AUSSCHUSS
FÜR FINANZMARKTSTABILITÄT

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Response to the Warning of the European Systemic Risk Board (ESRB) on vulnerabilities in the residential real estate sector in Liechtenstein

Dear Mr Mazzaferro,

We take reference to your letter of 9 December 2021 notifying the Liechtenstein Ministry of General Government Affairs and Finance that the General Board of the ESRB has adopted the Warning of the ESRB of 2 December 2021 on medium-term vulnerabilities in the residential real estate sector of Liechtenstein (ESRB/2021/14), following its assessment on the vulnerabilities in the residential real estate sectors of the European Economic Area (EEA) countries. Liechtenstein authorities fully endorse the work of the ESRB to assess vulnerabilities in the RRE sectors in the EEA and appreciate the close collaboration with the ESRB on this issue.

In general, Liechtenstein authorities agree with the ESRB's views on risks and vulnerabilities stemming from Liechtenstein's residential real estate (RRE) sector. The ESRB's findings on the vulnerabilities related to the high and still increasing indebtedness of households are in line with those reached by Liechtenstein authorities. In recent years, the Liechtenstein Financial Market Authority (FMA) has repeatedly pointed to medium-term RRE-related risks in its Financial Stability Report[1]. Furthermore, a recently published in-depth assessment[2] focusing on vulnerabilities in the housing and mortgage market and the appropriateness of activated measures to address these risks in Liechtenstein has raised the risk awareness for RRE-related vulnerabilities both among lenders and borrowers.

In light of the high indebtedness of private households, medium-term vulnerabilities in Liechtenstein's real estate market have been a policy issue in recent years. However, based on the recent in-depth analysis by the FMA, which is also confirmed by the ESRB's findings, financial stability risks are assessed to be currently limited. Moderate price increases in the last 20 years suggest that imbalances in terms of price overvaluations in the RRE market are

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[1] The Financial Stability Report can be accessed on the FMA website.
[2] The report can be accessed on the FMA website (only available in German).

likely to be quite limited, indicating relatively low risks in the "collateral stretch" category. Risks in the "funding stretch" category are also assessed as low in light of moderate mortgage credit growth in recent years and a banking sector characterized by high capital and liquidity indicators. However, as noted by the ESRB, vulnerabilities of households are the main cause of concern in light of the relatively high household debt. At the same time, Liechtenstein's real estate sector is characterized by important risk-mitigating structural specifics which limit a comprehensive comparison with other countries.

Therefore, when assessing the overall risks in the household sector, important risk-mitigating factors in Liechtenstein's RRE sector have to be considered, such as

- an extremely resilient labor market;
- high job security;
- a relatively high share of fixed interest rate loans;
- the low taxation on household income leading to higher disposable income;
- the overall low level of indebtedness in the economy; and
- the favorable asset quality of lenders.

Thus, after carefully considering these factors, Liechtenstein agrees with the ESRB's assessment that the direct financial stability risks in Liechtenstein's RRE sector are currently not a cause of concern. Still, while lending standards have remained prudent in recent years, a distributional perspective on mortgage affordability and debt-to-income (DTI) levels suggests certain vulnerabilities in the medium term. Against this background, the high indebtedness of private households requires an open discussion on how to address the related systemic risks in the medium term.

To further increase the resilience of the economy against the identified risks stemming from the RRE sector and to strengthen financial stability, Liechtenstein authorities have introduced a targeted policy mix consisting of various borrower- and lender-based measures already in 2015, as also noted by the ESRB. In 2021, the Liechtenstein Financial Stability Council (FSC) recommended to introduce a sectoral systemic risk buffer of 1% to all Liechtenstein banks for loans secured by mortgages in Liechtenstein to increase their risk-bearing capacity against the real estate-related vulnerabilities, which is expected to enter into force in May 2022. Combined with the other macroprudential capital buffer requirements in the banking sector, Liechtenstein has an effective and transparent policy-mix in place, which has significantly contributed to an overall effective mitigation of financial stability risks in recent years.

To address the medium-term vulnerabilities, the FSC has already started the implementation of the set of recommendations based on the FMA's findings. Firstly, data availability will be improved. While the implementation of the ESRB recommendation on closing data gaps in real estate (ESRB/2016/14) is an important step to increase data availability with regard to lending standards, Liechtenstein authorities have also proposed to conduct a feasibility study on calculating an official real estate price index. Secondly, risk awareness both among lenders and borrowers has been fostered with targeted measures. While the discussion based on the publication of the FMA's report on RRE vulnerabilities has already had a positive effect on public risk awareness, banks play a particularly important role in advising their clients about possible risks of high indebtedness. Thirdly, Liechtenstein authorities have also recommended to discuss a strengthening of the existing borrower-based measures, particularly with regard to income-based instruments. The dialogue with the relevant banks as well as the Liechtenstein Bankers Association has already started and the discussion is characterized by an effective and targeted collaboration between the private sector and authorities.

The FMA and the FSC will continue to closely monitor the evolution of the financial sector as a whole as well as the RRE-related risks in Liechtenstein. Authorities will propose additional measures to contain the identified risks if deemed necessary. In this context, we will continue the excellent collaboration with the ESRB Secretariat and keep the ESRB informed of any activation or recalibration of macroprudential or other relevant policy measures taken.

Yours sincerely,

Simon Biedermann
Secretary General
Ministry of General Government Affairs and Finance

Mario Gassner
Chief Executive Officer
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