The anatomy of Sweden's banking deregulation debacle

by William Engdahl

"The Swedish government is going to have to put in possibly three or four times what they have so far, in order to bail out Swedish banks before this is over," confided a Scandinavian banking source familiar with the ongoing Swedish real estate debacle. "After deregulation in the 1980s, many Swedish banks lent to anything you could think of, in areas where in many cases they had no prior experience."

In 1991, Swedish banks totaled record loan losses of SKr 35 billion [roughly $6.6 billion]. By far the largest loser was the state-controlled Nordbanken, with a hefty SKr 10.5 billion in loan losses alone. Nordbanken has total loans outstanding of some SKr 260 billion.

But more worrisome are the not-yet-realized potential loan losses of Swedish banks. Some Swedish private economists estimate that it could take 5-10 years, or more, to digest the glut of commercial office construction which grew in especially the west coast of the country over the past decade. According to a recent study by Enskilda Fondkommission of Stockholm, the total volume of "problem loans" on the books of Swedish banks in 1991 totaled an all-time high of SKr 91 billion, some 10% of total bank loans.

But far from expecting improvement this year, Enskilda estimates that sum will go beyond SKr 150 billion by the end of December. The vast bulk of these loans are being held by the banks in desperate hope of an upturn in Sweden's depressed economy. Ironically, it was a socialist government, under Olof Palme and later Ingvar Carlsson, which opened the door to financial market deregulation during the 1980s—in the same way that Jimmy Carter's Democratic administration initiated banking deregulation in the United States.

Biggest real estate bubble in history

Traditionally Sweden had one of Europe's most conservative banking sectors and defaults were almost unheard of. By the time the Ingvar Carlsson government lifted final capital controls on Swedish banks and companies at the end of the 1980s, the biggest speculative real estate bubble in the country's history was fully under way.

During the series of measures introduced by Social Democratic Finance Minister Kjell Olof Feldt, in the mid-1980s, Sweden's traditional rural mortgage banks, which had been restricted to lending at 100% collateral to local customers—often farmers or homeowners whom the local bank had known for generations—suddenly were free to invest where they wished.

Overnight, small *sparbanken* (similar at that time to the pre-1982 U.S. savings and loan institutions) merged to create "competitive" all-purpose banks. "Banks with no prior experience in commercial property lending were suddenly major players in speculative real estate projects," K.-A. Olsen of Copenhagen's Unibank told *EIR*. "Some of the actual stories of lending terms by these new banks would astonish you." Two of the banks which racked up the largest loan losses last year, Foersta Sparbanken and Sparbanksgruppen, were examples of such conglomerations of smaller *sparbanken*. Both banks had combined loan losses in 1991 of just over SKr 9 billion, an astonishing sum for Sweden's once-conservative banking sector.

The Nordbanken saga

The speculative boom came to an abrupt halt at the end of 1990, when the government and the central bank (Riksbank) took steps to "shadow" or peg the kroner to the European Monetry System's currency bloc, specifically the German deutschemark, as preparation for eventual Swedish membership in the European Community (EC). With no capital restrictions and an overvalued kroner, the Riksbank has more than once, since then, been forced to raise short-term rates to 17% or more to stabilize the kroner against the deutschemark. The result of the high interest rates was a predictable collapse of the domestic real estate bubble by the end of 1990.

The first real indication of the dimension of the Swedish property problems erupted last autumn, days after the election of a new conservative coalition under Prime Minister Carl Bildt. The large state-controlled Nordbanken announced huge real estate-linked losses tied to the collapse of Gamlestaden AB, Nobel Industrier AB, and Yggdrasil AB, all three linked to Nordbanken minority shareowner Erik Penser. The bank told the new government it needed an emergency SKr 5 billion capital injection to keep afloat and prevent a panic run on deposits.

At that point, according to well-informed Stockholm financial sources, Finance Minister Anne Wibble and the Bildt government, with a strong "Thatcherite" free market bias, were initially inclined to let the bank fend for itself. But reportedly, a conference call with Riksbank Governor Bengt Dennis, at the time in Bangkok attending the annual meeting of the International Monetary Fund, "persuaded" the government that failure to step in with an immediate bailout of the bank would risk a domino-effect crisis, not merely in the Swedish banking sector, but possibly internationally. Dennis also sits as present chairman of the central bankers' Bank for International Settlements.

While the Riksbank would not comment on the issue, Anders Salen, head of the government bank regulatory agency, Finans Inspektionen, did say that it was his personal view at the time of the Nordbanken crisis last autumn, that a "major crisis was imminent" unless swift and decisive government intervention to restore depositor confidence was taken.

The government has been taking such steps ever since. While no one likes to speak about it, Sweden is one of the few OECD countries which has no system of deposit insurance in place, meaning a confidence crisis in any single large bank could rapidly become systemic.

But the government's Nordbanken capital injection last fall didn't solve much. By the end of the first trimester (January-April) of this year, Nordbanken had recorded another SKr 2 billion in loan losses. And this was before the giant Gothenburg property group AB Coronado collapsed in early June. Coronado, Sweden's third largest property conglomerate, had SKr 9.3 billion in debts. Its two largest creditors were Nordbanken and Sweden's largest private bank, S-E-Banken. The day Coronado failed, Swedish bank share prices plunged yet lower on the Stockholm stock exchange.

The government rescue plan

Nordbanken spokesman Mikael Anderkrona said that a government rescue plan, first made public at the end of June, is going ahead on schedule. "On Sept. 1, the new entity, Securum, will start business, still a part of Nordbanken. In January next year, Securum will then be split from Nordbanken, which then will again be a healthy bank. Securum will stay in state hands." The government hopes to clean up the remaining Nordbanken for sale to a foreign buyer.

Securum is the name of the entity proposed by the government at end April this year, after Wibble and the government became informed that the bank's losses were mounting alarmingly. The name was clearly chosen to give a public image of security to potential investors, but the assets of Securum—billions in bankrupt construction projects—will be "secure" only through an open-ended obligation on the highly taxed Swedish population to bail out the worthless speculative boondoggles. The Securum idea, not surprisingly, came from U.S. bank bailout "experts." Wibble flew to Washington for emergency consultations with U.S. banking officials and returned with a proposal for a U.S.-style "good bank," "bad bank" system.

Securum will be the "bad bank," holding most of Nordbanken's defaulted real estate portfolio. Nordbanken deputy director Lars Thunell will run the Securum operation until January. "Securum thus will become one of the largest owners of real estate in Sweden, and will hold many properties abroad including holiday resorts in Marbella and London properties," Anderkrona added.

The idea is that, with a capital infusion of SKr 20 billion from Parliament, voted in mid-June, Securum will have sufficient capital to be able to ride out the storm until real estate prices recover. But not everyone is convinced. One Stockholm banker, who asked to be anonymous, said, "People believe this SKr 20 billion will be enough to fill the 'gap' in the bank's loan losses. But this is only a minimum needed to extend the life of Securum and prevent the all-out death of Sweden's property market."

Bankers are worried

And some of Sweden's healthier private banks such as Handelsbanken are up in arms over the preferential SKr 20 billion bailout for Securum. Handelsbanken chairman Arne Maartensson, also Swedish Banking Association president, has called the government aid a direct hit against other healthier banks.

Another scheme which Nordbank-Securum's Thunell is proposing is creation of special new "junk bonds" to take the pressure off Sweden's banks, allowing them to buy time for a future property recovery. Under the scheme, banks would convert some SKr 50 billion in worst-case real estate loans into 10-year bonds. For the first several years until the economy recovers, and the properties can be sold at a profit, no interest would be paid bondholders. Nordbanken says it has successfully tried the bond scheme on some properties in Gothenburg.

However, some analysts of the Swedish real estate sector expect recovery will take more than a decade. Already since the crisis began in late 1990, Swedish property prices have fallen some 40%, the worst in history.

But with no deposit insurance, the worst banking crisis in its history, and the worst domestic economic depression since the 1930s the Bildt government has little room to maneuver. This is compounded by pressures for Sweden to "harmonize" key value-added tax (VAT) policies with the EC, as a precondition for membership. With the 1992 budget deficit likely to top 7% of Gross Domestic Product, some SKr 110 billion, and unemployment support to cost up to SKr 25 billion, the government must also begin to reduce Sweden's stiff 25% VAT. A cut to only 20% VAT would mean revenue loss of some SKr 15 billion. With the government ideologically locked into a too-high kroner, Sweden's traditional export economy is suffering even more than normal, further delaying recovery. We have not heard the last from the Swedish banking crisis.