

**WARNING OF THE EUROPEAN SYSTEMIC RISK BOARD**  
**of 22 September 2016**  
**on medium-term vulnerabilities in the residential real estate sector of Sweden**  
**(ESRB/2016/11)**  
(2017/C 31/08)

THE GENERAL BOARD OF THE EUROPEAN SYSTEMIC RISK BOARD,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macroprudential oversight of the financial system and establishing a European Systemic Risk Board <sup>(1)</sup>, and in particular Articles 3 and 16 thereof,

Whereas:

- (1) Past experience in many countries shows that the manifestation of residential real estate vulnerabilities may lead to significant risks to domestic financial stability and serious negative consequences for the real economy, as well as potentially leading to negative spill-overs to other countries.
- (2) The European Systemic Risk Board (ESRB) has recently concluded a systematic and forward-looking Union-wide assessment of vulnerabilities relating to residential real estate. In this context, the ESRB has identified in eight countries certain medium-term vulnerabilities as a source of systemic risk to financial stability, which may have the potential for serious negative consequences for the real economy.
- (3) The ESRB's vulnerability assessment highlights the following for Sweden:
  - a. There has been a substantial and prolonged increase in residential real estate prices in Sweden. In recent years, residential real estate prices have been increasing at a faster rate than household income (although a slow-down in price growth has been noted in recent months). As a result, residential real estate prices appear to be over-valued based on estimates by the European Central Bank and the International Monetary Fund.
  - b. Residential real estate price developments are also mirrored in the debt levels of Swedish households. The level of debt relative to households' disposable income and to GDP is increasing and also elevated in comparison with most countries in the Union. For example, those households that took out new mortgages in 2015 have mortgage debt that is on average four times their annual disposable income, while there was a non-negligible share of households taking up new loans of more than seven times their annual disposable income. Although Swedish households have high savings rates and large asset holdings, a large proportion of their assets are in the form of residential real estate and pension schemes, the value and liquidity of which may not be resilient in stressed market conditions. In addition, there is no good data available on the distribution of these assets among households.
  - c. Beyond cyclical factors, the drivers behind the rapid increase in residential real estate prices and high household indebtedness also include structural factors. Some of these factors are outside the direct control of the Swedish authorities, such as changes in demographics, urbanisation and strong income growth. However, some factors that are within the control of the authorities, such as the tax regime related to real estate (e.g. tax benefits to homeowners, mortgage interest tax deductibility, capital gains tax) and supply-side constraints (e.g. the strongly regulated rental market and the regulatory constraints in relation to the construction of new homes), also contribute to the build-up of residential real estate vulnerabilities. In these types of situations, macroprudential policy measures could be used to enhance the resilience of the financial system and households' balance sheets if the structural drivers behind the vulnerabilities are not otherwise addressed by structural reforms.
  - d. In the event of an economic or financial shock – such as an increase in unemployment and/or a decrease in income growth or house prices – then highly indebted households may find it particularly difficult to service their debts and the number of mortgage defaults may increase leading to direct credit losses to banks, especially

<sup>(1)</sup> OJ L 331, 15.12.2010, p. 1.

in the event of a decrease in residential real estate prices. Moreover, if an adverse scenario for the economy does materialise, the associated negative household income and wealth effects may reinforce the initial shock, further enhancing the negative direct and indirect effects on financial stability (e.g. if households need to reduce consumption in order to service their mortgage loans).

- e. Adverse dynamics in residential real estate prices and household consumption may also pose a threat to the banking system. Downside risk could be amplified by the high reliance of Swedish banks on market and foreign currency funding. Further, the interconnectedness between banks across the Nordic-Baltic region means that there could be significant cross-border spill-overs between banking systems as a result of difficulties related to residential real estate stresses in any of the countries of the region. Nevertheless, the Swedish banking sector is well-capitalised and profitable compared to European peers, and lending standards appear prudent. The stress tests conducted on the Swedish banking system suggest that it would be resilient to withstand a severe macroeconomic deterioration. In addition, the Swedish authorities have adopted several measures to strengthen the resilience of the Swedish banking sector, including through capital buffers, higher capital requirements for mortgage exposures and the introduction of separate liquidity coverage ratio requirements for several currencies.
- f. The ESRB notes the measures that have been implemented in Sweden with respect to vulnerabilities relating to household indebtedness and residential real estate prices. The introduction in 2010 of an 85 % limit on the loan-to-value ratio for new mortgages and an amortisation requirement in 2016 are expected to address the build-up of further vulnerabilities to some extent. While the current policy measures are appropriate given the nature of residential real estate vulnerabilities in Sweden, they may not be sufficient to fully address them. Given that the measures apply only to new housing loans it will take time for the vulnerabilities related to the level of household indebtedness to substantially decrease,

HAS ADOPTED THIS WARNING:

The ESRB has identified medium-term vulnerabilities in the residential real estate sector of Sweden as a source of systemic risk to financial stability, which may have the potential for serious negative consequences for the real economy. From a macroprudential perspective, the ESRB considers the main vulnerabilities to be the rapidly growing residential real estate prices that appear to be overvalued, and high and increasing indebtedness especially among some groups of households. In addition, if risks were to materialise, there could be potential spill-over effects to other countries in the Nordic-Baltic region.

Done at Frankfurt am Main, 22 September 2016.

Francesco MAZZAFERRO

*Head of the ESRB Secretariat*

*On behalf of the General Board of the ESRB*

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