

Czech Republic

Very gradual return to normal financial habits

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- The economic crisis has resulted in mounting problems on the labour market, thereby curbing household disposable income. Despite an overall increase in the saving propensity (and thus lower consumption propensity), the dynamic of household wealth accumulation is estimated to have fallen to the decade's low in 2009
- However, the net financial position of households has benefited from the severe slowdown in lending growth, both in terms of consumer loans and mortgages
- Households have already begun shifting their money from cash and bank accounts back to riskier instruments. The positive performance of both mutual funds and equities in 2009 is the consequence of financial assets appreciation rather than of new inflows
- Full recovery in the debt appetite should materialise only toward end of 2010

Table 1: Household real and financial indicators

	2006	2007	2008	2009 e	2010 f	2011 f
Per capita net financial wealth (€)	5,149	5,366	5,289	5,574	5,773	6,163
Monthly wage (€)	690	755	910	887	924	983
Monthly wage (% YoY LC)	6.5	7.2	8.4	4.1	2.3	3.6
Unemployment rate, avg (%) ⁽¹⁾	8.1	6.6	5.5	8.1	9.5	9.5
Home ownership (%)	58.7	59.9	60.6	n.a.	n.a.	n.a.
Household financial assets (% YoY LC)	10.9	11.1	7.1	5.1	5.5	7.3
Household financial liabilities (% YoY LC)	25.2	33.6	18.1	6.3	9.4	12.9
Household financial saving ratio (% GDP)	2.3	0.4	0.3	1.7	1.1	1.3
Household net financial wealth (% GDP)	45.2	41.6	40.1	42.1	42.0	41.5
Housing affordability index (house price per sqm over gross monthly wage)	0.9	1.1	1.2	n.a.	n.a.	n.a.
Mortgage in % GDP	11.5	14.5	16.7	18.5	19.8	21.5
FX indexed/denominated loans (% total)	0.2	0.2	0.1	0.1	0.1	0.1
Households NPLs ratio (%) ⁽²⁾	3.3	3.0	3.0	4.8	6.5	6.3

Note: (1) According to local definition; (2) Over gross loans

Source: CNB, CZSO, UniCredit Group CEE Strategic Analysis – UniCredit Bank Czech R. Economic Research

The global crisis has led to an increase in households' saving propensity, although in the context of strongly capped disposable income. The crisis continued to cap wealth accumulation of Czech households for most of 2009. But while the largest part of the lost momentum in H2 2008 came from depreciation of financial assets, it was mainly the weakening inflow of new money that slowed wealth creation in 2009. Although a rally in asset prices since Q2 2009 has somewhat reduced the drop, a combination of surging unemployment and decelerating wage growth pushed the growth rate of household wealth to its lowest in this decade toward year end. Nevertheless, with growth of household indebtedness slowing much more dramatically, the net financial position of Czech households over GDP, after many years of continuous deterioration, is expected to have improved in 2009. In 2010, an upturn in the lending dynamic is expected to be accompanied by only a mild acceleration in wealth growth, leading to a stabilisation of the net assets over GDP ratio at the 2009 level.

While traditional saving tools – cash and bank accounts – benefited most during the escalation of the crisis in H2 2008, the signs of economic stabilisation observed since Q2 2009 led to a reverse flow. Cash holdings have been gradually decreasing since the start of 2009 and are estimated to have recorded the first negative yoy growth rate of this decade.

Transfers of money back to riskier instruments in combination with weakening private incomes have also curbed the inflow into bank accounts. A certain portion of this slowdown can also be attributed to a technical factor: the sharp CZK retreat since Q1 2009 has slashed the value of FX savings. Unlike cash holdings, however, bank deposit volumes (apart from housing savings) still grew at a double-digit rate in Q3 2009. Nonetheless, this is unlikely to last too long as labour market problems have yet to peak and the disposable income of households is set to decelerate further.

The inflow of money into the system of construction savings banks continued to weaken during H1 2009 affected mainly by the approaching saturation. Speculation regarding possible further reduction in the still generous state support for this scheme from around mid-2010 may have been the main factor that drove the yoy growth rate slightly upward in Q3 2009. In any event, we look for more or less stagnating volumes in construction savings in the years to come.

Unlike investments into equities which recorded a net outflow until Q2 2009, household holdings in other securities have risen steeply since late 2008. In addition to a gradual inflow of money into bonds issued by banks, households have sharply increased their holdings in government debt. Moreover, we expect this pattern to continue given the government's plan to start selling bonds tailored to the retail segment. The project should be kicked off in spring 2010 and the Ministry of Finance believes it can attract as much as CZK 20 bn during the first year.

Assets of mutual funds were deeply hit by the global financial turbulence. From their peak at the end of 2007 to their trough in Q1 2009, the funds' assets contracted by almost a third, with money and equity-linked funds suffering the biggest losses. The recovery observed since Q2 2009 has been mainly driven by equity funds, while the other types of funds have so far posted only limited gains. Going forward, we expect mutual funds assets to gradually pick up, but 2007's record is unlikely to be reached before 2012.

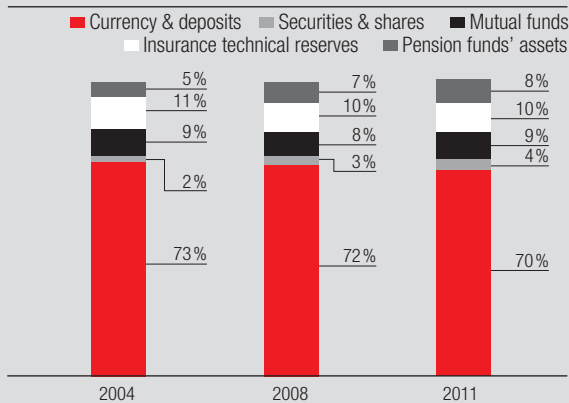
The growth dynamic of insurance technical reserves declined throughout 2008 and reached its low in Q1 2009. But while the non-life segment continued its downward trend in Q2 2009, indi-

viduals' money in life insurance reserves posted a solid increase in this period, apparently related mostly to an improved financial market performance. We assume that inflows of new money into insurance companies will remain weak over the next two years. Hence, the larger part of the estimated increase will primarily come from the asset price growth within the life segment.

Similar to insurance, the growth rate of pension funds assets has eased to around half the level seen in the pre-crisis period. Unless the government makes any significant progress in strengthening the role of private pensions at the expense of the pay-as-you-go scheme, no substantial pickup in this form of savings can be expected.

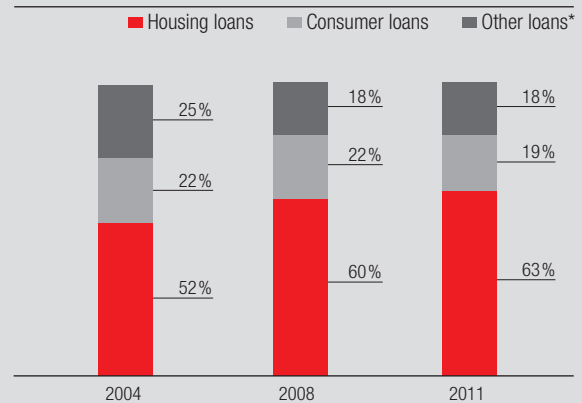
Lower demand from households in combination with banks' tighter criteria for granting a credit has led to a substantial drop in households' lending growth. Loans for housing purposes drove down the overall rate, with many households putting off a new home purchase in expectation of real estate prices declining further. While mortgage loan growth became more moderate as early as the beginning of 2008, consumer loans followed suit with roughly a one-year lag. Within the consumer loans category, the downturn was particularly severe in the non-bank segment where the indebtedness level actually fell. The same holds true for financial leasing where the volume of debt decreased by almost 20% from its peak at the end of 2007. We expect lending growth to regain momentum as early as in 2010 as real estate prices bottom out, triggering demand for mortgage loans.

Household Financial Assets (% of total)*



*) The aggregate currency and deposits also include savings kept in building societies; Source: CNB, UniCredit Group CEE Strategic Analysis – UniCredit Bank Czech R. Economic Research

Household Financial Liabilities (% of total)



*) Other loans include overdrafts, other loans granted by banks, revolving credit cards and financial leasing; Source: CNB, Czech Association of leasing and consumer finance companies, UniCredit Group CEE Strategic Analysis – UniCredit Bank Czech R. Economic Research