

Activation of the countercyclical capital buffer in Greenland

1 October 2024

The Systemic Risk Council recommends to the Minister for Industry, Business and Financial Affairs to activate a countercyclical capital buffer at a rate of 0.5 per cent in Greenland from 1 January 2026, increasing to 1.0 per cent from 1 July 2026, pursuant to section 343s(3)(4) of the Financial Business Act.

The Minister for Industry, Business and Financial Affairs is responsible for setting capital buffer requirements in Greenland, including the countercyclical capital buffer rate. The Minister is obliged to either follow the recommendation or present a statement explaining and justifying why the recommendation has not been followed within a period of three months.

The Systemic Risk Council is tasked with identifying and monitoring systemic financial risks in Greenland and can recommend macroprudential measures that can reduce or prevent the build-up of systemic financial risks. The purpose of introducing a countercyclical capital buffer is to minimise the real economic downturn that would otherwise follow if access to credit for households and businesses is unduly tightened during periods of stress in the financial system.

The Council sets the countercyclical capital buffer rate based on an overall assessment of developments in the financial system and the economy.¹ In addition to indicators on developments in the financial system and the economy, the Council also considers other relevant information, such as other policy measures and current and future requirements for institutions.

With their current capital level, institutions with credit exposures in Greenland can already fulfil a requirement for a total countercyclical capital buffer rate of 1 per cent. Overall, activation of the countercyclical capital buffer is therefore not expected to affect the ability of creditworthy customers to obtain financing.

The Council is ready to recommend a reduction of the buffer rate with immediate effect if there is a risk of a severe tightening of credit to households and businesses. Foreign institutions with credit exposures in Greenland will be subject to a countercyclical buffer in Greenland as long as this does not exceed 2.5 per cent.²

The Council assesses the countercyclical capital buffer level in Greenland on a regular basis.

¹ See the Council's method paper on setting of the buffer rate ([link](#)).

² This applies to institutions in the Faroe Islands and Denmark, as well as other EU countries.

Explanatory statement

There are signs of cyclical systemic risks building up in Greenland.

Greenland is in a long economic upswing with a tight labour market (see Appendix, chart 1, left).³ Although rising interest rates have dampened domestic demand, the impact has been limited so far. The widespread use of fixed-rate mortgages means that higher interest rates have not increased existing interest rate costs for homeowners. Inflation was low in 2022 and 2023 (see Appendix chart 1, right) compared to the rest of the world. Household purchasing power has therefore not been eroded to the same extent as in other countries.

There has generally been strong growth in total lending in Greenland over a number of years, with annual growth rates of up to 16 per cent from 2019 to mid-2024 (see Appendix, chart 6, left). The growth in lending has thus exceeded the growth in nominal GDP.⁴ Overall, this has led to an increase in the credit-to-GDP ratio, which is expected to reach 60 per cent by the end of 2023. The total credit in Greenland as a share of GDP remains relatively low in an international context, but has increased significantly from 2019 to 2023 (see Appendix, chart 4).

Over a number of years, there has also been strong growth in lending to businesses. There has been high growth in lending to the real estate sector, with lending doubling in the period from 2019 to mid-2024 (see Appendix, chart 6, right). The real estate sector also accounts for a significant share of lending in Greenland.

Increasing lending to the real estate sector is a particular source of systemic risk build-up. International experience suggests that developments in the commercial real estate market have played an important role in previous financial crises.⁵

Higher lending to the property sector means that institutions are more exposed to movements in property prices. There is increased exposure via the value of the collateral. At the same time high activity can lead to optimistic expectations of continued growth in property prices and activity. Overall, the valuation of collateral as well as the profitability of projects can be too optimistic. If the trend reverses, it could lead to major losses.

Strong growth in activity and lending when the economy is doing well means an overall build-up of systemic financial risks. During a period of high activity, it can be harder to assess the value of collateral and projects. When competition for customers is also intensified, it can increase the likelihood of a situation of excessive risk-taking in general.

In Greenland, there may be signs that institutions are underestimating risks and relaxing credit standards more than economic developments warrant. This is reflected in the interest rate spread by institutions on new loans to Greenlandic residents, which has decreased since the beginning of 2022 (see Appendix, chart 3).⁶ The interest rate spread has fallen from around 6 per cent at the beginning of 2022 to just under 4 per cent at the end of Q2 2024.

The large public sector and the block subsidy act as shock absorbers in the Greenlandic economy. Regardless of the stabilising effects, large shocks can have a large impact on Greenland's economy with a downturn in the private sector, rising unemployment and falling tax revenues. Periods of lower nominal GDP growth and rising unemployment have historically resulted in higher impairment charges for banks.

Overall, the Council finds that a countercyclical capital buffer can contribute to addressing cyclical systemic risks.

³ See Søren Bjerregaard, Labour shortages increase the need for tight economic policy in Greenland, *Danmarks Nationalbank Analysis (Greenlandic economy)*, no. 14, 1 November 2023(link).

⁴ Lending growth is compared with a projection of nominal GDP growth as described in Appendix, chart 1, right.

⁵ See also ESRB, [Report on vulnerabilities in the EU commercial real estate sector \(europa.eu\); Understanding the Surge in Commercial Real Estate Lending \(richmondfed.org\)](#).

⁶ The interest rate spread indicates bank interest rates on new loans in Greenland relative to Danmarks Nationalbank's leading monetary policy interest rate.

The purpose of the buffer is to increase the resilience of institutions and ensure credit during periods of financial stress.

The countercyclical capital buffer is an instrument used to make the institutions more resilient by increasing the requirement for their capitalisation during periods in which risks build up in the financial system. If financial stress occurs with a risk of a severe tightening of credit, the buffer can be reduced with immediate effect, thus releasing capital to the institutions.

To the extent that the institutions do not use the released capital to absorb losses, they may use it for new lending or to secure their excess capital adequacy. This improves the possibility for credit institutions to maintain an adequate level of credit granting during periods of stress in the financial system. The buffer thus contributes to limiting negative effects on the real economy in the event of financial stress.

Institutions with credit exposures in Greenland can already meet a countercyclical capital buffer rate requirement of a total of 1 per cent with their current capital level. The phase-in period until 1 July 2026 also allows institutions to build up capital by retaining profits. Overall, the activation of the countercyclical capital buffer is therefore not expected to affect the ability of creditworthy customers to obtain financing.

The countercyclical capital buffer requirement is not a hard requirement. Institutions that do not comply with the requirement will therefore not lose their licence to operate as a bank. Instead, institutions will be required to submit a capital conservation plan to the Danish Financial Supervisory Authority, and there may be restrictions on the distribution of bonuses and dividends if they do not comply with the combined capital buffer requirements.⁷

Other capital adequacy requirements

The Council also takes into account other policy measures in its reflections on the countercyclical capital buffer rate. It takes into account other current requirements and the phasing-in of future requirements for the institutions, including the requirement for the institutions' eligible liabilities, MREL.⁸ The MREL can be met with several types of capital and debt instruments, while the capital buffer requirement can only be met with CET1 capital. Institutions have sufficient time to retain profits and/or issue MREL debt to fulfil a fully phased-in MREL.

Christian Kettel Thomsen, Chairman of the Systemic Risk Council

⁷ In addition to the countercyclical capital buffer, the combined capital buffer requirement consists of the general systemic buffer, the capital conservation buffer and a SIFI buffer for systemically important institutions, referred to as SIFIs.

⁸ The MREL requirement concerns eligible liabilities that can absorb losses and recapitalise an institution in a liquidation situation. The MREL requirement differs significantly from the countercyclical capital buffer. The purpose of the MREL requirement is to ensure that the institutions can be restructured or wound up without the use of government funds, and without such resolution having any substantial negative impact on financial stability. This purpose differs from the purpose of the countercyclical capital buffer, which is to make it possible for credit institutions to maintain an adequate level of credit granting during periods of stress in the financial system.

Statements from the representatives of the ministries on the Council

Section 343 s (5) of the Financial Business Act states that recommendations addressed to the government must include statements from the representatives of the ministries on the Council. The representatives of the ministries and the Danish Financial Supervisory Authority do not have the right to vote on recommendations directed at the government.

["The representatives of the ministries and the Danish Financial Supervisory Authority do not have the right to vote on recommendations addressed to the government.

The government will request Greenland's self-government for an assessment of the recommendation with a view to an overall assessment of whether there is a basis for complying with the recommendation. Against that background, the government will decide on the recommendation from the Systemic Risk Council within a period of three months."].

Appendix A: Indicators

The Council includes a number of key indicators in its assessment of the buffer rate in order to capture the build-up of systemic risks at different stages of financial development. Supplementary indicators and other relevant information are also taken into account in the assessment to provide a more detailed picture than that shown by the key indicators.

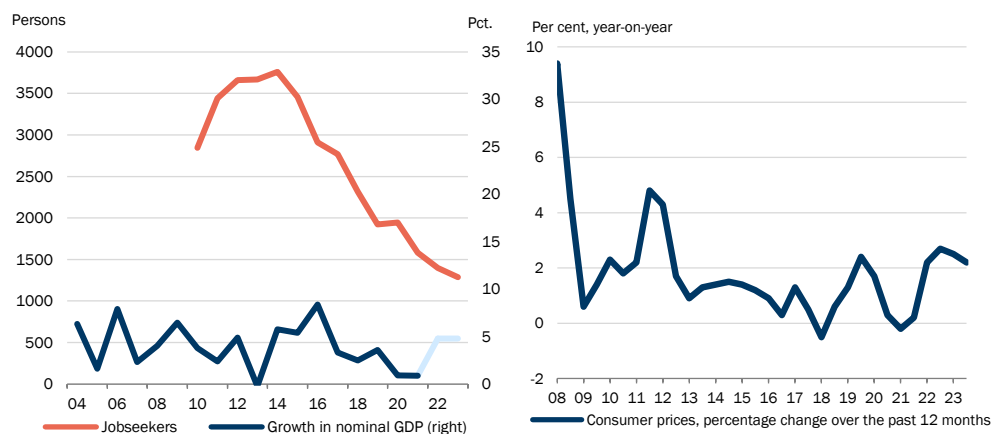
Indicators

Development in GDP, unemployment and inflation

Chart 1

Development in GDP and job seekers

Development in consumer prices

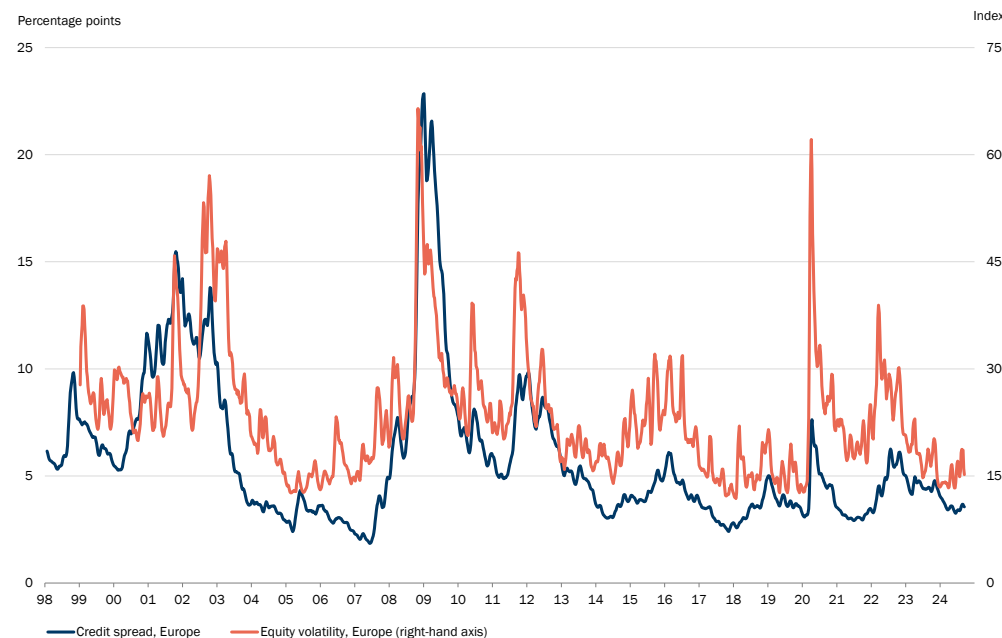


Note: Left: The nominal GDP figures for 2022 and 2023 are simple projections with the expected real GDP growth and inflation based on the latest Economic Council forecast. Right: Development in consumer prices, semi-annual observations, changes in per cent per rolling 12 months. The most recent observation is from January 2024.

Source: The Economic Council, Statistics Greenland and own calculations.

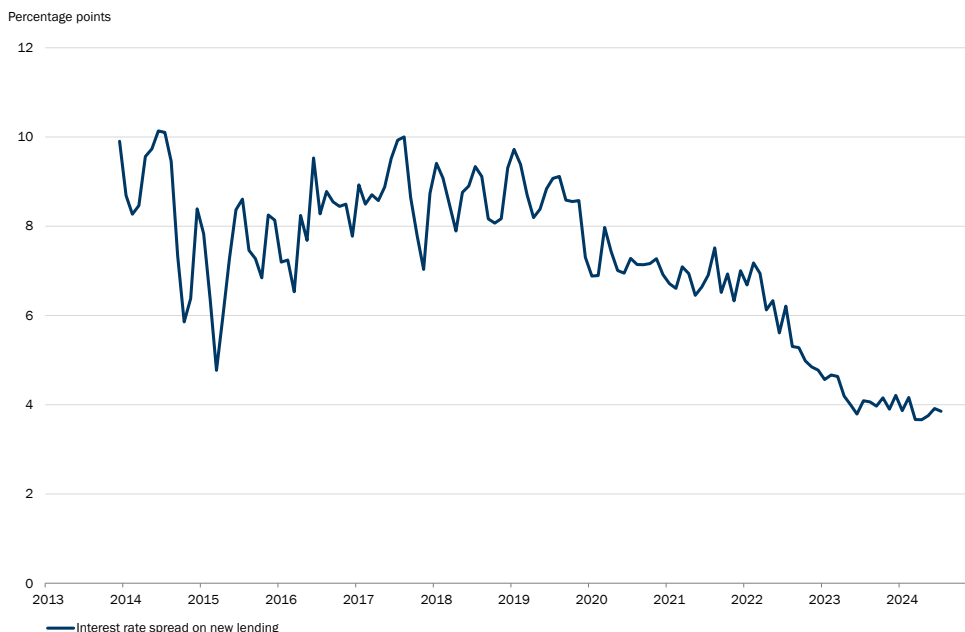
Credit spread and equity volatility

Chart 2



Note: Credit spread is the yield spread between European high yield corporate bonds and government bonds. Equity volatility is measured by the implicit volatility of options on the Stoxx Europe 600, VSTOXX (European VIX). The most recent observation is from 15 September 2024.

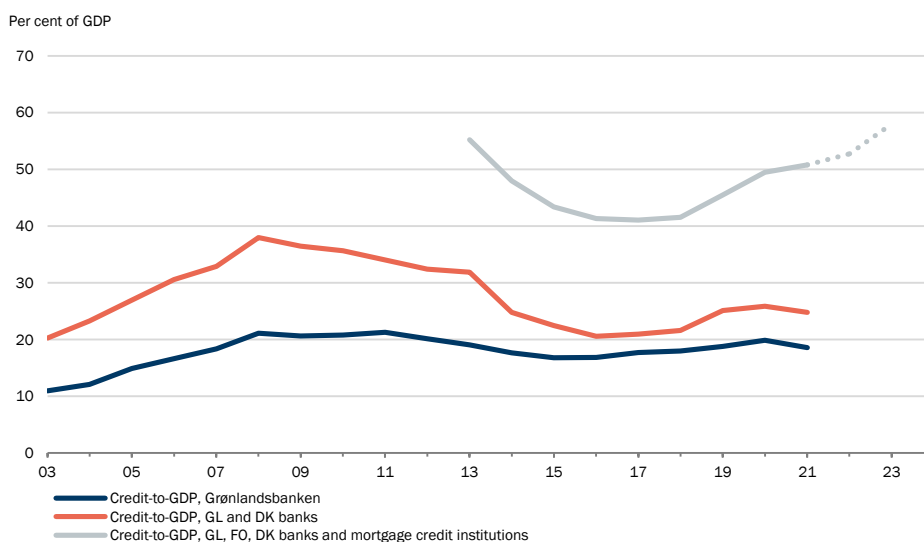
Source: Thomson Reuters and Bloomberg.



Note: 3-month moving averages. The interest rate spread is defined as the interest rate charged by banks on new loans to Greenlandic households and businesses, excluding overdraft facilities, relative to Danmarks Nationalbank's leading monetary policy rate (the interest rate on certificates of deposit). The banks' lending rate is a weighted average of the interest rates on new loans from Danish, Greenlandic and Faroese banks. The development of interest rates on new loans reflects movements in interest rates, but is also greatly affected by the composition of the month's new loans, where e.g. an increased weight of secured loans in isolation will drag the total down.

Source: Danmarks Nationalbank.

Lending to GDP ratio

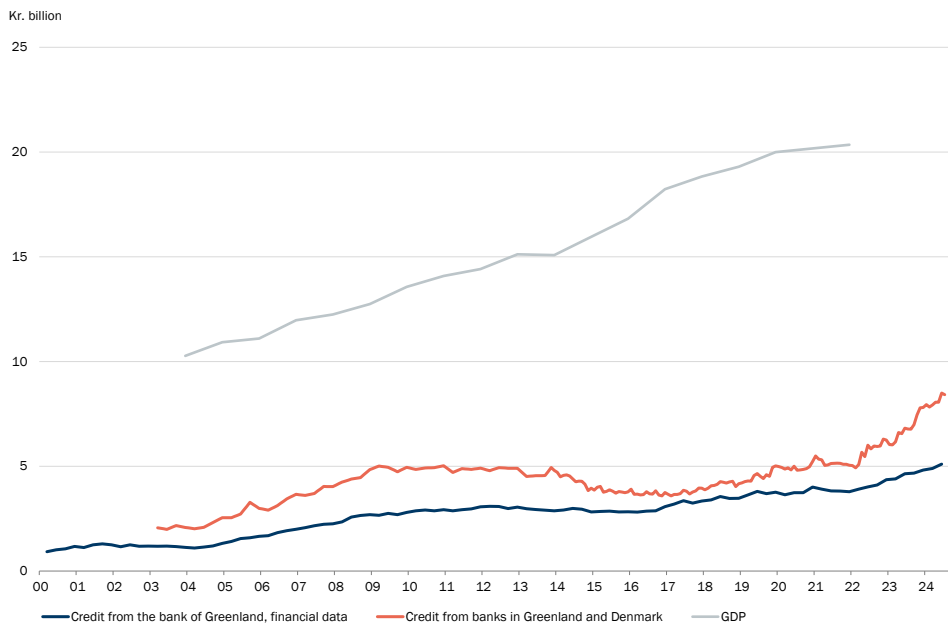


Note: The dashed line indicates the projection for the lending-to-GDP series. Actual figures for total lending are used, while figures for nominal GDP are simple projections with the expected real GDP growth and inflation based on the Economic Council's latest forecast. "Credit-to-GDP, Grønlandsbanken " is based on Grønlandsbankens loans, as reported to the Danish Financial Supervisory Authority. "Credit-to-GDP, GL and DK banks" and "Credit-to-GDP, GL, FO, DK banks and mortgage credit institutions" comprises lending to households (incl. non-profit organisations) and non-financial corporations in Greenland based on Danmarks Nationalbank's Statistics on balance sheets of banks and mortgage banks. GDP in 2020 and 2021 are preliminary data from Statistics Greenland.

Source: Danmarks Nationalbank, Danish Financial Supervisory Authority, Statistics Greenland and Greenland's Economic Council.

Decomposition of lending to GDP ratio

Chart 5



Note: The 'Lending from Grønlandsbanken, accounting figures' series is based on reporting to the Danish Financial Supervisory Authority. The 'Lending from banks in Greenland and Denmark' series and the 'Lending from banks in Greenland, Denmark and the Faroe Islands as well as Danish mortgage credit institutions' series contains lending to households (including non-profit institutions) and non-financial corporations in Greenland based on Danmarks

Source: Nationalbank's balance sheet and flow statistics for the MFI sector.

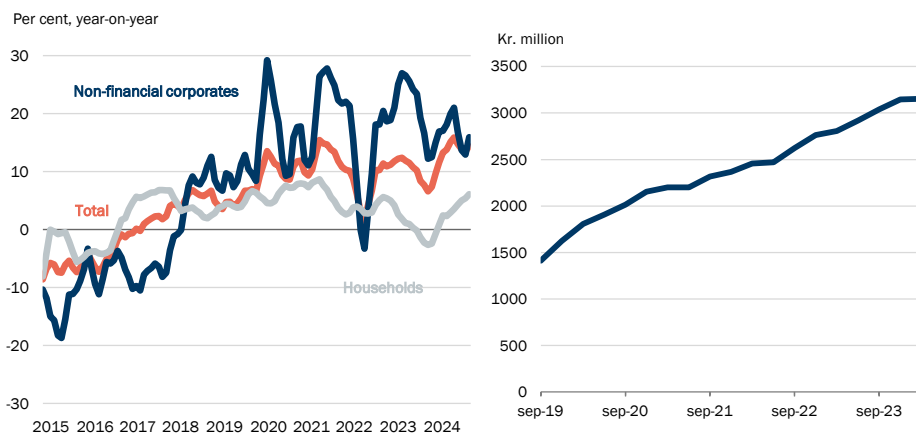
e: Danmarks Nationalbank, The Danish Financial Supervisory Authority, Statistics Greenland and Greenland's Economic Council.

Credit development by sector

Chart 6

Credit growth by sector

Total lending to the real estate industry

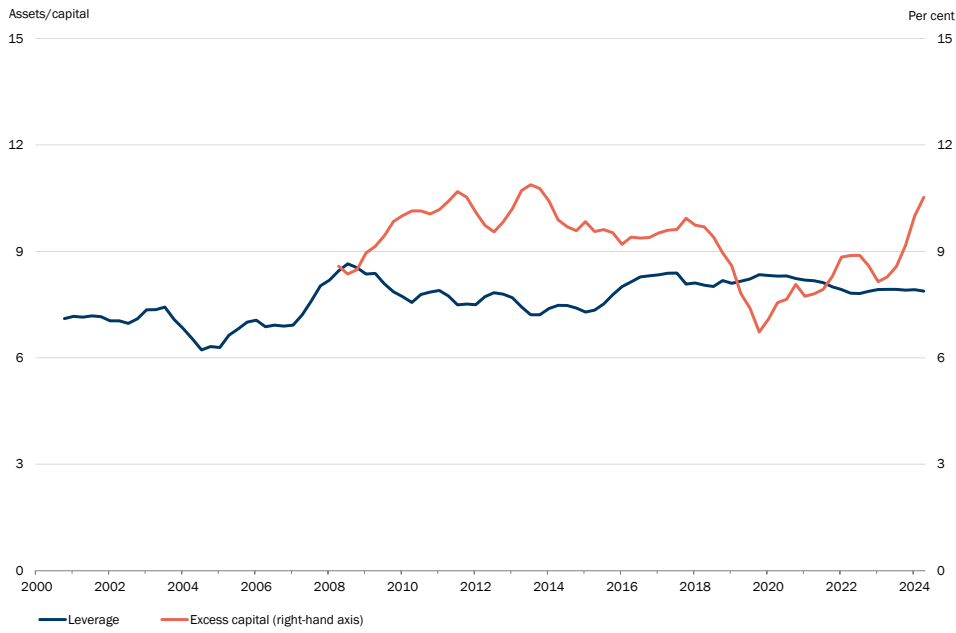


Note: Left: The chart shows loans at nominal value from Grønlandsbanken, Faroese banks and the Danish MFI sector broken down by counterparty sector. "Total" includes loans to all sectors except the financial sector. The most recent observation is from July 2024. Right: Data based on the credit registry. The chart shows all loans from Grønlandsbanken, Faroese banks and the Danish MFI sector to counterparties in Greenland, with economic activity "Real estate". The counterparty economic activity is identified by: All debtors either reported with country "Greenland" and industry "Real Estate", or who have a CVR (CRN) number registered in Greenland from the business register and with the industry "Real Estate". The most recent observation is from Q2 2024.

Source: Danmarks Nationalbank.

Gronlandsbanken's leverage and excess capital adequacy

Chart 7



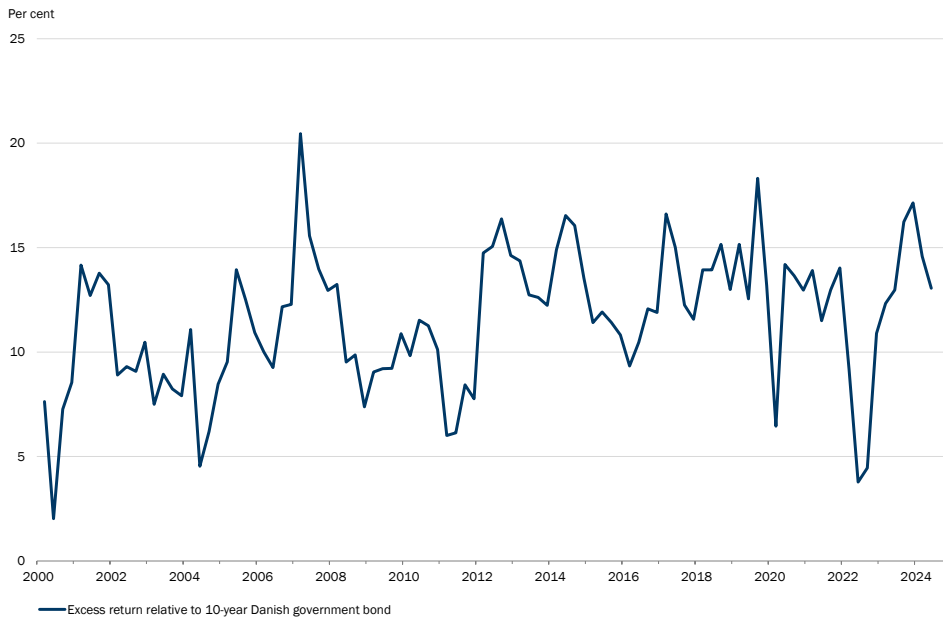
Note: Leverage is defined as the sum of assets, guarantees and credit commitments divided by Tier 1 capital (including additional Tier 1 capital). The excess capital adequacy is calculated as the actual Common Equity Tier 1 capital less the total Common Equity Tier 1 capital requirement (including capital buffers) as a percentage of risk-weighted exposures. The most recent observation is from Q2 2024.

Source: The Danish Financial Supervisory Authority.

e:

Gronlandsbanken's return on equity

Chart 8



Note: Return on equity is annualised quarterly data calculated before tax. The most recent observation is from Q2 2024.

Source: The Danish Financial Supervisory Authority.

Appendix B: Impact on other countries

Foreign institutions must also comply with a countercyclical buffer in Greenland

Foreign institutions with credit exposures in Greenland must also comply with a countercyclical capital buffer requirement for their credit exposures in Greenland. There is so-called mandatory reciprocity for the countercyclical capital buffer up to 2.5 per cent for EU countries.⁹ 'Reciprocity' means that relevant authorities across countries recognise each other's measures, so that identical requirements are imposed on the institutions.

Impact of a higher countercyclical buffer in Greenland on other countries

According to the European Systemic Risk Board, ESRB, macroprudential authorities must assess possible cross-border effects of macroprudential measures. The Council's approach to assessing these effects is described in the memo Mutual recognition of macroprudential measures on the Council's website [\[link\]](#).

The Council expects that institutions with exposures in Greenland will not significantly change their lending abroad as a result of an increase in the countercyclical capital buffer to 1.0 per cent in Greenland. The effect on the capital requirement for individual institutions is expected to be limited, as Greenlandic exposures constitute a small share of the total exposures of the institutions in question.

A macroprudential measure is generally expected to have positive consequential effects on other countries. A lower risk of systemic risks materialising in Greenland also reduces the risk of contagion to other countries exposed to developments in Greenland.

Grønlandsbanken predominantly has exposures against Greenland's economy. One Faroese institution, Føroya Banki, has major exposures to Greenland's economy relative to the size of the Greenlandic economy. Danish banks have a low exposure to the Greenlandic economy. A few of the Danish mortgage credit institutions have major exposures relative to the size of the Greenlandic economy. All of these will also have to comply with a countercyclical capital buffer rate on their Greenlandic exposures.

⁹ The same applies to countries with which the EU has entered into agreements in the financial area.