Guidelines for central government debt management 2023

Decision taken at the government meeting
10 November 2022

Government Offices of Sweden

Summary

The starting point for the Swedish Government's guidelines decision is the objective of central government debt policy adopted by the Riksdag (Swedish Parliament). The objective is that central government debt shall be managed so as to minimise the long-term cost of the debt while taking the risk associated with its management into account, and within the framework of the requirements of monetary policy.

Central government debt has decreased as a share of GDP (gross domestic product) in 2022 and 2021. After having increased temporarily in 2020, signs of a return to the previous trend of declining central government debt and declining borrowing requirement are now being seen. The surpluses in the central government budget continue to reduce the borrowing requirement. Central government debt is expected to continue to decrease in 2023.

The guidelines decision for 2023 makes the following changes in the steering of debt management compared with the preceding year.

- Central government debt's foreign exchange exposure is to be gradually phased out with the guideline value being zero as of 2027. This is based on the National Debt Office's analysis and review of what long-term foreign exchange exposure should look like, finalised in this year's guidelines proposal.
- The phasing out of the foreign currency exposure of the central government debt is to be evaluated in relation to a steady pace of reduction over the period 2023–2026.
- The results of retail market borrowing will no longer be reported.

Otherwise, there are no changes in the composition of central government debt which is to be steered towards the following:

- Inflation-linked krona debt – it is to be 20% of the central government debt in the long term.
- Nominal krona debt – it is to make up the remaining share of the central government debt.
- The term to maturity (in terms of duration) of the central government debt is to be steered towards 3.5–6 years.

The Debt Office's proposed guidelines, among other factors, formed the basis for this guidelines decision. The Riksbank has provided its opinion on the Debt Office's proposal and has raised no objections. The Government's guidelines decision for 2023 is in line with the Debt Office's proposed guidelines.

Table of contents

1 Guidelines decision for central government debt management 2023

The guidelines for 2023–2025 are set out below. For 2024 and 2025, the guidelines are preliminary, based on the same principle as applied in the Government's budget proposal in the Budget Act (2011:203). 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 National Debt Office Instructions Ordinance (2007:1447) are presented here.

The Government's guidelines decision accords with the Debt Office's proposed guidelines for 2023–2026.

1.1 Objective for the management of central government debt

1. Central government debt shall be managed so as to minimise the long-term cost of the debt while taking the risk associated with its management into account. Debt management shall be conducted within the framework of the requirements of monetary policy (Chapter 5, Section 5 of the Budget Act).

1.2 The Debt Office's task and purposes of the borrowing

2. The Debt Office shall provide loans to and accept funds on account from, primarily, central government agencies (Section 2 of the National Debt Office Instructions Ordinance).

3. The Debt Office may raise loans for central government in order to:

- finance current deficits in the central government budget and other expenditure based on decisions of the Riksdag;
- provide credits and fulfil guarantees decided on by the Riksdag;
- amortise, redeem, and purchase central government loans;
- in consultation with the Riksbank, meet the need for central government loans at different maturities; and
- meet the Riksbank's need for currency reserves (Chapter 5, Section 1 of the Budget Act).

1.3 Guidelines process

4. The Debt Office shall submit proposed guidelines for central government debt management to the Government by 1 October each year (Section 26f of the National Debt Office Instructions Ordinance).

5. The Government shall request an opinion from the Riksbank on the proposal of the National Debt Office (Chapter 5, Section 6 of the Budget Act).

6. No later than 15 November each year, the Government shall adopt guidelines for the management by the National Debt Office of the central government debt (Chapter 5, Section 6 of the Budget Act).

7. The Debt Office shall submit information for the evaluation of the management of central government debt to the Government no later than 22 February each year (Section 26f of the National Debt Office Instructions Ordinance).

8. Every second year, the Government shall deliver a written communication to the Riksdag evaluating the management of the central government debt. The written communication shall be submitted to the Riksdag no later than 25 April (Chapter 5, Section 7 of the Budget Act).

9. The Debt Office shall decide on principles for how to implement the guidelines adopted by the Government for central government debt management (Section 15 of the National Debt Office Instructions Ordinance).

10. The Debt Office is to adopt 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 individual debt types, the currency distribution of the foreign currency debt, and principles for market support and debt maintenance.

1.4 Composition of central government debt – debt shares

11. The share of inflation-linked krona debt is to be 20% 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

12. The central government debt's foreign exchange exposure is to *remain unchanged. The exposure is to be calculated in a way that excludes changes in the krona exchange rate.* However, foreign currency exposure *shall be permitted to* vary as a consequence of the Debt Office's currency exchanges in accordance with point 35.

Adopted wording

12. The central government debt's foreign exchange exposure is to *be gradually phased out with the target level being zero as of 2027.* However, foreign currency exposure *can* vary as a consequence of the Debt Office's currency exchanges in accordance with point 35.

13. The Debt Office is to set a target level 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.

1.5 Term to maturity of central government debt

15. The term to maturity of the central government debt is to be between 3.5 and 6 years.

16. The Debt Office is to determine a term-to-maturity interval for the nominal krona debt, the inflation-linked krona debt and the foreign currency debt.

17. The term to maturity of the central government debt may deviate temporarily from the maturity interval stated in point 15.

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

1.6 Cost and risk

19. The trade-off between expected cost and risk is to be made primarily through the choice of the composition and term to maturity of the central government debt.

20. The main measure of cost 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.

21. The main measure of risk is to be the variation of the average issue yield.

22. 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.

23. Borrowing is to be conducted in a way that ensures a broad investor base and diversification in a range of funding currencies in order to maintain good borrowing preparedness.

24. Positions are not to be included when calculating the debt shares and term to maturity.

25. When taking positions, market values are to be used as the measure of cost and risk in the management of the debt.

1.7 Market support and debt maintenance

26. Through its market support and debt maintenance, the Debt Office is to contribute 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.

27. The Debt Office is to adopt on principles for market support and debt maintenance.

1.8 Position-taking

28. 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 that are also potentially a borrowing currency in the context of debt management.

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

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

30. Positions in the krona exchange rate are limited to a maximum of SEK 7.5 billion. When the positions are built up or phased out, 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 day-to-day debt 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.

1.9 Borrowing to meet the need for government loans

31. 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.

Previous wording	*Adopted wording*
32. 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).	32. 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) *and concerning the Stability Fund.*

1.10 Management of funds etc.

33. 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 National Debt Office Instructions Ordinance).

34. The Debt Office shall cover the deficits that occur in the central government cheque account (Section 7 of the National Debt Office Instructions Ordinance).

35. The management by the Debt Office of exchanges between Swedish and foreign currency shall be characterised by predictability and clarity (Section 7 of the National Debt Office Instructions Ordinance).

1.11 Consultation and collaboration

36. The Riksbank on matters concerning those parts of its borrowing operations that can be of major importance for monetary policy (Section 12 of the National Debt Office Instructions Ordinance).

37. The Debt Office shall collaborate with the National Institute of Economic Research (NIER) and the Swedish National Financial Management Authority (ESV) in matters relating to the Debt Office's forecasts of the central government borrowing requirement (Section 11 of the National Debt Office Instructions Ordinance).

38. 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.

1.12 Evaluation

39. The management of the central government debt is to be evaluated in qualitative terms in 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.

40. 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 the management of currency exchanges.

41. For inflation-linked borrowing, the realised cost difference between inflation-linked and nominal borrowing is to be reported.

Previous wording	*Adopted wording*
42. For borrowing on the retail market, the cost savings compared to alternative borrowing are to be reported.	
43. Gains and losses are to be recorded continuously for holdings within a position-taking mandate and evaluated in terms of market values.	*42*. Gains and losses are to be recorded continuously for holdings within a position-taking mandate and evaluated in terms of market values.
	43. The phasing out of the foreign currency exposure of the central government debt is to be evaluated in relation to a steady pace of reduction over the period 2023–2026. The evaluation is to follow the same principles that apply for positions within the position-taking mandate (point 42). Only transactions that are carried out for the purposes of phasing out the foreign currency exposure of the central government debt are to be included in the evaluation.

2 Basis for the Government's guidelines

2.1 Objective and steering

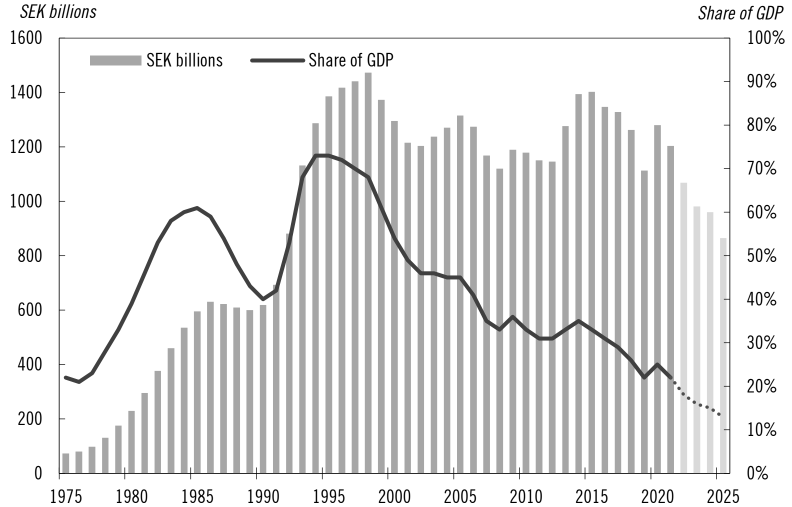
In its annual guidelines decisions, the Government steers the trade-off between cost and risk at a general level in the management of central government debt on the basis of the statutory objective of central government debt policy. The objective is to manage the central government debt in such a way as to minimise the long-term cost of the debt while taking risk in its management into account. 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 has led to a lower average cost than a longer term to maturity. In recent years the cost advantage of choosing shorter interest rates is judged to have decreased, and interest rate levels have also been very low from a historical perspective. Other important parameters that affect the cost of the central government debt are the size and expected development of the central government debt and interest rate levels at the time when debt instruments are issued. Since part of the central government debt is exposed to foreign currencies, exchange rate movements also affect the cost of the central government debt, and the costs of the inflation-linked debt affects the development of inflation (measured as the consumer price index).

The Debt Office can decide on deviations from the target levels 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.

2.2 Size of the central government debt

The central government debt is affected by the development of the economy and by decisions on economic policy. Individual events can also affect the development of the central government debt; examples are the sale of shares in state-owned enterprises and on-lending to the Riksbank.

Figure 2.1 Unconsolidated central government debt



Source: Swedish National Debt Office and the Budget Bill for 2023 (Govt Bill 2022/23:1)
Note. Outcome 1975–2021, Government forecast 2022–2025

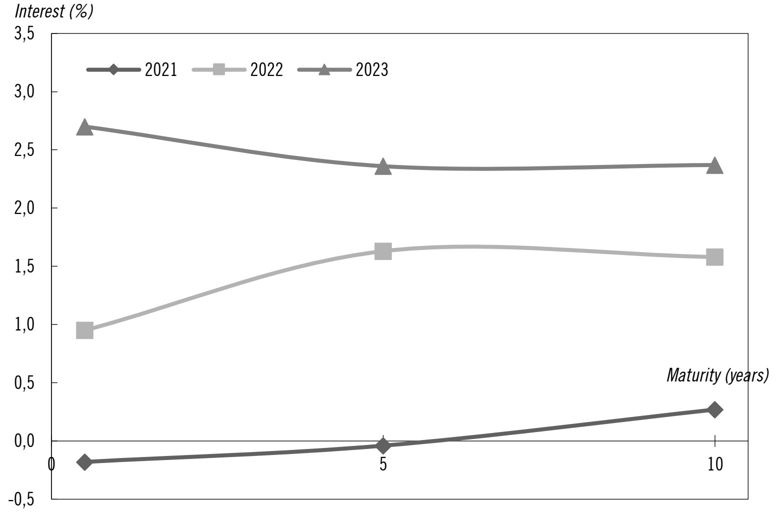
Figure 2.1 shows that central government debt decreased by 3 percentage points to 22% of GDP in 2021, and has returned to the previous trend of decreasing government debt and the borrowing requirement, after having temporarily increased in 2020. The surpluses in the central government budget imply that central government debt will continue to decrease, for example through the Riksbank's amortisation and the inflow of congestion revenue to Affärsverket svenska kraftnät (the Swedish national electricity grid). The central government debt is estimated to decrease both as a share of GDP and in billions of kronor during the forecast period. At the end of 2022, the central government debt is estimated to amount to SEK 1 285 billion; and is estimated to subsequently decrease by around SEK 20–90 billion per year due to surpluses in the central government budget (Govt Bill 2021/23:1).

2.3 Development of interest rates

Central government's cost for borrowing at different maturities can be described, in simplified terms, with the aid of the yield curve for Swedish government securities, which shows the correlation between interest rates and maturities. The slope of the yield curve affects the trade-off between cost and risk. When the slope of the yield curve is positive, the interest rate for borrowing at short maturities (Treasury bills) is lower than that for borrowing at long maturities (government bonds). This increases the cost saving, in relative terms, by borrowing at short maturities and vice-versa. At the same time, a rise in interest rates has a quicker impact on interest costs when borrowing has been at short maturities, as borrowing in shorter maturities increases the risk of variations in interest rate costs. In recent years, interest rates have been at historically low levels and also negative at times. The Riksbank has conducted an expansionary monetary policy, which has contributed to keeping Swedish interest rates at a low level. The difference between interest rates with short and long maturities has decreased, resulting in a relatively flat yield curve.

During the recovery following the pandemic, inflationary pressure arose which has increased in the current year through high energy prices and supply shocks. In view of the fact that inflation has continued to rise and has been higher than expected, the Riksbank has decided to tighten monetary policy at a rapid pace and has signalled that further increases in the policy rate can be expected in the future. This has had a clear impact on interest rates for all maturities, especially for interest rates with the shortest maturities.

Figure 2.2 Yield curve for Swedish government securities, annual average



Source: Budget Bill for 2023 (Govt Bill 2022/23:1)
Note. The graph shows the annual average market rates for the 2021 outcome and forecasts for 2022 and 2023. Rates refer to 6-month Treasury bills, 5-year government bonds, and 10-year government bonds. The annual average is an average of all daily closing rates up to the current month. For the current month and onwards, it is a forecast monthly average.

The development in market rates is normally less important for the National Debt Office’s overall trade-off between cost and risk. In the trade-off between cost and risk, and between risks, structural changes such as the development of different types of premiums (e.g. term premiums) and the size of the central government debt over time are the factors that are relevant.

2.4 Liquidity in the credit markets

The term ‘liquidity’ refers to the general possibility of concluding a transaction quickly, at a reasonable cost, and with little impact on prices. As an issuer, the Debt Office is active in the primary market and the bonds are then sold to investors in the secondary market. If liquidity in the secondary market decreases, pricing in the market will worsen, leading to more volatile prices and increased uncertainty for all actors. In the long term, this can risk leading to higher borrowing costs for central government and difficulties in attracting investors.

The issue of liquidity in the credit markets has been the subject of discussion and analysis on many occasions in recent years, and is mentioned, among other things, in the Government's evaluation of central government borrowing and debt management 2017–2021 (Comm. 2021/22:104).

The Financial Stability Council is a forum where representatives of the Government, the Swedish Financial Supervisory Authority, the National Debt Office and the Riksbank meet regularly to discuss matters pertaining to financial stability, the need for measures to counteract the build-up of financial imbalances and, in the event of a financial crisis, the need for measures to address such a situation (Committee on Financial Stability [Fi2013:09]). At its meeting in June 2022, the Council discussed the shortage of liquidity in several bond markets, including the secondary government bond market, where the situation has become worrying. For this reason, the Council proposed that the government agencies on the Financial Stability Council should jointly map the functioning of the various bond markets. A first interim report is planned for December 2022.

2.5 The Swedish krona

The size of the foreign currency exposure expressed in Swedish kronor is affected by the value of the Swedish krona in relation to the currencies that the foreign currency debt has exposure to. Foreign currency exposure therefore means that the interest cost in Swedish kronor increases if the Swedish krona weakens and vice versa, and the risk entailed in foreign currency exposure is therefore also affected by the volatility of the currency market. The exchange rate for the Swedish krona is affected by demand in the international currency market.

The Swedish krona weakened against several important currencies at the start of the pandemic in 2020, but was then strengthened, partly due to less unrest in financial markets up until the beginning of 2022, when the krona weakened again. In 2022, the krona is expected to weaken against the euro and the US dollar and then strengthen again in 2023 (Govt Bill 2022/23:1). Volatility in the foreign exchange markets has increased during 2022 as a result of Russia's invasion of Ukraine at the beginning of the year, which has led to increased economic uncertainty. Increased unrest and volatility in the financial markets usually lead to a weakening of the krona against larger and more liquid currencies for a period of time.

2.6 The Riksbank's opinion on the Debt Office's proposal

Under the Budget Act, the Government is required to obtain proposed guidelines from the National Debt Office and request an opinion from the Riksbank on the proposal of the Debt Office (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 2023-2026.

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, according to them, is primarily to be made through the choice of the composition and term to maturity of the debt (point 19). The main measure of cost is the average issue yield (point 20), and the main measure of risk refers to the variation in this measure (point 21).

The decline in global and Swedish interest rates in recent years has contributed to substantially reduced costs for the central government debt. The interest rate situation changed at the beginning of 2022, both globally and in Sweden, and interest rates have risen in pace with a rising rate of inflation, resulting in monetary policy tightening, in both Sweden and internationally. At the same time, central government debt continues to decrease, partly as a result of surpluses in the central government budget.

In its guidelines, the Government steers exposure to various risks, while giving the Debt Office flexibility about how to implement the financing. The Debt Office can therefore borrow in debt instruments with the maturities that are best suited to the circumstances and keep the risks within the guidelines via derivative instruments. In recent years, the Government has refined this steering so as to clarify the overall level of risk. This flexibility is of particular importance in keeping borrowing costs down when the borrowing requirement increases, especially if the increase is temporary, as in 2020, when the Debt Office was able to borrow large sums at short maturities without deviating from the term-to-maturity interval.

3.2 Foreign currency exposure is being phased out

A significant aspect of the trade-off between cost and risk is central government debt's foreign currency exposure. The Debt Office's multi-year analysis ahead of its proposed guidelines for 2015–2018 showed that the foreign currency exposure could not systematically contribute to reducing the cost of the central government debt. Therefore, the assessment was made that there was no reason to take a currency risk if it did not result in any expected saving. In its guidelines decision for 2015, the Government therefore decided that foreign currency exposure was to gradually decrease.

According to the Debt Office's proposed guidelines for 2020–2023, there were signals of a structural shift in financial markets. The assessments of the advantages and disadvantages of foreign currency exposure in the central government debt might therefore have changed, so there was reason to analyse whether the strategic foreign currency exposure of the central government debt should be changed. Pending the Debt Office's analysis, the Government therefore decided to halt the decrease in foreign currency exposure.

The Debt Office's proposal for guidelines for 2023–2036 sets out the final analysis as well as analyses in connection with establishing both a long-term target level for the foreign currency exposure and an appropriate course of action for reaching the target level. The results of the analyses connected to the long-term target level show that the foreign currency exposure does not provide any systematic savings, while the risk it brings in the form of cost variation increases. The conclusion therefore is that the target level should be zero. However, even if the target level for the foreign currency exposure is zero, the actual currency exposure of the central government debt will continue to vary at around the target level, as a result of the Debt Office's management of currency flows and currency risks in its day-to-day operations.

The risk in having foreign currency exposure is that its interest cost in Swedish kronor would increase if the krona weakened. In addition, the exposure translated into kronor would increase. When the decrease in foreign currency exposure began in 2015, this exposure was around SEK 200 billion. Since then it has decreased by roughly half and was just over SEK 100 billion in September 2022.

The Government establishes in the guidelines decision for 2023 that the foreign currency exposure of the central government debt is to be discontinued because it creates a higher risk without providing systematic cost advantages. The foreign exchange exposure of central government debt will be gradually phased out from the beginning of 2023 to the end of 2026, and will assume a target level of zero from 2027. The decision to phase out foreign currency exposure over a period of four years is based on the trade-off between a potential cost advantage and the risk in connection with the length of the phase-out period. This means a reduction of on average approximately SEK 25 billion per year based on the current exchange rate. However, it is also possible to adjust this pace within the specified time period. The phasing out of the foreign currency exposure is to be evaluated in relation to a steady (uniform) pace of reduction.

The Debt Office's analysis, which formed the basis for the pace decided for the phasing out, included assurance that the selected approach for the phasing out does not risk affecting the krona exchange rate. In addition, in accordance with its Instructions Ordinance, the Debt Office is to manage currency exchanges with predictability and clarity.

3.3 Steering of term to maturity retained unchanged

Measured as duration, the term to maturity of the central government debt is to be between 3.5 and 6 years.

In recent years, the guidelines have been adjusted to streamline this steering in order to clarify the overall level of risk.

This streamlined steering, and especially the common term to maturity for all of the central government debt, enables the Debt Office to adapt borrowing both to what demand looks like and to temporary fluctuations in the borrowing requirement so that it can keep borrowing costs down by doing so. This flexibility has been important particularly in the past year since uncertainty and fluctuations in the borrowing requirement have been greater than in previous years.

Therefore the Government does not consider that there are reasons to change the steering of the term to maturity.

3.4 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% of central government debt over the long term (point 11).

The share of inflation-linked debt has fluctuated around the long-term target of 20% in recent years.

Since the beginning of 2022, the share of inflation-linked debt has exceeded the long-term target, while in 2021 it fell below the target. It is important to remember that this is a long-term target, and hence the previous steering remains in place in the present situation.

By issuing inflation-linked bonds, the Debt Office can reach investors who do not want to risk inflation eroding the value of their bonds. This borrowing needs to be large enough to enable liquid trading, but must not crowd out nominal bonds so that liquidity in that market deteriorates. Against this background, the Government sees no reason to change the steering of the share of inflation-linked debt.

3.5 Follow-up of cost savings for borrowing in the retail market to cease

In 2018, the Debt Office decided to phase out its issuance of lottery bonds since lottery bonds were no longer able to meet the objective of decreasing the cost of the central government debt compared with borrowing in the institutional market. The last outstanding lottery bond matured in December 2021. In its proposed guidelines for 2023–2026, as in the proposed guidelines for 2022–2025, the Debt Office has proposed that the reporting of the cost saving for borrowing in the retail market should be deleted from the evaluation of the central government debt (point 42). The Government announced in last year’s guidelines decision that this reporting should be retained for another year as part of the evaluation of 2021, since the last lottery bond matured in December 2021. Since the last lottery bond has now matured, the Government considers that the reporting of the cost savings for borrowing on the retail market may cease. As neither the National Debt Savings (a form of savings that gave interest on the saved amount) nor lottery bonds remain as savings products targeting the retail market, it is no longer relevant to report any results regarding retail market borrowing.