

## No serious credit crunch in Sweden

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During the financial crisis and subsequent substantial economic downturn, lending by the banks to households and companies has diminished. In a recession, it is normal for demand for loans to decline and for the banks' willingness to finance high-risk projects to diminish. However, if a credit crunch should develop, meaning that credit-worthy households and companies do not receive the financing they require due to problems in the credit market, this will risk delaying an economic recovery. This economic commentary examines whether there are any signs indicating a credit crunch in Sweden. The conclusion reached is that, at present, there is nothing to indicate that Swedish companies and households are facing a serious credit restriction. The authors examine the debt financing of both households and companies, as well as Swedish banks' lending capacity, which provides important information on the situation in the credit market.

To what extent are Swedish households and companies facing a credit crunch?<sup>2</sup> Different sources, such as company surveys and the daily press, indicate that companies are finding it difficult to obtain loans from their usual sources of financing and that this is impeding their investing activities and deepening the already substantial economic downturn. In certain countries, central banks have adopted unconventional measures, with the intention, among others, of easing financing restrictions on companies.<sup>3</sup> Examples of such measures include the purchase of companies' debt obligations.<sup>4</sup> The financing situation of households has also been the subject of discussion and action.

### What do we mean by 'credit crunch'?

Before we can answer the question of whether there exists a credit crunch, it is necessary to define precisely what this term signifies. In an economic downturn, lending to households and companies normally declines. This is primarily due to the fact that a decline in economic activity usually leads to a decrease in demand for loans. Furthermore, credit risks increase in less prosperous times. This leads banks to tighten their terms for granting credit and to reduce their lending activities. A number of companies and households may then experience difficulties in raising loans. This is not surprising. When the level of risk in the economy increases, the banks, to some extent, must ration their lending to high-risk projects in order to avoid excessive loan losses.

In addition to such cyclical effects, there may be serious problems or frictions in the credit market, meaning that creditworthy companies or households cannot obtain sufficient financing, for example due to the fact that important channels of financing no longer function. In such cases, the central bank may need to act as an intermediary. Otherwise, robust companies risk collapsing and creditworthy households risk having to cut back on their consumption to an unnecessarily large extent. This is the perspective from which we define credit crunch – that is, as a reduction in the granting of credit in excess of that justified by the prevailing economic situation.

However, for natural reasons, it is very difficult to draw clear boundaries between the reduction of lending due to the economic situation and the reduction of lending due to problems on the credit market. Even so, our analysis provides no support for the hypothesis that there currently exists a serious credit crunch in Sweden. Statistics indicate that there were problems within certain segments of the credit market towards the end of 2008. Above all, it was difficult for companies to obtain financing from the overseas securities market. In order to compensate for this, companies instead increased their bank borrowing, both in Sweden and abroad. However, after the beginning of 2009, statistics indicate that it has again become slightly easier for companies to raise loans on the foreign securities markets.

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<sup>2</sup> In this context, the word 'companies' refers to non-financial companies.

<sup>3</sup> Refer also to the box "Differences in financial structure and crisis measures in various countries" in the Riksbank's Monetary Policy Report 2009:2.

<sup>4</sup> For example, the Riksbank has issued loans with longer maturities and against more types of collateral than is usually the case. More information about the measures adopted by the Riksbank during the financial crisis is available at the Riksbank's website, [www.riksbank.com](http://www.riksbank.com).

One important reservation is that we consider, in our analysis, the fact that the Riksbank and government authorities have adopted measures to ensure the functioning of the credit markets.<sup>5</sup> The supply of credits is determined by the banks' lending capacity. Issues of bonds and certificates normally constitute an important source of financing for them. However, in the wake of the global financial crisis, foreign issues came to a halt and those bonds and certificates falling due for payment could not be traded. During the last three months of 2008, the Riksbank lent USD to the banking system in an amount equivalent to almost SEK 200 billion. The amount lent by the end of the first six months of 2009 was equivalent to approximately SEK 205 billion. The Riksbank's USD lending has acted as a replacement for the banks' reduced market borrowing abroad. Without the measures implemented by the Riksbank and other government authorities in Sweden, we would probably have experienced disturbances in the financial system that may ultimately have led to a credit crunch.

## Forms of borrowing among households and companies

Both companies and households in Sweden are heavily dependent upon loans from banks and other credit institutions.<sup>6</sup> The mortgage institutions and banks account for the greatest part of households' loans.<sup>7</sup> The greatest part of households' loans, approximately 90 per cent, consists of loans with real property as collateral. The remaining part of households' borrowing consists of loans for consumption and other types of loans.

Bank loans account for just over half of corporate debt financing (see Figure 1). On the other hand, the portion of debt financed via the securities markets plays a significantly lesser role for companies. Corporate bonds and commercial papers comprise only 9 and 2 per cent, respectively, of companies' total borrowing.<sup>8</sup> The remaining part, other loans, mainly consists of loans raised within the corporate group. Above all, this refers to Swedish-registered foreign subsidiaries borrowing from their parent companies overseas and Swedish companies borrowing from their subsidiaries registered overseas. This accounts for a significant part of companies' total borrowing. This part has increased over the most recent three years.

## Households' financing situation

### Households are increasing their borrowing – albeit at a reduced rate

Household borrowing is strongly linked to the development of house prices.<sup>9</sup> This is not surprising, considering that approximately 90 per cent of household borrowing from banks is comprised of loans with real property as collateral. When house prices fell at the beginning of the 1990s, household borrowing also declined (see Figures 2 and 3). In the later part of the 1990s, when the housing market recovered and house prices increased, household borrowing also increased. Consequently, neither is it surprising that household borrowing has declined when the price trend on the housing market has also recently weakened.

Households' borrowing needs have also declined as the growth of housing prices has fallen, albeit at a slower rate (see Figure 2). In May 2009, household borrowing increased by an annual rate of 8 per cent. In order to gain an understanding of recent trends in household borrowing, we have also studied three-month changes (seasonally adjusted) in the estimated annual rate. These indicate that the growth rate in borrowing has slackened since 2008 (see Figure 4), in line with the price trend for residential properties (see Figure 3). Borrowing statistics indicate that households are not currently facing any serious credit restrictions when applying for new loans.


<sup>5</sup> A compilation of measures implemented by Swedish authorities during the autumn of 2008 can be found in the box "Measures taken by the Riksbank and Swedish authorities during the financial crisis, autumn 2008" in the Riksbank's Financial Stability Report 2008:2.

<sup>6</sup> The term 'credit institutions' refers to Monetary Financial Institutions (MFIs), that is banks, mortgage institutions, finance companies and other credit market companies.

<sup>7</sup> The household sector is defined as households and non-profit organisations serving households.

<sup>8</sup> Of which approximately half, that is 5 per cent, consists of securities issuance in foreign currency.

<sup>9</sup> Refer also to the economic commentary "House prices and the economy" at the Riksbank's website, [www.riksbank.com](http://www.riksbank.com).



For the banks, loaning to households entails a comparatively low risk. This is primarily due to the fact that most households have loans with real property as collateral and that households are unable to avoid responsibility to pay for loans they have taken. This means that the degree of recovery is high and that loan losses are low for this type of loan. In addition, loans to households are given a low risk-weighting according to the regulations covering capital adequacy. This implies a lower capital cost for the banks, compared with other, higher risk lending, such as lending to companies. For this reason, in times of great uncertainty, banks can choose to increase lending to households at the expense of other, higher risk lending activities, if capital is a scarce resource in the bank. Consequently, it is easier for banks to maintain lending to households, even in periods of economic decline, compared with higher risk lending to companies.

### **Households' financing situation according to surveys and the Riksbank's stress tests**

ALMI's survey<sup>10</sup>, conducted among bank managers around the country during the first and second quarters of 2009, indicates that bank managers generally believe that lending to households will remain unchanged or will increase slightly in both the short and long term. Most bank managers state that it is not currently more difficult for either existing or new private customers to obtain a loan than it was in previous quarters.

Other factors affecting lending to households include unemployment and interest rate levels. Higher interest rates and unemployment can impair households' ability to repay loans over the long term. However, the Riksbank's stress tests<sup>11</sup> indicate that households' ability to pay continues to be good and that it is not appreciably impacted by a rise in unemployment. Heavily increased mortgage rates may yet impact low-income households in particular. However, this is not expected to lead to greater loan losses for the banks as this group is comparatively small and loans have primarily been taken out by households with higher incomes. In other words, loan losses arising from loans to households are not deemed to form a major risk for the banks' future lending capacity.

## **Companies' financing situation**

### **Declining growth rate in corporate borrowing**

As was stated in the introduction, corporate borrowing in Sweden is largely bank-based. The aggregate value of corporate borrowing from banks and credit institutions amounted to almost SEK 1 800 billion in May 2009. The growth rate of corporate borrowing has gradually weakened since peaking at the end of 2007 (see Figure 5). In May 2009, the annual growth rate amounted to around 5 per cent. The three-month change (seasonally adjusted), calculated on an annual basis, provides a better illustration of the development of corporate borrowing in the most recent period (see Figure 6). It indicates that corporate borrowing has decreased over the most recent two months. The outcome of -14 per cent for May 2009 is far below the historic average of 6.5 per cent. However, considering the major economic slowdown, it is not surprising that corporate borrowing has decreased.

### **Companies have raised long-term loans**

An understanding of corporate borrowing in terms of long and short term bank loans can be gained from an examination of the companies' balance sheets. Over the most recent two years, companies, taken as a group, have raised loans with longer maturities to a greater degree than previously. During the final quarter of the previous year, as well as following the end of the year, the number of long-term loans increased at a significantly greater rate than that of short-term loans, indicating that companies demanded – and received – loans with longer maturities to a greater extent than previously. In this context, the term long duration refers to loans with original fixed terms of more than one year. Considering the weaker economic climate and disruptions

<sup>10</sup> ALMI Företagspartner AB has carried out a quarterly survey called "Loan indicator" since September 2004. During the autumn of 2008, the Riksbank initiated a collaboration with ALMI in order to rework the questionnaire so that the survey now covers five areas of interest: lending to companies, bank offices' lending conditions for companies, lending to households, bank offices' lending conditions for households and economic developments.

<sup>11</sup> See the Riksbank's Financial Stability Report 2009:1.

on the financial markets, it seems rational of the companies to ensure that they have financing over the long term.

### **Companies' loans from foreign banks have not decreased<sup>12</sup>**

The examination of companies' balance sheets indicates that companies increased their loans from foreign banks during the previous year. Both flows in the balance of payments statistics and companies' balance sheets indicate that Swedish companies' net borrowing in foreign currencies increased during 2008 and that this development also continued after the end of the year, albeit at a reduced pace. In other words, according to the statistics, companies' loans from foreign banks have not decreased.

### **Companies increased their borrowing on foreign securities markets after the end of the year**

Major companies are the primary issuers of corporate loans on the securities markets. These loans mostly have maturities exceeding one year – that is to say, they are bonds. The flow statistics for corporate bonds in foreign currency indicate comprehensive net repayments from and including the second six-month period of 2007. One exception is formed by the strong net inflow in December 2008, which derives from a single (state-owned) company's issue of bonds. Excluding this company, the reduction was close to SEK 20 billion during the year. A reasonable interpretation is that, during the previous year, a number of companies encountered difficulties in finding buyers for their bonds overseas.

The outcome for the period following the beginning of this year indicates that circumstances on the securities markets have eased for Swedish companies. The inflow via issues of bonds in foreign currencies amounted to as much as SEK 50 billion during the first quarter of the year.

It is reasonable to assume that the shortfall in financing for major companies arising during 2008 has partly been replaced by foreign bank loans and partly by bank loans in Sweden. The shortfall in financing from overseas may also have been covered by market financing in Sweden. While companies' financing via bonds in foreign currencies decreased between the third and fourth quarters of 2008, their financing via bonds in Sweden increased over the same period. Companies have also continued to issue bonds on the Swedish market after the end of the year. The outcome for the first and second quarters of this year indicates that Swedish companies' non state-guaranteed issue volumes were more than doubled in comparison with the previous quarter.

### **Companies' financing problems according to surveys**

In both the National Institute of Economic Research's business tendency survey (June 2009) and the Riksbank's company survey (May–June 2009), a large proportion of companies state that the availability of financing is far from normal, compared with the period before the crisis broke out in the autumn of 2008. Although both surveys indicate that financing possibilities have improved slightly during the second quarter of 2009, the majority of companies responding to the Riksbank's company survey state that financing possibilities for future investments constitute a problem.

According to ALMI's loan indicator (first and second quarters 2009), bank managers deem that lending to companies will increase henceforth. On the other hand, the banks believe that it will be slightly more difficult for new corporate customers to obtain loans than for existing corporate customers. The National Institute of Economic Research's business tendency survey (April 2009) lists those companies citing "financial restrictions" as the foremost obstacles to the company's production. The survey states that there exists a difference between different industries as regards how seriously these credit restrictions are experienced. The problem seems to be greatest for the construction industry, particularly among companies whose creditworthiness has declined sharply since the autumn of 2008. Seen from this perspective, the problems in obtaining financing may rather be due to the heavily deteriorated economic climate.

<sup>12</sup> The definition of foreign banks includes Swedish banks' subsidiaries and/or branches overseas.

## The banks and credit granting

One central issue in the assessment of whether a credit crunch has arisen is the situation of the banks.<sup>13</sup> Banks with sufficient amounts of capital have the strength and capacity to maintain credit granting to households and companies, even during economic declines.

The four major Swedish banks are currently relatively adequately capitalised from an international perspective. The Tier 1 capital ratio<sup>14</sup> exceeds by far the minimum requirement of 4 per cent specified by Basel II, the regulatory framework for capital adequacy in banks. Following the implementation of new issues, the Tier 1 capital ratio in the banks varies between 10.5 and 12.1 per cent. The banks' accumulation of capital buffers may reasonably lead to a restrictive effect on the banks' lending, as greater capital requirements entail increased capital costs for the banks.

The extent to which capital will form a limitation for lending in the future depends on the size of the loan losses that will impact the banks. At present, great uncertainty prevails regarding companies' creditworthiness and thus the amount of these loan losses. The banks' loan losses began to increase during 2008 when companies' creditworthiness declined and bankruptcies increased. Companies' credit risks are rising and the likelihood of bankruptcies can be expected to increase further as the economy slows down.

In its latest Financial Stability Report, published in June, the Riksbank presented its estimate of the extent of the banks' loan losses for the years 2009–2010. In the Report's main scenario, the four major banks' loan losses for these two years are expected to amount to SEK 170 billion. Just under 40 per cent of these loan losses refer to activities in the Baltic countries and Eastern Europe, while approximately 50 per cent derive from Sweden and the Nordic countries. The aggregate result for the major banks in 2009 and 2010 will be marginally positive, as the amount of the loan losses is almost equivalent to the banks' expected profit before loan losses. The Swedish banks thus have sufficient capital to cover these loan losses. This means that the banks can continue to maintain their current credit volumes.

However, there are major elements of uncertainty in the main scenario, which mean that the situation for the major Swedish banks could be even more unfavourable. Less positive economic development than expected in the Baltic countries and an extended recovery process in the global economic situation are examples of various possible risks. The Riksbank has therefore tested the banks' resilience towards a significantly less favourable scenario than the main scenario in what is known as a stress test. In such a scenario, loan losses would amount to just over SEK 300 billion over two years. Profit before loan losses is calculated to amount to 85 per cent of the figure expected by the market (consensus). This scenario hits those banks with exposures to the Baltic countries and the rest of Eastern Europe hard. The results of the test indicate that the major Swedish banks will fulfil the statutory Tier 1 capital requirement of 4 per cent. In such a situation, the banks' credit ratings will be under pressure, complicating their financing situation. The banks would then reasonably need to strengthen their capital bases. Two different main strategies would enable them to do this: reducing growth in lending and issuing new capital. It is, of course, better for the banks to strengthen their capital bases before loan losses increase. Once loan losses do occur, it will be both more expensive and more difficult, or even impossible, for the banks to acquire new capital.

## Conclusions

In the introduction, we emphasised the importance of the measures undertaken by the Riksbank and other Swedish authorities to ensure successfully-operating credit markets. Without these measures, the range of credits available for Swedish households and companies would probably have become heavily restricted. At present, we see no signs of any credit crunch, either for households or companies. It is certainly difficult to precisely identify the extent to which the granting of credit is regulated by the

<sup>13</sup> The discussion in this section is based on the Riksbank's Financial Stability Report, 2009:1.

<sup>14</sup> Tier 1 capital is defined as equity less goodwill, proposed dividends and any repurchased shares. The Tier 1 capital ratio states Tier 1 capital in relation to risk-weighted assets.



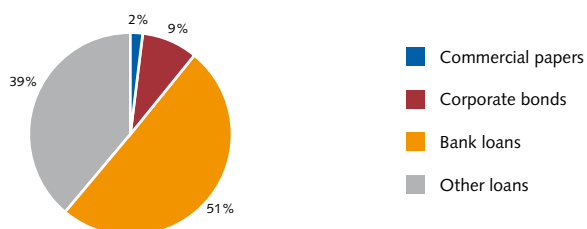
respective factors of supply and demand. Despite this, we have attempted to identify the presence of both of these factors. The statistics indicate that, at the beginning of this year, problems had arisen with one channel of financing – securities issuance in foreign currency. However, circumstances on the foreign securities markets have eased since then. Different investigations confirm that companies are also experiencing a slight improvement in the financing situation. However, in the Riksbank's company survey, carried out in May and June, the majority of companies state that it continues to be difficult to obtain new loans for investment purposes.

As regards cyclical factors, there are signs that lending to companies has decreased. We assess that the stricter credit terms observed are primarily a result of the increased credit risk following in the wake of a severe economic downturn. Furthermore, it is natural for demand for loans to decline in an economic downturn.

Neither does the analysis find any cause for a credit crunch justified by the banks' limited lending capacity. The Riksbank's stress tests indicate that Swedish banks are well-capitalised in an international perspective and have the capacity to meet household and corporate demands for credit.

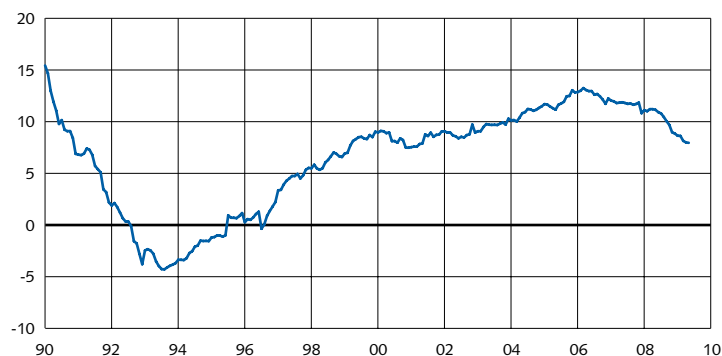
## Figures

**Figure 1. Allocation of non-financial companies' outstanding loans**  
Per cent



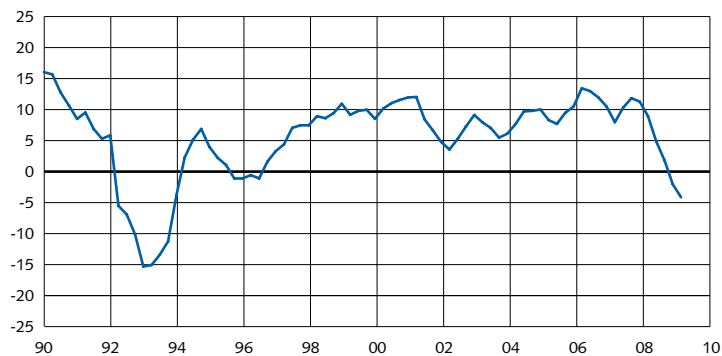
Source: Statistics Sweden.

**Figure 2. Households' borrowing from Swedish credit institutions**  
Annual percentage change



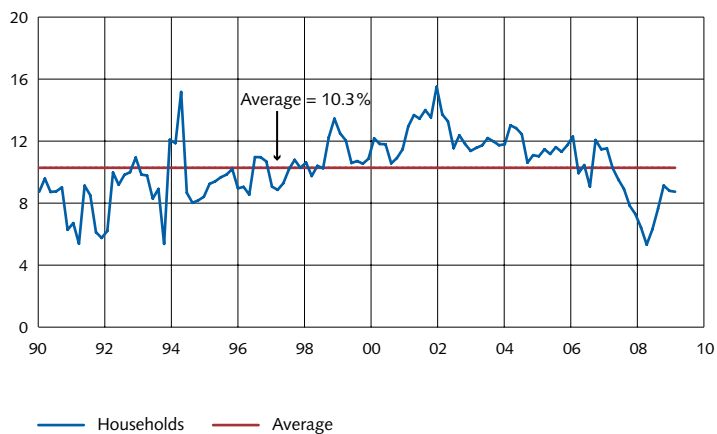
Sources: The Riksbank and Statistics Sweden.

**Figure 3. Housing prices in Sweden**  
Annual percentage change



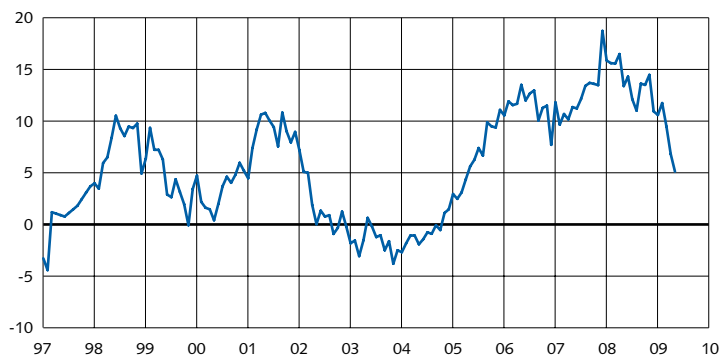
Source: Statistics Sweden, Property Price Index.

**Figure 4. Households' borrowing from Swedish credit institutions, three-month change**  
Per cent, calculated on annual basis, seasonally-adjusted data



Sources: The Riksbank and Statistics Sweden.

**Figure 5. Corporate borrowing from Swedish credit institutions**  
Annual percentage change



Sources: The Riksbank and Statistics Sweden.

**Figure 6. Corporate borrowing from Swedish credit institutions, three-month change**  
Per cent, calculated on annual basis, seasonally-adjusted data

