



Weekly Briefing

**Czech Republic social briefing:
Restrictive Monetary Policy And Its Impacts
On The Housing Affordability
Ladislav Zemánek**

China-CEE Institute

Kiadó: Kína-KKE Intézet Nonprofit Kft.

Szerkesztésért felelős személy: Chen Xin

Kiadásért felelős személy: : Feng Zhongping

 1052 Budapest Petőfi Sándor utca 11.

 +36 1 5858 690

 office@china-cee.eu

 china-cee.eu

Restrictive Monetary Policy And Its Impacts On The Housing Affordability

Summary

The present study follows the May economic briefing and focuses on the dynamics of both basic and commercial interest rates and their consequences in the field of mortgages and the real estate market in greater detail. This question is utterly relevant since the rise in the basic interest rates is the quickest in the history of the Czech Republic and the related soaring of the interest rates of mortgages contributes to the considerable unaffordability of housing which becomes one of the most serious social issues of the present day. The analysis shows the impacts of the current restrictive monetary policy as well as the tightening of rules in terms of credit granting.

Introduction

The Czech National Bank has opted for a more active monetary policy compared to an overwhelming majority of the Western central banks. It manifests itself particularly at the level of the basic interest rates. This specific attitude is a rather long-term strategy since the basic rates were higher even during the pandemic period in comparison with some other states where the interest rates were negative. For instance, the European Central Bank set the negative rate in 2014 for the first time. Since the beginning of this year, the Czech National Bank has been increasing the rates at the quickest pace in its history. Naturally, it has multiple impacts in a wide array of areas of both economic and social life.

Soaring rates

The increases in the basic interest rates make money more expensive. The rising level of the basic rates spills over to the commercial interest rates, even though there is no firm, automatic connection. It was obvious in 2021 when the commercial interest rates were increasing irrespective of the fact that the central bank kept the basic rates unchanged at the level of 0.25 per cent until June. Individual market subjects, nevertheless, expected the future rise in interest rates and inflation and these expectations became a reality indeed soon. Whereas the increase in the commercial interest rates outpaced those set by the Czech National Bank

until the last autumn, the situation has changed since then. Between October 01, 2021, and May 06, 2022, the two-week repo rate rocketed from 1.50 to 5.75 per cent.

The consequences of such a policy have reflected on the mortgage rates and the mortgage market as such. At the turn of 2020 and 2021, people could have gotten a mortgage with an interest rate below 2 per cent, in some cases even close to 1.5 per cent. In the course of the last year, however, the average interest rate was rising gradually and the pace became swift in the autumn in response to the behaviour of the central bankers. The current tendency is demonstrated by the following chart:

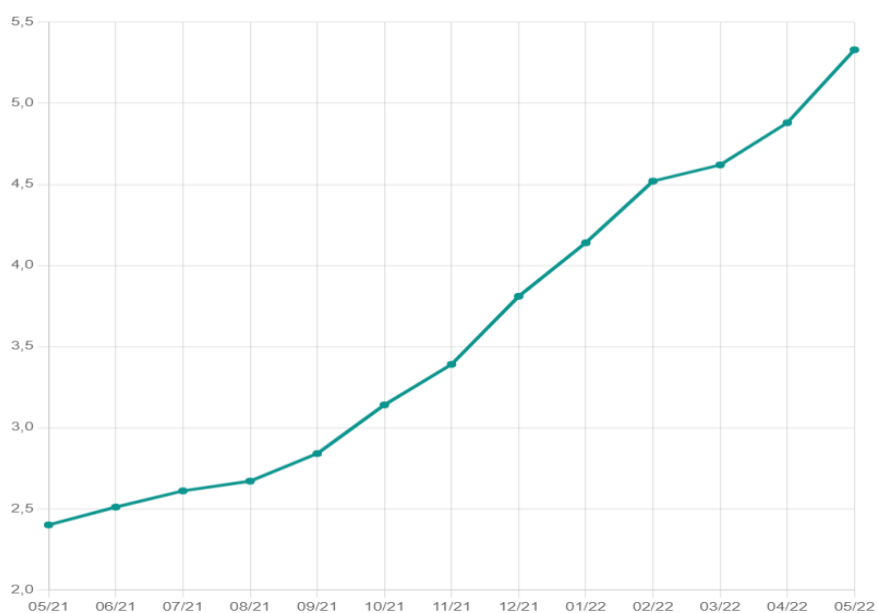


Chart 1: Average interest rate of mortgages between May 2021 and 2022

Source: [hypindex.cz](https://www.hypindex.cz)

By May 2022, the average rate reached 5.33 per cent. Nevertheless, this figure reflects the new mortgage contracts, and the process leading towards their conclusion usually lasts several weeks. It follows that the interest rates in the currently concluded contracts have been agreed upon earlier. In other words, clients who applied for the mortgage in May must have expected a higher figure than the May average rate was. The standard offer from the banks oscillated between 5.5 and 7.0 per cent depending on the fixation period and the LTV (loan-to-value) ratio.¹ As far as the fixation period, during which the bank is not authorised to change

¹ Zámečnicková, J. (2022, May 17). *Aktuální sazby hypoték: Hranice 7 % zatím odolává*. Hypoindex. <https://www.hypindex.cz/clanky/aktualni-sazby-hypotek-hranice-7-zatim-odolava/>.

the set interest rate, and its impact on the rate is concerned, there is a difference compared to the last two years. While in 2020 and the first months of 2021 the longer fixation period resulted in a higher rate, under the influence of the rising rates, on the contrary, the longer fixation brings about a lower interest rate. This phenomenon is connected with the market expectations regarding the future development of basic interest rates.

Employing macroprudential instruments

The rocketing interest rates may cause financial problems to those debtors whose fixation period is about to end in the near future and have had a considerably lower rate so far. It regards especially those who took a mortgage loan between 2015 and 2018 when the average interest rate oscillated around 2 per cent and even hit the record minimum of 1.77 per cent at the turn of 2016 and 2017. Given the most frequent fixation period is 5 years, the shock will be strong for many. It can be demonstrated by the comparison of monthly payments under the conditions existing in 2017 and now. The following table shows the payments in the case of a 3-, 5- and 7-million loan and 30-year maturity.

(in CZK)	1.77%	5.33%	7.00%
3M	10,747	16,715	19,959
5M	17,911	27,858	33,265
7M	25,076	39,002	46,571

The rise in average salary over the last years does not offset the dynamics of the mortgage interest rates. Moreover, many of those who took a mortgage did so to establish a family, consequently, their expenses have also increased in the meantime. Nevertheless, the data do not show a considerable increase in the number of loans that are not duly repaid. In the first quarter of this year, only 0.2 per cent of mortgages were not repaid by the debtors.² The following months, however, might bring a turnabout. That is why the Czech National Bank has ordered to expand the countercyclical capital buffer which is to increase the resilience of the Czech

² Moniová, E. (2022, May 18). *Češi mají rekordně napůjčováno. Přestali šetřit jako za dob covidu. Seznam Zprávy.* <https://www.seznamzpravy.cz/clanek/ekonomika-finance-osobni-cesi-maji-rekordne-napujcovano-prestali-setrit-jako-za-dob-covidu-202734>.

banking sector to risks emerging from the possible insolvency of debtors. This macroprudential instrument was introduced in 2014, being legally binding. The current countercyclical capital buffer rate amounts to 0.5 per cent and will be increasing gradually to 2.5 per cent by April 2023.³

The rapid rise in rates led to the end of enormous demand for mortgages observable in the last two years. According to the statistics from April, banks and building societies provided clients with mortgages of 17.5 billion CZK (711.3 million EUR) which implies a drop of 40 per cent compared to March, and a slump of 60 per cent year-on-year. The number of new mortgages was less than 4,500 in April whereas the figure amounted to 9,500 in 2021.⁴ Such a development is not related to the decreasing interest of people in the homeownership but to the rising interest rates, increasing price of real estate and last but not least the tightening of rules for providing mortgages.

Reintroducing limits on loans

In response to the easing of credit standards in providing mortgages by banks and the alleged overvaluation of prices of real estate, the central bankers have decided to reintroduce the binding parameters with effect from April 2022. The easing of rules was made in connection with the outburst of the pandemic with the aim to boost the economic processes in those extremely uncertain times and applied to the DTI and DSTI ratios. The DTI – i.e. the ratio of the applicant's total debt to his/her net annual income – has been set to 8.5 (9.5 for applicants under 36 years), while the DSTI – the ratio of the sum of the applicant's monthly repayments to his/her net monthly income – to 45% (50% for those younger than 36 years). The third parameter is the LTV which represents the ratio of the value of a mortgage to the value of the collateral. Since April the LTV has been set to 80 per cent (and 90 per cent for applicants under 36 years). These limits were imposed in 2015 for the first time. Unlike the then practice, the current rules are not recommendations anymore but binding regulations based on the legal amendment from 2021.⁵

³ *The countercyclical capital buffer* (2022). Czech National Bank. <https://www.cnb.cz/en/financial-stability/macprudential-policy/the-countercyclical-capital-buffer/>.

⁴ *Zájem o hypotéky v dubnu prudce spadl. Začala platit nová pravidla* (2022, May 13). E15.cz. <https://www.e15.cz/byznys/finance-a-bankovnictvi/zajem-o-hypoteky-v-dubnu-prudce-spadl-zacala-platit-nova-pravidla-1390038>.

⁵ Fišerová, M. (2021, November 25). *CNB to reintroduce LTV, DTI and DSTI limits on mortgage loans and increase countercyclical capital buffer rate to 2%*. Czech National Bank. <https://www.cnb.cz/en/cnb-news/press-releases/CNB-to-reintroduce-LTV-DTI-and-DSTI-limits-on-mortgage-loans-and-increase-countercyclical-capital-buffer-rate-to-2/>.

The actions carried out by the Czech National Bank contributed to the decrease in demand for mortgages. This partial goal was thus met, however, the main goal – the decrease in prices of real estate – remains intact. According to the central bankers, the apartment prices are overvalued by roughly 25 per cent, in the case of the investment ones by more than 30 per cent. These assessments are frequently called into question, nevertheless, they serve as a rationale for the restrictive policies regarding credits. Despite the imposed limits, rising interest rates and slump in the number of new mortgages as well as sold flats, the prices of real estate continue to increase. Since the beginning of the year, the price of new flats in Prague rose by 5.7 per cent to 149,255 CZK (6,067 EUR) per square metre, which is by 22.8 per cent year-on-year. Moreover, the difference between the offer and selling prices became smaller, decreasing from 5.0–10.0 per cent to 2.4 per cent.⁶

Conclusion

The long-term rise in prices of the Czech real estate is going on which gradually makes housing a serious social problem. The factors, stimulating a further rise, preponderate over those mitigating this problematic tendency. First, the insufficient offer of real estate, lagging far behind the existing demand. Second, soaring prices of building materials together with their shortages related to the disruption of trade chains as well as the rise of prices of emission permits in the EU. Third, unsatisfactory legal framework at the level of African countries hindering quicker construction, especially in cities.⁷ Other factors such as the increasingly strong demand for rental housing or the influx of the Ukrainian refugees will also play a negative role in terms of affordability of homeownership.

⁶ Zámečnicková, J. (2022, April 28). *Ceny nových bytů se blíží hranici 150 tisíc za m²*. Hypoindex. <https://www.hypoindex.cz/clanky/ceny-novych-bytu-se-blizi-hranici-150-tisic-za-m2/>.

⁷ *Pět hlavních důvodů, proč nemovitosti nezlevní* (2022, May 12). Hypoindex. <https://www.hypoindex.cz/clanky/pet-hlavnich-duvodu-proc-nemovitosti-nezlevni/>.