Reykjavik, 24 June 2019

Recommendation on countercyclical capital buffer

On a quarterly basis, the Financial Stability Council shall submit recommendations to the Financial Supervisory Authority concerning the value of the countercyclical capital buffer pursuant to Article 86(d), Paragraph 1 of the Act on Financial Undertakings, no. 161/2002. In particular, the Council bases its recommendations on recommendations and analysis from the Systemic Risk Committee in determining the value of the countercyclical capital buffer; cf. the Act on a Financial Stability Council, no. 66/2014.

The main purpose of the countercyclical capital buffer is to enhance financial system resilience against potential losses following excessive debt accumulation and build-up of cyclical systemic risk. The buffer may be built up concurrent with the accumulation of imbalances in the financial system. The buffer requirement is reduced or lifted during a concurrent downward financial and business cycle so as to enhance financial institutions' ability to maintain a sustainable supply of credit. The countercyclical capital buffer therefore changes with developments in cyclical systemic risk.

With reference to the analysis conducted by the Systemic Risk Committee, the Financial Stability Council recommends to the Financial Supervisory Authority that the countercyclical capital buffer be held unchanged. While household and corporate debt growth has been positive for some time, economic indicators now suggest that the real economy is entering a recession. Changes in the real economy will have an effect on financial institutions, although there is uncertainty to what extent. Forthcoming recommendations on the countercyclical capital buffer will take note of developments in systemic risk.

## Appendix to recommendation concerning countercyclical capital buffer

This recommendation is based on the Financial Stability Concil's general guidelines of the application of the countercyclical capital buffer. In accordance with offical financial stability policy, the Financial Stability Council shall regularly disclose which indicators it takes into particular consideration in analysing systemic risk. Below are the indicators considered most important in the assessment of the countercyclical capital buffer at the Financial Stability Council meeting of 24 June 2019.

The credit-to-GDP gap
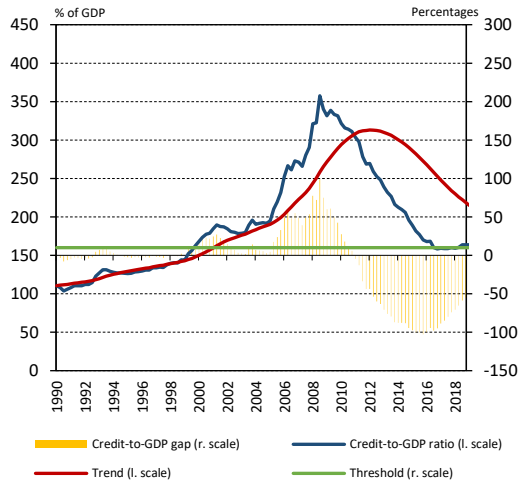
Total credit to households and firms in relation to GDP. The trend componen obtained with a one-sided HP-filter with λ=400.000. The 9% threshold value comes from Laina, Nyholm & Sarlin (2015).

Real growth in credit to households and firms
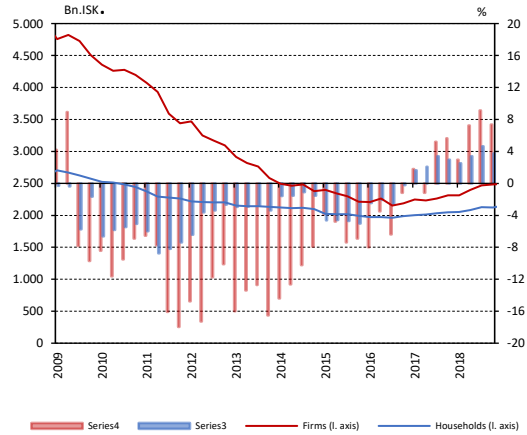
Total credit to households and firms, excluding holding companies. Deflated by the consumer price index. Year-on-year growth.
Sources: Statistics Iceland, Central bank of Iceland

### Real house prices in the capital area
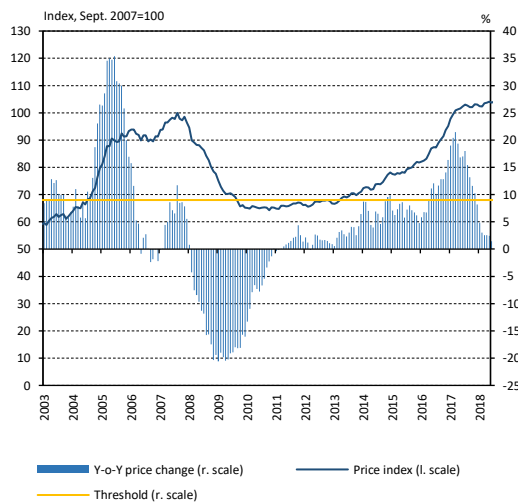
Capital city area house price index deflated by the consumer price index. The 9% threshold is from Laina, Nyholm & Sarlin (2015).
Sources: Statistics Iceland, Registers Iceland, Central Bank of Iceland.

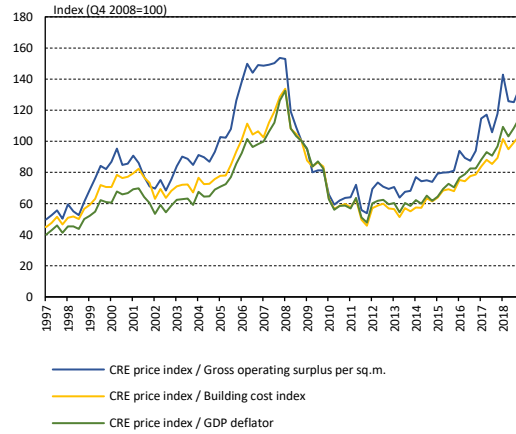### Capital area house prices and other variables
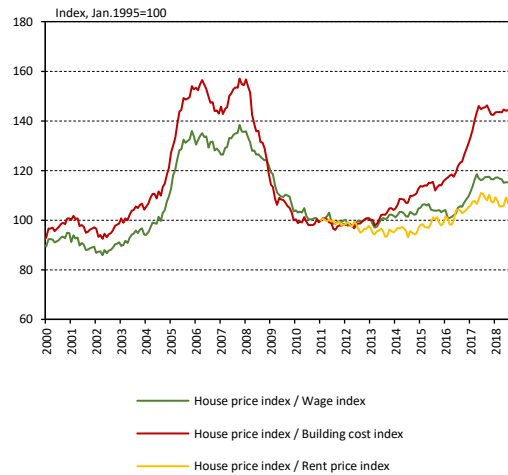
Sources: Statistics Iceland, Registers Iceland, Central Bank of Iceland.

CRE market of the capital area

Index (1995=100)   %

- Y-o-Y change (r. scale)   — Price index (l. scale)
- Threshold (r. scale)
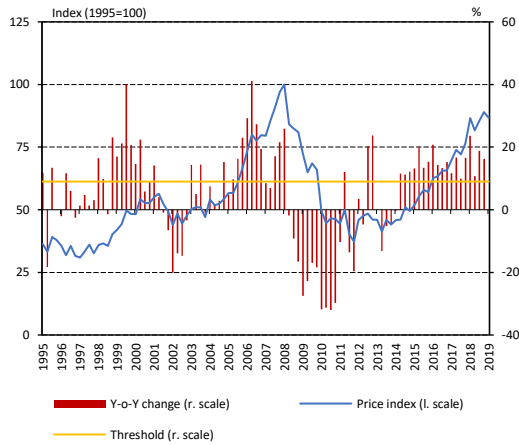
Price indices at constant prices according to CPI. Commercial property index is a
weighted average of industrial, retail and office housing. The 9% threshold is from Laina,
Nyholm & Sarlin (2015). Q2 2018 commercial property value is preliminary.
Sources: Statistics Iceland, Registers Iceland, Central Bank of Iceland.

Commercial real estate prices and other economic variables

Index (Q4 2008=100)

- CRE price index / Gross operating surplus per sq.m.
- CRE price index / Building cost index
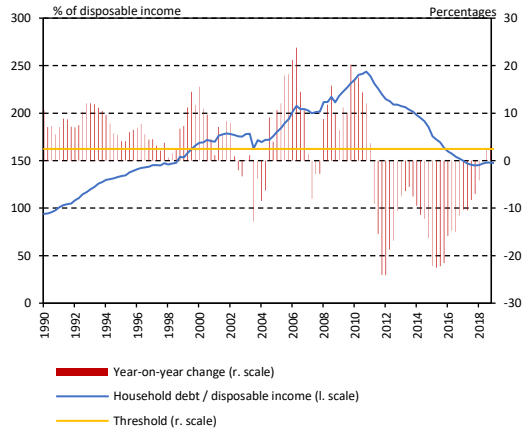- CRE price index / GDP deflator

All variables set to 100 at Q4 2008, before calculating a ratio. Annual data for gross
operating surplus and the housing stock are non-linearly interpolated.

Total credit growth

%   Price and exchange rate adjusted

- Price indexed   ■ FX   ■ Non-indexed   — Total
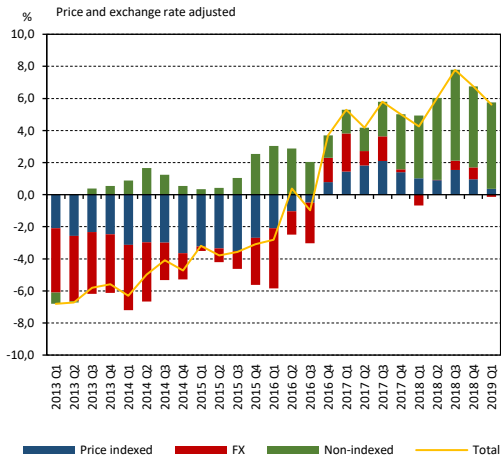
Price-indexed credit at fixed prices, FX credit at fixed exchange rate, and non-indexed
credit at current prices. Claim value.
Sources: Statistics Iceland, Central Bank of Iceland.

Household debt to disposable income

% of disposable income   Percentages

- Year-on-year change (r. scale)
- Household debt / disposable income (l. scale)
- Threshold (r. scale)

Disposable income data is obtained from the Central Bank's Quarterly Macro-
economic Model dataset. The value for 2Q 2018 is nowcasted. The threshold
value is the avg. of the ratio's year-on-year change in the period 1989-2018.
Sources: Statistics Iceland, Central Bank of Iceland.