

Property in Sweden

Home is where the heartache is

House prices in Sweden continue to soar, to regulators' despair

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ASK a central banker what regulators should do when rock-bottom rates cause house prices to soar, and the reply will almost always be “macropru”. Raising rates to burst house-price bubbles is a bad idea, the logic runs, since the needs of the broader economy may not square with those of the property market. Instead, “macroprudential” measures, meaning restrictions on mortgage lending and borrowing, are seen as the answer. But this medicine is hard to administer, as Sweden’s housing market vividly illustrates.

Swedish house prices have doubled in the past decade, their rapid ascent only briefly interrupted by the financial crisis (see chart). So far this year they have risen by about 14%. Apartment prices have been even giddier, rising by more than 150% in ten years.

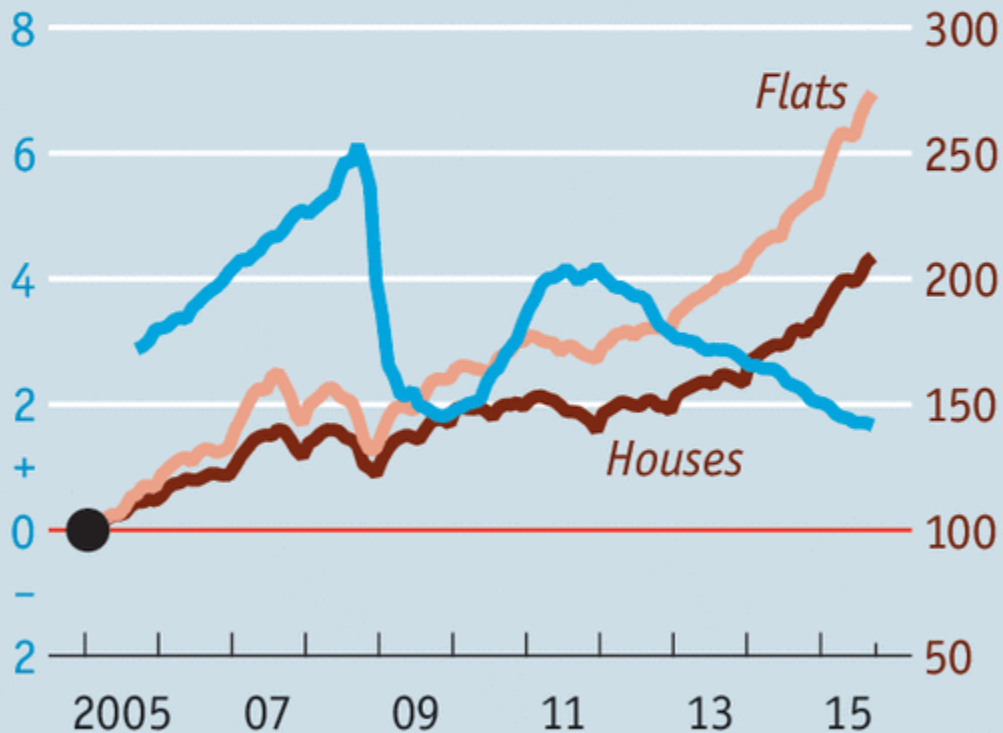


Cheap money, expensive property

Sweden

Average interest rate,
New housing loans %

Prices
January 2005=100



Sources: Statistics Sweden; Nasdaq OMX; Valueguard

Economist.com

In part, this is a simple function of supply and demand. Stockholm is among Europe's fastest-growing cities, with the recent influx of Middle Eastern refugees only adding to the demand for housing. Last month the country's migration agency said it expected as many as 190,000 new arrivals by the end of the year, double its previous estimate. Sluggish and restrictive planning procedures limit supply: the current shortage of around 150,000 homes is expected to triple by 2025. A counterproductive rent-control regime has crimped the supply of flats in particular, and led to long waiting lists. Earlier this year an apartment in central Stockholm went to someone who had been in the queue since 1989.

Low interest rates have given Swedes the capacity to borrow more, pushing prices ever higher. The debt of the average household has reached 172% of income after tax. For people with mortgages in the big cities, the figure is nearly double that.

The most obvious way to calm things down is to raise rates. But the Riksbank, Sweden's central bank, tried that in 2010-11, with disastrous results. Unemployment stopped falling and inflation soon withered, stirring fears of deflation. That prompted the Riksbank to reverse course in late 2011 and start cutting rates again. The benchmark has ended up lower than it was to begin with, at -0.35%, increasing the sums flooding into housing. "It's like mopping whilst the tap is running at full flow," complains one official.

To try to stanch the flow, the Finansinspektionen (FI), the country's financial watchdog, has adopted curbs on both lending and borrowing. In 2013 it tightened capital requirements for mortgages, and since September it has required banks to hold an extra counter-cyclical capital buffer of 1% of all risk-weighted assets, to increase to 1.5% by next June. This will help if the property bubble bursts, but clearly has not been enough to stop it inflating.

Caps on how much individuals can borrow, in the form of maximum loan-to-value (LTV) and debt-to-income ratios, are another option. A recent IMF study found that in more than half of countries where this has been tried, credit growth and asset-price inflation fell. In 2010 the Riksbank embraced this policy, requiring a deposit of at least 15% for new mortgages.

The authorities have also tried to restrict the use of interest-only mortgages, which are common in Sweden. If borrowers use these to protect themselves from temporary financial problems while still paying down their debt, they can be helpful. But if they take out interest-only loans simply to borrow more, they exacerbate the bubble. Almost 40% of Swedish mortgages by value are not being paid down at all, and for many of the remainder the pace of repayments is slow. The FI has been trying to push banks and borrowers to agree voluntary repayment plans. It suggested that those with LTVs above 70% pay down at least 2% a year, and those with LTVs of 50-70% pay 1% a year. But in April a court quashed such efforts, arguing the FI had no authority to promote such plans.

In any case, the allure of cheap loans is so great that households in Sweden and beyond will find ways around the restrictions that remain in place. When the Slovakian government put limits on housing loans, banks boosted other forms of lending to bridge the gap. In Sweden, so-called "blanco-loans", more expensive unsecured loans, can be used for that purpose. All told, credit is still growing and asset prices climbing, despite regulators' efforts.

A better solution might be to eliminate the tax code's various incentives for home ownership. Property taxes were abolished in Sweden in 2008; up to 30% of mortgage interest can be deducted from personal tax bills and a rebate of up to 50% can be claimed on home extensions and repairs. The Riksbank thinks that abolishing mortgage-interest relief alone could cut aggregate debt as a

share of income by more than 50 percentage points over the next 50 years. Reducing the maximum LTV ratio to 80% would only trim debt-to-income ratios by five percentage points; the FI's repayment scheme would cut them by 12.

The tax code is in the hands of politicians, as are the planning and rent-control regimes that impede the construction of new homes. An independent commission last year recommended urgent reforms to all three, but has been ignored. Politicians at least seem to be warming to the idea of cutting mortgage-interest relief, partly because they are looking for money to pay for the influx of refugees. But for the most part, measures to slow the property boom seem politically unpalatable. "People feel rich today thanks to these crazy prices," says one member of parliament. "Nobody wants to be the one who breaks the spell."

Politicians and regulators also know that any measure that obliges Swedes to spend more of their income on deposits or mortgage payments would be a drag on consumption, and thus a blow to an already fragile economy. "Ideally, I'd like to have something in my toolkit with which I could influence the housing market and nothing else," says Henrik Braconier of the FI, "but up to now I have not found it."

From the print edition: Finance and economics