DET SYSTEMISKE RISIKORÅD

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The Systemic Risk Council
www.risikoraad.dk
mail@risikoraad.dk

Inflation has fallen, but core inflation remains too high. If interest rates remain higher for an extended period of time, it will continue to weigh on some homeowners and businesses. There are still signs of a soft economic landing, although the risk of a sharp economic slowdown persists. The higher earnings in credit institutions continue to contribute to strengthening the institutions' resilience against future losses.

The risk outlook is still characterised by higher interest rates. In the euro area and Denmark, inflation has declined significantly during 2023. However, core inflation is still relatively high, and there is a possibility that interest rates remain higher for an extended period of time. The tightening of monetary policy has not yet given rise to a significant increase in unemployment, indicating a soft economic landing in, for example, the United States and the euro area. In Denmark, a tight labour market and the prospect of further wage growth are expected to contribute to maintaining the underlying price pressure. Geopolitical tensions may also lead to fluctuations in, for example, commodity prices and thus inflation.

Financial market volatility has abated during 2023, while credit standards have become tighter. The credit spreads across European banks' capital and debt instruments have declined since the banking turmoil in March 2023, although they remain higher than before the central banks' tightening of monetary policy in early 2022. There are also signs that credit standards have been tightened for loans to households and businesses, and that the demand for new loans has fallen.

The upturn in the housing market continues despite higher interest rates. After the significant decline in house prices in 2022, prices of single-family houses have increased slightly in recent months, while the increases are more pronounced in the market for owner-occupied flats. This development should be seen in the context of the strong Danish labour market and the increase in household real wages. In addition, the housing tax reform, which is scheduled to enter into force on 1 January 2024, may have contributed to advance purchases of owner-occupied flat. The interest expenses of households are expected to continue to rise given the higher interest rates, especially for homeowners with variable rate loans.

The credit institutions' earnings are still rising. The increase in systemic credit institutions' earnings in the first half of the year has been driven by increased core earnings due to higher net interest income. In addition, impairment charges on the credit institutions' loans remain low. The high earnings provide a good opportunity to build resilience against future losses. Despite higher deposit margins, private customers have only to a limited extent sought alternatives to bank deposits. The Danish bank continue to have a robust liquidity position and are able to handle severe liquidity stress.

Risks related to deferred amortisation in the housing market

The Council discussed the use of loans with deferred amortisation in Denmark and connected systemic risks. Mortgage debt with deferred amortisation constitute a larger share of homeowners' mortgage debt today compared to 2020. While deferred amortisation can be useful for some homeowners as it provides an opportunity to smooth consumption over time and build up higher liquid savings, the widespread use of loans with deferred amortisation in Denmark may also be a source of systemic risk. For example, deferred amortisation for homeowners with high loan-to-value ratios can imply higher risk of losses, since the debt, in monetary terms, is not reduced on a continuous basis. The Council will continue to oversee risks related to deferred amortisation in the housing market.

The countercyclical capital buffer in Denmark

Every quarter, the Council assesses the adequate countercyclical capital buffer level. The Council finds it appropriate that the countercyclical capital buffer rate is maintained at 2.5 per cent of the risk-weighted exposure amount. The objective of the buffer is to ensure that the institutions have a cushion that makes them more resilient if risks materialise. 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 a severe tightening of credit granting to households and companies.

Status of the recommendation on activation of a sector-specific systemic risk buffer

The council was briefed by the Ministry of Industry, Business and Financial Affairs on the status of the process of the Council's recommendation to activate a sector-specific systemic risk buffer for corporate exposures to real estate companies (link). A sector-specific systemic risk buffer is a targeted capital requirement. The buffer addresses systemic risks related to the institutions' exposures to real estate companies and is determined based on the institutions' risk-weighted exposures. The relative risk weighting of the underlying portfolio is therefore maintained and institutions with more risky loans, as reflected in their risk weights, will therefore have a higher capital requirement.

A set buffer rate must be evaluated at least every two years. The buffer can be released fully or partially if the identified systemic risks materialize or abate.

The European Banking Authority, EBA, published its opinion on the Danish policy measure on 30 November. The EBA acknowledges the identified systemic risks. The EBA assesses that the policy measure is proportionate to the identified risks and avoids adverse effects on the institutions' credit supply in light of the institutions' earnings.

Activation of a sector-specific systemic risk buffer is in accordance with the ESRB's recommendation

The Council discussed a recommendation of the European Systemic Risk Board, ESRB, on vulnerabilities in the commercial real estate sector. The purpose of the recommendation is to improve the monitoring and handling of systemic risks related to commercial real estate and strengthen the financial resilience against potential systemic risks across European countries (link). The Council assesses that the expanded monitoring of the specific sector and the implementation of the sector-specific risk buffer for exposures to real estate companies meet the ESRB's recommendations.

Other items

The Council was briefed on the cyber testing programme TIBER-DK (Threat Intelligence Based Ethical Red-teaming in Denmark). Since January 2019, key financial sector players have conducted threat-based tests of their cyber defences in actual production environments. The purpose is to strengthen cyber resilience and thus support financial stability.

For further information, please contact mail@risikoraad.dk or *Teis Hald Jensen*, Communications and Press Officer, on tel. +45 3363 6066.