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FINANSDEPARTEMENT

*Royal Ministry of Finance*

*The Minister of Finance*

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**Response to the warning of the European Systemic Risk Board on vulnerabilities in the residential real estate sector in Norway**

Dear Mr Mazzaferro,

Thank you for your letter of 10 July notifying me of the warning of the European Systemic Risk Board (ESRB) on medium-term vulnerabilities in the residential real estate sector in Norway. The Norwegian Ministry of Finance welcomes the analysis, and supports the important work of the ESRB to monitor systemic risks. We particularly welcome that the ESRB now has extended the scope of its residential real estate assessments to cover the entire European Economic Area. I appreciate the opportunity to submit my comments on the matter, and I kindly ask that you publish this letter alongside the ESRB warning.

The Norwegian Ministry of Finance agrees with the ESRB assessment of risks and vulnerabilities presented in the warning. The ESRB's conclusions closely correspond with those reached by the Ministry based on our own analyses of the residential real estate sector.

The debt burden of households has increased for several years, and Norwegian households now rank among the most indebted in the world. The steady build-up of debt increases household vulnerability and poses risks to financial stability and economic growth. While household debt continues to grow at a faster pace than income, the growth rate has gradually slowed down in recent years and has come down to an annual rate of 5.5 percent.

After several years of rapid growth, house prices fell through 2017. They started increasing again in the first half of 2018. Since last summer, the pace has been moderate. Nationally, nominal house prices are now slightly above their peak in 2017, while house prices in Oslo are still somewhat lower than their peak. In real terms, the national house prices have decreased over the past two years.

As pointed out in the ESRB warning, Norwegian authorities have implemented a comprehensive set of macroprudential policy measures to mitigate systemic risks related to vulnerabilities in the residential real estate sector. The Government has a broad policy approach to address housing market issues, and a revision of our housing market strategy was presented last year. The strategy takes a broad view of the housing market, emphasizing supply side efficiency, consumer protection, and a sustainable development in household debt.

Measures taken on the borrower side to achieve a sustainable growth in debt include limitations on residential mortgage lending practices, which have been in place as guidelines since 2010, and as a regulation from 2015. The regulation was tightened in 2017, and includes caps on borrowers' loan-to-value (LTV) and debt-to-income (DTI) ratios. Banks now give fewer loans with a DTI above 5, indicating that the regulation has had the intended effect. Norwegian authorities introduced a similar regulation on consumer credit earlier this year. Moreover, new debt information providers have recently launched their services, which will oblige banks to obtain and assess high-quality information on potential borrowers' unsecured debt before granting them new loans. This is expected to curb growth in consumer credit.

Another key element in the Government's housing market strategy has been to improve supply side efficiency. In recent years, the supply of housing has increased, contributing to the slower growth in house prices.

Norwegian banks are profitable, and have been able to build up robust liquidity and capital buffers necessary to comply with new requirements introduced in recent years. This includes the counter-cyclical capital buffer requirement, which has been increased as a response to the build-up of financial imbalances, and will reach 2.5 percent this year. Comparatively high capital ratios are seen as necessary also given the structural characteristics of the Norwegian economy with i.a. high household debt, limited diversification of industries, and banks that are highly dependent on confidence in international capital markets for their funding. Furthermore, strong interconnection with the other Nordic countries, especially through branching, underlines the need for mutual recognition of capital requirements in order to safeguard financial stability. The CRR/CRD IV framework is expected to enter into force as part of the EEA Agreement later this year, which amongst other things entails that the Basel I floor will be abolished in Norway. With a view to maintain banks' actual capital requirements at levels that are commensurate with prevailing risk factors, the Government is currently



considering adjustments in the systemic risk buffer requirement and the introduction of temporary risk weight floors for real estate exposures.

In 2018, the regulation on monetary policy was modernized. The new regulation formalizes Norges Bank's long-standing emphasis on financial stability in the conduct of monetary policy; within the frame of the inflation target, monetary policy shall also contribute to counteract the build-up of financial imbalances.

It is our view that proper measures are in place to mitigate the risks pointed out by the ESRB. Norwegian authorities closely monitor developments in the residential real estate sector and the financial system, and stand ready to amend or supplement current measures as needed. This fall, the Ministry of Finance is reviewing both the residential mortgage regulation and key elements of banks' capital requirements.

Norwegian authorities will keep the ESRB informed of any further macroprudential or other policy measures taken to address vulnerabilities in the residential real estate sector. We will also provide information on the evolution of the identified vulnerabilities, as requested.

Yours sincerely,



Siv Jensen