WARNING OF THE EUROPEAN SYSTEMIC RISK BOARD

of 22 September 2016

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

(ESRB/2016/10)

(2017/C 31/07)

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.

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

a. Households in the Netherlands are highly indebted having a ratio of household debt to income that is among the highest in the Union, despite a slight decrease in recent years.

b. In addition, Dutch mortgages are among the highest in Europe in relation to the value of their underlying collateral. Approximately one quarter of all mortgage owners and half of all mortgagors under 40 years old have a total debt that exceeds the value of their home. This vulnerability is likely to remain elevated, first because new mortgage loans tend to be high in relation to the value of the purchased property and second due to the low average amortisation rates. For new mortgage loans, however, the amortisation rates are higher, because only amortising mortgages may deduct interest for tax purposes, which acts as an incentive for households to amortise their loans.

c. Currently, there are no overall signs of overvaluation in the residential real estate market in the Netherlands and prices appear to be low compared to income from a historic perspective. This is despite the fact that residential real estate prices have been growing robustly in recent years, following a significant downturn after the global financial crisis. In major cities, although not nationwide, prices are returning to pre-crisis levels.

d. High household indebtedness coupled with relatively low mortgage collateralisation could lead to considerable negative direct and indirect effects on the macroeconomic and financial stability. For example, in the event of an adverse economic or financial shock such as an increase in unemployment and/or a decrease in income growth, 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 decrease 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).

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

e. Overall, the Dutch banking system is well capitalised, and the Dutch authorities have introduced a number of capital buffers that are being phased-in over the coming years. Also, stress tests indicate that Dutch banks have sufficient capital to withstand adverse scenarios related to residential real estate. For these reasons, the banking system is considered to be resilient against direct residential real estate shocks. It is also important to note the growing importance of the non-bank sector for residential real estate lending. Currently around half of all new mortgages are provided by non-banks, such as insurance institutions. Selected macroprudential measures adopted for loans (such as the limit on the loan-to-value ratio) also apply to loans provided by the non-banking sector. However, there is limited analysis available on the potential risks to financial stability of non-bank mortgage lenders.

f. In mitigation of the above-mentioned vulnerabilities, there are some structural factors that limit the direct credit risk from mortgage lending, such as strong recourse facilities for lenders and strict personal bankruptcy rules.

g. The ESRB notes the measures that have been implemented in the Netherlands regarding the residential real estate sector. These include limits on the debt service-to-income and loan-to-value ratios for new lending that are being gradually tightened over time and reductions in the tax deductibility of mortgage interest payments. While these policy measures are appropriate given the nature of residential real estate vulnerabilities in the Netherlands, they may not be sufficient to fully address them as most measures are only being gradually phased-in and their calibration will not be very constraining even after full implementation,

HAS ADOPTED THIS WARNING:

The ESRB has identified medium-term vulnerabilities in the residential real estate sector of the Netherlands 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 persistently high household debt levels combined with low mortgage collateralisation. In particular, there is a large group of households, especially younger mortgagors, which have debt levels that exceed the value of their home.

Done at Frankfurt am Main, 22 September 2016.

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On behalf of the General Board of the ESRB