

## ARTICLE – The Riksbank supports Finansinspektionen's proposal for stricter amortisation requirements

It is the Riksbank's assessment that high and rising household indebtedness poses the greatest risk to the Swedish economy. It is therefore important to continue with measures to increase resilience in the household sector and reduce the risks. The Riksbank therefore supports FI's proposal for a stricter amortisation requirement aimed at households with high debts in relation to income.

### Proposal for stricter amortisation requirement

FI has proposed that a stricter amortisation requirement, aimed at households with high debts in relation to income, be introduced on 1 March 2018. This proposal means that new mortgage borrowers with mortgage debts exceeding 4.5 times their income before tax shall amortise at least 1 per cent of their debts, in addition to the existing amortisation requirement.<sup>55</sup> This means that, if a new mortgage borrower has debt exceeding 4.5 times their pre-tax income, that borrower would have to amortise 1 per cent of their mortgage per year if their loan-to-value ratio is below 50 per cent. If the loan-to-value ratio is higher, between 50 and 70 per cent, amortisation increases to 2 per cent and then to 3 per cent if the loan-to-value ratio is over 70 per cent.

In a consultation response, the Riksbank has expressed support for FI's proposal. The Riksbank also considers that the proposal is important in light of the most recent development of the housing market, with prices that have fallen over the autumn, and unease that prices will continue to fall and that housing construction will come to a standstill in the period ahead.

### Only highly-indebted households will be affected

The tightened amortisation requirement is thus aimed at the households choosing to take up large loans. For the vast majority of households, the consequences will be limited as currently most new mortgage holders already borrow less than 450 per cent of their pre-tax income. This could partly be because many of the banks already set a limit on debt in relation to income. Only 15 per cent of those taking out new mortgages are expected to be covered by the new rules. In Stockholm, the corresponding figure is 30 per cent and, in Göteborg, 19 per cent. These figures are based on an assumption that borrowers will not adjust their behaviour. However, as

this measure only applies to new borrowers, they will have an opportunity to adjust by purchasing cheaper housing. This would mean that fewer people would be affected by the requirement. Similarly, most macroprudential policy measures previously introduced by FI have been aimed at new borrowers. This means that it will take a long time before the measures have an effect on the entire mortgage stock. In addition, tax policy measures such as tax relief, which could have affected the stock, were not introduced. The Riksbank's assessment is that FI's new proposal will also have limited effects on the housing market and household consumption and thereby on current economic developments. But by contributing to the prevention of household indebtedness from continuing to grow faster than incomes, the proposal may help slow down the continued upwards spiral in which higher debts bring about higher housing prices, thereby bringing about even higher debts.

### The requirement may contribute towards reducing risks

Nevertheless, it cannot be ruled out that a tightened amortisation requirement could lead to falling housing prices. In such a case, this would indicate that the development of prices in recent years has been driven by the relatively small group of highly-indebted households covered by the amortisation requirement and which would adjust by purchasing cheaper housing instead of accepting faster amortisations. But the economy as a whole hardly benefits from a price development based on high indebtedness and low or non-existent amortisation when the level of interest rates is very low. Prices could then be pushed up to levels that are not sustainable when the level of interest rates is higher. Households unwilling to take major risks would then find it difficult to find suitable housing. Measures leading to a more restrained development of housing prices may then make it easier

<sup>55</sup> The existing amortisation requirement means that new borrowers need to amortise 1 per cent per year if the loan-to-value ratio is between 50 and 70 per cent, and 2 per cent per year if the loan-to-value ratio is over 70 per cent.

for young households to enter the housing market, for example.

The most recent discussion on the risk that housing prices are on the way towards a downturn should make it clear that it cannot be assumed that housing prices will always rise. Falling prices can pose major problems for highly indebted households, partly because there is a risk of lock-in effects if the value of the home falls below the debt. Households may then find it difficult to adjust their housing and hence their housing expenses to changed economic conditions. From the perspective of consumer protection, it is therefore hardly desirable for households to be allowed or tempted to take large debts that are not amortised. But such lock-in effects on the housing market will also become a problem for the economy at large if they affect many households, as this may impair the functioning of both the housing market and the labour market. In a situation in which economic conditions become significantly worse than expected, highly indebted households may substantially reduce their consumption, which could affect the profitability of Swedish companies and, ultimately, increase the banks' loan credit losses and impair their ability to obtain funding. Households' high indebtedness thus entails risks both for individual households and for financial and macroeconomic stability. The tightened amortisation requirement could contribute towards reducing these risks.

#### **The Riksbank supports FI's proposal**

The Riksbank considers it important to continue to apply measures to increase the resilience of the household sector and reduce the risks on the housing market and the risks connected with households' high indebtedness and therefore supports FI's proposal for a tightened amortisation requirement. It is important that the Government takes a decision in this matter, so that the tightened amortisation requirement can be implemented rapidly. During this period of low interest rates, highly indebted households have a good opportunity to amortise and strengthen their resilience against shocks.