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■ Nyberg: Economic activity and the property market

In several countries increases in house prices have slackened recently and in some countries prices are even falling. The same applies to commercial property prices. Prices in Sweden have not yet slackened to the same extent as in some other countries. But a slowdown in international economic activity and higher financing costs as a result of the financial crisis could also have effects on the Swedish property market. These are some of the points made by Deputy Governor Lars Nyberg, speaking today at a property seminar in Karlstad. He also discusses the background to the decision to raise the repo rate to 4.25 per cent at the most recent monetary policy meeting.

"As in Sweden, international house prices have risen substantially, with a few exceptions, over the past ten years. However, in some countries prices are now increasing at a slower rate than before. This applies for instance to Denmark, France, the United Kingdom and Spain. In the United States and Ireland property prices are falling."

"Houses are not goods subject to cross-border trading. But changes abroad can nevertheless affect the Swedish housing market. When international economic activity declines, demand for Swedish goods falls and gradually also Swedish households' willingness and ability to pay for new or better housing. The Swedish mortgage institutions are dependent on being able to borrow on the international capital market. Interest rates on this market have risen as a result of the financial crisis. Higher interest rates contribute to reducing the demand for housing and to subduing the rate of price increase."

"Up to last autumn pricing in the covered bonds market in Europe was clearly homogeneous. But since September significant price differences have arisen, depending on who is issuing the bond. The domestic market has functioned well for Swedish mortgage institutions. Since the beginning of the year they have once again begun issuing on the international market, although the interest rates have been higher than before. Credit institutions in other European countries have fared much worse. Bonds issued in the United Kingdom and Spain have in many cases met with suspicion in the market, which has been reflected in higher interest demands from investors. "



■ "Commercial property prices have risen in many countries in recent years. However, in some of these, including Ireland, the United Kingdom and Sweden, rents have not increased to the same extent. The fact that prices have nevertheless risen implies that investors have been demanding less payment for the risk they take. Consequently, risk premiums have declined. But as a result of the financial market turmoil, investors have now reassessed their view of risk and are again demanding higher compensation. All other things being equal, this entails downward pressure on commercial property prices. This is most evident in the United Kingdom, where prices were more than ten per cent lower in January compared with the same time last year."

"Rising risk premiums also have a negative effect on prices in the Swedish market. But prospects in the rental market indicate the opposite. Employment in the services sector has increased substantially since 2006, which has meant that vacancy rates in the office market are currently low. This indicates a positive development in rents and higher prices in the future. The way economic activity in Sweden develops will also be decisive for prices in the commercial property market."

"Developments in the international financial markets have deteriorated rather than improved in recent months, and uncertainty has increased. The risk premiums required by investors to buy bank bonds have risen. And share prices for financial institutions have fallen on the whole. This is partly linked to the US economic downswing appearing to be deeper than previously expected. The downswing increases credit losses and intensifies the financial crisis. At the same time, the financial crisis reinforces the economic slowdown, as the banks are tightening their conditions for lending now that they have less capital. I don't believe we have seen the end of this yet. There are many indications that the uncertainty in the financial markets will remain for a long time."

"In Sweden we have largely been able to observe the financial crisis as onlookers. Swedish banks do not have any direct exposures to the problematic subprime market, and we have not seen the negative development in the property market that is being experienced in the United States and several European countries. Nor are we seeing the falling economic activity that forms the basis for the concern regarding the United States. On the contrary, economic activity in Sweden is still good, although we are assuming it will slow down slightly over the coming year. Cost pressures are high and inflation is above the target of 2 per cent. In addition, inflation expectations have risen, both in the short term and the long term.

"This was essentially the background when we Executive Board members met to determine the repo rate a couple of weeks ago. The monetary policy considerations were unusually difficult. At the same time as the financial crisis entails risks of much weaker developments abroad and thereby also in Sweden, domestic events implied fairly clearly that the repo rate should be raised. Personally, I considered that the risks linked to the financial crisis weighed heaviest and I therefore wanted to wait before raising the repo rate."