

**REAL ESTATE IN THE CZECH REPUBLIC:
NUMBER ONE INVESTMENT OR A PRICE SHOCK**
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Abstract. Nowadays the impact of Covid could be seen not only in the Czech Republic, but all over the world; the value of money also constantly decreases due to inflation and negative trends in the economy. People usually try to save their money and they want to be sure, that their savings will not lose value. Citizens of the Czech Republic now perceive housing market as a safe haven and protect their savings by buying real estate. That is why, according to Czech economists, there is no reason for the withdrawal of the Czechs' huge interest in investing in real estate in the coming years. At the same time, it should be understood that overheated markets sometimes collapse with terrible consequences for the country's economy. And this is the responsibility of regulators, who must anticipate and prevent such trends in the markets.

Keywords: cost of money, inflation, real estate market, mortgage, discount rate, volume of loans.

One of the differences between Czechs and the rest of Western Europe is that in the Czech Republic it is customary to save money to secure one's children's future, whereas in Western Europe people save for retirement. Thus, the Czech tradition is to redistribute money from generation to generation. The question today is particularly acute: will this behavior change in view of the growing instability in the country and the world? However, on top of that, this situation has become a stimulus to support housing construction in the country.

At present, everyone in the Czech Republic is well aware that the supply of apartments for sale in the country is extremely low. At the end of the first half of 2021 in the price lists of developers was only 3,350 free apartments, compared with 5,800 a year earlier, i.e. during the past year, the number of free apartments have decreased by more than 40%. The reason is the paperwork at the stage of preparing the area for development, as well as the fact that some apartments do not enter the market at all, because they are purchased by institutional investors in order to rent them out. [1].

The growing interest in real estate is also evidenced by the attendance of the largest real estate advertising portal Sreality.cz. Thus, if in June 2019, according to the official traffic measurement by Netmonitor, 1.5 million real users (RU) were registered, in 2020 this number is 1.9 million RU, and in mid-2021 already 2.1 million RU. [2].

And as a result - a record rate of new apartment sales in the first few months of 2021. In the first half of 2021, twice as many units were sold in Prague as last year. But mostly smaller floor plans (1 + kk and 2 + kk), whose share in sales has been growing for a long time, are being sold.

Earlier, their share in sales of new apartments in Prague was less than 50-60%, but in recent years it is approaching 70%. In addition, the vast majority of apartments today are sold through a so-called paper transaction, i.e. before completion [3].

Moreover, wealthy people in the Czech Republic are now investing their money in apartments in order to protect their savings from inflation, which has been greatly contributed to by covidial restrictions. Rising inflation and the instability of world currencies is a serious blow to those who keep their savings in cash, so people want to own

any assets that have at least some hope of appreciation. In times when the value of money declines, people usually try to save their savings where there is certainty that they will not lose value [4]. And it's even better when it can all be evaluated.

And everyone is now well aware that unexpectedly rising inflation always favors the debtor, who can repay his debt with depreciated money. It also follows that if a person is in debtor's rights and is waiting for inflation rising, in some cases it may even be profitable for him to borrow even more [5]. Inflation could make credit cheaper. With today's mortgage index of 2.5% and year-end inflation of 7%, the real mortgage interest rate in the Czech Republic (for the fixing period) will average minus 5% [6].

Let's take a look at what is happening with inflation in the Czech Republic right now. Especially since, according to many economists, inflation in the Czech Republic will affect everyone.

For example, for the third year in a row, transport price increases have had the biggest impact on overall price growth in 2021 (year-on-year). Automobile prices rose 5.4 percent and fuel and oil prices rose 18.5 percent. For example, natural-95 gasoline sold at gas stations in July 2021 at an average price of 33.5 kroner per liter, which was the highest since December 2014.

Food and non-alcoholic beverage prices also rose. Vegetable prices rose in 2021 from 6.8% in June to 6.9% in July, of which potato prices rose 2.8%. At the same time, in July 2021, fruit prices were down 4.8% year-over-year and meat prices were down 1.4% [7].

In the food and accommodation section, prices in restaurants and cafes rose by 4.4% year on year.

In the housing section, apartment rental prices rose by 2.5%, and prices for goods and services for current maintenance and repair of apartments rose by 5.5%.

Still, it is better to focus on the figures by month. They clearly show that the difference between industries and services is not only in volume, but also in prices. While in July 2021 prices of goods were up 5% year-over-year, prices of services were up 25%. Since service prices are determined by seasonal and holiday prices, we can expect prices to rise again in the fall and winter. In addition, there was maximum bankruptcy in the service industry. And if there has been a bankruptcy, the service industry will increase prices, which also has to make up for lost income from the effects of the quarantine or pay off debts that have been financed in connection with it.

So when inflation is zero, it doesn't matter that the savings account won't charge interest. But as inflation rises, so does the "fee" for keeping money in the bank. And now Czechs have to prepare for inflation they haven't experienced in a long time: regular savings will be the fastest way to devalue money, inflation will quickly eat up those savings. And the most effective way of protection today is to buy inflation bonds, the face value or coupon of which is adjusted according to the development of the consumer price index. However, the availability of these instruments on the Czech financial market is still limited. The second major reason for the increase in demand for real estate in the Czech Republic is the reduction of the interest rate by the Czech National Bank (CNB) (Fig.1). This was also a forced measure due to the effects of the coronavirus and the decline in business activity in the country.



Figure 1. – Change of the CHNB interest rate [8].

For the most part, this is a direct reflection of the covid pandemic. The whole world is now trying to catch up with the past 2020. It is taking advantage of that situation, it wants to do everything faster, to build faster.

The third serious reason for the growth in demand for real estate in the Czech Republic - is the volume of issued mortgages. Interest in home ownership has not cooled down even during the Covid pandemic, so banks and savings banks in the Czech Republic are reporting record loans.

The ČSOB Group estimates that banks and building societies lent a lot of money for housing in 2020. The volume of mortgage loans granted last year reached 250 billion crowns, which was the highest figure in the history of the Czech Republic. The volume of these loans increased by 38 percent compared to the same period in 2019.

The record growth is mainly due to the continued interest of Czechs in solving their own housing problem and very low mortgage interest rates, which have been practically falling since April 2020 (Fig. 3).

It should be added here that today's record 2021 loan volume will involve not only brand new mortgages, but also the refinancing of existing loans.

Indeed, there was quite a lot of interest in refinancing in 2021, because interest rates bottomed out back in 2020, and mortgages could be made at a rate just above 1.5%.

There was also great interest in longer interest rate fixings for 7 to 10 years. For example, in Česká spořitelna there have been interest rate fixings for 8, 10 or more years.

[11].



Figure 2. – The volume of issued mortgage loans
(in the graph on the left the numbers should be multiplied by 10) [10]

The current popularity of long interest rate fixings is a customer reaction to the development of the mortgage market in recent years, especially the series of tightening measures by the national bank. However, Czech banks now have to somehow counteract the sharply increased interest rate risks and have already started to shorten the periods of interest rate fixing.



Figure 3. – Mortgage interest rate index [11]

For now it is important to understand that so far all types of real estate are becoming more expensive. In the Czech capital there are no areas that can be called depressed, with unclaimed housing. Even old panel houses - analogues of "Khrushchev" are growing in price after the new buildings. But it is the latter that set the price trends.

The cost of 1 sq.m. in Prague in mid-2021:

- Prague - 1 €7 400
- Prague - 2 €5 250
- Prague - 3 €3 900
- Prague - 4 €3 800
- Prague - 5 €4 250
- Prague - 6 €4 750
- Prague - 7 €4 000
- Prague - 8 €4 400
- Prague - 9 €3 550
- Prague - 10 €3 550

Source: Deloitte [12].

Here we should emphasize that the modern world of finance, and not only in the Czech Republic, is changing rapidly and brings with it a number of new problems. For example, we know of cases where central banks applied negative interest rates and were forced to conduct quantitative easing [13]. However, unlike many other central banks, the CHNB's hands are tied in this regard because of rising inflation.

Nevertheless, Czech banks are no longer making mortgages cheaper. The main reason is the price at which banks receive money for further lending in the interbank market. And it is the price of money in the interbank market that has begun to rise rapidly since September 2021. However, this does not necessarily mean that mortgages will immediately start to become more expensive. Competition in the mortgage market in the Czech Republic is very strong, and the uncertainty associated with the crisis due to the Corona virus is still present.

At the same time, the Czech National Bank's outlined increase in interest rates will not be able to cope with this particular type of inflation, caused by rising costs rather than rising demand. But according to experts the Czech National Bank's interest rates will have to reduce demand significantly in order to compensate for the rise in production costs in producer prices, which in turn could have serious consequences for the health of the economy in the long run. Now the Covid impact on inflation, not only in the Czech Republic but around the world, is more reminiscent of the oil shock of the 1970s. It was even more expensive to produce anything in a shattered economy.

The conclusions:

1. Now we are still seeing the impact of Covid, not only in the Czech Republic, but all over the world.

2. The Czech National Bank was held hostage to the situation:

a) On the one hand, it had to loosen the parameters of monetary regulation and help the domestic economy,

b) On the other hand, it is not yet able to curb the emerging growth of inflation in the country.

3. The current pandemic situation has not affected the real estate market, which is perhaps surprising. The Czech population now perceives housing as a safe haven and protects their savings by buying real estate.

4. According to local economists, the demand for home loans in the Czech Republic will continue in the near future. You can expect even a small correction of up to 10%, but interest in home loans in the Czech Republic will still be very high.

5. The main task of all financial market regulators, not only in the Czech Republic but worldwide, is and will be to prevent the sudden bursting of the bubbles that have formed, including the real estate market. In a shattered economy it is more expensive to produce anything.

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