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D I R E C T I O N A L D E C I S I O N

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Countercyclical buffer rate

Finansinspektionen explores raising the counter cyclical capital buffer

Finansinspektionen (FI) makes the assessment that the countercyclical buffer rate may need to be raised. FI will therefore submit for consultation on 30 July a proposal for new regulations regarding the countercyclical buffer rate. Finansinspektionen's Board of Directors will decide on the change to the buffer rate in September 2018.

FI will set the countercyclical buffer guide at 0.11 per cent at the same time.

The case

Finansinspektionen (FI), in accordance with Chapter 7, section 1 of the Capital Buffers Act (2014:966), shall set a countercyclical buffer guide and a countercyclical buffer rate each quarter.

FI activated the countercyclical capital buffer for Sweden on 8 September 2014 and has thereafter raised it gradually. FI most recently decided to raise the countercyclical buffer rate from 1.5 to 2 per cent on 14 March 2016. This rate has been applied since 19 March 2017.¹

FI last decided on this matter on 26 April 2018. FI decided at that time to leave the countercyclical buffer rate unchanged at 2 per cent. The countercyclical buffer guide was set at the same time at 0 per cent.

Finansinspektionen's assessment

The purpose of the countercyclical capital buffer is to maintain and strengthen the banks' resilience. It shall ensure that the banking system as a whole has sufficient capital to sustain the flow of credit to households and corporations following shocks to the financial system that could cause a credit crunch. The countercyclical capital buffer is a time-varying capital requirement. This means that the buffer should be activated and built up when financial imbalances, and hence systemic risks, are judged to be increasing. In an ensuing recession or in the event of major losses for the banks, the buffer requirement may be reduced to counteract more restrictive lending and thereby alleviate the economic downturn.

¹*Ändring av föreskrifter om kontracykliskt buffertvärde.* Published on www.fi.se on 15 March 2016, FI Ref. 16-742. An English translation is available on the website.

FI raised the countercyclical capital buffer to 2 per cent in March 2016. Since then, interest rates have continued to be low, which is judged to have increased risk-taking in the financial sector. The strong desire to take on risk has resulted in an increase in the supply of corporate bonds with lower credit ratings. The difference in the expected return on risky and secure assets (referred to as the risk premium) has been very low the past five years (Diagram 1).

In addition, lending to households and non-financial firms since March 2016 has increased faster than what FI considers to be sustainable in the long run. During the autumn of 2017, FI indicated that an increase in the buffer rate could become relevant if the lending rate did not decline. Such a decline has not occurred (Diagram 2). Lending has increased on average 7.7 per cent the past five quarters compared to the 6.4 per cent observed when FI raised the buffer in 2016.² This implies that systemic risks have increased since 2016.

The Swedish banking system's resilience is considered to have increased slightly since 2016 since the banks now hold more capital (Diagram 3). However, FI judges that the increase is not sufficient to cover the increase in systemic risks that occurred during the same period. The risks for the Swedish economy have thus increased. This suggests that the countercyclical capital buffer should be raised to 2.5 per cent, and FI will therefore submit such a proposal for consultation on July 30.

The credit-to-GDP gap amounted to 2.34 per cent in Q1 2018 (Diagram 4).³ This means that the countercyclical buffer guide is set at 0.11 per cent (Diagram 5).

FINANSINSPEKTIONEN

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Director General

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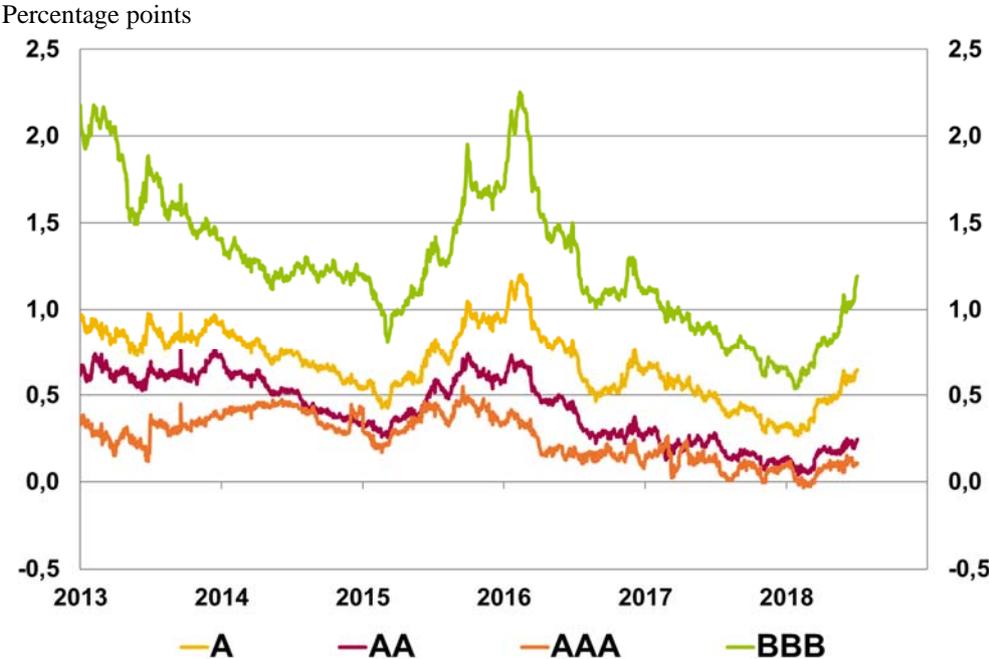
A decision in this matter was made by Finansinspektionen's Director General (Erik Thedéen) following a presentation by Senior Analyst Michael Andersson. The Chief Economist (Henrik Braconier) also participated in the final proceedings.

² Prior to this decision (Q3 2018), FI decided to change its data source for the non-financial firms' market financing from Finansräkenskaper to Svensk värdepappersdatabas (SVDB).

³ FI calculates the credit-to-GDP gap using the Basel Committee's standard approach, see *Guidance for national authorities operating the countercyclical capital buffer*, December 2010, Basel Committee on Banking Supervision, Bank for International Settlements.

Appendix 1: Diagrams

Diagram 1. Risk premiums

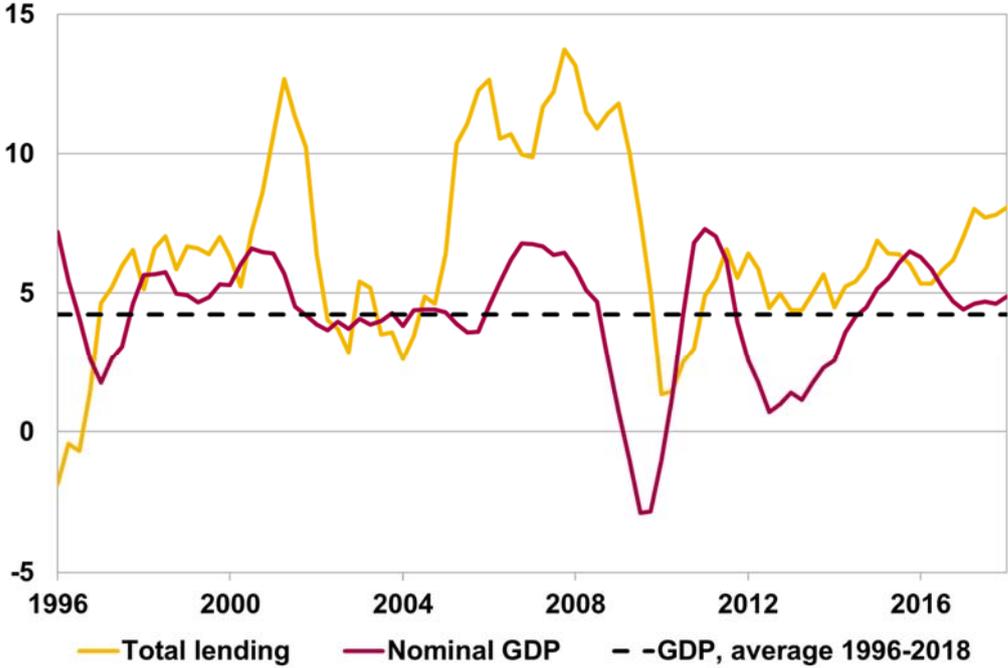


Note: Interest rate differences for corporate bonds with different credit ratings in the euro area. Calculated as the difference between iBoxx euro corporates with a maturity of 5-7 years and Thomson Reuters euro vs. EURIBOR interest rate swaps.

Source: Thomson Reuters Datastream.

Diagram 2. Total lending and nominal GDP

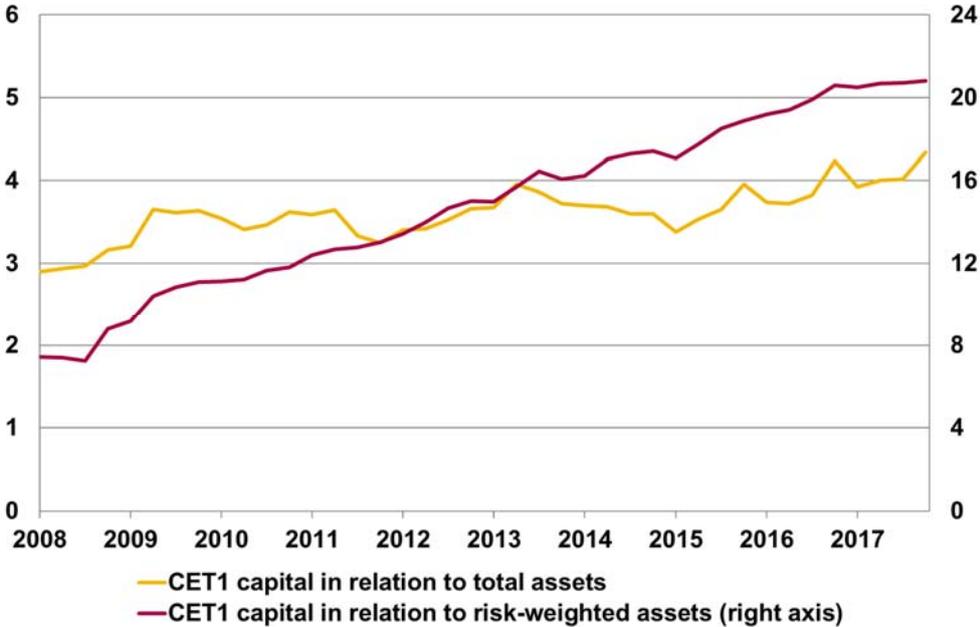
Annual change in per cent



Source: Statistics Sweden.

Diagram 3. CET1 capital

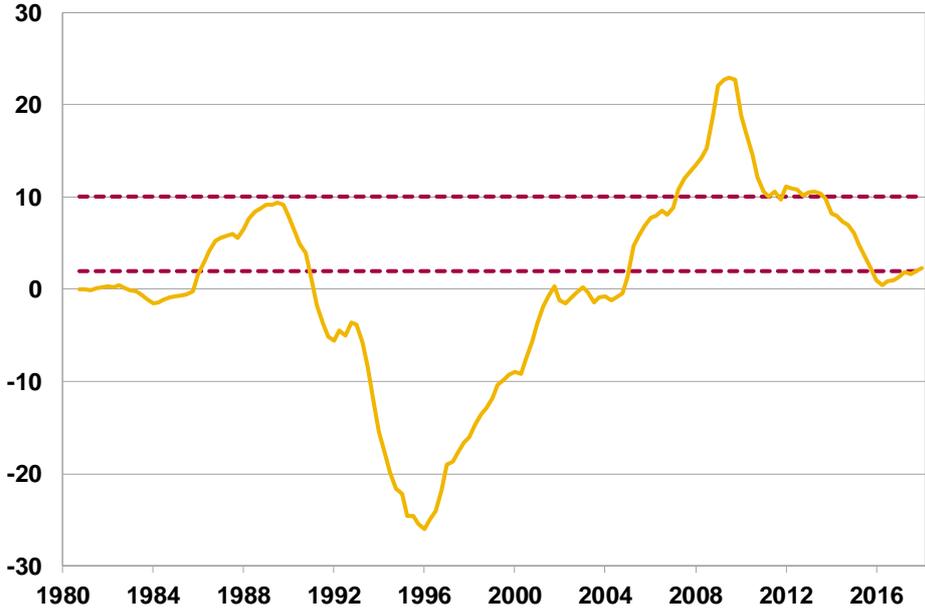
Per cent



Source: FI.

Diagram 4. Credit-to-GDP gap according to the standardised approach

Deviation from trend in percentage points

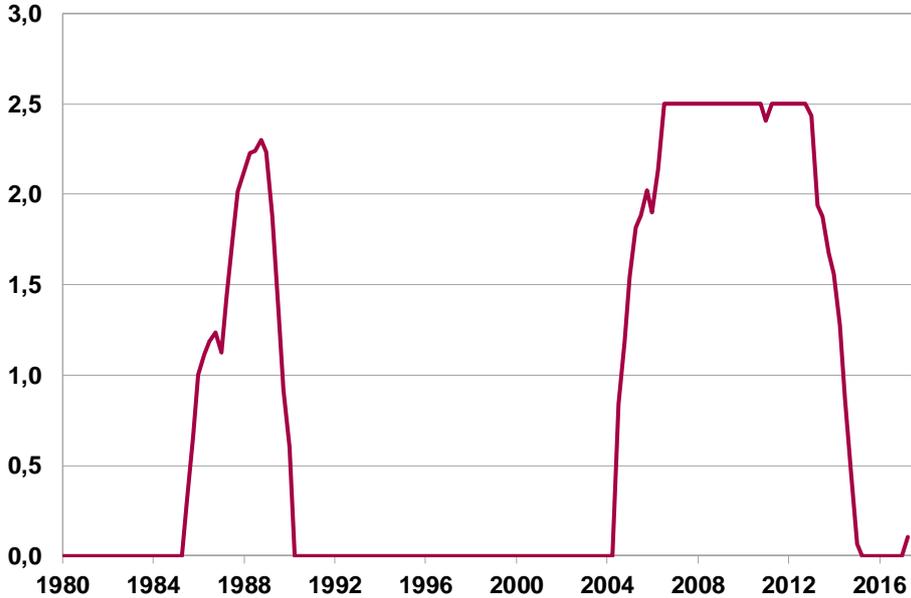


Note: The dashed lines show the thresholds (2 and 10 per cent, respectively) that according to the standardised approach are to be used to transform the credit-to-GDP gap into a buffer guide.

Source: FI and Statistics Sweden.

Diagram 5. Buffer guide according to the standardised approach

Per cent



Source: FI.