



# Memorandum

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DEPARTMENT: Financial Stability Department /Monetary Policy Department

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## ■ Terms of reference for a commission of inquiry into risks in the Swedish housing market

### Summary

A commission of inquiry will be given the task of reviewing the Swedish housing market. The commission of inquiry aims to illustrate the relationship between the housing market and, on the one hand, the Riksbank's tasks and objective and, on the other hand, developments in the economy as a whole. The task will include examining what risks exist in the housing market and what tools should be available to prevent risks from building up.

The commission of inquiry should also look at developments in the market for commercial property.

The results of the commission of inquiry should be reported no later than 31 January 2011.

### Background

From both an historical and an international perspective, large falls in property prices have played a prominent role in economic crises. A common feature of these crises has in most cases been that they have been preceded by a strong expansion in credit and an increase in indebtedness.

In some cases, such as during the Swedish banking crisis of the 1990s, this has primarily concerned commercial property. In other cases, such as the most recent international financial crisis, the focus has rather been on residential property.

Various international analysts have expressed concern over developments in the housing market over a long period of time, as house prices and household indebtedness in many countries have risen rapidly. The risk is that such price increases will be exaggerated. In the wake of the most recent financial crisis, house prices have fallen in many countries.

In Sweden, too, house prices have risen sharply over several years. However, the financial crisis has not led to any major fall in house prices in Sweden. Banks and other lenders have made very small loan losses on mortgages to households.

■ A distinguishing feature of the Swedish housing market in recent years has been that the loan-to-value ratio – that is, the size of the loan in relation to the value of the property – has been relatively high for new borrowers, that the fixed rate terms of the loans have been short and that amortisation payments have been small.

The commercial property market has recently been characterised by price falls and by an increase in property companies' leverage ratios. The Swedish property companies are dependent on loans to be able to fund their activities. Moreover, the banks' lending to the property companies comprises a not insignificant share of their total lending. The commercial property market is therefore highly important to financial stability.

The Riksbank has responsibility for monetary policy. The objective of monetary policy is to maintain price stability. This has been interpreted as a low and stable inflation rate. However, the Riksbank also has the task of promoting a safe and efficient payment system.

The most recent financial crisis has given new life to the debate on whether a central bank should try to counteract rising asset prices to prevent bubbles from building up. If a house price bubble bursts, house prices fall substantially. It is possible that this could have repercussions on the financial system and the payment system, particularly if the increase in house prices has gone hand in hand with high indebtedness. Moreover, large fluctuations in house prices can affect the economy as a whole and thus monetary policy. At the same time, however, monetary policy affects house prices. In addition, a high loan-to-value ratio and a variable mortgage rate can make individual households sensitive to changes in interest rates. All in all, this means that house prices interact in a complicated manner with the Riksbank's tasks and objective.

## The task

The Riksbank, other public authorities and individual academics have, in various contexts, analysed the function of the housing market in Sweden. The results of these discussions have not been clear-cut. Moreover, they have usually been based on individual issues, such as whether a housing bubble has arisen, or how robust the system is to isolated events, such as an interest rate increase. The Riksbank therefore considers that a more cohesive analysis of the Swedish housing market is necessary. The inquiry should examine the relationship between the housing market and the Riksbank's tasks and objective. The commission should examine, on the basis of the current regulatory framework, what risks exist in the Swedish housing market and what tools the authorities have at their disposal for dealing with them. The task includes making international comparisons where this is relevant.

The market for commercial properties, in a number of respects, has been better analysed than the housing market. However, considering our experiences of earlier crises, the development of this market should also be analysed under the framework of the inquiry.

The commission of inquiry should be given the task of

- Analysing what factors lie behind Swedish housing prices having risen for a long time and why the loan-to-value ratios have increased. The inquiry should in this connection analyse whether there are any differences between metropolitan areas and other parts of the country.

- Discussing the role played by monetary policy in developments in the Swedish housing market and how central banks should take developments in asset prices into account.
- Discussing what role institutional factors such as the tax system, the financial regulatory framework and the forms for housing finance have played in the development of the Swedish housing market.
- Analysing what risks there are with a high loan-to-value ratio and with little or no amortisation.
- Examining what risks arise when the percentage of households with loans at a variable interest rate increases.
- Examining what events might trigger a fall in house prices and what consequences this could have for the economy as a whole, for monetary policy, for the financial markets and for financial stability.
- Examining developments in the commercial property market and discussing price developments in this market and the property companies' leverage ratios.
- Analysing the role that monetary policy can and should play in affecting the unfavourable development of credit stocks and property prices.
- Discussing which alternative tools could be implemented to affect such unfavourable development, and under which circumstances such tools should be implemented.
- Discussing how responsibility for the implementation of such alternative tools can be allocated among various authorities.

### **Consultation and reporting the task**

The commission of inquiry shall be carried out within the Riksbank. The Riksbank will where necessary make use of the assistance of external experts. The work should be reported with appropriate regularity to the Executive Board of the Riksbank.

The commission of inquiry will consult with Finansinspektionen (the Swedish financial supervisory authority) and with other authorities concerned.

In autumn 2010, the commission of inquiry will organise a conference on the housing market with the participation of experts from Sweden and abroad.

The commission of inquiry will present its final report no later than 31 January 2011.