

PRESS RELEASE

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The Systemic Risk Council

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MEETING OF THE SYSTEMIC RISK COUNCIL

The Systemic Risk Council has held its twenty-fifth meeting. It is still the assessment of the Council that risks are building up in the Danish financial system. The countercyclical capital buffer should be built up before stress occurs in the financial system. The Council therefore recommends that the Minister for Industry, Business and Financial Affairs increase the countercyclical capital buffer from 1.0 per cent to 1.5 per cent from 30 June 2020. The Council expects to recommend a further increase of the buffer rate in the 3rd quarter of 2019 unless the build-up of risks in the financial system slows down considerably.

Continued build-up of systemic financial risks in Denmark

There are signs that global growth has peaked. The forecasts of international organisations are dominated by downside risks, particularly the risk of escalation of the trade conflict between the USA and China, a "no deal" Brexit outcome and a slowdown in China. The largest economies' scope for mitigating an economic slowdown has diminished since the financial crisis, reflecting higher government debt and lower monetary policy interest rates. Interest rates are expected to remain low for a long period of time. In the euro area, market participants expect monetary policy interest rates to remain negative throughout 2021.

Risk perception in the financial markets is still very low. The financial markets were characterised by equity price falls, more pronounced market volatility and widening of credit spreads at the end of 2018. This development partly reversed in early 2019. As a result, the risk appetite among investors is still notable and risk perception in the financial markets remains low in a historical perspective.

In Denmark, there are signs of build up of risks in the institutions' credit allocation. Driven by intensified competition for customers, some banks have eased corporate credit standards and granted loans to more vulnerable customers. The moderate corporate credit growth continues and is now broadly based across industries and institutions. Especially growth in the banks' lending to corporate customers increased in 2018. As regards lending to households, a number of medium-sized banks have strengthened their activities in growth areas by opening new branches and substantially increasing lending for housing purposes. Risks are amplified by the already high level of total lending. Long-term mortgage bond yields have fallen to a historically low level. This fall may induce a further increase in indebtedness.

The Danish economy is still in an upswing, and asset prices are generally high. In the housing market, prices have flattened over the past year. Especially for owner-occupied flats in the Copenhagen area, growth in both prices and activity has slowed down, but price levels remain high. The slowdown may be the result of increased housing supply, forthcoming changes in real estate property taxation, and implementation of good practice rules on risky mortgage loans for highly indebted households that entered into force in January 2018. Although the current slowdown is a positive development, a further downturn may have negative consequences for the institutions' exposures to the real estate market, including project financing.

There are still incentives for increased risk taking among credit institutions. Interest rates remain very low and – especially in combination with a continued cyclical upswing, high asset prices and intensified competition for customers – this may provide an incentive for credit institutions to increase their risk-taking. The economic agents should prepare for a downturn without falling interest rates, given the already very low interest rate environment. It is important that institutions are robust before a reversal in the benign economic development.

The Council recommends that the countercyclical capital buffer rate is increased to 1.5 per cent

Against the background of the financial development, the [Council recommends](#) that the countercyclical capital buffer be increased from 1.0 per cent to 1.5 per cent from 30 June 2020.

There are no Danish institutions that breach their capital requirements as a result of an increase in the countercyclical capital buffer. Furthermore, the institutions are in a good position to increase their capitalisation. The institutions have generally high, albeit declining, earnings and distribute a large share of the profits to their shareholders.

The Council is ready to recommend a reduction of the buffer rate with immediate effect, if substantial stress occurs in the financial system. Release of the buffer can help to limit the negative effects on the real economy if there is a risk of severe tightening of lending to households and firms.

The Council expects to recommend a further increase of the buffer rate of 0.5 percentage points in the 3rd quarter of 2019 unless the risk build-up in the financial system slows down considerably. It is the Council's opinion that the buffer rate should be gradually increased to a level of 2.5 per cent.

SIFI-requirements on the Faroe Islands

The Council has received a letter of opinion from the Faroese systemic risk council on the criteria for determining systemically important financial institutions on the Faroe Islands. The Council has decided to initiate an analysis of capital buffers on the Faroe Islands in cooperation with the Faroese systemic risk council. Representatives of the Faroese systemic risk council participated in the discussions.

Other issues

The Council discussed the resolution of mortgage credit institutions as a follow up of its discussions in December 2018. Mortgage credit institutions are exempt from having to meet a minimum requirement for own funds and eligible liabilities, MREL. Instead, they must observe a debt buffer requirement. The Council discussed how being subject to a debt buffer requirement rather than an MREL will affect the resolution of a mortgage credit institution.

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