

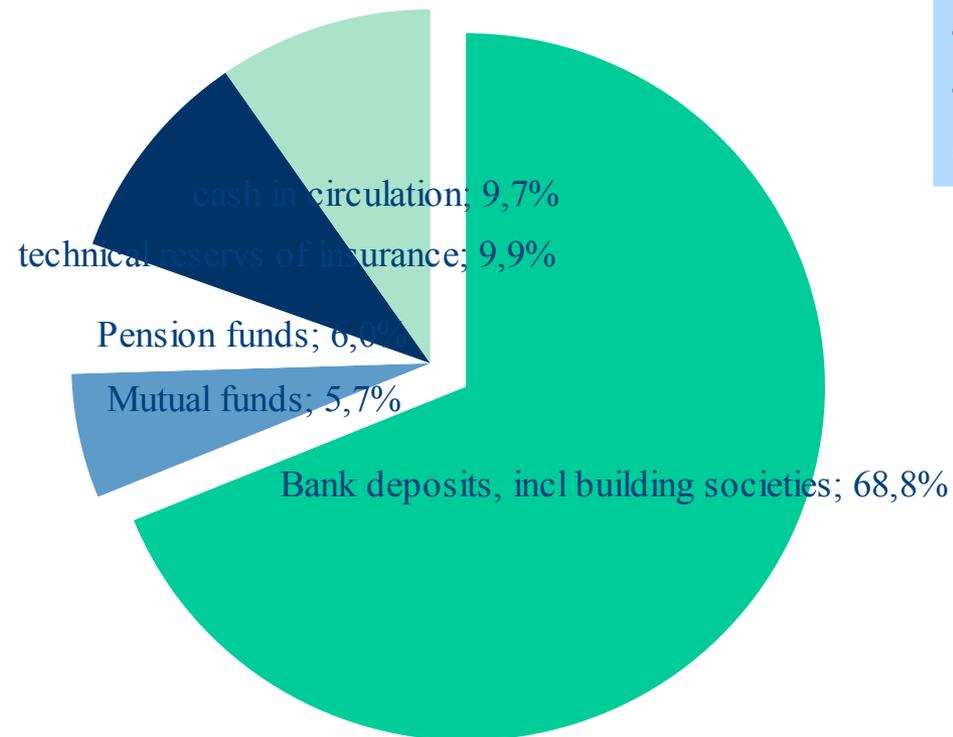
# The Czech Financial Sector, Brief Overview

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CNB Board member  
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China Investment Forum  
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## Funds for Use in the Financial Market, end of 2012, in %

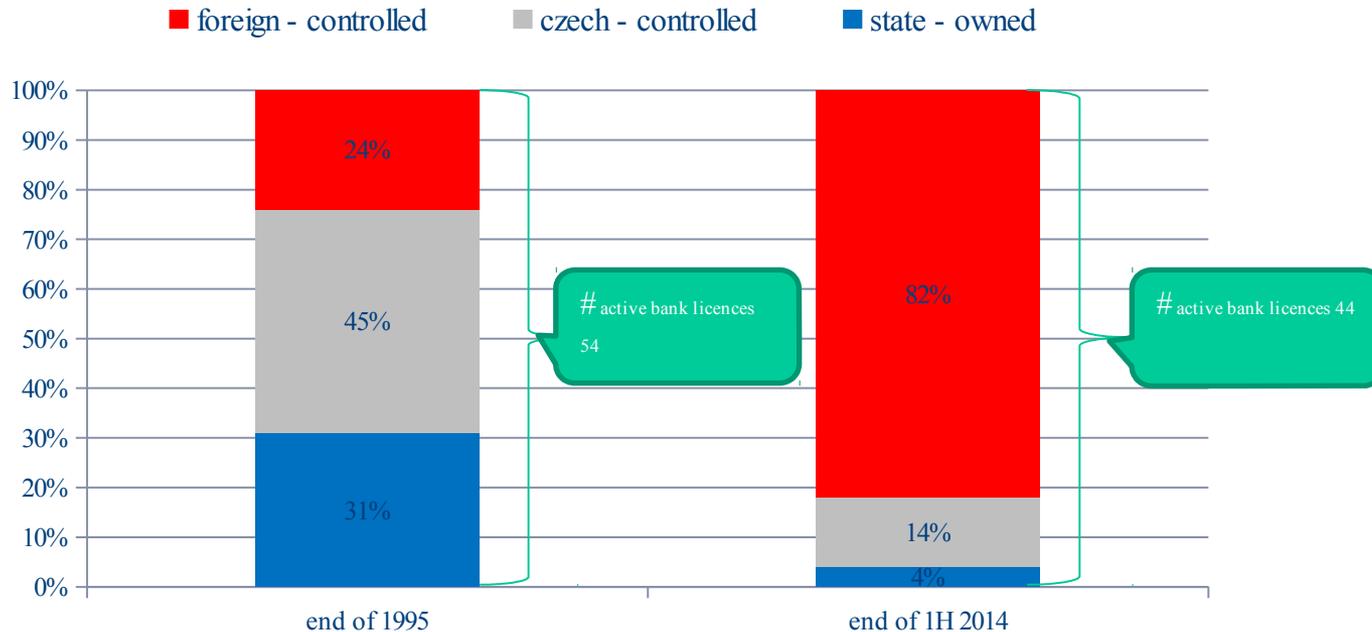


**At the end of 2012,  
the Total Amount of  
the Funds = 4 574bn  
CZK = 182bn €**

Source: Zpráva o vývoji finančního trhu v roce 2012, Ministry of Finance of the CR

# A little of History....

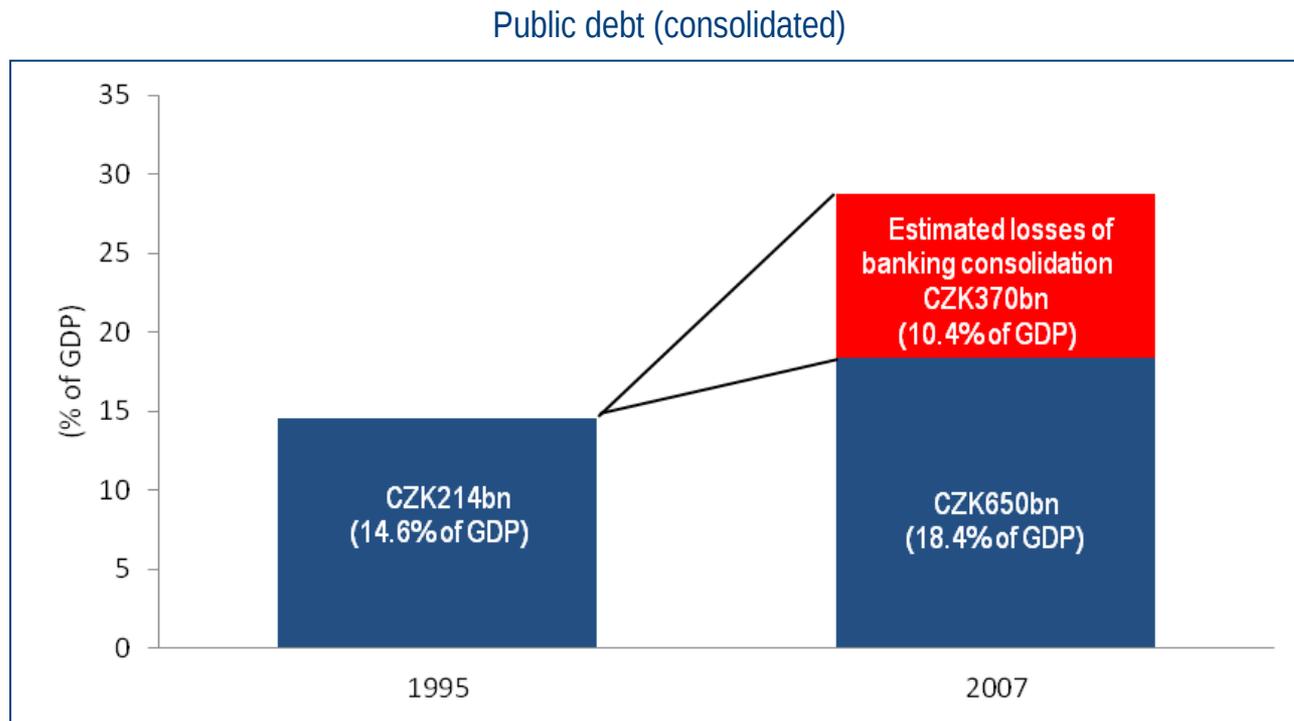
## Czech banking sector: development of ownership structure



Source: CNB

- In early 90's Czech- and state-owned banks dominated the market and the number of licenses was growing sharply.
- The number of banking licenses peaked in 1995 (54 active banks of 55 licences).
- The accumulation of non-performing loans to the corporate sector triggered a banking crisis in the 2nd half of 90's (at least 10 smaller banks collapsed, the biggest four banks were later taken over by foreign investors after the government had cleared up their balance sheets).
- As a result, the number of banks was reduced to 37 in 2002 and has been remaining almost stable since then (currently 44 active banks).

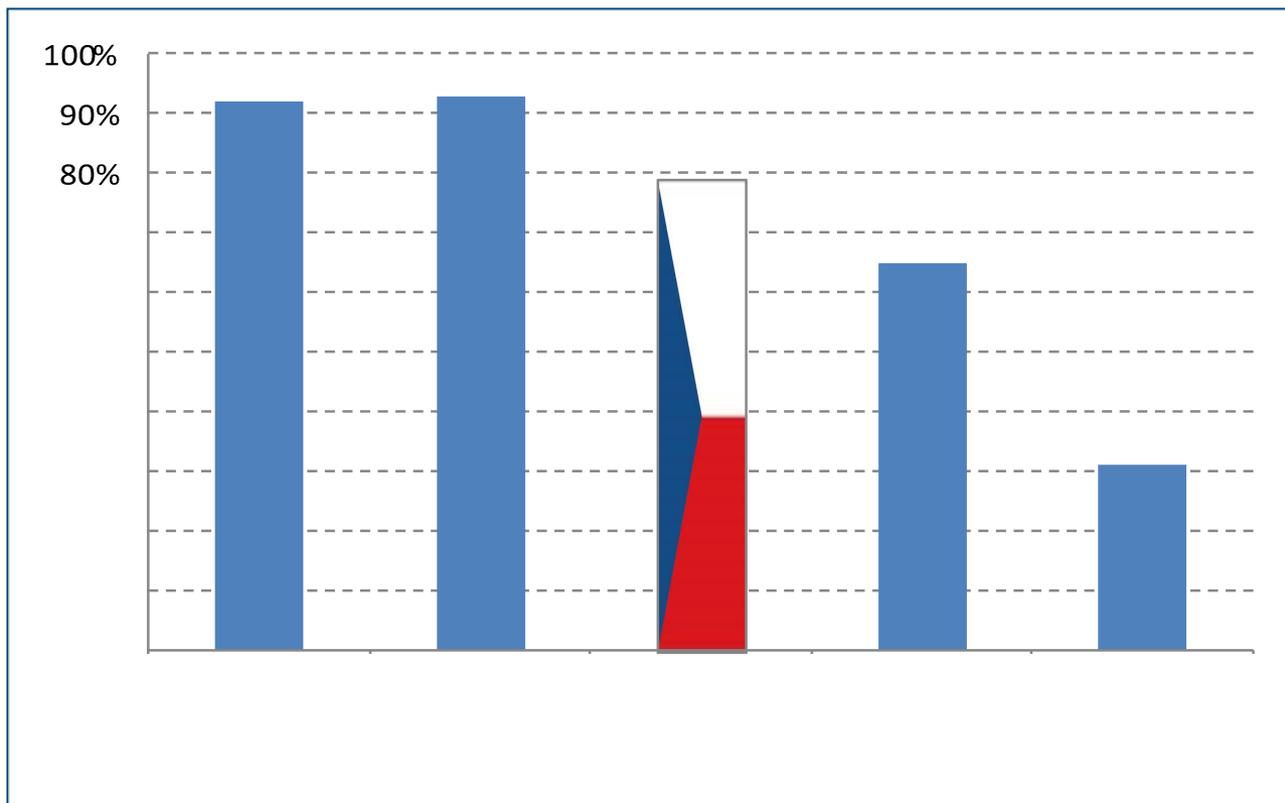
# The Costs of Banking Sector Rescue



Source: Accumulated losses in 2007 based on estimate of Finance Ministry

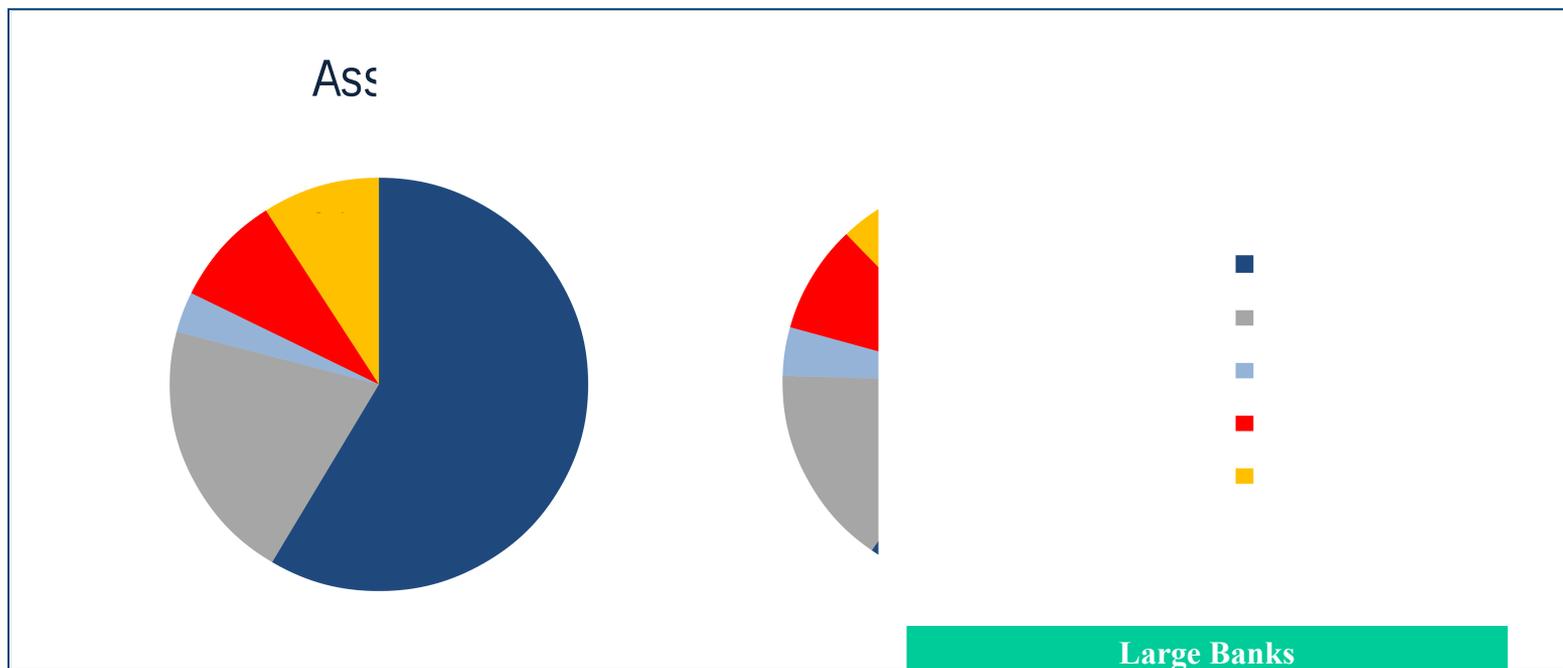
- The estimated costs of banks' rescue package are ranging from CZK225bn (CNB) to CZK370bn (Finance Ministry); i.e. approximately 1/3 of public debt in 2007.
- The 'toxic' assets were transferred to state-owned „bad bank“ (Czech Consolidation Bank) and sold with a discount (selling price somewhere between 15% to 40% of book value) in tenders.
- The impact on public finance was not as much destructive as the initial public debt had been relatively low.

# Foreign Ownership of Domestic Banks



- Foreign capital with a direct share in domestic banks (i.e. direct foreign shareholders holding shares directly) has gradually increased to 79% (in 2012) of total banking-sector equity.
- This share would be even higher, if domestic financial institutions, controlled by foreign-owned subsidiaries, were also included.

# Breakdown of Banks according the Size



- large banks - total assets of more than CZK250bn (€9bn),
- medium-sized banks - total assets of between CZK50bn (€2bn) and CZK250bn,
- small banks - total assets of less than CZK50bn
- the other groups are foreign bank branches and building societies

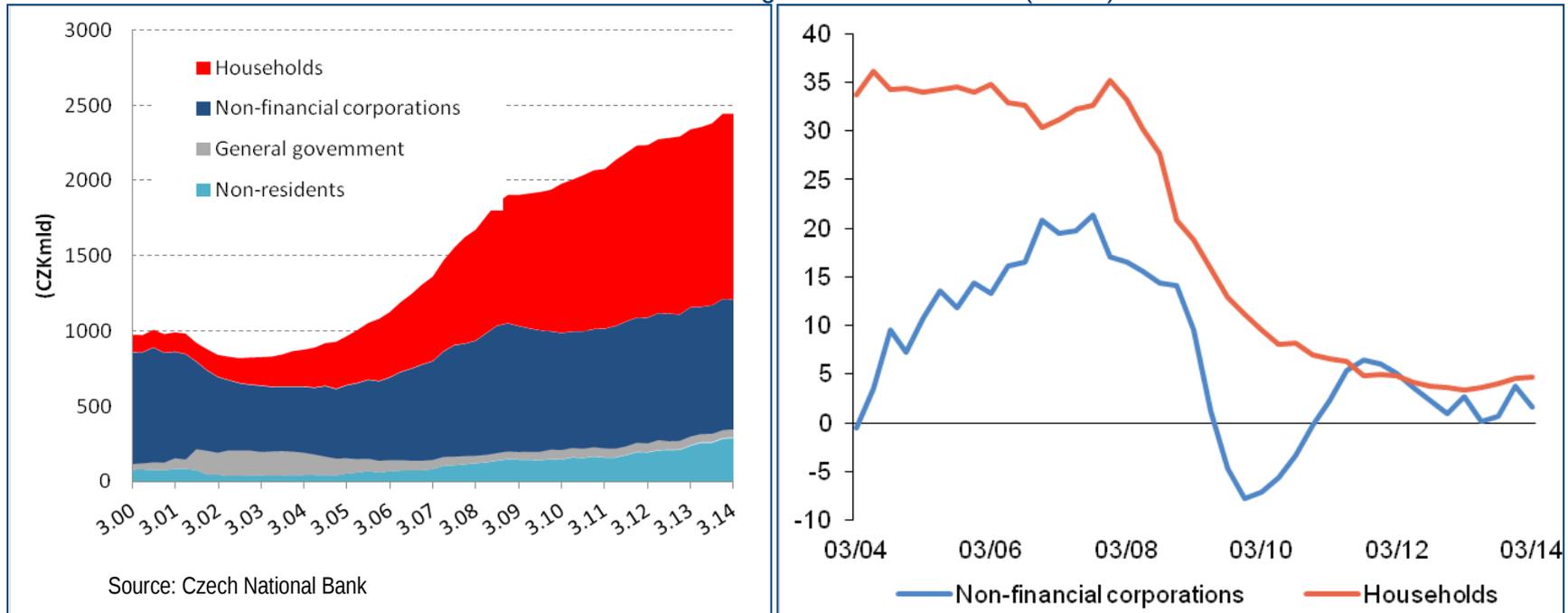
Source: CNB

Large Banks	
Name (Group)	Assets (end of 2013; in bn CZK)
ČSOB (KBC)	921
Česka Spořitelna (ERSTE)	857
Komerční Banka (SoGe)	774
UniCredit Bank CZ/SK (UniCredit)	466

# Breakdown of Bank Loans

Structure of bank loans

Nominal growth in bank loans (YoY%)



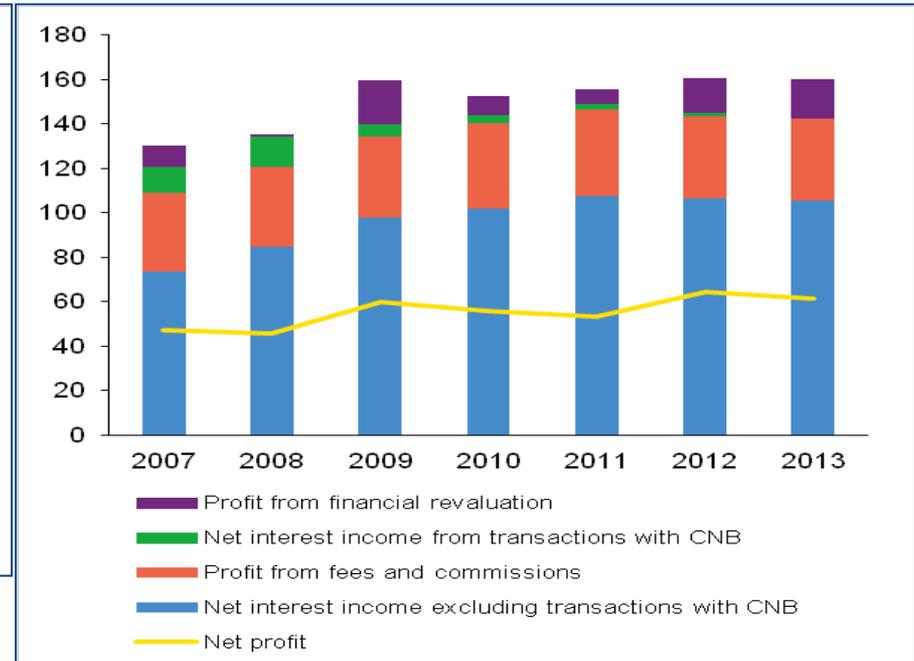
- Czech banks maintain relatively conservative business model, i.e. providing loans to non-financial corporations and to households.
- The share of banking loans to households (mainly mortgages) has been gradually increasing.

Loan-to-deposit ratio (%)

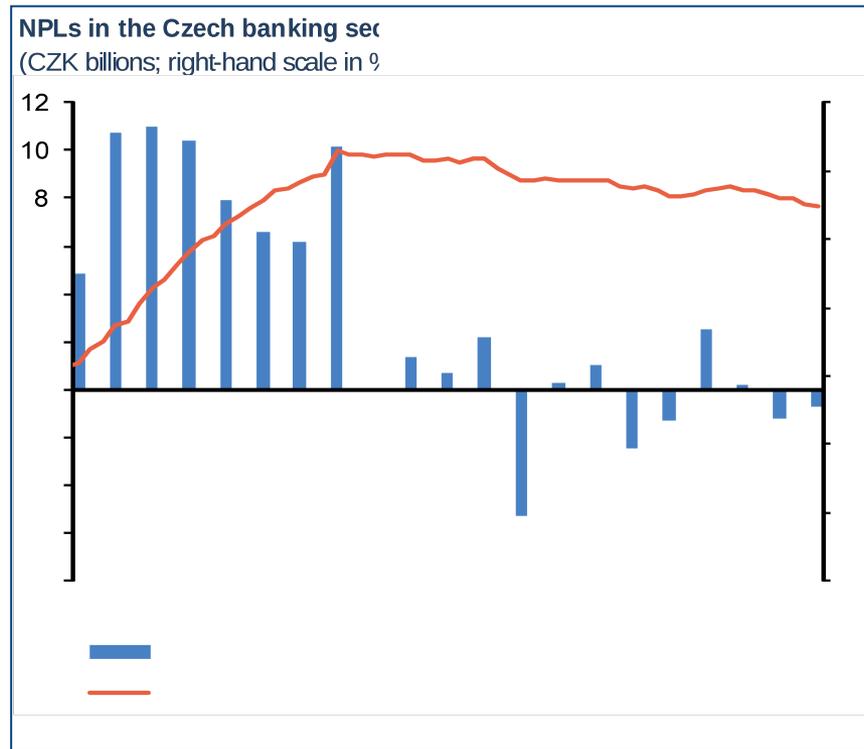


Source: Czech National Bank

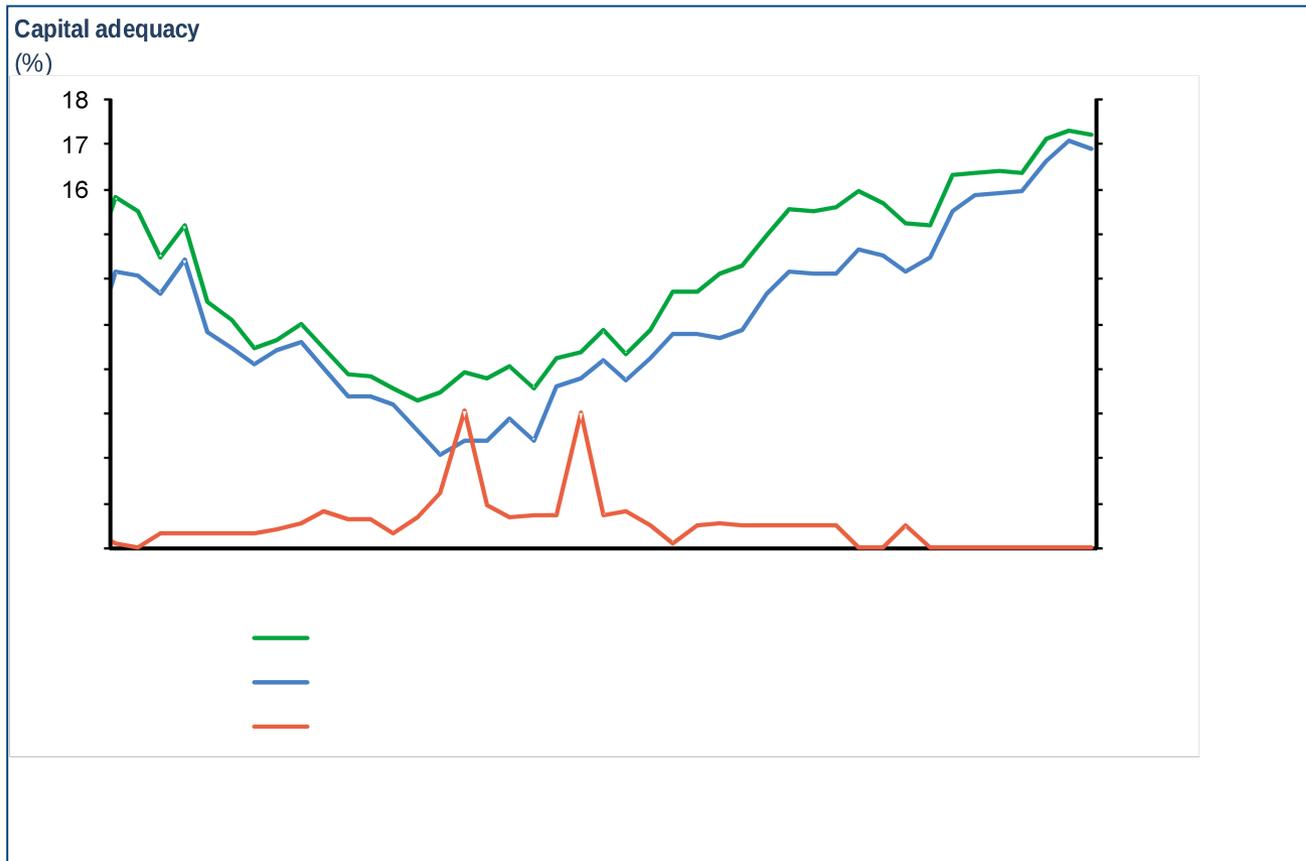
Key components of profit from financial activities (CZKbn)



- Bank business activities are mainly financed from domestic deposits, which is well illustrated with relatively stable loan-to-deposit ratio around 75%.
- The key profitable financial activities remain interest income and fees, which makes Czech banks less vulnerable to financial-market turmoil.

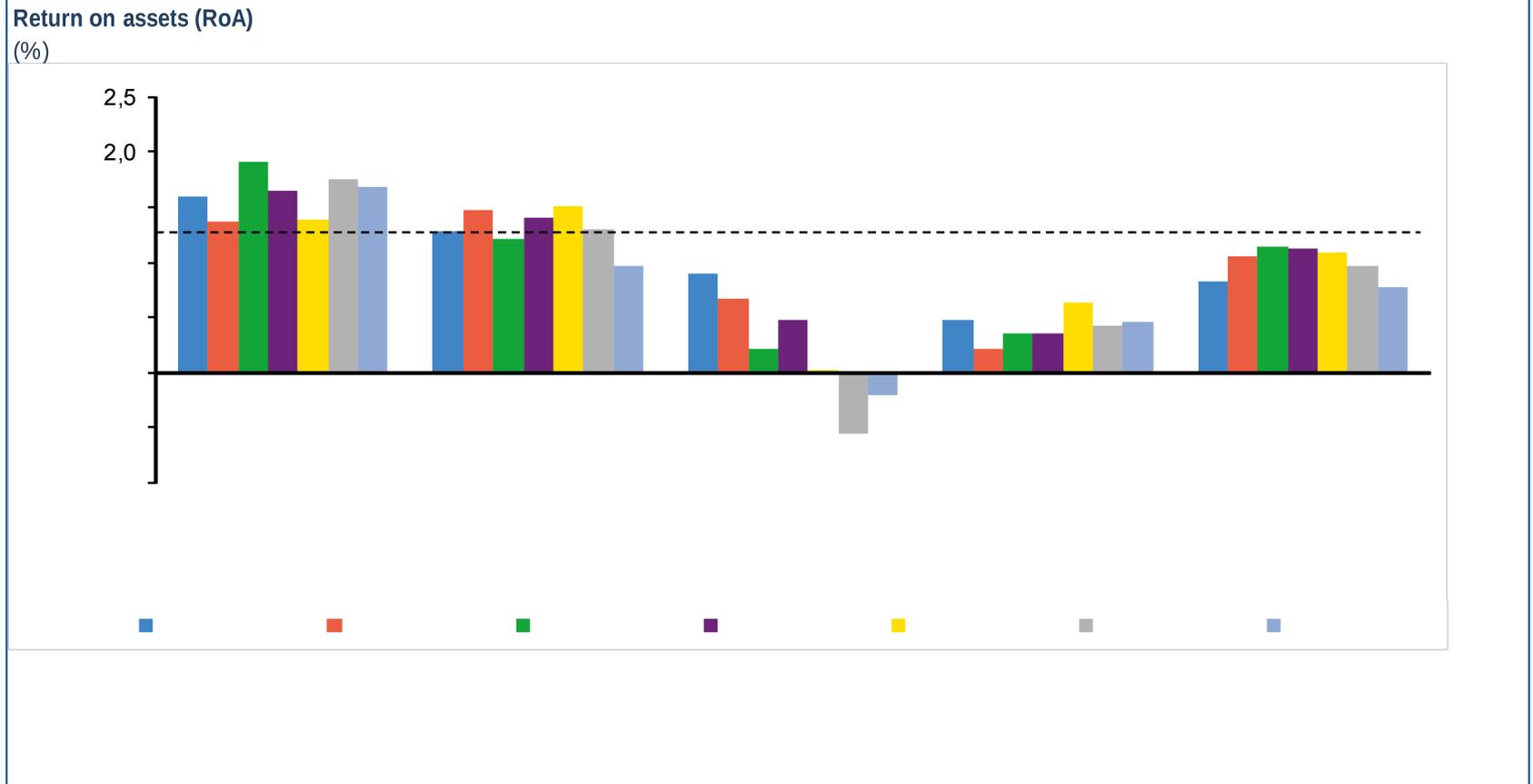


- Despite the previous protracted recession, the share of non-performing loans shows gradual declining trend since end-2010.



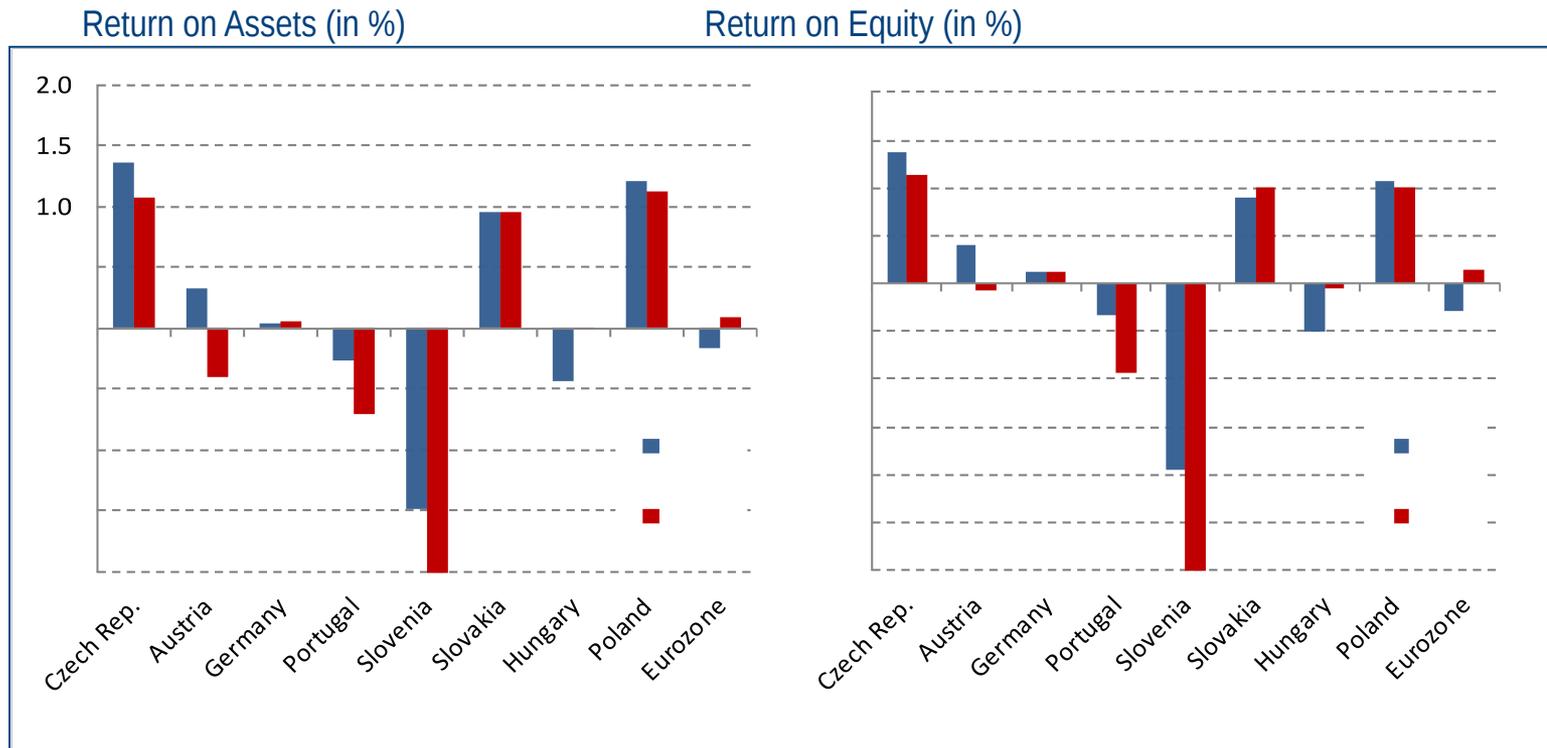
- Capital adequacy ratio (CAR) has been gradually increasing.

# Profitability of Czech Banks



- Return on assets (RoA) of almost 90% of the Czech banks exceeds 1% (which is supposed to be relatively sound level in banking sector).

# Profitability of CZ banks (cross-country comparison)



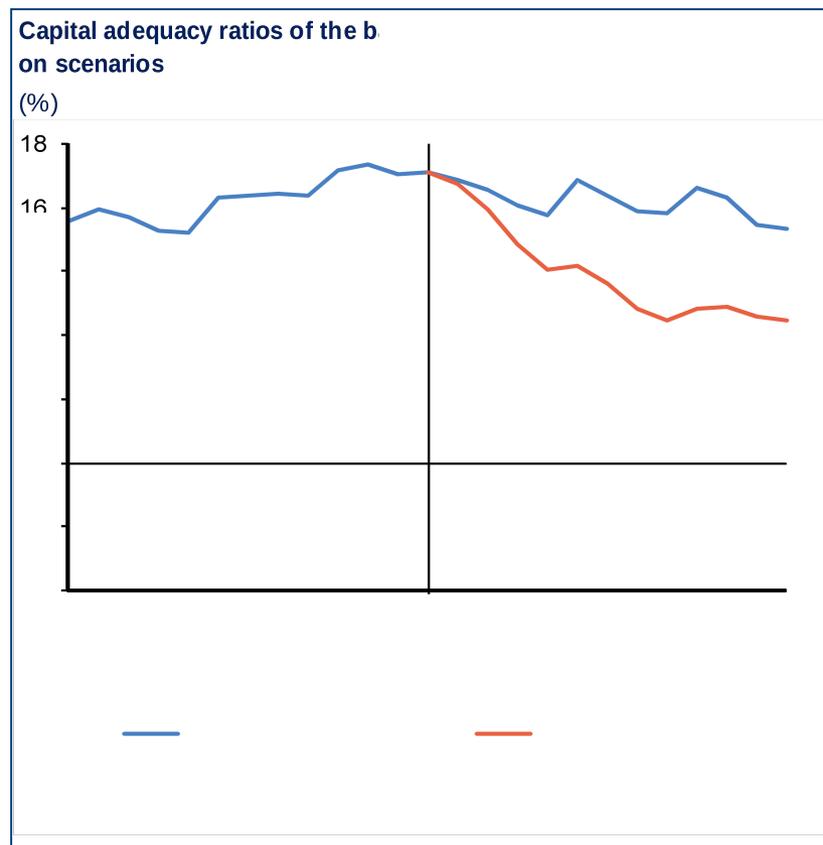
Source: European Central Bank

- Both main profitability indicators (RoA and RoE) of the Czech banking sector significantly outperform not only the Eurozone's average but Western-European regional peers as well.

- The Czech National Bank presents the results of its financial stability analyses primarily in the **Financial Stability Report**, which is published once a year.
- The objective of the Report is to identify the risks to the financial stability of the Czech Republic in the near future on the basis of previous and expected developments in the real and financial sectors.
- For evaluation of the resilience of the financial system as a whole the CNB uses the instrument of **stress testing**. The stress tests results are published in the annual Financial Stability Report.
- Since mid-2012 **the CNB publishes stress tests twice a year** – once in the annual Financial Stability Report in June and once in the form of a short report at the turn of November and December.
- The methodology of stress testing has been regularly amended and published in the individual Financial Stability Report, usually as thematic articles or boxes.

- *Baseline Scenario*
  - based on the CNB's May forecast published in Inflation Report (IR) II/2014,
  - assumes a recovery of the domestic economy in 2014, continuing growth in 2015 and a gradual decrease in unemployment over the scenario horizon.
- *Europe in Deflation*
  - the return of a V-shaped recession,
  - a fall of the economy into deflation,
  - a jump in government bond yields,
  - a surge in unemployment and a drop in wages leads to exhaustion of the financial reserves of some households and corporations,
  - the adverse developments cause growth in credit risk and high credit losses in the banking sector.

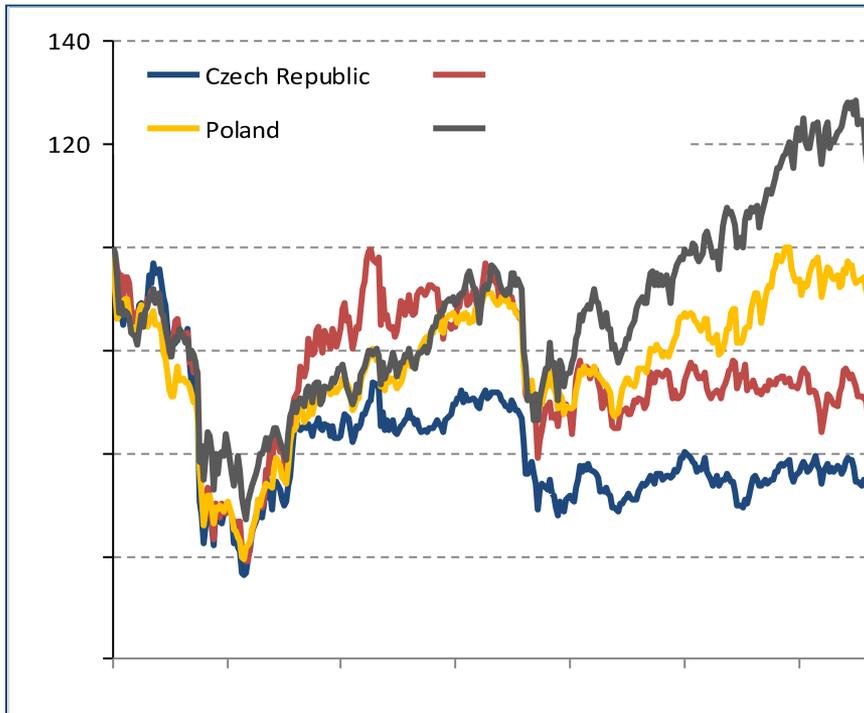
- In the *Baseline Scenario* only two banks fall below the 8% level of CAR:
  - These are small banks with assets below 1% of the sector's total assets,
  - According to the stress tests, their business models are unsustainable.
- In the *Europe in Deflation* scenario 11 banks would fall below the 8% threshold:
  - They account for about 17% of the sector's assets.
  - To get their CARs back up to 8% they would need capital injections totaling around CZK 12 billion (0.3% of GDP).
  - The sector's total CAR does not drop below 12%.



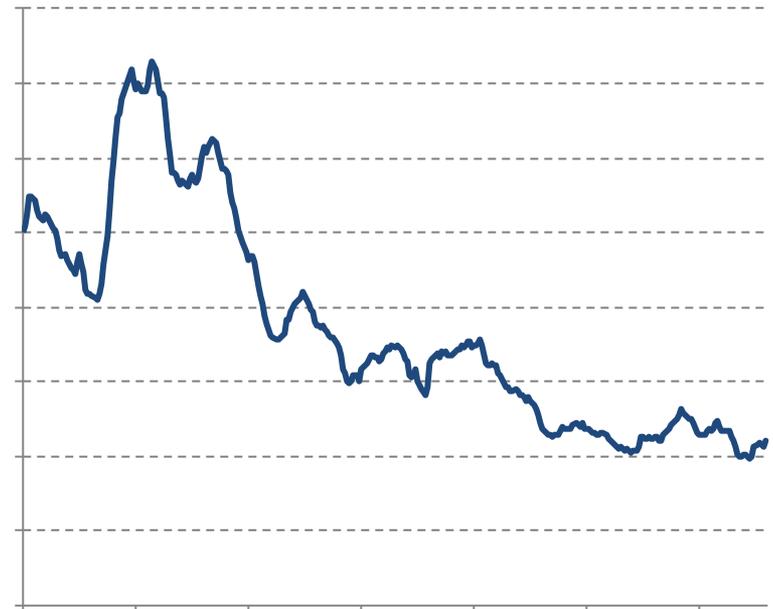
# Overall Assessment of Risks and Position in Financial Cycle

- **CNB assesses the risks to financial stability as being mostly low.**
  - A potential deterioration of the credit portfolio resulting from renewed adverse developments in the real economy remains the main risk to the Czech banking sector.
  - Persisting very low long-term yields worldwide are also a source of risks – the Czech financial sector could be adversely affected by bond market volatility.
- **The absence of unhealthily optimistic expectations due to the weakened domestic activity is discouraging strong lending activity and excessive risk-taking.**
- The financial cycle in the Czech Republic
  - is in a phase of modest credit recovery,
  - so the CNB currently does not regard a non-zero countercyclical capital buffer as necessary.

Regional equity indices



Prague Stock Exchange – traded volumes (6M moving totals)



Source: Bloomberg

- Equity market has been playing relatively insignificant role in the Czech economy.
- This is well illustrated with the long-term underperformance of Czech equity index vs. its regional peers, as well as with the gradually declining traded volumes on the Prague Stock Exchange or only scarce IPOs.

Thank you for your attention.



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