

DNR 2008-723-AFS



# Swedish market participants' views of risks and the functioning of the Swedish money and bond and foreign exchange markets

RISK SURVEY AUTUMN 2008

## ■ **Swedish market participants' views of risks and the functioning of the Swedish money and bond and foreign exchange markets**

*With effect from spring 2008 the Riksbank sends out a risk questionnaire once every six months to participants active in the Swedish fixed-income and foreign exchange markets. The purpose of the questionnaire is to obtain an overall picture of the view of risk among the participants. It also aims to provide an idea of the views on the functioning of the markets. The autumn risk survey shows that willingness to take risk has declined substantially. Moreover, the fixed-income market and some parts of the foreign exchange market are assessed as functioning unsatisfactorily and having poor liquidity. Half of the participants do not believe that the financial crisis has peaked yet.*

### ***Summary***

This report describes the results of the autumn risk questionnaire that was carried out between 18 September and 8 October 2008.<sup>1</sup> It was sent to 88 participants and the response frequency amounted to 86 per cent. The groups included in the survey are the Riksbank's monetary policy counterparties and other participants active in the Swedish fixed-income and foreign exchange markets.

The survey shows that participants' willingness to take risk has declined significantly over the past six months and it is expected to remain low over the coming six months. Just over one third of those asked state that their liquidity buffer has increased over the past six months, in connection with the financial crisis. A majority of those questioned expect the buffers to be unchanged or larger over the coming six months. Generally, the respondents considered that the markets were in general functioning more poorly than half a year ago and that liquidity has diminished.

A broad impression is that the fixed-income market for both government and mortgage securities has deteriorated over the past six months. The deterioration is particularly marked in the mortgage bond market. However, the view of the Swedish foreign exchange market is positive. A substantial majority of those questioned assess that the market for Swedish krona has functioned well and that the Swedish krona market holds up well in an international comparison.

Half of the participants do not believe that the financial crisis has peaked yet.

Market liquidity and the banking system's financing possibilities will be in focus on the Swedish financial markets over the coming six months.

Deep recession and deeper crisis in the Baltic countries are examples of risks to the Swedish financial markets over the coming six months that the participants mention.

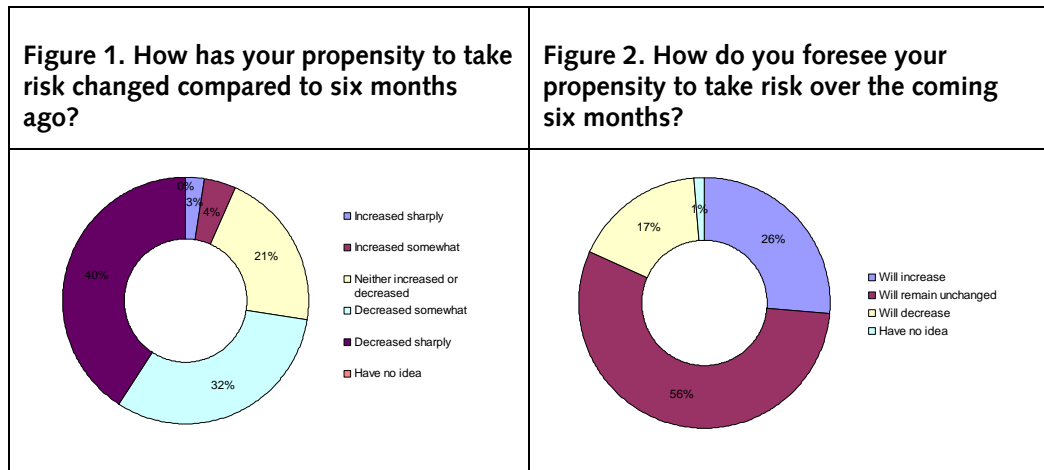
Tighter regulation of the financial sector and permanently higher risk premiums are mentioned as long-term effects of the financial crisis.

### ***Risks in the Swedish money and bond and foreign exchange markets***

The participants' willingness to take risks has declined substantially since the previous risk survey was carried out in April 2008. As many as 72 per cent of the responding

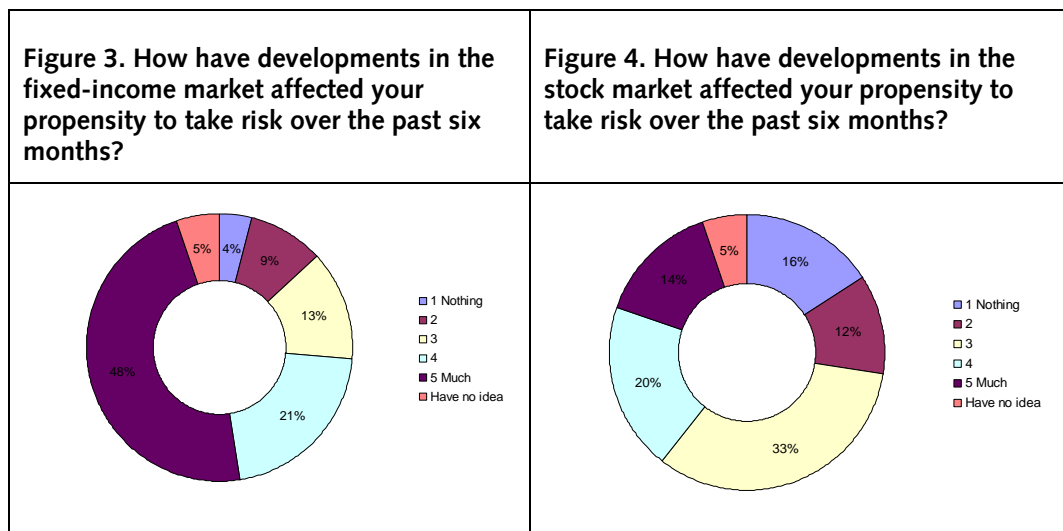
<sup>1</sup> The Risk survey is a follow-up to the spring risk survey that was carried out between 10 and 25 April 2008. The Riksbank commissioned survey company Markör to send out the questionnaires on its behalf.

participants in the Swedish fixed-income and foreign exchange markets state that their willingness to take risk has declined substantially or slightly compared with six months ago (see Figure 1). The pattern is largely the same regardless of whether the respondents are participants in the fixed-income or foreign exchange markets, but with the difference that the Riksbank's primary monetary policy counterparties state to a greater degree that their willingness to take risk has declined slightly rather than declined substantially. The decline in the willingness to take risk will remain, according to the survey. The majority of the respondents, 73 per cent, state that their reduced willingness to take risks will remain the same or decline further over the coming six months (see Figure 2).

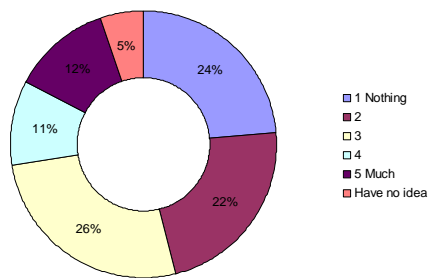


The respondents were asked to what extent developments in the stock market, fixed-income market and foreign exchange market respectively had affected their willingness to take risk. Developments in the fixed-income market were stated as having the strongest effect, followed by developments in the stock market. Developments in the foreign exchange market were considered to have had the least effect (see Figures 3, 4 and 5).

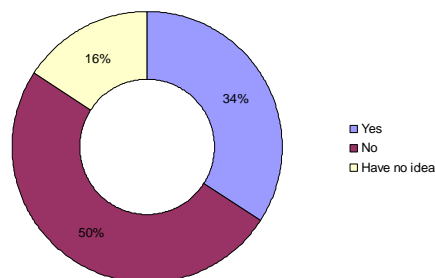
There is great uncertainty with regard to what phase the financial crisis is in. Half of the participants do not believe that the financial crisis has peaked yet. However, a relatively large percentage, 16 per cent, stated that they did not know what phase the financial crisis was in (see Figure 6).



**Figure 5. How have developments in the foreign exchange market affected your propensity to take risk over the past six months?**

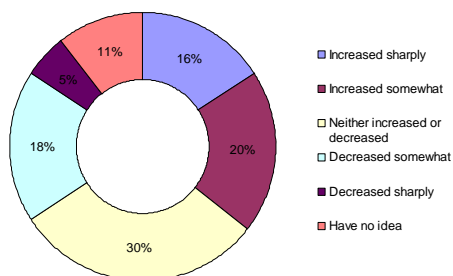


**Figure 6. Do you consider that the financial crisis has peaked?**

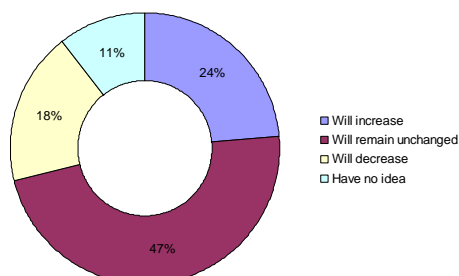


When there is great uncertainty in the financial markets, the need for liquidity buffers often increases. This picture is confirmed by the questionnaire responses, which show that the buffers of liquid assets have increased somewhat compared to six months ago (see Figure 7). Just over one third, 36 per cent, state that their liquidity buffer has increased. A further almost one third, 30 per cent, states that it has remained unchanged. A large majority of the respondents, 71 per cent, are expecting their liquidity buffers to continue to remain larger than normal over the coming period. Out of these, almost one third state that the liquidity buffer will increase over the coming six months, and the remaining two thirds state that it will remain unchanged (see Figure 8).

**Figure 7. How has your institution's buffer of liquid assets changed in relation to six months ago?**



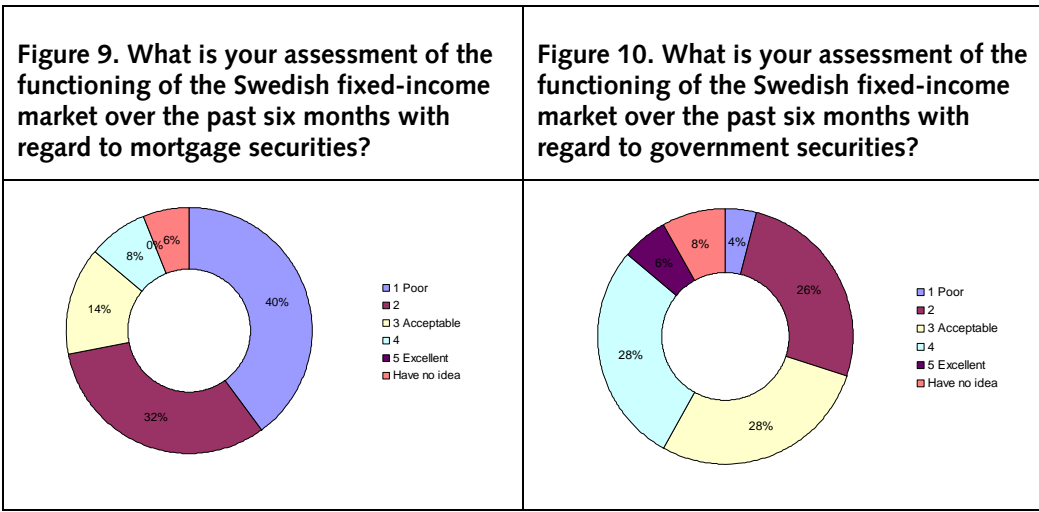
**Figure 8. How do you think your institution's buffer of liquid assets will change in the coming six months?**



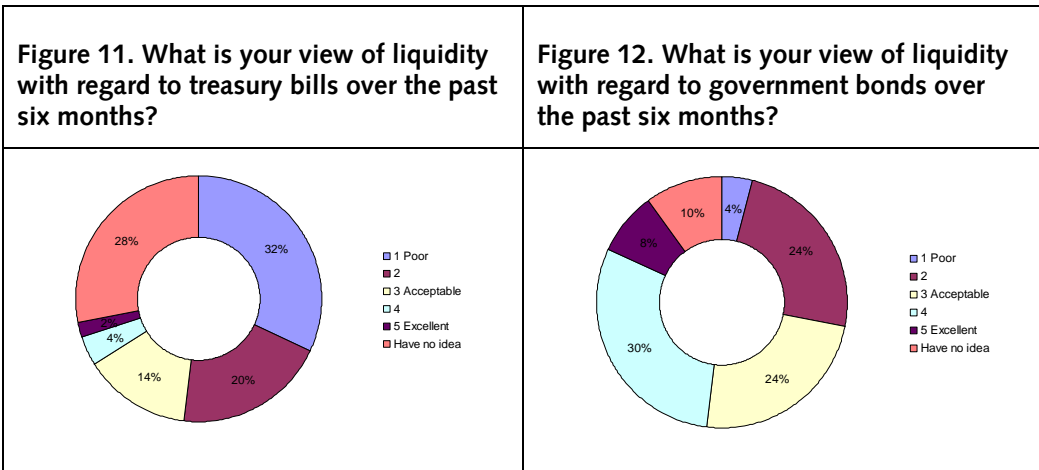
### ***The functioning and liquidity of the Swedish money and bond market<sup>2</sup>***

A broad impression is that the fixed-income market for both government and mortgage securities has deteriorated over the past six months. The deterioration in the market for mortgage securities is particularly marked, with almost three out of four participants saying it has functioned poorly (see Figure 9). Less than one third of those asked consider that the market for government securities has functioned poorly (see Figure 10). This is a substantial difference compared with the previous risk survey carried out in spring 2008. Then, 93 per cent of those asked considered that the fixed-income market for government securities was functioning well, while 86 per cent considered that the market for mortgage securities was functioning well.

<sup>2</sup> Only participants active either solely in the Swedish fixed income market, or active in both the fixed-income market and the foreign exchange market, have responded to this part of the survey. This means that 50 participants have answered the questions in this part of the survey. Of these, 34 were active only in the fixed-income market and 7 were the Riksbank's primary counterparties.

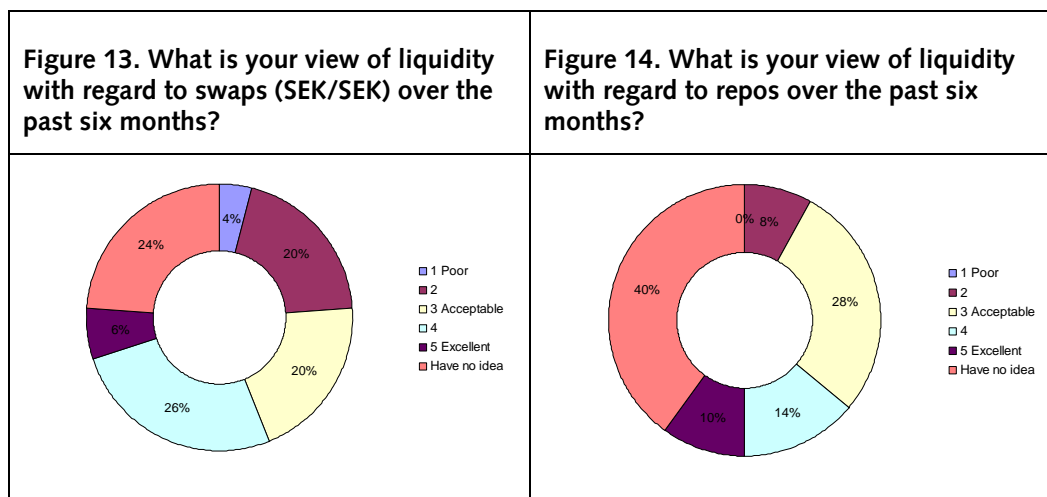


The deterioration in the functioning of the fixed-income market is also reflected in the participants' views of liquidity in the trade in various credit instruments. Only 20 per cent consider that the liquidity in treasury bills has been satisfactory over the past six months (see Figure 11). This is a substantial deterioration compared with the previous survey, where 75 per cent considered that liquidity in this part of the fixed-income market was good in 2007. Similarly, the liquidity for government bonds has deteriorated over the past six months. Only 62 per cent of the participants consider that liquidity has been satisfactory (see Figure 12). In the previous survey, 95 per cent considered liquidity to be good in 2007.



With regard to trade in mortgage securities, the survey responses indicate that developments have been even worse. This applies to both mortgage certificates and mortgage bonds. Only 14 per cent and 16 per cent of participants respectively consider that the liquidity in trade in mortgage certificates and mortgage bonds has been satisfactory over the past six months. This can be compared with 64 per cent of the participants considering liquidity to be acceptable or better for mortgage certificates in 2007 in the previous risk survey. The corresponding figure was 80 per cent for the mortgage bond market.

The view of how the market for fixed-income swaps and repos functions is slightly unclear, in that a relatively large share of the participants state that they do not know how the liquidity is in these parts of the credit market. For fixed-income swaps this share is 24 per cent and for repos it is 40 per cent (see Figures 13 and 14). With this proviso, 52 per cent of the respondents considered that liquidity regarding both fixed-income swaps and repos was good over the past six months. In the previous survey, 84 per cent considered liquidity regarding fixed-income swaps to be good in 2007. With regard to the functioning of the repo market, 92 per cent considered liquidity to have been good in 2007.



When the participants are asked to state what has functioned well or poorly in the Swedish fixed-income market over the past six months, most state that liquidity has been poorer than normal and that the market for mortgage securities has functioned particularly poorly. The Riksbank receives both positive and negative comments. The positive include the Riksbank having acted forcefully and receiving praise for its measures during the crisis. The negative include the Riksbank not being up to date with market events, the Riksbank's communication could have been better and the Riksbank has had too low a profile.

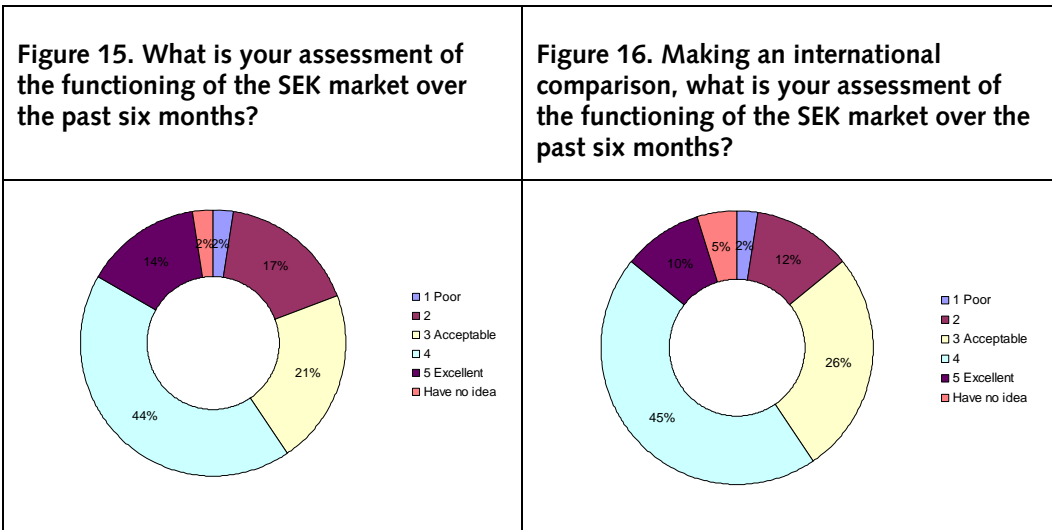
### ***Comments on instruments in individual fixed-income markets***

In response to the question whether any specific instrument would play a more important role on the Swedish fixed-income market in the future mentioned, most of the respondents expressed an opinion on Swedish government securities, both government bonds and treasury bills. Covered bonds are the second most mentioned, followed by cleared and listed derivatives.

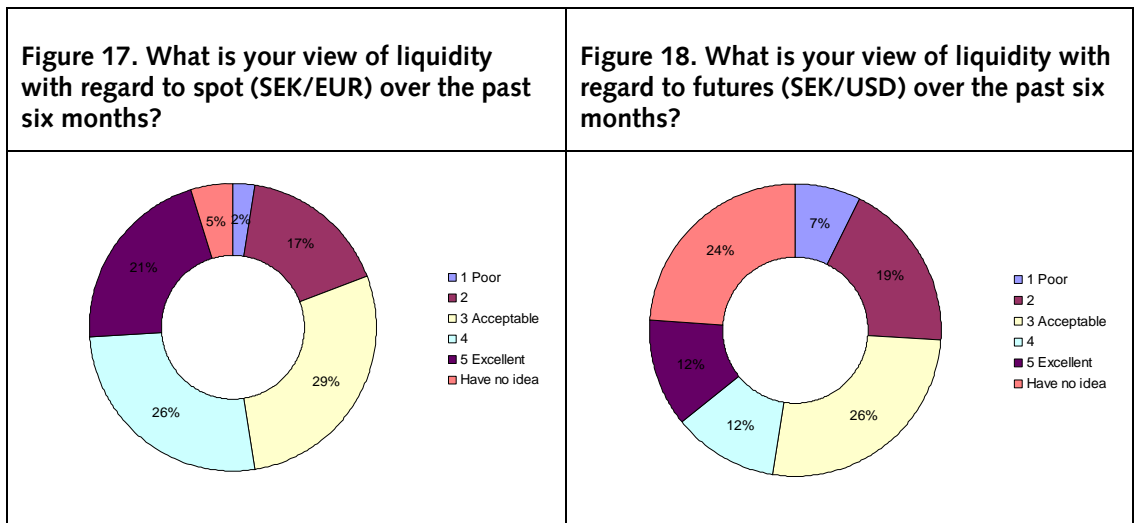
### ***The functioning and liquidity of the Swedish foreign exchange market<sup>3</sup>***

Judging by the responses, the participants have a positive picture of the Swedish foreign exchange market. A large majority of the respondents, 79 per cent, assesses that the market for Swedish krona has functioned efficiently over the past six months (see Figure 15). The Swedish krona market also fares well in an international comparison. 81 per cent of the participants state that the functioning of the Swedish krona market has been acceptable or better in an international comparison over the past six months (see Figure 16). Similarly, 76 per cent of the participants considered the liquidity of the spot market for SEK/EUR has been acceptable or better over the past six months (see Figure 17).

<sup>3</sup> A total of 42 participants responded to this part of the survey (8 of them are the Riksbank's primary counterparties). Of these, 26 were only active in the Swedish foreign exchange market, while 16 were equally active on both the Swedish foreign exchange market and the Swedish fixed-income market.

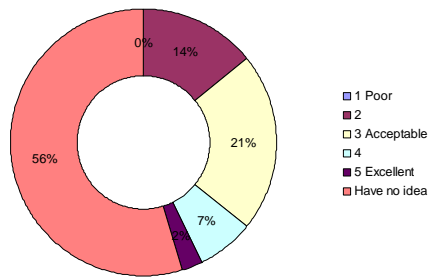


The results for other parts of the foreign exchange market are more uncertain as a result of a relatively large percentage of the respondents not expressing an opinion. Nevertheless, it can be said that half of the participants consider the liquidity in the forward market for SEK/USD to have been acceptable or better during the past six months (see Figure 18). Slightly more than half of the participants did not express an opinion regarding the liquidity in the FRA market. As few as 30 per cent of the participants consider that liquidity in this part of the foreign exchange market has been acceptable or better over the past six months (see Figure 19). The liquidity in the market for swap/STINA in SEK was considered acceptable or better by 26 per cent of the participants. However, more than half of the participants, 53 per cent, stated that they did not have any opinion on the liquidity in this part of the foreign exchange market.

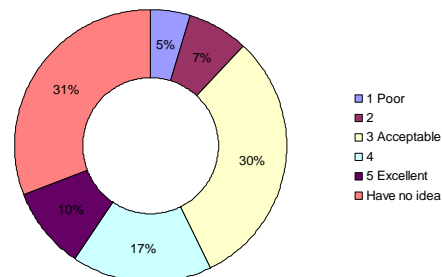


Slightly more than half of the participants, 57 per cent consider that liquidity in the market for over night lending (O/N) and from tomorrow to the next day (T/N) in SEK was acceptable or better over the past six months (see Figure 20). In this case almost one third of the participants respond that they do not have an opinion regarding the liquidity in this part of the market.

**Figure 19. What is your view of liquidity with regard to FRA (in SEK) over the past six months?**

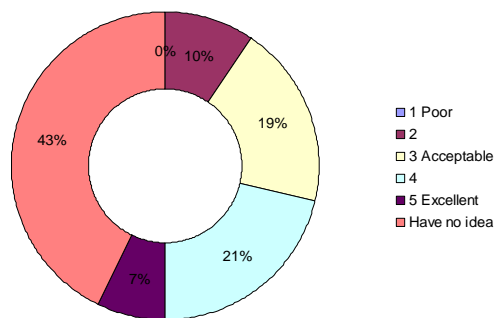


**Figure 20. What is your view of liquidity regarding O/N and T/N (in SEK) over the past six months?**



Almost half of the participants, 47 per cent, consider that liquidity regarding currency options in SEK was acceptable or better over the past six months (see Figure 21). However, almost as many participants, 43 per cent, state that they do not have an opinion regarding the liquidity in this type of instrument.

**Figure 21. What is your view of liquidity with regard to currency options (in SEK) over the past six months?**



In response to the question of what has functioned well/functioned poorly in the SEK market over the past six months, most participants state that the foreign exchange market has functioned well. However, most state that the forward market has functioned poorly. Increased risk aversion, repercussions of the financial crisis on liquidity and a weaker krona are quoted as the most important changes and trends in the market for Swedish krona over the past six months.



## ***Open questions***

### ***Focus will be on market liquidity and financing possibilities over the coming six months***

Most of the participants believe that market liquidity, the banking system's financing possibilities, consolidation in the financial sector, bank mergers and economic activity will be in focus on the Swedish financial markets over the coming six months. Long-term effects of the financial crisis mentioned include tighter regulation of the financial sector, permanently higher risk premiums, consolidation in the financial sector and few counterparts to trade with. Poorer liquidity, the banks' financing, deep recession and deeper crisis in the Baltic countries are mentioned as risks to the Swedish financial markets over the coming six months.

### ***The new Markets in Financial Instruments Directive (MiFID) is not considered to have affected the Swedish financial markets to any great extent***

Only a few participants state that the new Markets in Financial Instruments Directive (MiFID) has affected the part of the Swedish financial markets in which they are mainly active. Those participants state that documentation and insight into trading in securities has improved and in some cases that it has contributed to stabilising the market in an efficient manner.

### ***Central counterparty clearing is preferred to some extent by participants in the Swedish fixed-income market***

Just over half of the participants in the fixed-income market would prefer to see central counterparty clearing in the fixed-income market. This would increase transparency and reduce counterparty, credit and operational risks.



Financial Stability Department  
Sveriges riksbank, 2008