



New reforms to decrease the risk of a housing asset bubble in Sweden

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JOHAN FRITZELL AND JOAKIM PALME – EUROPEAN SOCIAL POLICY NETWORK

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Swedish house prices and household debts have increased dramatically over a long period, increasing the risk of producing a housing bubble. New legislation was implemented in June 2016, making amortisation mandatory for all new mortgage loans. Further policy reforms, with different distributional consequences, are also being discussed.

Description

During the 2000s, house prices and household debts increased dramatically in Sweden (in 2015, the ratio of household debts to disposable income was 177%; source: Statistics Sweden). This evolution has been a serious concern for a long time, and there is an obvious risk that the housing asset bubble may burst. In fact, in 2009 a European Central Bank working paper already noted that the price boom in Sweden beginning in 1997 was the longest constant increase of housing prices among 18 OECD countries. Since then the trend has continued at an increasing speed. More recently, this has also been noted at international level by both the OECD (2016) and the European Commission (2016). Moreover, the only sharp EU Council of Ministers' recommendation to Sweden in 2016, repeated for several years, was that Sweden should take action to address the rise in household debt. Structurally, Sweden has a severe housing shortage due to underproduction of new dwellings, combined with population growth due to net immigration. A recent report from the National Board of Housing, Building and Planning estimates that over the next ten years 88 000 new dwellings will be needed yearly, whereas actual numbers over the period 2012-2016 varied between 25,000 and 40,000.

The Figure on the next page shows the marked increase in housing prices, set against disposable income. Interestingly enough, and definitely part of the story,

these dramatic changes do not imply that relative housing expenditure, as part of disposable income, has increased. Instead, the opposite tends to be the case, due to falling interest rates and the relative ease with which households have been able to borrow money without any amortisation requirements.

In the new legislation implemented on 1 June 2016, the Swedish parliament decided, in short, that all new mortgage loans must have a mortgage plan and that 2% of the loan should be amortised down to 70% of the housing value, and 1% of the loan amortised down to 50% of the value. Households with already existing loans are not affected.

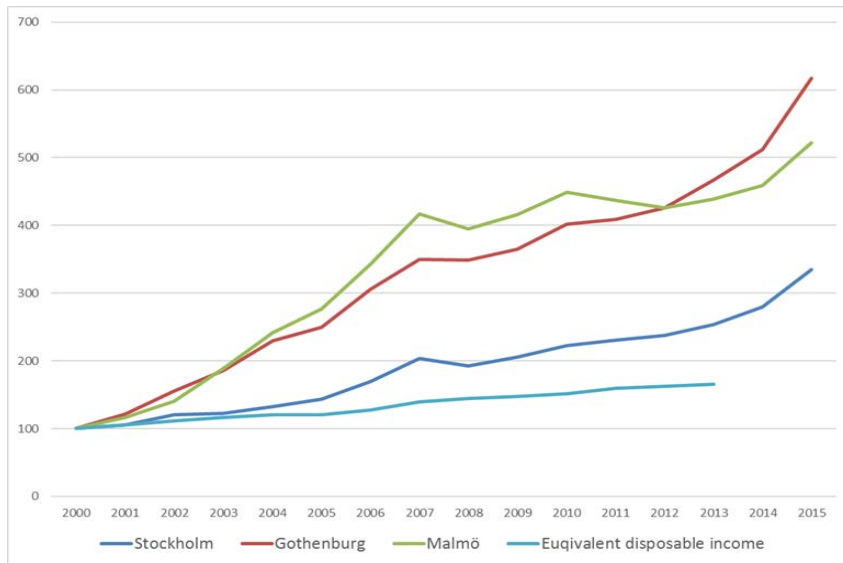
Outlook & Commentary

It is highly uncertain that the new legislation will have the stabilising impact sought by the Swedish government, the Swedish parliament and the EU Council of Ministers. First, it has had unintended negative short-term effects, as households have increased their debts before the entry into force of the new legislation. Second, this discussion has been on-going in Sweden for more than a year, and an earlier attempt was stopped because of uncertainty surrounding the legal mandate to impose such a rule. Thus, this change has been foreseen for a long time, which has meant that households and, in particular, banks, have already started to implement a system with amortisation.

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Price changes for condominiums in the three larger Swedish urban areas, 2000-2015, and changes of mean equivalent disposable income (EDI), 2000-2013 (mean EDI 2013: 216 800 SEK, around 22 800 EUR). Index 2000=100.



Source: Statistics Sweden

From a social policy perspective, it is important to stress that the new legislation has distributional implications. In practice, it means that many households, in particular younger ones, may find it even more difficult than previously to enter the housing market. For those on a lower income, there are ample possibilities today to borrow money in the less "official" part of the financial system, but this involves much higher interest rates. The legislation might therefore, if anything, foster even higher residential segregation and have negative distributional effects.

Given that many economic policy analysts believe that the new legislation is "not enough" to stabilise the unbalanced housing markets, several additional policy changes are already on the table for discussion. Three reforms are most often discussed: to increase property taxes; to remove or at least limit the tax deductibility of interest payments; and to introduce a debt ceiling related to the disposable income of the household. Again, it is important to stress that each of these reforms would have not only

macroeconomic, but also specific distributional consequences. Analyses carried out for the Swedish Fiscal Policy Council have, not surprisingly, found that a change in the property tax system would primarily hit the upper income groups (Englund, 2016). The distributional consequence of limiting the tax deductibility of mortgage was age dependent: progressive effects for younger households but not for older ones. The problem from a political perspective is that any discussed reform needs to be negotiated and agreed upon also by opposition parties since they are likely to be unpopular among voters.

While there appears to have been some short-term effect of the new legislation on housing prices, it is unclear if this is a lasting effect since the decline was due to a strong short-term increase in supply. Much stronger reforms are needed to increase the stability of the housing market. More fundamentally, to lower the risk of creating a financial bubble and to reduce negative distributional aspects, the supply of housing must increase.

Further reading

Agnello, L. and L. Schuknecht (2009), "Booms and busts in housing markets: determinants and implications". European Central Bank Working Paper No. 1071.

Englund, P (2016), En mer neutral kapitalbeskattning [A more neutral taxation of capital]. Rapport till Finanspolitiska rådet 2016/3. The Swedish Fiscal Policy Council.

European Commission (2016), "Country Report Sweden 2016", Commission Staff Working Document, Brussels 26.2.2016.

National Board of Housing, Building and Planning [Boverket] (2016) Reviderad prognos över behovet av nya bostäder.

OECD (2016), "Sweden" in OECD Economic Outlook, Issue 1, OECD Publishing, Paris

Author

[Johan Fritzell](#), Karolinska Institutet and Stockholm University, and [Joakim Palme](#), Uppsala University