2017

GUIDELINES FOR CENTRAL GOVERNMENT DEBT MANAGEMENT 2017

Decision taken at the Cabinet meeting
November 10 2016

LONG-TERM PERSPECTIVES COST MINIMISATION FLEXIBILITY

Government Offices of Sweden

Contents

Summary

Direction of central government debt policy
The guideline decision for 2017 means a slight extension of the maturity of the nominal krona government debt. The meaning of the term position is clarified and the mandate to take positions in the SEK exchange rate is left unchanged. The steering of the composition of the central government debt is also left unchanged. The objective for retail market borrowing is set in a longer-term perspective than before at the same time as the sale of lottery bonds is limited as long as this borrowing is more expensive than other borrowing

The maturity of the three types of debt is to be steered towards:

- Foreign currency debt: duration 0–1 years
- Inflation-linked krona debt: duration 6-9 years
- Nominal krona debt:
  - Instruments with a maturity of up to 12 years: duration 2.9–3.9 years
  - Instruments with a maturity of more than 12 years:
    long-term benchmark for the outstanding volume of SEK 70 billion.

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

- Foreign currency debt: A reduction of up to SEK 30 billion per year
- Inflation-linked krona debt: 20 per cent
- The nominal krona debt is to make up the remaining share.

Extended maturity of the central government debt
The maturity of the central government debt is one of several factors that affect the expected cost and risk in the debt. In its proposed guidelines for 2017 the Debt Office has again analysed the importance of the maturity of the central government debt. Its analysis shows that the cost advantage of short-term borrowing is low, so the maturity of the nominal krona debt should increase. The Government shares the view of the Debt Office and decides to increase the interval for the nominal krona debt for instruments with a maturity of up to 12 years by 0.3 years from 2.6–3.6 years to 2.9–3.9 years. By extending its maturity, the cost of the nominal krona debt will vary less, meaning that the risk will decrease. As in the current year, the extension of the maturity will be attained by making less use of swaps. At present, interest rate swaps are used to actively shorten the maturity of this debt. The steering of the maturity of the foreign currency debt and the inflation-linked krona debt remain unchanged.

Clarification of the meaning of the term position and unchanged mandate for positions in the krona exchange rate.
The guidelines clarify that positions can also be used to reduce the risk in the central government debt. Previously they only stated that positions could be taken to reduce the costs of the debt. The mandate for positions in the krona exchange rate is left unchanged at SEK 7.5 billion. In its proposed guidelines the Debt Office proposes increasing the mandate to SEK 20 billion. However, the Government makes the assessment that an increased mandate could risk coming into conflict with monetary policy being pursued, as highlighted by the Riksbank (the Swedish central bank), in its opinion on the Debt Office's proposed guidelines.

Unchanged steering of the composition of the central government debt
The Debt Office has analysed whether it would be better to steer the size of the inflation-linked krona debt in terms of monetary amounts instead of as a share. The Government shares the conclusion of the Debt Office that the advantages of the present steering model outweigh those of the alternative.

The objective for retail market borrowing is set in a longer-term perspective at the same time as the sale of lottery bonds should be limited for the time being
The low level of interest rates means that borrowing in lottery bonds cannot currently contribute to reducing the cost of the central government debt. The Government's decision to set the target for retail market lending in a longer-term perspective makes it possible to retain this form of borrowing since it is expected to be able to be profitable once interest rates rise. To limit the interest expense loss until this form of borrowing is judged to be profitable again, the Debt Office should consider not issuing lottery bonds.

Basis for the guideline decision
The basis for the Government's guideline decision is the objective of central government debt policy adopted by the Riksdag (the Swedish Parliament), Chapter 5, Section 5 of the Budget Act (2011:203). This objective means that the cost of the debt in the long-term is to be minimised while taking risk in the management of the debt into account. The management of the debt shall be conducted within the framework of monetary policy requirements.

Division of responsibilities and process
Responsibility for attaining the objective of central government debt policy is divided between the Government and the Debt Office. The Government sets the overall level of risk in its annual guideline decisions while the Debt Office is responsible for borrowing and management being conducted within the framework of the guidelines and in accordance with the objective.

The guideline decision has to be taken by the Government no later than 15 November each year. This decision is based, in part, on the National Debt Office's proposed guidelines. The Riksbank is given the opportunity to state an opinion in connection with the preparation of the proposed guidelines from the National Debt Office.

The Government makes a report on the attainment of the objective to the Riksdag in an evaluation communication every other year. In the intervening years the Government presents a preliminary evaluation of the management of the central government debt in the Budget Bill.

1 Decision on guidelines for central government debt management in 2017

Summary: The guideline decision for the management of the central government debt in 2017 means a slight extension of the maturity of the central government debt. This extension is achieved by increasing the maturity interval of instruments in the nominal krona debt with up to twelve years to maturity to 2.9–3.9 years from 2.6–3.6 years (duration). For instruments with more than 12 years to maturity, the long-term benchmark for the outstanding volume of SEK 70 billion is retained. For the foreign currency debt and the inflation-linked krona debt the maturities of 0–1 years and 6–9 years respectively (duration) are left unchanged.

The steering of the composition of the central government debt is left unchanged. The share of inflation-linked krona debt is to be steered towards 20 per cent in the long term. As in the previous year, the foreign currency debt is to decrease by no more than SEK 30 billion per year, excluding changes in the krona exchange rate. The term position is altered so as to make it clearer that positions can also be used to reduce the risk in the central government debt. The mandate for positions in the krona exchange rate is left unchanged at SEK 7.5 billion. The objective for retail market borrowing is set in a longer-term perspective than before.

Central government debt policy has been steered and evaluated according to the present process since 1998. Over the years a large number of analyses and discussions have led to the current steering of the central government debt portfolio.

The guidelines for 2017–2020 are set out below; the decisions for 2018–2020 are to be regarded as preliminary. In the cases where individual points in the guidelines differ from the Debt Office's proposal or from earlier guideline decisions this is stated. 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.

1.1 The objective for the management of central government debt

1. The central government debt shall be managed 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 management of the debt shall be conducted within the framework of monetary policy requirements. *Budget Act (2011:203).*

1.2 The task of the Debt Office and the purpose of borrowing

2. The task of the Debt Office is to raise and manage loans for the central government in accordance with the Budget Act. *Ordinance (2007:1447) containing Instructions for the National Debt Office.*

3. Under the Budget Act the Debt Office may raise loans for the central government 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 central government loans;
   4. meet the need for central government loans at different maturities in consultation with the Riksbank; and
   5. satisfy the Riksbank's need for foreign currency reserves.

1.3 The 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. *Ordinance containing Instructions for the National Debt Office.*

5. The Government shall request an opinion from the Riksbank on the proposal of the Debt Office. *Budget Act.*

6. The Government shall adopt guidelines for the Debt Office's management of the central government debt no later than 15 November each year. *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. *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. *Budget Act.*

9. The Debt Office shall establish principles for the implementation of the guidelines for central government debt management established by the Government. *Ordinance containing Instructions for the National Debt Office.*

10. The Debt Office shall establish internal guidelines based on the Government's guidelines. These decisions shall concern the use of the position mandate, the foreign currency distribution in the foreign currency debt and principles for market and debt maintenance.

1.4 Composition of central government debt – debt shares

The Government's decision	Debt Office proposal	Comment
11. The share of *inflation-linked krona debt* in the central government debt is to be 20 per cent in 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 compensation for inflation.	In line with the Government's decision.	Corresponds to current guideline.

12. The foreign currency exposure of the central government debt shall decrease. The decrease is to be no more than SEK 30 billion per year. The exposure shall be calculated in a way that excludes changes in the krona exchange rate.	In line with the Government's decision.	Corresponds to current guideline.
13. The Debt Office is to set a benchmark for the distribution of the foreign currency debt among different currencies.	In line with the Government's decision.	Corresponds to current guideline.
14. In addition to inflation-linked krona debt and foreign currency debt, central government debt is to be composed of *nominal krona debt*.	In line with the Government's decision.	Corresponds to current guideline.

1.5 Maturity of the central government debt

The Government's decision	Debt Office proposal	Comment
15. The maturity of the nominal krona debt for instruments with maturities of up to twelve years is to be between 2.9 and 3.9 years.	In line with the Government's decision.	The maturity interval is increased from 2.6–3.6 years; see section 3.3.
16. For nominal krona instruments with maturities of more than twelve years, the long-term benchmark for the outstanding volume is to be SEK 70 billion.	In line with the Government's decision.	Corresponds to current guideline.
17. The maturity of the inflation-linked krona debt is to be between 6 and 9 years.	In line with the Government's decision.	Corresponds to current guideline.
18. The maturity of the foreign currency debt is to be between 0 and 1 year.	In line with the Government's decision.	Corresponds to current guideline.
19. The maturity of the types of debt may deviate temporarily from the maturities given in points 15, 17 and 18.	In line with the Government's decision.	Corresponds to current guideline.
20. Maturity is to be measured as duration.	In line with the Government's decision.	Corresponds to current guideline.

1.6 Cost and risk

The Government's decision	Debt Office proposal	Comment
21. The trade-off between expected cost and risk is primarily to be made through the choice of the composition and maturity of the central government debt.	In line with the Government's decision.	Corresponds to current guideline.
22. The main cost measure is to be the average issue yield.	In line with the Government's decision.	Corresponds to current guideline.
23. The main risk measure is to be the average issue yield risk.	In line with the Government's decision.	Corresponds to current guideline.
24. The Debt Office is to take account of refinancing risks in the management of the central government debt.	In line with the Government's decision	Corresponds to current guideline.
25. Borrowing shall 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.	In line with the Government's decision	Corresponds to current guideline.
26. Positions are not to be included in the calculation of debt shares and maturities.	In line with the Government's decision	Corresponds to current guideline.
27. When taking positions, market values are to be used as the measure of the costs and risks in the management of the debt.	In line with the Government's decision	Corresponds to current guideline.

1.7 Market and debt maintenance

The Government's decision	Debt Office proposal	Comment
28. The Debt Office is to contribute, through market and debt maintenance, to the effective functioning of the government securities market in order to achieve the long-term cost minimisation objective while taking account of risk.	In line with the Government's decision.	Corresponds to current guideline.
29. The Debt Office is to adopt principles for market and debt maintenance.	In line with the Government's decision.	Corresponds to current guideline.

1.8 Position-taking

The Government's decision	Debt Office proposal	Comment
30. 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.	In line with the Government's decision.	Corresponds to current guideline.
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.	In line with the Government's decision.	Clarification that positions can also be used to reduce the risk for the central government debt taking account of cost, see section 3.4.
31. Positions in *foreign currency* are limited to SEK 300 million, measured as daily Value-at-Risk with a 95 per cent probability. The Debt Office is to decide how much of this scope may be used at most in its ongoing management.	In line with the Government's decision.	Corresponds to current guideline.
32. Positions in the *krona exchange rate* may not exceed 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 ongoing management in connection with exchanges between the krona and other currencies. This volume shall be of a limited size and the positions do not need to be announced in advance.	The Debt Office proposes increasing the mandate in the krona exchange rate to SEK 20 billion, see section 3.4.	Corresponds to current guideline.

1.9 Retail market borrowing

The Government's decision	Debt Office proposal	Comment
33. The Debt Office is to contribute through retail market borrowing to reducing the costs of central government debt compared with equivalent borrowing in the institutional market in the long term.	In line with the Government's decision.	The objective is given a longer-term perspective, see section 3.5.

1.10 Borrowing to meet the need for central government loans

The Government's decision	Debt Office proposal	Comment
34. The possibility of raising loans to meet the need for central government loans under Chapter 5, Section 1 of the Budget Act may only be used if required 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.	In line with the Government's decision.	Corresponds to current guideline.
35. 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).	In line with the Government's decision.	The guideline refers to a new act since the Government Support to Credit Institutions Act (2008:814) was repealed on 1 February 2016, see section 3.6.

1.11 Management of funds etc.

36. The Debt Office shall place its funds, to the extent that they do not need to be used for 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. Deposits may be made abroad and in foreign currency. *Ordinance containing Instructions for the National Debt Office.*

37. The Debt Office is to cover the deficits that occur in the Government central account. *Ordinance containing Instructions for the National Debt Office.*

38. The management of exchanges between Swedish and foreign currency (currency exchanges) shall be predictable and transparent. *Ordinance containing Instructions for the National Debt Office.*

1.12 Consultation and collaboration

39. The Debt Office is to consult with the Riksbank on matters concerning the components of its borrowing operations that may be assumed to be of major importance for monetary policy. *Ordinance containing Instructions for the National Debt Office.*

40. The Debt Office is to 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. *Ordinance containing Instructions for the National Debt Office.*

41. The Debt Office should obtain the Riksbank's views on how the funds borrowed to meet the need for central government loans under the Budget Act are to be invested.

1.13 Evaluation

42. 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 shall also include quantitative measures. The evaluation shall cover five-year periods.

43. The evaluation of the operational management shall include borrowing and management of the different types of debt, market and debt maintenance measures and management of currency exchanges.

44. The realised cost difference between inflation-linked and nominal borrowing is to be reported for inflation-linked borrowing.

45. The cost saving compared with alternative borrowing is to be reported for retail market borrowing.
46. Positions within a position mandate given are to be recorded continuously in income, and evaluated in terms of market values.

2 Basis for the Government's guidelines

Summary: The basis for the Government's decision on the guidelines is that the central government debt is to be managed in such a way as to minimise the long-term cost of the debt while taking account of the risk in its management. The management of the debt shall be conducted within the framework of monetary policy requirements.

A further consideration is the size of the debt and its expected development. At the end of 2015 the unconsolidated central government debt was SEK 1 403 billion (34 per cent of GDP). Forecasts indicate that at the end of 2020 the corresponding debt will be between SEK 1 193 and 1 330 billion (23 and 26 per cent of GDP). Compared with the previous year the size and expected development of the central government debt do not influence the Government's view of the scope for risk-taking in the management of the central government debt. However, as a result of continued low term premiums the trade-off between cost and risk is adjusted so as to justify a slightly longer maturity of the nominal krona debt.

The steering of the management of the central government debt is based on the statutory objective for debt policy. In its annual guideline decisions the Government steers the trade-off between cost and risk at a general level. The trade-off is mainly made by choosing the maturity of the central government debt. If a shorter maturity is chosen, the average cost is expected to be lower, while the risk in management rises (and the other way round). This is because it is assumed that the slope of the yield curve is positive over time while short-term interest rates vary more. So, when the interest rate on a greater part of the debt is refixed in every period, the variation in the total interest rate costs for the central government debt increases. 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.

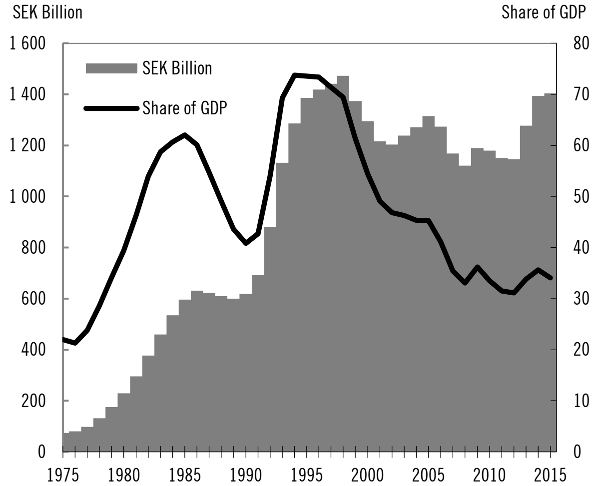
In order to reduce the cost of the central government debt the Debt Office is able to take decisions on deviations from the benchmarks within the mandates it has been given. Derivatives are used for these deviations, which are defined as positions. These positions are evaluated separately and must not be taken in the Swedish fixed income market.

2.1 Central government debt

Development from a historical perspective

The central government debt has arisen because, historically, the central government budget has shown larger deficits than surpluses. Budget deficits are financed by new borrowing, while budget surpluses are 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 companies and on-lending to the Riksbank.

Figure 2.1 Unconsolidated central government debt



Source: Swedish National Debt Office

Figure 2.1 shows the development of unconsolidated central government debt since 1975.[1] As shown in the figure the central government debt has increased sharply as a share of GDP in two periods since 1975. Between 1976 and 1985 the central government debt increased as a share of GDP from 22 to 65 per cent and between 1990 and 1995 it increased from 43 to 77 per cent. As a share of GDP central government debt has decreased gradually since the mid-1990s, reaching 34 per cent at the end of 2015. A large part of the increase in the central government debt in 2009 and 2013 is explained by foreign currency borrowing by the Debt Office on behalf of the Riksbank corresponding to SEK 100 billion in each year. This borrowing was carried out following a request by the Riksbank, in order to strengthen the currency reserve. At the end of 2015 on-lending to the Riksbank amounted to SEK 241 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.

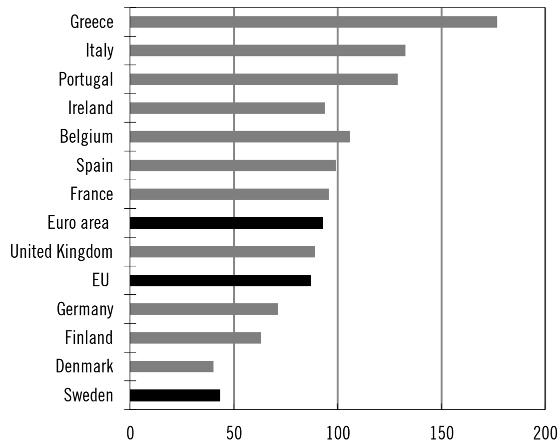
[1] The Budget Bill chiefly reports the consolidated central government debt. The difference between the consolidated and unconsolidated central government debt is made up of government agency holdings of government securities (SEK 51 billion at the end of 2015).

Comparison from an international perspective

Comparisons of general government sector debt in different EU countries 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 countries. The Maastricht debt thus makes it possible to increase comparability between countries.

For Sweden the Maastricht debt was 43 per cent of GDP at the end of 2015. At the same point in time the corresponding share for the EU as a whole was 87 per cent and for the euro area it was 93 per cent.

Figure 2.2 Maastricht debt in 2015 as a share of GDP



Source: EU Commission (03/05/2016)

Future development of the central government debt

The development of the central government debt is strongly dependent on economic developments in Sweden and in our export countries. Economic policy decisions are also of great importance for the development of the central government debt, as are one-time events in some years. So, it goes without saying that it is difficult to forecast the development of the central government debt 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 are made for different purposes. The forecasting methods and time horizons also differ.

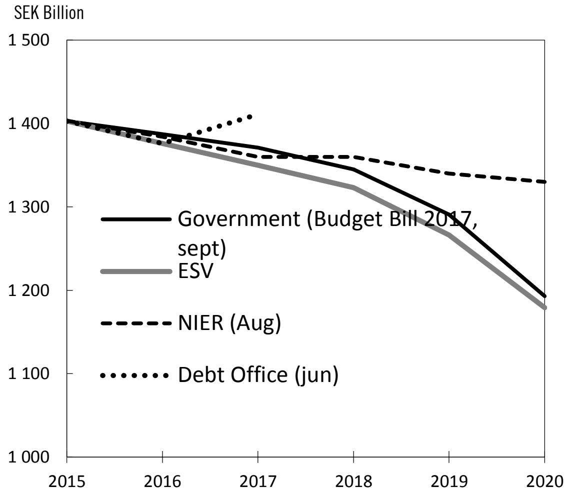
The Government's forecasts are an important part of the political process since they form the basis for Riksdag decisions on taxes and expenditure. The Government's forecast has been taken from the Budget Bill for 2017 (Govt Bill 2016/17:1).

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 the publication The Swedish Economy *[Konjunkturläget]* in August 2016.

The National Financial Management Authority's 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 National Financial Management Authority's forecast has been taken from the publication Forecast of the central government budget and public finances *[Prognos Statens budget och de offentliga finanserna]* from September 2016. Both the Government's and the National Financial Management Authority's forecasts are based on impact assessments given proposed or unchanged regulations and on a particular development of the macro economy. One difference is that the Government makes a technical assumption for its calculations of sales income of SEK 5 billion per year during the forecast period.

The Debt Office's forecasts are made in cash terms and form the basis for the agency's issue planning. By presenting a plan showing the loan instruments in which issues will be made in the present and coming year, this helps to make central government debt policy more predictable for market participants. The Debt Office's forecast has been taken from the publication Central Government Borrowing. Forecast and analysis *[Statsupplåning Prognos och analys]* 2016:2 from June 2016.

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 agencies of the unconsolidated central government debt until the end of the calculation period in 2020, apart from the Debt Office, which has a shorter forecast horizon. The forecasts show a range for the unconsolidated central government debt at the end of 2020 of between SEK 1 193 and 1 330 billion (23 and 26 per cent of GBP). This can be compared with the fact that at the end of 2015 the debt was SEK 1 403 billion, or 34 per cent of GDP. On-lending to the Riksbank, which was SEK 241 billion at the end of 2015, is included in the forecasts.

Prospects for the development of the Swedish economy according to the Budget Bill for 2017

The Swedish economy grew rapidly in 2015 and strong GDP growth is also expected in 2016. In relation to comparable countries, GDP growth in Sweden is very high and is almost twice as high as the EU average. Business investments and household consumption provide important contributions. Resource utilisation is estimated to be almost in balance and GDP growth in the coming years is expected to be more normal (see table 2.1).

[2] The National Financial Management Authority's forecast of government agencies' holdings of government bonds has been used to calculate the unconsolidated central government debt. The unconsolidated central government debt is about SEK 50 billion higher than the consolidated central government debt.

Table 2.1. GDP forecast (according to Budget Bill för 2017)

	2015	2016	2017	2018	2019	2020
GDP[1]	3.9	3.2	2.5	2.0	2.3	2.4

Fixed prices, reference year 2015 (corrected for calendar effects) Source: Budget Bill for 2017 (Govt Bill 2016/17:1).

Public consumption has increased strongly in recent years as a result of demographic developments, asylum reception and investments in health care, schools and social care. Public investments are also expected to increase strongly, partly as a result of demographic developments and the Government's investments in infrastructure and a fossil-free welfare society. The rate of investment growth in the business sector is expected to decline gradually in 2016 and 2017 after two strong years. But the level of investments will remain high in the coming years.

The employment rate is higher than before the financial crisis and the highest in the EU. The strong demand in the economy and the Government's reforms are expected to contribute to continued good growth of employment and to unemployment decreasing to 6.3 per cent in 2017.

Inflation has been low for long time, even though monetary policy has been expansive. However, the underlying rate of inflation has shown a rising trend since 2014. As a consequence of higher resource utilisation inflation is expected to continue to rise in 2016 and 2017.

There is great uncertainty about the development of the international economy and therefore also about developments in Sweden. Many of Sweden's most important export markets, in the euro area especially, are judged to be sensitive to negative economic disturbances. The possibilities of stabilising the economy, particularly through monetary policy, are limited.

In the referendum on 23 June 2016 the population of the UK voted to leave the EU. This result led initially to severe reactions in financial markets, but in the summer share markets in many countries recovered. The result of the referendum is expected to damp economic growth in the UK, but the impacts on Sweden are expected to be limited.

Economic growth internationally may also be stronger than assumed in the forecast presented in the Budget Bill. For example, growth in China and many other emerging economies is hard to assess. A stronger performance in these economies would lead to higher growth of Swedish exports.

But there are also risks in the Swedish economy. Since the mid-1990s housing prices and household debt have risen at a relatively high rate. With rapidly rising housing prices there is an increased risk of a rapid fall in prices in the future. Together with a high level of debt, such a development would result in a risk that household consumption would slacken, and this could then lead to lower growth and employment. However, in 2016 housing prices have increased much more slowly than in 2015. The amortisation requirement introduced on 1 June 2016 in order to damp this development has probably contributed to the slow-down. The Government and the relevant agencies are following developments closely and are prepared to take further action, if needed.

The fiscal policy framework is the foundation of the Government's economic policy. Sweden's public finances must be in good order. This contributes to a good economic development and to safeguarding welfare services. The Riksdag has set the level of the surplus target at 1 per cent of GDP over an economic cycle. The Committee for the Review of the Surplus Target (terms of reference 2015:63) has stated that the target should be reduced to one third of one per cent of GDP as of 2019. The Social Democrats and the Green Party as well as the Left Party, the Moderate Party, the Liberal Party, the Centre Party and the Christian Democrats are behind this proposal. The Government intends to revert to the Riksdag with an assessment in the Spring Fiscal Policy Bill in 2017 and a proposal to change the level in the Budget Bill for 2018.

Conclusion

The forecasts of the unconsolidated central government debt indicate that in 2020 the debt will be lower as a share 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 therefore judged to be largely the same as before.

2.2 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 is explained both by market participants expecting, on average, that interest rates will rise (the expectations hypothesis) and on market participants wanting 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).

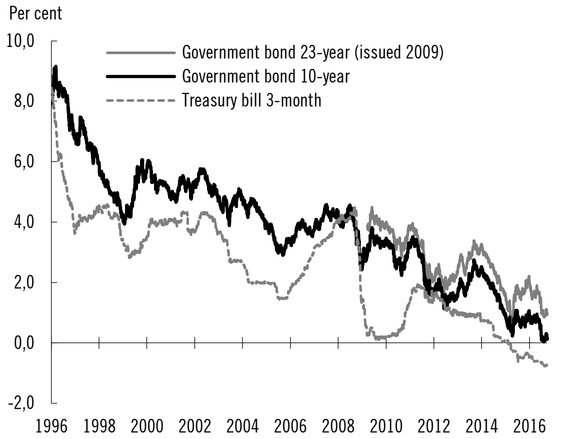
In preparing this year's proposed guidelines the Debt Office has again analysed how the maturity of the central government debt affects its cost. This analysis confirms the conclusions presented in the proposed guidelines for 2016. The analysis shows that term premiums have fallen over time and are now close to zero. Even though it is not possible to rule out a rise in these premiums in coming years, the Debt Office makes the assessment that the cost advantage of short-term borrowing is smaller than it used to be (see section 3.3.)

The yield curve level

The yield curve level is not normally of importance for the choice of maturity. Considering that increases and decreases in the interest rate offset each other 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 maturities. 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 interest rates.

In recent years the Riksbank has pursued an expansive monetary policy in order to achieve 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; after that the repo rate has remained unchanged. For monetary policy reasons the Riksbank has also bought government bonds, the volume of these is planned to be SEK 245 billion at the end of 2016.

Figure 2.4 Swedish government interest rate



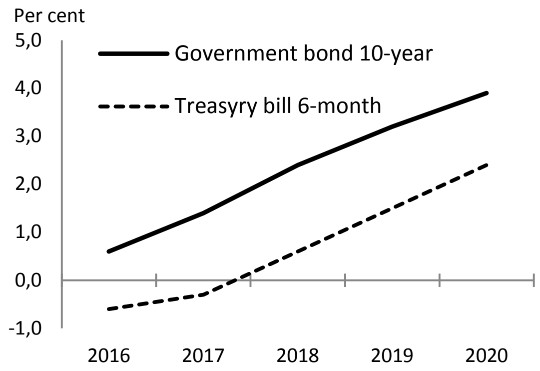
Source: Macrobond

Figure 2.4 shows that both short and long government interest rates have fallen sharply since 2014. The short interest rate has followed the direction of the repo rate as has the interest rate on longer government bonds as investors have adapted their expectations to the repo rate being low for a long period of time. At the end of September 2016 the interest rate was -0.75 per cent for three-month T-bills, 0.17 per cent for the ten-year government bond and 0.99 per cent for the twenty thee-year government bond.

Government forecast of interest rate developments

In the Budget Bill for 2017 the Government expects interest rates to rise gradually during the forecast horizon up until the end of 2020. The average annual interest rate for T-bills with a maturity of six months is expected to rise from -0.6 per cent in 2016 to 2.4 per cent in 2020. The average annual interest rate for government bonds with a maturity of ten years is expected to rise from 0.6 per cent to 3.9 per cent in the same period, see figure 2.5.

Figure 2.5 Government forecast of Swedish government interest rate, annual average 2016–2020



Source: Budget Bill for 2017 (Govt Bill 2016/17:1).

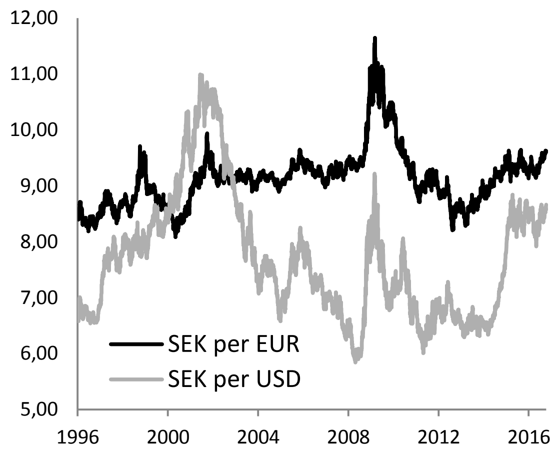
Conclusion
In recent years term premiums have fallen, and they are expected to be low for the foreseeable future. The trade-off between the expected cost saving from short-term borrowing in relation to the increased risk this entails has therefore shifted slightly, see section 3.3.

2.3 The Swedish krona

The size of the currency debt expressed in Swedish kronor is affected by the value of the Swedish krona in relation to the currencies against which the 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. The last time this happened was in May 2009, when the krona was judged to be severely undervalued in connection with the financial crisis. The mandate for positions in the krona exchange rate was raised at that time from SEK 15 billion to SEK 50 billion.

The 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 the country's economic growth, future level of interest rates and inflation. In periods of financial unrest larger currencies, such as the US dollar and euro, tend to get stronger, while smaller currencies often fall in value. During the financial crisis in 2008 and 2009 this is exactly what happened, resulting in a weaker Swedish krona. As financial markets stabilised and when signals about economic developments became more positive, the Swedish krona strengthened. Since 2011 the krona has weakened slightly against the euro. In the latter part of 2014 and in spring 2015 the US dollar strengthened considerably, resulting in a weaker krona exchange rate against the US dollar.

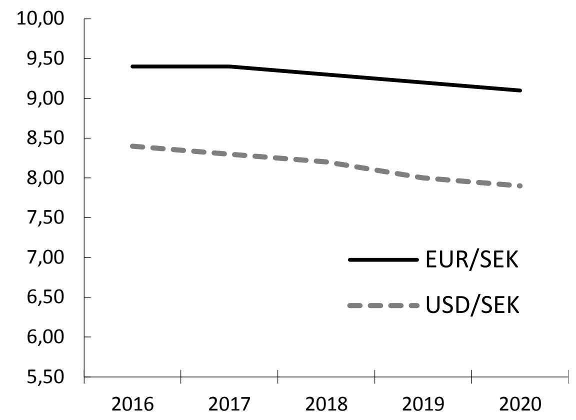
Figure 2.6 Development of the Swedish krona as of 1996



Source: Macrobond/Riksbank

Government forecast of the development of the krona
In the Budget Bill for 2017 the Government expects the krona to strengthen slightly against the euro and US dollar up until the end of the forecasting horizon in 2020. The annual average EUR/SEK exchange rate is estimated at 9.40 in 2016 and at 9.10 in 2020. Correspondingly, in the same period the krona is expected to strengthen from 8.40 to 7.90 against the US dollar, see figure 2.7

Figure 2.7 Government forecast of the Swedish krona exchange rate, annual average 2016–2020



Source: Budget Bill for 2017 (Govt Bill 2016/17:1).

Conclusion

Assessments of the development of the krona do not affect this year's guidelines. The mandate for positions in the Swedish krona is left unchanged since the Government makes the assessment that an increased mandate could risk coming into conflict with monetary policy being pursued (see sections 2.4 and 3.4).

2.4 The Riksbank's comments on the Debt Office's proposal

Under the Budget Act the Government shall request an opinion from the Riksbank on the proposal of the Debt Office for guidelines for the management of the central government debt (Chapter 5, Section 6). The opinion of the Riksbank on the proposal of the Debt Office for guidelines for the management of the central government debt in 2017–2020 is set out below.

"Under the present guidelines for the management of the central government debt the Debt Office is to amortise down the foreign currency debt. At present the Debt Office has a mandate to take foreign currency positions for a maximum of SEK 7.5 billion. In its proposed guidelines the Debt Office now proposes that it would be more cost-effective if there was more scope to defer amortisation payments on the foreign currency debt if the krona is judged to be undervalued. As part of this the Debt Office wants the mandate for foreign currency positions to be increased from SEK 7.5 to 20 billion.

The Executive Board of the Riksbank has communicated that it is ready to intervene in the currency market if too rapid a strengthening of the krona risks threatening the rise in inflation towards the target. An expanded mandate for the Debt Office, with the possibility of taking positions for a stronger krona, might then come into conflict with the monetary policy being pursued and generate a lack of clarity and unnecessary uncertainty in financial markets about the price formation of the Swedish krona. The Riksbank finds that the other proposals are compatible with monetary policy."

3 Reasons for the Government's decision

3.1 Trade-off between cost and risk in debt management

The basis for the steering of the management of the central government debt is the objective for debt policy adopted by the Riksdag, cost minimisation taking account of risk within the limits set by the demands made by monetary policy. The trade-off between cost and risk is set in the annual guidelines and shall, according to them, primarily be made through the choice of the composition and maturity of the debt (point 21). The guidelines state that the main cost and risk measure is the average issue yield (points 22 and 23).

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. When the central government debt is low and government finances are strong, there is greater 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.

At the end of 2015 the unconsolidated central government debt was SEK 1 403 billion, corresponding to 34 per cent of GDP. The unconsolidated central government debt included on-lending of SEK 241 billion to the Riksbank. Forecasts from the Government, the National Financial Management Authority and the National Institute of Economic Research indicate that at the end of 2020 the central government debt will be between SEK 1 193 and 1 330 billion (including on-lending to the Riksbank). As a share of GDP this corresponds to 23 and 26 per cent respectively. In combination with the risks with which the forecasts are associated, the scope for risk-taking in the management of the central government debt is judged to be unchanged.

Costs of the central government debt

The costs of the central government debt are primarily affected by the size of the debt and the interest rate levels when the debt instruments are issued. Exchange rate movements also affect the cost of the 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 the CPI.

The global and Swedish decline in interest rates since the financial crisis has led to a gradual decrease in the costs of the management of the central government debt. In 2015 the interest on the central government debt in cost terms was SEK 16 billion and in the Budget Bill for 2017 the corresponding interest costs are estimated at SEK 12.5 billion for 2016. For years 2017–2020 the interest costs are expected to rise successively and reach SEK 33.5 billion at the end of the period. The rise is due to expectations of higher market interest rates.

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 the budget balance 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 Swedish 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 general measures of both cost and risk are based on the average issue yield. The issue yield means the interest rate (or yield) at which the Debt Office borrowed at the time of the issue. The average issue yield is calculated by weighing together all the individual issue yields with their outstanding volumes.

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. Short borrowing is generally cheaper than long borrowing, which means that a trade-off must be made between expected cost and risk. In recent years term premiums, i.e. the compensation investors demand to invest in government securities with longer maturities, have decreased. Term premiums are expected to be low for the foreseeable future so there is a slight change in the trade-off between shorter and longer maturities. In view of this the maturity of the nominal krona debt was extended by 0.25 years (3 months) for 2016.[3] For 2017 the maturity of the nominal krona debt is extended by a further 0.3 years for the same reason. As a result of this extension the cost of the central government debt will vary less and the expectation is that it will be possible to manage the debt at a low cost or no cost at all.

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 time 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 (point 24) and that the Debt Office is to ensure good borrowing preparedness in foreign currencies (point 25).

The refinancing risk is taken into account in several different ways in the Debt Office's strategies for borrowing and market maintenance. This is done 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. A large part of the borrowing is carried out in the 10-year government bond, where the investor base is largest. Since 2009 the Debt Office also has nominal krona borrowing at longer maturities than twelve years, which means that the dates when the central government debt reaches maturity are spread over a longer period of time. 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 market makes 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 mentioned 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.

[3] Relates to instruments in the nominal krona debt with maturities of up to twelve years. The maturity of instruments in the nominal krona debt with maturities of more than twelve years are steered by a target for their outstanding volume. This target is not affected by the extended maturity.

3.2 The steering of the composition of the central government debt is left unchanged

The Government sees no reason to alter the steering of the composition of the central government debt. The share of inflation-linked krona debt is to be steered towards 20 per cent in the long term and the foreign currency debt is to be amortised by up to SEK 30 billion per year The remainder of the central government debt (currently around 65 per cent) is to consist of nominal krona debt.

Inflation-linked krona debt

It its proposed guidelines for 2017 the Debt Office has made an analysis of whether it would be better to steer the inflation-linked debt in terms of nominal amounts instead of as a share. The Government shares the Debt Office's conclusion that the advantages of the present steering model outweigh those of steering the inflation-linked debt towards an absolute level in nominal terms. The difficulties of steering the share of inflation-linked krona debt are already well-known. In the event of great changes in the borrowing requirement and the size of the central government debt, considerable changes are required in the outstanding volume of inflation-linked krona bonds. Such changes are difficult to put into effect without the costs of borrowing increasing. There is no possibility of using derivative instruments to adapt the size of the inflation-linked krona debt in the same way as for the foreign currency debt.

In the present model for steering it is clear that the Debt Office always aims at the target share in the long term even though the deviation from the target can be large in periods. The transparency of the present model is maintained because the reasons for deviations from the target share will be reported in coming years in the Debt Office's proposed guidelines and the deviations in historical outcomes in the annual evaluation of the management of the central government debt. The alternative model for steering in nominal terms is judged to result in less transparency and flexibility. Establishing a flexible steering model in nominal terms would require broad intervals (of the order of SEK ±20 billion or 10 per cent of the stock of inflation-linked bonds), which would make this steering weaker and less transparent than it is today. Another disadvantage of a steering model in nominal terms for the inflation-linked debt is that borrowing in nominal government bonds could be crowded out in situations where the borrowing requirement decreases sharply (central government debt decreases). This could ultimately lead to a higher borrowing cost for the central government debt as a whole since the liquidity of nominal government bonds would deteriorate.

Since the end of 2013 the share of inflation-linked krona debt has been less than 20 per cent. Before this the share of inflation-linked debt was above the target level. For the past ten-year period the share of inflation-linked debt has been in line with the target share of 20 per cent. In the evaluation of central government borrowing and debt management in 2011–2015 (Govt. comm. 2015/16:104) the Government made the assessment that the historical deviations from the target level were reasonable from a cost perspective but that the Debt Office should give a clearer account than in the past of the reasons for expected deviations in coming years. According to the Debt Office's forecast the share of inflation-linked debt will be slightly below the target value in the coming years. The reason is that a sharp increase in the issue volumes would risk driving up inflation-linked bond interest rates in the short term and creating uncertainty about the future supply of inflation-linked bonds. The Debt Office takes the view that this would probably lead to higher costs even in the long term. The adaptation of borrowing in inflation-linked bonds should be made in small stages in order to ensure a well-functioning market and, thereby, a low borrowing cost. If the borrowing requirement rises or falls quickly, this is handled in the first place by foreign currency borrowing and in the money market. Since the inflation-linked krona debt is difficult to steer, its share depends to a great extent on the development of the total central government debt. The accrued compensation for inflation has decreased gradually with the lower inflation rate, which has also contributed to a lower share of inflation-linked krona debt. As previously noted, the Debt Office is not able to use derivatives to steer the inflation-linked debt since this type of instrument does not exist. The reasons given by the Debt Office for deviating from the long-term target share during the forecast period are deemed by the Government to be reasonable. The guidelines are therefore left unchanged (point 11).

Foreign currency debt
In the period 2008–2014 the foreign currency debt was steered towards a target share of 15 per cent of the total central government debt. Following several years of analytical work this steering was changed in the guidelines for 2015. The guideline decision for 2015 laid down that foreign currency exposure in the central government debt is to decrease by no more than SEK 30 billion per year[4]. The planned rate of reduction is SEK 20 billion. The justification for this new direction was the lack of sufficient evidence that foreign currency exposure results in lower expected costs for central government. A gradual reduction of currency exposure means a decrease in the probability of variations in costs, and thereby in risk, as the currency risk in the debt declines. The guidelines for the foreign currency debt are left unchanged (point 12).

Nominal krona debt
The largest part of the central government debt consists of nominal krona debt (about 65 per cent). This share is not steered in the guidelines but is a residual item between the total central government debt and the shares of inflation-linked krona debt and foreign currency debt. The Government sees no reason to alter this steering.

3.3 Extended maturity of the nominal krona debt

Nominal krona debt
The steering of the nominal krona debt is divided into instruments with less than and more than 12 years to maturity.

For instruments with more than 12 years to maturity the steering is unchanged, which means that the long-term benchmark for the outstanding volume is to be SEK 70 billion (point 16).

For instruments with up to 12 years to maturity, the maturity (the duration[5]) is to be between 2.9 and 3.9 years (point 15). This mean that the steering interval is extended by 0.3 years from 2.6–3.6 years. The reason for the change is that the cost advantage of short-term borrowing remains small. As in the current year, the extension of the maturity will be attained by making less use of swaps. At present, interest rate swaps are used to actively shorten the maturity of this debt. In the guideline decision for 2016 the mid-point of the steering interval was extended by 0.25 years. At the same time the interval was widened from 0.5 to 1.0 years. Last year's guideline decision stated that an extension of maturity should take place in small steps since a substantial extension could lead to a disturbance of the balance between supply and demand in a way that would make long-term interest rates rise. As was the case last year the extension is to take place by reducing the use of interest rate swaps. By extending its maturity, the cost of the nominal krona debt will vary less, meaning that the risk will decrease. The decision to further extend maturity is based on the analytical work done by the Debt Office regarding term premiums and is in accordance with the Debt Office's proposal.

Historically the yield curve has generally had a positive slope, which means that long interest rates have been higher than short interest rates. One explanation of this is that market participants expect, on average, that interest rates will rise (the expectations hypothesis). Another explanation is that market players want compensation for binding money if it turns out that they are wrong or if they want to reinvest the funds in another asset before the bond matures (term premium). It is difficult to measure how much of the difference between long and short interest rates consists of expectations of higher interest rates and of term premiums respectively, as neither component can be observed separately. The term premium

[4] The exposure is to be calculated in a way that excludes changes in the SEK exchange rate.

[5] Duration is calculated as the weighted average of the period until each cashflow (coupons and final payments) where the weights are determined by the market value of each cashflow.

can be estimated by estimating expectations of future interest rates and then deducting them from the actual difference in interest rates for different maturities. The analysis shows that term premiums have fallen over time and are currently judged to be close to zero. Even if a rise in term premiums cannot be ruled out in the coming years, the assessment made is that the reasons for short-term borrowing have weakened, so the maturity is extended. Several factors contribute to the fall in term premiums. These factors include less uncertainty as the inflation target has gained credibility, an expansive monetary policy that has involved purchases of government bonds, greater requirements for matching of the long-term commitments of insurance companies and a higher share of floating interest rates for mortgage borrowers. But future requirements concerning the long-term financing of banks are a factor that may affect the term premium in years to come.

Foreign currency debt
The maturity interval for the foreign currency debt is to be 0–1 years, which is unchanged compared with the present interval. The governance of the foreign currency debt was changed in the guidelines for 2016, when the previous point value (0.125 years) was replaced by an interval of 0–1 years. The maturity of the foreign currency debt is much shorter than the maturity of the two other kinds of debt. This short interest rate refixing period is deemed to be appropriate in terms of cost and risk. The reason is that the foreign currency debt is spread across several currencies and that its share is lower than that of the other types of debt. Access to a broad and deep derivatives market also makes it possible in practice to achieve a short interest rate refixing period for this type of debt.

Inflation-linked krona debt
The maturity interval for the inflation-linked krona debt is to be 6–9 years, which is unchanged compared with the present interval. Inflation-linked bonds reduce the risk in the central government debt since they help to increase the diversification of the debt portfolio. By issuing inflation-linked bonds, the Debt Office also reaches a broader investor base. In situations when the borrowing requirement is large, inflation-linked bonds can reduce pressure on the market for nominal bonds.

3.4 Clarification that positions can be used to reduce risk and unchanged mandate in the Swedish krona exchange rate

This year's guideline decision for position-taking makes a clarification that broadens the meaning of the term position (point 30). The nominal mandate for positions in the krona exchange rate remains unchanged (point 32).

The Debt Office has taken positions since 1992. The guidelines state that the Debt Office may take positions in foreign currency and in the krona exchange rate, but not in Swedish interest rates. Positions are taken through over- and under-exposure to interest rates and currencies that are included or could be included in the central government debt. The Government steers risk exposure in position-taking activities by deciding in the guidelines on two different mandates (point 31 and point 32).

In the evaluation of central government borrowing and debt management in 2011–2015 (Govt. comm. 2015/16:104) the Government concludes that position-taking activities have contributed to reducing the costs of the central government debt by SEK 28 billion since they started. The communication also concludes that position-taking activities have not taken risks in excess of those contained in the mandates assigned. The result of position-taking activities is reported separately but is part of the central government debt.

Clarification of the term position
The clarification in point 30 is shown in italics below. "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 while taking account of cost,* and that are not motivated by underlying borrowing or investment requirements." This amendment is made so as to clearly state that the Debt Office's positions can also be used to reduce the risks in the central government debt, in addition to reducing the cost of the central government debt. Since they started, position activities have been wholly focused on reducing the cost of the

central government debt. However, in recent years positions have also been used to actively reduce the variation in the cost of the central government debt, i.e. the risk. The Government considers that it can be appropriate to make active use of position activities in order to reduce the cost of the central government debt.

Unchanged mandate in the Swedish krona exchange rate

The mandate for positions in the krona exchange rate is left unchanged at SEK 7.5 billion. In its proposed guidelines the Debt Office proposes increasing the mandate to SEK 20 billion. The present mandate makes it possible to temporarily stop foreign currency amortisation for a period of four and a half months if the Debt Office considers that this is justified by the krona exchange rate. The Debt Office's proposal to increase the amortisation mandate to SEK 20 billion would make a temporary amortisation stop of up to one year possible on the basis of the present amortisation rate.

The objective of central government debt policy, which is laid down in the Budget Act, states that the cost of the central government debt shall be minimised in the long-term while taking risk in its management into account. The wording of the objective also states that the management of the debt shall be conducted within the framework of monetary policy requirements. The reason why the Debt Office's proposal is rejected is that the Government makes the assessment that an increased mandate could risk coming into conflict with the monetary policy being pursued. The Riksbank's opinion on the Debt Office's proposed guidelines states that the Executive Board of the Riksbank has communicated that it is ready to intervene in the currency market if too rapid a strengthening of the krona risks threatening the rise in inflation towards the target. In its opinion the Riksbank writes that an expanded mandate for the Debt Office, with the possibility of taking positions for a stronger krona, might come into conflict with the monetary policy being pursued and generate a lack of clarity and unnecessary uncertainty in financial markets about the price formation of the Swedish krona (see section 2.4)

Since 2015 the foreign currency debt is being steered so as to gradually reduce foreign currency exposure in the next few years. The guidelines (point 12) state that the annual rate of decrease is limited by a ceiling of SEK 30 billion. The explanatory text to the decision states that the reduction is planned to be SEK 20 billion per year. The decision in the guidelines for 2015 to reduce the foreign currency debt was taken after several years of analytical work. This analytical work resulted in the conclusion that there is not sufficient evidence to show that foreign currency exposure results in lower expected costs. It was concluded at the same time that the foreign currency risk can be reduced without the expected cost increasing.

Analysis of whether position activities can be expected to contribute in the future to reducing costs and risks for the central government debt as a whole

The government communication on the evaluation of central government borrowing and debt management in 2011–2015 concludes that the quantitative target that position activities are to contribute to reducing the cost of the central government debt has not been achieved in the past five-year period. In aggregate, position activities showed a deficit of SEK 42 million in the five-year period.

In the light of the weak result from position activities in 2011–2015 the Government commissioned the Debt Office to analyse whether position activities can be expected to contribute in the future to reducing costs and risks for the central government debt as a whole. This results of this commission were reported in the Debt Office's proposed guidelines 2017 (reg. no Fi2016/03458/FPM) and in a separate report (reg. no Fi2016/01559/FPM). The Debt Office's analysis states that the agency is better able than many other market participants to act in a long-term and sustainable manner. This means that the Debt Office is able to take positions in situations that other market actors also identify but that few are able to make use of. The Debt Office's conclusion is that there are good possibilities for its position activities to also be able to contribute to reducing costs and risks for the central government debt in the future. The Government shares this view.

Position activities contribute to an increase in the Debt Office's activity in financial markets. The greater market focus resulting from its position activities strengthens the Debt Office's analytical capacity and business intelligence work, as well as its operational capacity to handle complicated derivative transactions, for example. The increased operational skills resulting from position activities also provide better preparedness to handle difficult market situations and unforeseen events A higher market presence also leads to the Debt Office being able to get better prices for transactions in the rest of its borrowing operations. The importance of this last point will increase when the Debt Office takes over the currency exchange transactions of government agencies from spring 2017.[6]

The commission to the Debt Office to analyse the future possibilities for position activities to contribute to reducing costs for and risks in the central government debt as a whole also included describing any changes in its internal ongoing position activities intended to improve their results. The evaluation communication stated that internal ongoing position activities had shown an aggregate negative result of SEK -367 million for the past five years, at the same time as external ongoing management had shown an aggregate positive result of SEK 74 million in the same period. A large part of this difference in results arose in autumn 2014 when all positions were closed and losses realised. The reason for this closure was that the framework for the internal operations needed to be clarified and developed.

On 1 January 2015 a new framework for internal management was introduced. It included greater internal reporting and the setting up of an investment council. The council is a forum in which the managers responsible report how the Debt Office's macroeconomic analysis is converted into positions and what the relationship between risk and expected return looks like for these positions. The new framework also means that the level of risk was reduced. The notional portfolio size was reduced from SEK 164 to 64 billion and the daily VaR mandate from SEK 180 to 70 billion. This corresponds to a reduction from SEK 2.9 to 1.1 billion measured as annual VaR. In addition, a loss limitation mechanism was introduced that gradually reduces the risk mandate if losses of more than SEK 125 million arise. If the losses rise despite the reduced risk mandate, the mandate is reduced even more and ultimately prevents risk taking. The way the mechanism works is that the largest possible loss over a rolling twelve-month period is SEK 250 million.

In summer 2016 the Debt Office decided to remove the loss limitation mechanism for its internal ongoing management. The reason was that it had turned out to be very difficult in practice to combine the new loss limitation mechanism with the capacity to act in a long-term manner. To ensure that the risks would not increase it was decided at the same time to reduce the scale of these operations by reducing the risk mandate. The Debt Office's decision means that in the future its internal position activities will be conducted with a much lower risk than in the past. At the same time, the possibilities of making a profit again have been improved. The reduction of the risk mandate means that the Debt Office's internal ongoing management will be a smaller part of the aggregate ongoing management, since, in aggregate, the external management has an unchanged mandate. This results in the spread of risk in ongoing management being better. The use of external managers goes back to 1992 and is intended to provide better information for internal position-taking at the same time as the external managers' results are a natural benchmark for evaluation. Taken together, these changes in ongoing positon activities ought to lead to better possibilities for the position activities to also be able to contribute to reducing costs and risks for the central government debt in the future.

3.5 Extended target perspective for retail market borrowing but lottery bond borrowing should be limited for the time being

The Government's decision to extend the target perspective for retail market lending (point 33) makes it possible to retain lottery bond borrowing while waiting for this form of borrowing to be able to contribute to the

[6] At present currency exchange transactions for government agencies are carried out by banks with which the Debt Office has framework agreements regarding payment services. The new system will apply as of 1 April 2017.

objective of government debt policy again. In the meantime the outstanding stock of lottery bonds should be limited so as to keep the interest expense loss down.

The evaluation for 2011–2015 concluded that retail market borrowing for the whole period had contributed by reducing the cost of the central government debt by SEK 433 million. Lottery bonds accounted for SEK 441 million of this saving and National Debt Savings for SEK -8 million. Together the two forms of borrowing thus achieved the quantitative target that the cost of retail market borrowing is to be lower than the cost of equivalent borrowing in the institutional market. However, the evaluation concluded that the lottery bond loans raised in 2015 increased the cost of the central government debt by SEK 45 million. It also concluded that the low level of interest rates means that the earliest point when lottery bond borrowing can generate cost savings is 2018 (based on the Riksbank's repo rate forecast). Against this background the Government commissioned the Debt Office to analyse whether borrowing in lottery bonds is expected to be able to contribute to the objective of central government debt policy in the future.

The results of this commission were reported in the Debt Office's proposed guidelines for 2017 and in a separate report (reg. no Fi2016/01559/FPM). The report on the commission states that it will not be possible to issue lottery bonds at a lower interest rate than equivalent borrowing in the institutional market as long as government bond yields are negative or very low. Once interest rates rise, lottery bonds are expected to become profitable again. At present the interest rate on a five-year government bond is -0.5 per cent. If the rise in interest rates comes soon and is rapid and provided that it is possible to issue larger lottery bonds than at present, the losses will be limited. But if the negative interest rate continues for a long time, the losses can extend for several years into the future.

The extended target perspective is justified by the fact that the savings will probably come much further into the future than the five years that are normally used in evaluating the management of the central government debt. To limit the interest expense loss until this form of borrowing is judged to be profitable again, the Debt Office should consider not issuing lottery bonds. The reason is that the savings that lottery bonds can contribute in the longer term are uncertain and are based on being able to issue larger lottery bond loans than at present. There is also uncertainty about when in time the level of interest rates will be high enough to make this form of borrowing profitable.

3.6 Reference to new Act to meet the market's need of government securities

Since autumn 2008 the Debt Office had had the right to raise loans to meet the need for government securities if required on account of threats to the functioning of the financial market. This rule, the background to which is the strong demand that followed on the bankruptcy of Lehman Brothers in September 2008, was introduced to meet the great demand for government securities in order to thereby reduce the financial unrest.

Under point 35 of the present guidelines the investment of funds raised through such loans should be guided by principles set out in the Government Support to Credit Institutions Act (2008:814). This means, for instance, that the investments should be made in a way that avoids improper distortion of competition, that as much central government funding as possible should be recovered and that central government is compensated for its risk-taking.

The Government Support to Credit Institutions Act (2008:814) was repealed on 1 February 2016. These principles are now set out in the Preventive Government Support to Credit Institutions Act (2015:1017). The change means that the guidelines refer to the new Act.

Telephone +46 8 405 10 00, www.sweden.gov.se/finance

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