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

RISK SURVEY AUTUMN 2009

# Swedish market participants' views of risks and the functioning of the Swedish fixed-income and foreign exchange markets

*With effect from spring 2008 the Riksbank has sent out a risk questionnaire twice a year to participants in the Swedish fixed-income and foreign exchange markets. The purpose of this survey is to obtain an overall picture of the view of risk in the Swedish fixed-income and foreign exchange markets and also to provide an idea of the views on the functioning of the markets.*

## **Summary**

This report describes all of the results of the Riksbank's risk survey where responses were received between 21 September and 14 October 2009.<sup>1</sup> This was the fourth occasion on which the risk survey was held since the start in spring 2008. The survey supplements the annual discussions the Riksbank has with its monetary and foreign exchange policy counterparties on developments in the financial markets. Many of the questions in the survey recur for the purpose of following developments over time. Other questions are non-recurring to instead capture up-to-date events and phenomena that are of interest.

The autumn survey was sent out to 95 participants active in the Swedish fixed-income and foreign exchange markets. The groups surveyed are the Riksbank's monetary and foreign exchange policy counterparties and active participants in these markets. The total response frequency amounted to 85 per cent.

The autumn survey indicates that ***propensity to take risk has increased among a large percentage of the participants over the past six months***. Only a small percentage of the respondents state that their propensity to take risk has declined during the period. At the same time, almost one third of the participants, which is approximately as many as in the previous survey, state that their institution's liquidity buffer has increased over the past six months.

***Both the Swedish fixed-income market and the foreign exchange market are considered to have functioned well over the past six months***. The participants also consider that both of these markets have functioned well compared with the corresponding markets in other parts of the world. At the same time, the participants state, as in the previous survey, that there has periodically been poorer liquidity in the market for Swedish kronor. In the fixed-income market, however, liquidity has functioned well and larger issues can be made without problems. A number of participants state nevertheless that the liquidity in the secondary market is still poorer than prior to the crisis.

In this survey we also asked participants in the fixed-income market if they consider there is a need for a central counterparty in the Swedish repo market. The responses show that most participants are positive to this idea. Moreover, participants were asked to assess how the Swedish STIBOR fixing had functioned during the crisis, and the responses indicate that views are divided among the market participants.

***The participants are more or less unanimous that the financial crisis has now peaked***. On the other hand, most of them consider that the financial markets have not yet begun functioning normally. New regulations are expected to be one of the lasting effects of the crisis, as well as increased risk awareness and larger price differences on risk premiums for different instruments and for different borrowers, depending on how the risks are assessed.

<sup>1</sup> The Riksbank commissioned survey company Markör to send out the survey on its behalf.

The market participants are expecting the focus to be on economic developments in Sweden and globally over the coming months. Developments in the Baltic countries are regarded as the greatest risk for the financial markets in Sweden, above all in the short term, while the risk of asset bubbles is regarded as the most important in the long term.

### ***The participants' views on the financial crisis and future developments***

On the whole, the participants are now agreed that the financial crisis has peaked, which can be compared with the previous survey in which almost half of the respondents felt that the crisis had reached its peak (see Figure 1). However, a large proportion of the respondents point out that the improved conditions on the financial markets are due to the support measures implemented by central banks and other government authorities.

#### **THE MAJORITY DO NOT CONSIDER THE FINANCIAL MARKETS TO HAVE NORMALISED**

Although most participants now consider the crisis to have passed its peak, the majority do not consider that the financial markets are functioning entirely as normal. Of the 90 per cent who responded to the question regarding the functioning of the financial markets, only 15 per cent considered a normal situation to have been reached, while 11 per cent responded that the situation had largely returned to normal and 4 per cent questioned what could be defined as a normal situation. The majority, 70 per cent, consider that the market is not in what can be described as a normal situation. Of those who responded to the follow-up question regarding the point in time at which normality may return, 35 per cent state that they believe this will be reached at some point during the years 2010 to 2011, while 12 per cent consider that it will take even longer.

The participants deem that the most important indicators that can be used to determine whether the market is functioning normally are credit spreads and the difference between interbank rates and government securities, together with the development of liquidity on the submarkets. Moreover, several of the respondents state that one important indicator will be the reactions of the financial participants when central banks and authorities phase out their measures.

A widespread opinion among the participants in the Riksbank's survey is that the financial crisis will lead to new regulations and legislation on capital and liquidity reserves. Several participants also reply that risk awareness among both companies and investors has increased. Furthermore, it is believed that risks will be reflected in prices to a greater extent than previously, that is, risk premiums will vary more for different instruments, and also between different borrowers.

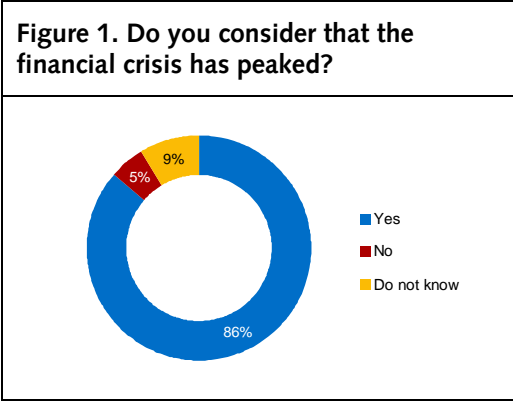
#### **FOCUS ON MACROECONOMIC DEVELOPMENTS IN COMING PERIOD BUT BALTIC AREA IS A RISK**

In response to the question of what areas the Swedish financial markets will focus on most over the coming period, a majority of respondents state macroeconomic factors such as the development of the repo rate and the economic recovery. Several respondents also consider that companies' interim reports and profit trends will receive great attention. A smaller proportion than in the spring's survey believes that the Baltic will be in focus. A further area that will be in focus over the next six months is that of exit strategies for the extraordinary measures implemented during the crisis.

Even if the Baltic is not expected to be in focus in the coming period, the most frequent response to the question of what risks the participants see for the Swedish financial markets over the coming six months is developments in the Baltic. Future economic activity and the risk that it may fail to accelerate or that it may fall short of expectations are also mentioned as risks for the near future. Some participants also consider that there is a risk that the current expansionary monetary policy may be retained too long, which could in turn lead to the formation of asset price bubbles, while a few see a risk that the Riksbank may start to raise interest rates too soon.

The responses to the question of what risks are envisaged in the longer term varied. Around one-fifth of the respondents stated that they were also concerned over asset price bubbles in the longer term, either in the form of excessive debt or in the form of a property price bubble. But an equally large percentage stated that they did not envisage

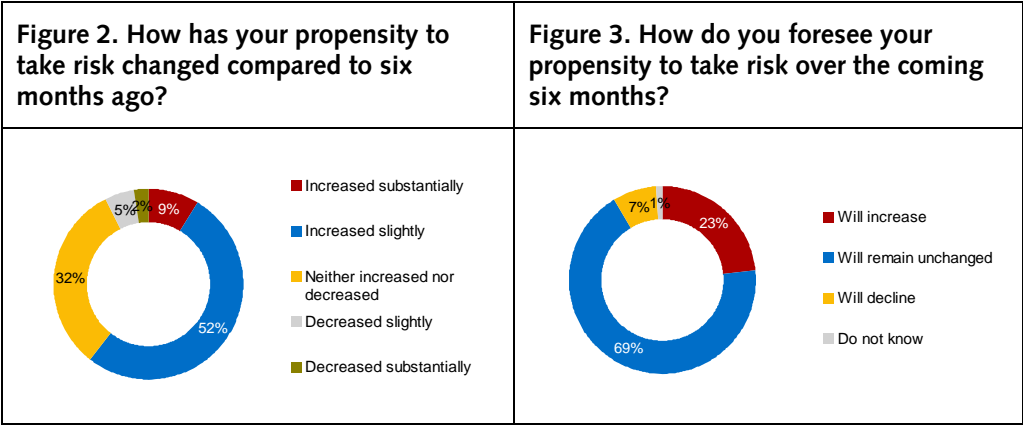
any major risks in the longer term. Some participants saw a risk that new regulation would go too far. A few also implied that a reduced propensity to take risk in the long term could lead to Sweden, with its small, volatile currency, becoming a peripheral country. This would mean that the capital inflow declined. In the long term this is also expected to lead to poor liquidity in both the fixed-income and foreign exchange markets and to the markets ceasing to function.



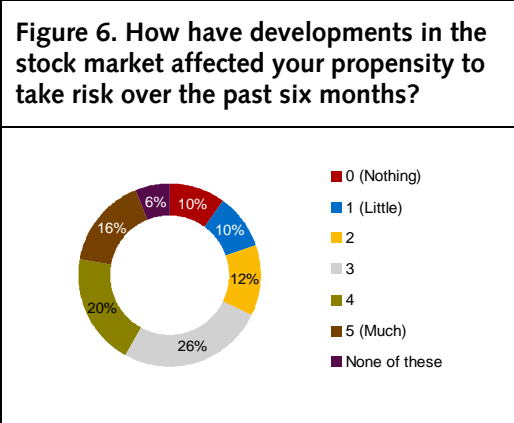
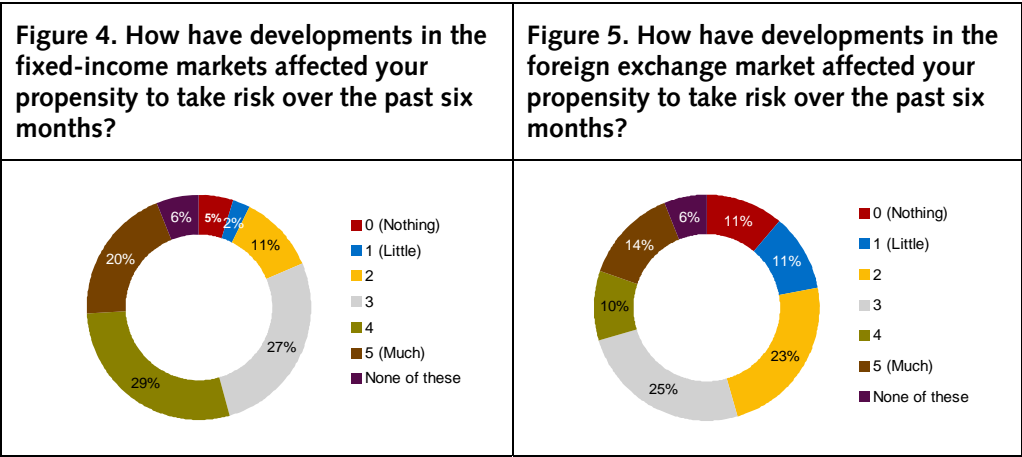
***Risk propensity in the Swedish fixed-income and foreign exchange markets***

**TREND TOWARDS INCREASED RISK PROPENSITY CONTINUING**

The concern that has marked the financial markets over the past two years is also reflected in the Riksbank’s risk survey. However, the risk survey carried out by the Riksbank in the spring implied some change in this respect, as 35 per cent of the participants stated that their propensity to take risk had increased over the past six months. This trend continues in the autumn survey, with 61 per cent of the participants stating that their propensity to take risk has increased compared with six months ago (see Figure 2). The responses confirm that the situation on the financial markets has stabilised and that propensity to take risk in the market has increased. A majority of the participants, almost 70 per cent, believe that their propensity to take risk will remain unchanged over the coming six months, 23 per cent expect that it will increase, while 7 per cent believe that the propensity to take risk will decline (see Figure 3).

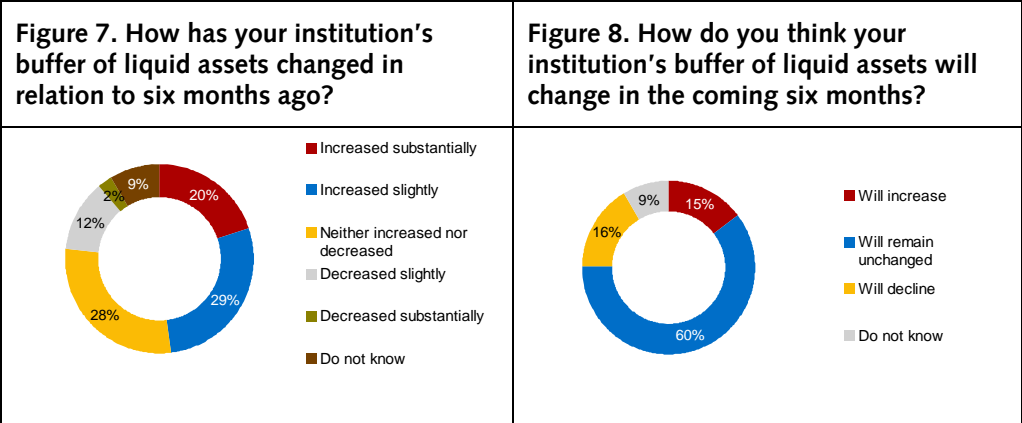


As in the spring survey, the respondents consider that developments in the fixed-income market have affected the propensity to take risk more than developments in the foreign exchange market or the stock market (see Figures 4, 5 and 6). However, this result should be seen in the light of a majority of the respondents being active primarily in the fixed-income market. The responses to the survey also show that among participants who are active only in the foreign exchange market, 47 per cent consider that developments there have had the most influence on their propensity to take risks. The respondents as a whole consider that stock market developments have affected propensity to take risk to a greater extent than developments in the foreign exchange market.



**PARTICIPANTS CONTINUING TO INCREASE THEIR LIQUIDITY BUFFERS**

The need for liquidity buffers often increases in times of great uncertainty. Despite the propensity to take risk having increased compared with the past six months, a large percentage of participants state in this survey that their institution has increased its buffer of liquid assets. Almost half of the respondents answer that their institution's liquidity buffer has increased over the past six months, which is slightly more than in the spring survey (45 per cent). In addition, 28 per cent respond that the institution's liquidity buffer remained unchanged, while only 14 per cent state that it has decreased (see Figure 7). 60 per cent of the respondents believe that their institution's buffer of liquid assets will remain unchanged over the coming six months, while the percentages believing the buffers will increase and decline respectively are of roughly equal size (see Figure 8).

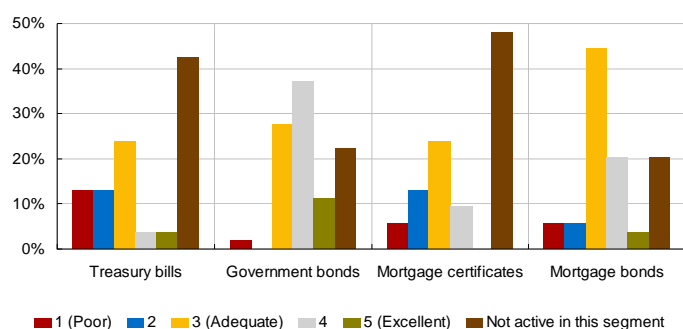


## The functioning of the Swedish fixed-income market<sup>2</sup>

The autumn's risk survey shows that market participants consider the Swedish fixed-income market to have functioned much better over the past six months. While there is still a broad impression among market participants that some submarkets are functioning less efficiently than prior to the financial crisis, looking at the respondents' comments it would appear that these submarkets are also gradually beginning to function better. As before, the market participants emphasise that the Swedish fixed-income market has functioned well in relation to markets in other countries. This is because there have always been prices in Sweden, which has not always been the case on the corresponding markets abroad.

The markets for government bonds and mortgage bonds are said to have functioned better than other submarkets. Of the participants trading in these instruments, 98 per cent and 86 per cent respectively state that the market has functioned adequately or better. However, 45 per cent of those trading in treasury bills do not consider the market to be functioning adequately (see Figure 9).

**Figure 9. What is your assessment of the functioning of the Swedish fixed-income market over the past six months with regard to the submarkets below?**



### IN PRINCIPLE, LIQUIDITY IS CONSIDERED TO FUNCTION BETTER ON ALL SUBMARKETS

The fact that participants in the Swedish fixed-income market consider the market has functioned better is also reflected in their views on liquidity in the trading of various fixed-income instruments. The autumn survey indicates a substantial improvement in this respect over the past six months.

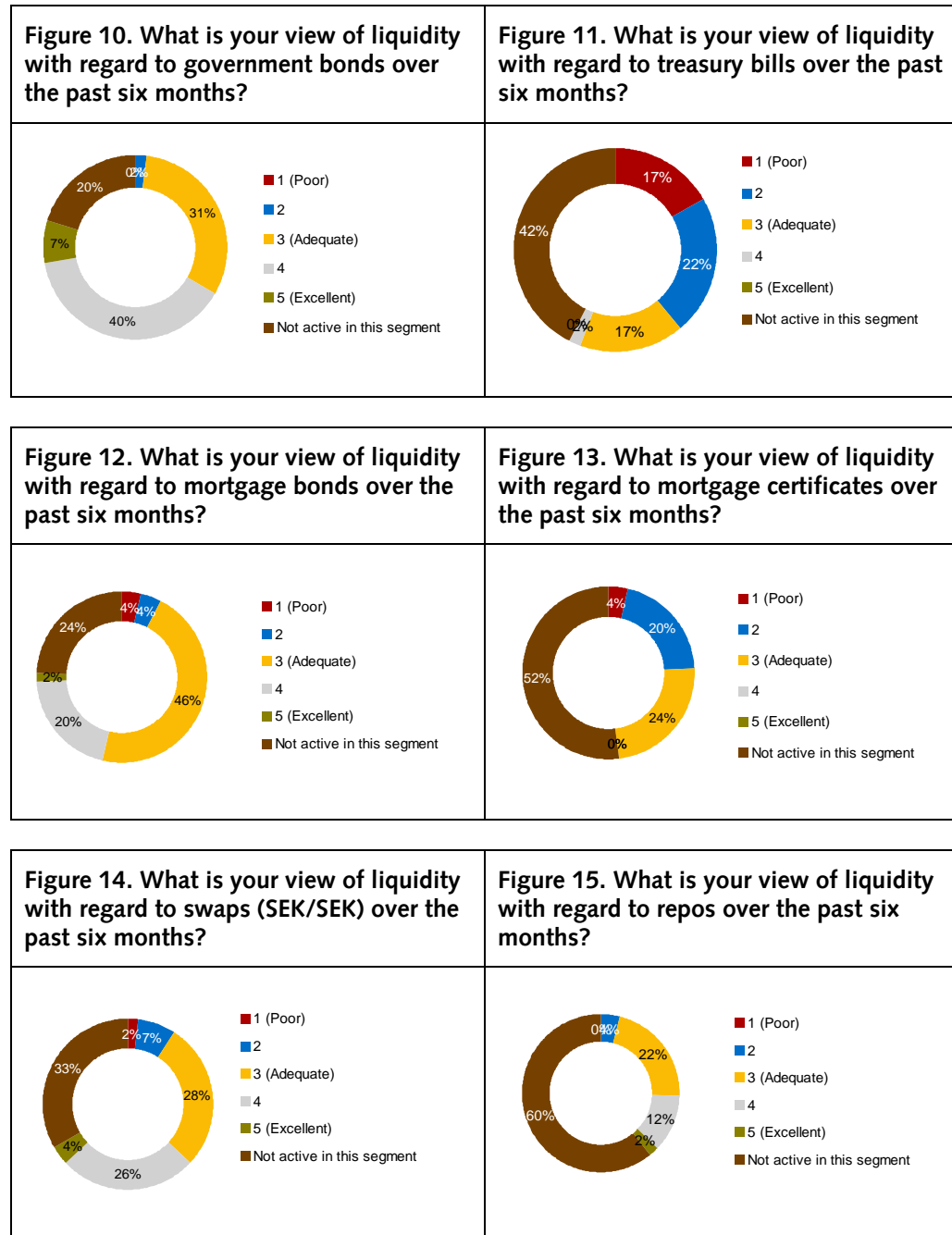
The liquidity in the government bond market is assessed to have been better than on other fixed-income markets. In the autumn survey 98 per cent of the respondents state that liquidity in the trading of government bonds has been adequate over the past six months. Only 2 per cent consider that this was not the case (Figure 10). The liquidity in the trade with treasury bills is still considered inadequate (see Figure 11). However, earlier risk surveys have indicated that liquidity in this market was considered relatively poor even prior to the crisis. This could to a large extent be due to these securities being by their nature "buy and hold". A further reason for the poor liquidity could be that the supply of treasury bills has more than halved since the beginning of the year.

The liquidity in the mortgage securities market has also improved significantly, primarily with regard to mortgage bonds. A good 90 per cent of the participants active in these markets respond that liquidity in mortgage bond trading has been adequate over the past six months (see Figure 12). However, only half of the respondents consider that liquidity in the mortgage certificate market is adequate (see Figure 13). The responses are more positive than in the spring, particularly with regard to liquidity in the mortgage bonds market. In the spring only 45 per cent and 30 per cent respectively stated that liquidity in the markets for mortgage bonds and mortgage certificates was adequate. The fact that liquidity in the mortgage securities market has improved over the past six months is also confirmed by some of the written comments made by the respondents.

<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, a total of 54 participants. Of these, 13 were the Riksbank's Primary Monetary Policy Counterparties.

Although liquidity is on the whole considered to have improved on the Swedish fixed-income market, a number of participants state in their comments to the questions that smaller volumes are still being traded than was the case before the crisis. One can also see that it is primarily the primary market that is considered to have improved, while there are still sales problems in the secondary market because of the increased supply of credit bonds. The large supply is in turn due to foreign investors largely selling off their holdings and leaving the Swedish bond market during the crisis. The difficulty in selling credit bonds is reflected in a larger difference between bid and ask prices.

With regard to the market for interest rate swaps (SEK/SEK) and repos, 86 per cent and 90 per cent of the respondents active in these respective markets state that liquidity has been satisfactory over the past six months, while the remainder consider liquidity to have been insufficient (see Figures 14 and 15). Among the Riksbank's primary counterparties all respondents consider, as they did in the spring survey, that liquidity in the market for interest rate swaps was satisfactory during this period.



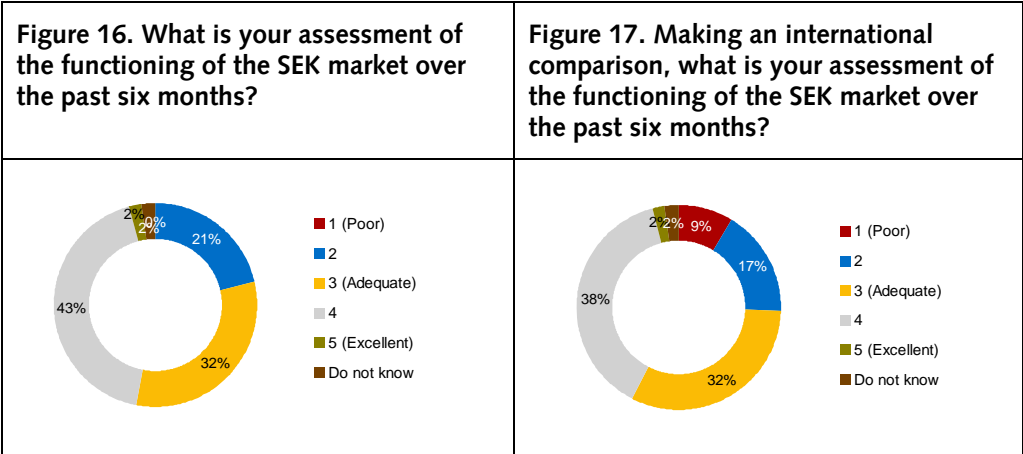
In this survey we also asked participants in the fixed-income market whether they consider there is a need for a central counterparty in the Swedish repo market. Around half of the respondents in the fixed-income market answered this question and the

majority of these, 64 per cent, consider that there is a need for this, while approximately 20 per cent consider that there is no need. The others respond that such a need may exist.

Moreover, the participants were asked to assess how the Swedish STIBOR fixing had functioned during the crisis.<sup>3</sup> The responses are divided between stating that this functioned adequately and that it functioned poorly. The participants who consider that the fixing has functioned poorly also point out that compared with the fixing of larger currencies it has functioned relatively well.<sup>4</sup> Several participants also point out that there are too few participants who price STIBOR and that on some days it has been difficult to know what the fixing should be. Some also consider that as there have been no large investments at this rate during the crisis, it is difficult to determine what the correct level is for STIBOR.

***The functioning of the Swedish foreign exchange market<sup>5</sup>***

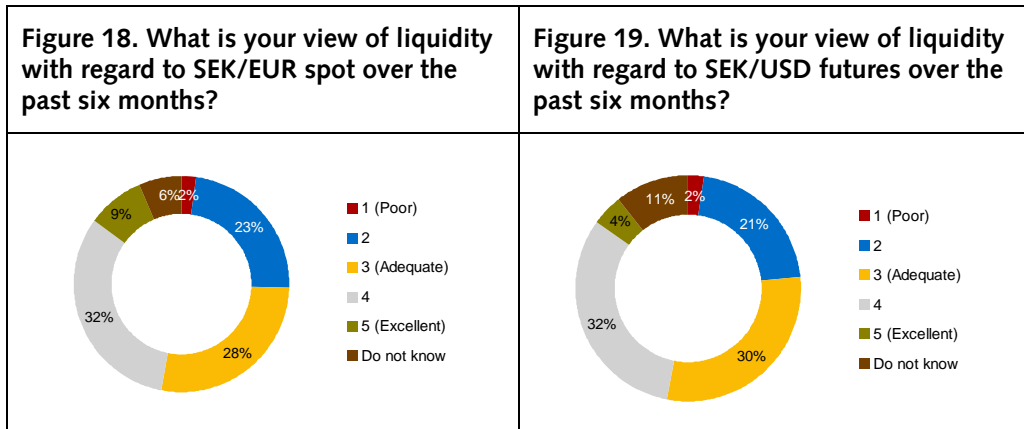
A broad impression among the respondents who are participants in the Swedish foreign exchange market is that it has functioned better during the past six months than before. 78 per cent of the respondents state that the functioning of the market for Swedish kronor has been adequate during the period (see Figure 16). This is in line with how they assessed the market last autumn. It is also a significant improvement on the spring survey, where almost half considered that the foreign exchange market was functioning adequately. Even in an international comparison, the market for Swedish kronor is considered to have functioned adequately (see Figure 17). While the comments on the questions indicate that the market for Swedish kronor has functioned better, just as in the spring many respondents describe liquidity as uneven and state that it is difficult and expensive to trade large volumes. Several of the respondents state in the comments that the speculations regarding developments in the Baltic, which have previously had a negative effect on the krona, and created greater uncertainty, are slowly subsiding.



Looking at the period as a whole, almost 70 per cent of the respondents consider that the liquidity regarding spots in SEK/EUR has been adequate (Figure 18). An almost equally large percentage states that this was also the case on the market for futures in SEK/USD (Figure 19). Most of the respondents write in the comments that the market has functioned adequately, despite liquidity still being considered poor and that it can still be difficult to sell large volumes.

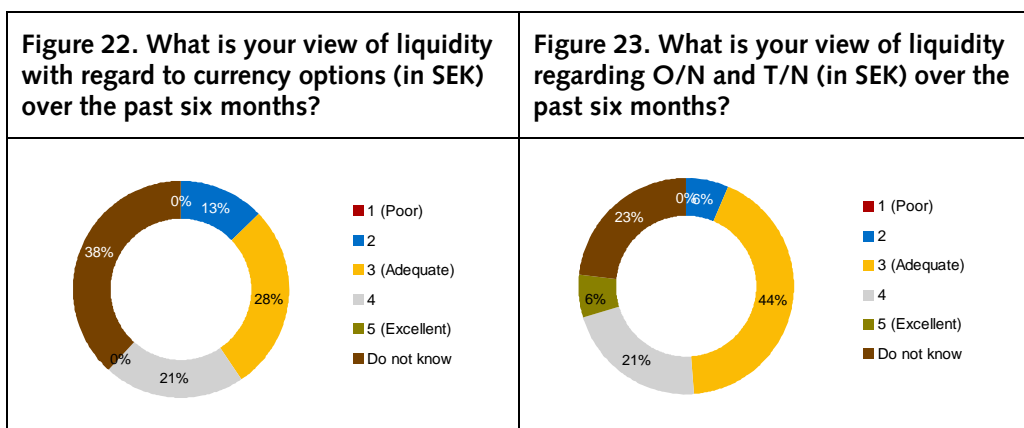
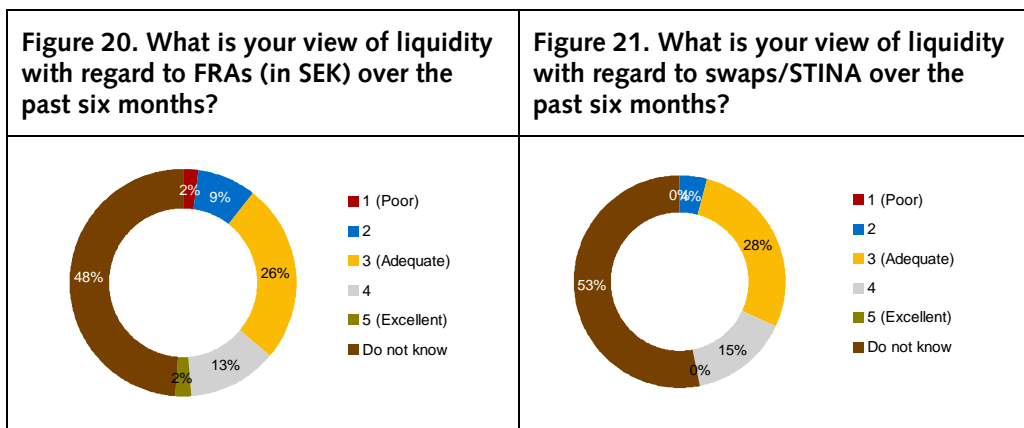
<sup>3</sup> STIBOR stands for Stockholm Interbank Offered Rate. STIBOR Fixing is the interest rate that constitutes the average (with the exception of highest and lowest listing) of the interest rates listed daily by selected banks in Sweden. STIBOR is also used as a reference for setting interest rates or pricing derivative contracts.  
<sup>4</sup> By larger currencies they mean the equivalent fixing for currencies such as the USD, EUR and GBP.  
<sup>5</sup> Only participants active either solely in the Swedish foreign exchange market, or active in both the money and bond market and the foreign exchange market, have responded to this part of the survey, a total of 47 participants. Of these, 12 were the Riksbank’s Primary Monetary Policy Counterparties.





The results for the other parts of the foreign exchange market are more uncertain, as a large percentage of the respondents, between 23 and 53 per cent, have stated that they do not have any opinion regarding the liquidity in these submarkets. Around 40 per cent of the respondents state that liquidity in the markets for FRAs in Swedish kronor, swap/STINA and currency options have been adequate over the past six months (see Figures 20-22). In the market for overnight loans (O/N) and loans from tomorrow until the day after (T/N), liquidity during the past six months has been adequate according to 70 per cent of the participants (see Figure 23).

If one disregards those who have stated that they do not have an opinion, which is probably because they are not active in these submarkets, then almost 80 per cent consider that the market for FRAs in Swedish kronor and currency options are functioning adequately. More than 90 per cent consider that the market for swap/STINA and the market for overnight loans are functioning adequately.





Financial Stability Department  
Sveriges riksbank, 2009