

Guidelines for central government debt management 2020

Decision taken at the government meeting
14 November 2019



Innehåll

Summary.....	2
1 Guidelines decision for central government debt management 2020	4
Objective for the management of central government debt	4
Debt Office’s task and purposes of the borrowing.....	4
Guidelines process.....	5
Composition of central government debt – debt shares	5
Maturity of central government debt.....	6
Cost and risk.....	6
Market support and debt maintenance	7
Positiontaking.....	7
Borrowing to meet need for government loans.....	7
Management of funds etc.....	8
Consultation and collaboration	8
Evaluation.....	8
2 Basis for the Government’s guidelines.....	10
2.1 Introduction.....	10
2.2 Central government debt	11
2.3 Loan markets.....	14
2.4 The Swedish krona.....	15
2.5 Riksbank’s comments on the Debt Office’s proposal.....	16
3 Reasons for the Government’s decision	17
3.1 Trade-off between cost and risk in debt management	17
3.2 Foreign currency exposure left unchanged	17
3.3 Steering of the term to maturity of krona debt and foreign currency debt merged	18
3.4 Term to maturity unchanged in practice	19
3.5 Share of inflation-linked krona debt kept unchanged	19

Summary

Direction of central government debt policy

The guidelines decision for 2020 adjusts the steering of the foreign currency exposure of the central government debt. The adjustment means that its foreign currency exposure is to be unchanged. A combined maturity target for the central government debt replaces the present steering divided up into krona debt (4–6.5 years) and foreign currency debt (0–1 year). As a result, the term to maturity of the central government debt is changed to 3.5–6 years.

The steering of the composition of the krona debt is kept unchanged.

The government green bonds, which the Debt Office has been commissioned with issuing, are covered by the general guidelines for the composition and term to maturity of the central government debt.

The composition of the central government debt is to be steered towards:

- Foreign currency debt: The foreign currency is to be unchanged.
- Inflation-linked krona debt: 20 per cent (over the long term).
- The nominal krona debt is to make up the remaining share.

The term to maturity (in terms of duration) of the central government debt is to be steered towards:

- 3.5–6 years

The foreign currency exposure is to be unchanged

Since 2015, when the Government decided to gradually reduce the foreign currency exposure over the next few years, the foreign currency debt has been halved. The risk in retaining the present foreign currency exposure is assessed as very limited, and it is, on account of developments in financial markets in recent years, appropriate to analyse the strategic distribution of the central government debt with respect to foreign currency exposure. The Government therefore considers that the decrease of the foreign

currency exposure of the central government debt should stop pending the Debt Office's analysis of the strategic foreign currency exposure of the central government debt. One reason for doing so is that the analysis may show that there is reason to review the previous focus on reducing this exposure.

Combined steering of term to maturity

The choice of terms to maturity for the different types of debt in the central government debt is of great importance for the trade-off between cost and risk in the management of the central government debt. In its guidelines decisions in recent years, the Government has gradually adjusted its steering of term to maturity so as to refine this steering. The guidelines for 2020–2023 continue these adjustments so as to further refine steering and clarify the overall level of risk. A combined maturity target for the central government debt also provides a better overview of the interest rate refixing risk in the debt.

The composition of the krona debt is kept unchanged

The Government sees no reason to alter the steering of the composition of the krona debt.

Objective, division of responsibility and process

The starting point for the Government's guidelines decisions is the objective of central government debt management adopted by the Riksdag, i.e. that the debt has to be managed in such a way as to minimise the cost of the debt over the long-term while taking risk in its management into account, and that the management of the debt has to be conducted within the framework of monetary policy requirements.

Responsibility for attaining the objective is divided between the Government and the Debt Office. The Government steers the overall level of risk via its annual guidelines decision while the Debt Office is responsible for borrowing and

management being conducted within the framework of the guidelines and in accordance with the objective. This basis for this decision includes the National Debt Office's proposed guidelines. The Riksbank has stated an opinion on the Debt Office's proposed guidelines and has no objections to its proposal.

The Government's guidelines decision for 2020–2023 corresponds to the Debt Office's proposal.

1 Guidelines decision for central government debt management 2020

The steering of the central government debt portfolio builds on a large number of analyses and discussions conducted over the years. The present process for the steering and evaluation of central government debt policy has been applied since 1998.

The guidelines for 2020–2023 are set out below; 2023 being the horizon for calculations applied in the Budget Bill for 2020 (Govt Bill 2019/20:1). As in the case of the Budget Bill, the decisions for 2021–2023 are to be regarded as preliminary. In order to provide an overview of the regulations that govern the management of the central government debt, the relevant parts of the Budget Act (2011:203) and the Ordinance (2007:1447) containing Instructions for the National Debt Office are presented here.

The Government's guidelines decision corresponds to the Debt Office's proposal.

Objective for the management of central government debt

1. The central government debt is to be managed in such a way as to minimise the cost of the debt over the long-term while taking risk in its management into account. The management of the debt shall be conducted within the framework of monetary policy requirements (Chapter 5, Section 5 of the Budget Act).

Debt Office's task and purposes of the borrowing

2. The task of the Debt Office is to raise and manage loans for central government in accordance with the Budget Act. (Section 2 of the Ordinance containing Instructions for the National Debt Office.
3. The Debt Office may raise loans for the central government in order to:
 1. finance current deficits in the central government budget and other expenditure based on decisions of the Riksdag (the Swedish Parliament);
 2. provide credits and perform guarantees decided by the Riksdag;
 3. amortise, redeem and buy back government loans;
 4. meet the need for government loans at different maturities in consultation with the Riksbank; and
 5. meet the Riksbank's need for foreign currency reserves.(Chapter 5, Section 1 of the Budget Act).

Guidelines process

4. The Debt Office shall submit proposed guidelines for central government debt management to the Government no later than 1 October each year (Section 26 f of the Ordinance containing Instructions for the National Debt Office).
5. The Government shall give the Riksbank the opportunity to state an opinion on the Debt Office's proposed guidelines (Chapter 5, Section 6 of the Budget Act).
6. The Government shall adopt guidelines for the Debt Office's management of the central government debt by 15 November each year (Chapter 5, Section 6 of the Budget Act).
7. The Debt Office shall submit information for the evaluation of the management of the central government debt to the Government no later than 22 February each year. (Section 26 f of the Ordinance containing Instructions for the National Debt Office).
8. The Government shall evaluate the management of the central government debt every other year. The evaluation shall be presented to the Riksdag no later than 25 April (Chapter 5, Section 7 of the Budget Act).
9. The Debt Office shall establish principles for the implementation of the guidelines for central government debt management adopted by the Government (Section 15 of the Ordinance containing Instructions for the National Debt Office).

Previous wording	Wording adopted
10.	
The Debt Office is to establish internal guidelines based on the Government's guidelines. These decisions are to concern the use of the mandate for position taking, the term to maturity of <i>the nominal and inflation-linked krona debt</i> , the currency distribution of the foreign currency debt, and principles for market support and debt maintenance.	The Debt Office is to establish internal guidelines based on the Government's guidelines. These decisions are to concern the use of the mandate for position taking, the term to maturity of <i>individual debt types</i> , the currency distribution of the foreign currency debt, and principles for market support and debt maintenance.

Composition of central government debt – debt shares

11. The share of inflation-linked krona debt is to be 20 per cent of the central government debt over the long term. The shares of the debt types in the central government debt are to be calculated as nominal amounts at the present exchange rate including accrued inflation compensation.

Previous wording	Wording adopted
12.	
The foreign currency exposure of the central government debt is to <i>decrease</i> . <i>The decrease is to correspond to no more than SEK 30 billion per year</i> . The exposure is to be calculated in a way that excludes changes in the krona exchange rate.	The foreign currency exposure of the central government debt is to <i>be unchanged</i> . The exposure is to be calculated in a way that excludes changes in the krona exchange rate.

13. The Debt Office is to set a target value for the distribution of the foreign currency debt among different currencies.
14. In addition to inflation-linked krona debt and foreign currency debt, central government debt is to consist of nominal krona debt.

Maturity of central government debt

Previous wording	Wording adopted
15.	15.
The term to maturity of the <i>krona debt</i> is to be between 4 and 6.5 years.	The maturity of the <i>central government debt</i> is to be between 3.5 and 6 years.
16.	16.
The Debt Office is to determine a term-to-maturity interval for <i>the nominal krona debt and the inflation-linked krona debt</i> .	The Debt Office is to determine a term-to-maturity interval for <i>the nominal krona debt, the inflation-linked krona debt, and the foreign currency debt</i> .
17.	17.
<i>The term to maturity of the foreign currency debt is to be between 0 and 1 year.</i>	The point is removed (because the separate term to maturity for foreign currency debt, and for the other types of debt, is set in accordance with point 16).
18.	18.
<i>The term to maturity of the types of debt may deviate temporarily from the maturities stated in points 15 and 17.</i>	<i>The term to maturity of the central government debt may deviate temporarily from the maturity interval stated in point 15.</i>

19. Term to maturity is to be measured as duration.

Cost and risk

20. The trade-off between expected cost and risk is primarily to be made through the choice of the composition and term to maturity of the central government debt.
21. The main cost measure is to be the average issue yield. The cost is to be calculated using the valuation principle of amortised cost taking accrued inflation and exchange rate changes into account.
22. The main risk measure is to be the variation of the average issue yield.
23. The Debt Office is to take account of refinancing risks in the management of the central government debt, including by issuing instruments with more than twelve years to maturity.
24. Borrowing is to be conducted in such a way as to ensure a broad investor base and diversification in a range of funding currencies in order to maintain good borrowing preparedness.
25. Positions are not to be included in the calculation of debt shares and terms to maturity.

26. When taking positions, market values are to be used as the measure of the costs and risks in the management of the debt.

Market support and debt maintenance

27. The Debt Office is to contribute, through its market support and debt maintenance, to the effective functioning of the government securities market in order to achieve the objective of long-term cost minimisation while taking account of risk.
28. The Debt Office is to adopt principles for market support and debt maintenance.

Positiontaking

29. The Debt Office may take positions in foreign currency and the krona exchange rate.

Positions in foreign currency may only be taken using derivative instruments.

Positions may not be taken in the Swedish fixed income market.

Positions refer to transactions that are intended to reduce the costs of the central government debt while taking account of risk, or to reduce the risks for the central government debt while taking account of cost, and that are not motivated by underlying borrowing or investment requirements.

Positions may only be taken in markets that permit the management of market risk through liquid and otherwise well-developed derivative instruments and that are potentially a borrowing currency in the context of debt management.

30. Positions in foreign currency are limited to SEK 300 million, measured as daily Value-at-Risk at 95 per cent probability.

The Debt Office is to decide how much of this scope may be used at most in day-to-day management.

31. Positions in the krona exchange rate are limited to a maximum of SEK 7.5 billion. When the positions are built up or wound down, this is to be done gradually and announced in advance.

The Debt Office is to decide how much of this volume may be used at most in its continuous management in connection with exchanges between the krona and other currencies. This volume is to be of a limited size and the positions do not need to be announced in advance.

Borrowing to meet need for government loans

32. The possibility of raising loans to meet the need for government loans under Chapter 5, Section 1 of the Budget Act may only be used if necessary on account of threats to the functioning of the financial market.

The Debt Office may have outstanding loans with a maximum nominal value of SEK 200 billion for this purpose.

33. Investment of funds raised through loans to meet the need for government loans should be guided by the principles set out in the Preventive Government Support to Credit Institutions Act (2015:1017).

Management of funds etc.

34. The Debt Office shall place its funds, to the extent that they are not needed for outgoing payments, in an account at the Riksbank, a bank or a credit market company, or in government securities or other debt instruments with a low credit risk. Investments may be made abroad and in foreign currency (Section 5 of the Ordinance Containing Instructions for the National Debt Office).
35. The Debt Office shall cover the deficits that occur in the Government central account (Section 7 of the Ordinance Containing Instructions for the National Debt Office).
36. The management of exchanges between Swedish and foreign currency (currency exchanges) shall be predictable and transparent (Section 7 of the Ordinance Containing Instructions for the National Debt Office).

Consultation and collaboration

37. The Debt Office shall consult with the Riksbank on matters concerning the components of its borrowing operations that may be assumed to be of significant importance for monetary policy (Section 12 of the Ordinance Containing Instructions for the National Debt Office).
38. The Debt Office shall collaborate with the National Institute of Economic Research and the National Financial Management Authority on matters concerning the Debt Office's forecasts of the central government borrowing requirement (Section 11 of the Ordinance Containing Instructions for the National Debt Office).
39. The Debt Office should obtain the Riksbank's views on how the funds borrowed to meet the need for central government loans are to be invested.

Evaluation

40. Evaluation of the management of the central government debt is to be carried out in qualitative terms in the light of the knowledge available at the time of the decision. Where possible, the evaluation is also to include quantitative measures. The evaluation is to cover five-year periods.
41. The evaluation of the operational management is to include borrowing in and management of the different types of debt; market support and debt maintenance measures; and management of currency exchanges.
42. For inflation-linked borrowing, the realised cost difference between inflation-linked and nominal borrowing is to be reported.

43. For retail market borrowing, the cost saving compared with alternative borrowing is to be reported.
44. Gains and losses are to be recorded continuously for holdings within a position taking mandate and evaluated in terms of market values.

2 Basis for the Government's guidelines

2.1 Introduction

In its annual guidelines decisions the Government steers the trade-off between cost and risk at a general level in the management of the central government debt. This steering is based on the statutory objective for central government debt policy.

The starting point for the Government's guidelines decision is that the central government debt is to be managed in such a way as to minimise the cost of the debt over the long-term while taking account of the risk in its management. The debt is to be managed within the framework of monetary policy requirements. The trade-off is mainly made by choosing the term to maturity of the central government debt. Historically, a shorter term to maturity had led to a lower average cost than a longer term to maturity. If a shorter term to maturity is chosen, the risk in debt management rises, on the other hand, since short rates vary more. So, when the interest rate on a larger part of the debt is rolled over in every period, the variation in the total interest rate costs for the central government debt increases. In recent years, however, the cost advantage of choosing a shorter term to maturity is judged to have decreased.

In general, strong government finances and a low central government debt mean that the scope for risk-taking increases in return for lower expected costs. In exceptional cases the absolute level of interest rates can also be taken into account, as can the situation in loan markets and the Swedish krona exchange rate.

Other important parameters are the size and expected development of the central government debt. The central government debt has decreased as a proportion of GDP since the mid-1990s and was 26 per cent at the end of 2018. The central government debt is low from both an international and a historical perspective.

The Debt Office is able to decide on deviations from the benchmarks within the mandates it has

been given. Derivatives are used for these deviations, which are defined as positions. These positions are evaluated separately and must not be taken in the Swedish fixed income market.

Risks in the management of the central government debt

The risk in the central government debt is defined at a general level as its contribution to variations in central government net lending and the central government debt. A lower central government debt, which results in lower costs, contributes to a lower risk since the variation in the costs (expressed in kronor) decreases. A lower central government debt initially also makes it easier for central government to borrow large sums in a crisis situation without a sharp rise in interest rates.

There is no single measure that describes the aggregate risk in the management of the central government debt. Instead different types of risk are reported, the most important being the interest rate refixing risk, the refinancing risk, the financing risk and the counterparty risk.

The interest rate refixing risk means the risk that the interest costs on the debt will rise rapidly if market interest rates move upwards. The greater the share of the debt that consists of short and floating-rate loans, the more sensitive is the debt to changes in market interest rates.

The refinancing risk refers to the risk that it will turn out to be difficult or expensive to replace maturing loans with new ones. In general, the refinancing risk appears at the same time as the need for new borrowing rises sharply (financing risk). The refinancing risk reflects the period remaining to maturity, i.e. when the debt needs to be refinanced. The guidelines state that the Debt Office is to take account of refinancing risks in the management of the central government debt and that the Debt Office is to ensure good borrowing preparedness in foreign currencies.

The refinancing risk is taken into account in several different ways in the Debt Office's

strategies for borrowing and its market support by, for example, ensuring infrastructure, an investor base and liquidity in the loan market. The bulk of the borrowing is done in government bonds that are spread over several loans with different maturity dates. The borrowing is spread continuously across small, regularly held auctions. Moreover, the Debt Office's borrowing in foreign currency reduces the refinancing and the financing risk since the channel to the international capital markets is kept open. The international capital markets make it possible to borrow large volumes in a short space of time.

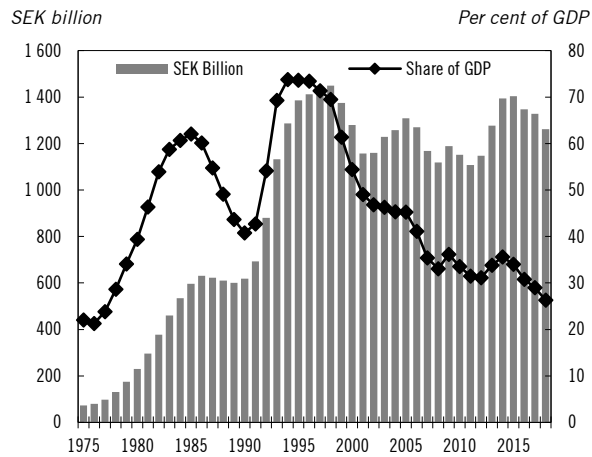
In its annual evaluation of the management of the central government debt the Debt Office has to report on how the requirements concerning refinancing risks have been met. Finally, it should be underlined that strong and sustainable central government finances are the most important factors in limiting the refinancing risk and the financing risk in the central government debt.

2.2 Central government debt

Historical development

The central government debt has arisen because, historically, the central government budget has shown larger deficits than surpluses. By definition, the central government borrowing requirement is identical to the central government budget balance but with the opposite sign. Budget deficits are financed by new borrowing, while budget surpluses can be used to amortise the existing debt. The central government debt is very much affected by the development of the economy and by decisions on economic policy. In some years one-time events also affect the development of the central government debt. Examples of this are sales of shares in state-owned enterprises and on-lending to the Riksbank.

Figure 2.1 Unconsolidated central government debt 1975-2018



Source: Swedish National Debt Office

Figure 2.1 shows the development of the unconsolidated central government debt since 1975.¹ The figure shows that the central government debt has increased sharply as a proportion of GDP in two periods. The first period was between 1976 and 1985, when the central government debt increased as a proportion of GDP from 22 to 65 per cent. The second period was between 1990 and 1995, when it increased from 43 to 77 per cent. As seen from the figure, central government debt has decreased gradually as a proportion of GDP since the mid-1990s, reaching 26 per cent at the end of 2018, which is a low level from a historical perspective. The increase in the central government debt in 2009 and in 2013 is largely explained by foreign currency borrowing by the Debt Office on behalf of the Riksbank corresponding to SEK 100 billion in each of these years. This borrowing was carried out following a request by the Riksbank, in order to strengthen the currency reserve. At the end of 2018 on-lending to the Riksbank amounted to SEK 259 billion of the unconsolidated central government debt. This on-lending to the Riksbank is a receivable for central government, so it does not affect the steering of the central government debt.

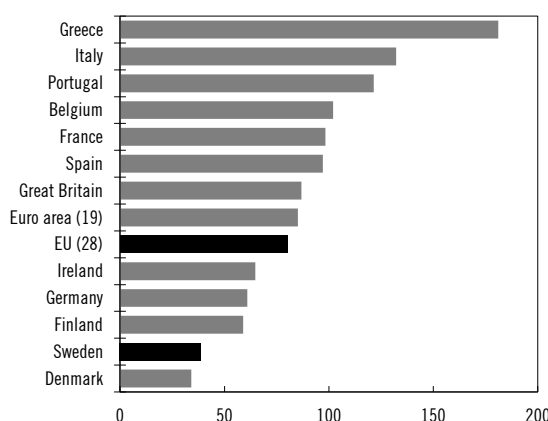
¹ The Budget Bill chiefly reports the consolidated central government debt. The difference between the consolidated and unconsolidated debt is made up of government agency holdings of government securities (SEK 65 billion at the end of 2018).

International comparison

Comparisons of general government sector debt in different EU member states use the ‘Maastricht debt’. This measure of debt refers to the consolidated gross debt of the whole of the general government sector, which, for Sweden, means that the central government debt and the local government sector’s capital market debts are added together while the National Swedish Pension Funds’ holdings of government securities are deducted. The reason why this broader measure of debt is used in EU contexts is that the public sector is organised in different ways in different member states. The Maastricht debt thus makes it possible to increase comparability between countries.

For Sweden, the Maastricht debt was 39 per cent of GDP at the end of 2018. At the same point in time the corresponding share for the EU as a whole was 80 per cent, and for the euro area it was 85 per cent.

Figure 2.2 Maastricht debt in 2018 as a proportion of GDP



Source: Eurostat

Forecasts of the future development of the central government debt

The development of the central government debt is affected by a large number of factors, making it difficult to forecast its development over a number of years. Several forecasts of the development of the central government debt are therefore presented below. In addition to the

Government, the National Financial Management Authority (ESV), the National Institute of Economic Research (NIER) and the Debt Office make forecasts of public finances. These forecasts have different purposes, and both the forecasting methods and time horizons used differ.

The Government’s forecasts are an important part of the political process since they form the basis for Riksdag decisions on taxes and expenditure. The Government’s forecast has been taken from the Budget Bill for 2020 (Govt Bill 2019/20:1).

NIER forecasts focus on the development of the real economy in national accounts terms. NIER forecasts also estimate the development of the consolidated central government debt.² The NIER forecast has been taken from its publication *The Swedish Economy* from October 2019.

The ESV forecasts provide supporting information for decisions and discussions in fiscal policy. Its forecasts are based on decisions taken and legislative proposals as well as, in some cases, measures announced by the Government and the Riksdag. The ESV forecast has been taken from its publication *Forecast of the central government budget and public finances [Prognos Statens budget och de offentliga finanserna]* from September 2019. Both the Government’s and the ESV’s forecasts are based on impact assessments given proposed or unchanged regulations and on a particular development of the macro economy.

The Debt Office’s forecasts are made in cash terms and form the basis for its issue planning. The Debt Office’s reporting of planned borrowing by borrowing instrument makes the government securities market more predictable. In the long term this contributes to lower costs for the central government debt. The Debt Office’s forecast has been taken from the publication *Central government borrowing – Forecast and analysis 2019:3* from October 2019.

² The NIER forecast of government agencies’ holdings of government securities has been used to calculate the unconsolidated central government debt. The unconsolidated central government debt is SEK 65–73 billion

higher than the consolidated central government debt in the period 2019–2022.

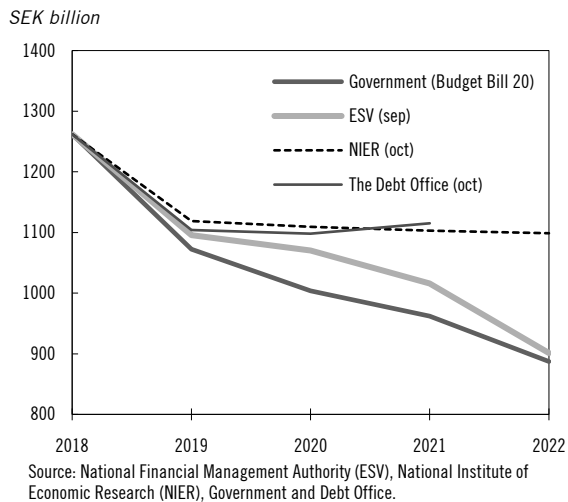
Figure 2.3 Forecasts of unconsolidated central government debt

Figure 2.3 presents the forecasts made by the various agencies of the unconsolidated central government debt up until the end of the calculation period in 2022, apart from the Debt Office, whose forecast extends to 2021. The forecasts show a range for the unconsolidated central government debt at the end of 2022 of between SEK 887 and 1 099 billion (16 and 20 per cent of GDP). At the end of 2018 the corresponding debt was SEK 1 262 billion, or 26 per cent of GDP. On-lending to the Riksbank, which was SEK 259 billion at the end of 2018, is included in the forecasts.

Prospects for the Swedish economy according to the Budget Bill for 2020

The performance of the Swedish economy is of great importance for the development of the central government debt. When the economy is strong and employment high, central government receives more taxes at the same time as the pressure on social security systems decreases when unemployment falls. A rapidly growing economy therefore generally results in stronger central government finances and a lower central government debt.

In Sweden the economy has strengthened in recent years and growth has been high. Resource utilisation is still judged to be higher than normal. However, in the first half of 2019 domestic demand slowed. Forward indicators suggest that growth will also be muted in the second half of 2019. Weaker performance of the international economy, lower housing investments and a slow-

down in public consumption are expected to contribute to muted growth continuing in 2020.

The economic situation is expected to be balanced in 2021 and 2022. Public consumption shows comparatively weak growth in 2021 and 2022, as a result of the assumption of unchanged regulations. The technical assumptions for these calculations mean that fiscal policy as a whole will be contractionary. The effects of this are countered to some extent by monetary policy becoming more expansionary than would otherwise be the case, which is assumed to stimulate the growth of household consumption and gross fixed capital formation in particular. In an overall assessment, GDP growth in 2021 and 2022 is expected to be slightly lower than the average since 2000 (see table 2.1).

Table 2.1. GDP forecast (Budget Bill for 2020)

	2018	2019	2020	2021	2022
GDP ¹	2.4	1.4	1.4	1.8	1.9

¹ Constant prices

Source: Budget Bill for 2020 (Govt Bill 2019/20:1)

Sweden is a small and open economy. This means that economic growth in Sweden is greatly affected by international developments.

Continued trade policy tensions and the introduction of trade restrictions, between the US and China especially, have contributed to a slowing of international trade and to expectations of lower economic growth. There is great uncertainty about how this situation will develop in the future. If additional trade barriers are introduced, this may lead to weaker global economic growth and therefore poorer prospects for Swedish exports. Investments and household consumption may also be affected adversely. China also has overcapacity problems in state-owned enterprises, housing market imbalances and high private and public sector indebtedness. A severe slowdown of growth in China would have a major impact on the development of the world economy since Chinese demand for raw materials and other input goods is an important driver.

Another uncertainty is the UK's exit from the EU. The risk of a no-deal exit is judged to be substantial. The forms for the exit and the future relationship will affect economic performance in both the UK and the EU. This applies particularly to the EU member states, including Sweden, that have close links to the UK economy.

Climate change, extreme weather events and biodiversity loss are also risks to the global

economy, since they can result in major costs both for individuals and for society as a whole.

In the worst case, several of the above-mentioned uncertainties could trigger a period of general financial unrest and higher risk premiums.

The performance of the international economy may also be stronger than expected if, for instance, the trade conflict is de-escalated so that global confidence increases. Such stronger economic growth internationally would benefit Swedish export industry.

Conclusion

The central government debt is low both from an international and a historical perspective, and is expected to continue to decrease. The forecasts of the unconsolidated central government debt indicate that in 2022 the debt will be lower as a proportion of GDP than it is today. But these forecasts are associated with uncertainty. The scope for risk-taking in the management of the central government debt is judged to be largely the same as before. The low central government debt makes it important to focus on maintaining important funding channels so as to be sure of future borrowing at low costs.

2.3 Loan markets

The yield curve slope

The slope of the yield curve affects the trade-off between cost and risk. When the yield curve has a steep positive slope, the cost saving from borrowing at shorter maturities increases and the other way round. Borrowing at shorter maturities means that an interest rate rise has a quicker impact on interest costs since the debt is refinanced more often. This increases the risk of variations in interest costs.

Historically the yield curve has generally had a positive slope, i.e. long interest rates have been higher than short interest rates. This could be explained by market participants expecting, on average, that interest rates will rise (the expectations hypothesis) but it is more likely that they want compensation for binding money if it turns out that they are wrong or if they want to reinvest the funds before the bond matures (term premium). In recent years, however, the cost

advantage of choosing shorter interest rates is judged to have decreased.

Level of the yield curve

The level of the yield curve is not normally of importance for the choice of maturity. Considering that increases and decreases in interest rates offset one another in the long run, the gain from having a long-term debt when interest rates rise is reduced by a loss that can be said to arise when interest rates fall again. However, in certain extraordinary cases, the interest rate level has affected the steering of terms to maturity. This happened, for example, in spring 2009 when the Government made it possible for the Debt Office to issue a 30-year bond, partly with the aim of locking in low long rates.

In recent years the Riksbank has pursued an expansionary monetary policy aiming at the monetary policy target of inflation of 2 per cent. Since July 2014 the repo rate has been reduced from 0.75 per cent to -0.50 per cent in February 2016. In January 2019 the Riksbank raised the repo rate to -0.25 per cent. Since then the repo rate has remained unchanged. As a result of lower interest rate expectations in financial markets and lower interest rates internationally, the repo rate is expected to be left unchanged in 2019 and 2020 and then gradually be raised.

For monetary policy reasons the Riksbank has also bought government bonds; their volume is SEK 372 billion at the end of September 2019.

Figure 2.4 Swedish government interest rate

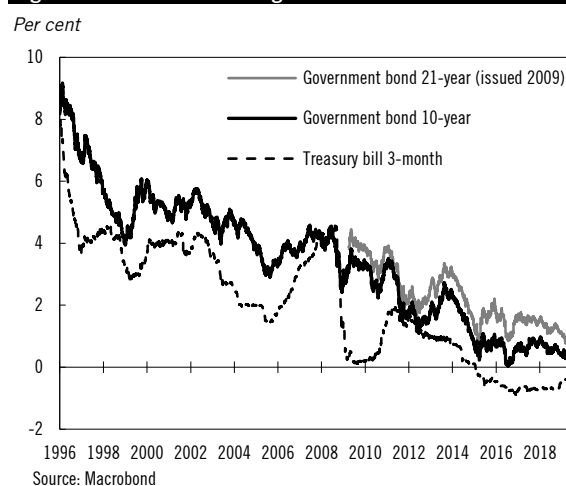


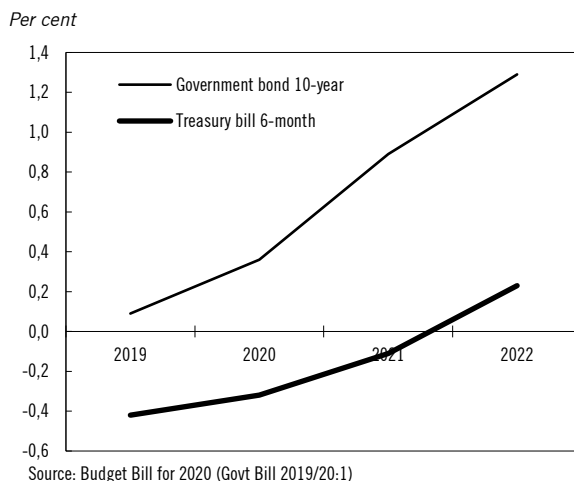
Figure 2.4 shows that government interest rates have fallen sharply since 2014, particularly for longer maturities. The short rate, which follows the direction of the repo rate, has not fallen as

markedly while longer interest rates have continued downwards in periods. At the end of September 2019 the yield was -0.4 per cent for three-month T-bills, -0.28 per cent for the ten-year government bond and 0.14 per cent for the 21-year government bond.

Government forecast of interest rate developments

In the Budget Bill for 2020 the Government expects interest rates to rise gradually during the forecast horizon up until the end of 2022. The average annual interest rate for T-bills with a maturity of six months is expected to rise from -0.42 per cent in 2019 to 0.23 per cent in 2022. The annual average for government bonds with a term to maturity of ten years is expected to rise from 0.09 per cent to 1.29 per cent in the same period, see figure 2.5.

Figure 2.5 Government forecast of Swedish government interest rate, annual average 2018-2022



Conclusion

Historically, long interest rates have been higher than short interest rates, but recently the term premium has decreased, and it is expected to remain low in the future. The Government forecasts gradually rising government interest rates.

2.4 The Swedish krona

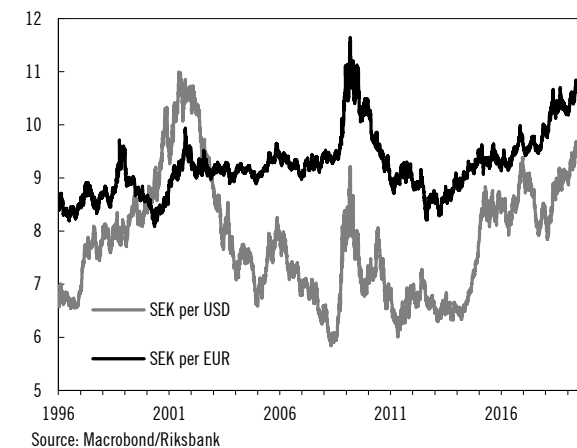
The size of the foreign currency debt expressed in Swedish kronor is affected by the value of the Swedish krona in relation to the currencies against which the foreign currency debt has

exposure. In exceptional cases the guidelines for central government debt management have been affected by the expected development of the Swedish krona.

Historical development of the Swedish krona

For countries with a floating exchange rate (like Sweden), their exchange rate is affected by demand in the international currency market. This demand is affected, in turn, by a large number of factors, including expectations regarding a country's economic growth, future level of interest rates and inflation. In periods of financial unrest, larger currencies, such as the euro and the US dollar, tend to get stronger, while smaller currencies often fall in value. This became clear during the financial crisis in 2008 and 2009, when the value of the Swedish krona weakened sharply against both the euro and the US dollar. As financial markets stabilised and when signals about the performance of the economy became more positive, the Swedish krona then gained strength. The krona weakened in spring and summer 2019 and is at low levels in historical terms. The exchange rate is also judged to be at a weak level in relation to the factors that can be expected to determine the value of the krona in the longer term, e.g. the current account balance.

Figure 2.6 Development of the Swedish krona as of 1996

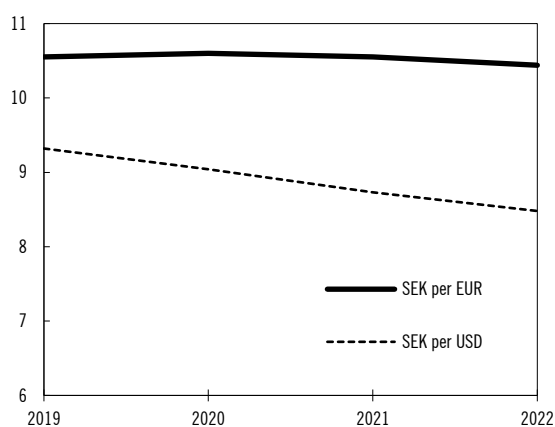


Government forecast of the development of the krona

In the Budget Bill for 2020 the Government expects the krona to strengthen slightly during forecasting horizon, against both the euro and US dollar. The annual average for kronor per euro is estimated at 10.55 in 2019 and at 10.44 in 2022. In the same period the krona is expected to

strengthen from 9.3 to 8.5 against the US dollar, see figure 2.7

Figure 2.7 Government forecast of the Swedish krona, annual average 2018–2022



Source: Budget Bill for 2020 (Govt Bill 2019/20:1)

Conclusion

The changes in financial markets, including the fixed income and currency markets, have affected the Debt Office's assessment concerning the composition of the central government debt, with the result that the agency intends to conduct an analysis of the strategic foreign currency exposure of the central government debt. The Government considers, in view of the coming analysis, that the foreign currency exposure should be left unchanged until the result of the analysis is presented. The mandate for positions in the krona exchange rate is kept unchanged.

2.5 Riksbank's comments on the Debt Office's proposal

Under the Budget Act the Government has to give the Riksbank the opportunity to state an opinion on the Debt Office's proposed guidelines for the management of the central government debt (Chapter 5, Section 6). The Riksbank has no objections to the Debt Office's proposal for guidelines for the management of the central government debt in 2020–2023.

3 Reasons for the Government's decision

3.1 Trade-off between cost and risk in debt management

The trade-off between cost and risk is set in the annual guidelines and is, according to them, primarily to be made through the choice of the composition and term to maturity of the debt (point 20). The guidelines state that the main cost measure is the average issue yield (point 21) and that the main risk measure refers to the variation of this measure (point 22).

The size and expected development of the central government debt

The trade-off between cost and risk takes account of the size and expected development of the central government debt. A low central government debt and strong government finances increase the scope for risk-taking in return for lower expected costs. In exceptional cases the absolute level of interest rates can also affect the guidelines, as can the situation in loan markets and the Swedish krona exchange rate.

Costs of the central government debt

Central government finances in good order and a resulting low central government debt are important factors in ensuring a low cost for the central government debt. Interest rate levels in the Swedish and global fixed income markets are also of great importance for borrowing costs. Exchange rate movements also affect the cost of the central government debt since part of the debt is exposed to foreign currencies. Similarly, the costs of the inflation-linked debt are affected by the development of inflation (CPI).

The decline in global and Swedish interest rates since the most recent financial crisis has contributed to substantially reduced costs for the central government debt.

3.2 Foreign currency exposure left unchanged

The foreign currency exposure of the central government debt is left unchanged. The Government considers that the reduction of the foreign currency exposure of the central government debt should stop pending the Debt Office's analysis of the strategic foreign currency exposure of the central government debt.

Background

Ahead of the guidelines for 2015 the Debt Office conducted an analysis of the foreign currency exposure of the central government debt. Its analysis showed that the foreign currency exposure was unable to contribute systematically to reducing the cost of the central government debt, and the Debt Office concluded that there was no reason to take a currency risk if it did not lead to an expected saving. However, the foreign currency risk was judged not to be a great problem since the level of the foreign currency debt was already substantially lower than it had been historically and interest on the central government debt accounted for a relatively small share of the central government budget. The Debt Office's conclusion was also supported by the ESV's examination (*Evaluation of central government borrowing and debt management 2013–2017 [Utvärdering av statens upplåning och skuldförvaltning 2013–2017]*, 2018) Since there was judged not to be any cost saving, the guidelines provided that the foreign currency exposure was to decrease gradually over the next few years. Since 2015 the Debt Office has decreased the foreign currency exposure by buying foreign currency corresponding to SEK 20 billion per year, in accordance with the guidelines for 2015.

However, in recent years there have been rapid developments in the economy. Given the surprising development of, for instance, interest

rates, term premiums and currencies, the Debt Office announced in its proposed guidelines for 2020–2023 that it intends to conduct an analysis of the strategic size of the foreign currency exposure and to report the results in its proposed guidelines for 2021–2024. The Debt Office considers that the conditions that formed the basis for the most recent analysis of the foreign currency exposure of the central government debt have changed and that there are signals of a structural shift in financial markets. The assessments of the advantages and disadvantages of foreign currency exposure in the central government debt may therefore have changed, and there may be reason to analyse whether the strategic foreign currency exposure of the central government debt should be changed.

When the reduction of the foreign currency exposure was begun in 2015, the foreign currency debt was almost SEK 200 billion. Since then the foreign currency debt has decreased by about half, and it was around SEK 100 billion on 30 September 2019. The risk in retaining the present foreign currency exposure is therefore assessed as very limited. If the analysis were to show that foreign currency exposure in line with or above the present level is justified, it would be unfortunate if the foreign currency exposure were to first be reduced and then to increase again.

The Government considers that it is appropriate to retain the present level of foreign currency exposure until the analysis has been conducted.

The Debt Office carries out currency exchanges continuously. Its currency handling is to be conducted in a predictable way, which results in the currency exchanges being spread over time. This means that the exposure can vary in the short term.

3.3 Steering of the term to maturity of krona debt and foreign currency debt merged

A combined maturity target (interval) is introduced for the whole of the central government debt. The new target thus covers both the krona debt and the foreign currency debt. Measured as duration, the term to maturity

of the central government debt is to be between 3.5 and 6 years.

Background

In recent years several adjustments have been made to the guidelines to refine steering. The guidelines for the central government debt for 2018–2021 removed the volume target for bonds with long terms to maturity, replacing it with a term-to-maturity interval for the whole of the nominal krona debt. This refinement continued in the guidelines for 2019–2022 with the merging of the term-to-maturity for the inflation-linked and nominal debt. The background to this merger was that the strategy concerning term to maturity had changed and was now the same for both inflation-linked and nominal krona bonds, so there was no reason to steer the inflation-linked debt separately.

The guidelines for 2020–2023 continue the adjustment of the term-to-maturity steering so as to further refine steering and clarify the overall level of risk. A combined term-to-maturity interval for the whole of the central government debt is intended to separate the choice of debt shares from the term to maturity of the central government debt. Since different types of debt have separate term-to-maturity targets, the overall term to maturity of the central government debt is affected when the distribution between different types of debt is changed. With the steering proposed, it will be clearer what term to maturity, and therefore what level of interest rate refixing risk, will apply to the central government debt, irrespective of whether the shares changed.

To retain transparency in relation to market participants, the Debt Office will adopt separate internal guidelines for the foreign currency debt, in the same way as the Debt Office currently does for nominal and inflation-linked debt.

The target is set as an interval since there are several factors that influence the duration of the debt alongside the actions of the Debt Office. Both the interest rate and inflation influence duration. If the interest rate and inflation rise, duration goes down.

3.4 Term to maturity unchanged in practice

Short borrowing is generally cheaper than long borrowing, which means that a trade-off must be made between expected cost and risk, especially refinancing risk and interest rate refixing risk. In recent years term premiums, i.e. the compensation investors demand to invest in government securities with longer maturities, have decreased. The term to maturity of the nominal krona debt has therefore been extended by a total of one year in the period 2016–2018. In practice duration has mainly increased through less use of interest rate swaps.

The Government does not consider that there are reasons to further extend the term to maturity. But since the Government's guidelines decision for 2020 merges the maturity steering of the krona debt and the foreign currency debt, the new merged interval is different from what applied in 2019 (see section 3.3). As a result of the merger, the term to maturity of the central government debt is changed to between 3.5 and 6 years. In its guidelines decision for 2019 the Government set the term-to-maturity interval at between 4 and 6 years for the krona debt and between 0 and 1 year for the foreign currency debt. The foreign currency debt is small in relation to the krona debt and has a much shorter term to maturity. When the target values for the krona debt and the foreign currency debt are weighted by the size of these types of debt, the term to maturity is about half a year shorter than for the krona debt.

3.5 Share of inflation-linked krona debt kept unchanged

The Government sees no reason to alter the steering of the composition of the krona debt. This steering means that the share of inflation-linked krona debt is to be steered towards 20 per cent over the long term (point 11). The remaining part of the central government debt (currently around 63 per cent) is to consist of nominal krona debt.

The Swedish National Financial Management Authority (ESV) noted in its examination of the management of the central government debt that the limited borrowing requirement makes it more

necessary demands to give priority to borrowing in nominal government bonds in order to safeguard that market (*Evaluation of central government borrowing and debt management 2013–2017, 2018*). ESV considered that if there are no strong cost or risk arguments for retaining the present level, there may be reason to review the share of the inflation-linked debt. On account of ESV's assessment, the Debt Office has made an analysis in its proposed guidelines for 2020–2023 of whether the share of inflation-linked debt should be changed. The analysis shows that there are no systematic differences in cost between inflation-linked and nominal borrowing. Therefore, the choice of share is a matter of balancing various risks so as to ensure good borrowing preparedness and low cost over the long term. With a decreasing central government debt, this balancing is primarily an operational issue of how to distribute borrowing among different government securities. With the current guidelines the stock of inflation-linked bonds is expected to decrease substantially. The Debt Office therefore sees no need to lower the target value for the share of inflation-linked debt in order to create greater scope for nominal government bonds.

Nominal bonds are central government's greatest and most important source of funding and the Government therefore considers that it is important that the inflation-linked bonds do not crowd out issues of nominal bonds and thereby worsen liquidity in that market. Poorer liquidity may, in turn, result in higher costs and worsen borrowing preparedness in the longer term. However, with the present guidelines the stock of inflation-linked bonds will decrease substantially, and the Debt Office's analysis shows no distinct systematic differences in cost. The Government therefore considers, like the Debt Office, that the guidelines for the share of inflation-linked bonds should remain unchanged.

In 2020 the Debt Office is going to issue government green bonds. No special guidelines are needed for these green government bonds; they are, instead, covered by the general guidelines for the composition and term to maturity of the central government debt.