



NORGES BANK

Ministry of Finance  
P.O. Box 8008 Dep  
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Our ref.: 18-8279

## Advice on the countercyclical capital buffer 2018 Q4

Norges Bank's Executive Board has decided to advise the Ministry of Finance to increase the buffer rate to 2.5 percent effective from 31 December 2019.

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 decision basis for Norges Bank's advice in 2018 Q4 is presented in the December 2018 Monetary Policy Report.

Banks should build up and hold a buffer when financial imbalances are building up or have built up. Financial imbalances increase the risk of an abrupt decline in demand and bank loan losses. The buffer rate may be reduced in the event of an economic downturn and prospects for large bank losses, with a view to mitigating the procyclical effects of tighter bank lending.

Norges Bank's assessment of financial imbalances is based on developments in credit and property prices and banks' wholesale funding ratios.

Large Norwegian banks are posting low losses and meet the total Common Equity Tier 1 (CET1) capital requirement. The profitability of banks is solid. Norwegian banks have ample access to wholesale funding, and wholesale funding ratios have been fairly stable for a long period. International financial markets are marked by heightened uncertainty, which entails a risk of a sharp rise in prices for banks' wholesale funding.

Household debt ratios are high, and debt continues to rise faster than income. Debt growth has slowed somewhat in recent years, but has been stable in recent months.

The Norwegian economy is growing at a solid pace. Corporate credit growth has slowed, but is still higher than GDP growth. Growth in bond financing has shown the largest decline. Risk premiums have risen somewhat in recent months, in line with global risk premiums. Enterprises have ample access to credit, and credit growth is still broadly even across sectors.

House price inflation has been low in recent months, but housing market turnover has remained high. However, the number of unsold homes has risen. In the commercial real estate market, estimated selling prices for prime office space in Oslo continue to increase rapidly. Higher rents



have recently driven the rise in prices, while yields are stable after having fallen for several years. Rents in other cities have shown more moderate developments.

In the 2018 Financial Stability Report, financial system vulnerabilities in Norway are assessed as having increased somewhat over the past year, primarily owing to rising commercial property prices. Commercial property prices may decline sharply in the event of a pronounced rise in long-term rates or risk premiums, or of an economic downturn resulting in falling rents. Experience shows that commercial real estate lending can be a source of substantial bank losses. The stress test in the 2018 Financial Stability Report shows that banks would have to draw down their countercyclical capital buffer and some of the other buffers in order to maintain lending in the event of a pronounced downturn in the Norwegian economy. This suggests that a larger portion of the total buffer requirement should be time-varying.

Household debt ratios are high and rising. Property prices have risen rapidly for many years and are now at historically high levels. As a result, financial imbalances have built up. Looking ahead, low house price inflation and gradually rising interest rates are expected to curb a further increase in debt growth. The persistent and sharp rise in commercial real estate prices is contributing to higher financial imbalances.

Banks should become more resilient during an upturn. EU regulations will be implemented in 2019, which will reduce the capital required to achieve the same risk-weighted capital ratio level. This means that banks can now withstand an increase in the buffer rate without having to make substantial adjustments.

On the basis of an overall assessment, Norges Bank's Executive Board has decided to advise the Ministry of Finance to increase the buffer rate to 2.5 percent effective from 31 December 2019. The decision was unanimous.

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

Sincerely,

Øystein Olsen

Torbjørn Hægeland

Copy: Finanstilsynet