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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-first meeting. A prolonged period of low interest rates, especially in combination with an economic upswing, entail a risk of systemic financial risks building up. Recent years' strong activity in the commercial property market calls for caution. However, the property companies appear better capitalised today, compared to the years up to the financial crisis. The Council has adopted a recommendation to raise the systemic buffer in the Faroe Islands gradually from 1 to 3 per cent.

Risk of continued build-up of systemic financial risks

Economic and financial developments, internationally and in Denmark, are characterised by optimism, although geopolitical risks have been increasing recently.

The Danish economy is in a solid upswing, and asset prices are generally high. Prices of residential and commercial properties continue to rise, although the rate of increase for owner-occupied flats has abated a little. The residential and commercial property markets both show signs of a more broad-based upswing across Denmark, no longer isolated to Aarhus and Copenhagen. Lending growth in the Copenhagen area continues, while total lending for housing purposes is virtually unchanged.

Although market expectations for interest rate increases have moved slightly forward, interest rates are expected to remain very low over the coming years. A prolonged period of low interest rates, especially in combination with an economic upswing, could entail a risk of systemic financial risks building up.

Interest rates and risk premia could rise suddenly, leading to large fluctuations in the financial markets

Equity prices fell temporarily, but sharply, in early February, following considerable increases for several months. The falls illustrate how sudden shifts in market expectations regarding normalisation of monetary policy may entail large market fluctuations. The fluctuations might have been reinforced by investors simultaneously unwinding some of their positions in complex financial products. The market turmoil was short-lived, and credit spreads are still historically low, while risk appetite is high.

Strong activity in the commercial property market calls for caution

The Council has discussed developments in the commercial property market to follow up the discussion at its meeting in June 2017. Many of the banks that ceased to exist as independent firms during the crisis suffered substantial losses on their commercial property exposures.

In recent years, the market has again been characterised by strong price increases, falling yields and very high transaction volumes. Copenhagen, especially, has seen strong growth in nominal prices, which are now higher than the pre-crisis peak. Lending growth has not followed suit, however. The property companies are now better capitalised, compared to the pre-crisis years, although there are signs of higher risk-taking in certain segments. The largest property companies, in particular, have started to raise new debt. In addition, the market today is more regulated by e.g. the supervisory diamonds which set the framework for lending by banks and mortgage banks against commercial real estate.

Strong, sudden increases in interest rates will have a negative impact on property prices, causing earnings in the property companies to fall. In addition, a price drop may be reinforced if foreign actors withdraw from the Danish market.

Some of the data underlying the Council's monitoring of the commercial property market is available with a considerable lag. The Council will continually monitor market developments.

The countercyclical capital buffer rate in Denmark

The Council notes that the Minister for Industry, Business and Financial Affairs has complied with the Council's recommendation of December 2017 to set a countercyclical capital buffer rate for exposures in Denmark at 0.5 per cent with effect from 31 March 2019. The Council assesses the suitable buffer rate level on a quarterly basis. The Council finds that the basis for a buffer rate of 0.5 per cent still exists. If the current rate of risk build-up continues, the Council expects to issue a recommendation during 2018 to raise the buffer rate by 0.5 per cent.

The systemic buffer for the Faroe Islands should be raised gradually from 1 to 3 per cent

The Council [recommends](#) that the general systemic buffer rate in the Faroe Islands be increased to 2 per cent from 1 January 2019 and 3 per cent from 1 January 2020. The systemic buffer is aimed at increasing the Faroese banks resilience to *structural* risks in the Faroe Islands. These risks arise because the Faroese economy is small and open with a concentrated business structure. The economy is therefore vulnerable to negative shocks, which could lead to large, unexpected losses for the banks.

The general systemic buffer rate has been set at 1 per cent from 1 January 2018. When the Council recommended this buffer rate, it also assessed that the buffer rate should be raised further in the coming years.

The Council advises the Minister for Industry, Business and Financial Affairs to maintain the countercyclical capital buffer rate for the Faroe Islands at 0 per cent.

The Faroese Systemic Risk Council has participated in the discussion of the buffer rate.

Other issues

The Council was informed about the efforts of the Financial Sector forum for Operational Resilience (FSOR) to increase cyber resilience in the financial sector. The FSOR is a forum for collaboration between authorities and key

financial sector participants, established after the Systemic Risk Council's discussions of operational risks and cyber risks in December 2015.

Moreover, the Council was informed about the status of resolution plans and MREL for SIFIs.

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