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KONTORET
THE SWEDISH NATIONAL DEBT OFFICE

The Swedish Central Government Borrowing Requirement and Funding – forecasts and plans

January 31, 2001

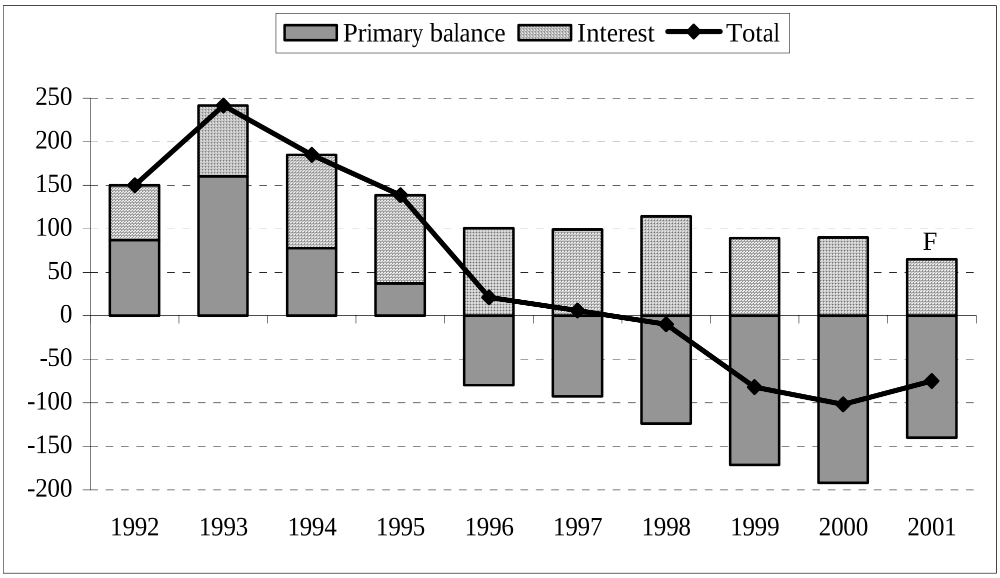
THE SWEDISH CENTRAL GOVERNMENT BORROWING REQUIREMENT

The annual forecast for 2001

The forecast of the Swedish National Debt Office for 2001 indicates a surplus in central government payments of SEK 70–80 billion. Thus, the range is SEK 20 billion higher than in the previous forecast.

For obvious reasons the cyclical development is a very important factor in forecasting the borrowing requirement. New information about the general economic situation suggests that growth prospects for the Swedish economy have deteriorated since the publication of the previous forecast. Normally a weaker cyclical development should imply a larger borrowing requirement since lower tax payments reduce government revenue while at the same time larger disbursements of unemployment benefits increase spending. However, fairly strong declines in growth and employment are required for the borrowing requirement to be appreciably affected. Fluctuations drastic enough to influence the borrowing requirement noticeably are not likely to occur during the current year. Thus, the weaker cycle does not lead to any changes in the forecast for the borrowing requirement.

Figure 1: Central government borrowing requirement 1992–2001, SEK billion.



As the central government debt has been reduced and the interest rate level has declined, interest payments on the debt have edged down. For 2001, interest payments are estimated to be somewhat in excess of SEK 65 billion, which is almost SEK 25 billion less than last year; see Figure 1.[1] However, the primary surplus, which summarises all other payments, will

[1] The calculation is based on interest rates and exchange rates on January 18, 2001.

shrink compared with last year. In all, this means that the Debt Office expects the surplus to be smaller than the SEK 102 billion shown for 2000.

The fall in the primary surplus owes mainly to smaller revenues from the sale of state assets. The Debt Office's assumption is SEK 15 billion compared to about 75 billion in 2000. This is only partly offset by the fact that the disbursement of premium pension funds will be smaller than last year, when balances accumulated over four years were transferred to fund managers. Tax payments are expected to increase. However, the bulk of the increase will be passed on to the municipalities and the National Pension Fund (AP Funds), since in both cases their revenues are strongly linked to the wage bill.

The primary borrowing requirement is expected to yield a surplus of the order of SEK 140–150 billion in 2001. In the forecast presented by the Debt Office in December, the primary surplus was estimated to be SEK 120–130 billion. The increase is mainly a consequence of an upward adjustment of the forecasts for supplementary payments of taxes.

During the second half of the 1990's, supplementary tax payments have in general been growing from year to year. During the same period the Debt Office has often underestimated the size of these payments, which are among the most difficult to forecast. The increase in recent years is partly related to price developments in asset markets and to the shift by the general public of savings from traditional bank savings to savings in funds and securities. The reason is that interest income on bank savings, as distinguished from capital gains on funds and securities, is subject to withholding tax. However, it is not possible to explain the increase in supplementary payments only on the basis of these factors. According to the Debt Office's statistics, supplementary payments in December 2000 were more than SEK 10 billion higher than a year earlier even though the stock market performance was less favourable in 2000 than in 1999. A possible reason is that capital gains may have been realized as households, in view of the stock market volatility last autumn, chose to shift their savings to less risky investments.

Since it is likely that there is still a large stock of unrealised gains, it can be assumed that this behaviour continues during the current year. An additional factor suggesting that supplementary tax payments will remain large is that the shift into savings in funds and securities implies that withdrawals from bank accounts are to some extent replaced by sales. This leads to capital gains and losses. Accordingly, the forecast for supplementary payments in December 2001 has been revised strongly upwards. At the same time the forecast for supplementary payments during the spring has been revised downwards since the large payments last December may mean that payments, which would otherwise have been made during the spring, have already been received. It should be noted that the uncertainty surrounding supplementary tax payments remains large.

Temporary net revenues are estimated to amount to about SEK 45 billion, which is unchanged compared with the previous forecast. A more detailed analysis of the temporary payments, including a presentation of the development of the borrowing requirement on a cash basis and the borrowing requirement adjusted for temporary payments, is provided in a box on p. 6 below.

Monthly forecasts

As of the present report, The Debt Office has changed the procedures for publication of forecasts of the borrowing requirement. From now on forecasts will be published four times a year instead of every month. Each report will therefore include a larger number of monthly forecasts than previously; see Figure 2 and Table 1 below. If, as a result of outcome data or other new information, the forecasts have to be revised in the period between the published forecasts, this will be reported in connection with the publication of the actual borrowing requirement for the past month.

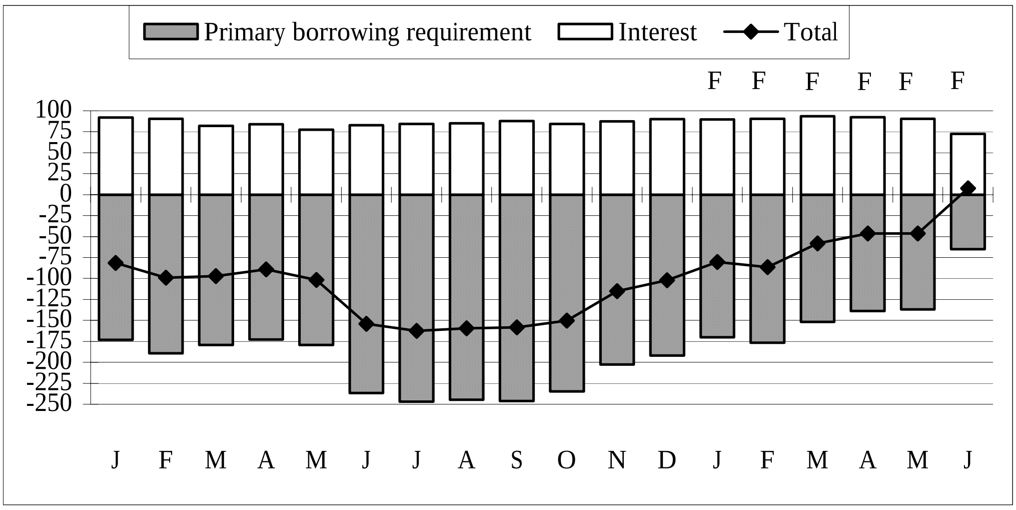
January

When the current forecast was prepared, the outcome for January was not yet available. However, the evidence suggests that the borrowing requirement for January will be somewhat lower than the forecast of SEK 22.8 billion published on January 5. The outcome for January will be published on February 6.

February

The estimate for February indicates a budget surplus of SEK 34.9 billion, 6.1 billion more than the corresponding month in 2000. The main reason for the increase is that supplementary tax payments are expected to be larger than in February 2000. This in turn has to do with the fact that the reimbursement by SPP (an insurance company) of enterprise-specific funds improves business results for 2000.

Figure 2: Central government borrowing requirement, twelve-month figures, SEK billion.



March

The estimate for March indicates a budget deficit of SEK 16.5 billion. In March last year a surplus of almost 12 billion was recorded. The large difference is explained, first, by a transfer to the central government from the AP Funds in March 2000. Second, premium pension payments made in 1999 were disbursed to fund managers outside the central government in March and April this year whereas last year the premium pension disbursements took place during the fall.

April

In April, too, the central government finances are expected to show a deficit, estimated to be SEK 5.5 billion. In April 2000, a surplus of just over 6 billion was recorded. As indicated, the premium pension disbursements will continue in April. At the same time there will be an annual reconciliation of the allocations to the premium pension system. Last year money was put into the system, while this year the payment is expected to go in the opposite direction.

May

The estimate for May indicates a budget surplus of SEK 9 billion. This is unchanged compared with May last year.

June

The estimate for June indicates a budget surplus of SEK 7.5 billion, a sharp turnaround compared with the surplus of 61.5 billion in June 2000. Large revenues from the sale of Telia shares, a large dividend from Stattum (a government holding company) and a transfer from the AP Funds contributed to the exceptional result in June last year. The large difference in interest payments between the two years – a decline of about 18 billion – is due partly to large capital losses on the buybacks of bonds made in connection with the Telia sale. In addition, current payments of interest decline, since an old bond with coupon maturity in June has been paid off.

Table 1: Central government borrowing requirement, SEK billion.

	February		**March**		**April**		**May**		**June**	
	2000	**2001**	**2000**	**2001**	**2000**	**2001**	**2000**	**2001**	**2000**	**2001**
Primary borrowing requirement	-34.5	-41.3	-14.7	10.4	-16.4	-3.5	-26.0	-24.2	-84.3	-12.3
Interest payments	5.7	6.4	2.9	6.1	10.2	9.0	17.1	15.2	22.8	4.8
- Interest on loans in SEK	5.1	3.0	1.6	2.6	8.9	6.4	17.4	11.7	20.7	3.5
- Interest on loans in foreign currency	1.7	1.4	1.5	1.5	2.2	1.8	1.5	0.8	2.0	1.2
- Realized currency gains and losses	-1.1	2.0	-0.2	2.0	-0.8	0.8	-1.7	2.7	0.1	0.1
Net borrowing requirement	-28.8	-34.9	-11.8	16.5	-6.1	5.5	-8.9	-9.0	-61.5	-7.5

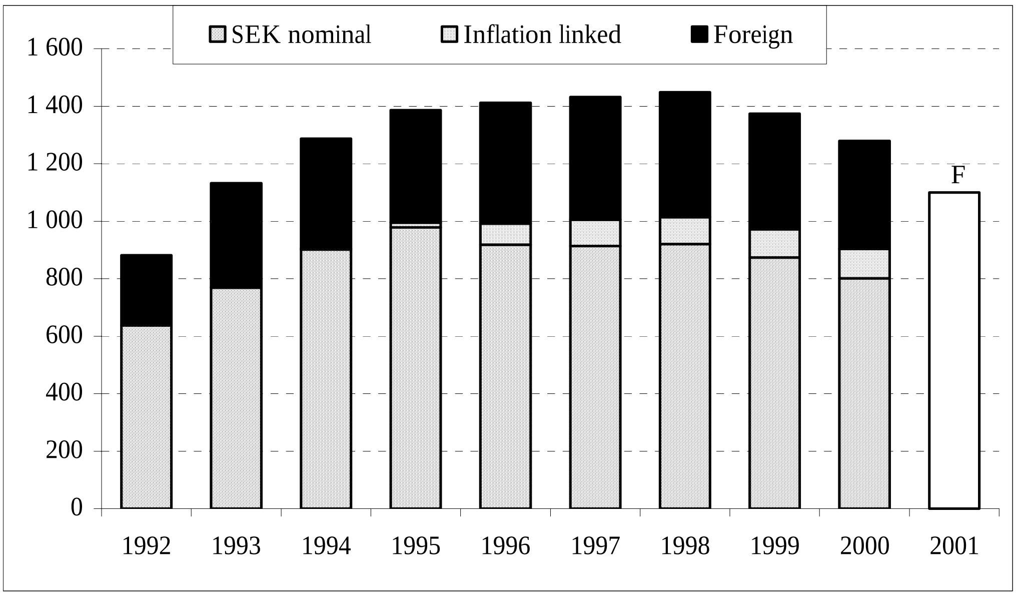
For the twelve-month period ending June 30, a borrowing requirement of SEK 7.5 billion is foreseen. The big difference between the twelve-month figure for June and the calendar year forecast reflects the fact that the Telia payment falls out of the twelve-month data while the large disbursements of premium pension funds during the final quarter of last year are still included.

THE CENTRAL GOVERNMENT DEBT

The National Debt Office anticipates that by the end of 2001, the central government debt will amount to approximately SEK 1100 billion. This implies a reduction by about 180 billion compared with December 2000. Thus, the debt is expected to decline by more than the amount of the budget surplus and this is due mainly to the fact that the state at the turn of the year received central government bonds from the AP Funds in a total amount 77.4 billion. These bonds have reduced the debt by the same amount without affecting the surplus on a cash basis. In addition, by the end of last year the Debt Office had short-term investments, i.e. a certain excess indebtedness, to the tune of SEK 10 billion as a result of unexpectedly large tax revenues just before the end of the year.

A further factor giving rise to differences between the surplus on a cash basis and the change in debt is the exchange rate of the krona. If the krona strengthens, the foreign currency debt declines, measured in kronor (and vice versa if the krona weakens), as does the total debt. The borrowing requirement is affected only if and when exchange rate movements cause realized exchange rate losses, i.e. to the extent that the exchange rate remains at the same level until a foreign currency loan is repaid. The debt forecast as well as the forecasts of the borrowing requirement have been prepared on the basis of the exchange rates prevailing at the time of the forecast.

Figure 3: Central Government Debt 1992–2001, SEK billion.



TEMPORARY PAYMENTS

The National Debt Office regularly publishes figures on the borrowing requirement adjusted for so called temporary payments. The point is that the borrowing requirement – and with it the budget balance – in any given period is influenced by transactions that do not change the government finances in a lasting fashion. By removing such payments from the borrowing requirement one might hopefully get a clearer picture of the underlying development.

Principles for identifying such temporary payments were developed in a report published by the Debt Office in 1997.[2] In it, temporary payments are defined as *transactions, which reflect the reallocation of (expected) payments between periods*. Behind this definition lies an ambition to isolate transactions that do not influence the central government net wealth. Thus, temporary transactions are, for example, revenue from the sale of state assets, such as shares in companies, since payments in the form of future dividends are exchanged for a lump sum in connection with the sale. Included are also deposit and lending transactions where the depositors and borrowers are located outside the central government and the money eventually will have to be paid back. In the report, the Office emphasizes that the classifications are based on considerations with subjective elements. Moreover, adjustment for temporary factors does not provide a measure of the ”underlying borrowing requirement” in any formal sense, inter alia because it does not take into account differences between structural and temporary factors. In particular, it should be noted that tax payments are not included in the calculations. In order to emphasize the approximate nature of the calculations, the Office has adopted the practice of presenting temporary payments as amounts in billions rounded to the nearest multiple of five.

Experiences

The basic classifications made in the report of 1997 are still valid. An addition has been made inasmuch as capital losses (as well as possible capital gains) arising in connection with exchanges and buybacks of bonds – which are added to the central government interest payments – are also counted as temporary. The reason is that capital losses are matched by a reduction in future coupon payments, i.e. it is a matter of reallocation between periods.

In addition, the Debt Office defines the cash effects of transfers from the AP Funds as temporary payments. This is a departure from the definition above since the transfers are not redistributions between periods but amount to an increase in the net wealth of the state. The justification is that the amount transferred strongly overstates the lasting effect of the transfers. The latter is equivalent to the reduction in future interest payments that follow because the debt is smaller. Since the annual effect on interest payments is lower than the limit otherwise applied by the Office and would

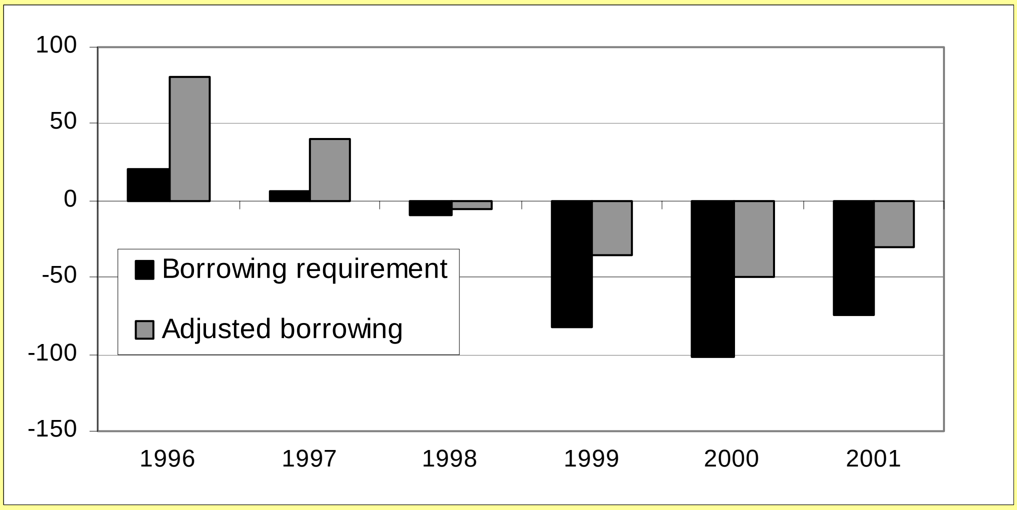
[2] The report (in Swedish) can be downloaded from the Office’s web site (www.rgk.se).

not change the overall picture, the Debt Office has chosen to see the entire amount of transfers as temporary.

The development of borrowing requirement and adjusted borrowing requirement

The development of the borrowing requirement on a cash basis and of the adjusted borrowing requirement since 1996 is shown in the figure below, where a negative borrowing requirement indicates a surplus and, of course, the figures for 2001 are forecasts.

Borrowing requirement and adjusted borrowing requirement 1996–2001, SEK billion.



Except for 1998, the net temporary revenues have ranged between SEK 35 and 60 billion and have therefore contributed to considerable reductions in the borrowing requirement (increases in the budget surplus). Nevertheless, they do not change the picture of a marked improvement in the central government finances during the period under review. For 2001, the Debt Office anticipates that the adjusted surplus will decline by about the same amount as the actual surplus. The explanation of this development is provided in the forecast section of this report. The table below gives a more detailed account of the temporary payments.

Temporary payments 1996–2001, SEK billion.

	1996	1997	1998	1999	2000	2001*
Revenue from sales and extra dividends	9	21	6	1	76	15
Net lending by the Office	42	20	6	7	-56	-9
Transfers from the AP Fund				45	45	42
Capital losses in connection with exchanges/buybacks	-5	-5	-15	-10	-14	-5
Other	12	–	8	–	–	–
Temporary payments	**60**	**35**	**5**	**45**	**50**	**45**

*Forecasts

FUNDING

Nominal borrowing

Since the turn of the year, nominal bonds are issued in an amount of SEK 4 billion per auction, or about SEK 8 billion per month. However, the decline in the borrowing requirement will lead to a gradual reduction in issues in the course of the year. Probably a reduction in issue volumes will take place before the summer; the precise time will be communicated to the market well in advance. The Debt Office expects to issue nominal bonds in an amount of SEK 60–70 billion in the course of 2001.

The issues will be concentrated on the newer loans, with prime focus on the most recently introduced loan, 1045 (5.25 %, March 2011). To the extent possible, the issue policy will also support electronic trade in bonds, which centres above all on the maturity segments 2, 5 and 10 years. This does not necessarily mean that issues will take place in all these maturities, but the Debt Office will maintain outstanding volumes in these maturities at levels that ensure liquidity. The borrowing will be distributed across five to six loans for the purpose of achieving a proper distribution across maturities. In this manner the refinancing risk is smoothed while at the same time it will be possible to comply with the duration target that has been established for the debt.

In April, loan 1039 (5.5 %, April 2002) will have less than twelve months until maturity. In the usual manner, holders of the loan will be offered to exchange the loan for a package of Treasury bills. By exchanging benchmark loans for Treasury bills ahead of maturity, the Debt Office reduces its refinancing risk, since the maturity is spread out over several points of time. At the same time, it benefits the liquidity in the market for Treasury bills. Details of the exchange will be published during the spring closer to the time of the exchange.

In order to comply with the guidelines issued by the government to the effect that no more than 30 percent of the central government debt may mature in twelve months, the Debt Office will spread the borrowing in Treasury bills over a few more maturities than usual, and issue Treasury bills with maturities ranging up to 18 months. This practice was begun already in December last year, when a 15-month bill, maturing in March 2002, was introduced.

In a box on page 9, the Office explains the principles governing the attribution of benchmark status to a bond loan.

WHAT IS A BENCHMARK LOAN?

The transfer from the AP Funds to the National Debt Office at the turn of the year and subsequent exchanges of loans 1038 and 1034 has brought the issue of so called benchmark status to the fore. The definition of benchmark status is also important in relation to the repo facilities offered to the dealers by the Office. The Debt Office considers it important to inform briefly about the principles in force.

When the system of benchmark loans was introduced in 1989, there were 40–50 loans outstanding. The purpose was to concentrate liquidity in a small number of loans. The bulk of new issues were made in the benchmark loans, and the volumes outstanding of these loans increased rapidly. In the dealer agreement, the Office also introduced requirements regarding the secondary market, such as binding two-way prices, minimum trading lots etc. in the benchmark loans. As the stock of bonds has grown and previously issued non-benchmark loans have matured, the number of loans has fallen markedly. At the same time the volumes of the loans outstanding have increased. In recent years, there have been 8–12 benchmark loans. This issue strategy has meant that the stock of bonds almost exclusively consists of benchmark loans, as a result of which the concept of non-benchmark loans has lost its meaning. In the dealer agreement, moreover, previous, explicit requirements regarding the quoting of prices in the benchmark loans have been removed and replaced by more general formulations.

When new loans are introduced, a loan is defined as a benchmark loan when the volume outstanding reaches SEK 15 billion. In order to ensure good liquidity in the new loan, the Office offers particularly generous repo facilities until this volume has been reached. (See separate text on the web site, www.rgk.se, under Investor Information, Technical guide.)

When the remaining time to maturity for a benchmark loan is short, normally less than a year, the Office offers an exchange for Treasury bills for the purpose of spreading the refinancing risk and assuring the investors of good liquidity. After the period of the exchange, the bond looses its benchmark status regardless of the remaining volume outstanding. The significance of non-benchmark status is that the repo facilities for the loan deteriorate from an approximate level corresponding to the repo rate minus 15 basis points to a level corresponding to the repo rate minus 120 basis points. For these loans the trade in the secondary market are limited.

On past occasions of exchanges between bonds, the issue of benchmark status has not arisen, since the remaining volume of the loans has been far in excess of SEK 15 billion. The most recent exchange, carried out at the beginning of January in loans 1038 and 1034, differs from earlier exchanges in that the remaining volume in the two loans is less than SEK 15 billion. Thus, they no longer meet the volume requirement and have lost their benchmark status. The immediate effect is that the repo facilities have changed and since January 18 are offered at the level of the repo rate minus 120 basis points. The offer to exchange loans 1038 and 1034 for more liquid benchmark loans will remain open, at a small transaction cost.

Exchange rate and interest rate exposure through swaps

Guidelines laid down by the government stipulate that the foreign currency debt be amortized by SEK 35±15 billion in 2001. Taking into consideration, among other things, the value of the krona, the Debt Office has chosen to lower the rate of amortization from the beginning of the year to SEK 25 billion, thus exploiting the flexibility provided in the foreign currency mandate. (The reasoning underlying this is explained in a press release dated December 22, 2000, which can be downloaded from the Office's web site, www.rgk.se, under Press Information.) Allowing for the maturing of loans and swaps, this yields a gross borrowing requirement in foreign currency of about SEK 20 billion in the course of the year. As was the case last year, the major part of this exposure will be achieved via borrowing in the domestic market, which is subsequently swapped into foreign currency.

This year, along with krona/foreign exchange swaps, the Office is, as already indicated, planning to carry out interest rate swaps in Swedish kronor. In this way, borrowing via bonds is converted into short krona borrowing through interest rate swaps, in which the Office receives a long interest rate and pays a short interest rate. The purpose is to obtain a lower cost compared to issuing Treasury bills. A more detailed description of the construction of these swaps was presented in ”The Swedish Central Government Borrowing Requirement and Funding”, dated November 9, 2000.

Krona/foreign exchange swaps actually consist of two parts; an interest rate swap in Swedish kronor and a basis swap with an asset in Swedish kronor and a liability in foreign exchange. The Debt Office is planning to carry out swaps in the krona market, krona/foreign exchange swaps and krona interest rate swaps in a total amount of the order of SEK 30 billion during the year. A change in the volume of krona/foreign exchange swaps, for example as a consequence of a change in the rate of amortization of the foreign currency debt, may affect the volume of interest rate swaps in kronor.

Auction activities in the market for inflation-linked bonds

The government's guidelines for the management of the central government debt direct that the share of inflation-linked bonds in the debt is to rise in the long term, but that the increase should be adapted to the demand. The Debt Office is planning a net issue of inflation-linked bonds during 2001 of about SEK 5 billion. The auctions will include both sales, exchanges and buybacks, which means that gross volumes may be as large as SEK 10–20 billion. Most of the new inflation-linked bonds will have a maturity of at least 10 years. As last year, the issues will probably be concentrated on coupon bonds and the buybacks on zero-coupon bonds.

Since all transactions have to be cost effective and be justified from a debt management perspective, the Debt Office will, as in the past, assess the prevailing price picture. In a situation where the break-even inflation, i.e. the future inflation rate required for investments in nominal and inflation-linked bonds to be equivalent, for an issue under consideration obviously differs from prevailing inflation expectations or from the prevailing break-even inflation in other inflation-linked bonds, the transaction will be cancelled.

The next quarterly report, that amongst other things will contain a forecast for the borrowing requirement for 2002, will be published at 9.30 a.m. May 21, 2001.

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