WARNING OF THE EUROPEAN SYSTEMIC RISK BOARD

of 2 December 2021

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

(ESRB/2021/15)

(2022/C 122/06)

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 macro-prudential oversight of the financial system and establishing a European Systemic Risk Board ([1]), and in particular Article 3(2)(c) and Articles 16 and 18 thereof,

Having regard to Decision ESRB/2011/1 of the European Systemic Risk Board of 20 January 2011 adopting the Rules of Procedure of the European Systemic Risk Board ([2]), and in particular Article 18 thereof,

Whereas:

(1) Housing is a key sector of the real economy and represents a major part of household wealth and bank lending. Residential real estate (RRE) properties make up a large component of households' asset holdings and loans for housing are often a large part of banks' balance sheets. Furthermore, housing construction is typically an important component of the real economy, as a source of employment, investment and growth.

(2) Past financial crises and experience in many countries have demonstrated that unsustainable development in real estate markets may have severe repercussions for the stability of the financial system and the economy as a whole in any given country, which may also lead to negative cross-border spill-overs. The effects on financial stability may be both direct and indirect. Direct effects consist of credit losses from mortgage portfolios due to adverse economic and financial conditions and simultaneous negative developments in the RRE market. Indirect effects relate to adjustments in household consumption, with further consequences for the real economy and for financial stability.

(3) Real estate markets are prone to cyclical developments. Excessive risk-taking, excessive leverage and misaligned incentives during the upturn of the real estate cycle may lead to severe negative implications for both financial stability and the real economy. Given the relevance of RRE for financial and macroeconomic stability, seeking to prevent the build-up of vulnerabilities in RRE markets by the use of macroprudential policy is especially important, in addition to its use as a means of mitigating systemic risk.

(4) While cyclical factors play an important role in fuelling the vulnerabilities identified in RRE markets in European Economic Area (EEA) countries, structural factors have also driven these vulnerabilities. These structural factors can include a lack of housing supply, which has exerted upward pressure on house prices and debt for households that buy their own property, and other public policies that may act as an incentive for households to overborrow. Given that these factors go beyond macroprudential policy, measures originating from other policy areas can complement and support the current macroprudential measures in addressing the vulnerabilities present in RRE markets in individual countries efficiently and effectively, without generating excessive costs for the real economy and the financial system.

(5) The outbreak of the COVID-19 pandemic in 2020 and the related crisis have not led to a cyclical decline in housing markets. Rather, following a period of gradual growth, and amidst the low interest rate environment, real house price and lending growth have accelerated further in several countries, largely outpacing the growth in household income. In order to mitigate the impact of the pandemic and the resulting economic uncertainty, various measures and policies, such as moratoria and public guarantees, have been implemented. In this broad policy context, previously

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

([2]) OJ C 58, 24.2.2011, p. 4.

scheduled macroprudential measures have been temporarily relaxed or their activation delayed in some countries. The currently observed improvement in the economic situation allows for an adjustment of macroprudential policy in those countries in which RRE-related vulnerabilities have continued to build up.

(6) The European Systemic Risk Board (ESRB) has recently concluded a systematic and forward-looking EEA-wide assessment of vulnerabilities relating to RRE.

(7) As regards Hungary, this recent assessment has revealed that:

a. Annual growth in real house prices was close to or exceeding 10 % between 2015 to 2019 and was especially pronounced in Budapest. According to estimates produced by the Magyar Nemzeti Bank (MNB), such dynamism led to significant overvaluation, peaking at 18 % in Budapest and 3 % in the country as a whole in the third quarter of 2019. MNB data indicates that price developments have diverged significantly in different parts of the country. On the one hand, in real terms house prices in Budapest started slowing down in late 2019, stagnated or slightly declined in 2020 and remained moderate in the first half of 2021. On the other hand, prices accelerated to double digit growth in other areas, especially in smaller municipalities and rural areas, in which households were eligible for the government house purchase subsidy. From a forward-looking perspective, the return of international tourism will be an important determinant of house price developments in Budapest. In the country as whole, further utilisation of various government subsidy programmes ([3]) may contribute to demand pressures on house prices, while the preferential value added tax for new construction ([4]) may ease supply constraints in the medium term.

b. Mortgage credit has been increasing robustly since mid-2018, with real annual growth rates higher than or close to 5 %. Even though, according to the MNB estimates, only about half of housing transactions were realised through bank credit in 2020, real annual mortgage credit growth accelerated to an average of 6,8 % between January and August 2021. In the meantime, real growth of household credit amounted to an average of 10 % year-on-year. While this growth outpaced the real growth of mortgages, it has been driven by the growth in prenatal baby support loans, as well as the have share of household loans in moratorium (31 % of total RRE loans and 42 % of eligible RRE loans were still in that moratorium, and therefore not amortizing, in June 2021). Without the effect of the moratorium, the real annual growth of mortgage and household credit in the first half of 2021 reached 0,7 % and 2,7 %, respectively, according to MNB estimates. The broad range of government subsidy programmes, including the additional government subsidy programme introduced at the beginning of 2021, has also contributed to the growth in household credit ([5]).

c. Even though mortgage loans were provided with very high loan-to-value (LTV) ratios prior to 2008, 90 % of the stock of loans bore LTV ratios of less than 80 % in the first half of 2021. This has been the result, to some extent, of fast growth in house prices and old loans being amortised. Additionally, the LTV ratios of new loans have been limited to 80 % since 2015. As regards the debt service-to-income (DSTI) ratios, however, about 22 % of existing and almost 25 % of new mortgage loans (expressed in terms of volume) in the first half of 2021 had DSTI ratios between 40 % and 60 %. This has been partially the result of higher limits on the DSTI ratio for high-income borrowers, whose share of new lending has been growing: in the first half of 2021, about 60 % of new lending for housing purposes was eligible for the higher 60 % limits to the DSTI ratio limit (with borrowers' monthly net income above the regulatory threshold of HUF 500 000), and 5 % of new housing lending had a DSTI ratio above 50 %. Even though maturities of the new loans have been lengthening slightly, according to the MNB, the evidence does not suggest that longer maturities are being increasingly used to circumvent the existing limits on DSTI ratios.

d. Fixed interest rates became more frequently used in relation to household credit after the MNB introduced a certification trademark in 2017. This is only available for housing loans with an interest rate fixation period of at least five years. The expansion of housing loans with longer interest rate fixation periods has been further amplified by the lower limits to DSTI ratios, applicable since October 2018, for mortgage loans with an interest rate fixation period shorter than 10 years. As of February 2021, about 75 % and 25 % of new loans were fixed

([3]) The house purchase subsidy and the prenatal baby support loans, which is an interest-free loan without limits on the purpose.

([4]) The preferential value added tax for new construction was reintroduced in January 2021 and provides benefits to dwellings finished by 2026 (with building permits issued by 2022).

([5]) The additional government subsidy programme provides fiscal support to households already involved in the house purchase subsidy programme.

for 10 and 5 years, respectively. Taking into account the stock of loans, however, loans with fixation periods shorter than one year still represented almost 40 % of the credit issued, although this share has been gradually decreasing.

e. The loan moratorium related to the COVID-19 pandemic has recently been extended until June 2022. However, eligibility in respect of the moratorium has been reduced, and the household loan stock that remained under moratorium accounts for around 5 % of the total outstanding household loan portfolio. According to the MNB's analysis, loans in the earlier and wider-ranging moratorium of household borrowers who are employed in vulnerable sectors accounted for approximately 10 % of all outstanding loans.

f. The ESRB acknowledges the macroprudential measures that are in place in Hungary that mitigate the current real estate vulnerabilities, namely the limits on the LTV and DSTI ratios. Furthermore, the ESRB acknowledges that banks have duly recognised the increase of credit risk due to the extended moratorium by classifying some of the loans as Stage 2 loans.

g. From a forward-looking perspective and taking into account the medium-term risk outlook, the current macroprudential policy mix is considered to be partially appropriate and partially sufficient. If RRE vulnerabilities keep increasing, tightening the limit on the DSTI ratio, complementing it with a maturity limit, and/or introducing a systemic risk buffer or countercyclical capital buffer would contribute to mitigating those vulnerabilities. Nevertheless, macroprudential policies should be complemented by broader policy action aimed at the mitigation or elimination of the factors which facilitate or promote increasing household indebtedness or unbalanced housing affordability. These policies should support the current macroprudential measures to address the remaining vulnerabilities identified in the RRE market in Hungary efficiently and effectively, without producing excessive costs for the Hungarian real economy and financial system. In Hungary, government subsidies and support loans can contribute to fuelling demand for owner-occupier housing, leading to higher overvaluation of house prices as well as indebtedness of households, against a backdrop of an insufficient supply of housing. Further policies could therefore include removing incentives for higher household indebtedness, especially government subsidies and support loans, and ensuring adequate housing supply and an efficient rental market. It would be advisable, in the coming quarters, for the national authorities to continue to monitor the credit quality of household debt under moratorium and ensure adequate provisioning for the expected losses.

(8) When activating any measures to address the identified vulnerabilities, their calibration and phasing-in should take into account Hungary's position in the economic and financial cycles, and any potential implications as regards the associated costs and benefits,

HAS ADOPTED THIS WARNING:

The ESRB has identified medium-term vulnerabilities in the residential real estate sector in Hungary 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 increasing risk of house price overvaluation coupled with the rapid growth in the provision of mortgage and household credit together with pockets of vulnerabilities related to borrowers with high debt service.

Done at Frankfurt am Main, 2 December 2021.

The Head of the ESRB Secretariat,
on behalf of the General Board of the ESRB
Francesco MAZZAFERRO