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1 Summary

The Government's decision on the guidelines for central government debt management has a multiyear perspective aimed at developing a central government debt policy that is predictable and long term in nature. This year's guidelines decision covers 2007 to 2009, but the guidelines for 2008 and 2009 should be considered preliminary.

In 2007 a new control system and a new method of calculating the composition of the central government debt will be introduced. To control the debt's composition, the Government sets a target for the debt percentage for each type of debt and a control interval around the foreign currency percentage. The new method of measuring percentages, *the debt's aggregate cash flows (CCF)*, provides a better picture of the central government debt's total risk exposure. With the new measure the composition of the debt changes. The inflation-linked percentage rises to almost 25 per cent and the foreign currency percentage falls to just over 20 per cent. The control system will be introduced at the beginning of 2007 but it will not apply to the foreign currency debt, which will be controlled by the traditional amortisation amount until further notice.

The foreign currency debt will be amortised by SEK 40 billion a year from 2007 to 2009, with the aim of bringing the foreign currency percentage close to its target within a reasonable time horizon. Thus the amortisation rate will be SEK 15 billion higher in 2007 than in 2006. The Debt Office may deviate from this benchmark by SEK ±15 billion.

The percentage targets in the debt have been set at 15 per cent for the foreign currency debt and 25 per cent for the inflation-linked debt. This is about the same as they are now, once the shift to the new CCF measure is taken into account. The Debt Office is to establish a deviation interval around the benchmark for inflation-linked debt.

A new control system for the Debt Office's active position-taking will be introduced in 2007. The risk mandate, which amounts to SEK 600 million in terms of daily Value-at-Risk, in principle covers all the Debt Office's positions. To make the dividing line between the basis for financing the central government debt and position-taking clear, the Government will no longer allow the Debt Office to take positions in the Swedish fixed income market.

The coverage of the maturity measure will be expanded to apply to the entire central government debt, i.e., it will now also cover the inflation-linked debt. The debt’s comprehensive maturity will be shortened from the current 5.0 years to the benchmark 4.7 years by the end of 2007. The aim for 2008 and 2009 is that the maturity will continue to decline at the same pace that outstanding inflation-linked loans approach maturity. The maturity for the nominal krona debt should remain at its current level.

Other decisions found in the guidelines are:

- In addition to inflation-linked krona and foreign currency borrowing, central government financing needs are to be met by nominal krona loans.
- The Debt Office shall promote the proper functioning of the market for government securities by market and debt support. This must not entail setting aside the goal of long-term cost minimisation.
- The Debt Office shall contribute to lowering the cost of central government debt by retail market borrowing.
- The Debt Office is being instructed to review the analysis and the assessments that form the basis of the

current targets for the foreign currency and inflation linked debt percentages.

2 Introduction

In 1998 the Riksdag (Swedish Parliament) decided objectives and a decision-making structure for central government debt policy (Government Bill 1997/98:154, bet. 1997/98:FiU29, Riksdag Comm. 1997/98:253). Section 5 of the statute (1988:1387) on central government borrowing and debt management stipulates that a general goal of central government debt management is to minimise the cost of the debt in the long term while taking the inherent risk into consideration. In addition, the debt is to be managed within the constraints imposed by monetary policy.

The Riksdag's 1998 decision means that the Government is to decide on guidelines for the Debt Office's management of the central government debt by no later than 15 November every year. The decision is made after the Debt Office has presented its proposed guidelines and the Riksbank (the Swedish Central Bank) has been given the opportunity to comment.

The Debt Office submitted its proposed guidelines on 27 September 2006 and the Riksbank's comments (Fi2006/4488) were received 16 October 2006. Their comments are reported in section 4.1 Foreign Currency Debt.

Upon completion of each year of debt management, the Government presents an evaluation of central government borrowing and debt management to the Riksdag no later than April 25. The report contains an evaluation of the Government's guidelines as well as an evaluation of the decisions taken by the Board of the Debt Office and the Debt Office's operational activities.

3 The Basis for the Government's Decision on the Guidelines

3.1 The Composition of the Debt

The general goal of central government debt policy is to minimise the long-term cost of the debt while taking the risk into consideration. Thus the decision on the guidelines for debt management is an expression of the central government's view of the balance between expected total costs and the total risk that the central government is willing to assume. Three types of debt are used in borrowing for the central government debt.

- Nominal loans in Swedish kronor;
- Inflation-linked loans in Swedish kronor;
- Nominal loans in foreign currency.

The debt's characteristics are determined primarily by how the debt is distributed between the three types of debt and what maturity is chosen for each type. The debt's distribution and maturity, along with its size, decide the expected total cost and risk of managing it.

At the end of 2005, the central government debt[1] came to SEK 1 309 billion – an increase of SEK 32 billion compared with the figure at the end of 2004 – or 49 per cent of GDP. The Government's decision on the guidelines refers to all debt instruments issued by the Debt Office, i.e., even those held by

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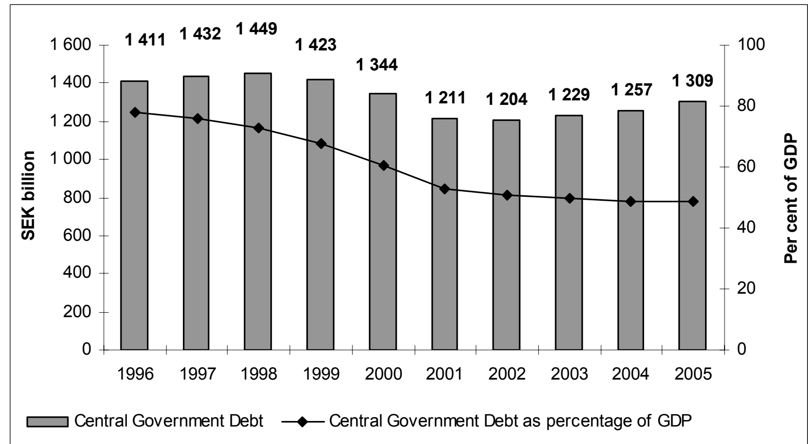
[1] Refers to the unconsolidated central government debt, i.e., the official debt that the Debt Office manages and reports. The Budget Bill and the central government's annual report generally show a consolidated debt measure that excludes the holding of government securities by government agencies.

other central government agencies. The debt measure is called the unconsolidated central government debt and is used in calculating the size of the debt.

Diagram 1: Unconsolidated Central Government Debt, 1996-2005 (SEK billions and per cent of GDP).



Source: The Debt Office and Ministry of Finance.

Nominal loans are the central government's most important financing instrument. At the end of 2005, they made up 61 per cent of the debt stock. Most of the nominal borrowing is in treasury bonds (loans having a maturity of more than one year at the time of issue). Almost all the borrowing in the private market consists of nominal loans. Private market loans enable the Debt Office to diversify borrowing to include more lenders such as private persons, smaller companies and organisations. Private market borrowing includes lottery bonds and National Debt Savings Accounts.

Table 1: Composition of the Central Government Debt 2002–2005 and as of 31 October 2006 [SEK billions and per cent].

	2002	2003	2004	2005	2006
Nominal loans, SEK bn.	671	726	766	798	729
Nominal loans, per cent	*56 %*	*59 %*	*61 %*	*61 %*	*60%*
Inflation-linked loans, SEK bn.	158	173	190	208	*215*
Inflation-linked loans, per cent	*13 %*	*14 %*	*15 %*	*16 %*	*17%*
Foreign currency loans, incl. debt management, SEK bn.	375	330	301	303	*278*
Foreign currency loans, per cent	*31 %*	*27 %*	*24 %*	*23 %*	*23%*
Unconsolidated central government debt, SEK bn.	1 204	1 229	1 257	1 309	1 222

Source: The Debt Office
Note: Foreign currency debt, including the Debt Office's foreign currency swaps and forward contracts, is revalued at exchange rates at year end.

Inflation-linked loans fulfil an important function in the central government debt portfolio since they make it possible to diversify the debt. Hence the total risk in the debt can be reduced. The share of inflation-linked bonds has steadily grown since they were first issued in 1994. At the end of 2005, they constituted about 16 per cent of the central government debt.

The third type of debt is the foreign currency debt. At the end of 2001 the foreign currency debt came to almost 35 per cent of the central government debt, but in recent years its share has fallen sharply. At the end of 2005 the foreign currency debt was 23 per cent of the debt's value. The stronger krona and recent years' amortisations of the foreign currency debt explain the reduced share of foreign currency debt.

A new measure for calculating the debt percentages is being introduced in this year's guidelines. It is comprised of the debt's aggregate cash flow, i.e., not only the amount of the debt outstanding, but also coupon payments and inflation

compensation. Called the central government debt's aggregated cash flows (CCF), the measure is based on the same principles as the current measure, the average interest rate refixing period (IRR). As the bases for calculating the change in debt percentages, the measured size and relationship between the percentages will change compared with the outcome when the unconsolidated central government debt measure is used. A calculation made 31 July 2006 shows that the changes will be relatively large. The percentage of inflation-linked debt will increase by 7 percentage points to almost 25 per cent. The foreign currency percentage will fall by three percentage points to just over 20 per cent as a result of the new calculation measure.

3.2 The Basis for This Year's Decision on the Guidelines

The Basis for the Government's Decision As in previous years, this year's decision on the guidelines has a three-year perspective and refers to the years 2007 to 2009. The guidelines for 2008 and 2009 are preliminary and may, in future, be changed.

The calculation of the percentages used for controlling the composition of the debt is to be based on a measure that takes into account all the cash flows of the debt, i.e., also future coupon payments and compensation for expected inflation.

The Government exercises control of debt management by specifying benchmarks for the percentage of foreign currency and inflation-linked debt and a control interval for the foreign currency debt. The new control system will come into effect at the beginning of 2007 with the exception of control of the foreign currency debt, which will be introduced at a later date.

3.2.1 The Analysis Leading to This Year's Guidelines Proposal

In last year's guidelines decision, the Debt Office was asked to analyse how the control system for percentage control and a comprehensive maturity measure covering all types of debt in the central government debt could be designed and made operational. In this year's guidelines proposals, the Debt Office therefore presented three innovations: a new control system and a new measure for calculating the various debt percentages (see below), a maturity measure that includes the inflation-linked debt (see section 4.4) and a new control system for the Debt Office's active position-taking (section 4.5).

A New Control System for Debt Percentages

The Debt Office is proposing a new system for percentage control in which the Government specifies the benchmark for each of the different types of debt. The Debt Office is then to set a fixed interval around the specified benchmarks for the foreign currency debt and inflation-linked debt, with the intervals proposed having different functions depending on the different characteristics of the types of debt.

The inflation-linked debt percentage is difficult to micromanage and thus the deviation interval around the benchmark for the inflation-linked debt is warranted. In its operations, the Debt Office will try to control the inflation-linked percentage vis-à-vis the benchmark specified by the Government but the percentage will in practice vary within the interval, owing in part to the coupon payments, maturities and unforeseen changes in the borrowing requirement. Preliminary estimates indicate that a deviation interval of 2 to 3 percentage points is reasonable to manage the fluctuations in the inflation-linked debt percentage.

For the foreign currency debt, a control interval around the benchmark has been proposed instead, since it is not considered suitable to micromanage the foreign currency percentage even though it is possible to do so with the help of derivatives. The Swedish krona is assumed to vary over time around a long-term, relatively stable average ('mean reversion'). Too strict a control might lead to the Debt Office systematically making bad deals, i.e., selling kronor when the Swedish krona is weak and buying kronor when it is strong. The foreign currency percentage is therefore to be permitted to fluctuate within the control interval owing to exchange rate changes. However, in the event of other types of deviations, for example, owing to loans falling due, coupon payments and changes in the borrowing requirement, measures to adjust the foreign currency percentage are to be taken. If the currency percentage exceeds the control interval, the percentage is gradually to be brought back to the interval limit by changes in the borrowing plans (at present three times a year).

The proposed percentage control system has led to the Debt Office's recommendation of a new measure for calculating the debt percentages: the *central government debt's aggregated cash flows (CCF)*. The measure takes into account the total contracted cash flows of all types of debt by including future coupon payments and inflation compensation in addition to the nominal amount payable at maturity. The proposal would mean a change in the currency percentages. The greatest impact will be on the inflation-linked debt percentage, which will rise almost 7 percentage points while the percentage of foreign currency debt will fall about 2 percentage points compared with results obtained with the current method of calculation (see the table below). This is due partly to the inflation-linked debt's long time to maturity and many outstanding coupons and partly to the inclusion of the future inflation compensation in the calculation. The percentage of inflation-linked debt increases to almost 25 per cent (per 31 July 2006). The foreign currency percentage declines to just over 20 per cent.

Table 2: Type of Debt as a Percentage of Total Debt, Measured As CCF, for the Unconsolidated Debt Measure

	Nominal debt	Inflation-linked debt	Foreign currency debt
2006-07-31	54.9 % (58.9)	24.6 % (17.9)	20.5 % (23.2)
2005-12-31	56.9 % (61.0)	22.5 % (15.9)	20.7 % (23.2)
2004-12-31	56.9 % (61.0)	21.7 % (15.1)	21.4 % (23.9)
2003-12-31	55.0 % (59.2)	20.8 % (13.9)	24.2 % (26.9)

A direct recalculation of the current benchmarks with the same proportions that were in effect on 31 July 2006 gives 13 per cent for the foreign currency debt and 27 per cent for the inflation-linked debt. With rounding to the nearest multiple of five, the benchmarks proposed by the Debt Office are 25 per cent for the inflation-linked debt and 15 per cent for the foreign currency debt. Thus the benchmark for the nominal debt becomes 60 per cent.

The new control system for the inflation-linked debt is proposed to come into force on 1 January 2007. It is proposed that the current control system for the foreign currency debt be kept until further notice since the currency percentage (20 per cent) is still some distance from the long-term target (15 per cent). It would thus be difficult to include the foreign currency debt in the new control system starting 1 January 2007.

In earlier guideline decisions the Government has discussed the possibilities of introducing a portfolio based control system but has then come to the conclusion that percentage control is difficult to combine with the cost minimisation target since there is a risk that amortisations would be obligatory at times when the krona is weak (and thus buying foreign currency is expensive) and vice versa. However it has been the view of the Government that percentage control seems to be a simpler and more straightforward control compared with current forms of

control. This view is also the reason for the instructions on percentage control given in the guidelines for the past two years.

It is the Government's view that the Debt Office has developed a well thought out and appropriate control system and that the new control principles are to apply as far as possible from the beginning of 2007. According to the Government the proposed new cash flow based debt measure makes it much easier to compare the types of debt and gives a better picture of the risk exposure in the central government debt. Thus it makes effective control of the composition of the debt easier. Another advantage is that the current maturity measure, the average interest rate refixing period, and the new cash flow based measure are based on the same principles. In this way, there is consistency in the calculation and control of the percentages and maturity. One disadvantage of the CCF measure is that it introduces a new definition of debt into debt management. However, the CCF measure is intended to be used in connection with control, while the official debt measure, unconsolidated central government debt, will henceforth also be used in the Debt Office's ongoing reporting of the central government debt.

As proposed by the Debt Office, the Government is to decide that the targets for the foreign currency and inflation-linked debt percentages will be 15 percent and 25 per cent respectively. This means some increase in the foreign currency percentage target and a decrease in the inflation-linked percentage when compared with the results of a purely mathematical recalculation of the debt percentages based on the new cash flow-based measure (13 per cent and 27 per cent respectively). However, this is acceptable, given that the accuracy of the original calculation of the percentages was assumed to be limited. The Government intends to instruct the Debt Office to review the analysis and the assessments that form the basis of the current targets for the foreign currency and inflation-linked debt percentages (see also section 6).

The Government shares the Debt Office's assessment that control of the foreign currency debt has to be deferred until the

foreign currency percentage is nearing its specified target. Combining a control interval with a gradually falling bench mark leads to major operational problems and ambiguities. The Government considers the new control system as most suitable for times when the foreign currency percentage has reached the desired long-term level. The most suitable way of steering the foreign currency debt towards its target is thus to apply the current control principle, amortising a nominal amount each year. Exactly when the foreign currency debt might be included in the new control system will be taken up in future guidelines decisions.

The Government intends until further notice to retain its decision-making authority over the control interval around the target for the foreign currency percentage. It will then be clear what fluctuations in the foreign currency percentage related to the krona's exchange rate the Government finds acceptable without corrective measures being taken. The situations in which the Debt Office can avoid making adjustments as a result of temporary fluctuations in the exchange rate and in which it will be expected to act will also be made clear. Thus the control system ensures the detection of major fluctuations and leads to counteracting measures to adjust the composition of the debt. The Debt Office is, however, to decide the deviation interval around the benchmark for the inflation-linked percentage. Deviations from the benchmark are more technical in character and thus it is inappropriate for the Government to fix the intervals. Too strict a control by the Government here could mean that the Debt Office would be compelled to undertake expensive adjustments that would conflict with the goal of debt management.

In the Debt Office's judgment, a control interval around the foreign currency benchmark of ±2 percentage points is reasonable.

3.2.2 Key Positions Taken in Previous Years' Guidelines

In earlier decisions on the guidelines, the Government has taken a position on a number of key issues with the aim of making clear the preconditions and principles on which central government debt policy is based. Time perspective and advance planning as well as cost and risk measures are some of the issues that have been addressed.

Time Perspective and Advance Planning in Central Government Debt Policy

Here the Government has in different connections emphasised that the focus should be on the long-term perspective and that the guidelines should therefore be drawn up with a longer and strategic time perspective. One reason is the general and long-term formulation of the overall goal of debt management. Another reason is that it takes time for the debt's characteristics, for example, its composition and maturity, to have any impact and thus they require good long-term planning. The Government has thus elected to establish a three-year perspective for the guidelines decision, primarily because it coincides with the time horizon that normally applies to expenditure ceilings in the central government budget and forecasts of the borrowing requirement, etc. are available. Therefore this year's decision on the guidelines covers the years 2007 to 2009. The decisions for 2008 and 2009 should be considered preliminary.

The Guidelines' strategic and long-term character means that they are drawn up as an expression of the central government's trade-off between expected cost and risk in central government debt management. This means that the decision will not normally be based on market trends for such matters as actual or forecast interest rate levels. Within the framework for debt management policy's overall goal and the Government's guidelines, the Debt Office instead has to tailor its operational

management to meet evolving market conditions. However, this does not preclude the Government during the current operational year from taking circumstances in the financial markets into account as happened in 2001 and 2002, when owing to a falling Swedish krona and for reasons of cost, there were reductions in the amortisation of the foreign currency debt. The same applies if the grounds for a decision on the guidelines are otherwise changed in a crucial way. However, changes to guideline decisions already taken must be warranted.

Cost and Risk Measures

The Government has earlier stated that cost should be measured as average running yield to maturity and risk as a variation in this. The cost is measured in nominal terms here.

The Government has also taken more of a real approach, inspired by methods based on ALM (Asset-Liability-Management), in which the main idea is that financial risks can be minimised by matching the characteristics of liabilities against those of assets on the balance sheet. In the implementation of central government debt policy, this means that the central government can reduce the risk in the debt portfolio by structuring a portfolio in which interest costs co-vary with the budget balance (excluding interest payments) and the debt's size. When government finances are strained (for example, due to a deep economic downturn), a debt portfolio that typically has low costs is thought to be less risky than one having high costs.

4 The Guidelines Decision for Central Government Debt Management in 2007

4.1 Foreign Currency Debt

The Government's decision: The foreign currency debt is to decrease in the long term to 15 per cent of the central government debt.

The benchmark for the amortisation of the foreign currency debt in 2007 is to be set at SEK 40 billion. The amortisation rate for 2008 and 2009 should remain unchanged at SEK 40 billion a year. The Debt Office may deviate from the specified amortisation rate by SEK ±15 billion.

The Debt Office's proposal: The proportion of foreign currency debt should be reduced in the long term to 15 per cent. The benchmark for the amortisation rate should be set at SEK 25 billion kronor during 2007. The benchmark for 2008 should remain unchanged. It should be possible to introduce a percentage-based control system in 2009. The Debt Office should be permitted to deviate from the specified amortisation rate by SEK ±15 billion.

The Riksbank's comments: The Riksbank considers the proposals presented by the Debt Office to be compatible with the constraints imposed by monetary policy. Future percentage control and the Debt Office's proposal to take away its ability to take positions in krona interest rates via derivatives are thought to reduce the uncertainty concerning the Debt Office's actions

in the foreign exchange market. Nevertheless, the Riksbank believes that reducing the deviation mandate specified for the foreign currency debt's amortisation rate would be justified. The mandate should primarily address deviations in the expected borrowing requirement.

Reasons for the Government's decision: Since the beginning of the 2000s, the Government has sought to reduce the foreign currency percentage and increase the inflation-linked percentage of the debt over the long term. The main reason for this is to better spread the risks in the debt. The long-term aim was defined in the 2005 guidelines with the establishment of the current target for the foreign currency percentage, 15 per cent. This percentage is considered to be a reasonable balance between the positive diversification characteristics and the exchange rate risk inherent in a large foreign currency debt.

In the Debt Office's opinion there are at present no new factors that would lead to any other conclusion in this year's guidelines decision. The Government shares this opinion, even when taking into account that the measure of the foreign currency percentage in the new cash-flow based measure (CCF) has in fact risen somewhat compared with the percentage estimated using the traditional unconsolidated debt measure. However, the Government considers it urgent to take a fresh look at the analyses and considerations underlying the current targets for the percentage of foreign currency and inflation-linked debt (see section 6). This is underlined by the Government's decision, reported in section 3, that the control system for the foreign currency debt is to be introduced when the foreign currency percentage is nearing its specified target.

Last year's decision on the guidelines specified a preliminary foreign currency amortisation of SEK 25 billion for 2007, which is also the Debt Office's proposal. However, the Government notes that there has been a marked change in conditions underlying public finances recently. Good economic growth in Sweden has led to an improved balance in the general government budget, mostly as a result of rising tax revenues.

Likewise expenditure reductions have contributed to a declining borrowing requirement. Revenues from sales amounting to SEK 50 billion annually announced in the Budget Bill for 2007 to 2009 are expected to further reduce the central government borrowing requirement noticeably during the forecast period. The deficit forecast in last year's budget bill is now expected to become a surplus of over SEK 60 billion for 2007 to 2009 (see the following table).

Table 3: Foreign Currency Debt, Central Government Borrowing Requirement, Unconsolidated Central Government Debt and TCW Index, 2004-2009 (SEK billions and per cent).

	2004	2005	2006	2007	2008	2009
Guidelines, net foreign currency borrowing, SEK bn.	-25	-25	-25	-40	-40	-40
Foreign currency debt, per cent	24	23	23[1]			
Central govt. borrowing require-ment, SEK bn.	50	-14	9	-63	-62	-90
Unconsolidated central govt. debt, SEK bn.	1 257	1 309	1 284	1 219	1 156	1 066
Unconsolidated central govt. debt Per cent of GDP	49	49	45	41	37	32
TCW; closing rates	122	127	126	123	122	122

Source: Ministry of Finance and the Debt Office.
[1] Per cent of total unconsolidated debt.

The Government believes that there is cause to consider an increase in the amortisation rate of the foreign currency debt, even though fiscal developments are now predicted to reduce the central government debt as a percentage of GDP and thereby the total risk that the debt represents in the central government

budget. The main reason is that despite an amortisation benchmark of SEK 25 billion a year since 2003, the foreign currency percentage has declined relatively slowly. Given the current amortisation rate and the fiscal developments forecast in the Budget Bill for 2007, there is a risk that the decline in the foreign currency percentage will continue at a slow pace. The Government should therefore take more decisive action in the next few years to reduce the foreign currency percentage relative to the specified target, primarily to reduce the risk in the central government debt, but also to enable the new control system for the debt's percentages to enter into force in its entirety within a reasonable time horizon.

One more argument is that the Government has earlier expressed the opinion that substantial changes in estimating the future borrowing requirement might lead to reconsideration of preliminarily decided benchmarks. Current fiscal prospects therefore warrant having the foreign currency debt bear some of the adjustment to an ongoing steep decline in the borrowing requirement by increasing its amortisation rate.

The Government therefore is fixing the amortisation of the foreign currency debt at SEK 40 billion in 2007. The aim for 2008 and 2009 is an amortisation of the same amount. According to estimates, the target for the foreign currency percentage will thus be met before 2010.

It is the Government's opinion that the Debt Office should continue to be allowed to deviate from this amortisation rate by SEK ±15 billion. The size of the interval is a reasonable trade-off between providing the Debt Office with significant flexibility and meeting the Government's need to exercise control. Deviations from the benchmark may be based on strategic assessments of trends in the krona's exchange rate, substantial changes in the central government borrowing requirement, smoothing the borrowing requirement over the years and major changes in the borrowing terms in the Swedish fixed income market.

The Riksbank's comments do not add any new factual arguments on using the deviation interval. The Government believes that the guidelines now in force, including the instruction to take the exchange rate into consideration, have worked well and consequently sees no reason to change how the interval is to be used.

4.2 Inflation-Linked Debt

The Government's decision: The percentage of inflation-linked debt is to be 25 per cent of the central government debt. The Debt Office is to establish a deviation interval around the percentage of inflation-linked debt.

The Debt Office's proposal: The benchmark for the percentage of inflation-linked loans in central government debt should be 25 per cent. The Debt Office should specify the operational deviation interval around this benchmark and guidelines for the operational control of the inflation-linked percentage.

Reasons for the Government's decision: The Debt Office is proposing that the Government specify a benchmark of 25 per cent for the proportion of inflation-linked loans. The Government believes this to be a reasonable benchmark from a cost and risk perspective. The Debt Office is to establish a deviation interval based on this benchmark. The inflation-linked percentage is to be allowed to vary within this interval for operational reasons. An interval is necessary since the Debt Office is only able to control inflation-linked debt approximately, even in the medium term. This is due to the fact that there are not any short inflation-linked loans or any sufficiently developed derivatives market for inflation-linked instruments. Issues and redemptions will therefore have a major impact on the inflation-linked percentage. The inflation-linked percentage will fall below the benchmark in connection with loans falling due, only gradually to increase with new sales at

auctions. In this way normal issue operations can be maintained and these operations facilitate liquidity in the market for inflation-linked bonds. The Debt Office has made a preliminary estimate of the deviation interval at ± 2–3 per cent around the benchmark for the inflation-linked debt.

In last year's decision on the guidelines, it was decided that the percentage of inflation-linked debt should increase to 20 per cent in the long term under the old calculation method. The new method of calculation means an increase in the measured inflation-linked percentage for technical reasons from 17.9 per cent to 24.6 per cent (as at 31 July 2006). A proportional change would give a benchmark of 27 per cent for the inflation-linked debt. With rounding to the nearest multiple of five, the benchmark for the inflation linked debt is 25 per cent. Thus the inflation linked percentage is now close to its benchmark.

4.3 Nominal Krona Debt

The Government's decision: In addition to inflation-linked krona and foreign currency borrowing, central government financing needs are to be met by nominal krona loans.

The target for the percentage of nominal krona debt is thus by definition 60 per cent of the central government debt.

The Debt Office's proposal: With guidelines specified for both inflation-linked borrowing and foreign currency borrowing, it follows by definition that the central government's financing requirements should otherwise be met by nominal krona borrowing.

Reasons for the Government's decision: The nominal krona borrowing is the central government's most important source of financing and represents 55 per cent of the central government debt. Given the guidelines specified for the foreign currency and inflation-linked debt, the rest of the borrowing requirement is met by nominal krona loans. The changes in the gross borrowing

requirement can be easily handled by the Debt Office's regular auctions of nominal bonds and treasury bills. The krona market thus serves as a buffer if there are fluctuations in the central government borrowing requirement or if plans for the other two types of debt change.

4.4 Maturity

The Government's decision: The Government establishes a benchmark for the debt as a whole and this benchmark is used to control the maturity of the central government debt. The Debt Office is to decide on benchmarks for the each individual type of debt and specify operational deviation intervals for them.

The benchmark for the comprehensive maturity of the central government debt is to be 4.7 years at the end of 2007. The aim for the 2008 and 2009 year-ends is to be 4.6 and 4.4 years respectively.

The Debt Office's proposal: The Debt Office proposes control of the maturity of the central government debt by means of a common maturity measure that includes the whole debt, i.e. including inflation-linked debt. The maturity in the different types of debt should be weighed together in a one-for-one relationship. The Debt Office is proposing that the calculations showing how the maturity is allocated between the types of debt be based on the percentage specified by the Government for each type of debt, rather than the actual percentages at each particular time. This is to avoid costly transactions as a consequence of variations in the debt's composition.

Otherwise the proposed control system will mostly function as it does today, i.e. the Government states a benchmark for the debt's maturity and instructs the Debt Office to decide how the maturity should be allocated to the three different types of debt and to state operational deviation intervals around the benchmark for each type of debt. In this way the Government is

able to control the expected costs and risks associated with the central government debt's maturity. At the same time, the real control of the debt's maturity takes place at the operational level since more micromanagement by the Government risks leading to transaction costs not in proportion to the advantages that might be achieved.

In the guidelines for 2006, the maturity benchmark specified for the nominal part of the debt was 3.1 years. The Debt Office allocated 3.5 years to the krona debt and 2.1 years to the foreign currency debt (see the following table). At the same time, the maturity, expressed in terms of the average interest rate refixing period, was 12.0 years in the inflation-linked debt and 5.0 years in the debt as a whole at the end of 2005.

Table 4: The Maturity Benchmarks, per Type of Debt & Total Debt, (IRR, year)

Year	Nominal krona debt	Foreign currency debt	Inflation-linked Debt	Total
2006	3.5	2.1	-	3.1
2007	3.5	0.125[1]	10.4	4.7
2008	3.5	0.125[1]	9.9	4.6
2009	3.5	0.125[1]	9.0	4.4

[1] 0.125 years corresponds to one and a half months' maturity.

It is the Debt Office's assessment, based on qualitative reasoning as well as model analyses, that there is scope for shortening the debt's maturity compared with current assumptions. The benchmark for the debt's comprehensive maturity should be 4.7 years by the end of 2007. The aim for 2008 and 2009 should be 4.6 and 4.4 years respectively. The reduction should be achieved through shortening the maturity in the foreign currency debt to maturities where the diversification effect of borrowing in various foreign currencies is greatest and the maturity of the inflation-linked debt should be permitted to fall at the same pace

that outstanding loans approach their maturity date. The maturity for the nominal krona debt should be retained unchanged, one reason being to ensure sufficient liquidity in the Swedish government securities market.

Reasons for the Government's decision: The maturity of the central government debt, along with the debt's composition, is the most important central government debt policy decision variable. The Government has looked for and in the guidelines for 2000 and 2005 found scope for shortening the maturity in the nominal part of the debt, mostly for cost reasons. The Swedish yield curve has typically been assumed to have a positive slope so that shortening the maturity leads over time to lower average costs for the central government debt.

The Government has also endeavoured to get a more comprehensive view of the debt's maturity with the aim of improving the balance between expected costs and risk in debt management. This is also the underlying reason that in 2005 and 2006 the Government instructed the Debt Office to specify in more detail how a comprehensive maturity measure that would cover all types of debt in the central government debt could be designed and made operational.

The Debt Office's proposal for a comprehensive control of the maturity is considered appropriate and each of its parts represents a reasonable balance between overall control and flexibility while aiming not to raise the cost of debt management unnecessarily. Retaining the current control system and debt measure (the average interest rate refixing period) is a positive move. The inflation-linked debt, control of which might be said to have been marginalised, can now be included and control of the comprehensive maturity can be made transparent. However, the Government wishes to get clarification of a few additional aspects of maturity control as specified in section 6.

The Government shares the view of the Debt Office that maturity, measured as the average interest rate refixing period, can be shortened without any appreciable rise in the debt's risk level. One reason is that large surpluses in the public finances are

expected in the next few years with a drastic drop in central government debt as a percentage of GDP, which means that the total risk level in the central government debt will fall. In addition the composition of the debt is now approaching the targets set for the inflation-linked and foreign currency debt percentages. From the point of view of risk, this means better balance and a lower risk level in the debt. The qualitative arguments are supported by the simulations reported by the Debt Office.

The Government considers the allocation of the maturity in the various types of debt to be reasonable and can endorse a decision that basically reflects the long-term aim of the Debt Office's preliminary report.

4.5 Position-Taking

The Government's decision: Active position-taking by the Debt Office is to be possible in order to lower the cost of the central government debt, while taking risk into account. Positions are to be taken with derivative instruments. The extent of the position-taking is limited by the Government's specification of a highest risk level, measured in terms of daily Value-at–Risk. The risk limitation is to include all of the Debt Office's positions except those that relate to the krona's exchange rates for other currencies.

The limitation on the Debt Office's position-taking is to be set at SEK 600 million, measured as daily Value-at-Risk at 95 per cent probability. The Board of the Debt Office is to decide how the risk mandate is to be divided between the strategic and operational levels.

The Debt Office's proposal: The Debt Office proposes that within certain specified limits, it be possible for it to lower the cost of the central government debt through active position-taking. The Debt Office proposes that the risk mandate for position-taking be stated in terms of the daily Value-at-Risk

(VaR) and include all types of positions except those that concern the krona's exchange rates in relation to other currencies. Position-taking is only to take place via derivatives and derivative positions are to be booked in a separate portfolio and their market value reported on an ongoing basis.

The risk mandate for the Debt Office's position-taking should be set at SEK 600 million, measured as daily Value-at-Risk at 95 per cent probability. The risk mandate should include all of the Debt Office's positions except those that relate to the krona's exchange rate for other currencies.

Reasons for the Government's decision: The Government considers the proposal in principle to be good and to provide a more explicit and comprehensive grasp of the Debt Office's risk taking than was previously possible. There is also an advantage in having a risk measure (VaR), which includes all types of interest-rate and foreign currency positions, both strategic and more tactical.

The Government also notes that the Debt Office's active position-taking aimed at reducing the central government's debt management costs has thus far been profitable. The most recent evaluation of the Debt Office's debt management (Comm. 2005/06:104) indicated operating results in the active management of more than SEK 1 billion for 2001 to 2005.

Over and above the results aspect, it is also of value that the Debt Office is active in the international capital market. These activities can be seen as a way to build skills and competence in the Debt Office, both directly and via the external managers, which the krona borrowing will also benefit from.

The new system for position-taking comes into force on 1 January 2007. The decisions concerning the amortisations of the foreign currency debt and the krona's exchange rate are not part of the risk mandate and are regulated by the usual amortisation mandate (see section 4.1).

The guidelines proposal also points out that the Debt Office's ability to take positions in the Swedish fixed income markets should be terminated for nominal and inflation-linked bonds as

well as positions in krona interest rates via derivatives. One reason is that the Debt Office with its dominant position in the fixed income market risks influencing price formation. The Debt Office wants to avoid causing concern among other market participants that it uses information about its own future conduct for active position-taking.

The Riksbank also supports the Debt Office on this matter. In the Riksbank's comments, it points out that removing the ability to take positions in krona interest rates via derivatives from the Debt Office should contribute to reduced uncertainty about the Debt Office's actions.

The Government has thus far given the National Debt Office the room to enable it to take strategic decisions based on its assessment of interest rate trends in the Swedish fixed income market. In light of the proposals for new control systems set out in this year's guidelines proposal, the advantages of a clear division between the Debt Office's core role to finance the central government debt (issuance activities) and pure position-taking are all the more apparent. To make the dividing line between the basis for financing the central government debt and position-taking clear, the Government will no longer allow the Debt Office to take positions in the Swedish fixed income market.

As to the size of the risk mandate, the Government's view is that it is essentially to correspond to the risk exposure that the Debt Office has thus far worked with. Thus the Debt Office should be given the scope to conduct active management at the operational level to the same extent as it has today, while its ability to take major strategic positions (such as the dollar-euro-position that was closed with good results in 2003) should be kept.

The Government presumes that the risk mandate is handled with the customary prudence and in about the same manner as it has been previously. It is also important that the Board, in accordance with the current instruction for the Debt Office,

ensures that clear internal guidelines control activities at both strategic and operational levels.

The risk mandate for position-taking is being set at SEK 600 million, measured as daily Value-at-Risk (VaR) at 95 per cent probability. VaR is a measure of market risk that is calculated based on historical data for correlation and volatility in the fixed income and foreign exchange markets. The mandate means that the Debt Office (given the VaR calculation) has the ability to take positions that with a 95 per cent probability will not lose more than SEK 600 million in value during one day if market trends are unfavourable. The probability of a loss of SEK 600 million or more is therefore 5 per cent.

4.6 Market and Debt Support

The Government's decision: The Debt Office shall promote the proper functioning of the market for government securities by market and debt support. This must not entail setting aside the goal of long-term cost minimisation.

The Debt Office's proposal: The Debt Office should contribute to improving the market's functioning by market and debt support. This must not entail setting aside the goal of long-term cost minimisation.

Reasons for the Government's decision: A well-functioning Swedish fixed income market is important for cost and risk in the Government debt. The Debt Office therefore has the task of improving how the market functions by market and debt support. However, this must not lead to setting aside the goal of keeping costs to a minimum in the long term.

The Debt Office contributes to market and debt support by such means as its regular issuances of nominal and inflation-linked government securities with different maturities. Other important factors are a transparent and predictable borrowing policy and concentrating the borrowing to a limited number of maturities. However, all debt and market maintenance must be

in line with the overall goal of central government debt policy. Hence market support must not lead in the long term to higher loan costs for central government borrowing and debt management.

At a strategic level, market and debt support deal chiefly with establishing principles for operational borrowing and management. The Debt Office's borrowing strategy and guiding concepts such as predictability, long-term perspective and transparency are among the important principles found here.

At the operational level, it concerns bond trading and purchasing, market support, repos, and so forth. As the Government usually notes in its annual evaluation, it is often difficult to quantify precisely what effect the Debt Office's principles and measures have. Therefore the evaluation is primarily of a qualitative nature.

4.7 Borrowing in the Private Market

The Government's decision: The Debt Office is to contribute to reducing the costs of central government debt by retail market borrowing.

The Debt Office's proposal: The Debt Office is to contribute to reducing the costs of central government debt by retail market borrowing.

Reasons for the Government's decision: Retail market borrowing is to achieve the greatest possible cost savings in relation to the Debt Office's alternative forms of borrowing in the capital market. The Debt Office borrows in the retail market primarily for reasons of cost. The borrowing could otherwise just as well be conducted as institutional borrowing.

The objective of private market borrowing was formulated earlier in the Debt Office's appropriation directive, but beginning in 2007 it is being made part of the guidelines decision. It appears appropriate to include guidelines for all parts of central government debt management in the same document.

5 Evaluation of the Government's Guidelines Decision

The Government's Decision: The Debt Office is to establish internal guidelines for 2007 based on the Government's guidelines. The decisions are to refer mainly to the maturity benchmark for each type of debt, possible deviations from the benchmark for the amortisation rate in the foreign currency debt and the Debt Office's position-taking.

The evaluation of the decisions made by the Board of the Debt Office is to be made in qualitative terms in light of the information available at the time the decision was taken. Where possible, the evaluation is to contain quantitative measures, for example, contrafactual calculations.

The evaluation of the operational management is to include a qualitative evaluation of nominal and inflation-linked krona management and a quantitative evaluation of the foreign currency trades. For inflation-linked borrowing, the realised difference in cost between the inflation-linked and nominal borrowing is to be reported.

The results of strategic and operational positions within the prescribed risk mandate are to be reported on an ongoing basis and evaluation is to be made in terms of market values.

5.1 Background

By April 25 every year the Government, in accordance with a decision by the Riksdag, is to present to the Riksdag a written report evaluating central government debt management. The

evaluation takes place at different levels and covers the decisions taken by the Board of the Debt Office as well as the management at the operational level in the Debt Office. In the report to the Riksdag, there is also an account of the decisions taken by the Government on the guidelines for debt management.

The goal of central government debt policy is long term in nature and it is thus natural to do the evaluation using a time perspective in which temporary fluctuations in the results are smoothed out. The Government therefore uses rolling five-year periods in its evaluation of debt management. The evaluation of the decision on the guidelines for 2007, which will be made in the spring of 2008, will thus concern the years 2003 to 2007.

5.2 Evaluation of Central Government Debt Management in 2007

5.2.1 Evaluation of the Government's Guidelines

The Government's decision on the guidelines should be evaluated directly against the long-term goal of central government debt management. The report to the Riksdag should thus refer primarily to the strategic considerations forming the basis for the guidelines decision and in light of the knowledge available at the time the decisions were taken.

Another requirement is that the evaluation must be conducted following principles established in advance. Otherwise the evaluation may be arbitrary since it is always possible with hindsight to construct other guidelines or debt portfolios that would have resulted in lower costs and/or lower risk.

One key factor in the decision on the guidelines should be the amount of risk that the Government is willing to assume. The basic assumption should be that the debt portfolio selected should have a lower cost and/or lower risk than other portfolios.

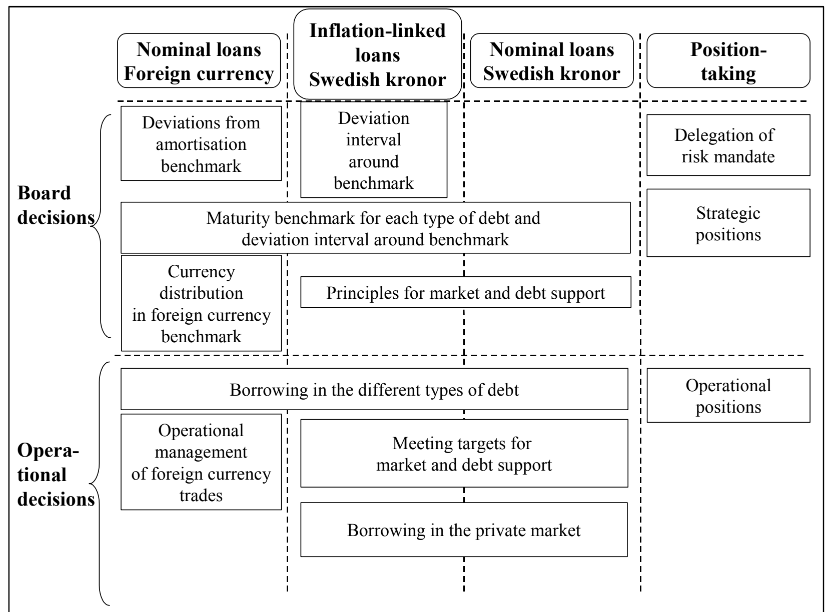
Debt portfolios that have undue risk, for example, those with little or no diversification, should thus be rejected even though they afterwards prove to have had a lower cost than a portfolio with less risk. The evaluation of the decision on the guidelines for 2007, which will be made in the spring of 2008, will thus concern the years 2003 to 2007.

5.2.2 Evaluating the Debt Office's Management of the Debt

In addition to the Government's guidelines, debt management activities of the Debt Office, for example, matters concerning financial management, are regulated in the Ordinance (1996:311) with instructions for the Debt Office. The Government also delegates certain decisions to the Debt Office as seen in the following material.

In the figure below, there is a schematic overview showing how the evaluation of the Debt Office's decisions is structured. The evaluation concerns the decisions taken by the Board of the Debt Office as well as operational activities.

Figure 1: Evaluation of the Debt Office's Strategic and Operational Decisions



Decisions by the Board of the Debt Office

Deviations from the Benchmark for the Amortisation Rate in the Foreign Currency Debt

Decisions of the Board of the Debt Office that involve deviations from the given foreign currency amortisation mandate are to be evaluated. Such decisions are based on strategic long-term considerations and should also be evaluated from that perspective. An assessment of the correctness of decreasing/increasing the amortisation of the foreign currency debt at some point must largely be based on a review of the reasonableness of the analysis that originally led to the decision.

The quantitative evaluation of the Debt Office's management of the foreign currency mandate can be made by contrafactual comparison of two simplified calculations in which the amortisations take place at a uniform rate over the evaluation period – one corresponding to the benchmark in the guidelines and the other to the Debt Office's decisions. Using the actual amortisation profile is not meaningful since it presents an uneven pattern.

Deviation Interval for the Inflation-Linked Debt

Decisions on the deviation interval for the inflation-linked percentage in the debt are to be evaluated.

The evaluation is to be mainly qualitative since the decisions probably cannot be evaluated quantitatively in a meaningful way.

Maturity Benchmarks for Each Type of Debt

The decision on the benchmark and deviation interval for the three types of debt in the central government debt is to be evaluated.

The evaluation of how the maturity for the total debt is to be allocated between the nominal krona debt, the inflation-linked debt and the foreign currency debt is to be mostly qualitative. These decisions can probably not be evaluated quantitatively in a meaningful way.

Distribution of Foreign Currencies in the Foreign Currency Benchmark

Decisions on the currency distribution in the foreign currency benchmark are to be evaluated. Mostly qualitative terms are to be used to evaluate this benchmark since there are no reasonable norms for quantitative comparisons. The Debt Office should

report analyses and arguments for a specified benchmark composition. To the extent that partial analyses have been allowed to influence the currency distribution in the benchmark, the grounds for doing so and a basis enabling a quantitative follow-up are to be reported.

Principles for Market and Debt Support

Decisions on market and debt support principles in the krona market are to be evaluated. The evaluation primarily concerns the choice of principles and the likelihood that they will lead to the desired effects.

Delegation of the Risk Mandate for Position-Taking

The decisions on delegating the risk mandate for position-taking are to be evaluated. The evaluation is chiefly qualitative.

Strategic Interest Rate and Foreign Currency Positions

The Board's decisions on strategic interest rate and foreign currency positions are to be evaluated in terms of market values. The positions are to be taken with derivatives and placed in their own portfolio so that they can be continuously monitored.

The Debt Office is to report evaluation measures that relate the results obtained to the risks taken.

The Debt Office's Operational Management

Borrowing in the Different Types of Debt and Their Management

There is to be an evaluation of the conduct of the borrowing in the different types of debt and the management of each type.

The evaluation is to be primarily in qualitative terms and on an ex ante basis.

Moreover, the realised difference in cost should be reported for inflation-linked borrowing. This means that a cost comparison between borrowing in inflation-linked bonds and borrowing in nominal government bonds for the latest five-year period should be reported.

Market and Debt Support at the Operational Level

The market and debt support conducted with the aim of achieving a well-functioning nominal and inflation-linked krona market is to be evaluated. The evaluation is chiefly qualitative.

Retail Market Borrowing

The Debt Office is to report any cost savings realised through borrowing in the private market compared with alternative forms of borrowing. The cost savings for each form of borrowing as well as for total private market borrowing is to be reported.

In addition the Debt Office's position in the market for savings products needs to be specified.

Operational Management of Foreign Currency Exchanges

The Board of the Debt Office is to adopt a relatively smooth cost-neutral path for the Debt Office's exchanges between kronor and foreign currency. The Board is to specify a certain fluctuation interval around this path within which currency exchanges may deviate for practical reasons. The interval is considered neutral with respect to results. In addition the Board is to specify risk limits on how large the currency positions taken by the operational management may be. Within these

bounds, the Debt Office can then vary the trades it makes at times when they seem particularly advantageous or disadvantageous.

Possible deviations can then be evaluated ex post by calculating differences in costs between the trajectory for the foreign currency trades that are neutral in outcome and the actual trajectory.

Operational Interest Rate and Foreign Currency Positions

Evaluation of the operational interest rate and foreign currency positions are to be done in terms of market values. The positions are to be taken with derivatives and placed in their own portfolio so that they can be continuously monitored.

The Debt Office is to report evaluation measures that relate the results obtained to the risks taken.

6 The Debt Office's Remit

The Government's decision: The Debt Office is to improve its control and evaluation of central government debt management on an ongoing basis.

The Debt Office is to revise the analyses and estimates that form the basis of the Government's decision on debt percentages for the foreign currency debt and the inflation-linked debt, particularly in the light of the current outlook for public finances.

The Debt Office is to deepen its analysis of the control of the benchmark for the maturity in the central government debt to include, for example, the conditions under which the comprehensive maturity is expected to stabilise and the cost aspects of the choice of maturity in the central government debt.

In the guidelines proposal submitted in the autumn of 2007, the Debt Office is to report on the development work completed during the year.

Reasons for the Government´s decision: Earlier in this decision on the guidelines, the Government established a new control system for the different debt percentages and a new method of calculating these percentages. This led the Government to make some adjustments to the long-term targets for the composition of the central government debt compared with the targets in last year's guidelines decision. In this year's guidelines the Government has also decided to increase the amortisation rate for the foreign currency debt, with one aim

being to meet the target specified for the proportion of debt held in foreign currency within a reasonable time horizon.

Thus the Government considers it urgent that the Debt Office revise the analyses and estimates underpinning the current targets. This appears to be especially important in light of the improved fiscal prospects projected in the medium term, which differ substantially from the projections in last year's decision on the guidelines. In the 2007 Budget Bill both the borrowing requirement and the central government debt are expected to fall sharply, owing in part to the revenues expected from the sale of public enterprises.

The guidelines decision this year also entails a broadening of the maturity measure to include the inflation-linked part of the krona debt. The comprehensive maturity benchmark is to be gradually shortened compared with the maturity as it now stands. The aim is for the maturity to shrink to 4.4 years by the end of 2009. The shortening of the maturity is expected to be achieved mainly by permitting the maturity in the inflation-linked debt to fall at the same pace that outstanding loans approach their maturity date.

The Government would like to deepen the analysis of the conditions under which the comprehensive maturity in the central government debt is expected to stabilise and when that might take place.

In addition the conditions for inflation-linked issuances with different maturities should be more closely analysed, for example, with respect to the cost aspects of issuances in the longer maturity segments.

In the guidelines proposal submitted in the autumn of 2007, the Debt Office is to report on the development work completed during the year.