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

At its meeting on 28 September 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%.

The FIN-FSA Board has also decided to clarify its recommendation of 27 June 2022 on a maximum debt-servicing burden for housing loan applicants' loans and housing company-related charges for financial costs. According to the revised recommendation, in assessing the maximum debt-servicing burden, all loans (excl. loans with interest rate hedges and fixed-rate loans referred to in the recommendation) and housing company-related charges for financial costs are calculated using a stressed interest rate of 6% and a maturity of 25 years. However, lenders can, at their own discretion, use higher interest rates and shorter maturities in their stressed calculations of housing affordability for applicants of housing loans. The FIN-FSA will assess compliance with the recommendation by using a stressed interest rate of 6% and a maturity of 25 years for all a loan applicants' loans and housing company-related charges for financial costs. The revised recommendation will enter into force on 1 January 2023.

The full text of the revised recommendation is attached at the end of this document.

Justification for the decision

Countercyclical capital buffer (CCyB) requirement

Russia's war in Ukraine has undermined economic growth globally and in Finland by increasing uncertainty, exacerbating pandemic-induced production bottlenecks and pushing up energy and food prices in particular. The uncertain operating environment and expectations about a swift tightening of monetary policy in major economic areas to bring down persistently high inflation have led to tighter funding conditions in the international financial markets.

The Bank of Finland's September interim forecast sees Finnish economic growth moderating notably this year and the next. The Finnish economy is forecast to grow by 2.2% in 2022, and in 2023 the economy is expected to contract by 0.3%. However, due to the adverse geopolitical situation, forecasts are surrounded by significant uncertainty, and downside risks to growth are elevated. These downside risks may materialise if the war in Ukraine escalates further, global economic growth slows more sharply than estimated, financing conditions tighten more than projected or disruptions in energy availability become more severe.

The cyclical vulnerabilities relating to total lending have remained moderate in Finland. The most recent figures for the primary risk indicator for setting a countercyclical capital buffer (CCyB) requirement – the private sector credit-to-GDP gap – have been clearly negative irrespective of the measure of credit used in the calculations. Using the broad measure of credit, the primary risk indicator stood at -16.4 percentage points in the second quarter of 2022. Using the narrow measure of credit, which is less sensitive to statistical revisions, the value was -7.5 percentage points. With both calculation methods, the credit-to-GDP gap is moving deeper into negative territory.

The upsurge in cost-push inflation, fuelled by rising energy prices, is dampening the financial cycle and reducing the need to activate the CCyB. Higher costs erode the ability of households and firms to service their debts, which, together with increased uncertainty, makes borrowing less tempting. From the perspective of the application of the CCyB, higher cost-push inflation immediately raises nominal GDP but not the size of the stock of loans, and potentially affects the growth of nominal loan stocks only with a lag. For this reason, higher inflation pushes down the primary risk indicator and the core risk indicators capturing changes in the credit-to-GDP ratio.

Based on the revised set of risk indicators adopted this quarter for the CCyB requirement, there are no such signs of changes in the credit markets as would require an increase in the CCyB rate. As for the indicators supplementing the primary risk indicator and included in the revised set of indicators, none is significantly high based on observations extending up to the 1980s. Many of these indicators are well below their historical averages.

The growth rates of the stocks of loans granted to non-financial corporations and households have remained fairly stable, and there are signs of growth moderating, particularly in the case of households and housing corporations. The Finnish financial market stress indicator derived from the pricing of securities rose notably in the spring and early summer but has remained below the levels recorded at the height of the COVID-19 crisis.

Maximum loan-to-collateral (LTC) ratio

House sales and mortgage lending moderated in January–July 2022 from a year earlier. In July 2022, sales of old dwellings in housing companies and drawdowns of new housing loans were lower than in 2018–2021. Average nominal house prices continued to rise in annual terms in July, but the pace of growth has slowed. Real house prices, in turn, have declined in response to high inflation.

Although mortgage interest rates are still fairly low by historical standards, the average rate on new housing loans rose in the spring and early summer on the back of higher reference rates and a greater use of interest rate hedging. The share of new housing loans with longer-than-usual maturities has grown further. In May–July, loans with maturities exceeding 26 and 30 years accounted for a record large share (19% and 13% respectively) of new housing loans. The average size of new housing loans grew in the first half of 2022. In the second quarter of 2022, the shares of mortgages with the highest LTC ratios for new first-home loans, and for other new housing loans, were roughly unchanged on the previous quarter.

Total household debt relative to annual disposable income increased slightly in the second quarter of 2022. Indebtedness increased also relative to financial assets, owing to a contraction in household financial assets.

Weaker economic prospects, tightening financing conditions and increased uncertainty have fuelled the risk of housing market activity falling from recent levels. Consumer confidence in the economy is historically low, and fewer people consider the time favourable for taking out a loan. Consumers' borrowing and house purchase intentions have dropped to their long-term average levels, and banks expect household credit demand to decrease. Although housing construction activity is still relatively brisk, construction is slackening based on the number of building permits.

The systemic risks relating to the housing market and household indebtedness have increased since the start of the war. Debt levels remain historically high, which is one of the key structural vulnerabilities in the financial system. Sharp increases in consumer prices will drive up household spending on essentials, while increases in market interest rates will do the same for loan-servicing costs. Higher consumption spending and loan-servicing costs may put a strain on the finances of households, particularly for those that are heavily indebted relative to income, and hamper their ability to maintain their level of consumption. As mortgages with longer-than-usual maturities become more common, this will increase the sensitivity of households' loan-servicing costs to changes in interest rates.

With tightening financing conditions and a weakening economic environment, it remains important to prevent further growth in high household debt levels and to ensure that new mortgage borrowers have sufficient financial buffers against higher loan-service burdens 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. The recommendation on housing loan applicants' maximum debt-servicing burden, taken in June 2022 and effective from the beginning of 2023, also serves to safeguard households' capacity to service their loans and maintain consumption under stressed conditions.

Clarification of the recommendation on a maximum debt-servicing burden for housing loan applicants’ loans and housing company-related charges for financial costs

Discussions with Finance Finland and credit institutions have revealed that the FIN-FSA Board’s recommendation on a maximum debt-servicing burden for housing loan applicants’ loans and housing company-related charges for financial costs, issued on 27 June 2022, needs to be clarified. Based on feedback received, the recommendation will be revised so that all housing loans, charges for financial costs and other debts can be assessed in calculations of housing affordability with an interest rate of 6% and a maturity of 25 years (excl. fixed-rate loans and loans with interest rate hedges). The FIN-FSA will assess compliance with the recommendation with the aforementioned interest rate and maturity. The reason for the clarification is that in some cases it is difficult for credit institutions to obtain precise information on their customers’ old loans. In its previous form, the recommendation might lead customers lengthening their loans.

However, lenders can, at their own discretion, use higher interest rates and shorter maturities in their stressed calculations of housing affordability for applicants of housing loans.