



NORGES BANK

Ministry of Finance  
P.O. Box 8008 Dep  
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## Advice on the countercyclical capital buffer 2017 Q4

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

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 on the countercyclical capital buffer in 2017 Q4 is presented in the December 2017 Monetary Policy Report. From 31 December 2017, the rate will increase to 2.0 percent from the current level of 1.5 percent, in accordance with the Ministry of Finance's decision in December 2016.

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 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.

Norges Bank's assessment of financial imbalances is based on developments in credit and property prices and banks' wholesale funding ratios. The buffer rate is not an instrument for fine-tuning the economy and 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 largest banks further increased their capital levels in 2017 Q3 and meet their long-term targets. Loan losses as a share of gross lending increased slightly in 2017 Q3, but remain lower than at the same time in 2016. A stress test in the 2017 Financial Stability Report shows that the largest banks' capital buffers are sufficient to absorb losses in the event of a pronounced downturn in the Norwegian economy. Banks' wholesale funding ratios have been fairly stable for a long period, and Norwegian banks have ample access to wholesale funding.

Household debt has long risen faster than household income and debt ratios have increased. Interest and ordinary principal payments therefore account for a high share of household income, despite the low interest rate level. The rise in household credit has been the main reason why total credit has risen faster than mainland GDP. Growth in household credit has been high since the turn of the year, but has edged down in recent months. The residential mortgage lending survey conducted by Finanstilsynet (Financial Supervisory Authority of Norway) indicates that the share of new mortgages



extended to borrowers with very high debt-to-income and loan-to-value ratios is lower than in 2016. In Norges Bank's Survey of Bank Lending for 2017 Q3, banks reported some decline in household residential mortgage demand, with a further decline expected in Q4. Banks reported that corporate credit demand has picked up somewhat and that demand is expected to remain unchanged in Q4. Credit standards are reported to have remained unchanged for both households and enterprises, with no changes expected in Q4. Corporate credit growth remains moderate but has picked up since spring. Growth in credit from both Norwegian banks and the bond market has picked up.

House prices have long been rising faster than household income. Since April, house prices have fallen. Housing construction has risen to a high level, while population growth has fallen markedly. There is uncertainty surrounding housing market developments ahead. In commercial real estate, estimated selling prices for office space in Oslo have risen sharply for several years. In recent years, the rise in prices for office space in other cities has been moderate. Yields on prime real estate in Oslo have recently stabilised and office rents are expected to edge up.

Financial imbalances have built up, owing to a persistent rise in household debt ratios and high property price inflation over a long period. Household credit growth remains high, but the decline in house prices in 2017 has reduced the extent of a fall in the housing market. Low house price inflation will curb household debt accumulation, but it will take time for household sector vulnerabilities to recede. Bank losses are low and banks have built up capital buffers that can absorb losses in the event of a downturn in the Norwegian economy. Creditworthy enterprises appear to have ample access to credit.

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

In preparing its advice on the countercyclical capital buffer, Norges Bank has exchanged information and assessments with Finanstilsynet.

Sincerely,

Øystein Olsen

Torbjørn Hægeland

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