



Financial stability assessment: Coronavirus pandemic demonstrates the necessity of risk buffers

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Annual assessment of the stability of the Finnish financial system and related risks and vulnerabilities

- Editorial: Regulation has strengthened the financial system's resilience
- Financial stability assessment: Coronavirus pandemic demonstrates the necessity of risk buffers
- Three articles on topical issues
 - Banks must be able to finance firms and withstand loan losses amid the coronavirus pandemic
 - Nordic countries are vulnerable to housing market risks aggravated by the coronavirus pandemic
 - Coronavirus shock will further weaken bank profitability in the euro area
- Accessible summary: Rainy-day buffers now prove their worth
- Bank of Finland Bulletin website <https://www.bofbulletin.fi/en/financial-stability/>

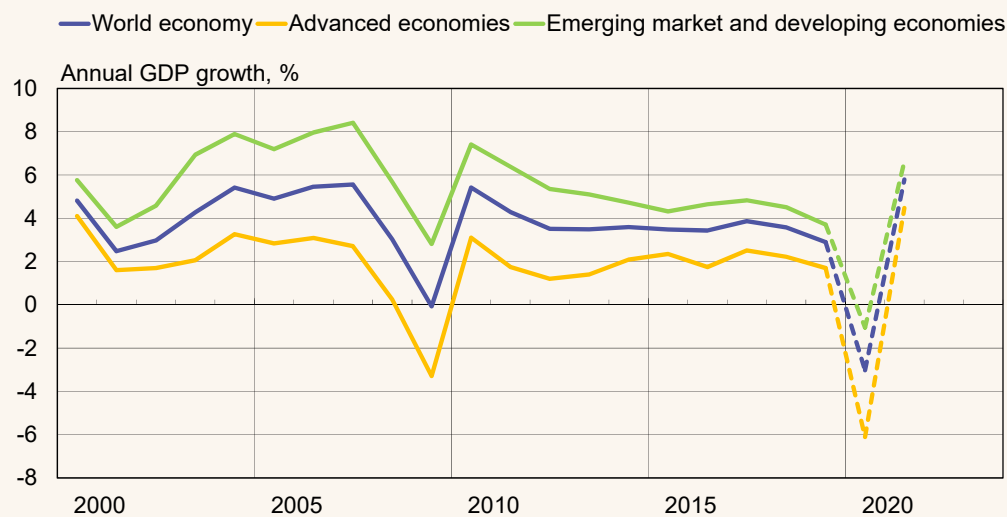
Main topics

- The coronavirus pandemic is pushing Finland and the world economy into a deep recession
- Sound businesses must be supported through the pandemic
- Banks' loan losses will increase on account of the coronavirus crisis
- Nordic banks vulnerable to similar housing finance risks
- Banks, households and businesses must build up adequate buffers to confront future crises

The coronavirus pandemic is pushing Finland and the world economy into a deep recession

The contraction in the global economy appears to be at least as large and more abrupt than the global financial crisis

IMF forecast 2020–2021



Source: IMF World Economic Outlook, April 2020.
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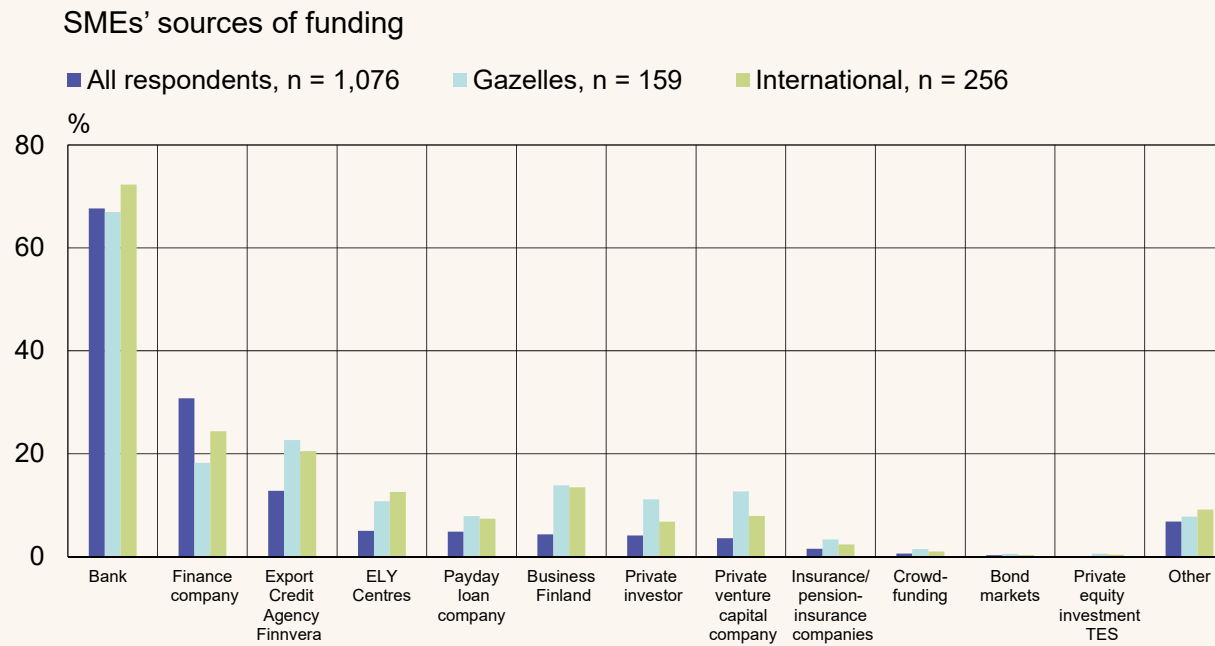
- The world economy has experienced an unprecedented sudden standstill
- The decline in output is very sharp, but there is uncertainty as to its duration
- According to IMF forecasts, the world economy will contract by around 3% in 2020

The outlook for the Finnish economy deteriorated suddenly as the coronavirus crisis struck

- According to the Bank of Finland's calculations, Finnish GDP will contract significantly in 2020
- The key questions are how long will the restrictive measures have to remain in place and how much more will bankruptcies and unemployment rise
- Ensuring the stability and functioning of the financial system is essential so that households and the economy can be supported through the crisis

Sound businesses must be helped through the pandemic

Availability of bank finance especially important for SMEs



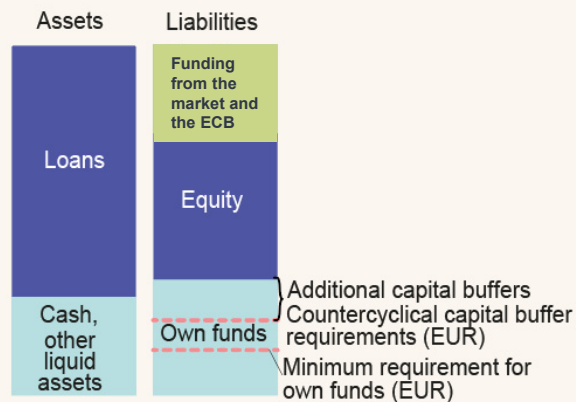
Source: Federation of Finnish Enterprises, SME Barometer Spring 2020.

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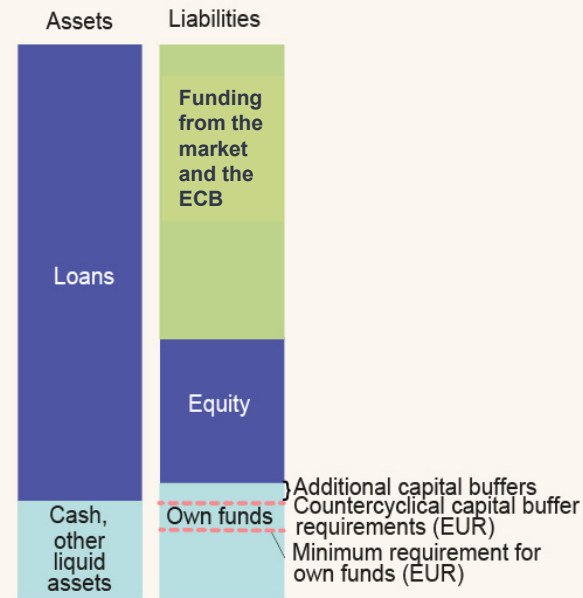
Banks must be able to increase their lending in crisis situations, if necessary

A bank's balance sheet before the crisis and after the escalation of the crisis

Before the crisis



After the crisis

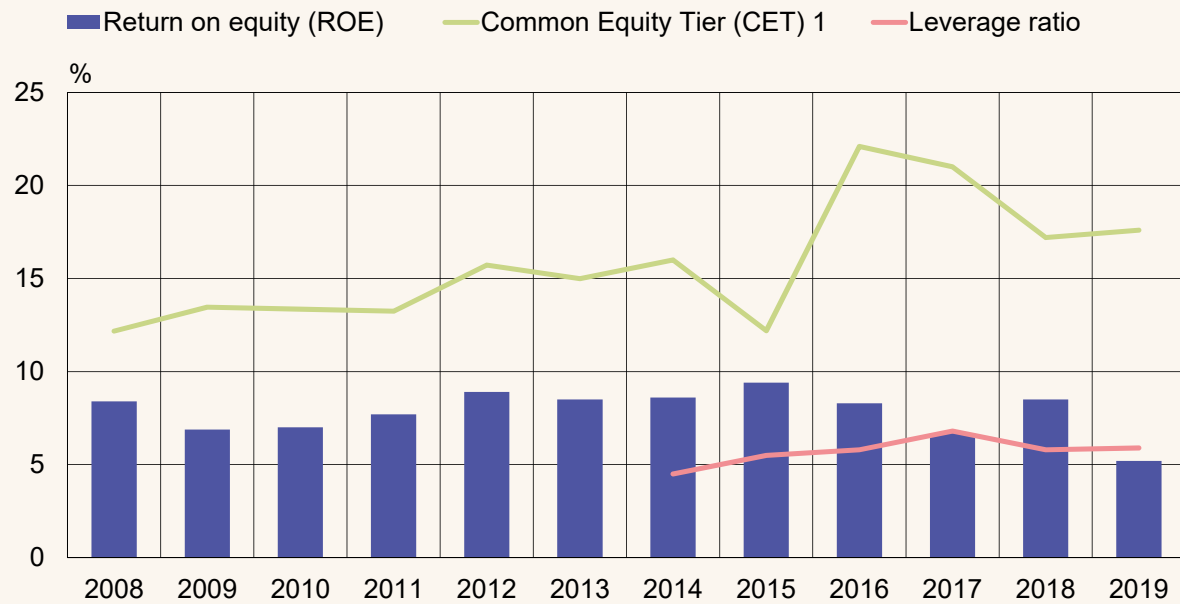


Source: Bank of Finland.

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Stronger capital adequacy bolsters the lending ability of banks

Key figures for Finnish banks

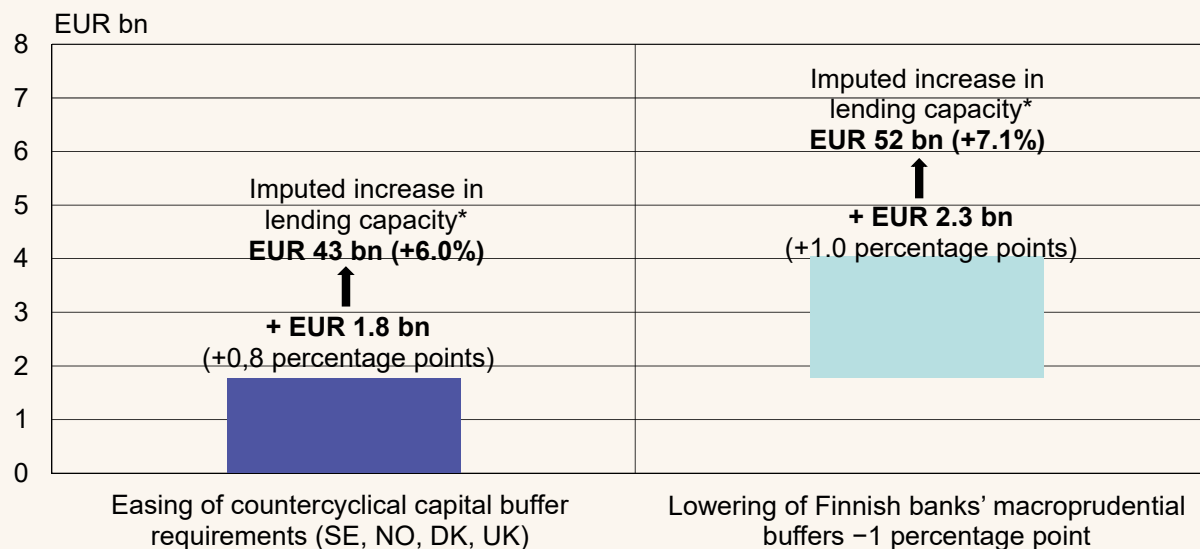


Source: Financial Supervisory Authority.

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Macroprudential decisions by the Nordics have significantly increased banks' lending capacity

Estimated impact of the macroprudential decisions taken by other countries and the FIN-FSA on Finnish banks' additional capital buffers and lending capacity



*Expansion of balance sheet that would keep total capital requirements unchanged at current risk-weight levels.

Source: Financial Supervisory Authority.

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ECB and Bank of Finland to ensure financial intermediation to businesses

- Central banks have increased their lending to banks to improve financial intermediation to businesses and households.
- The ECB's Pandemic Emergency Purchase Programme (PEPP) will have an envelope of EUR 750 billion and purchases will be made until the end of this year.
- Additional net asset purchases amounting to EUR 120 billion will be made under the Asset Purchase Programme (APP) until the end of this year.
- The Bank of Finland is investing in the domestic commercial paper market. The size of the programme is EUR 1 billion
 - Integrated into the Bank of Finland's investment operations
 - Indirectly eases small businesses' access to finance by freeing up banks' lending capacity

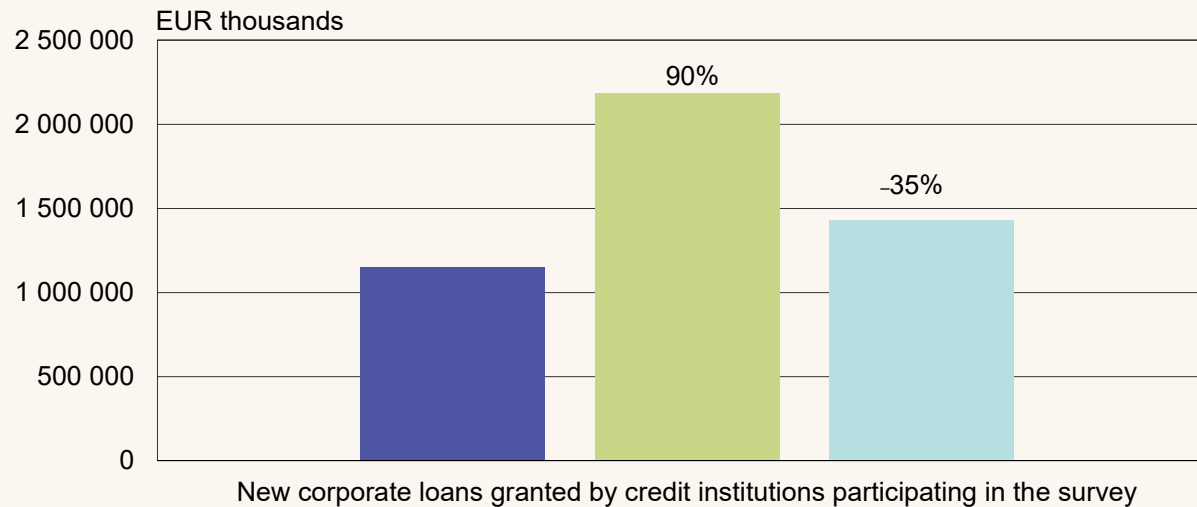
Bank lending to non-financial corporations increased strongly in late March, but levelled off in early April

Business Finland 17 March 2020

ELY Centres 27 March 2020

What was the volume of new corporate loans granted by your bank during the survey period, percentage change on the previous period

■ 1–13 March 2020 ■ 16–27 March 2020 ■ 30 March–10 April 2020

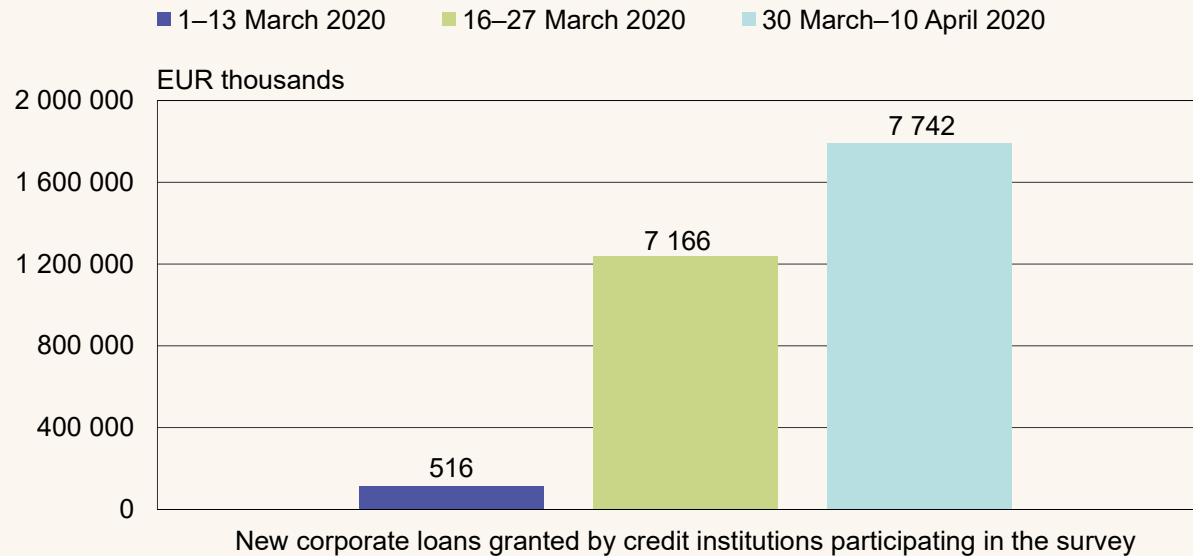


Source: Survey by FIN-FSA, Bank of Finland and Ministry of Finance.

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Banks have eased companies' liquidity problems by granting interest-only periods

To how many corporate loans did your bank grant interest-only periods or other changes in repayment arrangements during the survey period, quantity on bars



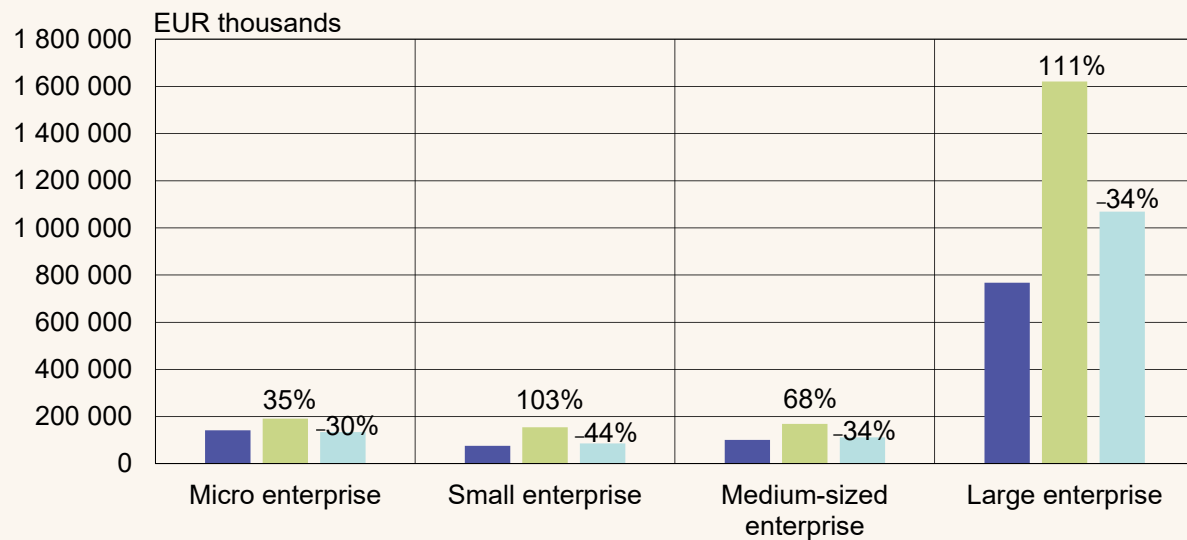
Source: Survey by the FIN-FSA, Bank of Finland and Ministry of Finance.

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The smallest companies have withdrawn the lowest amount of new loans in relative terms

Growth in new loans per size of enterprise, percentage change on the previous period

■ 1–13 March 2020 ■ 16–27 March 2020 ■ 30 March–10 April 2020



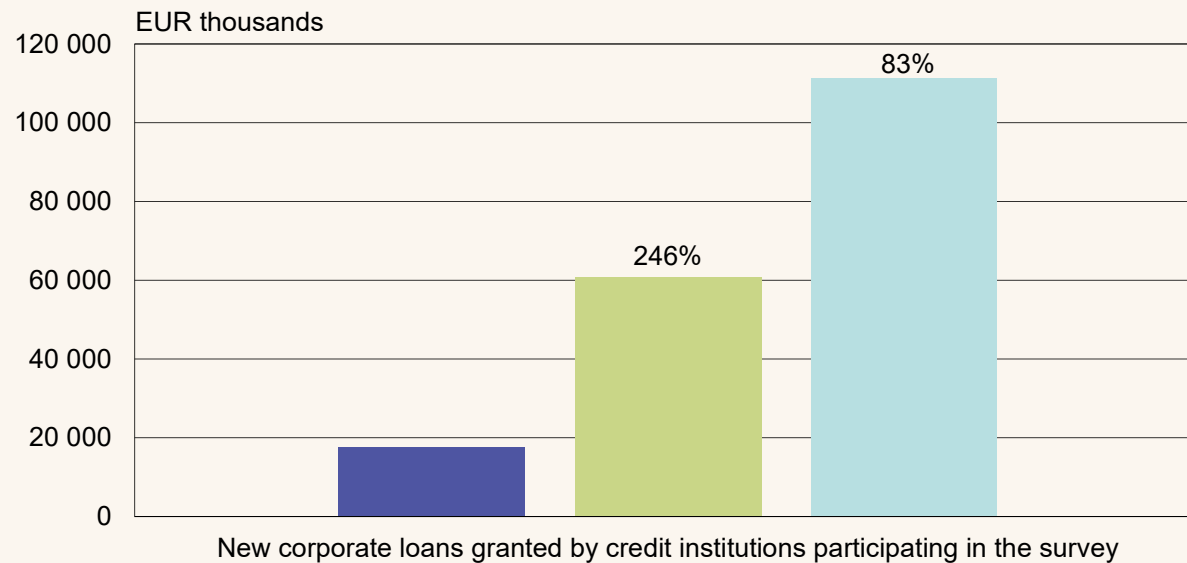
Source: Survey by the FIN-FSA, Bank of Finland and Ministry of Finance.

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Easing the cash-flow crisis of businesses requires loan guarantees and direct subsidies

Percentage of new corporate loans guaranteed by Export Credit Agency Finnvera during the survey period, percentage change on the previous period

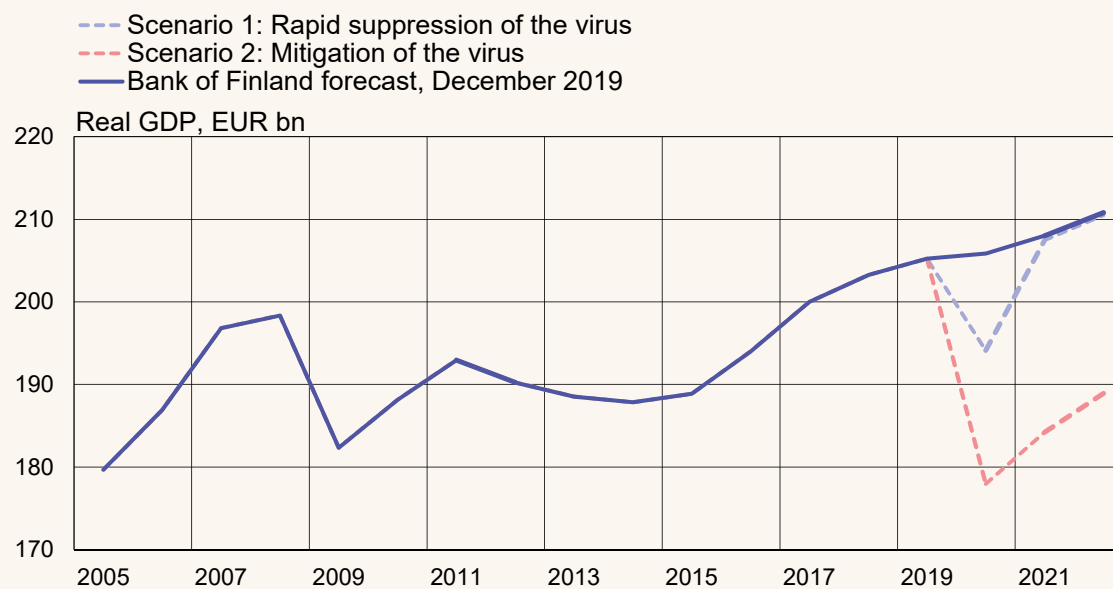
■ 1–13 March 2020 ■ 16–27 March 2020 ■ 30 March–10 April



Source: Survey by the FIN-FSA, Bank of Finland and Ministry of Finance.

Banks' loan losses will increase on account of the coronavirus crisis

Credit loss calculations are based on the Bank of Finland's scenarios for the economy

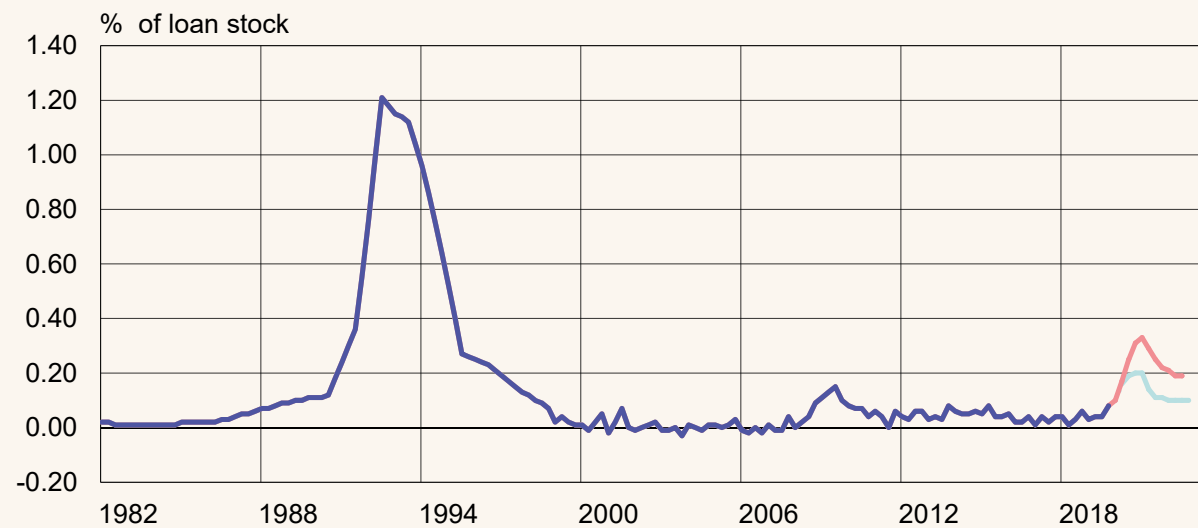


Sources: Statistics Finland and calculations by the Bank of Finland.

Credit losses on banks' domestic loans as estimated by the calculation

Credit losses of banks operating in Finland on loans to Finnish non-financial corporations and households

— Scenario 1, GDP -5% — Scenario 2, GDP -13% — History



Source: Bank of Finland calculations.

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Why are loan losses estimated by the model lower than in the 1990s recession?

- The scenarios are based on the assumption that the duration of the recession will be shorter than the 1990s recession
- Interest rates rose considerably during the 1990s recession; interest rates are now lower.
- In the 1990s recession the devaluation of the Finnish markka increased the debt burden of foreign-denominated loans; today the volume of foreign currency loans is virtually nil.

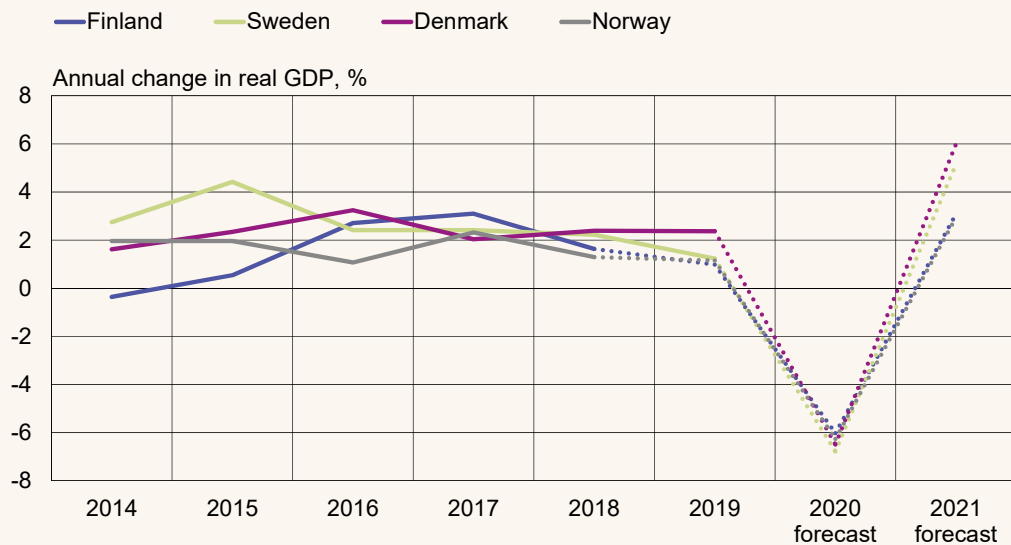
Loan loss calculations are subject to considerable uncertainty

- We do not yet know the path, duration and economic effects of the coronavirus pandemic.
- The calculation does not take into account loan losses on banks' foreign lending.
- The calculations do not take into account measures taken to support businesses.

Nordic banks vulnerable to similar housing finance risks

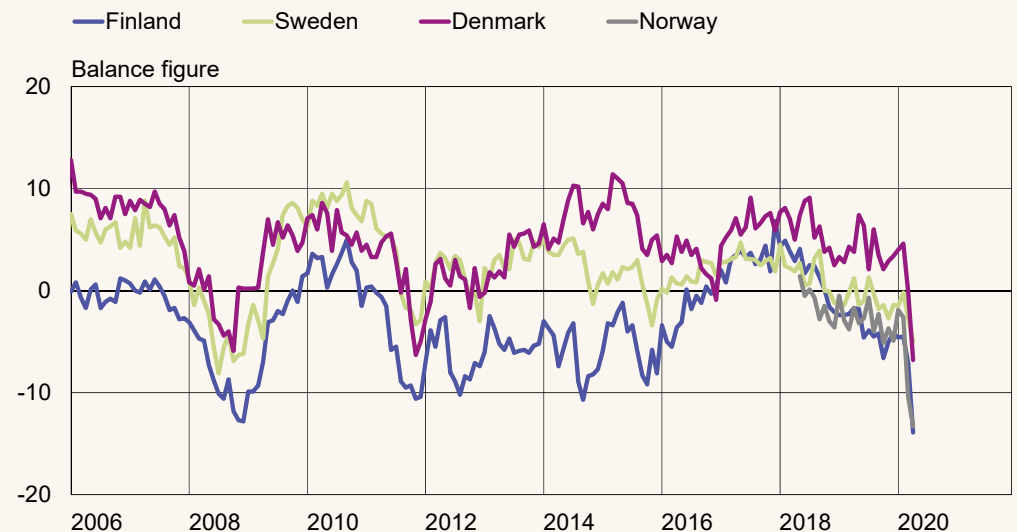
The economic outlook and consumer confidence have deteriorated precipitously in the Nordics due to the coronavirus crisis

Economy expected to contract significantly in 2020



Forecasts in dotted lines.
Source: International Monetary Fund, World Economic Outlook Database, April 2020.

Consumer confidence in the economy deteriorated amid the coronavirus crisis



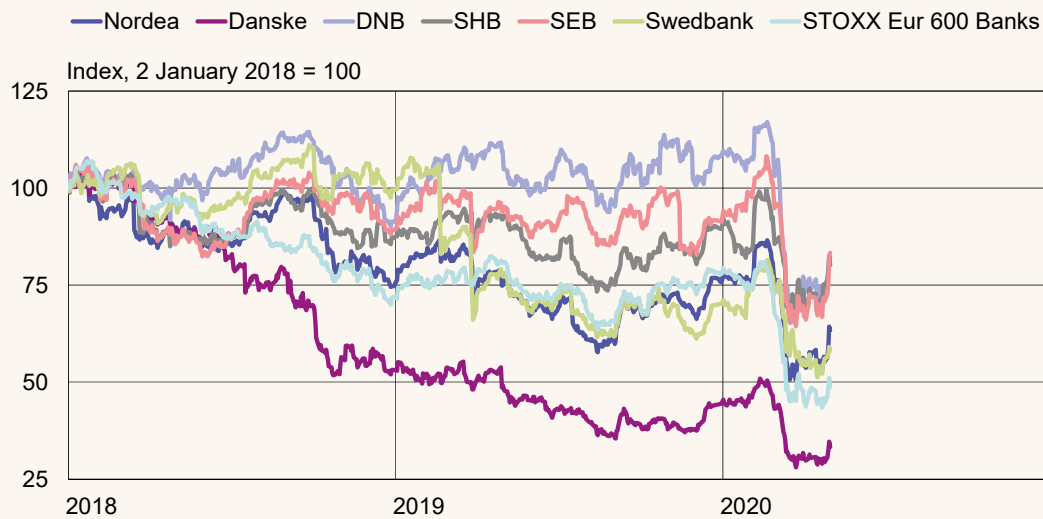
Sources: Statistics Finland, Opinion AS, Eurostat and Macrobond.
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Nordic banks vulnerable to housing market-linked credit and funding risks

- Risks caused by the coronavirus pandemic may spread across borders both through the real economy and through financial markets and banks
- The Nordic countries share many common structural vulnerabilities
 - Household debt is high relative to incomes
 - Housing loans and loans to the real-estate sector account for a significant share of bank lending
 - A large proportion of bank funding comes from the international financial markets
 - Covered bonds play a major role in both banks' market funding and liquid assets
- Economic recession increases the risk that long-accumulated vulnerabilities will begin to translate into losses

The coronavirus crisis was quickly reflected in the pricing of bank shares and market funding

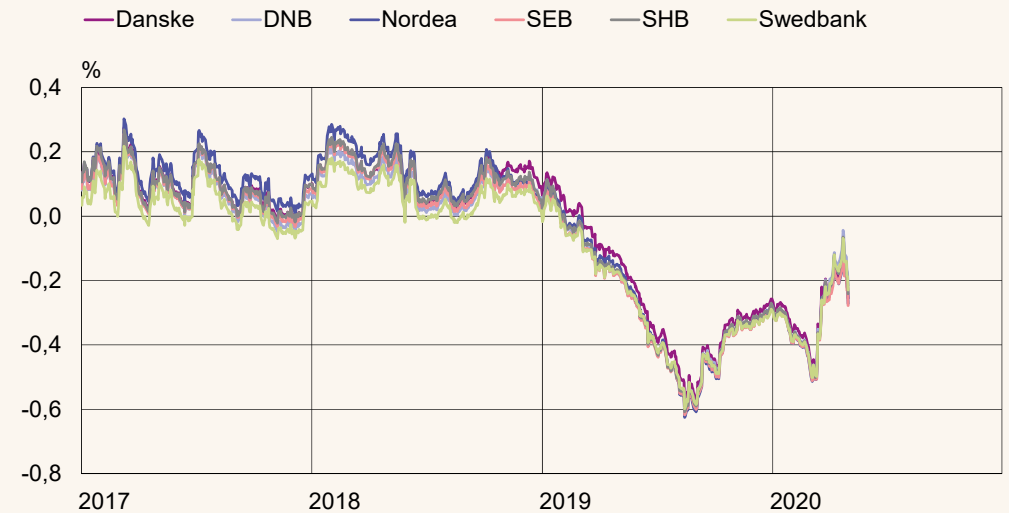
Steep drop in bank share prices at the outbreak of the coronavirus crisis



Source: SNL.

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Cost of market funding still low despite the crisis

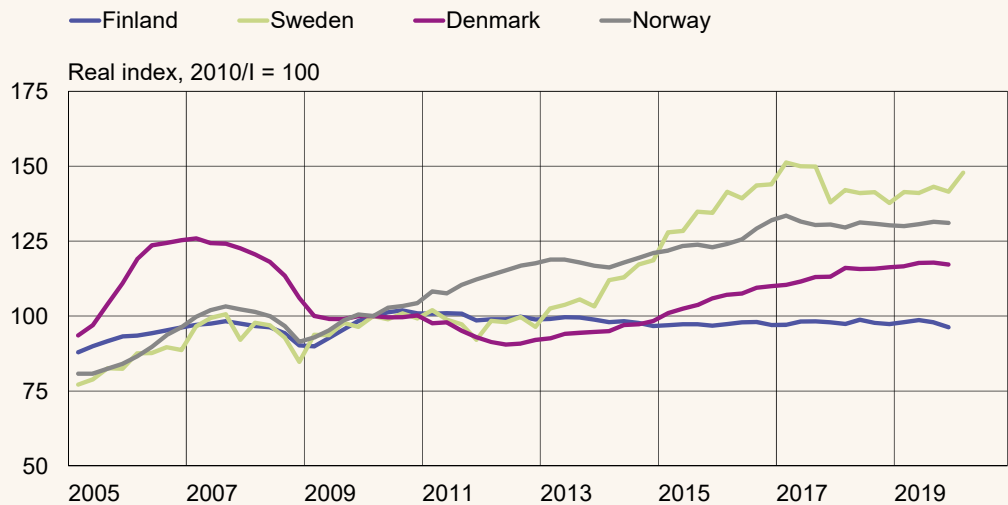


Source: Bloomberg.

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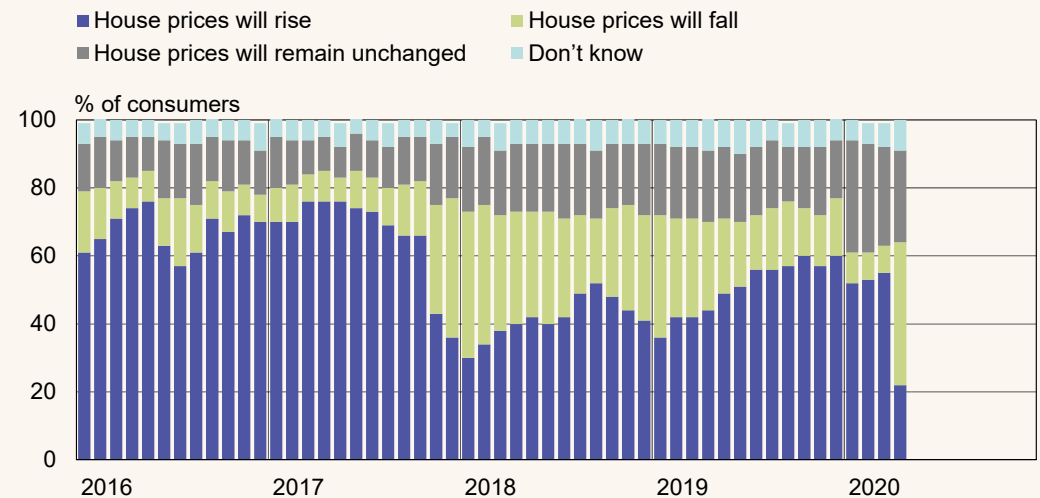
Fairly stable trend in house prices before the coronavirus crisis – expectations of a fall in house prices have increased

Stable trend in house prices before the coronavirus crisis



Sources: Statistics Finland, Valueguard, OECD, Macrobond and calculations by the Bank of Finland.
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Increasing number of Swedish consumers expecting a fall in house prices



Consumer expectations over the next 12 months. Flats and detached houses.
Sources: SEB and Macrobond.

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Banks, households and businesses must build up adequate buffers to confront future crises

The development of macroprudential tools that stabilise the financial system must be continued diligently

- The capital buffers built up in keeping with macroprudential policy are necessary
 - The capital buffers have increased banks' lending capacity
- The new macroprudential instruments proposed by the Ministry of Finance's working group on indebtedness are necessary to prevent excessive levels of household debt
- The EU regulatory changes are designed to ensure the resilience of the banking system to losses and its ability to undertake financial intermediation in all circumstances



Thank you!

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