



Financial markets survey

Spring 2019

Financial markets survey

As from autumn 2018, the Riksbank sends out the Financial markets survey twice a year to participants active in the Swedish fixed-income and foreign exchange (FX) markets.¹ The purpose of the survey is to gain an overall picture of participants' views on the functioning of the Swedish financial markets, market activity and what risks they see in the Swedish financial system going forward. This report presents the results of the survey responded to in the period 8–24 April 2019.² The report is based solely on participants' responses and is not an account of the Riksbank's assessments.³

Survey results – spring 2019

Market risk associated with Brexit is the risk factor most often mentioned by participants

When asked to describe which external events risk having a negative effect on the Swedish financial system going forward, participants see the market risk stemming from the United Kingdom's withdrawal from the EU (Brexit) as the main risk factor. Other factors mentioned include a financial crisis or recession, credit and liquidity risk, cyber risk, risks relating to the financial situation of one or more banks, money-laundering issues and increasing regulatory requirements.

A majority of participants consider that they take small or neutral risks

Almost half of participants describe their general risk-taking as low or very low while a third describe it as neutral. A clear majority of respondents consider that they have reduced their risk-taking or say they take just as high risks as before. Most participants consider themselves to be generally well prepared to manage credit and counterparty risk, market risk and liquidity risk, while only half consider themselves to be well prepared for legal risk. Only one in three participants consider themselves to be well prepared to manage cyber risk.

Every second participant considers that the market for FX trading in the Swedish krona (SEK) is working well

Half the participants consider that the market for FX trading in SEK is functioning well, and only one in seven say that it is functioning poorly. A less expansionary monetary policy in Sweden is something that is looked upon as positive for the functioning of the market in the future. However, Finansinspektionen's proposal for requirements for liquidity coverage ratios in individual currencies is considered to be negative for the functioning of the market over the next six months.

Divided opinion on how well the Swedish fixed-income market is functioning

The number of participants who consider that the fixed-income market is generally functioning well or very well is still the same as the number who think it is functioning poorly or very poorly. As with the FX market for SEK, many consider that a less expansionary monetary policy in Sweden, especially in the form of quantitative tightening, can improve the functioning of the market over the coming six months.

Electronic trading platforms are often used by participants in the market for FX trading in SEK while algorithms are more unusual

Most respondents active in the market for FX trading in SEK state that they use electronic

¹ The Riksbank conducted a biannual risk survey between 2008 and 2017 to provide an overall picture of participants' views on financial risks and the functioning of the financial market. In spring 2017, a review of the forms of the Risk survey was initiated and this has now resulted in an updated survey that covers functionality, market activity, risks, risk-taking and other general questions with regard to both the fixed-income and FX market. The name of the survey has therefore been changed to Financial markets survey. The Financial markets survey supplements the regular contacts the Riksbank has with market participants.

² The survey was carried out with the aid of the survey tool Epsilon, which is supplied by the European Central Bank (ECB). The survey this spring was sent out to 105 participants, both Swedish and non-Swedish, who are active in the Swedish fixed-income and/or FX market. The response frequency was 66 per cent for the survey as a whole.

³ In the continuation of this text, *(market) participants* refers to the participants who participated in the survey.

platforms in their trading, and around half of these state that they always use them. The majority of FX market participants still state that they rarely or never use algorithms, even though their use has increased over the past six months. As regards trade in Swedish government bonds, electronic aids, algorithms in particular, are still relatively unusual compared to the FX market. However, one in three fixed-income market participants say that they have increased their use of electronic platforms.

Market risk associated with Brexit is the risk factor most often mentioned by participants

Participants were asked in the survey to describe which external events risk having a negative effect on the Swedish financial system in the coming six months. The risk factor that the largest proportion of survey respondents say they are most worried about is market risk related to the risk of a disorderly UK withdrawal from the EU (Brexit).⁴ Several participants also mention market risk associated with the trade conflict between China and the United States.

Several participants mention liquidity risk, in certain cases related to increased regulatory requirements.⁵ One example highlighted is Finansinspektionen's proposal for liquidity coverage ratios (LCR) in individual currencies (especially SEK), which is said to increase the demand for FX swaps in SEK and Swedish interest-bearing assets, and thereby restrict liquidity in these markets.⁶

Other risk factors mentioned include the risk of a financial crisis or recession that spreads to the Swedish financial system, cyber risk and risks associated with money laundering issues in the banking sector. In the survey in autumn 2018, the risk of a severe deterioration in the Swedish housing and property market was the risk factor that most participants felt was the greatest over the coming six months. This time, only a small number of respondents see this as the primary risk factor. As in the last survey, risks associated with the failure of one or more Swedish banks are also mentioned by several participants.

A majority of participants consider that they take small or neutral risks

Almost half the participants describe their general risk-taking as low or very low while a third describe it as neutral in terms of positioning (i.e. neither high nor low) (see Diagram 1). Compared with the Financial markets survey in autumn 2018, a slightly higher proportion of respondents say that they take low risks. Approximately one in five participants describe their risk-taking as high, which is a larger share than in the previous survey. Only a few consider that they take very high risks.

Participants were also asked whether they think they have changed their risk-taking in the past six months. A clear majority of respondents think they have reduced their risk-taking or say they take as high risks as before, which is illustrated in Diagram 2. There is no clear pattern in the reasons mentioned for a change in risk-taking, but as in the previous survey, some respondents mention that they have less interest in investing in risky assets as market volatility is low, that they do not see any clear trend or direction in the market or that liquidity is low. One reason that is mentioned for increased risk-taking is that the risk-taking was very low to begin with and has now increased somewhat.

Participants were also asked to assess how well prepared they were to manage a number of risk factors: *credit and counterparty risk*, *market risk*, *legal risk*, *liquidity risk* and *cyber risk*.⁷ Most participants consider that they are generally well prepared to manage credit and counterparty risk, market risk and liquidity risk, but only half when it comes to legal risk. Only one in three participants consider themselves well prepared to manage cyber risk, which is also apparent in the open responses, where cyber risk is highlighted as the most prominent

⁴ Market risk here refers to the risk of a decline in the value of financial instruments as a result of fluctuations in market prices. Note that the survey was still open for responses during the last days of negotiations between the United Kingdom and the European Council. The European Council's decision to extend the UK's withdrawal period was taken the night before 11 April.

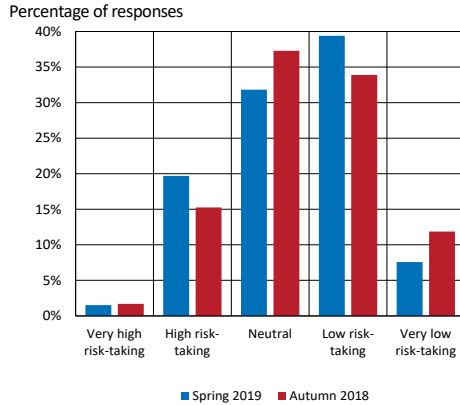
⁵ Market liquidity refers here to the ability to rapidly trade large volumes of a financial instrument at a low transaction cost without the transaction noticeably affecting the market price of the instrument. See also *Market liquidity on the Swedish bond market and its importance for financial stability*. Article in the Financial Stability Report 2016:1. Sveriges Riksbank.

⁶ The liquidity coverage ratio, LCR, measures banks' resilience to short-term liquidity stress over 30 days. An LCR of 100 per cent means, put simply, that the bank can manage outflows for 30 days. See Financial Stability Report 2019:1. Sveriges Riksbank.

⁷ Credit and counterparty risk refers here to the risk of a loss arising because a counterparty does not meet its commitments and the risk that a loss of value will arise due to poorer credit quality.

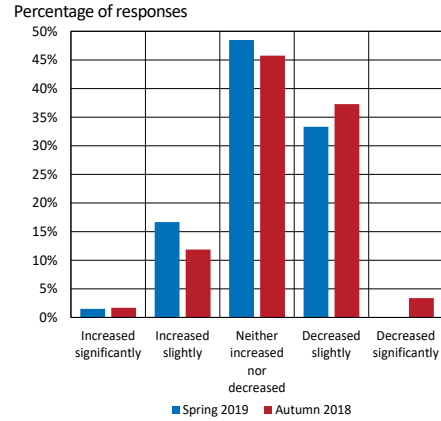
risk factor by a few participants. However, the proportion of respondents who consider themselves ill-prepared to manage cyber risk is clearly lower than in the previous survey.

Diagram 1. In terms of positioning, how do you assess your general risk-taking in the market at present?



Note. 66 responses in total (spring 2019).

Diagram 2. How do you consider your risk-taking to have changed over the past six months?



Note. 66 responses in total (spring 2019).

Every second participant considers that the market for FX trading in the Swedish krona (SEK) is working well

As in the Financial markets survey of autumn 2018, half the participants think that the market for FX trading in SEK is functioning well and only one in seven that it is functioning poorly (see Diagram 3). The percentage of the participants that think that the market is functioning poorly is slightly higher than in the last survey, but it is also a marginally higher percentage of them that think that the market is working well. The group that has diminished in size is those who think that the market is working neither well nor poorly, which now amounts to a third of participants. Participants were also asked to respond whether they see any important factors that may affect the functioning of the market going forward. Finansinspektionen's proposal for liquidity coverage ratios (LCRs) in individual currencies (especially SEK) is a factor that is considered to be negative for the functioning of the market in the future. Participants mention in particular the effect new LCRs may have on market liquidity in the forward market in SEK. Several consider that a less expansionary monetary policy in Sweden, with a higher repo rate and by the Riksbank reducing its purchases and holdings of Swedish government bonds, would be positive for the functioning of the market going forward.

Participants were asked in the survey to assess market liquidity in the spot and forward markets for SEK in relation to the other G10 currencies.⁸ About half of them stated that they consider market liquidity in SEK to be good or very good in both markets, which is approximately the same result as in the last survey. One in six respondents perceive liquidity to be poor or very poor, which is approximately the same percentage for the spot market as last time, but comparatively speaking slightly lower for the forward market.

There is no clear link between type of participant and their impression of market liquidity.⁹ When participants were asked to assess the change in market liquidity in the SEK market (for both spot and forward) over the past six months, most considered market liquidity to be unchanged or somewhat poorer, which is illustrated in Diagram 4 and Diagram 5. Just over one in four participants consider that market liquidity, both spot and forward, has

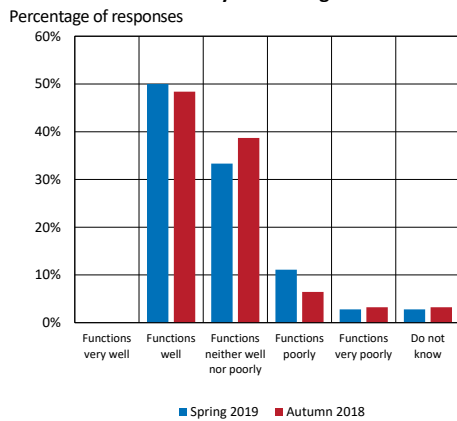
⁸ The G10 currencies and the ten most traded currencies in the world: US dollar, euro, pound sterling, Japanese yen, Australian dollar, New Zealand dollar, Canadian dollar, Swiss franc, Norwegian krone and Swedish krona.

⁹ Respondents were asked to classify their role in the market as either issuer/borrower, investor or market maker/dealer. See Diagram 9, Diagram 10 and Diagram 11 in Appendix 1.

deteriorated. As in the autumn, participants gave similar or the same reasons for their assessments of market liquidity as for their assessments of market functionality. This indicates that liquidity in the market is seen as one of the primary factors that determine how well the market functions. Several participants justified their responses by referring to liquidity in the market in particular, which is also in concordance with the results of the Financial markets survey in autumn 2018. Several participants specifically state that they are referring to liquidity in the market when large volumes are traded, and say that market liquidity is better when it comes to the trading of small volumes.

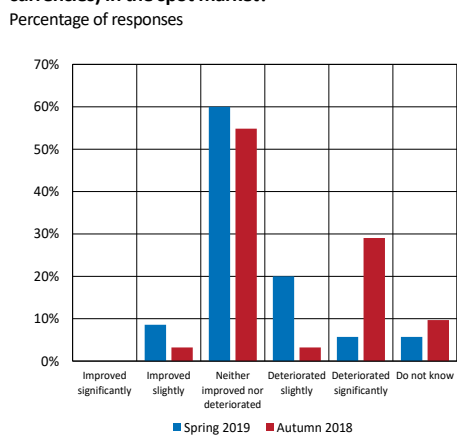
A large share of the respondents who chose to justify their answer consider the Riksbank’s monetary policy to have been the most important driving force behind developments in the SEK exchange rate over the last six months, in particular that the repo rate has been very low in a historical perspective. Global factors and differences in real interest rates are also mentioned as driving forces, as is the usage of SEK as a funding currency.¹⁰

Diagram 3. What is your general assessment of how the market for SEK is currently functioning?



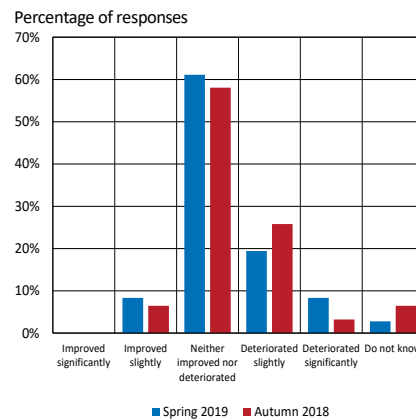
Note. 36 responses in total (spring 2019).

Diagram 4. How do you assess that market liquidity has changed over the past 6 months in SEK (in relation to the G10 currencies) in the spot market?



Note. 35 responses in total (spring 2019).

Diagram 5. How do you assess that market liquidity has changed over the past 6 months in SEK (in relation to the G10 currencies) in the forward market?



Note. 36 responses in total (spring 2019).

¹⁰ Carry trade is a type of trading strategy whereby the participant borrows in a low-yielding currency (“funding currency”), exchanges it for a high-yielding currency (“target currency”) and invests the resulting amount in the target currency at a higher interest rate. See also *Interest Rates, Carry Trades and Exchange Rate Movements*. Economic Letter 2006:31. Federal Reserve Bank of San Francisco.

Divided opinion on the functioning of the Swedish fixed-income market

Just over four tenths of respondents think that the Swedish fixed-income market is generally working well or very well, which is a higher share than in the previous survey (see Diagram 6). There is still about four tenths of participants who feel that the fixed-income market is working poorly or very poorly. Participants were also asked to give the main reason for their answer. They mention good liquidity in the market for interest derivatives and good access to funding among the main reasons why they feel the market is functioning well in general. A majority of those who consider the fixed-income market to be working poorly mention limited or poor liquidity as the main reason for their opinion. Several participants mention the Riksbank's government bond purchases as one of the reasons for this. More often than other participants, issuers say that they consider the general functioning of the market to be good. Two-thirds of them consider functioning to be good or very good. Investors take a more pessimistic view; just over half of them think that the general functioning is poor or very poor. Market makers have a more neutral picture.

Market liquidity in the secondary market for treasury bills and government bonds is currently perceived to be poor or very poor by a majority of respondents (see Diagram 7 and Diagram 8). The results are in line with or in some cases slightly more positive (i.e. liquidity is slightly improved) compared with the Financial markets survey in autumn 2018. Investors and market makers respond to a particularly large degree that they perceive market liquidity in these markets to be poor or very poor, while a large share of issuers say they have no opinion. Market liquidity in the secondary market for covered bonds is perceived by nearly one in two participants as good or very good, while the corresponding figure for interest rate swaps is two out of three participants (see Diagram 12 and Diagram 13 in Appendix 1).¹¹ The proportion who answer that market liquidity for covered bonds is functioning well or very well is basically unchanged, while the corresponding proportion for interest rate swaps has increased since the autumn.

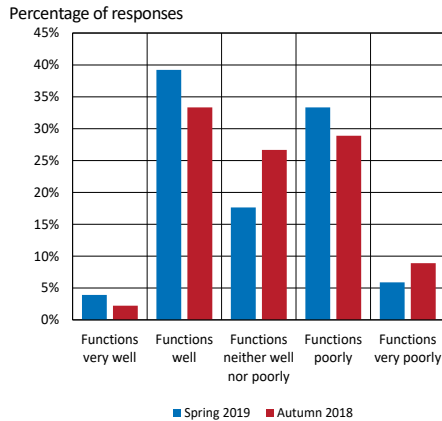
Participants were also asked to make an assessment of the change in market liquidity in the secondary market over the past six months, and to describe which driving forces they consider to have been the most important in this.¹² Most consider market liquidity in the secondary market, for all types of Swedish rate-bearing assets, to be unchanged or lower. The Riksbank's monetary policy, and in particular the government bond purchases, are described as the most important driving force behind the change in market liquidity over the past six months. Respondents state that the Riksbank's government bond purchases have restricted market liquidity, particularly in the government bond market.

The view is that a less expansionary monetary policy in Sweden, in particular by the Riksbank reducing its purchases and holdings of Swedish government bonds, could improve the way the market works over the next six months. Improved electronic trading options are also highlighted as a positive factor going forward. Several participants consider the reduced capacity of banks to act as risk mediators between different participants and to set prices to be a factor that may impair the functioning of the market in the period ahead. Some respondents also point to a reduced foreign interest in Swedish fixed-income assets as a negative factor.

¹¹ An interest-rate swap is a bilateral agreement to exchange a specific interest rate in return for another interest rate for a predetermined period according to specific conditions. In the survey, respondents are asked to assess functionality and market liquidity in interest rate swaps (SEK/SEK).

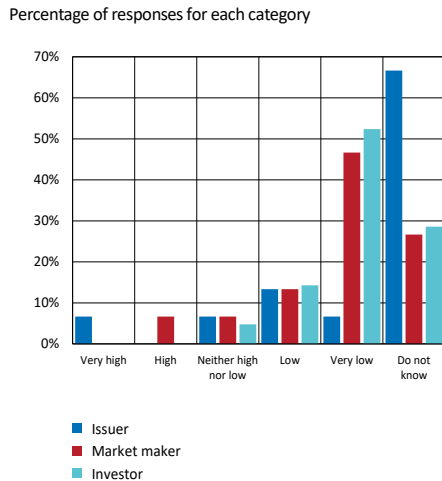
¹² The secondary market for *treasury bills, government bonds, covered bonds, corporate bonds, interest rate swaps (SEK/SEK), repos with government securities, repos with covered bonds and FRA contracts.*

Diagram 6. What is your assessment of the functioning of the Swedish fixed-income market at present?



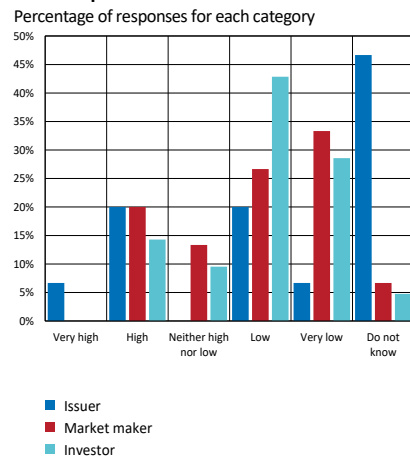
Note. 51 responses in total (spring 2019).

Diagram 7. What is your assessment of market liquidity in the secondary market for treasury bills at present?



Note. 51 responses in total, of which 15 issuers, 15 market makers, 21 investors.

Diagram 8. What is your assessment of market liquidity in the secondary market for government bonds at present?



Note. 51 responses in total, of which 15 issuers, 15 market makers, 21 investors.

Electronic trading platforms and algorithms often used by participants in the market for FX trading in SEK

The extent to which electronic aids are used in trade still differs substantially between respondents active in the market for SEK and those active in the fixed-income market. Nine out of ten participants active in the market for SEK state that they use electronic platforms in their trading in SEK, of whom around half say that they always use them (see Diagram 14 in Appendix 1).¹³ The results are very similar to what emerged from the Financial markets survey in autumn 2018, the difference being that this time, just under 6 per cent state that they never use electronic platforms, compared with 0 per cent in autumn 2018. A fifth of FX market participants say that they have increased their use of electronic platforms while a few participants state that they have reduced their use over the last six months.

Just over a quarter of participants active in the market for FX trading in SEK say that they often or always use algorithms in their SEK trading, while two out of five participants

¹³ Electronic trading platforms are computerised dealing rooms that mediate contact between the purchaser and the seller, and provide information on current prices for various currency pairs. See also *Algorithmic trading in the foreign exchange market*. Article in Economic Review 2013:1. Sveriges Riksbank.

state that they never use them (see Diagram 15 in Appendix 1).¹⁴ Compared with the results last time, a higher share of participants say that they often use algorithms, which coincides with just over one in five who say that they have increased their use over the last six months. The responses do not differ substantially between the different types of participant.

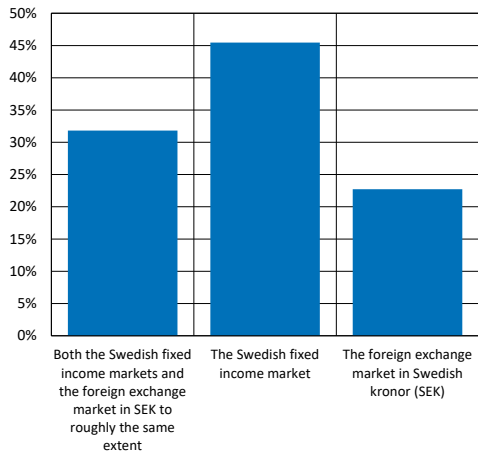
In comparison with the FX market, electronic aids are still relatively uncommon in the Swedish fixed-income market, in particular with regards to algorithms. The results are similar to those from the latest survey and show that around half of participants often or always use electronic platforms (see Diagram 16 in Appendix 1). One in three participants active in the fixed-income market state that they have increased their use of electronic platforms over the last six months. A large majority state that they seldom or never use algorithms in their trading (see Diagram 17 in Appendix 1) and most answer that they have not increased their use over the last six months. The responses do not differ substantially between the different types of participant.

¹⁴ Algorithms are mathematical models and formulas that create specific sets of rules in FX trading whereby orders can be placed and transactions executed. See also *Algorithmic trading in the foreign exchange market*. Article in Economic Review 2013:1. Sveriges Riksbank.

APPENDIX 1

Diagram 9. In which market are you most active?

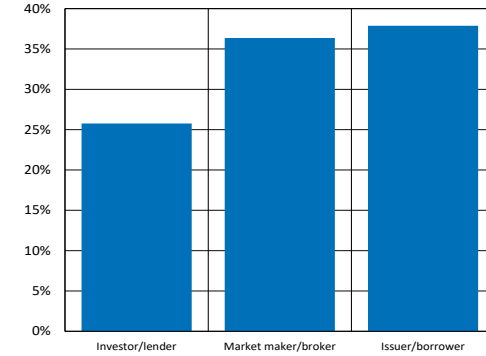
Percentage of responses



Note. 66 responses in total.

Diagram 10. What is your primary role in that market/those markets?

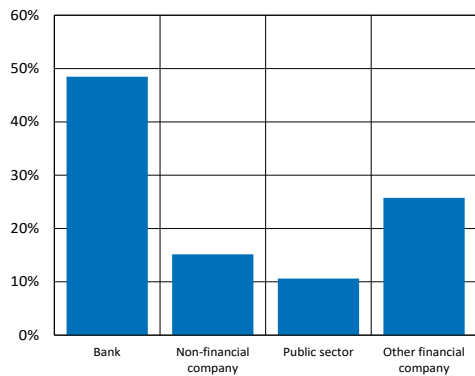
Percentage of responses



Note. 66 responses in total.

Diagram 11. To which sector do you primarily belong?

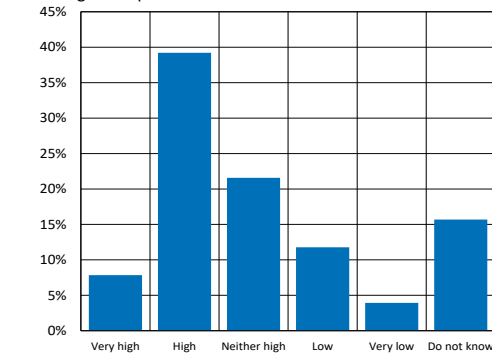
Percentage of responses



Note. 66 responses in total.

Diagram 12. What is your current assessment of market liquidity in covered bonds in the secondary market?

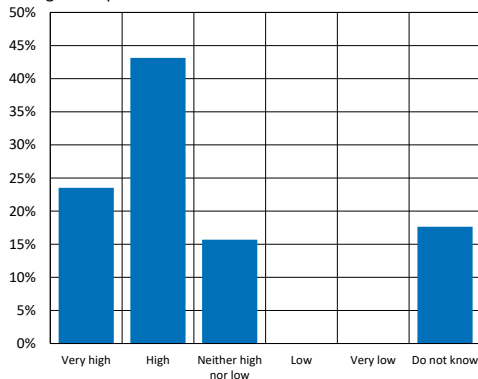
Percentage of responses



Note. 51 responses in total.

Diagram 13. What is your current assessment of market liquidity in interest rate swaps (SEK/SEK) in the secondary market?

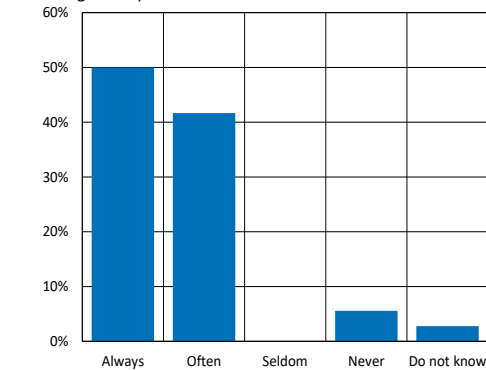
Percentage of responses



Note. 51 responses in total.

Diagram 14. To what extent do you use electronic platforms in your FX trading with SEK?

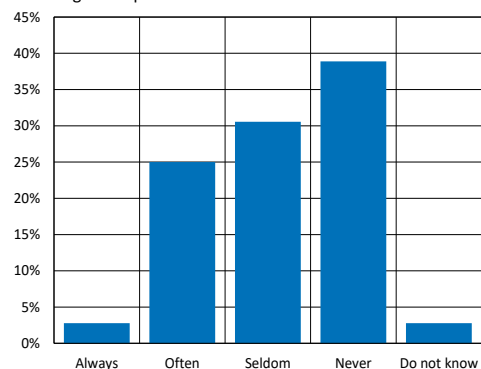
Percentage of responses



Note. 36 responses in total.

Diagram 15. To what extent do you use algorithms in your FX trading with SEK?

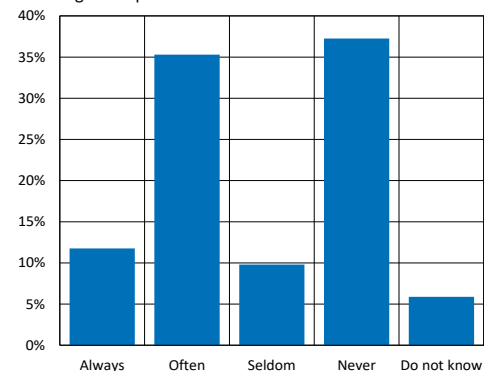
Percentage of responses



Note. 36 responses in total.

Diagram 16. To what extent do you use electronic platforms in your trading in Swedish government bonds?

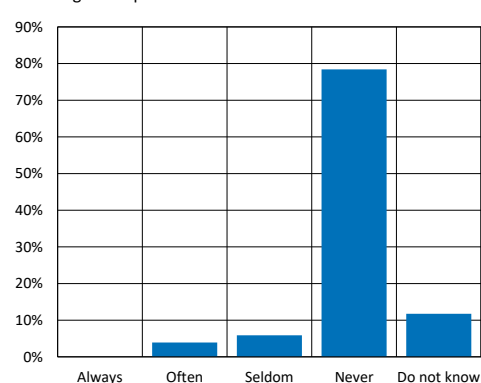
Percentage of responses



Note. 51 responses in total.

Diagram 17. To what extent do you use algorithms in your trading in Swedish government bonds?

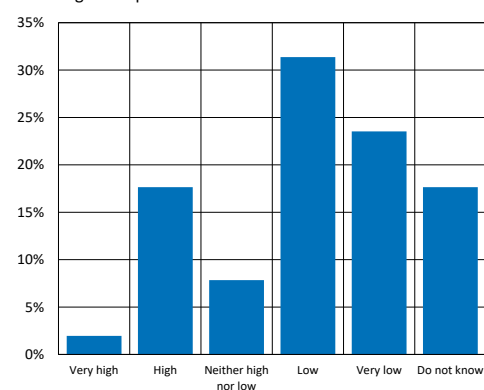
Percentage of responses



Note. 51 responses in total.

Diagram 18. What is your assessment of market liquidity in the secondary market for government bonds at present?

Percentage of responses



Note. 51 responses in total.



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