



ECB-CONFIDENTIAL

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10 July 2019
ESRB/2019/0168

Recommendation of the European Systemic Risk Board of 27 June 2019 on medium-term vulnerabilities in the residential real estate sector in Luxembourg (ESRB/2019/6)

Dear Mr Gramegna,

This is to inform you that on 27 June 2019, the General Board of the European Systemic Risk Board (ESRB) adopted Recommendation of the European Systemic Risk Board of 27 June 2019 on medium-term vulnerabilities in the residential estate sector in Luxembourg (hereinafter "Recommendation ESRB/2019/6"). The General Board of the ESRB also adopted five other country-specific ESRB Recommendations, addressed to five other Member States that also received ESRB Warnings in 2016, on medium-term vulnerabilities in their respective residential real estate sector. Furthermore, on the same date, the General Board of the ESRB also adopted five country-specific ESRB Warnings, addressed to Member States in which vulnerabilities relating to the residential real estate sector as a source of systemic risk have been newly identified as not being sufficiently addressed.

Vulnerabilities relating to the residential real estate can be a source of systemic risk and may affect financial stability both directly and indirectly. In 2016, the ESRB conducted a Union-wide assessment of the vulnerabilities relating to residential real estate¹. This assessment enabled the ESRB to identify a number of medium-term vulnerabilities in several countries as sources of systemic risk to financial stability, which led to the issuance of warnings to eight countries: Belgium², Denmark³, Luxembourg⁴, the Netherlands⁵, Austria⁶, Finland⁷, Sweden⁸ and the United Kingdom⁹.

¹ See 'Vulnerabilities in the EU Residential Real Estate Sector', ESRB, November 2016, available on the ESRB's website at www.esrb.europa.eu.

² Warning ESRB/2016/06 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Belgium (OJ C 31, 31.1.2017, p. 45).

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In 2016 the main vulnerabilities identified in the residential real estate market in Luxembourg related to the rapid growth in both house prices and mortgage loans, as well as the high and increasing household indebtedness. Moreover, a significant share of mortgagors had high debt and debt-servicing costs relative to income, thus making them vulnerable to a potential increase in interest rates.

The ESRB has recently concluded a systematic and forward-looking European Economic Area (EEA)-wide assessment of vulnerabilities relating to residential real estate. As regards Luxembourg, this recent assessment has revealed that, since 2016, strong growth in mortgage loans has continued to fuel household indebtedness. Despite the fact that the growth in house prices has decelerated, the previous dynamics raise concerns about potential overvaluation. Moreover, the most recent evidence on lending standards confirms that a significant share of households are potentially vulnerable to adverse economic or financial conditions or adverse developments in the residential real estate market.

Even though the national authorities in Luxembourg have proposed the establishment of a legal framework for legally binding borrower-based measures, these measures are not yet available in Luxembourg. However, the vulnerabilities identified, which are related to the growth in both house prices and mortgage loans as well as increasing household indebtedness, would require the activation of such measures.

Furthermore, while cyclical factors play an important role in fuelling the vulnerabilities identified in Luxembourg, there are also structural factors that have driven these vulnerabilities, resulting in a higher level of systemic risk. These factors include: (i) a lack of housing supply, which has been exerting upward pressure on house prices and debt for households that buy their own property; and (ii) the tax deductibility of interest paid on mortgage loans, which may act as an incentive for households to overborrow.

The General Board of the ESRB, having assessed the results of the risk and policy analyses carried out, and despite the capital-based measures that have been activated in Luxembourg, has concluded that the macroprudential measures that are in place or available in Luxembourg are partially appropriate and partially sufficient to address the medium-term vulnerabilities related to residential real estate that have been identified in Luxembourg. Consequently, further policy action is required to address these vulnerabilities, which can be a source of systemic risk.

For this reason, the General Board of the ESRB decided to issue a Recommendation to Luxembourg on medium-term vulnerabilities in its residential real estate sector. The purpose of Recommendation ESRB/2019/6 is to recommend the establishment in Luxembourg law of a framework for legally binding borrower-based measures, as well as the activation of such measures as soon as they are available under national law. Recommendation ESRB/2019/6 also aims to emphasise the need for broader policy action aiming to curb factors which facilitate or promote increasing household indebtedness. The measures proposed in Recommendation ESRB/2019/6 are intended to complement the existing

³ Warning ESRB/2016/07 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Denmark (OJ C 31, 31.1.2017, p. 47).

⁴ Warning ESRB/2016/09 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Luxembourg (OJ C 31, 31.1.2017, p. 51).

⁵ Warning ESRB/2016/10 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of the Netherlands (OJ C 31, 31.1.2017, p. 53).

⁶ Warning ESRB/2016/05 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Austria (OJ C 31, 31.1.2017, p. 43).

⁷ Warning ESRB/2016/08 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Finland (OJ C 31, 31.1.2017, p. 49).

⁸ Warning ESRB/2016/11 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Sweden (OJ C 31, 31.1.2017, p. 55).

⁹ Warning ESRB/2016/12 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of the United Kingdom (OJ C 31, 31.1.2017, p. 57).

macroprudential measures in Luxembourg, with the aim of strengthening resilience. They should not be considered as substitutes for the existing capital-based measures, which remain important in order to address existing vulnerabilities in the outstanding loan portfolio. Given that the vulnerabilities are, to some extent, driven by structural factors which go beyond macroprudential policy, other policies are needed to complement and support the current macroprudential measures, with the aim of addressing factors contributing to the build-up of systemic risks in the residential real estate market in Luxembourg more efficiently and effectively, without producing excessive costs for the Luxembourg real economy and financial system.

In line with Article 18(2) of Regulation (EU) No 1092/2010¹⁰, I would hereby like to inform you that Recommendation ESRB/2019/6 will be published on the ESRB's website and later in the *Official Journal of the European Union*. In addition, in line with Article 18(3) of Regulation (EU) No 1092/2010, addressees of public recommendations have the right to make public their views and reasoning on the matter. Should you wish to utilise this right, you are kindly invited to submit to the ESRB Secretariat any views and reasoning that you may have on the matter by 9 September 2019.

Please also note that the following reports, adopted by the ESRB on 27 June 2019, will be made available electronically:

- "Follow-up report on countries which received ESRB warnings in 2016 for medium-term vulnerabilities in the residential real estate sector";
- "Methodologies for the assessment of real estate vulnerabilities and macroprudential policies – residential real estate"; and
- "Vulnerabilities in the residential real estate sectors of the EEA countries".

Yours sincerely,



Francesco Mazzaferro

Head of the ESRB Secretariat

Enclosed:

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¹⁰ Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board (OJ L 331, 15.12.2010, p. 1).

