Joint EFMLG/FLB/FMLC/FMLG Meeting

hosted by

Federal Reserve Bank of New York

June 11-12, 2008

1990's Banking Crisis in the Nordic Countries

The Swedish case

presented by

Olof Myhrman

Head of Legal

SEB Merchant Banking, Stockholm

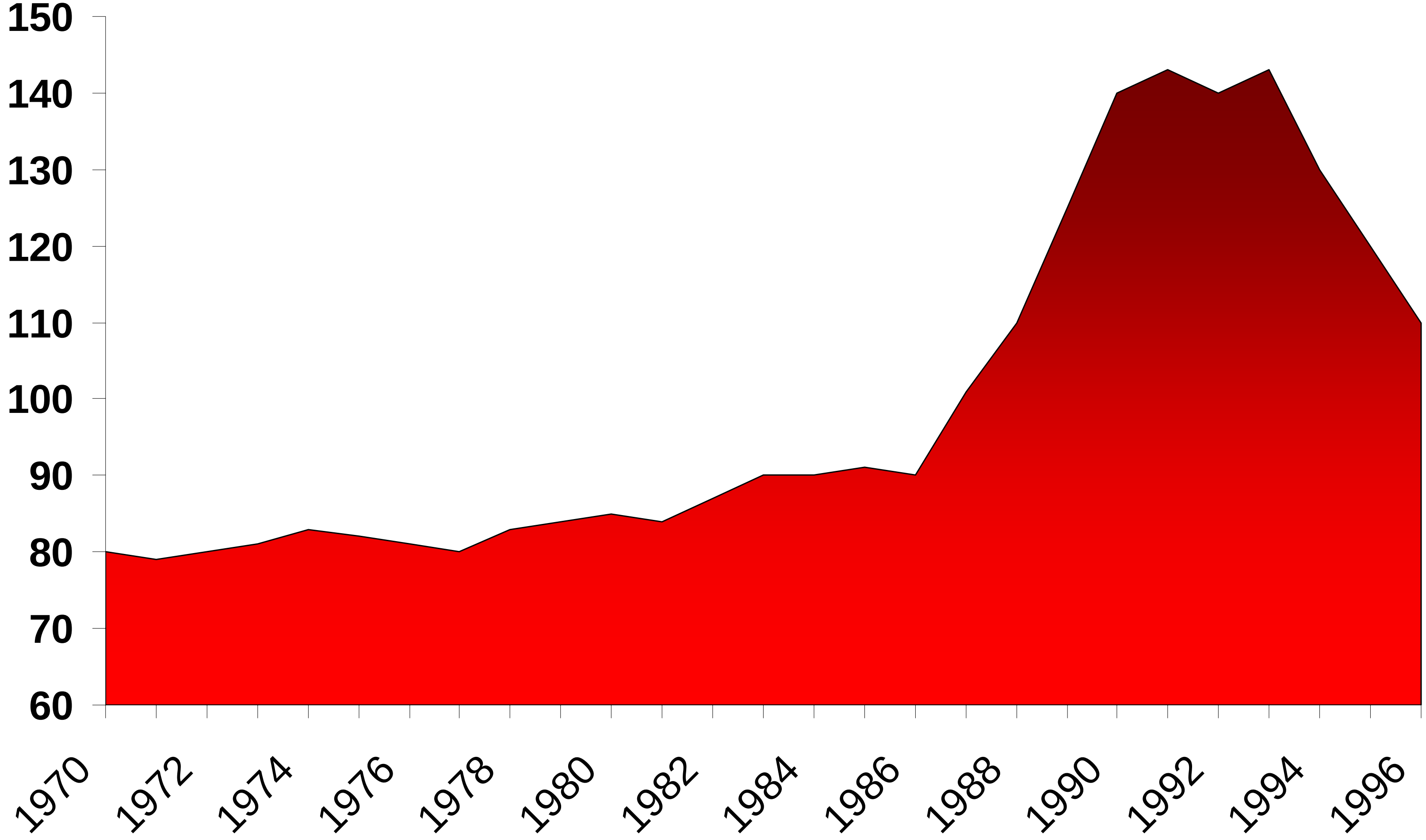
based on excerpts from a slide presentation by
SEB Chief Economist, Robert Bergqvist

Building the Swedish bubble

- **No framework for sound government finances**
  - Too loose fiscal policy (started 1974-1976)
- **Currency peg - monetary policy inactive**
- **Lack of understanding of the "inflation price"**
  - Several devaluations of the currency
  - Strong focus on labour market
- **Deregulation of credit markets (1985)**
- **Tax system favouring borrowing/speculations**
- **Deregulation of FX controls (1989)**

RESULT: Credit expansion, overheating, speculative capital flows, strong lending to real estate

Loan to non-bank public from Swedish credit institutions. % of GDP



Immediate policy reactions

- Riksbank defended the currency with high(er) interest rates
- Government presented policy to combat inflation
- Inflation fell => rising real interest rates
- Tax reform made it more expansive to borrow
- Global slowdown
- Rising unemployment - households increased savings

Depression

- Household savings ratio increased by 13 percentage points of GDP
- Result: A sharp credit contraction, bank losses
- Problems exacerbated by ERM crisis 1992-1993
- Markets mistrusted fixed exchange rate. Capital outflow forced tight monetary policy with high interest rates
- Worsened bank crisis
- Depression
- Eventually: A change of currency regime after huge FX interventions (SEK250bn)

Financial markets

- 1990: A major finance company (Nyckeln) suspended payments
- Liquidity crisis for commercial papers issued by finance companies
- Problems spread to banks; two major banks (Nordbanken and Gota Bank) needed new capital in 1991
- Currency crisis Aug-Sep 1992 caused sharp rise of key rates
- Dramatic situation. Loss of credibility in international markets. The stability of the system at risk in the autumn 1992

The work-out process

- **A Bank Support Authority was set up, to evaluate all banks:**
  - 1. Credit portfolios were classified and valued
  - 2. Property collateral was valued
  - 3. Sensitivity analyses were carried out
- **Three solutions identified**
  - 1. Private solution, owners put up new equity
  - 2. Semi-private solution with equity guarantee
  - 3. Total restructuring
- **The core task: Separate bad loans from good - split bad banks from sound. Create work-out companies**

Why was the rescue successful?

- The rescue action came early, was comprehensive and fully transparent
- Implemented without delay
- Broad political consensus about the support program
- No nepotism or protection of vested interests
- Market pricing of bad debt
- Immediate credibility among foreign investors and creditors