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Financial stability





Financial stability assessment

- Publication on Bank of Finland Bulletin site, see www.bofbulletin.fi/en/financial-stability/
- Annual assessment of the stability of the Finnish financial system and the risks to financial stability
- Comprises an editorial, a main article and a number of thematic articles



Weak global economic growth and financial market unrest are sources of concern

- Subdued growth in advanced economies and slower growth in emerging economies
 - Growth concerns contributed to financial market unrest in early 2016
- Low level of interest rates underlying the asset price rise
- Uncertainties in both the short and the long term
 - Price of oil, Chinese economic growth, normalisation of US monetary policy, geopolitical risks, refugee situation
 - See articles '*What would Brexit mean for the financial markets?*' and '*Low oil price reveals implications of carbon risk*'.



Construction of Banking Union and financial regulatory reform close to completion

- Banking Union's single supervision and resolution already operational; single deposit insurance scheme the missing piece
- Financial regulatory reform in the final phase; increasing attention to be focused on supporting economic growth
 - Capital Markets Union
- See articles '*Reform of bank capital regulation enters final phase*' and '*New European Deposit Insurance Scheme to be introduced soon*'



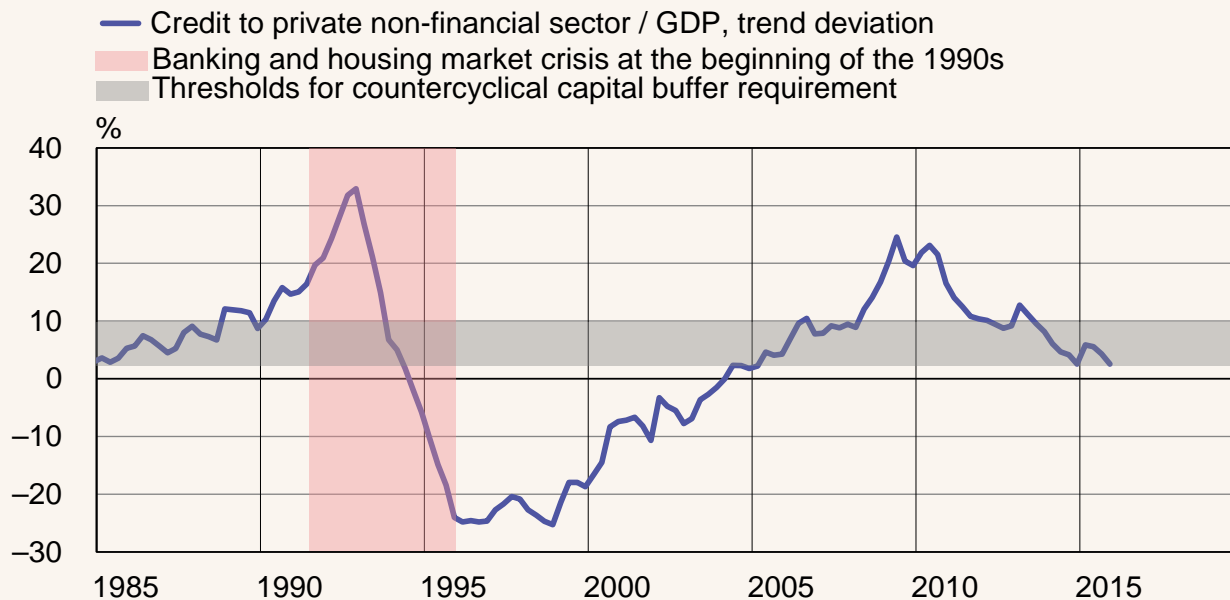
Finnish financial sector not facing any immediate cyclical threats to financial stability

- Credit growth and rising asset prices not associated with acute risks, but the risks must be monitored
 - See main article '*Stability of Finnish financial system cannot be taken for granted*'
- Increasing indebtedness a more permanent vulnerability
 - See article '*High housing debt increases risks to financial stability*'
- Finnish financial system has functioned reliably
 - Banking and insurance sectors financially sound and generating profits, but profitability will in future be eroded by the low level of interest rates
 - See article '*Low interest rates place a strain on the banks*'



No alert from the early warning indicator that has performed well in anticipating banking crises

Credit to private non-financial sector / GDP, trend deviation (primary risk indicator)



The indicator has been calculated according to Basel Committee (2010) recommendations using the one-sided Hodrick–Prescott filter ($\lambda = 400,000$).

Sources: Bank of International Settlements (BIS), Statistics Finland and Bank of Finland calculations.

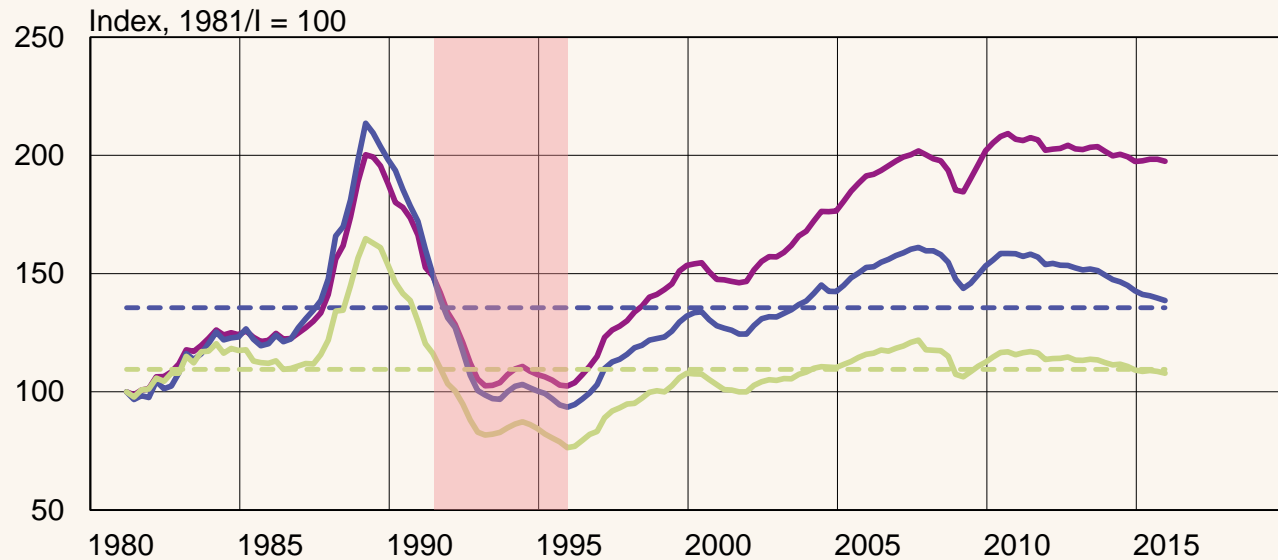
12.4.2016



Relative housing prices close to their long-term averages

Relative housing prices in Finland

- Housing prices relative to consumer prices
- Housing prices relative to rents
- - - Average of the review period
- Housing prices relative to wage and salary earnings
- - - Average of the review period
- Banking and housing market crisis at the beginning of the 1990s

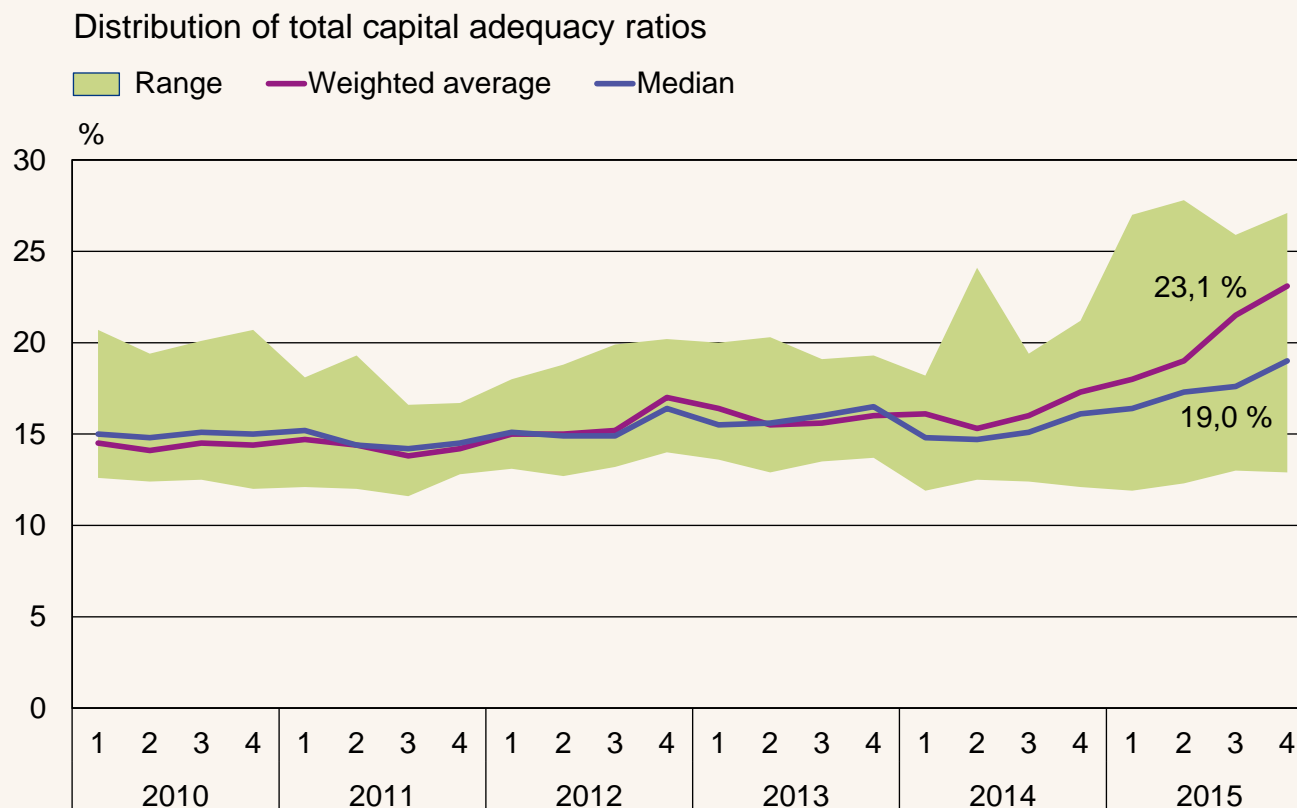


Sources: Statistics Finland and Bank of Finland calculations.

18.5.2016



Significant improvements in capital adequacy of Finnish banks



Source: Financial Supervisory Authority.



Finnish financial sector globally interconnected

- Finnish financial sector concentrated (large entities, significant market positions)
- Financial sector interconnected with global financial markets:
 - wholesale funding
 - investment activities
 - ownership
- In addition to domestic entities, foreign-owned banks also highly important for Finnish banking system
- Nordea's conversion of subsidiaries into branches strengthens banking sector's Nordic interconnectedness => problems in neighbouring countries may spread more directly to Finland
 - See article '*Conversion of Nordea's subsidiaries into branches – Nordic interconnectedness increases*'



Finnish financial system structurally vulnerable

- Finnish banking sector
 - highly concentrated
 - strongly interconnected across borders
 - dependent on market funding, a large share of which is in the form of mortgage-backed bonds

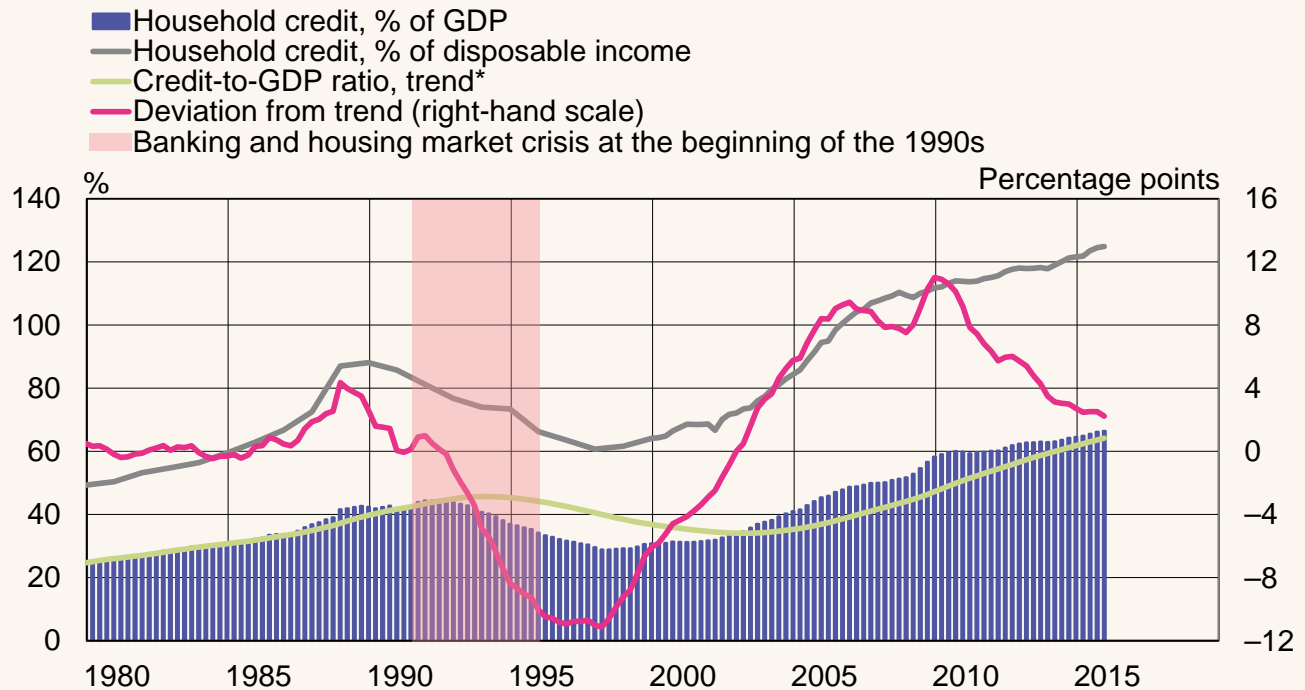
- Finnish financial system vulnerable to risks related to lending for house purchase
 - high household debt levels
 - housing wealth of high importance in terms of household wealth
 - housing loans a major part of bank lending
 - mortgage-backed funding reflected in high asset encumbrance

- Growth in housing loan-related risks partly levelled off
 - debt accumulation has slowed
 - shares of heavily indebted households have no longer increased



Household indebtedness growing, but more slowly than before

Household indebtedness in Finland



Credit incl. credit to housing corporations.

*Calculated using the one-sided Hodrick–Prescott filter ($\lambda = 400,000$).

Sources: Statistics Finland and Bank of Finland calculations.

13.5.2016



Difficult operating environment burdens particularly insurance sector

- Finnish insurance sector strongly concentrated and a significant investor
 - Balance sheets of three largest life and non-life insurance companies account for over three quarters of the sector's total assets.
 - Earnings-related pension company assets almost 90% of GDP
 - Finnish earnings-related pension companies and non-life insurance companies own nearly one third of domestic corporate debt securities.

- Low returns on fixed income investments burden insurance company profitability

- Solvency 2 regulation on insurance companies entered into force on 1 January 2016
 - Insurance corporations' assets and liabilities are valued using the mark-to-market approach.

- See article '*Reform of insurance sector regulation*'

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Conclusions





Changes in Finnish financial system

- Nordea's conversion of subsidiaries into branches transfers operations outside the scope of single banking supervision and crisis resolution within Banking Union.
=> We need close cooperation between the Banking Union's single supervision and Nordic banking supervisors.
- In the concentrated banking, insurance and earnings-related pension markets in Finland, we must ensure an adequate level of competition that forces companies to develop products and services and improve productivity.
- Financial sector undergoing changes due to new technology and business models



Low interest rates support growth but may create risks

- Euro area monetary policy that is supportive of growth also sustains provision of credit
- Accommodative monetary policy may in some countries lead to
 - excessive credit growth
 - flow of assets to financial investments
 - a rise in asset values.
- Macroprudential policy may be used to reduce adverse side effects of low interest rates.
- Authorities must be prepared to act in the event of an escalation of financial stability risks and increase in vulnerabilities.



Finland's macroprudential toolkit must be internationally comparable

- Risks and problems in the financial system spread rapidly across borders on integrated markets.
- Finnish authorities should have a toolkit comparable to other countries – particularly Nordic countries and Baltic States
 - See article '*Finland's neighbours rein in lending for house purchase*'
- The toolkit lacks
 - a systemic risk buffer
 - instruments ensuring households can adequately service their loans.
- Too late to build and introduce a toolkit in a crisis situation
 - Lessons learned from the global financial crisis and the 1990s crisis in the Finnish economy



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