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 tenth meeting. The conditions for a rapid build-up of systemic risks remain in place due to the very low interest rates. The Council's observations about low interest rates and build-up of systemic risks still apply.

The continued low interest rates may entail build-up of systemic risks
The level of interest rates remains very low despite the recent increase in long-term rates. The current upswing in the Danish economy is supported by the low interest rates, low oil prices, the low effective exchange rate of the krone and growth in certain export markets. Overall, the housing market is picking up. There are signs of accelerating house prices, but with sizable regional differences. Especially the market for owner-occupied flats in the City of Copenhagen is gaining momentum, with prices increasing around 10 per cent p.a. since early 2013. Approximately 10 per cent of the total mortage debt with owner-occupied homes and summer cottages pledged as collateral relates to the City of Copenhagen. Credit growth is modest at the national level, while outstanding credit is at a high level relative to GDP. Internationally, the financial risk taking continues in search for yield. The leading Danish stock index, C20 Cap, has risen by considerably more than e.g. leading German and US indices in recent years.

The Council notes that in the years prior to the most recent crisis there was considerable covariation between price developments in the markets for owner-occupied flats in the Cities of Copenhagen and Frederiksberg and in the Copenhagen environs, Northern Zealand and Eastern Zealand. The Council will investigate further the geographical variation and spillovers to other segments of the property market.

The conditions for a rapid build-up of systemic financial risks related to the property market are still in place due to the very low interest rates, especially if these are embedded into the expectations of borrowers and credit institutions. The current upswing could accelerate and lead to unsustainable credit growth and disproportionate price increases for housing in a larger geographical area or other parts of the property market. Widespread expectations of house price increases may lead to more risky behaviour among borrowers and credit institutions and may have a self-reinforcing effect.

The Council finds that there is reason to exercise due caution. In the absence of automatic stabilisers, a key condition for sustainable economic development is that the very low interest rates do not cause the housing market to derail. It is important for credit institutions to be attentive to the risks that may build up during a prolonged period of very low interest rates, cf. the Council's observation of 27 March 2015. 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.

Furthermore, the combination of low interest rates and low volatility in the financial markets may induce financial agents to behave risky and lead to underestimation of risks, cf. the Council's observation of 30 September 2014. In case of a reversal in the search for yield, this can lead to falling asset prices and the risk of self-reinforcing mechanisms via fire sales and lack of market liquidity.

The general credit growth is still modest. The Council advises the Minister for Business and Growth to maintain the countercyclical capital buffer rate at 0 per cent. The buffer rate is to be set on a quarterly basis. The Council's advice is based on an assessment of main indicators and other considerations. The method is described in the memo "The countercyclical capital buffer", which can be found on the Council's website.

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

- Economic and legal considerations in relation to the use of sector-specific capital requirements in a macroprudential context. This discussion is part of the Council's general work to analyse measures that may reduce or prevent systemic financial risks.
- The Danish Financial Supervisory Authority's amendment of the indicator for large exposures in the Supervisory Diamond for banks.
- Macroprudential aspects of the Banking Union on the basis of a report on possible Danish participation in the Banking Union prepared by a working group with representatives from several ministries.

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