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ESRB
European Systemic Risk Board
European System of Financial Supervision

Residential real estate sector vulnerabilities

"Financialisation in the Housing Market: Effects and Policy responses"

HOUS Committee public hearing

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Why real estate vulnerabilities matter for financial stability?

- Financial stability is a **precondition for economic stability**, increasing household welfare.
- Beyond providing housing services to households, housing represents a major part of households' wealth. Mortgages make up large parts of banks' balance sheets, and are the largest form of debt among households. Housing construction is an important component of the real economy, as a source of employment, investment and growth.
- As we have learned from past banking and financial crises, rapid and persisting growth in **credit and house prices** combined with high levels of **household indebtedness** and leverage, makes economies **vulnerable for shocks** and adverse developments in the housing markets with potential for severe systemic repercussions.
- Housing busts are common causes of **banking crises** and typically have severe consequences. These percussions can range from **reduced asset quality and credit contraction to decreases in consumption and bank failures**, which in the past lead to government bail-outs of financial institutions.

Sources of vulnerabilities and macroprudential instruments

Household stretch

The ability of households to service their debt

When debt levels are high relative to income, shocks can lead to repayment difficulties and defaults.

Main vulnerabilities:
- High level of HH indebtedness
- Exposure to interest rate changes
- Income and employment shocks

Macroprudential tools to address it:
- DSTI/LSTI limit (Debt/Loan-Service-to-Income)
- DTI/LTI limit (Debt/Loan-to-Income)
- Amortisation requirements

Objective: reduction of probability of default (PD) of borrowers

Collateral stretch

Resilience from changes in the value of the housing collateral

If house prices fall, the value of the collateral backing loans declines, increasing the likelihood of losses in the event of borrower default.

Main vulnerabilities:
- Overvaluation of house prices
- High Loan-to-Value ratios
- Weak underwriting standards

Macroprudential tools to address it:
- LTV limits (Loan-to-Value)
- Amortisation requirements

Objective: reduction of loss given default (LGD) of lenders

Funding stretch

Resilience of lenders to shocks originating from the housing market

If many loans turn non-performing at the same time, lenders may face solvency or liquidity problems.

Main vulnerabilities:
- High exposure to mortgage markets
- Insufficient capital buffers
- Procyclical credit supply

Macroprudential tools to address it:
- Countercyclical capital buffer (CCyB)
- Systemic Risk Buffer (SyRB)
- Risk weights increases

Objective: increase loss absorption capacity of lenders

Macroprudential measures and the role of the ESRB

- There are **24 EU Member States** with at least one borrower-based measure activated, and **6** with Sectoral SyRB applied to residential real estate exposures. In addition, there are **9** Member States, which have applied additional measures for risk weights for residential real estate exposures.
- The ESRB has been active in highlighting vulnerabilities and proposing policy actions related to RRE vulnerabilities. It has produced **6 reports** dedicated to RRE (2015, 2016, 2019, 2022, 2024) and a methodology paper that indicates best practices to the monitoring and mitigating of RRE vulnerabilities (2019).
- The ESRB has issued **18 Warnings and 8 Recommendations** dedicated to RRE risks.
  - ➢ Warnings in 2016 (AT, BE, DK, FI, LU, NL, SE, UK), 2019 (CZ, DE, FR, IS, NO), 2021 (BG, HR, HU, LI, SK).
  - ➢ Recommendations in 2019 (BE, DK, FI, LU, NL, SE) and 2022 (AT, DE).
- Overall, there has been a **good degree of compliance** with the ESRB Recommendations on RRE.

Interaction of macroprudential policy and trade-offs

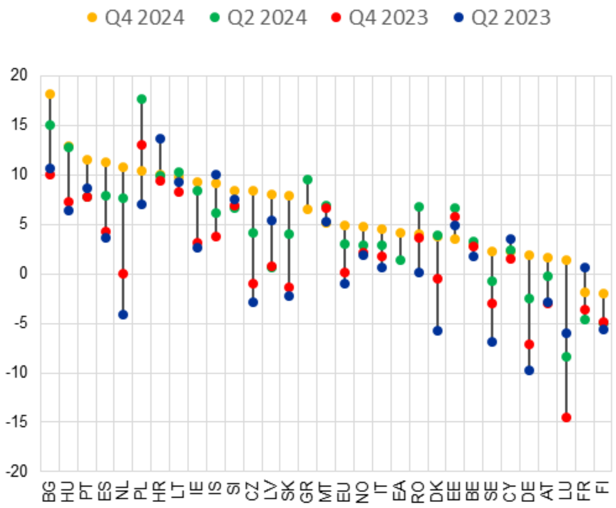
- Housing market dynamics and vulnerabilities are impacted by the **interaction** of various social and economic policies that need to be considered as well.
- The **housing sector is highly regulated by policies** that target the availability and affordability of dwellings, as well as safety and environmental regulation and urban planning. Importantly, **fiscal policy** impacts house prices and household indebtedness through tax incentives it may create for holding property or contracting mortgages.
- Moreover, **monetary policy** plays a key role by influencing interest rates and margins charged on mortgages, with an impact on household interest rate expenses and housing price dynamics, bank profitability and thereby their capital levels.
- Finally, implicit or explicit **state guarantees or subsidies** for the various actors in the real estate market may also further influence real estate prices.
- Thus, **macroprudential policies are needed to address vulnerabilities** and risks to financial stability also stemming from other policies and objectives, and their interactions.

Current vulnerabilities regarding housing markets in the EU

- After an **orderly correction** driven by the increase in interest rates in 2022, **cyclical risks** related to residential real estate markets are starting to build up again, while **structural risks**, such as high household indebtedness, are still present in several countries.
- Both aspects **require attention** from macroprudential authorities.

House price growth across the EEA

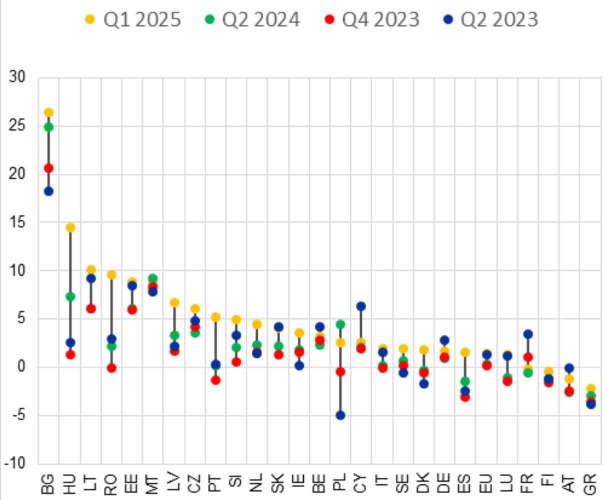
(y-o-y percentage change)



Source: Eurostat and national data.

Household loans for house purchases

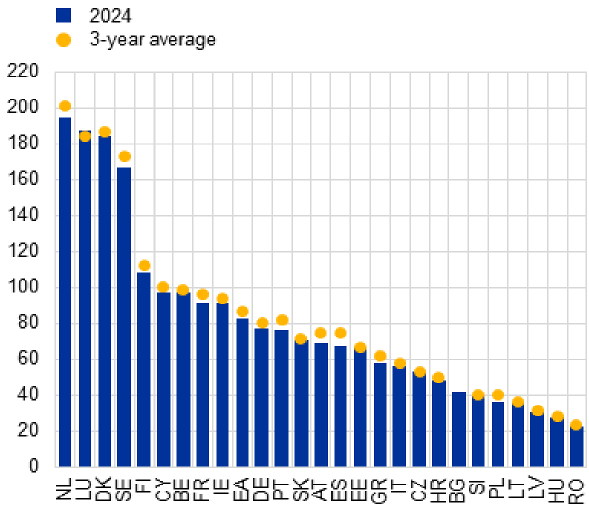
(y-o-y percentage change)



Source: ECB.

Household indebtedness

(percentage of household disposable income)



Source: ESRB Risk dashboard.

HR, CY, EE, LV, LT, LU, NL, RO, SK, SI: latest available data point from 2023; for BG: 2022

Thank you for your attention!

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