GUIDELINES FOR CENTRAL GOVERNMENT DEBT MANAGEMENT 2012

2012

Decision taken at the Cabinet meeting
November 10 2011

LONG-TERM PERSPECTIVES   COST MINIMISATION   FLEXIBILITY

REGERINGSKANSLIET

Contents

Summary

Debt policy direction

The guidelines decision for 2012–2014 signifies an increased focus on robust management of the central government debt. The Government considers it desirable to increase vigilance over refinancing risks. The Government's ambition is also to increase borrowing in long maturities with the aim of spreading the debt over a longer period of time. At the same time, the control of the maturity of the nominal krona debt shorter than twelve years will be made more flexible.

The Debt Office's mandate for positions in the Swedish krona exchange rate will be lowered from SEK 50 to SEK 15 billion. The mandate will thus return to its level before the financial crisis of 2008/2009.

The debt shares for the composition of the debt will remain unchanged.

In brief, the debt is to be steered towards:

The composition of the debt

- Foreign currency debt: 15 per cent
- Inflation-linked debt: 25 per cent
- Nominal krona debt: 60 per cent

The maturity of the three types of debt:

- Foreign currency debt: interest rate refixing period of 0.125 years
- Inflation-linked debt: interest rate refixing period of 7–10 years
- Nominal krona debt:
  – instruments with a maturity of up to twelve years: interest rate refixing period of 2.7-3.2 years
  – instruments with a maturity of over twelve years: benchmark SEK 60 billion

Reasons for the guideline changes

In the light of the considerable uncertainty prevailing because of the fiscal balance problems in some European countries and other countries' experiences refinancing their debt as it falls due, the Government sees reason to spread the maturities on central government debt over a longer period of time. For maturities in nominal krona bonds longer than twelve years, a benchmark of SEK 60 billion will be introduced. The benchmark replaces the current ceiling of SEK 65 billion. The Debt Office is also to take fiscal developments into account so that a sharp rise in the borrowing requirement, compared with current forecasts, could justify larger issuances of long bonds.

In the management of the nominal krona debt up to twelve years, the focus on refinancing risks in the central government debt should increase. The Debt Office should therefore be vigilant of the short-term maturity structure and ensure that individual amounts falling due do not become too large.

The control system for central government debt management is continually being developed and new conditions require appropriate adjustment. When the borrowing requirement is small and the central government debt declining, control in terms of debt shares and maturities becomes more difficult. For reasons of efficiency and cost, an interval for controlling the maturity of the nominal krona debt for instruments up to twelve years will be introduced. The control interval will be 2.7–3.2 years and replaces the previous maturity benchmark of 3.1 years. The midpoint in the interval is somewhat shorter than the previous maturity benchmark, but the change is more of a technical nature than real.

The maturity interval for the inflation-linked krona debt will be widened from two to three years and will be seven to ten years for 2012-2014. Widening the control interval makes the maturity guideline sustainable for several years while cost reasons argue for greater operational flexibility.

The mandate for the Debt Office's positions in the krona exchange rate will return to its original level of SEK 15 billion. The reason is

that the Government wants to reduce the delegated mandate and the krona is currently at a level regarded as more long term.

The goal and method of evaluating retail market borrowing will also be made clearer. Retail market borrowing is to contribute to reducing the costs of central government debt compared with equivalent borrowing in the institutional market.

Continued analysis of the robustness of debt management

In the light of the guidelines' increased focus on robustness in debt management, the Debt Office will be given the remit to review how the guidelines can to a greater extent take the refinancing risks in its management into account. Its findings will be reported in next year's guidelines proposal.

The central government debt is expected to decline

Towards the end of 2011, the unconsolidated debt is expected to come to SEK 1 100 billion and then decline to SEK 835 billion towards the end of 2015. Thus the government debt to GDP ratio is estimated to fall from 32 per cent to about 21 per cent.

When the debt ratio peaked, it came to 77 per cent, which is of the same order of magnitude as the current EU average for EU countries' consolidated gross debt (80 per cent at the end of 2010). Swedish government finances are thus strong in both a historical and an international perspective. This is reflected in the historically low interest rates on Swedish government securities, both in kronor and in foreign currencies. Uncertainty about international economic developments is greater than it was previously. Thanks to its strong starting position, however, Sweden will also have stronger government finances than most other borrowing countries, even in the event of more adverse international developments. This also provides the Debt Office with good conditions for the future financing of the central government debt at a low cost.

Decision on the guidelines and the debt policy objective

The overall objective guiding central government debt management is to minimise its long-term costs while taking the risk into account. The debt policy objective and process are stated in the Swedish Budget Act (2011:203).

The Government is to make a decision no later than 15 November each year on guidelines for the management of the central government debt. The Debt Office is to submit proposed guidelines no later than 1 October each year. The Government is to allow the Riksbank to comment on the Debt Office's proposed guidelines.

In the guidelines decision, the Government exercises general control over the expected cost and risk of the debt. The Debt Office is responsible for the strategic decisions taken within the framework of the guidelines and for their implementation in the operational management of the debt.

1 Decision on the guidelines for central government debt management in 2012

Summary: The guidelines decision for 2012–2014 signifies an increased focus on robust management of the central government debt. With the aim of increasing long borrowing, a benchmark of SEK 60 billion for the nominal krona debt for maturities longer than twelve years will be introduced. The benchmark replaces the previous ceiling of SEK 65 billion. For the nominal krona debt with maturities up to twelve years, a control interval will be introduced. The new control interval of 2.7–3.2 years replaces the previous maturity benchmark (3.1 years). By broadening the interval from two to three years, the control of the maturity of the inflation-linked debt will be made more flexible. The mandate for positions in the Swedish krona exchange rate will be lowered from SEK 50 to SEK 15 billion. The objective and methods for evaluating retail market borrowing will be made clearer.

The guidelines for central government debt management for 2012–2014 are presented below. The decision on the guidelines for 2013 and 2014 should be considered preliminary. In the guidelines, the Government establishes the overall frameworks for central government debt management. The Debt Office is responsible for taking the strategic decisions within the framework of the guidelines and for implementing them in the operational management of the central government debt. An appendix presents the provisions that establish the debt management objective, the Debt Office's remit and the purpose of the borrowing, the guidelines process, etc.

1.1 The guidelines process

The Government's decision	Debt Office proposal	Comment
1. The Debt Office is to establish internal guidelines based on the Government's guidelines. The decisions are to concern deviation intervals for the maturity benchmarks decided by the Government for each type of debt, the distribution of the risk mandate, the foreign currency distribution in the foreign currency benchmark and principles for market and debt maintenance.	Is consistent with the Government's decision	Corresponds to current guideline

1.2 The composition of central government debt – debt shares

The Government's decision	Debt Office proposal	Comment
1. The share of *inflation-linked krona debt* in the central government debt is to be 25 per cent in the long term.	Is consistent with the Government's decision	Corresponds to current guideline
2. The share of *foreign currency debt* is to be 15 per cent of central government debt. The control interval around the benchmark should be ±2 percentage points. If the foreign currency share goes outside the control interval, the share of foreign currency debt should be restored to the benchmark or within the interval if the deviation is due to currency movements.	Is consistent with the Government's decision	Corresponds to current guideline
3. The Debt Office is to set the benchmark for the distribution of the foreign currency debt among different currencies.	Is consistent with the Government's decision	Corresponds to current guideline
4. In addition to inflation-linked krona debt and foreign currency debt, central government debt is to be composed of *nominal krona debt*.	Is consistent with the Government's decision	Corresponds to current guideline

1.3 The debt maturity

The Government's decision	Debt Office proposal	Comment
1. The maturity of the nominal krona debt for maturities of up to twelve years is to be 2.7–3.2 years.	Is consistent with the Government's decision	Guideline changed. Government's reason, see Section 3.3
2. For maturities over twelve years in nominal krona bonds, the benchmark for the outstanding volume is to be SEK 60 billion.	Debt Office proposes that the ceiling for the outstanding volume be SEK 65 billion.	Guideline changed. Government's reason, see Section 3.3
3. The maturity of the inflation-linked krona debt is to be between 7 and10 years.	Is consistent with the Government's decision	Guideline changed. Government's reason, see Section 3.3
4. The maturity of the foreign currency debt is to be 0.125 years.	Is consistent with the Government's decision	Corresponds to current guideline
5. The Debt Office is to decide on a deviation interval for the maturities.	Is consistent with the Government's decision	Corresponds to current guideline

1.4 Position-taking

The Government's decision	Debt Office proposal	Comment
1. The Debt Office may take positions in *foreign currency* and *the krona exchange rate*. Positions in foreign currency may only be taken with derivative instruments. Positions may not be taken in the Swedish fixed income market. Position-taking refers to transactions which aim at reducing costs for the central government debt taking into account risk but which are not justified by underlying loans or investment needs. Positions may be strategic (long term) or operational (current).	Is consistent with the Government's decision	Corresponds to current guideline
2. *Positions in foreign currency* are limited to SEK 450 million, measured as daily Value-at-Risk with a 95 per cent probability. The Debt Office is to decide on how much of this room may be used in the operational management.	Is consistent with the Government's decision	Corresponds to current guideline
3. *Strategic positions in the krona exchange rate* may not exceed SEK 15 billion and are to be built up and wound down gradually and announced in advance.	Debt Office proposes that the ceiling should be SEK 50 billion.	Guideline changed. Government's reason, see Section 3.4
4. Operational positions in kronor relative to other currencies may in connection with exchanges between kronor and other currencies be taken to a limited extent. The Debt Office is to state the maximum permitted extent.	Is consistent with the Government's decision	Corresponds to current guideline

1.5 Market and debt maintenance

The Government's decision	Debt Office proposal	Comment
1. The Debt Office, through market and debt maintenance, is to contribute to the well-functioning of the government securities market with a view to achieving the long-term cost minimisation objective while taking risk into account.	Is consistent with the Government's decision	Corresponds to current guideline

2. The Debt Office is to decide on the principles for market and debt maintenance.	Is consistent with the Government's decision	Corresponds to current guideline

1.6 Loans to meet the need of central government loans

The Government's decision	Debt Office proposal	Comment
1. The possibility of raising loans to meet the need for central government lending may only be used if required on account of threats to the functioning of the financial market.	Is consistent with the Government's decision	Corresponds to current guideline
2. The Debt Office may have outstanding loans to a maximum nominal value of SEK 200 billion for this purpose.	Is consistent with the Government's decision	Corresponds to current guideline
3. Investment of funds raised through loans to meet the need for central government lending should be guided by the principles stated in the Government Support to Credit Institutions Act (2008:814).	Is consistent with the Government's decision	Corresponds to current guideline

1.7 Borrowing in the retail market

The Government's decision	Debt Office proposal	Comment
1. By retail market borrowing, the Debt Office is to contribute to reducing the costs of the central government debt compared with equivalent borrowing in the institutional market.	Is consistent with the Government's decision	Guideline changed. Government's reason, see Section 3.5

1.8 Guidelines for costs and risks, etc.

The Government's decision	Debt Office proposal	Comment
1. The balance between expected cost and risk is to be made primarily through the choice of the composition and maturity of the debt.	Is consistent with the Government's decision	Corresponds to current guideline
2. The overall *cost measure* is to be the average cut-off yield.	Is consistent with the Government's decision	Corresponds to current guideline
3. The overall *risk measure* is to be the average cut-off yield risk.	Is consistent with the Government's decision	Corresponds to current guideline
4. The shares of *the various types* of central government debt are to be calculated using a measure that takes into account all cash flows in	Is consistent with the Government's decision	Corresponds to current guideline

the debt, i.e. also future coupon payments and expected compensation for inflation.		
5. *The maturity* is to be measured by an average interest rate refixing period where all the cash flows including expected compensation for inflation are included. Cash flows are not to be discounted.	Is consistent with the Government's decision	Corresponds to current guideline
6. Positions are not to be included in the calculation of debt shares and maturities.	Is consistent with the Government's decision	Corresponds to current guideline
7. When taking positions, market values are to be used as a measure of the costs and risks in managing the debt.	Is consistent with the Government's decision	Corresponds to current guideline

2 Basis for the Government's decision on the guidelines

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

The decision is also based on the size of the debt and its expected development. From 2011 to 2015 the unconsolidated central government debt is estimated to decline from SEK 1 100 billion to SEK 835 billion (21 per cent of GDP). The yield curve is currently flat and interest rates are at historically low levels.

The Government exercises general control over the costs and risks in central government debt management via annual guidelines decisions. The basis for the Government's decisions is the overall objective of central government debt policy, namely that the debt is to be managed in such a way as to minimise the long-term costs while taking the risk into account. Management is to take place within the framework of monetary policy requirements. The debt policy objective, as well as the overall division of responsibilities and the process, is presented in Chapter 5 of the Swedish Budget Act (2011:203); see the appendix.

One important basis in the guidelines decision is the size of the central government debt and developments in central government finances. It is basically these factors, alongside the interest rate level, which determine the cost and risk involved in debt management.

Another important basis for the guidelines decision is the yield curve slope. Here the assumption about the slope of the curve and the maturity chosen are key in the cost/risk trade-off. The curve can normally be assumed to have a positive slope and thus average cost is expected to be lower for shorter maturities at the same time that the risk in the management increases (and vice versa). The absolute interest rate can under certain circumstances also be taken into account but it is then the Debt Office that, within a given mandate, is responsible for making decisions on taking positions with the aim of taking advantage of the savings possibilities that this may offer.

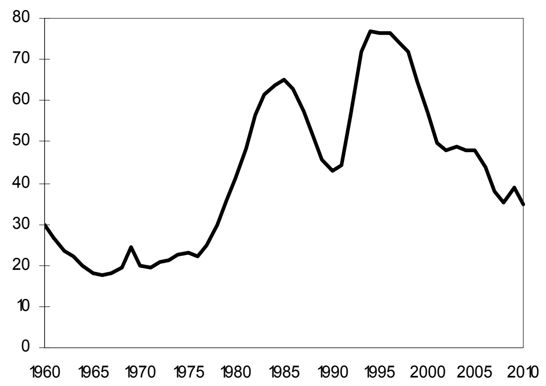
2.1 Central government debt

The central government debt's actual development

The central government debt is the result of a central government budget that historically has had larger deficits than surpluses. Simplified, the central government debt increases when the central government budget shows a deficit and decreases when the budget shows a surplus.

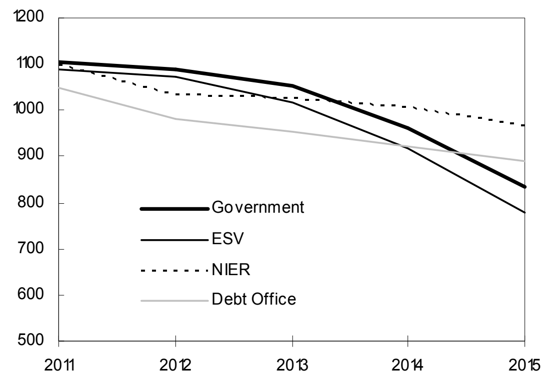
There have been two periods when central government debt as a percentage of GDP has increased sharply. From 1976 to1985 the central government debt increased from 22 to 65 per cent as a percentage of GDP and from 1990 to1995, it increased from 43 to 77 per cent as a percentage of GDP. Since 1996 the central government debt as a percentage of GDP has declined, coming to 35 per cent by the end of 2010. At the end of 2010, the unconsolidated central government debt came to SEK 1 151 billion. Over the past ten years, the central government debt has declined by 20 percentage points in relation to GDP.

Figure 1. Central government debt, per cent of GDP, 1960-2010.



Source: National Debt Office.

Figure 2. Forecasts of unconsolidated central government debt, SEK billion, 2011–2015.



Source: National Debt Office

Forecasts and development of central government debt

In addition to the Government, the National Financial Management Authority, the National Institute of Economic Research, and the Debt Office make forecasts of public finances and thus of the development of central government debt. The aims, time horizons and methods differ from one forecast to another.

The Government's forecasts are part of the political process and serve as the basis for tax and spending proposals. The National Financial Management Authority makes budget forecasts based on the current regulatory framework while the National Institute of Economic Research makes forecasts in national accounts terms of the whole economy. The National Financial Management Authority and the National Institute of Economic Research forecasts, like the Government's forecasts, cover the current year and the next four years. The Debt Office makes forecasts of the borrowing requirement for the next two years. Its forecasts provide the basis for borrowing plans but also help increase transparency for investors by making it possible to clarify how the borrowing requirement and borrowing plans fit together.

In the 2012 Budget Bill, the central government debt at the end of 2012 is estimated at SEK 835 billion, or 21 per cent of GDP. The Swedish National Financial Management Authority forecast indicates that the central government debt will be SEK 780 billion at that time while the National Institute of Economic Research forecast is SEK 966.

For the National Institute of Economic Research forecast, the Debt Office has estimated the borrowing requirement based on their medium-term forecast of central government net lending for 2013–2015. The Debt Office has also estimated the size of the central government debt at the end of 2015 based on its own latest forecast, with the assumption that general government net lending will come to 1.5 per cent in the period 2013–2015. According to these estimates, the central government debt will be SEK 889 billion by the end of 2015.

The downside risks are expected to predominate in the Swedish central government budget

There is considerable uncertainty about future economic developments and the sustainability of global macroeconomic development. Owing to fiscal balance problems in the United States and several countries in Europe, this uncertainty is currently particularly high. Sweden is a small, open economy with a large export sector relative to GDP. When the global economy slows, important tax bases are affected by consumption and wages, and thus government revenue decreases. Government expenditures are affected by the domestic economy, albeit with some lag.

There is also a risk that the fiscal balance problems in some European countries will spill over to the European banking sector to a greater extent than assumed in the Budget Bill. Worse financial turmoil could then have a more pronounced effect on Swedish banks and the Swedish real economy. All in all, the risks of weaker economic development and weaker public finances in Sweden are expected to dominate.

Thanks to its strong starting position, however, Sweden will also have stronger government finances than most other borrowing countries, even in the event of more adverse international developments. This also provides good conditions for the future financing of the central government debt at a low cost.

Various measures of the central government debt

The central government debt is measured in different ways, depending on the measure's aim. Figure 1 shows the development of the debt that the Debt Office manages, called unconsolidated debt. The unconsolidated central government debt shows the state's future obligations in terms of aggregated nominal final amounts for the Debt Office's outstanding loan instruments. In the Budget Bill, the Government uses the measure consolidated central government debt. The difference consists of government agencies' holdings of government securities. These holdings usually total about SEK 40–50 billion.

The measure used for control of the central government debt since 2007 has been *the consolidated cash flow* (the CCF measure). This measure measures risk in the central government debt by including the central government's future commitments in terms of cash flows. It also includes coupon payments and inflation compensation in addition to the nominal final amounts. Another important difference compared with unconsolidated and consolidated central government debt is that the CCF measure includes the cash flows from assets in the Debt Office's debt management. In some periods this type of asset has increased, for example, with extra borrowing in T-bills (autumn 2008) and on-lending to the Riksbank (from spring 2009). By the end of 2010, these assets totalled SEK 85 billion, of which SEK 83 billion represented lending to the Riksbank and SEK 2 billion lending to Iceland.

The target share for each type of debt and the maturity benchmarks are based on the CCF measure. Also included in these estimates are the derivative instruments that the Debt Office uses in its management of the debt.

The maturity is measured in terms of the interest rate refixing period, which corresponds to the time until these rates are next adjusted, due to either a cash flow or an agreement. The choice of control measure depends on there being interest rate adjustments that determine the costs. For most bonds, the interest rate refixing period is primarily governed by the remaining time to maturity, but the Debt Office uses derivatives, primarily interest swaps, to shorten the interest rate refixing period in the debt, rather than a large percentage of loans with a short time to maturity. Therefore the maturity benchmarks in the guidelines do not give a true picture of the average time until the state needs to return to the lending market to finance maturing loans.

Conclusions

In principle, robust public finances increase the scope for risk-taking in debt management in exchange for lower expected costs. A lower central government debt reduces interest costs as a percentage of the central government budget as well as the expected variation in interest costs. When gross borrowing per unit of time declines, the actual interest rate levels have less impact on interest costs.

Forecasts from the Government (and other forecasters) indicate a decline in the central government debt in the next few years. In the 2012 Budget Bill, the Government estimates that the unconsolidated central government debt will fall to 21 per cent of GDP by 2015. Taken separately, this indicates that the maturity in the central government debt could be shortened somewhat with the aim of reducing the costs of debt management.

On the other hand, uncertainty about government finances is unusually high at present and downside risks predominate. This in effect argues against taking on any more risk by shortening the maturity in the debt.

2.2 Loan markets

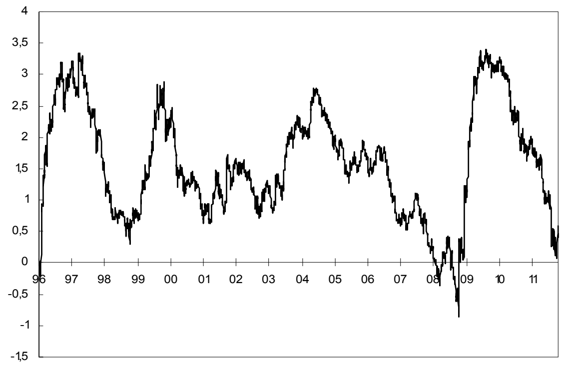
The yield curve slope

The yield curve slope depicts the interest for different maturities. The interest on shorter maturities is as a rule lower than the interest on longer maturities, as investors require a premium for locking in money for a longer time. The basic assumption that the yield curve, over time, has a positive slope affects the control of the maturity in the central government debt. A steeper positive slope to the yield curve improves the trade-off between cost and risk.

There is, however, a higher risk inherent in borrowing with shorter maturities, since the debt must be refinanced more often and the impact on interest expenditure of an interest rate increase will vary more (interest rate refixing risk).

The yield curve slope can be described as the difference between the level of the ten-year rate and the three-month rate. Figure 3 shows the difference between both maturities since 1996.

Figure 3. The difference between the ten-year and the three-month government borrowing rate, per cent, Sweden



Source: Reuters EcoWin

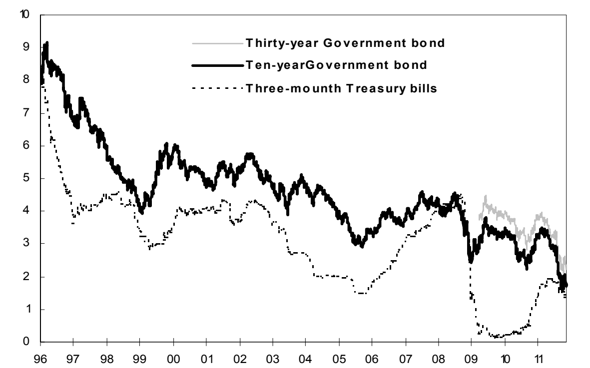
The difference between the ten-year rate and the three-month rate is currently 0.39 percentage points. On average, this difference has been 1.10 percentage points.

The yield curve level

The yield curve level is of minor importance in the long-term choice of maturity. Considering that increases and decreases in the interest rate offset each other in the long run, the advantage of having a long-term debt when interest rates rise is reduced by the loss that could be said to occur when interest rates fall again.

But in some extraordinary cases, the interest rate level may affect the control of the maturity. This happened, for example, in spring 2009 when the Government, with the aim of locking in low interest rates, made it possible for the Debt Office to issue nominal government bonds with long maturities.

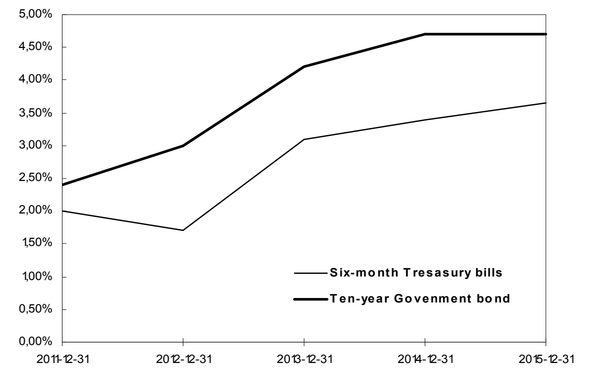
Figure 4. Thirty-year, ten-year and three-month government borrowing rate, per cent, Sweden



Source: Reuters EcoWin.

The thirty-year bonds were issued in spring 2009, thus explaining the lack of historical data before that time. Interest rates for the three maturities track each other even though the changes in the three-month rate are substantially larger. From a historical perspective, interest rate levels for both long and short maturities have been remarkably low since 2009. The three-month rate has fallen to less than 1.4 per cent and the rate on ten-year government bonds has been under 2 per cent (Figure 4) in autumn 2011.The low long rates illustrate both the credibility of Swedish government finances and the concern about weak economic growth elsewhere which characterises the international financial markets.

Figure 5. The Government's forecast of interest rate developments



Conclusions

In general, a shorter interest rate refixing period leads to lower expected costs since the yield curve over time has a positive slope. Conversely, the interest rate refixing risk increases for shorter maturities.

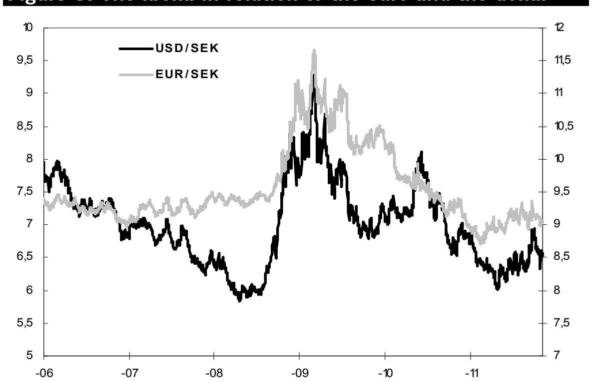
The slope on the yield curve during the autumn has generally been horizontal or negative. The Government expects that over the next few years the yield curve will be relatively flat, but with a positive slope. The upturn in long interest rates is expected to be relatively slow. All in all, the cost savings that a potential shortening of the maturity may provide can thus be expected to be more limited than would otherwise be the case.

At the same time, interest rates on long maturities are historically low in many countries, including Sweden. Here there could be scope for reducing borrowing costs. The possibility of using this situation is delegated to the Debt Office (see guideline 1.4 and Section 3.4).

2.3 The Swedish krona

The krona's exchange rate affects central government debt, as approximately 15 per cent of the debt is exposed to foreign currencies. With a weaker krona, the foreign currency debt, and thus the central government debt, increase and interest costs on the debt increase (and vice versa).

Figure 5. The krona in relation to the euro and the dollar



Source: Reuters EcoWin.

During the 2008/2009 financial crisis, the Swedish krona weakened substantially. Subsequently the krona has gradually strengthened. The krona is currently trading against the euro at 9.03 and the dollar at 6.52. Exchange rate developments are shown in Figure 5, where the left axis shows the USD/SEK exchange rate and the right axis the EUR/SEK exchange rate.

The guidelines do not take into account how the Swedish krona is expected to develop but the Government's long-term stance has been to have a reasonable volume of foreign currency debt, taking into account expected cost, and provide sufficient risk diversification between the debt's different types of debt. The foreign currency debt's long-term target value of 15 per cent was reached in 2008.

However, the Debt Office has some scope for changing the share of foreign currency debt should the Swedish krona weaken considerably. This scope has been used on a number of occasions, most recently in 2009 when a position against the euro was built up. It was closed in 2010, resulting in an estimated cost savings of SEK 8 billion. Estimating the krona's course is thus delegated to the Debt Office within the framework of the position mandate assigned it.

2.4 The Riksbank's comments on the Debt Office's proposed guidelines

The Riksbank is of the opinion that the proposals that the Debt Office presents in the guidelines for central government debt management for 2012-2014 are compatible with the requirements set by monetary policy. The Riksbank has, from a monetary policy perspective, has no objections to the Debt Office's proposed guidelines.

The Riksbank supports the proposal for a closer examination of the consequences of a reduced central government debt on the functioning of the market. In an analysis of this kind, the effects on both on the monetary policy transmission mechanism and financial stability should be taken into account.

3 Reasons for the Government's decision

3.1 Cost and risk

The debt policy objective states that the guidelines are to be based on a balance between long-term cost and risk. The cost of the central government debt is measured as the average cut-off yield.

The measure reflects the average interest rate at which the Debt Office has borrowed the outstanding debt.

Central government debt costs are primarily affected by the size of the debt and the interest rate levels when the interest rates on the debt instruments are set. Currency movements also affect the cost of the debt as some of the central government debt is exposed to foreign currency. The cost of the inflation-linked debt is likewise affected by how the CPI develops.

The risk in the central government debt portfolio is broadly defined in terms of variations in the cost of the debt. The risk measure used refers to the variation in the average cut-off yield and describes the interest rate refixing risk in the debt. It is also the interest rate refixing risk that the control of maturity in the guidelines has in view.

It is important to distinguish between the interest rate refixing risk and the refinancing risk. The interest rate refixing risk refers to the exposure in the central government debt (i.e. taking into account those derivatives used to adjust shares and maturities in the debt) while the refinancing risk reflects the remaining time to maturity (i.e. the actual borrowing in government securities and other borrowing instruments). This is illustrated by an interest rate refixing period in the nominal krona debt for maturities up to twelve years of about 3 years while the average time to maturity is about 4.5 years. The explanation for the difference is that the Debt Office uses derivatives, particularly interest swaps, so that the interest rate refixing period is shortened without affecting the maturity structure.

The Debt Office manages the refinancing risk by seeing that there is a judicious maturity profile and pursuing efficient liquidity management. In addition, the Debt Office uses various forms of market maintenance measures to maintain an efficient market and a broad investor base, important prerequisites for meeting both refinancing needs and unexpected increases in the borrowing requirement.

In the light of the increasing uncertainty about the development of the fiscal balance problems in some European countries, the Government is of the opinion that it is desirable to increase vigilance over the refinancing risks in debt management. In managing the maturity structure, the Debt Office should therefore maintain control so that individual amounts falling due do not become too large. In addition, a change will be made in the maturity guideline for nominal krona bonds with a maturity over 12 years (see 3.3.1).

3.2 The composition of the debt

Since 2007 the Government has steered the targets for the debt shares composing the central government debt towards: foreign currency debt 15 per cent, inflation-linked krona debt 25 per cent and nominal krona debt 60 per cent (residual). The current shares were reached in August 2008.

The main reason that the central government debt consists of several types of debt is the lower risk resulting from diversification. In a situation in which the central government debt rises rapidly, borrowing can be spread over several markets and thus reach a wider circle of investors. With diversification, the borrowing cost is also less affected by temporarily worse conditions in any type of debt (for example, due to inflation or exchange rates). The shares are based primarily on an analysis done by the Debt Office in 2004. The debt ratio measured as unconsolidated central government debt as a percentage of GDP was then 50 per cent compared with 35 per cent at the end of 2010.

In view of the Debt Office's continuing remit to analyse the composition of the central government debt (see below), the debt composition targets will be kept unchanged until further notice.

Analysis of the composition of the central government debt, its maturity and robustness to continue

In April 2010 the Government gave the Debt Office the remit to conduct an analysis, based on the assumption of a considerably higher or lower debt, of how large a share of the central government debt each type of debt should have, and how the maturity should be managed in each case. Analysing the strategy for managing the central government debt under different scenarios involves extensive work and there is a qualitative analysis in the guidelines proposal for 2012, presented by the Debt Office in September 2011. In the guidelines proposal for 2013, the Debt Office intends to come back with a detailed and quantitative analysis of central government debt maturities and shares.

In the light of the guidelines' increased focus on robustness in debt management, the Debt Office has been given a remit to review how the guidelines can to a greater extent take the refinancing risks in debt management into account. This applies to both control and content (i.e. how refinancing risks can be limited). Its findings will be reported in next year's guidelines proposal.

The Government has given an independent reviewer, who will evaluate the central government debt policy for 2007–2011, a remit to analyse aspects of the debt's robustness. The analysis will be made in the light of an expected decline in the debt, the rule changes in the financial sector expected in the wake of the financial crisis and the expected increase in borrowing internationally on account of fiscal problems in many countries.

The Government also intends to weigh the need for further investigation of the function and importance of the government securities market for financial stability. The Riksbank in its comments has also indicated that it is prepared to investigate the consequences of a reduced central government debt on the functioning of the market (see Section 2.4).

3.3 The debt maturity

Since 2009 the Government has steered the maturity in the central government debt by setting separate target values for the interest rate refixing period for each of the three types of debt. In the guidelines for 2010, control of the nominal krona debt was split up so that borrowing instruments with a maturity shorter than twelve years would be guided towards a maturity benchmark and borrowing instruments with a maturity longer than twelve years would be limited by a volume ceiling.

In the guidelines for 2012, the maturity guideline for the foreign currency debt will be kept unchanged while changes will be made in other maturity guidelines.

3.3.1 Nominal krona bonds with a maturity of over twelve years

In the light of the considerable turmoil and uncertainty there now is as a result of the fiscal balance problems in some European countries and other countries' experiences refinancing their debt as it falls due, the Government sees reason to spread the central government debt over a longer period of time. The Government's aim is therefore over time to increase the share of the debt held in the long maturity segment and thus to some extent reduce the refinancing risks in the central government debt. The larger the part of the debt falling due on a particular date, the smaller will be the refinancing need up to that date. This is an advantage should the budget balance deteriorate sharply during that period. Such measures should reduce the risk of the central government needing to resort to the market in times of increased stress. This would be particularly likely if at the same time, the Swedish state's borrowing requirement were for any reason to rise sharply.

For maturities in nominal krona bonds longer than twelve years, a benchmark of SEK 60 billion will be introduced. The rate of increase in relation to the benchmark is to be weighed against the growth in demand for long bonds and the cost of borrowing at other maturities, taking risk into account. The benchmark replaces the current ceiling of SEK 65 billion. SEK 40 billion is currently outstanding in the maturity segment (thirty-year bonds issued in 2009)

The Debt Office is also to take fiscal developments into account so that a sharp rise in the borrowing requirement, compared with the current forecast, could justify larger issuances of long bonds.

3.3.2 The nominal krona debt's maturity for maturities up to 12 years

Increased vigilance over refinancing risks
As shown in Section 3.1, the Government thinks that vigilance over refinancing risks in the central government debt should increase. This also applies to the management of the nominal krona debt for maturities up to 12 years, which constitute most of the debt.

The most important source of refinancing risk is too large a concentration of loans falling due in the near future (for example, in the next twelve months). At the same time, it is difficult to establish a mechanical rule for how large the maximum amount falling due should be. If the borrowing requirement increases unexpectedly, it may, for example, be appropriate for the Debt Office to make use of the exchange market as a first step in order to borrow large amounts quickly.

This requires a market for T-bills, which in turn requires that there always be a specific quantity of T-bills outstanding.

In the light of the considerable uncertainty in the next few years, the Debt Office should be vigilant of the maturity structure and ensure that individual amounts falling due do not become too large.

It is also important that the Debt Office as is customary in its borrowing policy endeavour to keep as even as possible a maturity structure, taking into account the borrowing requirement, market conditions, etc.

Maturity interval replaces benchmark as control instrument
For maturities up to twelve years, the interest rate refixing period is to be steered in the interval 2.7 to 3.2 years. The reason for replacing previous exact maturity benchmarks with an interval is to increase borrowing flexibility. Too tight a control of the central government debt risks being ineffective. In the period the guidelines decision refers to, the borrowing requirement is estimated to decline and the central government debt to fall. When the borrowing requirement is small, it is more difficult to control debt maturity (as well as its shares). Small loan volumes, in relation to the size of the outstanding debt stock, have little effect on the composition of the debt. When the borrowing requirement is small, it may also be more difficult to prevent unexpected deviations from the forecast of the borrowing requirement, as the deviation in that case will have a greater impact on borrowing plans. There is a risk, for example, that the Debt Office will be forced to make substantial changes in the volume of interest swaps.

The current maturity benchmark (3.1 years) lies within the new control interval (2.7–3.2 years), but the midpoint of the interval (2.95 years) is slightly under the current benchmark for the interest rate refixing period. The reason for this is that the emissions of new (long) and relatively small loan volumes have little effect on the debt's overall maturity. The central government debt is thus automatically shortened when the borrowing requirement is small compared to the size of the debt.

The Government considers the potential shortening of the nominal maturity as more technical than real, particularly as the yield curve's flat slope implies limited possibilities for cost savings (see 2.2). The Debt Office, within the framework of the control interval, has to decide where the interest rate refixing period in the nominal krona debt up to twelve years can best be steered, taking cost and risk into account.

3.3.3 The maturity of the inflation-linked krona debt

The interest rate refixing period for the inflation-linked krona debt is to be between 7 and 10 years. The interval is to be long term, which is a difference from the 2011 guidelines, when individual intervals were specified for the three most recent year-ends. At the same time that the interval was made long term, it was widened from two to three years.

The interest rate refixing period for the inflation-linked krona debt is difficult to steer as the market for inflation derivatives is relatively undeveloped. The interest rate refixing period can in practice only be controlled by new issues, exchanges and buybacks. Cost reasons argue for greater flexibility as this would make it possible to give more consideration to the market situation in conjunction with new issues. Increased flexibility also increases the possibilities of avoiding buybacks when the market situation indicates otherwise.

In the guidelines decision for 2011, the interval for 2012 and 2013 was preliminarily stated at between 9 and 11 years. The new long-term interval of 7 to 10 years thus results in a somewhat shorter interest rate refixing period. The reason for this is that limited borrowing requirements and small issue volumes of inflation-linked bonds in principle result in an increasingly shorter maturity in the inflation-linked debt. The Government expects, however, that the current forecast of the borrowing requirement and the Debt Office's planned borrowing in inflation-linked bonds provide the conditions enabling the control interval to be kept unchanged under the guidelines planning horizon.

3.4 The Debt Office's strategic positions

Strategic positions in the Swedish krona exchange rate

In connection with the acute stage of the financial crisis in 2008-2009, on the Debt Office's recommendation, the mandate for strategic positions in the Swedish krona's exchange rate against other currencies was expanded from SEK 15 to SEK 50 billion in May 2009. The Government considered the mandate to be a reasonable balance in terms of the size of the central government debt and the foreign currency debt and to give the Debt Office flexibility in attempting to limit the costs of the foreign currency debt should the Swedish krona develop weakly.

Because the downside risks in the Swedish economy and the central government budget predominate (see 2.1), the Government has chosen to limit the Debt Office's mandate for kronor positions. The ceiling for position-taking will thus be lowered from SEK 50 to SEK 15 billion. The level will thus return to its level before the crisis erupted in 2008.

In addition, the Swedish krona is currently at a level considered to be more sustainable in the long run. There is strong evidence that the Swedish krona is regarded as a more stable currency than was the case when the financial crisis began in 2008.The need for considerable room for the Debt Office to take kronor positions is therefore expected to be relatively small.

Positions in foreign currency

The Debt Office's possibilities of taking positions within the framework of the mandate for Value-at-Risk (see 1.4 Position-taking points 1 and 2, the guidelines decision) are unchanged.

This gives the Debt Office, based on its perception of future financial market developments, the opportunity to continue to take strategic positions in foreign interest rates/currencies if deemed appropriate.

3.5 Defined objective and evaluation for retail market borrowing

The objective for retail market borrowing is defined as follows: by retail market borrowing, the Debt Office is to contribute to reducing the costs of the central government debt compared with equivalent borrowing in the institutional market.

In spring 2010, the Government gave the Debt Office a special remit to continue working on improvements of the comparison between borrowing in the retail market and in the government securities market. In the Debt Office's proposed guidelines for 2012–2014, the reasoning behind the formulation of objectives and methods for evaluating retail market borrowing is developed.

The interest on retail market instruments is to be compared with the interest on equivalent instruments issued by the Debt Office in the government securities market. The result is to be calculated as the interest margin (converted into kronor) for both ways of borrowing. The result will, as before, also be charged with the added costs of distributing and handling retail market instruments.

4 Guidelines for evaluating debt management

The debt policy objective is to be long term and the result will be evaluated over rolling five-year periods. The evaluation for 2007–2011 will be submitted to the Riksdag no later than 25 April 2012. For 2009–2013, the evaluation is to be submitted no later than 25 April 2014. The Debt Office is to submit the documentation on which the evaluation is to be based to the Government no later than 22 February each year.

The Government's decision	Debt Office proposal	Comment
1. Evaluation of debt management is to be made in qualitative terms in the light of the knowledge available at the time of the decision. Where possible, the evaluation is also to include quantitative measures.	Is consistent with the Government's decision	Corresponds to current guideline
2. Evaluation of the operational management should, inter alia, cover borrowing and management of the different types of debt and market and debt maintenance measures as well as management of currency exchanges.	Is consistent with the Government's decision	Corresponds to current guideline
3. The realised cost difference between inflation-linked and nominal borrowing should be reported for inflation-linked borrowing.	Is consistent with the Government's decision	Corresponds to current guideline
4. The cost saving compared with alternative borrowing should be reported for retail market borrowing.	Is consistent with the Government's decision	Corresponds to current guideline
5. Strategic and operational interest rate and foreign currency positions within the given risk mandate are to be taken up on an ongoing basis as income, and evaluated in terms of market values.	Is consistent with the Government's decision	Corresponds to current guideline

Annex: Overview of current provisions that, together with the Government's guidelines, govern government borrowing and debt management

Goals of central government debt management

Regulations	Statutes
The central government debt is to be managed in such a way as to minimise the long-term costs while taking risk into account. Management is to take place within the framework of monetary policy requirements.	Chapter 5, Section 5 of the Swedish Budget Act (2011:203).

Debt Office's remit and the purpose of borrowing

Regulations	Statutes
The Debt Office's remit is to raise and manage loans for the central government in accordance with the Swedish Budget Act (2011:203).	2 § Ordinance containing Instructions for the National Debt Office (2007:1447)
Following special authorisation, which is given for one fiscal year at a time, the Government or, after authorisation by the Government, the National Debt Office, may raise loans for the central government to: • finance current deficits in the central government budget and other expenditure pursuant to decisions made by the Riksdag, • provide such credit and perform such guarantees as decided by the Riksdag, • amortise, redeem and buy back central government loans, • in consultation with the Riksbank, satisfy the requirement for central government loans with different maturities, and • satisfy the Riksbank's requirements for foreign currency reserves.	Chapter 5, Section 1 of the Swedish Budget Act (2011:203).

The guidelines process

Regulations	Statutes
The Debt Office is to submit proposed guidelines for central government debt management to the Government by 1 October each year. The Government is to allow the Riksbank to comment on the Debt Office's proposed guidelines.	3 § Ordinance containing Instructions for the National Debt Office (2007:1447) Chapter 5, Section 6 of the Swedish Budget Act (2011:203).

The Government is to make a decision by 15 November each year on guidelines for the Debt Office's management of the central government debt.	Chapter 5, Section 6 of the Swedish Budget Act (2011:203).
The Debt Office is to submit the documentation on which the evaluation of central government debt management is to be based to the Government no later than 22 February each year.	3 § Ordinance containing Instructions for the National Debt Office (2007:1447)
In a Government Communication, the Government, beginning in 2012 and every second year thereafter, is to evaluate central government debt management. The Government Communication is to be presented to the Riksdag no later than 25 April.	Chapter 5, Section 7 of the Swedish Budget Act (2011:203).
The Debt Office is to establish principles for the implementation of the guidelines for central government debt management decided by the Government.	15 § Ordinance containing Instructions for the National Debt Office (2007:1447)

Management of funds, etc.

Regulations	Statutes
The Debt Office is to deposit its funds, to the extent that they are not needed for disbursements, in an account at the Riksbank, a bank or a credit market company, or in government securities or other debt instruments with a low credit risk. Deposits may be made abroad and in foreign currency.	5 § Ordinance containing Instructions for the National Debt Office (2007:1447)
The Debt Office is to cover the deficits that occur in the Government central account.	7 § Ordinance containing Instructions for the National Debt Office (2007:1447)
Management of exchanges between Swedish and foreign currency (currency exchanges) is to be predictable and transparent.	6 § Ordinance containing Instructions for the National Debt Office (2007:1447)

Consultation and collaboration

Regulations	Statutes
The Debt Office is to consult the Riksbank on matters concerning the components of borrowing that may be assumed to be of major importance for monetary policy.	12 § Ordinance containing Instructions for the National Debt Office (2007:1447)
The Debt Office is to consult the National Institute of Economic Research and the National Financial Management Authority on matters concerning Debt Office forecasts of the central government borrowing requirement.	11 § Ordinance containing Instructions for the National Debt Office (2007:1447)

The Debt Office should obtain the Riksbank's views on how the funds borrowed to meet the need for central government lending are to be invested in accordance with the Act on Central Government Borrowing and Debt Management (1998:1387).	Corresponds to current guideline (introduced in the guidelines decision for 2009).

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