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Deputy Governor, Bank of Finland

## Financial stability – timely measures to curb household indebtedness necessary

Bank of Finland Bulletin 2/2019 press briefing





## Bank of Finland's financial stability assessment

- Annual assessment of the stability of the Finnish financial system and related risks and vulnerabilities
  
- Editorial, financial stability assessment, summary and various feature articles
  - Heavily indebted persons reduce their consumption in response to slowing economic growth
  - A cap on debt-to-income ratio would complement the housing loan cap
  - New tools necessary to curb consumer credit
  - Credit risk of a company dependent on economic cycle and business sector
  - Finnish and foreign commercial real estate markets increasingly interconnected
  - Effects of digitalisation on the profitability of banks
  
- Bank of Finland Bulletin website <https://www.bofbulletin.fi/en/financial-stability/>



## Main topics

- Uncertainties surrounding the global economy are weakening the outlook for the Finnish economy.
- Finland needs to introduce further tools to prevent excessive accumulation of household debt and related risks to the economy.
- The Finnish commercial real estate market is more closely interconnected with the international real estate market.
- The euro area financial architecture must be further reinforced by completing the Banking Union with a common Deposit Insurance Scheme and promoting the Capital Markets Union.

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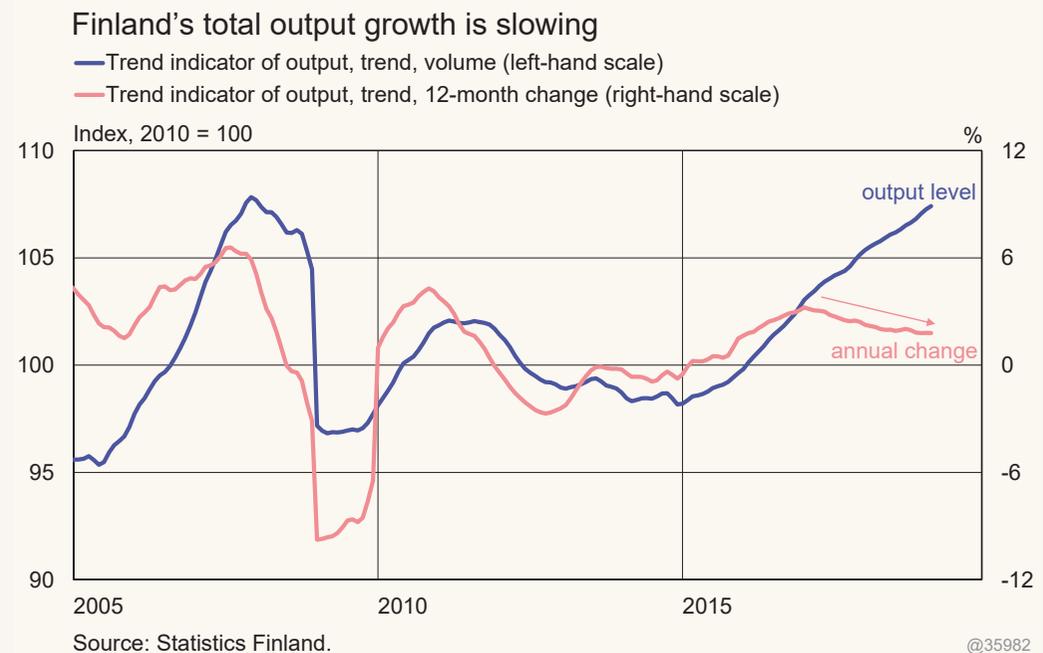
## Uncertainties surrounding the global economy weakening the outlook for the Finnish economy





## Finnish economic growth has slowed and outlook weakened faster than expected

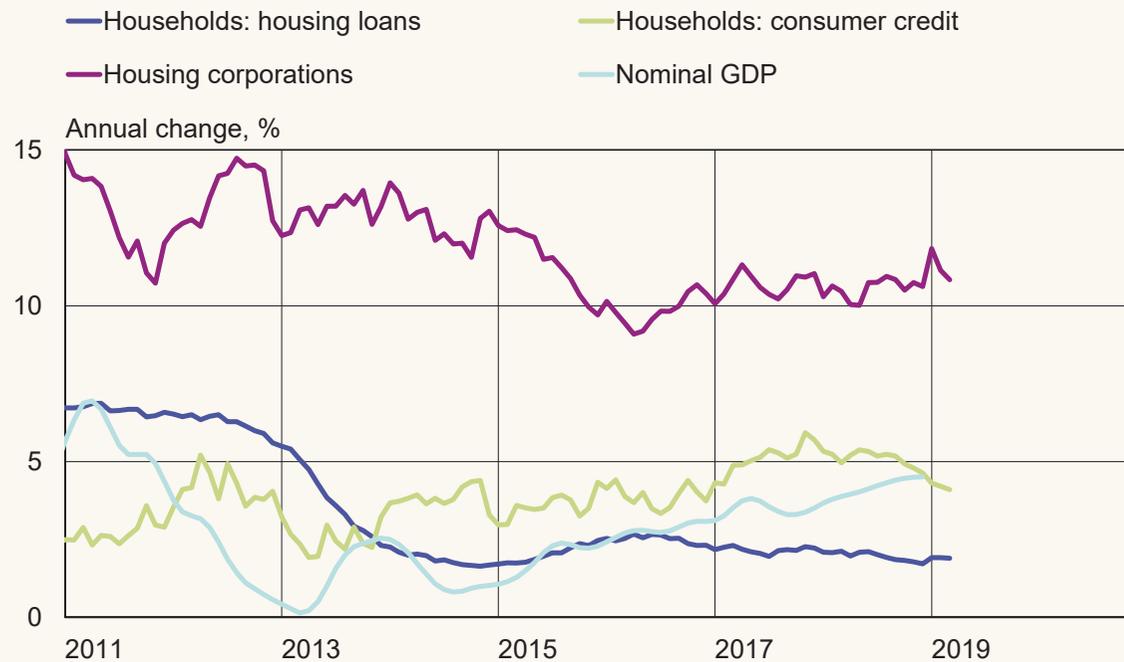
- Uncertainty in the global economy has increased in early 2019.
- Escalation of the trade dispute between the United States and China as well as Brexit pose the biggest risks to the economy in the short term.
- Faster-than-expected weakening of the euro area economic outlook is the biggest downside risk to the Finnish economy.
- Finnish economic growth is increasingly dependent on domestic demand.





## Loans to housing corporations and consumer credits have increased rapidly, driven by construction and consumption

Credit institutions' loan stock and GDP



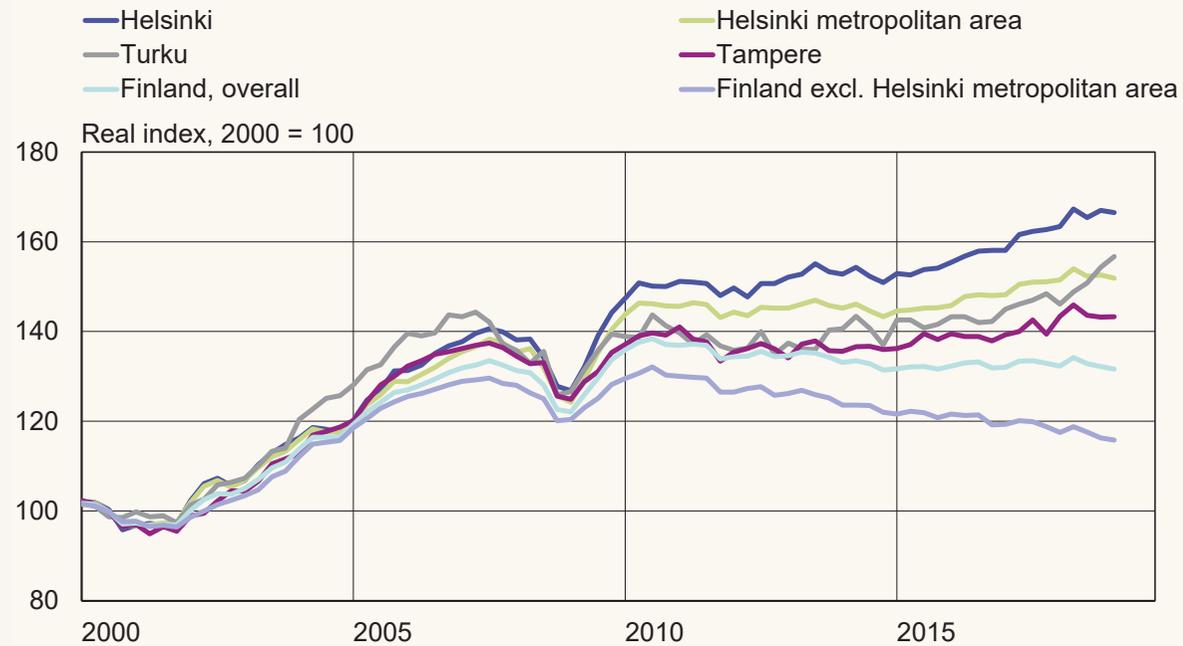
Sources: Statistics Finland and Bank of Finland.

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## Growth in house prices mostly moderate, while regional price divergence continues to widen

Regional disparities in prices of old dwellings have increased in the 2010s



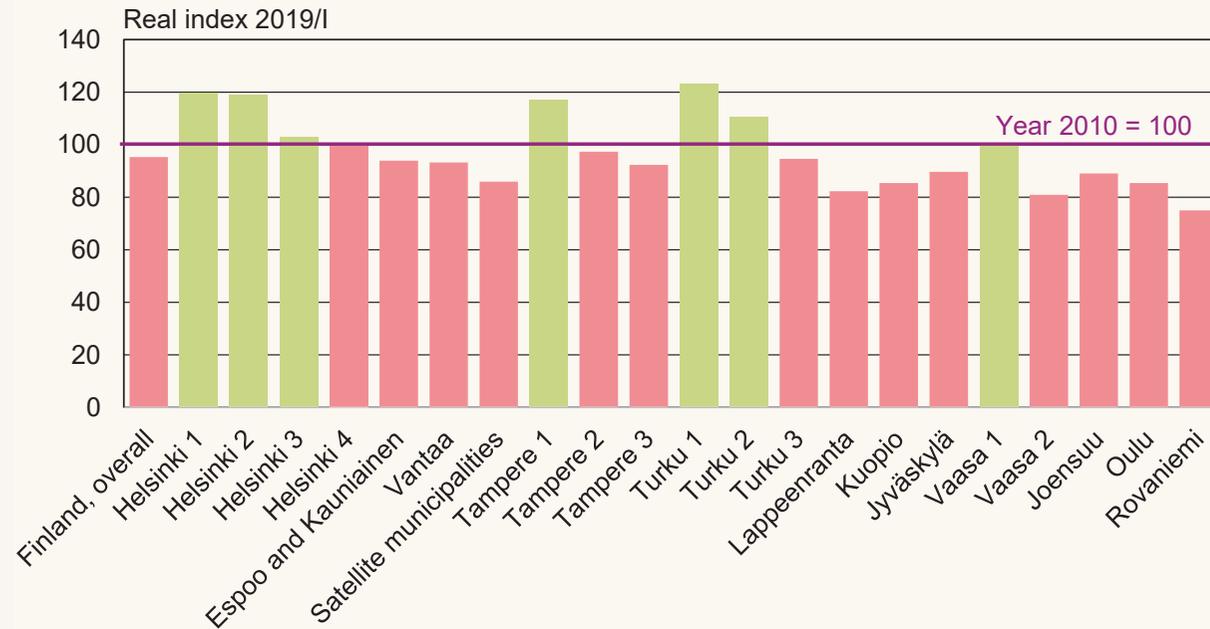
Source: Statistics Finland.

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## Real house prices have increased only in a few city centres

Prices of old dwellings in housing companies relative to the situation in 2010 in selected cities



Sources: Statistics Finland.

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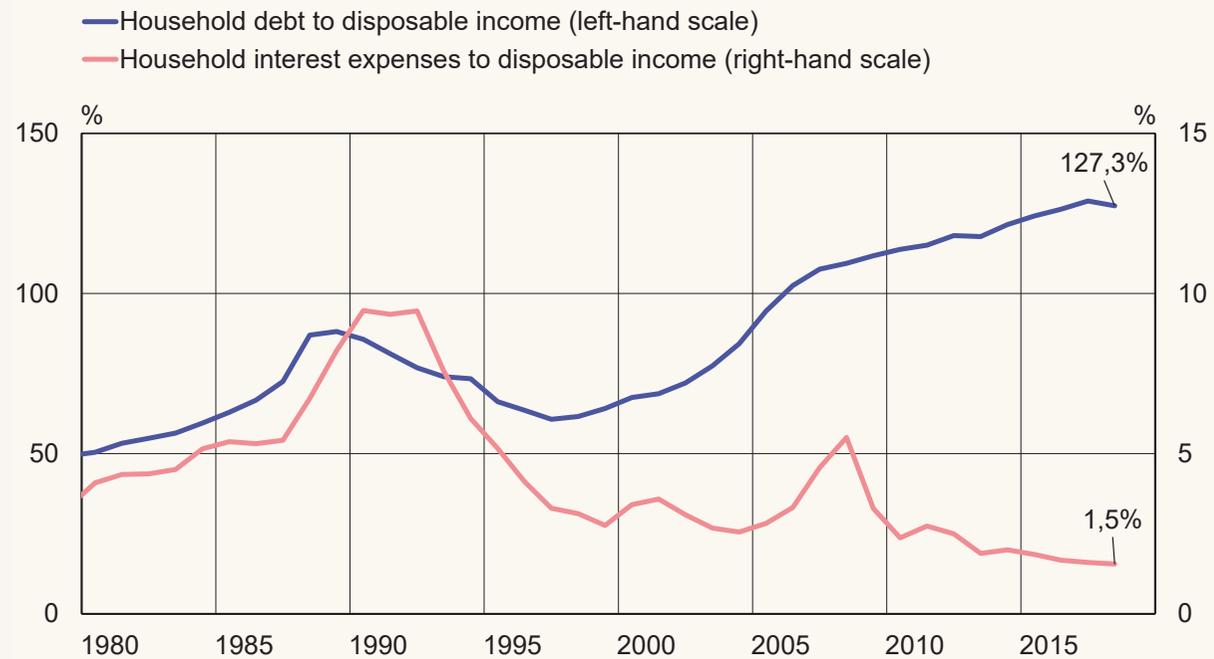
## **Finland needs to introduce further tools to prevent excessive accumulation of household debt and related risks to the economy**





# Excessive household indebtedness must not be allowed to jeopardise stable economic growth

Household indebtedness in Finland



Sources: Statistics Finland and calculations by the Bank of Finland.

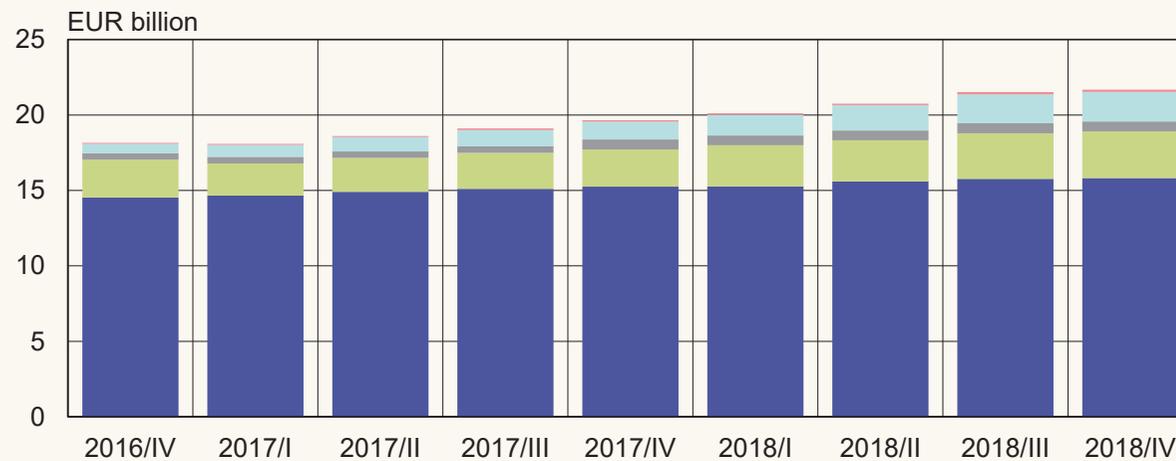
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## Consumer credit lending outside the banking sector is growing

Households' consumer credit stock estimated at almost EUR 22 bn

- Peer-to-peer lending
- Foreign credit institutions lending cross-border
- Small-loan companies
- Other financial institutions excl. small-loan companies
- Credit institutions



Sources: Bank of Finland, Statistics Finland, Ministry of Finance, Sweden's Riksbank, financial statements and consumer credit lenders' published data. @35982



## Indebted households prone to reduce consumption, which may aggravate problems in economy as a whole

Economic growth slows or interest rates rise



Households' debt servicing capacity becomes impaired, and dropping asset prices decrease their net wealth.

People pay their bills, but cut other spending and investment.



Reduced consumption decreases demand for products and services, thus increasing companies' financial difficulties, which may cause big credit losses for banks and weaken their ability to grant new loans.

Source: Bank of Finland.

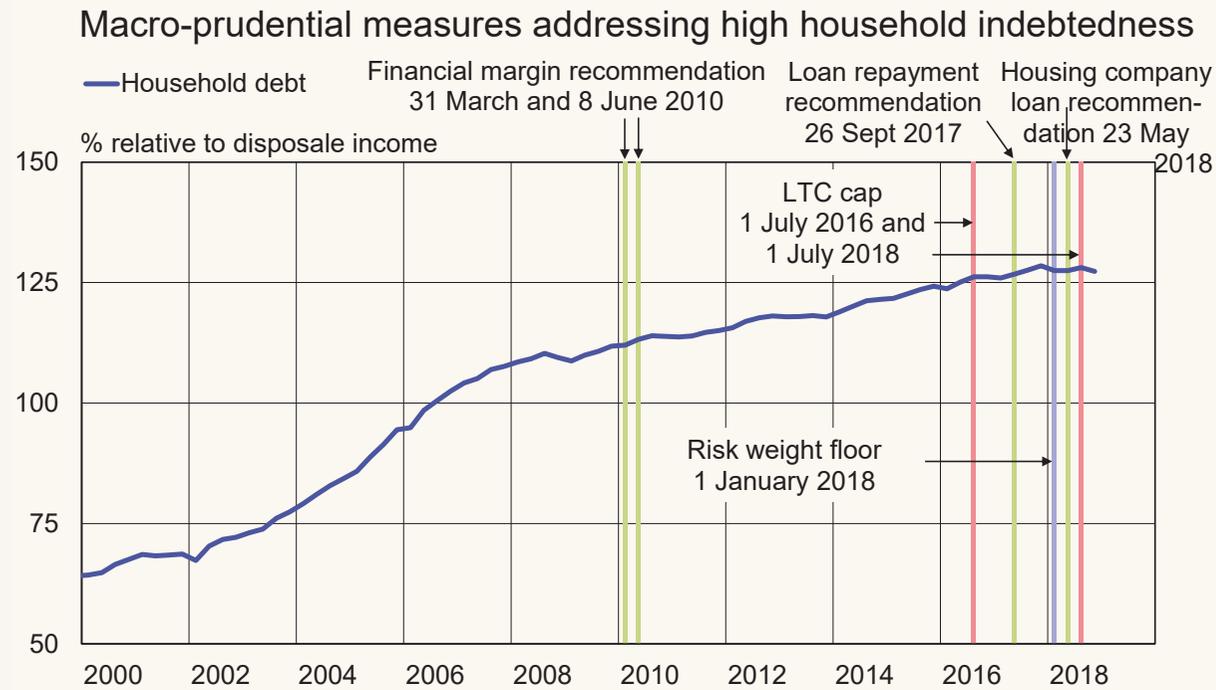


## Macroprudential policy supports long-term economic growth

- The objective is to reduce the probability of financial crises and their adverse effects on the real economy.
- Financial stability improves the conditions for economic growth in the long term.
- Macroprudential instruments particularly aim to mitigate excessive credit growth and debt accumulation and related risks to the economy.



# Household indebtedness at historically high level



Vertical lines: Effective date of the macroprudential measure in question.

Sources: Statistics Finland and Bank of Finland.

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## Macroprudential policy needs complementary measures

Households' ability  
to service their  
debt and consume

Financial  
margin  
assessment  
+ DTI cap  
(new)

LTC cap  
(housing  
loan cap)

Households' ability  
to withstand falling  
asset prices

Risk  
resilience

Credit  
institutions'  
capital  
buffers

Credit  
institutions'  
ability to  
supply credit

Credit  
institutions'  
capacity to  
absorb losses



## Macroprudential tools should also be extended outside the credit institutions sector

- Debt-to-income cap: limits the ratio of total debt to income
- Maximum maturity of housing loans and housing company loans
- Maximum share of housing company loan in loans for the purchase of new-build dwelling, and loan amortisation requirement
- Amortisation requirement for consumer credit and more extensive supervision

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## The Finnish commercial real estate market more closely interconnected with the international real estate market





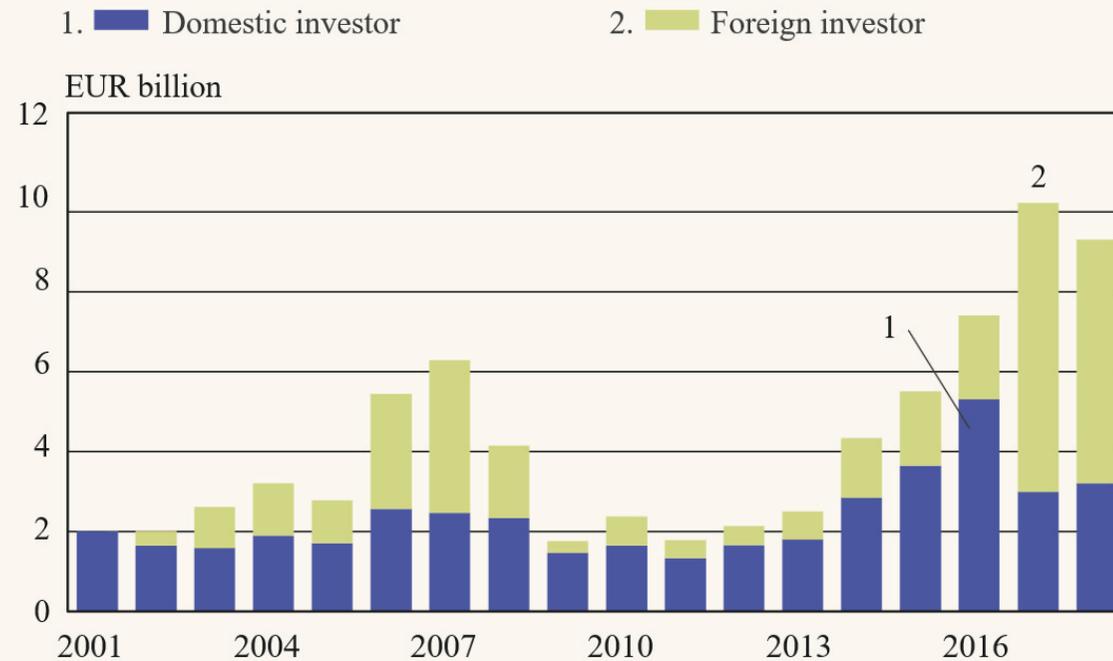
## Finnish real estate market increasingly vulnerable to international risks

- Prices up, total volume of transactions higher and international investors more active on the Finnish real estate market
- Because of foreign investors, the Finnish real estate investment market is more exposed to cyclical fluctuations in the European real estate market.
- Weakening of the international market or business cycle could also strengthen the volatility of real estate prices in Finland.



## Foreign investors participate more often in large real estate transactions in Finland

Volume of major real estate transactions in Finland



Source: KTI Property Information Ltd.



## Structural changes in Finland's commercial real estate market

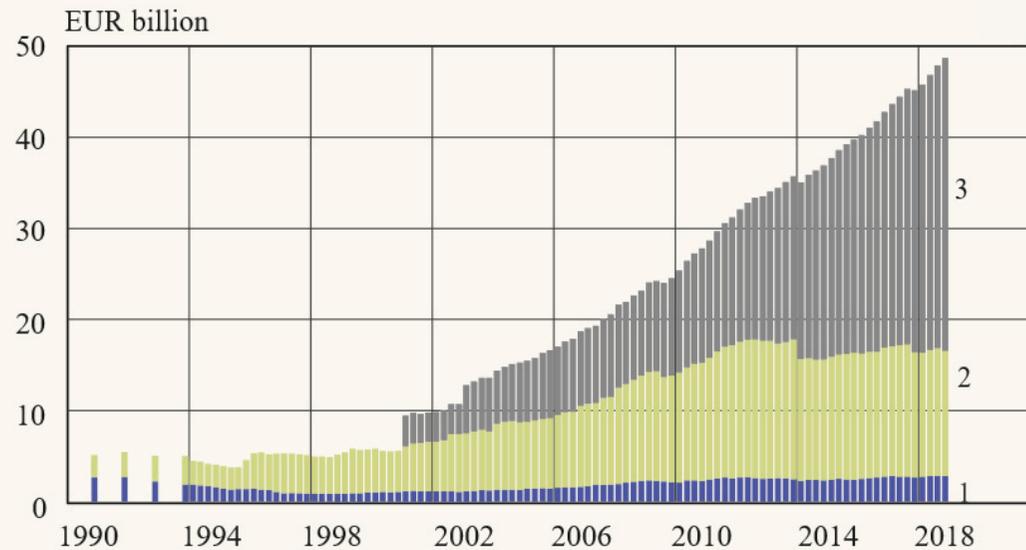
- Urbanisation and the favourable economic situation have boosted the construction of commercial and office properties in growth centres.
- Investors have also increased their holdings of rental housing.
- Urbanisation and digitalisation decrease particularly the demand for commercial and office properties located outside city centres.
- The growth in e-commerce and changes in consumer behaviour present a challenge to shopping centres.



## Domestic banks' real estate-related loan stock grown rapidly in past 20 years

The stock of loans exposed to real-estate risk has grown rapidly in recent decades

- 1. Construction, loans
- 2. Real estate sector, loans
- 3. Housing corporation loans



Sources: Bank of Finland and Statistic Finland.

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**The euro area financial architecture must be further reinforced by completing the Banking Union and promoting the Capital Markets Union**





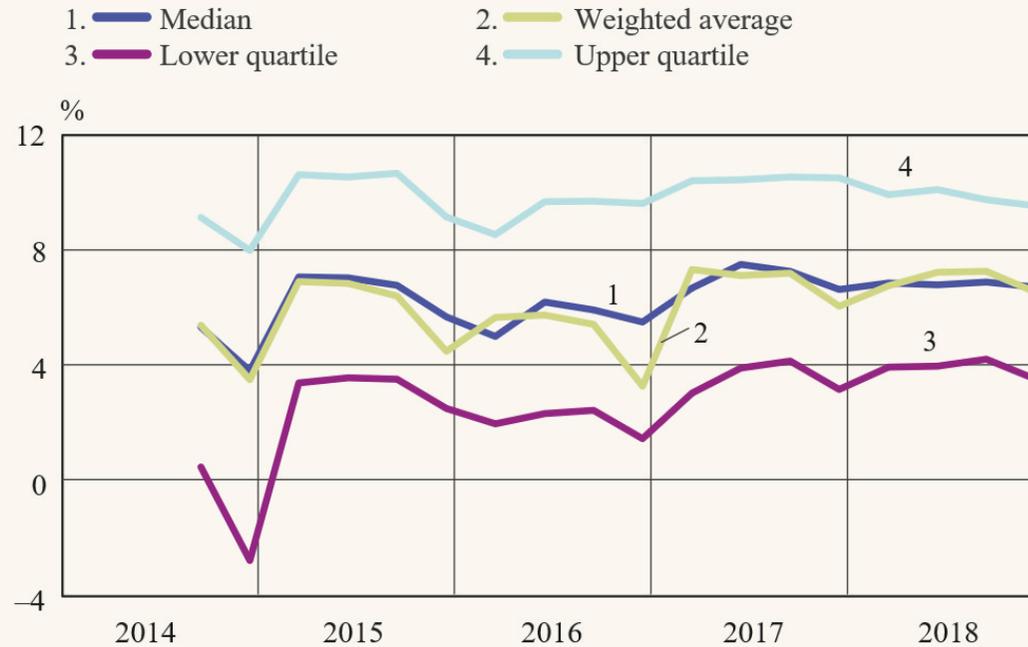
## Nordea's redomiciliation increased interconnectedness between Finnish and other Nordic banking sectors

- The banking sector's size, degree of concentration and interconnectedness increased as Nordea transferred its domicile to Finland.
- The banking system's strong capital and liquidity position ensure the sector's loss-absorbing capacity and lending capacity under all circumstances.
- The Nordic and Baltic authorities conducted in January 2019 a joint banking crisis simulation exercise.



## Subdued outlook for profitability in European banking sector

Major European banks' return on equity (ROE) has improved only slightly in recent years



Source: European Banking Authority (EBA).



## The resilience of the euro area's financial system must be reinforced further

- Banks' exposures to national sovereigns should be reduced further.
- Banking Union should be completed with a common Deposit Insurance Scheme.
- More determined action should be taken to dismantle the barriers to integration of the capital markets, and the EU's Capital Markets Union initiatives should be promoted.



**Thank you!**