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 λ=400.000. The 9% threshold value comes from Linnm, Nyholm & Særlín (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 Linnm, Nyholm & Særlín (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.