



45th meeting of the Systemic Risk Council

27 June 2024

The Systemic Risk Council

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Geopolitical risks dominate the risk outlook and geopolitical shocks can lead to growth being lower than expected. In the commercial real estate market, experience shows that periods such as recent years with higher interest rates and required rates of return on investment return requirements lead to decreasing property values, which reduces the value of the collateral that real estate companies pledge as security for their loans.

The risk outlook is largely dominated by the developments in interest rates and inflation.

The development in inflation is crucial for the monetary policy interest rates of the European Central Bank (ECB) and the US Federal Reserve (Fed), among others. The ECB has cut interest rates once this year, and the markets are currently expecting one more rate cut from the ECB and one to two from the Fed this year. The geopolitical tensions are significant and through disruptions in global supply chains, geopolitical shocks may lead to lower economic growth than estimated in the forecasts.

The growth in house prices has been subdued during 2024. The household debt relative to the homeowners' disposable income on new housing loans have decreased as interest rates have increased. This is because higher interest rates make it more expensive for households to service a housing loan with a high debt-to-income ratio.

Activity remains low on the commercial real estate market. The higher required rates of return on investments in commercial real estate, which historically lead to a decrease in property values, reduces the value of the collateral that real estate companies pledge as security for their bank loans and mortgage loans. It is important that the credit institutions focus on continuous reassessment of the value of the underlying collateral to real estate companies, as it contributes to their assessment of risk of losses.

The institutions' earnings are high, and their impairment charges remain low. Earnings are the first line of defence against losses, and with current profit levels, the banks can withstand relatively large losses. The impairment rate on banks' total loans is still significantly below the historical impairment ratio average, but it may increase if the Danish economy is hit by an economic downturn. The systemic banks in Denmark continue to have a robust liquidity position and are able to handle severe liquidity stress.

The cyber threat is significant and exacerbated by war and geopolitical tensions. Most recently, in June 2024, the Centre for Cyber Security increased the threat level for destructive cyber attacks against organisations in Denmark from low to medium based on an assessment that Russia's risk appetite has increased also includes destructive cyber attacks.

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.

The Council recommends that the systemic buffer be increased to 3 per cent in the Faroe Islands

The Council is responsible for identifying and overseeing systemic financial risks in the Faroe Islands. Representatives from the Faroese Risk Council contribute to the Council's meetings when topics related to the Faroe Islands are discussed.

The Council recommends that the Minister for Industry, Business and Financial Affairs raise the systemic buffer in the Faroe Islands from 2 to 3 per cent with effect from 1 July 2025. The Faroese Risk Council, Føroya Váðaráð, has recommended that the systemic risk buffer be increased from 2 to 3 per cent based on structural systemic risks. The Faroese financial sector is vulnerable to the structural factors characterising the Faroese economy. The Faroese economy is a small, open economy with a concentrated business structure heavily dependent on fisheries and aquaculture. This makes the economy vulnerable to negative economic shocks which may, via direct and indirect effects, entail losses in the financial sector and amplify real economic fluctuations. All credit institutions will be able to meet the requirement for a systemic risk buffer at 3 per cent and a fully phased-in MREL requirement with their current capital level.

Developments in systemic risks in Greenland

Greenland is undergoing a long economic upswing with a tight labour market. Although rising interest rates have dampened domestic demand, the effect has been limited so far. Total lending in Greenland is at a lower level in an international context, but credit growth is high and surpassed the growth in economic activity in both 2022 and 2023. For several years, lending growth to businesses, especially in the real estate sector, has increased strongly.

At its next meeting, the Council will assess whether developments provide a basis for recommending activation of the countercyclical capital buffer in Greenland.

Climate-related risks in the financial sector

The Council discussed possible financial risks related to climate change and the green transition. Climate-related risks in the financial system are generally similar in nature to traditional financial risks such as credit and market risk. The Council includes climate risks in its monitoring of systemic risks in Denmark, as climate change and the green transition will spill over to the financial sector and may affect the stability of the financial system.

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