

**EXECUTIVE
BOARD
MEETING**

SM/21/94
Correction 1

June 15, 2021

To: Members of the Executive Board
From: The Secretary
Subject: **Slovak Republic—Selected Issues**

Board Action: The attached correction to SM/21/94 (6/7/21) has been provided by the staff:

Typographical Errors Page 13

Questions: Ms. Topalova, EUR (ext. 39557)
Mr. Wu, EUR (ext. 37520)
Ms. Valderrama, EUR (ext. 37816)
Mr. Spector, EUR (MSpector@imf.org)

MACROPRUDENTIAL POLICY CALIBRATION IN SLOVAKIA¹

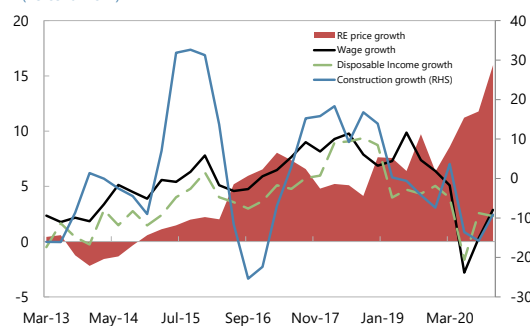
The Slovak banking sector has coped well with the COVID-19 pandemic so far, but vulnerabilities associated with the housing market have accumulated. Notwithstanding the proactive tightening of regulatory limits before the pandemic, mortgage credit and real estate prices continue to grow, and housing loans account for an increasing share in banks' private sector loan portfolio. We develop a modeling framework that quantifies the effectiveness of different macroprudential policy instruments in reducing mortgage losses, in case of a severe downside scenario including a house price correction. We show that different regulatory limits can achieve a similar reduction in default risk, but loan-to-value (LTV) restrictions can be particularly effective in addressing systemic risk in housing loans relative to other borrower-based tools in terms of decreasing bank losses. We calibrate the level of minimum risk weights on IRB banks and the sectoral systemic risk buffer (SyRB) on mortgage exposures, which would absorb mortgage losses under stressed conditions.

A. The Context

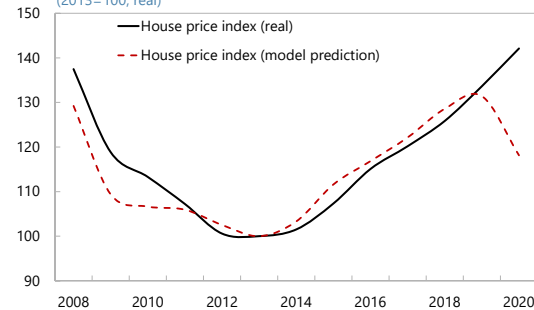
1. Real estate prices in Slovakia have continued growing at a brisk pace through the pandemic. House prices rose by 16 percent in 2020, significantly outpacing growth in wages and household disposable income. Several factors likely contributed to this phenomenon. Demand for housing remained strong, as mortgage rates declined to under 1 percent in 2020, fueled by the decrease in long-term yields and fierce banking system competition. Supply constraints, including land-use restrictions in urban areas and the 9 percent contraction in domestic construction, contributed to fewer houses being built despite rising demand.

2. With the significant GDP decline in 2020, a gap has emerged between actual and model-predicted residential real estate prices.² A regression-based assessment of fundamental drivers of real estate prices across a panel of Central, Eastern

Real Estate Price Growth, Demand and Supply Drivers
(Percent Y-o-Y)



House price index and the model prediction
(2013=100, real)



¹ Prepared by Laura Valderrama (EUR). The author thanks Marek Ličák, Pavol Jurča, Ján Klasco, and colleagues at the National Bank of Slovakia for sharing the data and for insightful comments and remarks, and Lucyna Górnicka, Peter Haver Harvan, and Erlend Nier for very fruitful discussions.

² The rise in house prices in Slovakia mirrors trends in global asset prices supported by accommodative financial conditions