

How do market participants view the market for Swedish inflation-linked bonds?

The Swedish National Debt Office's objective for central government debt management and borrowing is to minimise the cost of the debt over the long term while taking account of risk. Accordingly, we continually analyse market conditions for government bonds. The purpose of the questions in this survey is to gain a better understanding of how market participants view the inflation-linked bond market in light of recent developments, as well as to give primary dealers and investors the opportunity to provide their points of view in regard to long-term demand. We will use the responses in our analysis of how to best achieve our objective.

The Debt Office encourages primary dealers and investors to e-mail their written responses to fragor.realobligationer@riksdagen.se by 31 March 2023. A summary of the responses received will be presented in the report *Central Government Borrowing – Forecast and Analysis 2023:2*, which is scheduled for publication in May.

Questions

1. How would you characterise current overall demand for inflation-linked bonds?
 - What trends have you noticed over the past few years?
 - How do you expect demand to evolve in the future?
2. How would you compare the pricing of inflation-linked bonds with that of nominal bonds? Do you think that the spread between nominal and inflation-linked yields accurately reflects market inflation expectations? If not, what is the reason for the discrepancy?
3. Is there sufficient inflation-linked bond issuance to meet your institution's needs?
4. Over the longer term, in which maturity interval (s) do you see an interest in inflation-linked bonds?
5. What is your primary reason for holding inflation-linked bonds? Are there other reasons? If so, what are they?
6. Have you changed your share of inflation-linked bonds? If so, what is the primary reason for this? If you have reduced the share, what would

be required for you to increase your allocation again? Are there other reasons? If so, what are they?

7. If hedging against inflation is not the primary reason why you hold inflation-linked bonds, do you consider inflation-linked bonds to contribute to diversification in the portfolio?
8. Are there other assets that you hold for similar purposes as those of inflation-linked bonds? If so, what are these assets and what is their relative importance in your portfolio compared with inflation-linked bonds?

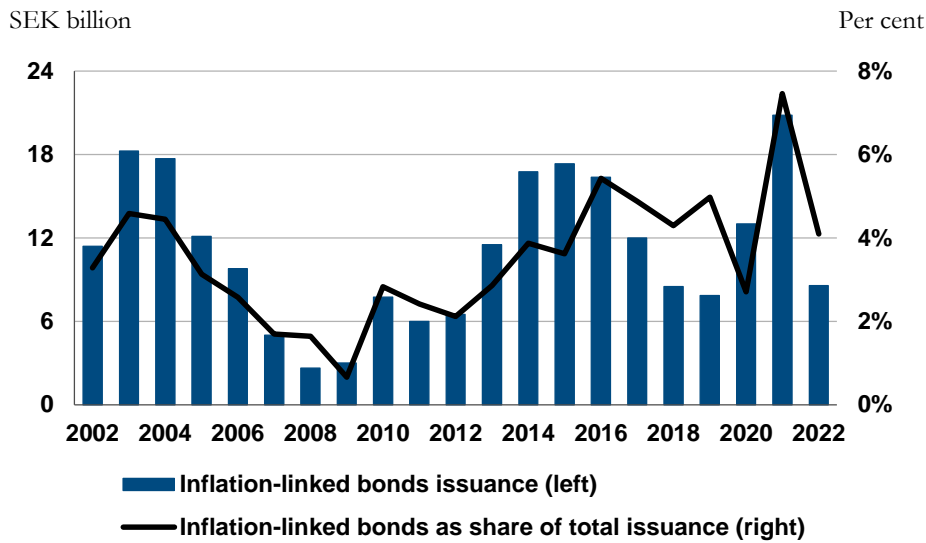
Background

The Debt Office introduced inflation-linked bonds in 1994 for several reasons. The instrument was expected to lower the cost of the central government debt, because investors would be willing to pay a premium for insurance against inflationary shocks. Inflation-linked bonds would also contribute to increasing the diversification of the central government debt in terms of both lower cost variation and a broader investor base.

The Debt Office's issuance of inflation-linked bonds has varied over time (see Figure 1). However, according to the guidelines for central government debt management, the share of inflation-linked krona debt is to be 20 per cent of the central government debt over the long term.

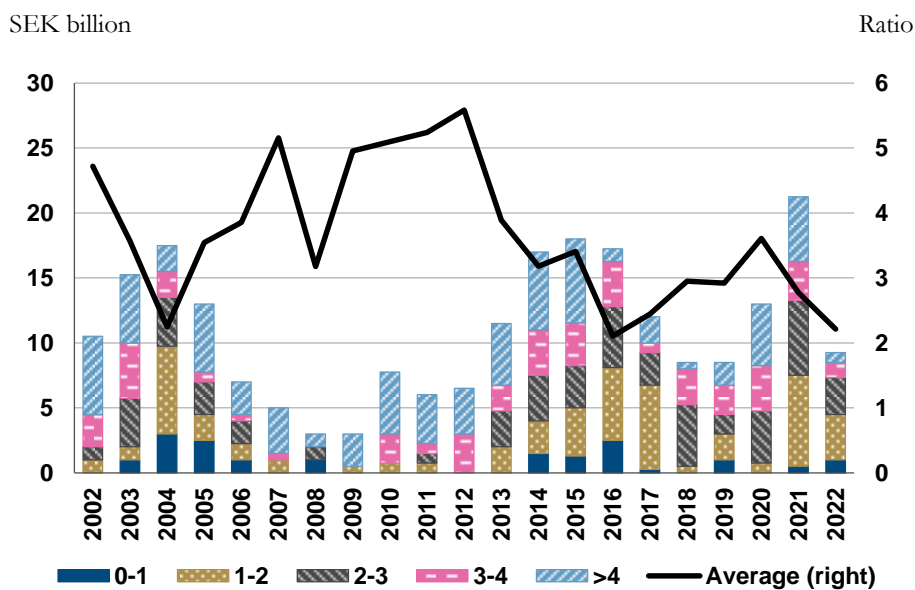
During the past year, demand for inflation-linked bonds in the Debt Office's auctions has varied. Figure 2 shows that the average bid-to-cover ratio in the auctions dropped. On a few occasions the auctions were under-subscribed. In the results of the Debt Office's annual survey in 2022, the biggest decline in ratings was noted for the market-maintaining facility connected to switches of inflation-linked bonds. In the secondary market, turnover has decreased (see Figure 3). Yields have varied periodically; in 2022 it became more expensive to trade, as can be seen from Figures 4 and 5.

Figure 1 Issuance varies over time



Source: The Debt Office.

Figure 2 Average bid-to-cover ratio in the auctions has dropped

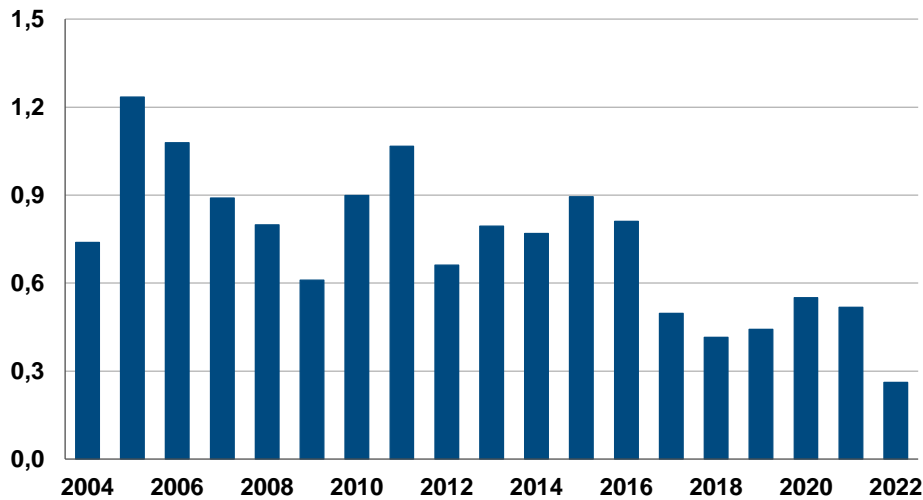


Note: The bars show the sum of the maximum volume offered in the auctions with a ratio between bid volume and maximum-offered volume within each interval. The line shows the annual weighted bid-to-cover ratio. Switches and buyouts are not included. For the weighting, the maximum volume of each issue is used in relation to the total maximum volume offered for each year.

Source: The Debt Office.

Figure 3 Turnover in the secondary market has decreased

SEK billion

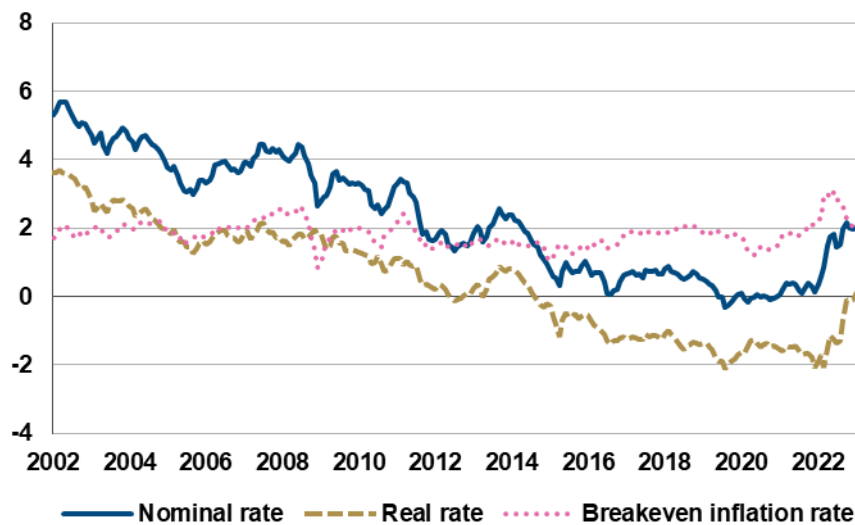


Note: Average daily turnover for inflation-linked bonds.

Source: The Debt Office.

Figure 4 Breakeven inflation, nominal and inflation-linked government bond rates

Percentage points

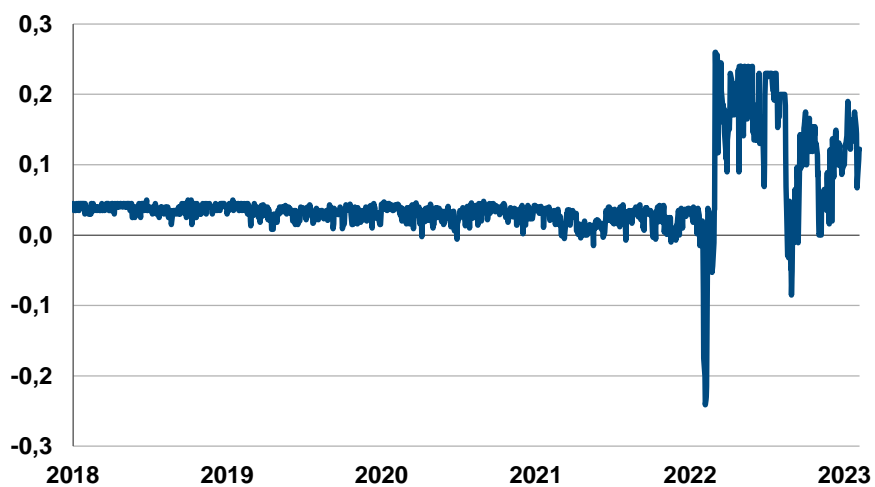


Note: Monthly average of ten-year interest rate for nominal and inflation-linked government bonds. The ten-year interest rate is calculated by linear interpolation of the quoted interest rate for the nearest bonds at any given time. Breakeven inflation rate is the difference between nominal and real interest rates. It indicates how high inflation must be on average during the maturity for the cost of an inflation-linked and a nominal loan to be the same. If inflation is higher than breakeven inflation, the loan becomes more expensive for the central government and vice versa.

Sources: Refinitiv and the Debt Office's own calculations.

Figure 5 Large bid-offer spreads over the past year

Percentage points



Note: Best bid-offer spread from the Debt Office's primary dealers for inflation-linked bond 3111 due in 2032.

Source: Bloomberg.