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

RISK SURVEY SPRING 2009

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With effect from spring 2008 the Riksbank sends out a risk survey once every six months to participants active in the Swedish fixed-income and foreign exchange markets. The purpose of the survey is partly to gain an overall picture of the view of risk among participants active in the Swedish fixed-income and foreign exchange markets, and partly to gain a picture of their views regarding the functioning of the market.

Summary

This report describes the results of the Riksbank's risk survey where responses were received between 19 March and 17 April 2009.¹ The risk survey has been sent out on two previous occasions, in spring and autumn 2008, and acts as a supplement to the annual interviews the Riksbank holds with its monetary policy and foreign exchange policy counterparties regarding 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 current events and developments that are of interest. The spring survey was sent out to 73 participants active in the Swedish fixed-income and foreign exchange markets. These included the Riksbank's monetary policy and foreign exchange policy counterparties and other participants active in these markets. The total response frequency amounted to 81 per cent.

The spring risk survey shows that the risk propensity among a large share of the market participants has declined over the past six months. However, a larger share of the respondents than in the previous survey state that their willingness to take risk has increased over the period. At the same time, a larger share of respondents than before 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 poorly over the past six months. However, the participants consider both markets to have functioned relatively well, compared to corresponding markets in other parts of the world. At the same time, they state that the functioning of the market for Swedish kronor has been poorer during the past six months than before, with at times very poor liquidity.

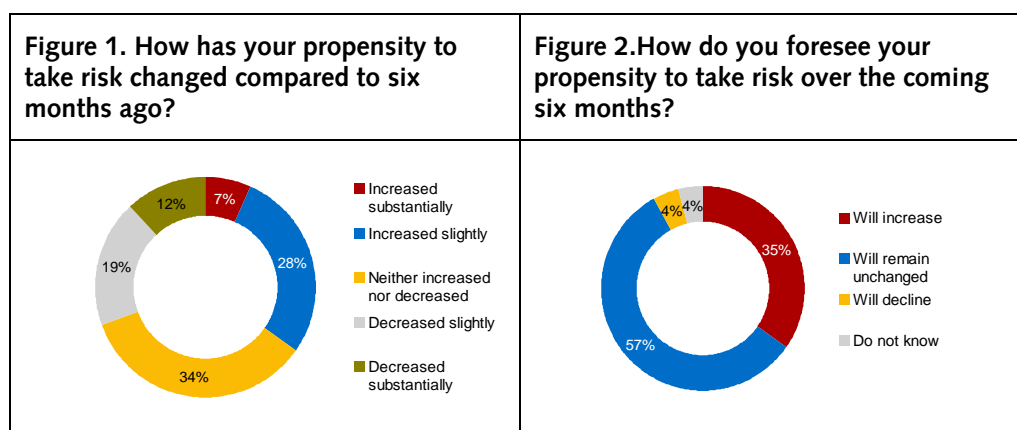
In the spring survey the participants in the fixed-income market were also asked about their view on the introduction of the two new interest rate derivatives RIBA and Swapfuture (NOIS). The responses show that most of the participants are positive to the introduction of these two derivatives. A larger number of the respondents state that they will use RIBA themselves than state that they will use NOIS.

Almost half of the participants believe that the financial crisis has now peaked. However, it is expected that there will still be increased risk awareness and a higher price for risk even when the crisis is over. Developments in the Baltic countries are expected to be the most important for developments in the financial markets in Sweden, particularly in the short term. For developments in the longer term, the participants regard the development of the economic activity in Sweden and globally as important factors.

¹ The Riksbank commissioned survey company Markör to send out the questionnaires on its behalf.

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

The uncertainty that has marked the financial markets over the past two years has also been reflected in the Riksbank's risk survey. In the two previous surveys the Riksbank has carried out, a majority of the respondents stated that their risk propensity had declined somewhat or declined sharply. Still, as many as 31 per cent of respondents state that their propensity to take risk has declined over the past six months, and 34 per cent state that it has remained unchanged (see Figure 1). However, the spring risk survey implies some change in this respect, as 35 per cent of the participants state that their propensity to take risk has increased over the past six months, which may be compared with less than 10 per cent of the respondents stating these answers six months ago and one year ago respectively. The responses thus confirm that the situation in the financial markets is marked by considerable uncertainty, but nevertheless they imply some increase in the propensity to take risk. A majority of the participants, almost 60 per cent, believe that their propensity to take risk will remain unchanged over the coming six months. 35 per cent of the participants expect their propensity to take risk to increase, while 4 per cent believe that it will decrease (see Figure 2).



The respondents as a whole consider that the 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 survey however reveals that among those participants who are only active in the foreign exchange market, most consider developments in this market to have had the greatest influence on their propensity to take risk. Among the respondents as a whole, developments in the stock market are considered to have had approximately equally much influence on the propensity to take risk as developments in the foreign exchange market.

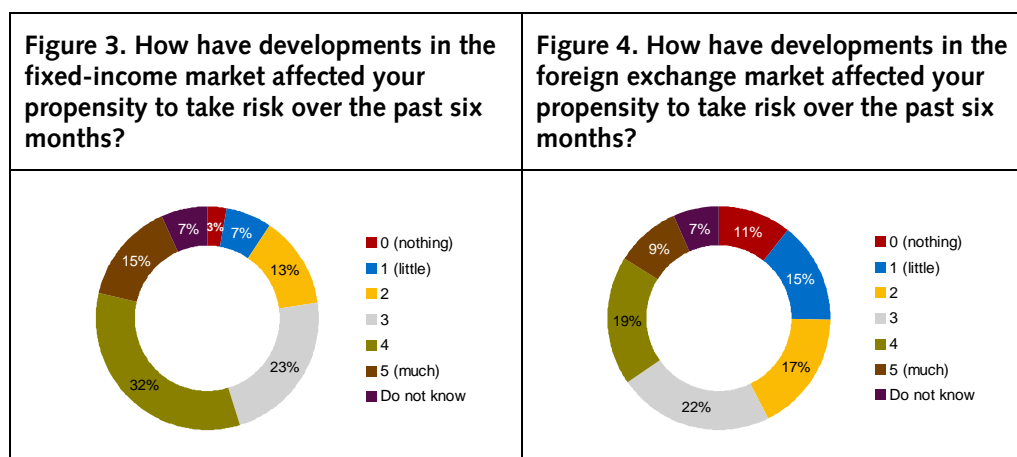
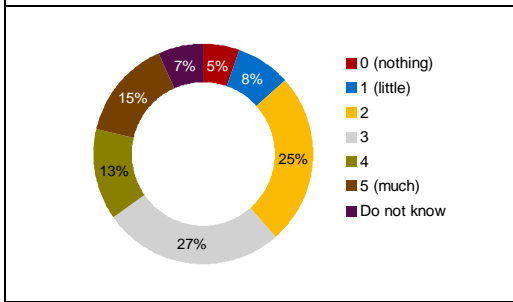


Figure 5. How have developments in the stock market affected your propensity to take risk over the past six months?



The need for liquidity buffers often increases in times of great uncertainty. Compared with the survey carried out last autumn, a larger percentage of participants respond in the current survey that their institution has increased its buffer of liquid assets. This is despite a slight increase in risk propensity. 45 per cent of the respondents stated that their institution's liquidity buffer has increased during the past six months, compared with approximately one third stating this last autumn. In addition, 20 per cent respond that the institution's liquidity buffer remained unchanged, while 22 per cent stated that it had decreased (see Figure 6). Around half of the respondents believe that their institution's liquidity buffer will remain unchanged over the coming six months, while 21 per cent and 17 per cent respectively believe it will decrease or increase respectively (see Figure 7).

Figure 6. How has your institution's buffer of liquid assets changed in relation to six months ago?

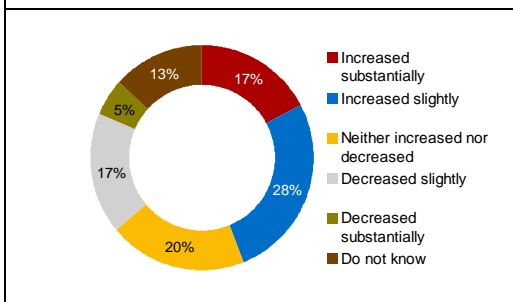
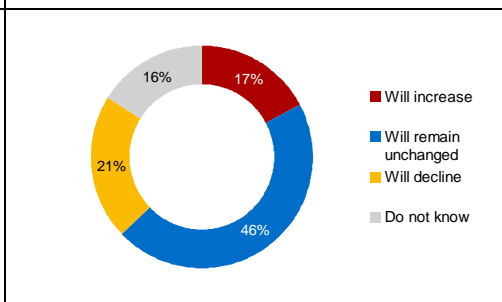


Figure 7. How do you think your institution's buffer of liquid assets will change in the coming six months?



The functioning of the Swedish fixed-income market²

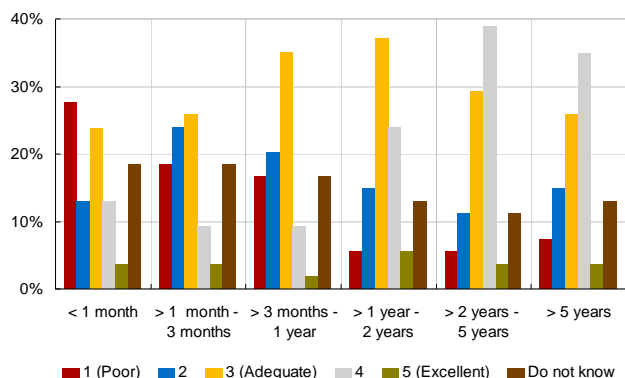
The spring 2009 risk survey shows that the Swedish fixed-income market is considered on the whole to have functioned poorly during the past six months. Some sub-markets are considered to have functioned better than others. However, there is still a broad opinion among respondents that all sub-markets have functioned much less efficiently than prior to the financial crisis and compared with what they stated in the risk survey carried out one year ago. Nevertheless, several participants state in comments to the questions that the Swedish fixed-income market has functioned relatively well in comparison with markets abroad, to the extent that in Sweden it has always been possible to obtain a price.

The market for government securities with longer maturities is said to have functioned better than other fixed-income markets, which was also stated in the autumn. The participants consider that the market for government securities with maturities of over two years has functioned best. More than two thirds of the respondents state that this market has functioned acceptably. However, about 15 per cent of the respondents

² 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 Counterparties.

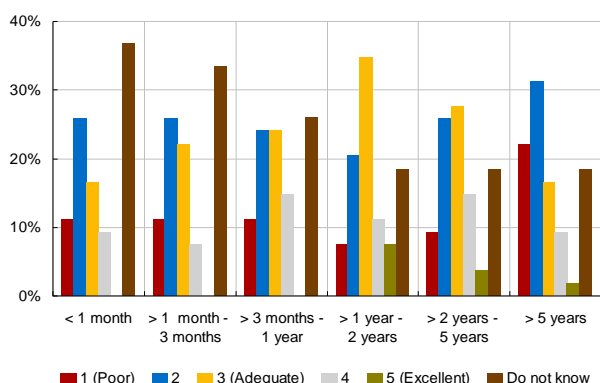
consider that the market has not functioned acceptably even at these maturities (see Figure 8).

Figure 8. What is your assessment of the functioning of the Swedish market for government securities over the past six months with regard to different maturities?



The previous risk survey revealed that the functioning of the market for mortgage securities had deteriorated sharply during the six-month period prior to the survey. The spring survey shows that the functioning of this market has been inadequate also in the past six months, both at short and long maturities. However, the situation appears to have been slightly better than it was in the autumn. The situation is said to be worst with regard to the shortest maturities and maturities over five years. For the latter category more than half of the respondents state that the market does not function acceptably (see Figure 9).

Figure 9. What is your assessment of the functioning of the Swedish market for mortgage securities over the past six months with regard to different maturities?

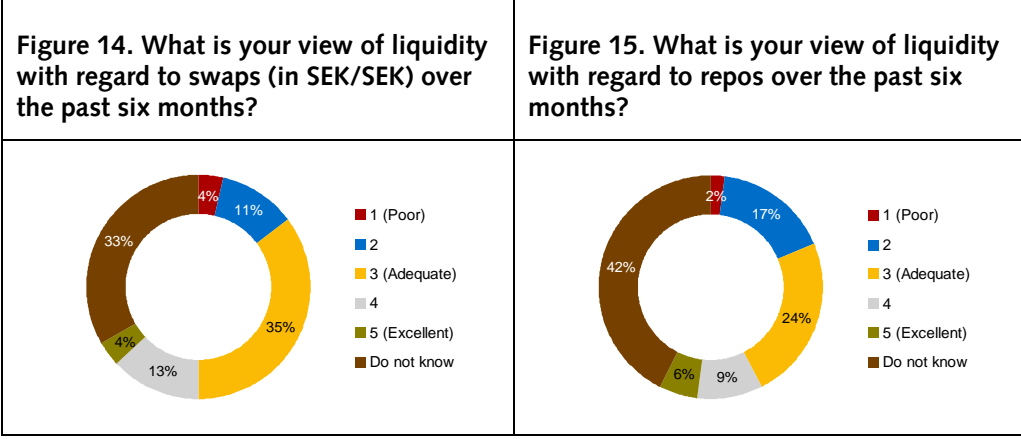
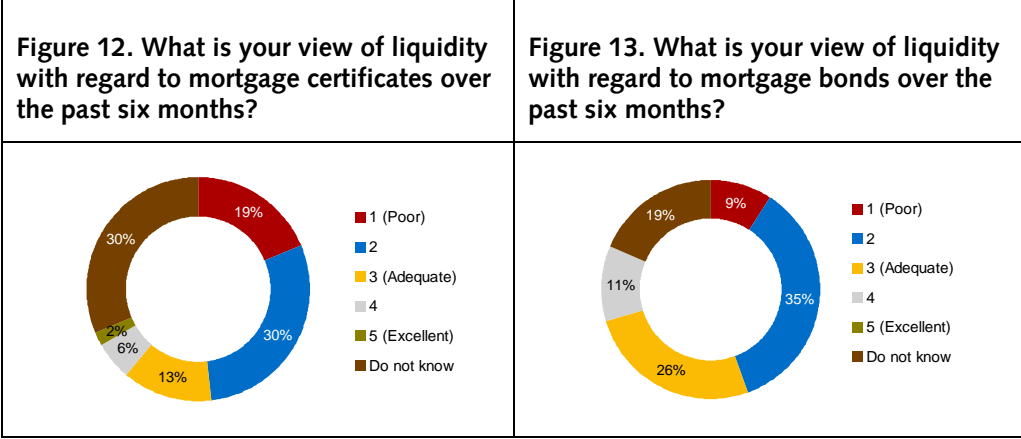
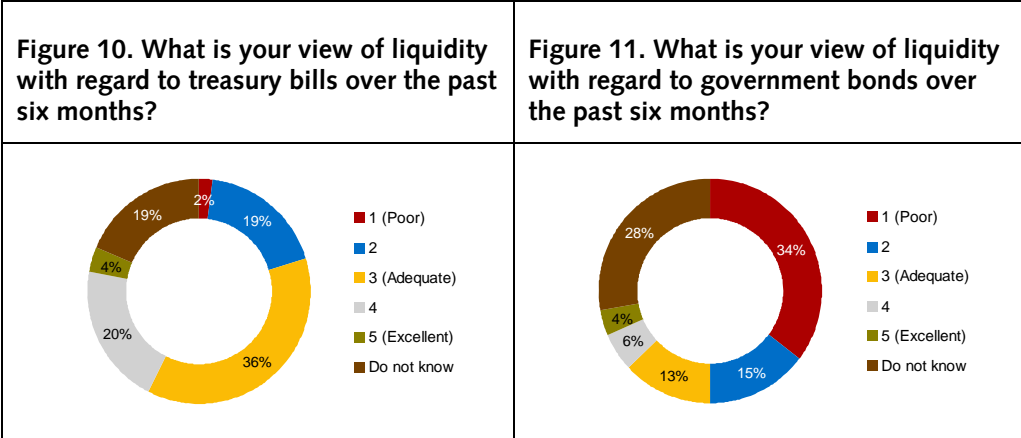


The fact that participants in the Swedish fixed-income market consider the market to have functioned poorly is also reflected in their views on liquidity in the trading of various fixed-income instruments. However, the spring survey does not indicate that any significant change has occurred in this respect over the past six months (see Figures 10–15).

In the market for government bonds liquidity is assessed to have been better than in other fixed-income markets. 60 per cent of the respondents in the survey state that liquidity in the trading of government bonds has been acceptable over the past six months. However, 21 per cent consider that this was not the case (see Figure 10). The liquidity in treasury bills is considered to be poor by almost half of the respondents (see Figure 11). 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". The poor liquidity in the market for treasury bills is therefore not something that have arisen in connection with the current financial crisis. Even so, it cannot be excluded that the financial crisis has affected the liquidity also in this market.

The liquidity in the mortgage securities market is considered to have been very poor with regard to both certificates and bonds. Only 20 per cent and 37 per cent of participants respectively respond that liquidity of mortgage certificates or mortgage bonds has been satisfactory over the past six months (see Figures 12 and 13). However, the responses are slightly less negative than last autumn, particularly with regard to the liquidity in the market for mortgage bonds. In the previous survey only 14 and 16 per cent respectively said that liquidity in mortgage certificates and mortgages bonds had been satisfactory. The fact that liquidity in the mortgage bond market has improved over the past six months is also confirmed by some of the written comments made by the respondents.

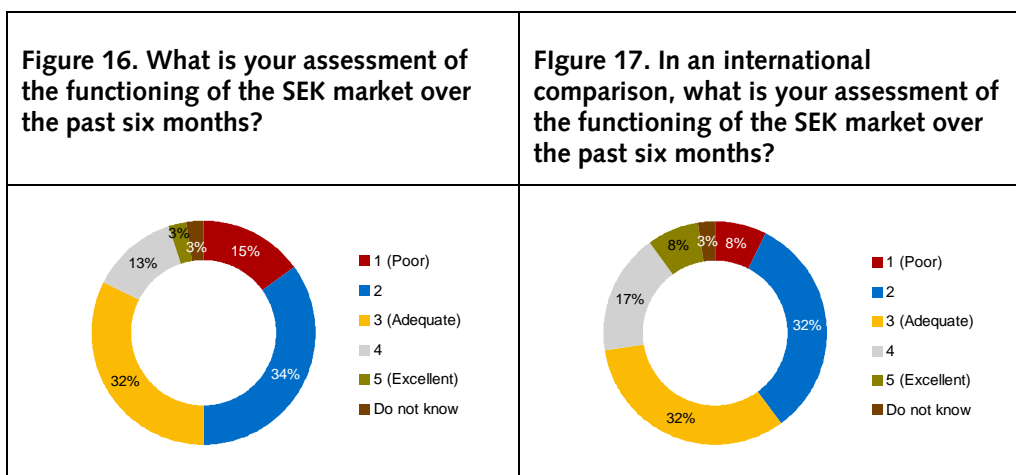
In the market for interest-rate swaps (SEK/SEK) and repos, 52 per cent and 39 per cent respectively respond that liquidity during the period concerned was acceptable, while 15 per cent and 19 per cent respectively consider that liquidity was not acceptable (see Figures 14 and 15). However, among the Riksbank's primary counterparties, almost all respondents state that the liquidity in the interest-rate swap market has been acceptable during the past six months.



In the spring survey the participants in the fixed-income market were also asked to respond to questions regarding the two new interest rate derivatives RIBA and Swap future (NOIS).³ Almost all participants are positive towards the introduction of RIBA and believe that it will be used by other participants in the market as well as by themselves. Most participants respond that they believe that also the NOIS will be traded, although in this case a smaller percentage believes that they will use the instrument themselves. A small percentage of the participants state that they see a risk that the liquidity in NOIS will not be adequate, which would mean that they refrained from using these instruments. Several participants state that trading in STINA swaps, and to some extent also in FRAs (Forward Rate Agreements), may decline when the RIBA is introduced. At the same time, a small number of the respondents believe that NOIS can replace some of the trading that currently takes place in bilateral swaps.

The functioning of the Swedish foreign exchange market⁴

A broad impression is that the Swedish foreign exchange market has functioned less well during the past six months than before. Nearly 50 per cent of the respondents state that the functioning of the market for Swedish kronor has been adequate or better over the period (see Figure 16). This is a substantial difference compared with the previous risk survey, which was carried out in the autumn and compared with the risk survey last spring when 79 per cent and 92 per cent respectively stated that market functioning was adequate or better. In an international comparison the market for Swedish kronor is not perceived to have functioned poorly, but even these responses were more negative than those in earlier surveys (see Figure 17). However, the comments to the questions in the survey indicate that the negative responses are to a large degree affected by the situation prevailing in the Swedish foreign exchange market during the late autumn and at the end of last year, which was also discussed in the previous Financial Stability Report (FSR 2008:2). Several respondents nevertheless stated that liquidity in, above all, the Swedish spot and futures markets has improved since the start of the year.

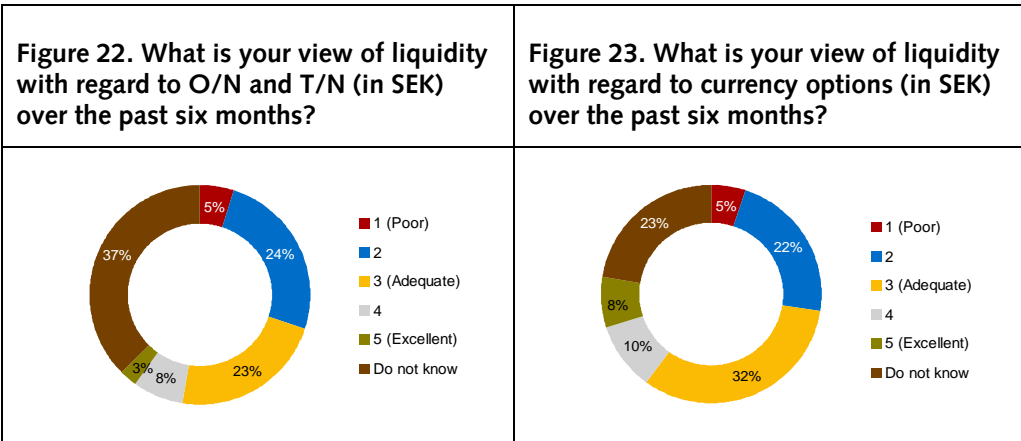
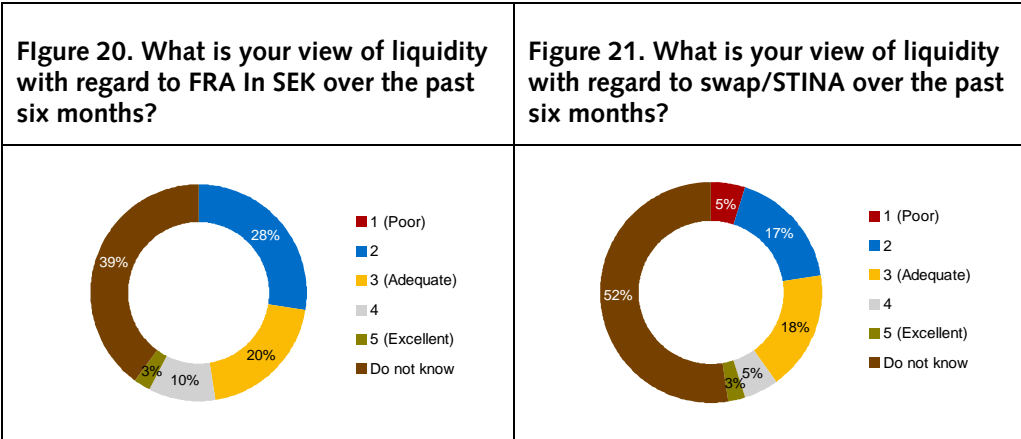
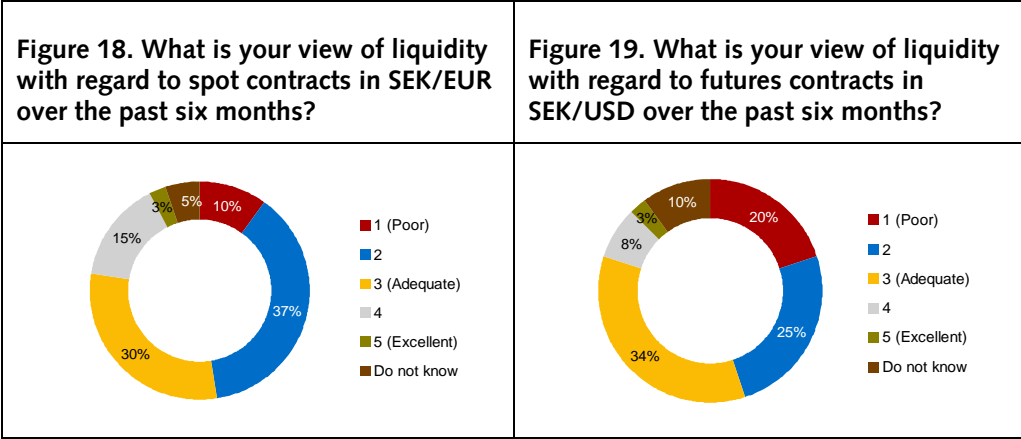


Looking at the period as a whole, almost half of the respondents consider that the liquidity regarding spots in SEK/EUR has not been acceptable (see Figure 18). An almost equally large percentage of the respondents state that this was also the case on the market for futures in SEK/USD (see Figure 19). The liquidity in these markets is described to have been irregular, as liquidity holes have arisen when liquidity has first disappeared entirely and then returned.

³ RIBA is a cash-settled futures contract based on the Riksbank's repo rate. NOIS is an interest rate swap where the starting date is in the future.

⁴ Only participants active either solely in the Swedish foreign exchange 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 40 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 25 and 52 per cent, have stated that they do not have any opinion regarding the liquidity in these markets. Only about one quarter of the respondents states that liquidity in the markets for FRAs in Swedish kronor, swap/STINA and currency options has been acceptable over the past six months (see Figures 20–22). The market for overnight loans (O/N) and loans from tomorrow to the day after (T/N) look slightly better, with half of the participants considering that liquidity in these markets was adequate or better during the period (see Figure 23).



The participants' views on the financial crisis and future developments

Almost half of the participants believe that the financial crisis has peaked (see Figure 24). This is an increase compared with in the previous survey, when around one third of the respondents stated that they believed the crisis had peaked. However, there is still great

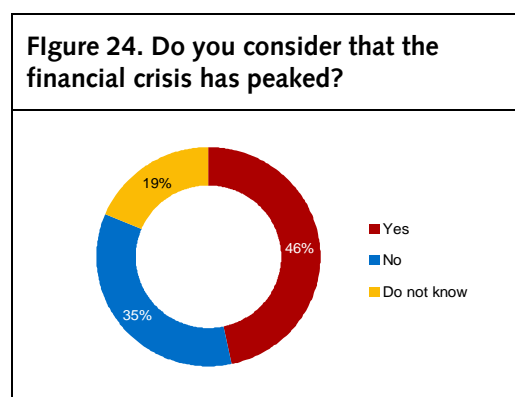
uncertainty among the participants regarding this issue. This is illustrated not least by the fact that 35 per cent of the respondents believe that things will get worse before they get better and that 19 per cent state that they do not know.

A widespread opinion among the respondents in the Riksbank's survey is that the view of risk has changed permanently as a consequence of the financial crisis. A greater number of participants respond that the increased risk awareness among both companies and investors will remain, which is expected to lead to more focus on risk-weighted assets, greater demand for capital and liquidity reserves, increased use of cleared products and that the risk premium, that is to say the price of risk, will be higher in the future than has historically been the case. Many of the respondents also mention an increased regulation of the financial markets as a probably lasting effect of the financial crisis.

Developments in the Baltic countries are expected to be the most important element in determining future developments in the financial markets in Sweden, particularly in the short term. This opinion is widespread among both participants in the fixed-income market and those in the foreign exchange market. Developments in the Baltic countries also recur as a response to the question of what will be most in focus in the Swedish financial market over the coming period. Moreover, many of the participants believe that there will be some focus on how central banks apply zero interest rate policy and quantitative easing, and whether the Riksbank will take such measures.

Many of the respondents consider that economic activity in Sweden and abroad are important factors for the developments in the Swedish financial market in the longer term. In addition, several participants mention that a continuing high risk aversion constitutes a long-term risk for the Swedish financial market. The same applies to the risk that the liquidity in the market will remain low.

With regard to the Riksbank's actions to support the markets, participants give both positive and negative assessments. Many state that the Riksbank has acted in a good way and that the measures taken have had an effect. However, one recurring view among the respondents is that the Riksbank acted late and that communication was not sufficiently clear.





Financial Stability Department
Sveriges riksbank, 2009