

## 36th meeting of the Systemic Risk Council

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The Systemic Risk Council

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**Risks continue to build up in the financial system. Low nominal interest rates, accommodative financing terms, high risk appetite and economic growth provide a fertile ground for the build-up of risks in the financial system. Therefore, the Council recommends to the Minister for Industry, Business and Financial Affairs that the countercyclical capital buffer be increased to 2.5 per cent from 31 March 2023. The war in Ukraine has resulted in increased uncertainty about the future development of the economy and financial conditions. The Council is ready to recommend a reduction of the buffer rate with immediate effect if stress occurs in the financial system and there is a risk of severe tightening of credit granting to households and companies.**

*Both the Danish and international economies are seeing continued growth, but the war in Ukraine will dampen this momentum. However, the Danish economy is strong, and there will be continued pressure on the labour market and low unemployment. Higher energy and commodity prices have resulted in rising inflation, which could become more persistent if labour shortages make themselves felt in higher pay increases. The war in Ukraine and the sanctions against Russia are weakening the supply of energy and food products, thus creating further upward price pressures. Together with an economic downturn in Ukraine and Russia, this will put a damper on economic growth both in Denmark and internationally. The extent and duration of the economic consequences of the war are connected with great uncertainty and will depend greatly on how the war develops and on the political reactions.*

*Despite increased uncertainty, there are still signs of high risk appetite in the financial system. 2022 has begun with turbulence and price falls in the equity markets, but from a very high level after sharp increases in 2021. Interest rates remain very low and the credit spread very narrow. Danish households have increasingly invested in high-risk equities and investment funds, which has made them more exposed to market risks and negative shocks to the financial markets. High risk appetite combined with high economic activity provides a fertile ground for build-up of risk in the financial system.*

*Very accommodative financing terms and increased credit growth give rise to risks, especially in the housing market. The institutions' credit standards remain accommodative. Credit growth has picked up in early 2022, especially for the corporate sector. The overall credit development for households is moderate, but covers differences across market segments. The credit growth is driven by loans with deferred amortisation in areas with heavy house price increases, primarily in and around the large cities. At the same time, new lending to households with a high debt-to-income ratio is increasing, and the same applies to the proportion of variable rate loans. House price growth has slowed down recently, but the price level remains high.*

*Credit institution earnings increased in 2021. The increase in earnings is mainly due to high activity in the housing market and continued very low impairment charges. With the growth in 2021, additional capital has been built up in the institutions. The very low level of interest rates, especially in combination with heavy economic growth, high asset prices and sharper competition for customers, can provide an incentive for increased risk-taking by the credit*

institutions. Experience shows that tight risk management during periods of economic growth is crucial for ensuring that a credit institution can weather an economic downturn. The institutions have maintained the management estimates for covid-19 losses, and there is consequently still a buffer against any future losses. The institutions' direct exposures to Russia and Ukraine are very limited, but it remains important that they build up capital to withstand losses that may occur from the derived economic effects of the war. The development in the institutions' earnings means that they have a good opportunity to set aside funds as provisions for such losses.

### **The Council recommends that the countercyclical capital buffer be increased to 2.5 per cent**

Based on the development in the risk outlook, [the Council](#) recommends to the Minister for Industry, Business and Financial Affairs that the countercyclical capital buffer be increased to 2.5 per cent from 31 March 2023. It is important that the buffer is built up when the economy is doing well and risks are building up, so that the institutions have cushioning when the economic trends reverse and the risks and losses materialise. Already at the end of the 4th quarter of 2021, all the Danish institutions had sufficient capital to meet a countercyclical capital buffer of 2.5 per cent.

Uncertainty about the future economic development and financial risks has increased as a result of the war in Ukraine. The Council is ready to recommend a reduction of the buffer rate with immediate effect if stress occurs in the financial system to counter the risk of severe tightening of credit granting to households and companies.

### **The Council recommends a countercyclical capital buffer of 0 per cent in Greenland**

The Council discussed the current economic and financial situation in Greenland. In light of the discussion, the Council currently recommends that the countercyclical capital buffer rate for Greenland continue to be set at 0 per cent. Representatives of the Greenlandic self-government participated in the discussion.

### **Other issues**

The Council was introduced to a new tool developed by the European Systemic Risk Council for assessing the balance between systemic risks, the robustness of the financial sector and the macroprudential measures in force. In future, the Council will use this tool in its oversight of systemic risks and the assessment of macroprudential measures.

The Council followed up on a seminar on IT and cyber risks held for the members of the Council in January 2022. At the seminar, Danmarks Nationalbank and the Danish Financial Supervisory Authority presented their work on IT and cyber risks. Danmarks Nationalbank and the Danish Financial Supervisory Authority will continue their work to address systemic risks in relation to cyber and IT security and will inform and involve the Council as necessary on an ongoing basis.

The Council ascertains that the Minister for Industry, Business and Financial Affairs has complied with the Council's recommendation on activation of the countercyclical capital in the Faroe Islands at a rate of 1 per cent with effect from 31 March 2023.

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