

The Annual Meeting of the Association of Danish Mortgage Banks 2009

Governor Nils Bernstein

Thank you for the invitation to speak here today.

At last year's meeting, I began by saying that economic predictions should always be taken with a grain of salt. The same applies this year.

Today's cyclical picture is a great deal gloomier than I – or others, for that matter – predicted a year ago. Expectations of global growth are being adjusted downwards all the time. At the moment, growth estimates come and go. The latest international forecasts expect output in the industrialised countries to drop by 4 per cent this year. Major exporting countries like Germany and Japan are hit especially hard; a decrease in output by more than 5 per cent is foreseen. In that case, the setback will be of a magnitude not seen for a long time. The current outlook is gloomy. But for some time the most pessimistic predictions have tended to stick most.

The global political willingness to address the crisis is one encouraging aspect. There is no universal agreement, but so far the world has managed to keep tendencies to profit at the expense of others at bay. Let us hope that it continues. The euro plays a major role here. I am not blind to the fact that the currencies of some of Denmark's important export markets have depreciated against the euro and thus the krone. This makes life hard for Danish exporters, but we will just have to accept it. And it is a reminder of how important it is to keep costs down.

The G20 summit in London early this month agreed to expand the lending capacity of international financial institutions, including the IMF. In addition, the G20 countries agreed on higher trade credits and a general increase in the foreign-exchange reserves of central banks. All this amounts to astronomical figures. Denmark will have to pay its share of the financing of these commitments.

A global economic downturn of the magnitude we are witnessing at the moment must necessarily have serious implications for a small open economy like Denmark. Exports have declined by almost one fifth over the last six months. And the downward trend continues.

Last year, output fell by more than 1 per cent in Denmark, while it rose in most other EU member states. This year, we expect output to decline even

more strongly than last year, but slightly less than in the rest of the EU. Nevertheless, unemployment is expected to continue to increase for some time as it typically lags behind demand. No one can say for certain how long the increase will continue and how strong it will be. Any calculations we make will have a considerable element of uncertainty. According to the latest estimate, unemployment will not peak until early 2011 at around 190,000 persons.

Denmark can use economic policy to mitigate the mounting crisis, but we cannot avoid it – no matter what we do. We have already launched significant measures to stimulate private consumption and activity in the building and construction sector. Fiscal policy is expansionary and has been so for several years. Danmarks Nationalbank's policy rates are historically low. We are running out of room to manoeuvre.

We cannot force consumers to spend more. In the worst case, consumers will save up and then spend the money at a time when it would be more appropriate for them to tighten the reins. If we cut to the chase, it is a question of how much we can use the building and construction sector as a cyclical regulator to create jobs as compensation for falling employment in other sectors – exports, trade, services and the financial sector. We are saying: wait a moment and let us see how the measures already implemented work. After all, capacity in building and construction is limited. Only recently, the sector was in full alert with overheating and shortage of craftsmen, while prices and wages were rising. If we overburden the building and construction sector again, history will repeat itself and that could ultimately exacerbate the crisis. Finally, the contribution to an overall reduction in unemployment will be limited in any case. And I have not even mentioned the difficulties of ensuring rational planning of building or construction projects moved forward or subsidy schemes that stimulate initiation of projects.

Indeed, the crux of the matter here is job creation and not what can be done to mitigate the consequences for the unemployed. Efforts should be directed at retaining and developing competencies, for example, and an extraordinary effort is required to create more places in education and training.

During the last six months of financial turbulence, the mortgage system has proved that it can ensure financing of real property.

Market confidence in the Danish mortgage system has been upheld, against the backdrop of mounting difficulties in financing real property in many other countries.

Monetary policy has been relaxed all over the world. On 3 April, Danmarks Nationalbank was able to lower its discount rate to 1.75 per cent – the lowest level since the establishment of Danmarks Nationalbank in 1818. Although the lending rate is slightly higher, the short-term interest rate is historically low .

Long-term interest rates have decreased less than policy rates. The central banks of several countries, including the UK and the USA, are buying back bonds to force down long-term interest rates in order to stimulate the economy. It remains to be seen whether the European Central Bank will steer a similar course. If it does, long-term interest rates in Denmark could also be affected.

It is essential that the current extraordinary stimulus measures do not increase long-term inflationary expectations as this would create problems for the economy in the longer term as a result of measures to mitigate the current crisis.

Thanks to the low policy rates, the banks can borrow from Danmarks Nationalbank at low cost. But Danmarks Nationalbank is by no means the only source of financing for Danish banks. The financial crisis has generally made it more difficult for the banks to obtain financing in the international money and financial markets. This has entailed higher financing costs. The importance of the international money markets as a source of financing has grown over the last 10 years as growth in the banks' deposits has lagged behind growth in lending.

The higher financing costs have been passed on to the banks' customers. Since last autumn, the banks have again reduced their interest rates somewhat. The decline in deposit rates has more or less mirrored the reduction in policy rates, while lending rates for households and the corporate sector have declined a little less. The result is higher interest margins for the banks, at a time when losses are expected to increase for a period to come. In addition, the banks' contribution to the financing of the government guarantee under Bank Rescue Package I will amount to kr. 35 billion. Danmarks Nationalbank's interest rates are guidelines for the banks' interest rates, but a one-to-one relation should not be expected.

The credit terms for bank and mortgage customers have been tightened further since last autumn. This is evident from Danmarks Nationalbank's latest bank lending survey. The tightening has been most pronounced for corporate loans. In the survey, the respondents give the more gloomy risk outlook as the main reason. The risks have proved to be greater than the institutions expected three months ago. The mortgage-credit institutes also state the supplementary collateral requirements for covered bonds as a

reason for tightening credit policies. Contribution rates have been raised. Overall, the institutions expect to tighten their credit policies further in the next three months. The survey also shows that demand for corporate loans has declined in 2009 – a sign that economic activity has shifted to a lower gear.

It is understandable that risk assessments have been tightened against the backdrop of the negative growth outlook. Expectations of mounting losses on the stock of existing loans entail a more prudent approach when considering applications for new loans. At the same time, credit quality is on the decrease. Does this mean that Bank Rescue Package II has failed? The answer is no, in my opinion. It has only been possible to apply for funds under Bank Rescue Package II for a very short time. Are we already witnessing a credit crunch? The bank lending survey leaves no basis for concluding that loan applications from borrowers who are considered creditworthy under the tightened credit policies of the recession are rejected to any considerable extent on the grounds of shortage of capital in banks and mortgage-credit institutes – yet.

Having said that, I would still like to repeat my request to all banks and mortgage-credit institutes: it is now possible to strengthen your capital base by means of hybrid core capital made available by the government. And, under special circumstances, it is now also possible to convert such capital injections into share capital. This might come in handy. This is an unusual scheme, but the current situation is also unusual. I encourage you to carefully consider these opportunities. Under the prevailing market conditions and the economic outlook for the next couple of years, you cannot be too careful. And a well-padded financial sector is a key prerequisite for turning the tide so that we will again enjoy positive economic development.

Thank you for your attention.