



NORGES BANK

Ministry of Finance
P.O. Box 8008 Dep
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Advice on the countercyclical capital buffer 2017 Q3

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 buffer is set at 1.5 percent, and in December 2016, the Ministry of Finance decided to raise the buffer rate to 2.0 percent effective from 31 December 2017. The decision basis for Norges Bank's advice on the countercyclical capital buffer in 2017 Q3 is presented in the September 2017 Monetary Policy Report.

The premise for Norges Bank's advice on the countercyclical capital buffer is that banks should build up and hold a buffer when financial imbalances are building up or have built up. Higher capital levels better equip banks to cope with losses further ahead. 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 countercyclical capital buffer is not an instrument for fine-tuning the economy.

Norges Bank's assessment of financial imbalances is based on developments in credit and property prices and banks' wholesale funding ratios. 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 largest banks further increased their capital levels in 2017 Q2 and meet their long-term targets. Loan losses as a share of gross lending were lower in the first half of 2017 than in the same period in 2016. Banks with the largest exposures in the petroleum and offshore sectors report that restructurings contributed to lower-than-expected losses. There is still uncertainty surrounding the need for additional restructuring in the oil-related sector. 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 income, and the share of households with high debt ratios has increased. Interest and ordinary principal payments therefore account for a high share of household income, despite the low interest rate level. Over time, household credit growth has been the main reason why total credit has risen faster than mainland GDP. Growth in household credit is



higher than in summer 2016, and has been fairly stable since the turn of the year. Banks included in Norges Bank's Survey of Bank Lending reported tighter credit standards for households in the first half of 2017 as a consequence of the changes in the regulation on requirements for new residential mortgage loans. Banks in the survey report that they do not have plans for further tightening in 2017 Q3.

Corporate credit growth is moderate, but has picked up over the past half-year, from both Norwegian banks and the bond market. There are no signs that creditworthy enterprises have problems with access to credit.

House prices have long risen considerably more than household disposable income. House prices increased sharply in 2016, especially in Oslo. House price inflation has slowed significantly since the turn of the year. The monthly rise has been negative in recent months. House price inflation has slowed most in Oslo. Housing construction is high, and an increase in the number of completed dwellings may restrain the rise in prices ahead. In the commercial real estate market, estimated selling prices for office space in Oslo have risen sharply over a number of years, primarily as a result of a lower required rate of return in line with a lower interest rate level. The rise in prices in other large cities has been moderate.

A persistent rise in household debt ratios and high property price inflation over a long period 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 will curb household debt accumulation, but it will take time for household vulnerabilities to recede. The correction in the housing market may lower the risk of an abrupt and more pronounced downturn further out.

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 (Financial Supervisory Authority of Norway).

Norges Bank is responsible for advising the Ministry of Finance on countercyclical capital buffer rates for Norwegian bank's exposures in non-EU countries. Norges Bank does not currently recommend different rates. Norges Bank will hereafter only address this in the letter on the countercyclical capital buffer when it is appropriate to change the advice on requirements in other countries.

Sincerely,

Øystein Olsen

Torbjørn Hægeland

Copy: Finanstilsynet