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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 2011

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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 assess that global imbalances and new regulations are the largest risks to the Swedish financial system. Participants' risk propensity is not much changed compared to six months ago, as the market situation has not changed substantially in the period. Most sub markets are reported to be functioning more effectively now than reported last autumn. The increased volatility in the Swedish interbank market after the phasing out of the Riksbank's extraordinary liquidity facility in October last year, which had a large impact on answers in the previous survey, has somewhat decreased. Market participants have adjusted to the new market situation, although they still see a risk with the increased volatility and high interest rates in the Swedish interbank market. These are the conclusions of the Riksbank's Risk Survey, which was carried out in April/early May 2011.[2]

The participants' views on risks to the Swedish financial system

GLOBAL IMBALANCES AND NEW REGULATIONS - THE GREATEST RISKS TO THE SWEDISH FINANCIAL SYSTEM

Participants were asked to rank the main risks to the Swedish financial system and estimate how each risk has changed since the previous Risk Survey in October 2010. They were asked to take into account both the probability of the risk materialising and the potential impact it could have on the Swedish financial system in the next six to twelve months. The ranking of the risks can be seen in Table 1. Grade 1 means that the risk is insignificant and grade 8 means that the risk is extremely high (see ranking scale in the footnote).[3]

According to the responses, global imbalances are considered to be the largest risk to the Swedish financial system. This is the only risk considered to be high, based on the ranking it received. Other risks that are ranked above average include new regulations such as Basel III and Solvency II, increased funding costs, house price developments in Sweden, political risk, market liquidity risk and funding liquidity risk. The risks associated with global imbalances and increased funding costs were estimated to have increased since the fall. The risk with the development in the Baltic countries is low, according to the respondents. Of the risks identified in the previous survey, this is the only risk to the Swedish financial system that has decreased since last autumn.[4]

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1 With effect from the 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 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 7 April and 2 May 2011. The Riksbank commissioned the 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 85 participants active in the Swedish fixed-income and foreign exchange markets. The groups surveyed are the Riksbank's monetary and foreign exchange policy counterparties (market makers) and active participants in these markets, both investors and borrowers. The total response frequency amounted to 81 per cent.
2 By the past six months/half year we hereinafter refer to the period October/November 2010 to April/May 2011.
3 The same grade could be assigned to more than one risk. Ranking scale: 1 = Insignificant, 2 = Very low, 3 = Low, 4 = Below medium, 5 = Above medium, 6 = High, 7 = Very high and 8 = Extremely high.

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Colour code for the ranking scale from 1 to 8:

1	2	3	4	5	6	7	8

Table 1: Respondents' ranking of risks to the Swedish financial system identified in the previous Risk Survey*.

Risks	**Ranking 1-8 (average)**	**Changes since October 2010**
Global imbalances	High **5.7**	Increased slightly
New regulations	Above average **5.0**	Unchanged
Increased funding cost	Above average **4.9**	Increased slightly
House price developments in Sweden	Above average **4.9**	Unchanged
Political risk	Above average **4.8**	Unchanged
Funding liquidity risk[5]	Above average **4.8**	Unchanged
Market liquidity risk[6]	Above average **4.6**	Unchanged
Credit risk	Below average **4.4**	Unchanged
Sovereign debt risk	Below average **3.9**	Unchanged
Development in the Baltic countries	Low **3.4**	Decreased slightly

*The risk categories are based on answers given by participants in the Risk Survey in the fall of 2010.

The Swedish financial markets are considered to be functioning well, but many of the respondents believe that global imbalances that have built up pose a risk to the Swedish financial system in the next year. The low interest rate environment has caused overpricing of riskier assets in the global financial markets, according to the respondents. There have, for example, been large capital inflows to emerging markets. There may be some underlying problems remaining in financial markets which are to be seen when economic policies in the major economies change, which is now more likely to happen than six months ago due to better growth prospects in these countries. Those changes may cause a turnaround in capital flows, which could have a large effect on global financial markets. A few of the respondents are worried about currency imbalances in the global environment, which is also related to this issue. Political uncertainty in many parts of the world, such as in the Middle East and in North Africa, and natural disasters such as the earthquakes in Japan, also have an impact on the currencies. To summarize, the respondents' view is that the development in the global environment is seen as a risk to the Swedish financial system since it could dampen economic developments in Sweden, which is a small country dependent on exports, and increase volatility in financial markets.

Many of the respondents discuss the unstable interest rate environment in the interbank market in Sweden since the autumn. Some of the respondents believe that the volatility in the interbank market has an impact on the liquidity and on confidence in all Swedish financial markets. In this perspective, both market liquidity and funding liquidity are seen as risks. A number of participants on the other hand state that the situation is better now than it was in October last year.

4 Participants in the fixed-income market (average ranking 5.6) are much more worried about new regulations than participants in the foreign exchange market (average ranking 4.4), since the fixed-income market will be more directly affected by new regulations. Participants in the fixed-income market (market makers have the strongest view) are also more worried about market- and funding liquidity since they have seen increased volatility in the market since the autumn last year. Investors (average ranking 5.2) are then much more worried about the house price development in Sweden than borrowers (average ranking 4.2). Market makers are then much less worried about global imbalances and political risk than investors and borrowers.
5 Liquidity situation in markets in terms of institutions' access to cash/funding.
6 Liquidity situation in markets in terms of depth and bid-ask spreads in instruments.

After the last of the Riksbank's extraordinary lending matured in the fall, the price of liquidity has increased and been more volatile. This has led to increased funding costs for borrowers, according to the respondents, which is considered as a risk by them. On the other hand, investors do not mention this as a risk.

The sovereign debt risk in the euro area is still considered to be high and the high sovereign debt in the US and the UK has also come into focus. The respondents are worried that if a country will default or has to restructure its debt it will cause problems in the financial markets. The sovereign debt risk is on the other hand not considered as a direct risk to the Swedish financial system. This is because Swedish institutions have low exposure to these countries, which can explain why the risk is ranked below average by the participants. However, there is an indirect risk through other countries' exposures, which could spill over to Sweden. Market participants have started to debate whether there is a "risk free" rate available in the market. Government bonds that were previously seen by the market as almost "risk free" now have more risk associated due to large government debt and structural problems in some countries. The role of the bonds is therefore changing from earlier being the safest bonds available in the market. This impacts the pricing of other products in the financial markets.

Participants were asked if there are any other main risks to the Swedish financial system that were not listed in Table 1. Some of them mentioned the lack of government bond supply in Sweden. New regulations will require more holdings of government bonds by market participants, but the respondents believe the supply of government bonds in Sweden is too low for that purpose. This is considered a risk for the financial system as the increased demand risks to decrease rather than increase liquidity in the financial markets, contrary to the aim of the regulations. Other risks mentioned were the risk of increasing inflation, developments in commodity prices and the increased household debt. Higher oil and food prices, due to for example political risk and natural disasters, may impact global economic growth, which has a direct impact on Sweden. Increased household debt and increasing house prices in Sweden make some respondents worried that a bubble is building up in the market. It is interesting to note that no participants mention economic downturn as a risk in itself, as many did in the previous Risk Survey. One reason for this could be that the global recovery is now on a firmer footing compared to six months ago.

LIQUIDITY RISK IS CONSIDERED THE MOST DIFFICULT RISK TO MANAGE FOR THE INSTITUTIONS

Participants were asked to select the risks to the Swedish financial system that their institution would find most difficult to manage. As can be seen in Table 2, market liquidity risk and funding liquidity risk are considered the most difficult risks to manage for the institutions, as 67 per cent and 54 per cent of the respondents selected those risks respectively.

Most institutions are reliant on well-functioning financial markets. If the liquidity is poor, it can create large problems for them. As an example, investors need to be able to adjust their asset portfolios when needed and borrowers in foreign currency are dependent on a well-functioning foreign exchange swap market. With poor liquidity, market makers will have difficulty with serving the system and their clients. Institutions may then end up with more risk on their books than they are willing (or able) to hold since they cannot perform their daily operations as planned. Access to liquidity is also very important for institutions' funding.

Table 2: Risks to Swedish financial system that are most difficult for the institutions to manage

Risks	% of respondents
Market liquidity risk	67%
Funding liquidity risk	54%
New regulations	34%
Global imbalances	30%
Sovereign debt risk	25%
Credit risk	25%
Increased funding cost	24%
Political risk	24%
Property price development in Sweden	10%
Development in the Baltics	4%

The risk categories are based on answers given in the previous Risk Survey in the fall of 2010. The table shows the percentage of the respondents that cited each risk.

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

LARGELY UNCHANGED RISK PROPENSITY

Previous Risk Surveys indicated that risk propensity had been increasing among the participants since the financial crisis began to wane in 2009. During the last six months the risk propensity has increased among 39 per cent of the participants, which is in line with the answers in the previous survey (41 per cent). When the participants looked six months ahead last autumn, only 26 per cent expected to increase their risk taking during the period. 47 per cent neither increased nor decreased their risk propensity in the last six months, stating that their risk mandates have not changed. This could be an indication that they are back to their normal risk-taking levels after the financial crisis. On the other hand, 14 per cent have decreased their risk taking in the last six months (see Figure 1). The majority of the respondents believe their risk propensity will be unchanged over the coming six months (see Figure 2).

According to the respondents, the increased risk taking is due to the recovery of the global economy, positive reporting from banks and corporations, and the beginning of a normalisation of the fixed-income market after the excess liquidity was pulled away in the Swedish market last autumn. Some say that the market has become more stable even though problems in the financial markets outside of Sweden remain.

The actors that have decreased their risk taking state that the uncertainty in the currency markets due to the global environment has made it more difficult for them to interpret the market development. Factors that have had an impact include the natural disasters in Japan, the political situation in the Middle East and North Africa, monetary policy development in the United States and the sovereign debt problems in the euro area. Some respondents state that new regulations call for less risk taking by institutions.

Figure 1. How has your propensity to take risk changed compared to six months ago?

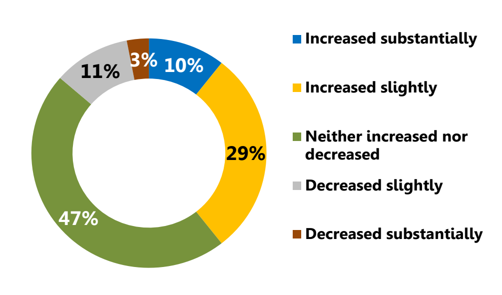
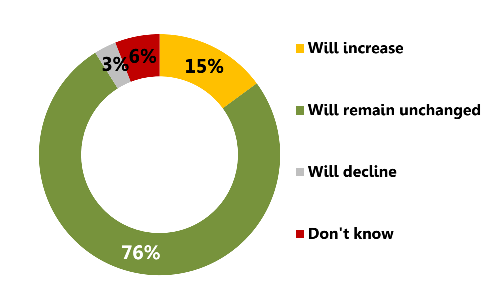


Figure 2. How do you foresee your propensity to take risk over the coming six months?



LIQUIDITY BUFFERS ARE MORE OR LESS UNCHANGED

The need for liquidity buffers often increases in times of uncertainty. A large percentage of the respondents, 40 per cent, state that they have not changed their liquidity buffers in the past six months. They state that the market situation has not changed much during the period. Around one third of respondents state that their institution has increased its liquidity buffer in the last six months (see Figure 3). The respondents claim that is due to increased volatility in the Swedish interbank market in the period after the last of the Riksbank's extraordinary lending matured during the autumn. The situation has on the other hand improved recently according to the respondents. Only 7 per cent have decreased their liquidity buffers in the past six months, due to less uncertainty in financial markets now compared to a few months ago (all of those respondents were investors). In response to the question on how the liquidity buffer will change in the coming six months the majority, or 51 per cent, believe it will remain unchanged (see Figure 4).

Figure 3. How has your institution's buffer of liquid assets changed in relation to six months ago?

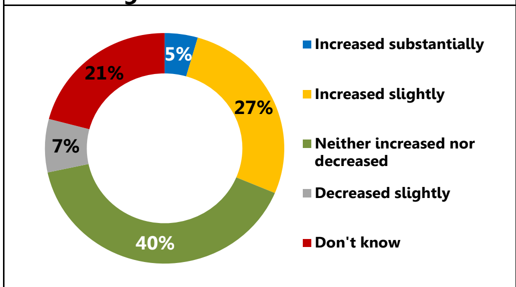
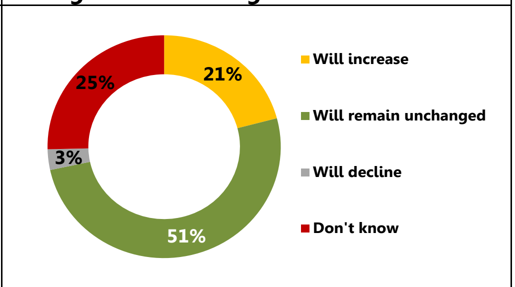


Figure 4. How do you think your institution's buffer of liquid assets will change in the coming six months?



The participants' view on the financial markets and future developments

INCREASED RISK AWARENESS AND INCREASED COST OF CAPITAL AFTER THE RECENT FINANCIAL CRISIS

Even though some of the respondents comment on volatility in the Swedish interbank market, the overall picture is that the functioning of the financial markets now, compared to six months ago, is considered to be the same or better by the majority of the respondents (88 per cent). 40 per cent consider the functioning to be slightly better due to less volatility and better liquidity in markets recently compared to half a year ago. 48 per cent, on the other hand, states that the functioning has not changed much in the past six months.

Respondents were asked what they see to be the lasting effects of the recent financial crisis. Several responded that risk awareness has increased and that less risk taking will have an impact on the liquidity in the markets. New regulations, a higher price for liquidity and increased credit spreads are parts of the new environment. In addition, imbalances remain as debt has been moved from the private sector to the public sector causing persistent government deficits.

When asked in what way participants expect new regulations to impact their business, most participants expect increasing cost of capital for all financial market participants. Some respondents believe they will take less risk and that the usage of collateral and clearing houses will increase. The respondents also think that corporations will increase their funding through the capital markets as they expect banks to be less willing to lend to them and the cost of bank loans will increase. They also see a possibility for new risks to build up since everyone will be working in the same direction due to the new regulations. As a result, volatility might increase and the liquidity decrease, but in the long run regulations are seen to be positive for the society. Administration costs for banks and insurance companies will increase when adapting to the new regulations and to fulfil requirements such as increased reporting.

A number of respondents believe that new regulations will be in focus in the Swedish financial markets in the coming six months. In addition, higher inflation in Sweden, the Riksbank's repo rate path as well as the housing market development will be in focus. Some mention the development of interest rates in the Swedish interbank market and the cross currency swaps. In international markets the focus will be on government debt restructuring and fiscal budgets, the end of "cheap" money with the Federal Reserve starting to hike interest rates and on political problems in the Middle East.

SOVEREIGN DEBT CRISIS HAS NOT SPILLED OVER TO SWEDISH FINANCIAL MARKETS

Most respondents do not see any spill over effect from the sovereign debt crisis in the euro area to Swedish financial markets. Demand for Swedish securities has on the other hand increased due to the strong economic standing of the country and it is currently considered as a safe haven for investors. This has, for example, led to stronger krona and lower yields on long-term government bonds in Sweden. A negative side to that is that the increased demand for Swedish government bonds from abroad collides with increased demand by Swedish banks and insurance companies due to new regulations. Some believe that in the long run the Swedish financial markets could be negatively impacted by the sovereign debt crisis if the situation gets worse. Sweden is dependent on exports and the Swedish banks on foreign currency funding. Sweden could therefore be impacted through decreased growth in the euro area and increasing funding costs in banks/mortgage institutions' mortgage portfolios or even decreased access to bank funding. If, for example, the situation takes a turn for the worse in Spain, stress on financial markets in the euro area with less risk taking, increased funding costs and decreased liquidity could also have a negative effect on Swedish financial markets, according to the respondents.

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Functioning of the Swedish fixed-income market[7]

LIQUIDITY HAS INCREASED IN MOST FIXED-INCOME SUB-MARKETS

The participants active in the money and bond market were asked how they viewed liquidity (in terms of depth and spread) over the past six months in different fixed-income instruments.

The liquidity in government bonds is assessed to have been better than in other fixed-income instruments. 89 per cent of the respondents state that the liquidity in government bonds has been adequate or better over the past six months (see Figure 5). Liquidity in treasury bills is still considered inadequate (see Figure 6). As indicated in earlier Risk Surveys, the liquidity in this market was considered relatively poor even prior to the crisis.[8]

Figure 5. What is your view of liquidity with regard to government bonds over the past six months?

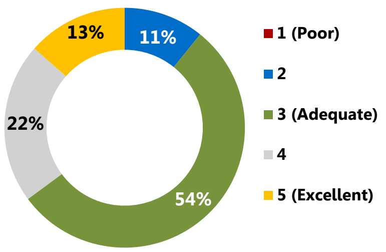
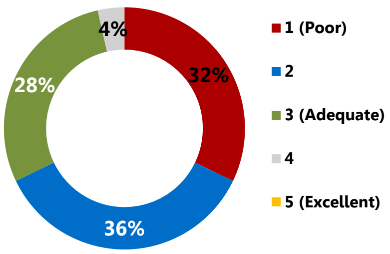


Figure 6. What is your view of liquidity with regard to treasury bills over the past six months?



Liquidity in mortgage bonds is assessed to be substantially better than in the previous survey. 33 per cent responded that the liquidity in the market has been less than adequate in the past six months, compared to 64 per cent six months ago (see Figure 7). 67 per cent state that liquidity in mortgage bonds is adequate or better. Liquidity in the mortgage certificates market is also considered to have improved in the past six months, with 65 per cent stating it is adequate or better (see Figure 8). The liquidity in corporate bonds is considered to be better than adequate by the majority of the respondents, or 75 per cent, which is better than for mortgage bonds (see Figure 9). That is interesting, since mortgage bond are considered less risky, due to the fact that they are collateralised.

7 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. The figures include only those who have been active in the specific segment.
8 This could to a large extent be due to the fact that these securities by their nature are "buy and hold" investments. Another reason for the poor liquidity could be that the supply of treasury bills has been declining.

Figure 7. What is your view of liquidity with regard to mortgage bonds over the past six months?

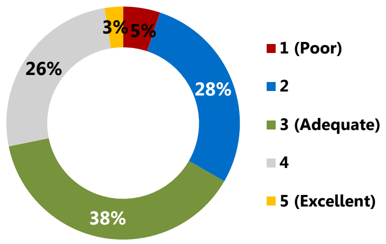


Figure 8. What is your view of liquidity with regard to mortgage certificates over the past six months?

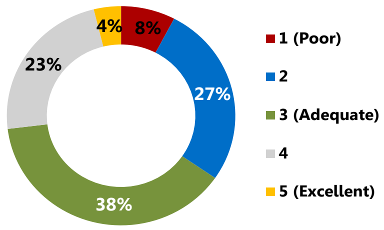
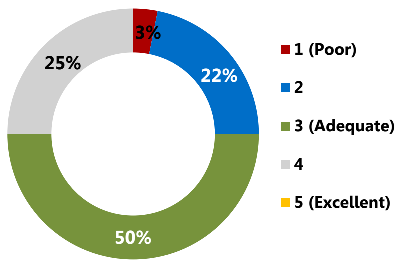


Figure 9. What is your view of liquidity with regard to corporate bonds over the past six months?



Liquidity in repo agreements using government bonds as collateral is considered adequate by 80 per cent. The responses were in line with the answers last autumn (see Figure 10). Liquidity in repo agreements using mortgage bonds as collateral is considered adequate by 57 per cent of the respondents (see Figure 11). That is an improvement from last autumn when only 35 per cent said it was adequate.

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

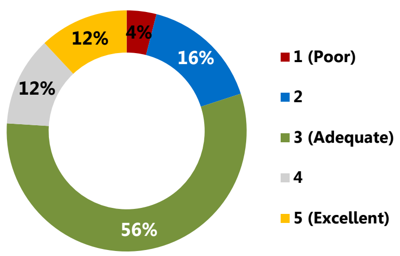
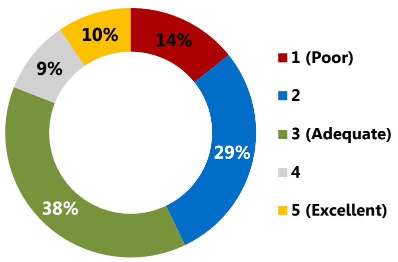


Figure 11. What is your view of liquidity with regard to repos with mortgage bonds over the past six months?



The liquidity in the shortest interbank market segment (overnight and tomorrow/next contracts in Swedish kronor) over the past six months has been poorer than adequate according to 60 per cent of the participants. This reflects the increased volatility and increased interest rates in the market since October last year (see Figure 12).

With regard to the market for interest rate swaps (in Swedish kronor), liquidity is adequate according to 88 per cent of the respondents (see Figure 13), which is slightly better than last fall.

Figure 12. What is your view of liquidity regarding O/N and T/N contracts (in SEK) over the past six months?

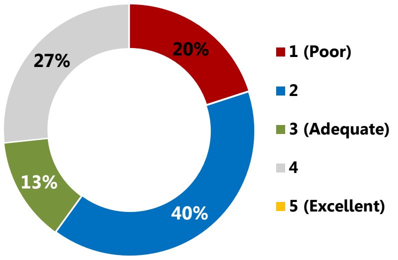
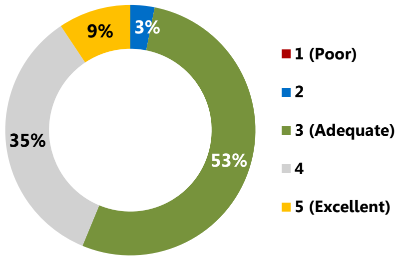


Figure 13. What is your view of liquidity with regard to interest rate swaps (SEK/SEK) over the past six months?



Liquidity in STINA swaps has been less than adequate according to 50 per cent of respondents (see Figure 14). According to the respondents, increased volatility in the underlying tomorrow/next STIBOR fixing is one reason for the poor liquidity in STINA swaps. Liquidity in RIBA futures is on the other hand considered to be adequate by 64 per cent of the respondents (see Figure 15).

Figure 14. What is your view of liquidity with regard to STINA swaps (in SEK) over the past six months?[9]

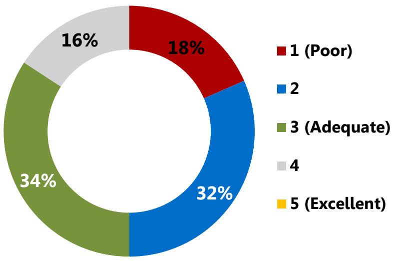
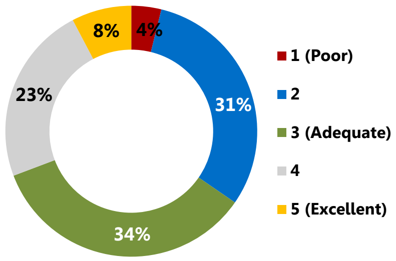


Figure 15. What is your view of liquidity with regard to RIBA futures (in SEK) over the past six months?[10]



The liquidity in cross currency swaps from euro to Swedish kronor is considered adequate by 65 per cent of the participants (see Figure 16), while 60 per cent state that the liquidity is adequate in cross currency swaps from dollar to Swedish kronor (see Figure 17).

9 Includes answers from participants active on both the fixed-income and foreign exchange markets. STINA stands for STIBOR T/N Average. A STINA contract is an agreement lasting up to a maximum of one year to pay or receive the difference between an agreed fixed rate of interest and a variable overnight rate (STIBOR T/N).
10 Includes answers from participants active on both the fixed-income and foreign exchange markets. RIBA is a cash-settled futures agreement, specifically based on the Riksbank's repo rate. The contract base is a fictitious loan with a term corresponding to the period between two international money market (IMM) dates, with final settlement occurring against the average repo rate for the period concerned.

Figure 16. What is your view of liquidity with regard to cross currency swaps (EUR/SEK) over the past six months?

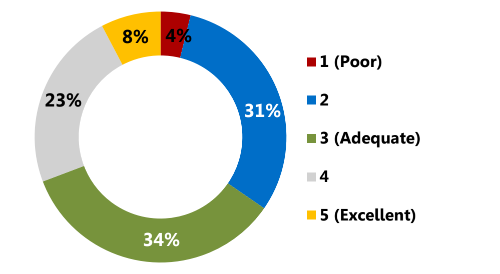
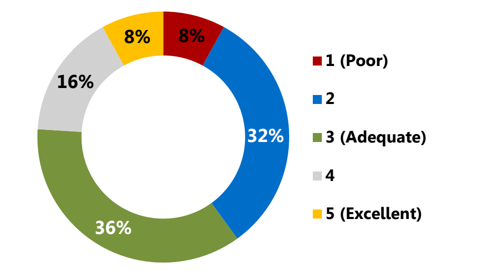


Figure 17. What is your view of liquidity with regard to cross currency swaps (USD/SEK) over the past six months?



The conclusion is that liquidity has increased in most fixed-income instruments in the past six months, but the liquidity is on the other hand still poorer compared with the results from the Risk Survey one year ago. Not many consider the liquidity in the O/N and T/N contracts and the STINA swaps to be adequate. Those instruments have been impacted by the increased volatility in the interbank market in Sweden since last fall. According to the respondents the increased volatility has pushed away some market actors in the money market, especially foreign, which has contributed to the decrease in liquidity. The liquidity in mortgage bonds has on the other hand improved notably since the fall. According to a few respondents it is astonishing to see how much effect the Riksbank's exit of extraordinary loan facilities in the fall had, even though it was according to plan.

Functionality of fixed-income products and other instruments used by the Swedish fixed-income market participants

In response to the question of whether there is any instrument that will be more important for the Swedish fixed-income market in the period ahead, a number of different instruments are mentioned. The participants believe that longer term mortgage bonds, all sorts of swaps and forwards contracts will become more important. Centrally cleared products are also believed to become more important. However, treasury bills and commercial paper are thought to become of less importance in the fixed-income market.

When assessing the Swedish STIBOR[11] fixings over the last six months, participants say they have in general reflected funding costs in the market well and that they have not been biased in any direction. Although from time to time they have not functioned well. Many of the respondents are more worried about the increased level of the STIBOR fixings after the maturity of the last extraordinary loans in October 2010, granted by the Riksbank during the crisis. As an example, the three month STIBOR has been trading around ninety basis points above the repo rate at a time when there are not considered to be any underlying problems in the market. Market participants raise the question of what would happen to the rates if a new crisis were to hit the Swedish financial markets.

When asked about the functioning of the SEK/EUR and SEK/USD cross-currency swaps, many participants state that they have been functioning adequately. This is despite the one-sided flow in the market as the demand for kronor through the cross currency swap is higher than the demand for foreign currencies. Liquidity has on the other hand been affected by the volatility in the Swedish interbank market. The shorter maturities have functioned better than the longer ones

11 Stockholm Interbank Offered Rate (STIBOR). The STIBOR fixing is the average (except for the highest and lowest offer) for the interest rates listed daily by selected banks in Sweden. Also, STIBOR is used as reference rate in interest rate agreements or for the pricing of derivatives.

and the SEK/EUR cross currency swap is more common than the SEK/USD cross currency swap. The swap market is mainly driven by Swedish mortgage institutions' issuance of mortgage bonds in foreign currency (mainly euro) which are swapped to SEK and by the overall access to liquidity in markets.

During 2010 Nasdaq OMX Stockholm launched a new central counterparty (CCP) clearing service of repos as an alternative to an over-the-counter (OTC) market. So far the traded volumes have been fairly low. According to the respondents the low trading through the CCP so far is due to too few participants in the market. One Swedish bank is for example not fully on board yet, foreign banks are excluded so far and not many clients are participating so far. Another explanation given is that Nasdaq OMX Stockholm has not set up the clearing possibility for repos with all mortgage bonds and index linked bonds available. Some of the respondents also claim that it is too expensive to use the repo clearing.

The functioning of the foreign exchange market[12]

A broad impression (76 per cent) among the respondents participating in the Swedish foreign exchange market is that the market has functioned adequately over the past six months (see Figure 18). However, in the previous survey a higher percentage (86 per cent) responded that the market was working better than adequately. In an international comparison, the foreign exchange market seems to be working very well according to 87 per cent of the respondents (see Figure 19), which is a higher percentage than last autumn. This can reflect that the global foreign exchange markets have in general been affected by the natural disasters in Japan and political uncertainty in the Middle East and North Africa.

Figure 18. What is your assessment of the functioning of the SEK market over the past six months?

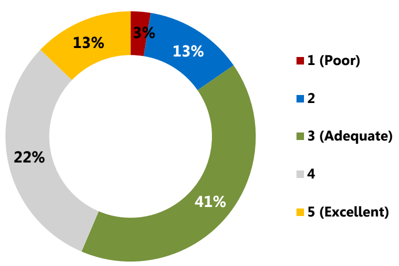
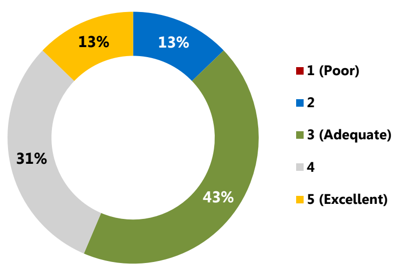


Figure 19. Making an international comparison, what is your assessment of the functioning of the SEK market over the past six months?



LIQUDITY IS CONSIDERED ADEQUATE IN THE FOREIGN EXCHANGE MARKET

Looking at the responses regarding liquidity in different foreign exchange instruments, the liquidity in the Swedish foreign exchange market is in general considered to be adequate, as can be seen in Figures 20-24. More respondents than in the previous survey consider liquidity to be better than adequate in most foreign exchange instruments. For example, regarding the spot market, 45 per cent responded that liquidity was better than adequate in this survey, compared to 31 per cent in the last autumn survey. The exception is currency options, where more think it is just working adequately. That market is on the other hand very small in Sweden.

12 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. The figures include only those who have been active in the specific segment.

Participants were asked what has functioned well or poorly in the foreign exchange instruments over the past six months. The majority answered that liquidity is in general very good, but from time to time it can be poor for shorter periods due to market events. Electronic platforms have boosted liquidity in the market according to some respondents. The market liquidity could on the other hand be impacted more by the volatility in the Swedish interbank market, if the situation worsens again. This would mainly impact O/N and T/N FX swaps and forward contracts.

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

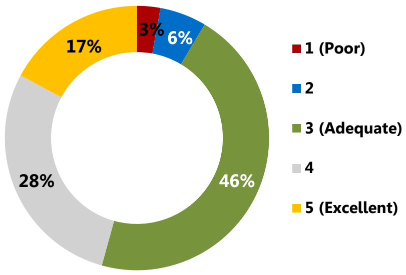


Figure 21. What is your view of liquidity with regard to currency options (in SEK) over the past six months?

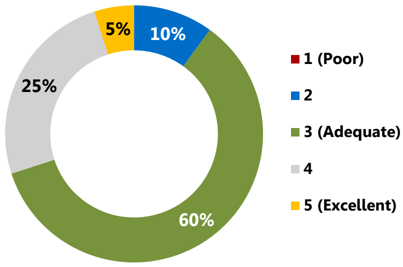


Figure 22. What is your view of liquidity with regard to O/N and T/N FX swaps (in SEK) over the past six months?

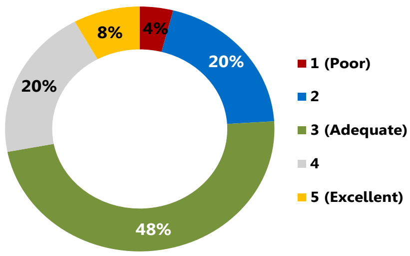


Figure 23. What is your view of liquidity with regard to forward contracts FRA (in SEK) over the past six months?[13]

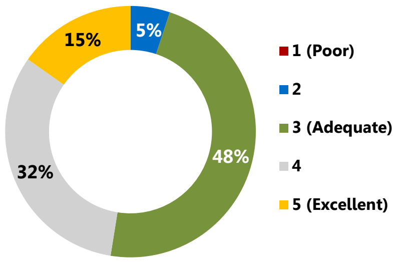
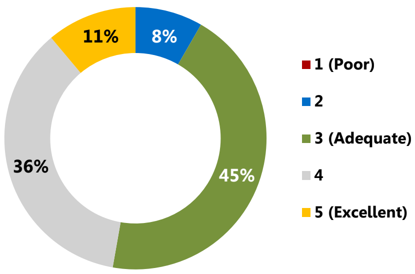


Figure 24. What is your view of liquidity with regard to forward contracts (in SEK) over the past six months?



When asked, some of the participants sees risks with the increased presence of algorithmic trading in the FX market.[14] For example, the algorithmic trading could make it difficult for market

13 Includes answers from participants active on both the fixed-income and foreign exchange markets.

participants to balance risks. Unusual market movements are seen more often since the systems cannot for example take event risk into account and estimate when liquidity decreases. Therefore there is a risk that trends will last longer than otherwise. When the trend finally ends, the move in the market can be exaggerated and more volatile. This has created problems for export/import corporations and fund managers, for example. However, others see no risks with the algorithmic trading and think it is good for pricing in the market.

Finally, participants were asked what the most important trends in, or changes to, the Swedish krona market were in the last six months. The most mentioned topic was that the krona has strengthened due to the strong Swedish economy, the strong banking sector and the safe haven status of Swedish securities. Increased volatility in the interbank market after the Riksbank's last extraordinary loans matured in October last year also had some effect on some instruments in the Swedish krona market.

14 Algorithmic trading is a trading system that utilises very advanced mathematical models for making transaction decisions in financial markets. The strict rules built into the model attempt to determine the optimal time for an order to be placed that will cause the least amount of impact on for example the FX price.

Financial Stability Department
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