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CONTACT: Tomas Lundberg, Press Officer, tel. +46-8-787 02 15

SVERIGES RIKSBANK
SE-103 37 Stockholm
(Brunkebergstorg 11)

Tel +46 8 787 00 00
Fax +46 8 21 05 31
registratorn@riksbank.se
www.riksbank.se

■ The economic situation and the property market

Deputy Governor Lars Nyberg today spoke at the Association of Electricity Suppliers about the economic situation and the property market.

”The recovery in the world economy is becoming increasingly evident and the uncertainty surrounding the upswing is diminishing. In the US and the rest of the world, economic activity is developing largely in line with or somewhat stronger than the assessment in the April Inflation Report. In the financial markets, rising long yields are indicating an economic upswing. The factors behind this include increased confidence in the US economic situation and increasingly clear signals from the Federal Reserve that it will raise its key interest rate. In the euro area, however, some uncertainty remains about the strength of the recovery, while the revival in Sweden is proceeding largely as expected. Budget proposals that are judged to stimulate demand in the period ahead and the most recent repo rate cut could result in a somewhat faster recovery than assumed in the Inflation Report. Inflation in Sweden has been weak in the past year and the repo rate is at an all-time low. Resource utilisation in the Swedish economy is estimated to rise during the forecast period, thus leading to mounting inflationary pressures and a higher key interest rate in Sweden as well. Developments will indicate when the time is right for this,” began Mr Nyberg.

”In the property market it is important to distinguish between commercial property (e.g. office premises) and residential property. During the crisis at the beginning of the 1990s prices of commercial property soared, largely owing to expectations of continued price increases - a so-called bubble developed. This burst eventually and caused major losses in the bank sector. In recent years, prices of commercial property have tracked the economic cycle relatively well. The weak economic activity has contributed to dampening demand for mainly office premises, with declining office rents and thereby falling prices as a result. Since 2000, real prices have dropped by 35 per cent in Stockholm and by 21 and

11 per cent, respectively, in Gothenburg and Malmö. However, since the beginning of the year the decline in rents has diminished in all three cities and prices have stopped falling. Given a continued recovery in the Swedish economy and a cautiously positive outlook for the Swedish business sector, there is a chance that prices and rent levels for commercial property will stabilise during the year. Price rises may not materialise, however, until somewhat further into the recovery, partly due to the current surplus of office space," said Mr Nyberg.

”Today, instead, it is price developments in the housing market that are being talked about as a possible bubble. Despite the economic slowdown in recent years, prices of residential property, notably in the big cities, have shot up, rising almost 60 per cent since 1992. The trend appears set to continue, with a risk of overheating in mainly the Stockholm region where there is a significant housing shortage. Factors that most likely have driven this price inflation are a low level of interest rates, increased disposable income and a low level of housing construction coupled with high demand in the metropolitan regions in particular. Another factor is rent controls, which lead to distortions and higher housing prices. So in our view the developments in housing prices are being driven by fundamentals, and are not an expectations-driven bubble. The impending economic upswing, a continued high level of housing demand in metropolitan regions and access to cheap borrowing means that the risk of a fall in prices in the housing market appears limited," concluded Mr Nyberg.

”Low interest rates have meant that households' debt in relation to income is approaching the levels seen before the crisis at the beginning of the 1990s. The average lending rate available to households today enables them to borrow twice as much as at the beginning of the 1990s at a lower interest cost. Households' interest costs are just less than 5 per cent of their disposable income, which is an historically low level and half of that seen at the beginning of the 1990s. Moreover the rapid build-up of debt appears to have been used largely to finance various assets, mainly housing. Even if households are capable of bearing the interest burden, there are fears that rising interest rates could affect the household sector's ability to pay," said Mr Nyberg.

”However, the interest costs for the loans constitute a relatively small fraction of the total household sector's disposable income. Furthermore it appears that households in general have margins to meet an increase in costs. Therefore I see no reason for concern over the household sector as a whole and neither for the banks nor the financial system. Households are not in a position to cause the banks such losses that would threaten financial stability. A more in-depth analysis of this shall be published in the Riksbank's Financial Stability Report at the beginning of June. Individual households, however, could encounter problems once interest rates rise again, especially if they have not fully considered the effects of this on their monthly budget. This could force households to cut back their consumption more than planned when the rate increase comes. But this also depends, of course, on developments in income and wealth," concluded Mr Nyberg.