CEE Banking and Housing Market

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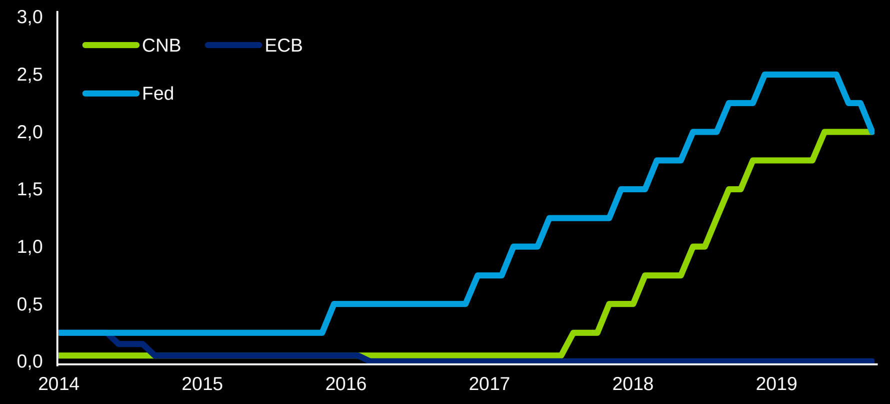
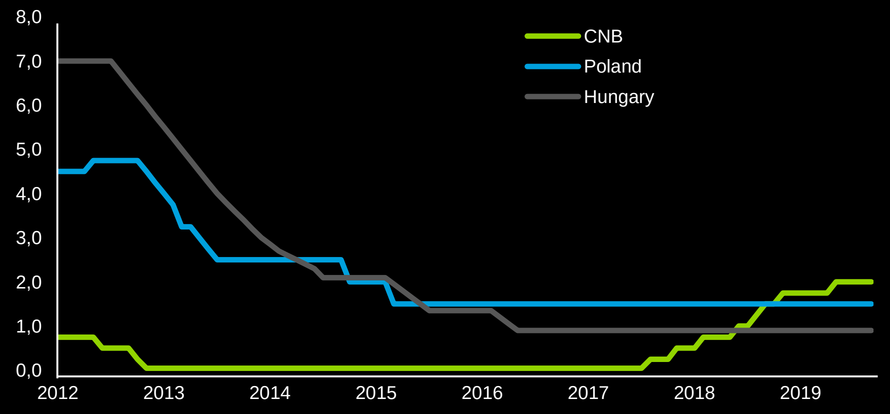
EFBS Housing Policy and Marketing Committee Meeting
Prague, 17 October 2019

Economic & monetary policy outlook

CEE is an economically healthy region, however global economy is expected to slow down

Monetary Policy Outlook
Global and CEE outlook





- Some central banks start (Fed, ECD) monetary policy loosening cycle.
- Fed cutting rates, ECB announced new asset buying program.

Reasons:

- Weak global economy due to trade tensions.
- Low inflation in the Euro Zone.

- *CNB managed to start rate hike cycle during the expansion phase of the business cycle but is not willing to react to current deceleration of economic growth.*
- *Czech Republic has relatively high interest rate environment (relative to the Euro Zone).*

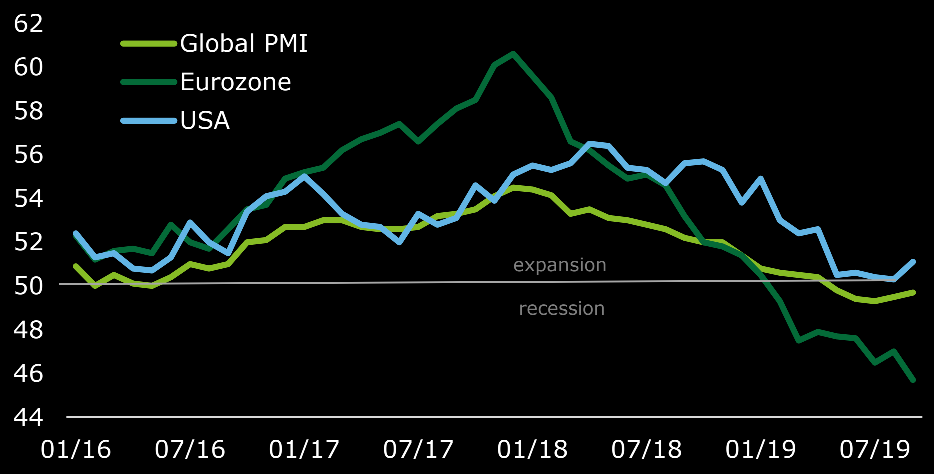
- *As Polish fiscal policy is expansionary (because of October 2019 general election) it is unlikely that NBP would loosen its monetary policy.*

- *Given mounting external risks, it is possible that National bank of Hungary will loosen its monetary policy in coming months.*

- *Pegged exchange rate regime in Bulgaria*

Changing weather in global economy

Risks for CEE



GDP (%)	2018	2019f	2020f
USA	2,9	2,6	1,9
Germany	1,4	0,7	1,7
France	1,7	1,3	1,4
Italy	0,9	0,1	0,8
UK	1,4	1,3	1,4
Japan	0,8	0,9	0,4
China	6,6	6,2	6,0
India	6,8	6,3	7,2

Recent PMI surveys point to the risk of significant slowdown / recession in major economies.

Especially Germany looks vulnerable to changing weather in the global economy. Risk for CEE countries as Germany is their main trading partner.

Key risks:

- Trade tensions: rising US tariffs and retaliation from China. US tariffs on European firms and retaliation from EU.
- Currency manipulation (currency wars): „Beggar-your-neighbour policy“. Which currency is undervalued/overvalued?
- No-deal Brexit

Limited possibilities of economic policy:

- Interest rates very low in Europe and Japan. Possibility to resume QE
- Fiscal capacity constrained by debts from previous crisis

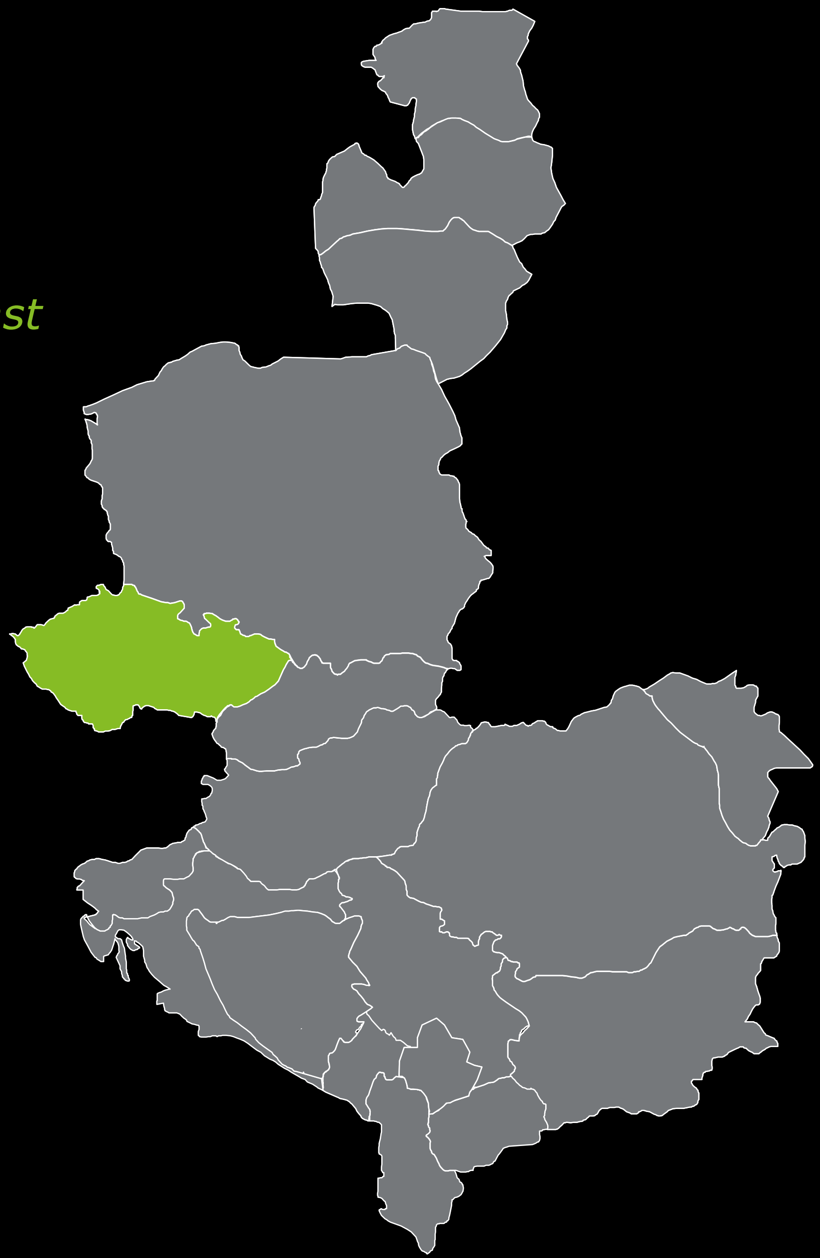
Czech Republic

Recent economic development / forecast

- GDP: 2.9% (2018) / 2.7% (2019)
- Long-term growth: 2.9%
- Unemployment rate: 2.2 %
- Inflation (HICP): 2.0%
- Current account: 0.3% GDP
- External debt: 82% GDP
- Government balance: 0.9% GDP
- Government debt: 33% GDP
- Credit rating: AA-

Key local topics

- Macroeconomic stability and strong financial sector.
- Negative impact of population ageing on the labour market and pension system/fiscal balance.
- High risk of negative impact of automation on local labour force.
- Low public investment in building transport infrastructure.
- Trade tensions negatively impact economy through export linkage to Germany.



Poland

Recent economic development / forecast

- GDP: 5.2% (2018) / 3.8% (2019)
- Long-term growth: 4.0%
- Unemployment rate: 3.8%
- Inflation (HICP): 1.2%
- Current account: -0.6% GDP
- External debt: 64% GDP
- Government balance: -0.4% GDP
- Government debt: 49% GDP
- Credit rating: A-

Key local topics

- Working age population is shrinking which is compensated by inflow of foreign workers. But risk is that they can prefer more attractive working location.
- Fiscal adjustment in recent years, improved tax collection.
- Generous social benefits: boost for the GDP growth, burden for government balance.
- Large state footprint in the economy could slow productivity growth.

Hungary

Recent economic development / forecast

- GDP: 5.0% (2018) / 3.6% (2019)
- Long-term growth: 3.6%
- Unemployment rate: 3.7%
- Inflation (HICP): 2.9%
- Current account: 0.3% GDP
- External debt: 99% GDP
- Government balance: -2.2% GDP
- Government debt: 71% GDP
- Credit rating: BBB

Key local topics

- Pro-cyclical fiscal policy.
- Gradually worsening primary structural fiscal balance
- High but declining external debt.
- Unhealthy price development in real estate market (house prices +11.3% y/y in Q1 2019).
- Labour shortages, rapid wage growth, labour costs outpaced productivity.

Slovakia

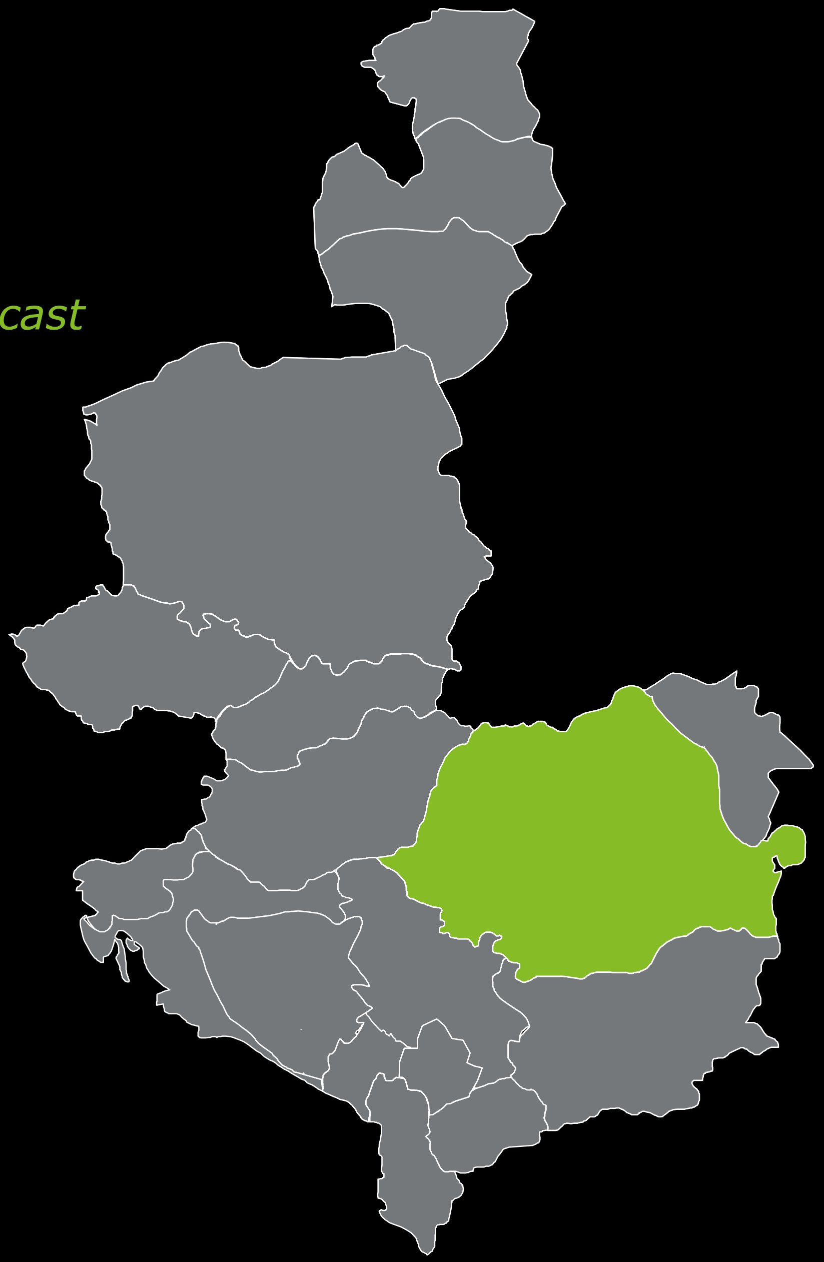
Recent economic development / forecast

- GDP: 4.1% (2018) / 3.7% (2019)
- Long-term growth: 3.2%
- Unemployment rate: 6.5%
- Inflation (HICP): 2.5%
- Current account: -2.5% GDP
- External debt: 91% GDP
- Government balance: -0.7% GDP
- Government debt: 49% GDP
- Credit rating: A+

Key local topics

- High participation in global value chains and heavy dependence on exports makes Slovak economy vulnerable to trade tensions and slower global growth.
- High household debt / disposable income ratio (70%) is a risk for banking sector (smaller banks with less capital buffers).
- Comparative advantage in the form of availability of low-cost skilled workers is threatened by rising automation.

Romania



Recent economic development / forecast

- GDP: 4.2% (2018) / 4.1% (2019)
- Long-term growth: 3.5%
- Unemployment rate: 4.2%
- Inflation (HICP): 4.1%
- Current account: -4.5% GDP
- External debt: 49% GDP
- Government balance: -3.0% GDP
- Government debt: 35.1% GDP
- Credit rating: BBB-

Key local topics

- Consumption expenditures driven economic growth has raised macroeconomic imbalances – current account and fiscal deficits and high inflation.
- Rising labour costs outpaced productivity growth and could undermine competitiveness.
- Fiscal consolidation and monetary policy tightening are needed.
- Recent legislative changes could have negative impact on the banking sector (cap on mortgage rates, tax on assets linked to ROBOR).
- Unsustainable household debt.

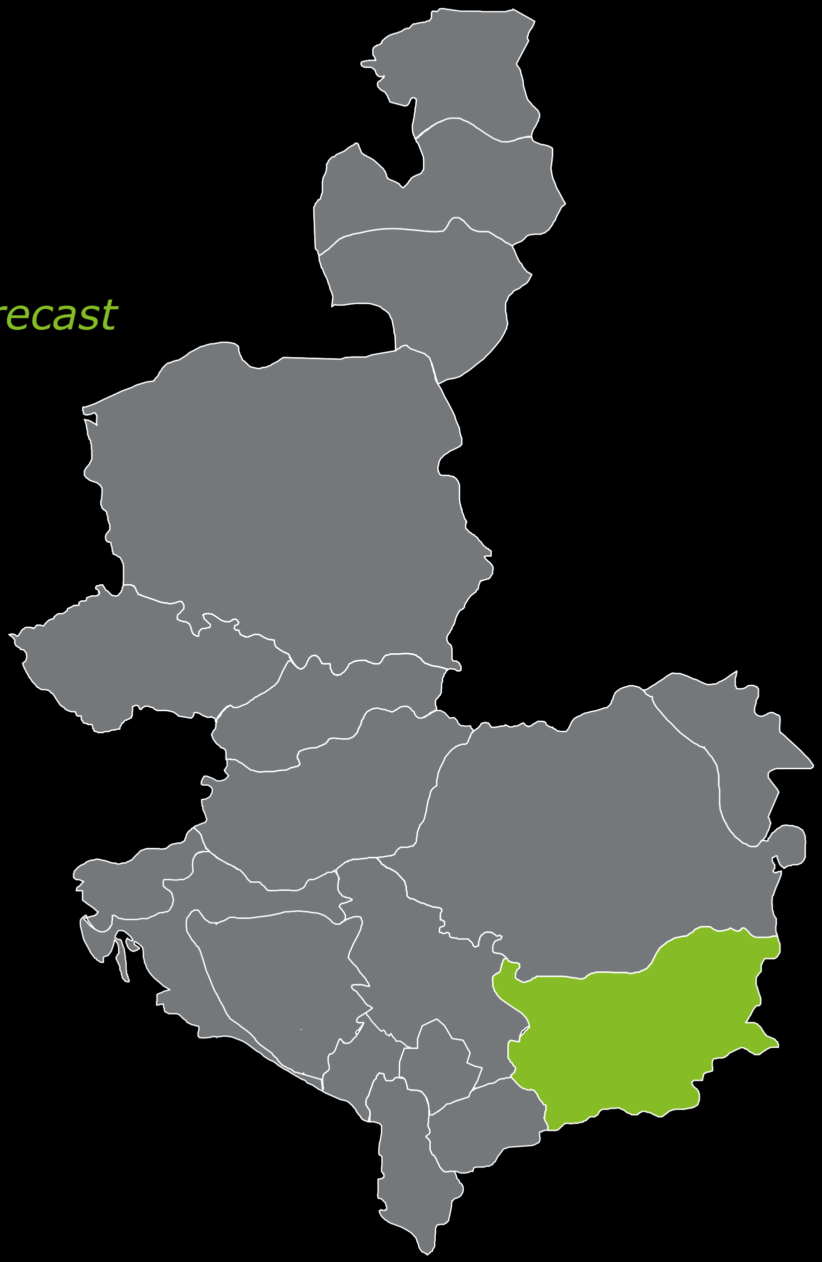
Bulgaria

Recent economic development / forecast

- GDP: 3.3% (2018) / 3.5% (2019)
- Long-term growth: 2.7%
- Unemployment rate: 5.2%
- Inflation (HICP): 2.6%
- Current account: 4.6% GDP
- External debt: 67% GDP
- Government balance: 2.0% GDP
- Government debt: 22.7% GDP
- Credit rating: BBB-

Key local topics

- Bulgaria formally started ERM II (and Banking union) entry process and is likely to adopt euro in 2023.
- Public budget is balanced (small surplus in 2018).
- External balance (current account) also in check (significant surplus).
- High private sector debt, but steadily decreasing ratios (debt/EBITDA).
- Economy faces high risk of negative impact of population ageing and persistent emigration.

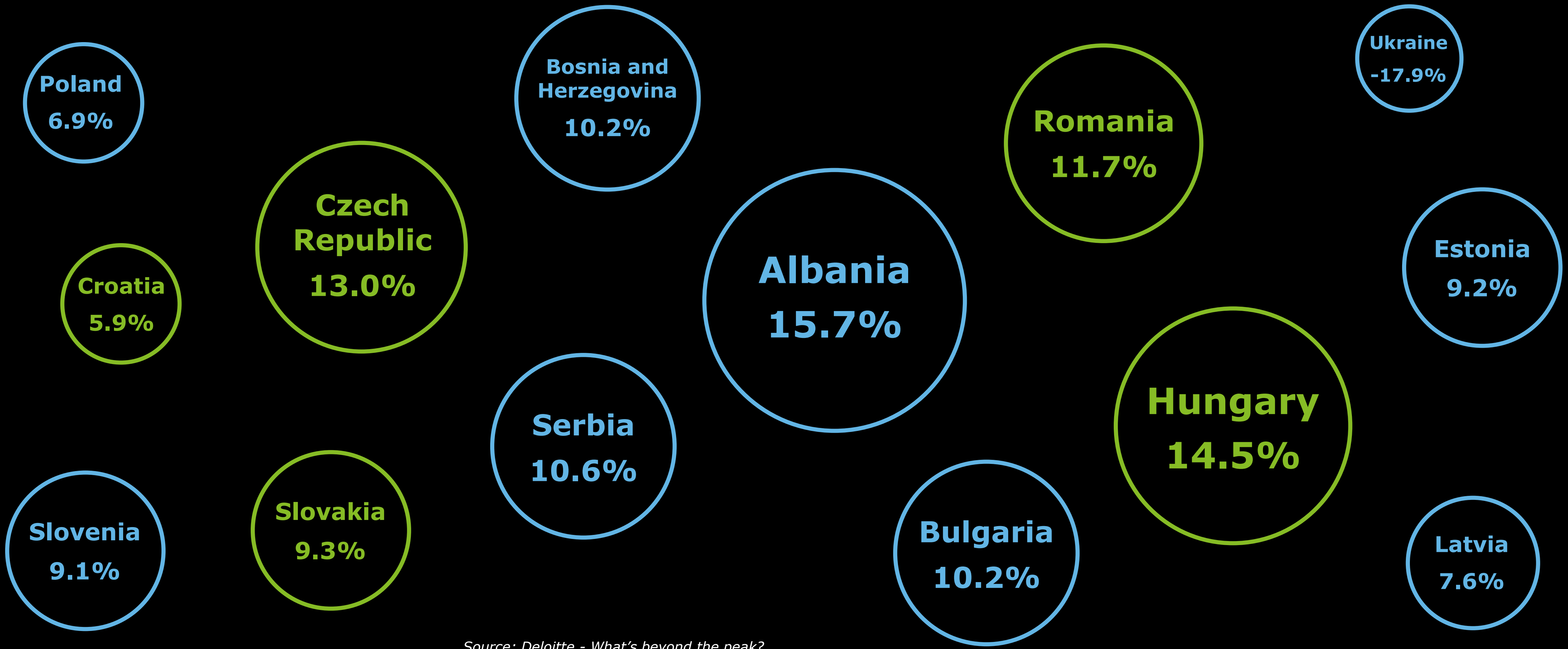


Banking sector trends

CEE has a healthy and profitable banking sector

CEE represents a healthy region with above-average profitability and growing potential thanks to convergence to WE countries

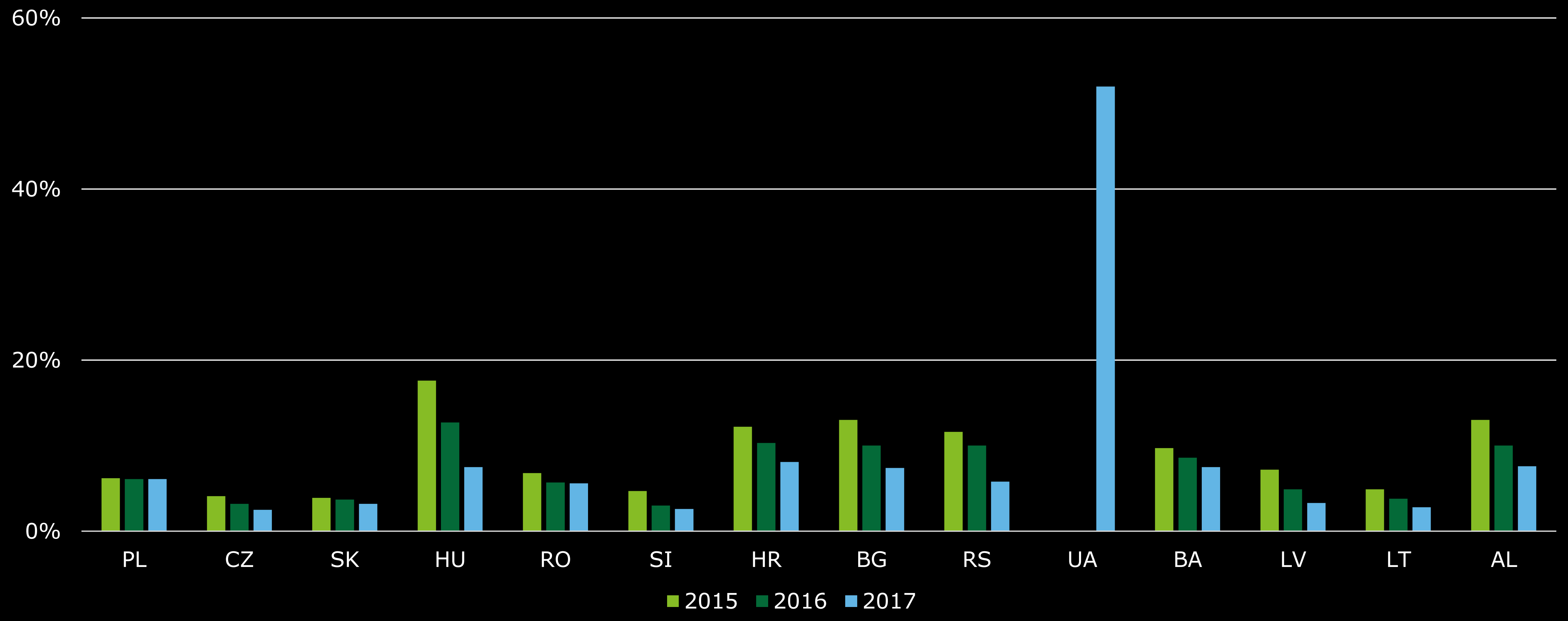
ROE (2017)



Source: Deloitte - What's beyond the peak?
CEE loan markets still offer new opportunities

Positive trend in loan portfolio quality is through the whole CEE region

NPL share



Source: Deloitte - What's beyond the peak? CEE loan markets still offer new opportunities

As the Czech banking sector continues to grow, share of building societies goes down

Overall profit share of building societies decreasing

Source: CNB

And also Fintechs can cannibalise revenue of the traditional banking players

Start-ups and FinTech companies bringing technological innovations in the financial sector

FinTech

- *Low operational costs and competitive pricing*
- *User-friendliness*
- *Big data*
- *Automation and personalisation*
- *Regulation?*

FinTech in the Czech Republic

Revenues 2017

400–800m CZK

Long-term revenue potential

5–15bn CZK

Source: Deloitte – FinTech in the Czech Republic and globally: Impact of new technologies on the financial sector

Restrictions on housing business

Examples of the CNB limiting housing loans

Recent regulatory restrictions imposed by CNB directly impacting housing financing

- By implementing the macro prudential policy, the CNB issues Recommendations limiting granting of retail loans secured by residential property
- The recommended limits relate especially to:
  - loan-to-value ratio (LTV)
  - the debt-to-income ratio (DTI) or DSTI (debt-to-income service)

- The Directive 2008/48/EC was designed to strengthen consumer rights in the area of consumer loans

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LTV limitations

LTV –percentage of the real estate collateral financed by the loan

2015 Determination of LTV limits

- max LTV = 100%, LTV>90% - max 10% of new loans

2016 Tightening of LTV limits

- max LTV = 95%, LTV>85% - max 10% of new loans

2017 Further tightening of limits

- max LTV = 90%, LTV>80% - max 15% of new loans

Limitations – DTI/DSTI

DTI - the ratio of total debt to total annual net income

DSTI - the ratio between monthly repayment of all loans against total net monthly

2015 Banks should carefully evaluate ability of client to repay

2017 DTI and DSTI limits were **firstly described**

2018

- **DTI – max 9, DTI>9** - max 5% of new loans,
- DSTI – max 45%, DSTI>45% - max 5% of new loans

Prepayment limitations

Consumer could repay his debt **anytime and the fee is strictly regulated**

2016 Law **limits fees** for early prepayment – only expenses **directly related to prepayment may be charged**

2019 Press release specifies **directly related expenses very narrowly.** Not permissible: provision paid by provider for loan intermediation, reduction of the provider's interest income after early repayment or its interest costs on debts

Regulation of the mortgage loans market in the Czech Republic

What is being regulated

Regulation

Ban on co-financing with other loan types (e.g. building loans)

Rental mortgages limited to max. 60% LTV

Maximum tenor – 30 years
+ consideration of the economically active age of the borrower

Reflection of the future income decline

Borrower scoring using interest rate of 2% p.a.

Standard mortgage loan – LTV 80%
90% LTV only allowed for 15% of the portfolio

Monthly repayments / Net income = max. 45% DSTI
Maximum mortgage loan amount = 9x annual income

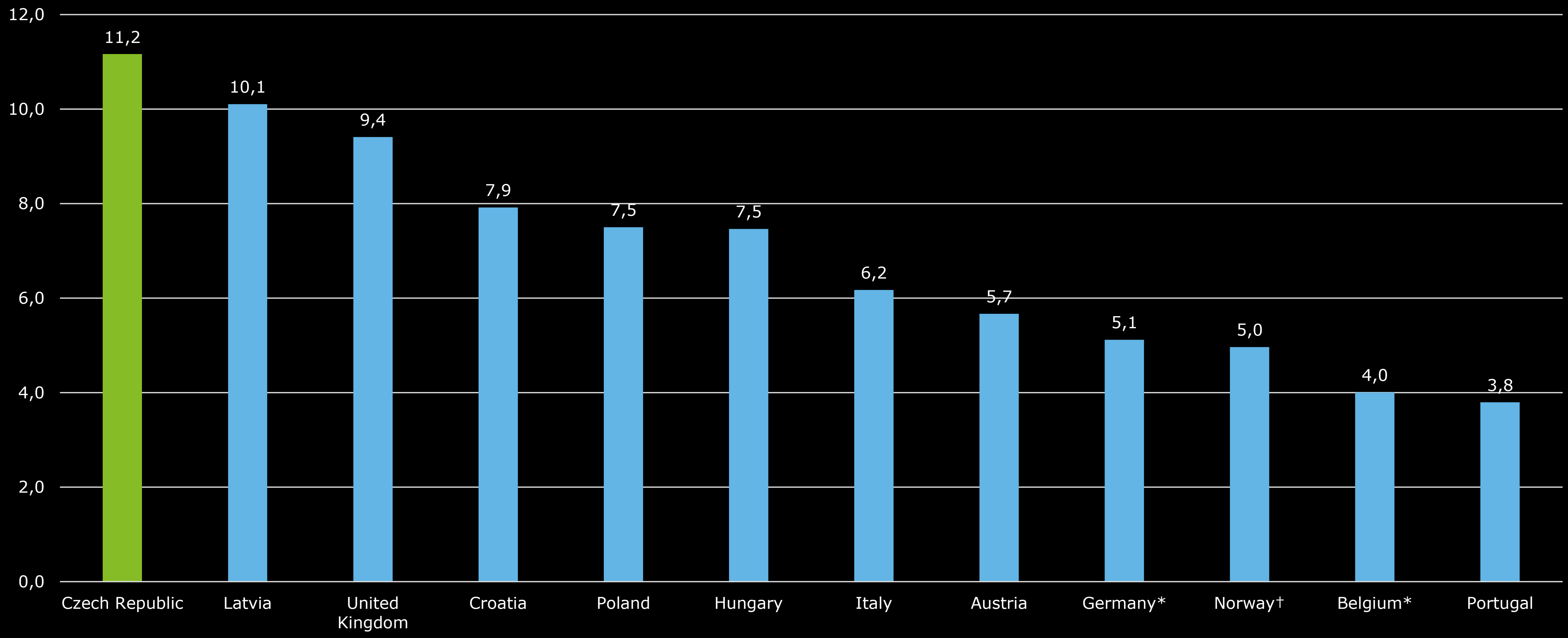
Consumer loans act – always check the client creditworthiness

Real estate market

Growing Czech RE market

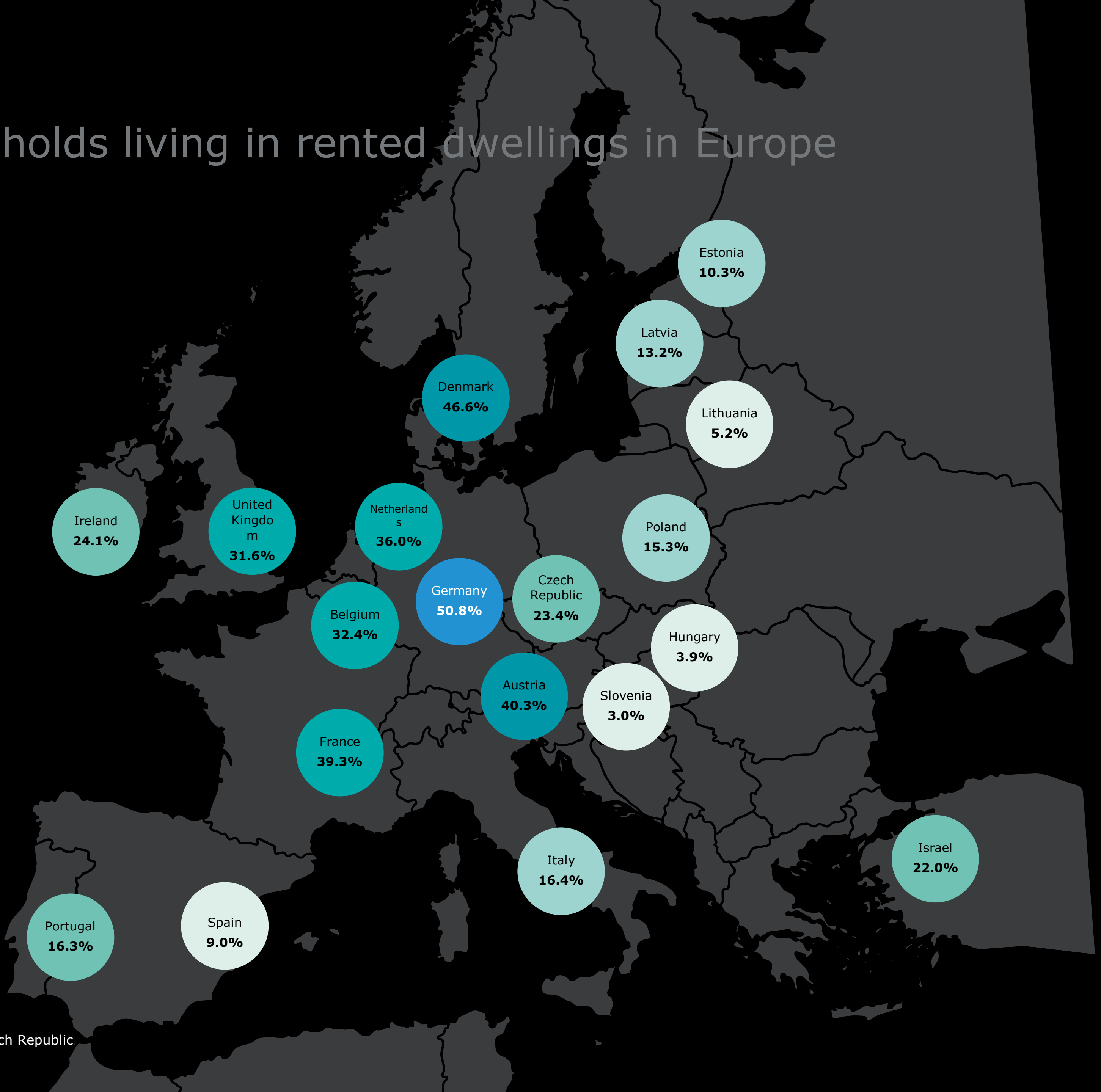
Affordability of own housing

Gross annual salaries for the standardized new dwelling (70 sqm), 2018



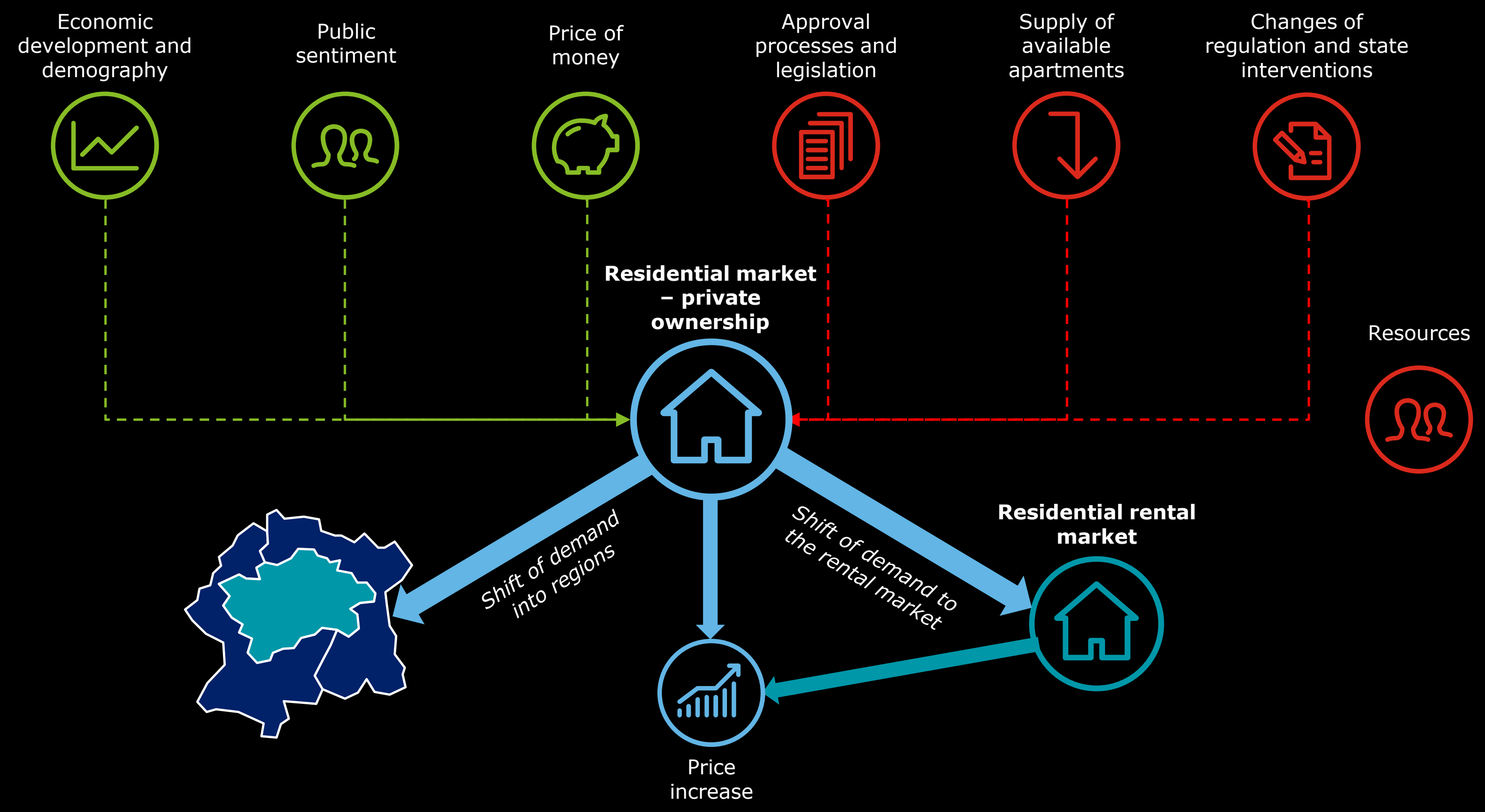
Shift to rental

Share of households living in rented dwellings in Europe



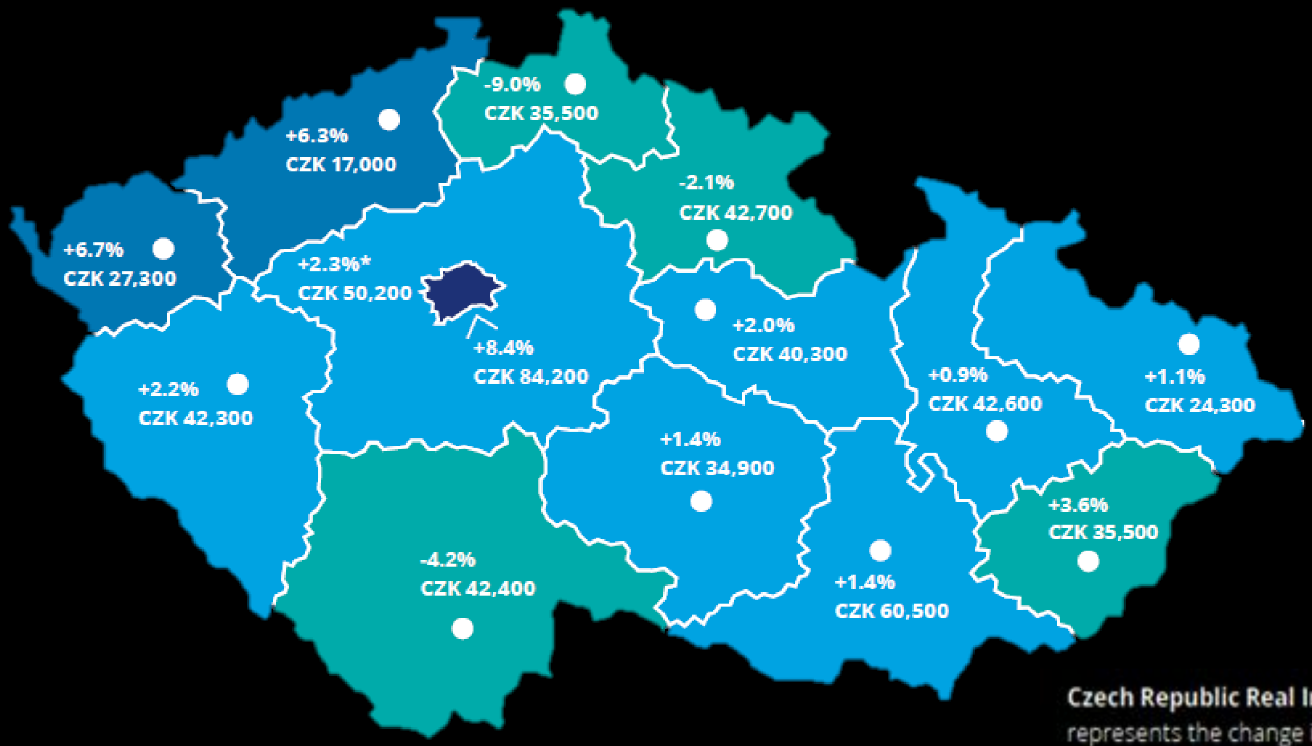
Factors affecting the housing market in the Czech Republic

Change in demand behaviour



Housing prices in the Czech Republic

Deloitte Real Index



Czech Republic Real Index, Q2 2019

60 700 CZK/sqm

Czech Republic Real Index
represents the change in the average price percentage denoting the apartments sold in the regional capitals compared to the previous period (Q1 2019).

Price per sq m in the reviewed quarter for the sales completed in the regionals capitals.

The data concerns the sales of apartments incorporated in the land registry in the form of purchase contracts.

* Average for the towns of Benešov, Beroun, Kladno and Mladá Boleslav and the districts of Prague-East and Prague-West.

-4 % – 0 %

0 % – 4 %

4 % – 8 %

8 % <

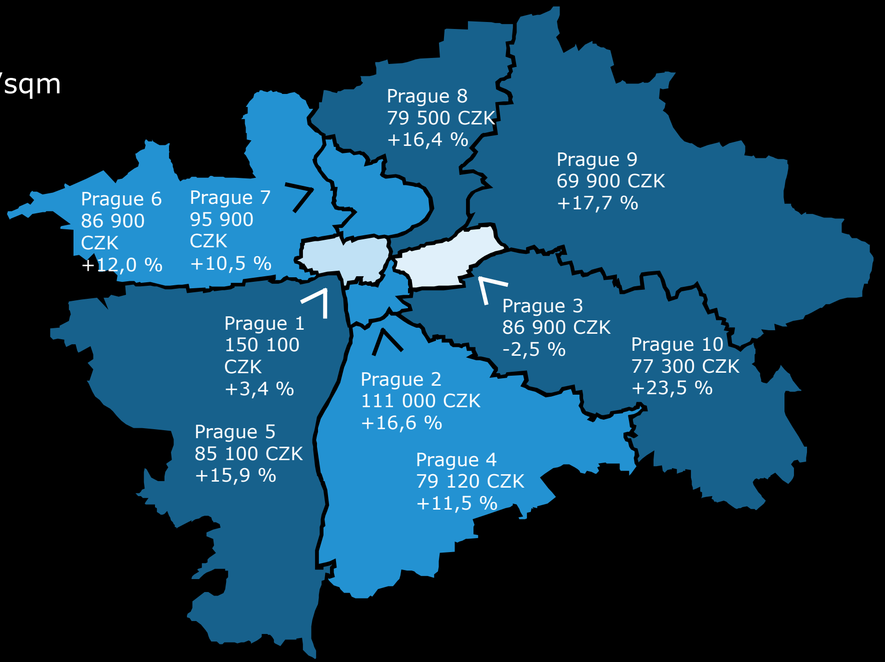
Prague housing prices
Unsustainable growth

Prague Real Index

Q2 2019

84 300 CZK/sqm

+17,4 %



Prague Real Index

Represents the change in the average price percentage denoting the apartments sold compared to the previous period (Q2 2018).

Price per sqm in the reviewed quarter for the sales completed.

The data concerns the sales of apartments incorporated in the land registry in the form of purchase contracts.

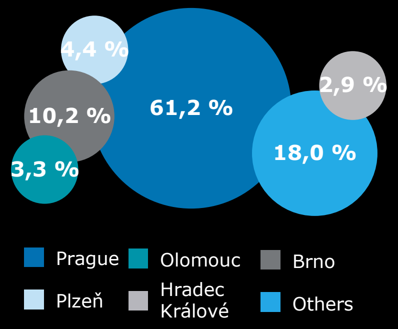
Average price, total transaction volume and number of sales during the period Q2 2019 by segment in Prague

Development projects
Initial sales 90 700 CZK/sqm
989 transactions – 5,9 bn CZK
Re-sales 87 400 CZK/sqm
438 transactions – 2,7 bn CZK
Disposed of price lists 97 500 CZ/sqm

Brick buildings
87 900 CZK/sqm
3,8 bn CZK
683 sales

Prefabricated buildings
68 500 CZK/sqm
2,6 bn CZK
676 sales

Structure of volume of sales during Q2 2019 in Czech Republic



Banking processes automation

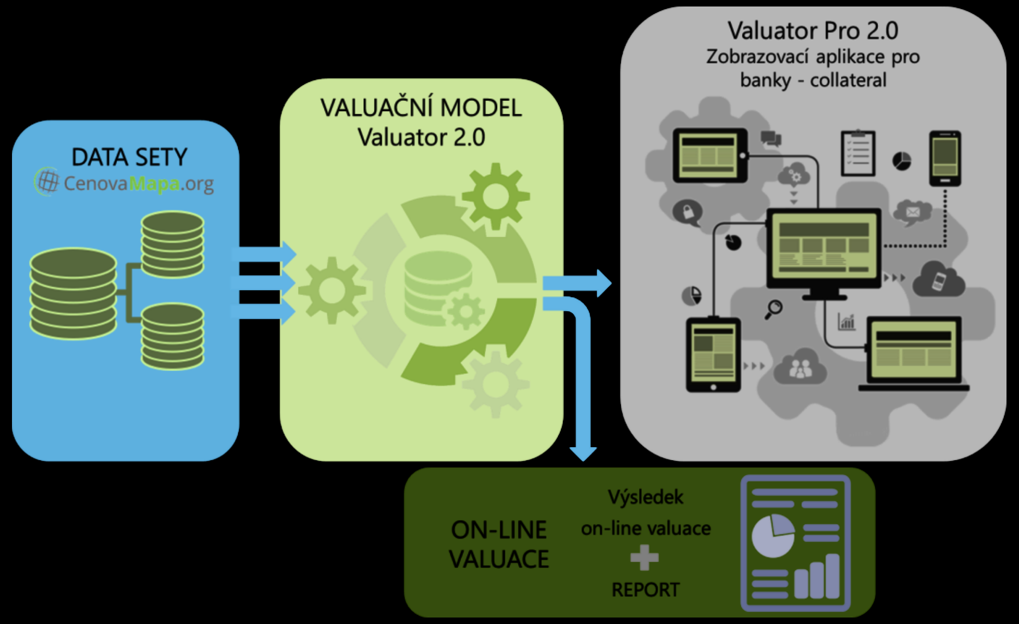
Going more and more online?

Banking trends
Going online

Vision for 2020+?

- A year of boom in online banking products… and they cannot be without an online valuation solution

> *"The banking sector is changing, digitizing and becoming more technologically advanced. In recent years, banks have increasingly come under pressure from startups and non-banking players, which, with their high rate of innovation, are able to bring to their users opportunities that traditional banks lacked."*



Banking trends
Online valuation

1) Expenditures

- Costs of commissions paid to intermediaries
  in 2018 amounting to about 1,7 to 2,0 bn CZK (estimate)
- Costs of expert appraisals
  in 2018 amounting to about 0,4 to 0,5 bn CZK (estimate)

Initial costs per mortgage loan

2) Dependence on third parties

- Aim of the banks to decrease the influence and costs of intermediaries
- Aim of the banks to lower the costs of appraisals

Current on-line trend can help banks:

- Decrease the dependence on intermediaries, and
- Decrease the costs of intermediation and of appraisals

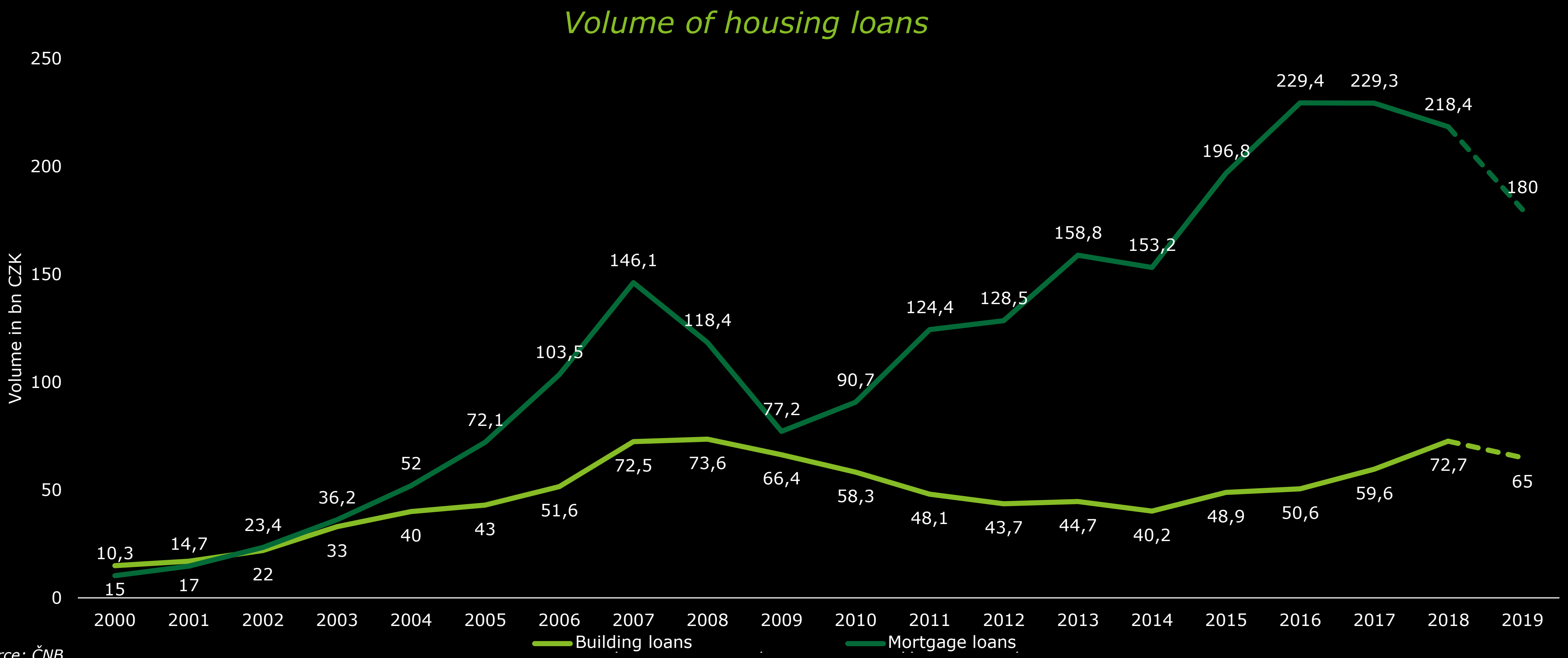
"Using an on-line valuation for 20 to 25% of loans can save the bank an estimated 25 000 000 to 30 000 000 CZK on yearly basis in appraisal costs."

Loans in RE transactions

Gradually rising interest rates

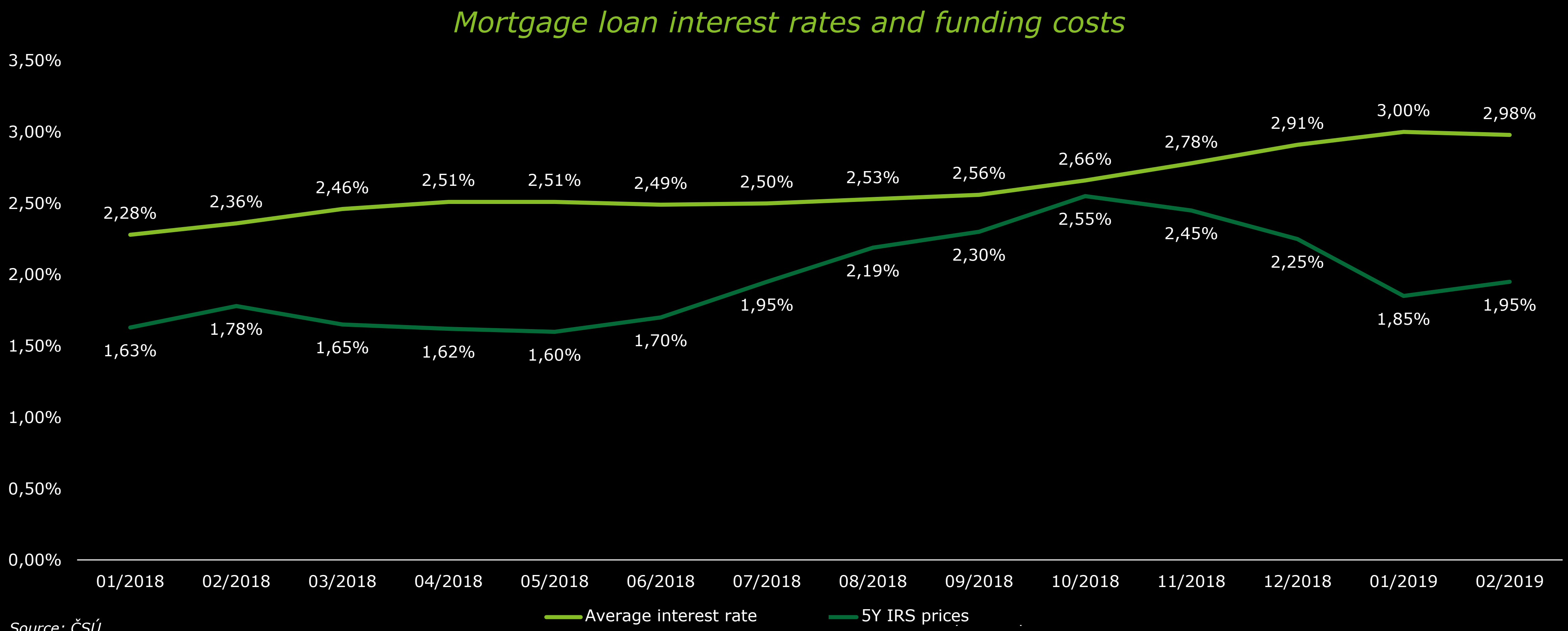
Development of housing lending – Czech Republic

Decrease following a long period of loan volumes growth



Source: ČNB

Funding costs – Czech Republic
Why the interest rates have been growing



Source: ČSÚ

What is next

What can building societies expect in the future?

So far, so good

… and what are the upcoming challenges for building societies?

Building savings

- An attractive way of saving – beating inflation
- Still gaining in popularity despite declining share of building societies on banking sector profit
- Possible extension of services
- Technologies may bring new opportunities for building societies

Challenges

- Need for digitalisation and investments
- Persisting traditional competition (savings accounts, mortgages)
- New competition - FinTech companies trying to break through

"Key to success lies in the ability of building societies to create a new role and position on the financial services markets."

Deloitte.