Decision of the Board of the Financial Supervisory Authority on the application of macroprudential instruments

At its meeting on 16 December 2022, the Board of the Financial Supervisory Authority (FIN-FSA) decided that the countercyclical capital buffer (CCyB) requirement, as referred to in chapter 10, section 4 of the Credit Institutions Act (610/2014), will remain at 0.0% and that the period of validity of the decision on a lower maximum loan-to-collateral (LTC) ratio, taken on 28 June 2021 pursuant to chapter 15, section 11 of the Credit Institutions Act, will be extended. With the June decision, the maximum LTC ratio for new residential mortgage loans other than first-home loans was lowered by 5 percentage points, to 85%.

In September 2022, the European Systemic Risk Board (ESRB) issued a general warning on vulnerabilities in the EU's financial system and emphasised the need to maintain and strengthen its risk resilience.[1] The ESRB warned the EU that the probability of the risks to financial stability materialising simultaneously has increased. According to the ESRB, the combined effects of these risks could be substantial. Due to pandemic-related support measures, the Finnish credit institutions sector's additional macroprudential capital requirements are currently below the level assessed as sufficient based on stress tests and other grounds for setting macroprudential buffers. For this reason, the FIN-FSA Board is preparing to make a decision on the imposition of a systemic risk buffer (SyRB) requirement on credit institutions in the first quarter of 2023. Before its final decision, the Board will assess the fulfilment of the grounds for setting an SyRB requirement and will update its estimate of the impacts of the requirement and of projected economic developments on the credit institutions sector and lending.

Justification for the decision

Countercyclical capital buffer (CCyB) requirement

The economic outlook has deteriorated in early autumn in Finland, the euro area and globally. Europe is being strained by an energy crisis and an upsurge in cost-push inflation. The rapid tightening of monetary policy and financing conditions in all major economic areas is weakening global economic growth.

The Finnish economy is sinking into a recession in the current quarter. Nevertheless, according to the Bank of Finland's December 2022 forecast, Finland's GDP will still grow by 1.9 % in 2022. Next year the economy is forecast to shrink by 0.5 %, while in 2024 growth is estimated to reach 1.1 %. The ECB is expecting euro area growth to be 0.5 % in 2023, but the risk of a recession is high.

[1] https://www.esrb.europa.eu/pub/pdf/warnings/esrb.warning220929_on_vulnerabilities_union_financial_system~6ae5572939.en.pdf

Confidence in the economy has weakened on a broad front. Earlier in 2022 consumers were concerned about the general economic situation in Finland, but now they are also increasingly worried about their personal finances. The unemployment rate trended up in May, and employment expectations are deteriorating in all sectors of the economy.

Indicators suggest that the risk of overheating in the Finnish financial system is low. Based on the revised set of risk indicators adopted for the CCyB requirement in the previous quarter, there are no such signs of an overheating in the credit markets as would require an increase in the CCyB rate. The primary risk indicator (credit-to-GDP gap) remains strongly negative (–16.4 percentage points) and is on a declining path.

The supplementary risk indicators are not pointing to an overheating in the Finnish credit cycle, either. Financial market volatility has remained elevated, and the cost of marked-based funding has increased in response to the general rise in interest rates. New bank loans to non-financial corporations have increased markedly from the previous year, reflecting in particular the increased need for liquidity of firms in the energy sector and the funding needs of specific large industrial companies. The current account has turned negative, which is largely attributable to the deficit recorded in the trade balance. Influenced by the weakening economic environment and tightening funding conditions, the Finnish financial cycle is expected to dampen further in the next few years.

Maximum loan-to-collateral (LTC) ratio

House sales and new mortgage lending have moderated since spring 2022, especially compared with the situation in 2021. House sales and drawdowns of new housing loans decreased on the previous year in October, in particular.

Compared with the previous year, drawdowns of new buy-to-let mortgages contracted more than those of owner-occupied housing loans.

According to Finance Finland's Banking Barometer survey, banks are expecting household demand for credit to decline in the first quarter of 2023 irrespective of the purpose of the loan. Expectations concerning the demand for buy-to-let mortgages were gloomier than those concerning loans for owner-occupied housing and renovation. According to the Bank Lending Survey conducted by the Bank of Finland, credit standards for housing loans were also expected to partly tighten during summer and early autumn.

In November 2022, consumers considered the time poor for taking out a loan. Consumer sentiment concerning the Finnish economic outlook and intentions to buy durables were at historically lows. Consumers' intentions to take out a loan or purchase a home in the next 12 months have also declined in the course of 2022. In November these intentions were below their long-term average levels, whereas in 2021 they were notably higher than in the preceding years.

Household debt as a ratio of disposable income was 134.4% in the second quarter of 2022. Debt levels are expected to rise in 2023, too, but to return to 2022 levels in 2024. Higher interest rates and slower growth of disposable income together with a cooler housing market will dampen household borrowing. Growth in the stock of housing loans is estimated to slow in the current year and to halt at the end of 2024. There is still a large number of new homes under construction which, together with renovation work, will sustain growth in households' loans via housing companies. The weakening of households' purchasing power, in turn, will support the demand for consumer credit.

The amounts of non-performing loans to households and housing corporations did not indicate an increase in loan-servicing difficulties in October 2022. Renegotiations of housing loans remained at their usual levels relative to the loan stock. Households' financial assets decreased in the second quarter of 2022 on account of holding losses. However, accumulated savings and lenders' forbearance towards customers will – at least in the short term – serve as buffers for mortgage-indebted households against higher interest rates and living costs. In addition, the use of interest rate hedges and fixed rates in an estimated one-third of new housing loans will mitigate the immediate interest rate risk.

There were no material changes in housing loans' loan-to-collateral (LTC) ratios in the third quarter of 2022. The shares of mortgages with high LTCs in new first-home loans, and in other new housing loans, were roughly unchanged on previous quarters. The number of drawdowns declined year-on-year, but the average loan sizes were roughly the same as a year earlier. In both the third quarter and October 2022, mortgages with maturities of over 26 years, and of over 30 years, accounted for a larger share of the euro volume of new housing loans than in the previous year.

The stock of loans to households as a ratio of household income has remained at a historically high level. Tightening financing conditions, increasing living costs and the weakening economic environment are eroding households' capacity to service their debts and maintain consumption. In such an environment, it is important to contain the growth of household debt and ensure that new mortgage borrowers have sufficient financial buffers against higher loan-service burdens and living costs and lower collateral values.

For these reasons, the FIN-FSA Board's decision of June 2021, effective in October, to set the maximum LTC ratio for new residential mortgage loans other than first-home loans to 85% remains justified in terms of curbing the number of large housing loans in relation to collateral. The maximum LTC ratio for first-home loans will not be adjusted at this stage.

Systemic risk buffer (SyRB) requirement

In its warning issued in September 2022, the European Systemic Risk Board (ESRB) stated that the probability of the risks to financial stability materialising simultaneously has increased. According to the ESRB, the combined effects of these risks could be substantial.

The structural risks and vulnerabilities surrounding the Finnish credit institutions sector are significant and provide a justification for the imposition of an SyRB requirement. The FIN-FSA Board withdrew the requirement from Finnish credit institutions in spring 2020 to mitigate the effects of the COVID-19 pandemic. As a result, the combined level of the Finnish credit institutions sector's macroprudential buffers is currently below the level assessed as sufficient based on stress tests and other grounds for setting macroprudential buffers.

For the reasons mentioned above, the FIN-FSA Board has assessed the needs and possibilities for strengthening the national financial system's risk resilience with an SyRB requirement of no more than 1%. Based on the current calculations, the forthcoming decision would not significantly weaken the credit institutions sector's lending capacity, but would instead strengthen credit institutions' risk resilience. The FIN-FSA Board is preparing to make a decision on the imposition of an SyRB requirement in the first quarter of 2023. Before its final decision, the Board will assess the fulfilment of the grounds for setting an SyRB requirement and will update its estimate of the impacts of the requirement and of projected economic developments on the credit institutions sector and lending. The SyRB requirement would become effective after a transitional period laid down in the law. The decision can be postponed if it is assessed to have a very negative impact on the operation of the credit markets in the short-term.