Berne, 7 February 2019

Basel III countercyclical capital buffer

Stance of the Basel III countercyclical capital buffer in Switzerland

- The Basel III countercyclical capital buffer (CCyB) in Switzerland remains at 0%.[1]
- The Swiss sectoral CCyB targeted at mortgage loans financing residential property located in Switzerland remains at 2% as decided and communicated by the Federal Council in January 2014. Mandatory reciprocity as foreseen in Basel III does not apply to the Swiss sectoral CCyB requirements.
- The SNB will continue to monitor periodically the developments in the mortgage and real estate markets. In parallel, the Swiss authority will regularly reassess the need for an adjustment of either the sectoral CCyB or the Basel III CCyB and will communicate to the public consequently.

Background

- In June 2012, a countercyclical capital buffer (CCyB) was introduced into Swiss legislation. One important characteristic of the Swiss CCyB framework is that it can be applied on a broad basis – consistent with the Basel III rules – or it can target specific segments of the credit market. In February 2013, a sectoral CCyB targeting residential real estate situated in Switzerland was activated and set at a level of 1% of relevant risk-weighted positions.[2] It was subsequently increased to 2% in January

[1] In the Ordinance on Capital Adequacy and Risk Diversification for Banks and Securities Traders, the specific provisions relating to the Basel III CCyB are included in Art. 44 and 44a.
[2] Banks were required to meet the CCyB requirements by 30 September 2013.

2014.[3] These decisions were taken by the Swiss Federal Council – based on a proposal by the Swiss National Bank.

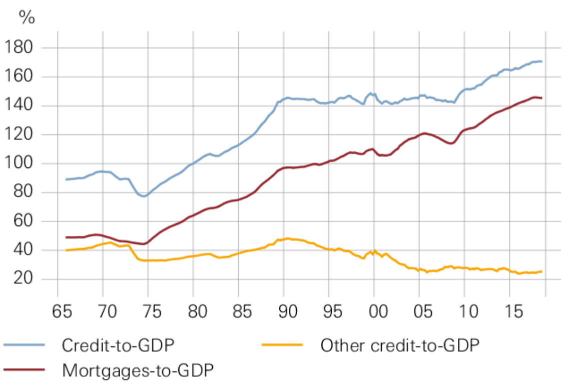
- In line with the international agreement, Swiss authorities periodically communicate and motivate the level of the Basel III CCyB, even if set at 0%.

Motivation for activating / increasing the sectoral CCyB

- Strong growth in both bank credit and real estate prices over the course of several years resulted in the build-up of imbalances in the residential mortgage and real estate markets. By the second half of 2012, Swiss authorities assessed the imbalances to have reached a level that posed a risk to the stability of the banking sector, and hence to the Swiss economy. In response, Swiss authorities introduced several measures. One of the measures, the activation of the sectoral CCyB, was taken in February 2013.
- The observed imbalances have been confined to the residential mortgage and real estate markets. Mortgage volumes relative to GDP have experienced significant growth since 2008 while the level of other credit – relative to GDP – has stagnated or even slightly decreased (cf. chart 1).[4] Similarly, the evolution of real estate prices for both single-family houses, apartments and residential investment property has been distinct from that observed for offices and businesses (cf. chart 2).

CREDIT AGGREGATES-TO-GDP

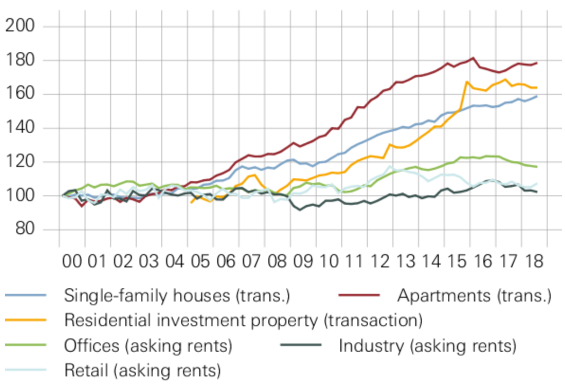
Chart 1



Sources: BFS, SECO, SNB

REAL ESTATE PRICE INDICES

Asking and transaction prices, in real terms, Q1/2000 = 100 Chart 2



Sources: BFS, Wüest Partner

- Given the confined nature of the observed imbalances, Swiss authorities considered the targeted sectoral CCyB to be the best-suited instrument. It temporarily increases

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3 Banks were required to meet the CCyB requirements by 30 June 2014.

4 At end-2016, around 85% of mortgages in Switzerland were residential mortgages. This share has been very stable over the last couple of years.

the capital requirements associated with residential mortgage loans while leaving those for other exposures unchanged. This minimizes unintended effects on other credit segments. The significant importance of mortgage loans for banks' business models ensures that an activation of the sectoral CCyB leads to an increase in resilience at the system level. The higher capital requirement and the increase of the relative price of mortgages may further help to 'lean against the wind'.

Developments since the last communication on the Basel III CCyB

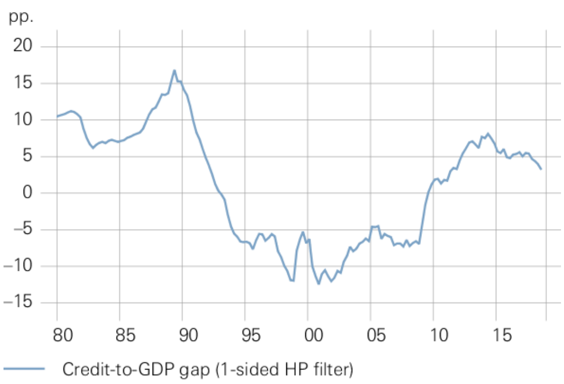
- Observed imbalances remain confined to the residential mortgage and real estate markets. Since the last communication on the Basel III CCyB, imbalances have decreased somewhat in the mortgage market, but they have increased in the residential real estate market. At the same time, affordability risks – as measured by the share of new mortgages with high loan-to-income (LTI) ratios – have risen further.
- In the credit market, imbalances have decreased due to moderate mortgage volume growth and robust GDP growth (cf. chart 3).
- In the residential real estate market, imbalances in the owner-occupied segment have increased. Transaction prices for apartments and single-family houses have risen faster than can be explained by fundamental factors such as rents (cf. chart 4), GDP, or population growth. While prices for residential investment property have not increased any further, the risk of a price correction in this segment is particularly high. The renewed increase in vacancy rates indicates that the robust activity in rental apartment construction may have led to oversupply, exerting downward pressure on rental income and, in turn, on the prices of these properties.
- Affordability risks have risen further in 2018, with a particularly marked increase in the segment of residential investment property held by commercial borrowers (cf. chart 5). In the owner-occupied residential property segment, the share of new mortgages where imputed costs would exceed one-third of gross wage or pension income at an interest rate of 5% was almost 50% in 2018.[5] Moreover, the share of new mortgages where imputed costs would no longer be covered by net rents at an interest rate of 5% exceeded 50% in the segment of residential investment property (cf. chart 5). Affordability risks may materialise not only in the event of an interest rate rise, but also in the event of a price correction in the real estate market. Banks may react to a fall in real estate prices by demanding additional collateral from borrowers or by including a higher risk premium in the lending rate (cf. *Financial Stability Report 2018*).

[5] Data up to 2018Q3. For details on the calculation, see the Financial Stability Report 2018, page 26.

- Based on these observations, the Swiss authorities are of the view that the Basel III countercyclical capital buffer (CCyB) in Switzerland should remain at 0%, as the sectoral CCyB, which currently amounts to 2%, remains the appropriate measure for tackling the observed imbalances and risks. The Swiss authorities continue to monitor closely the developments in the credit and real estate markets to assess the need for an adjustment to either the sectoral CCyB or a shift towards the broader based Basel III CCyB.

CREDIT-TO-GDP GAP

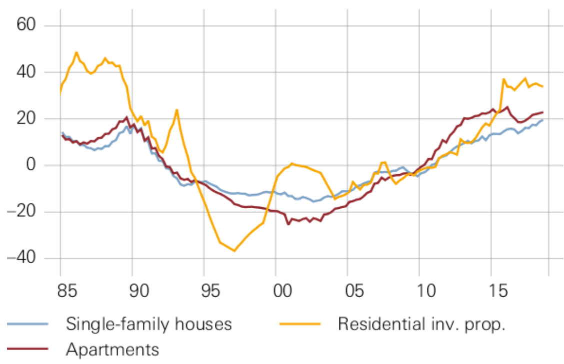
Domestic bank credit, ex-post evaluation — Chart 3



Sources: BFS, SECO, SNB

PRICE-TO-RENT RATIO*

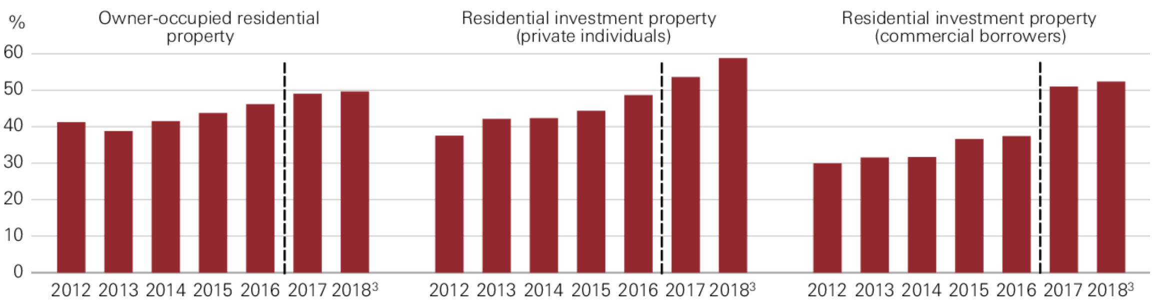
Deviation from average in % — Chart 4



* Transaction prices and existing rents.
Sources: BFS, Wüest Partner

LOAN-TO-INCOME OF NEW MORTGAGE LOANS[1]

Proportion where imputed costs exceed rents (inv.prop) or one-third of income (owner-occ.) at an interest rate of 5%[2] — Chart 5



[1] The dashed line denotes the beginning of the revised 'Survey on new mortgages'.
[2] For details on the calculation, see the Financial Stability Report 2018, page 26
[3] Data up to 2018Q3
Source: SNB