



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

Spring 2017



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

*Since the spring of 2008, the Riksbank has sent out a risk survey twice a year to participants in the Swedish fixed-income and foreign exchange markets.<sup>1</sup> The purpose of the survey is to gain an overall picture of the market participants' view of risk in the Swedish financial system and the functioning of the Swedish financial markets. The survey only refers to the Swedish financial system. This report describes the results of the survey where responses were received between 23 March and 7 April 2017.<sup>2</sup> The results reported are based on participants' responses to the survey and do not necessarily reflect the Riksbank's view of risks in the Swedish financial system and the functioning of the Swedish markets.*

## Survey results – spring 2017

### **Political uncertainty within the EU is the most cited risk by participants**

- Participants were asked in the survey to list the five greatest risks to the Swedish financial system. The risk most often mentioned by participants is political uncertainty within the EU. Among other factors, participants mention the presidential election in France, Brexit and the risk of a new election in Italy.

### **Continued concern over risks linked to a long period with low interest rates**

- As in previous surveys, the majority of participants also highlight the existence of risks linked to high housing and property prices and the low interest rates. Participants justify this by saying that household indebtedness and the valuation of various asset types, including housing and properties, have increased during a period of low interest rates. Furthermore, participants say that a long period of low interest rates may lead to an increase in the overall risk level in the financial system, as investors seek increasingly higher-risk investments in their search for yield. When it comes to their own risk-taking, however, every fourth participant states that it has decreased in the last six months, while the majority say that it has neither increased or decreased.

### **A majority of the participants consider that the functioning of the Swedish financial markets has remained unchanged**

- Slightly more than half of the participants take the view that the functioning of the Swedish financial markets has basically remained unchanged compared to six months ago. However, every third participant thinks that the markets are functioning slightly worse. At the same time, one-third of participants are of the opinion that the markets are currently functioning well, one-third say they are functioning poorly and one-third have no firm opinion on the subject.

### **Perceived decrease in market liquidity leading to poorer functioning**

- According to participants who think that the Swedish financial markets are functioning worse, it is mostly due to a perceived decrease in market liquidity on the bond markets. Participants point to several reasons why liquidity is perceived to have deteriorated, a fact

<sup>1</sup> The Riksbank commissioned survey company Markör Marknad and Kommunikation AB to send out the survey on its behalf. The survey supplements the regular contacts the Riksbank has with market participants. The spring survey was sent out to 71 participants active in the Swedish fixed-income and foreign exchange markets. 28 per cent of those surveyed are the Riksbank's monetary and foreign exchange policy counterparties, while the remaining 72 per cent are other participants on these markets, both investors and borrowers. The response rate was 80 per cent.

<sup>2</sup> The survey was conducted before the French presidential election.

also highlighted in previous surveys. The reason most often highlighted by participants is that market makers have become less active and less willing than previously to act as counterparty for purchases and sales, partly as a result of various financial regulations. The Riksbank's purchases of government bonds are also mentioned as a contributory factor in the deterioration in market liquidity for government bonds.

## Political uncertainty within the EU and generally low interest rates are a concern for participants

When the participants are asked to state and rank the five biggest risks (see Table 1 to the Swedish financial system, two out of three say that political uncertainty within the EU is one of the most prominent risks in the current situation. Participants specifically mention the presidential election in France (which had not yet taken place when the survey was conducted), Brexit and the risk of a new election in Italy. This is therefore the risk most often highlighted by participants, followed by risks related to high housing and property prices, which are mentioned by approximately every second participant.

Risks linked to low interest rates are ranked highest by around one in four participants. Participants justify this by saying that household indebtedness and the valuation of various asset types have increased as a result of low interest rates. According to the participants, it is also uncertain how different financial markets and valuation of different asset types will be affected when interest rates increase. Several of these reasons are also ranked by participants as separate risks, for example several mention both household indebtedness and risks linked to rapid rate rises as separate risks. Other risks mentioned by participants, in no particular order, include: the risk of a global economic downturn, risks linked to fiscal policy uncertainty in the US, stock exchange falls in Sweden or internationally and geopolitical unrest.

Based on these risks, participants have also ranked the three risks that, in their opinion, could most probably be materialized in the next six to twelve months. About one in four participants place risks linked to political uncertainty within the EU highest on the list (see Table 2 **Fel! Hittar inte referensskälla.**). Second on the list come risks linked to low interest rates.

**Table 1. Participants' assessment of the five greatest risks to the Swedish financial system**

Stated risk	Proportion who rank this risk highest	Proportion who mention this risk
<i>Risks linked to low interest rates</i>	23 %	44 %
<i>Political uncertainty in the EU</i>	16 %	63 %
<i>Risks linked to household indebtedness</i>	14 %	33 %
<i>Risks linked to high housing and property prices</i>	14 %	53 %
<i>Risks linked to a rapid rate rise</i>	5 %	26 %
<i>Risks linked to highly valued financial assets</i>	4 %	12 %
<i>Increased regulation</i>	4 %	30 %

Note. The Riksbank has grouped the risks based on what the participants have said they consider to be the five greatest risks to the Swedish financial system. The risks mentioned by only a small number of participants have been excluded from the table. Not all participants have stated five risks.

Source: The Riksbank

**Table 2. Participants' assessment of which three risks of the five stated in Table 1 are most likely to be materialized in the next six to twelve months**

Stated risk	Proportion who rank this risk highest	Proportion who mention this risk
<i>Political uncertainty in the EU</i>	23 %	42 %
<i>Risks linked to low interest rates</i>	16 %	30 %
<i>Increased regulation</i>	11 %	26 %
<i>Risks linked to high housing and property prices</i>	7 %	25 %
<i>Risks linked to a rapid rate rise</i>	5 %	12 %
<i>Risks linked to highly valued financial assets</i>	5 %	14 %
<i>Risks linked to household indebtedness</i>	4 %	21 %

Note. The Riksbank has grouped the risks based on what the participants have said they consider to be the three most likely risks out of the five risks they stated in Table 1. The risks mentioned by only a small number of participants have been excluded from the table. Not all participants have stated three risks.

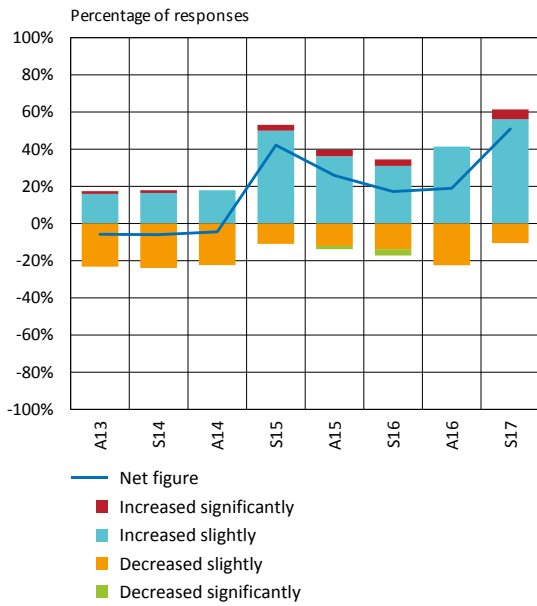
Source: The Riksbank

## Slightly higher risk level in the Swedish financial system

Three out of five participants perceive that the risk level has slightly increased over the last six months (see Chart 1). These participants highlight the generally low level of interest rates, political uncertainty within the EU and household indebtedness as the main reasons for this. For the same reasons, two out of five participants state that the risk level is currently high (see Chart 2). Meanwhile, just as many, two out of five, state instead that the risk level is average and some of these participants say that the Swedish financial system currently has good resilience, thanks partly to banks being well capitalised.

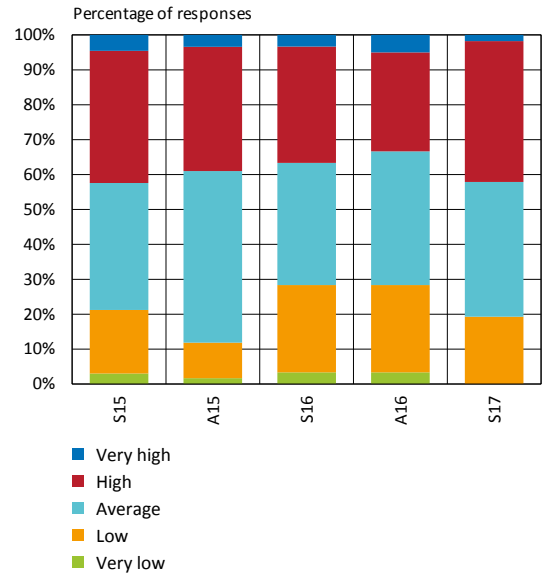
The higher risk level is also one explanation when one out of four market participants say that their own risk-taking has decreased slightly over the last six months (see Chart 3). Some of these participants point out that it is not as worthwhile as before to increase one's risk-taking to achieve higher returns. The majority of participants at the same time state that they have neither increased nor decreased their risk-taking in the last six months. Participants stating that they have increased their risk-taking justify it by saying that low interest rates require higher risk-taking if they are to be able to match previous returns.

**Chart 1. What is your perception of the way the total risk level in the Swedish financial system has developed in the past six months?**

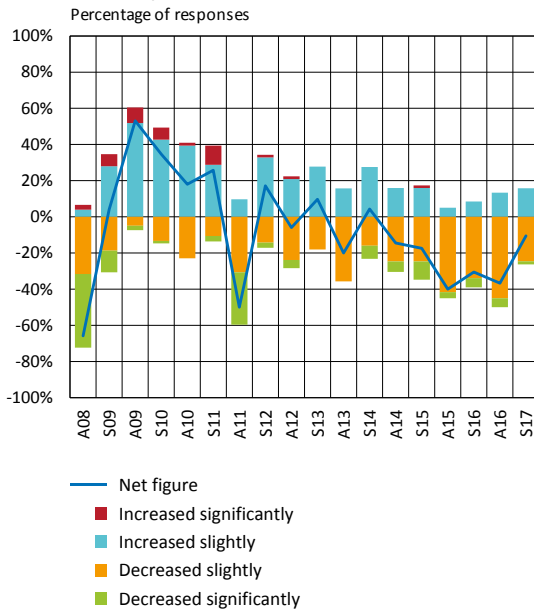


Note. The category "Neither better nor worse" is not shown in this chart. Net figure shows the difference between the columns above and below zero.

**Chart 2. What is your perception of the overall level of risk in the Swedish financial system today?**



**Chart 3. How do you consider that your risk-taking has changed over the past six months?**



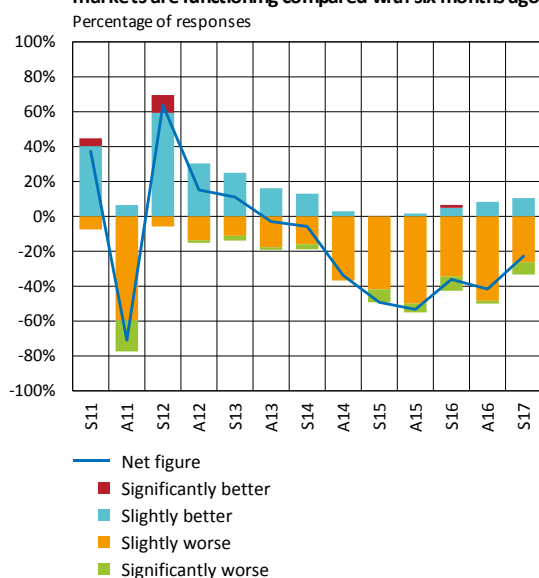
Note. The category "Neither increased nor decreased" is not shown in this chart. Net figure shows the difference between the columns above and below zero.

## A majority of the participants consider that the functioning of the Swedish financial markets has remained unchanged

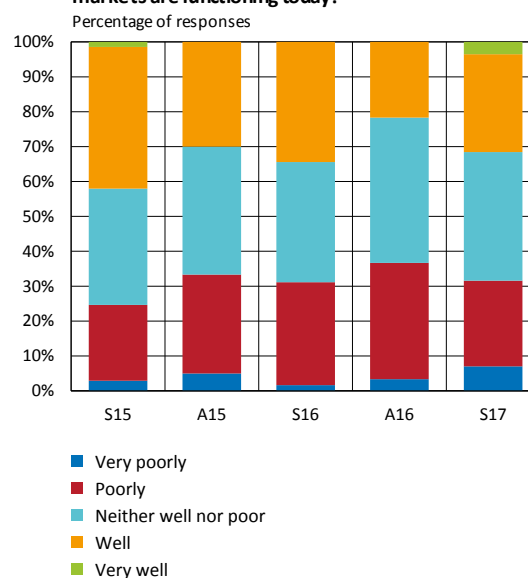
Slightly more than half of the participants take the view that the functioning of the Swedish financial markets has basically remained unchanged compared to six months ago. But every third participant states that the markets are functioning slightly worse than they were six months ago (see Chart 4 Chart 4), which is slightly fewer than in the last survey. It is mostly investors on the fixed-income market who think that the Swedish financial markets are functioning slightly worse and that this due to the perceived poorer market liquidity.<sup>3</sup>

Opinions are divided among participants when it comes to how the Swedish financial markets are functioning today. One-third of participants say that the markets are functioning well, one-third say they are functioning poorly and one-third have no firm opinion on the subject (see Chart 5 Chart 5).

**Chart 4. What is your assessment of how the Swedish financial markets are functioning compared with six months ago?**



**Chart 5. What is your assessment of how the Swedish financial markets are functioning today?**



Note. The category "Neither better nor worse" is not shown in this chart. Net figure shows the difference between the columns above and below zero.

Participants' assessments of liquidity for a number of instruments on the fixed-income market are largely in line with the previous survey (see Chart A1 to Chart A6 **Fel! Hittar inte referensskälla.**).<sup>4</sup> About half the participants active on the fixed-income market say that liquidity for government bonds is adequate or better, which is in line with the previous survey (see Chart A1). With regard to repos with government securities, the majority of the participants consider market liquidity to be adequate or better (see Chart A2). With regard to covered bonds, three out of five participants consider market liquidity to be adequate or better, which is also in line with the results in the previous survey (see Chart A3). With regard to corporate bonds, participants still consider liquidity to be low (see Chart A4).

The participants on the fixed-income market who consider liquidity to be worse than adequate give several explanations. For one thing, according to the participants, market makers have become less active over the years and less willing than previously to act as intermediaries on the fixed-income market, that is, to be counterparties in purchases and

<sup>3</sup> Market liquidity refers here to the ability to rapidly buy or sell significant volumes of a financial instrument at a low transaction cost and with limited market price impact. See also Market liquidity on the Swedish bond market and its importance for financial stability. Article in *Financial Stability Report 2016:1*. Sveriges Riksbank.

<sup>4</sup> When interpreting Charts A1-A10, it is important to remember that the markets and instruments are not necessarily comparable, as they often have structural differences. It is therefore more appropriate to analyse changes over time for individual instruments than to compare different instruments with each other.

sales of debt securities. According to the participants, this is because various financial regulations have made securities trading less profitable for market makers. The regulatory frameworks highlighted most often by participants as negative for market liquidity are: the resolution fee<sup>5</sup> at the turn of the year, Basel III<sup>6</sup> for banks (mainly new and stricter capital requirements), liquidity coverage ratio (LCR)<sup>7</sup> and to a certain extent the forthcoming transparency regulations in EU legislation MiFID II/MiFIR<sup>8</sup>. The Riksbank's purchases of government bonds are also brought up as a contributory factor in the deterioration in market liquidity for government bonds.

Some participants express concern over how liquidity in corporate bonds and covered bonds would be affected in a stress scenario, for example under high sales pressure. One participant explain that the outstanding volume of these bonds is currently higher than before, at the same time as there are fewer market makers. If sales pressure arises, for example in a stressed situation, it may also increase the need for market makers to participate as buyers. If market makers cannot or will not buy these bonds to the same extent as previously, it may have negative consequences for market liquidity and hence for the functioning of the markets, according to this participant.

Participants active on the foreign exchange market have a more positive view of liquidity for Swedish krona, particularly for forwards, compared with the last survey (see Chart A7-A9). The majority of participants take the view that liquidity on the foreign exchange swap market is adequate or more than adequate (see Chart A10). Some participants explain that forwards and short-term FX swaps are affected more than other instruments at the turn of the year, for example in conjunction with the resolution fee. Furthermore, some participants explain that the number of market makers and counterparties for short-term FX swaps has decreased in recent years, which has led to slight poorer liquidity for these.

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<sup>5</sup> This fee is paid annually by credit institutions and securities companies and is aimed at building up the resolution fund that forms part of the new crisis management directive introduced into Swedish legislation in 2016. The size of the annual resolution fee is primarily based on the individual institutions' balance sheets at the end of the year.

<sup>6</sup> Basel III is an international regulatory framework for the banks' capital adequacy and liquidity. Basel III will be progressively phased in by 2019.

<sup>7</sup> The LCR, Liquidity Coverage Ratio or liquidity ratio for short, is a liquidity measurement defined by the Basel Committee that measures a bank's ability to deal with a stressed net outflow of liquidity for 30 days. In simple terms, an LCR of 100 per cent means that a bank's liquidity reserves are adequate to enable the bank to manage an unexpected liquidity outflow for 30 days.

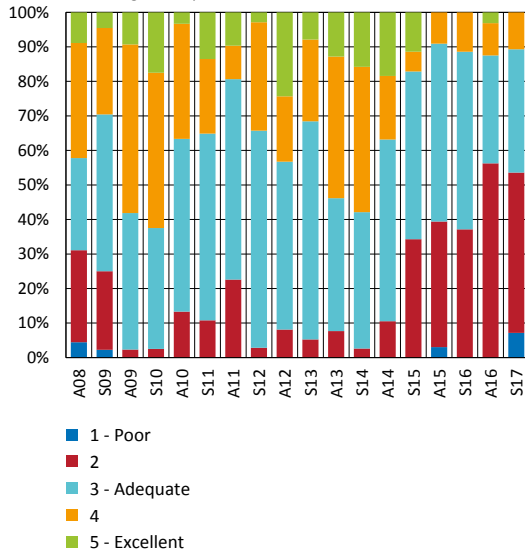
<sup>8</sup> The MiFID (Markets in Financial Instruments Directive) is an overarching EU regulatory framework for the financial markets. The first version of these regulations was introduced in EU 2007 (MiFID I). In the summer of 2014, the EU adopted a new version of MiFID (MiFID II) and a completely new regulation (MiFIR). These come into force within the EU on 1 January 2018.



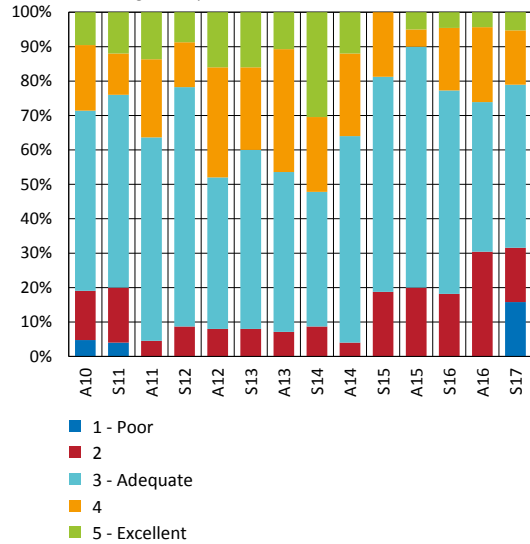
# APPENDIX 1– The participants’ assessments concerning the liquidity of selected instruments

## The participants' assessment of liquidity in instruments on the Swedish fixed-income market<sup>9,10</sup>

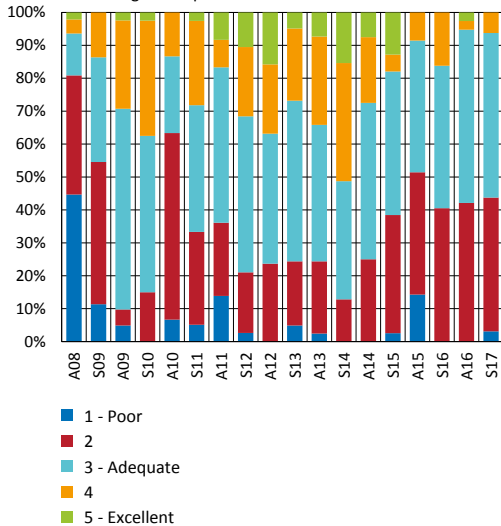
**Chart A1. What is your view of liquidity for government bonds over the past six months?**  
Percentage of responses



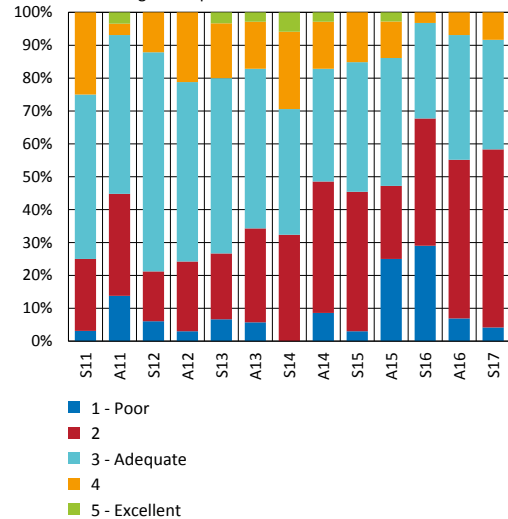
**Chart A2. What is your view of liquidity for repos with government securities over the past six months?**  
Percentage of responses



**Chart A3. What is your view of liquidity for covered bonds over the past six months?**  
Percentage of responses



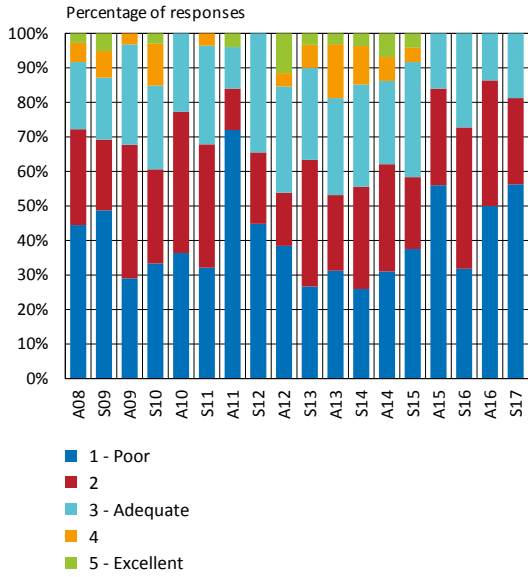
**Chart A4. What is your view of liquidity for corporate bonds over the past six months?**  
Percentage of responses



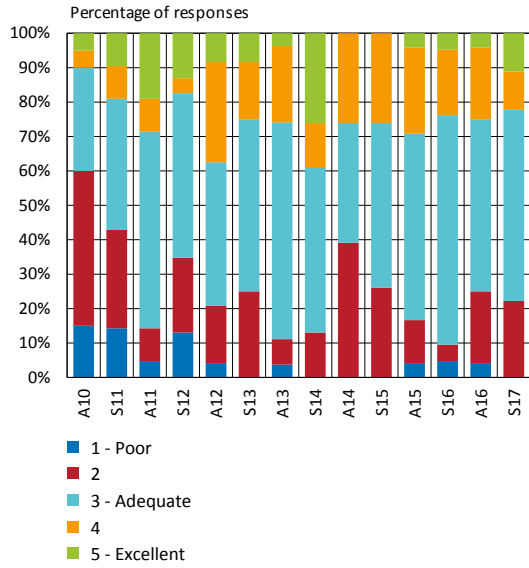
<sup>9</sup> When interpreting participants’ responses in Figures A1 to A9, it is important to remember that the markets and the instruments are not necessarily comparable. This is because they often have structural differences. It is therefore more appropriate to analyse changes over time for individual instruments than to compare different instruments.

<sup>10</sup> Only participants active either 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.

**Chart A5. What is your view of liquidity for treasury bills over the past six months?**

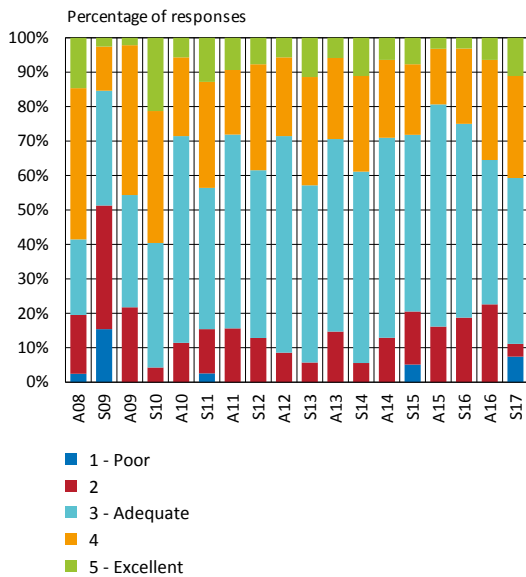


**Chart A6. What is your view of liquidity for repos with covered bonds over the past six months?**

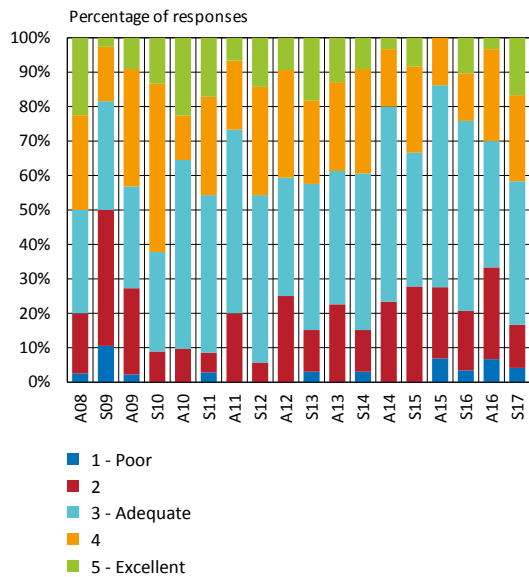


**The participants' assessment of liquidity in instruments on the Swedish foreign exchange market<sup>11</sup>**

**Chart A7. What is your view of liquidity for Swedish kronor over the past six months?**

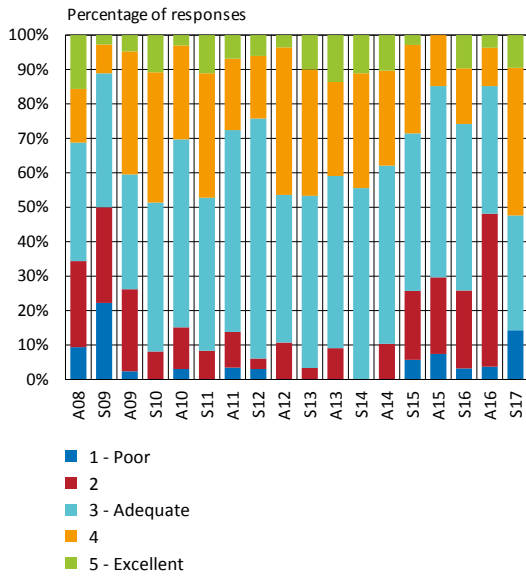


**Chart A8. What is your view of liquidity for spot transactions over the past six months?**

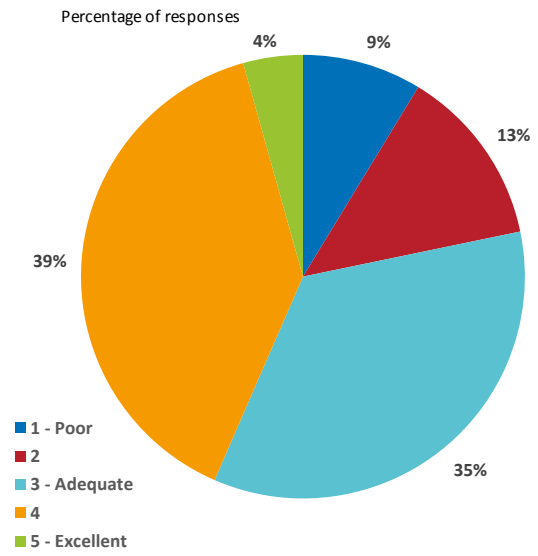


<sup>11</sup> Only participants active either only in the Swedish foreign exchange market or active in both the fixed-income market and the foreign exchange market have responded to this part of the survey. The figures include only those who have been active in the specific segment.

**Chart A9. What is your view of liquidity for forwards over the past six months?**



**Chart A10. In your view, how has the market for FXswaps and forwards for EUR/SEK and USD/SEK functioned over the past six months?**





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