

**WARNING OF THE EUROPEAN SYSTEMIC RISK BOARD**  
**of 27 June 2019**  
**on medium-term vulnerabilities in the residential real estate sector in Norway**  
**(ESRB/2019/14)**  
(2019/C 366/11)

THE GENERAL BOARD OF THE EUROPEAN SYSTEMIC RISK BOARD,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board <sup>(1)</sup>, and in particular Articles 3, 16 and 18 thereof,

Whereas:

- (1) Housing is a key sector of the real economy and represents a major part of household wealth and bank lending. Residential real estate properties make up a large component of households' asset holdings and loans for housing are often a large part of the balance sheets of credit institutions. Furthermore, housing construction is typically an important element of the real economy, being a source of employment, investment and growth.
- (2) Past financial crises and experience in many countries have demonstrated that unsustainable developments in real estate markets may have severe repercussions on the stability of the financial system and of the economy as a whole in a given country, which may also lead to negative cross-border spillovers. The effects on financial stability may be both direct and indirect. Direct effects consist of credit losses from mortgage portfolios due to adverse economic and financial conditions and simultaneous negative developments in the residential real estate market. Indirect effects relate to adjustments in household consumption, with further consequences for the real economy and financial stability.
- (3) Real estate markets are prone to cyclical developments. Excessive risk-taking, excessive leverage and misaligned incentives during the upturn of the real estate cycle may lead to severe negative implications for both financial stability and the real economy. Given the relevance of residential real estate (RRE) for financial and macroeconomic stability, seeking to prevent the build-up of vulnerabilities in residential real estate markets by the use of macroprudential policy is especially important, in addition to its use as a means of mitigating systemic risk.
- (4) While cyclical factors play an important role in fuelling the vulnerabilities identified in residential real estate markets in the European Economic Area (EEA) countries, there are also structural factors that have driven these vulnerabilities. These factors can include a lack of housing supply – which has been exerting upward pressure on house prices and debt for households that buy their own property – or other public policies which may act as an incentive for households to overborrow. Given that these factors go beyond macroprudential policy, measures originating from other policy areas can complement and support the current macroprudential measures in addressing the vulnerabilities present in the residential real estate markets in the individual countries efficiently and effectively, without generating excessive costs for the real economy and the financial system.

<sup>(1)</sup> OJ L 331, 15.12.2010, p. 1.

- (5) In 2016, the European Systemic Risk Board (ESRB) conducted a Union-wide assessment of medium-term vulnerabilities relating to residential real estate <sup>(2)</sup>. This assessment enabled the ESRB to identify a number of medium-term vulnerabilities in several countries as sources of systemic risk to financial stability, which led to the issuance of warnings to eight countries: Belgium <sup>(3)</sup>, Denmark <sup>(4)</sup>, Luxembourg <sup>(5)</sup>, the Netherlands <sup>(6)</sup>, Austria <sup>(7)</sup>, Finland <sup>(8)</sup>, Sweden <sup>(9)</sup> and the United Kingdom <sup>(10)</sup>.
- (6) The ESRB has recently concluded a systematic and forward-looking EEA-wide assessment of vulnerabilities relating to residential real estate <sup>(11)</sup>.
- (7) In this context, the ESRB has identified in eleven countries, of which Norway is one, certain medium-term vulnerabilities as sources of systemic risk to financial stability that have not been sufficiently addressed.
- (8) The ESRB's assessment of vulnerabilities highlights the following in relation to Norway:
- a. Household indebtedness is very high when compared with other countries and with previous years, and has been increasing steadily over the past 10 years. Moreover, a large share of loans are at variable interest rates, which also makes households vulnerable to interest rate increases. However, stress testing for interest rate increases has shown that mortgage applicants would generally be able to meet normal living expenses in case of a shock to interest rates. Therefore, the risk of potential defaults due to interest rate increases could be contained.
  - b. Mortgage lending has been growing over the medium term, and constitutes the main contributor to the growth in lending to households. Moreover, mortgage credit is systemically important for the banking sector, as it represents a high share of total loans by credit institutions. The banking sector may also be exposed to risks stemming from the international environment, owing to the large share of foreign investors participating in the covered bond market and the interconnectedness of Norway's financial system with the other Nordic countries.
  - c. There are signs of house price overvaluation, following a long period of elevated and persistent growth in house prices. Moreover, in recent quarters house prices have moderated, but transaction volumes have not decreased. The rate of home ownership through mortgages is high, which could potentially make households vulnerable to adverse economic and financial conditions or adverse developments in the residential real estate market.
  - d. An economic or financial shock could lead to the materialisation of direct and indirect risks to financial stability, given the vulnerabilities mentioned above. Potential direct risks to the banking system in Norway relate to potential credit losses from new mortgage loans, since these loans were granted in an environment of possibly overvalued house prices. Moreover, households may experience a negative wealth effect or fall into negative equity if a decrease in house prices is significant. Furthermore, if, for example, unemployment increases and/or growth of household income decreases, some households may find it more difficult to service their debts. The associated negative household income and wealth effects may reinforce the initial shock if households are required to reduce consumption in order to service their housing loans. This could lead to second-round effects and an increase in risks to the credit institutions and the financial system.

<sup>(2)</sup> See 'Vulnerabilities in the EU Residential Real Estate Sector', ESRB, November 2016, available on the ESRB's website at [www.esrb.europa.eu](http://www.esrb.europa.eu).

<sup>(3)</sup> Warning ESRB/2016/06 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Belgium (OJ C 31, 31.1.2017, p. 45).

<sup>(4)</sup> Warning ESRB/2016/07 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Denmark (OJ C 31, 31.1.2017, p. 47).

<sup>(5)</sup> Warning ESRB/2016/09 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Luxembourg (OJ C 31, 31.1.2017, p. 51).

<sup>(6)</sup> Warning ESRB/2016/10 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of the Netherlands (OJ C 31, 31.1.2017, p. 53).

<sup>(7)</sup> Warning ESRB/2016/09 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Austria (OJ C 31, 31.1.2017, p. 43).

<sup>(8)</sup> Warning ESRB/2016/08 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Finland (OJ C 31, 31.1.2017, p. 49).

<sup>(9)</sup> Warning ESRB/2016/11 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Sweden (OJ C 31, 31.1.2017, p. 55).

<sup>(10)</sup> Warning ESRB/2016/12 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of the United Kingdom (OJ C 31, 31.1.2017, p. 57).

<sup>(11)</sup> See 'Vulnerabilities in the residential real estate sectors of EEA countries', ESRB, 2019, available on the ESRB's website at [www.esrb.europa.eu](http://www.esrb.europa.eu).

- e. The ESRB takes note of the fact that Norway has implemented a comprehensive set of borrower-based and capital measures, which aim at ensuring the resilience of both credit institutions and borrowers. The loss-given-default (LGD) floor and the requirements for probability of default (PD) models <sup>(12)</sup>, alongside the countercyclical capital buffer are all important capital-based measures that are expected to ensure that credit institutions are able to absorb losses following a potential economic or financial shock. Moreover, the Norwegian authorities have activated a wide range of borrower-based measures: a combination of limits to loan-to-value (LTV) ratios and debt-to-income (DTI) ratios, and affordability tests. The effects of the borrower-based measures have been documented and there has been a decrease in the share of mortgages with high values in relation to the ratios to which limits apply. Notwithstanding the substantial efforts made in the area of macroprudential policy, systemic risks related to the residential real estate market remain elevated in Norway.
- f. The current macroprudential policy measures are assessed to be appropriate to mitigate the identified systemic risks related to vulnerabilities in the residential real estate sector in Norway. However, there is still considerable systemic risk related to the Norwegian residential real estate market, and on these grounds the macroprudential policy is assessed to be partially sufficient. Within the area of macroprudential policy, the mitigation of identified vulnerabilities has been a primary concern, resulting in a comprehensive set of policy measures. Nevertheless, macroprudential policies could be complemented by broader policy action aimed at the mitigation or elimination of the factors which facilitate or promote increasing household indebtedness. These policies should support the current macroprudential measures to address the remaining vulnerabilities identified in the residential real estate market in Norway efficiently and effectively, without producing excessive costs for the Norwegian real economy and financial system. Further policies could include removing incentives for higher household indebtedness, by increasing efficiency in the rental housing market and the development of owner-occupied housing, and by ensuring adequate housing supply. If no other policy action is taken and if the vulnerabilities do not recede, or if they increase due to economic and financial developments, existing macroprudential measures could be tightened or new macroprudential measures could be activated.
- (9) When activating any measures to address the identified vulnerabilities, their calibration and phasing-in should take into account the position of Norway in the economic and financial cycles, and any potential implications as regards the associated costs and benefits.
- (10) ESRB warnings are published after the General Board has informed the Council of the European Union of its intention to do so and provided the Council with an opportunity to react, and after the addressees have been informed of the intention to publish,

HAS ADOPTED THIS WARNING:

The ESRB has identified medium-term vulnerabilities in the residential real estate sector of Norway as a source of systemic risk to financial stability, which may have the potential for serious negative consequences for the real economy. From a macroprudential perspective, the ESRB considers the main vulnerability to be high household indebtedness associated with the long-term increase of house prices and their potential overvaluation.

Done at Frankfurt am Main, 27 June 2019.

*Head of the ESRB Secretariat,  
on behalf of the General Board of the ESRB*  
Francesco MAZZAFERRO

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<sup>(12)</sup> Norway has tighter requirements for the residential mortgage internal ratings-based approach in place, including an LGD floor of 20 % and specific requirements for calculating the PD for mortgage loans. National authorities report that the LGD floor and PD requirements work to increase the average risk weight on residential mortgages for Norwegian banks using internal ratings-based models.