

Debt Office Commentary

Long-term conditions for debt management

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Central government debt serves an important purpose in the public economy in a number of ways. While it is difficult to discuss an optimal size for the debt, both a level far too low and high can pose challenges. For debt management, there are many reasons to analyse the conditions in the long term. For example, because major changes sometimes do not become visible until further ahead in time, but also to see what types of strategy choices can follow from these changes. This commentary therefore considers three scenarios for the progression and management of the debt until 2034, given the current fiscal policy framework and the Debt Office's guidelines and strategy.

The size of central government debt is governed by the fiscal policy framework. This is the most important reason for the declining debt trend over the past 25 years, and has been a strong reason for the historically low cost level for the debt in recent years. If the debt measured in SEK were to continue falling, it will be increasingly difficult for debt management to maintain good and, above all, diversified borrowing preparedness. Given a challenging initial position, there is a risk that this will be difficult even if the historical trend is broken and the debt were to rise in future instead.

All in all, the three scenarios and the analysis indicate that the challenge for debt management in the coming years will largely concern striking the balance between diversification and concentration of borrowing instruments in the management strategy that best safeguards good borrowing preparedness.

¹ The opinions expressed in this Debt Office Commentary are those of the authors and should not be taken to be the Debt Office's view in these matters. The authors would like to thank Erika Färnstrand Damsgaard, Klas Granlund, Anna Olofsson and Linda Wik for their valuable input.

The role of central government debt in the public economy and the importance of its size

Central government debt is important from a public-economy angle, serving as a shock absorber, airbag and lubricant alike.

The debt acts as a *shock absorber* when central government expenditure and income vary with the state of the economy. The debt can parry these fluctuations by expanding or contracting, thus funding surpluses and deficits. The option of continuously adjusting tax rates would lead to efficiency losses, for instance because it would make it more difficult for businesses and households to plan.² The debt can also act as an *airbag* in the event of a crisis. A lower debt makes it easier to manage the impact on public finances that a crisis can have, as there is relatively ample scope to increase the debt without this causing problems. A third and final function is that debt acts as a *lubricant* in the financial system. Government securities are an important asset class for banks, pension managers, insurance companies and other entities, both as part of longer-term holdings but also as collateral in various transactions and as part of liquidity buffers. Besides, the interest rate on government securities is considered a risk-free benchmark on which the pricing of many other financial instruments is based.

The size of central government debt depends on the country's economic history, not least on the occurrence of wars and financial crises, but also on aspects such as past demographic trends. The debt also reflects trade-offs between various long-term economic policy objectives, such as the distribution of welfare between generations, the efficiency of the public economy and the sustainability of fiscal policy. While it is difficult to establish an optimal level for the debt, one that is both far too low and high can pose different types of challenges.

When is central government debt too high and what is the problem?

High central government debt can cause problems in the public economy as there is a risk of it functioning poorly both as a shock absorber and airbag. There is a risk that high debt will lead to lower growth and higher interest rates, and also it will be more difficult and expensive to manage a financial crisis.

The question of whether high debt has negative effects on growth and interest rates gained impetus after the 2008 financial crisis amid rapidly rising debt levels in many countries.³ All in all, neither theoretical nor empirical research provides an unequivocal answer to the question of how high debt should be. However, there are findings indicating that there may be a limit above which the level of debt weighs on the economy by leading to lower growth and higher interest rates. Although

² See, for example, Andersson (2016) for a detailed review of the role of central government debt in the economy and the importance of its size, from both a theoretical and empirical perspective.

³ The literature generally refers to the debt of the public sector as a whole and not just that of the central government.

there is uncertainty about the findings, the studies point to a possible threshold for adverse effects on growth when debt exceeds 80–100 per cent of GDP, while the threshold for adverse effects on the interest rate is somewhat lower.⁴

In terms of the debt's function as an airbag in, for example, financial crises, the discussion is often based on these possible and approximate threshold levels. Past experience suggests that in the event of a crisis, the debt almost doubles on average.⁵ A rough calculation indicates that, in that case, the initial debt should not be higher than around half of the estimated threshold value to thus provide scope for managing an average crisis and the sizeable and sudden increase in debt that may ensue.⁶ In this context, it should be emphasised that Sweden is currently very far from any of the thresholds mentioned above.

Excessively low debt can pose challenges

Although relatively low central government debt makes a good airbag, it can impair the debt's ability to act as an effective lubricant in the financial system. The potential negative effects of low debt on the public economy mainly emerge through the functioning and liquidity of the bond market, including through the impact on government securities' function as safe assets.⁷

Market liquidity is a term that is difficult to define unequivocally, although usually it typically refers to how easily and quickly a desired volume can be bought and sold at around the expected price. From an investor's perspective, it is for example negative if only small lots can be sold, if it takes a long time or if it is hard to know what price will actually be obtained when the holding is sold.

A state of worsened liquidity can cause investors to reduce their holdings over time, or withdraw from the market altogether. Moreover, if the situation persists or worsens, there is a risk of this turning into a self-perpetuating negative spiral, with poorer market liquidity leading to less and less activity among ever-dwindling investor numbers, in turn impairing market liquidity further. This could ultimately also lead to a deterioration in funding liquidity, thus making it more difficult for financial institutions to raise funding at a reasonable cost.⁸ This is partly because it may be more difficult to issue instruments on the primary market, and partly because it may become more difficult to raise funding by borrowing money collateralised by bonds on the repo market.⁹ Such a turn of events could ultimately

⁴ See, for example, Andersson (2016) for a review of the literature.

⁵ See Reinhart and Rogoff (2009) for a compilation and calculation of how much historical crises have cost.

⁶ See, for example, Andersson and Jonung (2016) and a box-contained article in the Debt Office (2016) for this type of argument. Waldenström (2022) has a similar discussion.

⁷ See, for example, Habib, Stracca and Venditti (2020) for this asset class' function and Angeletos, Collard and Dellas (2016) for how it can affect optimal debt size.

⁸ See, for example, Brunnermeier and Pedersen (2007) and Bonthron et al. (2016) and Crosta and Zhang (2020) for a more detailed description of market and funding liquidity and the links to financial stability.

⁹ Technically, it is not a matter of a loan but a repurchase agreement, hence the name repo (short for repurchase). Borrowing money through repos forms part of many participants'

threaten financial stability. An example is the developments in the UK in the autumn of 2022, when the Bank of England was forced to take measures at short notice as the worsened functioning of the market posed a serious risk to financial stability.¹⁰ However, situations of considerably worsened liquidity are fairly uncommon.¹¹

Both the Federal Reserve and the International Monetary Fund have, both previously and more recently, highlighted the risks that a deterioration in market liquidity could pose to financial stability.¹² More academically geared analyses of the matter are often based on the link to some kind of crisis situation, most recently studies analysing the worsened liquidity observed in several countries in connection with the outbreak of the pandemic.¹³

From a Swedish perspective, there are challenges in this context. A summary in the Financial Stability Council's (2023) report illuminates a number of important aspects concerning possible factors behind the deterioration of recent years. Both existing statistical sources as well as accounts given by investors indicate that there has been a decline over a number of years in both individual participants' holdings and trading volumes, and in the number of participants that still own Swedish government securities.

All in all, it is difficult to pinpoint an optimal level of debt and, from a practical debt management perspective, it is not clear-cut whether such a figure would be of any tangible benefit. However, it is important to emphasise that, from a public-economy angle, there are challenges presented by both excessively low or high debt, and that these affect the public economy in different ways. However, it also affects the ability to conduct effective debt management in line with the objective of long-term cost minimisation while taking account of risk.

Good reasons for debt management to look further ahead

In the effort to manage central government debt, there are numerous reasons for analysing central government debt over a longer horizon. A *first* reason is that debt management is long-term by nature, which means that the debt management guidelines are designed to achieve the objective of minimising the cost of the debt as a whole in the long term. A *second* and closely related reason is that a shorter horizon can sometimes make it difficult to capture important but slow changes in the economy and financial markets, which may need to be considered in the debt management strategy and the trade-off between low cost and various risks. A *third*

normal strategies, although it can also be driven by a need to free up liquid funds in the event of a crisis.

¹⁰ See the Bank of England (2022).

¹¹ In an international overview of a number of financial markets, the situation on bond markets in 2022 clearly stands out compared to the previous ten years. See, for example, Figure 1.17 in Chapter 1 of the IMF (2022).

¹² See Federal Reserve (2022) and IMF (2015 and 2022).

¹³ See, for example, Vissing-Jørgensen (2021) and Barone et al. (2022).

reason is that it helps to improve transparency and predictability. The longer horizon enables illustrating, for example, how different future sizes of central government debt could be addressed within debt management, given current guidelines and management strategy.

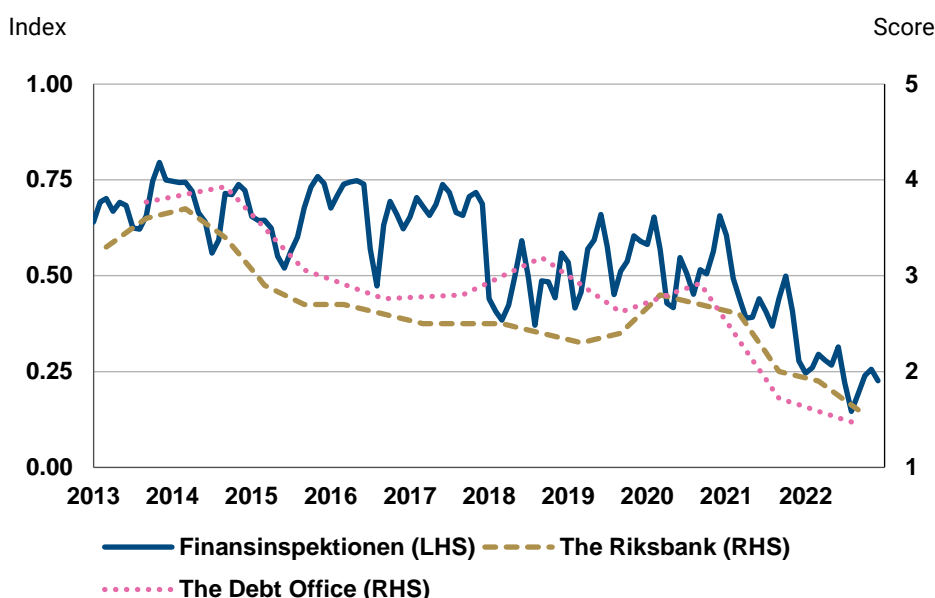
Initial position of low debt and poor liquidity

The starting point for the analysis of long-term conditions features two trends – that market liquidity for nominal government bonds has been deteriorating pretty much continuously for around ten years, and also that central government debt has fluctuated around a weakly declining trend for around 25 years.

Gradual worsening of markets’ functioning over the past ten years

The overall picture that three different measures portray of the progression of market liquidity is unequivocal. There has been a clear and essentially continuous deterioration over the past ten years. Both Finansinspektionen’s quantitative measure based on market data and the Riksbank’s and the Debt Office’s qualitative measures based on survey responses produce the same picture, see Figure 1. The latter measure can also be interpreted in terms of normative ratings and in the last two years market liquidity has been ‘Unsatisfactory’ by a margin (rating lower than 3).

Figure 1 Market liquidity for nominal government bonds over the past ten years, using three different measures



Note: The Riksbank’s qualitative survey is converted into a condensed quantitative measure, based on a ranking of the response options from 1 (worst) to 5 (highest).

Source: Finansinspektionen, the Riksbank and the Debt Office.

For debt management, a poorer-functioning market is negative for several reasons. It risks causing a higher liquidity premium, which leads to a higher management

cost. At worst, it can also mean that a market for one or several instruments will eventually function so poorly that it can no longer be considered that the market contributes to good borrowing preparedness. That is, demand is so low that it is not possible to borrow large amounts in a short space of time at a reasonable cost using the instrument concerned.

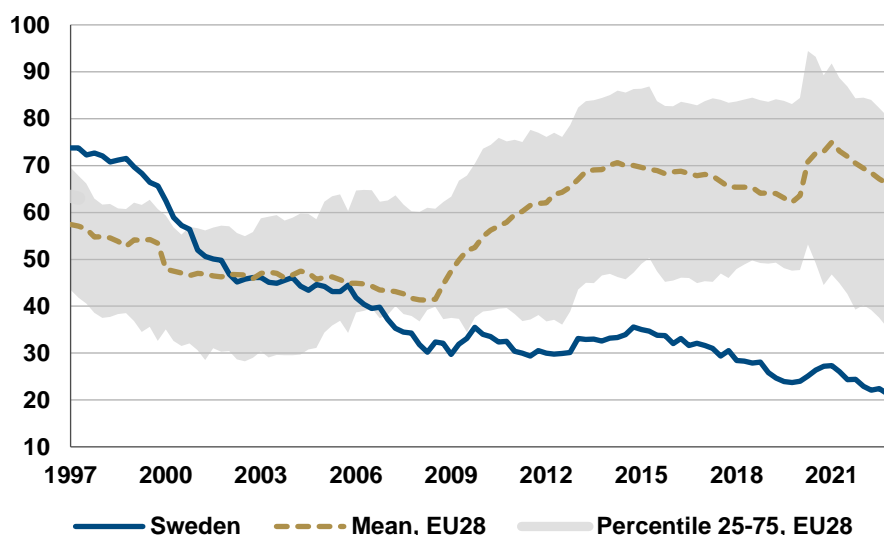
The size of central government debt is governed by the fiscal policy framework

The design of the fiscal policy framework is the most important reason for why central government debt has been on a declining trend for about 25 years. The current surplus target of one-third of a per cent of GDP is defined on the basis of consolidated public sector net lending which, besides the central government, includes the municipal and regional sector as well as the old-age pension system. The framework contains among other things a debt anchor – which is a target value, i.e. benchmark – of 35 per cent of GDP that applies to the entire public sector's consolidated gross debt.

The central government is the sector that has to adapt in order for the surplus target to be met, since the old-age pension system can be described as autonomous, and since municipalities and regions are subject to a balance requirement. In 2000–2021 central government net lending was just shy of 0.4 per cent of GDP on average, while it was around 0.1 for the old-age pension system and -0.2 for municipalities and regions. For the public sector as a whole, this meant average net lending of around 0.3 per cent of GDP.

Figure 2 Central government debt as a share of GDP, Sweden and the EU 28

Per cent of GDP



Source: Eurostat.

At the same time as debt in SEK has followed a weakly declining trend, debt as a share of GDP has fallen rapidly. From being one of the countries in the EU with high

central government debt around 25 years ago, Sweden is today one of the countries with the lowest debt, well below the average, see Figure 2.

There is no clear-cut appropriate debt measure to describe the conditions for central government debt management. In a number of debt management contexts, debt is best described in SEK, for example in the borrowing plan presented by the Debt Office in the Central Government Borrowing report three times a year. There, the forecast horizon is about two years. If instead the horizon is extended, as in the scenarios below, it might instead be relevant to relate to price developments or the size of the economy. An example of such an aspect is that part of demand for government securities comes from the desire, or regulatory obligation, of financial institutions to hold liquidity buffers, for which government securities are often used. As the economy and the financial sector grow, this demand will therefore increase in SEK.

Scenarios for the progression of central government debt

The purpose of the scenarios is to illustrate how different progressions of central government debt can affect long-term debt management conditions.¹⁴ The progression of central government debt is, as previously determined, largely governed by the old-age pension system as well as municipalities and regions, given the framework design. Besides an extrapolation of the historical trend, two supplementary scenarios are therefore based on assumptions from other agencies regarding the progression in these two sectors. Also, the scenarios are based on an additional number of simplifying assumptions and are thus illustrations, not forecasts.¹⁵ The end point of the scenarios, 2034, is chosen in light of it being ten years beyond the Debt Office's normal forecast horizon in the report Central government borrowing – forecast and analysis. The scenarios thus commence after 2024, to which the Debt Office's forecast from May this year extends.¹⁶

Scenario '*Trend*' means that the progression that started in connection with the introduction of the fiscal policy framework continues, see Figure 3.¹⁷ If the trend for 1997–2023 persists, debt will be approximately SEK 1,100 billion in 2034. If in turn GDP were to develop in line with the National Institute of Economic Research's

¹⁴ A similar approach is found in several previous editions of Proposed guidelines for central government debt management, but with a somewhat shorter horizon. See, for example, the Debt Office (2007).

¹⁵ In order to calculate a possible level of debt in 2034, a number of assumptions are made about several elements of both the progression of the economy and that of public finances, as well as assumptions such as the budget balance being equal to net lending. In order to emphasise that the scenarios are merely illustrative and approximate, the endpoints have been rounded to the nearest hundred billion.

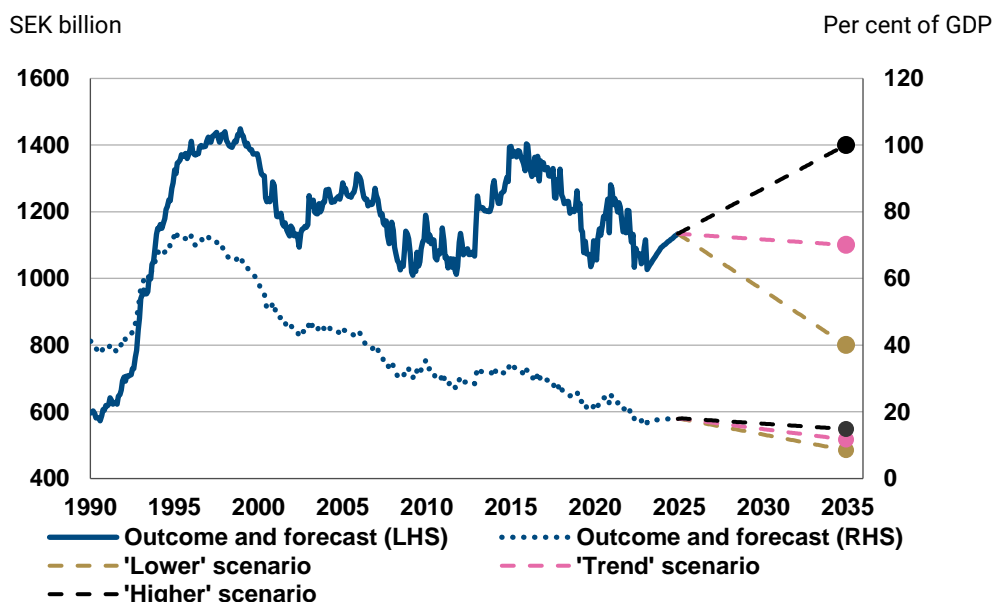
¹⁶ See the Debt Office (2023b).

¹⁷ The framework was introduced in stages and the starting point here is set at the middle of the introduction period.

latest long-term scenarios, this would mean central government debt just shy of 12 per cent of GDP.¹⁸

Scenario 'Lower' means that the debt will fall faster than in the 'Trend' scenario and is approximately SEK 800 billion in 2034. This would for example be consistent with a situation in which municipalities and regions incur larger deficits than they have done historically, more or less in line with, for example, the Swedish National Financial Management Authority's forecast from December 2022.¹⁹ If, at the same time, the old-age pension system progresses in line with historical patterns, this would mean the central government having to incur a larger surplus going forward, and thus clearly declining debt. Debt in 2034 would, in that case, equal just over 8 per cent of GDP.

Figure 3 Three scenarios for central government debt, in SEK and as a percentage of GDP



Note: The forecast for 2023 and 2024 is from the Central Government Borrowing report 2023:2.

Source: The Debt Office.

Scenario 'Higher' instead means that debt increases, reaching around SEK 1,400 billion in 2034. Such a progression could be driven, for example, by the old-age pension system gradually generating a growing surplus, more or less in line with, for example, the National Institute of Economic Research's scenario in its Swedish Economy report of December 2022.²⁰ Should the progression for municipalities and regions at the same time be in line with historical patterns, this would in turn mean the central government potentially incurring a deficit, leading to an increase

¹⁸ See the National Institute of Economic Research (2023).

¹⁹ See the Swedish National Financial Management Authority (2022).

²⁰ See the National Institute of Economic Research (2022).

in central government debt over time.²¹ In that case, debt would then represent just under 15 per cent of GDP in 2034. This scenario, *'Higher'*, thus derives its name from the progression of debt in SEK relative to the *'Trend'* scenario, but would, measured as a share of GDP, lead to debt that is *lower* than today's level.

Reduced volumes if debt continues to fall

The scenarios could be addressed in different ways, but to illustrate the conditions for debt management as clearly and simply as possible, the rationale below is based on current guidelines and borrowing strategy. This means that the share of inflation-linked bonds shall be 20 per cent and that nominal bonds are prioritised in the breakdown between different borrowing instruments in 0 below. As the size of central government debt differs between the scenarios, so too does the scope for the volume of nominal bonds. The outstanding stock of nominal bonds has, on average, made up just over 50 per cent of total central government debt over the past 20 years. These conditions are reflected in each scenario.

It should be emphasised that the distribution in the table below is hypothetical and aims to illustrate what different debt trends could entail in the long run. However, in order to strike a good balance between low cost and various risks, it is likely that new decisions would affect the distribution between instruments in one or several of the scenarios. For example, good borrowing preparedness requires sufficiently well-functioning markets, including a certain outstanding volume of the instruments concerned. For well-diversified borrowing preparedness, a number of borrowing instruments are needed.²²

Distribution between the instruments

In the *'Lower'* scenario, there is an assumption corresponding to five outstanding loans in nominal bonds of SEK 60 billion each, equalling issuance of a new 10-year loan every other year.²³ Adding to this stock of SEK 300 billion are current loans maturing beyond 2034 totalling SEK 70 billion. Increased by inflation of 2 per cent, this equals SEK 451 billion (or 4.8 per cent of GDP).²⁴

²¹ The matter of a potential future change to the surplus target, for example into a balance target, could also be modelled in a similar way. A lower surplus in the public sector leads to a lower central government budget balance, given unchanged assumptions for the old-age pension system and municipalities and regions.

²² See, for example, SOU 2014:8 (2014) for a long-term analysis discussing which borrowing instruments might perceptibly be discontinued if central government debt falls to an excessively low level.

²³ A loan size of SEK 60 billion is close to the last five years' average size (66) for loans with a maturity of up to 10 years, and is also in line with what the "Hessius report" (see SOU 2014:8, 2014) considered to be the level needed to "provide satisfactory liquidity". An even earlier estimate for a lower limit of SEK 40–50 billion can be found in the Debt Office (2008). However, it is not obvious which volume measure best reflects the relationship with market liquidity over longer horizons; another option is to measure loan volume as a share of GDP.

²⁴ The inflation-linked increase can be understood as the relevant size of the loans (see previous footnote) being assumed to grow at the rate of price increases in the economy, in that the financial system also grows as a consequence of this. This is relevant given this longer horizon, although in the shorter term this type of effect probably matters less.

In the *'Trend'* scenario, the pace of issuance of new loans increases, from every 24 months in the *'Lower'* scenario to every 18 months, equalling 7.5 outstanding loans.²⁵ This causes the total stock of nominal bonds to increase from SEK 451 billion to SEK 643 billion in 2034 (6.7 per cent of GDP).

In the *'Higher'* scenario there is an assumption corresponding to an even higher new issuance rate for nominal bonds of every 12 months, equalling ten outstanding loans of SEK 60 billion each, in addition to the loans with longer maturities. This totals 817 billion, corresponding to 8.7 per cent of GDP.

In today's monetary value, the outstanding stock of nominal bonds equals SEK 370, 520 and 670 billion in each respective scenario. Increased by inflation of 2 per cent, that will amount to SEK 451, 634 and 817 billion, respectively or 4.8, 6.7 and 8.7 per cent of GDP (see the top rows in the table 1).

Loans in foreign currency in the three scenarios correspond to SEK 20, 40 and 60 billion, respectively, in today's monetary value which, at two per cent inflation, will be SEK 24, 49 and 73 billion, respectively.²⁶ In all three scenarios, the stock of treasury bills is assumed to be equal to the average of the last 10 years, increased by inflation of 2 per cent (SEK 110 billion). Liquidity management is treated as a residual item, which causes its size in the *'Lower'* scenario to be less than half of the average of the past 10 years (approximately SEK 125 billion).

Table 1 Distribution between debt instruments in the central government debt scenarios

SEK billion

| | 2023 | 2024 | ... | 2034 | | |
|----------------------------------|------|------|-----|----------------|----------------|-----------------|
| | | | | <i>'Lower'</i> | <i>'Trend'</i> | <i>'Higher'</i> |
| Nominal bonds | 535 | 594 | ... | 451 | 634 | 817 |
| <i>as a percentage of GDP</i> | 8.8 | 9.5 | | 4.8 | 6.7 | 8.7 |
| Inflation-linked bonds | 238 | 249 | ... | 160 | 220 | 280 |
| Green bonds | 20 | 20 | ... | 0 | 0 | 0 |
| Bonds in foreign currency | 21 | 21 | ... | 24 | 49 | 73 |
| Treasury bills | 135 | 148 | ... | 110 | 110 | 110 |
| Liquidity management instruments | 123 | 89 | ... | 55 | 88 | 120 |
| Debt | 1071 | 1119 | ... | 800 | 1100 | 1400 |

Note: Forecast for 2023 and 2024 from the Central government borrowing report 2023:2. Central government debt including onward lending and assets under management. The amount refers to outstanding stock at the end of the year.

Source: The Debt Office.

²⁵ This can be understood as there being seven loans that have reached full size (60) and one that was issued more recently and which is half the size (30).

²⁶ Loans in foreign currency are a flexible form of borrowing that the Debt Office can use, for example, to meet sudden borrowing needs. Part of good borrowing preparedness can thus involve issuing such loans to maintain a presence on the international capital markets.

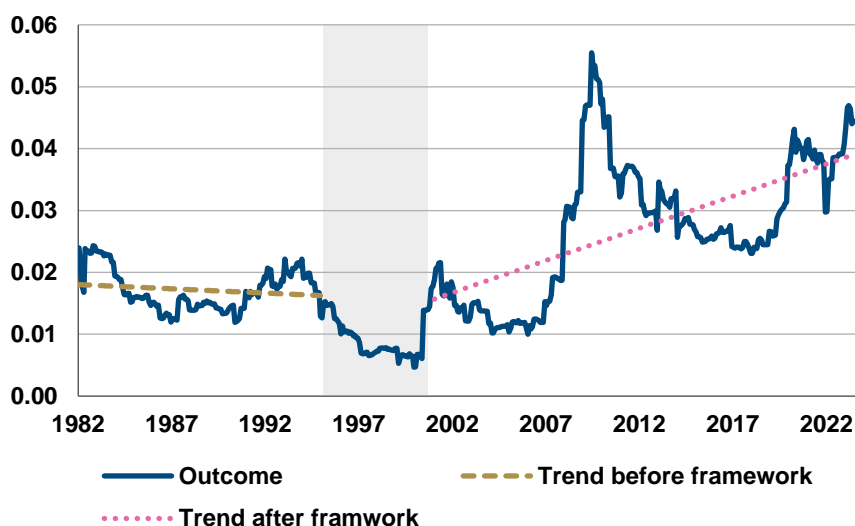
Under the assumption that each outstanding nominal loan with a maturity of up to 10 years equals SEK 60 billion in today’s monetary value, the issuance rate in the three scenarios can thus correspond to one new loan every 24th, 18th and 12th month, respectively.

Heightened uncertainty, altered investment behaviour and other factors

Besides the aspects addressed above, there are numerous additional factors that can affect debt management conditions in the longer term. A first factor is that uncertainty concerning liquidity management in debt management has increased in recent decades. This effect emerges because central government debt has slowly decreased while at the same time the economy has grown. Consequently, cyclical fluctuations in the budget balance have become larger in relative terms. For example, the variation in the past year is about three times greater than it was 20 years ago, see Figure 4. These developments may lead to a heightened need for a greater volume of short-term securities, as the borrowing strategy is based on dealing with changes in the borrowing need using shorter-term borrowings in the first instance. All else equal, an increased volume of treasury bills would cause a decrease in the volume of nominal bonds in all three of the above scenarios.

Figure 4 The variation in the net borrowing requirement as a share of central government debt, and the trend before and after the introduction of the fiscal policy framework

12-month rolling standard deviation



Note: The shaded area denotes the period of introduction in stages of the fiscal policy framework (1995–2000).

Source: The Debt Office.

A second factor concerns potential changes in investor behaviour. For several years, bond markets have been clearly affected by an increased focus among investors on ESG bonds – bonds that are somehow linked to Environmental, Social and Governance issues. To date, this has made its mark on the Swedish

government securities market in the form of the Debt Office's issuance of a green bond in 2020. Looking ahead, it is possible that this or other changes in investor behaviour might necessitate adjusting the choice of instruments used in debt management.

A third factor concerns how monetary policy will relate to quantitative easing – purchasing bonds aimed at attempting to reduce long market rates. Even if there is a correlation, it is difficult to say exactly what effect a decrease in the tradable volume has on, for example, the functioning of the market.²⁷

Another factor is that the Swedish government securities market has contracted considerably in recent decades compared with other countries, see Figure 2. This has meant that Sweden's share in international bond indices has shrunk drastically, which affects demand from global index funds, for example. An illustration of this is that the Swedish share in JP Morgan's Global Bond Index has fallen from just over 2 per cent in the mid-1990s to just below 0.15 percent today.

Increasingly challenging to have good borrowing preparedness

The management strategy is affected in many ways by both the initial position and the potential progression illustrated in the scenarios. Besides, there are also potential effects from the other factors discussed in the previous section. Increasingly poorer-functioning markets and falling debt mean that all three scenarios present challenges to debt management to varying degrees.

The progression of debt affects the importance of different risks in its management

The Debt Office designs the management strategy so as to fulfil the objective in the Budget Act of minimising the long-term cost of the debt while taking the risk associated with management into account. A substantial part of the cost depends, however, on the size of the debt and the general interest-rate level, rather than management. Falling debt and low interest rates have brought the cost to its lowest levels in modern times in recent years, measured as a share of GDP, see Figure 5. Such low costs also mean that the management's overriding measure of risk – cost variation – diminishes in significance in relative terms. Rather, focus turns not least to funding risk and borrowing preparedness.

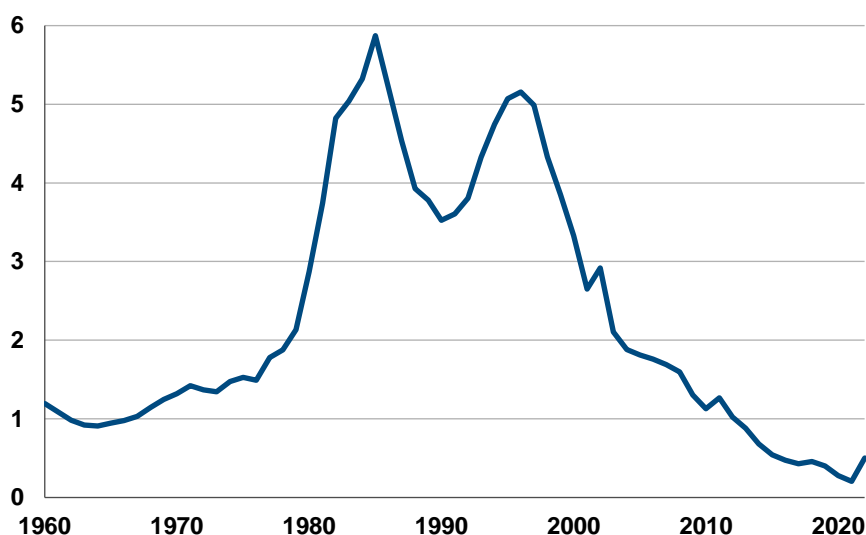
Put simply, good borrowing preparedness means access to a number of borrowing instruments with different characteristics and well-functioning markets. This is the case irrespective of whether it is a matter of the more ongoing, day-to-day debt management, or preparedness for – and the costs associated with – borrowing in the face of a crisis. The Debt Office's ability to borrow large amounts in a very short

²⁷ There are effects that can cause both an improvement and a deterioration, although studies indicate that the adverse effects outweigh (see Blix Grimaldi, Crosta and Zhang, 2021), as does a simple illustration of covariance over the past 10 years (see the Debt Office, 2023c).

space of time is a special kind of preparedness and an aspect that is analysed annually.²⁸ What is meant here is instead the borrowing preparedness that includes the ability to deal with, as cost-effectively as possible, a sharp and persistent rise in debt.²⁹ This preparedness can become more difficult to maintain if the debt shrinks too much. A challenge posed to management when the debt is small is that the supply of individual borrowing instruments can be so low that liquidity and the functioning of the market are impaired. This can lead to rising borrowing costs, for example, due to surging liquidity premiums and to it becoming more expensive than it would have been if markets were to have been better functioning. Shifting the emphasis of the strategy from diversification to concentration could counteract such developments.³⁰ However, regardless of the choice of management strategy, there are risks associated with the progression in the different scenarios.

Figure 5 General government interest payments as a share of GDP

Per cent



Source: OECD Economic Outlook and the Debt Office

Risks if the debt decreases

As the debt declines to increasingly lower levels in SEK, the risk of increasingly poorer liquidity in the secondary market rises. There are different factors that can act in the opposite direction both in the shorter and longer term, such as the Riksbank's ongoing tapering of government bonds. However, it is far from certain that this will be of sufficient help, especially if the total debt continues to decrease. If the management increases the concentration of borrowing instruments, supply

²⁸ See, for example, the latest version of Central government guarantees and lending – A risk analysis, the Debt Office (2023a) and its chapter on liquidity risks.

²⁹ See, for example, the Debt Office (2011) for an analysis of preparedness in the light of crises.

³⁰ This question was analysed in several consecutive editions of "Proposed guidelines for central government debt management" with the Debt Office (2011) as the end point, which was in turn followed by the Swedish Government Official Report that investigated the matter (SOU 2014:8, 2014).

in remaining instruments could increase, although such a change could also be both partly and fully counteracted if total debt falls. In such a situation, there is a risk that, despite the concentration, there will be no improvement in the functioning of the market, while at the same time the cost variation increases.

Risks if the debt increases

Also in a scenario of higher debt, there is a risk that the market will not start to function better, at least not for a number of years. Many of the factors highlighted as possible explanations for the deterioration of market liquidity are slow-acting.³¹ Should the future progression of these factors instead underpin liquidity, it is therefore nevertheless far from certain that there will be any tangible improvement on a horizon of a couple of years. The same can also be said for the effects of the size of the debt. With a management strategy involving heightened concentration of borrowing instruments, a future sharp increase in debt – as a trend or due to a crisis – might need to be addressed using fewer instruments in poorly functioning markets. This could bring about a considerable increase in cost due to the combination of a sharply rising debt, and poorly-functioning markets that makes it more expensive than otherwise to issue the volumes required.

The next few years will be marked by the balance between diversification and concentration.

Over a number of years, developments have brought debt management closer and closer to a crossroads – diversification or concentration of borrowing instruments. With ever-worsening functioning of markets and a falling central government debt, the question is how to best uphold borrowing preparedness. Is it better to have more instruments to choose from even if each market functions worse, or are fewer instruments with hopefully better functioning markets preferable?

The three debt progression scenarios and the analysis that follows illustrate that, even if the long-term progression of central government debt were to break with historical patterns and instead increase as a trend, the choice between diversification and concentration is likely to be central to debt management in the coming years.

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³¹ See the Financial Stability Council (2023) for a review of possible factors.

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The Swedish National Debt Office is the central government financial manager and the national resolution and deposit insurance authority. The Debt Office thus plays an important role in the Swedish economy as well as in the financial market.



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