PRESS RELEASE

DET SYSTEMISKE RISIKORÅD

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The current outlook with very loose financial conditions, increasing asset prices and prospects for a rapid economic recovery provides ground for risk build-up. Therefore, the Council recommends to the Minister for Industry, Business and Financial Affairs to reactivate the countercyclical capital buffer at a rate of 1.0 per cent from 30 September 2022. Unless risk build-up in the financial system slows down considerably, the Council expects to recommend a further increase of the buffer rate to 2.0 per cent by the end of 2021. There are also signs of risk build-up in the residential real estate market. The Council recommends to the government to restrict access to interest only mortgage loans.

Build-up of systemic financial risks in Denmark

The economic recovery continued in the 2nd quarter of 2021, and the global economy is entering an expansion. Real-time economic indicators for Denmark suggest that the pace of the economic recovery is faster than previously expected. The positive trend is expected to continue as larger segments of the population are vaccinated.

Financial conditions are generally accommodative, and many asset prices have surged. Interest rates are low, and market participants expect interest rates to remain low over the coming years. The current outlook with very loose financial conditions, increasing asset prices and prospects for a rapid economic recovery provides ground for risk build-up.

There are a number of indications of increased risk appetite among investors. Low yields on safe assets have boosted interest in risky investments, and investor compensation requirements for assuming credit, liquidity and interest rate risk have been further reduced. As a result, risk premia on a number of assets are very low.

Credit institution earnings increased in the 1st quarter of 2021. In addition, credit institutions raised their return on equity expectations for 2021 to pre-pandemic levels. So far, loan losses due to covid-19 have been limited. One explanation is that government relief packages have supported corporate and household finances. As restrictions have been lifted, corporate reliance on various compensation schemes has dropped sharply. As government compensation packages are phased out, some companies might not be able to obtain a bank loan due to an unsustainable financial situation and might consequently have to cease operating. Such a development should not be misinterpreted as a tightening in credit conditions. Banks are generally well capitalised, and have ample capacity both to absorb any losses and maintain lending to the economy.

The Council recommends that the countercyclical capital buffer is reactivated at a rate of 1.0 per cent.

In view of the current risk outlook, the Council recommends to the Minister for Industry, Business and Financial Affairs to set the rate of the countercyclical capital buffer at 1.0 per cent from 30 September 2022. Unless risk build-up in the financial system slows down considerably, the Council expects to recommend a further increase of the buffer rate by 1.0 percentage point to 2.0 per cent by the end of 2021. Step-wise increases of the buffer rate are in line with the Council's strategy of gradually increasing the buffer rate to a level of 2.5

per cent. At the end of the 1st quarter of 2021, almost all Danish institutions had sufficient capital to comply with a countercyclical capital buffer rate of 1.0 per cent. The Council has compiled a selection of Q&As about the countercyclical capital buffer on its website.

Risk build-up in the residential real estate market

There are signs of risk build-up in the residential real estate market. Home sales in both Copenhagen and the rest of Denmark have increased sharply to a record high level. House prices continue to rise at a rapid pace. Credit growth has remained moderate which, however, should be seen in light of already high household debt levels. At the same time, interest only loans are still very widespread, especially among the most indebted households. The current economic outlook coincides with soaring house prices, record levels of trading activity and a very low housing supply, close to levels in 2006. This provides ground for systemic risk build-up, for instance in the form of loose credit standards, higher lending growth and increased optimism about continued house price increases. The current development could exacerbate the risk of further house price inflation. There is also an elevated risk that house price increases are replaced by subsequent falls.

Therefore, the Council recommends to the government to restrict Danish homeowners' access to new interest only mortgage loans. With the measure, Danish homeowners will not be able to take out new interest only mortgage loans or mortgage-like bank loans if the loan-to-value (LTV) ratio of their home exceeds 60 per cent. The primary objective of the initiative is to make homeowners more resilient, thereby also increasing the balance sheet resilience of banks and mortgage credit institutions.

The Council assesses, that the presented measure addresses systemic risks in segments of the residential real estate market exhibiting signs of risk build-up in particular. The Council discussed a series of measures targeting the residential real estate market, including both higher down payment requirements and amortisation requirements. In the Council's assessment, the presented measure will contribute to gradually increase the resilience of the most indebted homeowners. When both short-term and long-term mortgage interest rates are very low, so is the interest rate burden for homeowners. In practice, the size of the mortgage debt instalments therefore determines the level of debt for potential homeowners' as well as how high they can bid up the price of a house for sale. The measure is therefore expected to have positive longer-term effects by reducing the risk of credit-financed house price inflation. The Council has published a selection of Q&As about the measure.

The representatives from economic ministries and the Danish Financial Supervisory Authority have no voting rights regarding recommendations addressing the government.

The Council advises the Minister for Industry, Business and Financial Affairs to reciprocate Norwegian measures

The European Systemic Risk Board (ESRB) has recommended to relevant authorities in the EU to reciprocate a number of Norwegian macroprudential measures. The measures include a systemic risk buffer of 4.5 per cent for Norwegian exposures and a risk weight floor requirement for property exposures in Norway. Norway requests that institutions with exposures exceeding 1 per cent of total exposures in Norway become subject to the new requirements. This is the case for Danske Bank.

The Council advises the Minister for Industry, Business and Financial Affairs to comply with ESRB's recommendation and reciprocate the Norwegian measures within the time frame proposed by ESRB. ESRB recommends reciprocation of the systemic risk buffer within 18 months, and reciprocation of the other measures within 3 months. Recognition of macroprudential measures ensures that the same requirements apply to all banks with activities in the same countries although they are not subject to the country's supervision.

Other issues

The Council was briefed about IT risks in the financial sector by Danmarks Nationalbank and the Danish Financial Supervisory Authority. The financial sector relies heavily on IT, and it is therefore necessary to assign corresponding attention to addressing associated risks. Across the sector, vast resources have been allocated to the efforts of improving the operational resilience of socially critical activities, reducing the likelihood of severe operational disruption. However, financial corporations must continue to work individually and jointly on improving the operational resilience of socially critical activities. According to the Danish Financial Supervisory Authority's assessment, several significant institutions and data centres are still operating with too high IT risks. The Council will at its next meeting continue its discussion of IT-risks in banks and data centres, focusing on specific measures necessary to address these risks as well as potential options to re-establish a bank's services after a large IT-failure.

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