Large maturity mismatches on the Swedish mortgage market – what do we want the market to look like?

Swedish House of Finance
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S V E R I G E S R I K S B A N K

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The major Swedish banks' structural liquidity risks

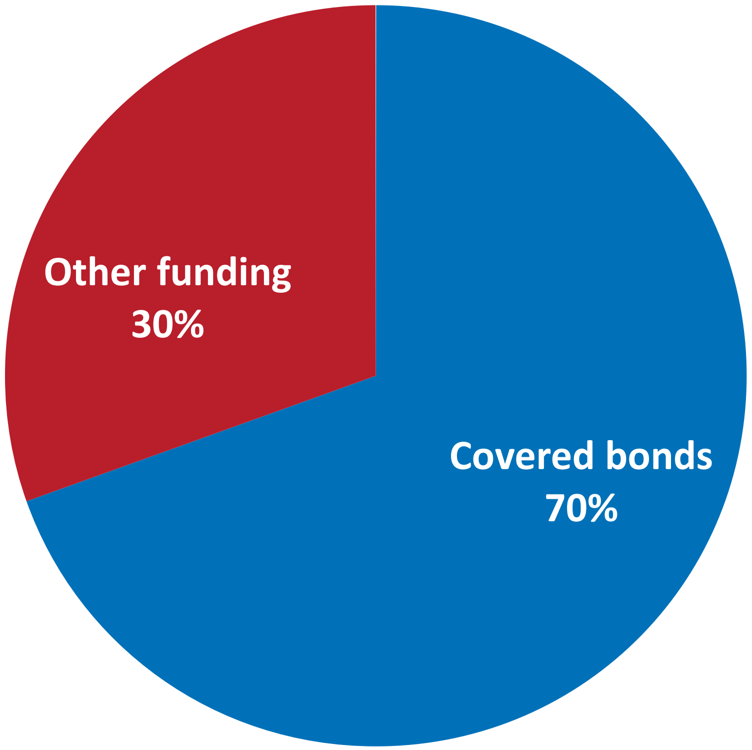
Riksbank Study, November 2016, with contributions by

- Marcus Pettersson, Riksbanken
- David Vander, Liquidatum
- Pehr Wissén, Swedish House of Finance

The Swedish financial system is vulnerable and exposed to risks

- The Swedish banking system is vulnerable
    - Large
    - Concentrated
    - Interconnected
    - Increasingly exposed to the housing market

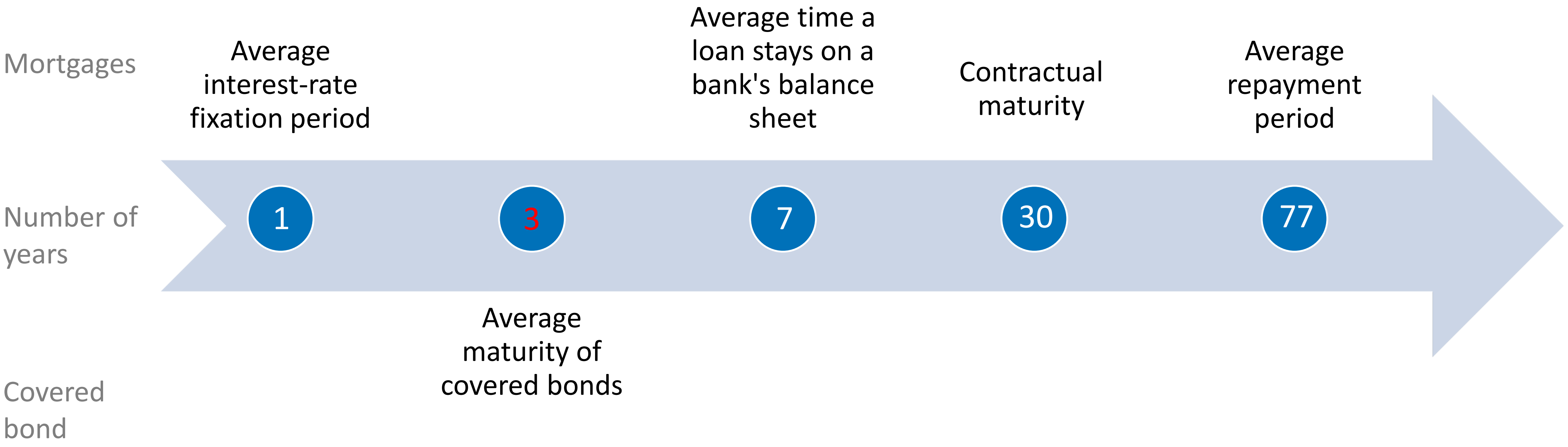
The major banks fund mortgage loans by issuing covered bonds



Note. The major Swedish banks' funding of Swedish mortgage loans, September 2016.

Sources: Major banks' "harmonised transparency template" and the Riksbank

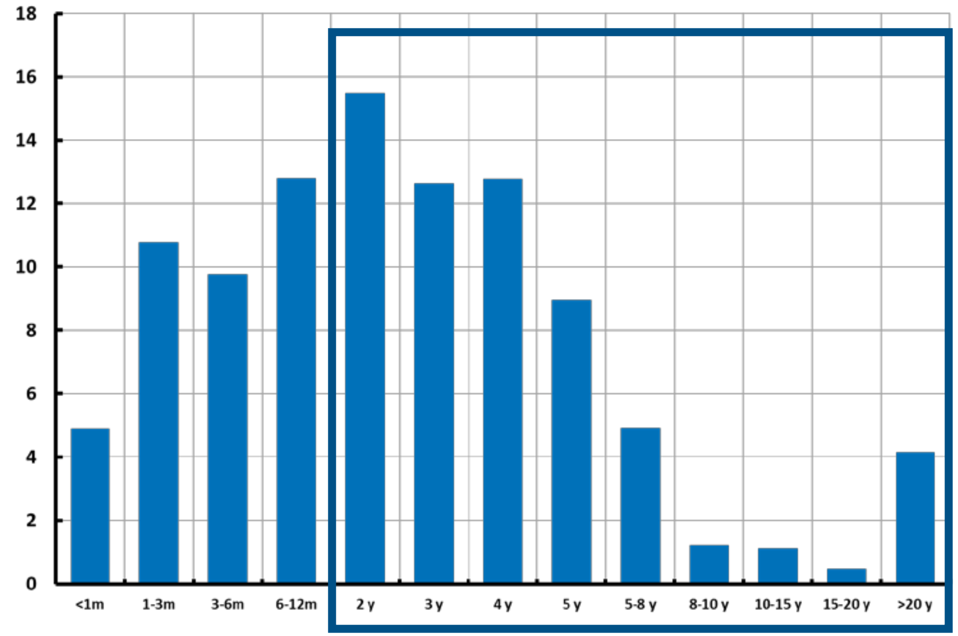
Major maturity mismatch between mortgages and covered bonds



Note. Contractual maturity means the maturity specified in a loan agreement. It can vary from borrower to borrower and, in many cases, agreements do not specify any such maturity.

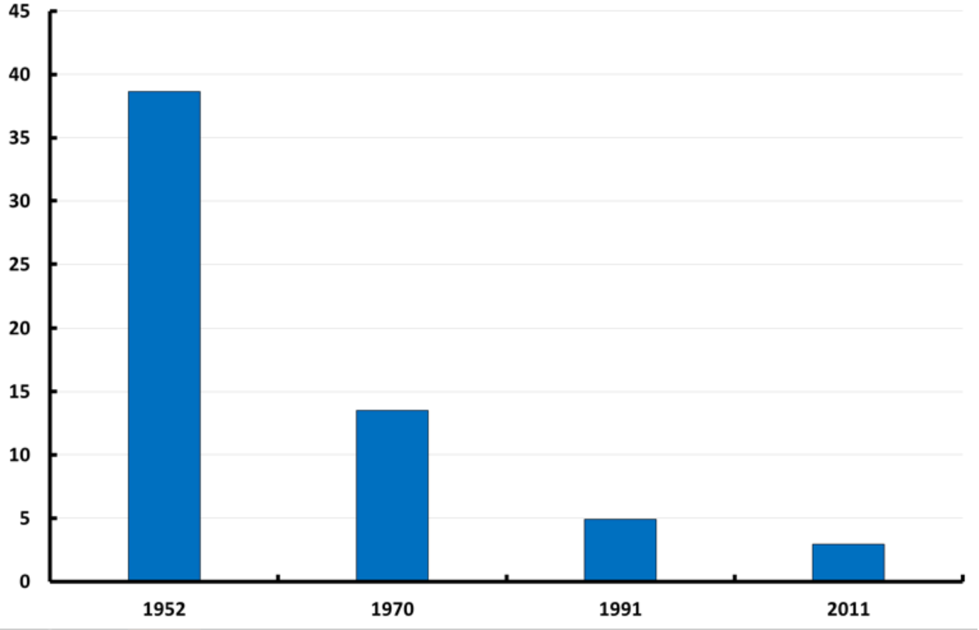
Banks have a small proportion of long-term funding

The major banks’ outstanding securities



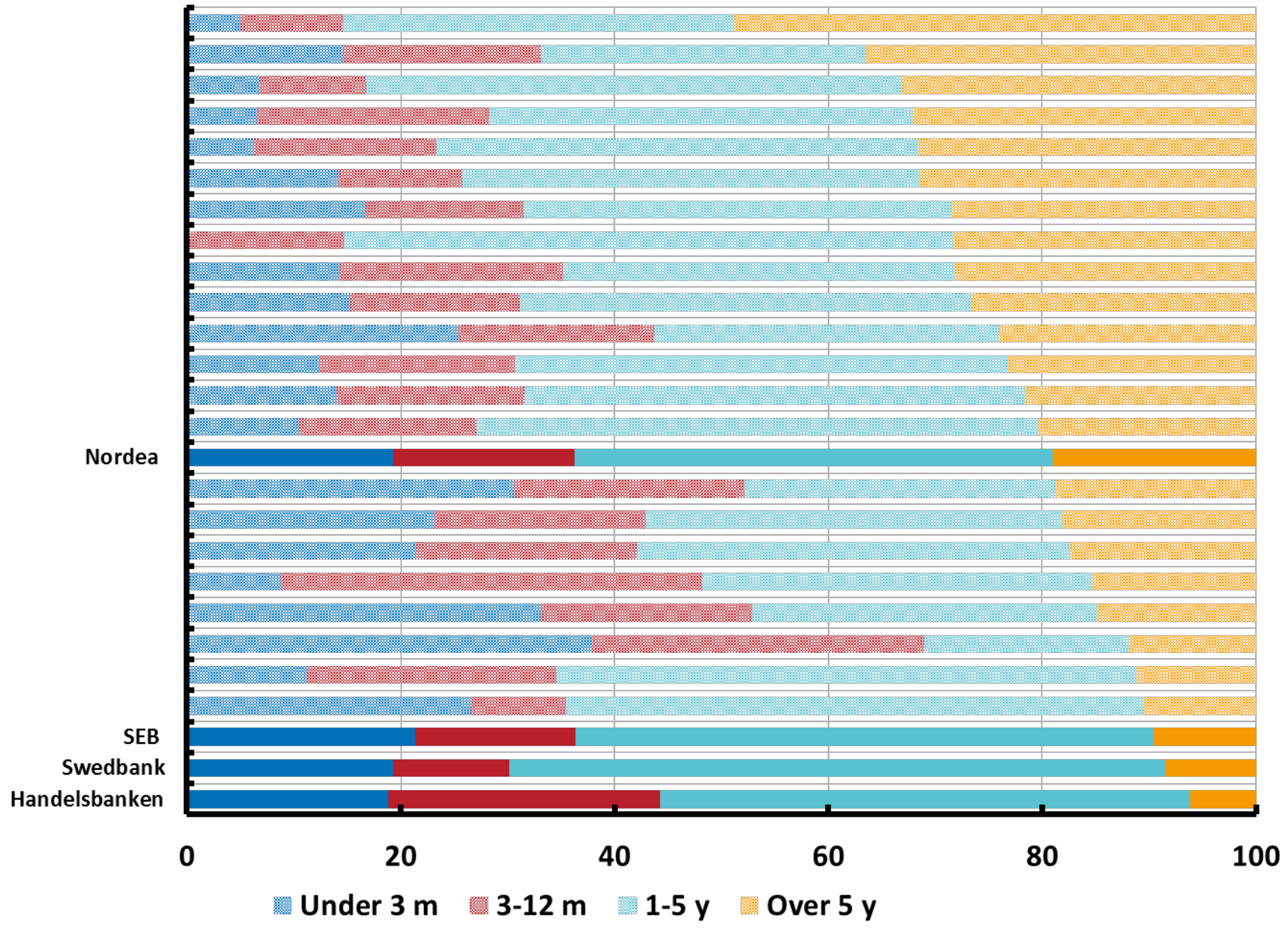
December 2016, per cent of outstanding volume. The chart shows the maturity structure for the major Swedish banks’ outstanding securities. Source: The Riksbank.

Average remaining maturity for Swedish mortgage bonds



Number of years. Remaining weighted maturity in the portfolio. Sources: Swedish bonds book (Swedish Bankers’ Association) from the years 1952, 1970 and 1991, the Association of Swedish Covered Bond Issuers, Sveriges Riksbank.

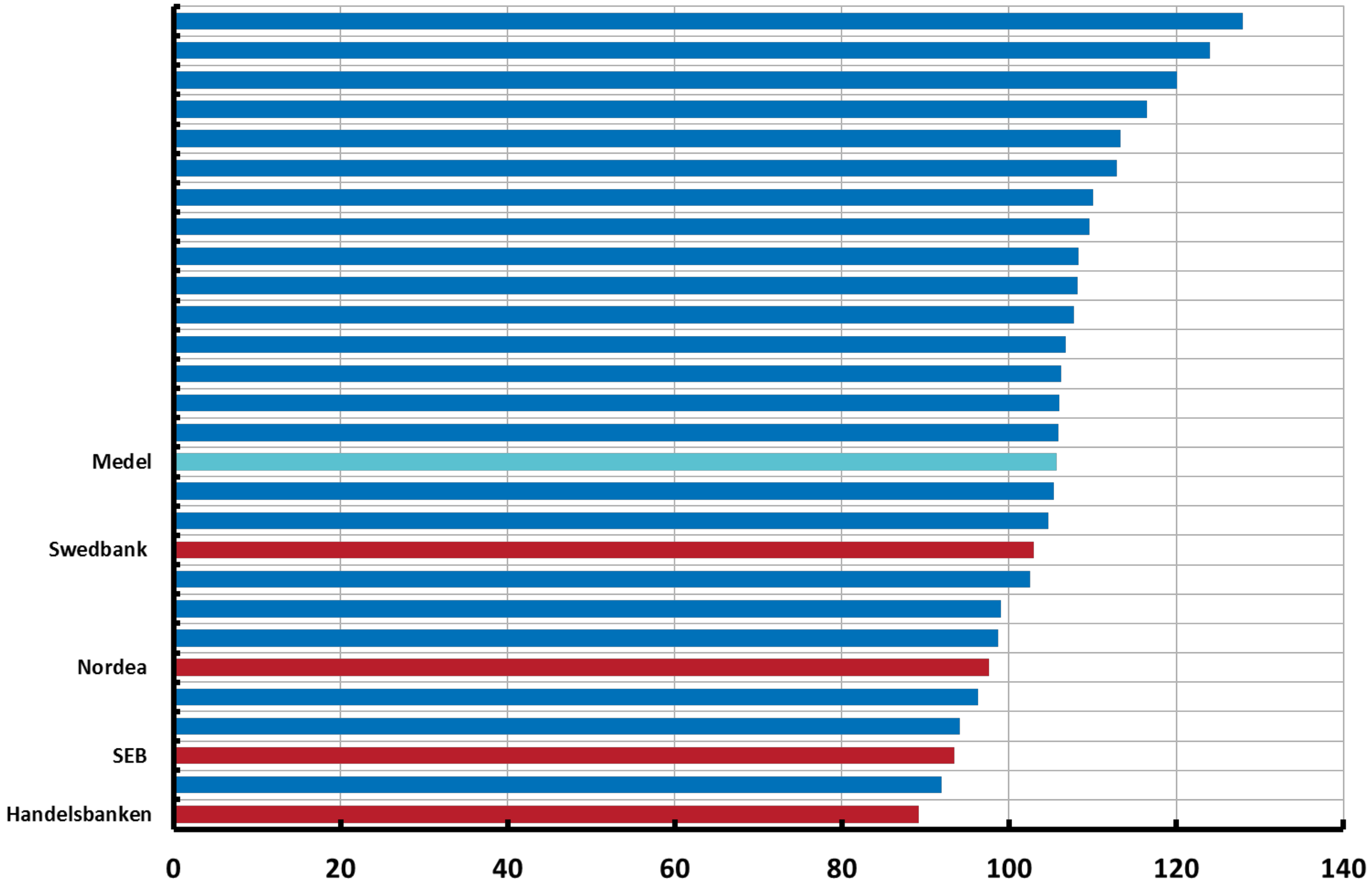
Swedish banks have a smaller proportion of funding at longer maturities compared with other European banks



Note. The banks' outstanding securities broken down by remaining maturity. December 2015, per cent of outstanding volume.

Sources: Liquidatum and the Riksbank

The major banks have larger structural liquidity risks than other European banks

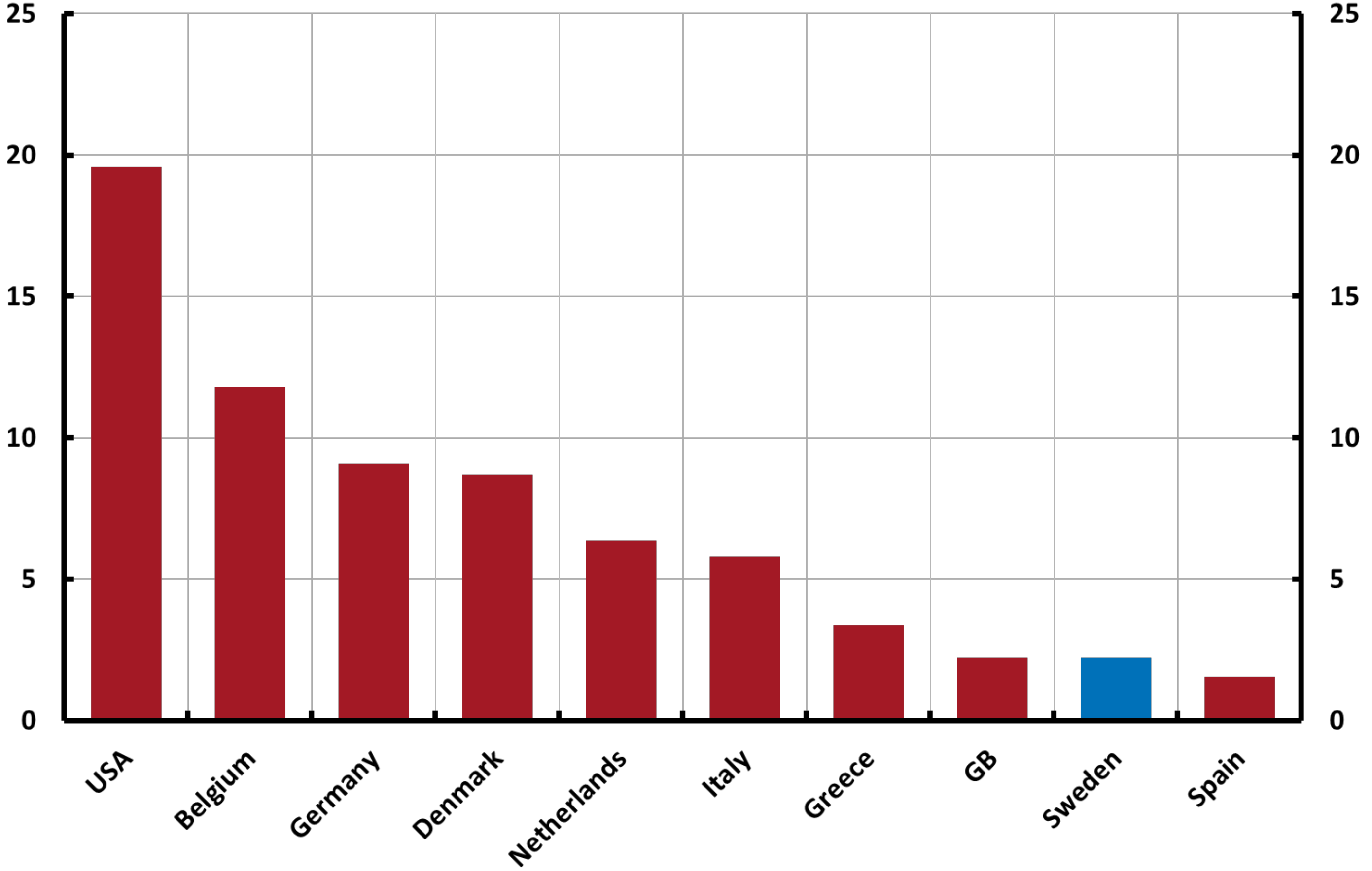


Note. The Riksbank's structural liquidity measure shows the ratio between a bank's stable funding and its illiquid assets. A low score indicates major structural liquidity risks. The turquoise column shows the unweighted average value for all banks in the comparison. December 2015. Sources: Liquidatum and the Riksbank

Household indebtedness

- Poorly-functioning housing market forcing many households to take on a lot of risk
    - High indebtedness
    - Long repayment period (low amortisation)
    - Short interest-rate fixation period, not linked to repayment of loan
- Monetary policy has a large (and excessively imbalanced?) impact on the economy

Shorter interest-rate fixation periods than in many other countries



Note: Average interest-rate fixation periods for a sample of countries. The figure is based on historical averages for all new mortgages with an interest-rate fixation period of less than 1 year. Note that historical averages are based on time periods of different lengths (for details, see Badarinza et al.). (2014)). Sources: Badarinza et al. (2014) and the Riksbank

Are we satisfied with this market?

- The market has changed a great deal in recent decades
  - The banks act increasingly as mortgage institutions
  - Funding of mortgage loans takes place over ever-shorter maturities
  - Households have larger mortgages, more often at variable interest rates, and lower amortisation rates
- The mortgage market functions very differently in different countries
- Are we satisfied with this mortgage market?
  - If not, what are the shortcomings? How can it be changed?
- Can we reduce the banks' structural liquidity risks?
- Funding at long maturities and interest-rate fixation is "expensive"
  - Market failure?
  - Market failure that can be corrected?

Riksbank Study mentions several measures that could extend the banks' funding

- Increase the transparency of the banks' operations
- Tighten up the NSFR
- Supplement with further liquidity measures
- Investigate requirement for limit for maturity mismatches in the Covered Bonds Act
- Longer interest-rate fixation periods for mortgages