12/09/2016

D E C I S I O N

FI Ref. 16-10564

Finansinspektionen
Box 7821
SE-103 97 Stockholm
[Brunnsgatan 3]
Tel +46 8 408 980 00
Fax +46 8 24 13 35
finansinspektionen@fi.se
www.fi.se

Decision regarding the countercyclical buffer rate

Finansinspektionen (the Swedish Financial Supervisory Authority) has decided not to amend Finansinspektionen's Regulations (FFFS 2016:15) regarding the countercyclical buffer rate.

Finansinspektionen's assessment

Lending in the Swedish economy in general is continuing to develop as it has previously. Lending to households continues to grow faster than both nominal GDP and disposable income. This growth in debt is closely linked to the housing market, which has long been characterised by rising prices and high activity. However, the most recent developments on the housing market indicate that there has been a slight slow-down. This slow-down could be in part the result of the amortisation requirement, which has now gone into effect, even if it is currently too early to measure its effects.

Corporate lending from monetary financial institutions (MFI) has demonstrated a normal level of growth at the same time as firms have significantly reduced the amount of funding they raise from the market. Finansinspektionen currently does not see any signs of excessive lending in the business sector.

The forecast for total debt, i.e. for both corporates and households, is that growth will be slower in the future compared to the previous forecast, but still at a level throughout the entire forecast period that is judged to be too high to be sustainable in the long run. This is primarily because the rate at which corporate debt will increase is expected to rise. Other indicators that Finansinspektionen takes into consideration are showing that the risks associated with the growth in debt have not changed appreciably since Finansinspektionen's decision in June 2016 to leave the countercyclical buffer unchanged. The most recent countercyclical buffer rate was set at 2 per cent and will apply as of 19 March 2017. Given this background, Finansinspektionen sees no reason to change the buffer rate now.

The matter

Finansinspektionen, in accordance with Chapter 7, section 1 of the Capital Buffers Act (2014:966), shall set a countercyclical buffer guide[1] and a countercyclical buffer rate each quarter.

The countercyclical capital buffer for Sweden was activated on 8 September 2014. The buffer rate was set at 1 per cent and went into effect on 13 September 2015.[2] On 22 June 2015, Finansinspektionen decided to raise the countercyclical buffer rate to 1.5 per cent. This rate has been applied as of 27 June 2016.[3] On 14 March 2016, Finansinspektionen announced a new decision to raise the countercyclical buffer to 2 per cent, which will apply as of 19 March 2017.[4]

Reasoning and considerations

The purpose of the countercyclical capital buffer is to strengthen the resilience of banks and ensure that the banking system as a whole has sufficient capital to sustain the flow of credit to households and corporations in situations when shocks to the financial system could cause a credit crunch. The countercyclical capital buffer is a time-varying capital requirement. This means that the buffer is activated when there is a risk that financial imbalances, and hence systemic risks, will increase. In an ensuing recession or in the event of major losses for the banks, the buffer requirement may be reduced to counteract tighter lending and thereby alleviate the economic downturn.

Finansinspektionen sets the countercyclical buffer rate for Sweden by means of a qualitative assessment that takes quantitative factors into consideration. The single most important factor is the development of debt among households and firms. Finansinspektionen therefore monitors debt carefully and in particular how it develops in relation to the gross domestic product (GDP) and the disposable income of households. *The buffer guide* is an indicator used to determine the level of the buffer rate.

[1] The buffer guide constitutes the point of departure for Finansinspektionen's assessment of the size of the countercyclical buffer rate.

[2] FI (2014), *Regulations regarding the countercyclical buffer rate*. Published on www.fi.se on 10 September 2014, FI Ref. 14-7010.

[3] FI (2015), *Amendment to regulations regarding the countercyclical buffer rate.* Published on www.fi.se on 23 June 2015, FI Ref. 15-7062.

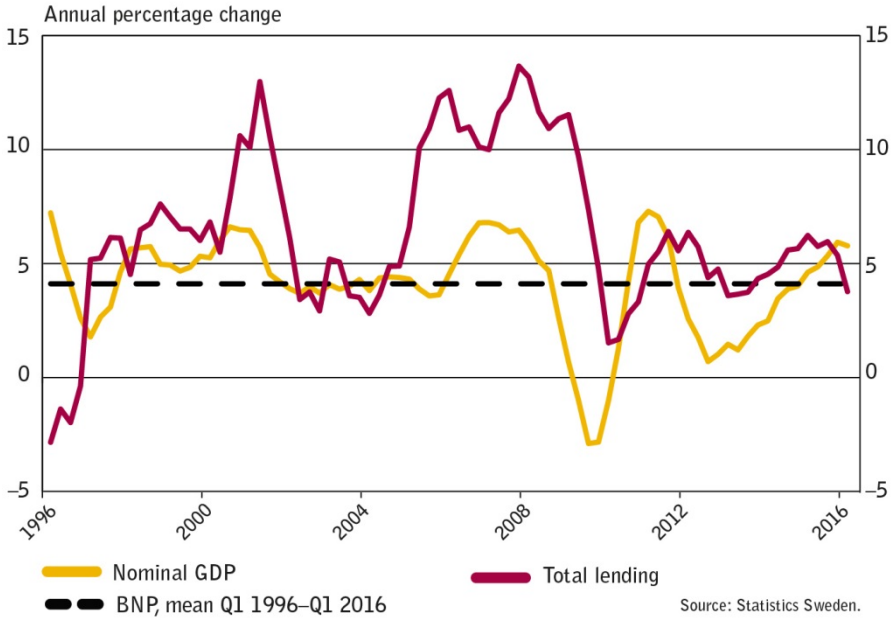
[4] FI (2016), *Amendment to regulations regarding the countercyclical buffer rate.* Published on www.fi.se on 15 March 2016, FI Ref. 16-742.

Reduced growth in total lending

The basis for Finansinspektionen's assessment of the cyclical systemic risks consists of the growth in lending to the non-financial sector[5] and how this growth develops in relation to GDP.

Lending to households and corporates in Sweden has increased at a faster pace than nominal GDP over the past five years (Diagram 1). However, since 2015, this difference has gradually decreased and in the past two quarters debts have increased at a lower rate than GDP. During Q1 2016, total lending increased 3.8 per cent at an annual rate, which is clearly slower than the previous quarter, during which the rate of growth was 5.4 per cent. Nominal GDP growth in Q1 2016 was 5.8 per cent, which was in line with GDP growth the previous quarter. This means that lending in relation to GDP continues to decrease and is currently at just over 144 per cent.

1 Total lending and nominal GDP



In order to understand what is driving this growth in total lending, it is important to look more closely at how lending to households and corporates has developed.

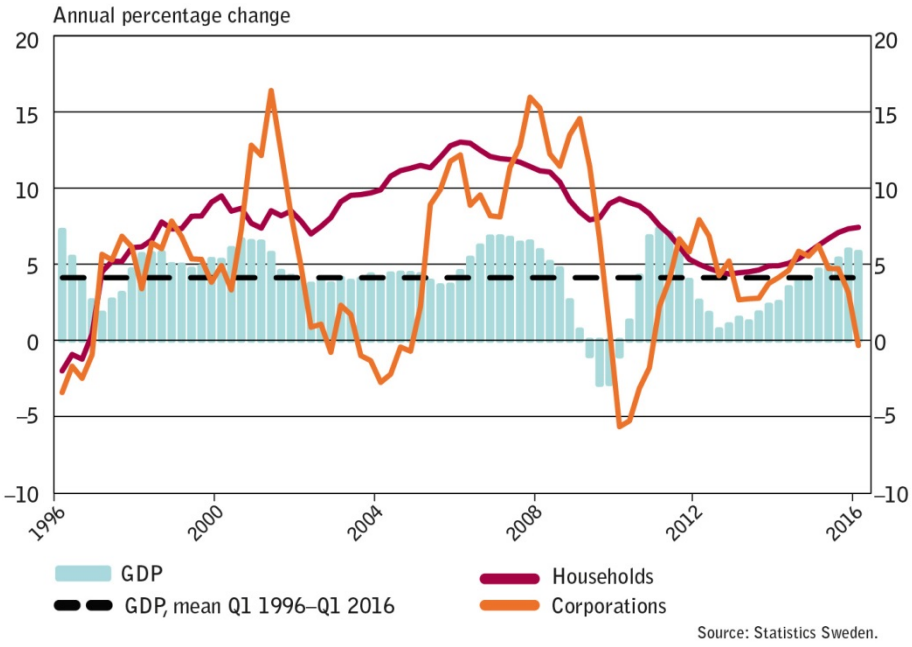
Continued strong growth in household lending

Lending to households has been increasing at a much higher rate than the growth of the nominal GDP since the end of the 1990s (Diagram 2). This trend continued into Q1 2016 when the annual growth rate rose slightly to 7.4 per cent. Monthly data from Statistics Sweden shows that the rate of growth continued to increase during the spring and then slowed slightly again during

[5] For Sweden, the measure of total credit to the private sector covers all corporate and household lending issued through monetary financial institutions (MFI) and the total market financing of firms. The market funding of firms has been defined as the value of all outstanding corporate bonds and certificates traded on the fixed-income market.

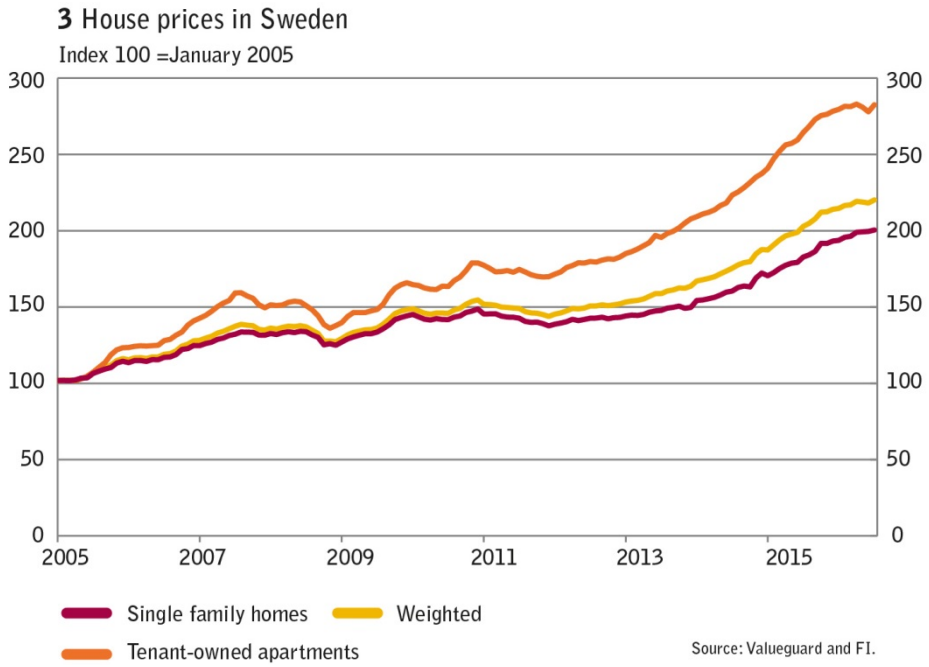
the summer. In July, growth was 7.6 per cent, a decrease of 0.2 percentage points compared to May.[6] Looking exclusively at household mortgages, the annual growth rate was 8.4 per cent in July.

2 Lending to households and corporations, and nominal GDP



Household debts consist primarily of mortgages. What happens to house prices is therefore important since a sharp increase in house prices can also lead to a sharp increase in household debt. House prices have increased rapidly in recent years (Diagram 3). At the end of 2015, the rate at which house prices were rising showed some signs of slowing, which in part could be due to the amortisation requirement that entered into force on 1 June 2016. According to Valueguard's price statistics, the annual growth rate for tenant-owned apartments was 6.9 per cent in July 2016. For single-family homes, the increase was 9.5 per cent. This can be compared to the annual growth rates in April, which were at 10.4 and 12.1 per cent, respectively. But it is still too early to evaluate the effects of the amortisation requirement, particularly because activity on the housing market slows considerably during the summer.

[6] SCB (2016), *Finansmarkandsstatistik*, July 2016.



Even if the rate of growth has declined slightly, the high level of house prices continues to contribute to the increase in household debt. House prices also continue to be high in relation to household income, despite the relatively strong growth in disposable income.

Even though household debt is increasing and households are borrowing more in relation to their income, Finansinspektionen's stress tests show that households are demonstrating strong resilience to higher interest rates, the loss of income and falling house prices.[7] Swedish households in general have sufficient margins for making their payments even given significant disruptions in the economy.

Significantly lower growth in lending to corporates

There are currently no clear signs that lending to corporates is too high, even though Sweden is currently experiencing an economic boom. On the contrary, lending to corporates decreased by 0.3 per cent on an annual basis during Q1 2016 (Diagram 2). Market funding, i.e. the market for raising funds through bonds and certificates, has been the primary driver behind this decline. Market funding for corporates decreased significantly during Q1 2016. This decrease amounts to 7.6 per cent on an annual basis, which can be compared to Q4 2015 when it increased by 4.4 per cent. Lending from MFI to non-financial firms increased, however, by 2.6 per cent on an annual basis in Q1 2016, which is slightly slower than in the previous quarter.

[7] FI (2016), *The Swedish Mortgage Market 2015*. Published on www.fi.se on 14 April 2016, FI ref. 16-3183.

Small changes in lending to corporates from MFI

As a complement to its analysis of outcomes, Finansinspektionen also uses forecasting models for households' and firms' debts.[8] The forecasts show how the debts could develop over time and help Finansinspektionen plan its work with the countercyclical capital buffer.

The household model contains debt, property prices, consumer confidence (economic activity) and a mortgage rate. The corporate model contains debt, a business tendency indicator (economic activity) from the National Institute of Economic Research (NIER) and a corporate borrowing rate.[9] The models' forecasts for individual variables depend on how the other variables develop and on a long-term normal state.[10] The normal state comes from a combination of judgements and information in data. The normal state for debts in this case assumes that they shall grow in line with nominal GDP.[11] The models are assessed on the basis of their forecasting performance and how well the estimated correlations between the variables coincide with economic theory. In the analysis that is presented here, the models are based on outcomes up to and including Q1 2016. This means that the debt series cover the same period as the previous forecast. This time GDP outcome is used up until Q1 2016, which means one outcome more than in the previous forecast. The forecasts for debts are conditional on the National Institute of Economic Research's (NIER) macroeconomic assessment in June 2016.[12]

Compared to the forecasts presented in Finansinspektionen's decision regarding the countercyclical buffer rate in June 2016, the GDP outcomes have been close to the forecast, and NIER has presented a similar forecast for GDP growth in 2016 and 2017 in its June report as it did in its March report (Diagram 4).

[8] For a description of the approach and the household model, see FI (2015), *A model for household debt*, FI Analysis no. 4. Published on www.fi.se on 1 December 2015.

[9] Finansinspektionen also uses a model that joins together GDP, salaries and the repo rate with the variables included in the two models, see *ibid*. for more information.

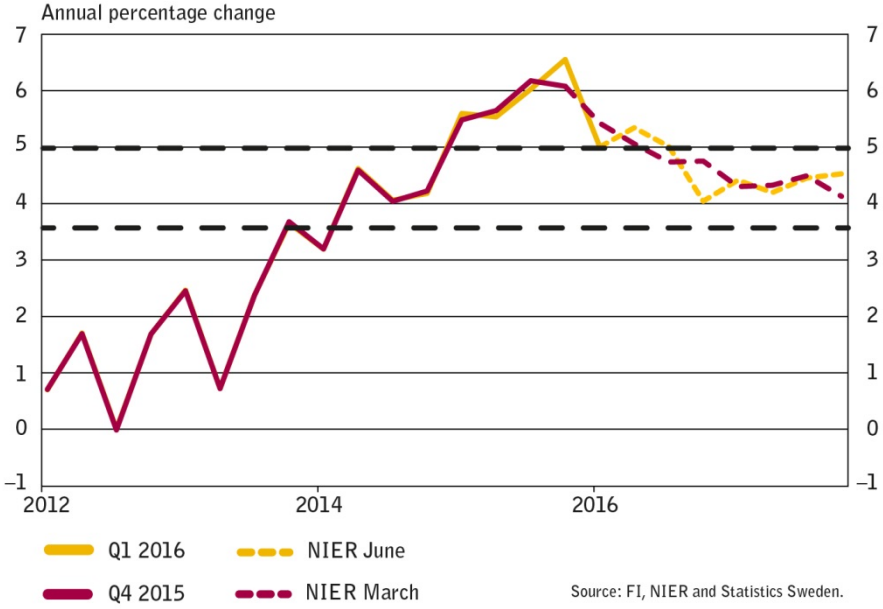
[10] The normal level is the growth that the model's variables will demonstrate in the long run.

[11] The model estimates a 95-per cent probability interval for the normal state of annual GDP growth to be between 3.6 per cent and 5.0 per cent.

[12] National Institute of Economic Research, *Konjunkturläget*, June 2016.

4 Nominal GDP

Annual percentage change



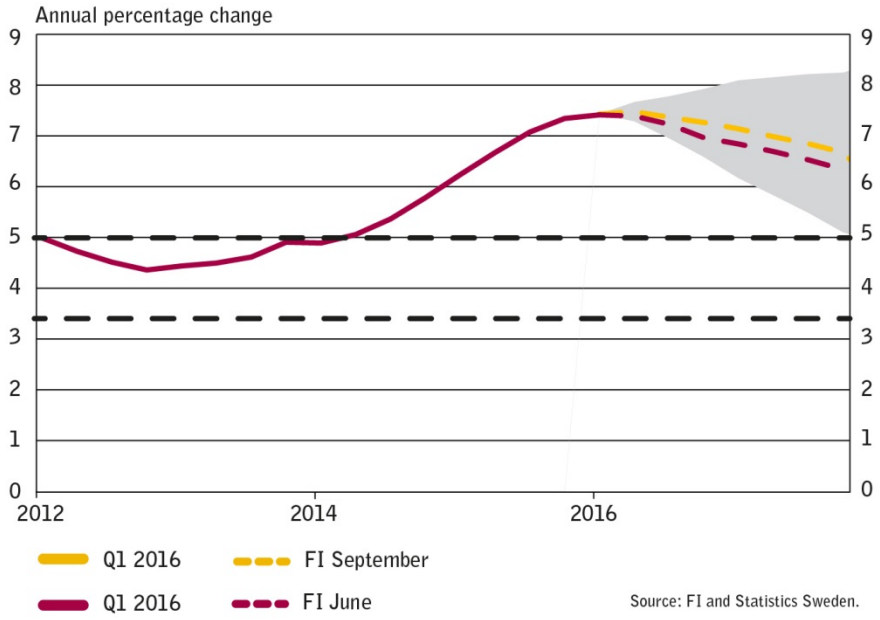
Source: FI, NIER and Statistics Sweden.

Note: The area between the black dotted lines shows a 95-per cent probability interval for growth of nominal GDP in a normal state.

Household debt is growing faster than the normal state during the entire forecast period (Diagram 5). The forecast for the rate of increase in household debt is slightly higher than the previous forecast occasion. This is in line with the fact that the outcome of household salaries was stronger than expected in Q1 2016.[13]

[13] Salaries are not included in the model, but can affect household confidence through a model that links salaries, GDP and consumer confidence. For more information about this model, see FI (2015), *A Model for Household Debt*, FI Analysis No. 4. Published on www.fi.se on 1 December 2015.

5 Households' nominal debt

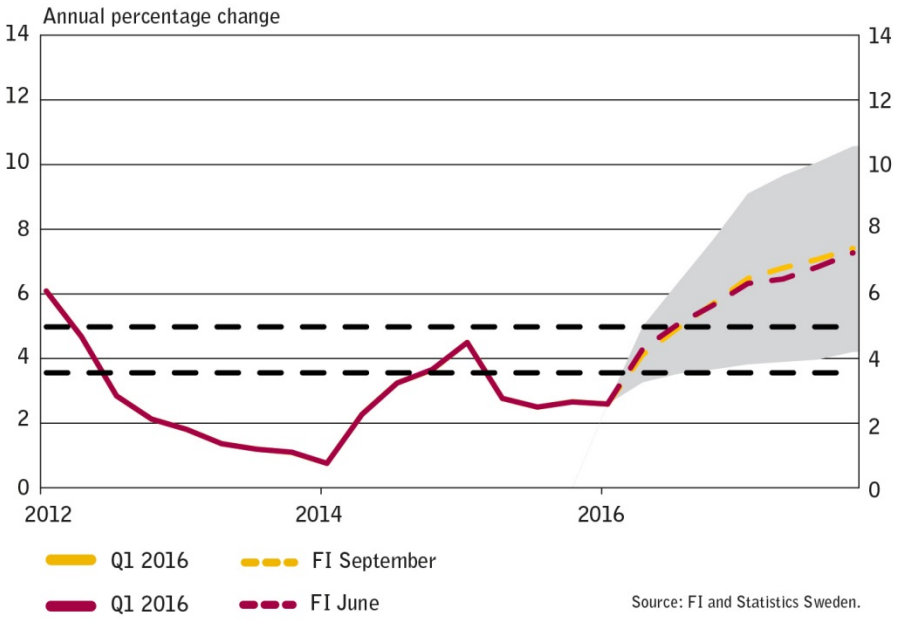


Source: FI and Statistics Sweden.

Note: The gray area shows a 68-per cent probability for the current forecast. The area between the black dotted lines shows a 95-per cent probability interval for growth of nominal GDP in a normal state. June refers to the forecast from the decision regarding the countercyclical buffer rate from June 2016.

Lending to corporates from MFI, according to the model estimation, is more sensitive to interest rates than lending to households, and the low interest rate explains why debt growth is accelerating during 2016 and 2017 (Diagram 6). The forecast for corporate debt is the same as the forecast in March. Corporate debt increases at a higher rate than normal starting at the end of 2016.

6 Corporates' nominal debt (MFI)

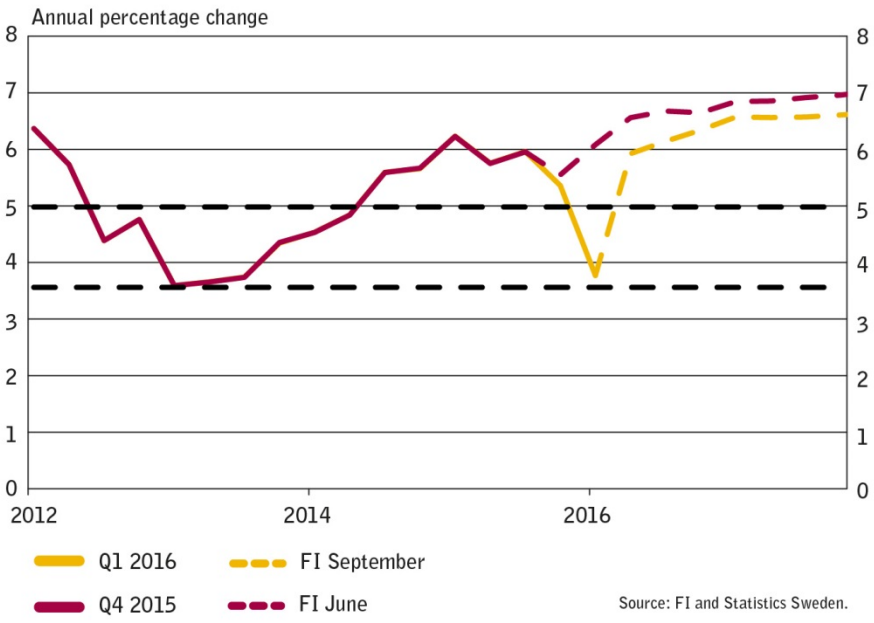


Source: FI and Statistics Sweden.

Note: The gray area shows a 68-per cent probability for the current forecast. The area between the black dotted lines shows a 95-per cent probability interval for growth of nominal GDP in a normal state. June refers to the forecast from the decision regarding the countercyclical buffer rate from June 2016.

Market funding for firms, in the form of certificates and bonds, has demonstrated an annual growth of around 10 per cent the last three years.[14] In recent quarters, however, its growth rate has slowed. In the current forecast, we assume that market funding will grow at a rate corresponding to the average of the past four quarters (4 per cent annually). As a whole, total debt is increasing slower in the current forecast than in the previous forecast (Diagram 7). However, total debt growth is still above the long-term sustainable growth level during the entire forecast period.

7 Total nominal debt



Note: The area between the black dotted lines shows a 95-per cent probability interval for growth of nominal GDP in a normal state. June refers to the forecast from the decision regarding the countercyclical buffer rate from June 2016.

Buffer guide and other indicators

In addition to debt levels, Finansinspektionen also monitors a number of other indicators that offer a comprehensive overview of the systemic risks. One of these indicators is the buffer guide. The guide serves as the point of departure for Finansinspektionen's assessment of the size of the countercyclical buffer.

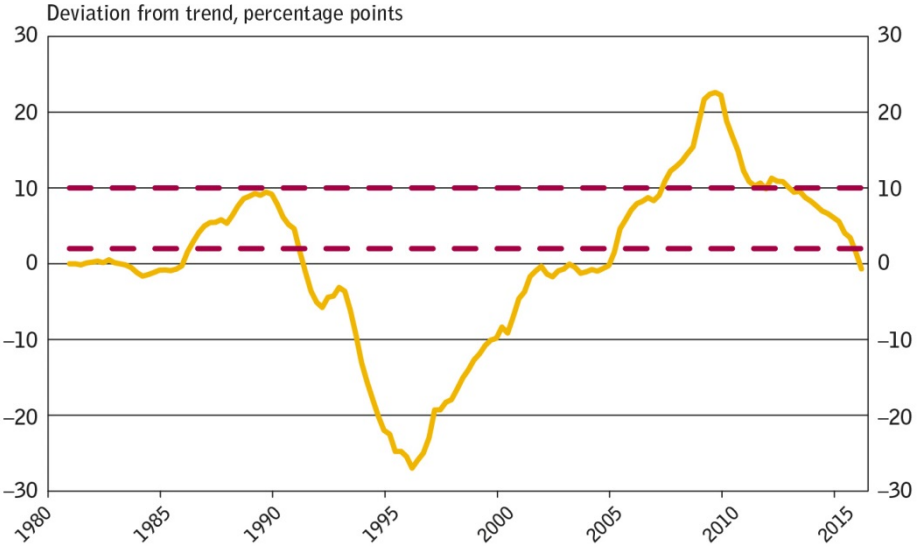
The buffer guide is based on the credit-to-GDP gap, which specifies how much the total lending to households and corporates in relation to GDP deviates from its estimated, long-term trend. The credit-to-GDP gap is considered to be a useful indicator for when to activate and raise the countercyclical buffer guide. However, the credit-to-GDP gap is considered to be less useful for determining when the buffer should be deactivated. With regard to reducing the buffer rate, therefore, other indicators are recommended, such as financial stress indicators.[15] There is no mechanical link between the guide and the level of the countercyclical buffer.

[14] FI has no formal model for the growth of market funding. On previous forecast occasions, the assumption was made that growth would continue at a rate of 10 per cent until 2017.
[15] ESRB (2014), *Operationalising the countercyclical capital buffer: indicator selection, threshold identification and calibration options*, Occasional Paper No. 5.

Finansinspektionen calculates the buffer guide in accordance with the Basel Committee's (BCBS) standardised approach, which uses the credit-to-GDP gap as its basis.[16] According to this approach, the credit-to-GDP gap is estimated at -0.67 per cent in Q1 2016 (Diagram 8).

8 Credit gap according to the standardised approach

Deviation from trend, percentage points



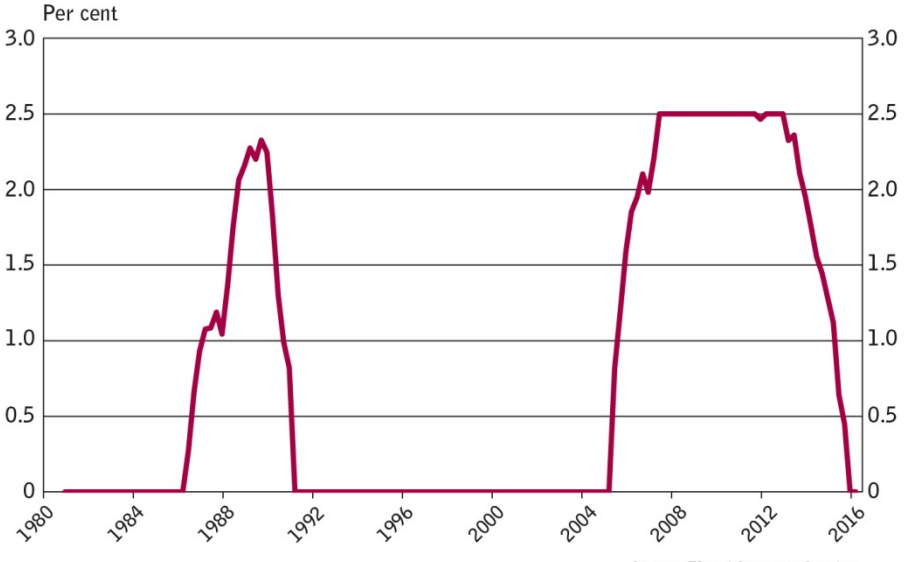
Note: The dotted lines show the thresholds (2 per cent and 10 per cent, respectively) which, under the standardised approach, are used to convert the credit gap into a buffer guide.

Sources: FI and Statistics Sweden.

The size of the credit-to-GDP gap is converted into a buffer guide using a formula for the relationship between the credit-to-GDP gap and the buffer guide. A credit gap that is below the lower threshold of 2 per cent gives a buffer guide of 0 per cent (Diagram 9).

9 Buffer level according to standardised approach

Per cent



Source: FI and Statistics Sweden.

[16] For more information about the standardised approach, see FI (2014), *Regulations regarding the countercyclical buffer rate*. Published on www.fi.se on 10 September 2014, FI Ref. 14-7010.

Finansinspektionen also monitors a number of indicators that are judged to be relevant when setting the countercyclical buffer rate in Sweden. These indicators include house prices in relation to disposable income, current account and financial savings in the public sector as a share of GDP, bank capital levels, interest-to-income ratios of households and developments in real equity prices.[17] These indicators show in general that there are no major changes compared to the previous quarter.

Conclusion

Finansinspektionen decided in June 2016 not to change the countercyclical buffer rate. The analysis in this decision shows that the risk outlook has not changed appreciably since the decision in June. The total lending rate decreased for the second consecutive quarter at the same time as the amortisation requirement has now entered into effect, and the housing market is demonstrating a slight slow-down. Other indicators used as a basis for the assessment of the risk outlook are also not giving any indication that the systemic risks have increased. However, household debt has increased over a long period of time, which motivates the current level of the buffer rate. Given this, the countercyclical buffer rate should not be changed.

Finansinspektionen

Sven-Erik Österberg
Chairman of the Board of Directors

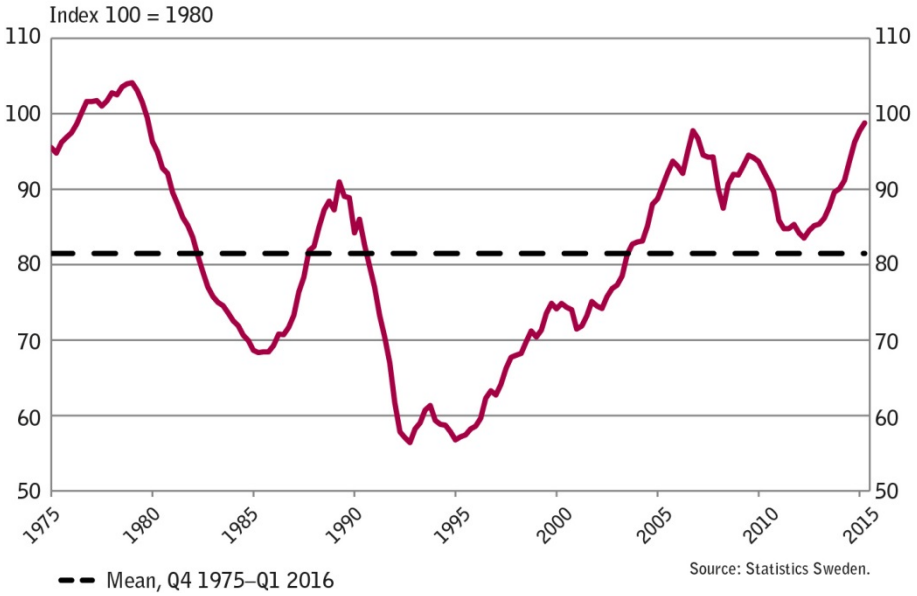
Matilda Gjirja
Senior Analyst

A decision in this matter was made by the Board of Directors of Finansinspektionen (Sven-Erik Österberg, Chair, Maria Bredberg Pettersson, Sonja Daltung, Marianne Eliason, Anders Kvist, Astri Muren, Hans Nyman, Gustaf Sjöberg and Erik Thedéen, Director General) following a presentation by Senior Analyst Matilda Gjirja. Per Håkansson (Chief Legal Counsel) and Henrik Braconier (Chief Economist) also participated in the final procedure.

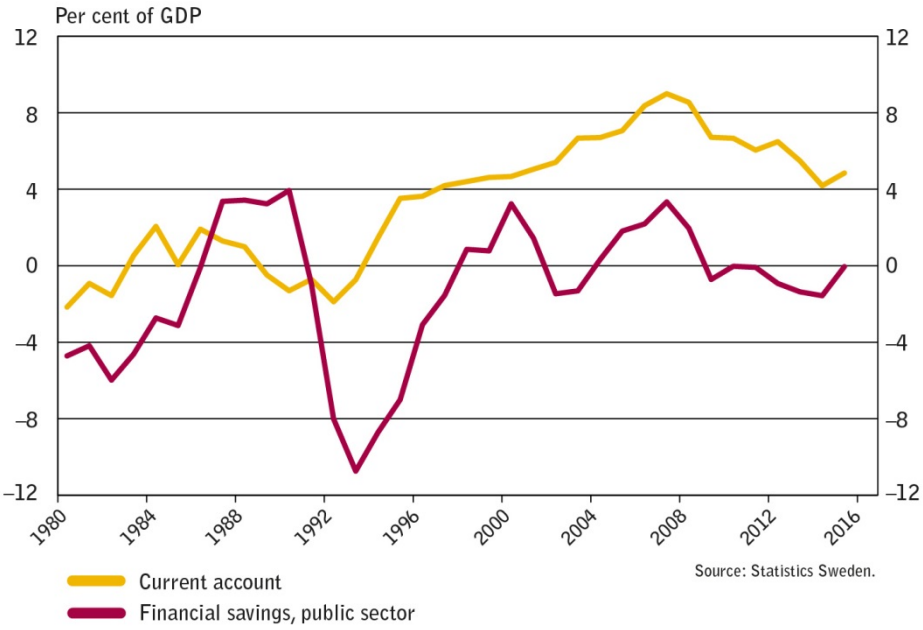
[17] Appendix 1 provides diagrams of the trend for these indicators.

Appendix 1: Diagrams

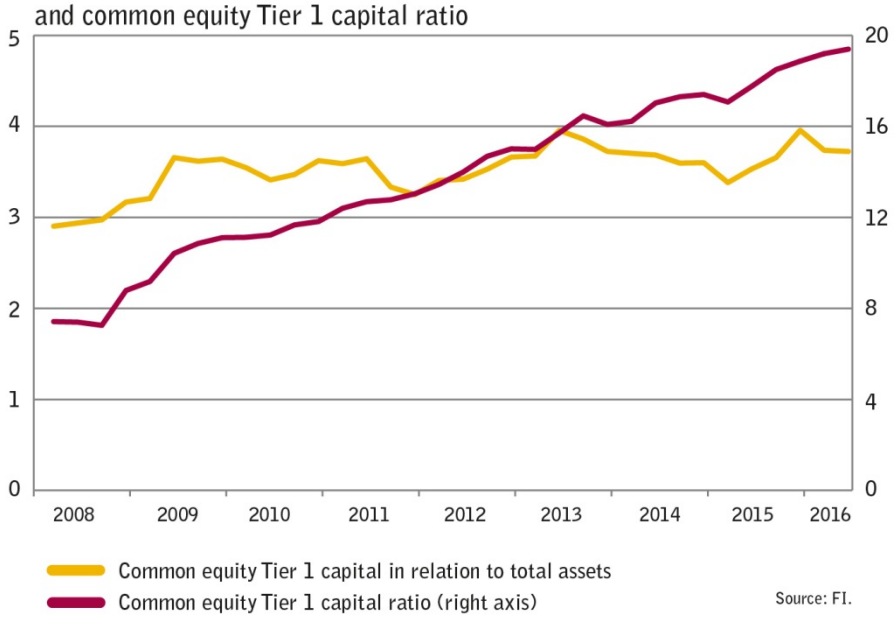
A 1.1 House prices in relation to disposable income



A 1.2 Current account and financial saving in the public sector

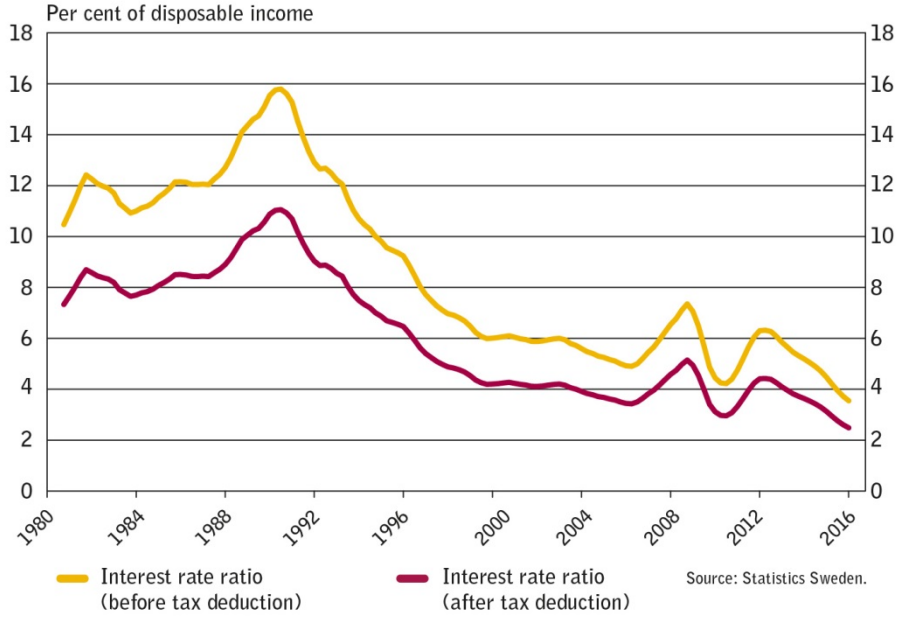


A 1.3 Common equity Tier 1 capital in relation to total assets and common equity Tier 1 capital ratio



A 1.4 Interest rate ratio of households

Per cent of disposable income



A 1.5 Real equity prices

Note: Real equity prices have been calculated by deflating the OMX by CPIF.

Source: Statistics Sweden and Reuters Datastream.