Bank of Finland Bulletin 2/2012 – Financial stability 2012

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Deputy Governor
8 May 2012

Themes

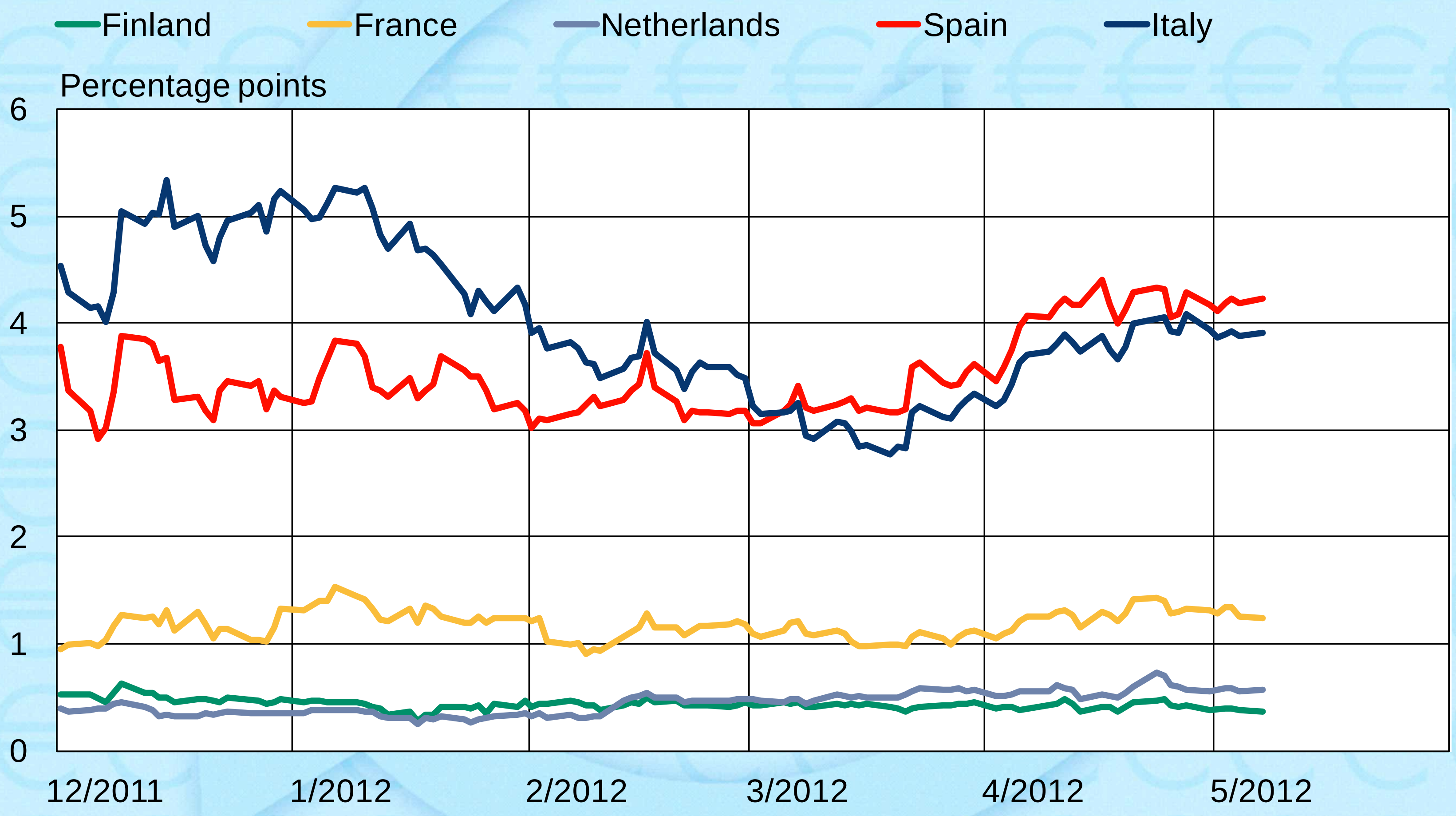
1) Stability situation and outlook for the Finnish financial system

   - domestic and foreign operational environment
   - situation of main debtor sectors

2) Risk resilience of the Finnish financial system

3) Necessary measures for strengthening the stability of the Finnish financial system

Euro area countries' 10-year bond yield spreads vis-à-vis German yields



Source: Reuters.

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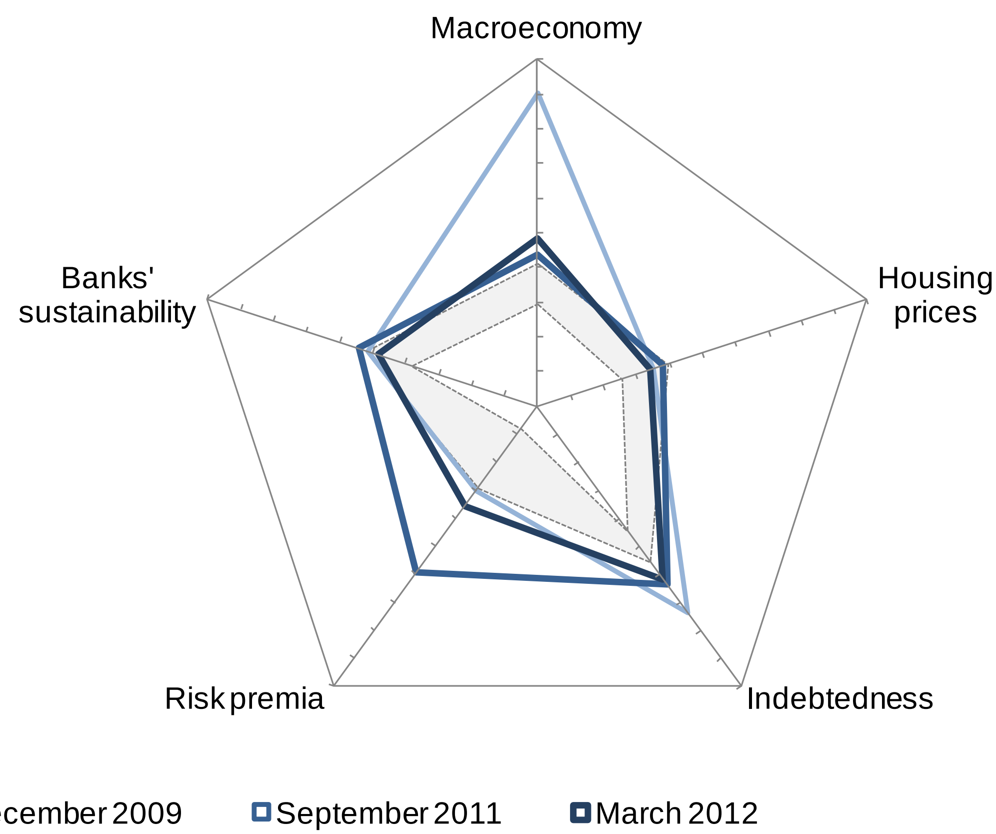
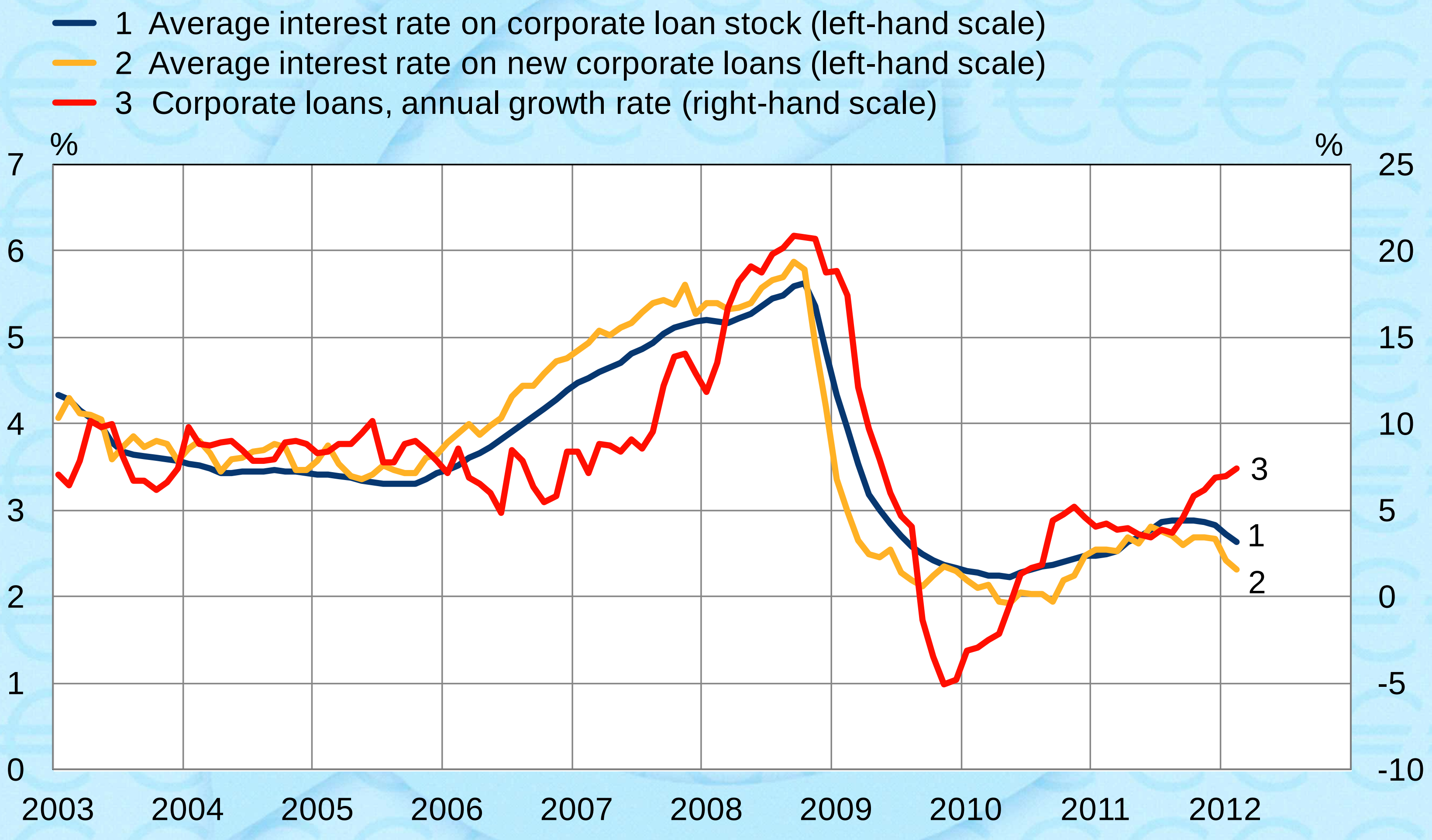
Stability situation and outlook for the Finnish financial system

Stability of the Finnish financial system strengthened in 2012



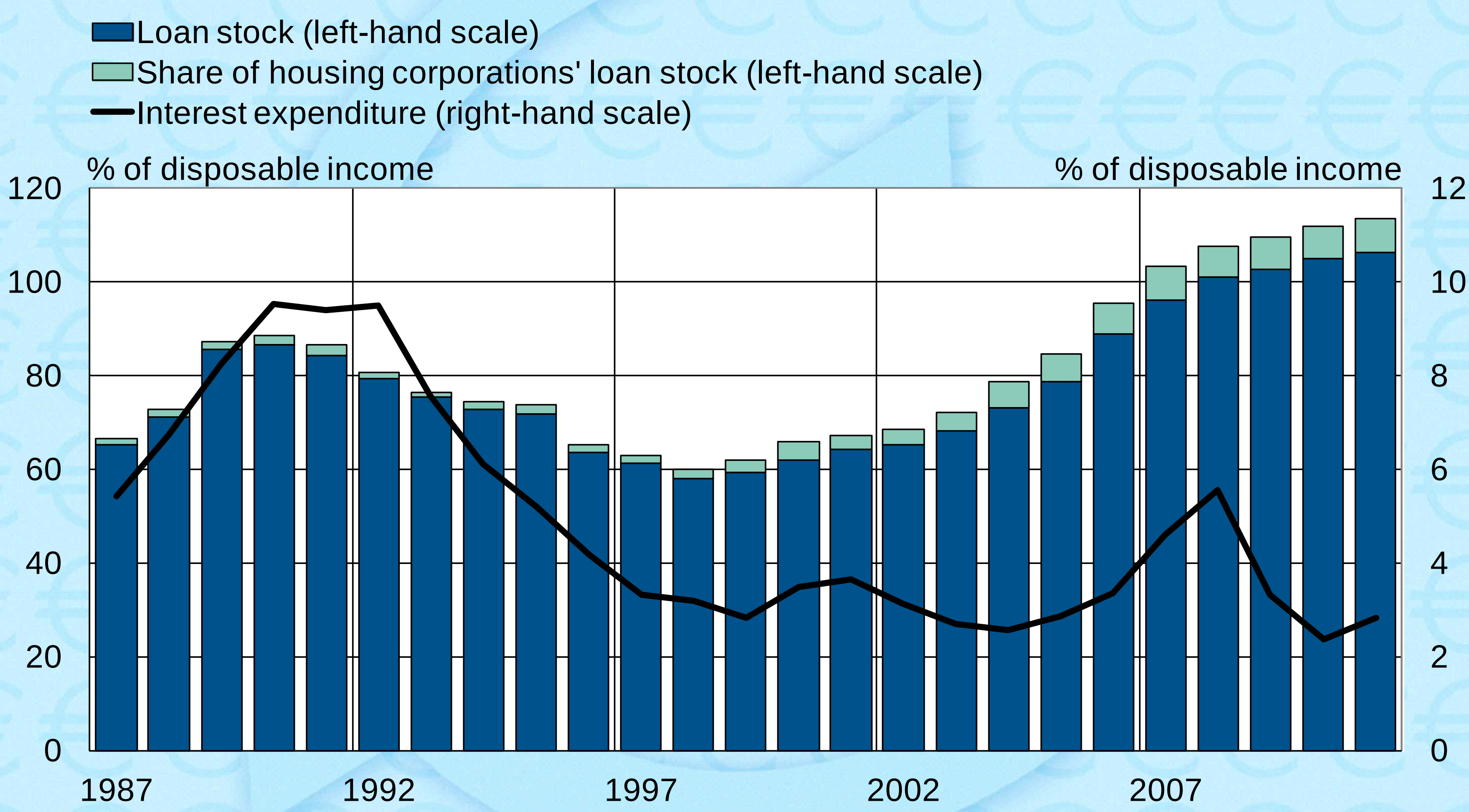
Sources: NASDAQ OMX Helsinki, banks, Statistics Finland and Bank of Finland.

Annual growth in corporate loans* accelerated



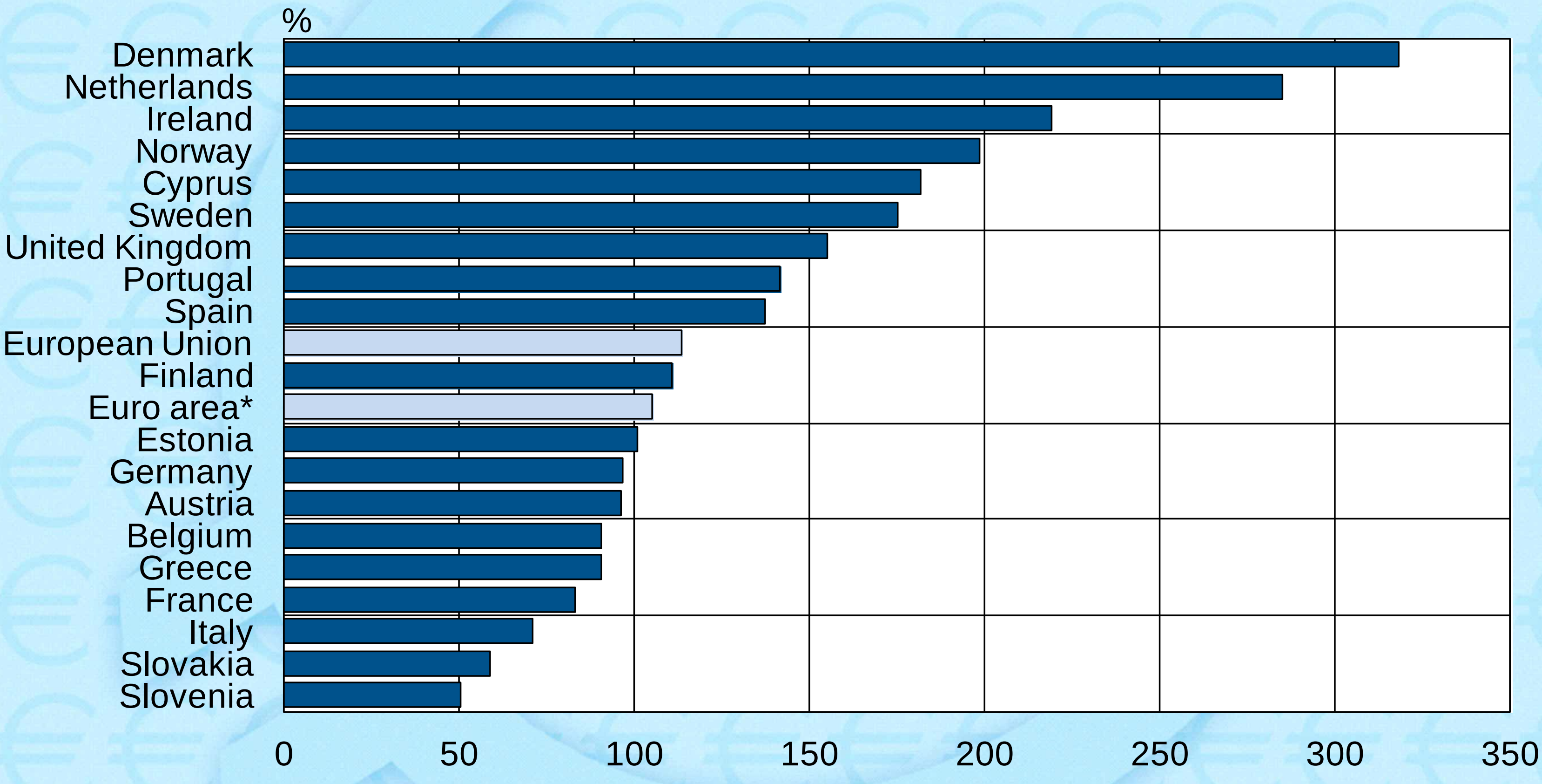
*Also includes housing corporations.
Source: Bank of Finland.

Household indebtedness continues to grow



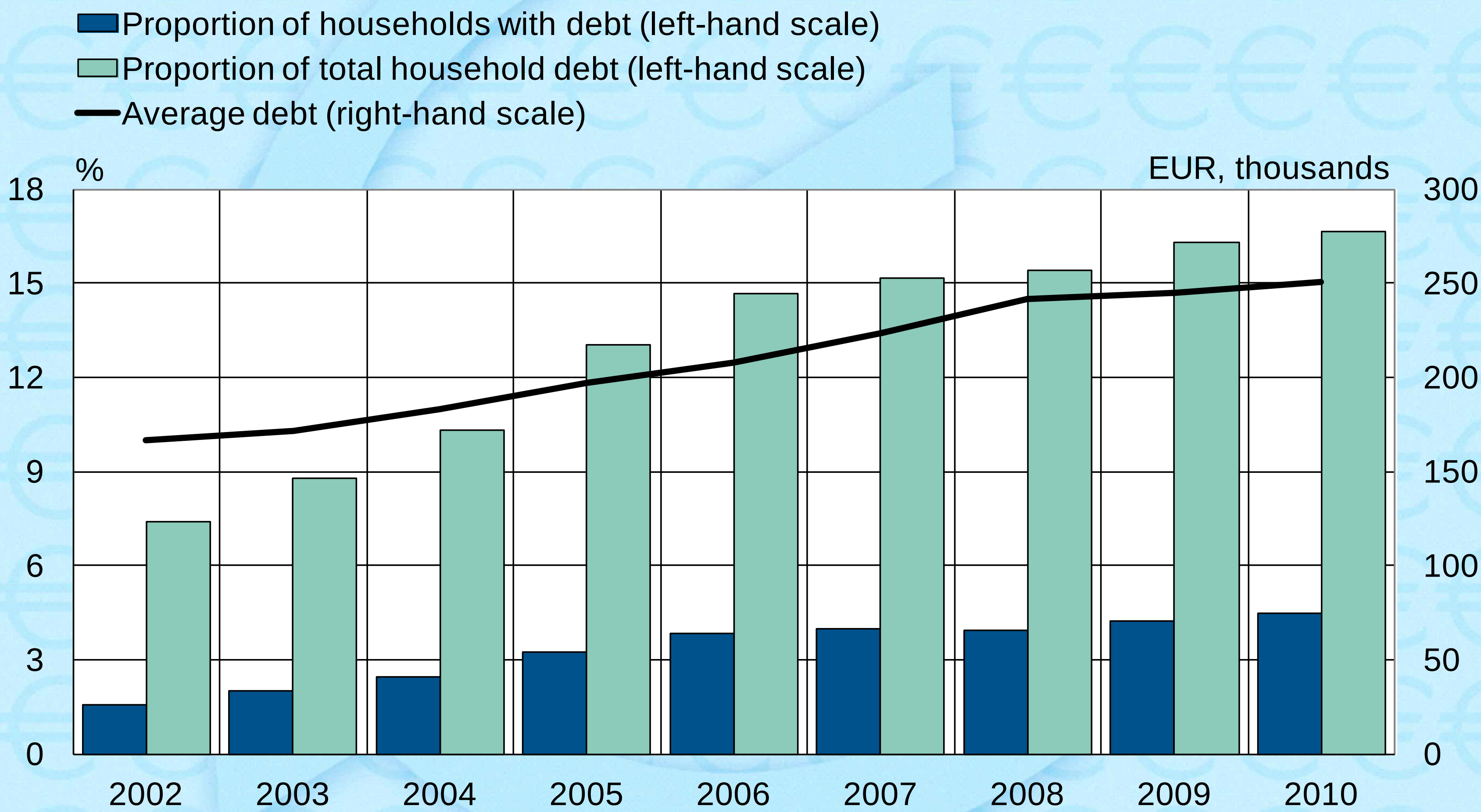
Sources: Statistics Finland and Bank of Finland calculations.

Household indebtedness at average European level



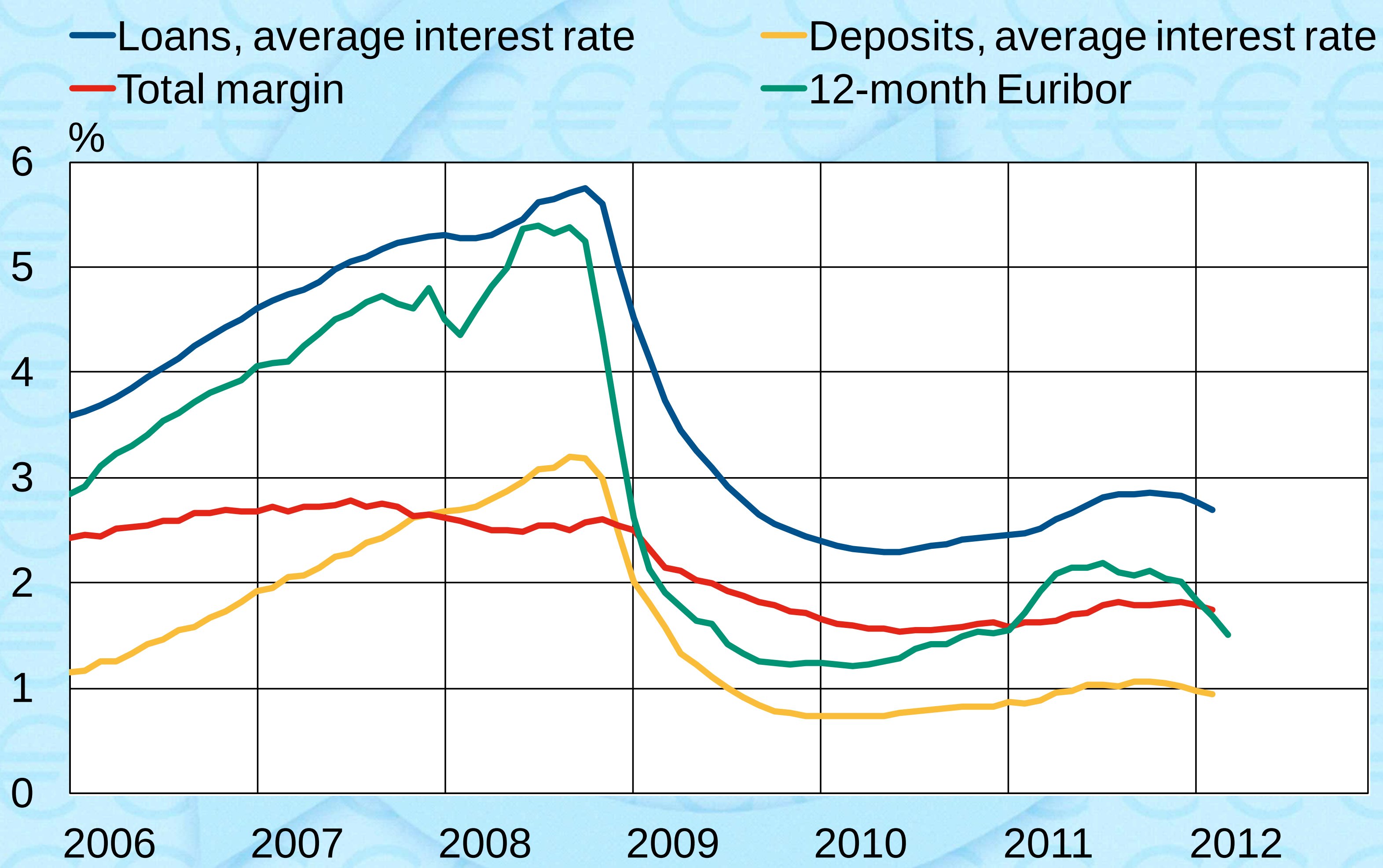
Loans, % of disposable income.
Also includes non-profit institutions serving households.
Sources: Eurostat and Bank of Finland calculations.
* Euro area figure has been corrected after the press conference (8.5.2012).

Share of heavily indebted households (debt ratio* in excess of 500%) on the increase



* Debt, % of disposable monetary income.
Sources: Statistics Finland and Bank of Finland calculations.

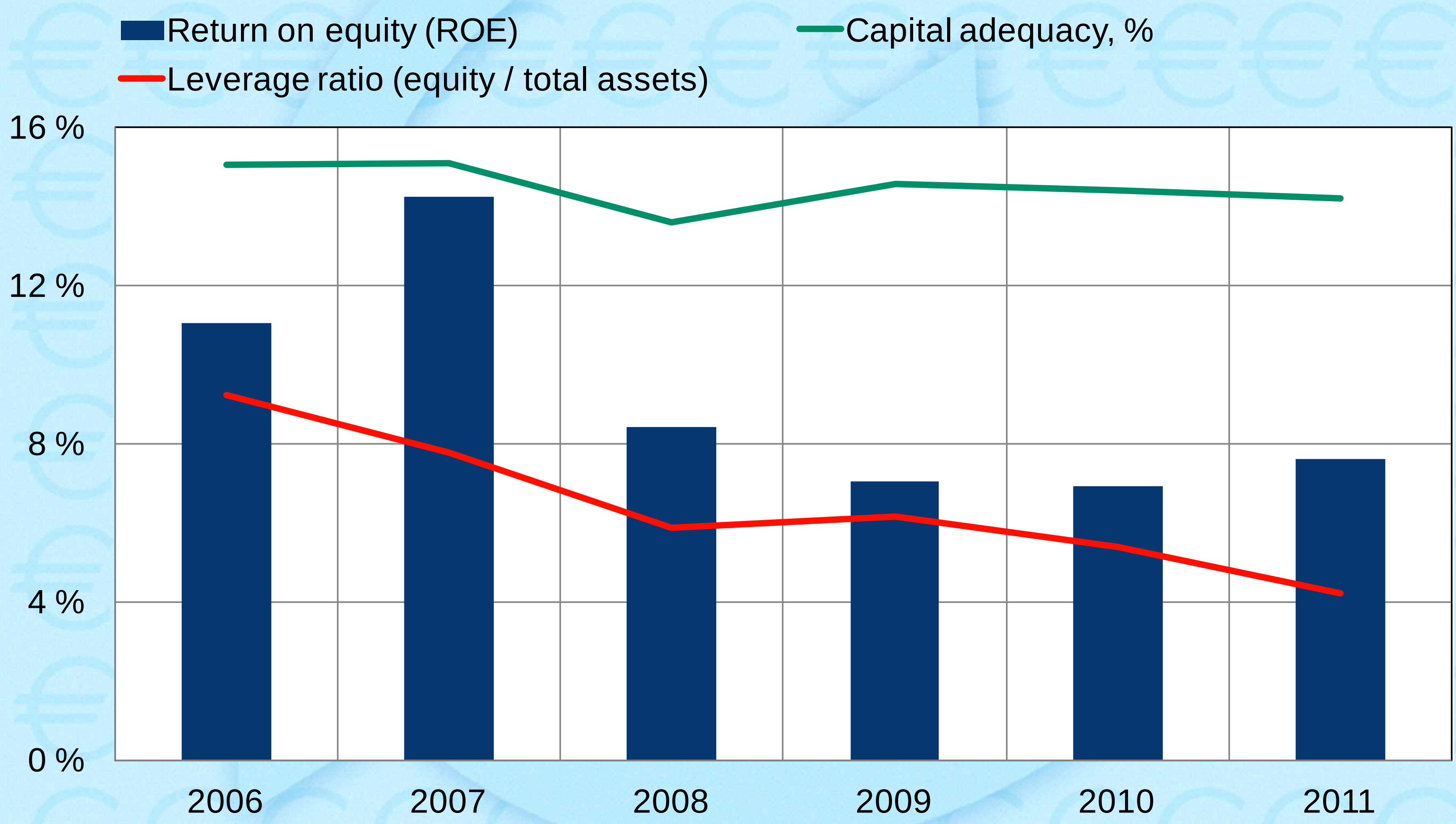
Low lending rates have kept interest payment burden at tolerable levels



Sources: Bank of Finland and Reuters.

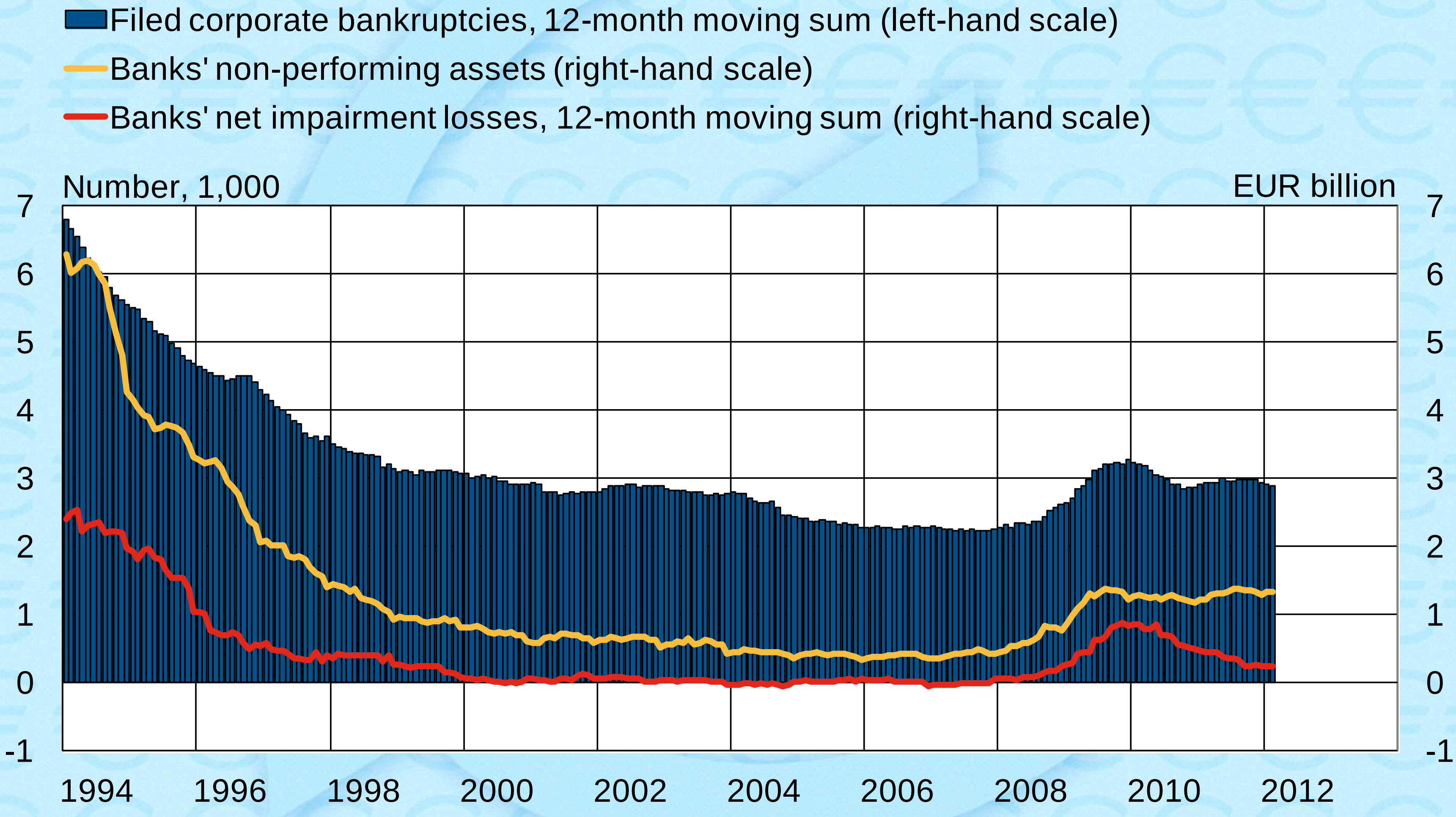
Risk resilience of the Finnish financial system

Banks strong in terms of profitability and capital adequacy, leverage ratio declined



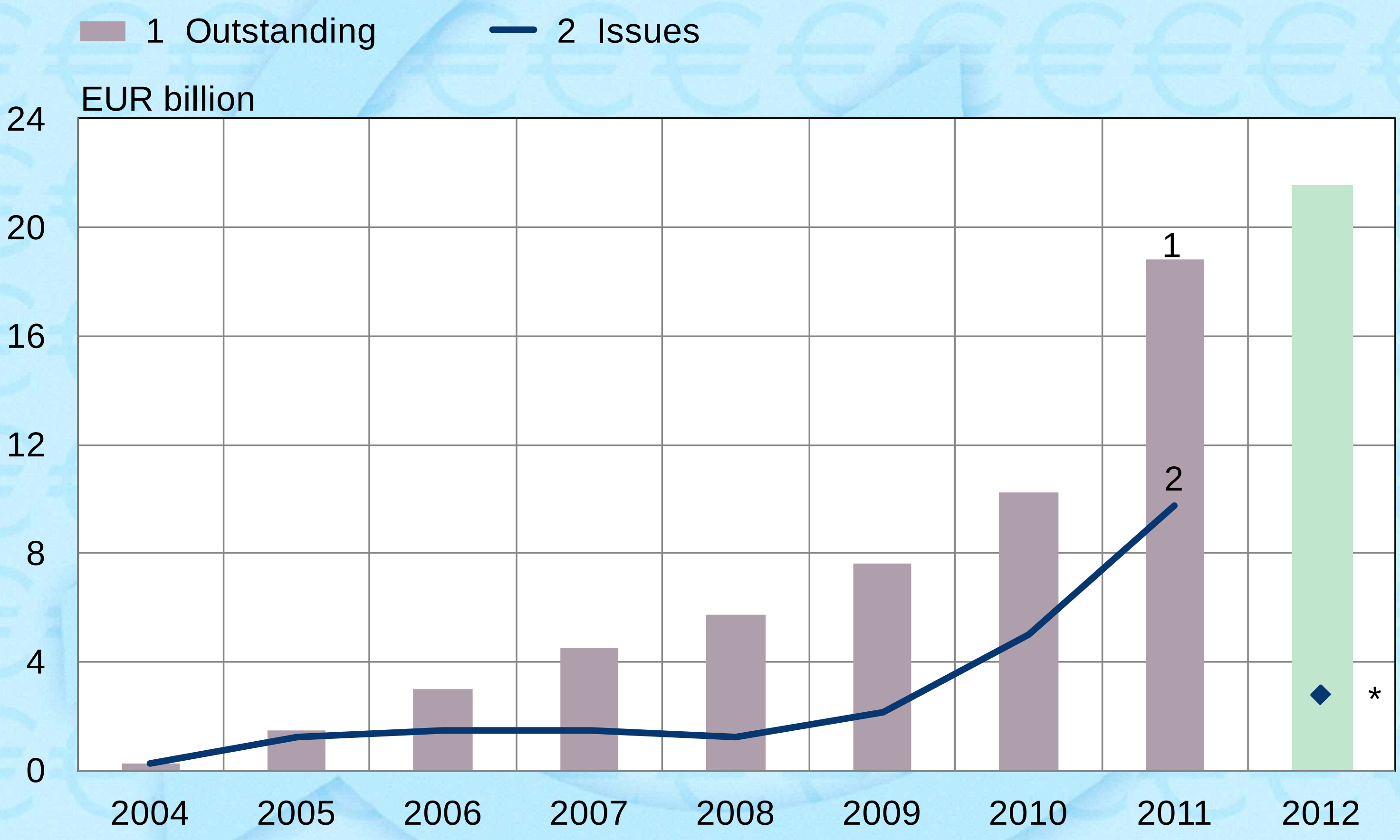
Source: Financial Supervisory Authority.

Banks' credit risk outlook stable



Sources: Statistics Finland, Financial Supervisory Authority and Bank of Finland calculations.

Covered bonds have diversified Finnish banks' funding structure



*For 2012, outstanding volume at end-February, issues in January-February.
Sources: Bank of Finland, European Covered Bonds Council and Bloomberg.

Special questions regarding payment and settlement systems

- Benefits from international infrastructure services
  - Lower prices with economies of scale
  - Broader markets for participants
- Challenges for international infrastructure services
  - Harmonised operational procedures still need to support the already achieved efficiency gains:
    - Eg automatic recording of payments at firms
    - Market development must be fostered
  - Risk management must be updated to correspond to the new environment
- Infrastructure decisions are strategically important
- Possibilities to influence infrastructures must be retained

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Measures to enhance financial stability

1) Household indebtedness must be tackled

- We have to increase awareness of interest rate risks and the risks related to large debts and various loan products.
- Banks must carefully comply with FIN-FSA's recommendations for assessing mortgage loan applicants' housing and repayment affordability and for caution regarding loan-to-value (LTV) ratios in excess of 90%.
- Banks and authorities should be cautious about amortisation-free and bullet housing loans that have become widespread in some countries.

2) Authorities need to be equipped with adequate macroprudential tools

- Finnish authorities must be equipped with discretionary means for restraining excessive overall lending and lending for house purchases, at least.

- We must also consider whether tools are needed to restrict excessive growth in banks’ balance sheets and short-term market funding.

3) Sustainability of Finland's public finances must be safeguarded

- Measures to safeguard the long-term sustainability of Finland's public finances must be continued in a determined manner.
  - The long-term sustainability of the public finances is an indispensable condition for the stability of the national financial system.

4) The quality and availability of infrastructure services directed at financial markets must be ensured

- In developing national financial markets, care must be taken to ensure that infrastructure services directed at financial markets remain reliable and effective and are flexibly accessible to different market participants.

5) Attention needs to be devoted to developments in equity ratios

- Supervisory authorities must pay attention to credit institutions’ balance sheet growth and declining leverage ratios.
- Banks operating in Finland differ in terms of their structures and business models, which places special demands on regulation and supervision.