



FINANCIAL STABILITY COUNCIL

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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.

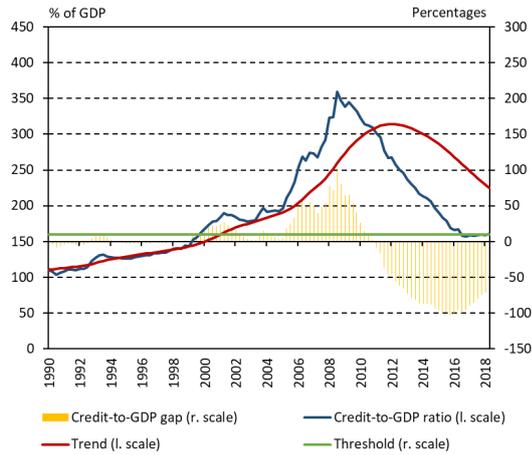
The main purpose of the countercyclical capital buffer is to enhance financial system resilience against potential losses following excessive debt accumulation and build-up of cyclical systemic risk. The buffer may be built up concurrent with the accumulation of imbalances in the financial system. The 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. Even though the financial cycle is still in an upswing, real estate prices are still rising and credit growth has been on the rise, there is considerable uncertainty surrounding developments in the tourism sector. The Financial Stability Council can be expected to recommend that the build-up of the countercyclical capital buffer continue in line with increased cyclical systemic risk.

Appendix to recommendation concerning countercyclical capital buffer

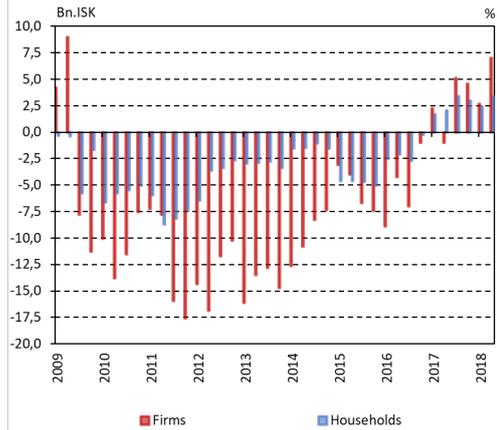
In accordance with official financial stability policy, the Financial Stability Council shall regularly disclose which indicators it takes into particular consideration in analysing systemic risk. Below are the indicators considered most important in the assessment of the countercyclical capital buffer at the Financial Stability Council meeting of 5 October 2018.

The credit-to-GDP gap



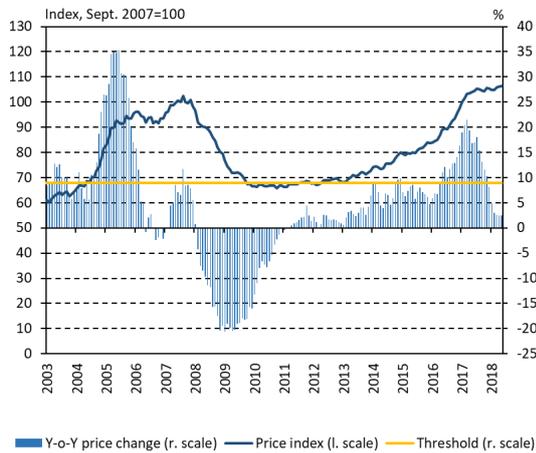
Total credit to households and firms in relation to GDP. The trend component is obtained with a one-sided HP-filter with $\lambda=400.000$. The 9% threshold value comes from Laina, Nyholm & Sarlin (2015).
 Sources: Statistics Iceland, Central Bank of Iceland.

Real growth in credit to households and firms



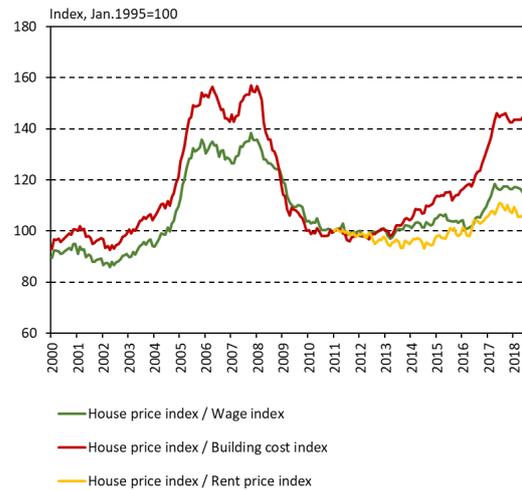
Total credit to households and firms, excluding holding companies. Deflated by the consumer price index. Year-on-year growth.
 Sources: Statistics Iceland, Central Bank of Iceland.

Real house prices in the capital area



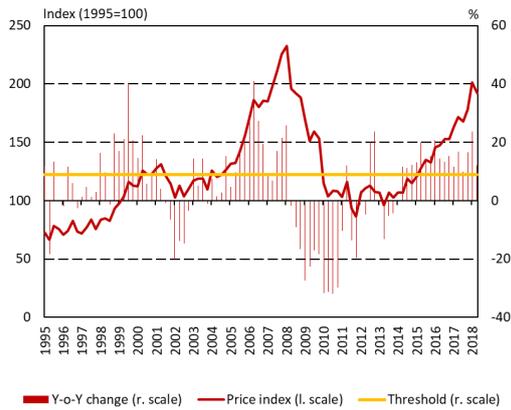
Capital city area house price index deflated by the consumer price index. The 9% threshold is from Laina, Nyholm & Sarlin (2015).
 Sources: Statistics Iceland, Registers Iceland, Central Bank of Iceland.

Capital area house prices and other variables



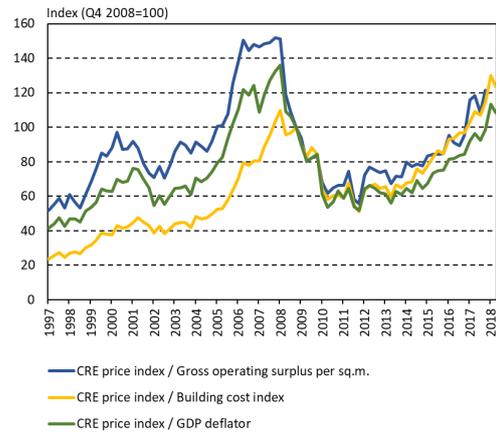
Sources: Statistics Iceland, Registers Iceland, Central Bank of Iceland.

CRE market of the capital area



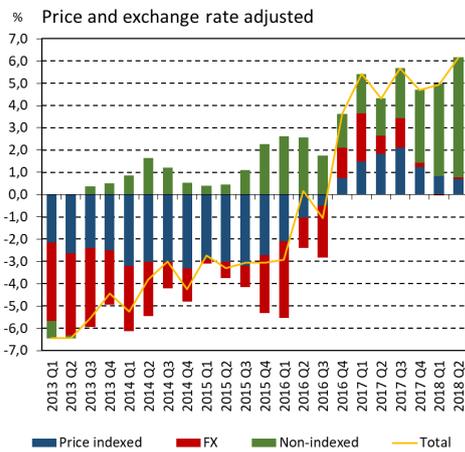
Price indices at constant prices according to CPI. Commercial property index is a weighted average of industrial, retail and office housing. The 9% threshold is from Laina, Nyholm & Sarlin (2015). Q2 2018 commercial property value is preliminary. Sources: Statistics Iceland, Registers Iceland, Central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

Commercial real estate prices and other economic variables



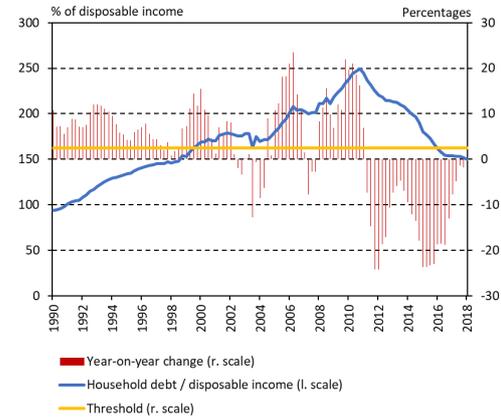
All variables set to 100 at Q4 2008, before calculating a ratio. Annual data for gross operating surplus and the housing stock are non-linearly interpolated. Sources: Statistics Iceland, Registers Iceland, Central Bank of Iceland.

Total credit growth



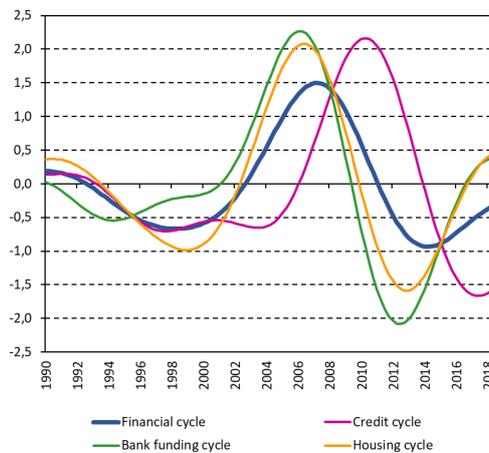
Price-indexed credit at fixed prices, FX credit at fixed exchange rate, and non-indexed credit at current prices. Claim value. Sources: Statistics Iceland, Central Bank of Iceland.

Household debt to disposable income



Disposable income data is obtained from the Central Bank's Quarterly Macroeconomic 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.

Financial cycle



Arithmetic mean of cyclical components from variables in each subcycle and the complete set of variables. Cyclical components are obtained using the Christiano-Fitzgerald band-pass filter with a frequency band of 8-30 years. Sources: Statistics Iceland, Registers Iceland, Central Bank of Iceland.