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 twenty-third meeting. It is still the assessment of the Council that risks are building up in the financial system. The countercyclical capital buffer should be built up before the financial system becomes stressed. The Council therefore recommends that the Minister for Industry, Business and Financial Affairs increase the countercyclical capital buffer rate from 0.5 per cent to 1 per cent from 30 September 2019. The representatives of the ministries have stated, that the government has decided to follow the recommendation. The Council expects to recommend a further increase of the buffer rate in the 1st quarter of 2019, unless the build-up of risks in the financial system slows down considerably.**

### Continued build-up of systemic financial risks

*International organisations expect continued economic growth*. Growth is supported by accommodative monetary policies, optimism among consumers and firms and higher wealth due to rising asset prices .

*The risk of a downturn has increased in the medium term* in the light of geopolitical tensions, protectionism and the risk of sudden interest rate hikes and falls in financial asset prices. Moreover, the scope for countercyclical economic policy in several of the largest economies has diminished since the financial crisis due to already high levels of government debt and low monetary policy interest rates.

*There are signs of increased risk-taking* among certain market participants in their search for yield. Risk perception is very low in the international financial markets and liquidity is ample. Sudden changes in risk perception may lead to substantial increases in long-term interest rates and strong falls in asset and property prices. Therefore it is important to have robust institutions in the event of an economic downturn.

*As Denmark's largest credit institution, Danske Bank is important to the Danish financial sector*.The Danish financial system is highly affected by developments and risk perception in the international markets. That is why the Danske Bank money laundering case poses a risk to the entire sector and to Denmark's international reputation. The political agreement on anti-money laundering enhances the authorities' scope to fight money laundering.

*There are signs of increasing risk in lending by credit institutions, although overall credit growth is modest*. Driven by intensified competition for customers, a number of banks have eased credit standards and granted loans to more vulnerable customers. The modest growth in total lending covers substantial differences across institutions, regions and industries. A number of small and medium sized banks have high credit growth levels. The Danish economy is in a solid upswing, and asset prices are generally high. Prices of residential and commercial properties continue to rise despite the slower rate of price increase for owner-occupied flats in Copenhagen. This provides a foundation for a rapid increase in credit growth.

*Credit institutions still have incentives to higher risk-taking,* especially given the very low interest rates*,* the gaining upswing, rising property prices and intensified competition for corporate customers. It is important that lenders, investors and borrowers make sure to be resilient to higher interest rates and large falls in property prices. Moreover, the economic actors should prepare for a downturn with no room for monetary easing, given the already very low interest rates.

**The Council recommends that the countercyclical capital buffer be increased to 1 per cent**
*Against the background of the financial development, the Council recommends that the countercyclical capital buffer be increased from 0.5 per cent to 1 per cent from 30 September 2019*. The representatives of the ministries have stated, that the government has decided to follow the recommendation. The Council expects to recommend a further increase of the buffer rate by 0.5percentage point in the 1st quarter of 2019 unless the risk build-up in the financial system slows down considerably.

*The buffer should be built up before substantial stress occurs in the financial system.* That is why it is importatnt to increase the buffer in good times to make credit institutions more resilient to a cyclical reversal. The buffer is to be used to counter a negative impact on the real economy when substantial stress occurs in the financial system.

*The Council's assessment of the buffer rate is based on an overall assessment* of financial system developments. The buffer rate should not be set mechanically on the basis of just one indicator, such as lending growth.

*At the current capital level, the vast majority of the institutions would be able to meet the higher buffer rate*. In addition, losses and loan impairment charges are low and earnings generally high for the institutions, and they distribute a large share of the profits to the shareholders. The institutions are thus well positioned to increase their capitalisation.

*The Council is ready to recommend a reduction of the buffer rate with immediate effect*, if substantial stress occurs in the financial system. Release of the buffer can help to limit the negative effects on the real economy if there is a risk of severe tightening of lending to households and firms.

**The commercial property market**
*The Council discussed systemic risks from the commercial property market*, following up its discussion of the subject at its meeting in April 2018. Activity in the commercial property market remains high in 2018 with rising prices and strong trading activity. The solvency ratio of property companies continues to rise, driven by increases in property values, which are only partly offset by higher indebtedness. However, several property companies still tend to increase their debt items relatively markedly. Strong, sudden hikes in interest rates will have a negative impact on property prices, putting pressure on earnings in the sector. In addition, a price drop may be reinforced if foreign actors withdraw from the Danish market.

**Other issues**
*The Council discussed risks related to the growing share of foreign investors in the Danish mortgage bond market*. The share of foreign ownership of long-term mortgage bonds in particular has risen strongly since 2015, exceeding 30 per cent in June 2018. The greater demand from foreign investors is driven by e.g. central bank asset purchase programmes which have reduced the global supply of bonds of high credit quality.

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