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PRESS RELEASE

The Systemic Risk Council
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MEETING OF THE SYSTEMIC RISK COUNCIL

The Systemic Risk Council has held its twenty-fourth meeting. It is still the assessment of the Council that risks are building up in the Danish financial system. The Council also discussed risks in the commercial property market, risks in mortgage credit institutions and the implications of future EU legislation for the use of macroprudential instruments in Denmark.

Continued build-up of systemic financial risks

International organisations still expect the global economic growth, but the risk of a downturn has increased in the medium term. This should be viewed in light of geopolitical tensions, protectionism and the risk of sudden interest rate hikes and falls in financial asset prices. An abrupt decline in risk appetite may lead to substantial increases in long-term interest rates and diving asset and property prices. Risk perception is very low in the international financial markets. There is an increased risk of overheating of the US economy and a subsequent downturn with derived effects on the global economy. The scope for countercyclical economic policy in the largest economies has diminished since the financial crisis, reflecting higher government debt and lower monetary policy interest rates.

There are signs of increased risk appetite although the overall credit growth is modest. The modest growth in total lending masks substantial differences across institutions, regions and industries. A number of small and medium-sized banks are recording high credit growth rates. A survey by the Danish Financial Supervisory Authority points to increased risk appetite behind the loans granted by several of the large institutions for company acquisitions. At the national level, prices for residential and commercial properties are still rising, but prices for owner-occupied flats in Copenhagen are levelling out. The new guidelines for housing loans to households with high levels of debt have contributed to curbing the institutions' lending to the most heavily indebted households.

Credit institutions still have incentives to increase risk-taking, especially given the very low interest rates, continued economic upswing, rising property prices and intensified competition for corporate customers. It is important that investors, lenders and borrowers make sure to be resilient to higher interest rates and an economic downturn.

The countercyclical capital buffer rate in Denmark

The Council currently advises that the buffer rate is kept unchanged. Every quarter, the Council assesses the suitable level for the buffer rate on the basis of risk developments in the financial system. Credit institutions are to maintain a countercyclical capital buffer of 0.5 per cent from 31 March 2019 and 1 per cent from 30 September 2019.

The Council still expects to make a recommendation in the 1st quarter of 2019 on a further increase of the buffer rate by 0.5 percentage point to 1.5 per cent unless the risk build-up in the financial system slows down considerably.

The commercial property market

The Council discussed systemic risks from the commercial property market, where activity and prices remain high. The Council discussed developments in mortgage credit institutions' risk weights, which have fallen substantially as the commercial property market has picked up. The institutions are in the process of implementing new measures to address the areas where risk weights have dropped sharply. But there is a risk that the downward trend in risk weights will continue. The Council will continue to monitor the commercial property market, and encourages the institutions to pay strong attention to the cyclical properties of the models so that capital requirements and pricing do not become too procyclical.

Other issues

The Council discussed systemic risks in mortgage credit institutions, following up its discussion of SIFI resolution plans in April 2018. Mortgage credit institutions are exempt from a minimum requirement for own funds and eligible liabilities, MREL. Instead, they must observe a debt buffer requirement. The Council discussed how SIFI requirements will develop in various stress scenarios, both with the current legislation and in a situation where mortgage credit institutions are not exempt from an MREL. The Council also discussed how risks in mortgage credit institutions have evolved over time as a result of deviations from the traditional mortgage credit model. Mortgage credit institutions have become more complex and are more exposed to liquidity risks.

The Council discussed the implications of future EU legislation (CRD V/CRR II) for Denmark's use of macroprudential instruments. The forthcoming rules specify the use of the various capital buffers in more detail. This means that the Danish SIFI requirements are to be implemented via the "O-SII buffer" rather than the systemic risk buffer applied today. Hence, the O-SII buffer must be implemented in Danish legislation. It will then be possible to use the systemic risk buffer to address other systemic risks, e.g. sector-specific capital requirements.

The Council also discussed risk build-up in Greenland. In light of the discussion, the Council decided to maintain its advice on a countercyclical capital buffer rate of 0 pct. for the time being. Representatives from the Greenlandic authorities were present at the discussion.

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