Denmark

By Kaare Christensen, Finance Denmark

IN A NUTSHELL

→ Continued deleveraging and balanced upswing in the Danish economy.
→ Borrowers still favouring fixed rate mortgages.
→ New and stricter loan requirements on borrowers with high leverage taking effect in 2018.

MACROECONOMIC OVERVIEW

The Danish economy continued previous years' expansion and grew in real terms by 2.2% in 2017, mainly driven by export growth of +4.4%. However, Danish exports for 2017 are influenced by a significant single sale of a patent. Excluding this sale, real GDP growth is more in the +2.0% region. Real gross total fixed capital formation rose by (+3.7%) including a rise in gross residential fixed capital formation of +8.7%. Private consumption (+1.6%) also added to real GDP growth in 2017. Factors driving private consumption including employment and real wage growth performed well in 2017 – perhaps well enough to justify a larger rise in consumption expenditure. However, Danish households continue to deleverage helping household net wealth improve by +6.0% during the year. The labour market continued to perform well with an increase of 1.6% in employment in 2017. The positive influence from the labour market can be read in consumer confidence that rose through 2017 after a sharp set-back in 2016. Real wages continued to improve as compensation per employee outpaced consumer price increases by almost +1%. Public consumption rose by +0.6%. The output gap for Denmark in 2017 was +0.2% showing an economy on a balanced growth path, however showing some early signs of labour shortage in few selected sectors. The deposit rate at the Danish central bank, Danmarks Nationalbank, remained at -0.65% throughout the year.

Unemployment decreased from 6.2% to 5.7% (Eurostat Unemployment Rates) by the end of 2017. Unit labour costs in the Danish private sector rose by 0.9%, while consumer prices increased by 1.1% in 2017.

The Danish government recorded a budget surplus of +1.0% of GDP for the year. Meanwhile, gross public debt was -36.4% of GDP, which is low in a European context. Meanwhile, Denmark ran a current account surplus of +7.6% of GDP.

HOUSING AND MORTGAGE MARKETS

HOUSING MARKETS

The Danish housing market is characterised by a relatively low owner occupation rate, which is even lower in larger cities. Hence, price developments in the owner-occupied segment impact macro-economic factors such as private consumption less, than if the owner occupation rate had been higher.

The owner occupation rate was 52.5% by the end of 2017. This marks a decrease of 0.2 pps over the year. Since 2007, the owner occupation rate has slightly decreased by a total of -1.9% pps. The development over the year could be the result of housing affordability conditions. Despite higher real incomes, user costs kept rising in 2017 due to higher house prices. User costs for the country as a whole have reached their long-term average. However, in Copenhagen user costs are now above the long-term average.

Domestic nominal house prices increased by 4.5% (y-o-y) in 2017 picking up slightly on the growth rate recorded for the previous year. Not only house prices, but also prices on owner occupied flats have been rising for some years. House price increases are now prevalent across the country. The current increasing trend started in the bigger cities and have spread from there. Prices on owner-occupied flats and detached and terraced houses in the Copenhagen area rose by 10.5% and 8.1% (y-o-y) in 2017.

Higher house prices have stimulated transaction activity. The number of transactions involving detached and terraced houses is up 10.0% in 2017, whereas 1.5% more owner-occupied flats were sold. Especially areas outside the larger cities are driving transaction activity. Meanwhile, the underlying demographic movement away from the countryside remains an underlying demand factor favouring markets in larger cities.

Construction activity is finally gaining momentum after a period of subdued activity since the financial crisis. Building upon a big leap in 2016, momentum carried from 2016 into 2017. Housing completions improved by 10.8% in 2017.

MORTGAGE MARKETS

By year end 2017, outstanding mortgage loans from mortgage banks amounted to DKK 2,670 bn, of which app. DKK 1,600 bn was for owner occupied housing. On top of this housing loans for households from commercial retail banks amounted to DKK 303bn. In total mortgage credit growth was recorded at 1.9% in 2017. In light of recent years' house price increases, mortgage credit growth remains modest. However, due to past years' faster house price growth in Copenhagen, lending growth for owner occupation is much higher in the capital area compared to the rest of the country.

Mortgage lending activity in 2017 has repeated previous years' developments. Fixed rate mortgages have gained market share while especially the share of variable rate mortgages has decreased. Outstanding mortgage loans issued by mortgage banks are split between fixed rate mortgages (34.4% by year end 2017), adjustable rate mortgages with an interest rate cap (3.5% by year end 2017), interest reset mortgages with interest reset under 1 year (35.3% by year end 2017) and interest reset mortgages with interest reset intervals between 1 and 10 years (30.3% by year end 2017).

Gross lending activity by mortgage banks increased slightly from the 2016 level. The activity level remains relatively high in a historic perspective due to attractive remortgaging opportunities as a consequence of low mortgage rates. All in all, total gross lending reached DKK 508.7 bn. Residential mortgages counted for 77.0% of gross lending which is slightly less than in 2016. Fixed rate mortgages (typically fixed for 30 years) accounted for 50.1% of gross lending in 2017, a decrease of 2 pps compared to 2016. Adjustable rate mortgages and interest reset mortgages accounted for 49.5% and adjustable rate mortgages with an interest rate cap accounted for 0.2% of gross lending in 2017.

The increasing popularity of fixed rate mortgages that picked up already in 2015 and has remained high since then as the majority of new mortgages are issued with a fixed interest rate. Furthermore, movements within the interest reset segment continued in 2017. Borrowers are still favouring fixed rate mortgages and interest rate reset mortgages with semi-annual and 3-5 year intervals over interest reset mortgages with yearly intervals. There are several potential reasons for this development. One reason that stands out is the industry's own measures which includes increased fees on interest reset mortgages with yearly intervals and interest only mortgages relative to other types of loans. On the margin, this has given borrowers an incentive to choose other mortgages than interest reset mortgages with 1 year interval and interest only mortgages. Other possible reasons for borrowers preferring fixed rate mortgages and mortgages with longer interest rate fixation could be borrowers' expectations of future interest rate increases. Indeed, in 2017 the interest rate on a 30 year fixed rate mortgage remained at the very low level of previous years, which provides equity protection from an interest rate increase (and hence expected house price decline) as the price of the mortgage is reduced as interest rates rise - neutralising possible value deterioration.

The interest rates on fixed mortgage loans continued at a historically low level in 2017. The interest rates on short term loans were so low, that investors received negative yields on the underlying bonds. The short term interest rate to borrowers was on average 1.00% in 2017 and 30 year fixed rate mortgages were issued with a coupon of between 2% or 2.5% during the year.

ANY FURTHER IMPORTANT EVOLUTION

Taking effect on 1. January 2018 a tightening of existing consumer protection legislation took effect. The new stricter requirements are a direct consequence of recommendations from the Danish Financial Stability Board from March 2017, stating that household with large loan exposures should be limited to loans with longer rate fixation combined with an amortisation requirement.

Even though households are still credit accessed on the same terms as before, households ending up with a loan to income ratio of more than 4 will be limited to safer mortgage products including amortisation requirement and fixed or longer term rate fixation. It is expected that the new legislation wil dampen overall demand for mortgage loans and that the existing market driven move towards fixed rates and amortisation will be consolidated by the new rules.

Even though the new rules did not take effect until the beginning of 2018, the new rules were announced in late 2017, and the mortgage banks and commercial banks already started observing the new requirements in late 2017.

MORTGAGE FUNDING

Mortgage loans issued by mortgage banks are solely funded through the issuance of covered bonds. Mortgage banks continuously supply extra collateral on a loan by loan basis if the value of cover assets (properties) deteriorates.

The funding mix – for the main part bullet bonds or callable long-term bonds – adjusts continuously according to borrower demand. Bonds are tapped and bullet bonds behind interest reset loans are refinanced by month end in March, September and December. December remains traditionally the largest refinancing date, however new bullet bonds have not been issued with maturity in December for the past years, spreading refinancing activity and hence the point risk more evenly across the year. In December 2017, the shortest bullet bonds (1 year maturity) were sold and resulted at a mortgage interest rate of approximately -0.21%, compared to 0.00% a year earlier.

Over the course of 2017, long-term callable bonds, which fund the fixed rate mortgages, were issued with a coupon of 2% or 2.5% matching the rate on the loans

	DENMARK 2016	DENMARK 2017	EU 28 2017
Real GDP growth (%) (1)	2.0	2.3	2.4
Unemployment Rate (LSF), annual average (%) (1)	6.2	5.7	7.6
HICP inflation (%) (1)	0.0	1.1	1.7
Outstanding Residential Loans (mn EUR) (2)	243,751	248,776	7,013,738
Outstanding Residential Loans per capita over 18 (EUR) (2)	53,692	54,311	16,872
Outstanding Residential Loans to disposable income ratio (%) (2)	174.7	172.6	73.8*
Gross residential lending, annual growth (%) (2)	-20.1	0.3	3.5
Typical mortgage rate, annual average (%) (2)	1.1	1.0	2.4**
Owner occupation rate (%) (1)	62.0	62.4	66.4*
Nominal house price growth (%) (2)	3.7	4.5	6.0

* The aggregate EU figure is from 2016.
** Please note that this value is the simple average of the typical interest rate of the EU 28 countries.

Sources:
(1) Eurostat
(2) European Mortgage Federation - Hypostat 2018, Statistical Tables.

DENMARK FACT TABLE

Entities which can issue mortgage loans:	Retail banks and mortgage banks
The market share of the mortgage issuances:	Not available – data for residential reflect mortgage banks issuance only (not available for retail banks)
Proportion of outstanding mortgage loans of the mortgage issuances:	Over the past twelve months, the proportion (for owner-occupied housing) has been the following: • Retail banks – 15% • Mortgage banks – 85%
Typical LTV ratio on residential mortgage loans:	For new loans for owner-occupied housing the LTV will normally be up to 80%. For other new residential loans the LTV will normally be 60%.
Any distinction made between residential and non-residential loans:	The difference is whether you live in the house or not.
Most common mortgage product(s):	We have three typical types of loans: • Loans with Fixed rate • Interest reset loans • Loans with variable rate with and without cap
Typical maturity of a mortgage:	For new housing loans the maturity is normally 30 years. For business loan the maturity is typically 20 years.
Most common way to fund mortgage lending:	Covered bonds
Level of costs associated with a house purchase:	For new loans at DKK 1 million (EUR 134,000) with fixed rate the following apply: • Taxes going to state: Approximately DKK 17,000 (EUR 2,280) • Costs going to the Mortgage bank: Approximately DKK 10,000 (EUR 1,340)
The level (if any) of government subsidies for house purchases:	The government doesn't have any role in house purchases.