

**WARNING OF THE EUROPEAN SYSTEMIC RISK BOARD**  
**of 2 December 2021**  
**on medium-term vulnerabilities in the residential real estate sector of Slovakia**  
**(ESRB/2021/16)**  
**(2022/C 122/07)**

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 macro-prudential oversight of the financial system and establishing a European Systemic Risk Board <sup>(1)</sup>, 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 <sup>(2)</sup>, 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

<sup>(1)</sup> OJ L 331, 15.12.2010, p. 1.

<sup>(2)</sup> OJ C 58, 24.2.2011, p. 4.

policies, such as moratoria and public guarantees, have been implemented. In this broad policy context, previously 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 Slovakia, this recent assessment has revealed that:
  - a. House prices have continuously increased in real terms in Slovakia during the last five years. Despite the tightening of the legally binding loan-to-value limit, the house price growth rate has accelerated since the beginning of 2019. During the COVID-19 pandemic, price rises have further accelerated and the annual real increase in house prices reached almost 16 % in the second quarter of 2021, the second highest level in the Union. Moreover, the affordability of housing has reduced over time as a result of house prices growing faster than household income. According to overvaluation metrics, there is an increasing risk of house price overvaluation. Price dynamics have been sustained by an economy in an expansionary phase, low interest rates, increased household saving and strong household demand for new housing against a shortage of supply.
  - b. Mortgage credit growth in Slovakia has been among the highest in the Union over the last three years, despite policy measures, and also withstood the COVID-19 shock. The Slovakian mortgage market is characterised by low interest rates, strong demand for mortgages, amplified by rising house price levels, as well as intense competition among lenders. Moreover, the Slovak banking sector is one of the most exposed to real estate activities across the EEA countries.
  - c. Household indebtedness in Slovakia has risen over the last years due to intense lending activity. After years of double digit increases in the stock of real household debt, the pace of growth of household indebtedness has decelerated, stabilising at around 4 % in 2020. Despite this deceleration, which also occurred thanks to macroprudential policy measures (the introduction of the debt-to-income limit and a tightening of the debt service-to-income limit), the growth in household indebtedness is still among the highest in the Union and has translated into a rising debt-to-GDP ratio. While households reduced their consumption throughout the COVID-19 pandemic, their demand for housing loans remained strong. In fact, refinancing of mortgage loans has increased recently and is often associated with the topping-up of the original notional loan amount. Another vulnerability arises from the fact that the maturity of a significant proportion of loans exceeds borrower retirement age. Both these developments and pockets of vulnerabilities need to be closely monitored going forward.
  - d. The build-up of the abovementioned vulnerabilities may also be attributed to a number of structural factors such as the favourable tax regime in respect of the property market as well as limitations in the functioning of the rental market.
  - e. The ESRB acknowledges that several measures aimed at the mitigation of current RRE vulnerabilities are in place in Slovakia, including, in particular, a comprehensive set of borrower-based measures to appropriately address the underlying risks related to mortgage lending and borrower vulnerabilities. Moreover, the positive countercyclical capital buffer (CCyB) rate is an appropriate tool to address vulnerabilities related to the high rapid credit growth, which has been widespread across sectors, and increase the resilience of the banking sector.
  - f. From a forward-looking perspective and taking into account the medium-term risk outlook, the current macroprudential policy mix is considered to be appropriate and partially sufficient. Given the continuing build-up of pockets of vulnerabilities, fine-tuning of the existing borrower-based measures would be appropriate. If the cumulation of cyclical risks continues or structural vulnerabilities intensify, the Slovakian authorities might consider rebuilding the CCyB or introducing a sectoral systemic risk buffer to further increase resilience against the risks that exist in the RRE sector. In addition, the activation of the risk weight floor for the internal ratings based RRE exposures through Article 458 of Regulation (EU) No 575/2013 of the European Parliament and of the Council<sup>(\*)</sup> also constitutes an option that would increase the resilience of the banking sector. Beyond macroprudential measures, considering adjustments to the favourable tax regime related to RRE, as well as measures improving the functioning of the rental market could mitigate the sources of systemic risks related to the Slovakian RRE sector.

(\*) Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1.)

- (8) When activating any measures to address the identified vulnerabilities, their calibration and phasing-in should take into account Slovakia'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 Slovakia 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 high rate of house price growth as well as rising household indebtedness together with pockets of risk related to increasing household indebtedness and provision of mortgage loans.

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

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