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■ Households increasing their debts and house prices continuing to rise

"Developments since the spring indicate that households are continuing to increase their debts at a rapid rate. The most recent Statistics Sweden Real Estate Price Index for July also indicates that house prices are continuing to rise. There must reasonably be a limit somewhere to how long this trend can continue." These comments were made by Deputy Governor Lars Nyberg at a conference organised by Lantmäteriet today.

"The fact that house prices have risen over a long period of time can be largely explained by traditional supply and demand factors. The supply of new housing has been low for many years, while demand has increased as household incomes have improved, and there has been a tendency to move to metropolitan areas. However, supply and demand can change. At the moment, a substantial amount of housing is being built in metropolitan areas and the supply will grow gradually as these building projects are completed. Demand usually follows the economic cycle. At present, the Swedish economy is strong, but when economic activity gradually slows down, it is reasonable to assume that demand for housing will also slow down," observed Mr Nyberg.

"Of course, low interest rates have also contributed to holding up demand for loans and housing. Moreover, competition in the mortgage market has increased, which has reduced the margins the mortgage institutions can take out on their borrowing, but has also made them accept a higher degree of mortgage loans and longer periods of repayment. One factor behind this development is probably that mortgages will become more profitable for the banks and their mortgage institutions with the new capital adequacy rules (Basel II)" continued Mr Nyberg.

"These supply and demand factors are usually sufficient to explain price and debt trends in Sweden. The speculative elements in the housing market are probably marginal. One reason for this is that Swedish households, unlike households in a number of other countries, are buying housing to live in and not merely to make a profit. It is not common to buy an apartment or house merely to be able to sell it a few years later for capital gain. Prices are therefore not being forced up in the same way as in a financial bubble like the one we saw in the equity market not so long ago," considered Mr Nyberg.

However, Mr Nyberg did point out that this in no way rules out the possibility of future price falls. "Demand can decline and supply can increase as a natural part of the economic cycle, just as I described earlier. It is probably immaterial to households whether we economists choose to call it a bubble or not if prices were to fall. Significant price falls are quite possible, even without a bubble, which households should bear in mind when calculating their finances. However, prices are not likely to fall as far and as quickly as if developments were mainly due to speculation."

"We have recently seen new products in the mortgage market, which have made it possible for new categories of household to borrow. One example is the "mortgage pension" – form of loan that enables older people to benefit from the increase in the value of their housing by taking out a mortgage on it. Another example is sub-prime lending – loans which are usually granted without, for instance, the requirement of a regular income, but in turn tend to be slightly more expensive," said Mr Nyberg.

"This type of loan has long been available in other countries. It is essentially a good thing for consumers that competition in the market is increasing and it is not wrong for borrowers who comprise a higher risk to the lender to pay a higher interest rate. Of course, this assumes that the interest rate constitutes reasonable compensation for the increased risk. As always where new and unfamiliar products are concerned, it is important that they are sold with prudence and that the customers are aware of how they work. Here both the banks and the new companies cropping up in the market bear considerable responsibility."

"There may also be reason to ask at regular intervals the question of what type of competition is desirable and what the changes that have occurred entail. So far, the increased competition and the new products have mostly concerned increasing credit volumes, but I would like to see more innovations aimed at helping households manage the risks that arise. This would benefit all those involved," maintained Mr Nyberg.

"The Riksbank closely follows developments in both house prices and household indebtedness. This is not because we fear a crisis in the financial system. On the whole, households can afford their mortgages and Swedish banks are adequately capitalised. However, experiences show that individual households may take on larger debts than they can manage in the longer term, and there is reason to warn people of this. Moreover, house price developments affect households' decisions with regard to saving and consumption, which in turn affect production and employment in Sweden. It is therefore obvious that these issues are of central importance in discussions on monetary policy," concluded Mr Nyberg.