Czech Republic

By Martin Kotek, Komerční banka, a. s.

IN A NUTSHELL

- → The Czech Republic is enjoying an economic upswing. Boosted by consumer confidence, low unemployment rate, increasing wages and low credit costs, private consumption growth remained high;
- → Housing prices are increasing rapidly against a backdrop of high demand, constrained supply and regulatory obstacles;
- → The mortgage market kept growing in 2017, also thanks to favourable economic conditions, despite a slight increase of average interest rates and tightened regulation.

MACROECONOMIC OVERVIEW

2017 was marked by renewed acceleration of economic growth, which was aided by the better – than-expected Eurozone developments and an improvement in all components of domestic demand, and supported by low interest rates and greater utilisation of EU funds. Domestic real GDP increased by 4.4% in 2017, driven by both internal and external demand. Household consumption increased by 3.5% thanks to the dynamic growth of employment and salaries.

The labour market reflected economic growth with a very high utilisation of the labour force, with employment growing at 78.5% in comparison to 76.7 in 2016. The unemployment rate (adjusted by seasonal influences) further decreased to 2.9% in 2017 and reached the lowest level of the EU. The low unemployment level and the mismatch in supply and demand for labour are reflected in the faster growth of real wages.

Lower capital spending and higher tax revenues have led to a fiscal surplus of 1.6% of GDP, while government debt dropped below 37% of GDP, one of the lowest levels in the EU.

Czech National Bank removed pegging to the Euro and increased the base interest rates (2W repo) and the base rate was 0.5%. Inflation picked up strongly in 2017 reaching an annual average of 2.5%. This increase in inflation – from around 0.5% during the last three years – was partly driven by an acceleration of wage growth.

HOUSING AND MORTGAGE MARKETS

The real estate market of the Czech Republic has been very buoyant and one of the fastest growing in the EU. In 2017 house prices increased by 10.3%. The most expensive flats are not located only in big cities (Prague, Brno), but also in smaller ones such as Hradec Kralove.

The house price increase is caused mainly by the economic boom. Thus, people are not afraid of losing their job, real salaries are increasing and it is more affordable to buy a property. Another driving factor is high demand for and the lack of available flats, especially newer ones, also due to strict building regulations. Although the offer of newly developed flats increased in 2017 by 4.5%, lack of the new housing opportunities remains the key issue of the Czech real estate market.

The favourable economic developments, coupled with low loan interest rates, are encouraging the emergence of optimistic expectations and increasing households' willingness to finance their expenditure using debt. Despite slight growth in interest rates, lending conditions remain without changes and the amounts of new loans provided to households are still high. From total sales volume perspective the mortgage market remained on the same level as in previous year, in which the production of mortgages was historically highest. The total amount of mortgages provided slightly decreased to 105,000 (from 112,000 in 2016) and the total volume outstanding was CZK 1,153.1 bn (8,8% y-o-y growth). The driving factors were not only economic growth, but also relatively low interest rates, despite a slight increase from last year reaching an average rate of 2.25% due to CNB counter-cyclical monetary policy decisions in order to cool the market.

At the end of 2016, CNB issued several recommendations in regards to LTV and the recommended maximum LTV was 95%, further decreased to 90% with effectiveness as of April 1st, 2017. Although banks are not legally obliged to follow this rule, the CNB can request higher volume of the Mandatory Minimum Reserve, if these recommendations are not met, which means higher costs for lending. Another recommendation relates to proportion of loans with LTV in range of 80% - 90%, which should not be more than 15% of total volume of loans provided by a bank.

MORTGAGE FUNDING

The covered bond (***"Hypotecni zastavni list"*** – hereinafter referred to as "MCB") market in the Czech Republic was kick started on 1 January 1992 on the basis of the general regulation contained in the Commercial Code. At present, MCBs and mortgage loans are regulated in detail in the Bond Act, which entered into force on 1 April 2004. The Bond Act was amended in 2012 with the new provisions, amongst other things, enabling the issuance of MCBs under a foreign law and clarifying the calculation of the minimum LTV required by the law. Specific provisions treating cover assets and applicable to the opening of insolvency proceedings or the declaration of bankruptcy of the issuing bank are part of the Insolvency Act No. 182/2006 Coll.

The main source of funding for banks are client deposits, which dominate the liability side of the banking sector. A higher degree of prudence also results in LTD ratios of 80%, which are much lower than other countries in the EU.

	CZECH REPUBLIC 2016	CZECH REPUBLIC 2017	EU 28 2017
Real GDP growth (%) (1)	2.5	4.3	2.4
Unemployment Rate (LSF), annual average (%) (1)	4.0	2.9	7.6
HICP inflation (%) (1)	0.6	2.4	1.7
Outstanding Residential Loans (mn EUR) (2)	34,940	45,160	7,013,738
Outstanding Residential Loans per capita over 18 (EUR) (2)	4,036	5,216	16,872
Outstanding Residential Loans to disposable income ratio (%) (2)	37.9	45.0	73.8*
Gross residential lending, annual growth (%) (2)	28.5	6.6	3.5
Typical mortgage rate, annual average (%) (2)	2.2	2.4	2.4**
Owner occupation rate (%) (1)	78.2	n/a	66.4*
Nominal house price growth (%) (2)	11.0	10.3	6.0

* The aggregate EU figure is from 2016.

** Please note that this value is the simple average of the typical interest rate of the EU 28 countries.

Sources:

(1) Eurostat

(2) European Mortgage Federation - Hypostat 2018, Statistical Tables.

CZECH REPUBLIC FACT TABLE

Entities which can issue mortgage loans:	In the Czech Republic, housing finance is mainly raised by banks, in some cases also by credit unions.
The market share of the mortgage issuances:	Not available
Proportion of outstanding mortgage loans of the mortgage issuances:	Three retail banks - Hypotečni banka, Česká spořitelna and Komerčni banka together hold almost 75% of the market share in the Czech Republic.
Typical LTV ratio on residential mortgage loans:	One of the recommendations of the Czech National Bank was that maximum LTV is 90% and share of mortgages with LTV 80+ should not exceed 15% of the total volume of new loans granted each quarter. Market fulfilled these recommendations and typical mortgage was with LTV 70 – 80%
Any distinction made between residential and non-residential loans:	75% of housing loans were provided for residential purpose.
Most common mortgage product(s):	Most common mortgage loan in 2017 was the loan for house/flat purchase (> 50%) secured by this property with interest rate fixation 5-7 years and maturity 20-30 years.
Typical maturity of a mortgage:	Typical mortgage loans have maturity 20 to 30 years. Again, the recommendation of the Czech National Bank is not to provide loans of over 30 years.
Most common way to fund mortgage lending:	Mainly deposits (Loan-to-deposit ratio is at about 80%), less often covered bonds.
Level of costs associated with a house purchase:	Taxes and fees when buying/selling a property in the Czech Republic: 1) Real Estate Transfer Tax (4% of purchase price – does not apply to the first transfer of ownership of a newly-built building or flat) 2) Real estate agency fee (at about 3%)
The level (if any) of government subsidies for house purchases:	1. With the current landscape of very low interest rates, the state does not consider it necessary to support mortgage loans for young people as used it used to do from 2004 to 2011. However, since the 21st April 2016 there was the possibility – for young families up to 36 years with at least one child under six years to receive a subsidy for a house purchase and construction in amount up to CZK 600,000 (EUR 23,000) in the form of a discounted rate derived from EU reference rate (EU basic rate + 1,0% - 2,0%) fixed for 5 years with maximum maturity 15 years. – for young people up to 36 years subsidy for reconstruction of housing in amount up to CZK 150,000 (EUR 5,750) in the form of a discounted rate of 2,0% with maturity max. 10 years 2. Tax-deductible paid interests: The amount paid in interest on a mortgage loan to finance housing needs can be deducted from the tax base of physical entities' income, up to CZK 300,000 per year (this also applies to foreigners who have a tax domiciliation in the Czech Republic).