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EUROJÄRJESTELMÄ



FINLANDS BANK  
EUROSYSTEMET

# Finland's financial system has proved resilient amid an array of risks

Bank of Finland's Financial Stability Report  
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Marja Nykänen  
Helsinki, Suomen Pankki

# Bank of Finland's financial stability assessment

- Editorial: Stability is paramount – Resilience will remain essential going forward
- Stability assessment: Geopolitical tensions and a standstill property market are casting a shadow over financial stability
- ‘Simply Short’ summary of main article: Finland's housing market has very swiftly come to a standstill
- Experts’ articles on topical issues:
  - Finland's banking sector could withstand even a harsher recession than forecast
  - Financial regulation has proved its worth in the financial system turbulence of recent years
  - The stability assessment is also based on recent articles and blog posts on e.g. the stability of the international financial system, risks in the property investment market, developments in mortgage lending, and the impacts of climate change on financial stability

# Key messages

- The recession in Finland's property market brings greater risks to the economy and the financial system
- The deterioration in the international security environment creates new threats to financial stability
- The financial system's resilience needs to be maintained and further strengthened.
  - The capacity of macroprudential policy to respond must be improved with a more flexible use of the countercyclical capital buffer requirement
  - The financial sector and the authorities must continue to prepare for operational disruptions and an increase in cyber risks
  - Europe's financial stability must be furthered by faster progress towards capital markets union and completing the banking union

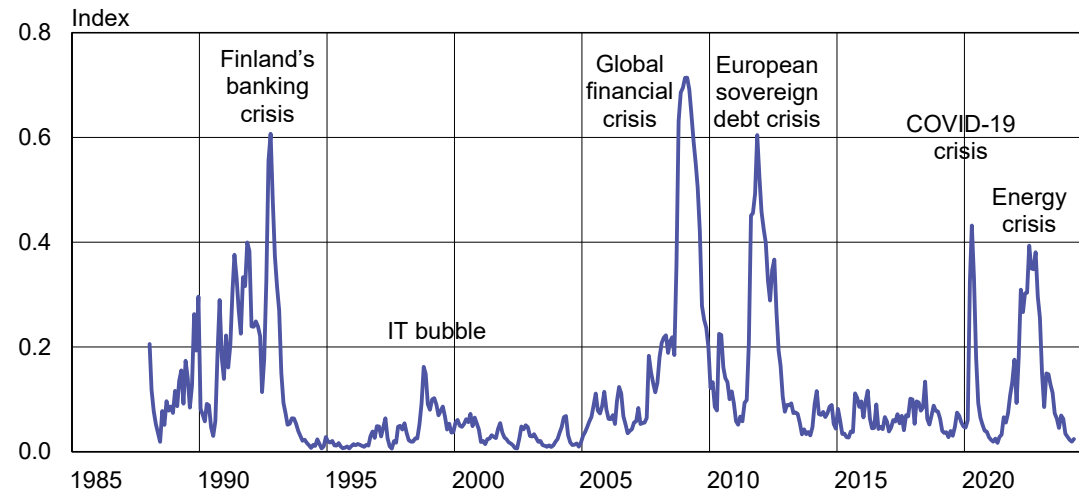
# Operating environment risks to financial stability



# Finland's financial system is stable

No signs of an increase in risk aversion in 2024

— Stress index for the Finnish financial market



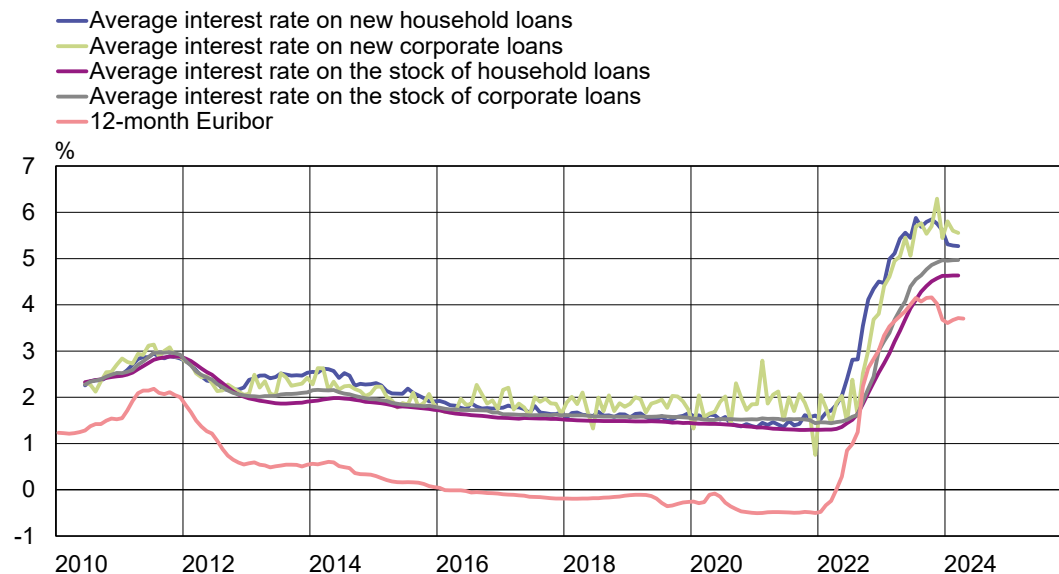
A higher value indicates higher stress and risk aversion in the financial markets.  
Sources: Bloomberg, Datastream and calculations by the Bank of Finland.

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- Financing costs have increased substantially with the rise in interest rates
- Availability of bank loans and market funding has remained good
- Banks' financial position has improved further, and the financial markets have not been affected by disruptions

# Lower interest rates and economic recovery in line with expectations would support financial stability

Interest rates on new loans have declined from their peak in 2023



Loans from Finnish credit institutions to households and non-financial corporations in Finland.  
Sources: Refinitiv and Bank of Finland.

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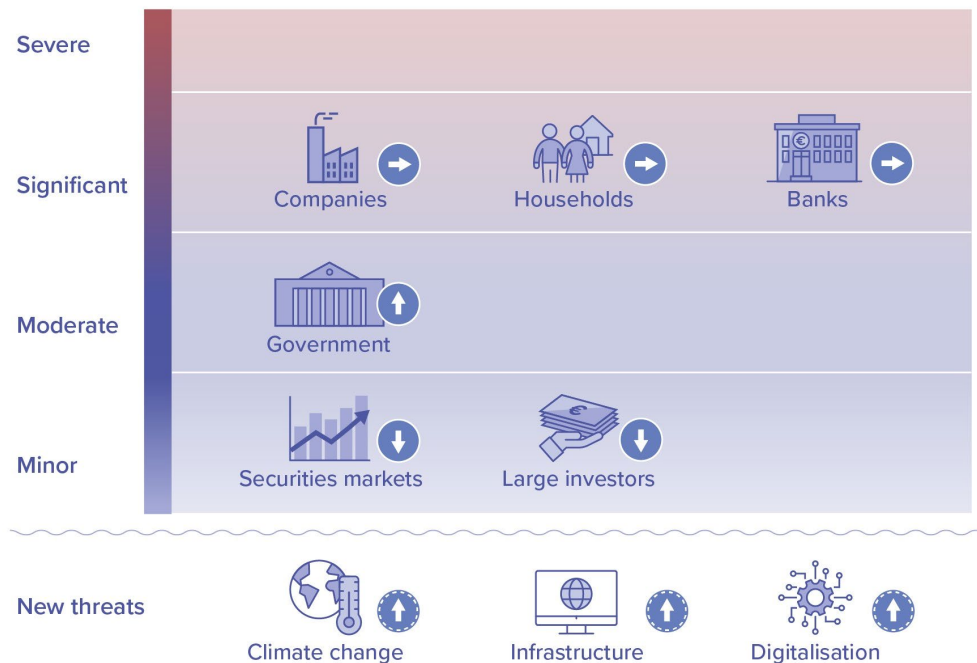
- Inflation is expected to slow, interest rates to decline, and the economy to gradually pick up
- Forecasts include a risk of weaker-than-expected economic growth and more persistent inflation
- The geopolitical situation is overshadowing the outlook for the economy and financial stability

# Financial system resilience



# Financial system's major structural vulnerabilities unchanged, new vulnerabilities increasing

## Assessment of the Finnish financial system's level of vulnerabilities and expected trends



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- Structural factors and risk exposures to the real estate markets maintain banks' vulnerabilities
- Growth in government indebtedness also increases vulnerabilities in financial stability
- Normalisation of the interest rate environment reduces securities market and investor vulnerabilities
- Climate change, harmful aspects of digitalisation, and weakening of the security environment create threats to stability

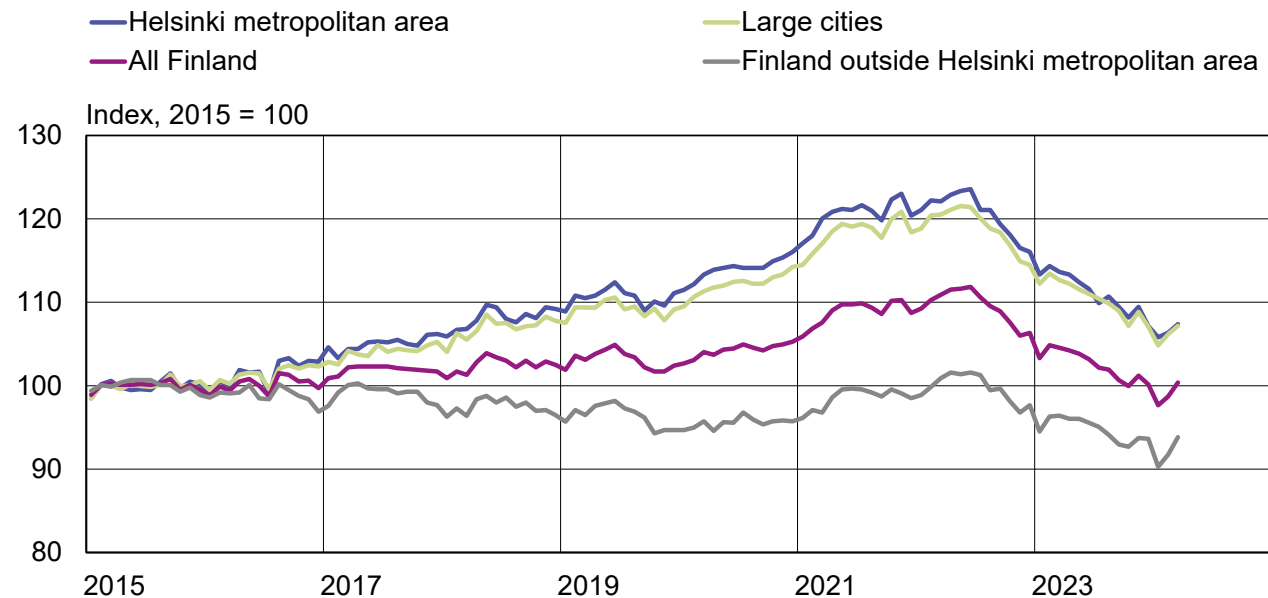




# Property market recession increases risks to the economy and the financial system

# The residential property and real estate investment markets have responded strongly to the rise in interest rates

Housing prices have declined most in the Helsinki metropolitan area



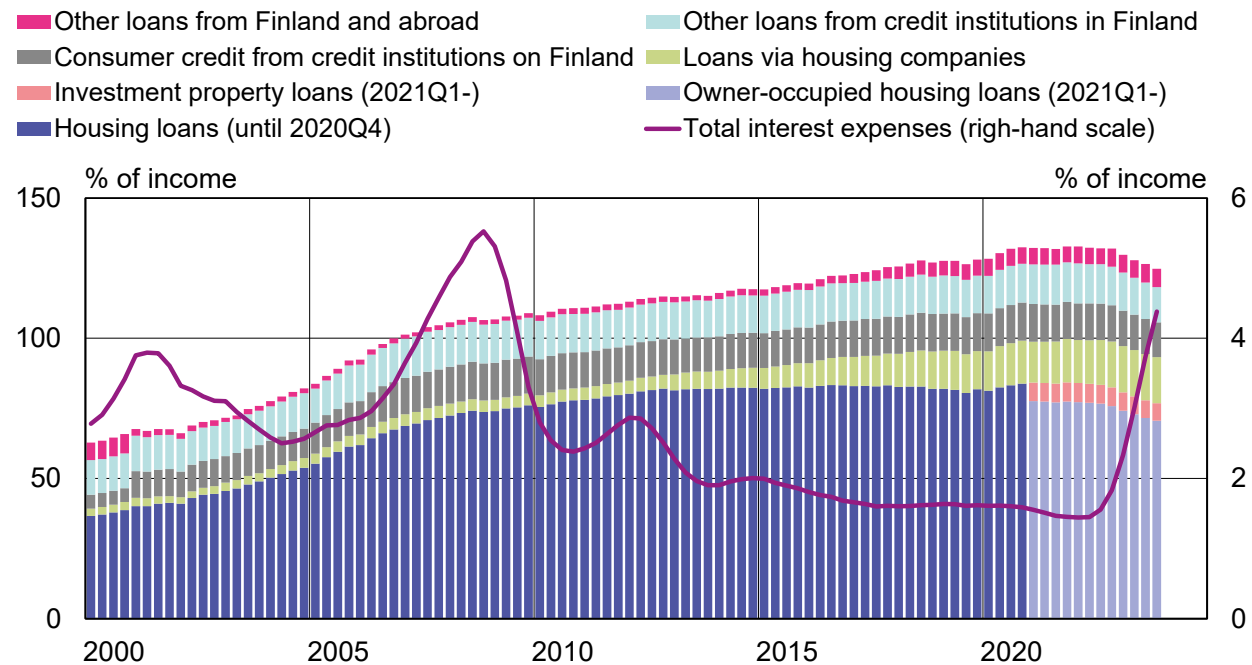
Nominal prices of existing dwellings in housing companies in Finland. Helsinki metropolitan area = Helsinki, Espoo, Vantaa and Kauniainen. Large cities = Helsinki metropolitan area, Turku, Tampere and Oulu.

Lähteet: Tilastokeskus ja Suomen Pankin laskelmat.

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# Vulnerabilities created during the period of low interest rates increase the sensitivity of housing markets

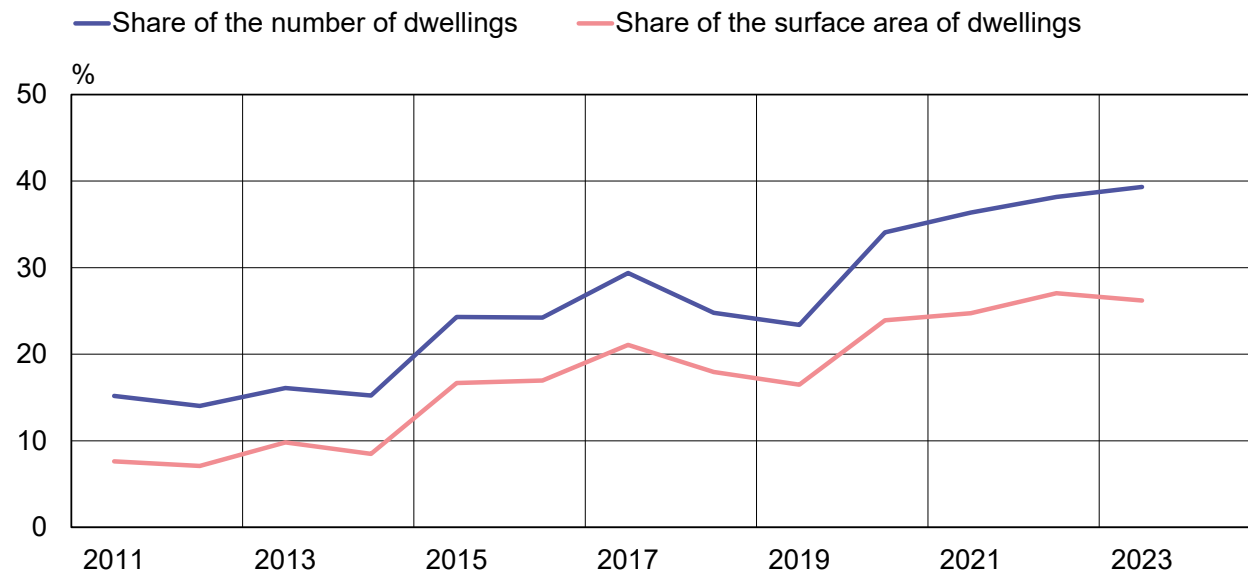
## Household debt has decreased relative to income



Finnish households' debts and annual interest expenses relative to disposable annual income.  
Sources: Statistics Finland and Bank of Finland.. @38215

# Uncertainty over pick-up in investor demand for residential properties and investor-driven construction

Importance of professional investors in housing production has increased in the past ten years



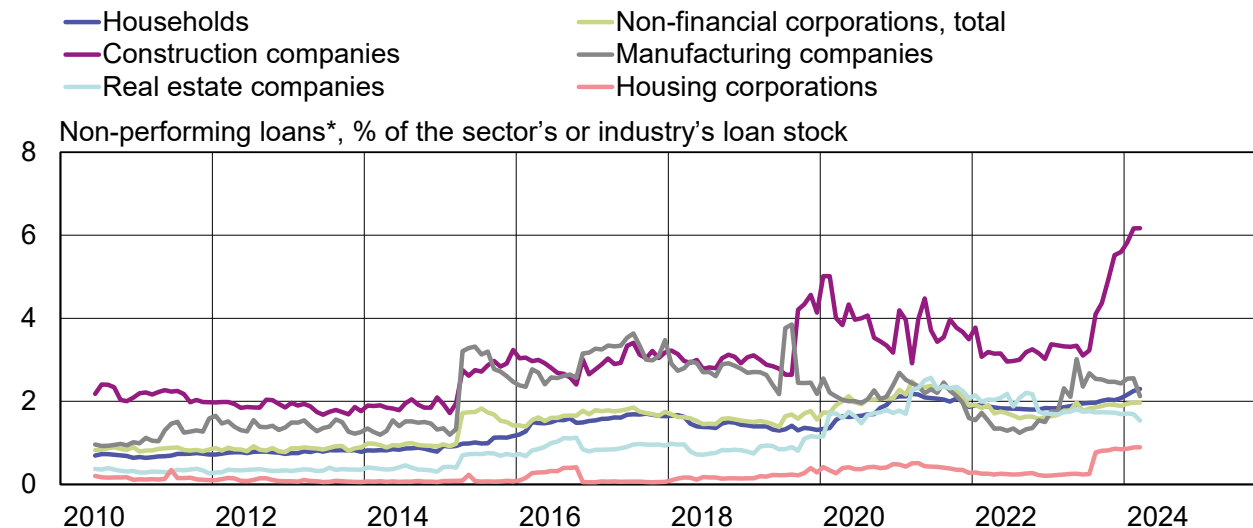
Share of dwellings completed for professional property investors in relation to the number of all new dwellings in blocks of flats per year in Finland.

Sources: Statistics Finland, KTI, and calculations by the Bank of Finland.

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# A longer and deeper recession in the property market would have a broad impact across the financial system

The proportion of non-performing loans has increased rapidly in the construction sector



Loans granted by Finnish credit institutions to households, non-financial corporations and housing corporations in Finland. \*Loans overdue by more than 90 days and loans where the borrower is unlikely to pay due to repayment difficulties. Loans are net, excluding recognized impairment losses.

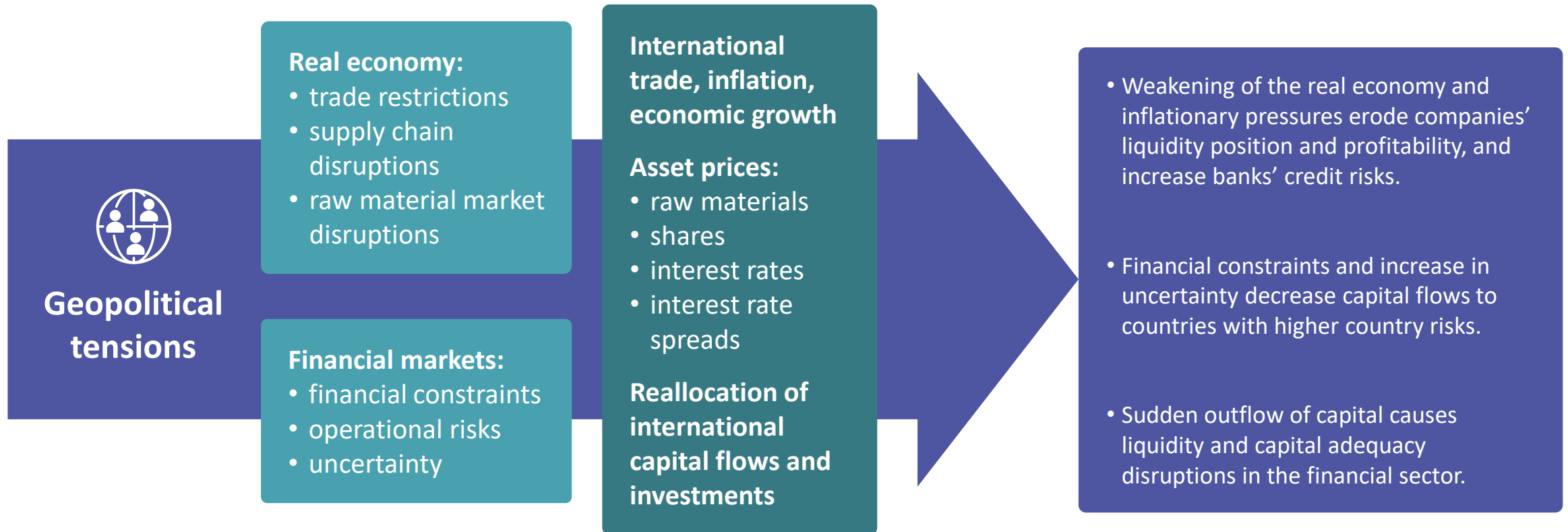
Source: Bank of Finland.

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# The deterioration in the international security environment creates new threats to financial stability

# Geopolitical tensions affect financial stability in a variety of ways



Sources: IMF and Bank of Finland.

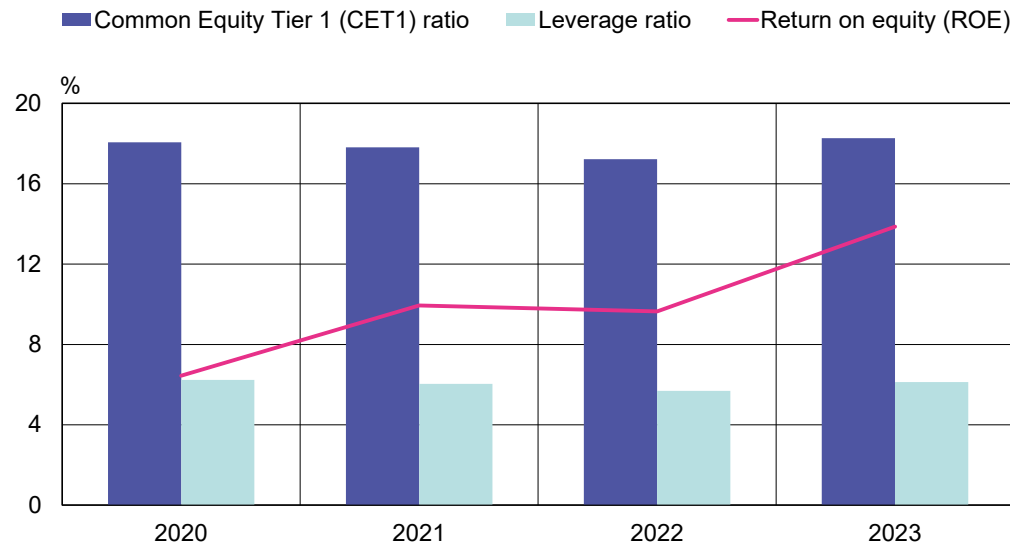
# Geopolitical situation and financial sector digitalisation increase risks to the infrastructure

- Geopolitical tensions have increased the risk that infrastructure and individual actors will become the target of hybrid interference, operational disruptions and cyber attacks
  - Disruptions of one participant could impact the functioning of the financial system more broadly.
- Digitalisation and technological advances in the financial sector may strengthen the effects of disruptions
  - E.g. artificial intelligence can be used for advanced deep fakes and the spreading of disinformation



# The Finnish banking sector could withstand even a deeper recession

Banking sector profitability and capital position improved notably in 2023



Source: Financial Supervisory Authority.

- Finnish banking sector's profitability and capital position have improved
- In a severe stress scenario, the CET1 capital ratio would weaken drastically – shows the importance of sufficient buffers
- The importance of managing liquidity and operational risks is highlighted in an uncertain operating environment

# Policy recommendations for strengthening financial stability



# Financial system's good resilience is no coincidence

- The tightening of banking regulation and supervision following the global financial crisis have provided protection from new crises
- Macroprudential policy is used to prevent risks to the financial system and prepare for cyclical fluctuations in the housing market
- Preparedness for emergency situations has been strengthened by e.g. introducing a national emergency account system

# Financial system resilience must be maintained and strengthened further

- Regulation must be developed based on careful planning
- Better tools are needed for curbing occasional excesses in credit provision and the housing market
- The capacity of macroprudential policy to respond must be improved through the more flexible use of the countercyclical capital buffer requirement
- The EU's banking union should be completed with a common European deposit insurance scheme (EDIS)

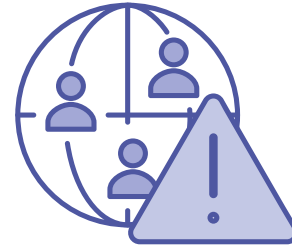
# European capital markets must be developed

- Non-financial corporations and households would benefit from a better-functioning and more integrated market for capital in the EU
- The EU's capital markets union must be promoted in a more determined manner
- At the same time, we must prepare better for risk created in the non-bank financial system and outside the financial system

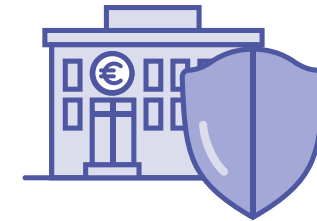
# Summary



The recession in Finland's property market brings greater risks to the economy and the financial system



The deterioration in the international security environment creates new threats to financial stability



The financial system's resilience needs to be maintained and further strengthened



Thank you!

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