Annex to CBA response to EBA/CP/2021/14

Basic argumentation for classifying the Czech capital market as an advanced market under Article 325ap(3) of Regulation (EU) No 575/2013 (Capital Requirements Regulation 2 – CRR2)

Summary: The Czech Republic is classified by many international institutions as advanced or high-income economy with GDP per capita in PPS approaching 95% of EU27, meaning being above some Eurozone countries like Greece, Spain, Portugal and/or Slovakia, and approaching to Italy. Credit rating is equal or higher compared to many eurozone member states, with risk-premium charged to its debt instruments not being different compared to other advanced economies. Also, capital market fulfils basic features of advanced economies.

1) Compared to several eurozone members, the **Czech Republic has higher income measured by GDP per capita in PPS**. In 2019, Czech economy reached 93% of EU27 average, being above many Eurozone countries classified as advanced countries (source: Eurostat)
   GDP per Capita in PPS (EU=100)

GEO	TIME	2008 ↕	2009 ↕	2010 ↕	2011 ↕	2012 ↕	2013 ↕	2014 ↕	2015 ↕	2016 ↕	2017 ↕	2018 ↕	2019 ↕
European Union - 27 countries (from 2020)		100	100	100	100	100	100	100	100	100	100	100	100
European Union - 28 countries (2013-2020)		102	101	101	101	101	101	101	101	101	101	101	101
European Union - 27 countries (2007-2013)		102	102	102	101	102	102	102	101	101	101	101	101
Euro area - 19 countries (from 2015)		110	110	109	109	108	108	108	108	107	107	107	106
Euro area - 18 countries (2014)		111	110	110	109	109	108	108	108	108	107	107	106
Belgium		116	118	121	119	121	121	121	121	120	118	118	118
Bulgaria		43	44	44	46	47	46	47	48	49	50	51	53
Czechia		86	87	84	84	84	86	88	89	89	91	92	93
Denmark		127	127	131	129	129	130	129	128	128	130	129	130
Germany (until 1990 former territory of the FRG)		118	118	121	124	124	125	127	125	125	124	123	120
Estonia		70	65	66	72	75	77	79	77	78	80	82	84
Ireland		136	130	132	131	133	133	181	177	185	191	193	193
Greece		95	95	85	75	71	72	72	70	68	67	67	67
Spain		102	101	96	93	91	90	91	91	92	93	91	91
France		108	109	109	109	108	110	108	107	106	104	104	106

2) **The Czech Republic is considered a developed,** high-income, or advanced economy **according to many global institutions:**
   - i. World Bank – High Income Economy (source: https://datahelpdesk.worldbank.org/knowledgebase/articles/906519)
   - ii. International Monetary Fund – Advanced Economy (source: https://www.imf.org/external/pubs/ft/weo/2021/01/weodata/groups.htm)

3) **Credit rating of the Czech Republic** is on a level equal or higher than that of a number of eurozone member countries: Moody's – Czechia: Aa3; Belgium: Aa3; Estonia: A1; Ireland: A2; Slovenia: A3; Spain: Ba1; Italy: Baa3; Greece: Ba3 (source: https://www.moodys.com/researchandratings/market-segment/sovereign-supranational/sovereign/)

4) **Functional advanced capital market** fulfils basic features of advanced economies:

   a. The premium charged for investment into Czech debt instrument is not significantly different from the premium charged for investment into other comparable Eurozone countries debt instruments (with the advantage as being accepted as collateral by ECB, e.g. Slovakia) as illustrated on a set of bank covered bonds:
      - i. KOMERC 0.01 01/20/26 Corp -> ispread: 9bp
      - ii. SLOSPO 0 ⅛ 06/12/26 Corp -> ispread: 10bp
      - iii. PKBSK 0.01 10/01/26 Corp -> ispread: 11/12bp

b. A relatively advanced character of the Czech capital market is documented also by the fact that the level of 5Y CDS spreads on CZ government bonds (the average since 2016 is 43) is lower than that in several euro area economies (46 for Slovakia, above 60 for Estonia, Latvia, Lithuania and Spain, 79 for Slovenia, above 100 for Portugal, Italy, Cyprus and Greece).

c. **The Prague Stock Exchange (PSE) is long time well-functioning, highly competitive market,** which is illustrated by:
   i. Low relative market volatility in comparison to other EU markets as a key measure of equity risk: The flagship PX equity index exhibited 29%/31%/27% annualized volatility over one, two and three years. This is almost exactly the same as Germany's DAX, ca. 7-8% less volatile than Austria's ATX and 15-19% less volatile than Greece's ASE.
   ii. Market risk, i.e. volatility, is driven by overall macroeconomic situation, equity trading functioning, regulation and level of disclosure.
   iii. The Prague Stock Exchange is a subsidiary of Wiener Boerse and uses the same proven trading platform and its trading hours are in line with EU standards. Its disclosure requirements fully meet EU standards (quarterly reporting etc.). There is no language barrier (reporting in Czech and English) nor limit on foreign ownership.
   iv. Czech shareholding reporting requirements and protection of minority shareholder rights (mandatory takeover offers, squeeze-out procedures) are in-line with established markets. This is one of key differentiators between emerging/frontier and developed markets.
   v. Size of the market tends to be a much less important driver of risk if trading activity/liquidity is sufficient. We believe that liquidity is best measured as turnover volume relative to free float mcap. This ratio reached 22% in the Czech Republic in 2020, i.e. one fifth of all available stakes changed hands.

5) **The Czech banking sector is strong and profitable**

Figures from the EBA Risk Dashboard for the last quarter of 2020 prove that the Czech banking sector is strong, healthy and profitable. The respective ratios for the Czech banking sector show significantly better values than ratios for EU 27/EEA.

	Czech Republic	**EU 27/EEA**
Tier 1 capital ratio	23.6	17.2
CET 1 ratio	22.4	15.9
NPL ratio	1.5	2.6
Coverage ratio	54.7	44.9
RoE	7.4	2.0
Cost to income ratio	51.1	65.1

(source: https://www.eba.europa.eu/eba-points-rising-share-loans-show-significant-increase-credit-risk-stage-2-loans)