

2021-09-28

## DECISION



FI Ref. 21-20492

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### Countercyclical buffer rate

#### **Finansinspektionen's decision (to be announced 29 September 2021 at 8:00 AM)**

Finansinspektionen decides to raise the countercyclical buffer rate to 1 per cent. The new buffer rate will be applied as of 29 September 2022. Until then, the buffer rate will continue to be 0 per cent.

#### **The case**

Finansinspektionen (FI), in accordance with Chapter 7, section 1 of the Capital Buffers Act (2014:966), shall calculate a countercyclical buffer guide each quarter and change or determine the countercyclical buffer rate when necessary.<sup>1</sup>

Pursuant to authorisation from the government, FI announced previous decisions regarding changes to the buffer rate through the authority's regulations regarding the countercyclical buffer rate. On 24 June, FI proposed that Regulations (FFFS 2014:33) regarding the countercyclical buffer rate be repealed and replaced with individual decisions that are published on the authority's website. The regulations were appealed on 28 September in accordance with a decision by FI's Board of Directors. The current decision to raise the buffer rate is the first decision made under the new procedure.

The purpose of the countercyclical capital buffer is to maintain and strengthen the banks' resilience to shocks. It is possible to lower the buffer requirement or completely remove it in the event of a financial crisis or when circumstances otherwise justify a decrease. This frees up capital, which gives the banks the possibility of maintaining large parts of their lending activities, thus alleviating a downturn in the economy.<sup>2</sup>

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<sup>1</sup> The countercyclical buffer rate is changed in multiples of 0.25 percentage points. There is no maximum buffer rate, but automatic reciprocity applies only up to 2.5 per cent.

<sup>2</sup> See the memorandum *Tillämpning av den kontracykliska kapitalbufferten* for a more detailed description of the tool's purpose and how FI applies it. An English translation is available at [www.fi.se](http://www.fi.se).

A countercyclical buffer rate of 0 per cent has been applied since 16 March 2020. FI decided then to lower the countercyclical buffer rate from 2.5 to 0 per cent, and the new rate went into force immediately.

Prior to this decision, FI consulted the Riksbank and the Swedish National Debt Office. Furthermore, the Swedish Bankers' Association, the Swedish Savings Banks Association, the Association of Swedish Finance Houses, the Swedish Investment Fund Association, and Kommuninvest i Sverige AB were given the opportunity to comment on a potential increase in Q3 2021 to the countercyclical buffer rate.

## **Finansinspektionen's assessment**

### ***Reasons for the current buffer rate***

On 16 March 2020, FI chose to lower the buffer rate due to the exceptional uncertainty surrounding the economic development as a result of the coronavirus pandemic. By lowering the rate, FI enabled the banks to better absorb credit losses and meet an elevated demand for credit, thus counteracting a credit crunch in the economy. Lowering the buffer freed up capital and increased banks' margins to the capital requirements so they could maintain lending, thereby mitigating a downturn in the economy. The fact that the banks entered the pandemic with robust capital buffers has, combined with various support measures, helped maintain the supply of credit.

### ***State of the economy***

The spread of COVID-19 created an exceptional degree of uncertainty surrounding the economic development in Sweden and other countries. This development also resulted in significant problems in the financial system, and extensive support measures from authorities, central banks and governments around the world were required to stabilise the situation. After the initial sharp fall in GDP, the real economy has rapidly recovered, although unemployment remains high. Despite the recovery, FI has delayed raising the countercyclical capital buffer due to the uncertainty associated with both systemic risks and the duration of the economic recovery. Because of this uncertainty, it was important for the banks to have capital to maintain their lending activities and support the real economy.

As more and more people are becoming vaccinated, the economic uncertainty has decreased. Confidence indicators returned to high levels a while ago, and forecasts have been gradually revised upward (see Diagram 1 in Appendix 1). There are many indications that the recovery will continue during the fall. The feared increase in credit losses in the banking system has thus not materialised. However, just because the systemic risks have not materialised does not mean that they have decreased. The sharp upswing in asset and housing prices combined with the rising growth of household debt indicates rather that the cyclical risks are rising. The fact that risk premiums on financial markets are

now at lower levels than before the crisis also shows that investors are demonstrating high risk-taking (see Diagram 12 in Appendix 1).

### ***Development on the credit market***

The development on the credit market differs for households and non-financial firms. As housing prices have continued to rise rapidly, households have taken larger mortgages. Accordingly, the growth in household debt has steadily increased in both 2020 and 2021. In Q2 2021, total household debt increased by an annual rate of 6.1 per cent. This is a significantly faster rate than the rate of growth of household income in recent quarters. Households' total debt in relation to disposable income have increased sharply since the spring of 2020 and amounted to 196.3 per cent in Q2 2021 (see Diagram 11 of Appendix 1).

Non-financial firms have experienced a different trend. Non-financial firms' new bank loans are smaller, and the total corporate debt is still increasing at a significantly slower rate now than before. In Q2 2021, the debt of non-financial firms grew at an annual rate of 1.8 per cent. This is 4.1 percentage points lower than Q2 2020. However, there are large differences between sectors. Many of the sectors that have been hit harder by the pandemic have reduced their debt. The commercial real estate sector, though, which already before the crisis was contributing to higher systemic risks, has steadily increased its debt burden during the crisis.

The development for non-financial firms depends on several factors. In Q2 and Q3 2020, non-financial firms raised significantly less financing via the capital markets, which was offset to some extent by the increase in bank lending through credit facilities. Capital market financing is still growing at a slower pace than before the crisis, even if there was a slight acceleration in Q2 2021. At the same time, the growth rate of loans from Swedish monetary financial institutions (MFIs) to corporates has gradually slowed, and lending decreased by 0.5 per cent at an annual rate in Q2 2021. FI makes the assessment that this decrease is primarily due to a drop in demand rather than shrinking credit supply.

Overall, total debt increased by 4 per cent at an annual rate in Q2 2021. This is 1.7 percentage points lower than in Q2 2020 and is being driven by the slower growth in the debt of non-financial firms. Total debt now amounts to 171.5 per cent of GDP (debt-to-GDP ratio), which is 1.9 percentage points higher than in Q2 2020. However, the debt-to-GDP ratio decreased by 3.4 percentage points compared to Q1 2021. The credit-to-GDP gap calculated in accordance with the Basel Committee's standardised approach decreased compared to Q1 2021. The countercyclical buffer guide also decreased and is calculated to be 0.22 per cent.

### ***Banks' capital and profitability***

The aim of lowering the countercyclical capital buffer in March 2020 was to free up capital so banks could maintain the supply of credit. This capital has not been used to the extent that it would have, given a more severe outcome.

This is in part because credit losses have been lower than expected. The amount of own funds held by the banks right now is significantly larger than what is required under the capital requirement. Diagram 10 in Appendix 1 shows the difference between the common equity Tier 1 capital and the common equity Tier 1 capital requirement at the three major banks and the Category 2 banks. In addition, profitability in the banking sector continues to be good in general. Overall, this means that the banks have the capacity to meet a higher countercyclical capital buffer requirement without the increase having a negative impact on the credit supply or economic development.

### ***Overall assessment***

The countercyclical capital buffer was lowered during the pandemic to ensure that the banks would be able to maintain the supply of credit even if they experienced large credit losses. These losses have not been realised, and the sharp upswing in asset and housing prices combined with the rising household debt indicates rather that the cyclical risks are rising. FI makes the assessment that the capital freed up by the lower capital buffer in the spring of 2020 needs to remain in the banks to manage future crises. FI therefore judges it suitable to start raising the countercyclical capital buffer. The economic recovery is showing sufficient strength and the banks' capital and profitability are sufficiently strong for an increase not to have a significant negative impact on the recovery. The first step will be to raise the buffer rate to 1 per cent. Due to the implementation period of twelve months, the new buffer rate will enter into force in Q3 2022.

As the economic recovery continues, demand for loans from non-financial firms is expected to increase. It is important that the banks are able to meet this demand. FI will therefore monitor the developments on the credit market carefully in future assessments of the countercyclical buffer rate. If the economic recovery continues, credit losses are low, and the banks have sufficient capacity for meeting credit demand, FI's intention is to decide on additional increases to the countercyclical buffer rate up to its neutral level. Given these conditions, FI considers it to be reasonable to gradually decide on additional increases to the buffer rate to bring it up to 2 per cent by the end of 2022.<sup>3</sup> If the risks associated with the asset markets and indebtedness remain, FI may then raise the buffer rate even higher.

### ***Impact of the increase on lenders and borrowers***

Raising the countercyclical buffer rate to 1 per cent means that the banks must hold more capital. The banks already hold enough capital today to cover the higher capital requirement resulting from the increase (see Table 1).

When banks must hold more capital, it normally increases their costs since the yield requirement is higher on equity than it is on debt financing. The banks can compensate for this cost increase by charging borrowers higher interest

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<sup>3</sup> An implementation period of twelve months means that a 2 per cent buffer rate can enter into force first at the end of 2023.

rates, but that need not always be the outcome. Better-capitalised banks tend to pay lower lending rates on the capital markets than less capitalised banks. This can compensate for some of the cost increase that comes from a higher capital requirement. The banks may also need to bear part of the cost since they are present on a competitive market. Overall, raising the countercyclical capital buffer is judged to have a small effect on lending rates. FI's calculations indicate that a one percentage point increase in the countercyclical capital buffer could result in an increase in lending rates to households and corporates of 0.02–0.05 percentage points.<sup>4</sup> Given the current situation, raising the countercyclical buffer rate is not judged to cause as large increases in the interest rate as previous buffer rate increases since the banks are judged to be able to meet the higher requirement without needing to gather additional equity.

Table 1. Impact on capital requirements of raising the countercyclical buffer rate to 1 per cent

SEK million

	Current CET 1 capital	Current CET 1 capital requirement	CET 1 capital requirement after CCyB increase
SEB	159,423	94,521	98,415
SHB	152,867	96,463	100,815
Swedbank	127,551	84,367	89,638
SBAB	18,039	10,945	12,298
Länsförsäkringar	16,879	8,941	10,075
SEK	19,710	8,283	8,847
Landshypotek	5,075	2,893	3,254
Sparbanken Skåne	7,146	2,745	3,082
Skandiabanken	4,402	2,060	2,290
Nordnet	2,691	1,298	1,407
Avanza	2,647	888	994
Kommuninvest	9,329	3,638	3,638

Source: FI

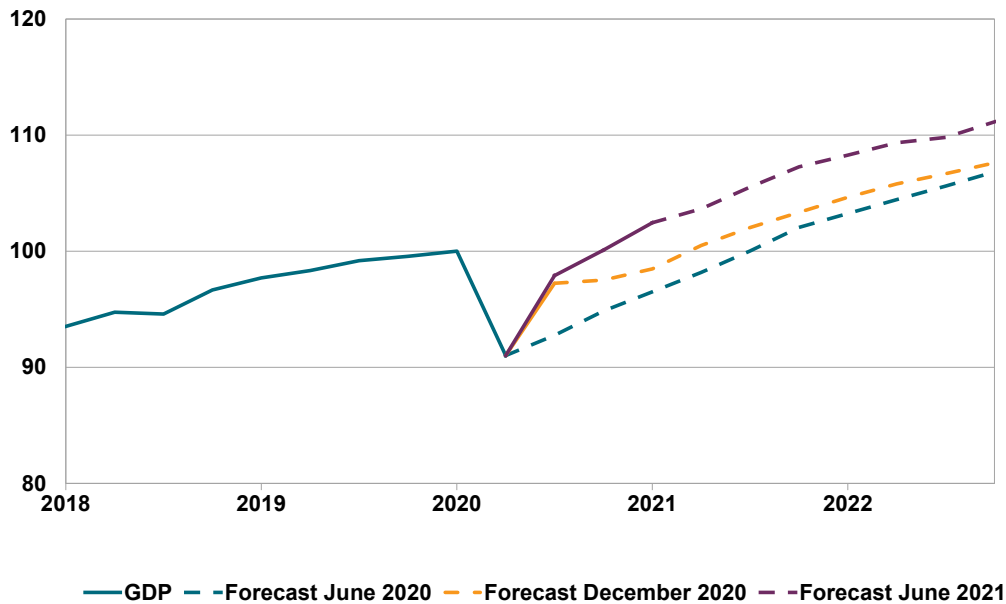
Note: Refers to CET 1 capital at the consolidated level. Data as per 30 June 2021.

<sup>4</sup> See, for example, BCBS (2019). The costs and benefits of bank capital – a review of the literature. BCBS Working Paper 37. The estimated effect in Sweden is lower than the interval in BCBS (2019) since the risk density in the Swedish banking sector in general is lower than in other EU countries.

## Appendix 1: Indicators

### 1 GDP and the National Institute of Economic Research's economic forecasts

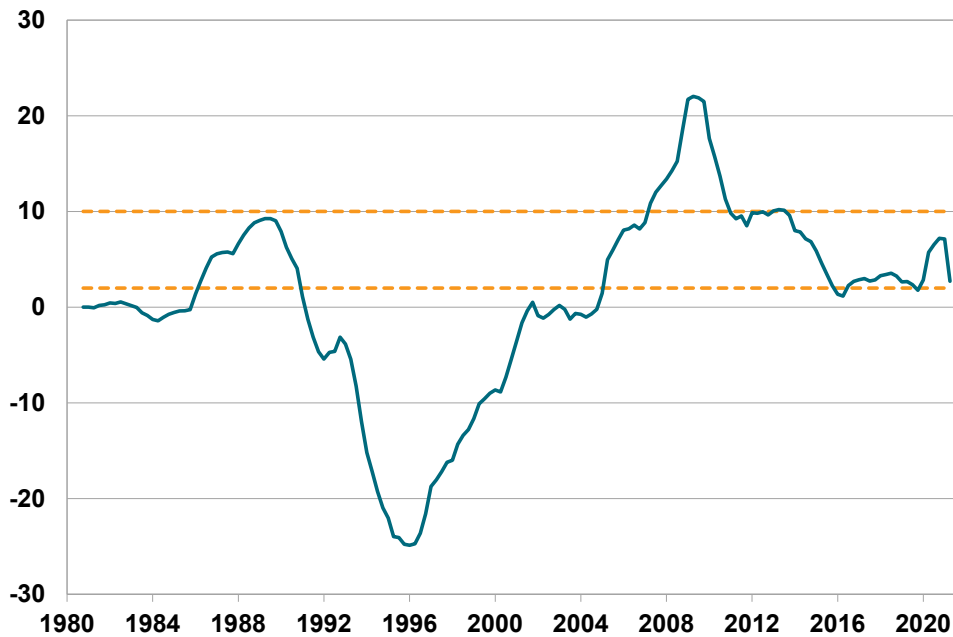
Index Q2 2020 = 100



Note: GDP per quarter, indexed. The dashed lines refer to the National Institute of Economic Research's forecasts in June 2020, December 2020 and June 2021 for GDP in current prices, seasonally adjusted.  
Source: NIER.

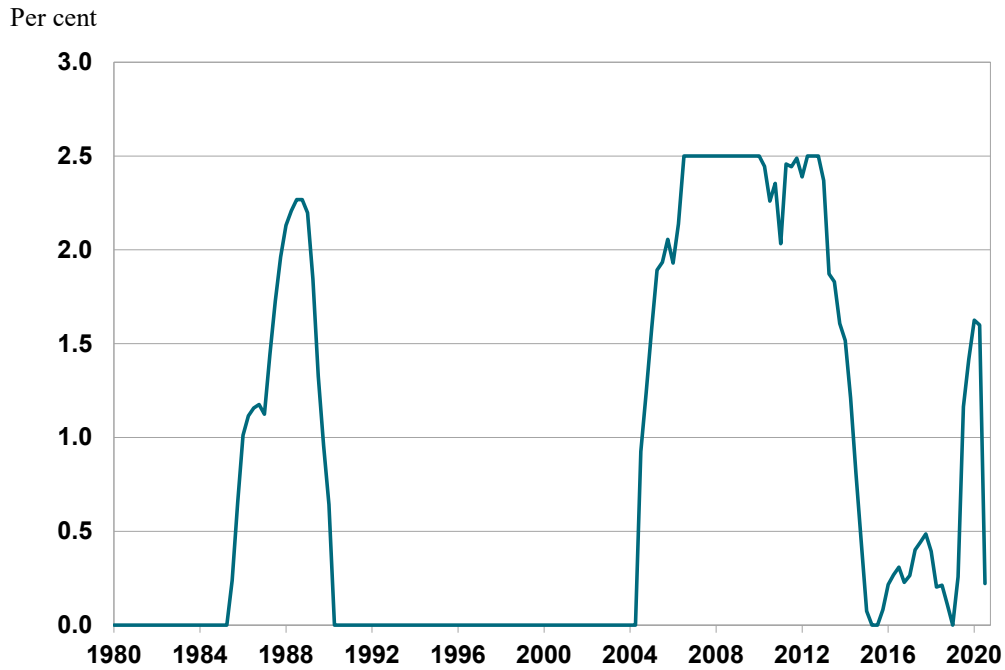
### 2 Credit-to-GDP gap according to the standardised approach

Deviation from trend in percentage points



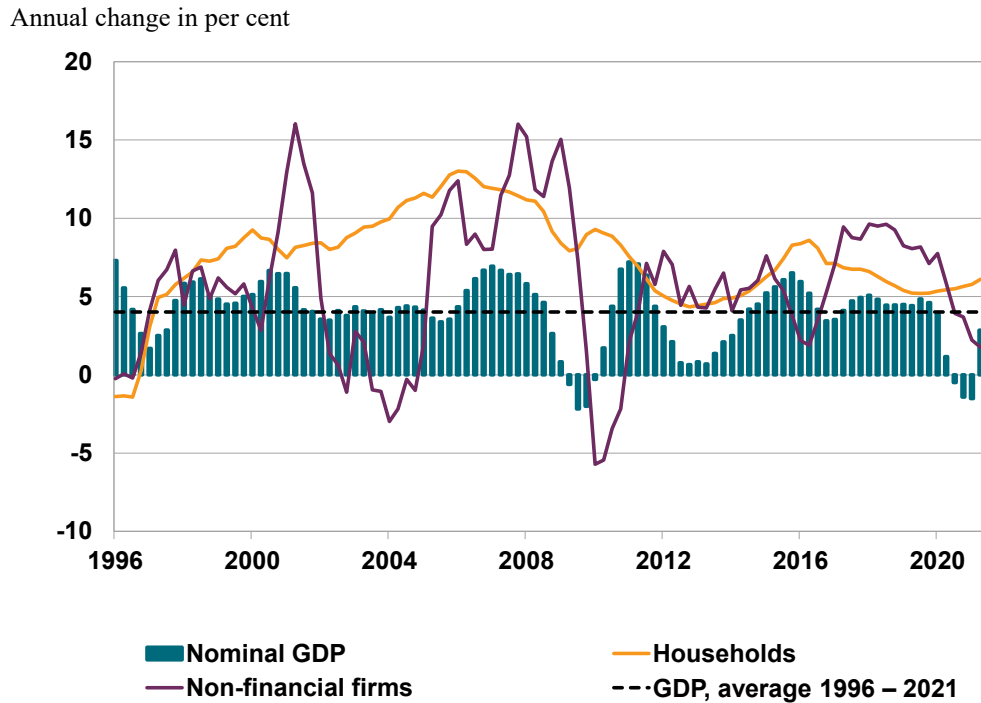
Note: The dashed lines show the thresholds (2 and 10 per cent, respectively) that according to the standardised approach are to be used to transform the credit-to-GDP gap into a buffer guide.  
Sources: FI and Statistics Sweden.

### 3 Buffer rate according to the standardised approach



Sources: FI and Statistics Sweden.

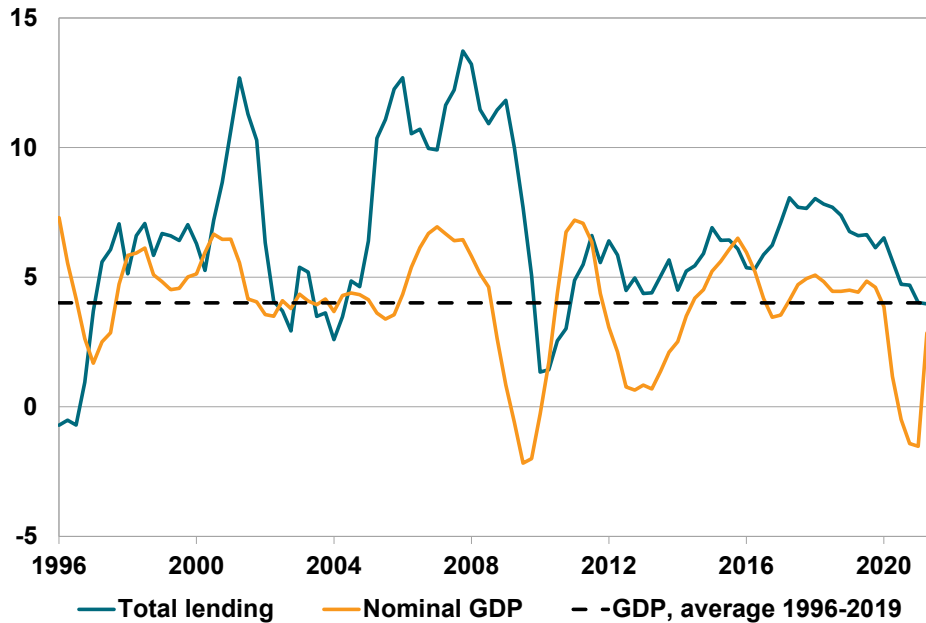
### 4 Lending to households and firms and nominal GDP



Source: Statistics Sweden.

### 5 Total lending and nominal GDP

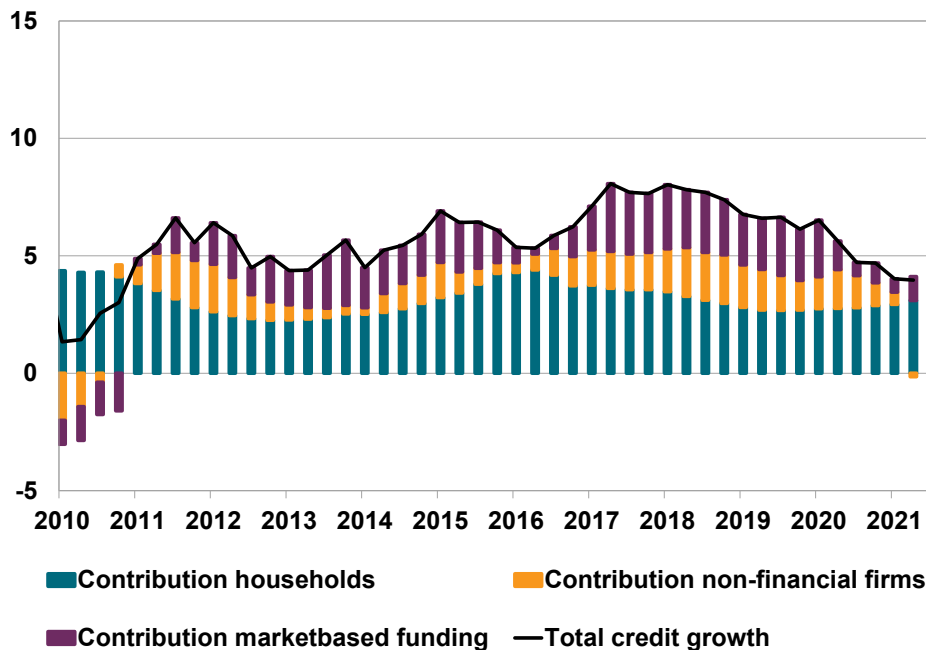
Annual change in per cent



Source: Statistics Sweden.

### 6 Contribution to total lending growth

Annual change in per cent



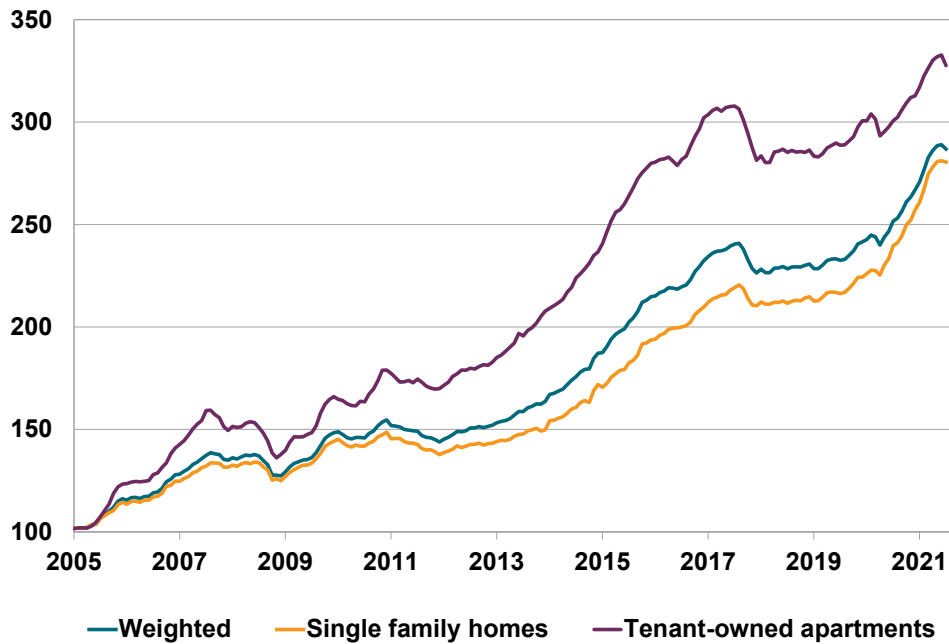
Note: Refers to total lending to households and corporates and their contribution to the annual rate of growth in per cent. Contribution of non-financial firms refers to MFI's lending to non-financial firms.

Sources: FI and Statistics Sweden.



### 7 House prices in Sweden

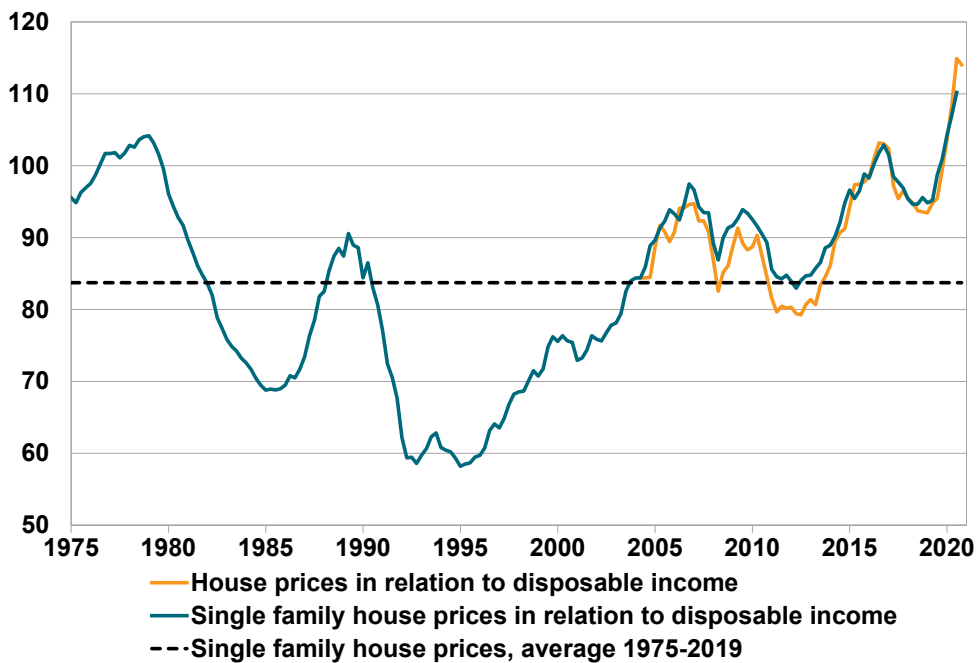
Index 100 = January 2005



Source: Valueguard.

### 8 House prices in relation to disposable income

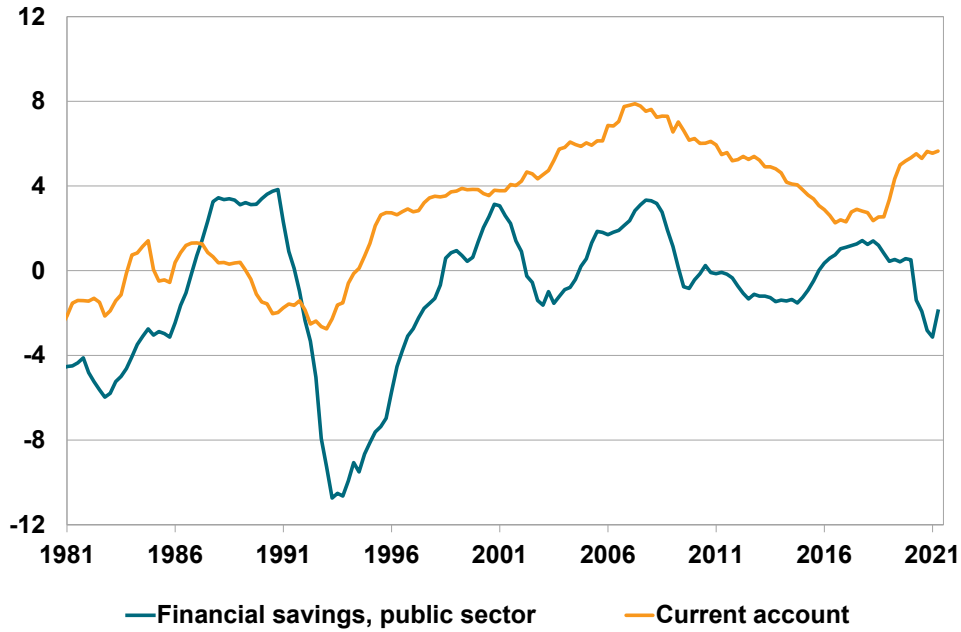
Index 100 = 1980



Sources: Statistics Sweden and Valueguard.

### 9 Current account and financial savings in the public sector

Per cent of GDP

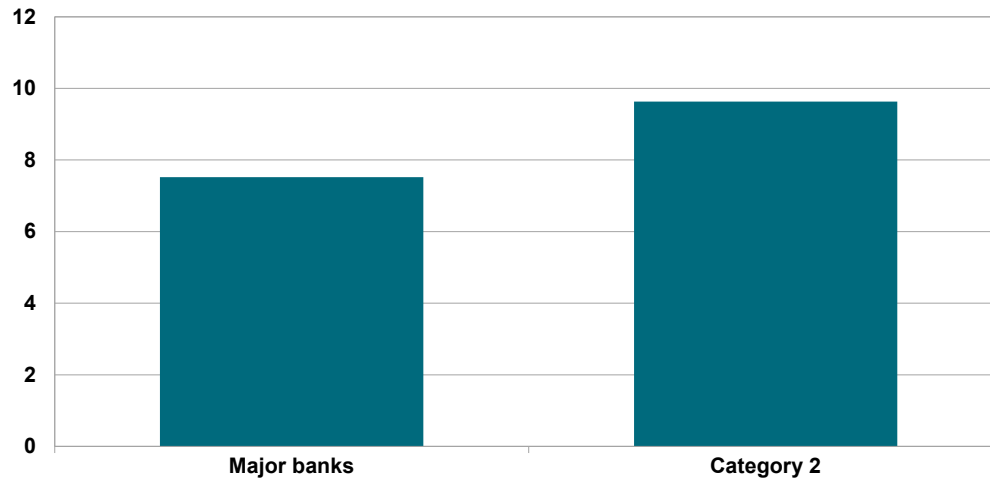


Note: The current account is estimated using the national accounts.

Source: Statistics Sweden.

### 10 Difference between the banks' CET 1 capital and CET 1 capital requirement, aggregated

Per cent

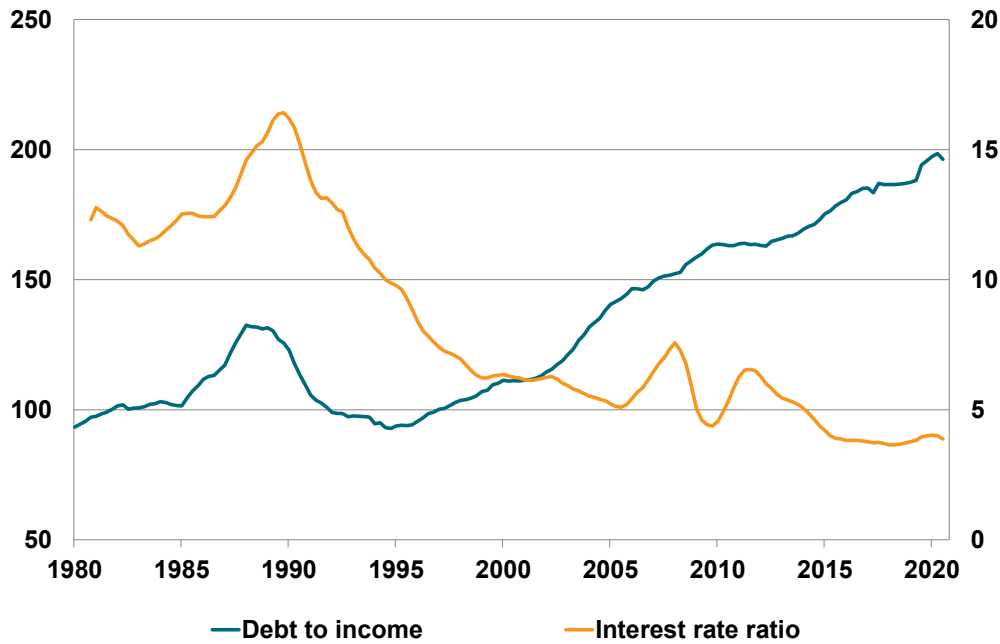


Note: Refers to the difference between CET1 capital and CET 1 capital requirement in relation to the risk-weighted assets at the aggregate level. The figures have a reference date of 30 June 2021.

Source: FI.

### 11 Household debt and interest rate payments in relation to income

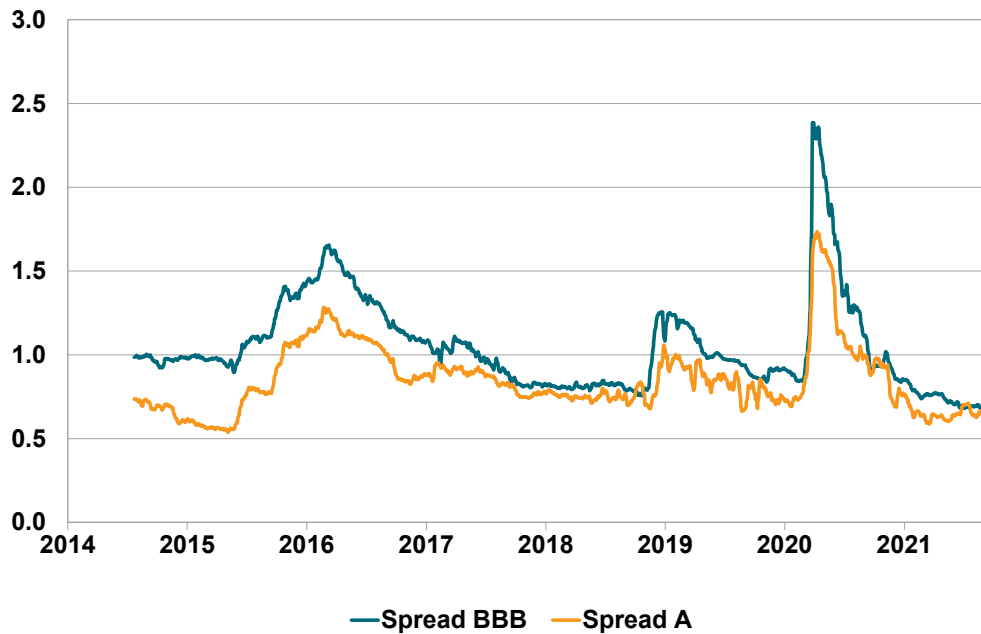
Per cent of disposable income



Source: Statistics Sweden.

### 12 Swedish risk premiums

Percentage points

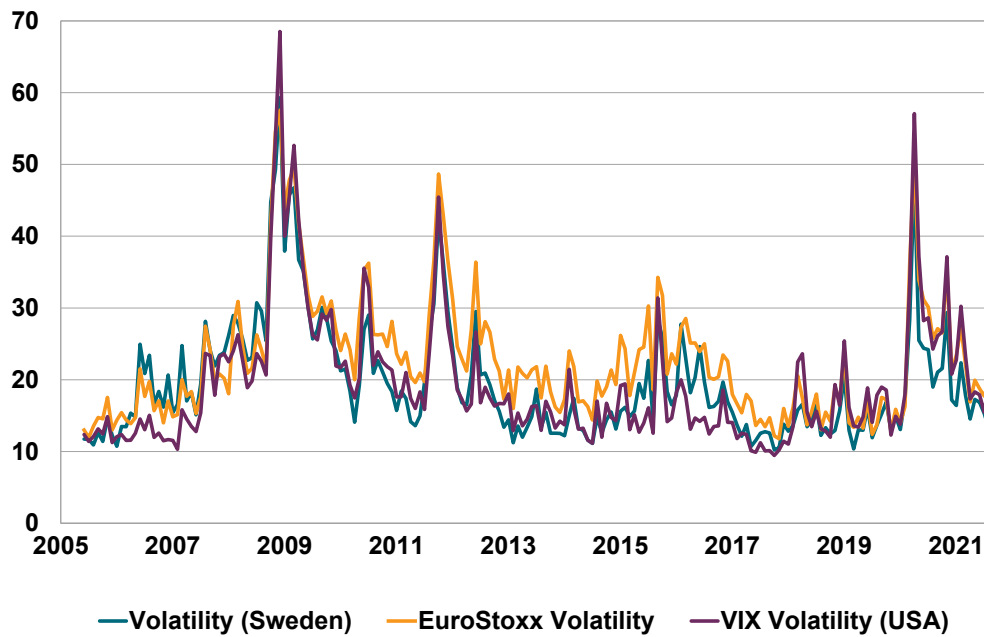


Note: Differences in interest rates for corporate bonds with different credit ratings in Sweden. The difference is calculated between the return for an index of Swedish corporate bonds (Thomson Reuters Sweden corporate benchmark) with a maturity of five years and a Swedish swap rate. The diagram shows five trading days' moving average.

Source: Refinitiv Datastream.

### 13 Volatility index

Standard deviation



Note: Implicit volatility calculated from index option prices. For Volatility (Sweden), SIX Volatility is used until September 2018. Starting in October 2018, an average of OS30C implicit volatility estimated for calls and puts is used instead.

Source: Refinitiv Datastream.