

8 December 2014

## DECISION



FI Ref. 14-16989

**Finansinspektionen**  
Box 7821  
SE-103 97 Stockholm  
[Brunnsgatan 3]  
Tel +46 8 787 80 00  
Fax +46 8 24 13 35  
finansinspektionen@fi.se  
www.fi.se

### Decision regarding the countercyclical buffer rate

#### Decision of Finansinspektionen

Finansinspektionen (Swedish Financial Supervisory Authority) has decided not to amend Finansinspektionen's Regulations (FFFS 2014:33) regarding the countercyclical buffer rate. The buffer rate of 1 per cent, which is specified in the Regulations, shall thus continue to apply.

#### The matter

According to Chapter 7, Section 1 of the Capital Buffers Act (2014:966) ('the Buffer Act'), Finansinspektionen shall set a countercyclical buffer guide<sup>1</sup> and a countercyclical buffer rate for each quarter. Finansinspektionen decided on 8 September 2014 to issue new regulations concerning a countercyclical buffer rate: Finansinspektionen's Regulations (FFFS 2014:33) regarding the countercyclical buffer rate. These regulations meant that the countercyclical capital buffer for Sweden was activated. According to the Regulations, the countercyclical buffer rate will be 1 per cent and shall be applied as of 13 September 2015. It was also stipulated in the Decision Memorandum<sup>2</sup> presenting the considerations behind the decision that the countercyclical buffer guide was set at 1.25 per cent.

The quarterly procedure for setting the countercyclical buffer rate is also described in the Decision Memorandum. According to the procedure, new regulations will be issued when Finansinspektionen assesses that the rate decided needs to be changed. In cases where Finansinspektionen considers that there is no need to change the rate, the Board of Directors of Finansinspektionen will decide on this on a quarterly basis and the Board's decision will be published on Finansinspektionen's website.

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<sup>1</sup> The buffer guide constitutes the point of departure for Finansinspektionen's assessment of the size of the countercyclical buffer rate.

<sup>2</sup> FI (2014), *Regulations regarding the countercyclical buffer rate*. Published on fi.se on 10 September 2014, FI Ref. 14-7010.

## Finansinspektionen's assessment

The purpose of the countercyclical capital buffer is to strengthen the resilience of firms 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 buffer is to be built up when financial imbalances risk building up and cause systemic risks. In the event of a recession and large losses at the banks, the buffer requirement may be reduced to prevent a tighter supply of credit reinforcing the downturn in the economy.

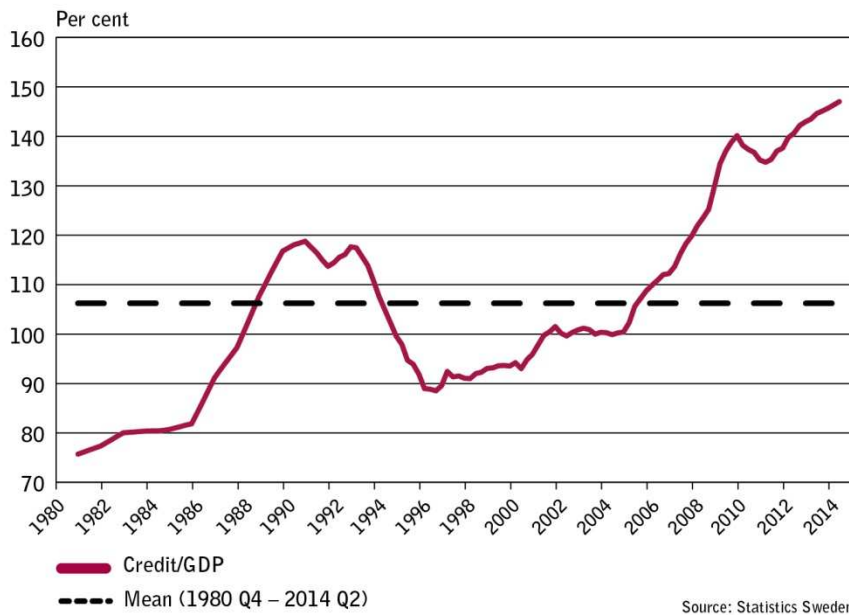
Finansinspektionen sets the countercyclical buffer rate for Sweden on the basis of a qualitative assessment that takes quantitative factors into consideration. The *buffer guide* is an important, but not determining, factor in this assessment. Consideration shall also be taken of other quantitative variables that are relevant for assessing the cyclical systemic risks.

The point of departure for Finansinspektionen's assessment of systemic risks is the 'credit gap', which is a measure of the deviation of the ratio of credit-to-GDP from its long-term trend.<sup>3</sup> Total household and corporate lending in Sweden rose faster than GDP in the 2000s. However, the growth rate for household and corporate credits has slowed down since the financial crisis. Despite this, total household and corporate lending is still at a historically high level and currently amounts to approximately 150 per cent of GDP (see Diagram 1).

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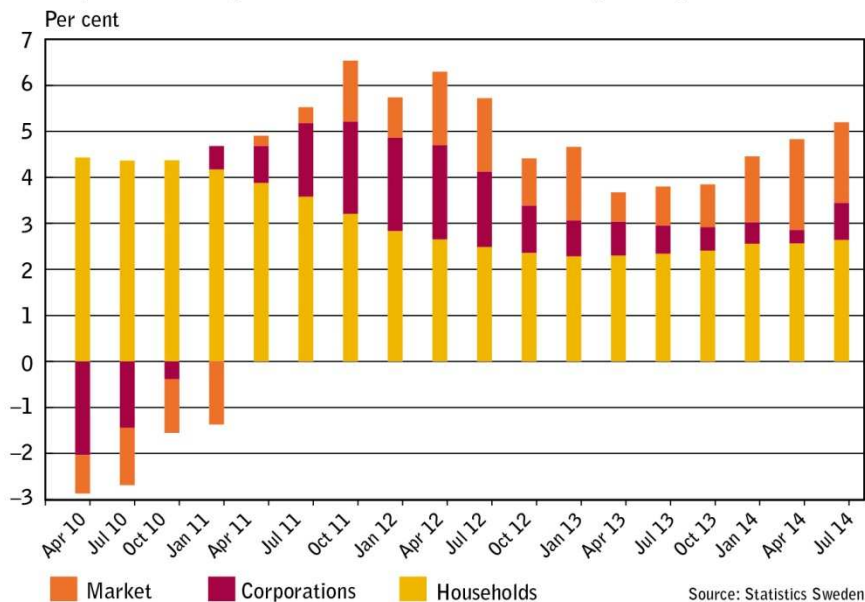
<sup>3</sup> For Sweden, the measure of total credit to the private sector covers all corporate and household lending issued through monetary financial institutions (MFI) and the total market financing of corporations. The market financing of corporations has been defined as the value of all outstanding corporate bonds and certificates traded on the fixed-income market.

**1 Credit in relation to GDP**



The growth rates in lending to the private sector increased slightly last year. This is shown in Diagram 2, which also shows how much household and corporate lending from monetary financial institutions (MFI) and the market financing of corporations contribute to total credit growth.

**2 Growth rates in lending broken down by contributions from households, corporate lending from MFI and market financing of corporations**



Credit is currently growing faster than GDP, and the growth rate for both household lending and corporate lending shows a weak upward trend (see Table 1). Corporate lending from financial institutions increased slightly during the second quarter of 2014, and the market financing of corporations also

continues to exhibit a strong growth rate. The growth rate in household lending lies at around 5 per cent.

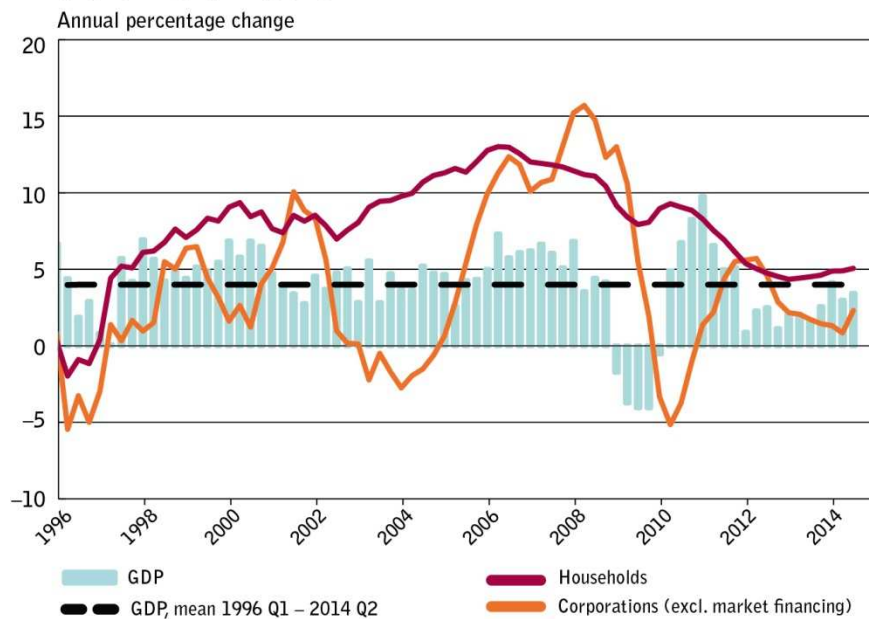
**Table 1.** Growth rates in lending to households and corporations (excluding and including the market financing of corporations)

	Households (MFI)	Corporations (MFI)	Corporations (market)	Corporations (MFI+market)	Total credit
2013 Q2	4.5	1.7	6.8	3.0	3.8
2013 Q3	4.6	1.4	7.5	3.0	3.8
2013 Q4	4.9	1.3	11.7	4.0	4.5
2014 Q1	4.9	0.8	15.9	4.8	4.8
2014 Q2	5.1	2.3	13.7	5.4	5.2

Source: Statistics Sweden

However, household debt is still growing slightly faster than GDP, while the growth rate for corporate lending from financial institutions is lower than the nominal GDP growth (see Diagram 3).

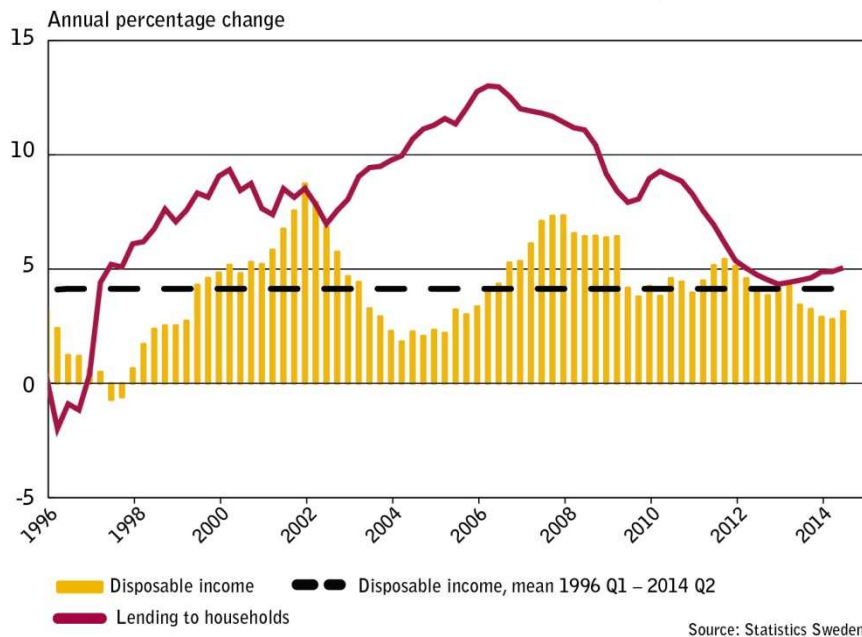
**3** Growth rate in lending to households and corporations and nominal GDP growth



Source: Statistics Sweden

A comparison of credit growth in the household sector with the development of household nominal disposable income shows that household credits have increased at a still slightly faster rate than disposable income (see Diagram 4). This may be due to house prices having increased slightly faster than household disposable income in the past few quarters. However, disposable income continues to increase at a healthy rate, close to the historical average, and the development is considered to be stable at the current time.

#### 4 Growth rate in lending to households and nominal disposable income



When setting the buffer rate, it is important to also consider other measures taken by Finansinspektionen to manage systemic risk. In this context it is worth noting that Finansinspektionen will introduce an amortisation requirement for mortgages.<sup>4</sup> This is because household debts involve risks for both Sweden's economy and for individual households. The regulation means that new mortgage holders will have to make repayments on their mortgages down to a 50 per cent loan-to-value ratio. The measure may have a curbing effect on household demand for mortgages, which account for most household credits.

#### *Buffer guide and other quantitative factors*

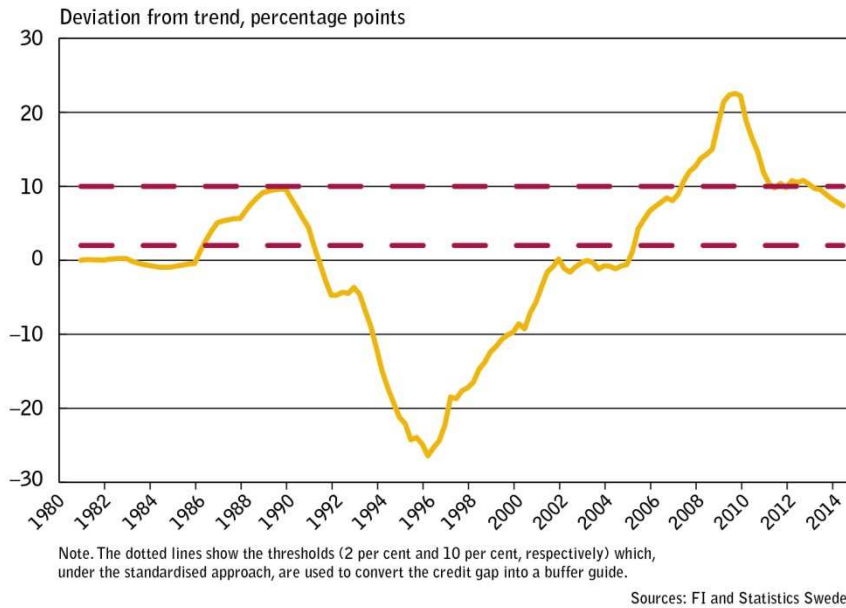
The buffer guide constitutes the point of departure for Finansinspektionen's assessment of the size of the countercyclical buffer rate in Sweden. There is, however, no mechanical link between the buffer guide and the level of the countercyclical buffer. Decisions on the countercyclical buffer rate are based on both quantitative and qualitative assessments of the sustainability of the credit development and the level of systemic risks. For this reason, Finansinspektionen also takes into account other relevant variables that could signal the build-up or slowdown of cyclical systemic risk, and performs its own qualitative assessments.

Finansinspektionen calculates the countercyclical buffer guide in accordance with the Basel Committee's standardised approach, which is based on the credit gap, i.e. the deviation of the ratio of credit-to-GDP from its long-term

<sup>4</sup> See press release published on fi.se on 11 November 2014, <http://www.fi.se/Folder-EN/Startpage/Press/Press-releases/Listan/ccc/>.

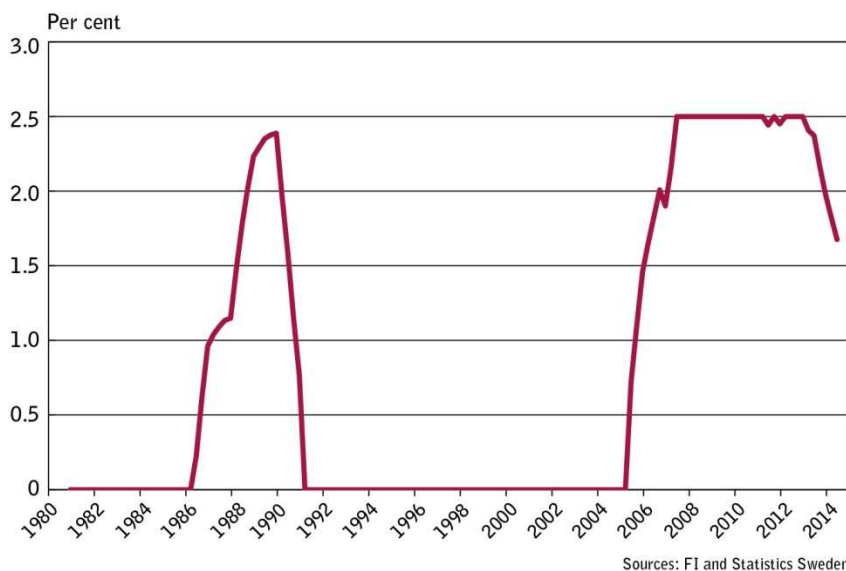
trend.<sup>5</sup> According to the standardised method, the credit gap lies at 7.8 per cent (see Diagram 5).

**5 Credit gap according to the standardised approach**



This means that the countercyclical buffer guide in Sweden is 1.65 per cent for the second quarter of 2014 (see Diagram 6).<sup>6</sup>

**6 Buffer level according to standardised approach**



<sup>5</sup> For more information about the standardised approach, see FI (2014), *Regulations regarding the countercyclical buffer rate*. Published on *fi.se* on 10 September 2014, FI Ref. 14-7010.

<sup>6</sup> National accounts have been reported in accordance with EU’s updated Regulation (the European System of National and Regional Accounts, ESA 2010) since September 2014. See Appendix 1 for more information about how this affects the calculation of the credit gap and buffer guide.

Finansinspektionen has also chosen to monitor a number of indicators that, in addition to the credit gap, are considered to be relevant to Sweden. These include various measures of credit developments, 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 rate ratio of households, and developments in real equity prices.<sup>7</sup>

A description of the development in lending for the second quarter of 2014 was provided above. The picture given by the other indicators for the same period is that development has not changed appreciably compared with the first quarter of the year. However, it is worth noting that the capital strength of banks improved also during the second quarter. There has been a further increase in the measures for both Tier 1 capital in relation to total assets and common equity Tier 1 capital ratio. This suggests that resilience in the Swedish banking sector has strengthened. As regards the measure of house prices in relation to disposable income, there has been a slight increase in the ratio. This suggests that house prices rose at a slightly faster rate than the disposable income of households during the second quarter.

### *Overall assessment*

Both household and corporate lending increased slightly during the second quarter of 2014. The growth rate in corporate lending from MFI continues to be weaker than the growth rate in lending to households, but is showing signs of a recovery. As companies continue to have good access to market financing, total corporate lending is increasing by about as much as household credits. However, the growth rate for corporate lending from MFI continues to be less than the nominal GDP growth, while household credits is growing slightly faster than nominal GDP growth and disposable income.

Finansinspektionen's analysis of the latest developments does not suggest a further build-up of financial imbalances. The assessment is that since September 2014 there has been no change in the risk profile with respect to cyclical systemic risks that the countercyclical buffer is intended to manage. A number of measures have been taken since the latest decision regarding the countercyclical buffer rate, including the introduction of higher capital requirements that aim to strengthen the banks' resilience.<sup>8</sup> In addition, Finansinspektionen has decided to introduce an amortisation requirement for mortgages, which may have a curbing impact on household demand for credit. Overall, this suggests that there is no need to change the countercyclical buffer

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<sup>7</sup> Appendix 2 provides diagrams of the development of these indicators.

<sup>8</sup> The higher capital requirements include, among other things, higher capital requirements for the four major Swedish banks and an increase in the risk weight floor for mortgages. For further information, see FI (2014), *Capital requirements for Swedish banks*. Published on fi.se on 10 September 2014, FI Ref. 14-6258.

rate. The buffer rate of 1 per cent, which is specified in current Regulations, shall thus continue to apply.

## FINANSINSPEKTIONEN

Bengt Westerberg  
*Chair of the Board*

Matilda Gjirja  
*Senior Analyst*

A decision in this matter was made by the Board of Directors of Finansinspektionen (Bengt Westerberg, Chair, Astri Muren, Hans Nyman, Gustaf Sjöberg, Kristina Ståhl, Sven-Erik Österberg and Martin Andersson, Director-General) following a presentation by Matilda Gjirja (Senior Analyst). Per Håkansson (Chief Legal Counsel) and Henrik Braconier (Chief Economist) also participated in the final procedure.



## Appendix 1

### ESA revision

The national accounts have since September 2014 been reported in accordance with EU's updated Regulation (the European System of National and Regional Accounts, ESA 2010).<sup>9</sup> This regulates what should be included in the national accounts and how the various parts are to be calculated. The most significant change to the new Regulation is a broadening of the term 'investment'. This means, among other things, that research and development expenditure is now reported as investments instead of as a cost in production.<sup>10</sup>

This revision means that Sweden's GDP level increased by just under 4 per cent on account of the introduction of ESA 2010. These updates mean a higher GDP level for the entire time series from 1993, but small differences in the historical rate of growth except for recent years. The ESA revision results in certain effects on the credit-to-GDP ratio and also its estimated trend, which form the basis of the calculation of the credit gap and the buffer guide. As the GDP level is revised upwards, the credit-to-GDP ratio and the estimated trend shift downwards. Despite relatively small differences, this still has effects on the buffer guide, which now amounts to just over 1.65 per cent as of the revision and new data for the second quarter of 2014.

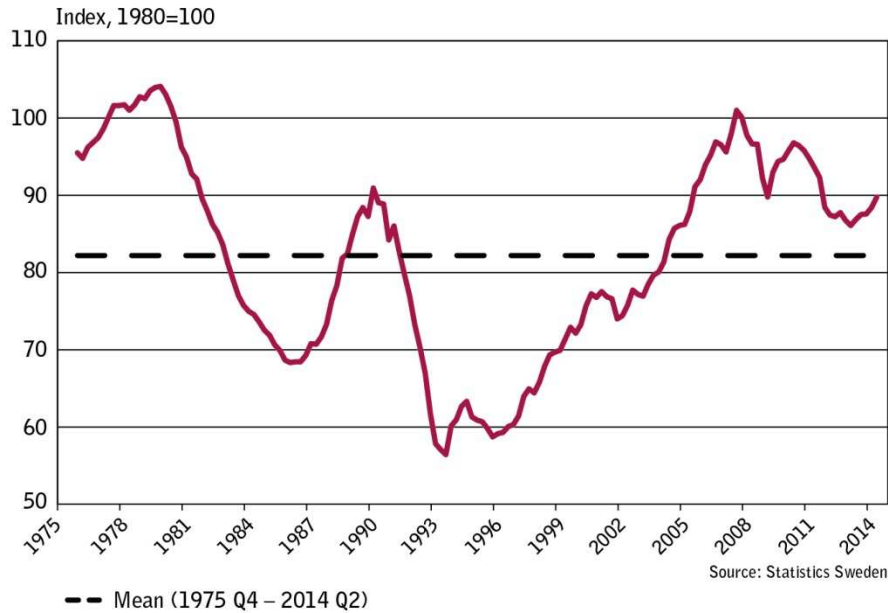
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<sup>9</sup> Regulation (EU) No 549/2013 of the European Parliament and of the Council of 21 May 2013 on the European system of national and regional accounts in the European Union. The ESA 2010 was published in the European Union's Official Journal as Annex A to this Regulation.

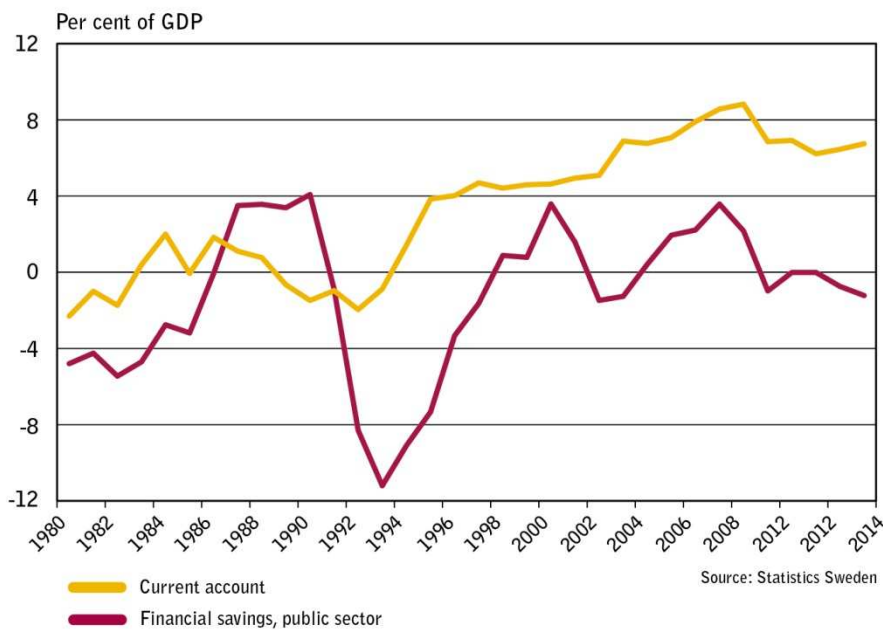
<sup>10</sup> For more information, see [http://www.scb.se/en /Finding-statistics/Statistics-by-subject-area/Financial-markets/Financial-accounts/Financial-accounts-quarterly-and-annual/Nyhetsbehallare/New-regulations-ESA-2010-for-financial-accounts/](http://www.scb.se/en/Finding-statistics/Statistics-by-subject-area/Financial-markets/Financial-accounts/Financial-accounts-quarterly-and-annual/Nyhetsbehallare/New-regulations-ESA-2010-for-financial-accounts/).

## Appendix 2

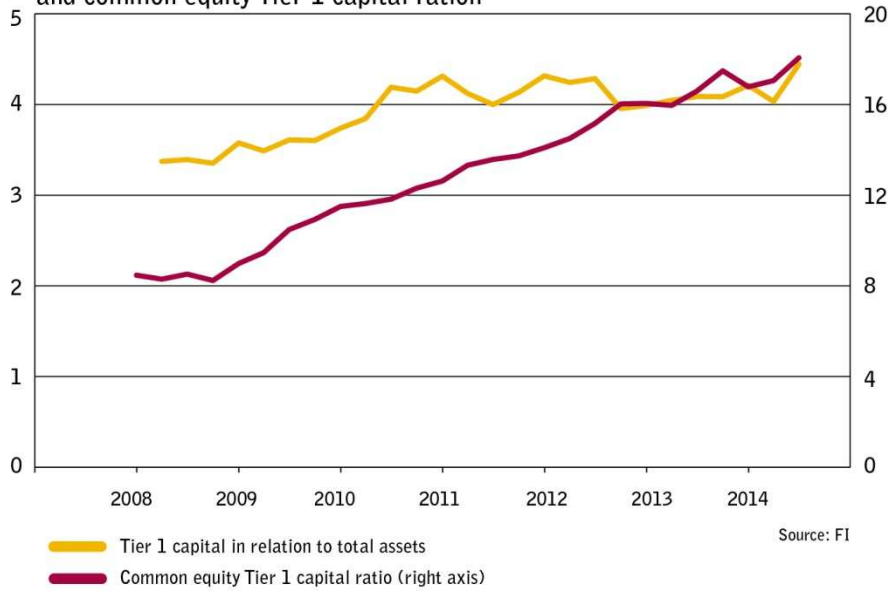
### B 2.1 House prices in relation to disposable income



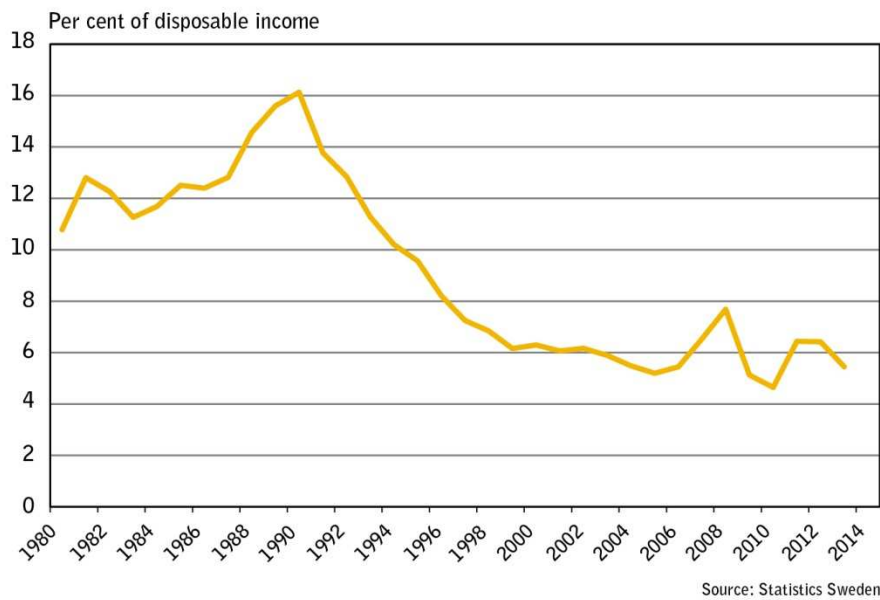
### B 2.2 Current account and financial saving in the public sector



**B 2.3 Tier 1 capital in relation to total assets and common equity Tier 1 capital ratio**



**B 2.4 Interest rate ratio of households**



### B 2.5 Real equity prices



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

Source: Statistics Sweden and Reuters Ecowin