Berne, 10 February 2022

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 real estate located in Switzerland was reactivated to 2.5% on 26 January 2022.[2] The increased requirements are to be met by 30 September 2022. Mandatory reciprocity as foreseen in Basel III does not apply to the Swiss sectoral CCyB requirements.
- The reasons that led to the deactivation of the sectoral CCyB in March 2020 no longer exist today. Thanks to the measures by the Swiss authorities and the business community, as well as the progress of the vaccination campaign, the pandemic-related uncertainties with regard to corporate credit access have decreased significantly.
- Meanwhile, the vulnerabilities in the Swiss mortgage and residential real estate markets have continued to increase.
- Given the confined nature of the observed vulnerabilities, the Swiss authorities consider the targeted sectoral CCyB to be the best-suited instrument.
- The Swiss authorities will continue to monitor the developments in the mortgage and real estate markets closely and examine whether further measures are necessary to contain the risks for financial stability.

[1] In line with the international agreement, the Swiss authorities periodically communicate and justify the level of the Basel III CCyB, even if set at 0%. 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] The Federal Council's decision (Federal Council requires banks to hold additional capital for residential mortgages (admin.ch)) followed a proposal by the Swiss National Bank.

Background

- In June 2012, the 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.
- The sectoral CCyB targeting residential real estate located in Switzerland was activated for the period from February 2013 to March 2020. It was initially set at a level of 1% of relevant risk-weighted positions[3] and subsequently increased to 2% in January 2014.[4] In March 2020, against the backdrop of the outbreak of the coronavirus pandemic, the sectoral CCyB was reduced to 0%.[5]

Developments since the deactivation of the sectoral CCyB in 2020

- The uncertainties regarding access to credit by companies related to the pandemic have decreased significantly since the deactivation of the sectoral CCyB in 2020. In spite of its negative impact on economic activity, the outbreak of the pandemic has neither been accompanied by a shortage in the credit supply, nor led to a correction on the Swiss mortgage and real estate markets.
- Meanwhile, the elevated vulnerabilities in the domestic mortgage and residential real estate markets, which had already been identified prior to the outbreak of the pandemic, have continued to increase.[6]
    - First, banks' lending has increased further, driven by mortgage volume growth. Coupled with the negative impact of the pandemic on economic activity, this led to a significant increase of the credit-to-GDP ratio and the credit-to-GDP gap until Q1 2021. Since then, both indicators have decreased as a result of the economic recovery (cf. charts 1 and 2).[7] With the expected continuation of the economic recovery, the credit-to-GDP ratio should continue to decline but remain above its pre-pandemic level.
    - Second, transaction prices for apartments, single-family houses and residential investment properties have continued to rise and are outpacing the growth of fundamental factors such as rents. Consequently, price-to-rent ratios have increased further (cf. chart 3). Furthermore, despite a slight decline in 2021,

[3] Banks were required to meet the CCyB requirements by 30 September 2013.
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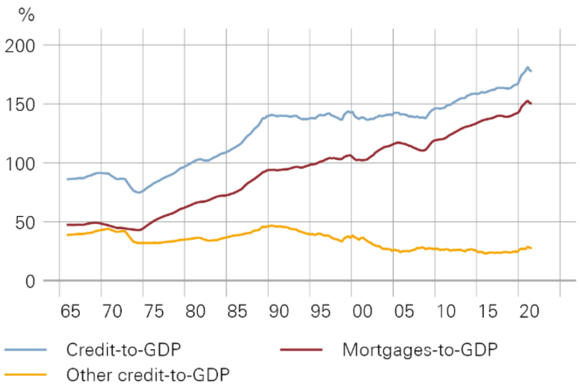
[5] www.admin.ch/gov/en/start/documentation/media-releases/media-releases-federal-council.msg-id-78604.html
[6] Cf. Financial Stability Reports 2015–2021, Swiss National Bank.
[7] The credit-to-GDP gap is computed according to the BCBS guidelines, with domestic bank credit.

residential vacancy rates remain high by historical standards, especially for rental properties (cf. chart 4).

- Third, affordability risks in residential real estate remain high and have even increased for residential investment properties owned by households (cf. chart 5).

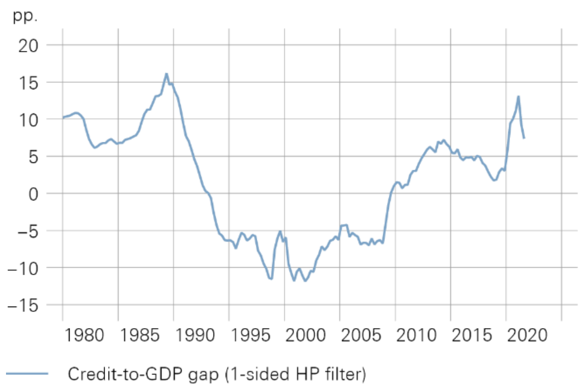
- Given the confined nature of the observed vulnerabilities, the Swiss authorities considered the targeted sectoral CCyB to be the best-suited instrument. It temporarily increases the capital requirements associated with residential mortgage loans while leaving those for other exposures unchanged.
- Consequently, the sectoral CCyB targeted at mortgage loans financing residential real estate located in Switzerland has been reactivated to 2.5%, while the level of the Basel III CCyB remains at 0%.

CREDIT AGGREGATES-TO-GDP
Domestic bank credit — Chart 1



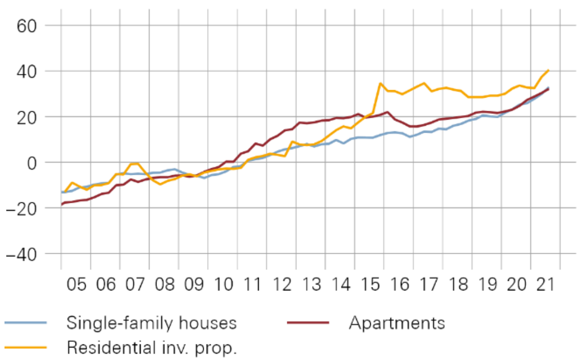
Sources: FSO, SECO, SNB

CREDIT-TO-GDP GAP
Domestic bank credit, ex-post evaluation — Chart 2



Sources: FSO, SECO, SNB

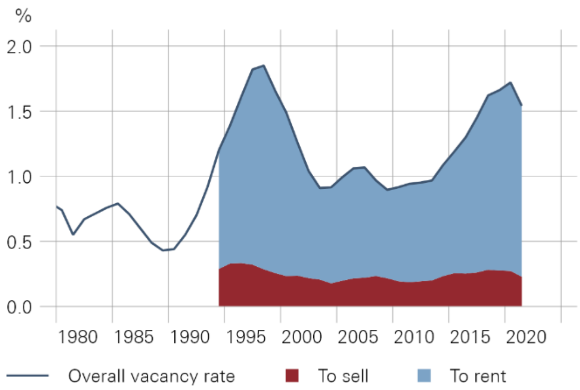
PRICE-TO-RENT RATIO[1]
Deviation from historical average in % — Chart 3



1 Transaction prices and existing rents.

Sources: FSO, Wüest Partner

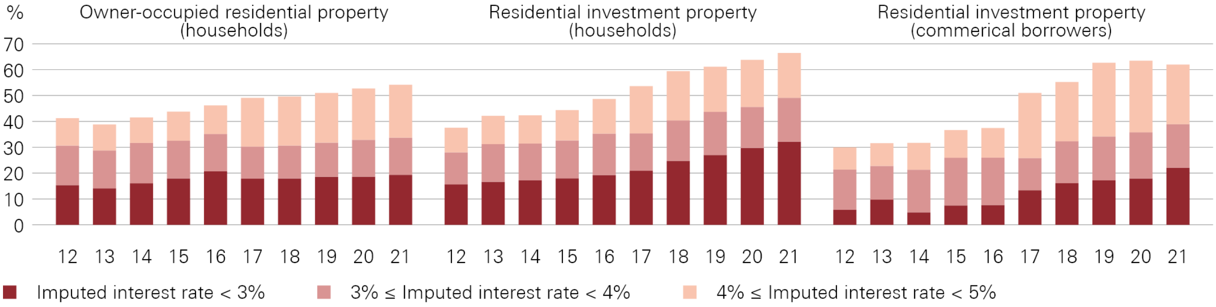
RESIDENTIAL VACANCY RATE
Vacant dwellings relative to total number of dwellings — Chart 4



Sources: FSO, SNB calculations

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 imputed interest rate of up to 5%[2] Chart 5



1 From 2017 on, data from the revised 'Survey on new mortgages' are shown. For 2021 data are up to 2021Q3.
2 The dark red shaded area shows the proportion where imputed costs exceed rents or one-third of income at an imputed interest rate of up to 3%. The red shade area shows the additional proportion for an imputed interest rate between 3% and 4%. The pale red shaded area shows the additional proportion for an imputed interest rate between 4% and 5%. For details on the calculation, see the Financial Stability Report 2019, page 21.

Sources: SNB