MINISTRY OF BUSINESS AND GROWTH
DENMARK

22 november 2016

Reaction to the ESRB warning from the Danish Minister of Business and Growth on behalf of the Danish Government:

The Danish Government takes note of the warning on vulnerabilities in the residential real estate sector of Denmark from the ESRB. The Government agrees that rapidly increasing prices of residential real estate in certain geographical areas of Denmark calls for close monitoring. Danish authorities thus already have a strong focus on the evolution of prices, credit standards etc. on the real estate market. For example the Danish FSA has recently carried out several inspections of credit policies in the largest banks[1]. Also, the Danish Systemic Risk Council follows developments in the housing market closely.

The gross debt level for Danish homeowners is overall relatively high, but should be seen in combination with a high level of pension wealth, housing assets and other assets. Danish household's net wealth has overall increased in recent years and is positive. From the Danish Government's point of view, the gross debt level is not in itself a significant risk, and the financial situation of Danish households is, in general, robust and able to withstand macroeconomic shocks and interest rate increases. However, households with a high debt level in combination with interest only loans and variable rate loans are less robust in case of e.g. an increase in interest rates. Safeguards have been put in place in recent years to limit the number of households with these characteristics, cf. below.

It is the government's assessment, that the current price increases observed in the Danish housing market are driven by fundamentals such as lower interest rates, higher income and demographics. Furthermore, credit growth is still generally modest. The build-up of systemic financial risks is typically accompanied by high credit growth, which was indeed the case in the build-up to the 2008 financial crisis.

The Danish authorities have already taken several measures addressing risks in the residential real estate market. The measures focus on the potential build-up of systemic risks stemming from households with a high debt level that does not amortize their mortgages and/or are sensitive to interest rate changes. The measures include:

[1] The findings of the inspections are publicly available on the Danish FSA's website: www.finanstilsynet.dk

1. Introduction of a supervisory diamond for mortgage credit institutions. The supervisory diamond sets out five indicators with corresponding limits for the mortgage credit institutions. The supervisory diamond sets limits for e.g. the share of interest only mortgages with high loan-to-value and variable rate mortgages.

2. A 5 percent down payment requirement in connection with financing residential real estate.

3. Introduction of guidelines for credit institutions to ensure cautious lending for residential real estate. This measure focuses on lending to geographical areas with high price levels and high price increases compared with the rest of the country. The guidelines consist of 7 best practices for credit institutions and instruct e.g. that lenders must consider the borrowers' ability to service debt under interest rate hikes and that borrowers with a high debt-to-income ratio should have loans with fixed interest rates and amortization or a positive net wealth even under severe price falls.

The above measures have been introduced recently and the full effects have yet to be seen. They complement the general strengthening of the EU financial regulatory framework since the crisis, including higher capital requirements, for credit institutions. Danish credit institutions have overall strengthened their capital positions significantly since the crisis, which strengthen their resilience to risks in relation to the housing market.

The Danish authorities will continually monitor the effectiveness of the measures in addressing the build-up of risks in the residential real estate sector.

The Danish government has proposed to further reduce interest rate tax-deductibility and reform the housing tax system so that tax-payments will be directly linked to house price developments. If implemented, these initiatives will contribute to reduce fluctuations in house prices.