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## Decision regarding the countercyclical buffer rate

Finansinspektionen (the Swedish Financial Supervisory Authority) has decided not to amend Finansinspektionen's Regulations (FFFS 2015:5) regarding the countercyclical buffer rate. The buffer rate of 1.5 per cent, which is specified in the regulations, shall thus continue to apply.

### Background

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. The countercyclical buffer for Sweden was activated on 8 September 2014, when Finansinspektionen decided to issue new regulations concerning a countercyclical buffer rate; Finansinspektionen's Regulations (FFFS 2014:33) regarding the countercyclical buffer rate.<sup>2</sup> These regulations established the countercyclical buffer rate at 1 per cent and stipulated that it would be applied as of 13 September 2015.

On 22 June 2014, Finansinspektionen made a new quarterly decision that entailed notifying new regulations concerning the countercyclical buffer rate; Regulations (FFFS 2015:5) amending Finansinspektionen's regulations (FFFS 2014:33) regarding the countercyclical buffer rate.<sup>3</sup> These regulations meant that the countercyclical capital buffer for Sweden was raised. According to the new regulations, the countercyclical buffer rate shall be 1.5 per cent and be applied as of 27 June 2016. In the motivation for the decision, it is also set out that the countercyclical buffer guide was then set at 1.5 per cent.

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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.

<sup>3</sup> FI (2015), *Amendment to regulations regarding the countercyclical buffer rate*. Published on fi.se on 23 June 2015, FI ref. 15-7062.

## Finansinspektionen's assessment

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 shall be built up when there is a risk of financial imbalances, and hence systemic risks, growing. In a subsequent recession or in the event of the banks sustaining major losses, the latter can tighten lending, which can amplify the economic downturn. In such a situation, the buffer requirement can be reduced to counteract a credit crunch.

Finansinspektionen sets the countercyclical buffer rate for Sweden by means of a qualitative assessment that takes quantitative factors into consideration. *The buffer guide* is an important, but not decisive, factor in this assessment. Finansinspektionen also considers other quantitative variables that are relevant for assessing the cyclical systemic risks.

### *The countercyclical buffer guide*

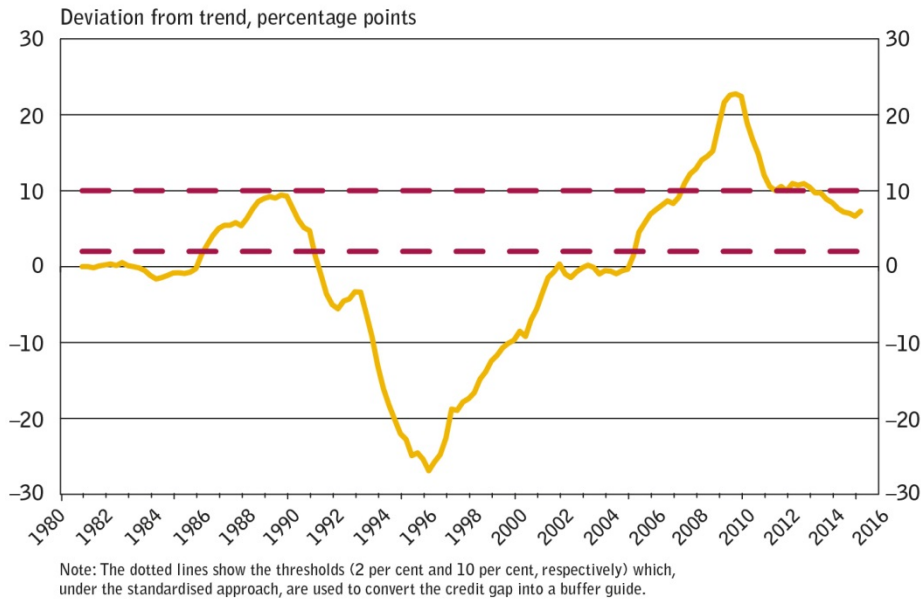
The buffer guide constitutes the point of departure for Finansinspektionen's analysis and assessment of the size of the countercyclical buffer rate in Sweden. There is, however, no mechanical link between the buffer guide and the level of the countercyclical buffer. Decisions on the countercyclical buffer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

Finansinspektionen calculates the countercyclical buffer guide in accordance with the Basel Committee's standardised approach<sup>4</sup>, which is based on the credit gap, i.e. how much total household and corporate lending in relation to gross domestic product (GDP) deviates from its long-term trend. According to the standardised approach, the credit gap was 7.3 per cent in the first quarter of 2015, which is the latest available outcome (see diagram 1).

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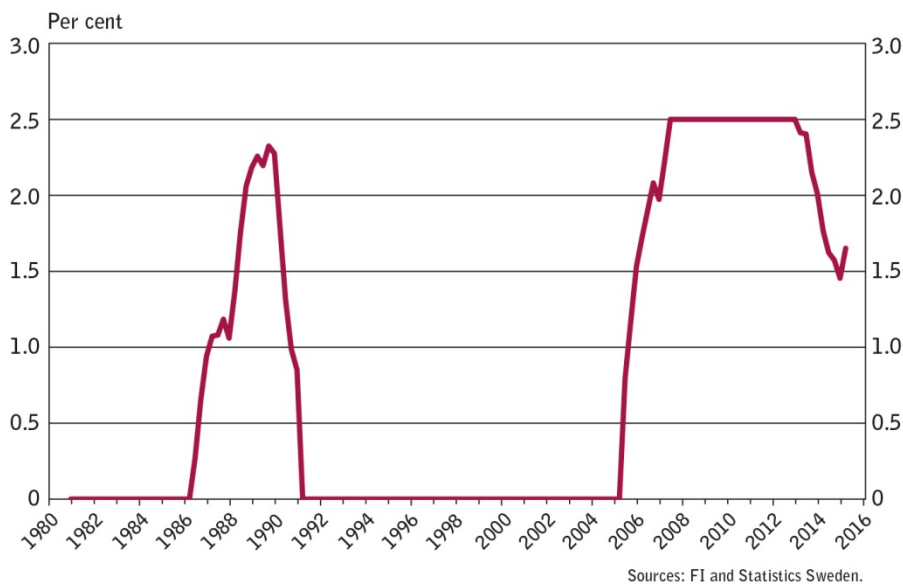
<sup>4</sup> For more information about the standardised approach, see FI (2014), *Regulations regarding the countercyclical buffer rate*. Published on fi.se on 10 September 2014, FI ref. 14-7010.

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



The credit gap is converted into a buffer guide according to a quantitative rule that specifies how the credit gap and buffer guide are to stand in relation to each other. A credit gap of 7.3 per cent means that the countercyclical buffer guide for Sweden is 1.65 per cent (see diagram 2).

**2 Buffer level according to standardised approach**



*Other quantitative indicators*

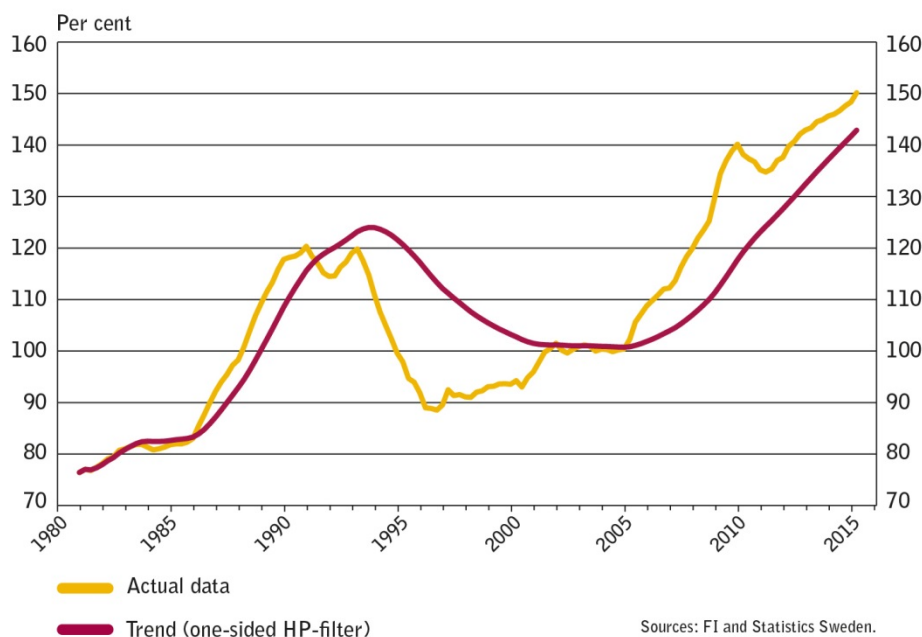
Finansiella inspektionen has chosen to monitor a number of indicators that, in addition to the credit gap, are considered to be relevant to Sweden when setting the countercyclical buffer rate. These include various measures of the progression of household and corporate lending, house prices in relation to

disposable income, current account and financial savings in the public sector as a share of GDP, bank capital levels, the interest-to-income ratio of households, and developments in real equity prices.<sup>5</sup>

The point of departure for Finansinspektionen's assessment of the cyclical systemic risks is the development in lending to the non-financial sector over time, both as a whole<sup>6</sup> and in its parts (for example lending to households and corporations, respectively). The lending development can then be related to other variables such as GDP or the household income development, in order to assess whether the trend appears reasonable or whether it signals that imbalances are being built up in the financial system.

Household and corporate lending continues to increase in Sweden. In addition, aggregate lending is increasing faster than nominal GDP, and has done so since 2011 (see diagram 3). Total lending to the private sector currently amounts to around 150 per cent of GDP.

### 3 Credit in relation to GDP, actual data and trend



In the first quarter of 2015 total lending grew 7.1 per cent year-on-year (see table 1), which can be compared with a nominal GDP growth of 4.1 per cent in the same quarter. This is a relatively large increase, compared with the growth rate for both the same quarter in the previous year (4.6 per cent) and with the previous quarter (5.6 per cent).

<sup>5</sup> Appendix 1 provides diagrams of the trend for these indicators.

<sup>6</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 Growth rates in lending to households and corporations (excluding and including the market financing of corporations)

Annual percentage change

	Households (MFI)	Corporations (MFI)	Corporations (market)	Corporations (MFI+market)	Total credit
2014 Q1	4.9	0.8	14.3	4.4	4.6
2014 Q2	5.1	2.4	11.3	4.8	4.9
2014 Q3	5.4	3.2	13.3	5.9	5.6
2014 Q4	5.7	3.7	10.6	5.6	5.6
2015 Q1	6.1	4.6	17.3	8.2	7.1

Note: MFI refer to Swedish financial institutions.

Source: Statistics Sweden.

Lending from monetary financial institutions (MFIs) to households is still showing an upward trend. The growth rate was 6.1 per cent during the first quarter of 2015. Moreover, monthly statistics from Statistics Sweden show that the rate of increase is still growing. In June 2015, the annual growth rate for household lending had increased to 6.9 per cent (see table 2).

## 2 Growth rates in MFI-lending to households and corporations

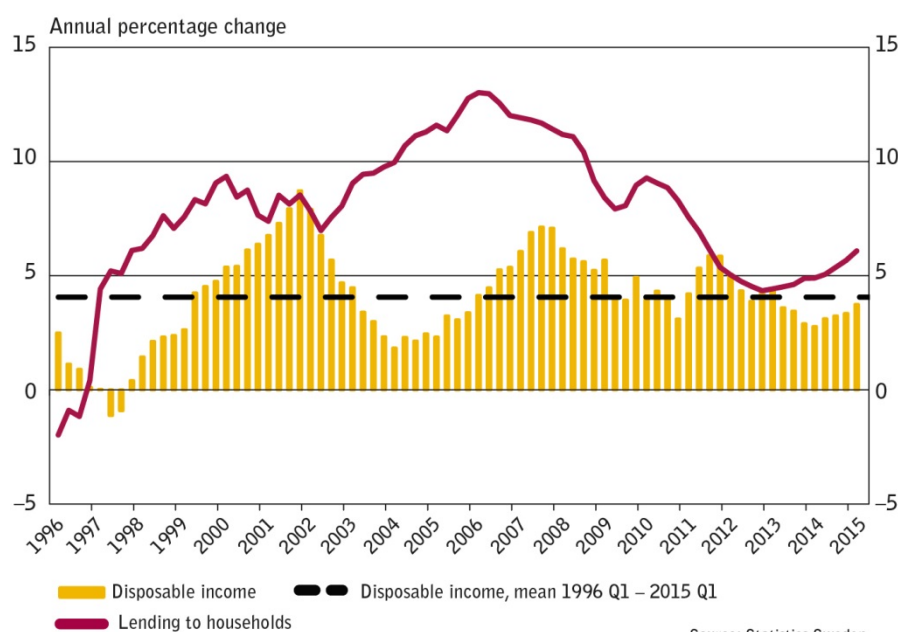
Annual percentage change

2015	Households, total	Households, housing	Corporations
April	6.5	7.0	3.9
May	6.7	7.1	2.5
June	6.9	7.4	2.5

Source: Statistics Sweden.

Household indebtedness is also increasing more rapidly in relation to households' disposable income, which increased 3.7 per cent in the first quarter of 2015 (see diagram 4).

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



One reason for the acceleration in household lending is the increasingly high house prices. The ratio between house prices and disposable income increased somewhat further in the first quarter of 2015 compared with the preceding quarter (see diagram B 1.1). Statistics from Statistics Sweden show that the prices of single-family dwellings rose 9 per cent in the three-month period May–July 2015 compared with the same period a year before.<sup>7</sup> Mortgages account for just over 80 per cent of total household lending. The annual growth rate for mortgages was 7.4 per cent in June 2015 (see table 2). The accelerating indebtedness linked to increasing house prices, therefore, poses a heightening risk.

At the same time, household mortgage rates have continued to gradually decline, both for short and long fixed-interest periods. This has a direct link to households' interest-to-income ratio<sup>8</sup>, which remains very low indeed. Currently, interest expense, after tax deduction, amounts to around 3.2 per cent of disposable income (see diagram B 1.4). In addition, Finansinspektionen's stress tests show that Swedish households have considerable resilience to higher interest rates, loss of income and declining house prices.<sup>9</sup> On the whole, Finansinspektionen finds that the risks of major credit losses linked to household indebtedness remain low.

Lending from MFIs to non-financial corporations continues to increase and the annual growth rate was 4.6 per cent during the first quarter of 2015. However, the latest monthly figures from Statistics Sweden show that the corporate lending of MFIs has declined somewhat. The growth rate was 2.5 per cent in July 2015 (see table 2).

As before, market funding is still an increasingly important source of funding for non-financial corporations. The growth rate increased and was 17.3 per cent for the first quarter of 2015. All in all, therefore, total lending to firms – which covers both lending from MFIs and via market funding – increased by 8.2 per cent, which is faster than both nominal GDP growth and growth in lending to households (see diagram 5).

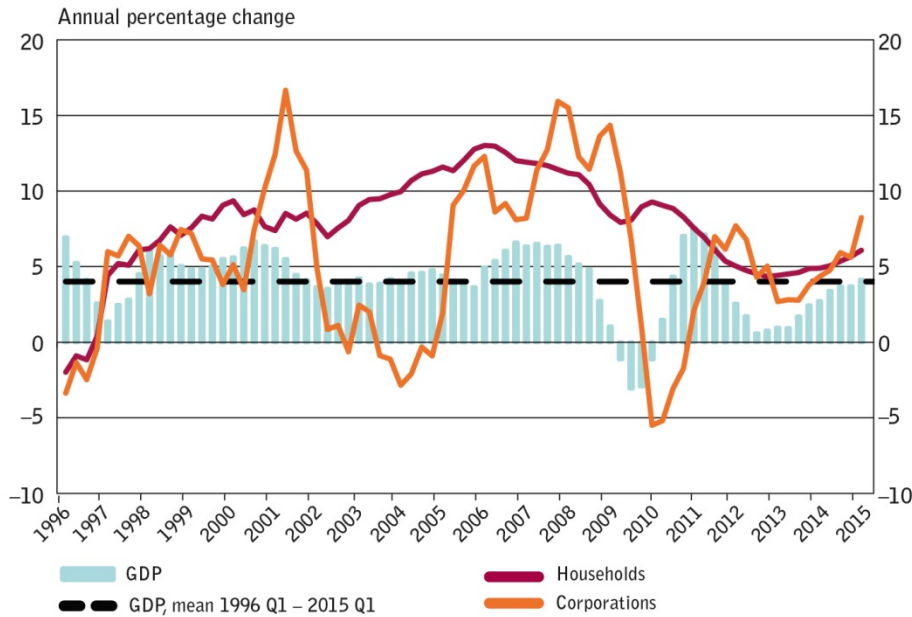
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<sup>7</sup> Data from Mäklarstatistik show that the price of tenant-owned apartments has declined by 3 per cent in Sweden during the most recent three-month period, May–July 2015 (which is assumed to be a natural consequence of the share of expensive apartments in metropolitan areas declining substantially over the summer), while the price of detached houses has increased by 2 per cent. Year-on-year, the price change is 14 per cent for tenant-owned apartments and 10 per cent for detached houses. See <http://www.maklarstatistik.se/pressmeddelande/pm-2015-08-14.aspx>.

<sup>8</sup> The interest-to-income rate ratio shows how large a share of households' disposable income is spent on interest expense; that is, households' debt servicing expenses.

<sup>9</sup> FI (2015), *The Swedish mortgage market 2015*. Published on fi.se on 14 April 2015, FI ref. 14-8731.

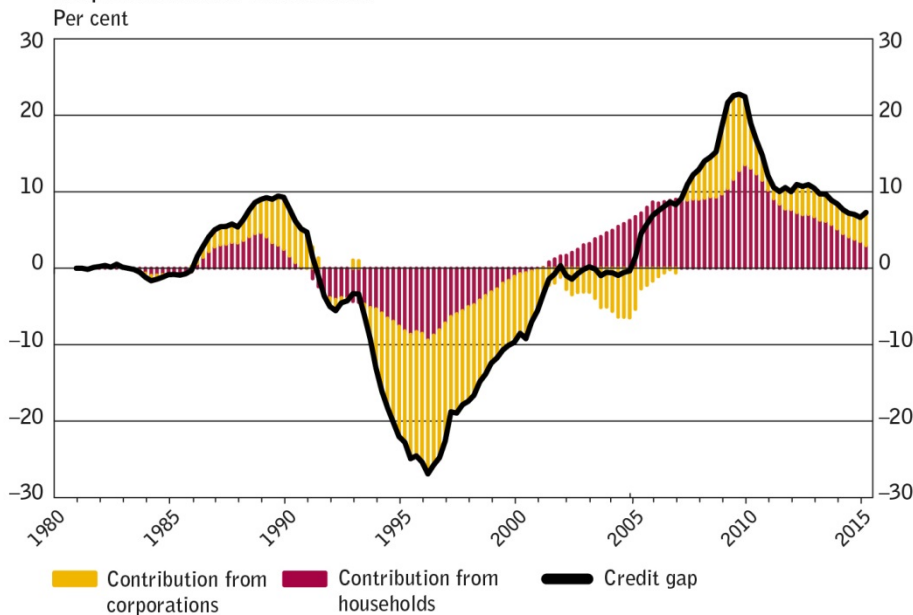
**5 Growth rate in MFI-lending to households and corporations and nominal GDP growth**



Source: Statistics Sweden.

Credit growth with respect to the household sector has long been the most important factor behind total lending growth in Sweden. However, due to the acceleration in corporate lending growth in recent quarters, the latter contributes to an increasing part of the total credit gap (see diagram 6). The contribution from household lending to the total credit gap is smaller than the contribution from lending to companies for the first time since 2009.

**6 Credit gap broken down to contributions from corporations and households**



Note: Contributions from corporations and households sum up to the total credit gap.

Sources: FI and Statistics Sweden.

A review of the other indicators does not imply that the risk outlook has changed substantially since the previous quarter. The banks' capital strength is still good and has improved during the second quarter of 2015 (see diagram B 1.3).<sup>10</sup> Swedish banks show a stable level of profitability and the banks' capital contributes to ensuring they currently have a strong position on the financial market. The resilience of the Swedish banking sector thus remains satisfactory.

A substantial current account surplus and – compared with many European countries – stable public finances, also imply relatively small risks (see diagram B 1.2). Real equity prices have fallen somewhat in recent months, but are still high relative to the levels noted since the financial crisis (see diagram B 1.5).

### *Overall assessment*

Total lending to the private non-financial sector continued to rise in the first quarter of 2015. Growth rates in lending to both households and firms accelerated. Corporate lending in particular is growing faster than in the same quarter of the previous year. The development in lending from both MFIs and through market funding is contributing to total corporate lending now increasing at a faster pace than household lending.

At the same time, lending to households is increasing at an ever faster pace. Lending to the household sector is growing faster than both nominal GDP and disposable income. One reason for the increase in household indebtedness is the ever-increasing house prices. As household debts largely consist of mortgages, developments in prices in the housing market have considerable significance for the development of household debt.<sup>11</sup> As house prices are continuing to rise, it is probable that lending to households will continue to grow faster in the near term. The rising indebtedness linked to increasing house prices, therefore, poses a heightening risk to the Swedish economy. Given this, Finansinspektionen considers that an amortisation requirement should be introduced as soon as possible to dampen the economic risks linked to household debt.<sup>12</sup>

Finansinspektionen decided in June 2015 to raise the countercyclical buffer to 1.5 per cent to boost the resilience of the banks. This assessment was based on

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<sup>10</sup> See also FI (2015), *The Swedish banks' capital requirements, second quarter 2015* Published on fi.se on 2 September 2015, FI ref. 15-7395.

<sup>11</sup> Sveriges Riksbank, Finansinspektionen and the Swedish National Debt Office (2015), *The driving forces behind household indebtedness*, report to the Financial Stability Council. Published on <http://www.sou.gov.se/finansiella-stabilitetsradet/> on 3 July 2015.

<sup>12</sup> FI (2015), *Proposal for new rules regarding mortgage amortisation requirements*. Published on fi.se on 11 March 2015. See also Ingves, Stefan and Lindblad, Hans and Noréus, Martin (2015), Tydligt amorteringskrav bör införas snarast möjligt (Clear amortisation requirements should be introduced as soon as possible), *Dagens Nyheter*. Debate article published on 17 August 2015.



the acceleration in credit growth, rapidly-rising house prices and the risk that the absence of an amortisation requirement could contribute to somewhat higher growth in credit. The above analysis show that developments in these parts are still worrying, but that the risk outlook has not altered significantly in relation to the previous quarter. Nor do other indicators used as a base for the assessment of the risk outlook indicate that the systemic risks have tangibly increased. Finansinspektionen will, in addition, continue to monitor developments and is prepared to take action if systemic risks linked to the growth in credit increase. In light of this, the countercyclical buffer rate is still set at 1.5 per cent.

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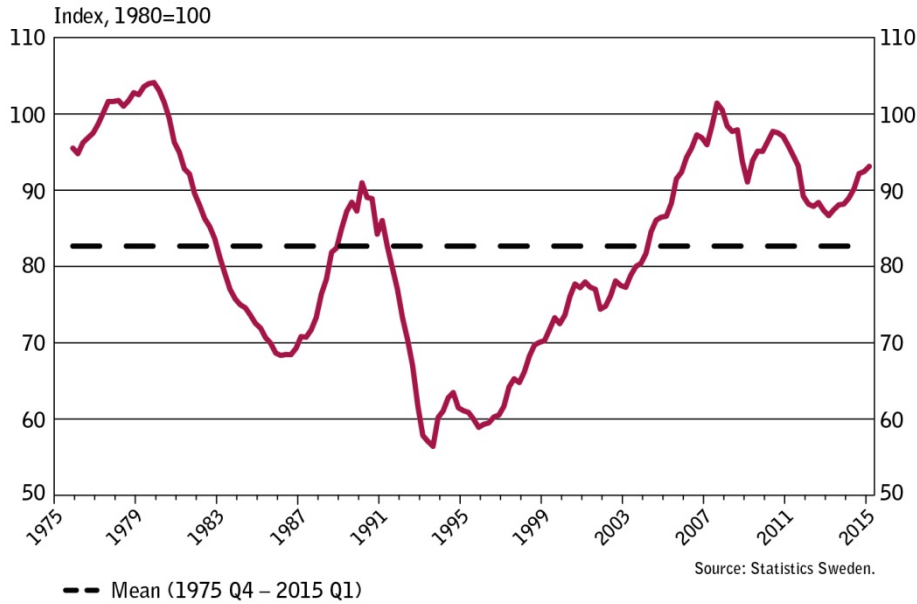
Sven-Erik Österberg  
*Chairman of the Board*

Matilda Gjirja  
*Senior Analyst*

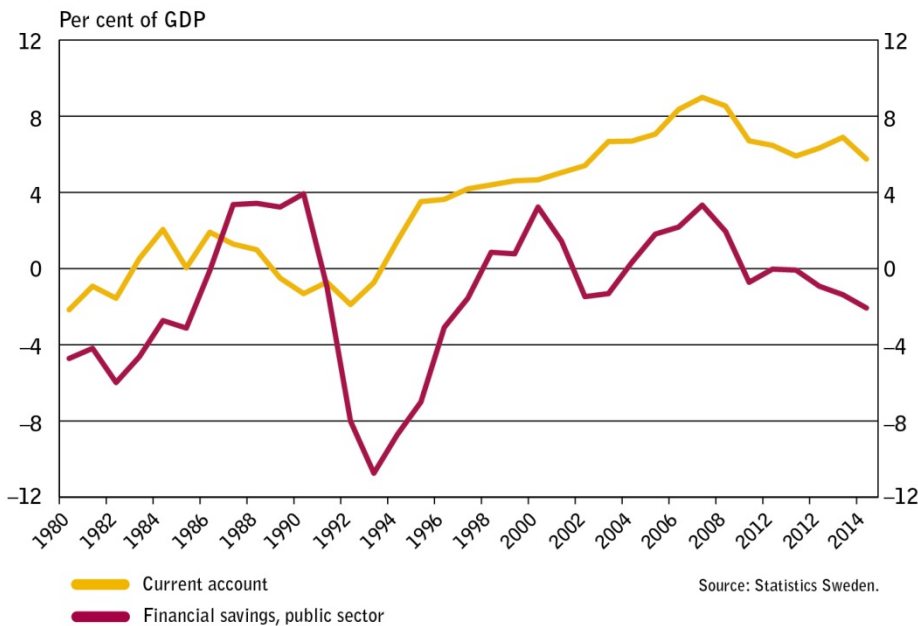
A decision in this matter was made by the Board of Directors of Finansinspektionen (Sven-Erik Österberg, Chair, Sonja Daltung, Hans Nyman, Gustaf Sjöberg, Anna Pettersson Westerberg and Martin Noréus, Acting Director General) following a presentation by Senior Analyst Matilda Gjirja. Per Håkansson (Chief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

## Appendix 1

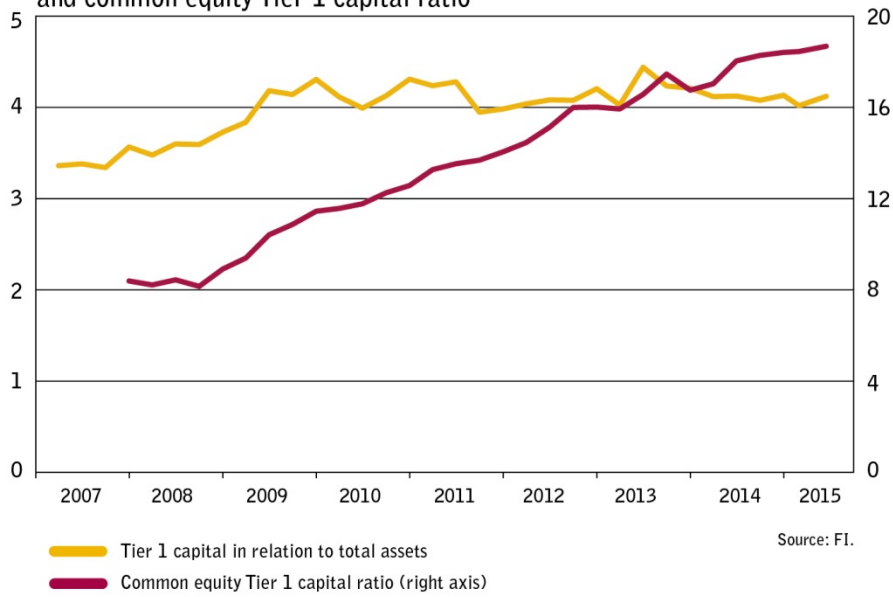
### B 1.1 House prices in relation to disposable income



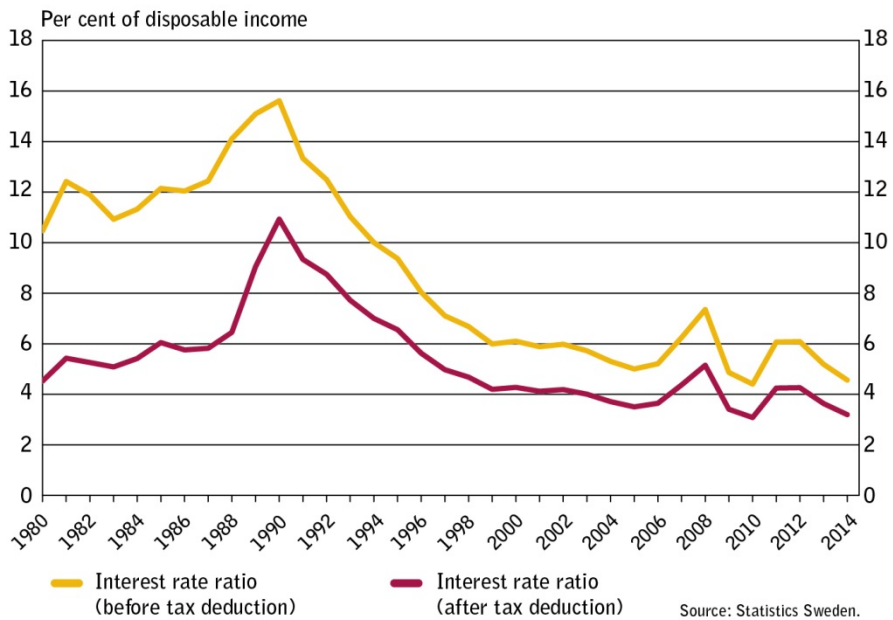
### B 1.2 Current account and financial saving in the public sector



**B 1.3 Tier 1 capital in relation to total assets and common equity Tier 1 capital ratio**



**B 1.4 Interest rate ratio of households**



### B 1.5 Real equity prices



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

Source: Statistics Sweden and Reuters Ecowin.