



NORGES BANK

Ministry of Finance
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Advice on the countercyclical capital buffer 2017 Q2

Norges Bank is responsible for preparing a decision basis and advising the Ministry of Finance on the level of the countercyclical capital buffer for banks four times a year. The buffer rate is set at 1.5 percent. In December 2016, the Ministry of Finance decided to raise the buffer rate to 2.0 percent effective from 31 December 2017, in line with Norges Bank's advice. The decision basis for Norges Bank's advice on the countercyclical capital buffer in 2017 Q2 is presented in the March 2017 Monetary Policy Report (2/17).

Banking regulation and macroprudential measures are the first line of defence against instability in the financial system. The premise for Norges Bank's assessment of the countercyclical capital buffer is that banks should build up and hold a buffer when financial imbalances are building up or have built up. The buffer rate will be assessed in the light of other requirements applying to banks. The buffer rate can be reduced in the event of an economic downturn and large bank losses, with a view to mitigating the procyclical effects of tighter bank lending. The buffer rate should not be reduced automatically even if there are signs that financial imbalances are receding. Advice to reduce the rate will be based on factors such as information about market turbulence, significant credit supply tightening and prospects for substantial bank losses. The countercyclical capital buffer is not an instrument for fine-tuning the economy.

Norwegian banks have built equity capital in recent years in order to meet higher Common Equity Tier 1 (CET 1) requirements, including the countercyclical capital buffer. The largest banks increased their capital levels in 2017 Q1 and are close to their capital targets. Banks' total loan losses increased in 2016, especially on oil-related exposures, but remained nonetheless at relatively low levels. The loan losses declined in 2017 Q1. There is still uncertainty surrounding the need for additional restructuring in the oil-related sector.

Norges Bank's assessment of financial imbalances is based on developments in credit and property prices and banks' wholesale funding ratio. Banks' wholesale funding ratios have been fairly stable for a longer period, and Norwegian banks have ample access to wholesale funding.

Household debt has long risen faster than income, and the share of households with high debt ratios has increased. Growth in household debt has been the main force behind the higher rate of growth in total credit relative to mainland GDP growth over time. Total debt has risen at about the same pace as GDP over the past year, reflecting lower growth in corporate debt, and foreign debt in particular. Over the past half-year, growth in corporate credit from Norwegian banks and the bond market have picked



up. There are no signs that creditworthy enterprises have problems with access to credit.

Household credit growth has picked up somewhat in recent quarters. Norges Bank's Survey of Bank Lending showed that banks tightened credit standards for households in 2017 Q1 as a result of changes in the regulation on requirements for new residential mortgage loans. The tightening pertained primarily to maximum debt-to-income ratios. Banks in the Survey report that they do not have plans for further tightening.

House prices have risen considerably more than household disposable income over the past year. House price inflation has been most pronounced in Eastern Norway. Inflation has declined in recent months, while housing construction has remained high. In the commercial real estate market, estimated selling prices for office spaces in Oslo have risen sharply over a number of years, primarily as a result of lower required rate of return in line with a lower interest rate level. Inflation in other large cities has been moderate.

High property price inflation over a longer period and a persistent rise in household debt ratios suggest that financial imbalances have built up. Financial imbalances increase the risk of an abrupt decline in demand and bank loan losses. Household credit growth remains high. Low house price inflation and tighter bank lending will have a dampening effect on household debt growth and may over time reduce vulnerabilities in the household sector.

At the end of 2017, the countercyclical capital buffer rate increases to 2%. With higher capital levels, banks will be better equipped to cope with losses further ahead.

Norges Bank's Executive Board has decided to advise the Ministry of Finance to keep the buffer rate unchanged at 2 percent at the end of 2017. The decision was unanimous.

Norges Bank is responsible for advising the Ministry of Finance on countercyclical capital buffer rates for Norwegian bank's exposures in non-EU countries. In principle, countercyclical capital buffer rates in non-EU countries must be recognised, while the Norwegian buffer rate applies for exposures in countries that have not set their own rate. Norges Bank does not currently recommend different rates.

In preparing its advice on the countercyclical capital buffer, Norges Bank has exchanged information and assessments with Finanstilsynet (Financial Supervisory Authority of Norway).

Sincerely,

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