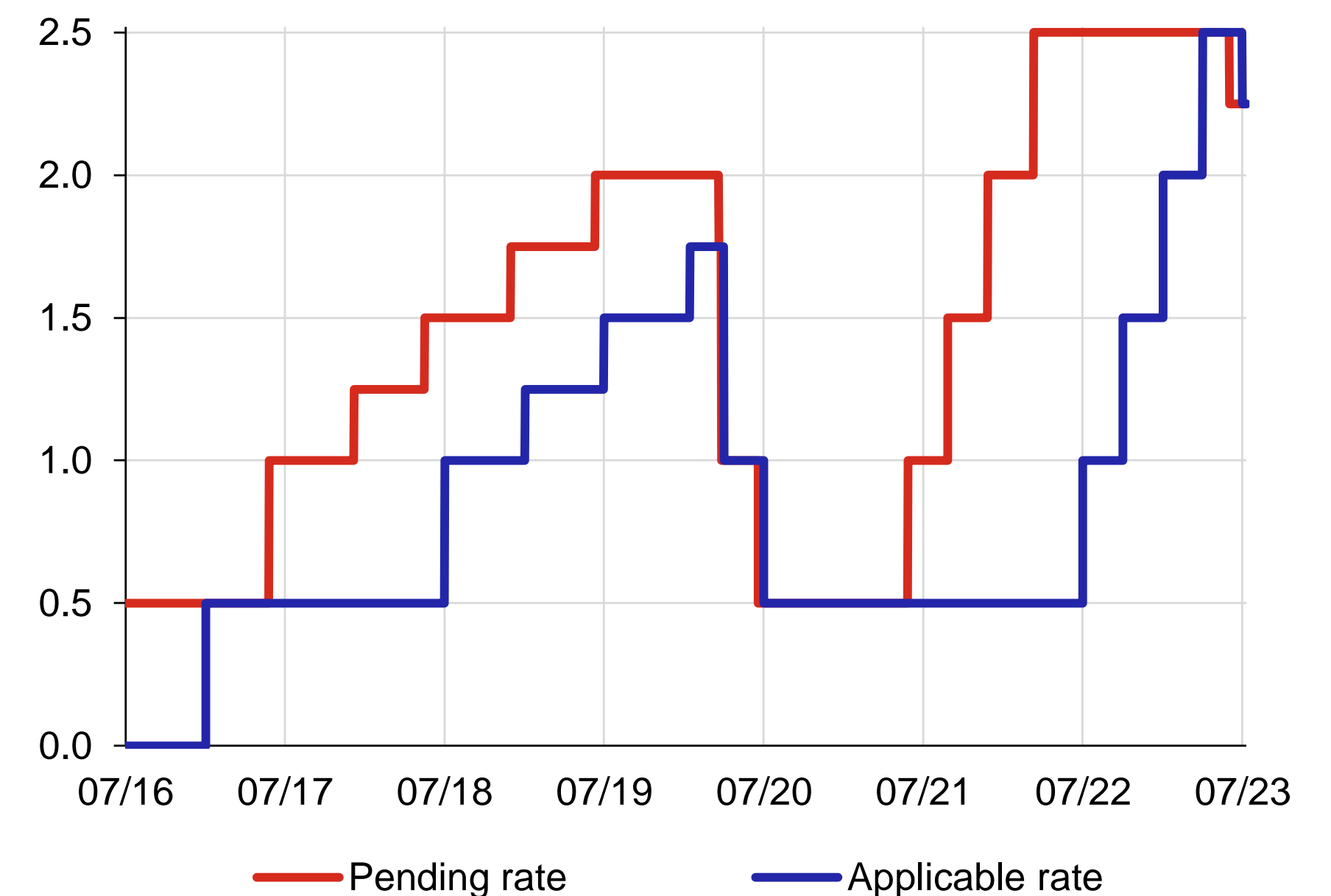
**Decomposition of the change in the value of investment and pension funds' assets**  
(% of assets as of end of previous quarter)



# Decision on countercyclical capital buffer rate (1)

- The **Bank Board decided today to lower the countercyclical capital buffer (CCyB) rate to 2.25% with effect from 1 July 2023.**
  - In the downward phase of the financial cycle, the CNB will gradually lower the buffer rate depending on how risks materialise and/or diminish.
  - Should the economic situation worsen and significant credit losses form in the domestic banking sector, the CNB is ready to release the buffer fully in order to cover the losses and ensure sufficient capital capacity for lending to the real economy.

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

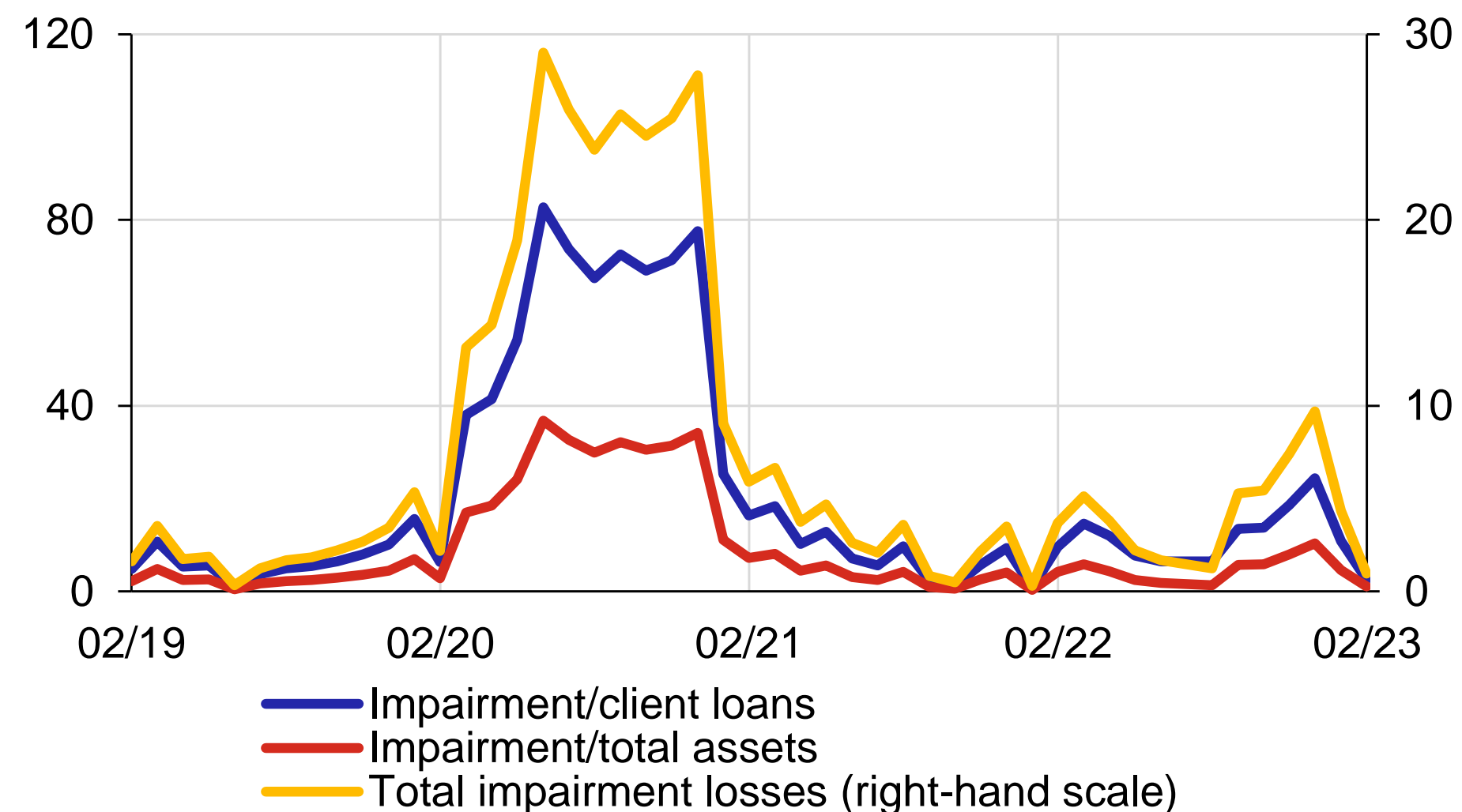


# Decision on countercyclical capital buffer rate (2)

- In our decision to lower the rate by 25 bp, we took into account:
  - decreasing but still high previously accepted cyclical risks in the banking sector's balance sheet
  - cyclically reduced risk weights for credit exposures
  - low intensity of newly accepted cyclical risks
  - decreasing risk of sudden and rapid materialisation of credit risks
  - stabilisation of economic and geopolitical uncertainties, albeit at higher levels

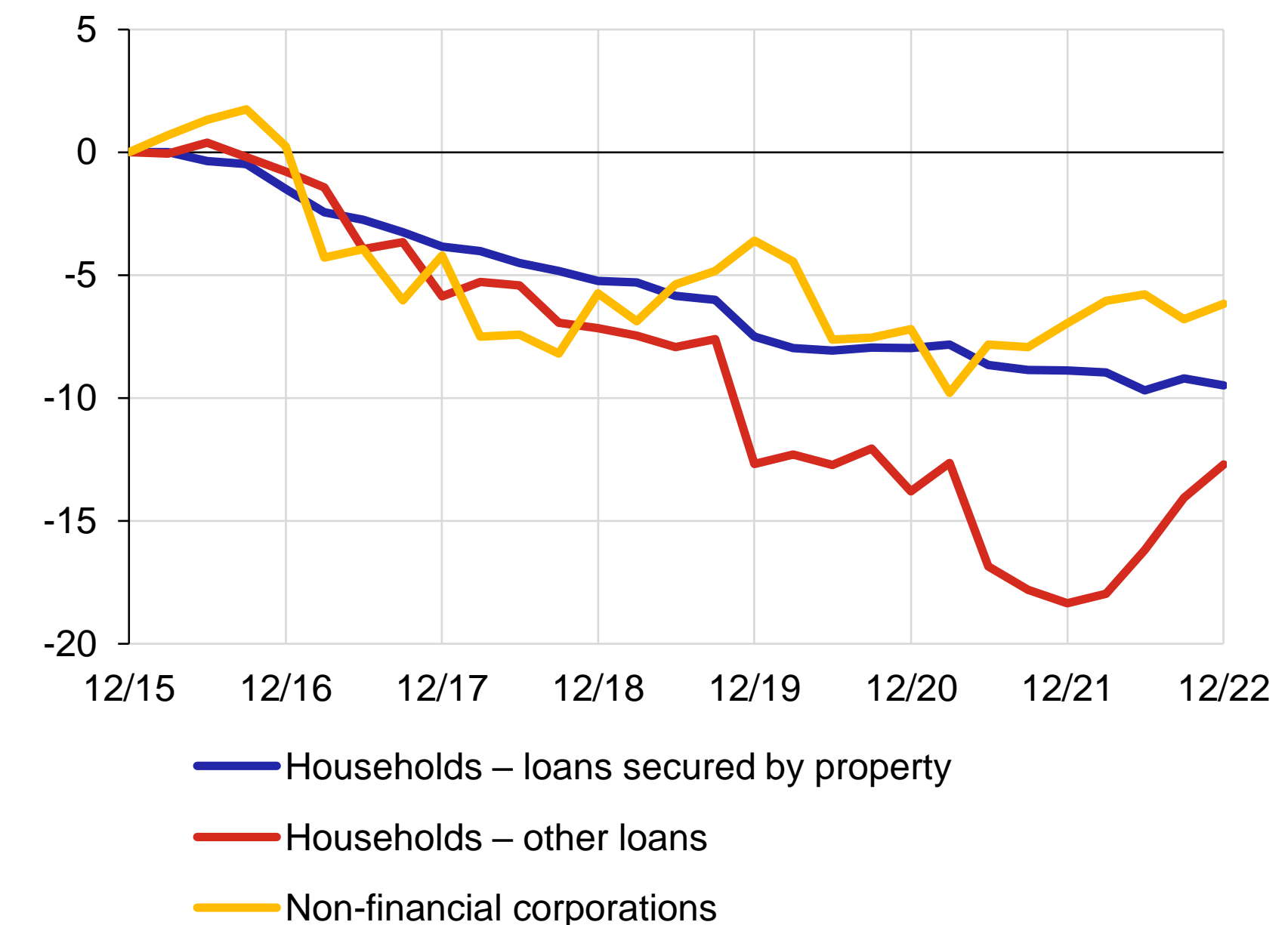
## Asset impairment losses

(bp; right-hand scale: CZK billions)



## Change in risk weights compared with the start of the strongly expansionary phase of the financial cycle

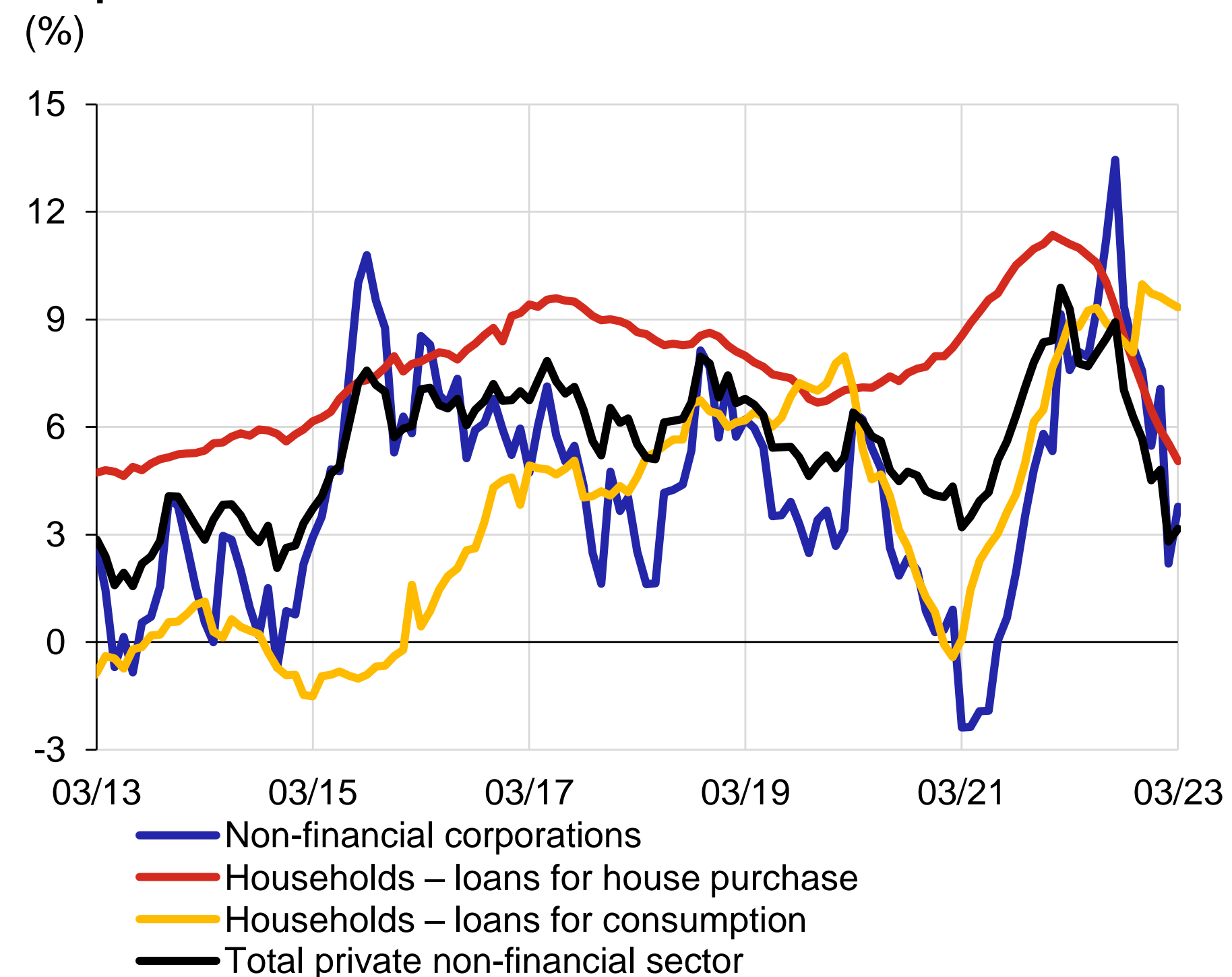
(pp)



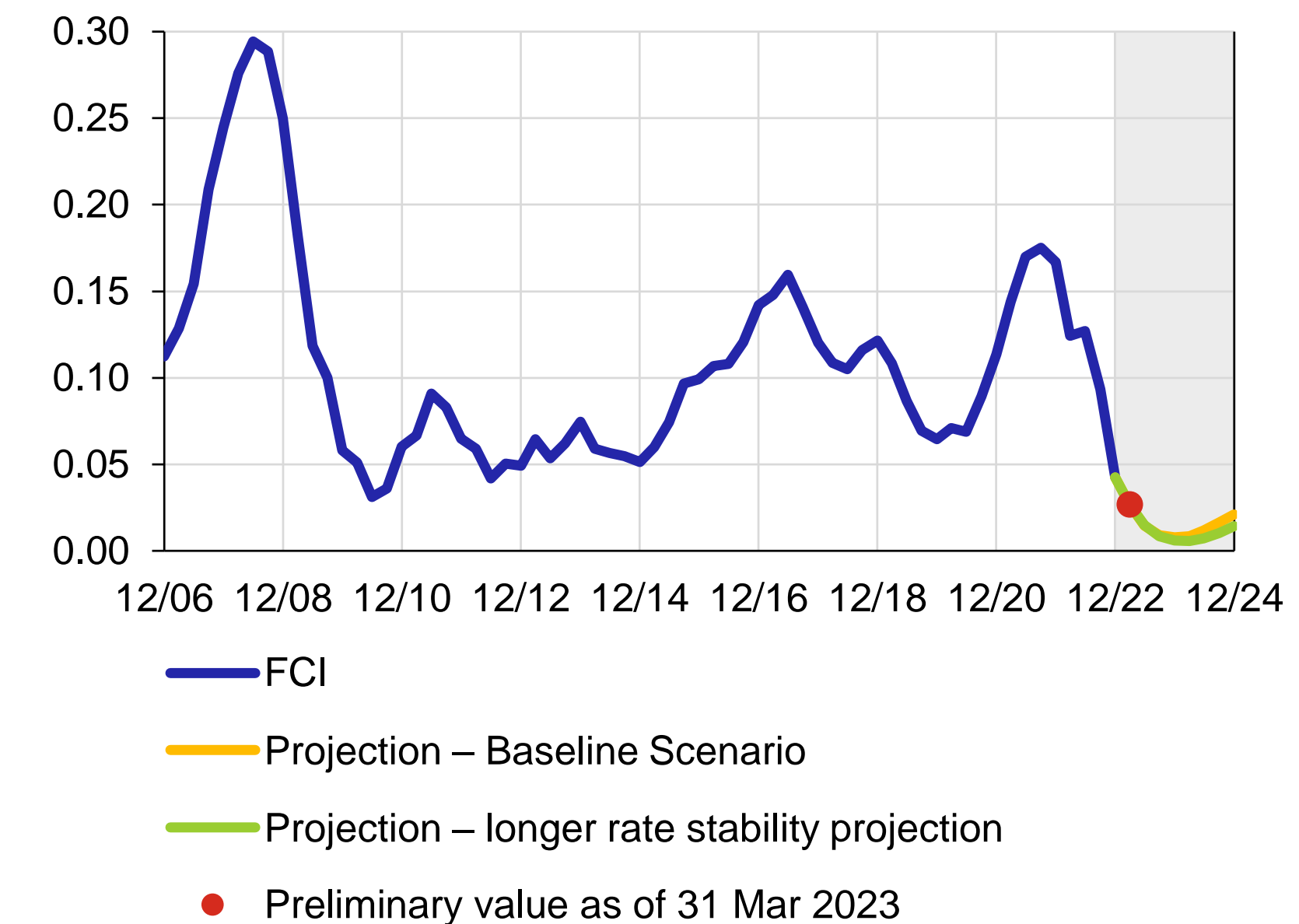
# Decision on countercyclical capital buffer rate (3)

- Year-on-year growth in loans was still low at the end of March 2023.
- The financial cycle is in a downward phase and near its trough over the forecast horizon.

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



Financial cycle indicator (0 minimum, 1 maximum)

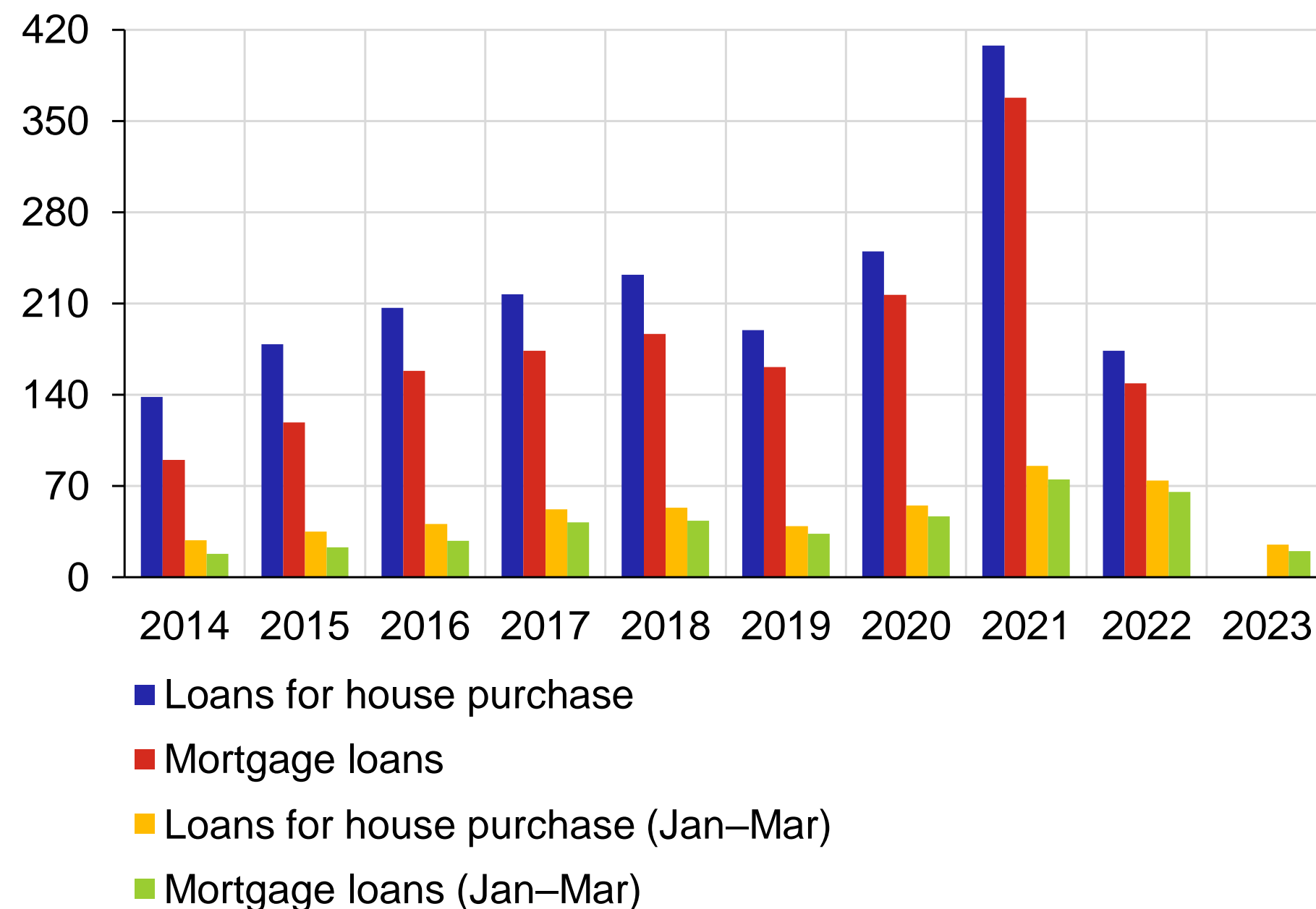




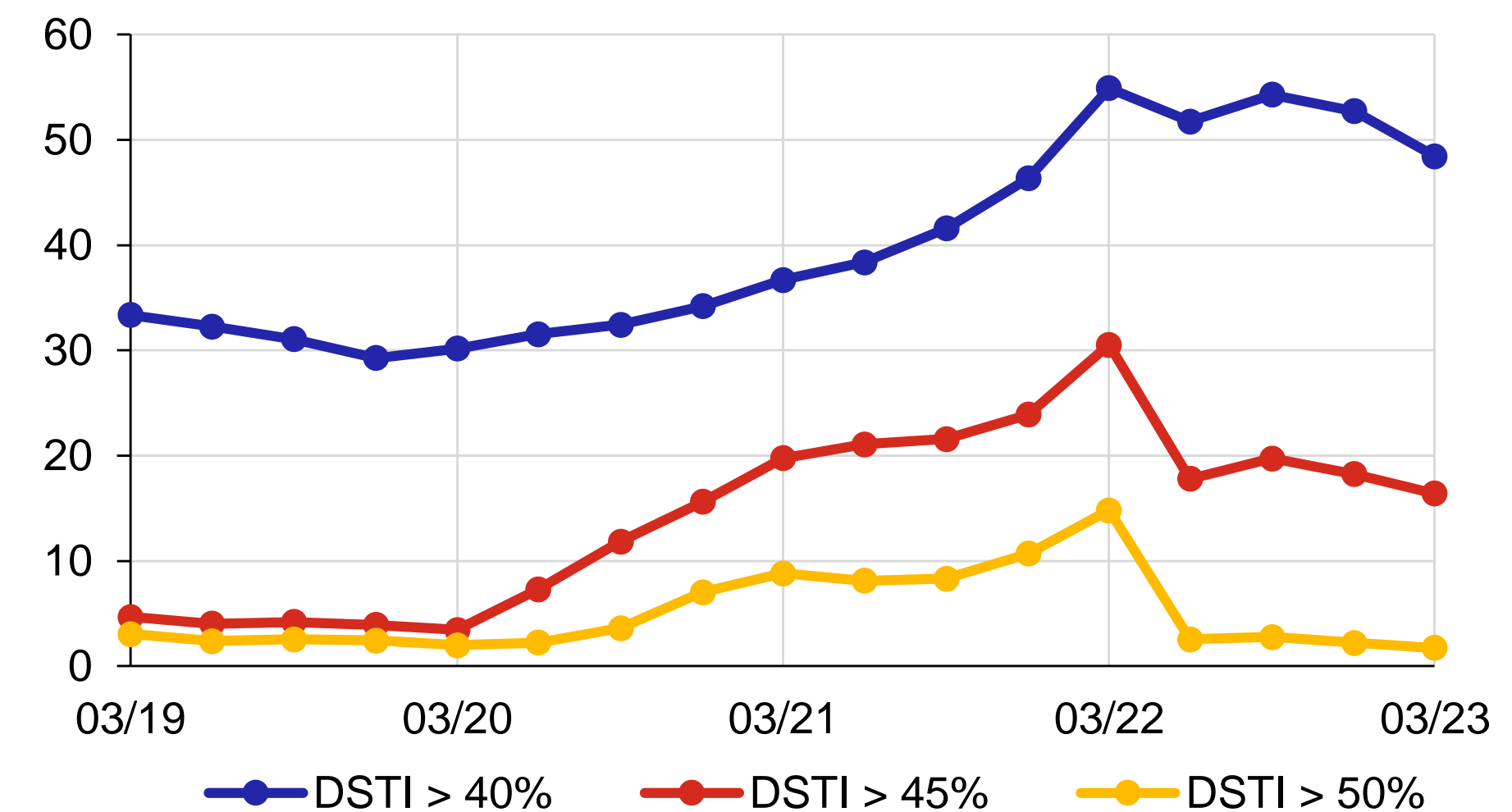
# Mortgage lending and property market (1)

- The volume of pure new mortgage loans dropped well below the long-term average in January–March 2023:
  - High interest rates and the applicable upper limits on credit ratios substantially dampened lending activity.
  - Banks were compliant with the LTV, DSTI and DTI limits effective since April 2022.
  - The share of mortgage loans with a DSTI of over 40% remains high, but their volume is not systemically important.

**Pure new bank loans for house purchase**  
(CZK billions)



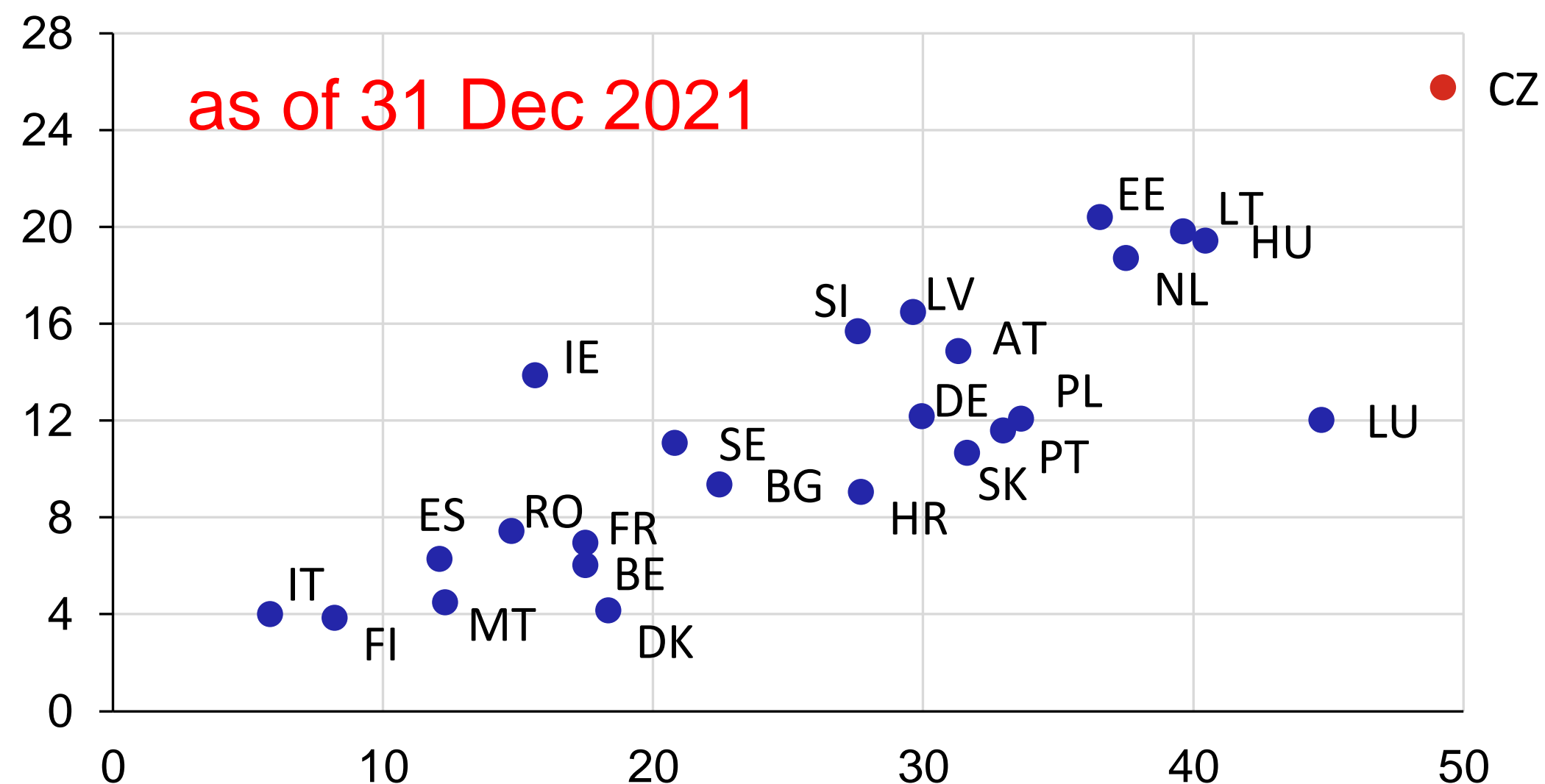
**Pure new consumer credit secured by residential property with DSTIs in selected bands**  
(share of loans in volume provided in given quarter in %)



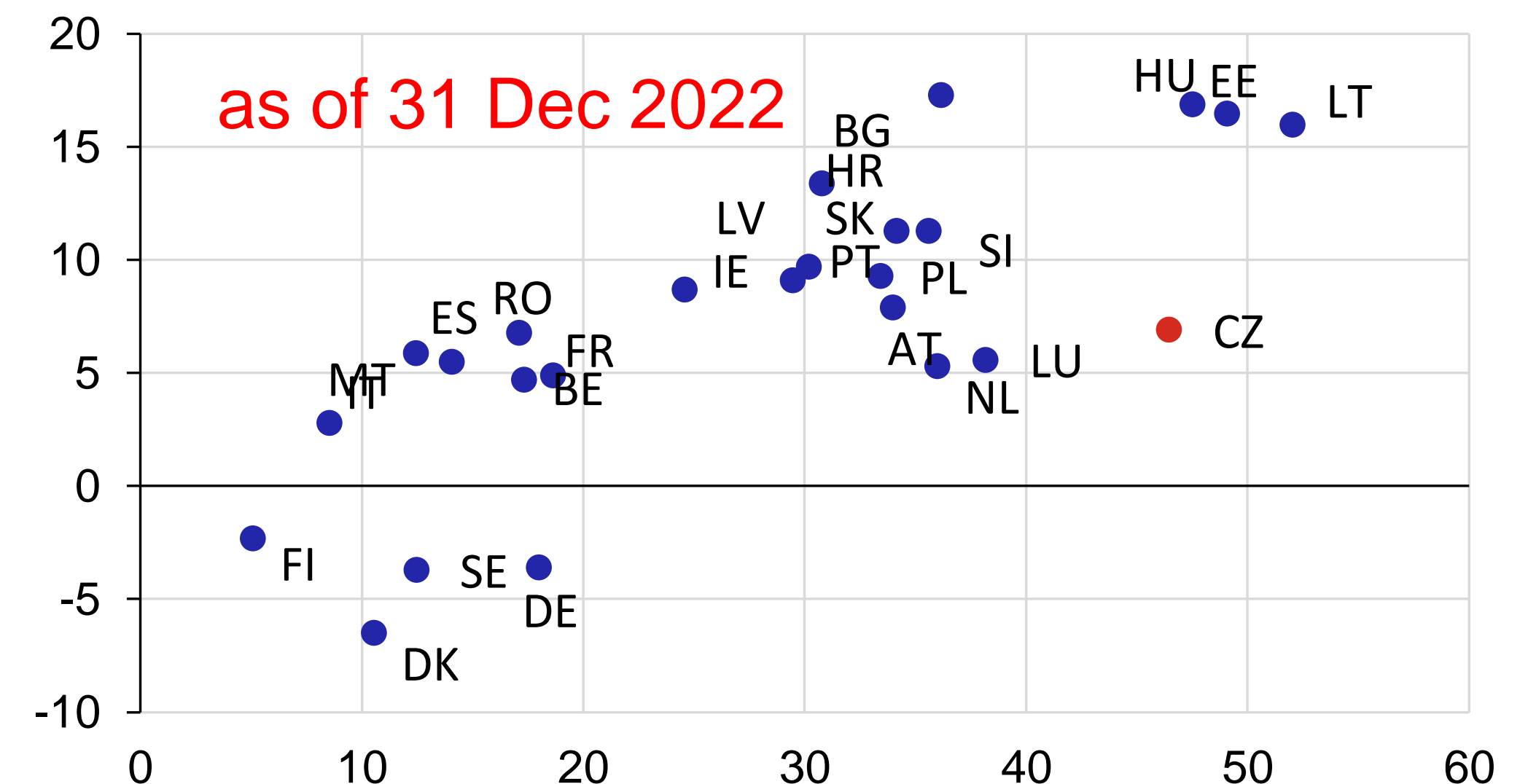
# Mortgage lending and property market (2)

- Following a period of growth in house prices, a correction is under way in the Czech Republic and European countries.
  - The almost 50% three-year growth rate in the Czech Republic was one of the highest, but the one-year rate slowed thanks to a cooling of the residential property market in 2022.

**Residential property price growth in selected EU countries**  
(%; x-axis: three-year growth; y-axis: one-year growth)



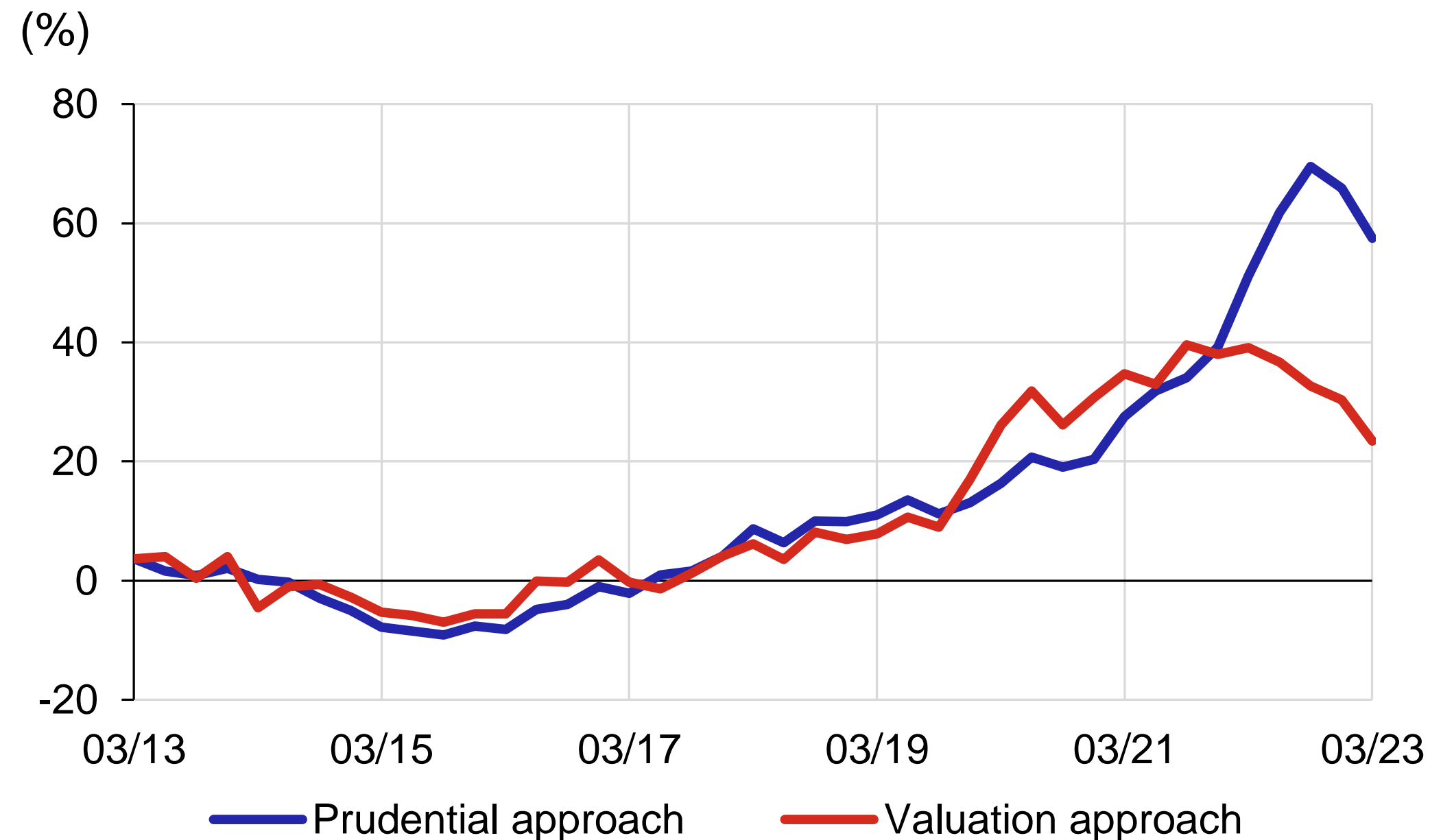
**Residential property price growth in selected EU countries**  
(%; x-axis: three-year growth; y-axis: one-year growth)



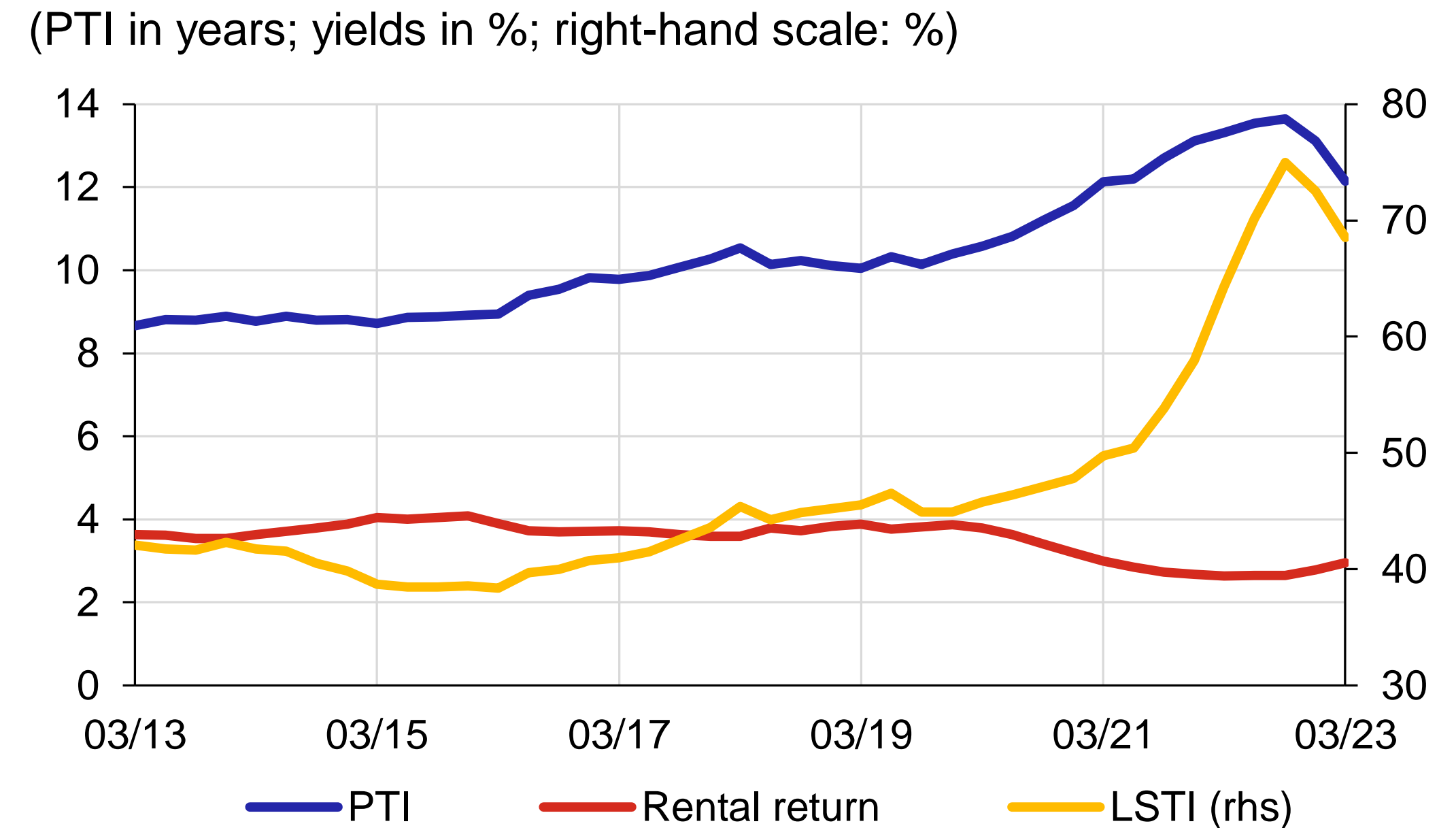
# Mortgage lending and property market (3)

- Overvaluation is beginning to decrease; the CNB estimates that apartments are overvalued by about 57% (3 pp less than in mid-2022) for median-income households and by 23% (17 pp less) for investors.

Estimated overvaluation of apartment prices



Selected apartment affordability indicators



# Limits on mortgage loan ratios (1)

- The Bank Board decided to **leave the upper limits on credit ratios** except for DSTI unchanged in view of the current level of interest rates.
- DSTI is deactivated with effect from 1 July 2023.

**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.*



# Limits on mortgage loan ratios (2)

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- Given the current and expected developments on the mortgage and property markets, the Bank Board **identified** persisting elevated **systemic risks in the area of residential property price overvaluation**:
  - The overvaluation of apartment prices has started to decrease but remains high.
  - In this price environment, less than 10% of households have income that allows them to safely debt-finance an average apartment at the given level of interest rates.
  - Therefore, the **LTV limit of 80%/90%** and the **DTI limit of 8.5/9.5 remain in effect**.
  
- The CNB will publish its next analysis of the residential property market and mortgage loans in December 2023 in **Financial Stability Report – Autumn 2023**.

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# Contents

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

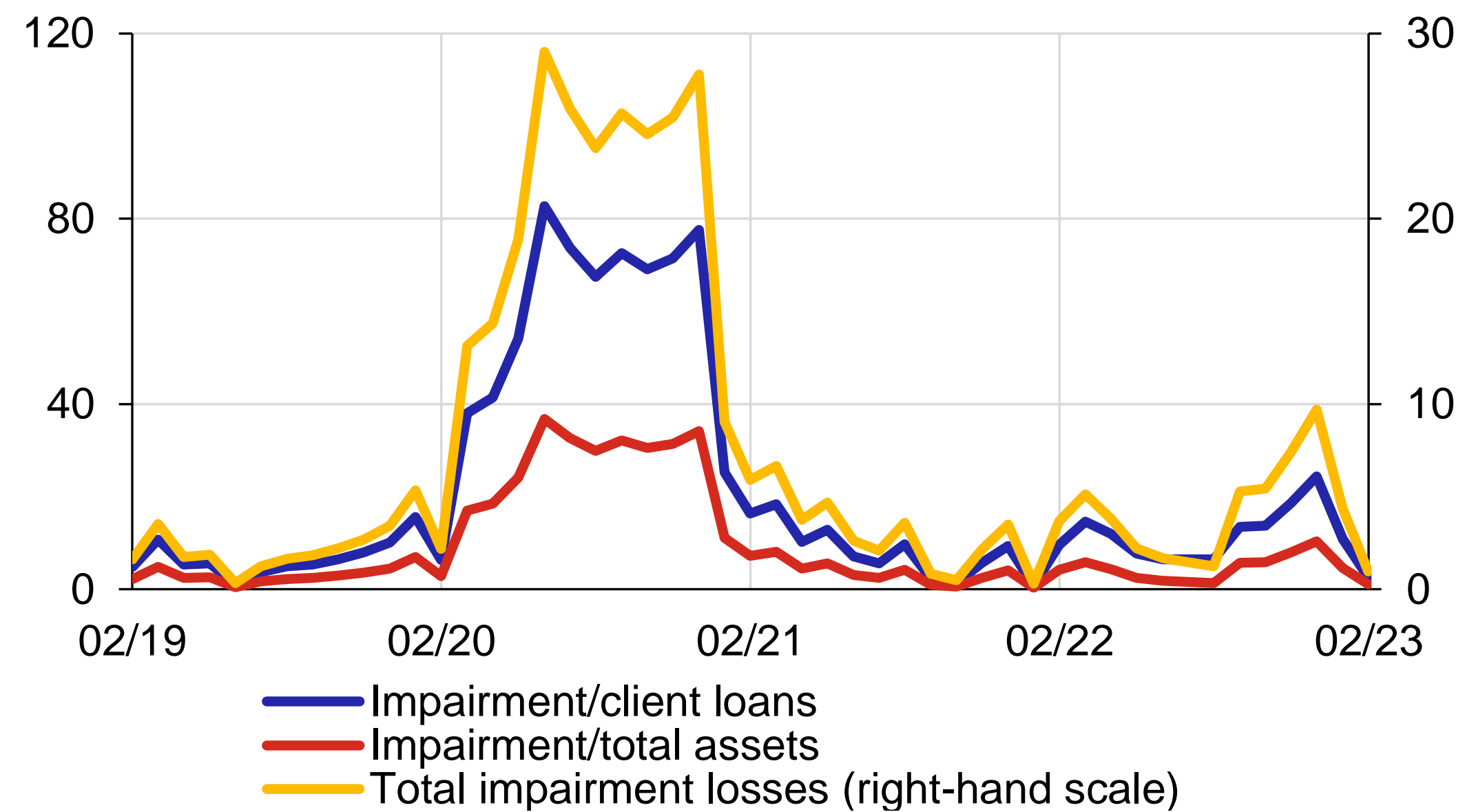
**2. Assessment of selected risks**



# Initial level of banks' credit risk (1)

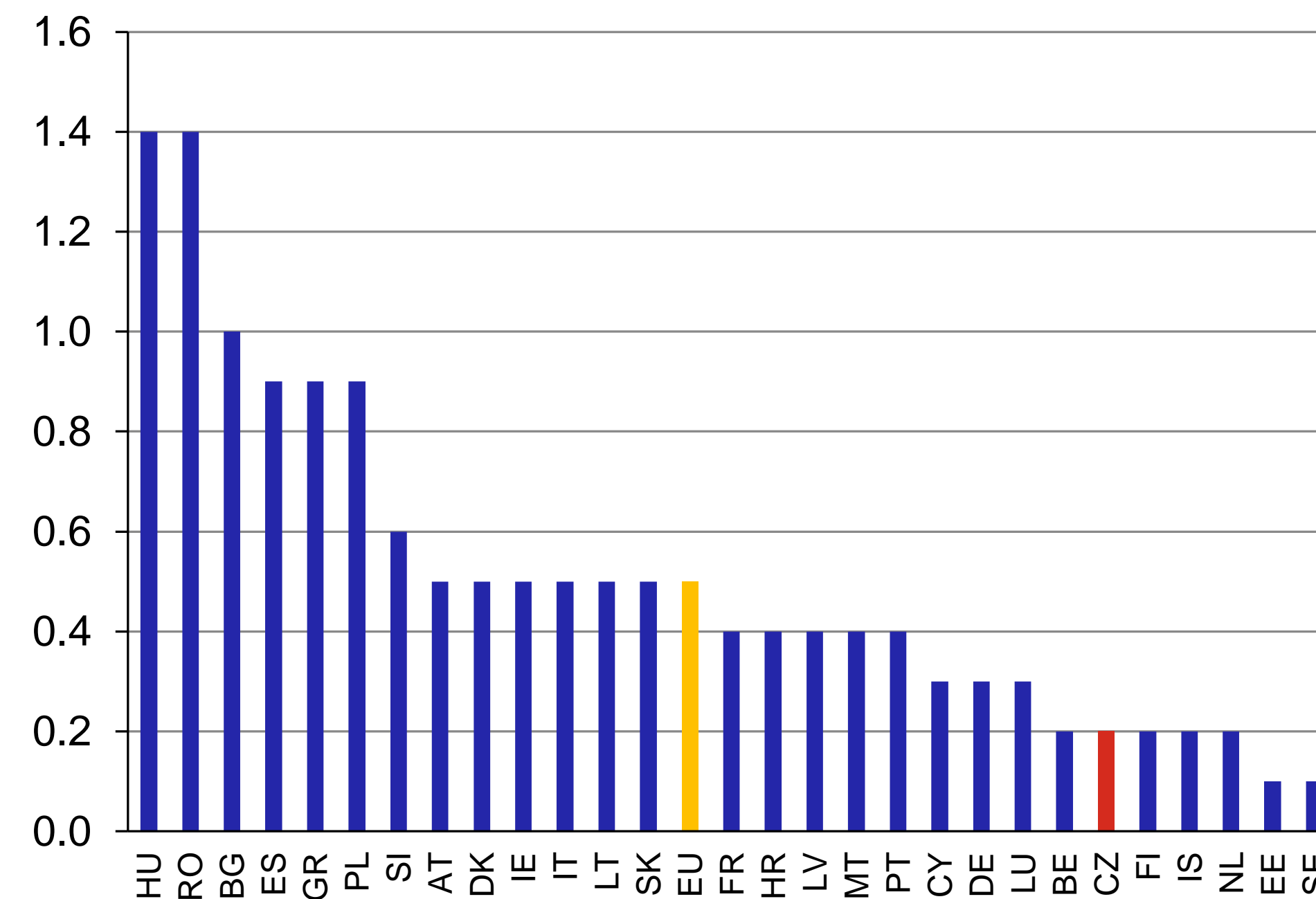
## Asset impairment losses

(bp; right-hand scale: CZK billions)



## Risk costs in selected EU countries

(%; as of 31 December 2022)



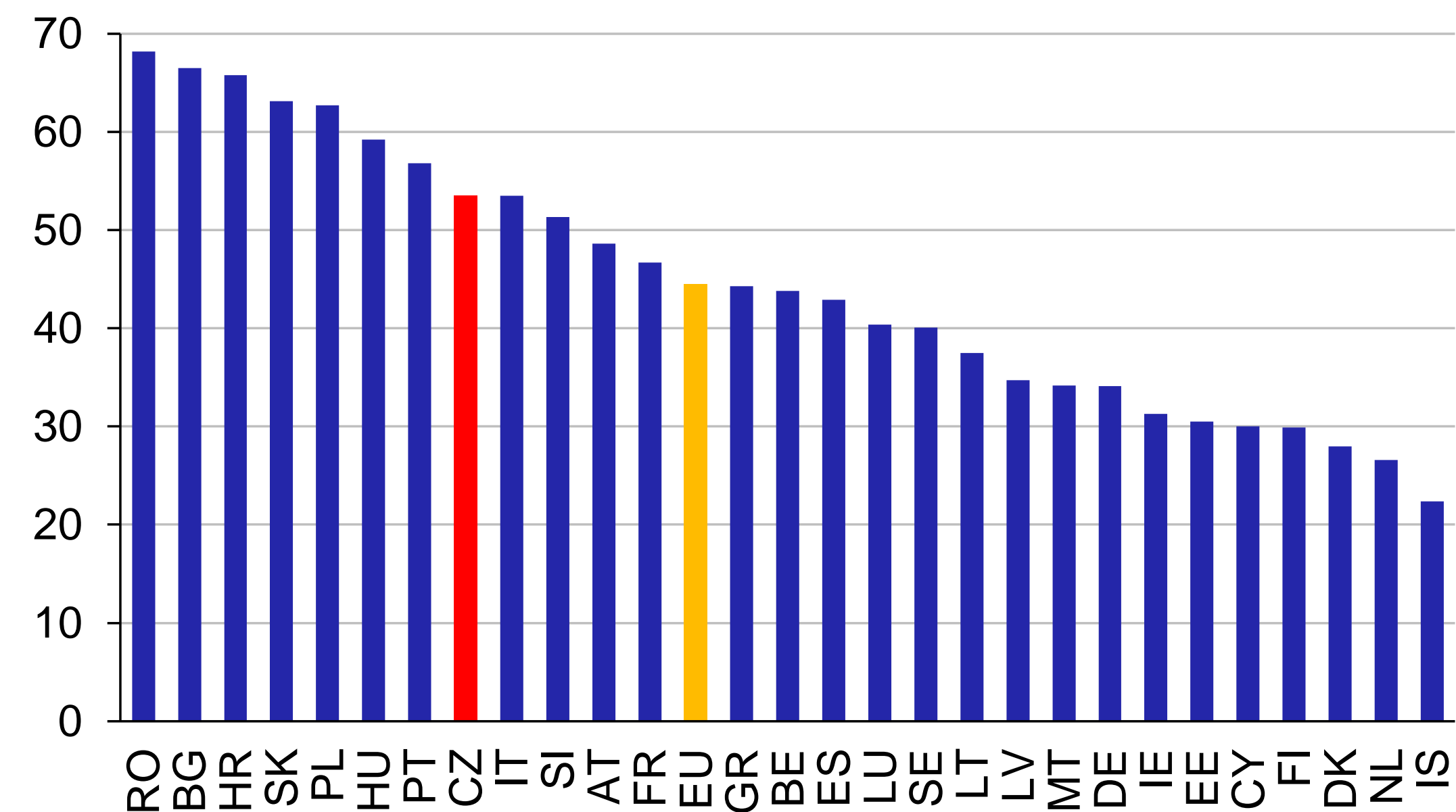
# Initial level of banks' credit risk (2)

Structure of credit exposures by portfolio quality (%)



Coverage rates of non-performing client loans by provisions in selected EU countries

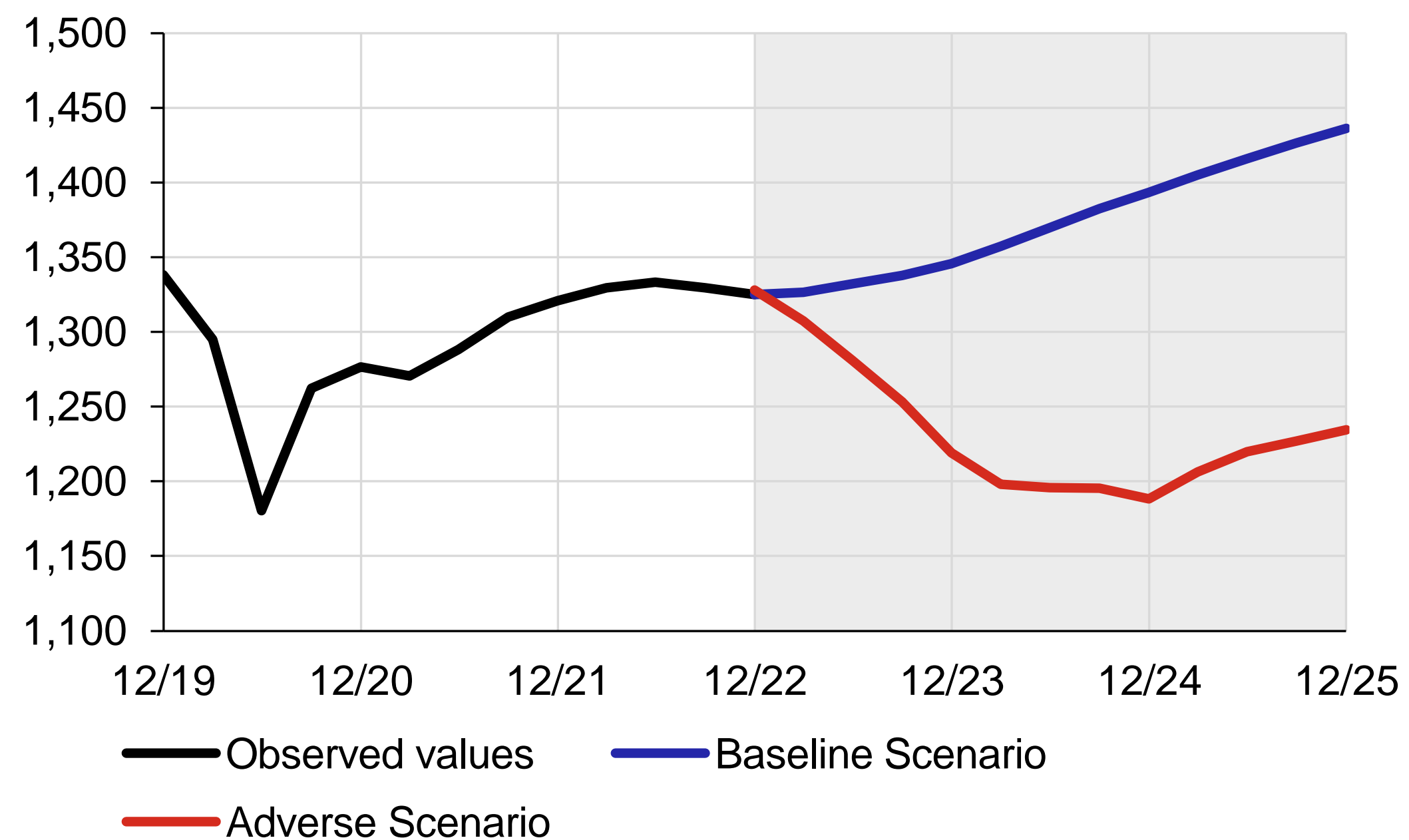
(%; as of 31 December 2022)



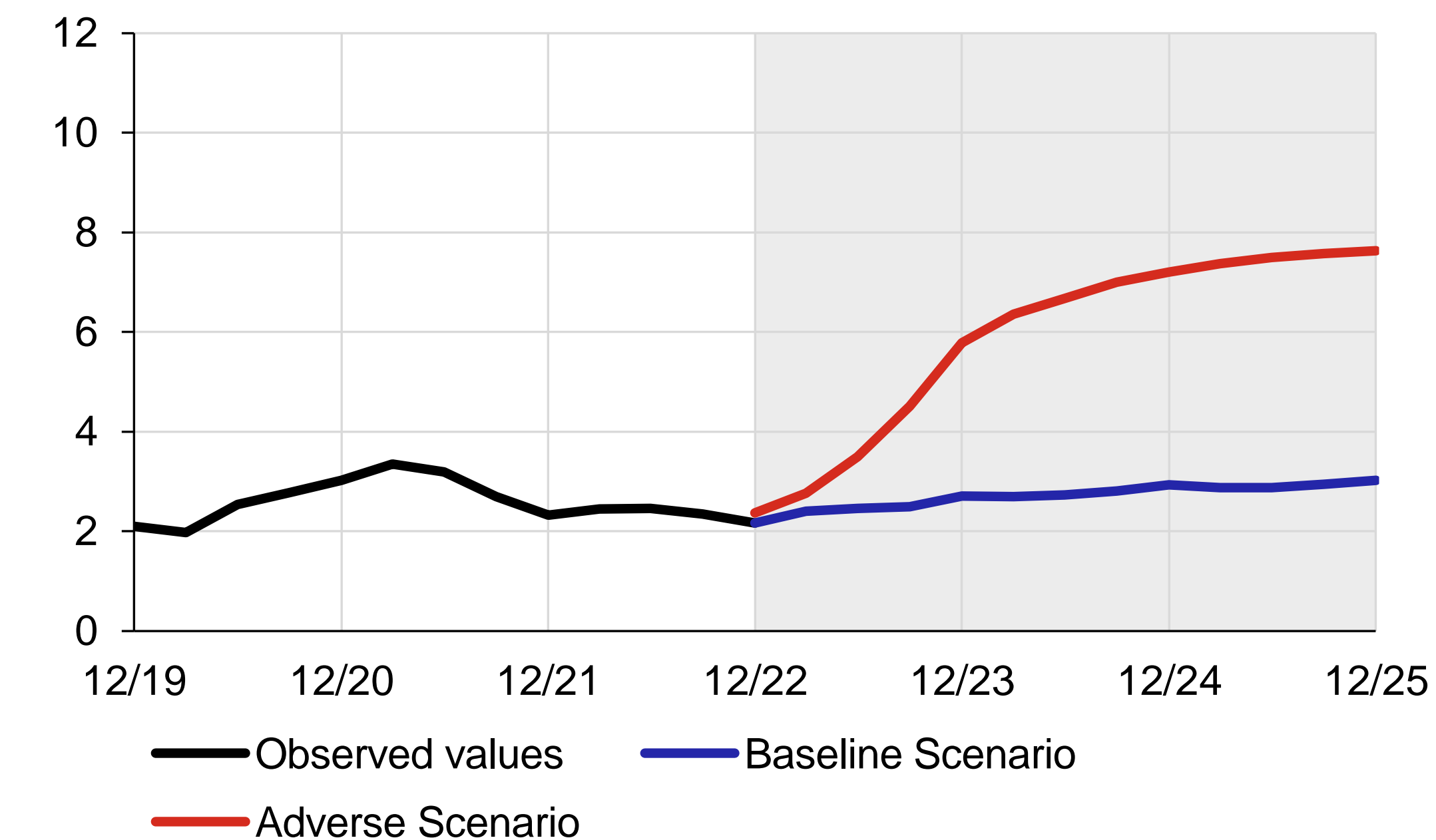


# Main characteristics of stress test scenarios

**Alternative scenarios: real GDP**  
(CZK billions; quarterly data)

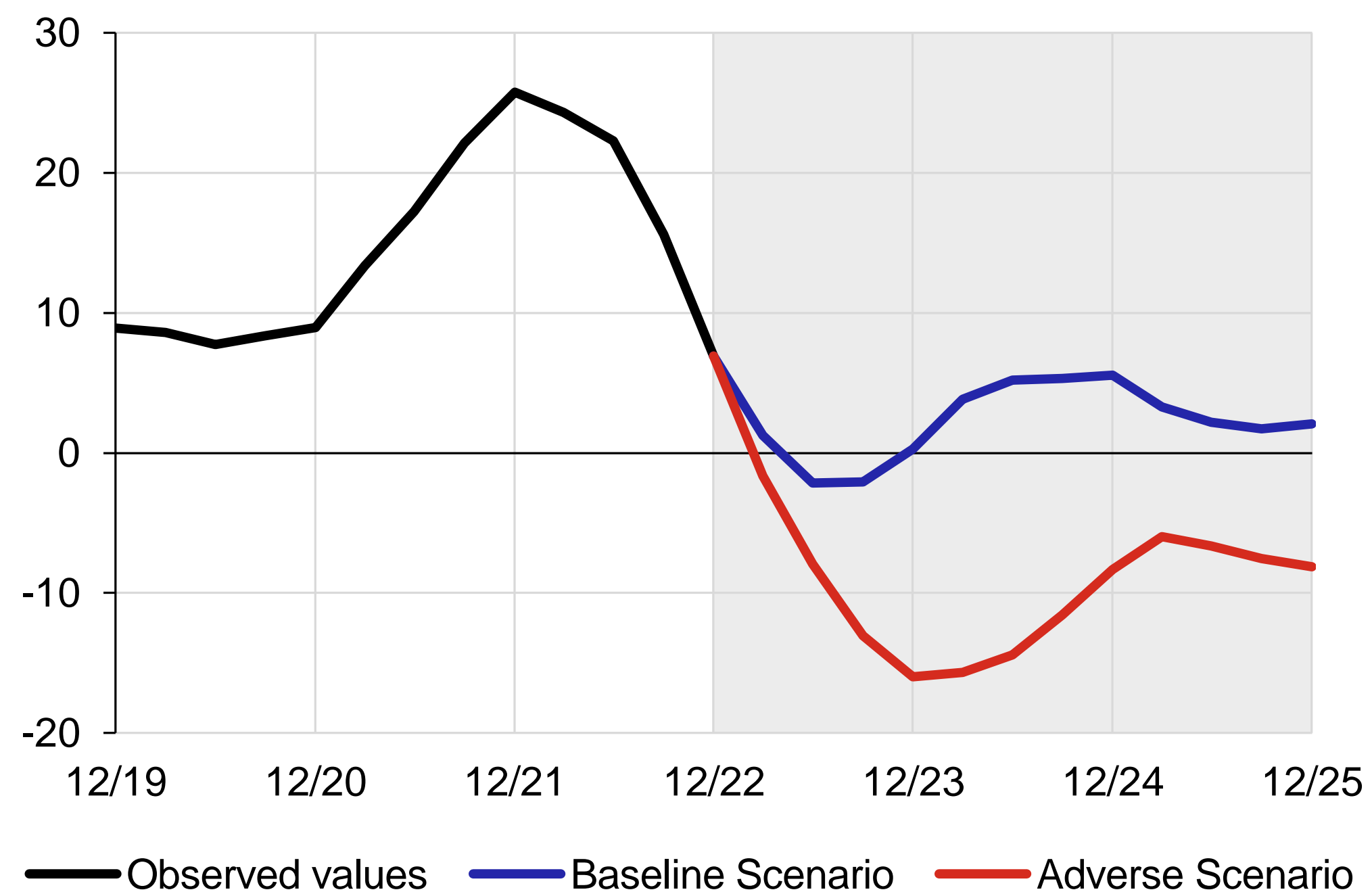


**Alternative scenarios: unemployment rate**  
(%)

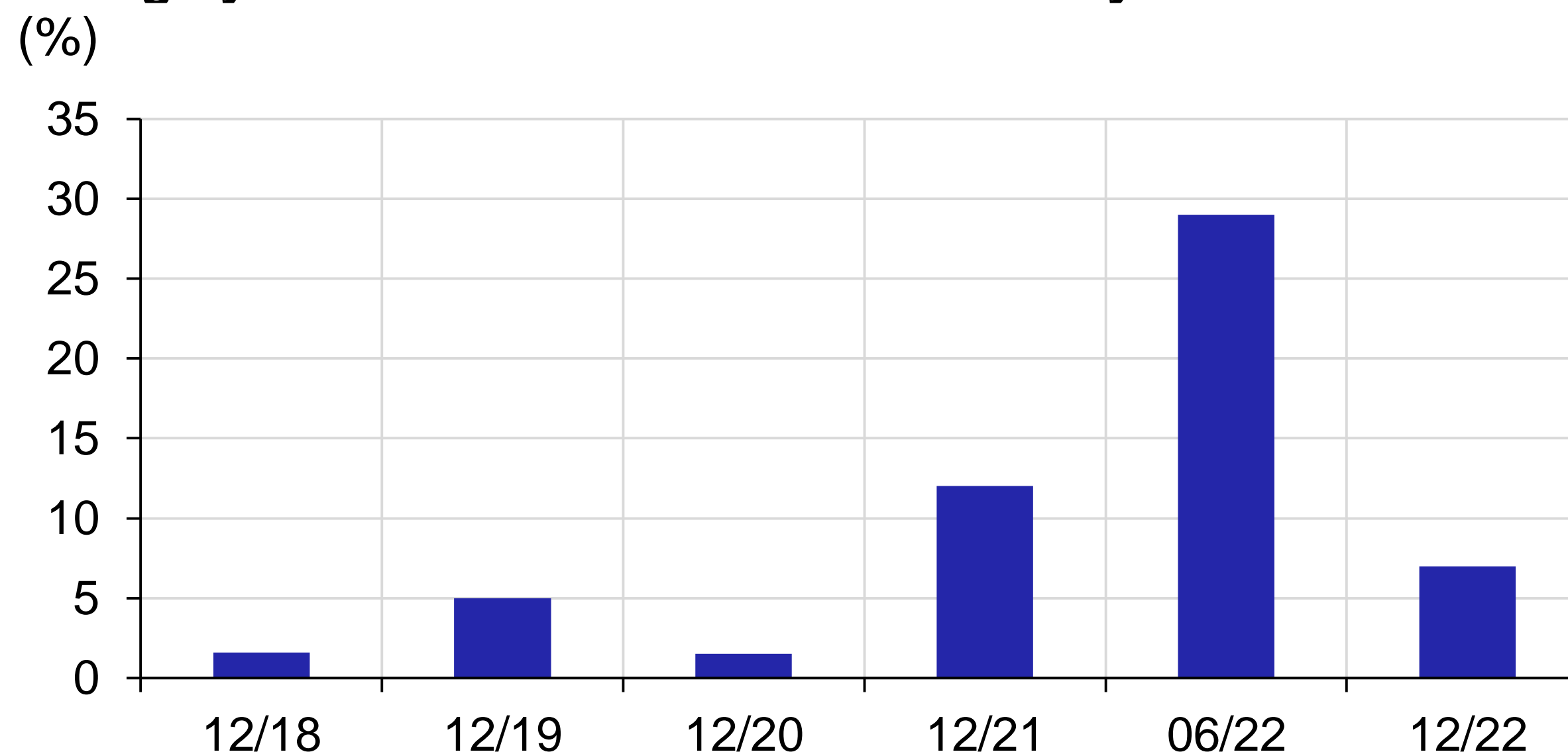


# Residential property price scenarios

**Projections of property price growth in the Czech Republic**  
(year-on-year growth in %)

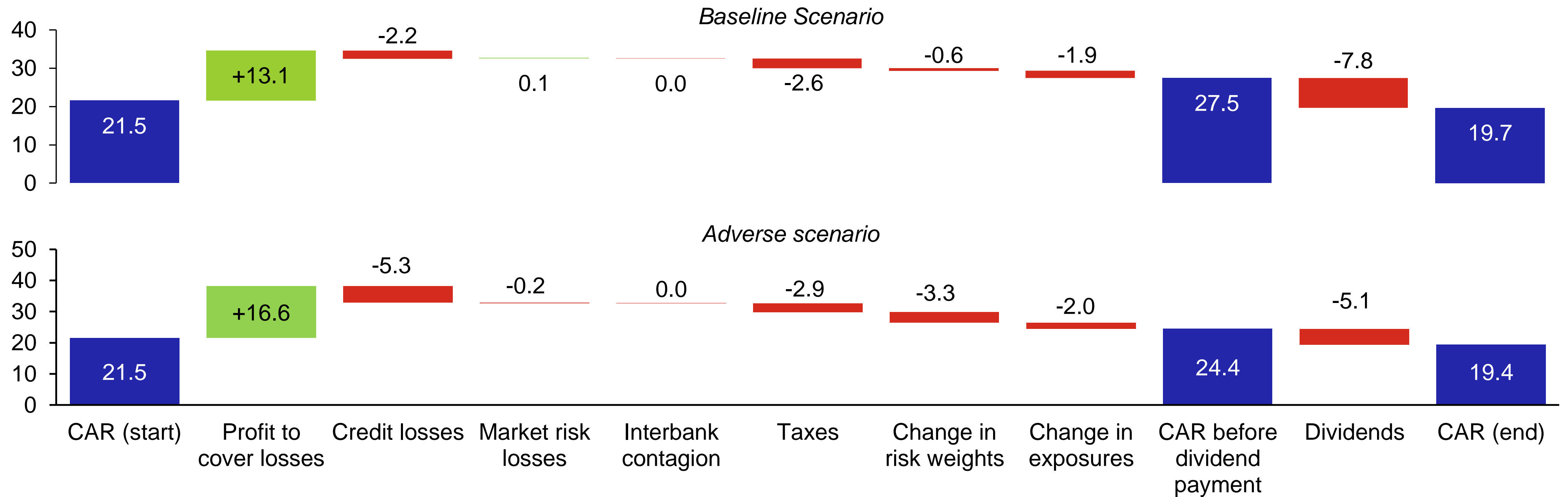


**Probability of average apartment prices in the Czech Republic falling by more than 10% over the next two years**  
(%)



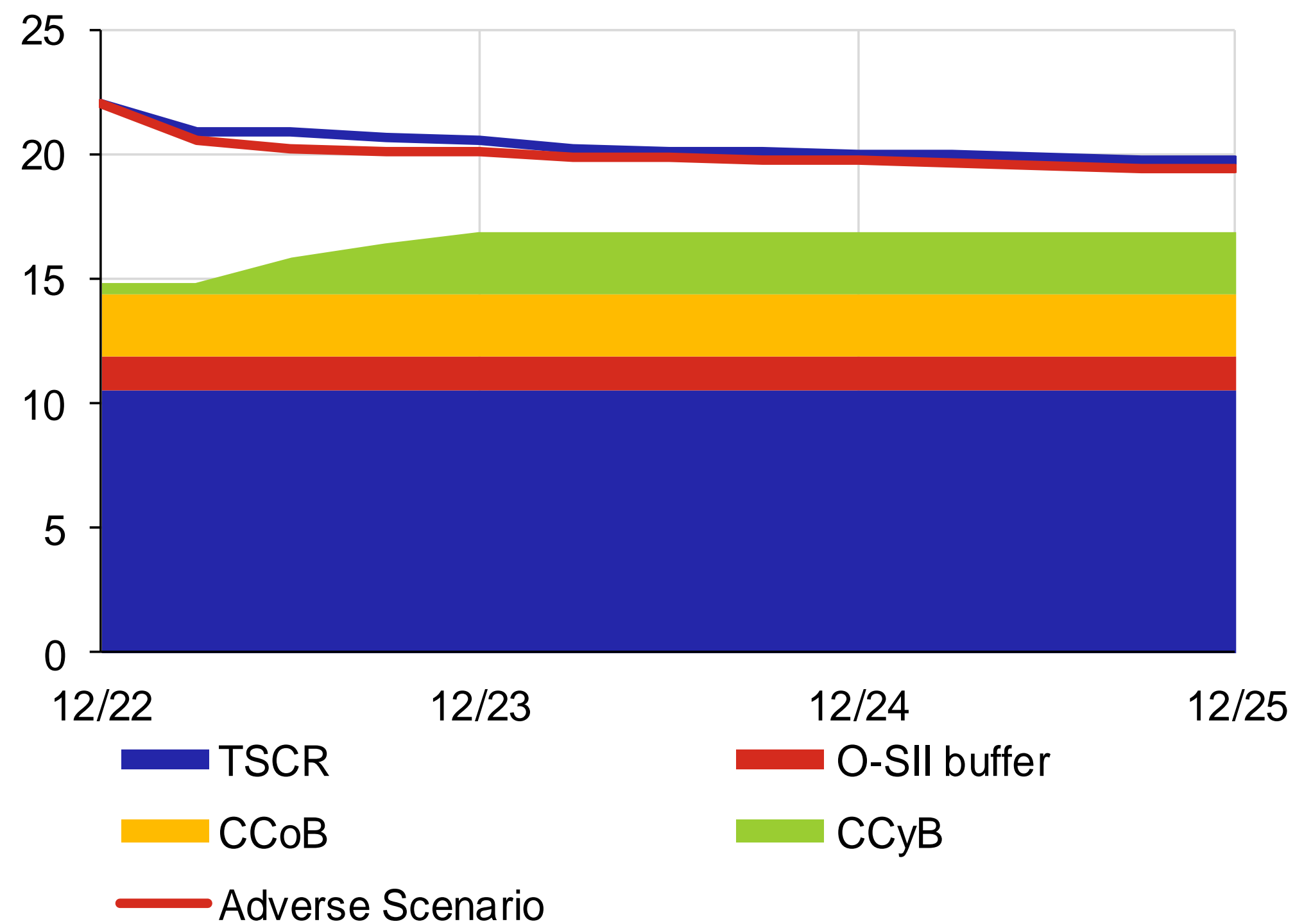
# Bank stress test results (1)

Decomposition of the change in the banking sector's overall capital ratio in the alternative scenarios (pp)

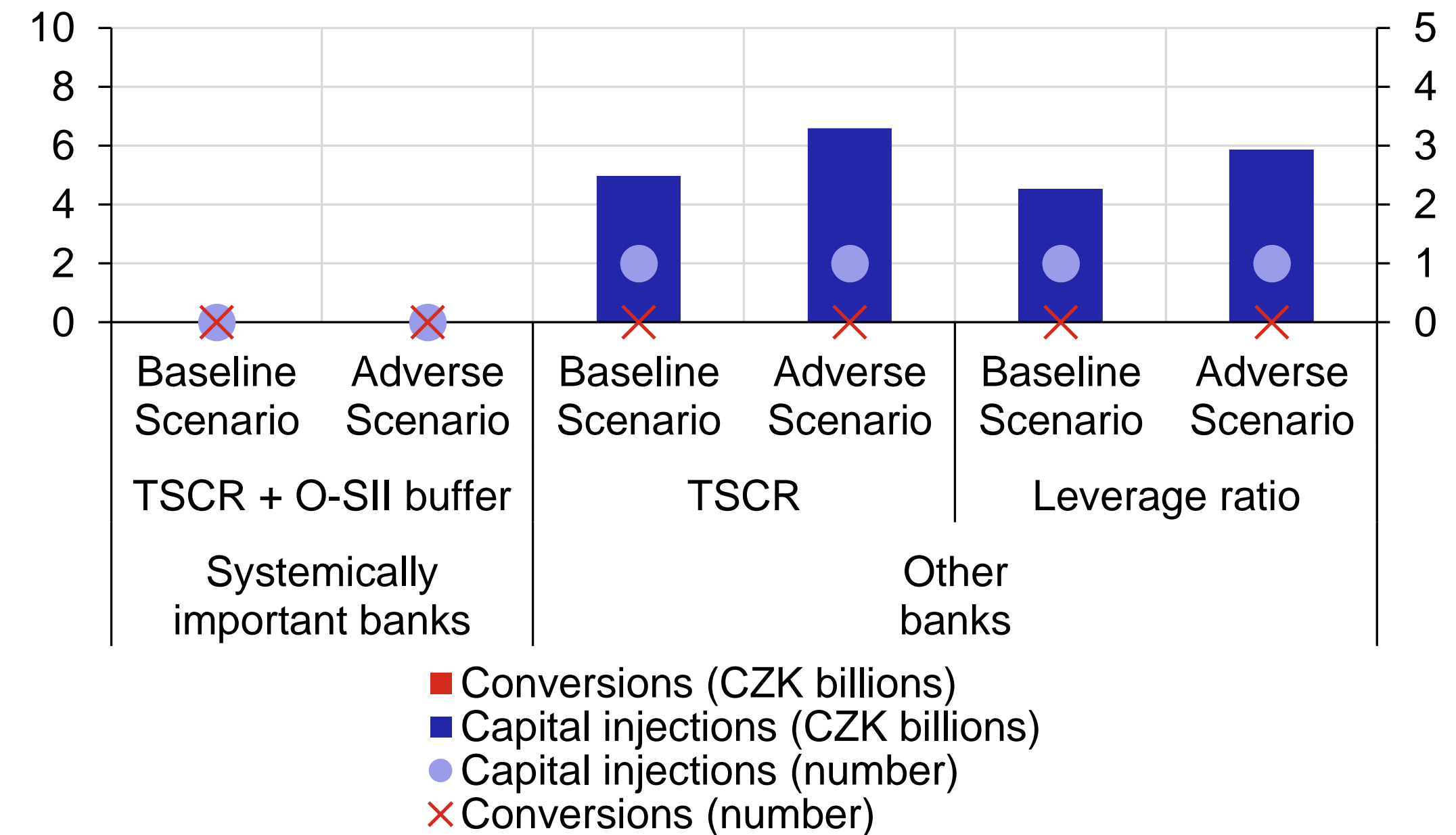


# Bank stress test results (2)

**Fulfilment of selected regulatory requirements by the banking sector in alternative scenarios**  
(% of total risk-weighted exposure)



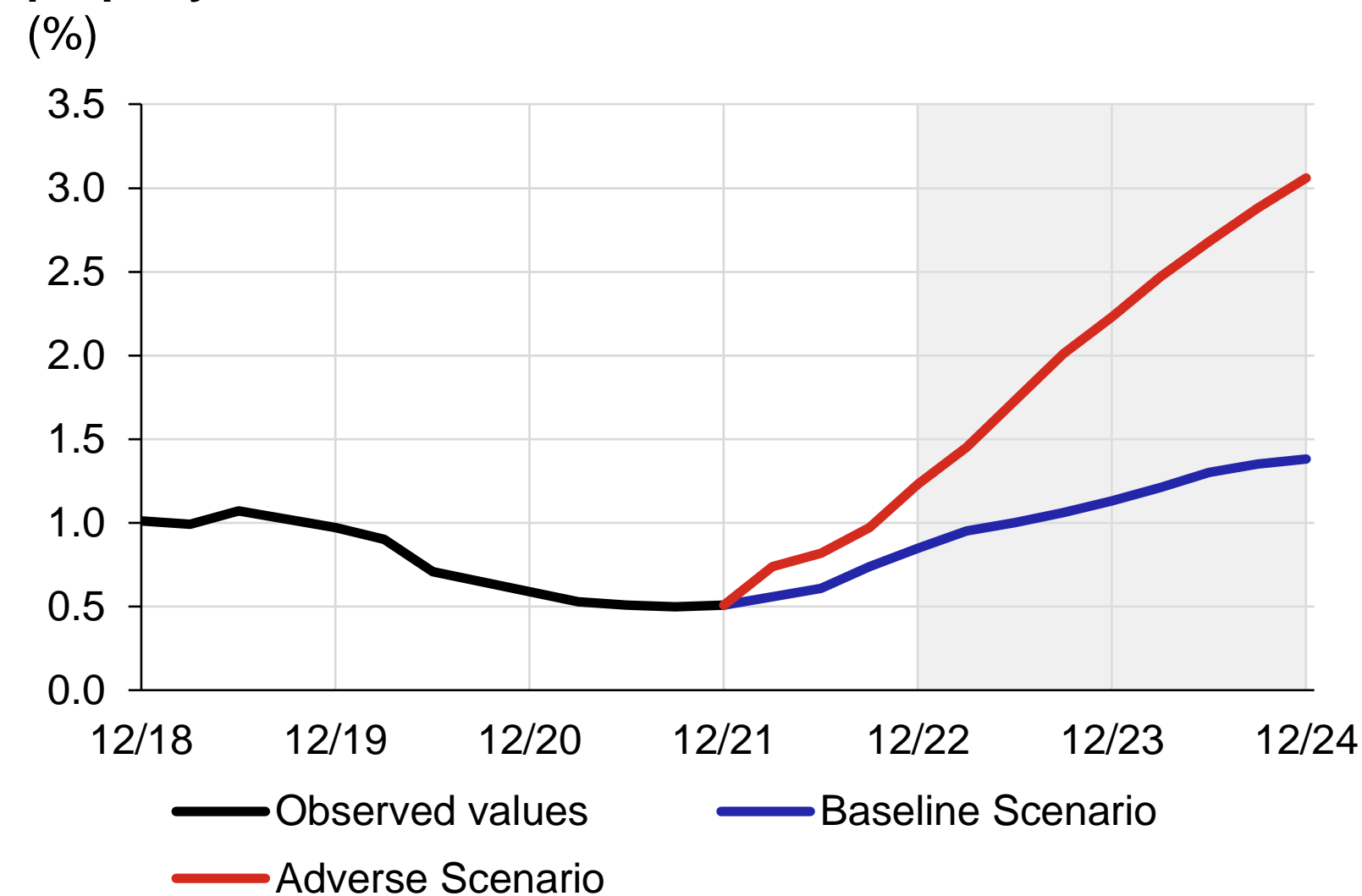
**Need and method for replenishing own funds at different capital requirement levels**  
(CZK billions; right-hand scale: number of banks)



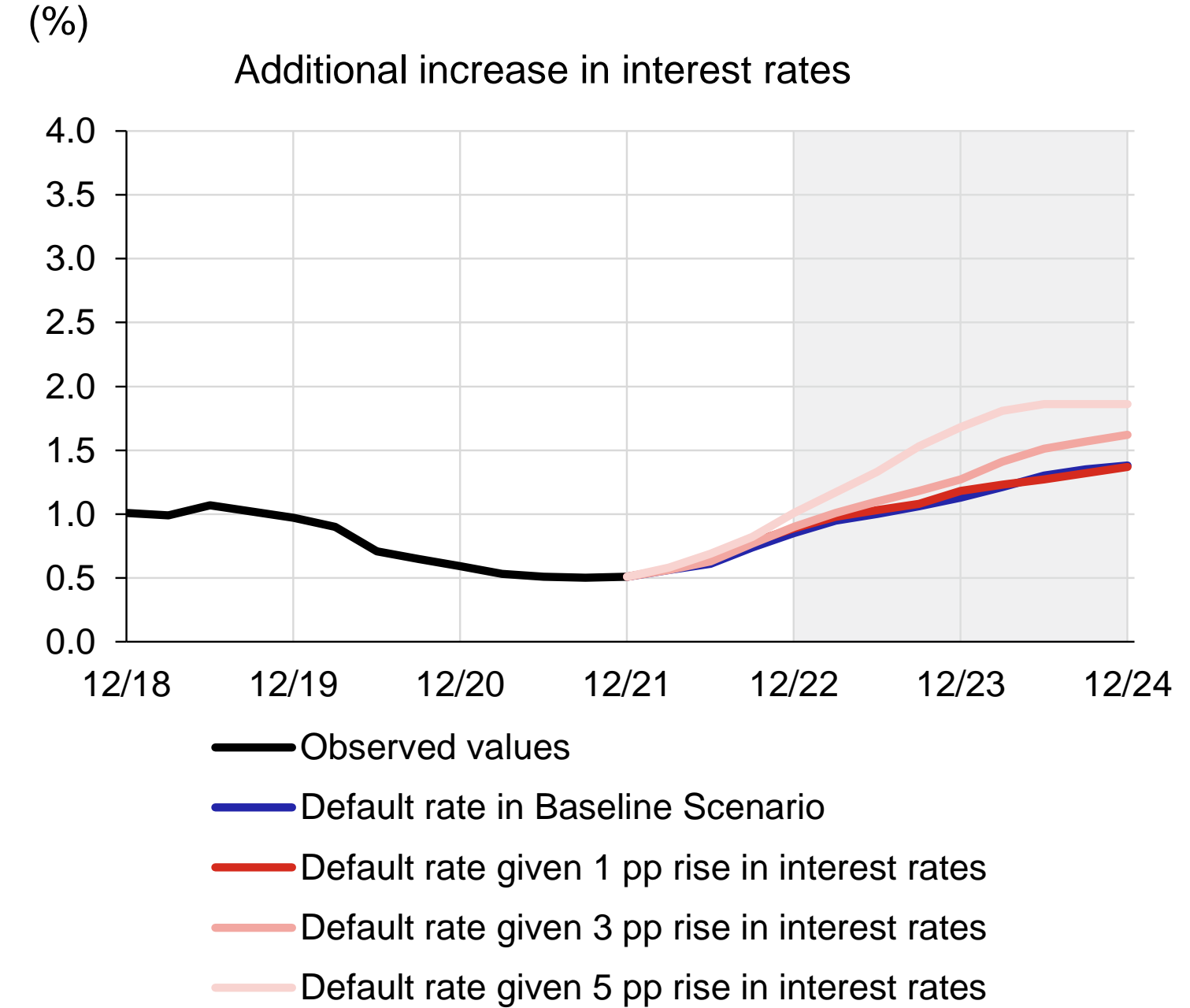


# Results of stress test of households (1)

**12M default rate on consumer credit secured by residential property**



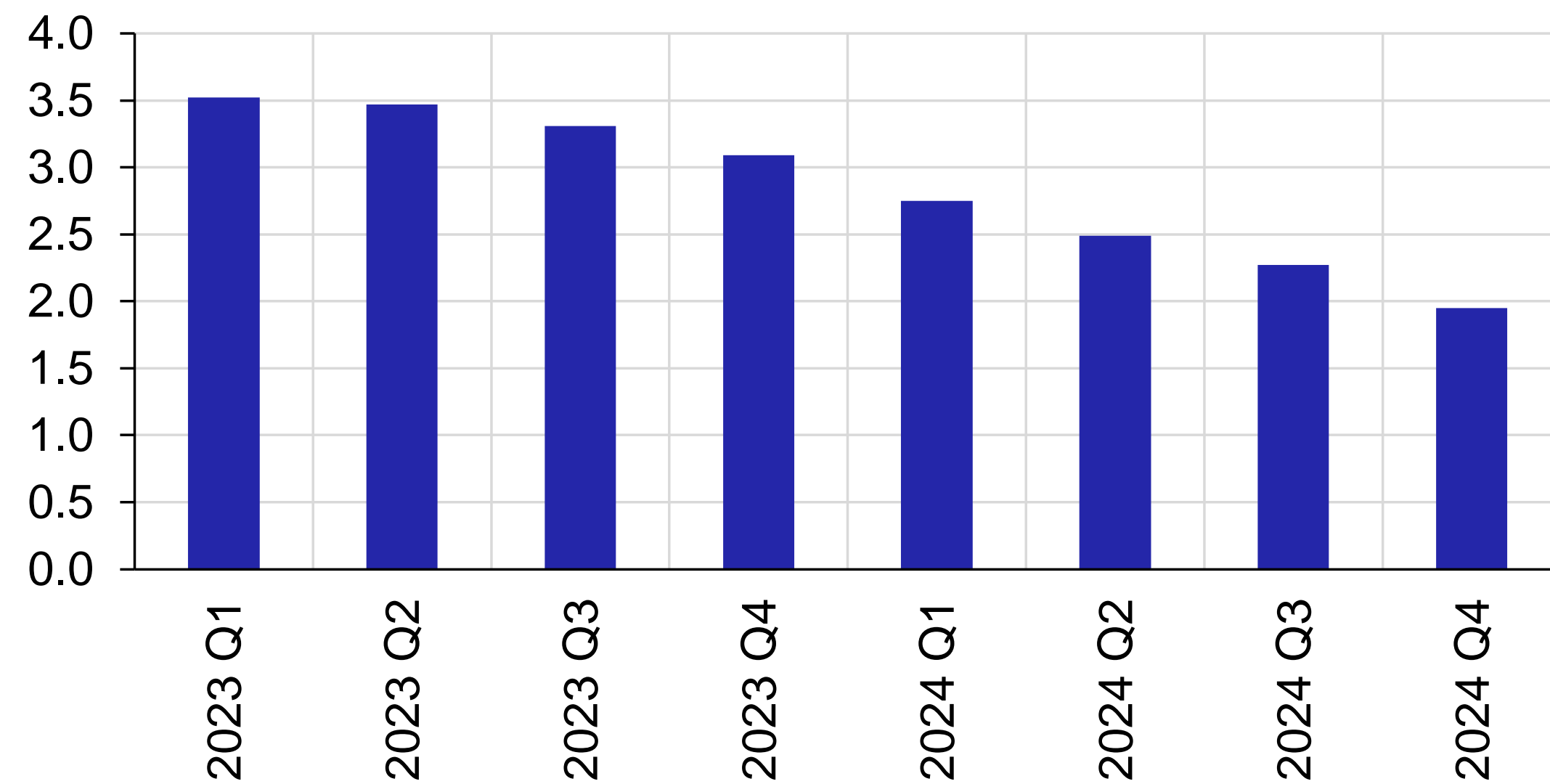
**12M default rate on mortgage loans to households given an additional rise in the unemployment rate and interest rates going beyond the Baseline Scenario**



# Results of stress test of households (2)

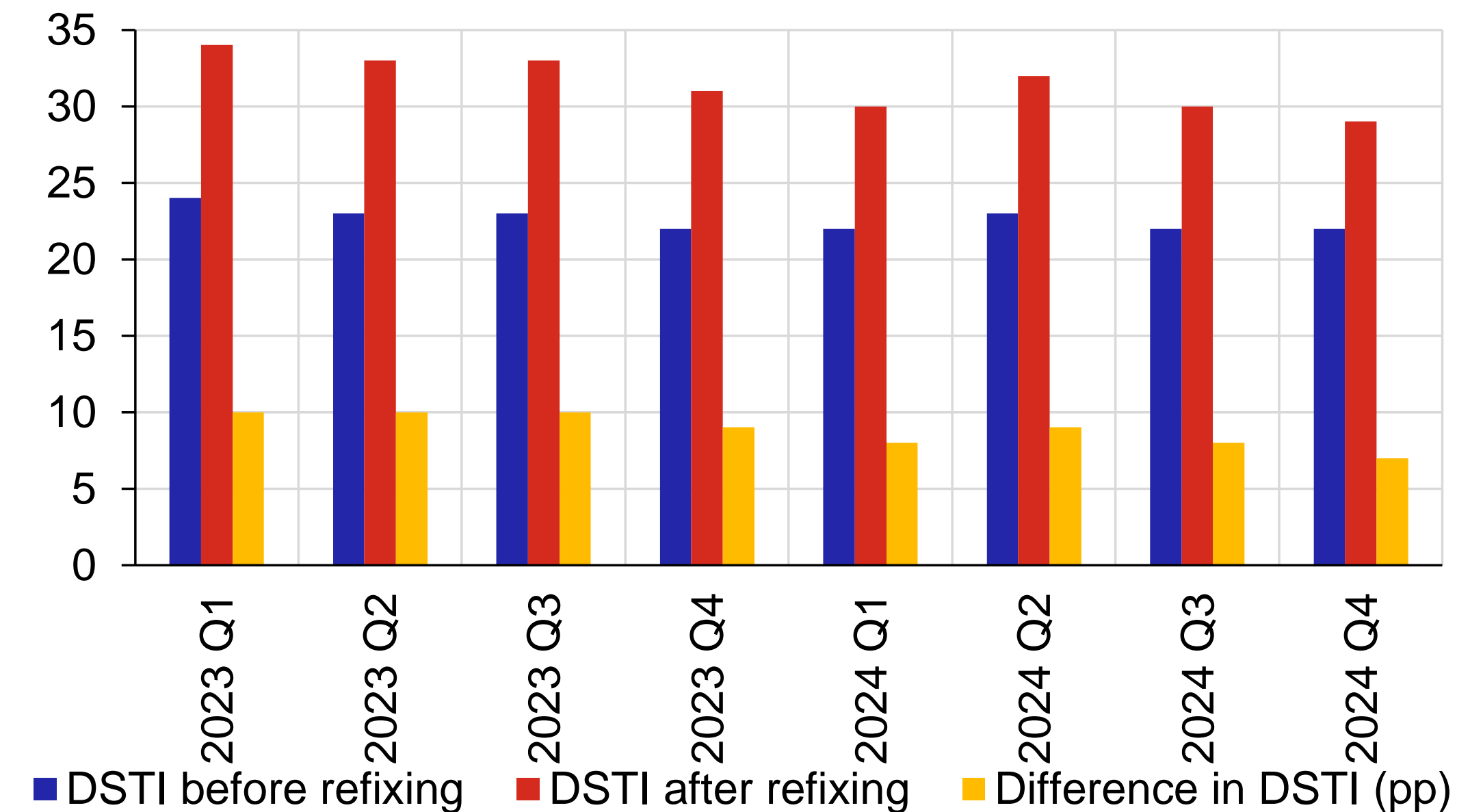
Estimate of the change in interest rates on consumer loans secured by residential property at refixing

(pp)



Estimate of the DSTI ratio of refixed consumer loans secured by residential property

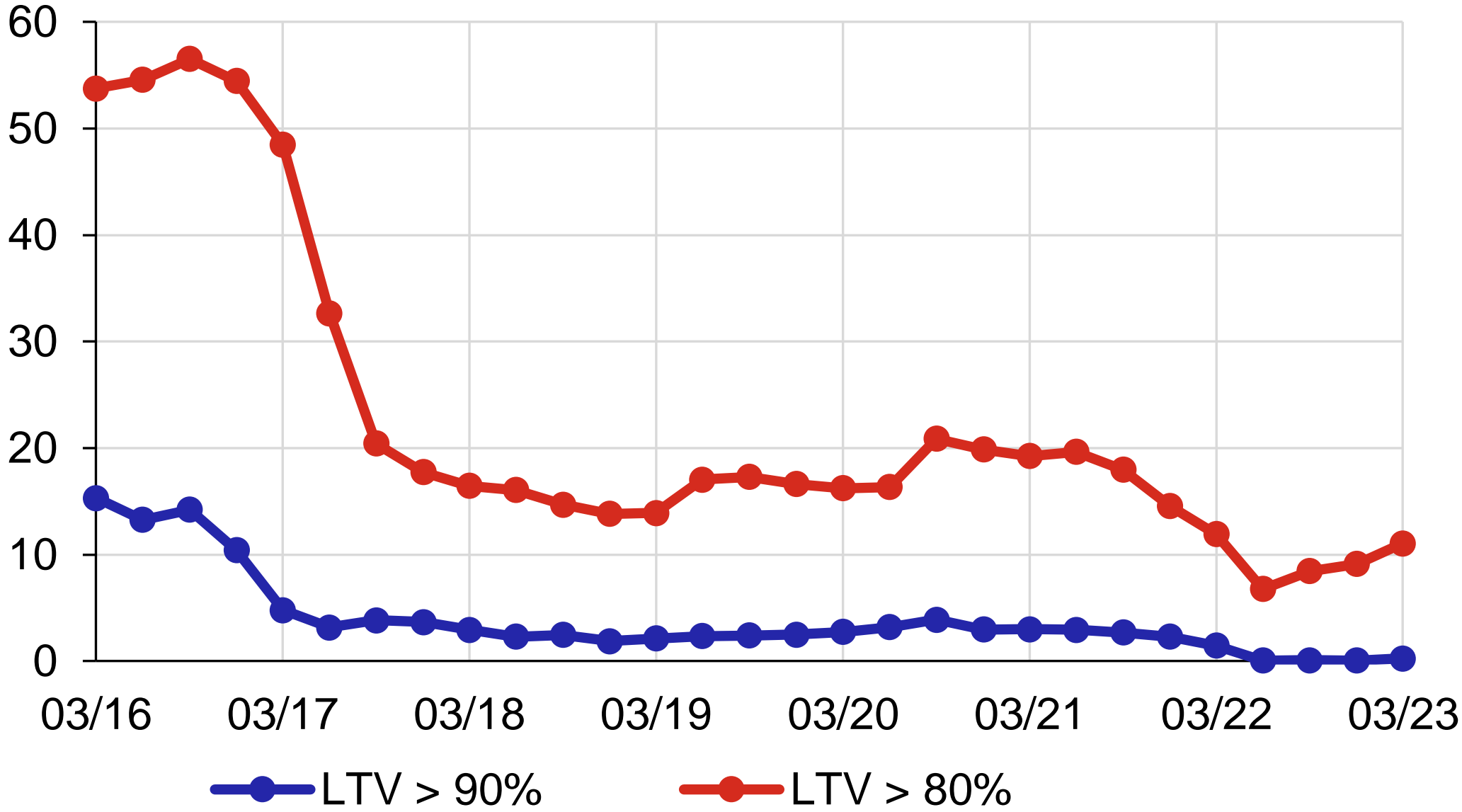
(%)



# Compliance with LTV limit

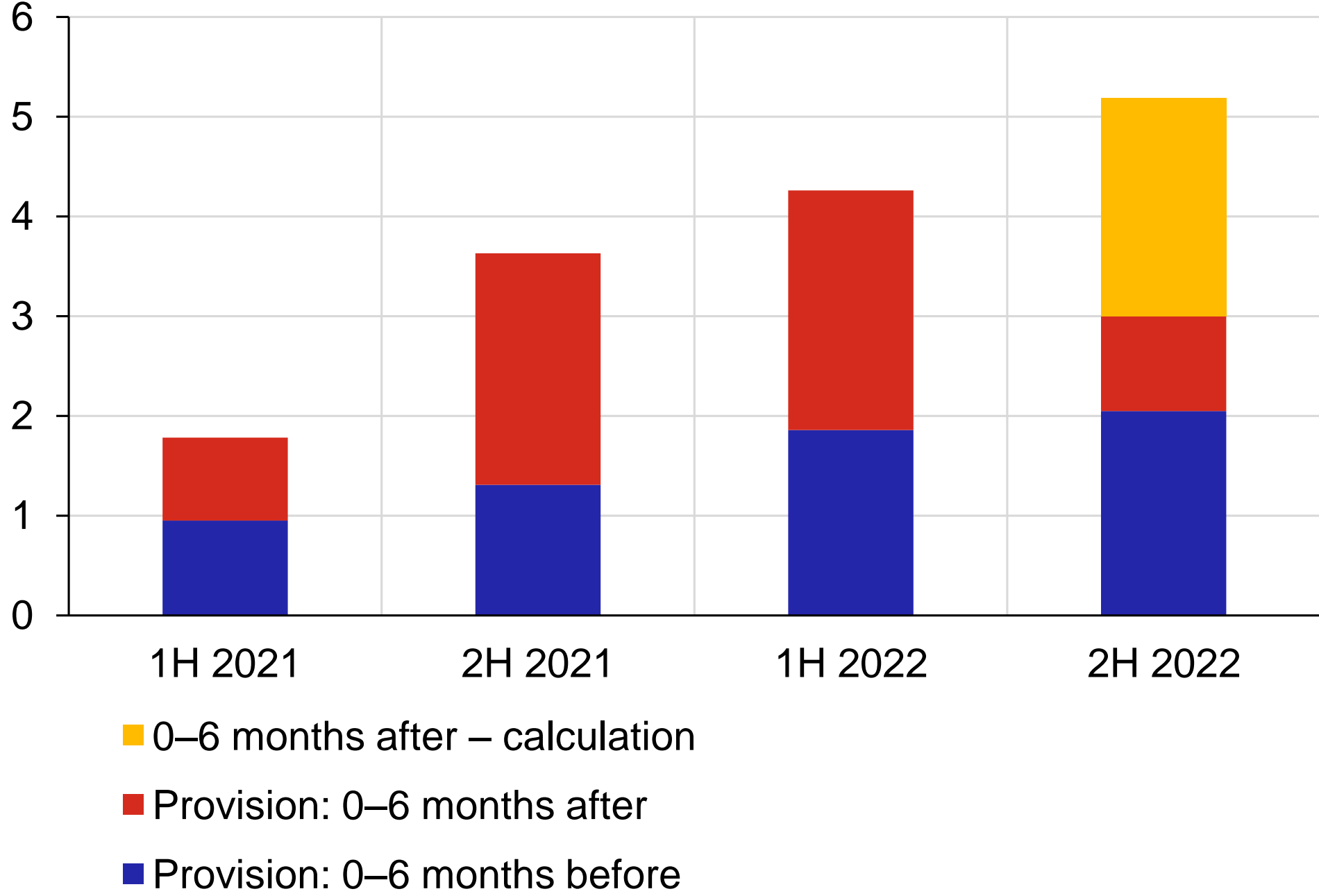
## Pure new consumer credit secured by residential property with LTV in selected bands

(share of loans in volume provided in given quarter in %)



## Concurrent provision of unsecured and secured consumer loans

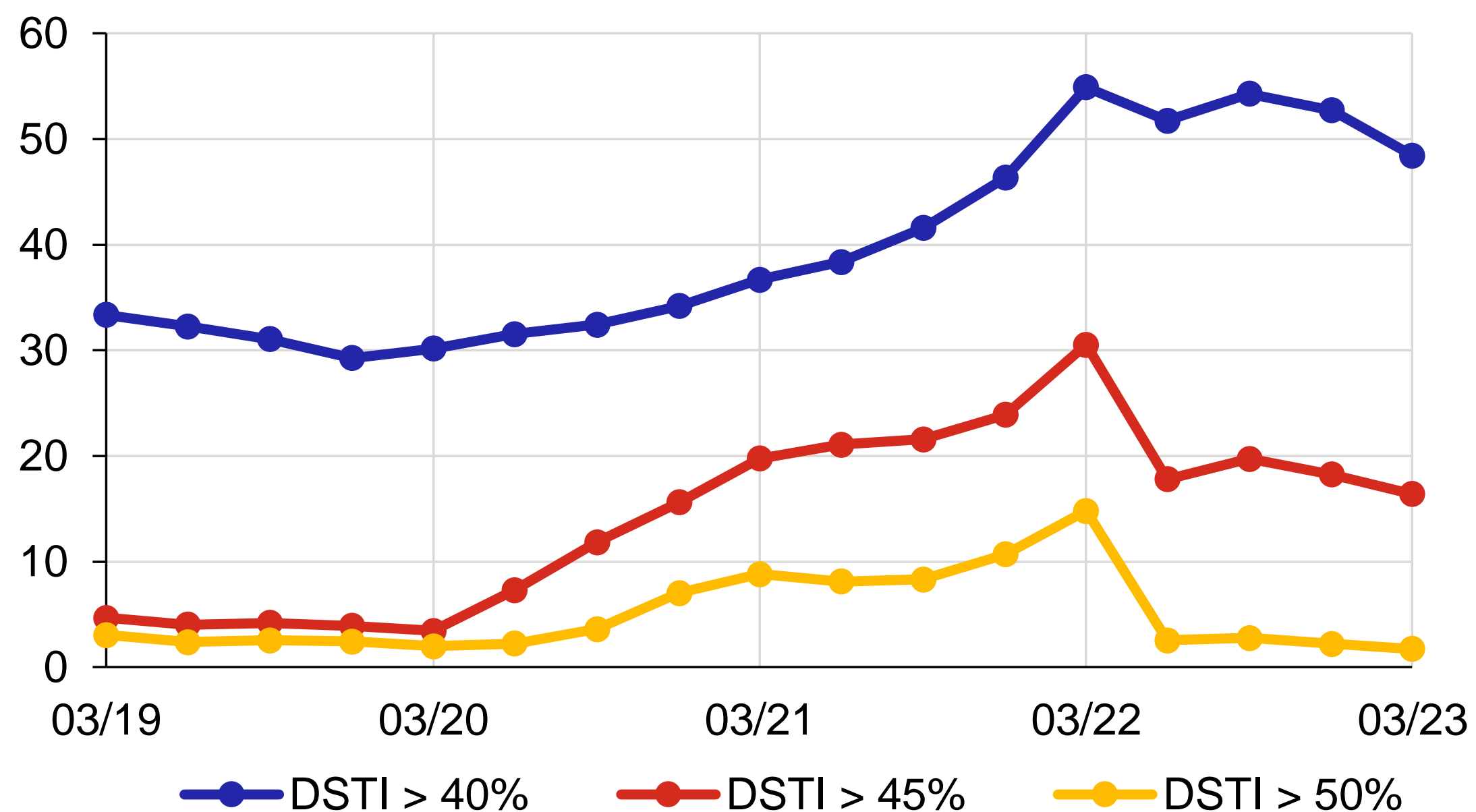
(unsecured loans in CZK billions; x-axis: half-year in which the loan was provided)



# Compliance with DSTI and DTI limits

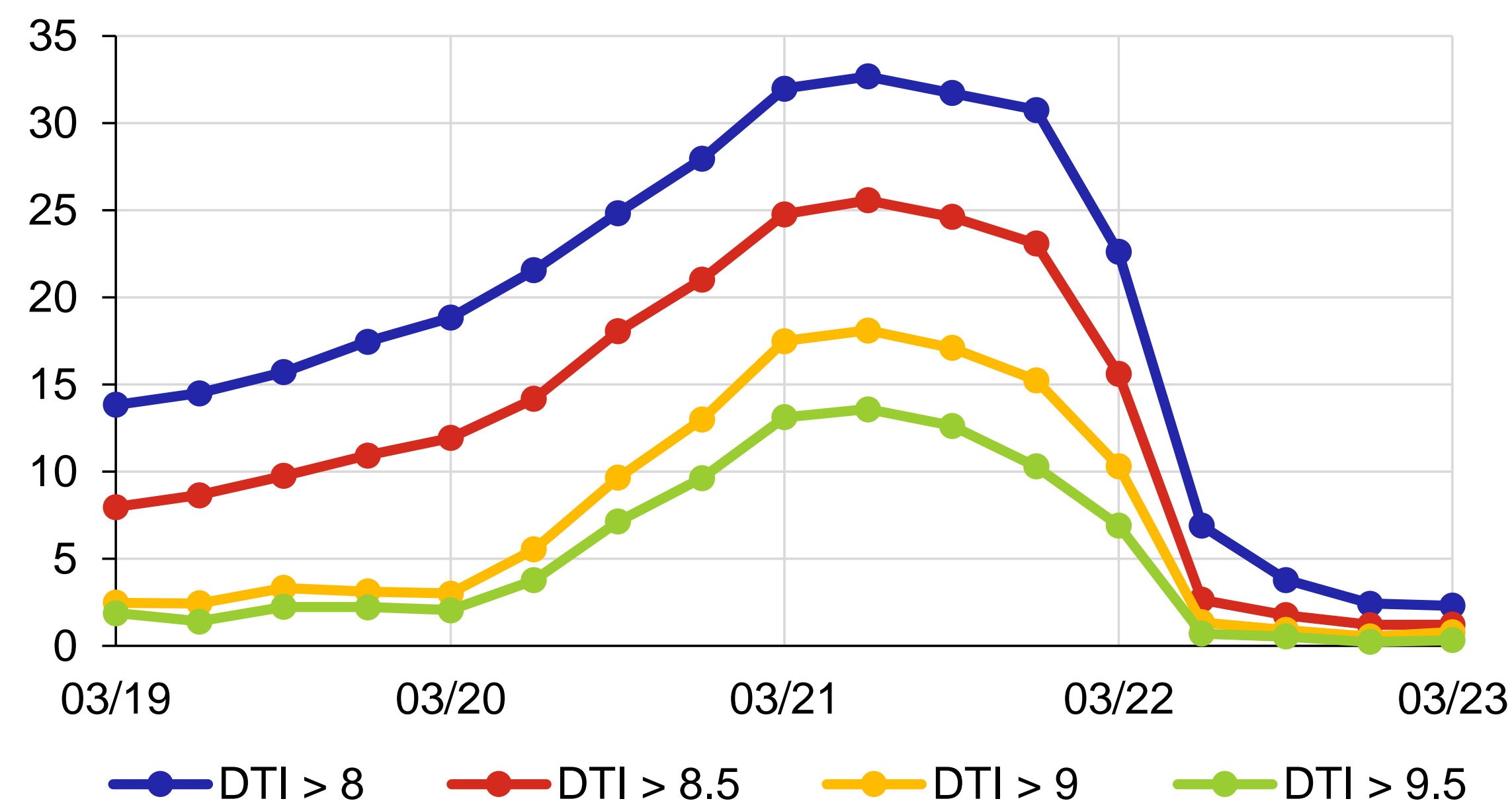
## Pure new consumer credit secured by residential property with DSTIs in selected bands

(share of loans in volume provided in given quarter in %)



## Pure new consumer credit secured by residential property with DTIs in selected bands

(share of loans in volume provided in given quarter in %)

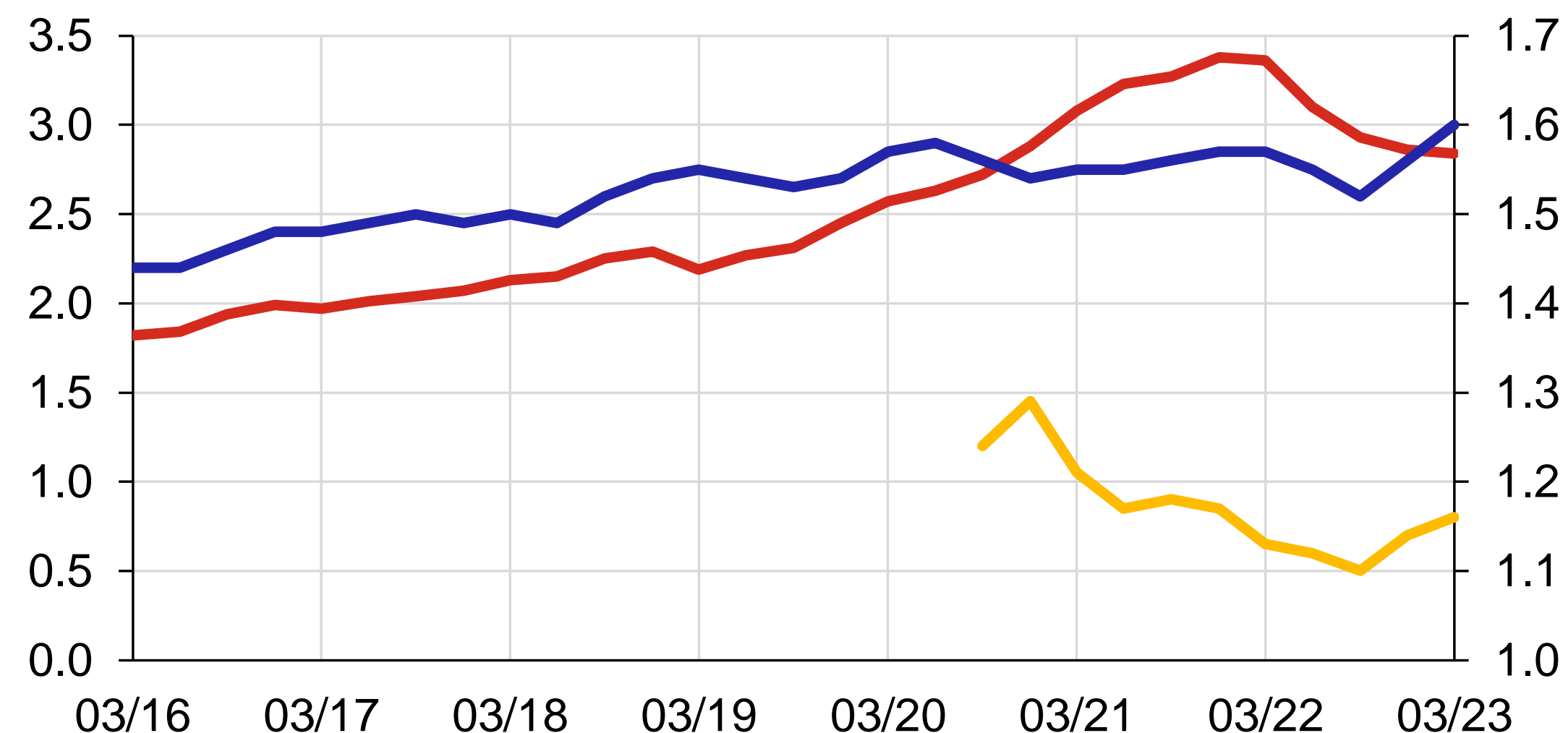




# Selected mortgage loan characteristics (1)

## Selected characteristics of new consumer loans secured by residential property

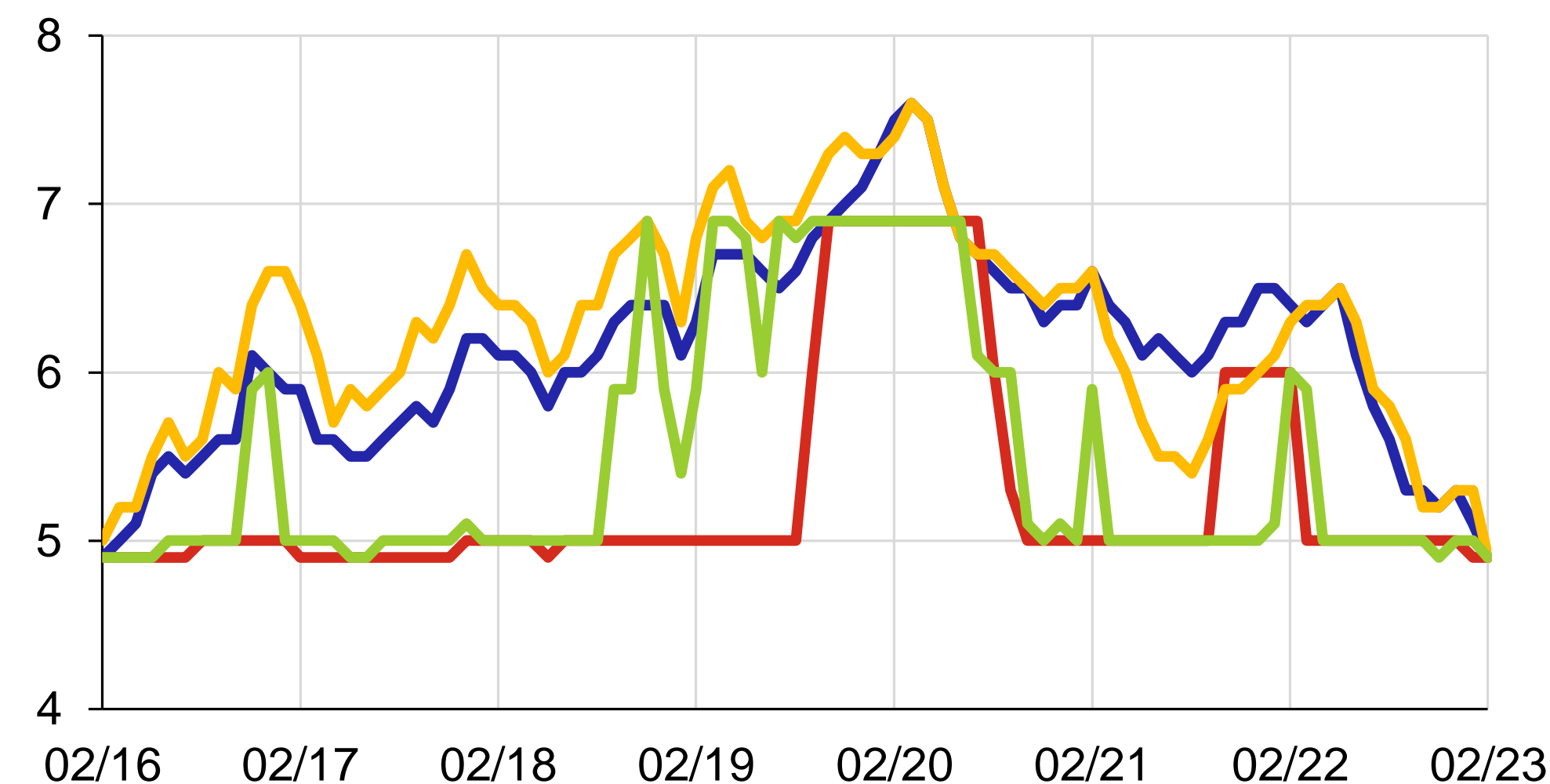
(CZK millions; right-hand scale: number of persons/properties)



- Average loan size
- Average number of clients (rhs)
- Average number of properties securing single loan (rhs)

## Fixed-rate periods of consumer loans secured by residential property

(years; averages weighted by loan amount)

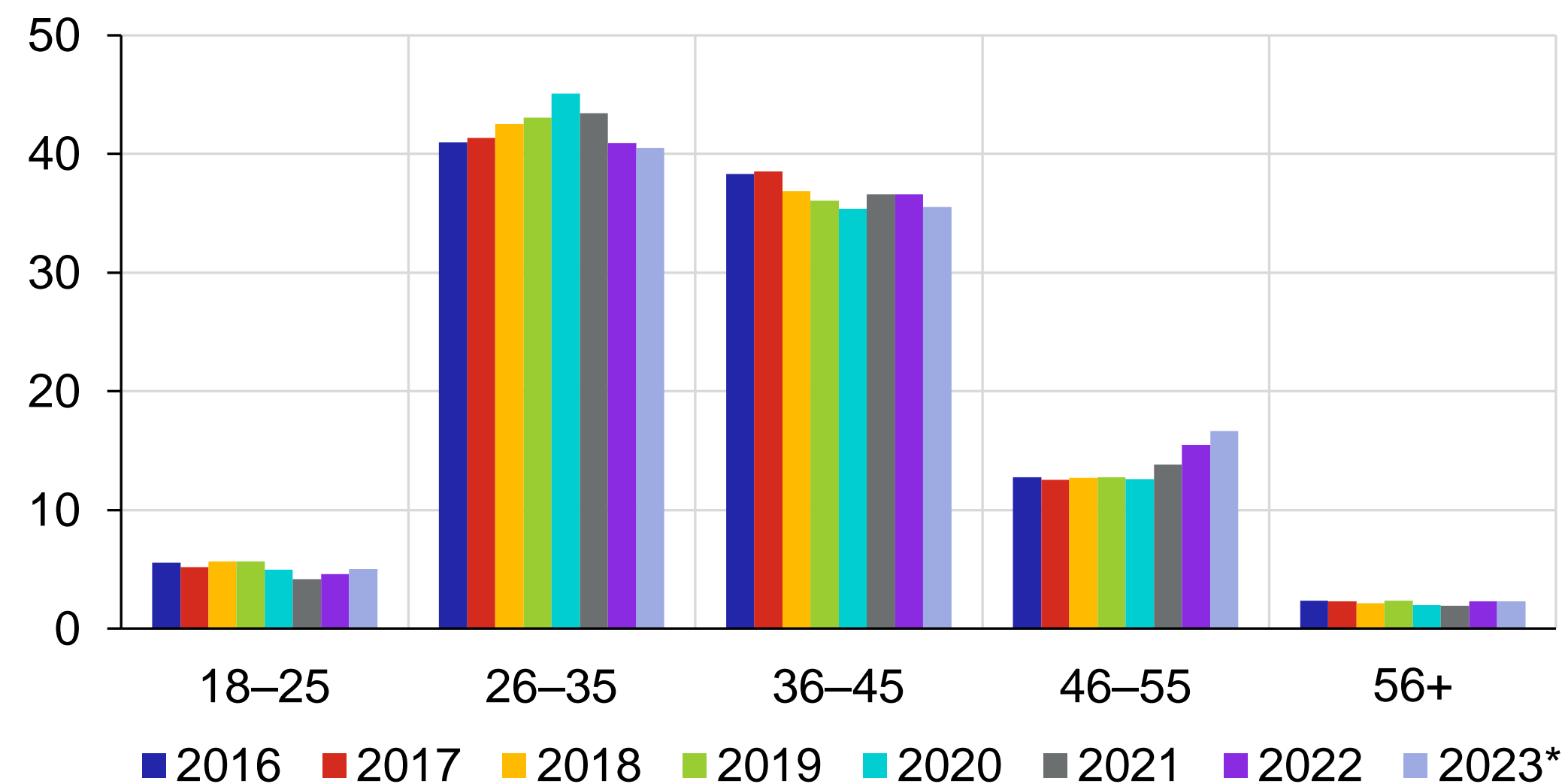


- Pure new loans (average)
- Pure new loans (median)
- Refinanced loans (average)
- Refinanced loans (median)

# Selected mortgage loan characteristics (2)

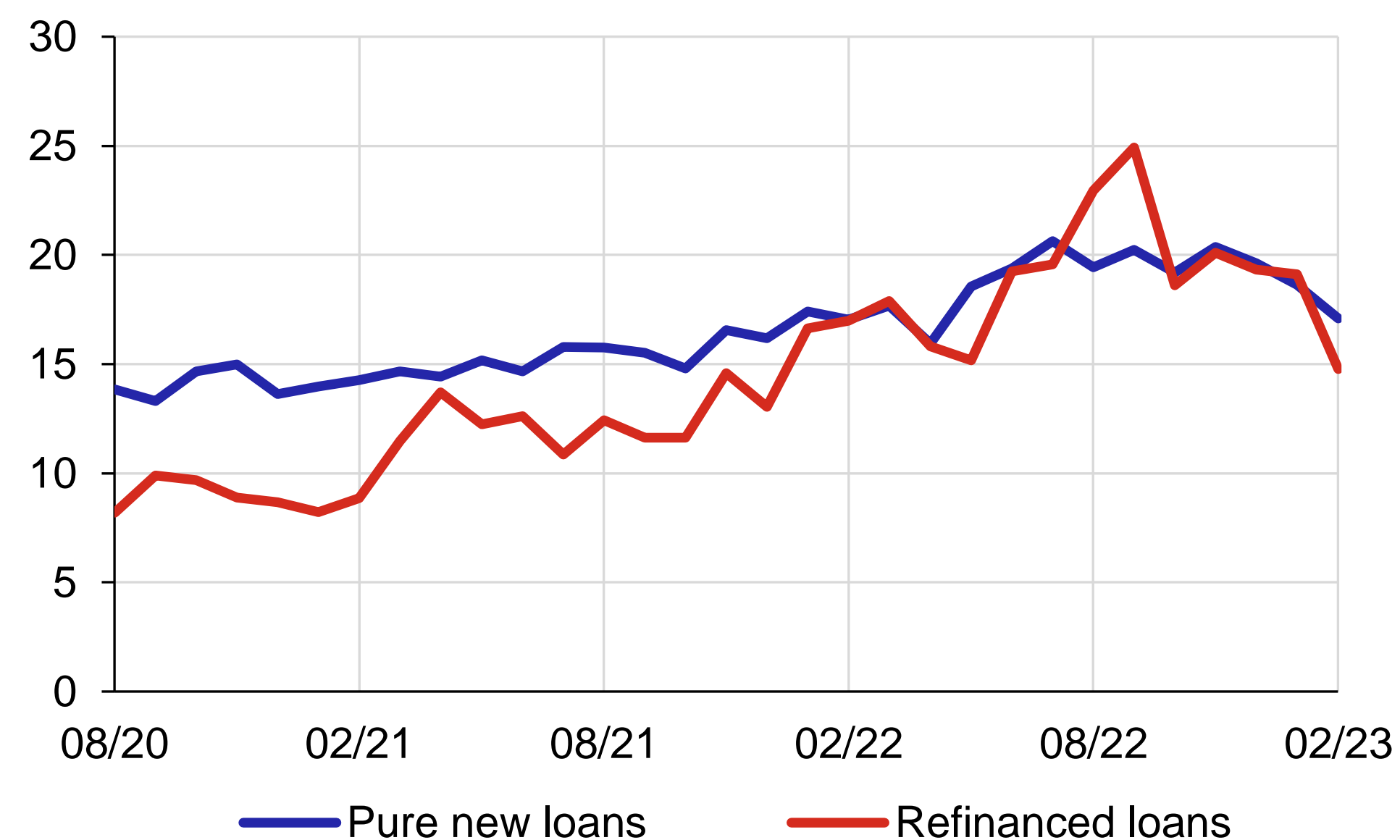
## Distribution of new consumer credit secured by residential property by the principal borrower's age

(share of loans in volume provided in %; x-axis: principal borrower's age in years)



## Share of second and additional consumer loans secured by residential property

(% of monthly volume)



# Thank you for your attention

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The following will be published on the CNB website on **2 June 2023**:

- Provision of a general nature on setting the countercyclical capital buffer rate II/2023
- Provision of a general nature on setting upper limits on credit ratios

The following will be published on the CNB website on **19 June 2022**:

- Financial Stability Report – Spring 2023
- The minutes of the Bank Board meeting on financial stability issues complete with attributed arguments of individual CNB Bank Board members, as in the case of monetary policy meetings
- Official information – Recommendation on the management of risks associated with the provision of consumer credit secured by residential property