DET SYSTEMISKE RISIKORÅD

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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 thirteenth meeting. Sudden changes in risk perception in the financial markets combined with low market liquidity may still lead to significant falls in asset prices and fire sales. Due caution should be exerted in relation to the low level of interest rates, which may lead to excessive risk-taking and risk illusion among borrowers and credit institutions.

There may be systemic risks associated with a sudden change in risk perception in the financial markets combined with low market liquidity
Recent months have seen a partial materialisation of the risk of a rapid and marked fall in asset prices in some of the global financial markets. The large fluctuations in the financial markets in early 2016 have not had systemic consequences in Denmark. Sudden changes in the perception of risk in the financial markets combined with low market liquidity may still lead to significant falls in asset prices and fire sales. The Council's observation of 30 September 2014 regarding low interest rates and build-up of systemic risks still applies.

Due caution should still be exercised in relation to the low level of interest rates
Seasonally adjusted prices in the housing market continued to rise in the 2nd half of 2015 – albeit at a more moderate pace than in the 1st half for single family houses. Expectations of future price developments remain high. While growth in housing loans in Copenhagen and Aarhus has subsided, market expectations of low interest rates several years ahead may still lead to excessive risk-taking and risk illusion among borrowers and credit institutions. That may be the case if the risks of higher interest rates and a reversal in house prices are not taken into account to a sufficient degree. The Council's observation of 27 March 2015 regarding low interest rates and build-up of systemic risks still applies.

Other topics discussed by the Council
At the meeting, the Council also discussed a range of other topics, including:

- The level of the countercyclical capital buffer rate. The Council still considers a rate of 0 per cent to be appropriate. The Council has refined its method for making advice regarding the level of the countercyclical capital buffer rate. An updated description of the method will be published on the Council's website.
- An analysis of Danish credit institutions' reaction to changes in capital requirements in the period from 2007-2014. The analysis indicates that

institutions with solvency problems are inclined to reduce lending. The Council expects the countercyclical capital buffer to be especially valuable in increasing the sector's resilience by a timely build-up of capital.

- The possibility of ensuring that any initiatives recommended by the Council also apply to foreign branches with relevant activities in Denmark. The Council will look further into this issue so that initiatives effectively address systemic risks. This has become particularly relevant in connection with Nordea's plans to convert Nordea Bank Denmark into a branch. In addition, the European Systemic Risk Board, ESRB, recommends that relevant authorities in the EU recognise each other's initiatives. The ESRB's recommendation seeks to ensure that the same requirements apply to resident institutions in a member state and to foreign branches in the same member state.
- Potential systemic risks stemming from the insurance and pension fund sectors. The Council considers it crucial that companies are appropriately capitalised in order to avoid fire sales in periods of sudden changes in asset prices. The Council will continue the analysis of systemic risks in the insurance and pension fund sectors.
- The implications of the lower trading activity in the uncollateralised Danish money market since the financial crisis in 2008. The Council finds contagion risks through the uncollateralised Danish money marked to be low at present. Up to the most recent crisis, a number of Danish credit institutions had high exposures in the market, which meant that problems could potentially spread between institutions, as was seen internationally. The Council's assessment that the risk of contagion in the form of waves of defaults or negative liquidity spirals is currently low is based on the low level of activity in the market and an analysis of the distribution of activities on individual market participants.[1] The analysis shows that today participants in the uncollateralised Danish money market do not have large exposure concentrations on individual counterparties, nor are they heavily dependent on liquidity from the market.

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[1] Danmarks Nationalbank (2015), The short-term Danish interbank market before, during and after the financial crisis, Working Paper no. 99.