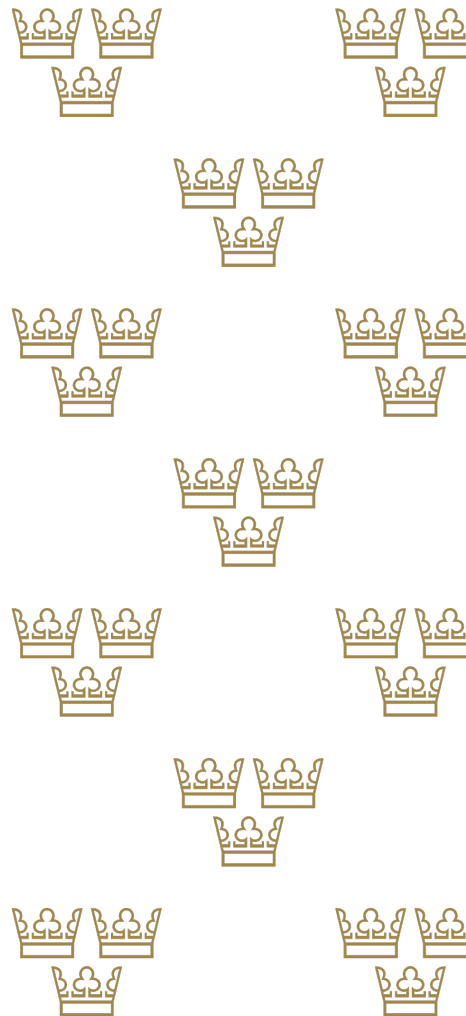


# Volatile energy markets and financial stability risks

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# Agenda

- The real and financial side of the electricity market
- The role of central counterparties (CCP:s) in the financial system
- Government credit guarantees



# The real and financial side of the electricity market

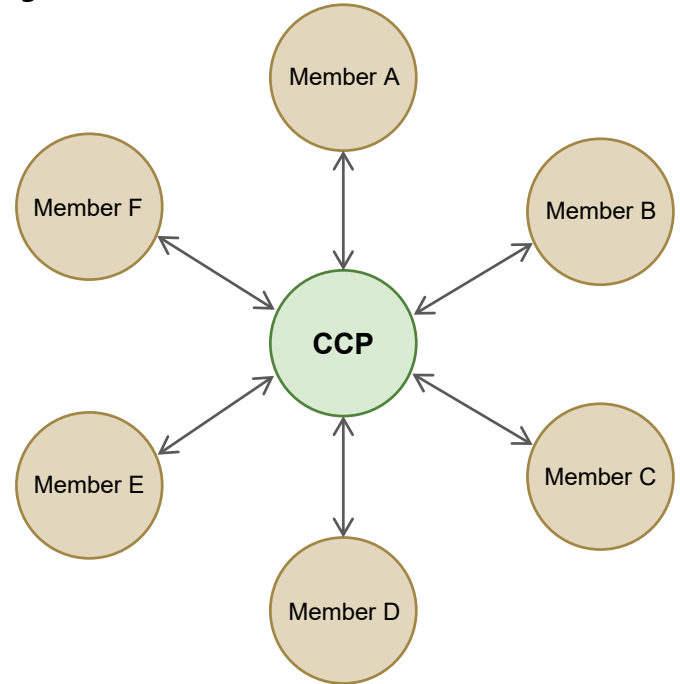
- In the Nordic region, the main market place for electricity is Nord Pool where the spot price is determined by supply and demand through auctions
- Financial contracts based on electricity can be traded on an exchange or bilaterally
- In the Nordic region, the main exchange for such contracts is Nasdaq Commodities
- Electricity sellers and buyers are hedging by selling and buying future production and consumption at prices determined in advance
  - Households and firms wish to secure future electricity costs
  - Electricity producers wish to secure compensation for future production costs





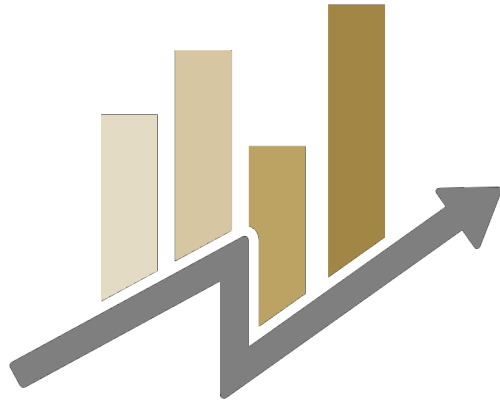
# The role of central counterparties (CCP:s) in the financial system

- Derivative trading entails counterparty risk
  - CCP:s contribute to a more secure trading by acting as buyer to all sellers and seller to all buyers
  - CCP:s have become increasingly important players in financial systems
- Important for the financial stability
- The Swedish National Debt Office (SNDO) is resolution authority for CCP:s, i.e. **Nasdaq Clearing**, since August 2022





# Global growth of central clearing



- Before the 2008 financial crisis, the majority of trading in derivatives was bilateral



- Lack of regulation led to major risk levels in the financial system



- G20 Leaders agreed that all standardised derivatives contracts should be cleared through central counterparties



- New regulations have been put in place and central clearing has evolved



# The central counterparty safety net

- To be able to guarantee payment at all times, the CCP has a safety net for losses that may arise for various reasons (the “waterfall”)
  1. **Require collateral** - Variation Margin and Initial Margin
  2. **Dedicated own resources**
  3. **Default fund**

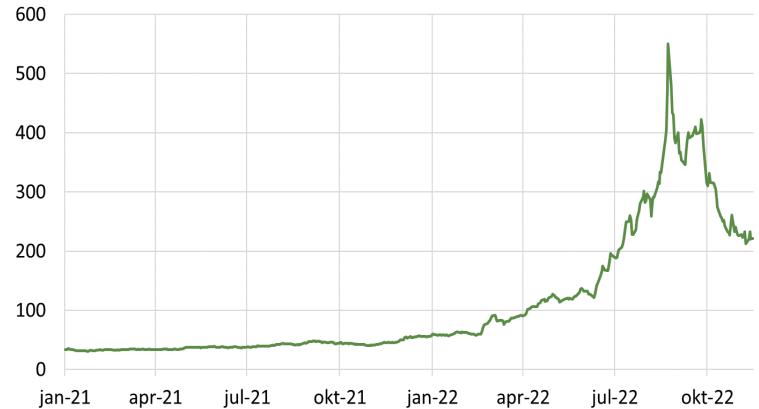


# Large price increases in August

- Electricity producers enter contracts to sell electricity at predetermined prices at specific future dates
- Losses are compensated each day
  - Do not necessarily match the cash flow of the electricity producers that have to borrow to pay margins
- The exceptional price rise and price volatility in August led to difficulties in borrowing sufficiently to meet margin requirements
- Member failure to meet margin requirements and defaults may lead to spill-over effects and potentially to financial instability

## Price of Nordic Power baseload Financial Future

Price in euro per MWh



— Nordic Power baseload Financial Future - January 2023

Note. Quarterly data

Source: Bloomberg



# Government guarantees to electricity producers

- The Debt Office was mandated to provide credit guarantees for loans to electricity producers 5 September 2022 (valid until 31 March 2023)
- The purpose of the measure was to prevent that a lack of liquidity created risks for contagion to other parts of the financial system
- Electricity producers can apply for a loan through their bank, which applies for a credit guarantee from the Debt Office
  - The guarantee covers 80 per cent of the loan
  - The overall guarantee framework amounts to SEK 250 billion
  - Denmark and Finland swiftly introduced corresponding schemes for liquidity support
- No applications have been submitted to date







# Final remarks

- Central counterparties have become important for financial stability
- Nasdaq Clearing also offers central clearing of equity and fixed income derivatives and there may be contagion from stress elsewhere
- The government credit guarantee scheme is a preventive measure established to avoid that a liquidity shortage triggers more serious problems





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