EUROPEAN SYSTEMIC RISK BOARD

WARNING OF THE EUROPEAN SYSTEMIC RISK BOARD

of 22 September 2016

on medium-term vulnerabilities in the residential real estate sector of Belgium

(ESRB/2016/06)

THE GENERAL BOARD OF THE EUROPEAN SYSTEMIC RISK BOARD,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macroprudential oversight of the financial system and establishing a European Systemic Risk Board[1], and in particular Articles 3 and 16 thereof,

Whereas:

(1) Past experience in many countries shows that the manifestation of residential real estate vulnerabilities may lead to significant risks to domestic financial stability and serious negative consequences for the real economy, as well as potentially leading to negative spill-overs to other countries.

(2) The European Systemic Risk Board (ESRB) has recently concluded a systematic and forward-looking Union-wide assessment of vulnerabilities relating to residential real estate. In this context, the ESRB has identified in eight countries certain medium-term vulnerabilities as a source of systemic risk to financial stability, which may have the potential for serious negative consequences for the real economy.

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[1] OJ L 331, 15.12.2010, p. 1.

(3) The ESRB's vulnerability assessment highlights the following for Belgium:

a. Belgium has experienced a trend of increasing overall household indebtedness that is largely the result of a continuing rapid increase in lending for house purchases. While credit standards have tightened in recent years, this development appears to have halted recently. At the same time, micro-level data suggest that there are specific groups of households with large mortgage loans in relation to the value of their real estate property, a high share of income spent on servicing their debt or a low level of net financial wealth compared to their level of debt.

b. In the event of an economic or financial shock - such as an increase in unemployment and/or a fall in income growth - then these highly indebted households may find it particularly difficult to service their debts and the number of mortgage defaults may increase leading to direct credit losses to banks, especially if accompanied by a fall in residential real estate prices. Moreover, if an adverse scenario for the economy does materialise, the associated negative household income and wealth effects may reinforce the initial shock, further enhancing the negative direct and indirect effects on financial stability (e.g. if households need to reduce consumption in order to service their mortgage loans).

c. In addition, residential real estate prices, which have increased significantly over the past 30 years, have been increasing more rapidly than incomes or rents in recent years. In nominal terms, residential real estate prices are now close to the level they had prior to the financial crisis. There are some signs of price overvaluation, however alternative valuation models do not demonstrate this unequivocally. Already high and increasing residential real estate prices could lead to a further increase in overall household indebtedness and in the number of vulnerable households.

d. At the same time, the ESRB recognises that there are a number of factors that mitigate vulnerabilities in the Belgian residential real estate market. First, Belgian households in aggregate have a relatively high value of financial assets relative to debt. Second, mortgage loans are typically amortised with maturities of less than 25 years, which means that Belgian household reduce their debt relatively quickly compared to households in other Union countries.

e. The ESRB notes the measures relating to residential real estate implemented in Belgium. Overall, the Belgian authorities have focused on ensuring the resilience of the banks to risks stemming from the residential real estate sector. The decision of the Nationale Bank van België/ Banque Nationale de Belgique (NBB/BNB) in December 2013 to impose an add-on to the capital adequacy requirements for mortgage exposures of banks using internal ratings-based models[2], as well as public communications from the NBB/BNB calling for increased vigilance to risks from residential real estate, may also serve to reduce the existing vulnerabilities. Moreover, the tax deductibility of mortgage loans is being tightened. The NBB/BNB's public commitment to taking additional capital measures to target high-risk loans (e.g. those with a high loan-to-value) if they continue to constitute a significant share of the new loans issued is also expected to limit, to some extent, a further build-up of vulnerabilities in the future. On the other hand, measures directly addressing the vulnerabilities related to highly indebted households or the continued increase in residential real estate prices have not been adopted. While the policy measures that have been implemented are appropriate given the nature of residential real estate vulnerabilities in Belgium, they may not be sufficient to fully address them,

HAS ADOPTED THIS WARNING;

The ESRB has identified medium-term vulnerabilities in the residential real estate sector of Belgium as a source of systemic risk to financial stability, which may have the potential for serious negative consequences for the real economy. From a macroprudential perspective, the ESRB considers the main vulnerabilities to be the fast increase in overall household indebtedness combined with significant groups of already highly indebted households, against the background of a significant increase in residential real estate prices over the past few years.

Done at Frankfurt am Main, 22 September 2016.

Francesco Mazzaferro

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Head of the ESRB Secretariat, on behalf of the General Board of the ESRB

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2 Application of a five percentage point add-on to the risk weights of Belgian mortgage loans for credit institutions using internal ratings-based models for the computation of capital requirements. That measure came into force with the Royal Decree of 8 December 2013 - https://www.nbb.be/en/articles/arrete-royal-du-8-decembre-2013-portant-approbation-du-reglement-du-22-octobre-2013-de-la - and was then implemented in 2014 under Article 458 of the EU Capital Requirements Regulation. This measure was extended for one year in May 2016 (Royal Decree of 31 May 2016 - https://www.nbb.be/en/financial-oversight/macroprudential-supervision/macroprudential-instruments/real-estate).