CNB press conference

Jiří Rusnok, Governor

Jan Frait, Executive Director, Financial Stability Department

Prague, 23 May 2019

Changes in communication of results of Bank Board meetings on financial stability issues

- Given the importance of the financial stability objective and macroprudential policy, the CNB will publish the results of the Bank Board meetings on financial stability issues and the key underlying document in **the same way as for monetary policy meetings**.
- The **results of the Bank Board meeting** will be disclosed on the day of the meeting in a press release and at a press conference attended by the Governor.
- The **underlying document** (the *Financial Stability Report* for the spring meeting and *Risks to financial stability and their indicators* for the autumn meeting), the **minutes of the meeting** and the **relevant legal rules** will be published with a lag.
  - The following will be published on 11 June: Financial Stability Report 2018/2019, minutes of the Bank Board meeting of 23 May 2019, Official Information – Recommendation on the management of risks associated with the provision of loans secured by residential property, and Provision of a general nature on setting the countercyclical capital buffer rate II/2019.

I.

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

- **Evolution of risks since previous Report:**
  - maintenance of financial sector's high resilience to potential adverse shocks.
- **Potential sources of future risks:**
  - minor increase in risks associated with financial and business cycle,
  - unchanged level of structural risks (exposure concentration, interconnectedness of entities, interconnectedness with rest of world).
- As regards risks to financial stability emerging in good times, the CNB as a macroprudential policy and microprudential supervisory authority must:
  - respond **in a preventive manner**,
  - adopt measures commensurate with the scale of potential risks **in time**.

- From October 2018, lenders should not exceed a debt-to-income (**DTI**) ratio of nine annual incomes and a debt service-to income (**DSTI**) ratio of 45%, according to the CNB's recommendation.
  - In 2018 Q3 – immediately before the recommended DTI and DSTI limits took effect – credit institutions were lending to a significant degree to clients who already had relatively high debts.
  - Following the introduction of the recommended limits in October 2018, this trend was reversed and the shares of loans in excess of the limit started to head towards the 5% exemption.
- The adjustment process was not completed and **banks did not meet the recommended limits overall during 2018 Q4**.
  - The share of loans drawn with a DSTI of more than 45% reached almost 12% of total loans in 2018 Q4.
  - The share of loans drawn with a DTI of more than 9 fell towards 6% of total loans in 2018 Q4.
  - The CNB expects that banks will achieve compliance with the DTI and DSTI limits during this year.

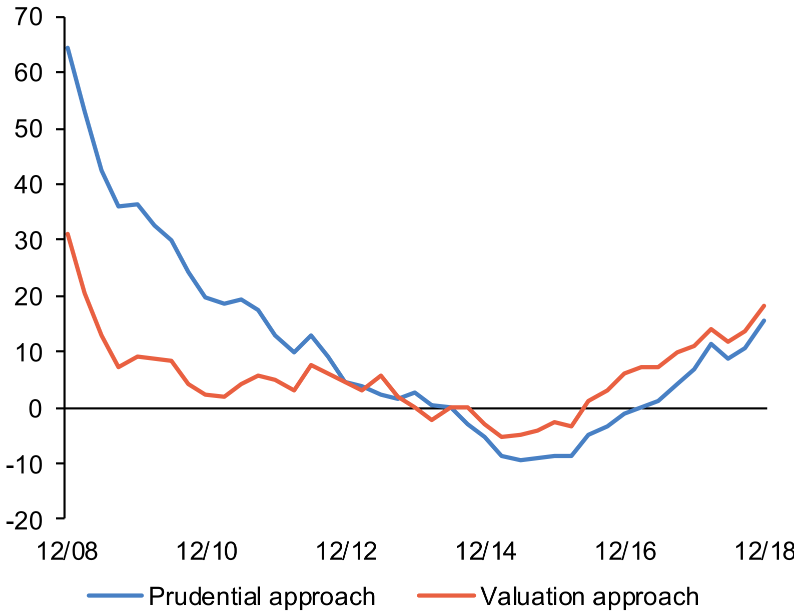
Property market and mortgage lending (2)

- The Bank Board discussed whether it was desirable to **change the recommended upper limit on the DSTI ratio to 50%**, given the rise in interest rates on mortgage loans to 3%.
  - Argument for an increase – the potential room for a jump in interest rates has been reduced and the risk of a sharp increase in debt service has decreased.
  - Arguments against an increase: (i) CNB analyses and stress tests show that loans with a DSTI of 40% or higher can be regarded as highly risky; (2) the recommendation regarding a 5% level of exemptions was not met in 2018 Q4.
- The Bank Board decided to **leave the DSTI limit at the current level of 45%**.
  - The topic will be discussed at the next meeting on financial stability issues in December 2019, especially in connection with the results of compliance with the relevant limits in the first half of 2019.

- Both methods used by the CNB indicate average **overvaluation of house prices of roughly 15%**.

Estimated overvaluation of apartment prices

(%)



Source: CNB

Property market and mortgage lending (4)

- The CNB **does not currently consider it necessary to tighten the current LTV limits**:
  - Banks should not provide loans with an LTV of more than 90% (individual limit).
  - Banks should not provide loans with an LTV of between 80% and 90% to an extent higher than 15% of total loans provided in the relevant period.
- In the case of the LTV limits, banks are mostly abiding by the applicable Recommendation and **are compliant with the recommended aggregate LTV limit of 15%**.
- The CNB observes that **in good times banks have a natural tendency to value collateral on the basis of current market prices** regardless of the fact that prices may be overvalued in an upward phase of the cycle.
- In view of the above estimate of house price overvaluation, the CNB regards the current LTV limits as **upper bounds**.

Decision on setting of countercyclical capital buffer rate (CCyB)

- The Bank Board decided to **increase the countercyclical capital buffer rate** to **2.0%** with effect **from 1 July 2020**.
  - The Bank Board decided to take into account (i) the upward movement of the domestic economy in the growth phase of the financial cycle, reflected in higher cyclical risk-taking, (ii) the decline in risk weights and hence also the capital requirements for loans, and (iii) the downward trend in provisioning.
  - Assuming reasonable dividend policies, banks have sufficient space for a prospective increase in this buffer and growth in their credit portfolios.
  - Given that the domestic economy is probably close to the peak of the financial cycle, the likelihood of a further increase in the countercyclical buffer rate has decreased significantly.

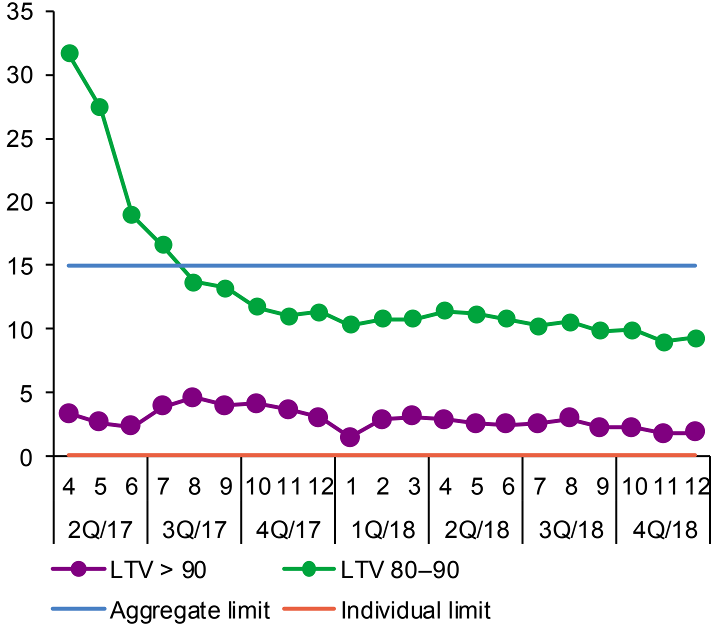
II.

Assessment of selected risks

Compliance with recommended LTV limits

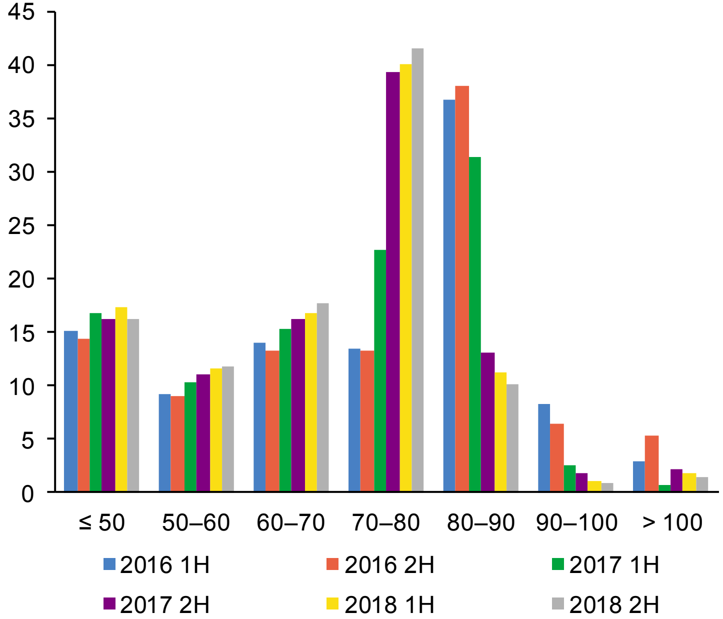
- The share of loans with an LTV of more than 90% fell below 2% in 2018 Q4.
- The shift of riskier loans to the category with an LTV of 70%–80% continued.

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



Source: CNB

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



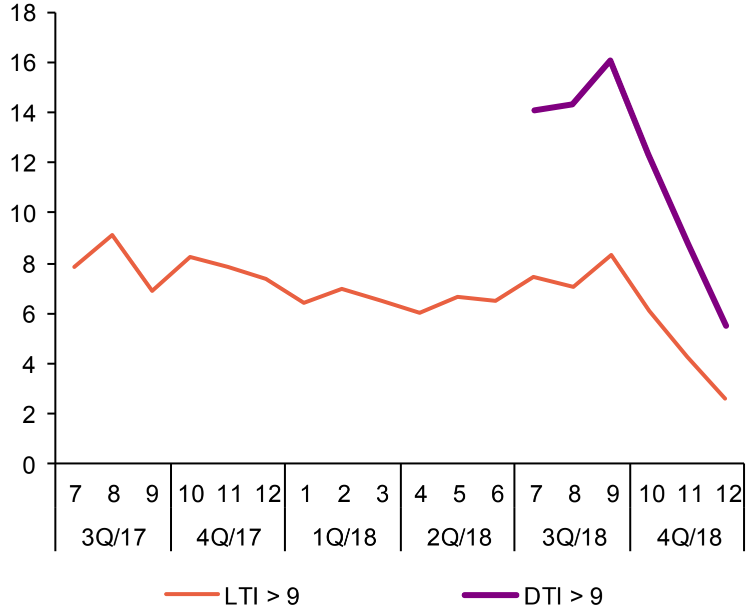
Source: CNB
Note: Interval closed from the right.

Riskiness of loans before introduction of DTI and DSTI limits

- The DSTI limit is the main constraint on lending, in many cases probably because of debt service on unsecured loans.

Fulfilment of the recommended DTI limits

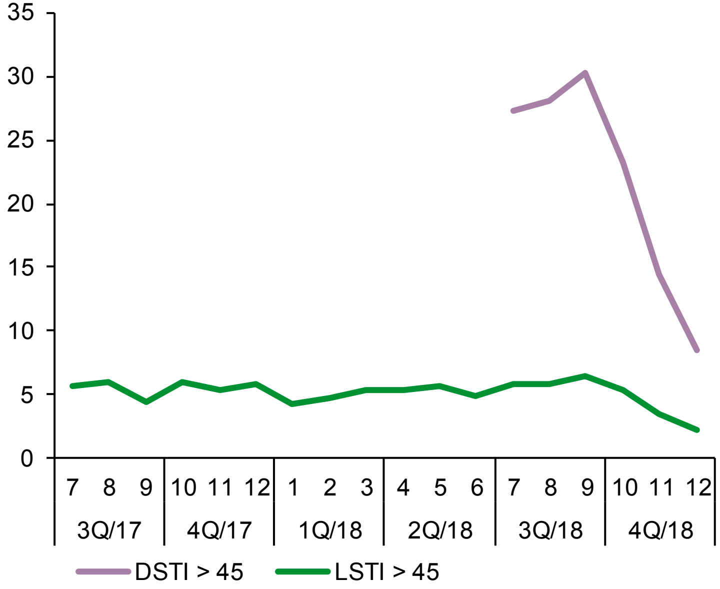
(share of loans in total volume of loans)



Source: CNB

Fulfilment of the recommended DSTI limits

(share of loans in total volume of loans)



Source: CNB

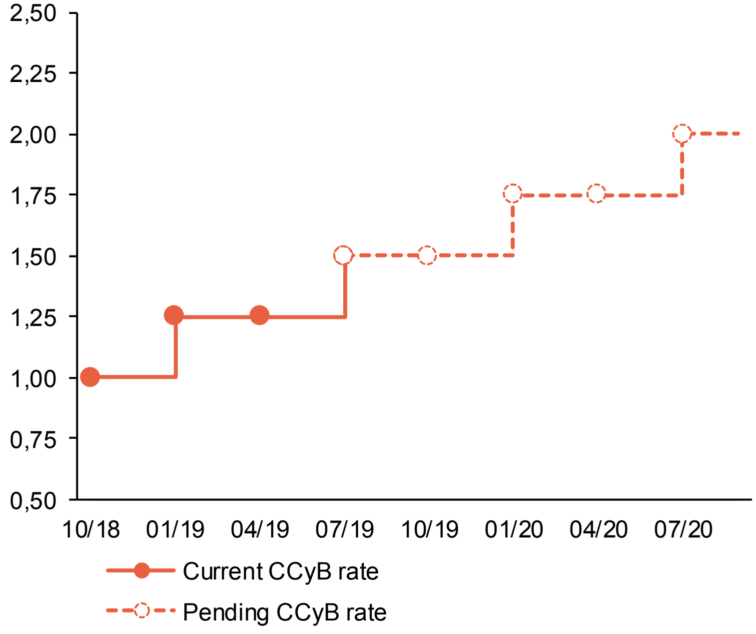
Technical adjustments and clarifications in Recommendation

- A provision was added concerning **refinancing of loans for consumption unsecured by residential property** for clients who already have a retail loan secured by residential property and simultaneously increase – as part of refinancing – the outstanding amount of principal of the unsecured loan by more than 10%.
  - In such cases, lenders should always assess whether clients' total debt is in line with the recommended DTI and DSTI limits.
- Following discussions with lenders, the **base for the calculation of the volume of admissible exemptions was adjusted in the same way** for all three indicators and now is:
  - one-half of the total volume of all retail loans secured by residential property provided over the previous two quarters, or one-half of the total volume of other loans for consumption unsecured by residential property provided over the previous two quarters.

- The **rise in the CCyB rate** to 2.0% with effect from 1 July 2020 is based on an assessment of the position of the economy in the financial cycle and of banking sector vulnerability indicators (all indicators are heading towards increase in the CCyB rate).

Current and pending CCyB rate in the Czech Republic

(% of total risk exposure)



Source: CNB

Changes in indicators of financial cycle and banking sector vulnerability

y-o-y change

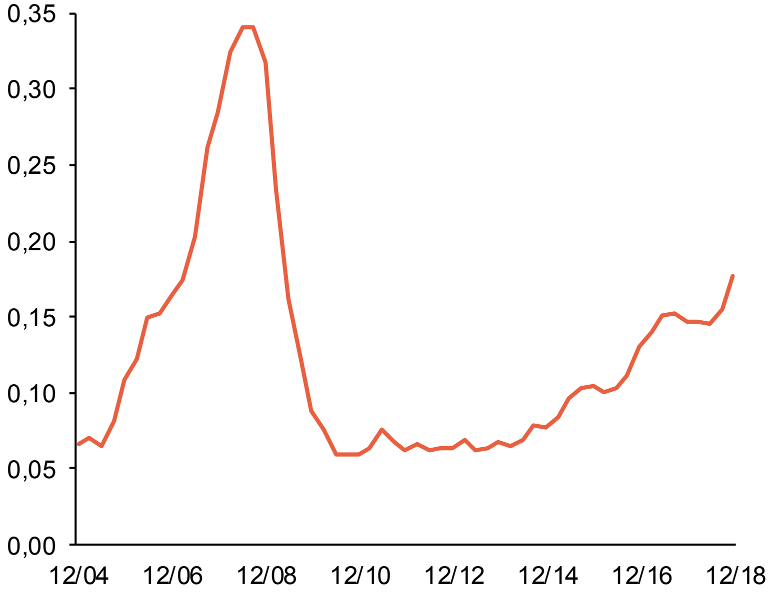
Financial cycle		Banking sector vulnerability	
Indicator	Shift	Indicator	Shift
IFC	↑	Risk weights	↓
Credit dynamics	↑	Provisions	↓
Potential cyclical losses	↑		
Risk characteristics of loans	↑		

Assessment of position in financial cycle

- According to the aggregate **Financial Cycle Indicator (FCI)**, the domestic economy entered the fourth year of the expansionary phase at the end of last year.

Financial Cycle Indicator

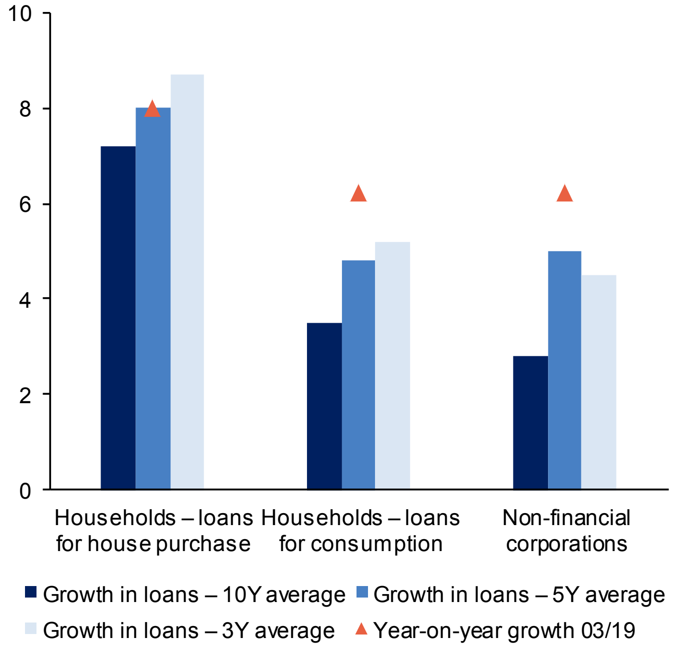
(%; right-hand scale: 0 minimum, 1 maximum)



Source: CNB

Average and current growth in bank loans to the private non-financial sector

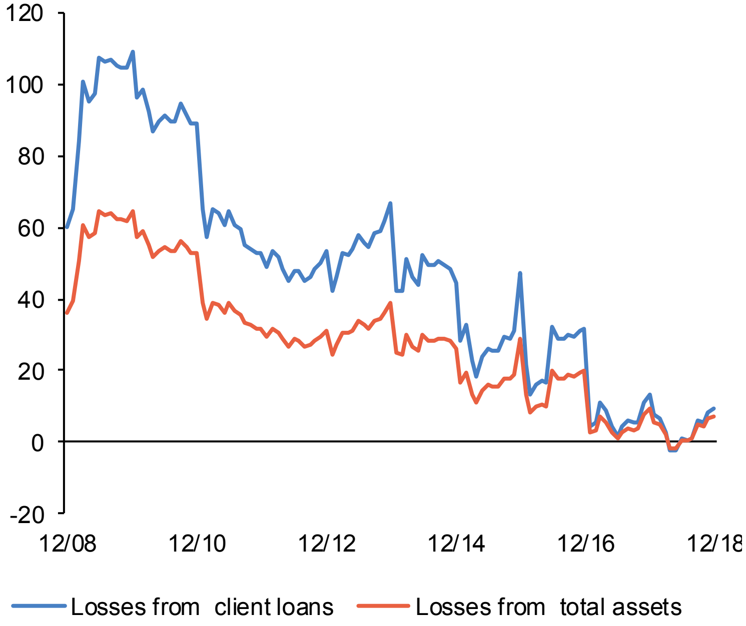
(%)



Source: CNB

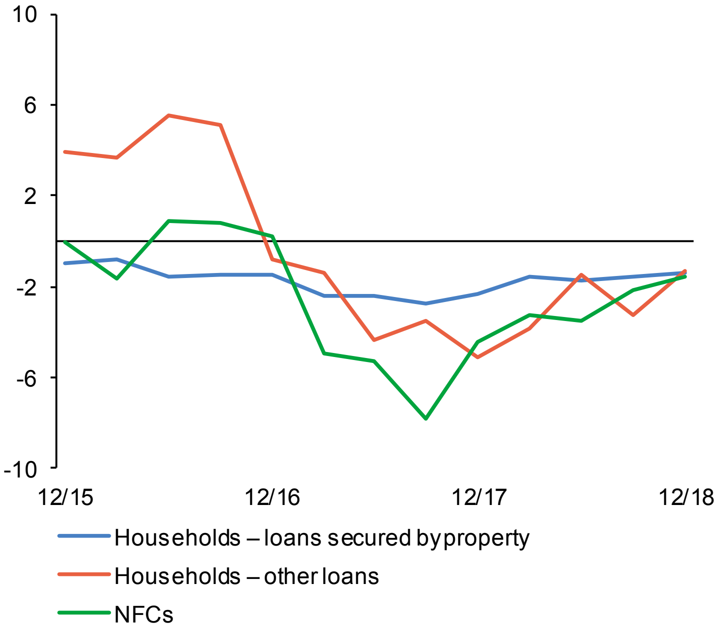
- Current asset impairment losses are very low and unsustainable, the ratio of provisions to loans is falling and risk weights are decreasing year on year.

Impairment charges
(in bp)



Source CNB

Quarterly change in IRB risk weights in the main loan categories
(pp)



Source: CNB

Thank you for your attention

Financial Stability Report 2018/2019
will be published on **11 June 2019** at
https://www.cnb.cz/en/financial-stability/fs-reports/
together with the **minutes of the Bank Board meeting** of 23 May 2019

Information on financial stability
and CNB macroprudential policy
is available at
https://www.cnb.cz/en/financial-stability/
https://www.cnb.cz/en/financial-stability/macroprudential-policy/