PRESS RELEASE

DET SYSTEMISKE RISIKORÅD

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The current risk picture is characterised by opposite tendencies. On the one hand, there is high activity in the Danish economy and high labour market pressure. Together with accommodative financing terms, it provides a fertile ground for risk-building in the financial system. Corporate credit growth is hence increasing, and homeowners are increasingly opting for risky loan types. On the other hand, there are prospects of lower economic growth and higher interest rates, as a consequence of the war in Ukraine, persistent disruptions in supply chains and increasing inflation. The persistent disruptions in supply chains can result in structural changes to the economy.

Every quarter, the Council assesses the suitable countercyclical capital buffer level. The Minister for Industry, Business and Financial Affairs has followed the Council's recommendation to raise the buffer rate to 2.5 per cent from 31 March 2023. The Council continues to consider this phasing-in appropriate. The Council is ready to recommend a reduction of the buffer rate with immediate effect if stress occurs in the financial system and there is a risk of severe tightening of credit granting to households and companies.

Both the Danish and international economies continue the upward trend, but growth is expected to slow down as a result of the war in Ukraine and rising inflation. In Denmark, the situation is still characterised by labour market pressure, low unemployment and high consumption. A number of factors, such as the war in Ukraine, the sanctions against Russia and Belarus and covid-19 lockdowns in China, are disrupting supply chains and impairing growth prospects. This has led to increases in the prices of energy, commodities and food, which combined with strong demand create further upward inflationary pressures. The war in Ukraine and the persistent disruptions in supply chains can result in structural changes to the economy in the long run.

Financing terms currently remain accommodative, and households and businesses continue to have access to cheap financing. Central banks have begun tightening monetary policy against the backdrop of high inflation. As a consequence, interest rates, especially on long-term government and mortgage bonds, have risen. In general, both the equity and bond markets have seen large fluctuations in early 2022 due to monetary policy tightening and the war in Ukraine. Credit spreads have also expanded. From a historical perspective, however, interest rates and credit spreads remain low, and prices on a number of assets, such as equities and housing, remain high. The prospect of rising interest rates combined with a lower growth outlook entails a risk of significant declines in asset prices.

Several institutions have increased earnings expectations for 2022. The increased expectations are based on good results in the 1st quarter, which showed progress in core earnings due to increasing lending growth and high refinancing activity. The institutions have reversed parts of their management estimates for covid-19-related losses, but at the same time book new estimates for losses as a consequence of the war in Ukraine and rising inflation. The institutions continued to deliver good results in 2021. The development in the institutions' earnings means that they have a good opportunity to build further capital to withstand losses during an economic downturn.

There are signs of risk build-up in the institutions' credit granting. Credit growth has picked up in early 2022, especially for the corporate sector. Currently, Danish businesses are facing higher costs in the form of increasing interest rates and energy and raw material prices. Credit institutions have the capacity to support viable businesses with liquidity. Homeowners are increasingly opting for risky loan types, with widespread use of loans with deferred amortisation and an increasing share of variable-rate loans. This makes homeowners more vulnerable to an increase in interest rates at a time of increased volatility and the prospect of higher short-term interest rates. House price growth has slowed lately, but house prices are on average 20 per cent higher than before the pandemic.

Homeowners' vulnerability to interest rate increases

The Council discussed systemic risks associated with the prevalence of mortgage loans with deferred amortisation and variable interest rates among Danish homeowners. The discussion was based on an analysis of how increasing interest rates would affect homeowners' ability to service their debt. The analysis indicates that particularly homeowners with variable-rate loans and deferred amortisation will experience an increase in debt servicing in case of increasing short term interest rates. The consequences for homeowners and credit institutions become more pronounced, if rising interest rates coincide with declining growth, falling house prices and lower disposable incomes. It is particularly important that the banks and mortgage banks exercise suitable caution when granting loans on the basis of real property, especially when granting loans with variable interest rate and deferred amortisation. The Council plan to prepare an observation about further systemic risk build-up from an increased uptake of loans with deferred amortisation and variable interest rate.

The countercyclical capital buffer rate in Denmark

Every quarter, the Council assesses the suitable countercyclical capital buffer level. The Minister for Industry, Business and Financial Affairs has followed the Council's recommendation to raise the buffer rate to 2.5 per cent from 31 March 2023. The Council continues to consider this phasing-in appropriate. It is important that the buffer is built up when the economy is doing well and risks are building up, thereby cushioning the institutions for when the economic trends reverse and the risks and losses materialise. The Council is ready to recommend a reduction of the buffer rate with immediate effect if stress occurs in the financial system and there is a risk of severe tightening of credit granting to households and companies.

Review of the macroprudential framework in the EU

Every five years, the European Commission must assess the legal framework (Capital Requirements Regulation, CRR, and Capital Requirements Directive, CRD) for pursuing a macroprudential policy in the EU. Any adjustments to the framework may have implications for the possibilities of pursuing a macroprudential policy in Denmark. These include the possibility of introducing borrower-based instruments into European legislation and the possibility of ensuring a more active and efficient use of capital buffers. The Council discussed possible solutions to improve the macroprudential framework. An overarching framework for borrower-based instruments in European regulation can make it easier to address systemic risks related to the housing market.

Other issues

The Council was informed about the Danish Financial Supervisory Authority's work to address low risk weights on the institutions' exposures to the commercial property market in dialogue with the institutions. According to the Financial Supervisory Authority, institutions compensate for the low risk weights on commercial property exposures by making capital reservations. The Council will monitor developments in the commercial property market, since these exposures historically have given rise to large losses for the credit institutions.

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