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Memorandum

DATE: 30 November 2012
DEPARTMENT: Financial Stability Department

■ Strengthening of the foreign currency reserve

Proposed decision

- The foreign currency reserve is to be increased by the equivalent of SEK 100 billion in foreign currency.
- The Governor of the Riksbank or a person appointed by him will have the task of making a request to the Swedish National Debt Office under the terms of the existing contract with an application to borrow the above amount on behalf of the Riksbank.

Considerations regarding the Riksbank's possibilities to offer emergency liquidity assistance are fundamental to ensure that the financial system functions satisfactorily, which in turn is a necessary condition to be able to conduct monetary policy and for the economy as a whole to function properly. One important reason why the Riksbank may need to grant emergency liquidity assistance in foreign currencies is the Swedish banks' use of funding in foreign currencies. The Riksbank therefore needs to hold foreign currencies to be able to replace such funding in the event of a crisis.

At present the Swedish financial system is stable. The major Swedish banks are well capitalised in an international comparison and have only minor exposures to the euro area countries with sovereign debt problems. The banks' earnings capacity is good and their loan losses are small. These factors have contributed to boosting market confidence and to the banks thus having good access to wholesale funding. However, the Riksbank has noted earlier that there are increased risks linked to developments abroad.¹ There is still a possibility that negative developments abroad could subject the Swedish financial system to stress. The role of the Riksbank in this type of situation is, if necessary, to provide emergency liquidity assistance in both Swedish and foreign currencies.

The Riksbank's need for foreign currency may also be affected for other reasons. On 22 November 2012 the Riksdag (the Swedish parliament) gave its consent to the Riksbank signing an agreement on credit to the International Monetary Fund (IMF) for SDR 6.7 billion. This corresponds to around USD 10 billion, or around SEK 70 billion,

¹ See *Financial Stability Report 2012:2*, Sveriges Riksbank and *Monetary Policy Report, October 2012*, Sveriges Riksbank.

■ in addition to the remaining commitment from earlier of around SEK 105 billion.² Under the assumption that these commitments mean that part of the foreign exchange reserve is earmarked, the Riksbank's possibility to provide liquidity assistance in foreign currency in a crisis situation would be limited.³

The serious situation abroad and the Swedish bank's extensive funding in foreign currencies entail a greater risk of shocks to the financial system. Given the experiences from the financial crisis 2008-2009 with regard to the banks' need for liquidity assistance in foreign currencies during that period, there is a possibility that the Riksbank's foreign exchange reserve is not sufficient for the Riksbank to be able to safeguard financial stability and meet Sweden's international commitments.⁴ The Riksbank therefore assesses that the foreign exchange reserve should be reinforced by the equivalent of SEK 100 billion, see further Annex A. This should be attained by borrowing the requisite funds through the agreement signed by the Riksbank and the Swedish National Debt Office on borrowing currency to reinforce the foreign exchange reserve. As Sweden currently enjoys a high level of international confidence because of its stable financial system and strong public finances, the loans should be made now.

The reinforcement of the foreign exchange reserve is temporary and should be wound up when considered appropriate with reference to international developments and the size of the commitments to the IMF.

² The size of the commitments varies, depending on the exchange rate.

³ On 31 July 2012, the market value of the foreign exchange reserve was SEK 270 billion, almost SEK 90 billion of which has been borrowed via the Swedish National Debt Office since the year 2009. The gold and foreign currency reserve amounted to a total of SEK 314 billion.

⁴ During the period 2008-2009 the total lending in foreign currencies supplied or guaranteed by the Swedish authorities amounted at most to a good SEK 450 billion. The Riksbank's lending to the banks in USD amounted to the equivalent of SEK 240 billion at its peak. In addition, the Riksbank entered into swap agreements with the central banks in Iceland, Estonia and Latvia.