



# Financial Crises: The case of Sweden in the 1990s and 2008-2009

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# Crisis in the 1990s: The Build Up

- 1985-1991: The property market was fuelled
  - Deregulated credit markets
  - Generous taxation
  - Weak supervision
  - Loose fiscal policy under fixed exchange rate
- Excessive lending (banks and new “finance companies”)
- Property bubble was created

# Crisis in the 1990s: Bursting Bubble

- 1990-1992: Property market bubble burst
  - The Riksbank defended the fixed exchange rate with high interest rates and inflation came down => high real rates
  - Property values fell
    - Huge losses in private sector
  - Private sector balance sheet consolidation
    - Domestic demand plunged
    - Unemployment exploded
  - Banks suffered large credit losses, mainly from lending to commercial property
  - Public debt crisis (deficit 12 percent of GDP in 1994)

# Crises in the 1990s: The Recovery

- 20 percent devaluation of the krona (floating exchange rate regime with inflation target)
- Sharp decline of interest rates
- Global growth - export led recovery
- Large public expenditure cuts and tax increases
- Structural reforms
  - Budgetary process, social security system, pension system, deregulation of markets, independent central bank

# Course of events

**PRELUDE** Aug 1990 – Sep 1991

- Non-bank financial institution Nyckeln fails
- Government majority owned Nordbanken reports increased losses

**PHASE 1** Oct 1991 – Aug 1992

- Case-by-case
- Första Sparbanken (government guarantee)
- Government buys Nordbanken from the stock exchange

**PHASE 2** Sep 1992 – Aug 1993

- Gota Bank fails – government buys the bank for 1 krona and merges it with Nordbanken
- Blanket government guarantee
- Bank support measures (bad bank, good bank)
- Devaluation of the krona, sharp decline of interest rates

# Course of events, cont.

**PHASE 3** Sep 1993 – Feb 1994

- "... beginning of the end...."

**THE END** July 1996

- Crisis legislation and blanket guarantee abolished (replaced by DGS)

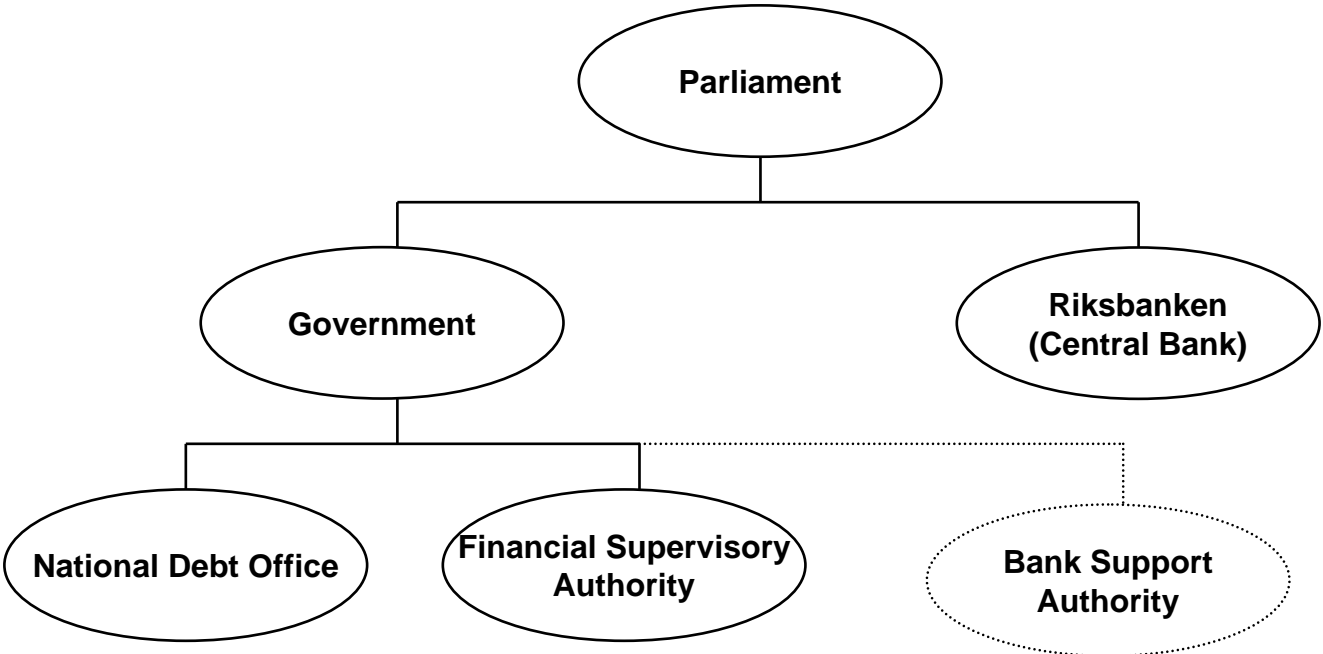
# Operational strategies

- Government intervention strong and prompt
- Openness and transparency
  - Mark to market
  - No smoke and mirrors
    - “A hole in the balance sheet is a hole in the balance sheet”
- Broad political consensus
- Minimize long term costs for tax payers
  - Shareholders and subordinated debt holders should take the first hit

# Operational strategies

- Temporary government guarantee to restore confidence and secure liquidity
- Restore capital base only for viable institutions
- Orderly wind up of non-viable institutions
- Good bank/bad bank in order to focus management

# Organization



# Costs (or expenditures)

- 1993 6 % of GDP,
- 1997 2 % of GDP,
- 2010 almost 0.
- The government recovered most (all) of the bank support
  - Property values in bad banks recovered
  - Share prices increased in Nordbanken (partly privatized)

# Ireland and Sweden: Similarities

- Both crises caused by property bubbles
  - The bubbles were created by unbalanced macroeconomic policies combined with bad bank practices
- Both countries introduced blanket guarantees
- Both countries created bad banks/good banks

# Ireland and Sweden: Differences

- The losses in the banking system in Ireland seem to be larger in magnitude
  - In Sweden no losses were made on retail mortgages (no walk away clauses, no rental market)
- More generous blanket guarantee in Ireland
  - Includes subordinated debt
- Sweden “nationalized” troubled banks
  - Easier to transfer assets to bad banks since mispricing of assets does not lead to wealth transfers
- Devaluation of the krona, interest rates cuts and a global boom made recovery easier for Sweden?

# Crisis in the 2000s: The Build Up

- No fall in property prices in Sweden
- Marginal exposure to “toxic asset” in Swedish banks
- Liquidity squeeze due to the international financial crisis
- Two major banks had expanded into the Baltics (10-15 percent of balance sheet)
  - Excessive lending to property
  - Hit by global recession - GDP fell by 10-20 percent
  - Massive credit losses

# Credit Crunch?

- International banks withdrew credits from Sweden
- Raised capital requirements from markets
- Credit losses in the Baltics?
- Equity in banking system a scarce resource?
- Functioning of equity markets?

# Operational strategies

- Government guarantee program only for new borrowing to secure liquidity
  - Legal mandate to issue a blanket guarantee if the situation deteriorated
- Capital injection program for solid banks in order to increase lending capacity
  - Prepared to nationalize and recapitalize banks if necessary
- Minimize long term costs for tax payers
  - Share holders and subordinated debt holder take first hit
- [Build a stability fund to finance the costs of the next crisis]

# Stability plan

- Emergency legislation in October 2008, giving the Government broad powers to do whatever is necessary to maintain financial stability:
  - Open-ended fiscal mandate to issue guarantees, inject capital etc.
  - Power to buy out shareholder in banks that have inadequate capital or fail to fulfill conditions in support agreements (subject to review by a special “Board of Approval”)

# The SNDO's Role in Bank Support

- The SNDO was made the bank support agency
- We administer
  - guarantee scheme for medium-term borrowing
  - capital injections programme
  - stability fund
- Responsible for analyzing the need for support and to enter into support agreements with individual banks
- All measures and agreements are subject to Government approval (except securities guarantees)

# Division of Labour

- **Ministry of Finance/ Parliament**
  - Legislations/Ordinance
- **Finansinspektionen (FSA)**
  - Day to day supervision
- **Riksbanken (central bank)**
  - Short term liquidity support
  - Emergency credit
- **Riksgälden (SNDO)**
  - Guarantees
  - Capital injections
  - Support to insolvent institutions
  - Debt management
  - Deposit guarantee

# What was done?

- Issued guarantees > 350 billion SEK
- Injected 5 billion SEK of equity capital into Nordea
- Took over a small investment bank in November 2008 (Carnegie).
  - And sold it again to private investors in February 2009

# Costs?

- Estimated total: +20 billion SEK (0,5 % of GDP)
  - Guarantee program projected to give surplus of 5 billion SEK
  - Capital injection program has generated an unrealized profit of 15 billion SEK.
  - The result of Carnegie is projected to be 0