Editorial

Rising household debt levels must be addressed in time

Financial stability | 09 May 2019

The Finnish financial system has operated smoothly and contributed to the expansion of economic activity. However, the economic outlook has deteriorated. The most significant near-term risk to the Finnish economy is if growth in the euro area slows more quickly than forecast. Cyclical risks to financial stability have so far remained slight, and the economy is expected to continue its moderate expansion.



Finland's financial system is structurally vulnerable due to the country's high levels of household debt and proportionately large banking system. Indebted households respond to declining economic conditions and increased uncertainty by reducing their levels of consumption and investment. Companies see their business conditions deteriorate, and the risks to the financial system are amplified.

The economy's ability to withstand serious economic shocks is weakened when household debt reaches excessively high levels. The experience of Ireland and Spain during the global financial crisis serves as a cautionary example. Household borrowing and overheating property markets at the height of an upswing amplified the downside risks to the economy — and these risks soon

rained down on taxpayers when the economy entered a downswing.

These sobering examples should be given due weight. The competent authorities must be allowed to address the risks posed by high levels of household debt with instruments that restrict borrowing according to borrowers' debt-servicing ability. Macroprudential instruments can be used to rein in the growth of large debt burdens, and also to avoid situations where house prices and housing loans grow significantly faster than household incomes. For example, a cap on debt-to-income ratios could help stem rising debt levels.

Such new instruments should be adopted as quickly as possible. Under current market conditions, these instruments could be calibrated so that the overall availability of loans would remain broadly unaffected. Determining the appropriate size for a loan would primarily remain a matter between the lender and the borrower.

New-build construction has continued briskly in recent years. This has in part been fuelled by professional investors showing increased interest in the market for rental housing. Investors have increased their holdings of rental housing alongside their more traditional investments in office and commercial properties. Housing company loans have grown rapidly in recent years, especially for new housing developments. Housing company loans can account for as much as 70% of the dwelling's debt-free sales price. New macroprudential instruments should cover household debt in its entirety, including liabilities incurred from housing company shares. Moreover, capping the amount of debt from housing company loans should be considered.

Foreign investors have become an increasing presence on Finland's commercial property market, especially in large transactions. The growing participation of foreign investors means that the Finnish property market is more closely tied to the cyclical fluctuations of other European real-estate markets. A decline in global markets or economic conditions may result in investors withdrawing from the Finnish market. This in turn would intensify price volatility in Finland.

In addition to the cyclical risks to the real-estate investment market, the market for commercial property in Finland is undergoing structural change. Commerce and retail trade are being pushed online because of the changes in consumer behaviour brought on by digitalisation, and flexible working arrangements have reduced the need for office space. Developments on the Finnish property market warrant a more watchful eye in future.

The effects of digitalisation are also readily apparent in payment services and in the availability of consumer credit and high-cost short-term loans. Consumer credit has expanded relatively quickly in Finland in recent years. The majority of new consumer loans are still issued by conventional banks. However, a growing share of unsecured consumer loans, while comprising only a small proportion of total household debt, is being taken out as so-called payday loans and loans issued

by foreign online lenders. People who borrow from payday lenders may struggle with their personal finances. The high fees and interest rates associated with these loans are likely to only exacerbate this. Credit standards and advertisements for consumer loans issued from outside the banking sector should be brought under more stringent supervision, to tackle the problems often associated with indebtedness.

Sound lending practices and good financial housekeeping could be promoted by establishing a positive credit register in Finland. In addition, the credit register would help authorities better understand the composition of household debt. For its part, the Bank of Finland will begin collecting information on loans issued from outside the banking sector.

Helsinki 8 May 2019

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Keywords

credit register, financial stability, macroprudential tools