PRESS RELEASE

DET SYSTEMISKE RISIKORÅD

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The risk outlook is affected by large price increases for energy, food etc., higher interest rates and expectations of declining growth. These factors have among other things contributed to high volatility and price decreases in the financial markets. At the same time, there are still signs of risks building up in credit granting. The annual growth rate in the banks' corporate lending remains high, while high activity in loan refinancing increases the prevalence of risky loan types among households.

A significant slowdown in growth is expected in both Denmark and abroad. After a prolonged period of high growth, the pressure on the Danish economy is diminishing. A lower proportion of companies report labour shortages. Real wages have also decreased, and private consumption has declined. High inflation and higher interest rates increase the risk of a sharp economic slowdown, with downside risks to financial stability.

Increased volatility and reduced liquidity in the financial markets trigger a greater need for liquidity management. After years of very low interest rates and highly accommodative financial conditions, higher interest rates have led to price falls on government bonds and mortgage bonds and resulted in high volatility in the financial markets. This has contributed to a deterioration in liquidity in, for example, the market for government bonds and mortgage bonds. Impaired liquidity may amplify price fluctuations in financial markets and lead to further declines in the price of financial assets. The institutions currently fulfil their liquidity requirements by a significant margin. However, market financing has become more expensive and the demand for liquidity may quickly increase, for example from the energy sector and pension companies. This leads to a greater need for the institutions to focus on their liquidity management, and they should take into account potential periods with limited refinancing opportunities.

Credit risks continue to build up, and there are currently no significant signs that more borrowers are defaulting on their loans. Growth in the banks' corporate lending has been high in 2022, but it has slowed down during the autumn. At the same time, households are increasingly taking out riskier loan types. Companies and households are affected by higher interest rates and increased energy costs. The slowdown in growth in the Danish economy will impair borrowers' debt servicing ability in the coming period. However, there are not yet any clear signs that more people are defaulting on their loans, and the institutions' impairment rates are low. Furthermore, several medium sized financial institutions have high exposures towards commercial real estate companies. During the financial crisis and the crisis in the 1990's, insolvent banks were characterised by a high concentration of credit towards this sector. Therefore, it is important that the credit institutions continue to conduct thorough credit quality assessments and monitor the development of loans to commercial real estate.

The institutions' core earnings are expected to increase as a result of higher interest rates. Improvements in the institutions' core earnings are driven in particular by rising net interest income due to higher interest rates. Conversely, price adjustments have contributed to significant losses, while higher impairment charges will fully or partially offset the positive effect on earnings. The institutions have been reluctant to issue new financing since the spring, and the distance to the MREL requirement has decreased. Some institutions therefore need to refinance maturing debt issuances, accumulate capital or issue new debt that can be used to meet the MREL requirement.

Implications of the energy crisis for the financial sector

The Council discussed systemic risks related to the development in the energy markets. Large price increases and fluctuations on the gas and electricity markets in the first three quarters of 2022 led to an increased requirement for collateral for variation margin calls in energy companies that use cleared derivatives contracts. This resulted in significant liquidity needs for the energy companies. There is a risk that volatility in the energy markets will continue, which could further increase energy companies' demand for liquidity. If volatility and financial stress occur simultaneously in several different markets, this may impact financial stability.

A general systemic risk buffer in Denmark

The Council discussed the decision-making basis for activation of a general systemic risk buffer in Denmark. The systemic risk buffer can be used if there are general systemic risks that are not addressed by the other macroprudential instruments.

The Council still finds that there are unaddressed systemic risks in Denmark. Risks are related to for instance the institutions' exposures to the real estate market – both in the form of housing loans and corporate loans secured by mortgage on properties. The Council has previously assessed that there are unaddressed risks related to highly indebted households' access to loans without amortisation.

The Council continues its work on different calibration methods for a systemic risk buffer. In light of the ongoing work and the current risk outlook, the Council recommends the Minister for Industry, Business and Financial Affairs that the systemic risk buffer rate is not to be activated at the present time.

Countercyclical capital buffer in Denmark

Every quarter, the Council assesses the adequate countercyclical capital buffer level. The Council still finds it appropriate to increase the countercyclical capital buffer to 2.5 per cent from March 2023, which was decided by the Minister for Industry, Business and Financial Affairs in March 2022. It is important to build up the buffer to make the institutions more resilient to any risks and losses that may occur. 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.

Expected effects of the EU proposal for revision of European capital requirements

The Council was informed about the expected effect of the Council of the European Union's compromise for revision of the Capital Requirements Directive and the Regulation (CRR III, CRD VI) on Danish credit institutions. In October 2021, The European Commission presented a proposal to implement several recommendations from the Basel Committee, including a capital floor and revised rules for the calculation of credit and market risks. Negotiations of the compromise with the European Parliament still remain before the proposed changes of European capital requirements enter into force. The changes are expected to be implemented after 1. January 2025.

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