



**INTERNATIONAL MONETARY FUND**



**SWEDEN 2016 ARTICLE IV  
AND  
FINANCIAL SYSTEM  
STABILITY ASSESSMENT**

**Craig Beaumont, Mission Chief for Sweden, IMF**

December 2, 2016



## Growth Cools in Near-term but Risks in Medium-term

Growth cools as monetary and fiscal impulses begin to fade and capacity constraints start to bite, especially on investment:

	2015	2016	2017	2018
GDP	4.1	3.4	2.4	2.2
Investment	7.2	6.9	3.9	3.8

Key Medium-term Risks:

- **Slow growth in Europe/globally**—political fragmentation?
- **Weak consumption if interest rates rise and house prices fall** (perhaps after further rises in house prices and household debt)



# How to Sustain Solid Growth?

- I. Raise inflation to target over time, to enable interest rates to normalize so monetary policy can cushion shocks**
- II. Protect fiscal health & Improve refugee integration**
- III. Contain household debt & housing vulnerabilities**
- IV. Ensure resilience of Sweden's large financial system**

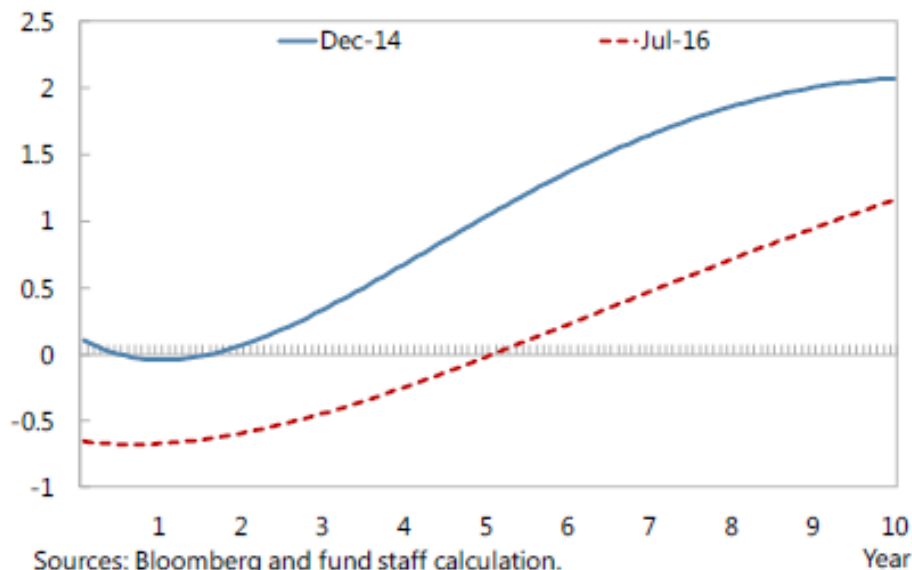


# I. Monetary Policy

## Yields decline across maturities:

- Negative rates (-0.5%)
- Expectations for rates to stay low
- Bond purchases at longer end

**Yield Curve**  
(Percent)



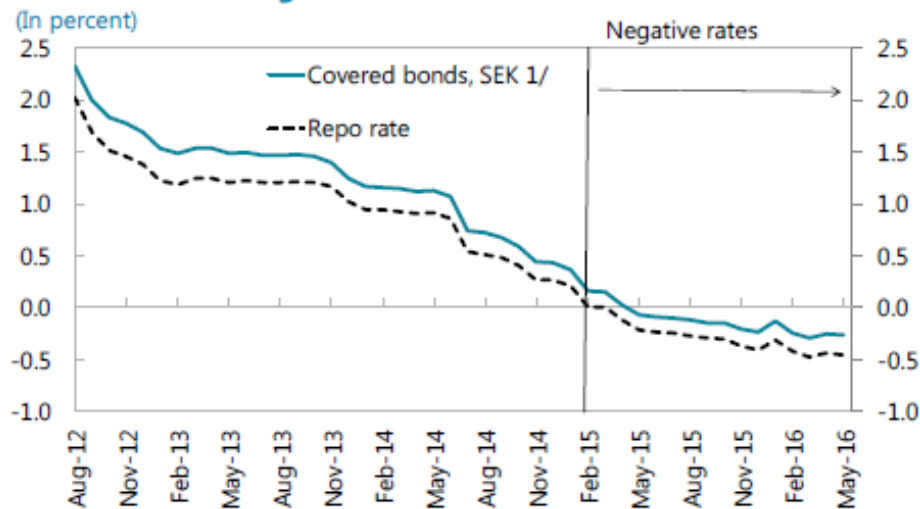
Sources: Bloomberg and fund staff calculation.

Note: Based on zero-coupon bond yields and Nelson-Siegel-Svensson method.

## Wholesale bank funding costs fall:

- Tracks repo rate closely owing to hedging of interest rate risks
- Limits impact of negative rates on bank profitability (WP/16/198)

**Estimated Funding Cost on Covered Bonds in SEK**



Sources: Haver and Fund staff calculations.

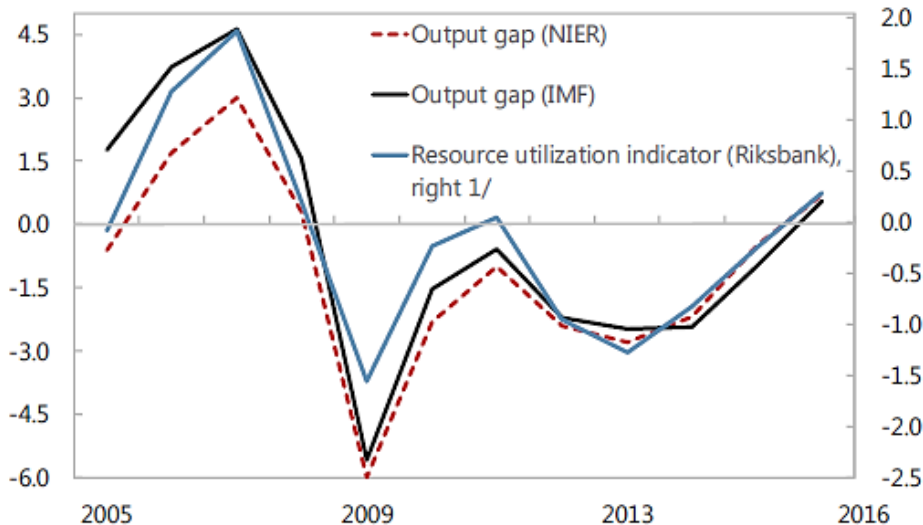
1/ 3-month Stibor + credit spread (SEK covered bond yield - SEK interest rate swap yield over Stibor) averaged over 3 years.



# Inflation Likely to Rise But Only Gradually

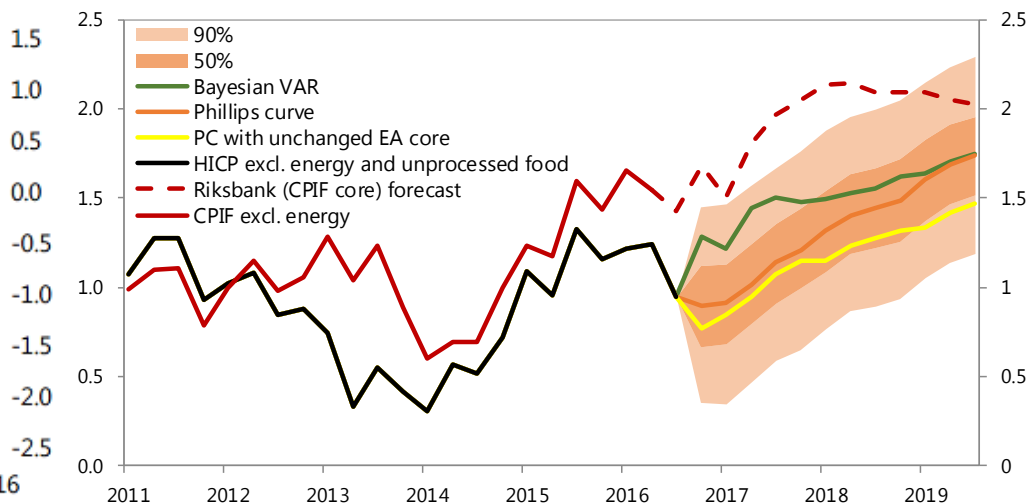
- Core inflation (HICP) 1.1 percent so far in 2016
- Resource utilization risen to just above normal levels
- Should feed into higher inflation from 2017, but
- Inflation rise slowed as sluggish euro area wages spillover to Sweden?

## Resource Utilization



## Core Inflation Projections

(Y-o-y percent change)





# So Monetary Policy Should Remain Expansionary for Some Time

## **Await durable inflation rise before unwinding easing:**

- Premature tightening could delay rate normalization
- Take symmetric risk of inflation above/below target

## **Ease further if inflation/expectations weaken:**

- More negative rates; *heighted vigilance on HH debt*
- Extend/broaden asset purchases; *monitor debt markets*

## **Foreign exchange intervention should remain a last resort:**

- Current account surplus of 5% of GDP relatively high
- Krona is assessed to be moderately undervalued



## II. Fiscal Policy

### **Accommodating migration-related spending is appropriate:**

- Sweden's strong fiscal position gives room to avoid making costly adjustments in other revenue/spending
- Modest support for growth complements monetary policy

### **Meet new surplus target with judicious use of fiscal space:**

- Structural balance projected at 0.6% of GDP by 2019, 0.3% of GDP above target
- Use room to support migrant integration and housing supply, with long-term economic and fiscal benefits

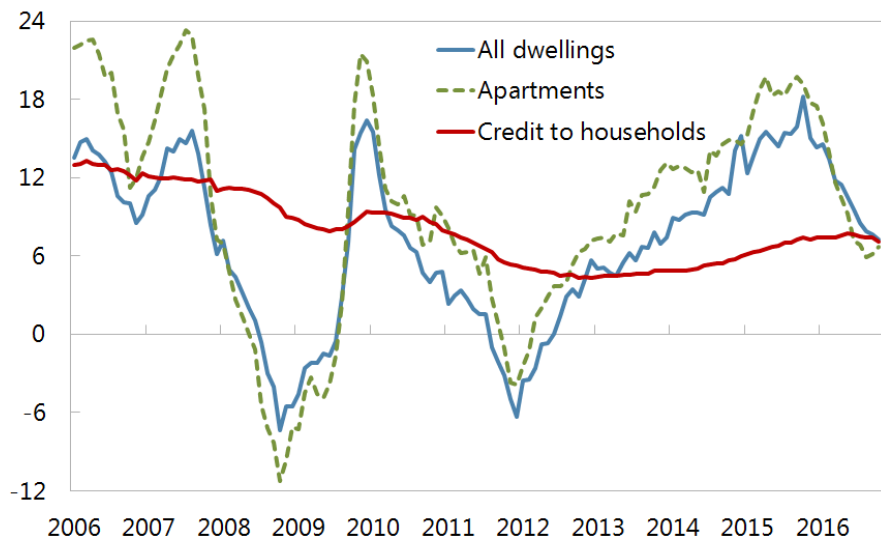


# III. Containing Household Debt and Housing Market Vulnerabilities

- House price increases slowed from Autumn 2015
- Credit appears to be lagging rather than driving prices
- Expectation of amortization requirement may have helped stabilize house prices
- But pick up in latest data?

## House Price and Household Credit

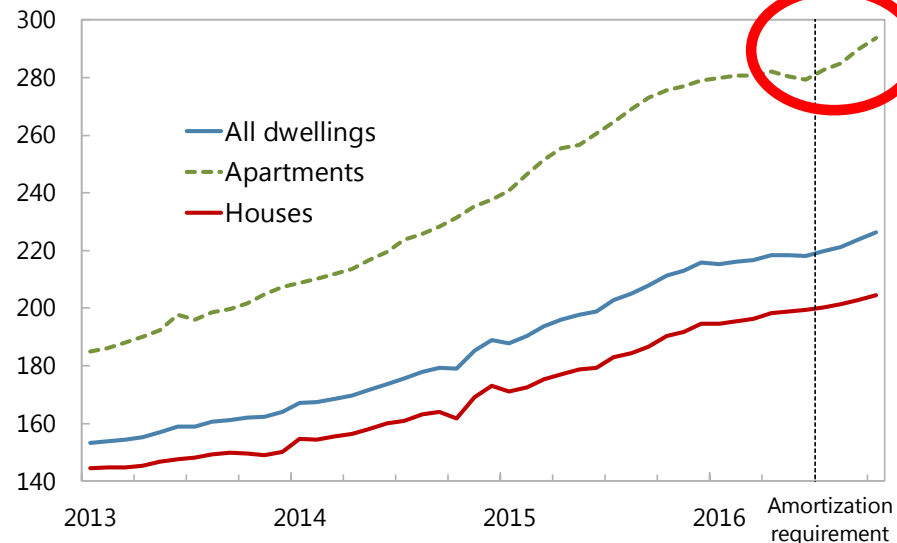
(Y/Y percent change)



Sources: Statistics Sweden, Valueguard, and Fund staff calculations.

## Housing Prices

(Index, January 2005 = 100, seasonally adjusted)



Sources: Statistics Sweden, Valueguard, and Fund staff calculations.



# Household Debt to Keep Rising

- Debt/Assets fallen given rising house prices and high saving

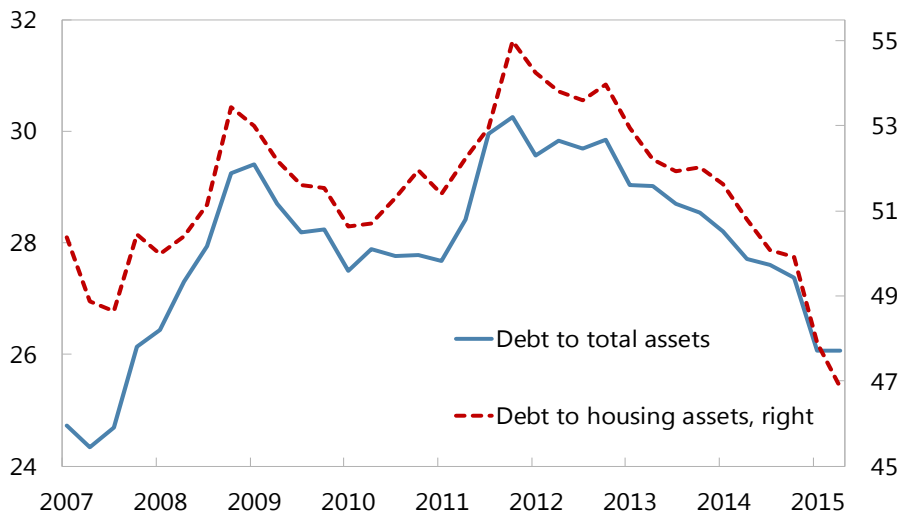
→ Debt could rise within historical norms for household leverage

- High level of house prices raises the amount borrowers need

→ HH debt burden relative to income likely to continue rising

## Debt Ratios

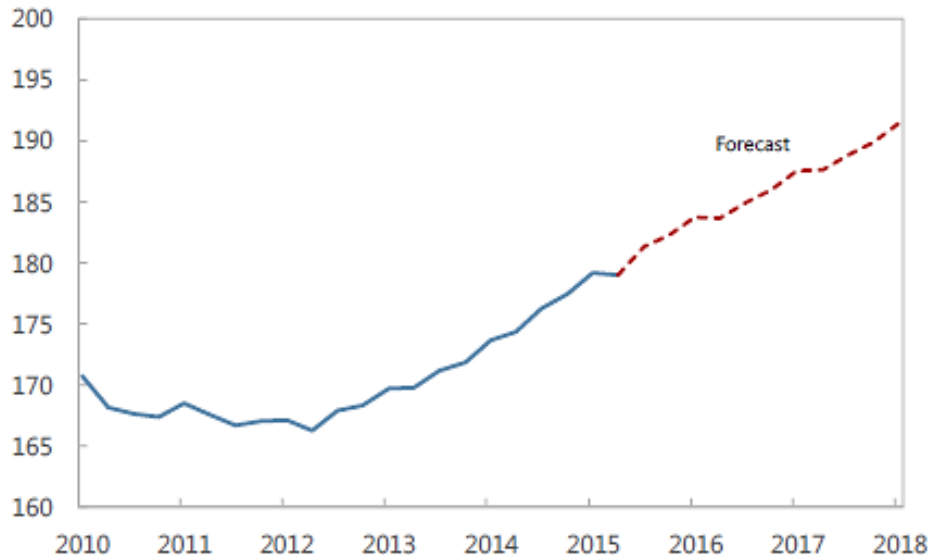
(Percent)



Sources: Sveriges Riksbank and Fund staff calculations.

## Household Debt to Disposable Income

(Percent)



Sources: Riksbank, Monetary Policy Report, September 2016.



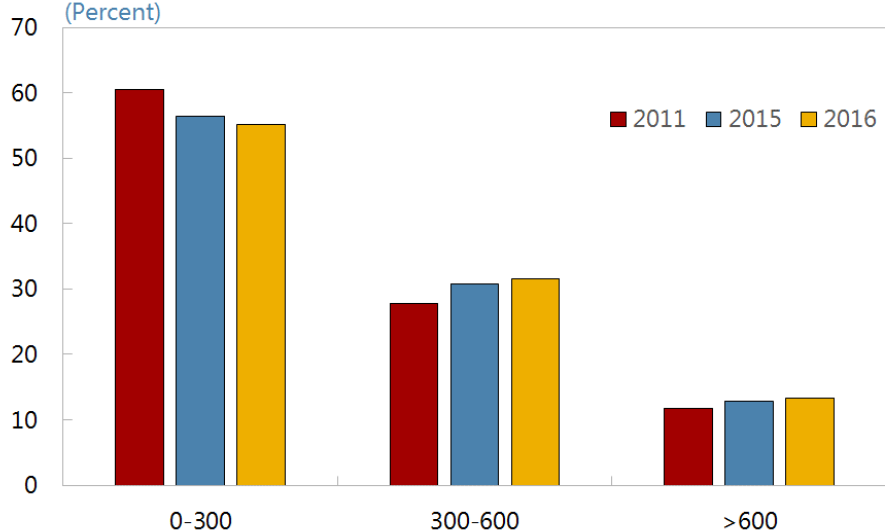
# Rising Share of Highly Indebted Households Adds to Vulnerabilities

Share of highly indebted households has risen modestly in recent years

But this rise will accelerate as a growing share of new borrowers are highly indebted

### Distribution of Debt-to-Disposable-Income Ratios of Households with Mortgages

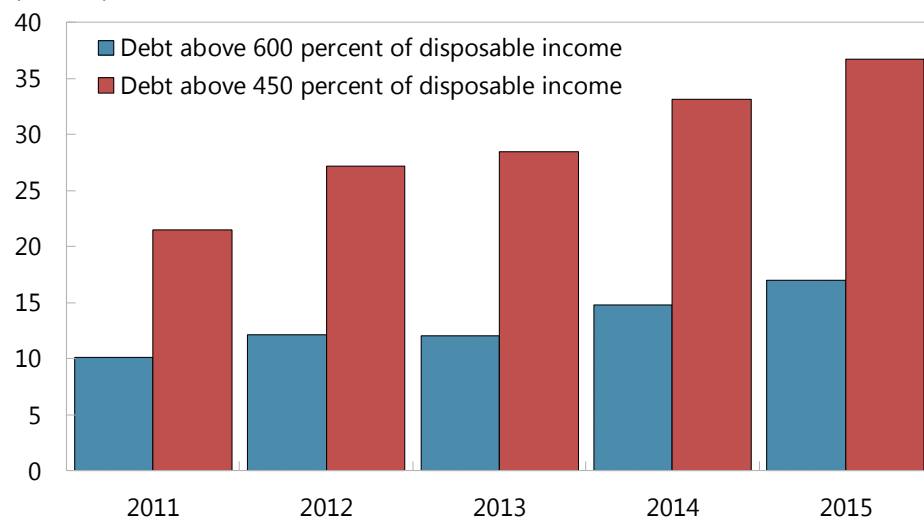
(Percent)



Source: Riskbank.

### Share of Highly-Indebted New Mortgage Borrowers 1/

(Percent)



Sources: Finansinspektionen and Fund staff calculations.

Note: The figure shows debt-to-income ratios based on households' total debt and net disposable income.



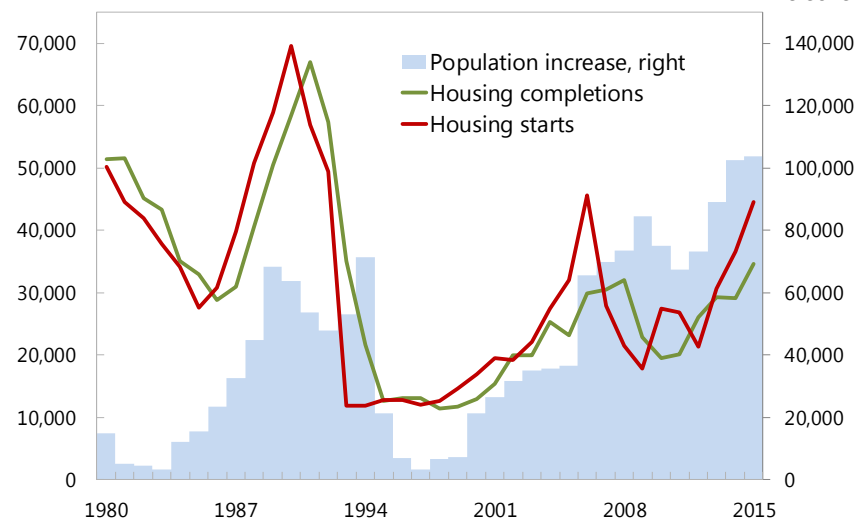
# Reform of Dysfunctional Housing Market is Key to Moderate Price & Debt Uptrend

Housing completions still lag population growth despite recent pick-up

## Increase in supply needs to be sustained:

- **Land supply:** improve land sales and planning procedures
- **Rent controls:** phase out while protecting vulnerable
- **Incentives:** increase budgetary support for building affordable rental housing

Housing Completions, Starts, and Change in Population (Housing units)



Sources: Statistics Sweden and Fund staff calculations.

## Tax reform to reduce demand for debt-financed housing:

- **Property tax:** raise ceilings
- **Deductibility:** phase out tax deductibility of interest payments



# Reinforce Macroprudential Toolkit with Timely Debt-to-Income Limit

## Debt-to-income (DTI) limit would:

- **Protect household resilience** to interest rates and income falls (at 600% DTI, disposable income falls 6% for 1% hike!)
- **Build larger buffers when house prices rise faster** than income by reducing LTVs on high DTI loans
- Impact on growth is found to be small (FI and Riksbank)

## Implementation:

- **Flexibility:** could allow a minority of borrowers to exceed the limit, as in UK (up to 15%) and Ireland (up to 20%)
- **Timing:** Reasonable to assess impact of amortization. Yet conditions for a renewed rise in house prices and debt remain, which urges timely action to lean against risk.



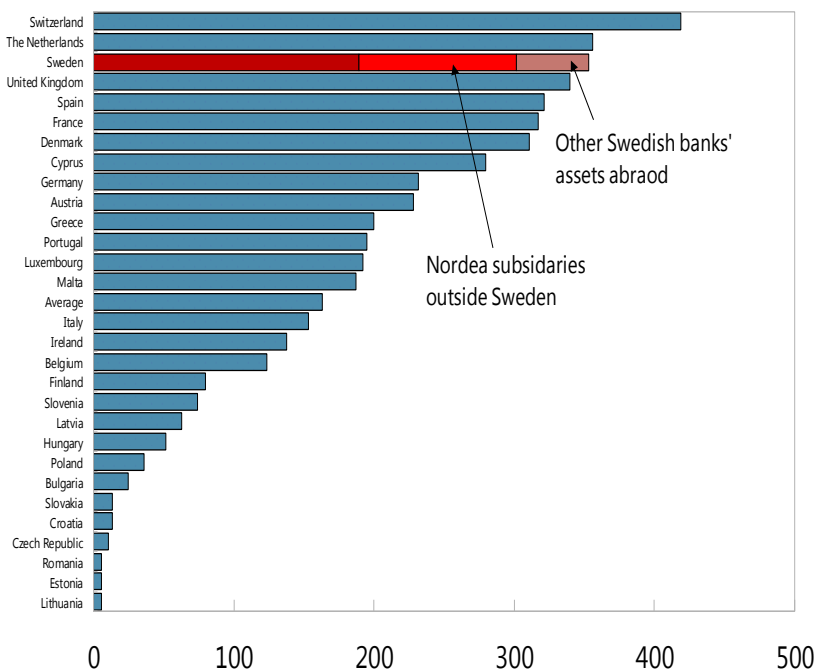
# IV. Preserving the Resilience of Sweden's Financial System

Swedish banks are large and are systemic for the Nordic-Baltic Region

Banks have high reliance on wholesale funding, including in foreign currency

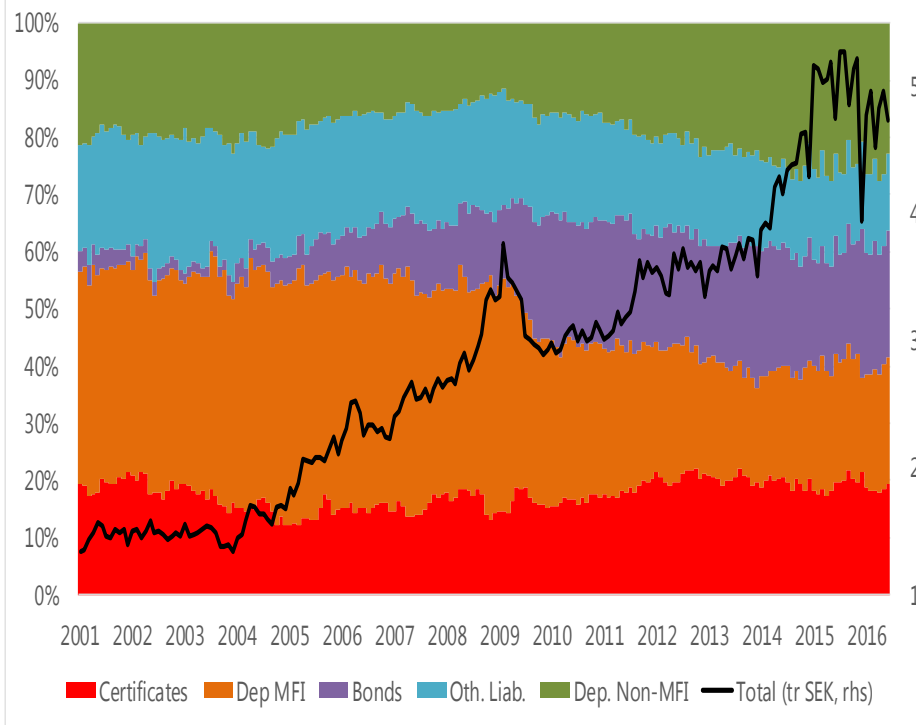
## Bank Assets

(December 2014, Percent of GDP)



Sources: Sveriges Riksbank.

## Bank Funding in Foreign Currency





# Elements of the Financial System Stability Assessment

## I. Vulnerabilities and resilience

**Structure and soundness of the financial system**

**Trends in financial and nonfinancial sectors**

**Stress testing**

- Banking
- Insurance
- Other

## II. Financial stability policy framework

**Financial sector supervision**

- Banking
- Insurance
- Market infrastructures
- Securities

**Macroprudential policy**

**Broader policy coordination**

## III. Crisis readiness, management & resolution

**Crisis preparedness, crisis management, resolution**

**Financial safety nets (deposit insurance, LOLR)**

**Systemic liquidity management**

**Spillovers from financial sector to sovereign**



# Fix the Legal Framework for Macroprudential Policies

**“Give FI a clear legal mandate for macroprudential policy, ensuring that FI has the tools to address systemic risks in a timely and effective manner” (FSSA Recommendation)**

## **Welcome progress:**

- Political agreement in late October to expand the ability of FI to take macroprudential measures.
- *Important that Government approval process enables FI to take timely and effective action.*

**Make Financial Stability Council more effective:** Forthcoming review should aim to utilize FSC to support FI’s fulfillment of its macroprudential mandate, including by expanding joint work.



# Clarify the Riksbank's Role in Financial Stability

**Riksbank Law review should put its financial stability role on firm footing:**

- ***Liquidity support***: authority for financial stability purposes
- ***Systemic financial risks***: specific role in identifying, monitoring, analyzing, and reporting on these risks



# Enhance Supervisory Intensity and FI Resources

**FI supervises some of largest banks in Nordic-Baltic region,** and global expectations for oversight continue to increase

**Less than 100 staff to supervise 124 institutions.** Result is:

- limited analytical capability,
- too few examinations, and
- over-reliance on a small number of key people

Welcome increase in FI resources from the Budget for 2017

**Need to review FI resources again next year,** especially with potential added needs from Nordea “branchification”



# Stress Tests Show Bank Resilience But Leverage Ratio Useful Backstop

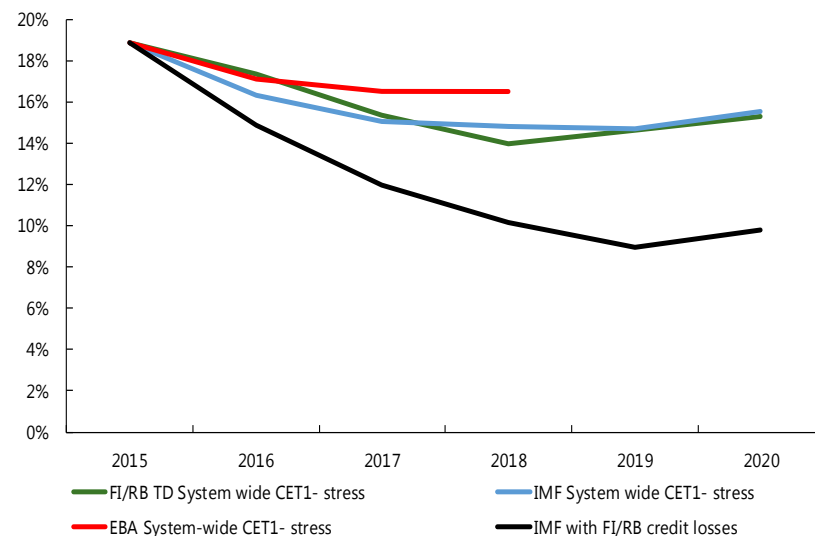
## System resilient to severe economic distress:

- Global slump, 6% rise in unemployment, 30% house price fall
- Higher provisions for credit losses, primarily corporate
- Lower net income from higher funding costs
- But no banks fall below regulatory threshold for capital ratio

- Results vary widely given difficulty of modeling tail risk!

- **Leverage ratio:** backstop that could safeguard against model/measurement risks

Common equity Tier I ratio, stress scenario, IMF top down and banks' bottom up, FI/RB top down





# Bank's Foreign Currency (FX) Liquidity and Foreign Reserves

Banks improve FX liquidity since the crisis (LCR in \$ and €)

**But substantial FX liquidity support from Riksbank could still be needed in a crisis**, though sensitive to assumptions:

- Prudent scenario: 8½ - 9½ % of GDP (US\$ 42-47 bn)
- Alternative scenario: 5-6 % of GDP (US\$ 25-30 bn)

**Evaluate further tightening of FX liquidity requirements:**

- Monitor 3-month LCR in US\$ and euro
- Raise share of banks' FX assets that are tradable in crisis

Reducing FX reserves (11% of GDP, US\$54 bn) not currently appropriate, need a buffer as raising FX liquidity takes time



# Regional Coordination Needed in Supervision, Liquidity, Resolution

## **Sweden central to interconnected Nordic-Baltic financial system:**

- Hosts 4 of the largest banks, with assets of 120% of regional GDP
- Nordea is a top-3 bank in Denmark, Finland, and Sweden
- Large share of total bank assets in Estonia, Latvia, and Lithuania

**Enhance regional cooperation on financial stability**, building on the Nordic-Baltic Macroprudential Forum established in 2011

## **Cooperative agreements among regional authorities are needed:**

- *Supervision*: sharing information including on-site inspections
- *Liquidity*: coordinate support to preserve market confidence
- *Resolution*: ensure financial stability in all countries is protected



**INTERNATIONAL MONETARY FUND**



**THANK YOU!**