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Housing market risks growing in the shadow of the COVID crisis

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The banks have coped well during the pandemic and have been able to provide credit to businesses and households. Very long loan durations are a cause for concern. New tools are needed to rein in the build-up of debt.

The crisis caused by the COVID-19 pandemic swept the Finnish economy into a sudden recession in 2020, but the progress with vaccinations means we can already see light at the end of the tunnel. The negative economic impacts of the crisis have so far been less than feared, and the most recent economic forecasts are encouraging.

Despite the economic crisis, the condition of Finnish banks has remained good. The banks are nowadays stronger than in previous crises, such as the financial crisis of around 10 years ago. They now have more own funds to cover the losses caused by households' payment difficulties and corporate bankruptcies. The banks have also managed to continue granting credit. In fact, in addition to support measures by the authorities, bank loans and amortization holidays have helped businesses and households cope with the loss of income caused by the pandemic.

However, it is not yet time to breathe a sigh of relief. Banks generally suffer losses from corporate loans long after the worst phase of an economic crisis is already over. Moreover, the COVID crisis is affecting different businesses and households in very different ways. Some industries and their employment situations are suffering from the pandemic much more than others. It is therefore important that the State and other authorities continue their support measures for a sufficiently prolonged period.

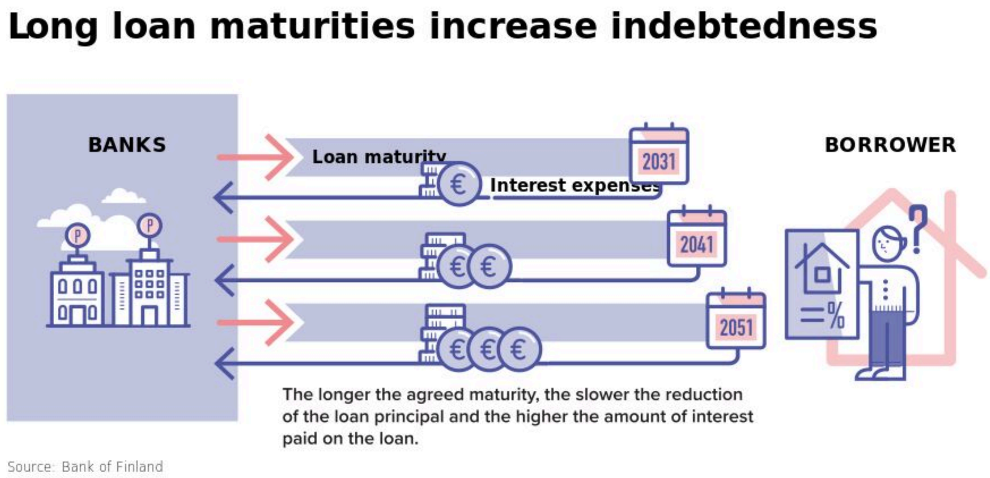
Accommodative monetary and fiscal policy are an important part of helping the economy through the COVID crisis. Ready access to credit and the low level of interest rates will help some households and businesses keep their heads above water during the crisis. At the same time, some may take too many risks and take on too much debt. The Bank of Finland is concerned about the excessive indebtedness of many households, and particularly the recent growth in housing loans and housing company loans. A rapid increase in debt and housing market risks have often had a significant influence in the genesis and severity of economic crises.

In Finland, growth in housing loans has accelerated since summer 2020. The worrying feature is that very long housing loans are now being taken out more than ever and a larger proportion of housing loans are being granted to households that already have a high level of debt relative to income. In addition, an increasingly large share of the debt burden on households is down to housing company loans, the costs of which not all households necessarily take into account when assessing their overall living costs or the effects of a rise in interest rates.

Nowadays the authorities can moderate excessive growth in debt by applying a loan cap. This ensures that new housing loans are not unreasonably large relative to the price of the housing being purchased and the borrower’s other assets. A working group set up by the Ministry of Finance has suggested the loan cap be supplemented with a debt-to-income cap that would take into account all the debts of a loan applicant relative to the applicant’s income. Such other debts could include, for example, consumer credit and the aforementioned housing company loans. The working group also proposed a maximum duration for new housing loans as well as limits on the size and duration of housing company loans.

The Bank of Finland considers that the proposed tools would help moderate the risks relating to growth in the level of household debt. In economically uncertain times, households with a lot of debt reduce their consumption and buy less goods and services produced by businesses. As a result, the businesses have to reduce their operations and can even run into difficulties with paying their own bills. For the banks, the loan losses caused by their customers’ payment difficulties reduce their ability to grant new loans to households and businesses, which further reinforces and prolongs the vicious circle in the economy. Thus, household debt has significance not just for the households themselves, but also for the economy as a whole.

Chart 1.



Key words

COVID-19, COVID-19 pandemic, debt-to-income cap, financial stability, households, housing markets, loan cap