



ECB-CONFIDENTIAL

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Copy to: Dr. Jörg Kukies, State Secretary at the Federal Ministry of Finance,
Chairman of the Financial Stability Committee, Ausschuss für
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ESRB/2019/0173

Warning of the European Systemic Risk Board of 27 June 2019 on medium-term vulnerabilities in the residential real estate sector in Germany (ESRB/2019/11)

Dear Mr Scholz,

This is to inform you that on 27 June 2019, the General Board of the European Systemic Risk Board (ESRB) adopted Warning of the European Systemic Risk Board of 27 June 2019 on medium-term vulnerabilities in the residential estate sector in Germany (hereinafter "Recommendation ESRB/2019/11"). The General Board of the ESRB also adopted four other country-specific ESRB Warnings, addressed to four other Member States in which vulnerabilities relating to the residential real estate sector as a source of systemic risk have also been newly identified as not being sufficiently addressed. Furthermore, on the same date, the General Board of the ESRB adopted country-specific ESRB Recommendations to six Member States that received country-specific ESRB Warnings in 2016 on medium-term vulnerabilities in their respective residential real estate sector, and in which vulnerabilities relating to the residential real estate sector as a source of systemic risk are still 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

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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.

The ESRB has recently concluded a systematic and forward-looking European Economic Area (EEA)-wide assessment of vulnerabilities relating to residential real estate. As a result of this assessment, the ESRB has identified certain medium-term vulnerabilities in the residential real estate sector in Germany as a source of systemic risk to financial stability, that have not been sufficiently addressed and 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 significant overvaluation of house prices in urban areas, associated with widespread and rapid house price dynamics and some indication of a loosening of lending standards, in the context of the overall uncertainty regarding lending standards for housing loans due to the significant data gaps.

The General Board of the ESRB, having assessed the results of the risk and policy analyses carried out, has concluded that the current policy measures that are in place or available in Germany are partially appropriate and partially sufficient to mitigate the identified systemic risks related to the vulnerabilities in the residential real estate sector in Germany. For this reason, the General Board of the ESRB decided to issue a Warning to Germany on medium-term vulnerabilities in its residential real estate sector.

In line with Article 18(2) of Regulation (EU) No 1092/2010¹⁰, I would hereby like to inform you that Warning ESRB/2019/11 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 warnings 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.

The ESRB intends to monitor the risks identified in Warning ESRB/2019/11 and invites Germany to provide information, within one year from the publication of Warning ESRB/2019/11 in the *Official Journal of the European Union*, on the evolution of the vulnerabilities identified and on any policy measures that may have been taken in order to address these vulnerabilities. In this regard, Germany could activate further capital-based measures requiring credit institutions to create additional capital buffers to increase the resilience of the banking system to cyclical risks and vulnerabilities (i.e.

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).

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).

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).

credit risk and interest rate risk) that might have accumulated, given the long-lasting economic upswing and also the rapidly evolving housing price dynamics. In addition, in view of the significant house price overvaluation in the urban areas of Germany that has already existed for several years, as well as uncertainty regarding lending standards, Germany could contribute to ensuring sound lending standards in relation to new loans in an appropriate manner (e.g. through a recommendation or activation of legally binding limits to LTV ratios, if the legal conditions for activation are met), in order to prevent a build-up of vulnerabilities, thereby fostering financial stability.

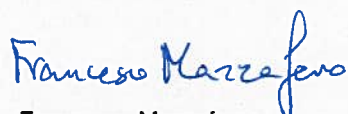
Furthermore, as already proposed by the *Ausschuss für Finanzstabilität* in 2015¹¹, it is also important that national authorities in Germany have all necessary macroprudential instruments at their disposal to provide them with the necessary powers to address potential financial stability vulnerabilities, including, in particular, powers to set legally binding limits to loan-to-value ratios – and to either debt-to-income ratios, or debt-service-to-income ratios, in combination with maturity limits – where necessary in relation to new housing loans. Currently, the income-based instruments are, however, not available in Germany. Although the national authorities do have the power to set legally binding loan-to-value limits if deemed necessary to guarantee financial stability, this is conditional on the identification of risks to financial stability stemming from a strong increase in house prices and mortgage lending accompanied by a substantial loosening of lending standards. The current data gaps with regard to lending standards for new mortgage loans should therefore also be closed, so as to improve the ability to identify those risks and to address them when needed – such an initiative is a necessary addition to the German macroprudential monitoring framework.

Moreover, when activating any measures to address the identified vulnerabilities, their calibration and phasing-in should take into account the position of Germany in the economic and financial cycles, and any potential implications as regards the associated costs and benefits.

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

- “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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¹¹ Recommendation AFS/2015/1 on new instruments for regulating loans for the construction or purchase of residential real estate (Empfehlung AFS/2015/1 vom 30. Juni 2015 zu neuen Instrumenten für die Regulierung der Darlehensvergabe zum Bau oder Erwerb von Wohnimmobilien).

