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The Systemic Risk Council

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PRESS RELEASE

MEETING OF THE SYSTEMIC RISK COUNCIL

The Systemic Risk Council has held its twenty-second meeting. According to the Council's assessment, risks continue to build up in the financial system. Interest rates are very low. Combined with a cyclical upswing, rising residential and commercial property prices and intensified competition for corporate customers, low interest rates may provide an incentive for credit institutions to increase their risk-taking. High earning levels leave ample space for capital build-up in credit institutions to prepare for an eventual cyclical reversal.

Risk of continued build-up of systemic financial risks

The economy is generally expected to continue to expand, both internationally and in Denmark. Growth is being supported by accommodative monetary policy, high asset prices and optimism among consumers and firms. In addition, the USA and the large European economies have, despite high public debt levels, indicated fiscal easing, which may add further steam to the economic expansion.

Accommodative fiscal policy in a boom limits the fiscal scope to curb a downturn in the economies when a reversal sets in. In addition, the current low interest rate levels limit the monetary policy scope for action. This emphasises the importance of the banks increasing their capital base, both internationally and in Denmark.

Despite increased uncertainty about the economic policies of several large European countries and the international protectionist measures, risk appetite is still pronounced among investors, and volatility and risk premia in the international financial markets remain very low.

The Danish economy is in a solid upswing, and asset prices are generally high. Prices of residential and commercial properties continue to rise. Aggregate credit growth is modest, but masks considerable differences in lending growth across credit institutions and regions. Interest rates remain very low and – especially in combination with a cyclical upswing, rising prices for residential and commercial properties and intensified competition for corporate customers – this may provide an incentive for credit institutions to increase their risk-taking. It is important that lenders, investors and borrowers build resilience to higher interest rates and large falls in property prices.

High earning levels leave ample space for capital build-up in credit institutions

Danish credit institutions are posting high profits, and several of the largest institutions spend a sizeable share of their profits on share buy-back and distribution of dividends. The high earnings and low losses and loan impairment charges of the institutions leave ample space to increase capital positions in preparation for an eventual cyclical reversal.

The countercyclical capital buffer rate in Denmark

The purpose of the countercyclical capital buffer is to increase the credit institutions' resilience to losses. This will reduce the risk of the institutions limiting lending to households and firms in a downturn. Hence, the Council finds it important to build up the buffer in an upturn so that the institutions have funds to mitigate adverse effects when the economy reverses.

Every quarter, the Council assesses the level for the buffer rate on the basis of risk developments in the financial system. Following the Council's recommendation from December 2017, the Minister for Industry, Business and Financial Affairs in March 2018 set a buffer rate of 0.5 per cent. The Council recommends that the buffer rate is currently kept unchanged at 0.5 per cent.

Economic and financial risks are building up faster than anticipated and the Council expects to issue a recommendation during 2018 to raise the buffer rate by a minimum of 0.5 percentage point. In a situation with limited scope for action in monetary and fiscal policy it is important that the banks are well capitalised to such an extent that pressure on lending capacity in a downturn is limited. In such a situation, the countercyclical buffer rate can be released and the banks can use the released capital for loss absorption purposes, among other purposes.

Other issues

The Council finds that the Minister for Industry, Business and Financial Affairs has complied with the Council's recommendation about increasing the general systemic capital buffer rate for exposures in the Faroe Islands to a level of 2 per cent as from 1 January 2019 and 3 per cent as from 1 January 2020.

The Council discussed potential risks to the financial system in Denmark as a result of Brexit. These risks depend on the outcome of the negotiations on a financial agreement between the UK and the EU. It is important that Danish financial corporations prepare for all conceivable outcomes.

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