

Erik Thedéen: Keynote address - OSC Dialogue 2024

Keynote address by Mr Erik Thedéen, Governor of the Sveriges Riksbank, at the Ontario Securities Commission Dialogue 2024, Toronto, 22 May 2024.

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Dear Members of the Ontario Securities Commission, thank you for the invitation to a fireside chat at your signature annual conference and the opportunity to provide a perspective from the other side of the Atlantic. In my brief talk today, I would like to make three points, coming from recent experience in my own country. First, I will emphasise the importance of usable capital in the banking system, a lesson that we learned during the Covid pandemic. Second, I would like to allude to the corporate bond market and some lessons from my side of the Atlantic. Finally, I would like to say a few words related to the new risks we see facing us today, not least arising from the current geopolitical environment.

But first, let me note that there are many similarities between Canada and Sweden. We are both nestled in the north. Hockey is a common theme, and here we are of course fierce opponents. Peter Forsberg's winning penalty goal against Canada in the Olympics in Lillehammer back in 1994 was even depicted on our postage stamps, marking how significant it was for us to beat the Canadian team. But even if they were rivals, I believe that there has been a solid base of friendship and respect between the two teams. They cooperate in setting rules and organising tournaments, and both teams want fair play.

Moving closer to the focus of today's discussion, we can note that both our countries have fairly large and concentrated banking systems, dominated by a few very large banks. We have also been facing rising house prices for a long period with an associated high level of household indebtedness. Moreover, both countries operate in the proximity of a large neighbour, Canada with the US and Sweden with the Euro area. In our case, this proximity to the euro area brings about challenges related to the implementation of monetary policy. Both Canada and Sweden rank high in terms of digital infrastructure relevant to cashless payments; both are seen as among the most significant adopters of cashless payment methods and both are considered among the most cashless societies in the world. To sum up, Canada and Sweden share many common themes, boding well for today's discussion. Let me now turn to my three points.

The Global Financial Crisis 15 years ago was a painful lesson of what improper supervision and regulation of the financial sector can lead to. The reaction was an unprecedented regulatory effort from global standard setters such as the Basel Committee and Financial Stability Board: more and better capital, liquidity requirements, central clearing when possible, and renewed focus on systemic risk with macro prudential supervision. And if things went wrong despite all this, institutions should have an option for resolution without recourse to public money.

The Covid pandemic was the first real test of the resilience this new regulation had built up in the banks. As the Covid pandemic struck, we needed to introduce a number of measures to address the potential for liquidity shortfalls in the financial system and to take regulatory measures to help banks cope with the situation. For example, in

Sweden, we had built up resilience by raising the countercyclical capital buffer to 2.5 per cent over a number of years. At the onset of the pandemic, we lowered this buffer to 0 per cent, freeing up a significant amount of capital. This leads me to my first point, the importance of usable capital buffers. This allowed the banks to continue to lend to corporates and households in spite of the fact that we were in a crisis situation. This time, the banks were part of the solution and not part of the problem as in the Global Financial Crisis. This shows the importance of usable capital.

Another lesson from the Covid pandemic was the importance of well-functioning bond markets. In Sweden, banks have traditionally provided the bulk of credit provision to the private sector. In recent years, the market for non-financial corporate bonds in Swedish kronor has grown in size. This means that we have two engines for credit provision: banks and financial markets. One way to look at this is to consider a twin-engine approach where we can use both engines and be less reliant on just one of them to foster economic growth. This also helps to spread the risks in the system. As the pandemic struck, it was the market-based engine that stuttered while the banks were able to continue to uphold the credit supply. A large outflow from some mutual funds followed as concerned investors wanted to make sure that their money was safe. It was clear that the Swedish corporate bond market did not have the depth and liquidity to handle the turbulence that followed. However, supported by a number of measures from the public sector, we managed to keep the plane flying as the bank engine never failed. The higher capital and liquidity in the banking system that came about from new regulations following the Global Financial Crisis clearly contributed to this beneficial outcome. Furthermore, in order for the fund sector to be better prepared for a situation with large outflows in the bond market, regulators are working on further developing liquidity management tools (LMTs) and their use.

Around half of the corporate bonds in Sweden are issued by commercial real estate (CRE) firms. History has shown, not least in my own country, that problems in the CRE market can affect the health of the banking system through their exposure to commercial real estate firms. The recent rise in interest rates has affected property companies through higher funding costs and lower property values. The situation has been particularly difficult for some companies, while others have been better placed to manage it. We have therefore argued that property companies need to reduce their financial risks and we are monitoring the situation closely.

A third and final point I would like to make relates to the present geopolitical situation. Geographically, Sweden is much closer than Canada to the Russian aggression in Ukraine. The war in Ukraine has reminded us of the need to prepare for the unthinkable. It has led to Sweden deciding to abandon our 200 year old neutrality policy by joining NATO. Closer to my own organisation, we have had a new Riksbank Act for over a year now. This new legislation gives the Riksbank extended tasks and powers to prepare for peacetime crisis situations and heightened preparedness. As an example, the Riksbank has been given the task of ensuring that companies that are of particular importance for the execution of payments plan and prepare for the continuation of their payment services during peacetime crisis situations and heightened states of alert. Moreover, a recent inquiry under the Ministry of Finance has proposed that a crisis management function with the task of handling serious operational disruptions in the payment system, for example following from a cyberattack, should be placed at the Riksbank. This new role, working with the other financial stability authorities in Sweden

as well as with the private financial sector participants, will help us be better prepared to handle operational disruptions, not only in peacetime crisis situations but also in situations with heightened alert.

While we have done a lot of work to handle crisis situations related to liquidity and capital shortfalls, we still have more work to do to be able to handle risks that are more on the operational side. Here we can learn from our peers. I recently visited the National Bank of Ukraine in Kiev to learn more about how they have handled the war situation. I was really impressed by their resolve and the way they continue to operate in spite of being in a full-fledged war situation. The National Bank of Ukraine was well-prepared for the Russian invasion as, along with the private banks, it had worked hard on contingency plans to ensure that payments could continue even in a war situation. As the war started, the focus was on more operational issues, such as ensuring the electricity supply to critical functions, enhancing digital payments, for example by recommending that banks extend the validity period of their cards without physically replacing them, as well as other measures that would ensure the uninterrupted operation of payments in the country. The experience from Ukraine shows the importance of being prepared.

Let me conclude by noting that it is by cooperating that we can learn from each other. I therefore hope that we can continue the transatlantic dialogue, which is perhaps more important than ever in today's situation. I look forward to today's discussion.