

# Czechia

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## IN A NUTSHELL

- Volatile development of Czech economy - Consumer confidence improves as the economy restarts in the aftermath of the pandemic. However, scepticism takes over amid a slowdown in 2021.
- Rising inflation forced the central bank to tighten monetary policy, leading to mortgage interest rate increases at the end of year.
- Housing demand, low interest rates in the first half and expectations of their increase resulted in historically high housing loan sales.
- House prices rose by 25%.

## MACROECONOMIC OVERVIEW

The development of the economy was very volatile. In the first months of the year there was a new wave of the pandemic and limitations on economic life. In the second quarter the economy improved with the easing of restrictions and a gradual restart of business activity. However, the optimism did not last long and in the second half of the year the economy was hit hard by a shortage of production components, especially microchips. In addition raw materials were in short supply for most industries and construction.

The economy grew by 3.5%. Growth was supported particularly by final consumption spending. In the meantime, gross value added expanded, significantly driven by industry, trade, transport, accommodation and hospitality, and in the group of general government expenditure.

Household consumption grew rapidly after the easing of containment and social distancing measures in spring. Its quarter-on-quarter real growth was 7.4% in the second quarter. However, a drop in consumer confidence in autumn, relating to the sharp rise in energy prices and the potential return of risks related to the pandemic, caused consumption to slow.

The unemployment rate was 3.5% in December, half a percentage point lower over the year due to the domestic economic recovery.

The average inflation rate reached 3.8%, 0.6 percentage points more than in 2020. Throughout the year, the rate gradually increased from 2.2% in Q1 to 6.2% in Q4. The development of inflation was influenced by rising prices in the categories of transport, housing, alcoholic beverages, and tobacco. Industrial producer prices rose by 7.1% in 2021, while agricultural producer prices increased by 6.9%. Prices of materials and products used in construction increased by 10.9%.

The Czech National Bank first tightened monetary conditions in June of last year, raising its base repo rate from 0.25% to 0.5%. It continued to gradually tighten monetary policy with an increase of the repo rate to 3.75% in December.

The pandemic situation was also reflected in the government's budget, which ended 2021 with a deficit of CZK 419.7 bn (6.9% of GDP).

## LOOKING AHEAD

Radical changes are expected in house financing market trend in 2022. The January – May period confirms this assumption. The mortgage market dropped by 25% in Q1 2022 and close to 50% year to year expected in Q2 (considering the exceptionally high sales figures in 2021Q2), given the significant increase of interest rates, which approach 6% - the highest rate in the last decade, and three times the rate in Q2 2021.

This growth is driven by an increase of the base rate by the central bank, amid the fight against growing inflation. The inflation rate exceeded 15% in the beginning of 2022Q2 and there is no expectation of a decrease in following months. The high interest rate environment is the main factor that will influence the mortgage market in 2022.

In addition, since 1 April 2022, the central bank implements again regulations on DTI and DSTI. These regulations, together with high interest rates and rapidly growing household expenditures due to inflation, will decrease the accessibility of house financing.

Despite this drop in housing finance, real estate prices are not expected to decrease, but rather slow its pace of growth.

## HOUSING MARKETS

The situation of the housing market did not change since last year. Significantly higher demand than the real estate supply has been a characteristic feature of the Czech real estate market over recent years. The number of housing starts slightly increased, but generally residential dwelling supply was quite limited. Against the backdrop of housing shortages and accelerating inflation during the second half of the year, prices increased at an accelerated pace by year end – they rose by 25% year on year. Prices growth concerned all regions and all types of housing, both old and new construction. Prices of new construction were influenced by growth in the cost of construction materials, energy and transport.

Due to decreasing accessibility of housing financing and thus housing ownership, there was rising demand for rental housing which is a new trend in the Czech housing market.

## MORTGAGE MARKETS

### MARKET DYNAMICS

The upward trend of 2020 continued in 2021, as residential mortgage lending achieved historically highest figures again. New sales of mortgages (new loans origination) increased by 60% y-o-y. Compared to 2019, total sales doubled. These record results were driven by a combination of factors. Firstly, low interest rates which were the main driver behind the production peak in Q2. This period was also influenced by the overall economic restart and growing

consumer confidence. In a low interest rate environment, the purchase of real estate was seen as an investment opportunity, providing regular rental income despite growing house prices.

The second half of the year was different. Interest rates started to increase, with base rates of the Czech National Bank increasing to combat inflation. In these changing conditions, mortgage demand remained high. For reasons including an expectation of further interest rate growth, accelerated demand for residential credit, and due to growing housing prices, real estate investment was perceived as the way to protect household savings from inflation. Growing real estate prices also led to an increase in average loan sizes.

When market interest rates increased especially in the last quarter lenders reduced their margins to not immediately reflect the rise in mortgage interest rates. Market competition increased and mortgages were provided on barely profitable terms. Banks expected a market readjustment in following months and tried to gain market share.

In last quarter of 2021, the Czech National Bank announced measures to regulate the market – namely, the reinstatement of income-related indicators DTI (Debt to Income) and DSTI (Debt Service to Income) and a tightened maximum LTV – effective since April 2022. These changes were communicated in the media as the reason for the deterioration of finance accessibility and became another drivers accelerating the market before they came to effectiveness.

#### NON-MARKET LED INITIATIVES

The DTI cap will be 8.5, for borrowers younger than 36 or 9.5% otherwise, the DSTI cap will be 45% or 50% for younger people. Also LTV, which was capped at 80%, is relaxed for young people for whom a 90% cap applies. The easier rules for younger people is to improve housing accessibility for them.

Banks will be allowed to provide 5% of their mortgages under conditions that are not in-line with these limitations. This exceptional limit, however, will be strictly monitored.

	CZECHIA 2020	CZECHIA 2021	EU 27 2021
<b>MACROECONOMIC VARIABLES</b>			
Real GDP growth (%) (1)	-5.5	3.5	5.4
Unemployment Rate (LSF), annual average (%) (1)	2.6	2.8	7.0
HICP inflation (%) (1)	3.3	3.3	3.0
<b>HOUSING MARKET</b>			
Owner occupation rate (%) (1)	78.9	78.3	70.0
Gross Fixed Investment in Housing (annual change)(1)	3.8	-1.6	6.6
Building Permits (2015=100) (2)	109.9	117.7	134.0
House Price Index – country (2015=100) (2)	156.8	197.3	145.2*
House Price Index – capital (2015=100) (2)	n/a	n/a	146.1*
Nominal house price growth (%) (2)	9.0	25.8	10.3*
<b>MORTGAGE MARKET</b>			
Outstanding Residential Loans (mn EUR) (2)	51,174	60,632	6,508,621
Outstanding Residential Loans per capita over 18 (EUR) (2)	5,886	6,983	17,782
Outstanding Residential Loans to disposable income ratio (%) (2)	41.7	44.5	62.8*
Gross residential lending, annual growth (%) (2)	37.3	62.3	12.2
Typical mortgage rate, annual average (%) (2)	2.3	2.3	2.0

\* Please note that this value is the simple average of the available values in 2021.

#### Sources:

(1) Eurostat

(2) European Mortgage Federation - Hypostat 2022, Statistical Tables.

## CZECHIA FACT TABLE

<b>Which entities can issue mortgage loans in your country?</b>	In Czechia, housing finance is mainly raised by banks.
<b>What is the market share of new mortgage issuances between these entities?</b>	Banks represent almost 100% of the mortgage market.
<b>Which entities hold what proportion of outstanding mortgage loans in your country?</b>	There are 3 big retail banks, which together hold almost 75% of the mortgage loans outstanding volume in Czechia.
<b>What is the typical LTV ratio on residential mortgage loans in your country?</b>	The Recommendations of the Czech National Bank defines the maximum LTV on 90%. Typical mortgage loan is the loan with LTV 80 – 90%
<b>How is the distinction made between loans for residential and non-residential purposes in your country?</b>	More than ¾ of the housing loans were provided for residential purposes.
<b>What is/are the most common mortgage product(s) in your country?</b>	The most common mortgage loan in 2020 was the loan for house/flat purchase secured by financed property with interest rate fixation period 7–10 years and maturity 25–30 years.
<b>What is the typical/average maturity for a mortgage in your country?</b>	The Recommendation of Czech National Bank sets the maximum mortgage loan maturity at 30 years. Typical mortgage loans have a maturity that ranges from 25 to 30 years.
<b>What is/are the most common ways to fund mortgage lending in your country?</b>	Combination of deposits and covered bonds.
<b>What is the level of costs associated with house purchase in your country (taxes and other transaction costs)?</b>	Taxes and fees when buying/selling a property are the following: <ol style="list-style-type: none"> <li>1. Fee for record of the ownership change and mortgage lien establishment to Real Estate Cadastre (state database)</li> <li>2. Real estate agency fee (only for purchase intermediated by RE agency)</li> </ol>
<b>What is the level (if any) of government subsidies for house purchases in your country?</b>	In a low interest rate environment and considering the generally positive macroeconomic development in throughout most of the year, a limited amount of subsidies was available: <ul style="list-style-type: none"> <li>• 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.</li> <li>• Support for establishing social housing for disadvantaged people due to their age or health</li> </ul>