

# Czechia

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## IN A NUTSHELL

- The economy grew by 2.5%, compared to the pandemic-affected 2021, but it slightly declined in the second half of the year.
- Inflation reached 15%, with average inflation above 10% expected for 2023.
- House prices are decelerating year on year, developments are nevertheless heterogeneous across regions/types of property and a double-digit decline in prices from the peak in mid-2022 is already observed in some regions.
- New mortgage origination fell by 60% last year and reached a decade-low in the second half of 2022.
- Average interest rate exceeded 6% at the end of the year, triple their rate in mid-2021.

## MACROECONOMIC OVERVIEW

The year was significantly influenced by the war in Ukraine. The economy shrank slightly in Q3 and Q4, leading to mild technical recession. Despite this, the economy grew more than expected according to estimates published after the onset of the war. The economy grew by 2.5% over the entire year. However, this was largely due to the low comparison base of the pandemic-affected 2021. The average quarterly growth was only slightly positive, and the domestic economy largely stagnated in 2022. All in all, the economy coped relatively well with the geopolitical risks and energy-related issues.

Unemployment remained low (the lowest in the EU), despite a small technical recession in the second half of the year, and industrial production increased by 2%, due to strong output of the automotive industry. Despite the shift from Russian gas, it was possible – through a combination of savings and new sources of liquefied gas – to ensure an adequate supply of energy, avoiding more serious energy shortages.

However, the energy crisis exacerbated inflation, which reached 15.1% for the year, the highest since 1993. The main driver of inflation was housing-related costs, particularly the increase in electricity and gas prices. Additionally, food prices significantly contributed to inflation, with a year-on-year increase of 26% in December 2022 and an average of over 17% for the entire year 2022.

Due to accelerating inflation, the Czech National Bank continued to raise the main interest rate in the first half of the year, starting at 3.75% and reaching 7% by the end of June. During the second half of the year, and at the beginning of 2023, interest rates remained stable.

According to the latest estimates from the banking industry, the economy is expected to record a modest growth in 2023 of around 0.4%. Unemployment is projected to remain low with the labour market being tight, supporting wage

growth of 9%. Inflation is expected to reach 11% for the entire year, gradually returning to the target 2-3% in 2024.

## LOOKING AHEAD

Despite unfavourable conditions affecting demand for mortgages at the beginning of 2023, the mortgage market has become more active since March. Activity has increased compared to the second half of 2022. However, it is still 50% lower than pre-pandemic levels at the start of 2020. Although the activity in the mortgage market may gradually improve throughout the year as many households stop postponing mortgage decisions, it is likely to experience a 20 to 30% decline after the 60% decline in 2022. This year-on-year fall in 2023 will be mainly due to the base effect, as the first half of 2022 was still relatively favourable.

Interest rates are expected to remain relatively stable throughout the year, as policy rates stay unchanged, and longer-term rates are expected to change only gradually based on market expectations.

Property prices have started to decline since the beginning of the year, based on activity data from the land registry. However, the development is heterogeneous across types of property and regions. Many regions have already had double-digit falls in property prices since the mid-2022 peak, with a lesser fall in Prague and new properties. A single average number for price development has limited explanatory power this year.

The Czech central bank reconsidered its macroprudential regulations and canceled DSTI limit since July 2023.

## HOUSING MARKETS

Property prices increased by 16.8%, based on the harmonised House Price Index (HPI). Prices of new properties increased by 18.2%, while those of older properties increased 16.5%. However, due to a significant increase in mortgage rates during 2022 and the subsequent fall in mortgage demand, property prices started to slow down since mid-2022. Property prices experienced a -2.2% quarter-on-quarter (q-o-q) fall in Q4, the first quarterly decline since the end of 2013, when the economy experienced a mild recession.

The weaker level of housing sales was related not only to high interest rates (which have been above the 5% threshold since June 2022) but also to stricter macroprudential measures of the central bank. Additionally, the very high price-to-income ratio, which is among the highest in the EU, contributed to the decline in demand. Property price growth has been among the highest in the EU countries in the past decade, especially since 2020 growing faster than average wages (50% vs. 20%).

According to non-official statistics from the private company Dataligence (dataligence.cz), which analyzes property prices based on real transactions

from the land registry, property prices peaked around mid-2022 and have been declining since. However, this has been very uneven across regions and types of properties. According to the same, prices of older flats in many regions have experienced a double-digit from mid-2022 to March 2023.

## MORTGAGE MARKETS

Banks and building societies provided mortgage loans amounting to CZK 172 bn (a 62.6% y-o-y decline), excluding loans for refinancing this was CZK 149 bn (59.6% decline). Although 2021 had exceptional market activity and a decline in 2022 was expected, the activity was nearly 40% lower than in 2020. The first half of the previous year was still relatively strong, and it was only in the second half of 2022 that mortgage market activity significantly slowed. The number of new mortgages reached 20-year lows and sales volumes dropped by 83% in Q4 y-o-y.

The main reason for this is a decline of consumer confidence due to the economic development. High interest rates, growing household expenditure (including on housing and basic consumer goods), as well as worsening affordability of housing, all drove the drop-in mortgage lending activity.

As the central bank continued to raise its interest rates, mortgage loans also rose with a small delay. The main central bank interest rate peaked at the end of June where it has remained since. Mortgage interest rates reached their maximum in Q4, as the average interest rate exceeded 6% level, three times higher than that in H1 2021. The average yearly mortgages interest rate was 4.61%, double the rate of 2021.

Increasing prices of consumer goods and household expenditure, particularly electricity and gas, significantly reduced household' repayment capacity. This, together with strict regulation of DTI and Debt Service-to-Income (DSTI) ratios, reduced the level of new financing.

Refinancing activity slowed down as offers by mortgage providers were comparable, varying by only 10 to 20 bps compared to an absolute rate of 6%. In addition, banks tried harder to keep customers when rates reset given the lack of new business opportunities for them.

As of April 1<sup>st</sup>, the central bank introduced tightened credit measures for DTI, DSTI and LTV ratios. The LTV cap tightened to 80% (from 90%), the DTI cap stood at 8.5% (for loan applicants younger than 36 years was 9.5%) and the DSTI cap was 45% (50% for people 36 years or younger).

These measures were driven by the intention to protect households from excess indebtedness in time of growing cost and thus to support the stability of the banking sector. This was among the major reasons for the slowdown in mortgage origination.

	CZECHIA 2021	CZECHIA 2022	EU 27 2022
<b>MACROECONOMIC VARIABLES</b>			
Real GDP growth (%) (1)	3.6	2.5	3.5
Unemployment Rate (LSF), annual average (%) (1)	2.8	2.2	6.2
HICP inflation (%) (1)	3.3	14.8	9.2
<b>HOUSING MARKET</b>			
Owner occupation rate (%) (1)	78.3	77.1	69.1
Gross Fixed Investment in Housing (annual change)(1)	-1.6	-1.4	1.5
Building Permits (2015=100) (2)	117.7	110.7	125.8
House Price Index – country (2015=100) (2)	197.3	211.0	164.6*
House Price Index – capital (2015=100) (2)	n/a	n/a	163.8*
Nominal house price growth (%) (2)	25.8	6.9	10.6*
<b>MORTGAGE MARKET</b>			
Outstanding Residential Loans (mn EUR) (2)	60,632	65,497	6,743,197
Outstanding Residential Loans per capita over 18 (EUR) (2)	6,983	7,693	18,433
Outstanding Residential Loans to disposable income ratio (%) (2)	44.5	42.3	71.5
Gross residential lending, annual growth (%) (2)	78.1	-61.0	-6.5
Typical mortgage rate, annual average (%) (2)	2.3	4.6	3.1

\* Please note that this value is the simple average of the available values in 2022.

### Sources:

(1) Eurostat

(2) European Mortgage Federation – Hypostat 2023, Statistical Tables.

## CZECHIA FACT TABLE

<b>Which entities can issue mortgage loans in your country?</b>	In the Czech Republic, housing finance is raised by banks.
<b>What is the market share of new mortgage issuances between these entities?</b>	Banks represent 100% of the mortgage market.
<b>Which entities hold what proportion of outstanding mortgage loans in your country?</b>	There are 3 big retail banks, which together hold 75% of the mortgage loans outstanding volume in the Czech Republic.
<b>What is the typical LTV ratio on residential mortgage loans in your country?</b>	The Recommendations of the Czech National Bank set the maximum LTV at 80%, or 90% for customers younger than 36 years. Typical mortgage loan have an LTV close to 80%.
<b>How is the distinction made between loans for residential and non-residential purposes in your country?</b>	More than ¾ of the housing loans were provided for residential purposes.
<b>What is/are the most common mortgage product(s) in your country?</b>	The most common mortgage loan in 2022 was the loan for house/flat purchases secured by financed property with an interest rate fixation period of 3 to 5 years and a maturity of 25–30 years.
<b>What is the typical/average maturity for a mortgage in your country?</b>	The Recommendation of Czech National Bank sets the maximum mortgage loan maturity at 30 years. Typical mortgage loans have a maturity that ranges from 25 to 30 years.
<b>What is/are the most common ways to fund mortgage lending in your country?</b>	Through a combination of deposits and covered bonds.
<b>What is the level of costs associated with house purchase in your country (taxes and other transaction costs)?</b>	Taxes and fees when buying/selling a property in the Czech Republic are the following: <ol style="list-style-type: none"> <li>1) Fee for record of the ownership change and fee for mortgage lien establishment to Real Estate Cadastre (state database)</li> <li>2) Real estate agency fee (only for purchase intermediated by RE agency).</li> </ol>
<b>What is the level (if any) of government subsidies for house purchases in your country?</b>	In a low interest rate environment and considering the generally positive macroeconomic development in throughout most of the year, a limited amount of subsidies was available: <ul style="list-style-type: none"> <li>• Tax-deductible paid interests: The amount paid in interest on a mortgage loan to finance housing needs can be deducted from the tax base of physical entities' income, up to CZK 300,000 per year if the housing was acquired by the end of 2020 and up to CZK 150,000 per year for housing acquired in 2021 and later.</li> <li>• Support for establishing social housing for disadvantaged people due to their age or health</li> <li>• Relaxed credit ratios applied for housing loans – LTV, DTI, DSTI - for loan applicants younger 36 years</li> </ul>