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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 eleventh meeting. The Council finds that there is still reason to exercise caution, as the conditions for a rapid build-up of systemic risks exist, given the very low interest rates. According to market data, interest rates are generally expected to stay low several years ahead.

There is still reason to exercise caution

The conditions for a rapid build-up of systemic risks remain in place. The level of interest rates is still very low, and, overall, the housing market is picking up. House price increases remain strong, even though trading activity seems to have abated somewhat in the 2nd quarter. The largest price increases are seen in and around the Copenhagen area, but price increases in Denmark's other regions have recently approached the level in and around the Copenhagen area. The increase in house prices should be seen in the light of the low level of interest rates, the generally improving economic conditions and positive expectations of the housing market. While total lending to households and the corporate sector rose moderately in the 2nd quarter, it is still at a high level relative to GDP. Growth in housing loans is highest in the City of Copenhagen and its environs and in Aarhus. At the same time, mortgage lending activity is increasing in most municipalities.

Due caution should be exercised in view of the very low interest rates relative to the economic upswing. According to market data, interest rates are generally expected to stay low several years ahead. It is highly uncertain how the sustained low interest rate environment will affect the behaviour and formation of expectations among households, firms and credit institutions. In the absence of automatic stabilisers, a key condition for sustainable economic development is that the very low interest rates do not cause the housing market to derail. It is important for financial corporations to be attentive to the risks that may build up during a prolonged period of very low interest rates, and sufficient prudence should be applied when granting loans on the basis of real property, especially when granting variable rate loans with deferred amortisation, cf. the Council's observation of 27 March 2015.

The Danish Financial Supervisory Authority presented seven "best practices" that will form the starting point for guidelines on granting loans on the basis of owner-occupied housing in growth areas. The Council will continue to discuss initiatives that may dampen a risky development in housing credit.

The countercyclical capital buffer is a broad capital requirement covering exposures to both firms and households. The Council expects that it can contribute to strengthening the credit institutions' resilience in order to better maintain credit extension in periods of strain in the financial system. It should be built up beforehand.

In view of developments in the Council's key indicators and the general risk outlook, the Council advises the Minister for Business and Growth to maintain the countercyclical capital buffer rate at 0 per cent, even though total lending is high relative to GDP.¹

The search for yield may still lead to systemic risks

Recent uncertainty concerning the development in China has resulted in falling asset prices and increased volatility in the Danish and international capital markets. At the same time, there are indications that the risk appetite of international investors was reduced during the summer. This has not been reflected in an abrupt reversal of the search for yield.

Developments in China may reinforce market expectations that interest rates in a number of countries, including Denmark, will remain low in the coming years. This may encourage a continued search for yield in the form of risky behaviour and lead to underestimation of risks, cf. the Council's observation of 30 September 2014.

Legislation implementing the countercyclical capital buffer in the Faroe Islands has come into force

Legislation implementing the countercyclical capital buffer in the Faroe Islands recently came into force. The Council advises the Minister for Business and Growth to currently set the buffer rate for the Faroe Islands at 0 per cent.

Other topics of relevance to the Council

At the meeting, the Council also discussed a range of other topics, including:

- Whether systemic risks may exist in the Danish financial system due to the interconnectedness between financial enterprises. The Council decided to initiate further analyses within the area, which may require the collection of data.
- Credit extension outside the regulated Danish banking sector, also referred to as the shadow banking system. The Council will monitor structural developments on a recurrent basis.

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¹ The Council's five key indicators are the credit-to-GDP gap, the house price-to-income gap, the debt service ratio, the leverage of banks and banks' interest premium, see the method memo on the Council's website.