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SVERIGES RIKSBANK

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

RISK SURVEY SPRING 2010

# Swedish market participants' views of risks and the functioning of the Swedish fixed-income and foreign exchange markets[1]

*Participants in the Swedish fixed-income and foreign exchange markets had increased their risk propensity up to the beginning of April, and most sub-markets were assessed as functioning better now than last autumn. This is the conclusion of the Riksbank's risk survey, which was carried out at the end of March/beginning of April[2]. However, the survey does not capture the effects of the concern over the European sovereign debt problems that had a tangible effect on the markets in May.*

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

The participants are largely in agreement that the financial crisis peaked between autumn 2008 and spring 2009 (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 CONSIDER THAT THE FINANCIAL MARKETS HAVE NORMALISED

A majority of the participants, 60 per cent, consider that the financial markets have functioned entirely as normal. Most of the 40 per cent who responded no believe that the situation will normalize within the next three years. However, some participants believe it will take even longer, and some claim that the market will never return to the same high level of risk propensity and that regulation by the supervisory authorities will be stricter than prior to the crisis.

The participants assess that the most important indicators in determining whether the market is functioning normally are the outcomes of various types of spreads. For example, the difference in yield on different securities with a certain type of credit rating and on government bonds, the difference between interbank rates and treasury bills, the difference between buy and sell prices and how liquidity and the volatility in the sub-markets develop. Moreover, several of the respondents state that one important indicator will be the reactions of the financial institutes when central banks and authorities exit from their extraordinary measures, such as the increased access to loans with longer maturities.

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, which they consider could reduce the potential economic growth rate. Several participants also respond that risk awareness and risk management have increased. Furthermore, it is believed that risks will be reflected in prices to a greater extent than

[1] 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. This report describes all of the results of the Riksbank's risk survey where responses were received between 18 March and 6 April 2010. The Riksbank commissioned survey company Markör to send out the survey on its behalf. The survey supplements the annual discussions the Riksbank has with its monetary and foreign exchange policy counterparties on developments in the financial markets, and the regular contacts with market participants. The spring survey was sent out to 97 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 77 per cent.

[2] By the past six months/half year we hereinafter refer to the period September/October 2009 to March/April 2010.

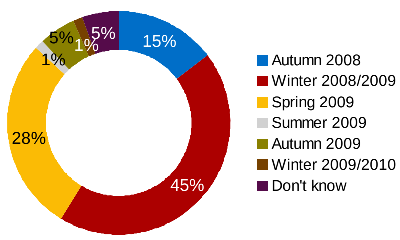
previously, that is, risk premiums will vary more for different instruments and also between different borrowers.

#### FOCUS WILL BE ON THE RIKSBANK'S MONETARY POLICY OVER THE COMING PERIOD, BUT SOVEREIGN DEBT PROBLEMS IN EUROPE COMPRISE A SHORT-TERM THREAT

In response to the question of what the Swedish financial markets will focus on most over the coming period, a majority of the respondents state the Riksbank's monetary policy and continued phasing out of extraordinary measures. Several also consider that the sovereign debt problems in Europe will receive considerable attention. A further area of great interest over the coming six months is said to be new regulations, such as Basel III and Solvency II. Developments in global economic activity are also expected to be in focus in the coming period, as was also stated in the previous survey.

The participants view the sovereign debt problems in several countries in southern Europe, with large budget deficits and rising national debts, as a large risk for the Swedish financial markets, both in the short and long term. A slowdown in the economic recovery and renewed concern over the banking sector are also mentioned as risks in the coming period. However, the participants are much less concerned over the Baltic region than they were last autumn, when the previous survey was carried out. Most of the participants consider that there is a risk in the longer term of too much and too extensive regulation in the financial sector. Some consider that household indebtedness will be a problem in the future, with the risk of a housing bubble arising, with an ensuing fall in house prices. As in the previous survey, some of the participants see no risks at all for the Swedish financial market, either in the short-term or the long-term.

**Figure 1. When do you consider that the financial crisis peaked?**




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

#### TREND TOWARDS INCREASED RISK PROPENSITY CONTINUING

The concern that has affected the markets during the financial crisis began to wane in 2009, which was illustrated in the last two risk surveys by the fact that risk propensity had increased among a large share of the participants. This trend continues in the spring survey. Half of the respondents stated that their risk propensity has increased over the past six months (see Figure 2). However, this is a reduction compared with the autumn survey, when the corresponding figure was 61 per cent. The responses nevertheless confirm that the situation on the financial markets has stabilised and that risk propensity has increased. A majority of the participants, 70 per cent, believe that their risk propensity will remain unchanged over the coming six months, 21 per cent expect that it will increase, while 5 per cent believe that their risk propensity will decline (see Figure 3). As pointed out earlier, however, the survey does not capture the market turbulence caused by concern over southern European sovereign debt problems.

**Figure 2. How has your propensity to take risk changed compared to six months ago?**

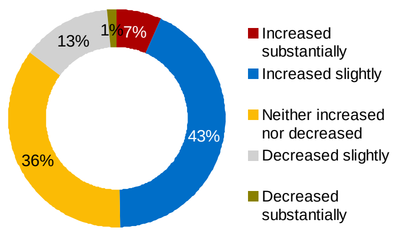
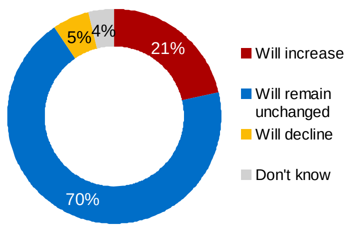



**Figure 3. How do you foresee your propensity to take risk over the coming six months?**




**PARTICIPANTS CONTINUING TO INCREASE THEIR LIQUIDITY BUFFERS**

The need for liquidity buffers often increases in times of great uncertainty. A large percentage of the participants also state in the spring survey that their institution has increased its liquidity buffer – despite an increase in risk propensity compared with the past six months. 37 per cent of the respondents say that their institution's liquidity buffer has increased over the past six months, which is fewer than in the autumn survey, when the figure was 48 per cent. In addition, 31 per cent respond that the institution's liquidity buffer has remained unchanged, while 21 per cent state that it has decreased (see Figure 4). In response to the question of how the liquidity buffer has changed in relation to before the crisis, 55 per cent say that it has increased and only 11 per cent that it has declined (see Figure 5). 55 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 decline is slightly larger than those who believe it will increase (see Figure 6).

**Figure 4. How has your institution's buffer of liquid assets changed in relation to six months ago?**

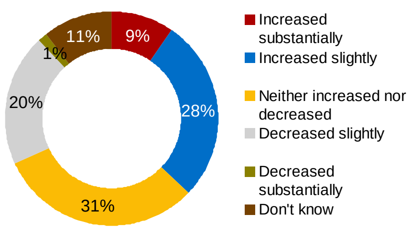



**Figure 5. How has your institution's buffer of liquid assets changed compared to before the crisis?**

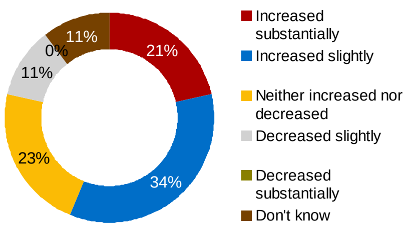
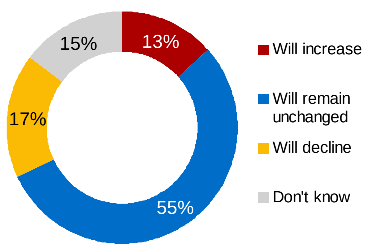


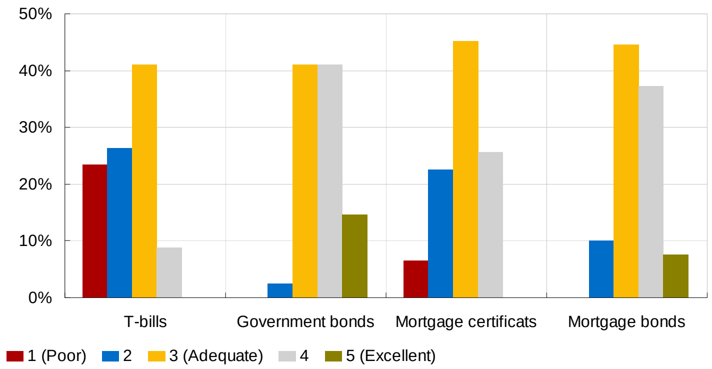

**Figure 6. How do you think your institution's buffer of liquid assets will change in the coming six months?**



## *The functioning of the Swedish fixed-income market*[3]

The spring risk survey shows that the market participants consider that the Swedish fixed-income market has functioned well over the past six months, which is the same view expressed in the autumn survey. The markets for benchmark 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 90 per cent respectively state that the market has functioned adequately or better. However, half of those trading in treasury bills do not consider the market to be functioning adequately (see Figure 7).

**Figure 7. 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 BE GOOD ON ALL SUB-MARKETS**

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

The liquidity in the government bond market is assessed to have been better than on other fixed-income markets. In the spring survey 97 per cent of the respondents state that liquidity in the trading of government bonds has been adequate over the past six months (Figure 8). Benchmark government bonds are assessed as having much better liquidity than other government bonds, however the liquidity deteriorates the longer the time to maturity the bond has. The liquidity in the trade with treasury bills is still considered inadequate (see Figure 9). 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 declined over the past year.

Liquidity in the mortgage certificates market is considered to have been about as good during the past six months as was stated in the previous survey. Of those participants who are active in the markets for mortgage bonds and mortgage certificates, 85 per cent and 60 per cent respectively responded that liquidity has been adequate over the past six months (see Figures 10-11). The liquidity for mortgage bonds is also assessed as poorer for longer maturities.

Although liquidity is largely deemed to have improved on the Swedish fixed-income market, a number of participants state in their comments to the questions that liquidity is still poorer than prior to the crisis. One can see from the responses that the difference between purchase and sales prices has declined and begun to return to normal.

With regard to the market for interest rate swaps (SEK/SEK) and repos, 94 per cent and 93 per cent of the respondents active in these respective markets state that liquidity has been adequate or better over the past six months (see Figures 12-13). The percentage who consider that liquidity has been adequate in FRA and swap/STINA in SEK are 98 and 78 per cent respectively (see Figures 14-15).

[3] 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 48 participants. The figures include only those who have been active in the specific segment.

**Figure 8. What is your view of liquidity with regard to government bonds over the past six months?**

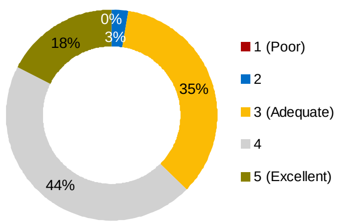



**Figure 9. What is your view of liquidity with regard to treasury bills over the past six months?**

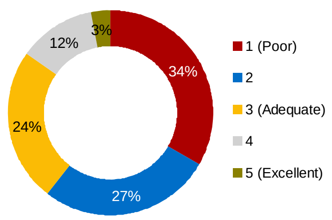



**Figure 10. What is your view of liquidity with regard to mortgage bonds over the past six months?**

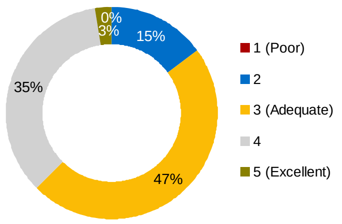



**Figure 11. What is your view of liquidity with regard to mortgage certificates over the past six months?**

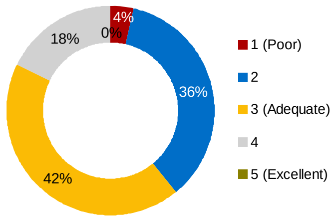



**Figure 12. What is your view of liquidity with regard to swaps (SEK/SEK) over the past six months?**

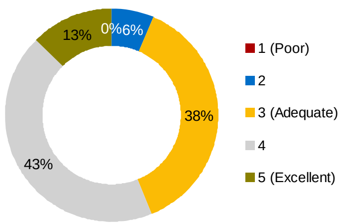



**Figure 13. What is your view of liquidity with regard to repos over the past six months?**

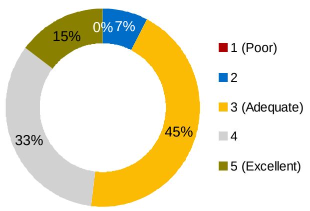



**Figure 14. What is your view of liquidity with regard to FRA (in SEK) over the past six months?[4]**

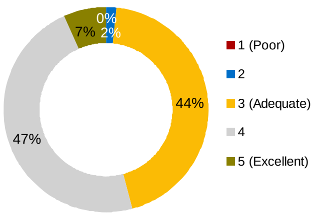
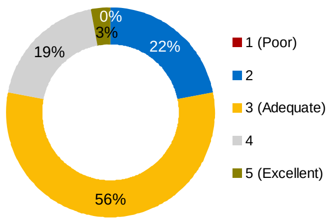



**Figure 15. What is your view of liquidity with regard to swap/STINA (in SEK) over the past six months?[5]**




[4] Includes answers from participants active on both the fixed-income and foreign exchange markets. FRA is short for Forward Rate Agreement.

[5] Includes answers from participants active on both the fixed-income and foreign exchange markets. STINA stands for STIBOR T/N Average, which is an average rate for the shortest rate on the STIBOR market.

In the spring survey the participants in the fixed-income market were also asked to respond to the question of how they consider the issue of corporate bonds and commercial paper to have functioned over the past six months. The responses from the companies issuing on these markets was rather varied with regard to issues of corporate bonds, while all of them agreed that issues of commercial paper have functioned well.

In response to the question of whether there is any particular instrument that will be more important on the Swedish fixed-income market in the coming period, a number of different instruments are mentioned. Some of those mentioned were inflation-linked bonds, mortgage bonds, swaps and RIBA futures. If repos traded through a central clearing counterpart (CCP) become a reality, they are expected to play an important role. However, treasury bills are only expected to play a minor role on the Swedish fixed-income market in the future.

Moreover, the participants were asked to assess how the Swedish STIBOR fixing had functioned over the past six months.[6] Almost all of them considered that this had worked satisfactorily. In the autumn survey the responses were more divided, but then the question was how the STIBOR fixing had functioned during the crisis.

## *The functioning of the Swedish foreign exchange market*[7]

A broad impression among the respondents who are participants in the Swedish foreign exchange market is that it has functioned well over the past six months. 94 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 an improvement on the autumn survey, when the figure was 78 per cent. Even in an international comparison, the SEK market is considered to have functioned better than before. Now, 88 per cent of respondents state that the SEK market is functioning adequately (see Figure 17), compared with 74 per cent in the autumn survey. The comments to the questions also indicate that liquidity is good and fewer respondents consider liquidity to be uneven, compared with six months ago.

**Figure 16. What is your assessment of the functioning of the SEK market over the past six months?**

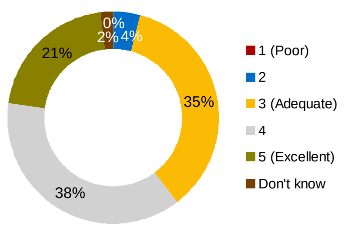
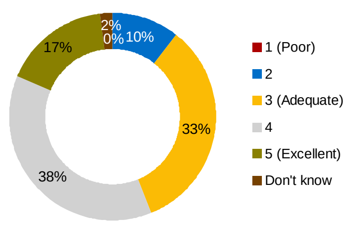



**Figure 17. Making an international comparison, what is your assessment of the functioning of the SEK market over the past six months?**




More than 90 per cent of the respondents consider that the liquidity in the market for spots in SEK/EUR and the market for futures in SEK/USD has been adequate (see Figures 18-19) over the past six months. This is an improvement of around 25 percentage points in both cases, compared with the autumn survey. In the comments regarding the most important changes in the SEK market many wrote that liquidity is better, volatility lower and that the Swedish krona is beginning to appreciate.

[6] 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.
[7] 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 48 participants. The figures include only those who have been active in the specific segment.

**Figure 18. What is your view of liquidity with regard to spots (SEK/EUR) over the past six months?**

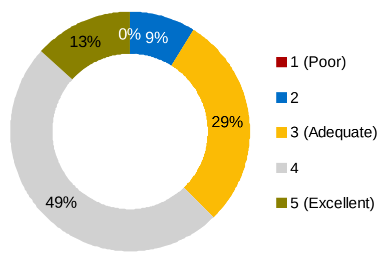
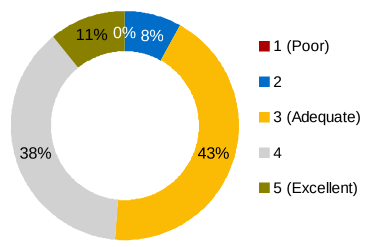



**Figure 19. What is your view of liquidity with regard to futures (SEK/USD) over the past six months?**




For other parts of the foreign exchange market the results are more uncertain, as a large share of the respondents, between 23 and 68 per cent, are not active in these segments. Almost all of those active in the market for currency options and overnight loans (O/N) and loans from tomorrow until the next day (T/N) in Swedish kronor consider that liquidity in the market has been adequate or better over the past six months (see Figures 20-21). With regard to liquidity in SEK for futures with maturities of more than three months (in SEK/EUR), 83 per cent of respondents consider it adequate (see Figure 22).

**Figure 20. What is your view of liquidity with regard to currency options (in SEK) over the past six months?**

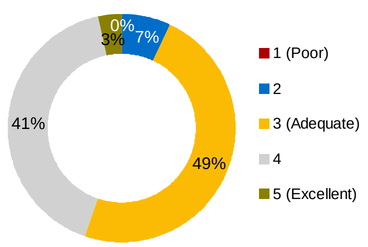
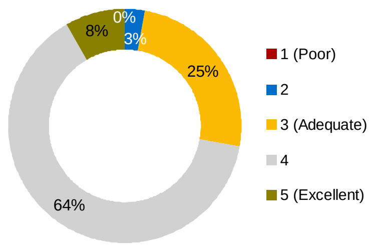
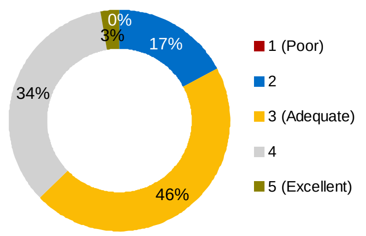



**Figure 21. What is your view of liquidity regarding O/N and T/N (in SEK) over the past six months?**




**What is your view of liquidity with regard to futures with maturities longer than 3 months (in SEK/EUR) over the past six months?**



Financial Stability Department
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