SPEECH

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Financial stability is important for us all

Today, I would like to give you a few examples from Sweden and abroad to illustrate why financial stability affects us all, not least in our role as consumers. It can easily happen that discussions of bank regulations, not least at the EU level, can be considered difficult to understand. This is partly because the discussions are often technical, and partly because they can seem abstract. I would like to demonstrate how the political framework for financial stability very strongly affects Swedish banking customers – in other words, almost all households.

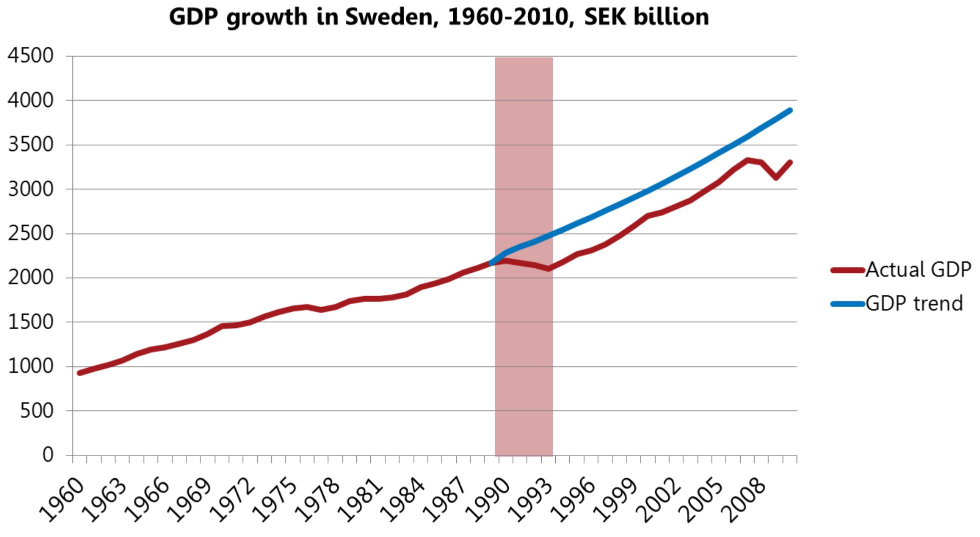
Crises cost society enormous amounts

As financial crises are very costly for the citizens of a society, we should try to avoid them at almost any price.

The financial system forms the cornerstone of a modern economy. Its basic functions are converting savings to investments, managing risks and mediating payments, functions that we all constantly come into contact with every day, in one way or another. A functioning financial system is also necessary for the repo rate, which is to say monetary policy, to have an impact. A modern society cannot do without the functions of the financial system. Without the financial sector, Sweden would grind to a halt. But the system also entails risks. Banks are dependent on confidence, are highly leveraged and are thus vulnerable. Problems in the financial sector are contagious.

Precisely because we need the financial system so much, reducing the risk of financial crises must be an important priority. Financial crises cause great damage to society. In addition, we know that financial crises have permanent effects on growth. It takes a long time to recover from the major fall in GDP following on from a deep financial crisis. Normally, we see a downwards shift in GDP level even if good times *may* then mean a return to the same *rate* of growth.

The modern Swedish example of a financial crisis was a frightening experience for many of us. The social costs of the crisis at the start of the 1990s can be illustrated in several ways. One way would be to compare actual growth with the trend development. The difference in Sweden's GDP towards the end of the 1990s corresponds to 20 per cent of GDP each year, or SEK 50 000 per person in 1998 prices. The financial crisis of a few years ago, which was milder for Sweden, has cost the people of Sweden thousands of kronor more per year.



Source: The Riksbank

The real effects have a high social and economic price

One of the more tangible effects of the crisis of the 1990s was its impact on the labour market. Having gotten used to a level of unemployment of a few per cent, we then saw unemployment increase to double figures over only a couple of years. Overheating at the end of the 1980s and the resulting financial crisis almost doubled long-term unemployment.

And, of course, shocks to the national economy of this kind do not spare us citizens in our role as taxpayers either.

Problems in the banking sector impact the country's citizens in several ways

A banking crisis thus impacts individual citizens in several ways.

Lower or even negative growth leads us, *as employees*, to run an increased risk of unemployment and to earn lower wages than would otherwise have been the case. When the growth path falls over the longer term, we also have to count on lower pensions.

Bank crises also risk being costly to us *in our role as taxpayers*. If the government is forced to compensate those who have put money into a bank, or even take over and capitalise a bank on the ropes, there will be less funding left for other purposes. Taxes will be higher or public welfare lower – or both.

As *almost all citizens are also bank customers*, they are also impacted more directly. A crisis in the Swedish banking system would lead to higher funding costs for the banks and thus higher lending rates. Customers in a bank needing to be restructured may also need to change bank and negotiate conditions under circumstances that would probably not be particularly favourable.

All of this risks leading to major difficulties for households. And this is something that we saw all too many examples of at the start of the 1990s.

Financial crises ultimately threaten fundamentally important social functions

An even more serious financial crisis could even threaten fundamentally more important social functions. Households are dependent on the banks' ability to manage payments so that they can receive wages, purchase food and so on. In turn, our banks are dependent on the financial market as a whole.

If a serious crisis should break out – if the payment systems should stop working, if the banks should stop trusting each other or if the banks should cancel payments – there would be problems for a great many of us. As a conjectural experiment, we could ask ourselves how many Swedish households would be able to cope with a week or two in which neither charge cards nor ATMs functioned. Thankfully, we haven't had to worry about such problems in Sweden.

The financial crisis of 2007–2009 impacted borrowers in other countries hard

A meltdown in the global financial economy was averted in 2008 and 2009 at a price we are still unable to calculate. Even if the total cost has yet to be calculated, we can still note that the consequences of the financial crisis are clear if we take one of its fundamental causes, the US housing crisis, as an example. In the autumn of 2011, 22 per cent of all US mortgage holders still owed more than the value of their property. This is almost 11 million homeowners.[1]

One of the factors behind the development of the US housing market was irresponsible lending to households with weak debt-servicing ability. We have also seen examples of this in Europe.

Problems in the housing sector could have severe consequences for households

We don't want to have to go through a similar development in Sweden. Our experiences of the crisis of the 1990s are more than enough. And we didn't emerge unscathed from the crisis of 2008 either. Nobody wants a new financial crisis.

At the moment, the greatest risks to financial stability in Sweden are the financial unease in the euro area and the resulting unease on the financial markets. However, our assessment is that the Swedish banks are also well-prepared for weaker development than in our main scenario.

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[1] Modestino & Dennett (2012)

I would also like to touch on a domestic risk that is frequently mentioned – Swedish households' high levels of indebtedness and the risk of a fall in housing prices. Firstly, I would like to say that we don't see any acute threat in this regard. We are not facing any dramatic falling housing prices. In addition, our assessment is that the Swedish banks can also cope with fairly large falls in the market value of housing.

Nonetheless, we at the Riksbank have long warned that the high level of indebtedness may make the Swedish economy vulnerable. If the economy should develop adversely, households may be forced to cut back on their consumption. When a home falls greatly in price, the household becomes unable to move without realising major losses. Individual households can then find themselves in particularly dire straits.

A couple of days ago, Finansinspektionen presented a report on housing loans in Sweden.[2] Encouragingly, this report showed that the mortgage ceiling introduced in 2010 may have dampened indebtedness and risk. At the same time, it can be noted, for example, that over half of new loans approved have no amortisation requirements whatsoever. Of the remaining loans, almost half must be amortised over a period of 50 years or longer. A large percentage of the loans being issued at present will remain for a long time. To a certain extent, these entail risks that the banks will also have to manage in several decades' time.

The higher capital adequacy demanded by the Ministry of Finance, Finansinspektionen and the Riksbank for the major Swedish banks should be seen in light of this. The banks need to lend a little more of their own money and slightly less of other people's. This would mean that they would be able to bear losses more easily and would reduce the risk of future costs for all of us, as citizens.

The European Commission is concerned about developments in Sweden

The European Commission is also concerned about the high debts accumulating among Swedish households. In a recent report, the Commission identified a number of risks to the financial stability of various EU countries, including Sweden.[3]

In this sense, the European Commission's analysis does not depart radically from our own. As I have already said, there are good reasons to try to prevent problems and to curb excessive risk-taking as regards housing loans. This is why we in Sweden have argued that Sweden must have the possibility of placing higher requirements on the Swedish banks – particularly the major banks.

As you are aware, the EU countries are currently negotiating new capital adequacy regulations for the EU. The Riksbank's opinion is that the EU should establish minimum requirements, but that individual countries, such as Sweden, for example, should be able to go further – just to reduce the risk of financial crises at a national level. I know that the Ministry of Finance and

[2] Finansinspektionen (2012).
[3] European Commission (2012)

Finansinspektionen agree, as do several other countries and, for example, the European Systemic Risk Board.

The Riksbank has an important role to play in the prevention of financial crises

The Riksbank's task of preventing new crises is connected to our responsibility for the country's means of payment. Only the Riksbank can provide unlimited liquidity to the Swedish banks in a crisis situation. During the crisis of 2008 and 2009, the banks could also borrow as much as they needed from the Riksbank.

The Riksbank monitors the financial sector with a systemic perspective. If we hadn't realised it before, one clear lesson from the crisis of 2008–2009 was that monitoring individual institutions is not enough. We and other authorities around the world learnt that we have to keep our eyes on the connections between the banks and how they are affected, as a whole, by developments on the markets. Among other means, the Riksbank influences financial market participants through the analyses we make and the recommendations we issue in the Financial Stability Reports.

Another important role for the Riksbank is being the country's representative in several forums that set the standards for the financial sector, primarily the Basel Committee on Banking Supervision, the European Systemic Risk Board (ESRB) and the Committee on Payment and Settlement Systems (CPSS).

At the same time, it is worth pointing out that, at present, the Riksbank does not have any sharper tools than words in the preventive work or macro-prudential supervision. We can warn and recommend, but when it comes to real measures, other authorities currently hold responsibility. It is a difficult task. Always raising a warning when everything seems to be going well seldom makes you popular.

Financial stability policy is of great importance for Swedish households

Preventing future crises is an important task – as is being able to manage them if they break out anyway.

I hope that this speech has clarified why Swedish households are dependent on financial stability. Firstly, households and the economy as a whole need functioning financial services. Secondly, all experience shows that the consequences of a financial crisis are very costly for households, employees, taxpayers and bank customers.

As citizens of a modern society, we thus have a right to expect that the authorities will do their best to prevent and manage financial crises. In turn, the authorities need tools and a clear responsibility structure to prevent crises, as far as is possible. It is equally important that there be efficient tools to manage crises if they break out anyway.

Sweden cannot afford to go through another crisis like that in the 1990s. Neither can the world afford a new 2008. This is why it is so important that we constantly strive to ensure that new financial crises do not break out. This is in the interests of every citizen.

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