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

At its meeting on 30 March 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%. The Board also decided to extend the period of validity of the decision on a tighter maximum loan-to-collateral (LTC) ratio, taken on 28 June 2021 pursuant to chapter 15, section 11 of the Credit Institutions Act. Hence, the maximum LTC ratio for new residential mortgage loans other than first-home loans will stay at 85%.

The FIN-FSA Board recommends that lenders carefully assess the loan applicant's ability to pay and exercise restraint in granting loans that are large with regard to the applicant's income and have a longer than usual repayment period. When deciding whether to grant a loan, lenders should particularly take into account potential future changes in the loan applicant's total debt servicing costs so that any increases in interest rates or disruptions in the applicant's debt repayment would not threaten their ability to service their debt or maintain consumption.

The FIN-FSA Board will specify the aforementioned recommendation in the second quarter of 2022. In this context, the Board will elaborate on, for example, the types of loans lenders should exercise restraint in granting.

Justification for the decision

Countercyclical capital buffer (CCyB) requirement

Russia's war of aggression against Ukraine has weakened the economic outlook in Finland and globally. The FIN-FSA Board is actively assessing the effects of the war on the stability of the Finnish financial system and on the need to deploy macroprudential instruments.

In addition to the war, the key risks to the global and Finnish economies relate to high inflation – which may lead to a faster tightening of financing conditions than previously expected – and to the continuation of the COVID-19 pandemic. At the same time, global disruptions in transport and in the availability of raw materials and components are also restraining Finland's economic growth.

The most significant long-term vulnerabilities for the Finnish financial system continue to relate to household indebtedness. The Finnish economy and banking sector are also exposed to risks in the financial markets of the other Nordic countries. The Russia-Ukraine war will be reflected as partial adjustments in pricing in the financial markets. The Finnish economy will also be impacted by the sanctions imposed by Western countries and Russia's potential counter-sanctions.

The risks associated with total lending have so far been moderate. The primary risk indicator, i.e. the private-sector credit-to-GDP gap, has fallen deeper into negative territory. As at the end of 2021, the preliminary estimate for the gap was -13.3 percentage points.

The growth rate of the stock of loans to non-financial corporations was negative for several months in 2021 and marginally positive in January 2022. Growth in household loans has moderated slightly as a whole. Growth in loans to housing corporations, in turn, has picked up again. Asset prices increased rapidly in 2021. After the start of Russia's war in Ukraine, Finland's financial market stress index rose rapidly.

Based on the primary and supplementary risk indicators and other available indicators and statistics, there are no such signs of a broad-based overheating of the credit market as would require an increase in the CCyB rate.

In the third quarter of 2022, the FIN-FSA Board will adopt a revised set of risk indicators which will guide decisions on the imposition of the CCyB requirement. The monitoring methods for measuring the financial cycle and for identifying cyclical risks have developed over recent years. The revised set of risk indicators will also be partly based on statistical sources that are more recent and less sensitive to revisions than the indicators used to date.

The new set of risk indicators will not change the assessment of the current level of cyclical risks in Finland. The indicators will be made public in the second quarter of 2022. When assessing the imposition of a CCyB rate in the second quarter, the FIN-FSA will use in parallel the current and the new set of risk indicators. However, the actual decision on the CCyB rate will be made based on the current set of indicators.

Extension of the decision on a tighter maximum loan-to-collateral (LTC) ratio

Growth in household indebtedness and relaxation of credit standards have increased the key vulnerabilities for the financial system in recent years. Debt has continued to grow relative to income, albeit at a slower pace. The share of longer-than-usual housing loans in the amount (in EUR) of new residential mortgages has also risen further.

Total household debt relative to disposable income grew to 135.9% in the fourth quarter of 2021. At the end of December 2021, the level of total household debt was almost 4% higher than a year earlier, while annual income grew by a good 1%. Indebtedness was most fuelled by housing loans. Should interest rates rise or debtors' financial situation deteriorate, the high level of indebtedness might affect borrowers' debt repayment capacity.

The annual growth rate of the housing loan stock moderated to 4% in January 2022. Meanwhile, fuelled by higher new-build construction activity, loans to housing corporations grew in January by 6.4%, faster than in summer and autumn 2021. In euro terms, growth in housing finance stems largely from owner-occupied housing loans.

The decision of the FIN-FSA Board of June 2021 to lower the maximum LTC ratio for new residential mortgage loans other than first-home loans from 90% back to 85% became effective at the beginning of October 2021. In this loan category, loans with an LTC ratio of over 80% accounted for a smaller share (17.5%) in the fourth quarter of 2021 than in the other quarters of the year. The share was roughly of the same magnitude as in the first half of 2020, before the easing of the maximum LTC ratio.

In the fourth quarter of 2021, the share of loans with an LTC ratio of over 90% in the euro amount of new first-home loans remained roughly unchanged on the previous two quarters. However, the share was notably smaller than in 2020. Both first-home loans and other new housing loans were larger, on average, in the fourth quarter of 2021 than loans granted earlier. Real house prices fell in late 2021 and January 2022 in many regions from spring 2021, when house sales activity was particularly buoyant compared with previous years.

House sales and residential mortgage lending continued at rather a brisk pace in late 2021 and January 2022. Transaction and loan volumes were slightly higher in January than in the corresponding period in previous years. However, there are no signs that demand would increase significantly from the current situation. Barometer data for March 2022 indicated that consumers' house purchase and borrowing intentions were still relatively high, but noticeably fewer consumers considered the situation favourable for taking out a housing loan. Russia's war in Ukraine and the consequent heightening of economic uncertainty have significantly weakened consumers' confidence in the economy.

The average repayment period of a new residential mortgage loan stayed at a good 21 years in January 2022. Loans with a longer-than-usual repayment period, i.e. a maturity of over 26 years, accounted for the first time for over 15% of the euro amount of all new housing loans. The majority of these loans have a maturity of around 30 or 35 years, and these loans are also typically larger than other new housing loans. Loans with a maturity of over 30 years accounted for about 10% of all new housing loans in January. The average lending margins on new housing loans have widened slightly since summer 2021, standing at about 0.8 of a percentage point in January (incl. the costs of interest rate protection, which affect the annualised agreed rate, AAR).

Since 2020, households' financial assets have grown faster than their liabilities, strengthening the sector's net financial asset position. Households' net financial assets grew in the fourth quarter of 2021, too. Savings accumulated by indebted households, such as deposits and fund and equity investments, may, in particular in the short term, serve as a buffer against a temporary fall in income, for example. However, during economic or financial crises, lower asset prices and the difficulty to realise illiquid investments may in practice reduce the savings available for debt repayment. Indebted households are prone to reduce their consumption when their debt servicing burden increases, which may have significant second-round effects on the economy.

The key structural vulnerabilities in the financial system relate to high and growing household indebtedness and the lengthening of new housing loans in an environment of low interest rates. Although total household wealth has also grown at the same time, changes in assets and liabilities are not evenly distributed between households. Cyclical vulnerabilities are mitigated by the fact that the aggregate growth rate of housing finance and the rise in house prices have not picked up markedly.

The FIN-FSA Board's decision of June 2021, effective in October, to adjust the maximum LTC ratio to 85% for new residential mortgage loans other than first-home loans 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.