

DANMARKS NATIONALBANK

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Two consecutive years of record earnings in systemic credit institutions

Strong pressure on banks' credit standards

The favourable developments in the financial sector continue, and the banks have significant capacity to increase lending. Combined with limited growth in demand for loans, this has intensified the banks' competition for customers. This means that there is a basis for the banks to lower their credit quality and ease credit conditions.

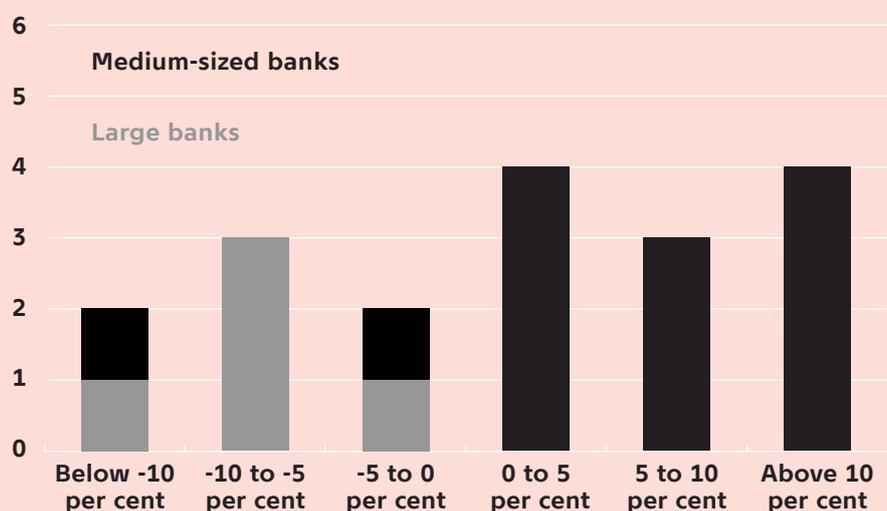
This is Danmarks Nationalbank's conclusion in its Financial Stability analysis, in which it is also noted that last year the largest banks posted record profits for the second year in a row. Reversal of loan impairment charges and large value adjustments boosted profits. Contributions from both items are temporary.

Lending growth varies considerably within the sector, cf. the chart. In recent years, it has been higher for the medium-sized banks than for other banks. As a result, the market shares of the medium-sized banks have started to increase. In the period up to the financial crisis, the market shares of the medium-sized banks rose amid economic growth and high risk appetite. Back then, some of the banks contributed to the pressure on credit standards and credit quality requirements in the market. Danmarks Nationalbank points out that it is essential that the competitive pressure does not ultimately affect the risk appetite of the banking system overall.

Large variation in banks' lending growth

Note: The chart shows the number of banks, broken down by annual lending growth ranges in 2017. Growth is based on banks' domestic lending to households and the corporate sector.
Source: Danmarks Nationalbank and own calculations.

Number of banks



If the banks ease their credit standards and the creditworthiness of customers deteriorates, risks may build up in the banking system without immediately being reflected in lending growth. The problems do not materialise until the cyclical position changes and customers prove unable to service their debts.

Risks build up in the financial system when times are good. And the banks need to build capital adequacy in good times to be able to withstand difficult times, for instance by holding back on dividend payments or by raising capital in the financial markets

As part of its monitoring of financial stability, Danmarks Nationalbank performs semi-annual stress tests to assess whether the credit institutions have

adequate capital to withstand three scenarios: severe recession, low growth and a baseline scenario. The six institutions designated as systemically important pass the stress test. In a severe recession scenario, they have sufficient capital, but several of the institutions are close to exceeding the add-on buffer requirements.

Several of the small, non-systemic banks are challenged in the stress test, and some will fall short of the minimum capital requirement if Denmark is hit by a severe recession. This is also the group of banks that have eased credit standards the most and which are recording the highest lending growth.

See the full Financial Stability analysis at Danmarks Nationalbank's website ([link](#)).

ABOUT NEWS



News are news articles based on analyses, working papers or other longer texts from Danmarks Nationalbank. News primarily

address journalists, politicians, government officials, specialists and others who want to be updated on current topics.

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SECRETARIAT AND
COMMUNICATIONS



In 2018, Danmarks Nationalbank will be celebrating its 200th anniversary. Danmarks Nationalbank's overall objective has been more or less unchanged during its 200-year life – to "maintain a safe and secure currency system" and "facilitate and regulate the traffic in money and the extension of credit", as the Danmarks Nationalbank Act says.

One of Danmarks Nationalbank's objectives is thus to contribute to the stability of the financial system. Danmarks Nationalbank began publishing financial stability analyses in 2002. These analyses are part of Danmarks Nationalbank's assessment of the financial system in Denmark.

Why Danmarks Nationalbank monitors financial stability

Danmarks Nationalbank must identify in a timely manner whether financial sector developments could pose risks for the stability of the financial system. This is why Danmarks Nationalbank prepares financial stability analyses.

These analyses support one of Danmarks Nationalbank's most important tasks: that of contributing to financial stability in Denmark. A well-functioning financial sector is essential for the economy, as it provides a necessary platform for borrowers and lenders to meet.

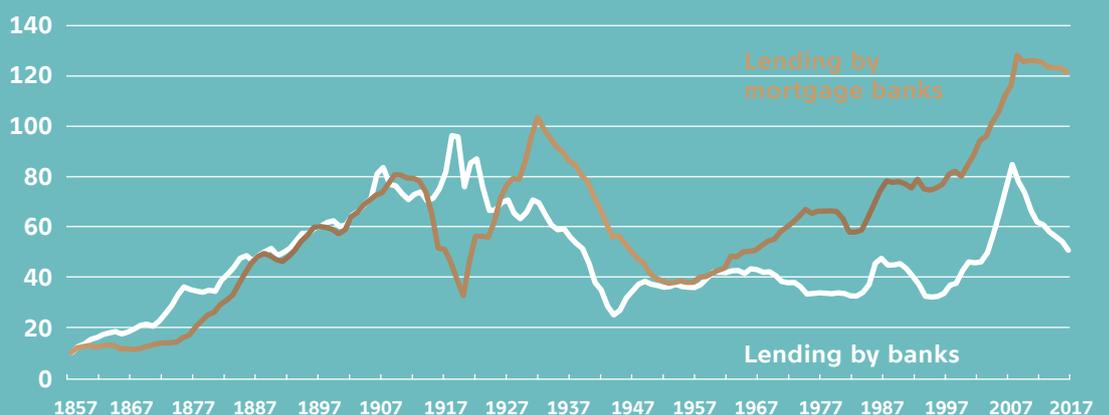
Citizens may need access to loans in order to buy a home or a car, while firms tend to borrow for investments to expand, thereby creating more jobs. Conversely, citizens may wish to place their savings in a secure manner.

That way, banks and mortgage banks are key to a society such as Denmark. Experience from previous financial crises shows that financial instability may have serious economic consequences. Therefore, it is vital to prevent and mitigate the risk of periods of financial instability. In the wake of the financial crisis, Danmarks Nationalbank has also been working to enable the resolution of distressed banks without the use of government funds.

Danmarks Nationalbank defines financial stability as a condition with an overall financial system that is robust enough for any problems in the sector not to spread and prevent the system from functioning. Financial instability may occur, for example, if a single large institution experiences difficulties. Or if problems in a single institution spread to the rest of the system.

Lending in Denmark, 1857-2017

Per cent of GDP



Note: Domestic lending by banks and mortgage banks.
Source: Danmarks Nationalbank.