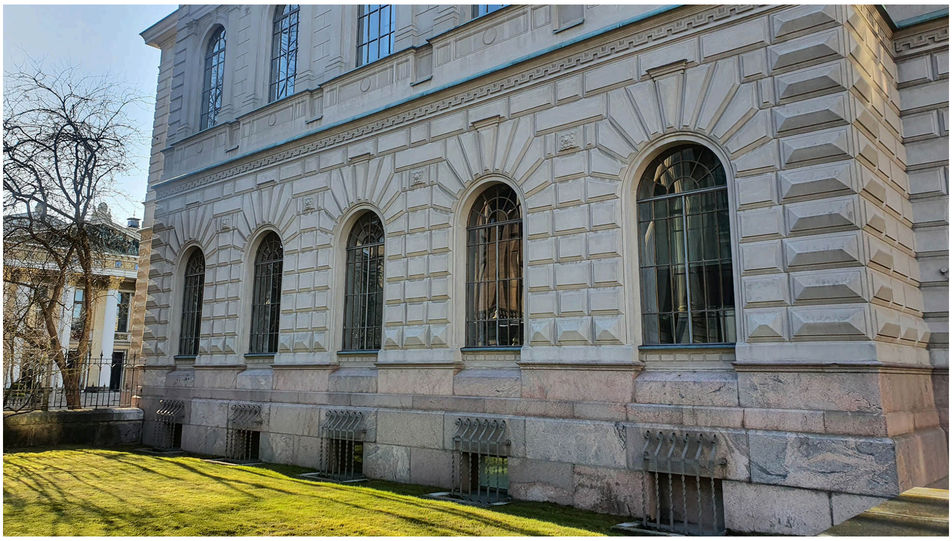
EDITORIAL

Resilience of borrowers, banks and payment systems must be strengthened

4 May 2022 – Editorial – Financial stability

The Russian invasion of Ukraine is causing an immeasurable amount of human suffering and destruction. The military actions will have extensive and long-term impacts on Finland's and the world's economy, politics and financial stability risks. In view of the uncertain operating environment and the structural vulnerabilities of the Finnish financial system, it is important to further strengthen the resilience of borrowers, banks and payment systems in Finland. More effective instruments are required to rein in the excessive indebtedness of Finnish households.



The Russian invasion of Ukraine in February 2022 is causing a devastating humanitarian and economic catastrophe for Ukraine. The war will weaken the entire European economy and is already driving higher inflation. As a neighbour and trading partner of Russia, Finland is strongly impacted by the effects of the war. But freedom and human life are beyond price. We must do all we can to end the war.

The financial markets reacted strongly to the outbreak of the war. Despite the heightened uncertainty, the financial system has remained operational, and so far there has been no need for new policy initiatives to support financial stability. Macroprudential policy, which regulates, among other things, capital buffer requirements on the banks, is still light in the wake of the pandemic.

The weakened economic outlook, higher energy prices, expected rise in interest rates and possible difficulties in accessing finance all serve to increase the risks to financial stability. From this perspective, it is to be hoped that households assess their loan-servicing capacity to take into account a weakening in their purchasing power and the possibility of rising interest rates allied to uncertainty on the labour market. The cyber risks faced by financial institutions and the financial infrastructure have grown with deepening digitalisation and the extension of Russia's war into the data networks. The materialisation of cyber risks may spread uncertainty broadly though the financial system.

In Finland, the financial system's key vulnerabilities relate to heavy household indebtedness and the structure of the banking sector. Over time, household debt has gradually become considerable and is still growing. Most of the debt is in the form of housing loans, which have over a prolonged period become significantly longer and larger. The banking sector is large and centralised, and its lending and own funding are very strongly linked to the real estate market. The Finnish banking sector also has close interlinkages with other Nordic banking sectors.

At present, the Finnish banks, like the other Nordic banks, enjoy strong confidence among investors – for good reason. Retaining this confidence is essential to the stability of our financial system. The existing structural vulnerabilities and the financial stability risks growing in the present aggravated operating environment reveal how important it is strengthen the resilience of borrowers, banks and payment systems alike.

Financial system stability has already been improved in a number of ways, but not yet sufficiently. Implementation of Basel III is incomplete, as is the Banking Union, and the Capital Markets Union is only on the starting blocks. Moreover, Finland's macroprudential tools are still incomplete.

In January 2022, the Ministry of Finance published a draft Government proposal on measures that could more effectively than at present rein in household indebtedness. The proposed reforms are welcome. In addition to these, there is also a need for tools that could be used to subdue growth in the number of households that are strongly indebted relative to their income; this would enhance households' ability to cope with their loans. Macroprudential authorities should also be given powers to impose on banks such capital buffer requirements as would when necessary during serious economic turbulence enable them to free up capital to support financial intermediation.

The objective of the macroprudential authorities is to ensure that the financial system is able to intermediate finance to businesses and households as well as carry out their other tasks of importance to society under all circumstances. This also means that the continuity of payment systems is secured during serious disruptions and states of emergency. The design, construction and testing of functional back-up systems in cooperation between the financial sector and the authorities will require even more determined work than before.

The war will have extensive and far-reaching impacts on the structures of the economy that will also be reflected in the financial system. For example, the structural changes on the energy markets may accelerate the Green transition and at the same time increase transitional risks for the financial sector. The changes will require many sorts of adaptations, but human beings are astonishingly good at that sort of thing. Consumers, businesses and the economy as a whole will in time adapt to the changes, and policies can be deployed to smooth out the most serious turbulence. There are, however, some things we should not adapt to. We cannot allow ourselves to become accustomed to war in Europe.

Helsinki 4 May 2022

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Tags

household indebtedness, financial stability, systemic risks, macroprudential policy