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

## Financial Stability Report – Autumn 2023

**Karina Kubelková**, CNB Bank Board member

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

29 November 2023

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# Contents

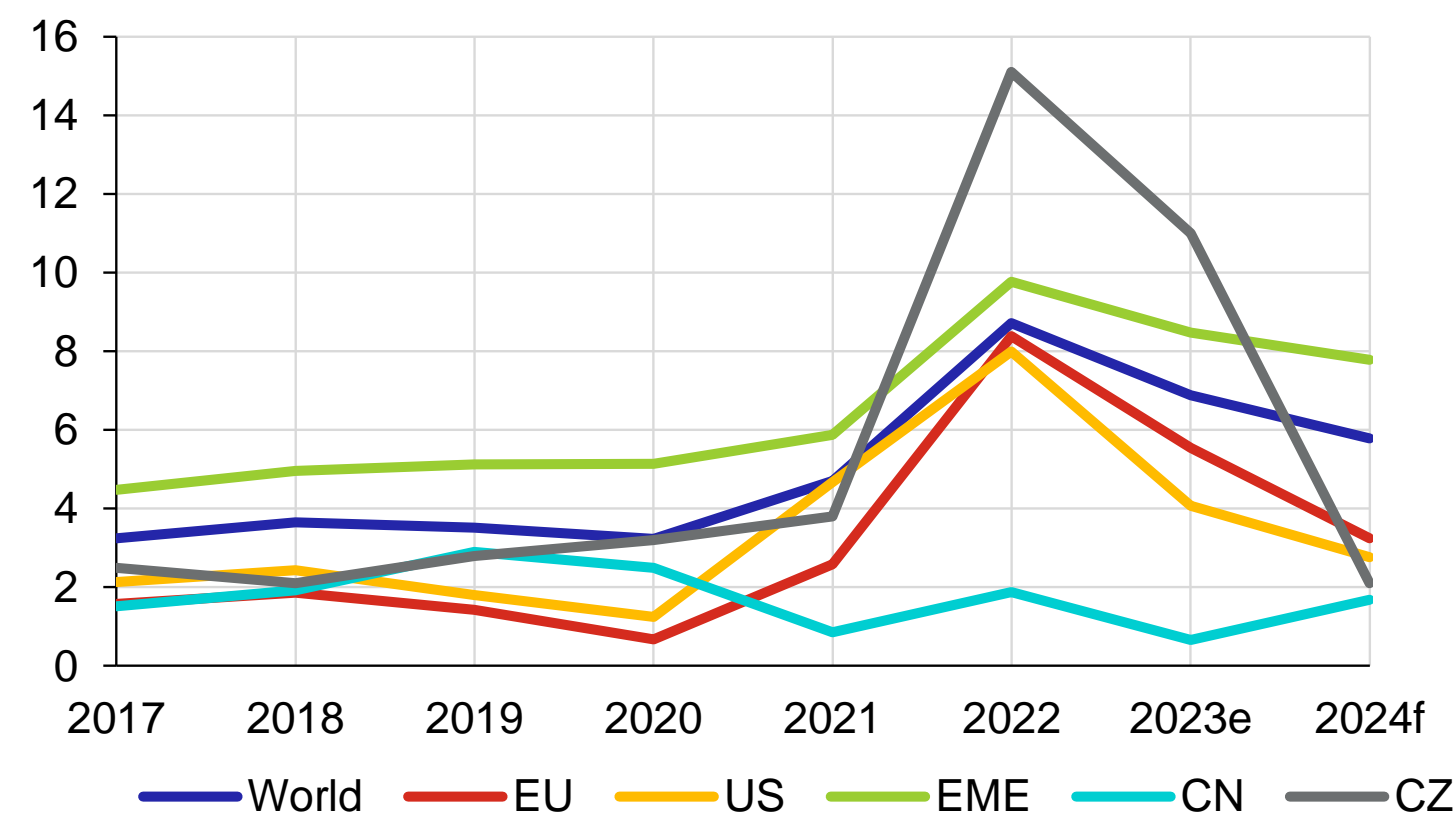
- 1. Aggregate assessment of risks and overview of CNB's main measures**
2. Assessment of selected risks



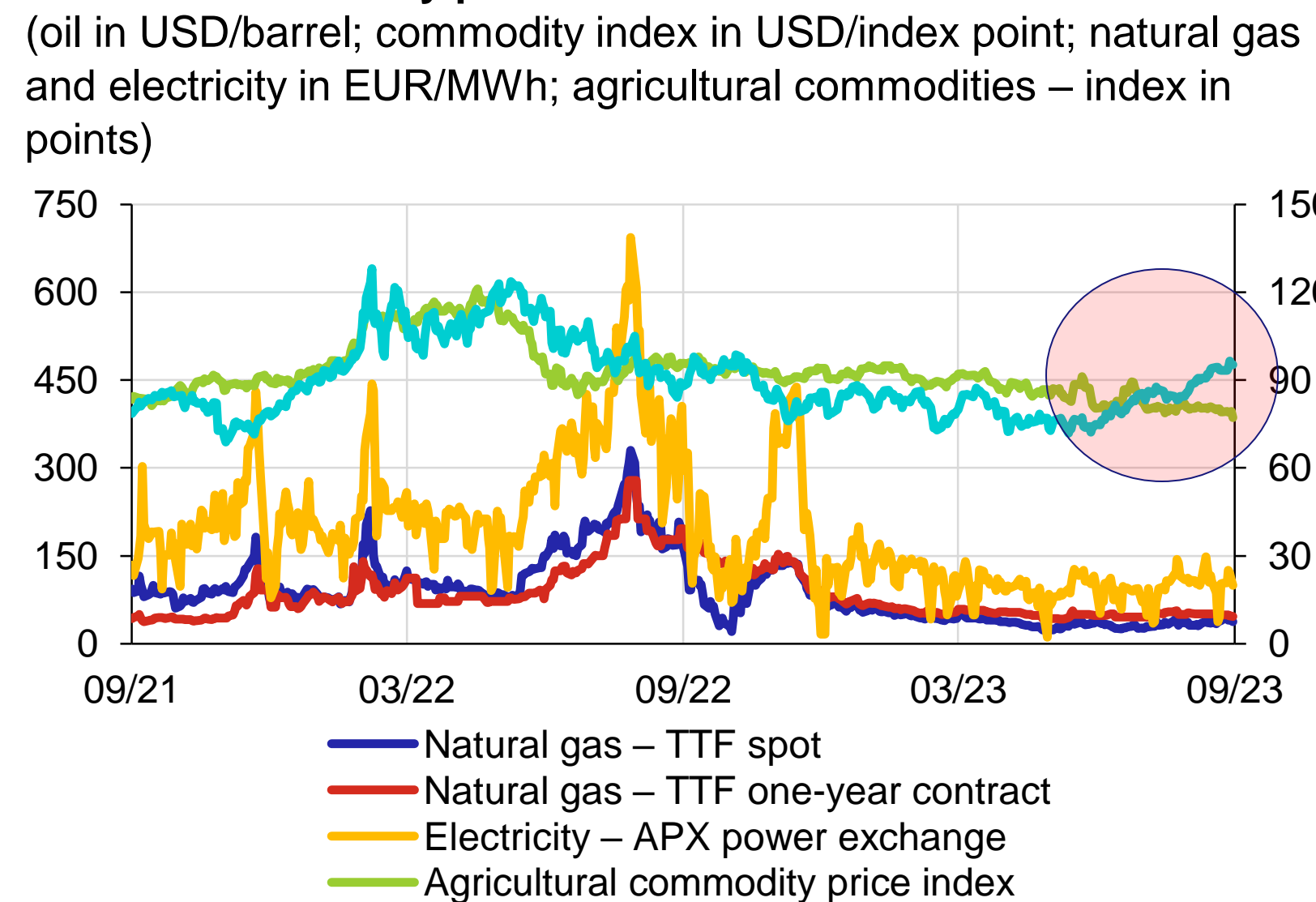
# Economic environment, aggregate risk assessment (1)

- The expected duration of restrictive monetary policies is being revised on a global scale:
  - Despite having decreased considerably, inflation remains above central banks' inflation targets in most countries.
  - Monetary policy is likely to be eased later and at a slower pace.
  - Higher oil and energy prices in particular could lead to a new supply-side inflation shock.
  - The European economy is recovering only gradually, with geopolitical uncertainties still having an adverse effect.

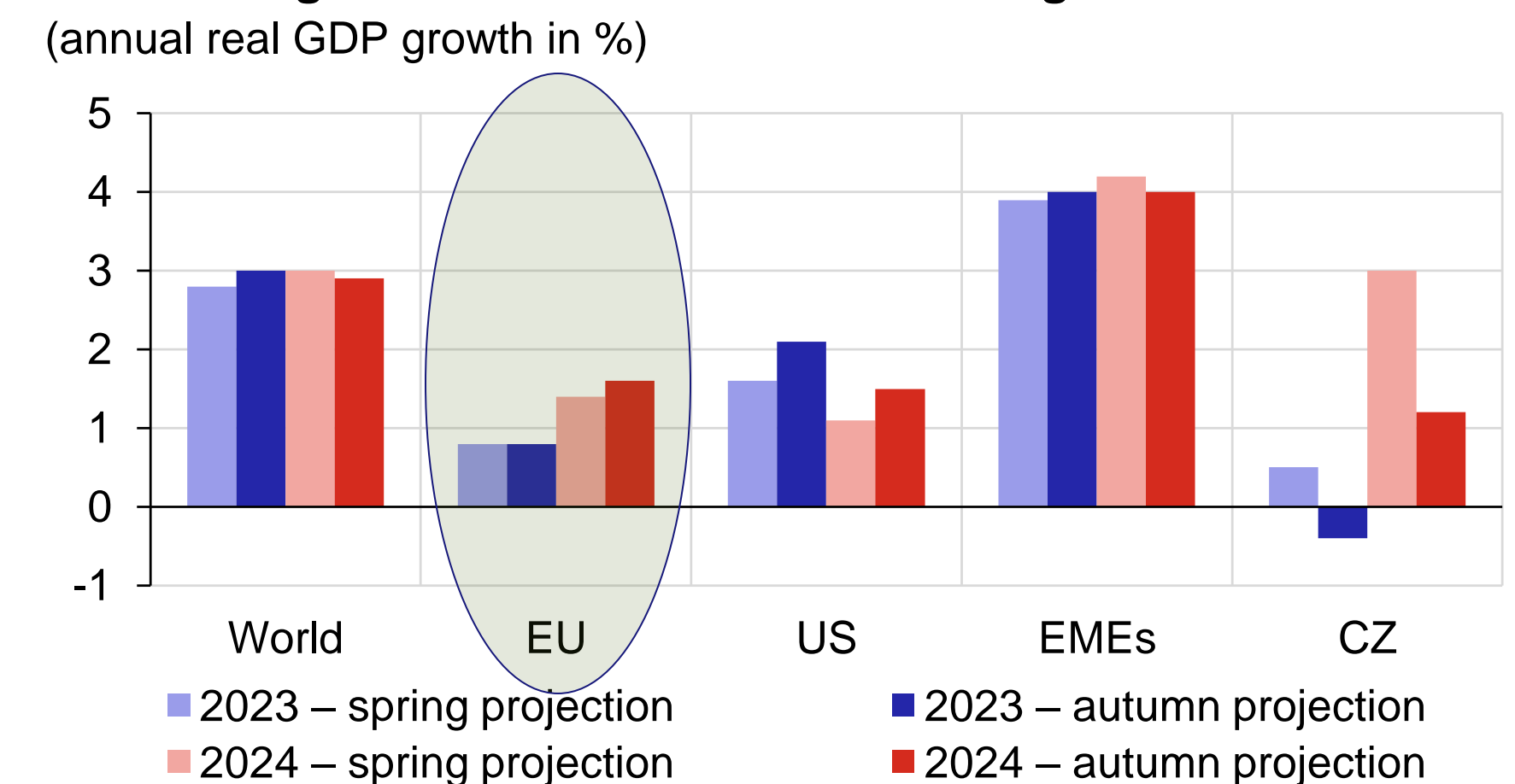
**Inflation in selected regions**  
(annual inflation rates in %)



**Selected commodity prices**



**Economic growth forecasts for selected regions**

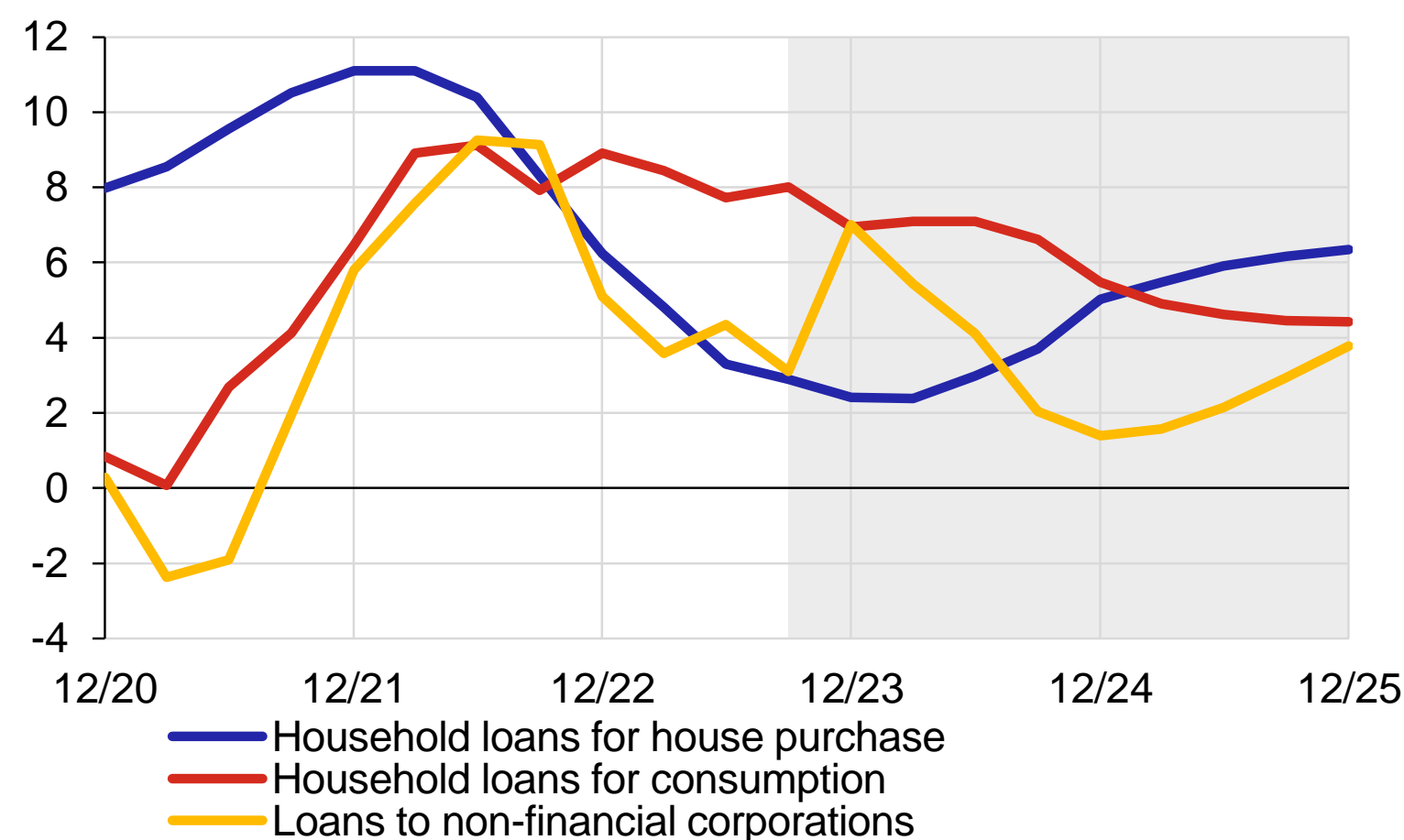




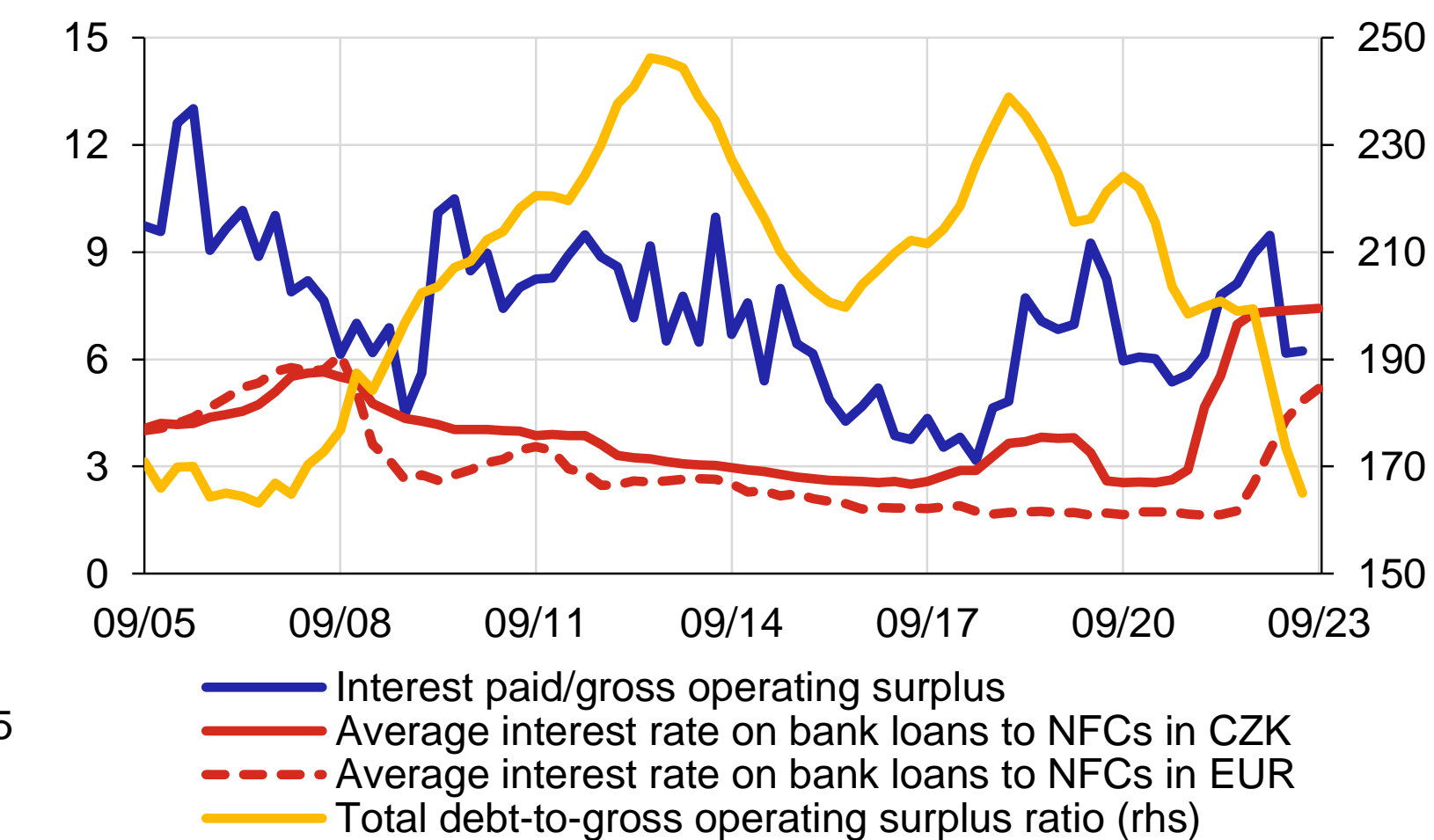
# Economic environment, aggregate risk assessment (2)

- GDP growth in the Czech Republic remains subdued:
  - Lending to non-financial corporations and households is below the long-term average, reducing their indebtedness and limiting growth in debt service.
  - However, corporations and households may face worse economic conditions in 2024, with potential impacts on their financial soundness.

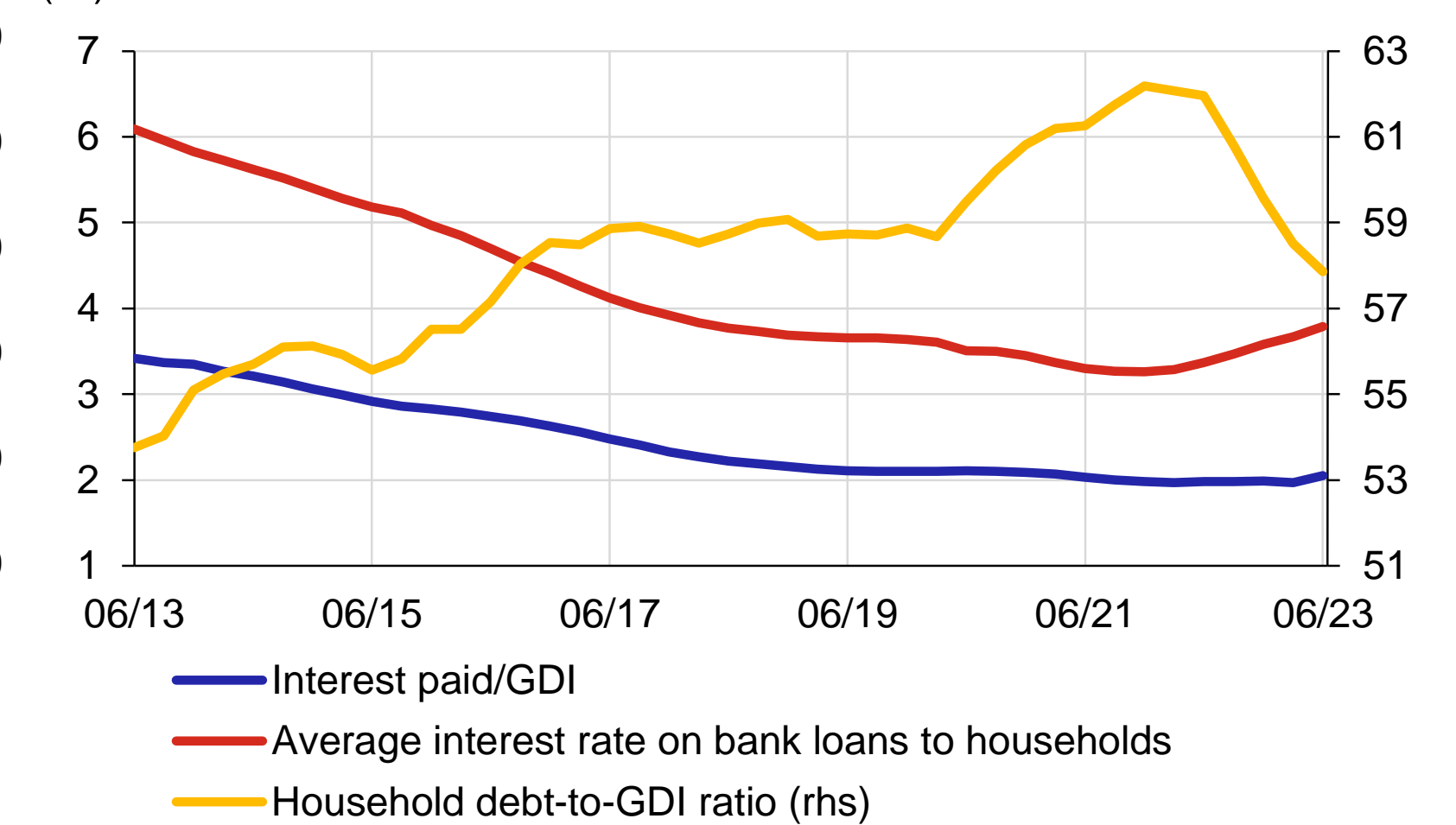
**Projections of growth in the stock of bank loans in the private non-financial sector**  
(year on year in %)



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



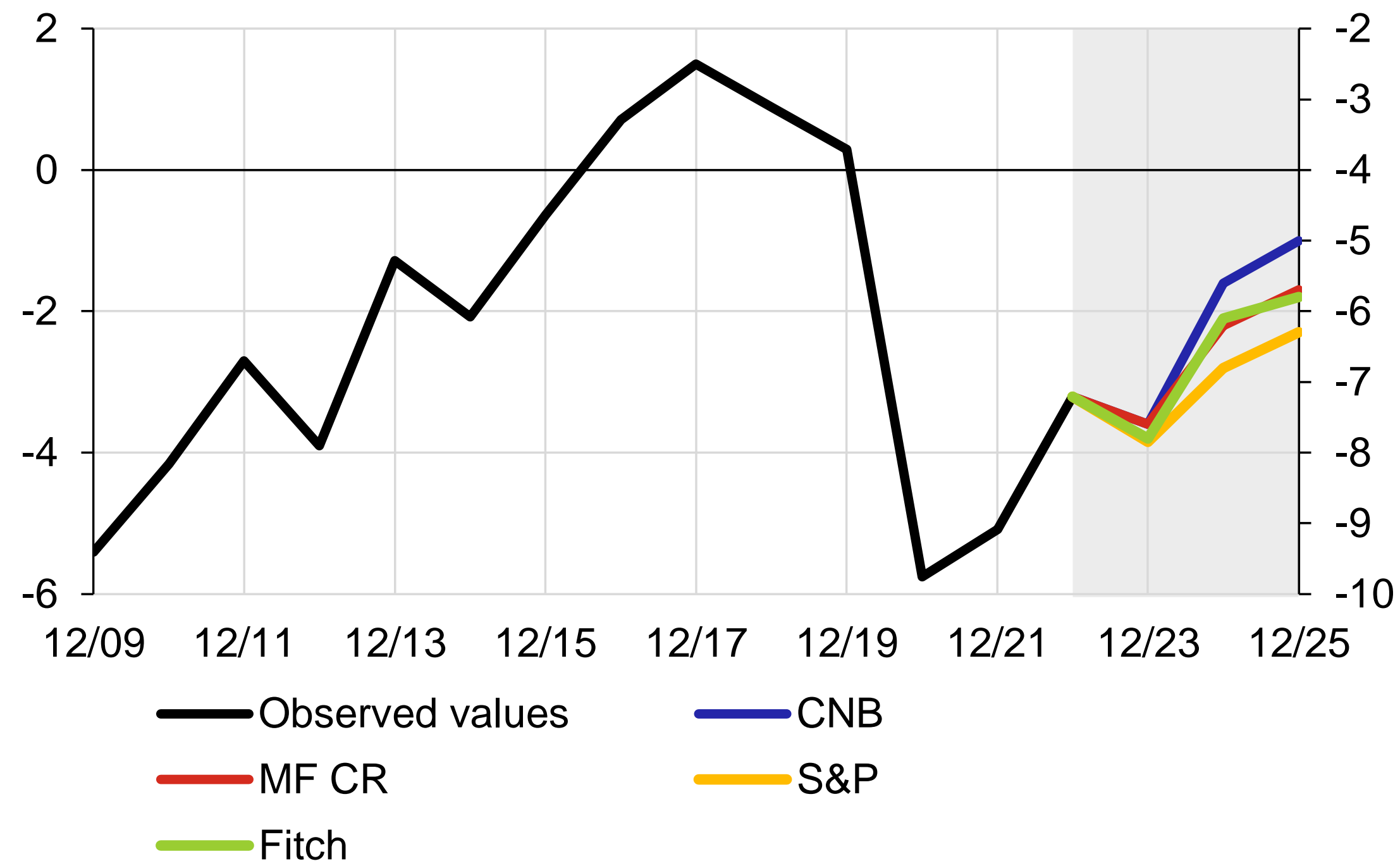
**Debt ratio and interest paid by households**  
(%)



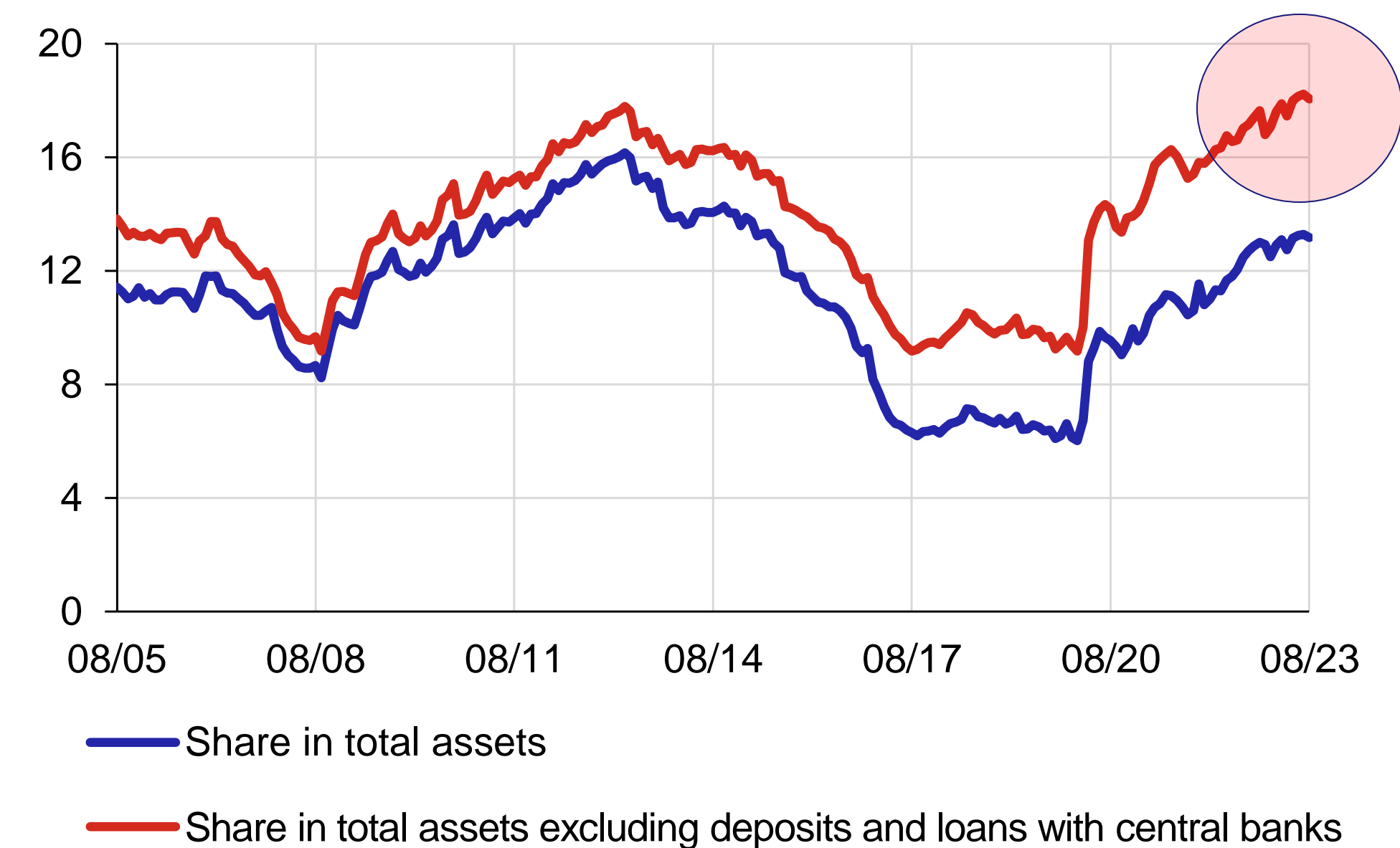
# Economic environment, aggregate risk assessment (3)

- 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)



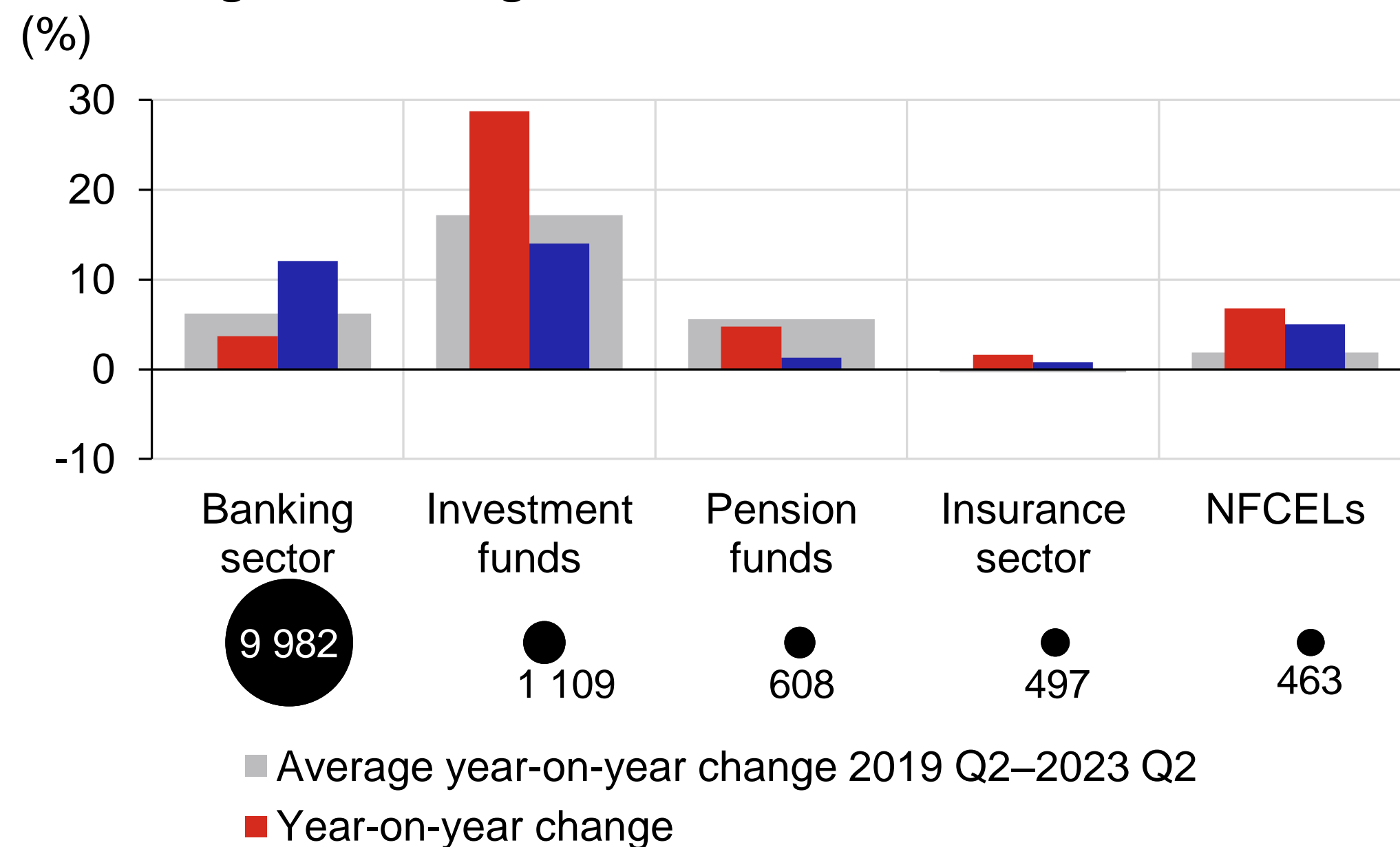
**Share of general government debt securities on the balance sheets of domestic banks**  
(%)



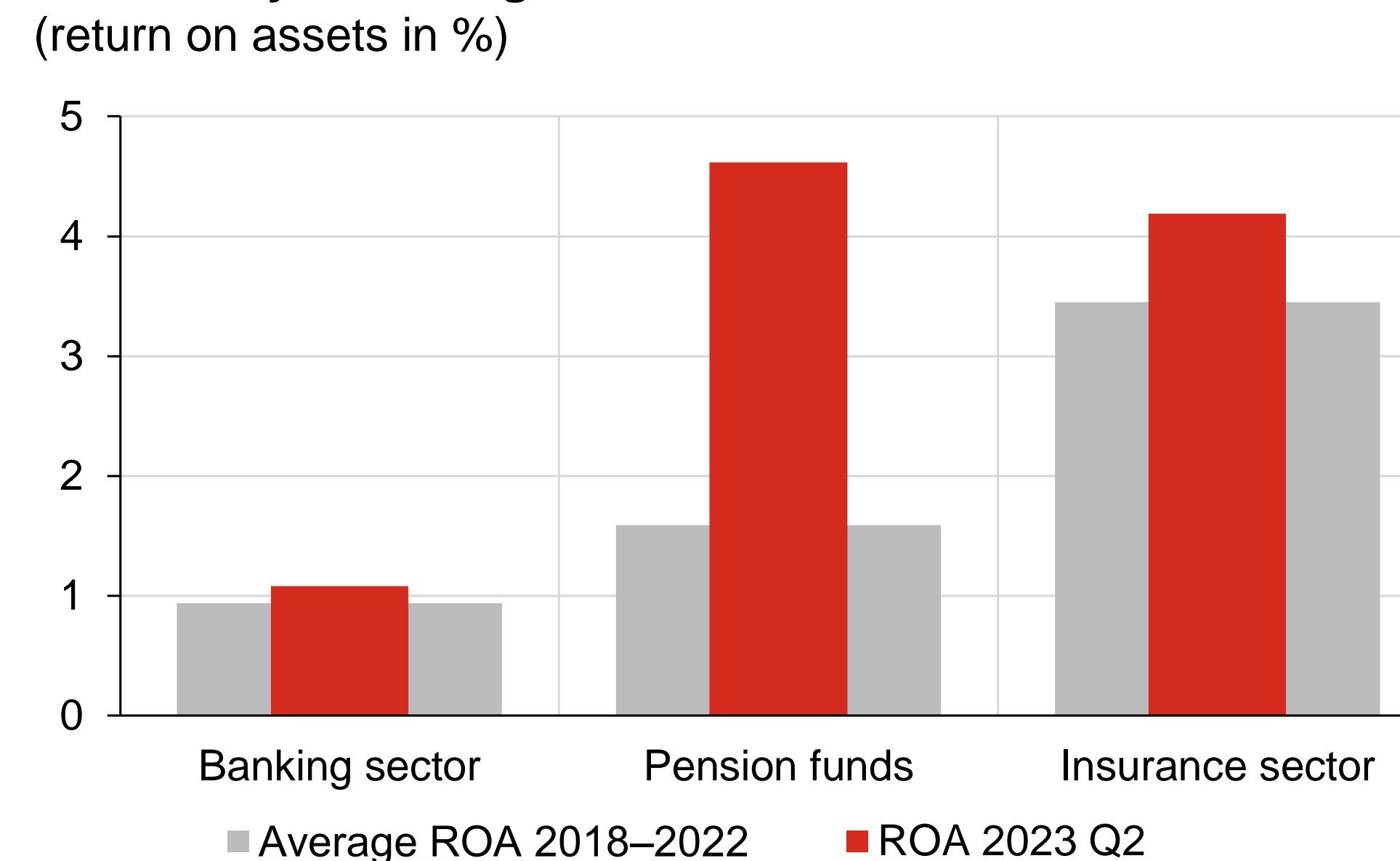
# Financial stability in November 2023 (1)

- The situation in the Czech financial sector showed favourable trends in the first half of 2023.
- Most of its segments recorded growth in total assets and profitability.
  - Their strong capitalisation and liquidity position is the foundation of their resilience to adverse shocks.

**Rates of growth of segments of the financial sector**



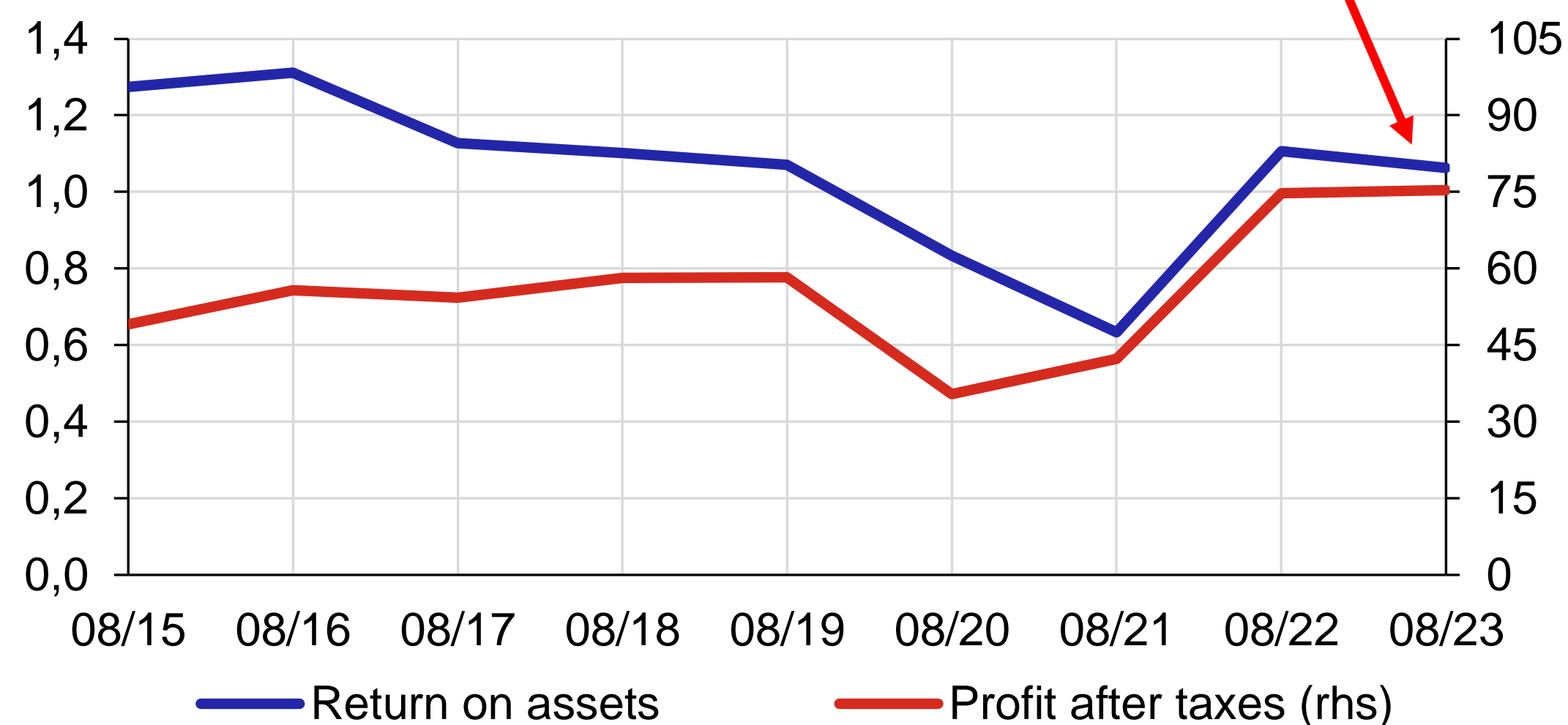
**Profitability of the segments of the financial sector**



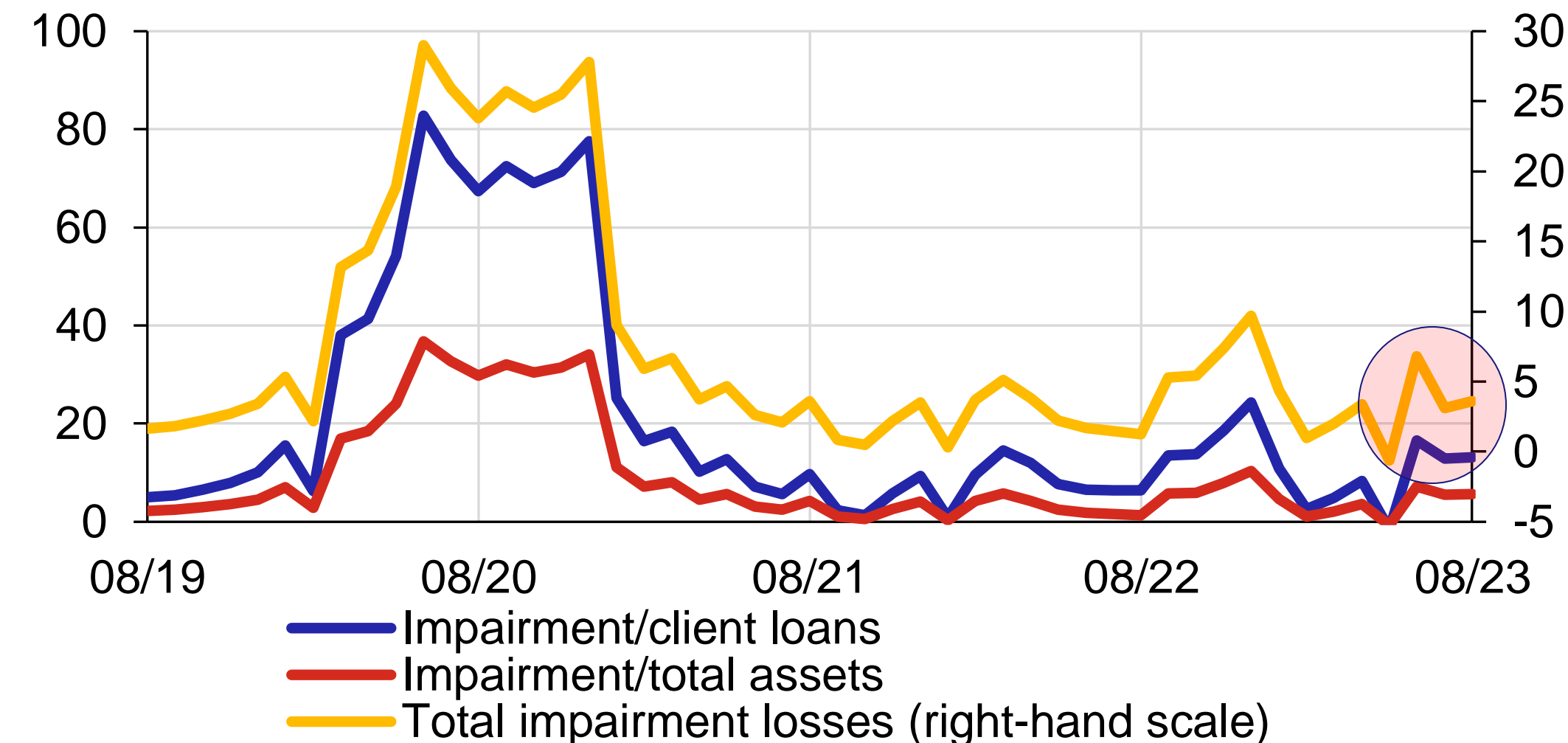
# Financial stability in November 2023 (2)

- The profitability of the banking sector fell slightly year on year.
  - The ongoing transmission of monetary policy rates to deposit rates is being reflected in net interest income.
  - The economic downturn is leading to higher impairment losses.

**Return on assets and profit**  
(%; right-hand scale: CZK billions)



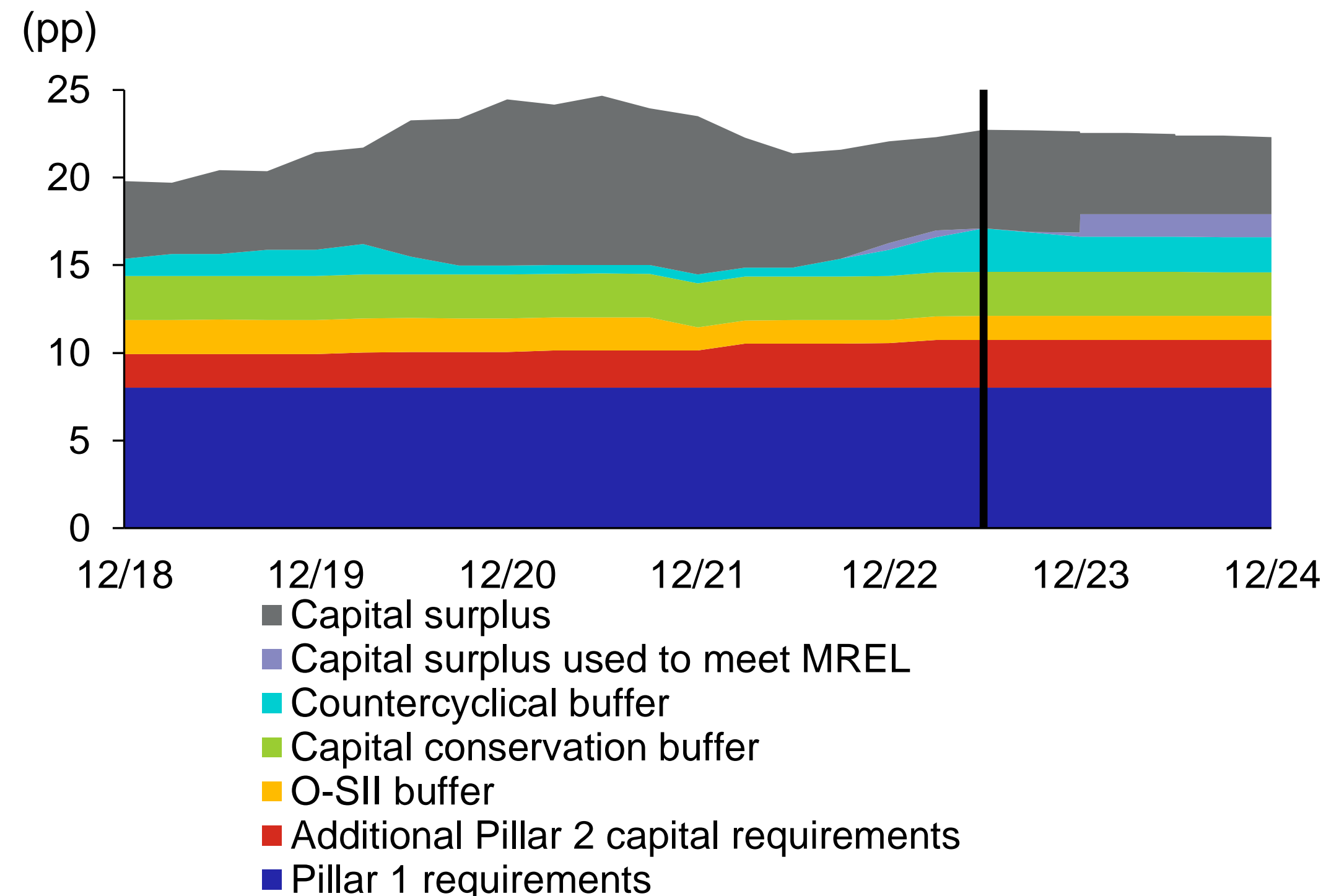
**Asset impairment losses**  
(bp; right-hand scale: CZK billions)



# Financial stability in November 2023 (3)

- The **crucial banking sector** is resilient to adverse shocks.
  - Its capitalisation remains 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

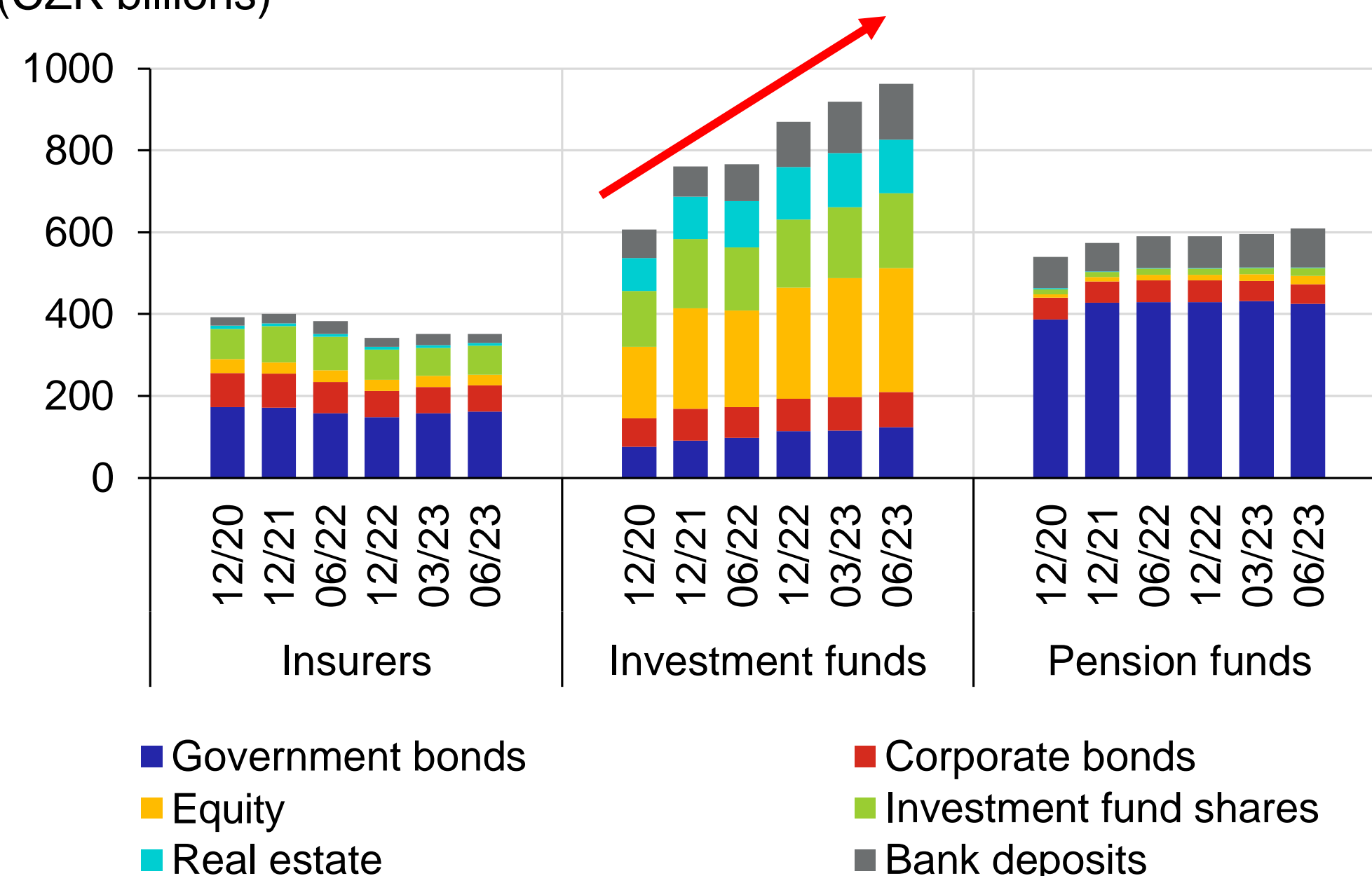




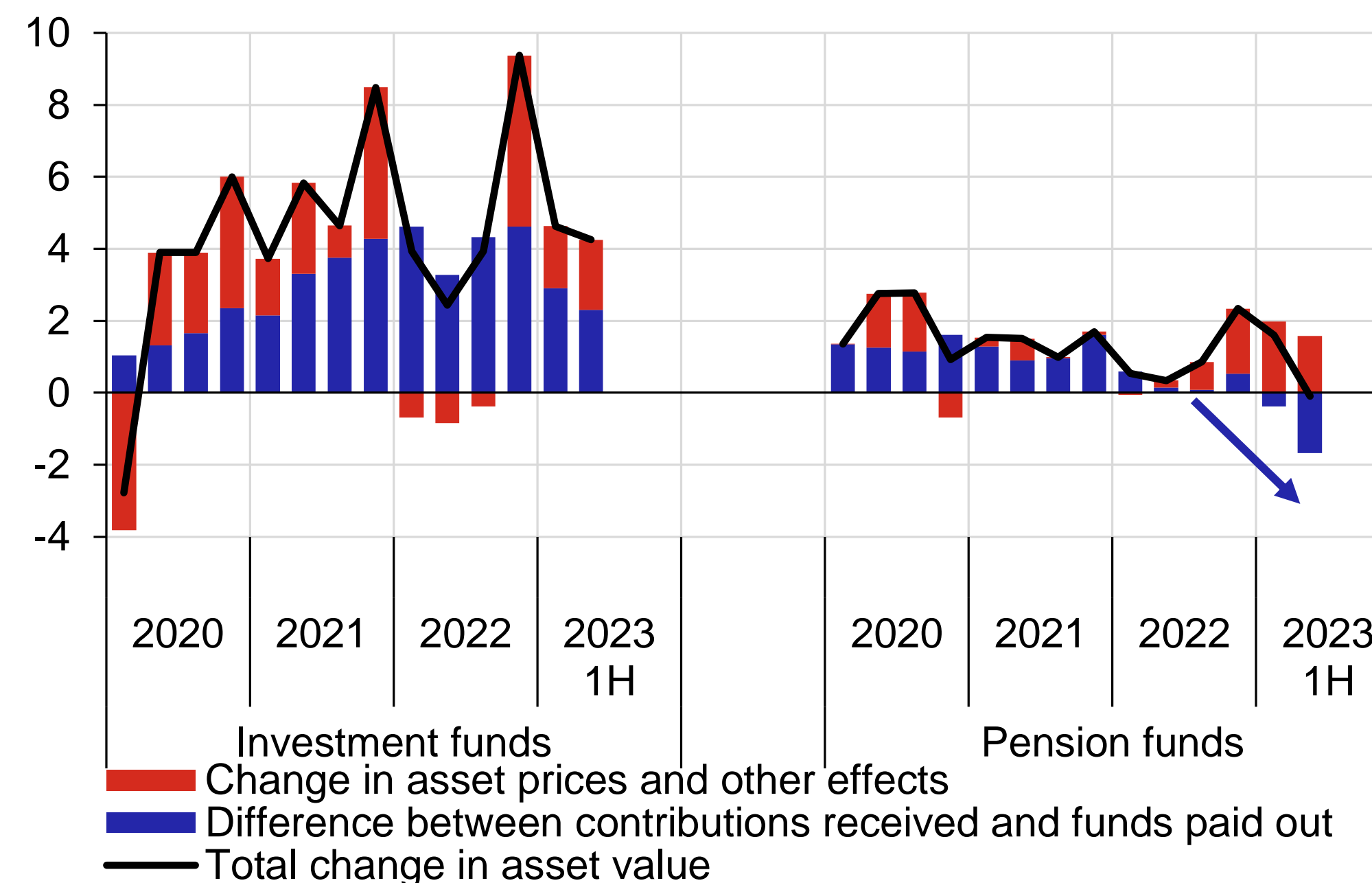
# Financial stability in November 2023 (4)

- The domestic **non-bank financial sector** is stable and resilient.
  - Investment funds continue to show dynamic growth.
  - Pension funds are recording outflows from transformed funds.

**Main components of domestic non-bank 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)



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

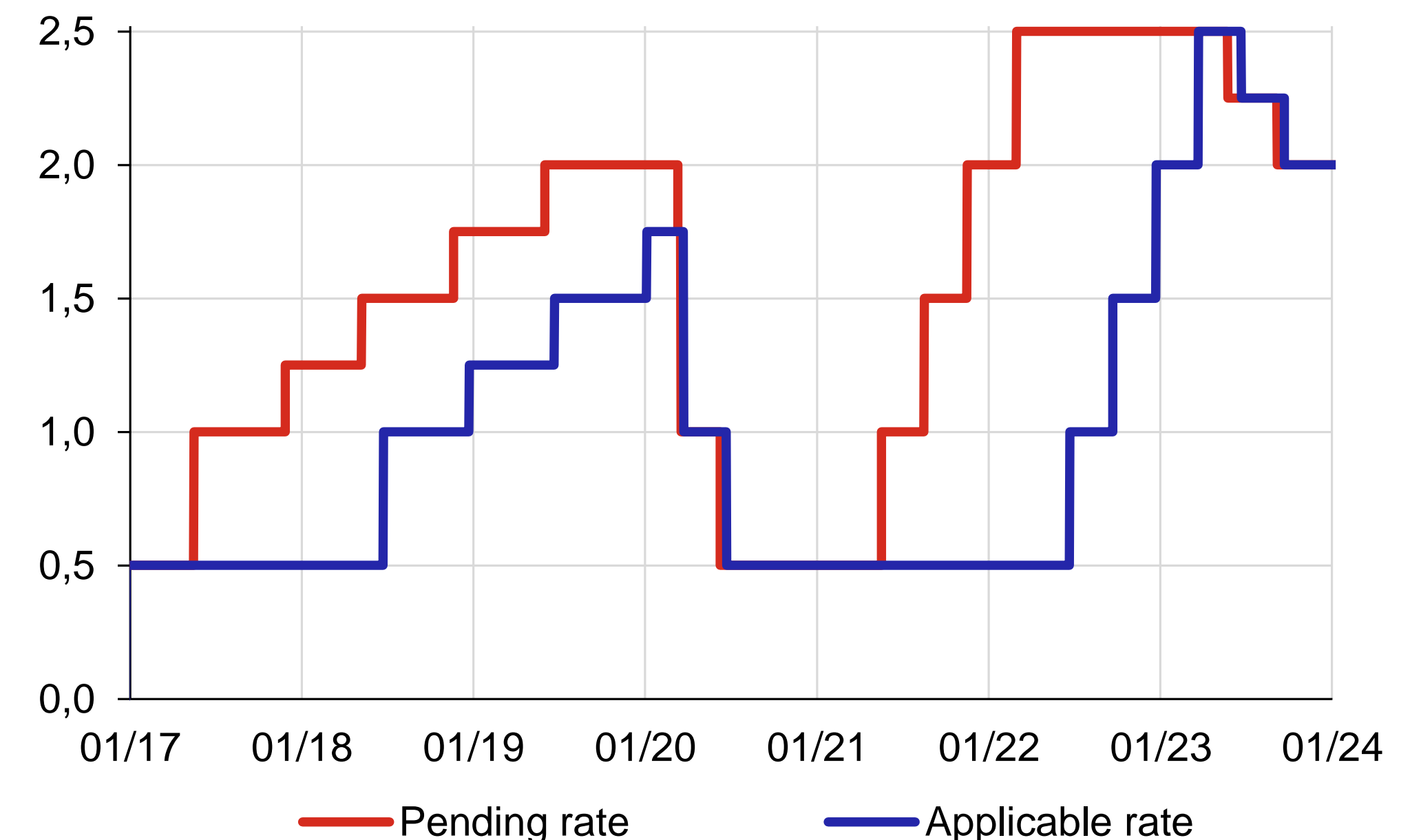
- Capital buffers



# Decision on countercyclical capital buffer rate (1)

- **The Bank Board decided today to leave the buffer rate at 2%.**
  - In the downward phase of the financial cycle, the CNB gradually and cautiously lowers the buffer rate depending on how risks materialise and/or diminish.
  - The CNB is ready to **gradually lower** the buffer rate further if the cyclical risks continue to disappear naturally from the banking sector's balance sheets.
  - Should the economic situation worsen substantially and significant unexpected credit losses arise, the CNB is ready to **lower the buffer rate more significantly or release the buffer fully.**

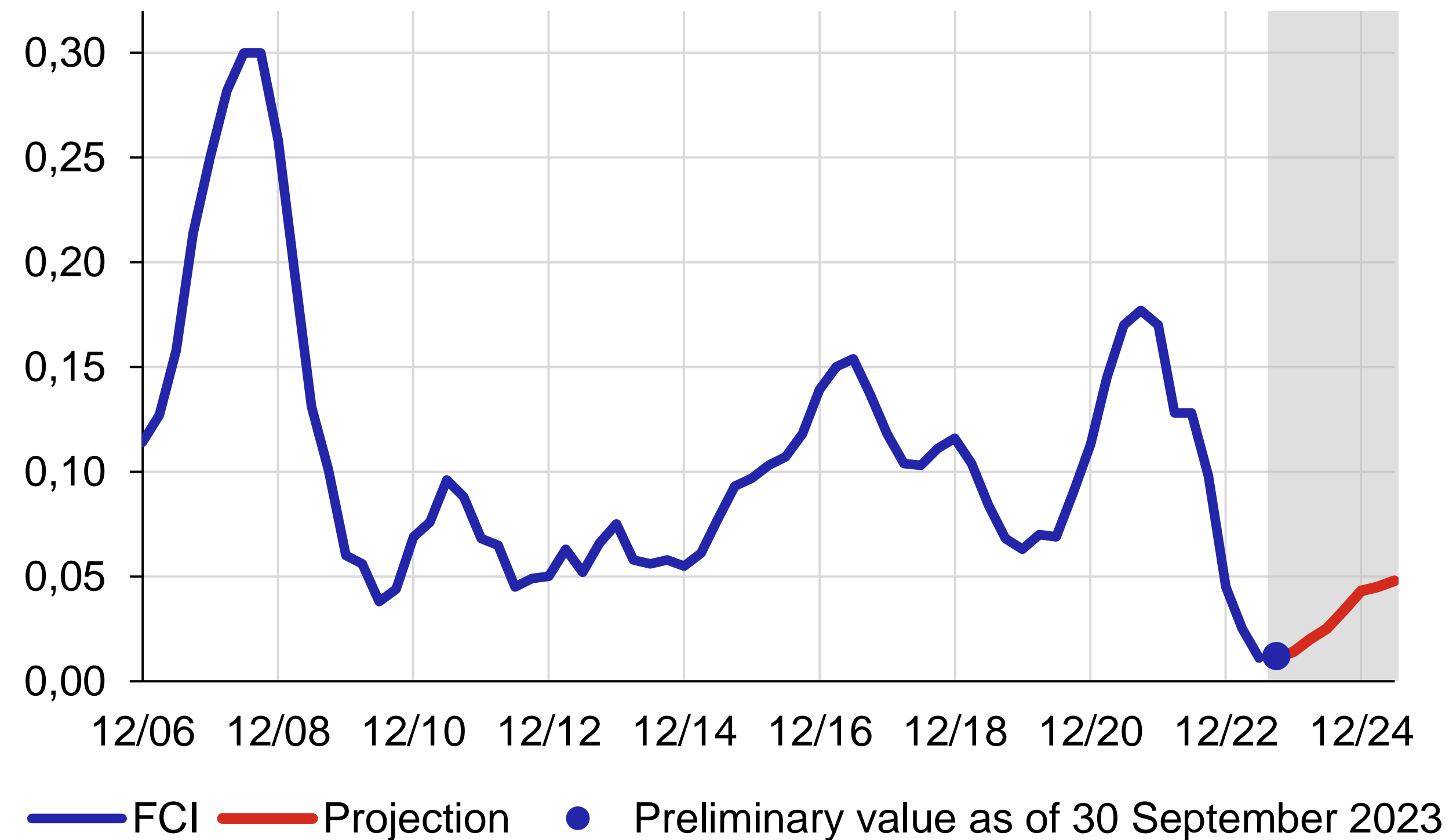
Pending and applicable CCyB rate in the Czech Republic  
(% of total risk exposure)



# Decision on countercyclical capital buffer rate (2)

- The financial cycle is in a downward phase and near its trough.

**Financial cycle indicator**  
(0 minimum, 1 maximum)



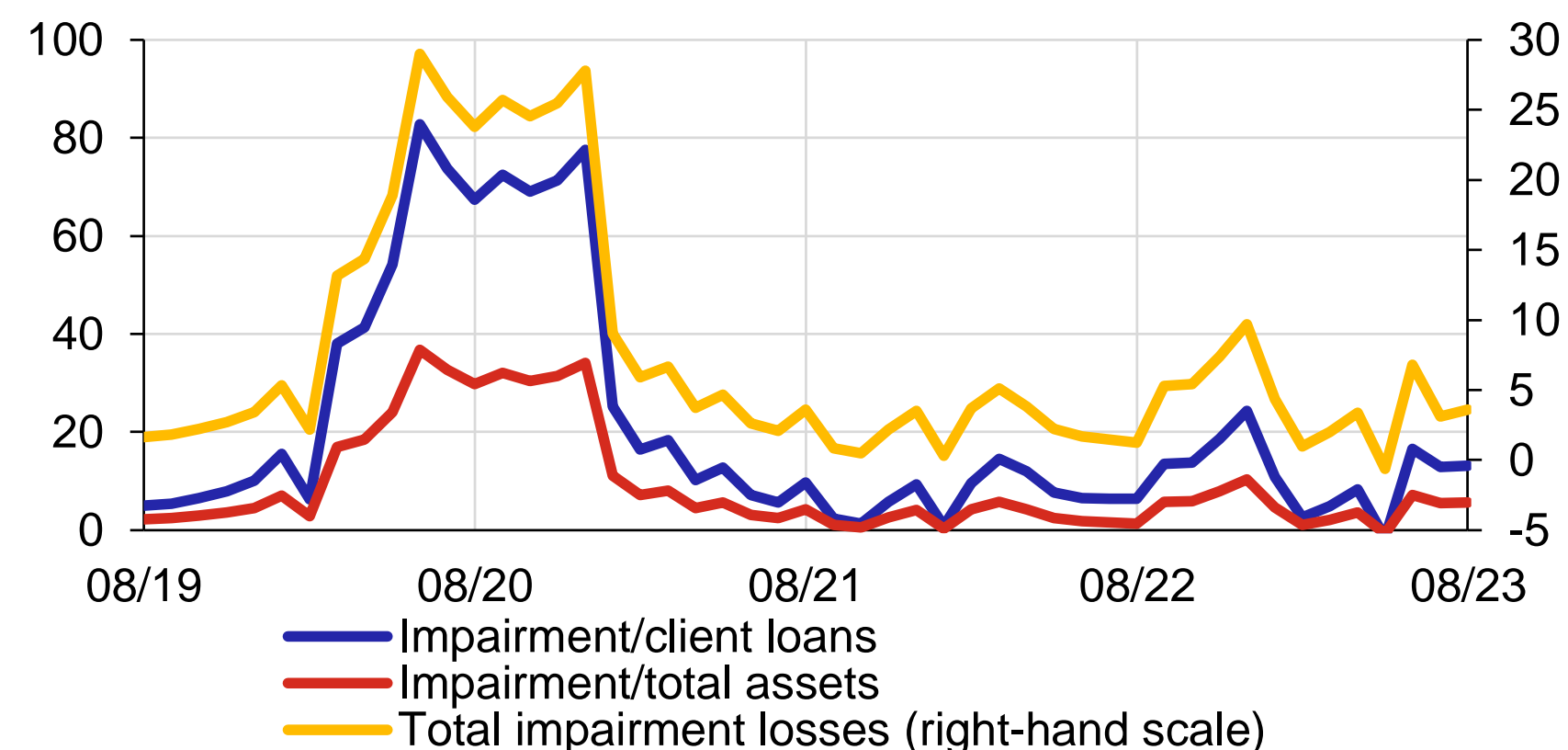


# Decision on countercyclical capital buffer rate (3)

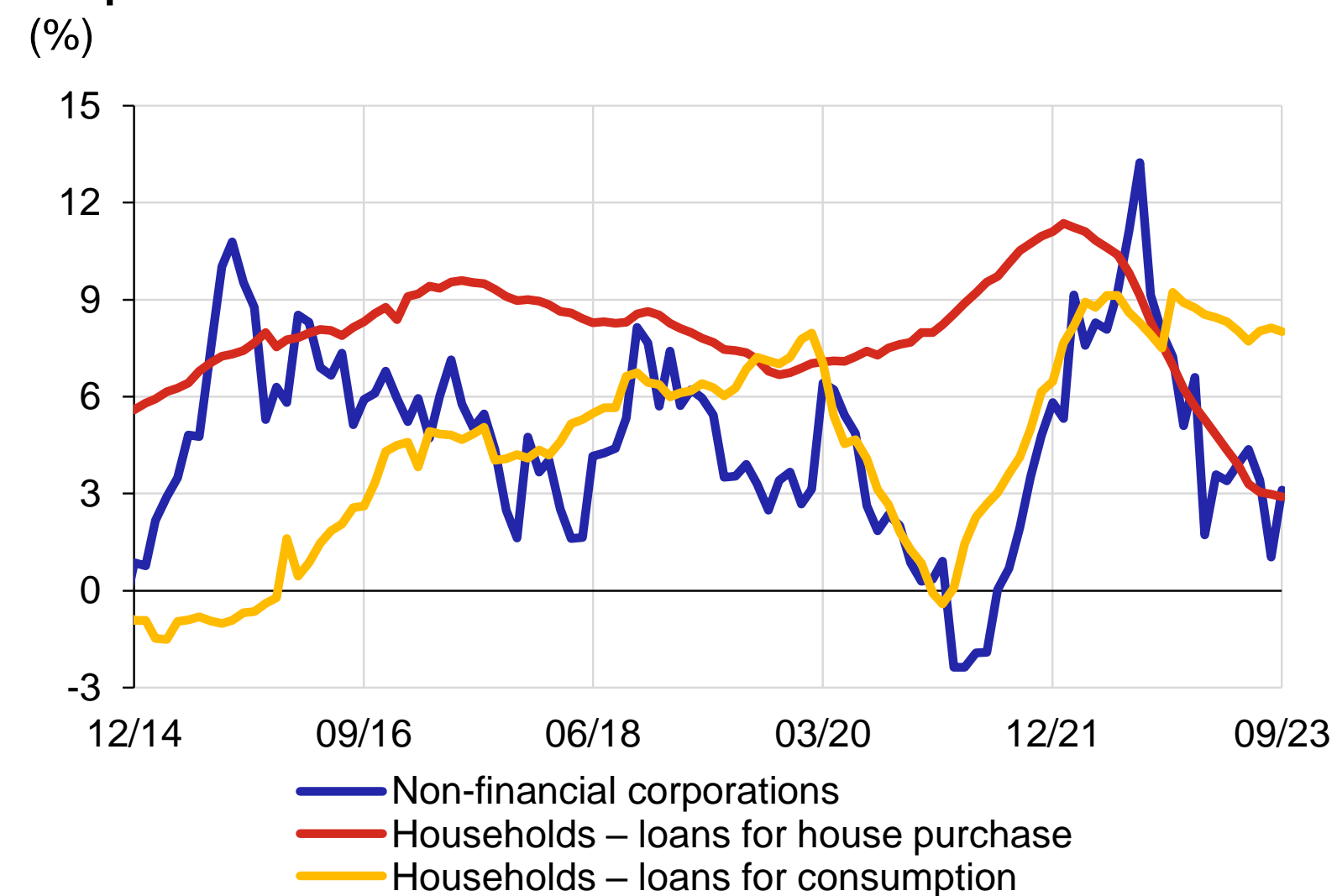
In our decision to keep the rate unchanged, we took into account:

- the decreasing but still significant previously accepted cyclical risks in the banking sector's balance sheet
- the cyclically reduced risk weights for credit exposures.

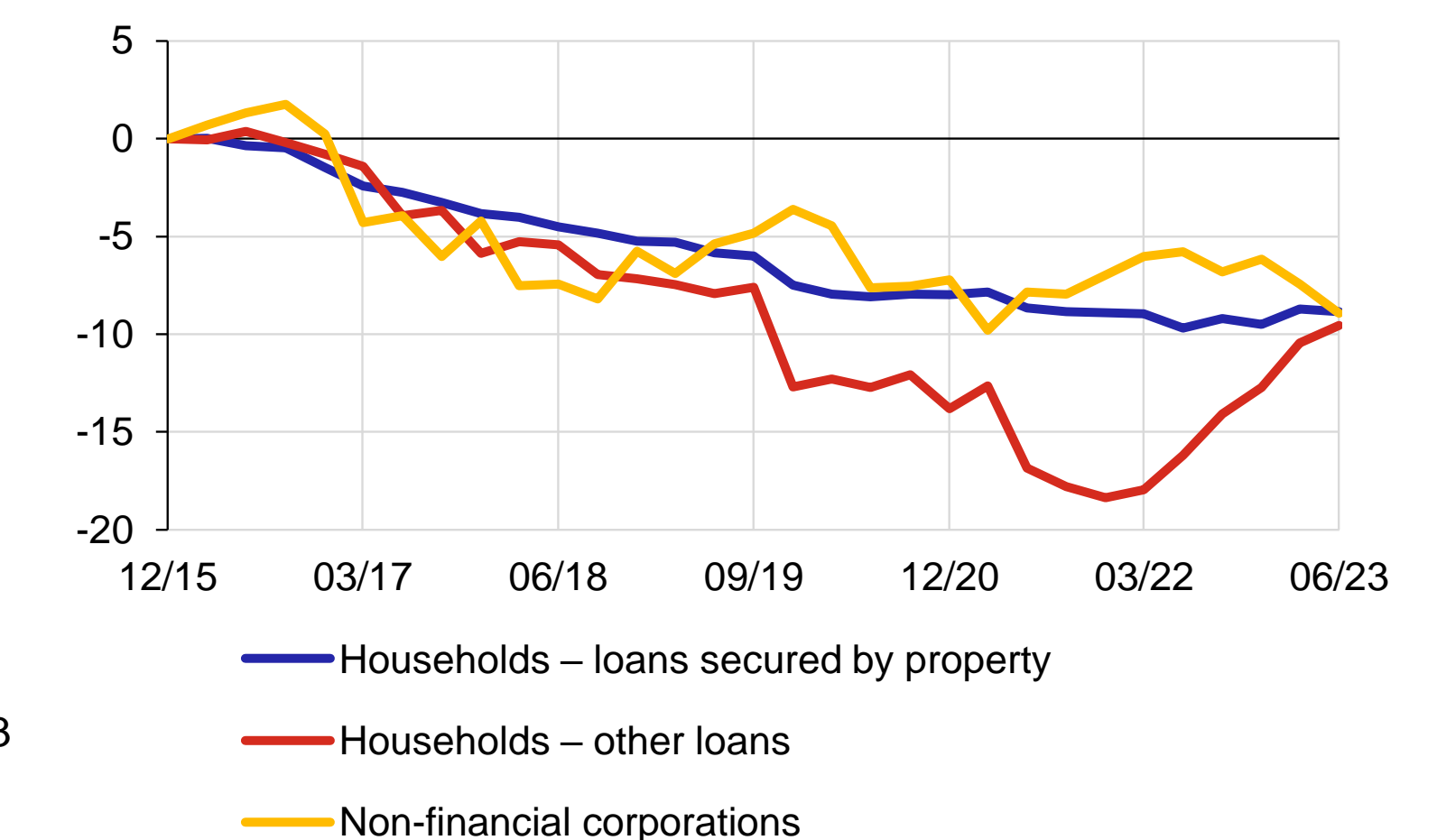
**Asset impairment losses**  
(bp; right-hand scale: CZK billions)



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



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

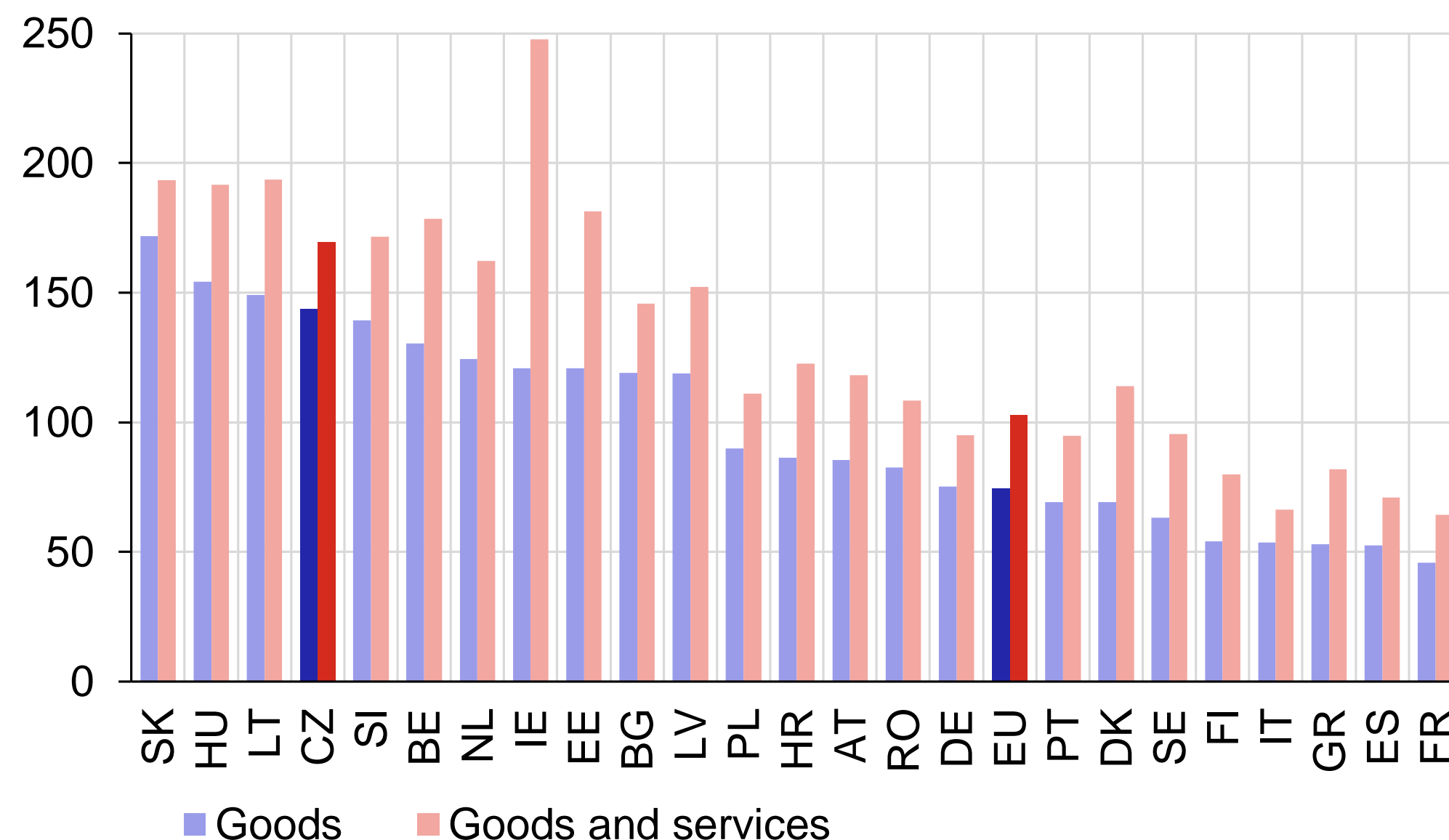


# Structural systemic risks (1)

- The CNB assessed the structural systemic risks in the domestic economy and the banking sector and it currently does not deem it necessary to react to them by deploying macroprudential capital instruments.
- The key structural sources of vulnerability are:
  - **the high openness of the domestic economy and**
  - **concentration of foreign trade.**

Indicator of economic openness for selected EU countries in 2022

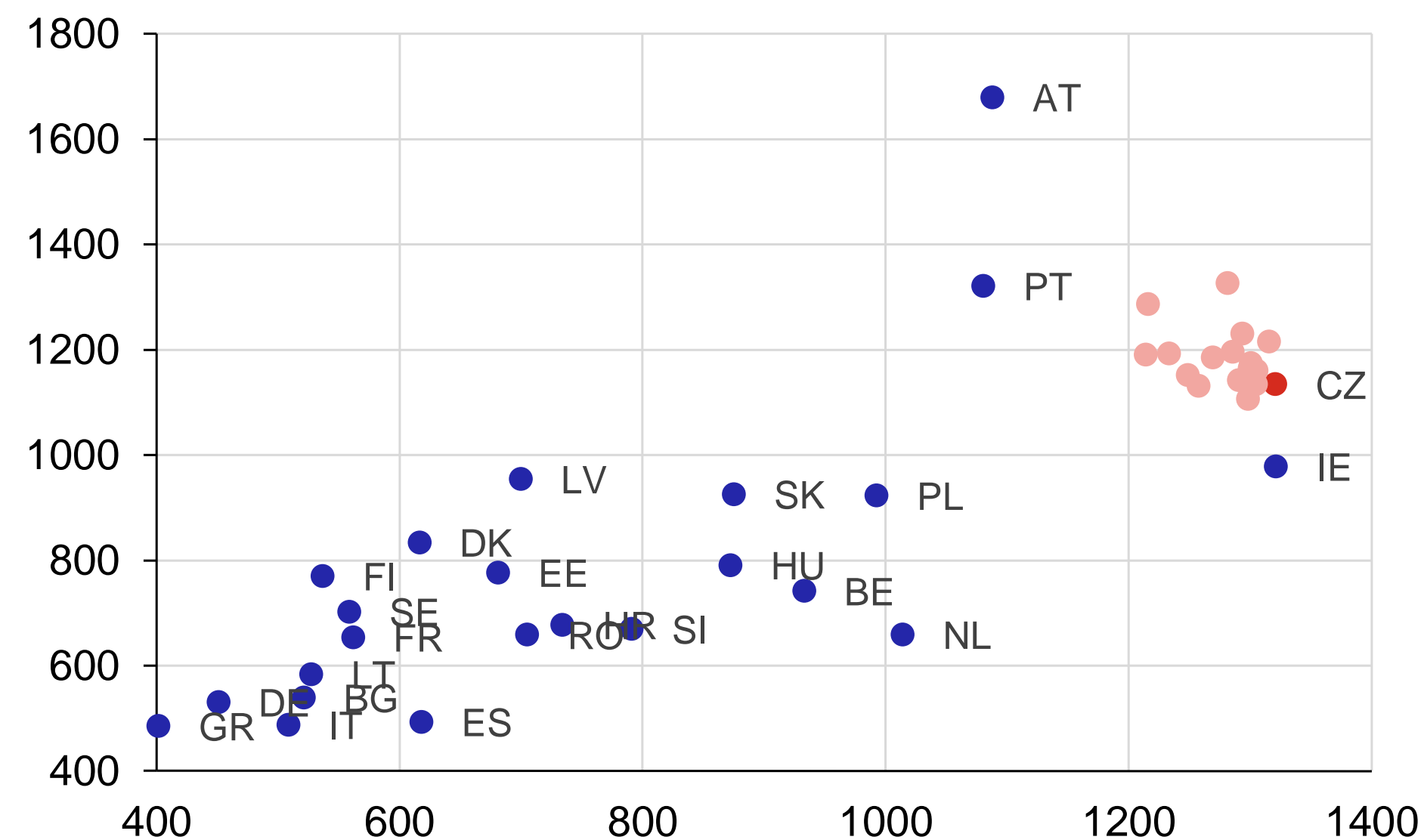
(sum of imports and exports in % of GDP; 2015 constant prices)



Source: Eurostat

Concentration index for exports and imports from selected EU countries to partner countries in 2022

(HHI in points; x-axis: exports, y-axis: imports)



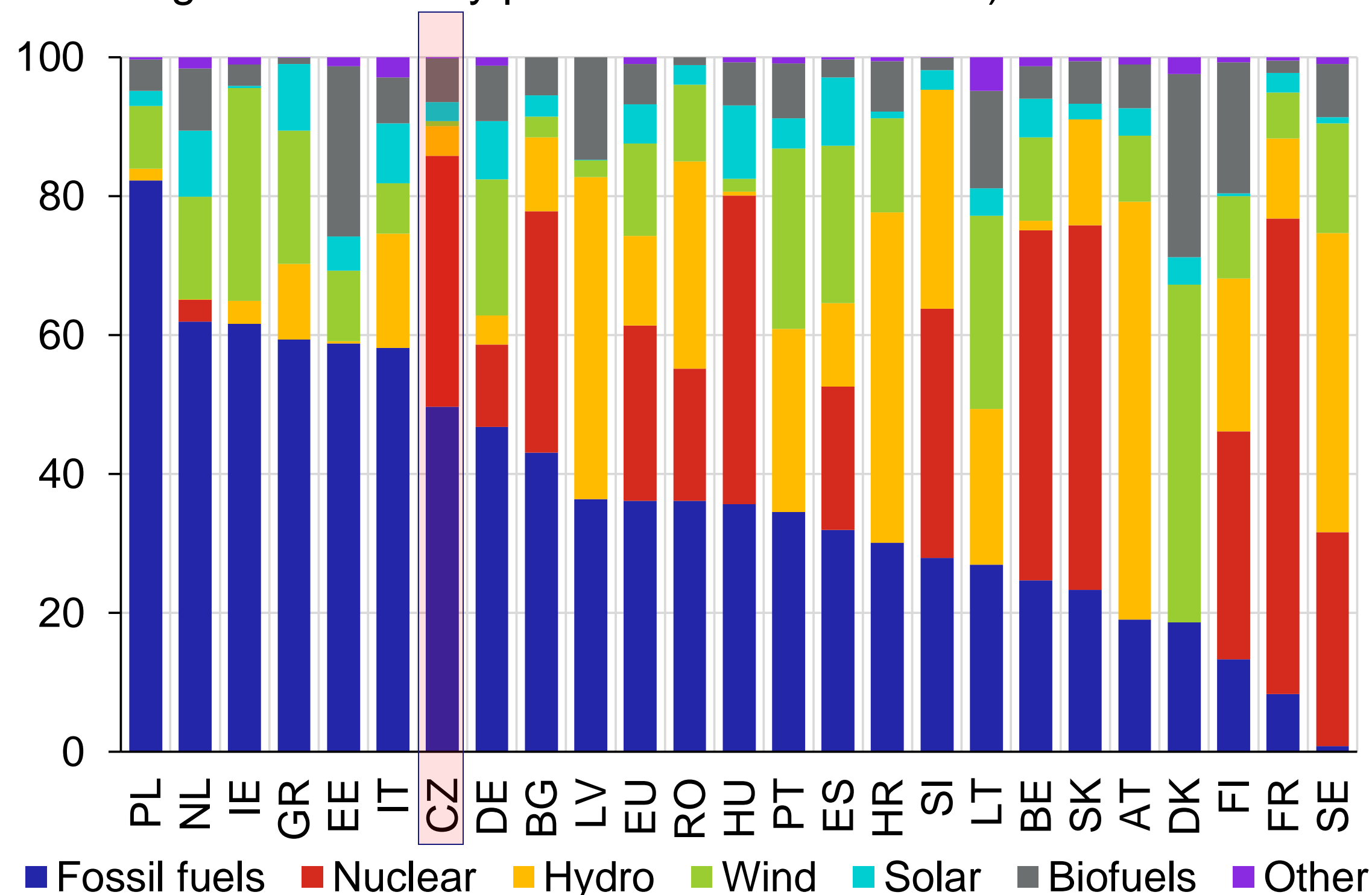
Source: Eurostat

Note: Light red points indicate values for CZ in 2006–2021.

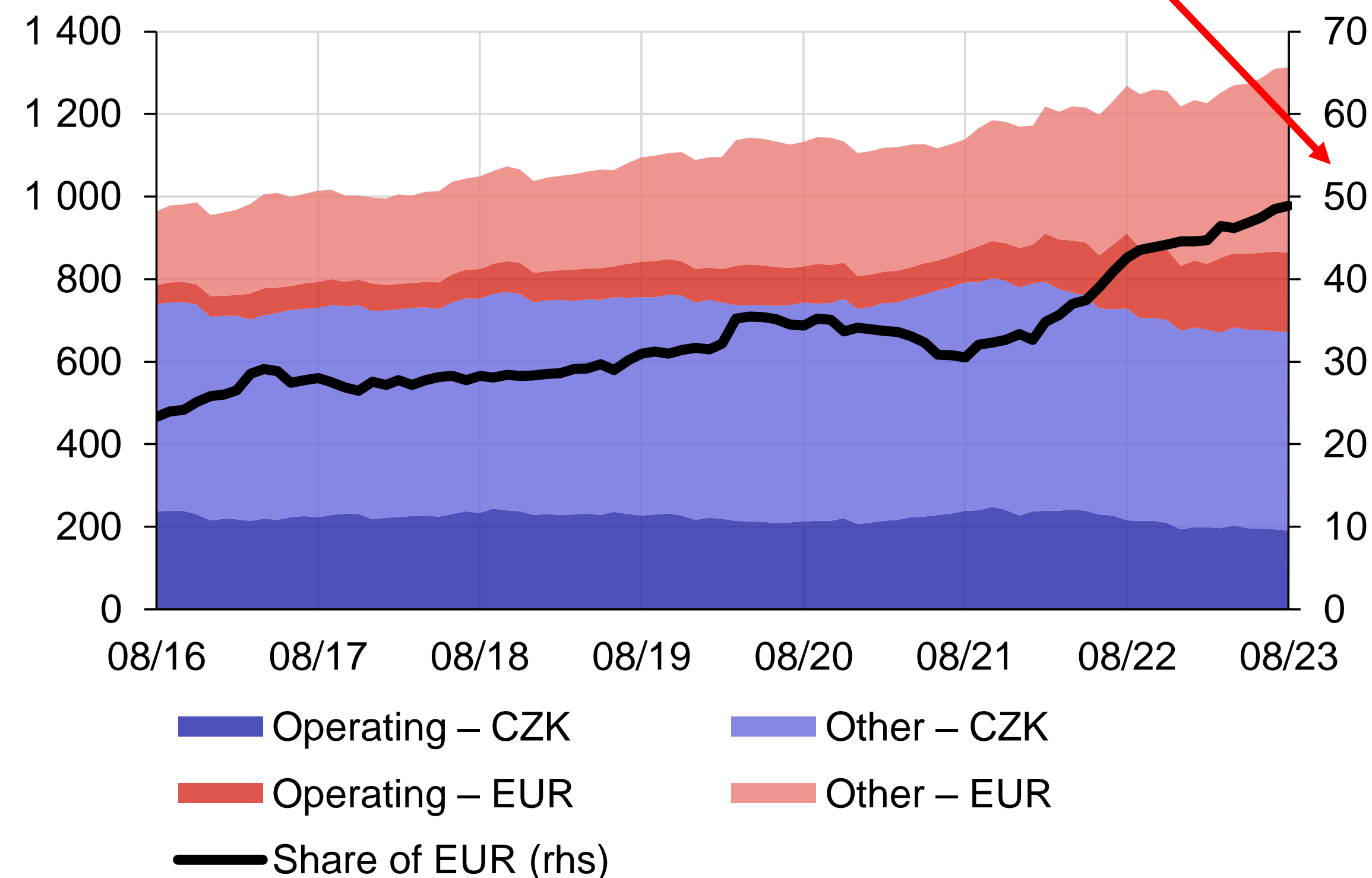
# Structural systemic risks (2)

- The potential vulnerability is also fostered by the potential impacts of transition climate risks and a high share of foreign currency funding of non-financial corporations.

**Electricity production by source in selected EU countries**  
(share in gross electricity production in % in 2021)



**Stocks of loans to non-financial corporation by currency**  
(CZK billions; right-hand scale: %)



Source: Eurostat

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

- Mortgage lending ratios

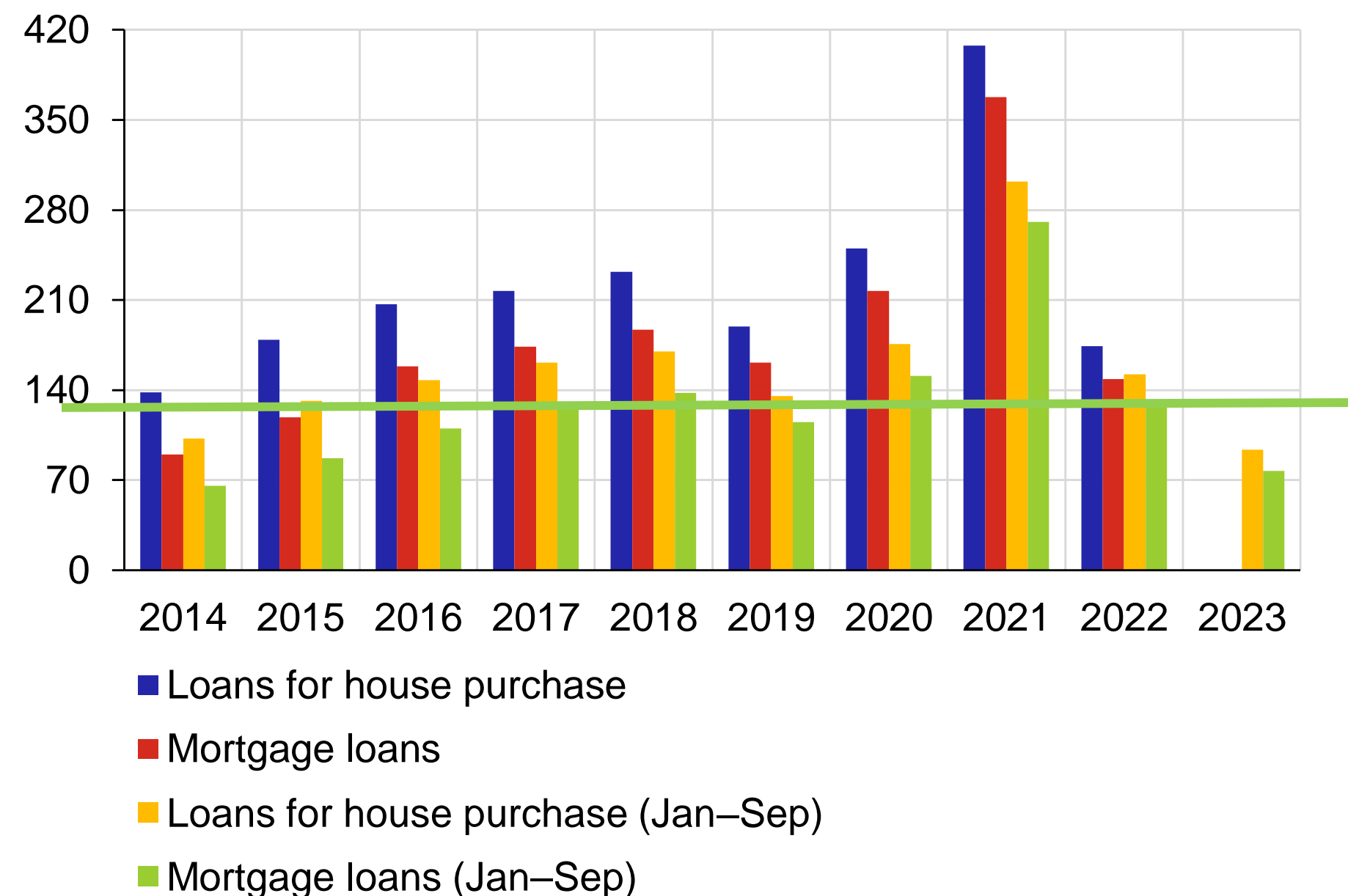




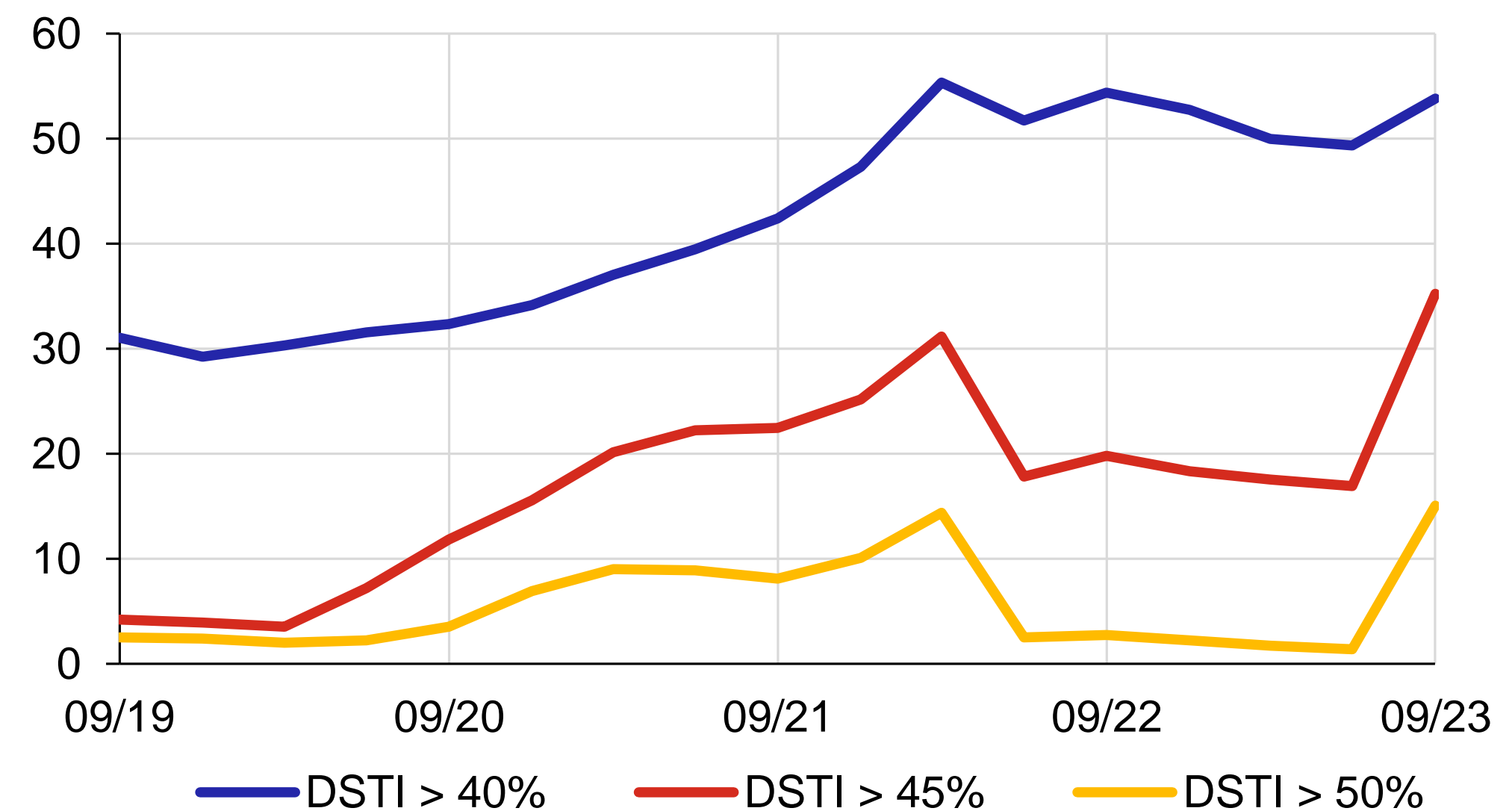
# Mortgage lending and property market (1)

- The volume of pure new mortgage loans dropped well below the long-term average (CZK 133 billion in 2014–2022) in January–September 2023:
  - High interest rates continued to dampen lending activity substantially.
  - Banks were compliant with the LTV and DTI limits effective since April 2022.
  - As expected, the share of mortgage loans with a DSTI of over 45% rose in 2023 Q3.
  - However, the rise in the share of these loans and their characteristics do not have potential for the build-up of systemic risks.

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



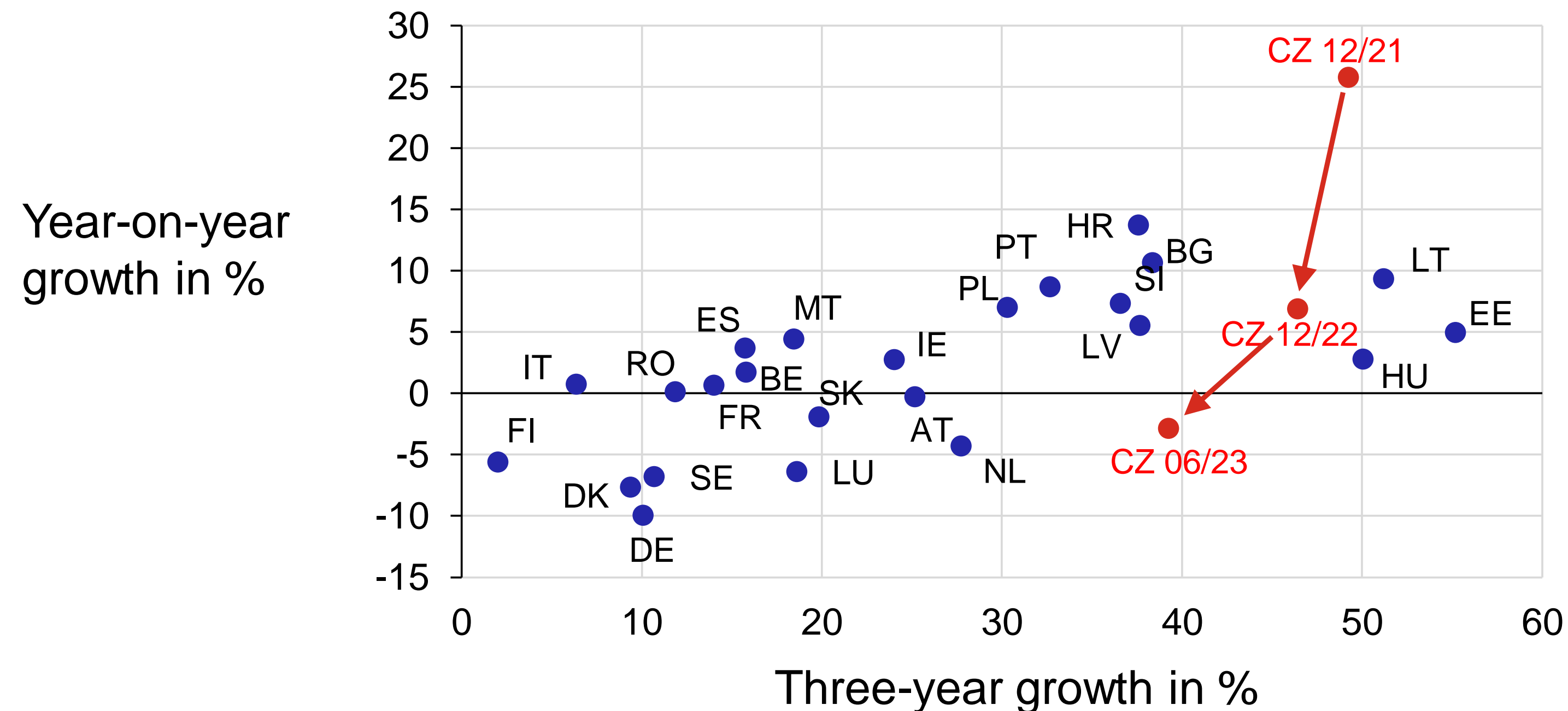
**Pure new mortgage loans with DSTIs in selected bands**  
(share of loans in volume provided in given quarter in %)



# 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.
  - Prices are falling year on year due to a substantial cooling of the Czech residential property market in 2022 and 2023.

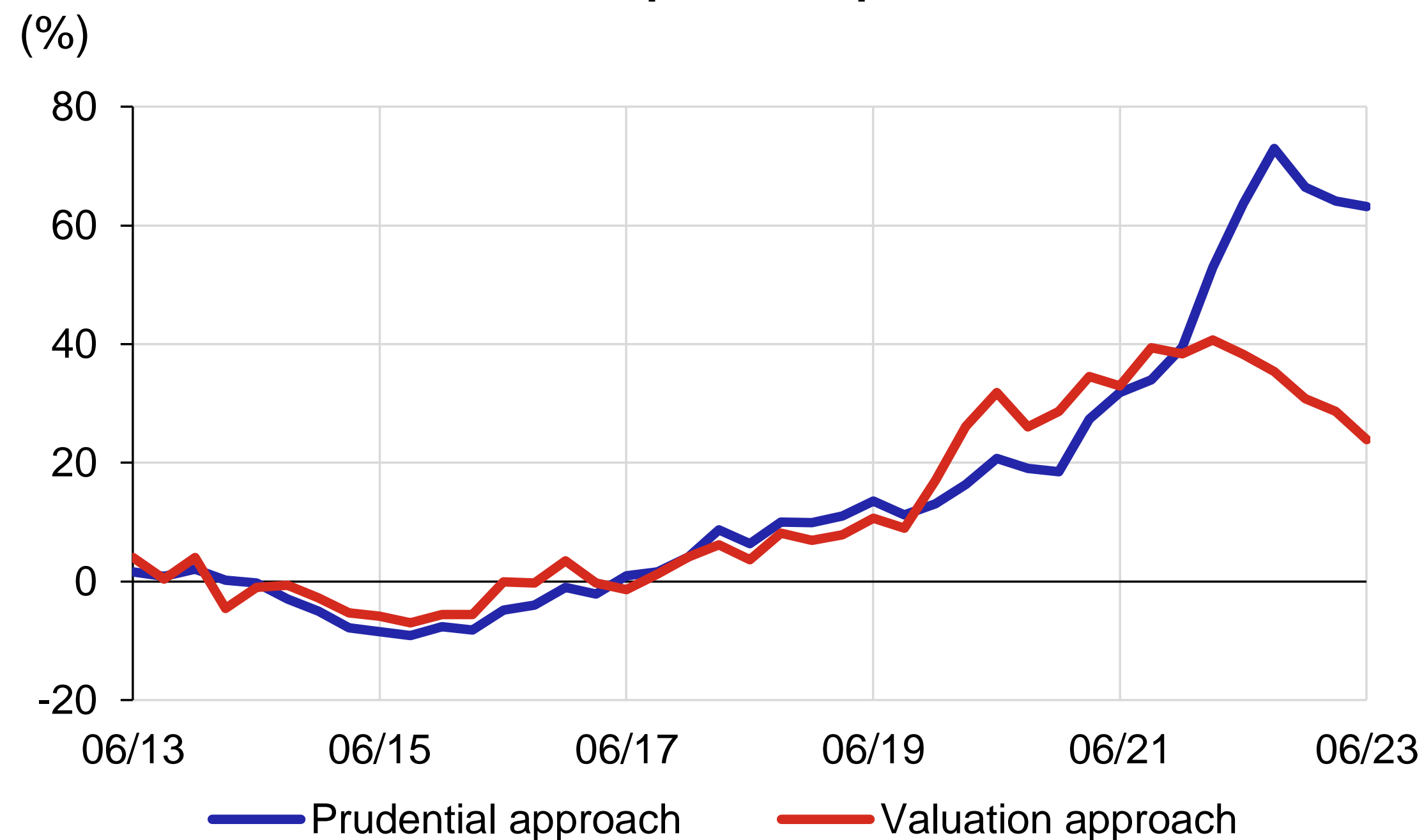
Residential property price growth in selected EU countries



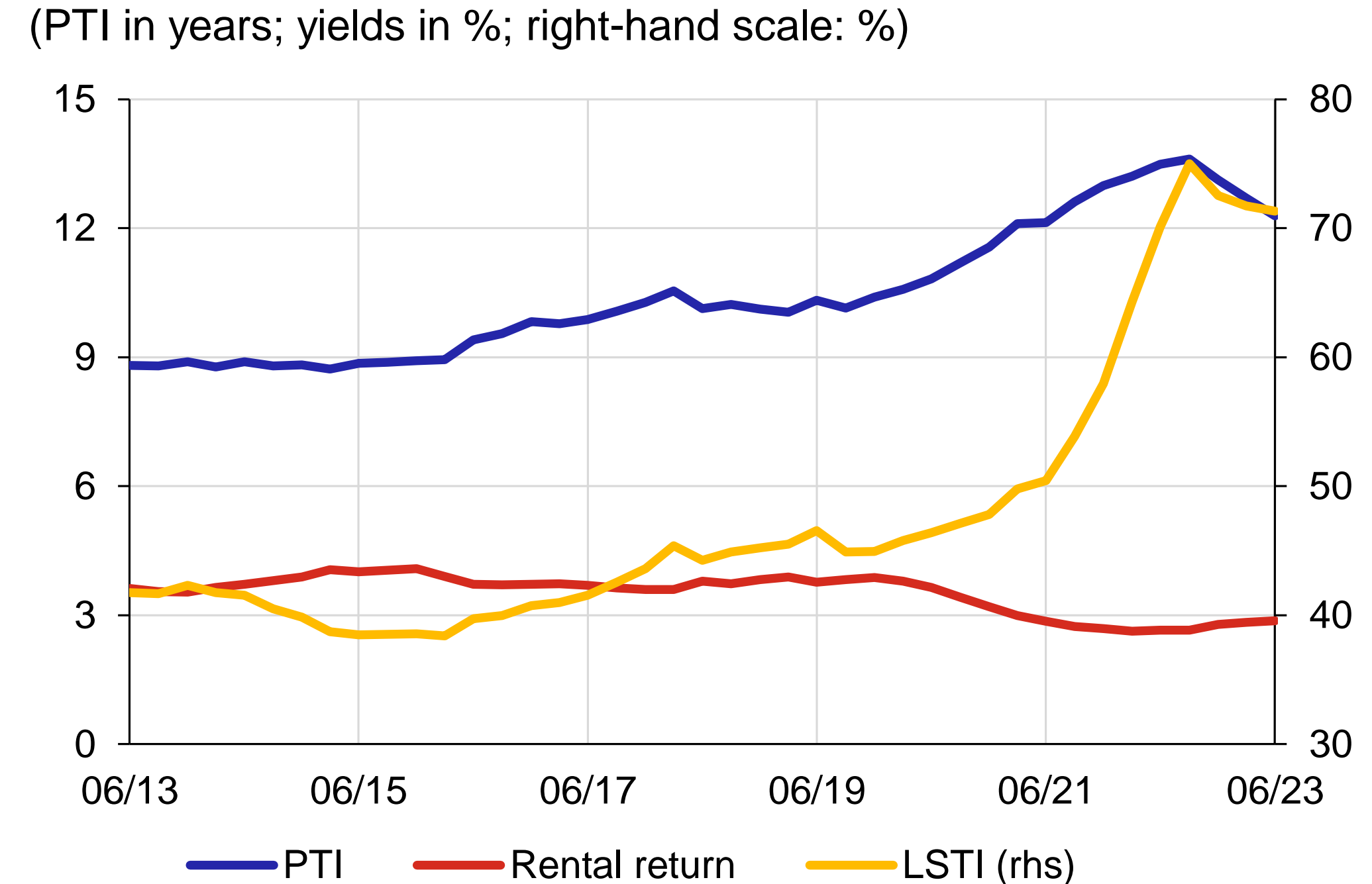
# Mortgage lending and property market (3)

- Overvaluation is beginning to decrease, but median-income households may still be at increased risk of default when buying owner-occupied housing.
- The CNB estimates that apartments are overvalued by about 60% for median-income households and by 20% for retail investors among households.

Estimated overvaluation of apartment prices



Selected apartment affordability indicators



# Limits on mortgage loan ratios

- The Bank Board decided to **retain the upper limits on the LTV ratio and deactivate the upper limits on the DTI credit ratio** with effect from **1 January 2024**.

**LTV**

Ratio of value of loan to value of collateral.

**80%**



**90%**

~~**DTI**~~

Ratio of applicant's total debt to net annual income.

~~**8.5**~~



~~**9.5**~~

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



# Limits on mortgage loan ratios

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- Given the current and expected developments in the mortgage and property markets, the Bank Board **identified** persisting **systemic risks** in the area of residential **property price overvaluation**:
  - A risk of a larger correction in property prices persists.
  - 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**.
  - Higher interest rates and subdued mortgage lending are significantly limiting the **risks associated with applicants' income levels**.
  - Therefore, the **DTI limit has been deactivated**.
  
- The CNB will publish its next analysis of the residential property market and mortgage loans in June 2024 in **Financial Stability Report – Spring 2024**.

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

**2. Assessment of selected risks**

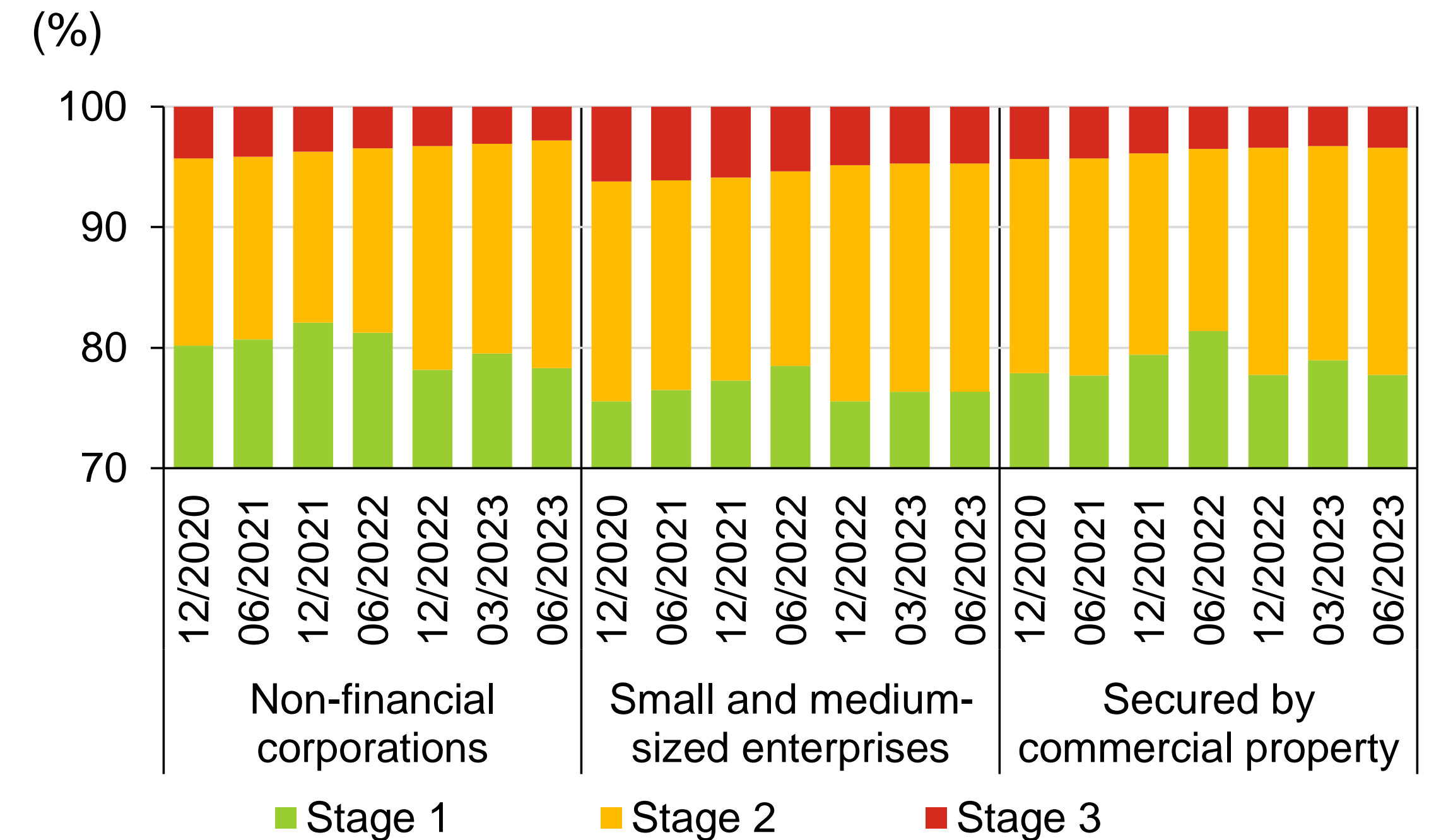


# Initial level of banks' credit risk (1)

Structure of loans by portfolio in the household segment (%)

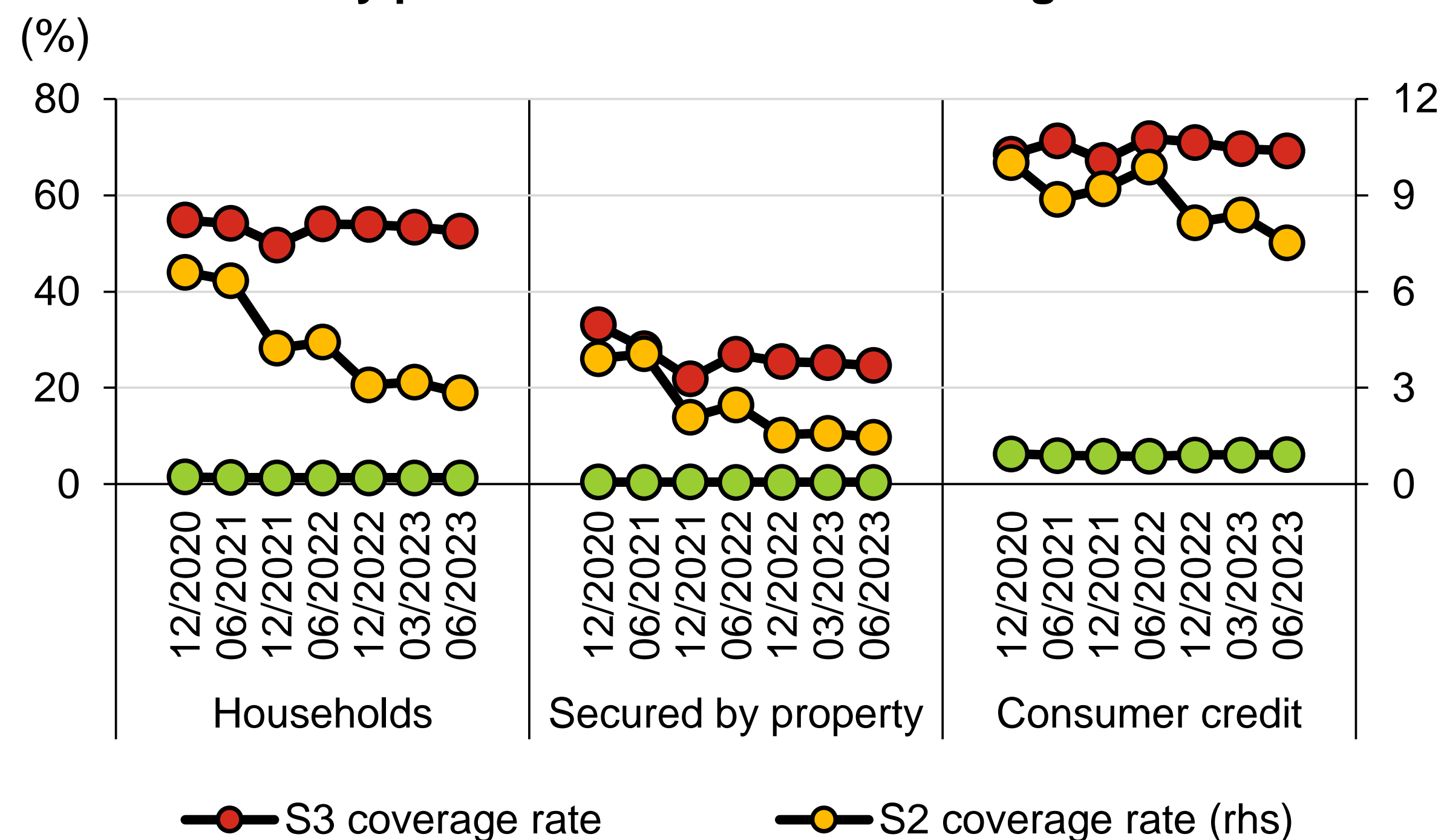


Structure of loans by portfolio in the non-financial corporations segment (%)

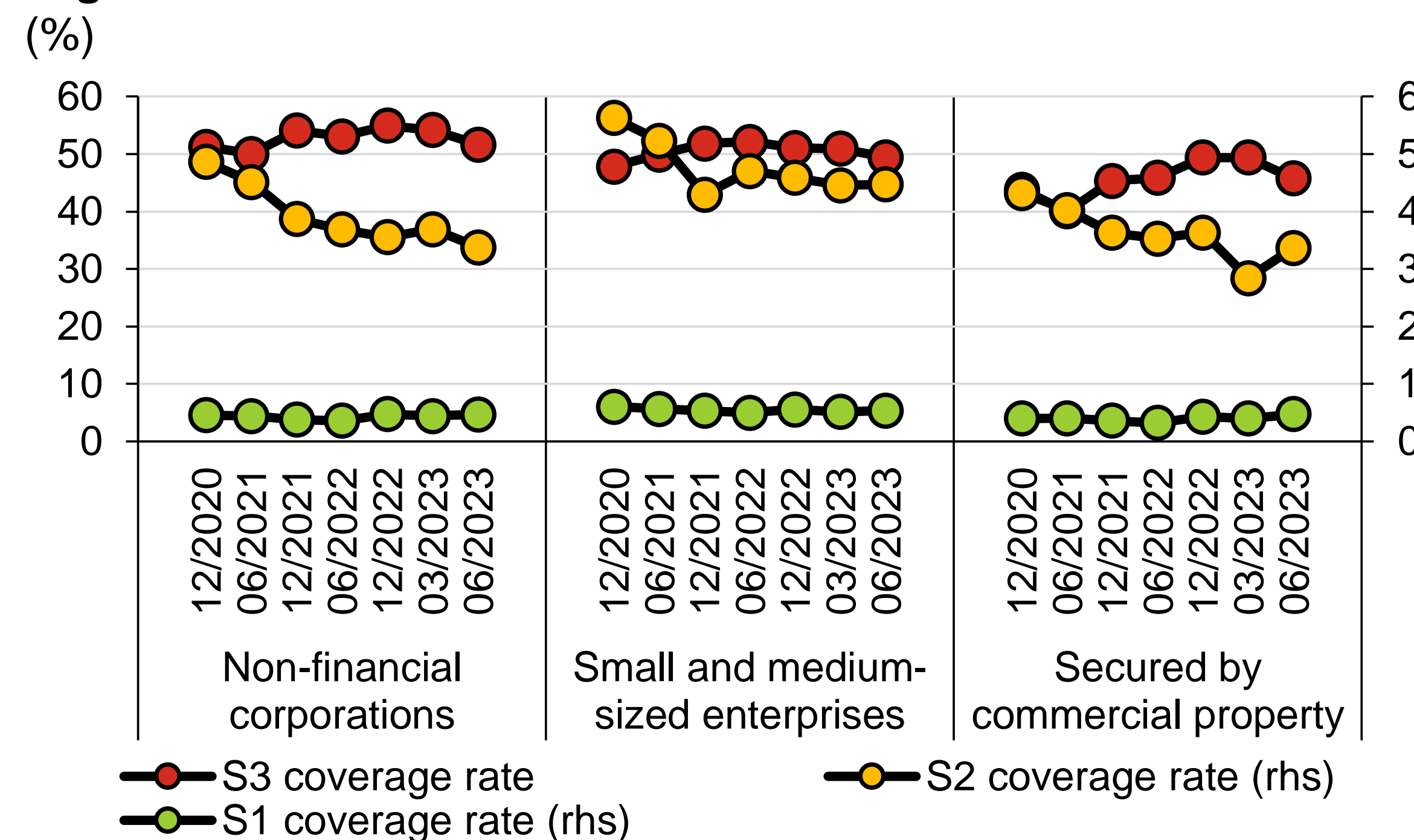


# Initial level of banks' credit risk (2)

Coverate rate by portfolio in the household segment



Coverage rate by portfolio in the non-financial corporations segment

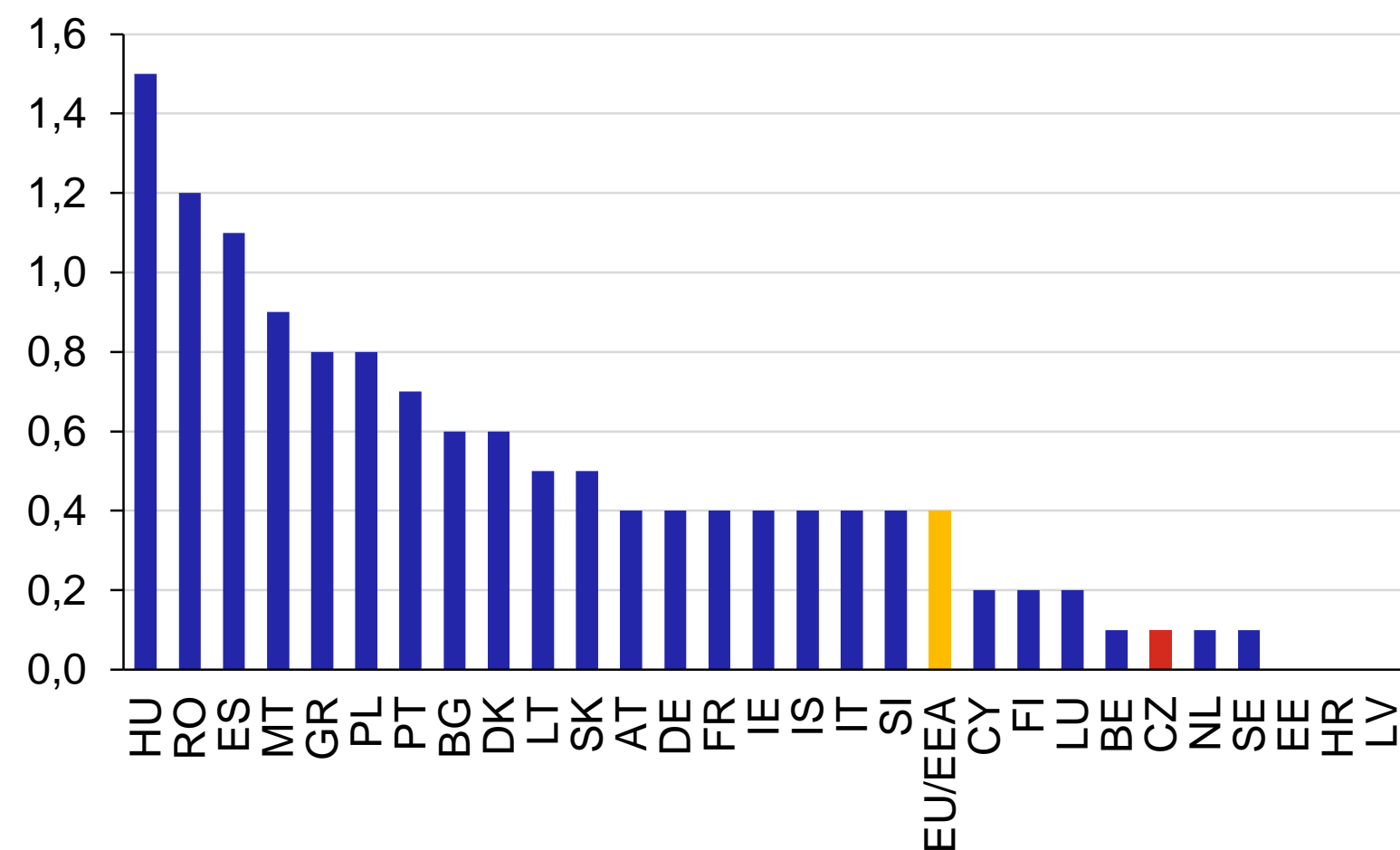




# Initial level of banks' credit risk (3)

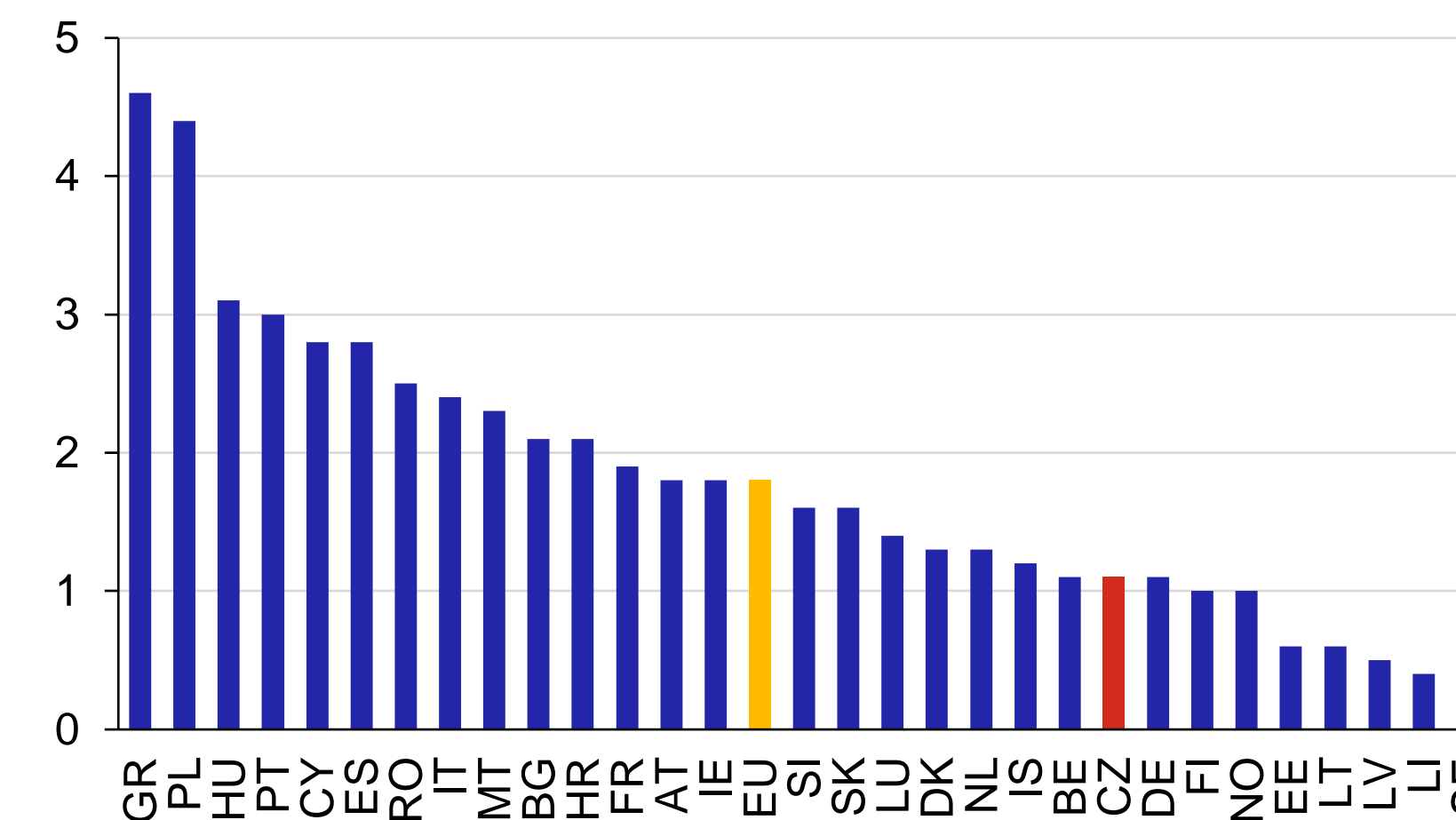
**Risk costs in selected EU countries**

(% as of June 2023)



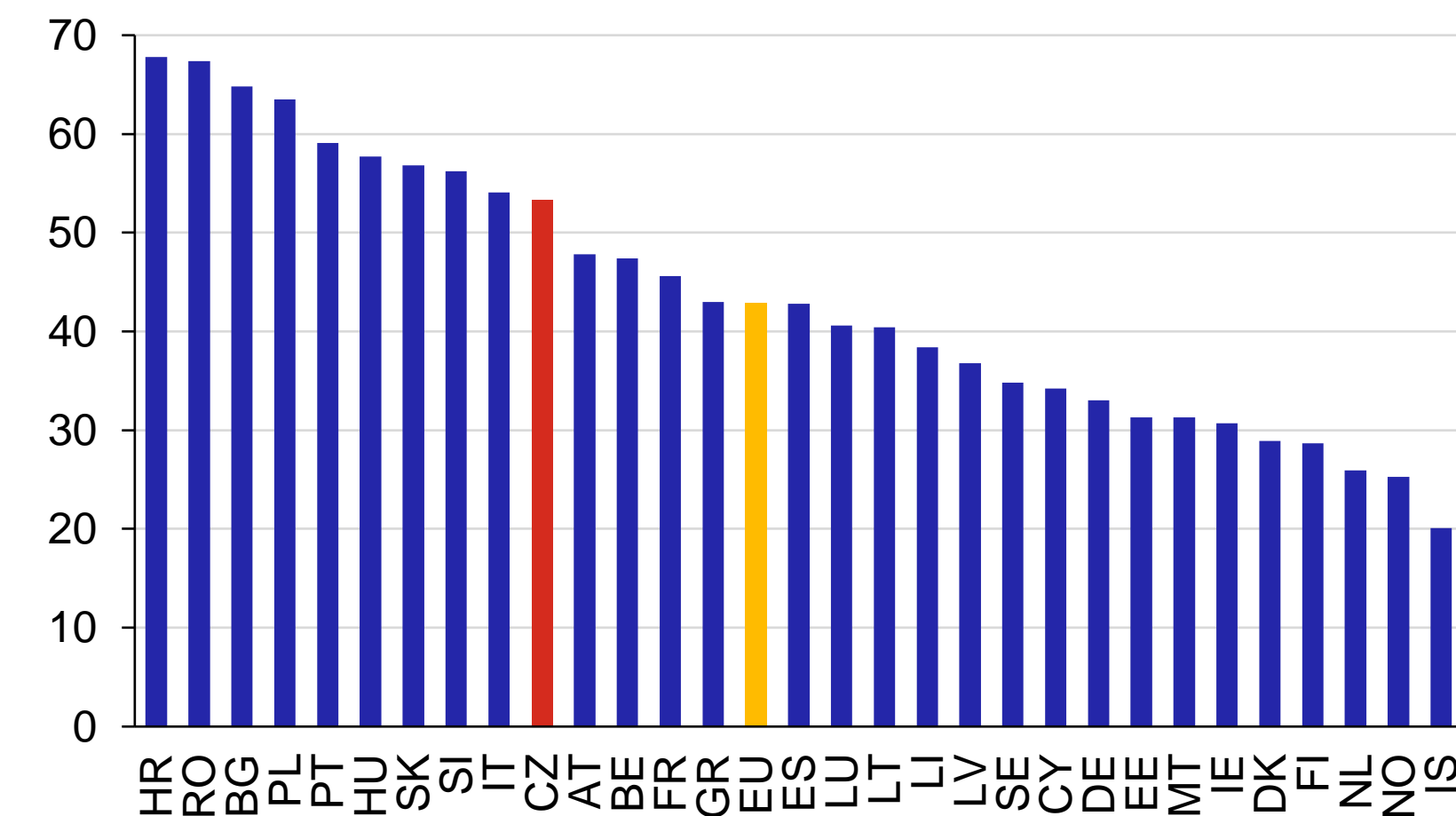
**Shares of non-performing client loans in EEA countries**

(%; as of 30 June 2023)



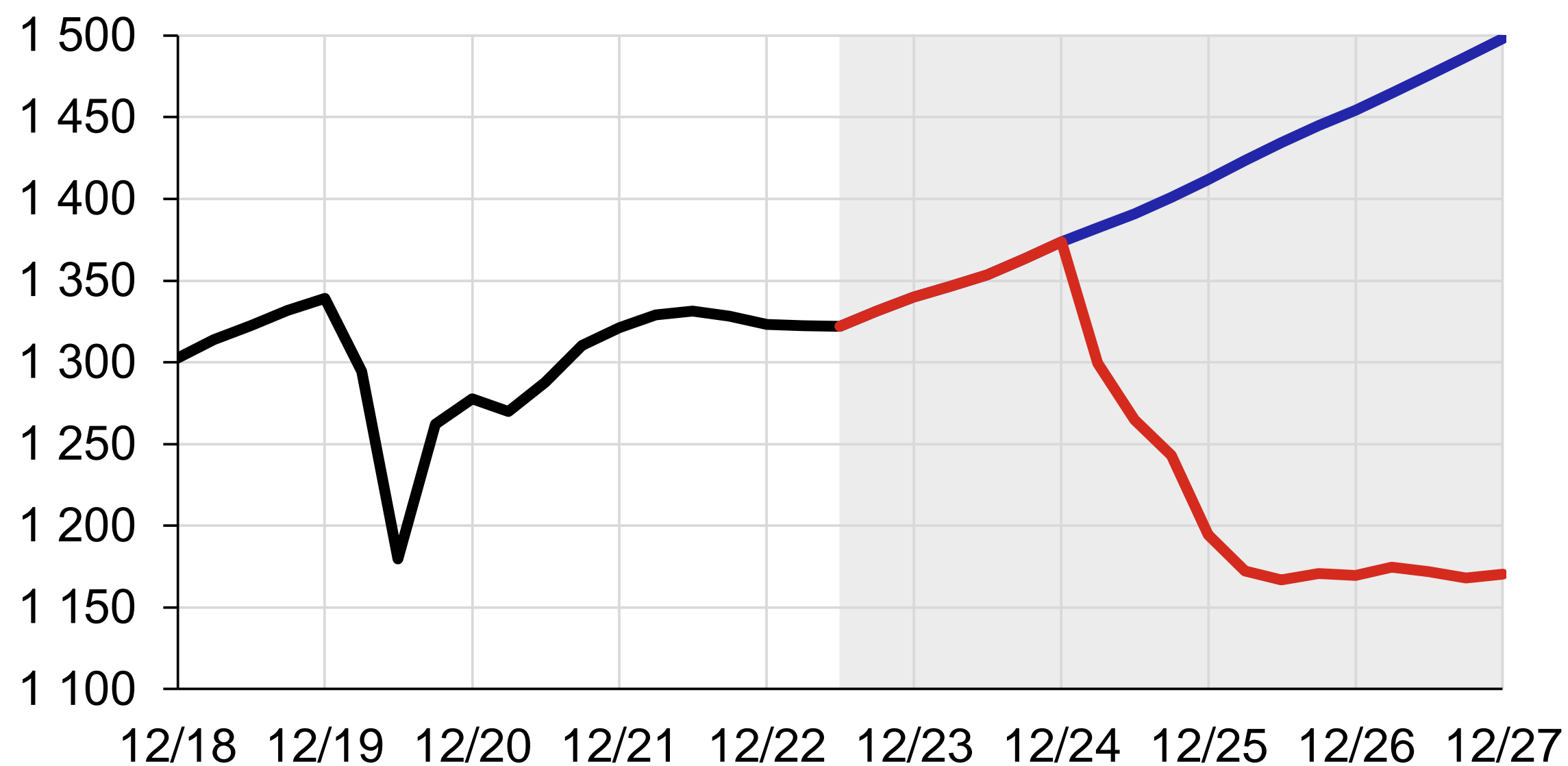
**Coverage rates of non-performing client loans by provisions in EEA countries**

(%; as of 30 June 2023)



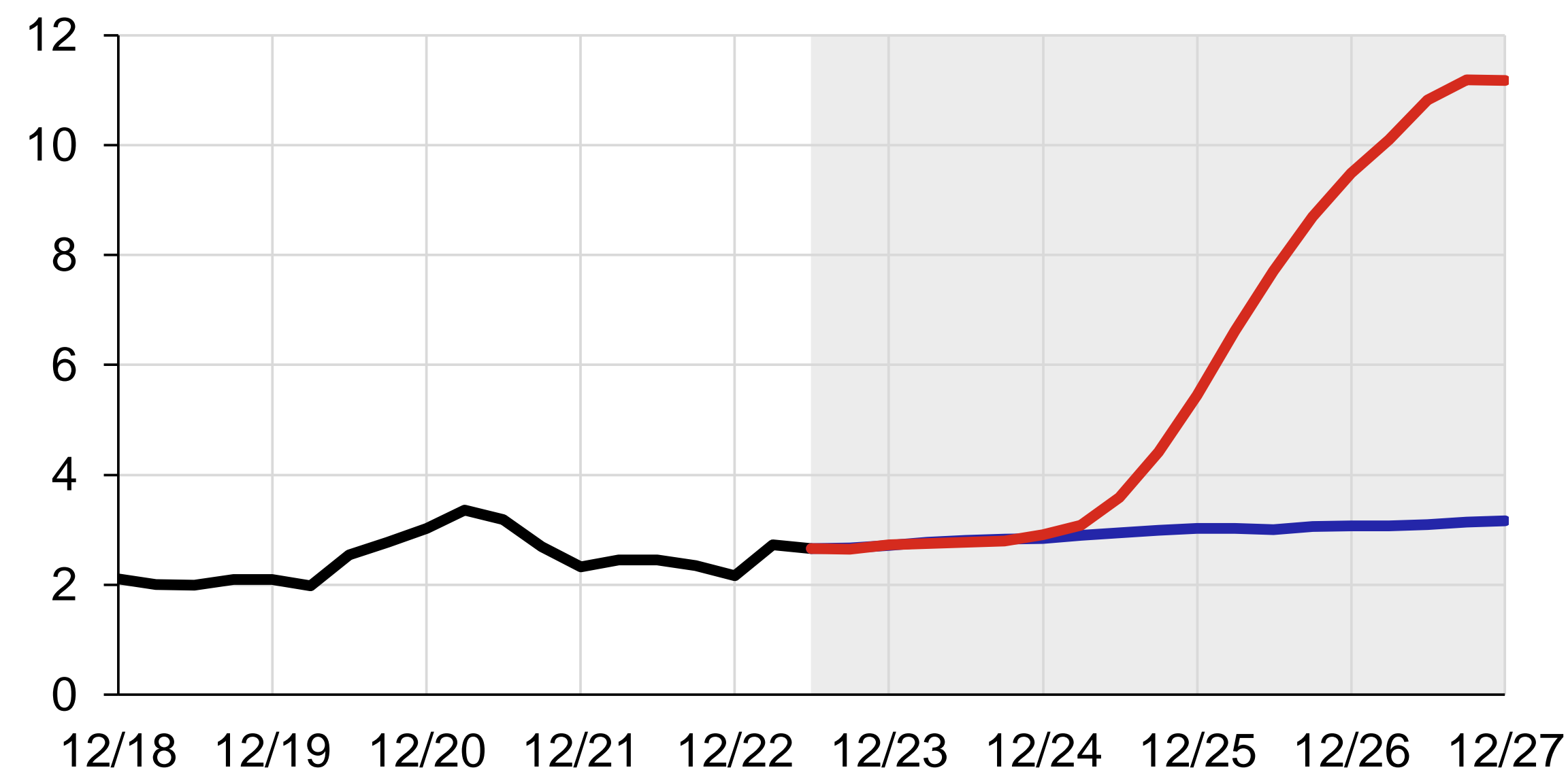
# Main characteristics of stress test scenarios (1)

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



— Observed values — Baseline Scenario — Adverse Scenario

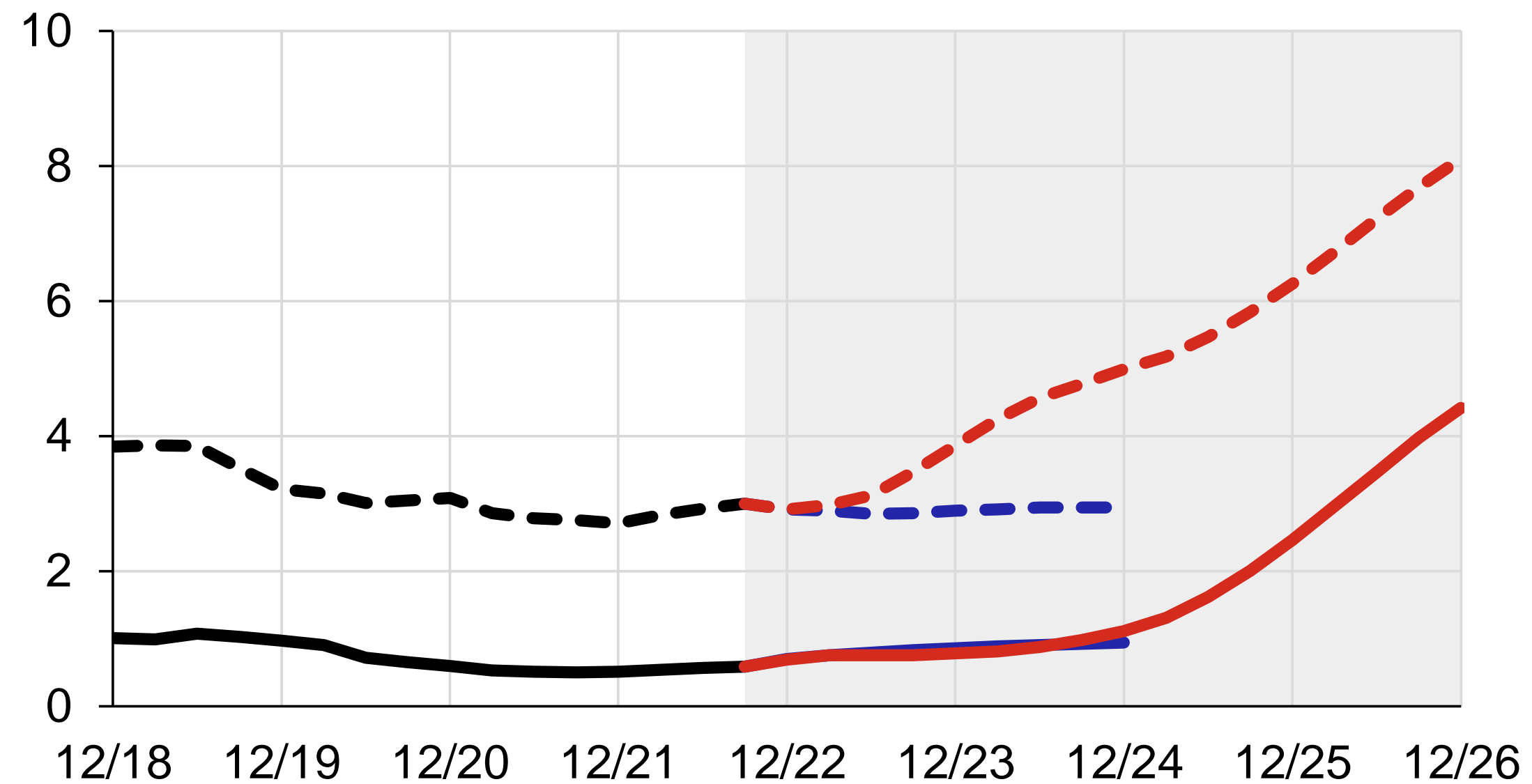
**Alternative scenarios: unemployment rate**  
(%)



— Observed values — Baseline Scenario — Adverse Scenario

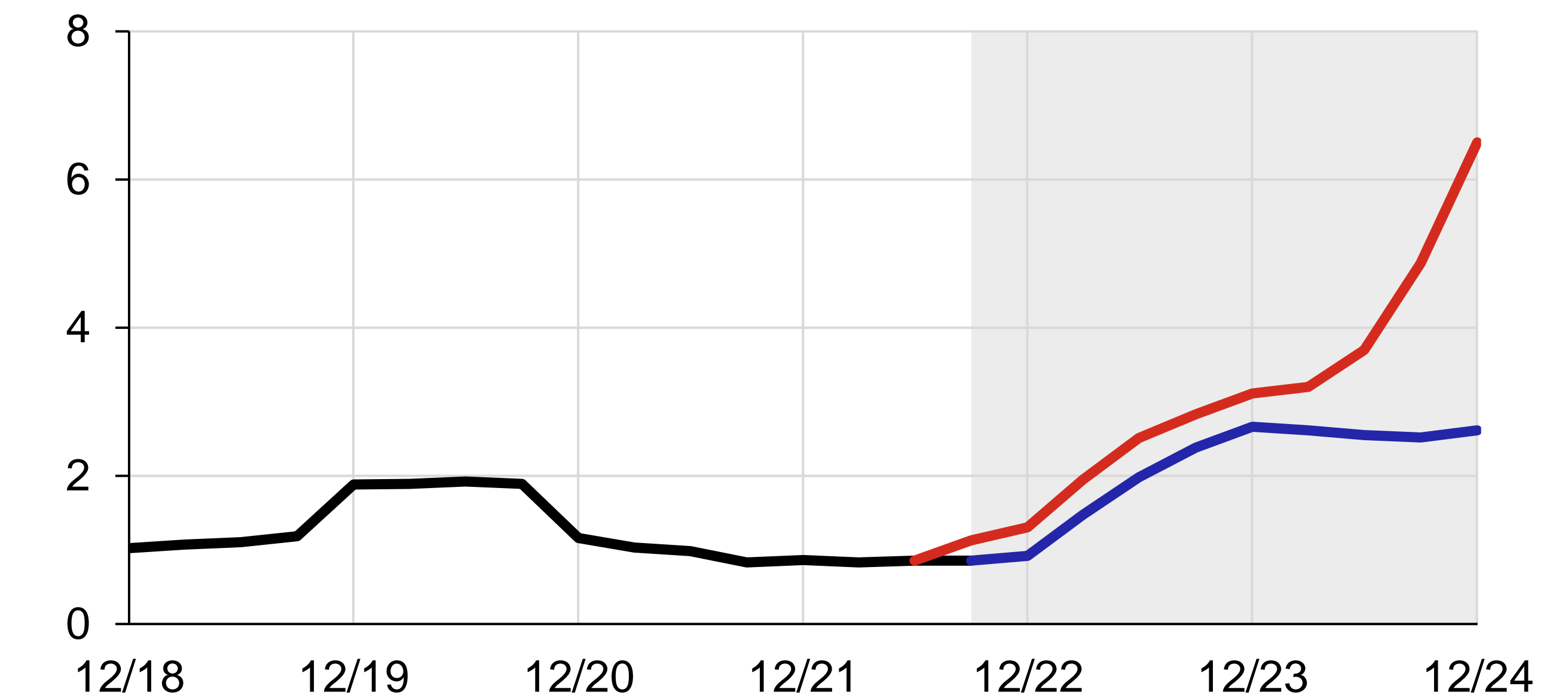
# Main characteristics of stress test scenarios (2)

12M default rate on loans to households for house purchase (%)



- Loans for house purchase – Observed values
- Loans for house purchase – CNB autumn projection
- Loans for house purchase – Adverse Scenario
- - - Consumer credit – Observed values
- - - Consumer credit – CNB autumn projection
- - - Consumer credit – Adverse Scenario

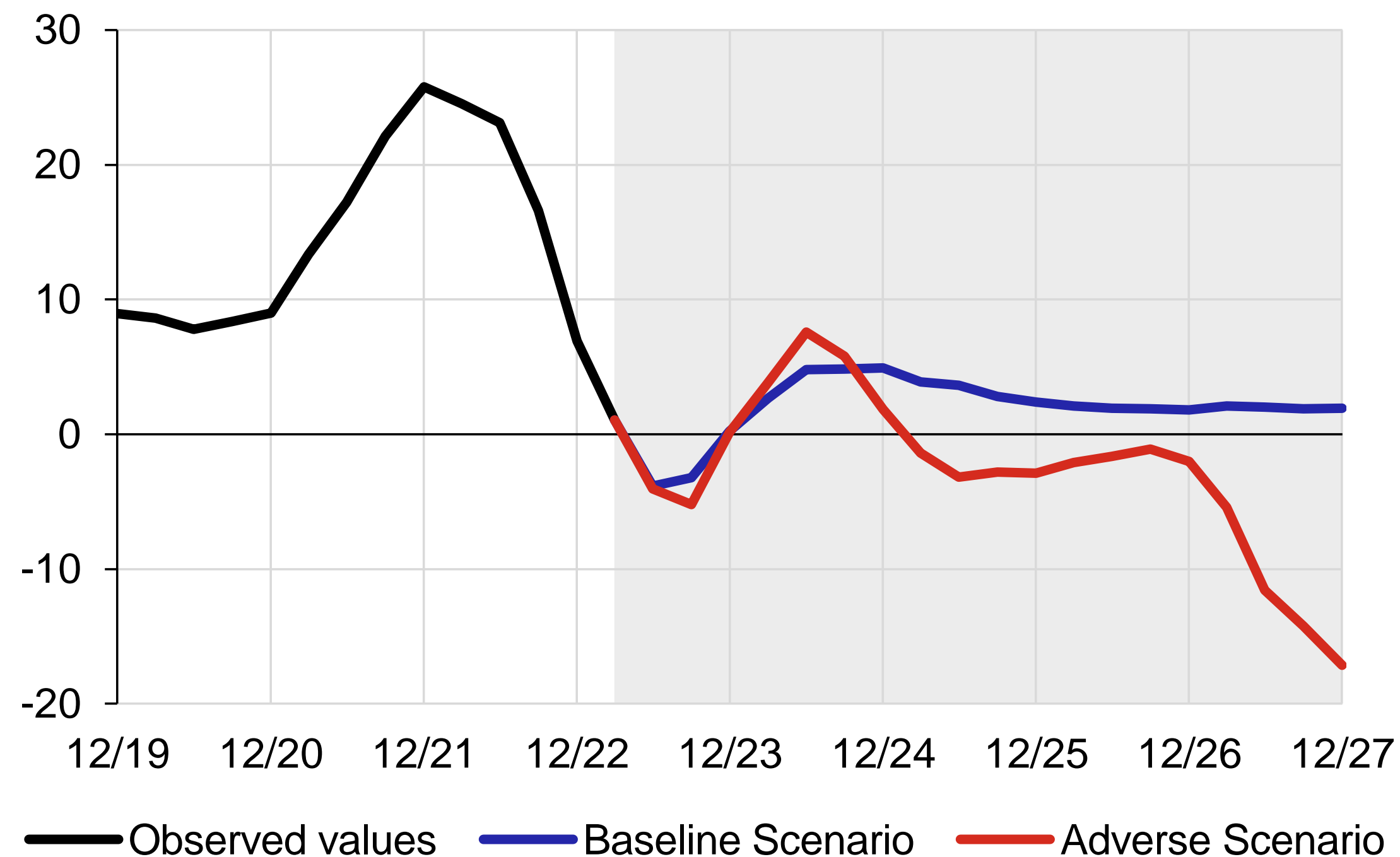
12M default rate on loans to non-financial corporations (%)



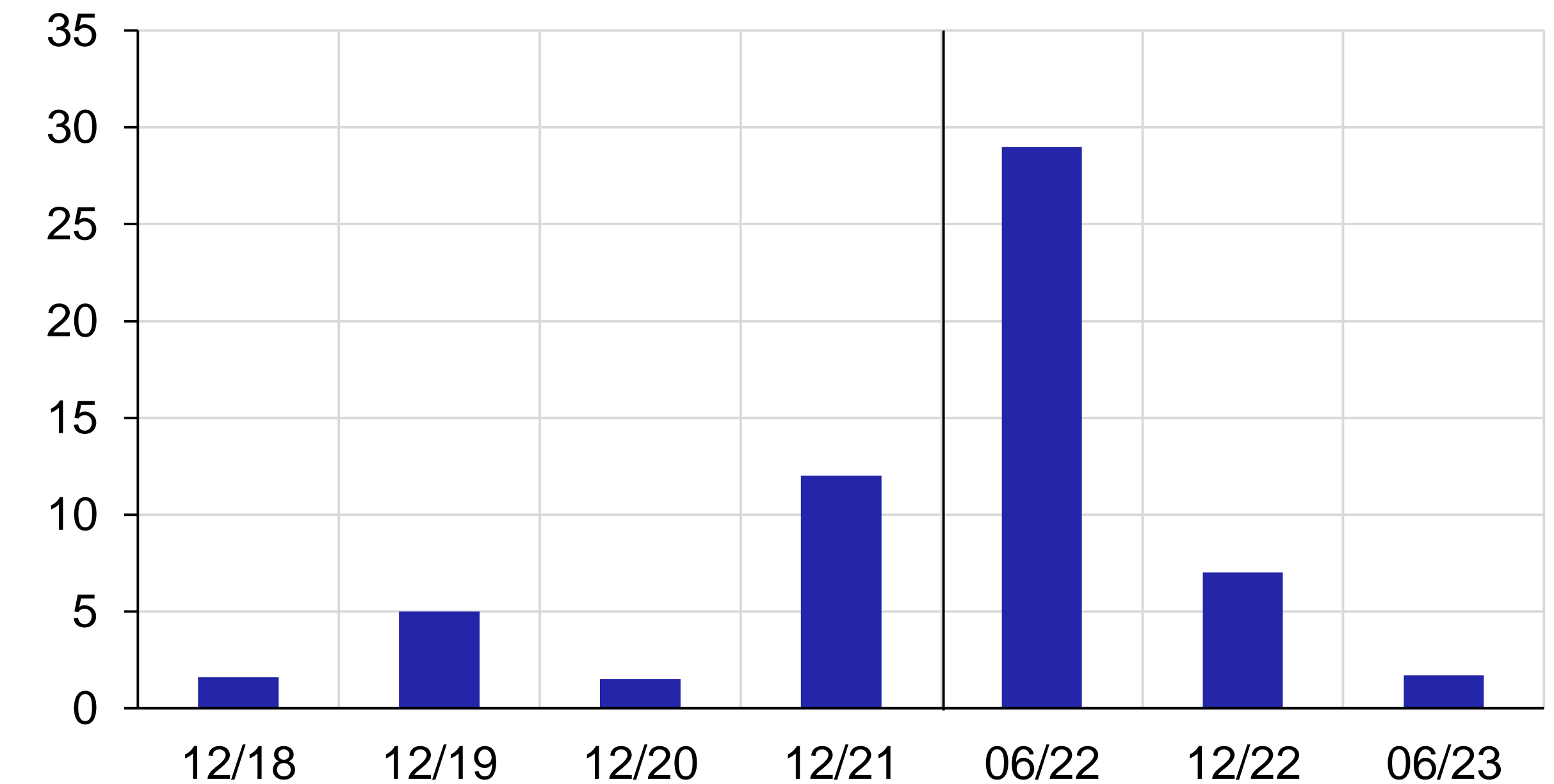
- Observed values
- CNB autumn projection
- Adverse Scenario

# Residential property price scenarios

**Alternative scenarios: property prices (HPI)**  
(year-on-year growth in %)



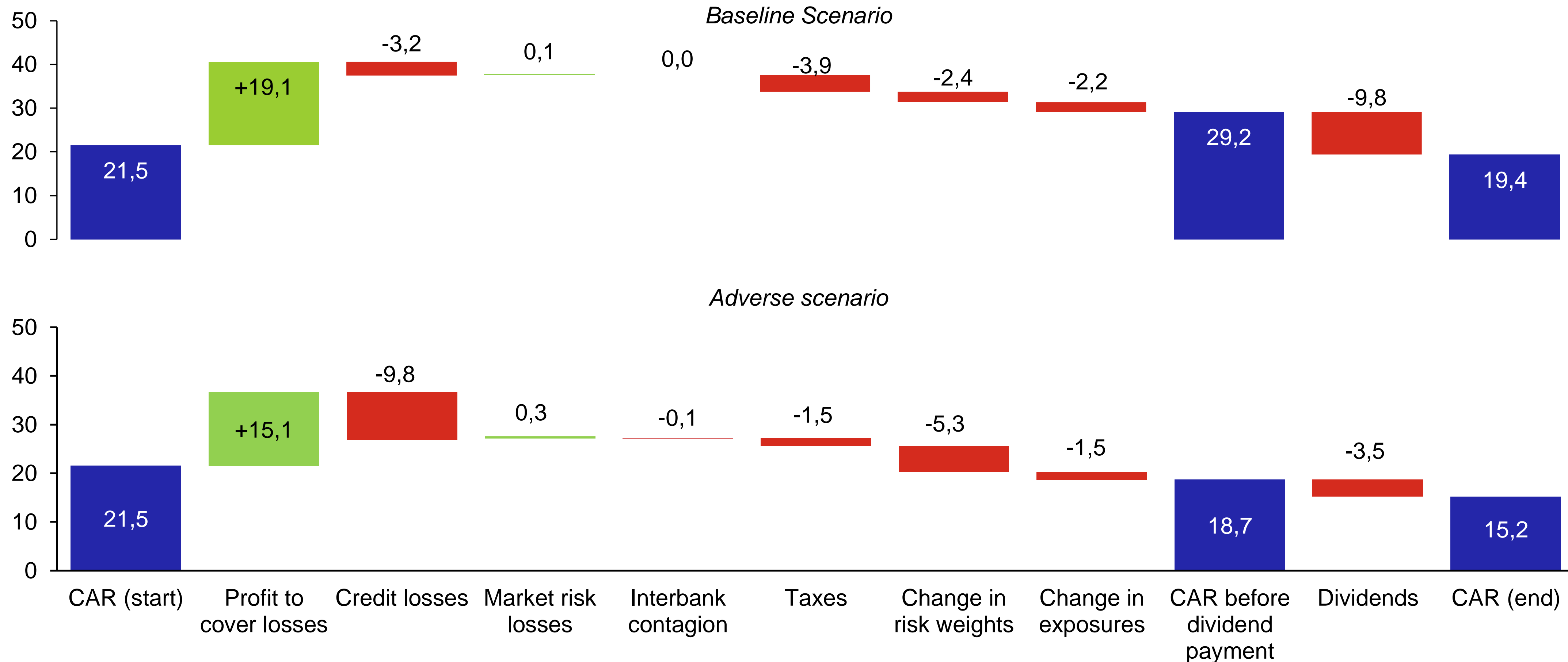
**Probability of average apartment prices in the Czech Republic falling by more than 10% over the next two years**  
(%)





# Bank stress test results (1)

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

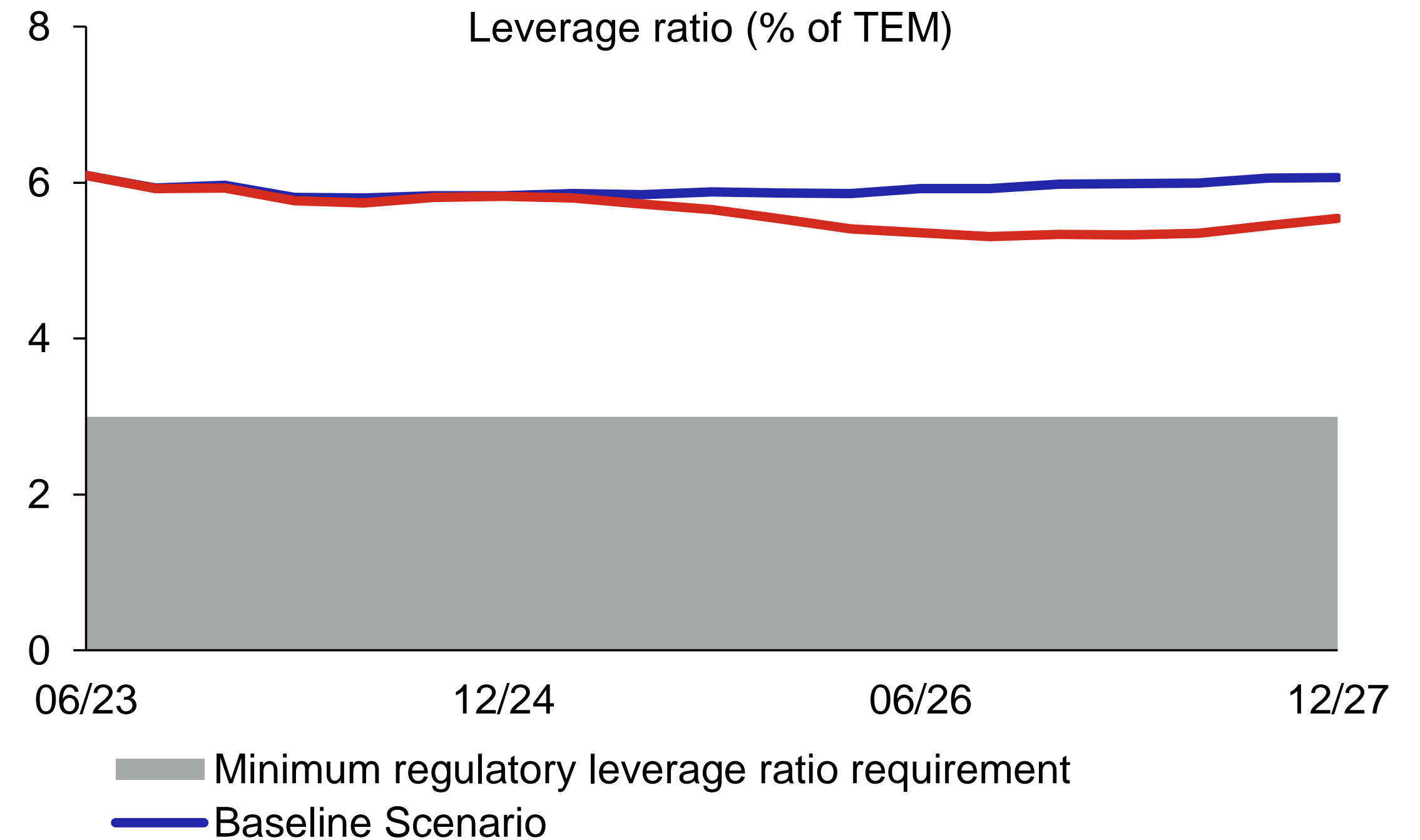
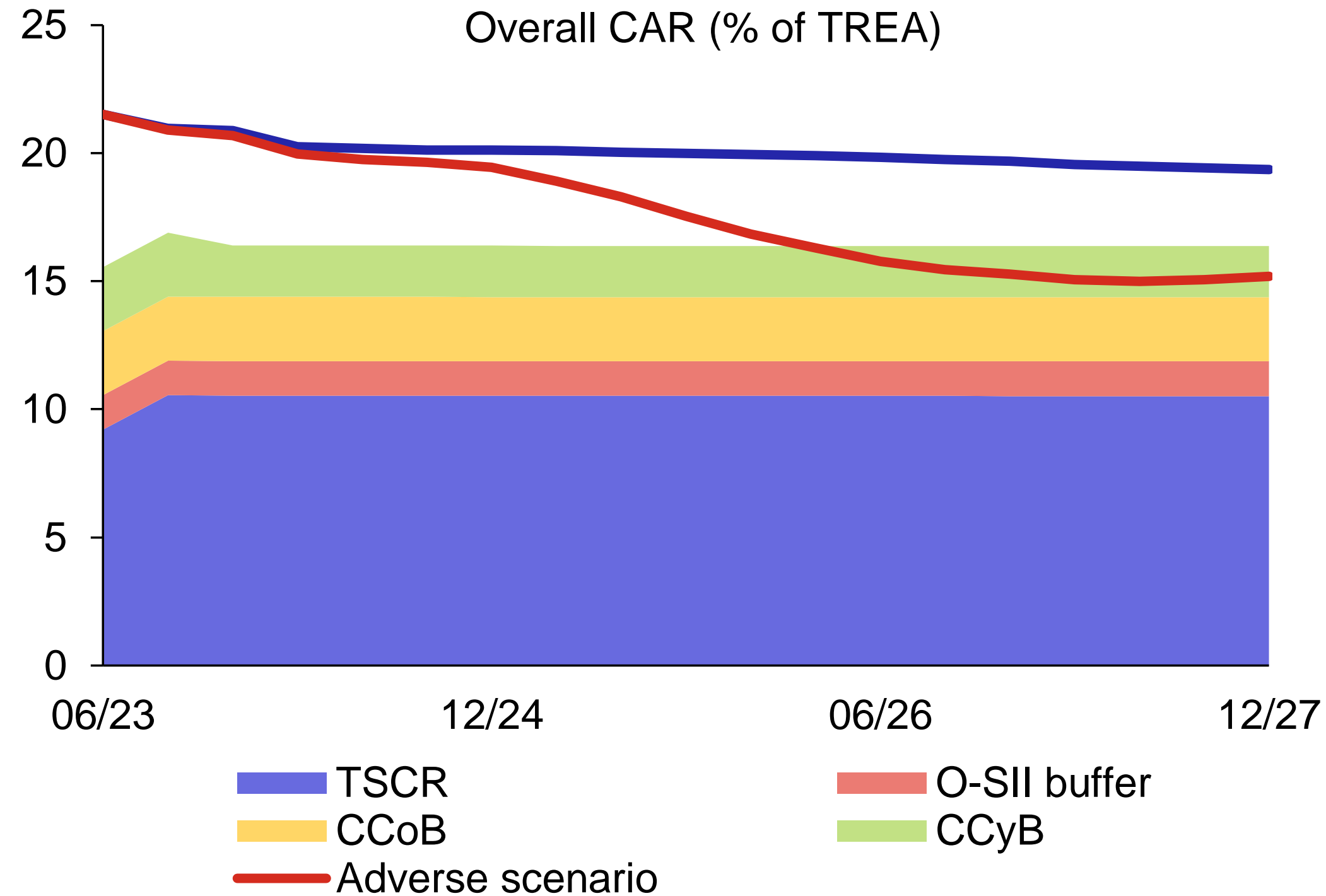


Source: CNB

Note: CAR = overall capital ratio. Items increasing the capital ratio are shown in green and items reducing it in red.

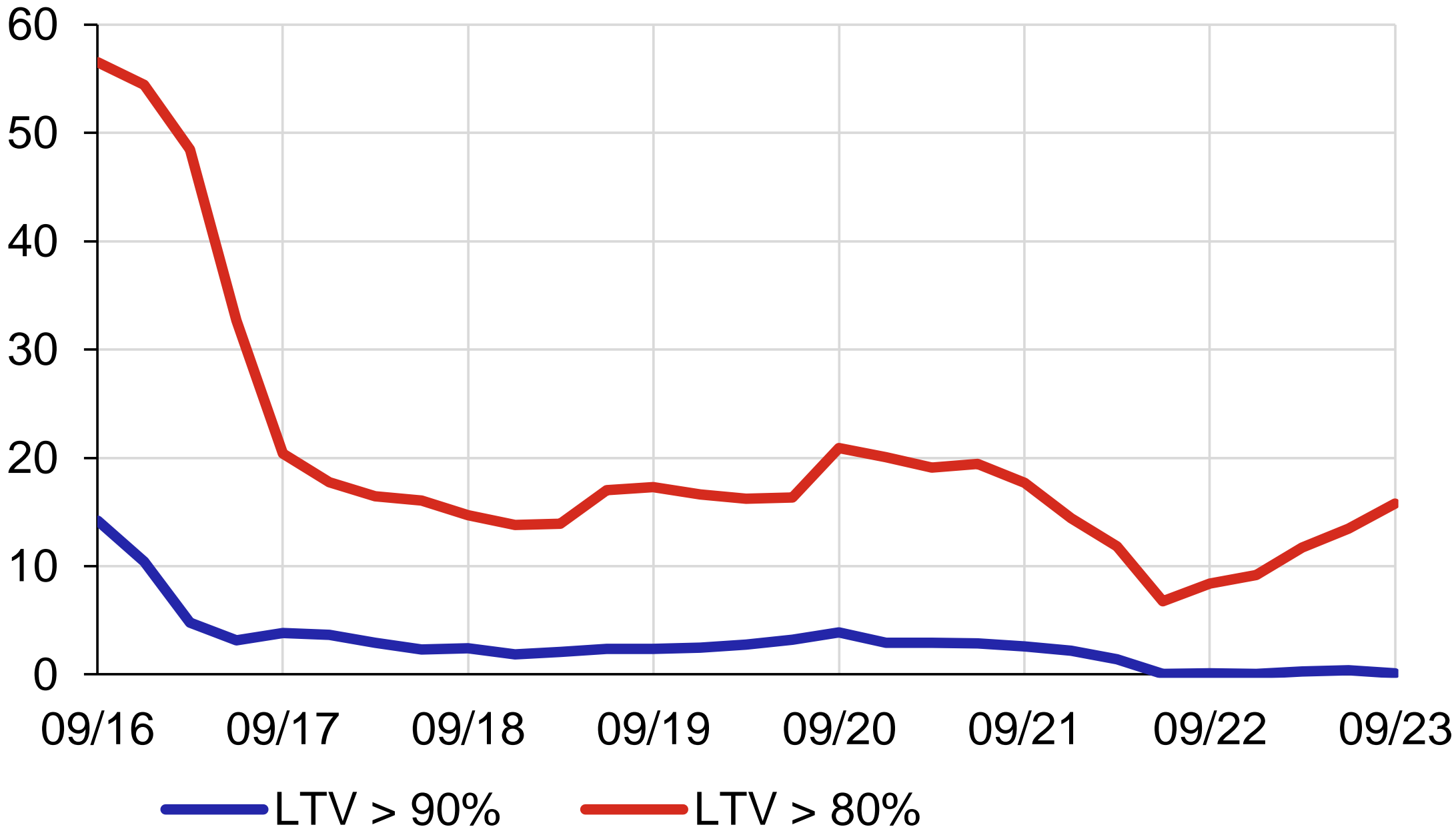
# Bank stress test results (2)

Compliance with selected regulatory requirements by the banking sector in the alternative scenarios

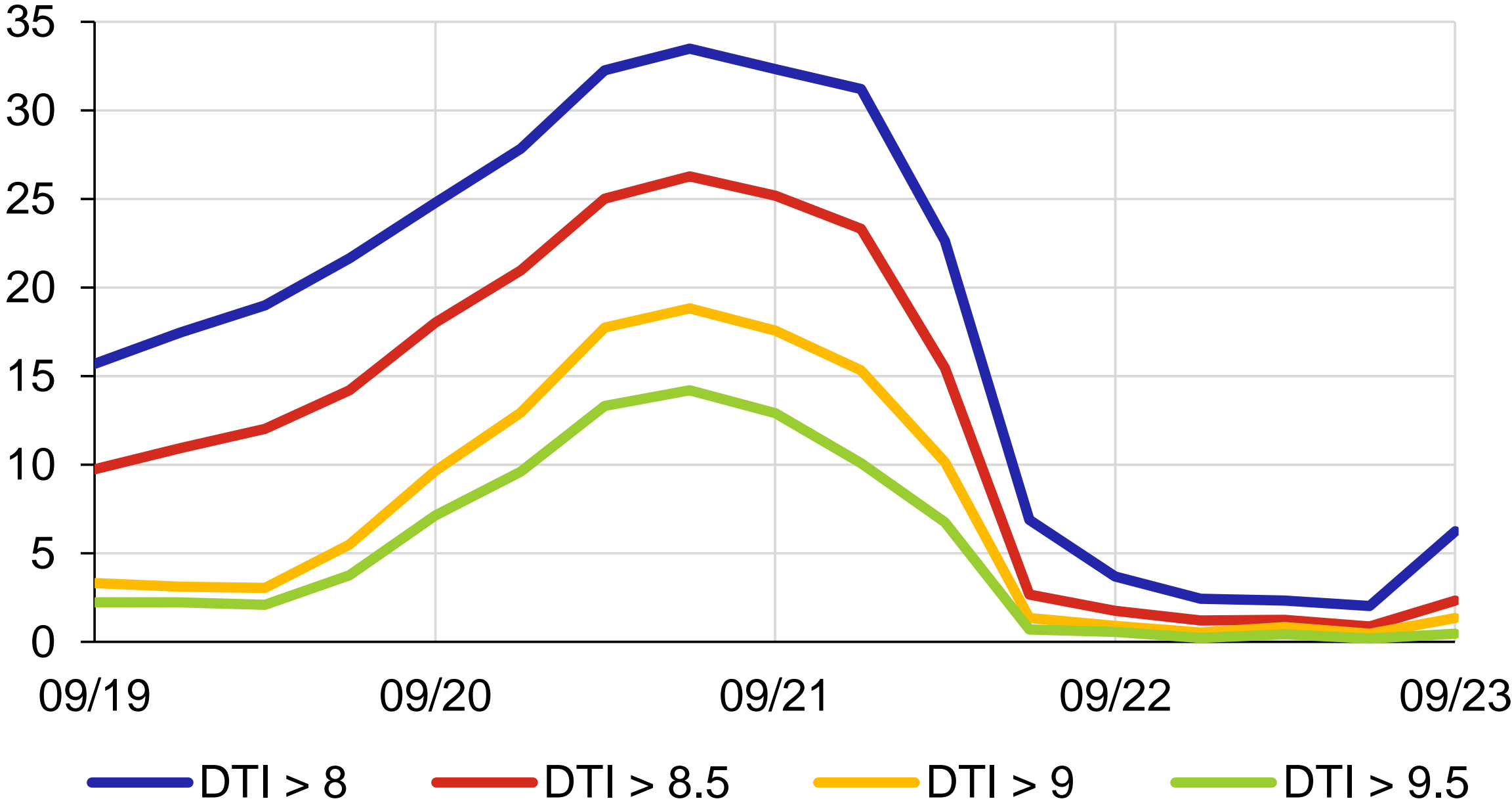


# Compliance with LTV and DTI limits

**Pure new mortgage loans with LTVs in selected bands**  
(share of loans in volume provided in given quarter in %)

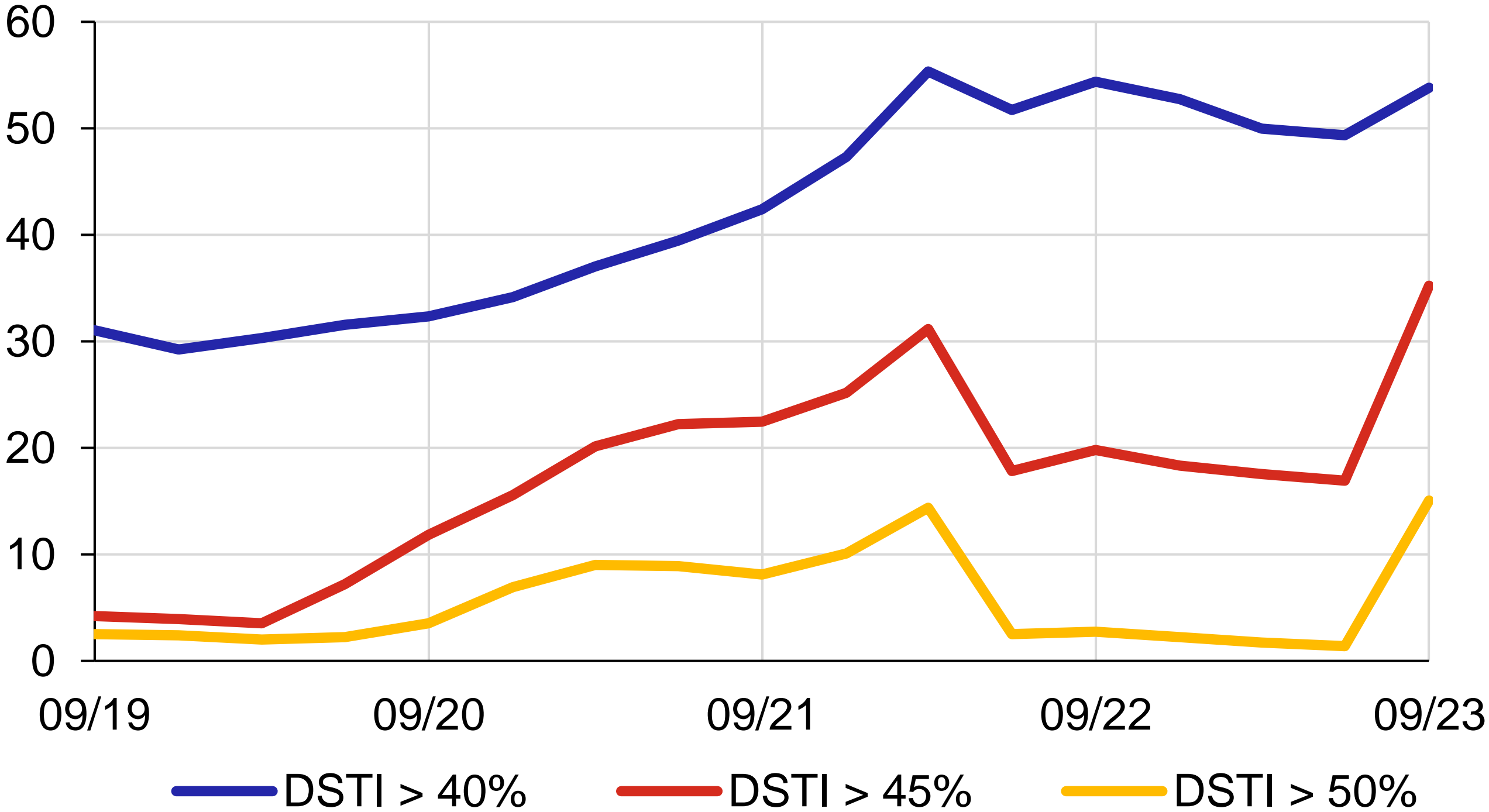


**Pure new mortgage loans with DTIs in selected bands**  
(share of loans in volume provided in given quarter in %)



# Share of loans by DSTI

**Pure new mortgage loans with DSTIs in selected bands**  
(share of loans in volume provided in given quarter in %)





# Selected mortgage loan characteristics

Weighted average in given period

## Average values of the characteristics of new mortgage loans and loan applicants

	2018	2019	2020	2021	2022	2023		
						Q1	Q2	Q3 *
Loan size (CZK millions)	2,2	2,3	2,7	3,3	3,2	2,9	3,0	3,1
Interest rate (%)	2,6	2,7	2,3	2,3	4,7	5,9	5,9	5,8
Instalment (CZK thousands)	11,7	11,3	12,0	15,5	17,5	18,3	18,8	19,3
Maturity (years)	26	26	26	26	26	26	26	26
Fixed-rate period (years)	5,9	6,5	6,7	6,1	6,0	4,9	4,6	4,3
Collateral value (CZK million)	3,7	4,0	4,5	5,5	6,2	5,5	5,7	5,7
Number of properties securing loan			1,2	1,1	1,1	1,1	1,1	1,1
LTV (%)	67,5	66,6	66,3	64,6	61,7	62,0	62,2	63,6
DTI (annual incomes)	5,4	5,1	5,5	5,9	5,3	4,6	4,5	4,9
DSTI (%)	34,2	32,1	32,1	34,2	36,7	35,8	35,8	37,5
Net annual income (CZK thousands)	50,8	54,4	71,5	64,4	77,7	80,1	85,7	85,1
Net monthly income adjusted for instalments (CZK thous.)	34,4	37,2	49,0	43,0	50,0	51,9	56,1	53,6
Number of loan applicants	1,5	1,5	1,5	1,5	1,5	1,6	1,6	1,6
Number of borrowers under 36 years (%)	52,6	51,9	53,1	51,1	48,7	49,4	48,2	49,8

# Thank you for your attention

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The following will be published on the CNB website on **30 November 2023**:

- Provision of a general nature on credit ratios

## **15 December:**

- Financial Stability Report – Autumn 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 on the countercyclical capital buffer