DET SYSTEMISKE RISIKORÅD

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The current outlook with very loose financial conditions, increasing asset prices and prospects for a rapid recovery provides ground for risk build-up. The Council expects to recommend an increase in the countercyclical capital buffer in the middle of 2021, unless risk build-up slows down considerably or there is a new negative shock to the economy. There are also signs of risk build-up in the residential real estate market, especially in Copenhagen. The Council finds the current development increasingly concerning and expects to recommend new initiatives to the government to curb risk build-up at its next meeting.

Systemic risk build-up in Denmark

Large parts of the Danish economy are still hampered by the restrictions to curb the spread of covid-19 infection. While activity in parts of the service sector is relatively constrained, activity in other sectors is booming. The overall economic recovery must be expected to pick up speed as the economy reopens and large parts of the population are vaccinated.

Financial conditions are generally loose and asset prices have increased substantially. Interest rates are low and market participants expect them to remain low in the coming years. This development will continue to support low financing costs and increasing asset prices. The current environment in Denmark with very loose financial conditions, increasing asset prices and prospects of a swift economic recovery provide the basis for the build-up of systemic risks.

Bank profits were positive in 2020. Credit losses resulting from covid-19 have so far been relatively low. That is primarily due to the fiscal measures providing economic support to companies and households. As restrictions are lifted and fiscal measures rolled back, companies will return to operate on normal market terms, where profitable companies will continue to operate while unprofitable companies will cease operations.

Risk build-up in the residential real estate market

A number of indicators point to risk build-up in the residential real estate market, especially in Copenhagen. Home sales in both Copenhagen and the rest of Denmark have surged. House price growth rates have also been accelerating. 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 at still very widespread, especially among the most indebted households.

The very low financing costs and the option of interest only loans combined with high housing demand could lead to further risk build-up with sharp house price increases and increasing debt levels. The Council finds the current development increasingly concerning and will analyze the effects of different measures targeting the residential real estate market. The Council expects to recommend to the government new initiatives to curb risk build-up at its next meeting.

The countercyclical capital buffer in Denmark remains unchanged

The Council recommends that the countercyclical capital buffer remain unchanged at 0 per cent. The Council expects to recommend an increase of the buffer rate in the middle of 2021 unless risk build-up slows down considerably or there is a new negative shock to the economy. Since it usually takes 12 months from a decision to increase the buffer rate until the increase becomes effective, banks will not be expected to meet a positive buffer requirement until the middle of 2022. In light of the very loose financial conditions it might be necessary to rebuild the countercyclical capital buffer relatively quickly.

Other discussions

The Council will be able to make recommendations regarding the systemic buffer rate in the future. The implementation of the Capital Requirements Directive, CRD V, in Denmark as from 1 January 2021 entails a number of changes in the bank capital buffers regulatory framework, including the possibility of activating a systemic risk buffer in addition to the other capital buffer requirements. The systemic risk buffer can be used if there are systemic financial risks not addressed by other macroprudential instruments. The systemic risk buffer can be used to address general systemic risks or risks related to specific groups of exposures.

The Council discussed the European Commission's report on leverage ratio buffers for national systemically important financial institutions (SIFIs). From 30 June 2021, all banks in the EU must meet a leverage ratio requirement of minimum 3 per cent of their total exposures. For institutions with low risk weights, the leverage ratio requirement might exceed the risk-based capital requirements. Some banks might not be able to use their entire capital buffers to absorb losses before breaching the minimum leverage ratio requirement. Global systemically important banks must meet a leverage ratio buffer requirement in addition to the leverage ratio requirement. Due to covid-19, the leverage ratio buffer requirement has been postponed by one year to 1 January 2023. The European Commission will decide on corresponding leverage ratio buffers for national SIFIs in connection with the European Commission's review of the macroprudential framework in 2022.

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