Czech mortgage limits unchanged, capital rate increased

The Czech National Bank published the main conclusions of the forthcoming Financial Stability Report planning to be published on 11 June. Income limits affecting housing loans affordability did not change, but the CNB increased the countercyclical capital buffer again to 2%

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New regime of announcing macroprudential policy

The CNB published the main conclusions of the new Financial Stability Report 2018/2019 (FSR). As such, the CNB switched to a similar standard as it does when publishing monetary policy decisions. The main conclusions of the report relevant to the setting of macroprudential policy are being agreed by CNB Board and published the same day, but the whole report will be released later, in this case on 11 June.

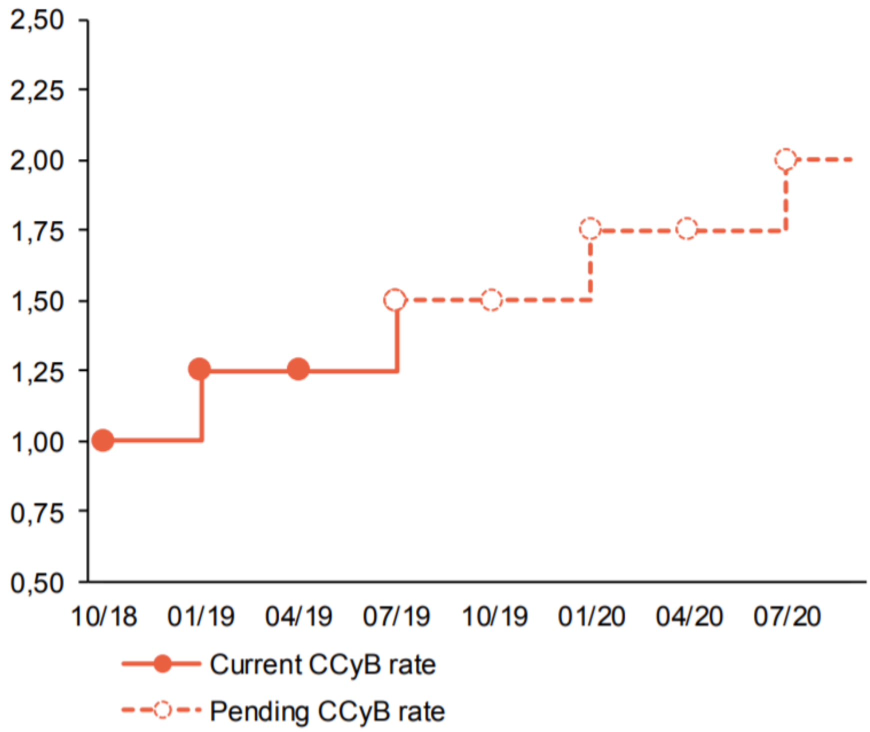
Income limits recommendations remained unchanged

Last year's FSR introduced a new recommendation for the banking sector in terms of households income limits, concretely DSTI (Debt Service-to-Income) at 45% and DTI (Debt-to-income) at 9. The new report keeps the limit unchanged and makes only some fine-tuning in terms of refinanced loans. This was expected as new housing loans volumes has fallen by 25% YoY in 1Q19 after the new limits started to apply since October 2018. Though part of a decline was given by frontloading in 2H18, it is becoming clear that new housing volume will fall at least by 15% YoY this year, bringing a solid credit slowdown. As such, the CNB even debated possibly easing the DSTI limit to 50%, but kept it unchanged in the end.

Countercyclical capital buffer was further increased

In the past two years, the release of FSR has been associated with an increase in the countercyclical capital buffer (CCyB) rate. This year's report continues this trend and CCyB rate was increased from 1.75% to 2% with effect from July 2020. Due to a one year delay between the announcement and the applicability of the buffer rate, the domestic sector had to increase the reserve from 1% to 1.25% since January this year, and will need to further increase it to 1.5% from July, 1.75% from January 2020 and to 2.0% from June 2020 (see the chart).

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



Source: Czech National Bank

Further increase in capital not motivated by banking sector stability

A further increase in the reserve might be somewhat surprising, as the combination of tighter monetary policy and earlier CNB recommendations has led to a sufficient credit market cooldown. Also, the credit-to-GDP ratio is signalling an increase in total economy indebtedness that has been relatively stable in recent years, which generally brings some questions why the CCyB rate is set close to its maximum on the Czech market, especially when the resilience of the Czech banking sector remains robust, as confirmed by the CNB's stress tests (CET1 ratio at 18.6% at end-2018).

Taking a preventive step

So why the CNB increased the rates further? Governor Rusnok mentioned during the press conference, that a further CCyB increase was rather a preventive step, as it had to be announced in advance, and the reserve could be reduced quickly if needed. Still, we believe that some motivation behind a high CCyB rate may also hinder dividend payouts, which implies the CNB statement in the press release: "*The domestic banking sector continues to have sufficient space for credit growth even after the capital buffer increases, assuming reasonable dividend policies*". Last but not least, the CNB gradually converges to the opinion, that the long-term neutral CCyB rate should not be zero, but positive, and the CCyB rate should fluctuate around this neutral level – therefore demands a higher rate now, at the peak of the economic cycle.

Higher capital requirements pushing off banking tax

Still, with a 1% CCyB rate applicable at the end of 2018, the Czech banking sector held CZK24bn more capital just due to CCyB purposes. With CCyB rate being 1 percentage point higher in a one-year horizon, the banking sector will need to increase its capital holding by another more than CZK20bn. Though the banking sector has a solid capital surplus above the minim requirements, a forthcoming growth in capital adequacy demanded by the Czech regulator might somehow mute or postpone a possible debate about a banking sector tax, as the combination of requirements might be rather excessive for the banking sector.