

DANMARKS NATIONALBANK

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Good times in the banking sector but risk of speed blindness

- Record high bank earnings underpinned by low loan impairment charges.
- In some areas, current developments are similar to developments in the period up to the financial crisis, but the banks have larger buffers today than in 2007.
- The Danish banks are already observing the EU capital requirements, which will be tightened towards 2019, but their capital base is lower than that of other Nordic banks.

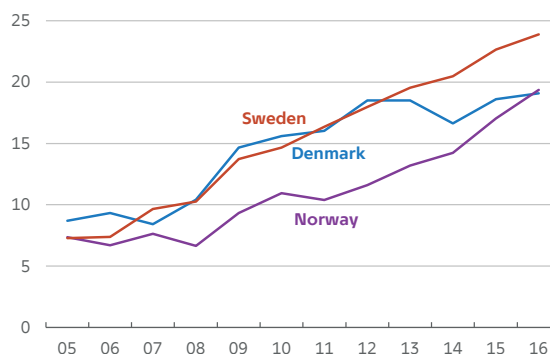
Overall, the largest Danish banks achieved their best ever performance in 2016, and their financial statements for the 1st quarter of 2017 also recorded sound profits. The bank's earnings are underpinned by temporary effects from very low loan impairment charges.

This is Danmarks Nationalbank's conclusion in its Financial stability analysis, also noting that the listed banks distribute a large share of their higher profits as dividend and share buy-backs to the shareholders. The analysis shows that the large banks are complying with the current capital requirements, which will be gradually tightened towards 2019. On the other hand, the capital base has not increased notably since 2013, unlike in Norway and Sweden where the banks have higher capital adequacy.

In some areas, financial developments are similar to developments in the period up to the financial crisis in 2008, so there is every reason to watch out for speed blindness.

Large Danish banks have stopped building up Tier 1 capital

Per cent of risk-weighted exposures

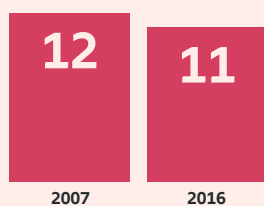


Note: The Danish banking groups are Danske Bank, Jyske Bank, Nykredit and Sydbank.

Source: SNL, financial statements and own calculations.

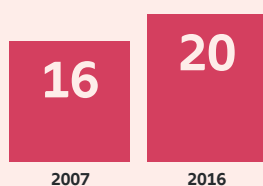
Earnings

Return on equity, per cent



Equity prices

Average annual growth 4 years before peak and 2016, per cent



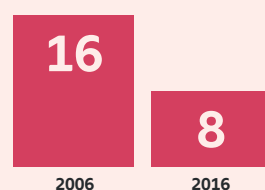
Loan impairment charges

Kr. billion



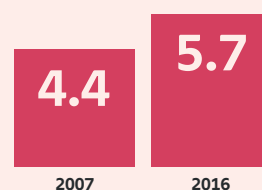
House prices in Cph

Average annual growth 4 years before peak and 2016, per cent



Leverage ratio

Base capital as a ratio of non-weighted exposures, per cent



Similarities

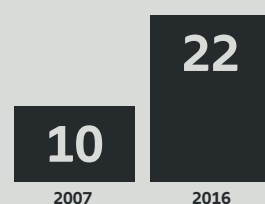
Similarities and differences between 2007 and 2016

In some areas, current developments are similar to developments in the period up to the financial crisis in 2008, but with key differences. The focus here is on the four largest banks, together accounting for 70 per cent of the Danish banking sector. As shown, lending growth is lower today, and the banks have larger buffers than in 2007.

Differences

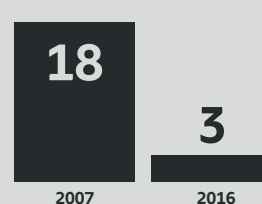
Solvency

Base capital as a ratio of risk-weighted exposures, per cent



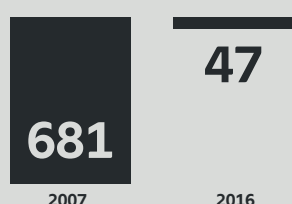
Lending growth

Annual increase in total lending, per cent



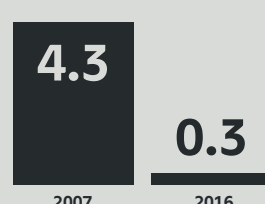
Customer funding gap

Kr. billion



Level of interest rates

Annual average, 10-year government bond



Differences and similarities relative to the period up to the financial crisis

In some areas, developments in the equity and housing markets and the recovery among banks are similar to the period prior to the onset of the financial crisis in 2008, but with key differences. At that time, strong economic growth and a low level of interest rates led to widespread optimism and risk appetite among households, firms and banks. The Danish economy heading towards a boom and a historically low level of interest rates provide the basis for some of the same risks potentially occurring again.

Both equity prices and prices of owner-occupied homes have soared, as they did in the years prior to the financial crisis. As then, prices of owner-occupied homes in Copenhagen have risen considerably, but with the difference that the price rises have not yet spread to the rest of Denmark to the same degree. The prices of rental properties have also increased and are back at the 2007 level immediately before the financial crisis set in and prices plummeted, resulting in substantial losses for some banks.

Up to the financial crisis, the banks also had high earnings supported by low loan impairment charges, but in some respects, the banks are more resilient today. In 2007, the largest banks had considerable customer funding gaps, which are now much smaller. Looking at all banks taken as one, with focus on their deposits and lending, they now have a substantial customer funding surplus. This reflects that lending growth is currently very limited, in contrast to the situation of strong lending growth before the financial crisis. Strong lending growth is a problem if credit standards are compromised, increasing the risk of losses for the banks.

Importantly, the banks have strengthened their capital base. The large banks' solvency ratio, which is a measure of the banks' capital as a ratio of their risk-weighted exposures, has doubled. Most of the increase in the capital ratios is due to a decline in the risk-weighted exposures used for weighting the capital base. The leverage ratio, which is a simpler, non-weighted measure of the banks' capitalisation, has increased relatively less over the period.

Results from Danmarks Nationalbank's stress test show that all the largest banks observe the statutory minimum requirement for capital adequacy, even if Denmark is hit by severe recession, but a few banks will fall short of the buffer requirements. In the event of non-compliance with the buffer requirements, the banks become subject to limitations, e.g. limitations of dividend payments. Moreover, the banks should expect that their access to external funding in the financial markets may be challenged.

Ensuring the stability of the financial system is one of Danmarks Nationalbank's overall objectives. Accordingly, especially the largest banks are subject to oversight, as it may have negative implications for the financial sector and for the economy as a whole if they encounter difficulties.

Read more about the Financial stability analysis at Danmarks Nationalbank's website ([link](#)).

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