



ECB-CONFIDENTIAL

Mr Simon Kollerup
Minister for Industry, Business and Financial affairs
Ministry of Industry, Business and Financial affairs
Slotsholmsgade 10-12
1216 Copenhagen K
Denmark

10 July 2019
ESRB/2019/0167

Recommendation of the European Systemic Risk Board of 27 June 2019 on medium-term vulnerabilities in the residential real estate sector in Denmark (ESRB/2019/5)

Dear Mr Kollerup,

This is to inform you that on 27 June 2019, the General Board of the European Systemic Risk Board (ESRB) adopted Recommendation of the European Systemic Risk Board of 27 June 2019 on medium-term vulnerabilities in the residential estate sector in Denmark (hereinafter "Recommendation ESRB/2019/5"). The General Board of the ESRB also adopted five other country-specific ESRB Recommendations, addressed to five other Member States that also received ESRB Warnings in 2016, on medium-term vulnerabilities in their respective residential real estate sector. Furthermore, on the same date, the General Board of the ESRB also adopted five country-specific ESRB Warnings, addressed to Member States in which vulnerabilities relating to the residential real estate sector as a source of systemic risk have been newly identified as not being sufficiently addressed.

Vulnerabilities relating to the residential real estate can be a source of systemic risk and may affect financial stability both directly and indirectly. In 2016, the ESRB conducted a Union-wide assessment of the vulnerabilities relating to residential real estate¹. This assessment enabled the ESRB to identify a number of medium-term vulnerabilities in several countries as sources of systemic risk to financial stability, which led to the issuance of warnings to eight countries: Belgium², Denmark³, Luxembourg⁴, the Netherlands⁵, Austria⁶, Finland⁷, Sweden⁸ and the United Kingdom⁹.

¹ See 'Vulnerabilities in the EU Residential Real Estate Sector', ESRB, November 2016, available on the ESRB's website at www.esrb.europa.eu.

² Warning ESRB/2016/06 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Belgium (OJ C 31, 31.1.2017, p. 45).

³ Warning ESRB/2016/07 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Denmark (OJ C 31, 31.1.2017, p. 47).

⁴ Warning ESRB/2016/09 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Luxembourg (OJ C 31, 31.1.2017, p. 51).

⁵ Warning ESRB/2016/10 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of the Netherlands (OJ C 31, 31.1.2017, p. 53).

⁶ Warning ESRB/2016/05 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Austria (OJ C 31, 31.1.2017, p. 43).

Address
ESRB
Sonnemannstrasse 20
60314 Frankfurt am Main
Germany

Postal address
ESRB
60640 Frankfurt am Main
Germany

Tel.: +49 69 1344 0
E-mail: esrbsecretariat@esrb.europa.eu
www.esrb.europa.eu

In 2016 the main vulnerability identified in the residential real estate market in Denmark related to high household indebtedness. A significant share of mortgagors had variable interest rate debt or debt exceeding the value of their home, making them vulnerable to adverse economic or financial conditions or adverse developments in the residential real estate market. Even though there were no overall signs of overvaluation, house prices had been increasing robustly particularly in major cities, and were close to pre-crisis levels.

The ESRB has recently concluded a systematic and forward-looking European Economic Area (EEA)-wide assessment of vulnerabilities relating to residential real estate. As regards Denmark, this recent assessment has revealed that, since 2016, even though household indebtedness has decreased, it nevertheless remains at one of the highest levels in the EEA. Moreover, the share of existing mortgage loans with deferred amortisation is significant, which makes households structurally more vulnerable to adverse economic or financial conditions or adverse developments in the residential real estate market. In addition, despite the fact that house price growth has slowed and apartment prices in Copenhagen have reached a plateau in recent years, the previous dynamics have led to pockets of overvaluation in the major cities, in particular in Copenhagen.

Despite the number of macroprudential measures in place, and given the high level of household indebtedness and the significant share of mortgagors vulnerable to adverse economic conditions or adverse developments in the residential real estate market, the current capital-based measures may not be sufficient to address the accumulated vulnerabilities. Furthermore, tightening of existing, or activation of additional, borrower-based measures may be necessary in the medium term if vulnerabilities related to household indebtedness, overvaluation of house prices and lending standards increase.

Furthermore, while cyclical factors play an important role in fuelling the vulnerabilities identified in Denmark, there are also structural factors that have driven these vulnerabilities, resulting in a higher level of systemic risk. These factors include: (i) complex rental market regulations with caps on rent in a significant share of apartment buildings in the major cities, which creates a lack of housing supply and exerts upward pressure on house prices and debt for households that buy their own property; and (ii) the tax deductibility of mortgages, which may act as an incentive for households to overborrow. Furthermore, while acknowledging the bill passed into law by the Danish parliament on a new housing taxation system which will take effect in 2021, since 2001 the system of housing property taxation has been decoupled from market prices, resulting in a decline in the effective tax rate, especially in the major cities.

The General Board of the ESRB, having assessed the results of the risk and policy analyses carried out, has concluded that while the macroprudential measures that are in place or available in Denmark are appropriate, they are partially sufficient to address the vulnerabilities related to household indebtedness in the medium term. Consequently, further policy action is required to address these vulnerabilities, which can be a source of systemic risk.

For this reason, the General Board of the ESRB decided to issue a Recommendation to Denmark on medium-term vulnerabilities in its residential real estate sector. The purpose of Recommendation ESRB/2019/5 is to recommend: a) the activation of further, or the tightening of existing, capital-based measures in order to ensure the resilience of the banking sector against the medium-term vulnerabilities identified in Denmark; and b) the monitoring of vulnerabilities and the activation of further, or the tightening of existing, borrower-based measures if house price growth and credit growth accelerate in the medium term. In addition, Recommendation ESRB/2019/5 also aims to emphasise the need for broader policy action aiming to curb factors which facilitate or promote increasing household indebtedness. The measures proposed in Recommendation ESRB/2019/5 are aimed at complementing the existing macroprudential measures in

⁷ Warning ESRB/2016/08 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Finland (OJ C 31, 31.1.2017, p. 49).

⁸ Warning ESRB/2016/11 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Sweden (OJ C 31, 31.1.2017, p. 55).

⁹ Warning ESRB/2016/12 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of the United Kingdom (OJ C 31, 31.1.2017, p. 57).

Denmark. Given that the vulnerabilities are, to some extent, driven by structural factors which go beyond macroprudential policy, other policies are needed to complement and support the current macroprudential measures, with the aim of addressing factors contributing to the build-up of systemic risks in the residential real estate market in Denmark more efficiently and effectively, without producing excessive costs for the Danish real economy and financial system.

In line with Article 18(2) of Regulation (EU) No 1092/2010¹⁰, I would hereby like to inform you that Recommendation ESRB/2019/5 will be published on the ESRB's website and later in the *Official Journal of the European Union*. In addition, in line with Article 18(3) of Regulation (EU) No 1092/2010, addressees of public recommendations have the right to make public their views and reasoning on the matter. Should you wish to utilise this right, you are kindly invited to submit to the ESRB Secretariat any views and reasoning that you may have on the matter by 9 September 2019.

Please also note that the following reports, adopted by the ESRB on 27 June 2019, will be made available electronically:

- "Follow-up report on countries which received ESRB warnings in 2016 for medium-term vulnerabilities in the residential real estate sector";
- "Methodologies for the assessment of real estate vulnerabilities and macroprudential policies – residential real estate"; and
- "Vulnerabilities in the residential real estate sectors of the EEA countries".

Yours sincerely,


Francesco Mazzaferro

Head of the ESRB Secretariat

Enclosed:

Recommendation of the European Systemic Risk Board of 27 June 2019 on medium-term vulnerabilities in the residential estate sector in Denmark (ESRB/2019/5)

¹⁰ Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board (OJ L 331, 15.12.2010, p. 1).

