Guidelines for central government debt management 2021

Decision taken at the government meeting
12 November 2020

Government Offices of Sweden

Summary

The starting point for the Government's guidelines decisions is the objective of central government debt policy 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.

The central government debt increased strongly in 2020 and is expected to continue to increase strongly in 2021 and 2022, to then decrease again in 2023. The increase in the central government debt is judged to be temporary and is therefore no reason to amend the guidelines for central government debt management.

No changes are made in the guidelines decision for 2021 to the steering of management compared with the preceding year. The government green bonds, which the Debt Office has issued, 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 exposure is to be unchanged.
- Inflation-linked krona debt – is to be 20 per cent of the central government debt in the long term.
- Nominal krona debt – 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 foreign currency exposure is, as in the preceding year, to be unchanged 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. This year's guidelines decision clarifies that the foreign currency exposure is allowed to vary as a result of currency exchanges by the Debt Office for reasons including its role as the central government's internal bank.

The basis for this decision includes the 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 2021–2023 corresponds to the Debt Office's proposal.

1 Guidelines decision for central government debt management 2021

The guidelines for 2021–2023 are set out below; 2023 being the horizon for calculations applied in the Budget Bill for 2021 (Govt Bill 2020/21:1). As in the case of the Budget Bill, the decisions for 2022–2023 are 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.

1.1 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).

1.2 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:

- finance current deficits in the central government budget and other expenditure based on decisions of the Riksdag (the Swedish Parliament);
- provide credits and perform guarantees decided by the Riksdag;
- amortise, redeem and buy back central government loans;
- meet the need for central government loans at different maturities in consultation with the Riksbank; and
- meet the Riksbank's need for foreign 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 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 proposal (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 by 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 by 25 April (Chapter 5, Section 7 of the Budget Act).

9. The Debt Office shall adopt 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).

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 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 be unchanged. The exposure is to be calculated in a way that excludes changes in the krona exchange rate.	12. The foreign currency exposure of the central government debt is to be unchanged. The exposure is to be calculated in a way that excludes changes in the krona exchange rate. *However, the foreign currency exposure shall be allowed to vary as a result of the Debt Office making*

currency exchanges in accordance with point 35.

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.

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 primarily to be made through the choice of the composition and term to maturity of the central government debt.

20. 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.

21. The main risk measure 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 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.

24. Positions are not to be included in the calculation of debt shares and terms to maturity.

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

1.7 Market support and debt maintenance

26. 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.

27. The Debt Office is to adopt 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 and that are 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 per cent probability.

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

1.9 Borrowing to meet 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.

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

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 Ordinance containing Instructions for the National Debt Office).

34. 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).

35. 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).

1.11 Consultation and collaboration

36. 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).

37. 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).

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. 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.

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 management of currency exchanges.

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

42. For retail market borrowing, the cost saving compared with alternative borrowing is to be reported.

43. Gains and losses are to be recorded continuously for positions within a position-taking mandate and evaluated in terms of market values.

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 the central government debt. This steering is based on the statutory objective for central government debt policy. The objective is to manage the central government debt in such a way as to minimise the cost of the debt in the long-term 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 had 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.

Other important parameters are the size and expected development of the central government debt. In 2020 the central government debt increased sharply due to the measures taken by the Government on account of COVID-19 and the recession brought on by the pandemic. In the current year the debt ratio is estimated to increase by 6 percentage points to 27%. Before this increase, the central government debt had decreased, as a share of GDP, since the mid-1990s and was around 21% at the end of 2019, which is a low level both internationally and from 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 overall 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.

Refinancing risk refers to the risk that it will turn out to be difficult or expensive to replace maturing loans with new ones and generally appears at the same time as the need for new borrowing rises sharply (financing risk). 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 diversification in a range of funding currencies to ensure good borrowing preparedness.

The refinancing risk is taken into account in several different ways in the Debt Office's strategies for borrowing and market support; these include working to maintain an even maturity profile for both nominal and inflation-linked bonds and contributing to a well-functioning market in government securities. The Debt Office's refinancing risk is also reduced by having access to different funding channels and investors. Borrowing in foreign currency contributes to reducing the refinancing risk and the financing risk since the channel to the international capital markets is kept open.

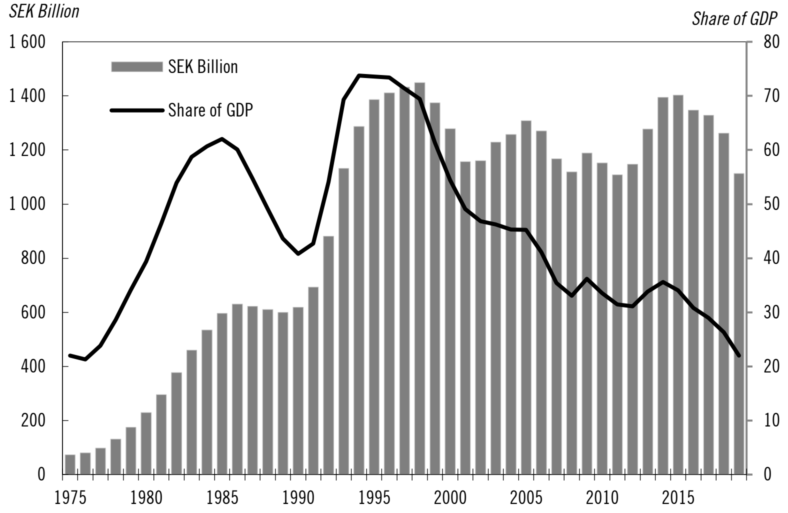
In its annual evaluation of central government management, the Debt Office has to evaluate its operational management on points including borrowing in and management of the different debt types; market support and debt maintenance measures; and management of currency exchanges.

2.2 Central government debt from a historical and international perspective

Historical development

The central government debt has arisen because, historically, the central government budget has shown larger deficits than surpluses. The central government borrowing requirement is 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 affected by the development of the economy and by decisions on economic policy. One-off 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 1975-2019



Source: Swedish National Debt Office

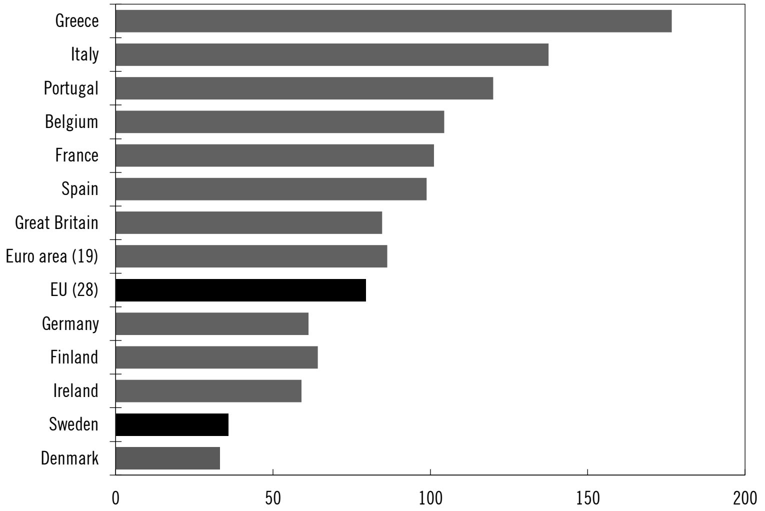
Figure 2.1 shows that the central government debt has increased sharply as a share of GDP in two periods. The first period was between 1976 and 1985 and the second was between 1990 and 1995. As a share of GDP, central government debt has decreased gradually since the mid-1990s, reaching 22 per cent at the end of 2019, 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 2019 on-lending to the Riksbank amounted to SEK 193 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. The strongly negative budget balance for 2020 means that, as a share of GDP, the central government debt increases by 6 percentage points from 22% of GDP in 2019 to 28% of GDP in 2020 according to the Budget Bill for 2021 (Govt Bill 2020/21:1). At the end of September 2020 the central government debt was SEK 1 210 billion according to the Budget Bill for 2021 (Govt Bill 2020/21:1).

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 35.9% of GDP in the first quarter of 2020. At the same point in time, the corresponding share for the EU as a whole was 79.5%, and for the euro area it was 86.3%. For 2020 the Maastricht debt for Sweden is forecast to increase to 42.6% according to the Budget Bill for 2021 (Govt Bill 2020/21:1).

Figure 2.2 Maastricht debt in first quarter of 2020 as a proportion of GDP



Source: Eurostat

2.3 Forecasts of the development of the central government debt

The development of the central government debt is affected by a large number of factors, and forecasting its development over a number of years is difficult. 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.

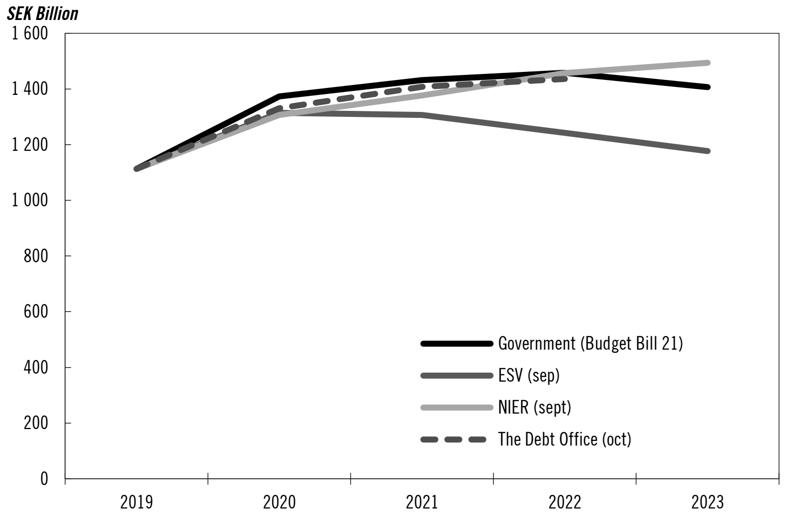
The Government's forecasts are an important part of the political process since they form the basis for Riksdag decisions on taxes and expenditure. The Government's forecast has been taken from the Budget Bill for 2021 (Govt Bill 2020/21:1).

NIER forecasts focus on the development of the real economy in national accounts terms and their forecasts also calculate the development of the consolidated central government debt.[1]

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.[2] Both the Government's and the ESV's forecasts are based on impact assessments with 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, which contributes to lower costs for the central government debt in the longer term.[3]

Figure 2.3 Forecasts of unconsolidated central government debt



Source: National Financial Management Authority (ESV), National Institute of Economic Research (NIER), Government and Debt Office.

Figure 2.3 presents the forecasts made by the various authorities of the unconsolidated central government debt until the end of the calculation period in 2023, apart from the Debt Office, which extends to 2022. The forecasts show a range for the unconsolidated central government debt at the end of 2023 of between SEK 1 177 and 1 494 billion (22 and 28% of GDP). At the end of 2019 the corresponding debt was SEK 1 113 billion,

[1] The NIER forecasts have been taken from its publication *The Swedish Economy* from September 2020.
[2] 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 2020.
[3]The Debt Office's forecast has been taken from the publication *Central government borrowing – Forecast and analysis 2020:3* from October 2020.

or 22% of GDP. On-lending to the Riksbank, which was SEK 193 billion at the end of 2019, is included in the forecasts.

Prospects for the Swedish economy according to the Budget Bill for 2021

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, while a recession has the opposite effect.

Sweden's GDP feel sharply in the second quarter of 2020, after being largely unchanged in the first quarter. This was the largest fall in a single quarter since the present measurements started in 1980. The decline was mainly driven by falls in exports and household consumption. However, GDP fell less in Sweden than in several other countries in Europe.

The economy is expected to recover gradually in the second half of 2020 and in 2021, bolstered by the Government’s extensive fiscal policy stimulus measures. However, the uncertainty about the development of the pandemic and the restrictions following from it, the deep international recession and the poorer prospects for the labour market are expected to hold back demand. Overall, GDP is expected to decrease by 4.6 per cent in 2020 and to increase by 4.1 per cent in 2021. It is expected to take to the end of 2021 for GDP to return to the same level as before the outbreak of the virus. The Swedish economy is judged to be in a deep recession. International trade is important for the Swedish economy with its export share of just under 50% and high participation in global value chains. At the same time, Sweden’s low central government debt provides good conditions for supporting companies and households hit hard by the pandemic.

Table 2.1 GDP forecast (Budget Bill for 2021)

	2019	2020	2021	2022	2023
GDP[1]	1.2	-4.6	4.1	3.8	2.7

1 Constant prices

Note: Outcome 2019, forecast 2020–2023

Source: Budget Bill for 2021 (Govt Bill 2020/21:1)

Great uncertainty about how long and deep the recession will be

The development of the global and Swedish economy remains very uncertain.

The risk that GDP growth will be poorer than set out above is primarily linked to greater spread of the infection. Restrictions to limit its spread may be reintroduced, extended and expanded both in Sweden and internationally, which can make the economic recovery more protracted. A longer period of spread can also affect the production capacity of countries if, for instance, delivery and value chains are disturbed by extensive bankruptcies.

After the great fall in world stock markets in March 2020, developments in financial markets stabilised during the rest of the spring and the summer. There is, however, still a risk that asset and housing prices will be affected. A price fall for housing and commercial properties, for example, could further exacerbate the recession.

Another uncertainty is what effects the economic decline, the ongoing pandemic and political developments will have on world trade. The forms for the UK's exit from the EU and the future relationship between them will alao affect world trade. Increasingly widespread protectionism can mean weaker global growth, and therefore poorer prospects for Swedish exports.

Moreover, the economic decline risks leading to negative effects in the long term. Rapidly rising unemployment can, in combination with people not being given the opportunity to transition when industry structures change, result in unemployment remaining at a higher level. Great uncertainty also contributes to less willingness to take risks, which can hold back investments and slow productivity growth. Taken together, this risks leading to lower growth in the long term.

The performance of the economy can also be stronger than assumed, especially if the rate of contagion slows and remains under control. Stronger economic growth internationally would benefit Swedish export industry.

In addition to the pandemic, there are several other uncertainties. Climate change, extreme weather events and biodiversity loss are risks to the global economy, since they can result in major costs both for individuals and businesses and for society as a whole.

Summing up, the forecasts of economic performance are subject to great uncertainty. In particular, higher transmission of the infection and political developments at global level risk leading to lower than expected growth, while reduced transmission of the infection and stronger economic growth can contribute to stronger GDP growth.

2.4 Loan markets

The yield curve

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.

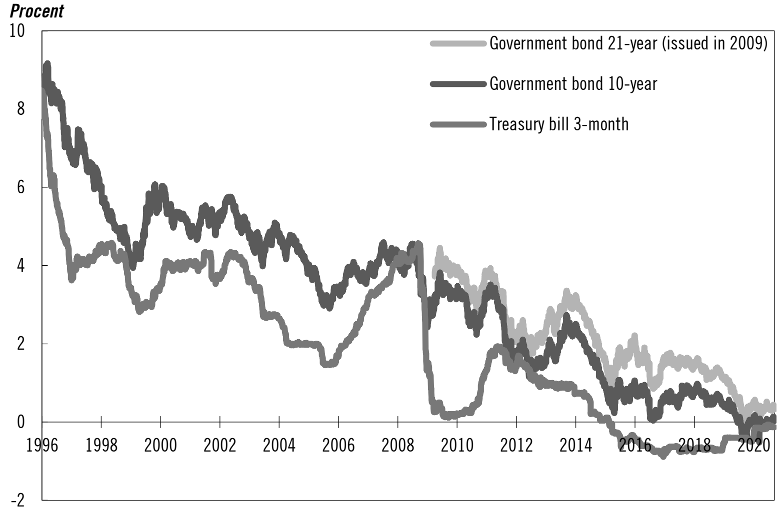
The slope of the yield curve affects the trade-off between cost and risk. When the slope of the yield curve is positive, the interest rate for borrowing at short maturities (T-bills) is lower than that for borrowing at long maturities (government bonds). This therefore increases the cost saving, in relative terms, from 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. This increases the risk of variations in interest costs. In recent years, the cost advantage of choosing short interest rates is judged to have decreased since the slope of the yield curve is relatively flat. Moreover, interest levels are below zero. In March 2020 government bond yields were negative for all maturities. This pattern for the yield curve is very unusual, but has occurred on several occasions in recent years. Investors have adapted their expectations to the repo rate being low for a long period. This means a small difference between interest rates on bonds with long and short maturities. Later in spring 2020, the Swedish 10-year government bond yield rose slightly and, up until September, it has fluctuated around zero.

The level of the yield curve is not normally of importance for the choice of maturity, rather it is the relative price that is, as mentioned above. 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 Debt Office was enabled 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. In February 2015 the repo rate was reduced to -0.10% and then it was reduced further, in stages, to -0.50%, at its lowest, from February 2016 to the end of 2018. In January 2019 the Riksbank raised the repo rate to -0.25%, and then went on, a year later, to raise the repo rate to 0%. To create conditions, in the wake of the corona pandemic, for a recovery of the Swedish economy, the repo rate is expected to be left unchanged at zero per cent over the next few years.

After a period of greater turbulence in financial markets in conjunction with the outbreak of the pandemic in February and March, the period in the spring and summer has been characterised by recovery. Several central banks have implemented support measures. For monetary policy reasons, the Riksbank has also bought government bonds in order to reduce interest rate levels along the whole of the yield curve. The volume of the Riksbank’s purchases was SEK 591 billion at the end of September 2020.

Figure 2.4 Swedish government interest rate 1996-2020



Source: Macrobond

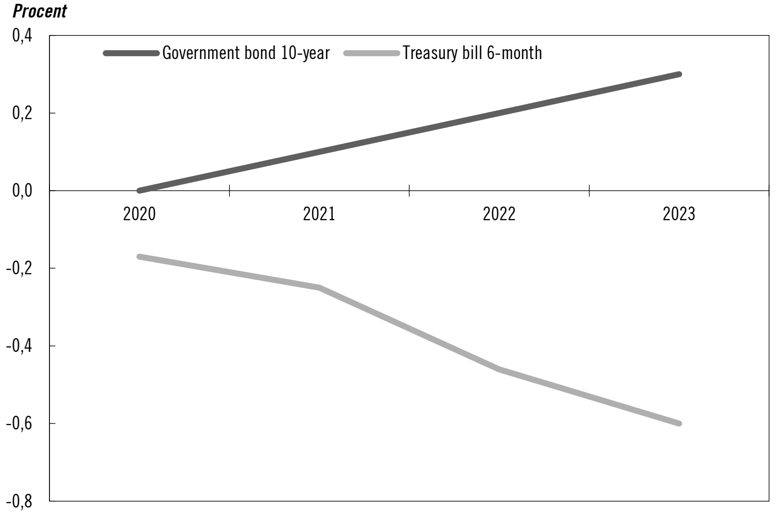
Figure 2.4 shows that government interest rates have fallen sharply since 2014, particularly for longer maturities. The short rate, which follows the direction of the repo rate, has not fallen as markedly while longer interest rates have continued downwards in periods.

In September 2020 the yield was -0.13 per cent for three-month T-bills, 0.01 per cent for the ten-year government bond and 0.34 per cent for the 21-year government bond.

Government forecast of interest rate developments

In the Budget Bill for 2021 the Government expects interest rates to remain low during the forecast horizon up until the end of 2023. The annual average for T-bills with a term to maturity of six months is expected to fall from -0.2 per cent in 2020 to -0.6 per cent in 2023. The annual average for government bonds with a term to maturity of ten years is expected to rise from 0.0 per cent to 0.3 per cent in the same period, see Figure 2.5

Figure 2.5 Government forecast of Swedish government interest rate, annual average 2020–2023



Source: Budget Bill for 2021 (Govt Bill 2020/21:1)

Liquidity on loan markets

As mentioned in the above sections, the central government debt decreased, generally speaking, as a share of GDP up until 2019. The forecasts now indicate that, after a sharp increase as a result of the COVID-19 epidemic, the central government debt will decrease each year again. It is estimated at 24.9% of GDP in 2023. A relatively small central government debt and a low borrowing requirement can affect access to different borrowing channels, which can result in poorer borrowing preparedness in the long term and therefore also higher borrowing costs.

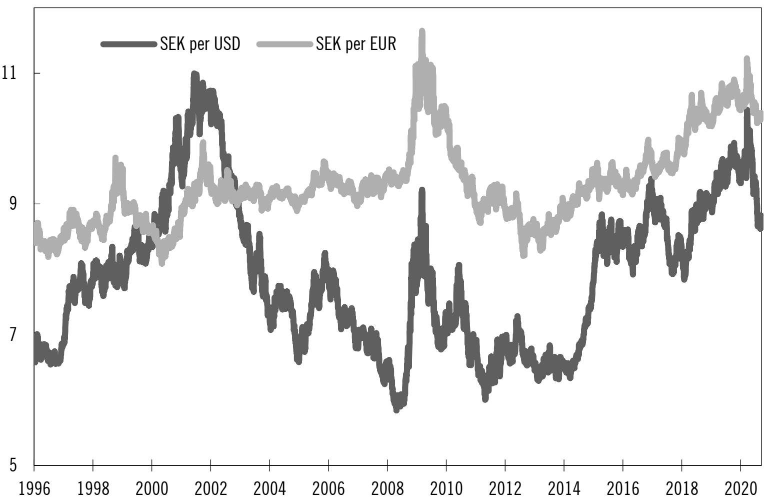
The Debt Office has worked in various ways to alleviate the negative effects of strained liquidity and has reviewed and supplemented its standing repo facilities. However, liquidity in loan markets is an important parameter to continue to monitor in the management of the central government debt.

2.5 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.

The exchange rate for the Swedish krona is affected by demand in the international currency market. In 2018 and 2019 the krona weakened against both the US dollar and the euro. The krona has strengthened in the spring and summer, partly due to less unrest in financial markets and lower interest rate spreads in relation to other countries.

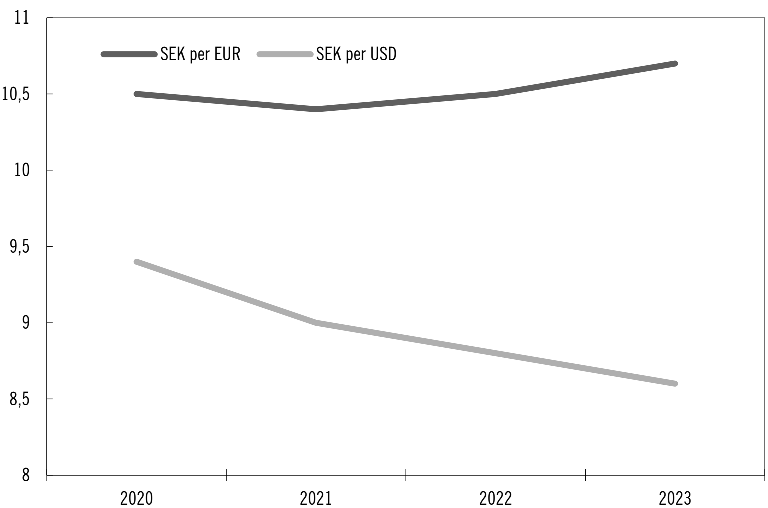
Figure 2.6 Development of the Swedish krona as of 1996



Source: Macrobond/Riksbank

In the Budget Bill for 2021 the Government expects the level of the krona to be relatively unchanged in 2020 and 2021. The assumption is that towards the end of the forecast period the krona will weaken slightly against the euro but strengthen against the dollar. The annual average for kronor per euro is estimated at 10.5 in 2020 and at 10.7 in 2023. In the same period the krona is expected to strengthen from 9.4 to 8.6 against the US dollar, see Figure 2.7

Figure 2.7 Government forecast for the Swedish krona, annual average 2020-2023



Source: Budget Bill for 2021 (Govt Bill 2020/21:1)

2.6 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 2021-2024.

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 19). The main cost measure is the average issue yield (point 20) and the main risk measure refers to the variation of this measure (point 21).

A low central government debt is an important factor in ensuring a low cost for the central government debt. Interest rate levels at the time when debt instruments are issued is also of great importance for its cost. Exchange rate movements also affect the costs 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. Even if the central government debt is now expected to increase, it will be doing so from a low level. Interest rates are still very low and are expected to remain so. The variation in cost is therefore of less importance than in the crisis in the 1990s, for example. In its guidelines the Government steers exposure to various risks, while giving the Debt Office flexibility about how to implement financing. The Debt Office can therefore borrow in the debt instruments with the maturities that are best in the circumstances and keep the risks within the guidelines via derivative instruments. In previous guidelines the Government has refined this steering so as to clarify the overall level of risk. This flexibility is of particular importance in holding borrowing costs down when the borrowing requirement rises.

3.2 Foreign currency exposure left unchanged

It was determined in the guidelines for 2020–2022 that the currency exposure would be left unchanged compared with the previous guidelines to reduce the currency exposure- The Government considered 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. This was because the surprising development of interest rates, term premiums and currencies, etc. had led the Debt Office to announce in its proposed guidelines for 2020–2023 that the Office intended to conduct a new analysis of the strategic size of the foreign currency exposure. The Debt Office considered that the conditions that formed the basis for the most recent analysis of the foreign currency exposure of the central government debt, which was conducted ahead of the guidelines decision for 2015, have changed and that 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.

The previous guidelines were based on an analysis conducted ahead of the guidelines decision for 2015. It turned out that the currency exposure could not systematically contribute to reducing the cost of the central government debt. The Debt Office concluded that there was no reason to take a currency risk if it did not lead to any 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 significantly lower than it had been historically and interest on the central government debt accounted for a relatively small share of the central government budget. 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.

In this year's proposed guidelines the Debt Office presents the result of the first part of the review it has announced. It consists of an updated and augmented analysis of the foreign currency exposure based on historical data. The Debt Office's analysis confirms the result of the previous analysis that formed the basis for decreasing the foreign currency debt between 2015 och 2019, that foreign currency exposure unambiguously leads to greater cost variation. If the foreign currency debt does not lead to a saving at the same time, the conclusion is that it is not possible to justify any foreign currency exposure in the long-term composition of the central government debt.

The Debt Office's conclusion from the first part of its review is therefore that the foreign currency exposure should continue to decrease. However, in determining whether the foreign currency exposure should continue to decrease, account also needs to be taken of more forward-looking aspects and circumstances. This will be included in the second part of the review, in which the Debt Office will make a forward-looking analysis of whether the historical correlations can be assumed to also apply in the future or whether the circumstances appear different. The outcome will be presented in its guidelines proposal for 2022–2025.

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 was around SEK 95 billion in September 2020. The risk in retaining the present foreign currency exposure is therefore assessed as very limited.

Against the background of what has been said above, the Government considers that it is appropriate to retain the present level of foreign currency exposure, at least until the second part or the review has been conducted.

3.3 Clarification regarding currency exposure

As mentioned above, the Government decided in its guidelines for 2020–2023 that the foreign currency exposure would be left unchanged. Since the Debt Office needs, in its role as the central government's internal bank for instance, to manage continual changes in foreign currency exposure, the foreign currency debt can vary in the short term. This is because the Debt Office spreads currency exchanges over time instead of doing them right away when needs arise. The reason for this is that currency management is to be predictable and transparent (see guidelines point 35). Spreading currency exchanges over time does not affect the long-term level of foreign currency exposure. Therefore the addition to this year's guidelines is only a clarification and not a change of the Government's steering regarding foreign currency exposure.

3.4 Steering of term to maturity remains unchanged

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

The adjustments made in recent years to refine this steering have been intended to clarify the overall level of risk. To be transparent in relation to market participants, the Debt Office adopts separate internal guidelines for the inflation-linked and nominal krona debt.

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 merging was that the strategy regarding term to maturity had been changed to be the same for both inflation-linked and nominal debt. This meant that there was no reason to steer the inflation-linked debt separately.

In the guidelines for 2020–2023 a combined term-to-maturity interval was adopted for the whole of the central government debt so as to separate the choice of debt shares from the term to maturity of the central government debt. With the combined term-to-maturity interval it is 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 are changed. The Swedish National Financial Management Authority stated in its report *Evaluation of central government borrowing and debt management 2015–2019 [Utvärderingren av statens upplåning och skuldförvaltning 2015–2019]* (2020) that these changes had meant that the guidelines were more fit for purpose.

This refined steering enables the Debt Office to adapt borrowing to the demand demonstrated, thereby enabling it to keep borrowing costs down. Considering the effects on the central government debt resulting from the COVID-19 pandemic and the high level of uncertainty about the development of the debt in the next few years, it is important that the Debt Office has the flexibility required to meet a higher borrowing requirement.

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

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 59 per cent) is to consist of nominal krona debt.

There is great uncertainty about the development of the debt in the next few years. The Debt Office therefore plans to chiefly meet the higher borrowing requirement by increasing short-term borrowing in nominal instruments. The market for inflation-linked bonds is, according to the Debt Office, not judged to accommodate a rapid increase in issue volumes partly because of poorer liquidity. The share of inflation-linked debt is therefore expected to fall below its target value. In a few years' time, the debt is expected to decrease again, and if the stock of inflation-linked bonds has grown by that time, its share may become too high instead.

The Swedish National Financial Management Authority stated in its evaluation of the management of the central government debt that there is reason to analyse the contribution of the inflation-linked debt to the achievement of its objective (*Evaluation of central government borrowing and debt management 2015–2019*, 2020). The Debt Office analysed in its proposed guidelines for 2020–2023 whether the share of inflation-linked debt should be changed. Its analysis shows that there are no systematic cost differences between inflation-linked and nominal borrowing and that the choice of share is, therefore, a matter of weighing various risks so as to ensure good borrowing preparedness and low cost over the long term. With the present guidelines and the rising central government debt, the stock of inflation-linked bonds is expected to decrease. However, the development of the central government debt is uncertain over the next few years. Against this background, the Government sees no reason to change the steering of the share of inflation-linked debt.

It can be mentioned in this context that on 1 September 2020 the Debt Office conducted an issue of government green bonds. The government green bonds are covered by the general guidelines for the composition and term to maturity of the central government debt.