RIKSGÄLDS KONTORET
THE SWEDISH NATIONAL DEBT OFFICE

CENTRAL GOVERNMENT BORROWING

FORECAST AND ANALYSIS

2005:1

BORROWING REQUIREMENT

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REDUCED BORROWING REQUIREMENT

The Swedish central government borrowing requirement in 2005 is estimated at SEK 38 billion. This is SEK 15 billion less than the outcome for 2004. The borrowing requirement is SEK 8 billion less compared with our forecast in October. The main reasons for the reduction are increased tax revenue, lower interest on central government debt and the state selling shares in Nordea for SEK 2 billion in connection with Nordea's repurchase of shares. Government debt is expected to increase by SEK 44 billion in 2005 to SEK 1 301 billion.

Interest rates have fallen since the October report, leading to a longer duration. The reduced net borrowing requirement and the lower interest rates therefore make it necessary to reduce the long borrowing. Accordingly, issue volumes in nominal government bonds are being reduced from SEK 3.5 to 2.5 billion per auction from March 9, 2005. Total bond borrowing is expected to be SEK 62 billion compared with SEK 81 billion in the October forecast.

As in previous government borrowing reports, this report includes articles relating to the operations of the Debt Office. There is a description of our liquidity management, which is an integrated part of government borrowing. Its task is to balance daily government cash flow by loans or investments to obtain a zero balance at the end of each day. The daily balance before these management transactions fluctuates greatly. On average, there is a daily cash deficit of SEK 15-20 billion, while a surplus of SEK 30-40 billion is invested on some days and a deficit of SEK 40-50 billion funded on other days.

To develop and improve the Debt Office, we have undertaken a survey of how investors, dealers and other sellers of government securities view our activity. This report contains a summary of the results of this survey. It is available on www.rgk.se. The Debt Office has largely received a favourable assessment. This is gratifying although our focus will be on the areas where we can make improvements, for instance increasing our direct contact with investors.

Bo Lundgren
Director General

CENTRAL GOVERNMENT BORROWING REQUIREMENT

The Swedish National Debt Office's forecast for 2005 indicates a borrowing requirement of SEK 38 billion, SEK 8 billion less than in the October forecast. The downward adjustment is primarily due to increased tax revenue, reduced interest payments on central government debt and the state selling shares in Nordea in connection with their repurchase programme. The borrowing requirement is decreasing by around SEK 15 billion from 2004 to 2005, mainly due to interest payments being abnormally low in 2005.

Forecast for 2005

The Debt Office's revised forecast for 2005 indicates a borrowing requirement of SEK 38 billion, SEK 8 billion below the October forecast.

In relation to 2004, the borrowing requirement is decreasing by SEK 15 billion, see Table 1. This is mainly due to a decrease in interest payments of SEK 20 billion. In addition, the cyclical upswing will lead to increased revenue from consumption and wage-based taxes, although it will be partly counteracted by the tax cuts decided in the state budget.

The primary borrowing requirement (all central government payments excluding interest payments on debt) is estimated at SEK 5 billion, SEK 6 billion lower than in the October forecast. The major part of the reduced primary borrowing requirement is due to increased tax payments and SEK 2 billion in income from sale of shares in Nordea. Government disbursements are as before limited by the expenditure ceiling.

To date the consumption and wage-based taxes have mainly developed as forecast. The major part of the year's supplementary tax payments are made in February, chiefly supplementary payments due to capital gains in the previous year. These have been large in the first half of February and, partly for this reason, we have increased the forecast for the year's tax payments by SEK 3 billion.

Net lending by the Debt Office to government agencies, public enterprises and state-owned companies is estimated at SEK 14 billion, SEK 1 billion lower than the previous forecast. Net lending can be affected during the year by the winding-up of individual skills saving account, which has a balance of SEK 6 billion. It is not clear how the winding-up is to take place, although the transaction will not in any case affect the borrowing requirement, since no payment from the government will be made. We have therefore not included the amount in the forecast for net lending.

Interest payments for 2005 are expected to be SEK 33 billion, a decrease of SEK 2 billion compared with the previous forecast. The explanation for this is estimated larger premiums on bond issues. Premiums are increasing despite reduced issue volumes due to a substantial decrease in interest rate levels. The Debt Office is not forecasting future interest rates but is using stop rates in the calculation of interest payments, see fact box on conditions behind the forecast.

Interest payments are expected to decrease by almost SEK 20 billion compared with 2004,

Figure 1. CENTRAL GOVERNMENT BORROWING REQUIREMENT 1995-2005

SEK BILLION

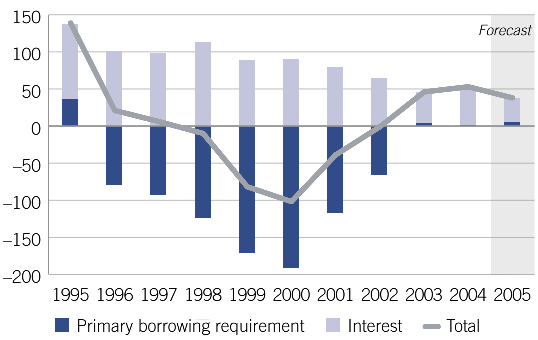


Table 1. CENTRAL GOVERNMENT BORROWING REQUIREMENT AND CENTRAL GOVERNMENT DEBT 2004-2005, SEK BILLION

	2004	2005 (forecast)
Primary borrowing requirement	1	5
Interest payments on debt	53	33
Net borrowing requirement	53	38
Debt adjustments	–17	6
Re-evaluation, foreign currency loans etc	–10	5
Short-term investments	–8	0
Change in central government debt	29	44
Debt at year-end	1,257	1,301

FACTS

Interest payments and interest cost

Interest payments on government debt have varied greatly in recent years due to different effects from capital gains and losses. What is then a normal level for interest payments? One way of adjusting for capital effects is to use cost accounting interest rates. This can be estimated by the average issue yield, which is a volume-weighted average of the yields at which the Debt Office has issued its instruments. Since the debt consists of loans issued at different times, older loans remain that were taken up when interest rates were higher than at present. This keeps the average up.

The average issue rate for all of the Debt Office's outstanding loans and swaps is now around 3.5 per cent. Applying the National Institute of Economic Research's (NIER) forecast for change in CPI for 2005 to calculate the nominal cost for the inflation-linked loans and the Debt Office's forecast of interest income from loans to government agencies, *interest cost* is calculated at around SEK 42 billion. This is an estimate of the underlying annual interest payments with the current government debt, interest-rate levels and exchange rates, and adjusted for all capital effects.

largely due to expected exchange rate gains of SEK 8 billion, compared with losses of SEK 5 billion in 2004. The gains are an accounting effect of the maturing this year of dollar loans taken in 2002. These were taken up at a considerably higher dollar rate than the current rate. However, the actual gain over the whole period to maturity of the loans is considerably lower as the Debt Office distributes the risk among different currencies with derivatives.

Table 2. BORROWING REQUIREMENT ADJUSTED FOR TEMPORARY PAYMENTS, SEK BILLION

	2000	2001	2002	2003	2004	2005
Borrowing requirement	–102	–39	–1	46	53	38
Divestment of government property	76					
Extra dividend from the central bank			20			
Transfers from National Pension Funds	45	42	7	14	4	2
Net lending to state agencies	–56	–25	–9	–3	–8	–8
Interest payments	–14	–5	–1	15	10	9
Other	1	2	–2	4	0	6
Adjusted borrowing requirement	–50	–25	14	75	59	46

Table 3. COMPARISONS BETWEEN BORROWING REQUIREMENT FORECASTS, SEK BILLION

	Debt Office 2005	Government 2005	NIER 2005	ESV 2005
Primary borrowing requirement	5	–1	10	0
Interest payments	33	39	37	38
Borrowing requirement	38	38	47	38
Borrowing requirement including Debt Office interest payments and divestment revenue	38	46	41	31

Comparisons

Borrowing requirement adjusted for temporary payments

Part of the payments that affect the borrowing requirement can be regarded as temporary. Previous examples of such payments are the payments for maturing of housing bonds transferred to the state from the AP (National Pension) funds and sale of state property. In 2005, we estimate that the state will sell shares in Nordea for SEK 2 billion and that the state's share of TeliaSonera will provide around SEK 4 billion in extra dividend. The borrowing requirement in 2005 is expected to be SEK 38 billion. Adjusted for temporary payments, it will be SEK 46 billion. See Table 2.

Comparisons with other forecasts of the borrowing requirement

The Debt Office's forecast for the current year indicates a lower borrowing requirement than the Government's and NIER's calculations adjusted for known differences in sales of state property and interest assumptions. See Table 3. Compared with the Financial Management Authority (ESV), we expect a higher borrowing requirement. ESV and NIER reported their government borrowing requirement forecasts in December 2004 and the Government in September.

Neither NIER nor ESV has counted on any income from sold property in 2005, while the Government assumes sales income of SEK 15 billion. Our assessment is that sales income will be SEK 2 billion this year due to sale of the state's shares in Nordea. Interest calculations differ slightly between the different forecasters, but what the Government, NIER and ESV all have in common is that they expect higher interest payments than we do.

Table 4. MONTHLY BORROWING REQUIREMENT 2004, SEK BILLION

	Feb.	Mar.	Apr.	May.	Jun.
Primary borrowing requirement	–28.5	–3.6	–8.1	–19.7	11.7
Interest payments	0.1	2.0	1.0	7.3	1.1
Borrowing requirement	–28.4	–1.6	–7.1	–12.4	12.8

Monthly forecasts

The Debt Office publishes annual forecasts three times a year. At the same time, we publish monthly forecasts for the intervening months. See Table 4. Between regular publications, the Debt Office only makes revisions of annual and monthly reports in exceptional cases. The revised forecast is then presented with the announcement of the monthly borrowing requirement outcome five working days after the end of each month.

There is a recurrent pattern in the borrowing requirement from year to year. In February, the state budget shows a large surplus due to supplementary tax payments. Compared with February the previous year, the surplus is expected to increase by SEK 13 billion. Approximately half of this is due to higher tax revenue and half to lower interest payments on government debt. The borrowing requirement in June will deteriorate by SEK 16 billion compared with last year due to increased excess tax payments. This is a changed payment pattern between months. Maturing housing bonds and increased net lending also contribute to the deterioration. Other months show fewer discrepancies compared with previous years.

Central government debt

At the end of January, government debt was SEK 1 287 billion, an increase of SEK 30 billion since 1 January. The borrowing requirement has increased government debt by SEK 24 billion since January 1. Debt-related depositions and short-term investments have increased the debt by SEK 6 billion. An example of a debt-related disposition is the revaluation of the foreign currency debt, which affects the size of the debt but not the borrowing requirement.

FACTS

Conditions behind the forecast

The Debt Office uses NIER's macroeconomic assessment in the areas where such assessment is needed for the forecast of the borrowing requirement. This forecast is based on the forecast presented by NIER in "The Swedish Economy" in December 2004.

NIER estimates a 3.2 per cent growth in GDP this year, which is in principle unchanged compared with our previous forecast. The growth is primarily expected to be driven by investments and consumption. This growth is more favourable for the borrowing requirement than export-driven growth, which was the predominant driving force in 2004.

Low inflation is restraining the nominal growth rate. The trend on the labour market is the most important single variable for the borrowing requirement. The upswing has still not lead to decreased unemployment. However, NIER forecasts a small improvement in the labour market in 2005. As the labour market has still not started to improve, we are making a slightly more cautious forecast for the increase in gross wages in 2005 than NIER did in December. Gross wages is the most important tax base. Our assessment is that it will increase by slightly over 4 per cent in 2005. As a whole, we substantially share NIER's macroeconomic assessment.

The Debt Office's forecast for interest payments on government debt is based on the interest and exchange rates at the time of the forecast. The stop date for the current forecast was 15 February 2005. We have also weighed in the outcome of the borrowing requirement up to 15 February and thus taken into account the large tax payments made to date in February.

FACTS

Sensitivity analysis

All forecasts include elements of uncertainty. The Debt Office does not produce any overall uncertainty analysis for the borrowing requirement. Instead we present a partial analysis of the impact on the borrowing requirement that changes in some important macro variables, roughly estimated, will have in a one-year perspective. If one wishes to make an assessment of an alternative scenario in which several variables develop differently, their effects must be added together.

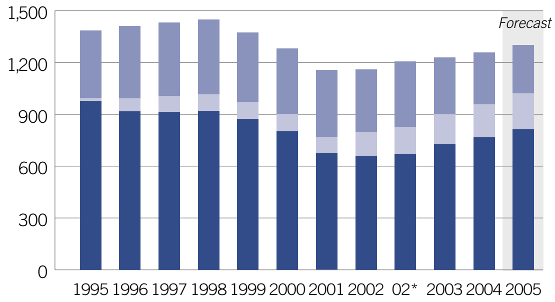
SENSITIVITY ANALYSIS, SEK BILLION

Increase by one per cent/ percentage point.	Impact on borrowing requirement
Gross wages [1]	–6
Household consumption, current prices	–2
Registered unemployment	4
Swedish interest rates	4
International interest rates	1
Exchange rate	0,5

[1] *Local taxes based on income from employment are disbursed to local government with a one-year time lag. As a result, the effect on the central government borrowing requirement in a one-year time perspective - the time horizon in the table - is larger than the permanent effect.*

The Debt Office does not take into account debt-related dispositions in its forecast of the development of central government debt. It is therefore expected to increase at the same pace as the borrowing requirement during the rest of the year. At the end of 2005, the debt is projected to be SEK 1 301 billion.

Figure 2. THE CENTRAL GOVERNMENT DEBT, 1995–2005
SEK billion



* *A new measure of the central government debt was introduced in the beginning of 2003.*

FUNDING

Issue volumes of nominal government bonds will be reduced from SEK 3.5 to 2.5 billion per auction. The Debt Office estimates that there will continue to be potential to issue inflation-linked bonds for approximately SEK 15 billion. Foreign currency borrowing is estimated at SEK 28 billion.

The net borrowing requirement is estimated at SEK 38 billion in 2005. The Debt Office also needs to fund maturing loans and buy-backs. Total funding in government securities (bonds and T-bills) is calculated at SEK 100 billion in 2005, SEK 15 billion lower than in the previous forecast in October. However, funding is increasing compared with last year, despite the reduced net borrowing requirement. The most important reason is funding of large maturities of foreign currency loans in 2005.

Table 1 presents an assessment of the allocation of funding between bonds and T-bills as well as the allocation of bond issues among nominal government bonds, inflation-linked bonds and foreign currency bonds.

Nominal krona borrowing

Nominal government bonds

Issue volume reduced to 2.5 billion per auction

The issue volumes of nominal government bonds will be reduced from SEK 3.5 till 2.5 billion per auction from March 9. We thus expect to borrow SEK 62 billion in nominal government bonds in 2005.

The duration target for the nominal krona debt is to be reduced from 3.0 years in 2004 to 2.8 at the end of 2005. To achieve this, one of the measures was to reduce the issue volume in nominal government bonds at the end of November last year from SEK 4 to 3.5 billion per auction.

The reduction in the issue volume now announced is being undertaken since the net borrowing requirement has been revised and interest rates have decreased since the last forecast. All else being equal, a lower interest rate leads to a longer duration. The lower net borrowing requirement and lower interest rates must be met by a reduction of the long borrowing if the duration is not to be too long.

The outstanding bond stock will decrease by SEK 22 billion in 2005. Exposure in bond interest rates taking into consideration planned interest-rate swaps decreases by SEK 40 billion, see Table 4. Swaps are discussed in more detail in the sections on T-bills and foreign currency borrowing.

Table 1. FUNDING 2004 AND 2005, SEK BILLION

	2004	2005
Net borrowing requirement	53	38
Change in cash equivalent holdings and retail market borrowing [1]	–12	–9
Maturing bonds and buy-backs [2]	43	71
Government bonds	21	28
Foreign currency bonds	22	43
Total	84	100
Net funding with T-bills [3]	–35	5
Bond issues, gross [4]	119	95
Foreign currency bonds	10	18
Inflation-linked bonds [5]	18	15
Nominal government bonds [6]	91	62
Funding	84	100

1 *Change in outstanding deposits, liquidity bills and repos. Retail borrowing is assumed to be unchanged in 2005.*
2 *No outright buy-backs are planned in 2005.*
3 *Net of issues (excluding exchanges) and maturities.*
4 *Noominal amounts. Premiums and discounts (including inflation compensation) and exchange rate differences on issues are included as interest payments in the net borrowing requirement.*
5 *Issue volume per auction, average* *0.9* *0.8*
6 *Issue volume per auction, average* *4.0* *2.7*

Table 2. NEW BONDS - MATURITIES AND ISSUE DATES

Bond	Maturity	First issue date
Ten-year nominal government bond (1050)	July 12, 2016	September 14, 2005
Seven-year inflation-linked bond (3106)	April 12, 2012	September 22, 2005

Table 3. IMPORTANT DATES

Date	Activity
March 23	Press release on exchanges of 1044 to T-bills
April 25-29	Exchanges of 1044 to T-bills
June 15	Central Government Borrowing – Forecast and Analysis 2005:2
September 1	Press release on exchanges to 1050 and 3106
September 7	Conditions for issue of 1050 (coupon fixing)
September 14	Issue of new ten-year nominal government bond 1050
September 15-20	Exchanges of loan 1050
September 15	Conditions for issue of 3106 (coupon fixing)
September 22	Issue of new seven-year inflation-linked bond 3106
	Exchanges of 3106

Table 4. CHANGE IN OUTSTANDING GOVERNMENT BONDS, NET INKL. SWAPS, SEK BILLION

	2004	2005
Nominal government bonds, issues	91	62
Maturities, buy-backs and exchanges	–69	–84
Change in nominal government bond stock	22	–22
Swaps, net	–21	–17
Nominal government bonds and swaps, net change	1	–40

Table 5. BENCHMARK LOANS IN THE ELECTRONIC INTERBANK MARKET [1]

Date for exchanges of benchmark loans (IMM-date)	2-year	5-year	10-year
December 15, 2004	1037	1048	1049
June 15, 2005		1045	
December 21, 2005	1040		1050

[1] *The above date for change of reference loans refer to the payment date. The first trading date for a new benchmark loan is normally the Friday before the IMM date.*

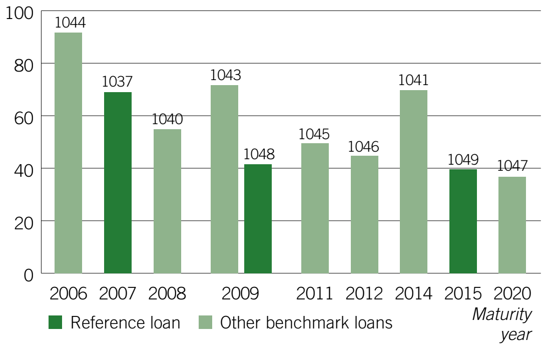
Table 6. CHANGE IN OUTSTANDING T-BILLS, NET INCLUDING SWAPS, SEK BILLION

	2004	2005
T-bill borrowing, net [1]	–35	5
Exchanges of government bonds for T-bills	50	65
Change in T-bill stock	15	70
Interest swaps, net [2]	30	25
T-bill stock and swaps, net change	45	95

[1] *Net of issues (excluding exchanges) and maturities.*
[2] *No interest swaps mature in 2004-2005.*

On September 14, a new ten-year government bond, loan 1050, will be introduced maturing on July 12, 2016. There will be an opportunity to exchange loan 1049 (August 2015) for the new ten-year loan on four business days after the auction. The conditions for these exchanges will be announced in a press release on September 1. The coupon will be notified a week before the first auction date. Trading will start in the loan as a ten-year benchmark loan in the electronic trading system with payment date on December 21, 2005.

Figure 1. NOMINAL GOVERNMENT BONDS (BENCHMARKS)
SEK billion



New ten-year loan introduced on September 14
Bond issues are usually made in the benchmark loans with two, five and ten year maturities that are traded in the electronic interbank market [1]. The issues are usually concentrated on new loans. In 2004, new five-year (loan 1048) and ten-year (loan 1049) loans were introduced. In 2005, a new ten-year loan (loan 1050) is being introduced.

To avoid excessively long duration, in particular in the spring, the issues will be allocated evenly between the two, five- and ten-year maturities in 2005. In present conditions, there is no scope for issuing the sixteen-year loan until the autumn, when it can be issued very occasionally.

[1] *The loans treated as benchmark loans in electronic trading are determined by which loans are closest in terms of maturity to two, five or ten years. However, benchmark loans change only on IMM dates (the third Wednesday of March, June, September and December) with the criterion that in terms of maturity the loans should be closest to two, five or ten years on the following IMM date. With this change, an underlying loan in the forward contracts will always be the same as a benchmark loan in the last three months of the contract.*

T-bills and interest swaps

Increased borrowing with T-bills
Funding in T-bills is increasing by SEK 40 billion in 2005 compared with 2004, an increase of SEK 10 billion compared with the October forecast and reflects the reduction in bond borrowing. This increase is spread over the whole year and can be regarded as relatively marginal. It is also limited by the downward adjustment of the net borrowing requirement.

Borrowing in T-bills varies over the calendar year due to seasonal variations in the funding requirement. In late autumn, as well as early in the year, the borrowing requirement and thus bill issues are relatively large. However, the borrowing requirement is usually lower in the period February to May. Bill maturities are concentrated in the IMM months, contributing to relatively large borrowing in bills at auctions these months. Bill borrowing can deviate from the normal pattern, however, due to, for instance, forecast deviations in tax revenue.

The T-bill stock is expected to increase by SEK 70 billion in 2005, see Table 6. The increase is due to increased net funding in T-bills in 2005 and the exchanges of bond loan 1044 to T-bills taking place in April.

SEK 35 billion in interest swaps
The Debt Office can also create short borrowing by issuing bonds and then using interest-rate swaps to reduce the duration. Provided that the difference between the swap rate and the government bond rate is sufficiently large, this borrowing technique reduces government borrowing costs. Interest swaps can also be used as part of the foreign currency borrowing. They are then combined with a currency swap so that the exposure in Swedish kronor is replaced by exposure in foreign currency[1].

In 2005, as previously announced, around SEK 35 billion of bond issues will be swapped to short exposure in SEK or foreign currency. The estimated increase in the swap volume in comparison with 2004 contributes to reducing the duration and thus keeping up issue volumes in government bonds.

If market conditions change, the actual swap volume can deviate from the forecast. Swaps will continue to take place at a relatively even pace during the year and with cost-effective maturities.

In 2004, practically the whole swap volume was used to replace T-bills. In 2005, a standardised assumption is made that SEK 25 billion will be used in this way.

Table 7 shows the net change in the outstanding swap volume. Despite a larger gross swap volume planned in 2005, the outstanding stock will not increase more quickly next year, since maturities will also be larger.

Inflation-linked borrowing

Issue policy

Unchanged pace of issues
The Debt Office expects to issue inflation-linked bonds at an annual pace of around SEK 15 billion. However, the growth of the market is difficult to assess and the annual pace is only an approximate estimation.

In 2004 SEK 18 billion were issued, i.e. approximately SEK 900 million on average per auction. Auction volumes were slightly lower during the autumn due to weak demand. In early 2005, demand has increased again.

This means that we expect to continue to issue inflation-linked bonds at about the same pace as last year, even though we are making a rather more cautious assumption this year than the SEK 20 billion we estimated in the October forecast.

Predictability with some flexibility
Inflation-linked are issued every other week. The announced issue volumes are normally about the same size at each auction. However, large deviations cannot be ruled out at times when market conditions are special, such as on coupon maturity.

During the spring we will review the forms for sale for inflation-linked bonds. We have previously emphasised that it is natural to place greater importance on predictability before and at auctions apace with the development of the market for inflation-linked bonds.

For the time being, however, we will continue to use flexible issue volumes in the same way as before, provided that demand is considered to be good. Flexible issues are announced as an interval. The lower interval limit corresponds to the issue volume

[1] *See fact box on borrowing instruments and swaps on p. 9 in Central Government Borrowing – Forecast and Analysis 2004:2. For an extended discussion on the use of swaps, see, Holmlund, A, (2002), "Swaps in central government debt management", Central Government Borrowing – Forecast and Analysis 2002:3, p. 17-20. An account of how funding is allocated to different loan instruments can be found in Olofsson, T. (2002), "How central government debt is funded", Central Government Borrowing – Forecast and Analysis 2002:3, p. 13-16.*

Table 7. CHANGE IN OUTSTANDING SWAPS, SEK BILLION

	2004	2005
Interest swaps [1]	30	25
Currency swaps [2]	2	10
Swaps total	32	35
Swaps, maturities	–11	–18
Swaps, net change	21	17

[1] *Interest swaps from long to short interest-rate exposure in SEK.*
[2] *Interest swaps from long to short interest-rate exposure combined with currency swaps to foreign currency.*

offered. The flexibility entails that the issues volume can be increased up to the upper interval limit provided that this can be done without significant impact on interest rates, i.e. that the bid curve is flat within the interval. Even if the issue volumes do not vary so much from one auction to another, to some extent, the Debt Office takes into account the prevailing demand situation and the pricing picture. The choice of loans, issue mechanisms and volume on individual issue dates is announced a week before the auction date after the Debt Office has gathered suggestions from primary dealers and investors. Both investors and dealers are welcome to pursue a continuous dialogue with the Debt Office on inflation-linked bonds and to submit suggestions before individual issues.

Current loans and issues

New inflation-linked bond on September 22

On September 22, the Debt Office will issue a new inflation-linked bond (loan 3106) maturing on April 12, 2012. The new loan is being introduced by an issue. There will then be an opportunity to exchange the new loan 3106 for 3101 at exchange auctions. Other loans may also come into question for the exchanges. There are reasons for making exchanges duration-neutral. Definitive dates, conditions and details of exchanges will be announced in a press release on September 1.

A phasing-out plan for loan 3101 has been discussed in *Central Government Borrowing* 2003:2 and 2003:3. The idea is for investors to be able to exchange to loan 3106 with an exchange volume of at most, for instance, SEK 10 billion per year. In this way, phasing-out of loan 3101 can take place in a predictable way.

Loans 3105, 3102 and 3104 will be issued during 2005, together with loan 3016 when it is introduced in the autumn. Loan 3101 can also come into question in the spring.

Foreign currency borrowing

In 2005, foreign currency loans equivalent to SEK 53 million will mature and we accordingly need to borrow the equivalent of SEK 28 billion in foreign currency to meet the target for the pace of amortisation. The increased currency borrowing compared with 2004 is explained by the high level of maturities in 2005.

We can borrow in foreign currency by issues of government bonds that are swapped to exposure in foreign currency (krona/swap borrowing) [1] or by issues of bonds in foreign currency (direct currency borrowing). The allocation of foreign currency loans between direct currency borrowing and krona/swap borrowing will depend on the interest rate conditions that can achieved.

In 2004, the major part took place by direct currency borrowing since it was possible to obtain very good loan conditions. To date this year, one

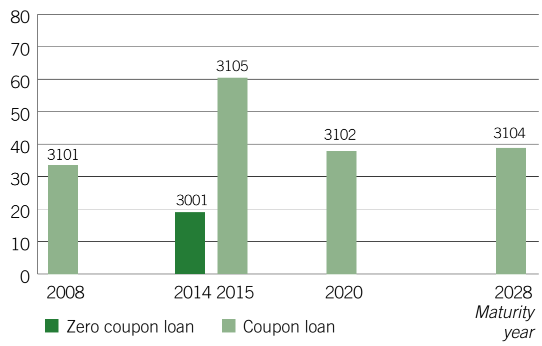
[1] *Government bond issues are first swapped to short interest rate exposure. Floating interest rates in SEK are then exchanged to short foreign interest rate by a currency swap with the same maturity as the interest-rate swap. At the same time, the Debt Office buys the foreign currency spot when the transaction is entered into. The currency is sold at the time of the swap. The currency swap thus creates a debt in foreign currency.*

Table 8. FOREIGN CURRENCY BORROWING 2004 AND 2005, SEK BILLION

	2004	2005
Foreign currency borrowing requirement, gross	12	28
Foreign currency amortisation	–26	–25
Maturities and exchange rate differences	37	53
Foreign currency bonds [1]	22	43
Foreign currency swaps [2]	11	18
Realised exchange rate differences	5	–9
Foreign currency borrowing, gross	13	28
Foreign currency bonds	10	18
Currency swaps, gross [2]	2	10

[1] *Valued at current exchange rates*
[2] *Interest-rate swaps from long to short interest rate exposure combined with currency swaps to foreign currency.*

Figure 2. INFLATION-LINKED GOVERNMENT BONDS
SEK billion



large foreign currency loan equivalent to SEK 7 billion has been taken up. The loan was a five-year euro–dollar bond with a volume of USD 1 billion maturing in 2010. The size of the loan and its time to maturity and public sale to large institutional investors makes it a benchmark loan. It is now being actively traded in the secondary market. If the loan conditions for issues of foreign currency bonds continue to be favourable, it may be possible to issue another benchmark loan during the autumn.

The remaining borrowing requirement during the year has been allocated in a standardised way between direct foreign currency borrowing and krona/swap borrowing, see Table 8. The actual allocation may, however, deviate from this scenario.

Summary

The issue volumes in nominal government bonds will be reduced from SEK 3.5 billion to SEK 2.5 billion per auction as from the auction on March 9. The reduction is due to a lower net borrowing requirement and a lower interest-rate level compared with the forecast from October. These changes must be countered by a reduction in the long borrowing to avoid the duration becoming too long. Bond borrowing is expected to be SEK 62 billion compared with SEK 81 billion in the October forecast. Issues in nominal government bonds will be allocated evenly between the two, five- and ten-year loans. A new ten-year loan will be introduced on September 14.

T-bill borrowing will increase by SEK 40 billion compared with 2004, which is a marginal increase compared with the last forecast. The Debt Office expects to make interest swaps of around SEK 35 billion in 2005.

The Debt Office makes the assessment that there are prerequisites to issue inflation-linked bonds of around SEK 15 billion. This is approximately the same amount as last year when SEK 18 billion were issued. A new inflation-linked bond maturing 2112 will be introduced on September 22.

The Debt Office is amortising the foreign currency debt at an annual pace of SEK 25 billion. Foreign currency borrowing is expected to be SEK 28 billion in 2005.

LAST YEAR IN REVIEW

In 2004, the central government's borrowing requirement was SEK 53 billion. This is an increase of SEK 7 billion in comparison to 2003. This means that the state budget for the second year in a row showed a deficit of 2 per cent of the gross domestic product. At the same time the central government debt increased by 29 billion to SEK 1,257 billion. That the debt increased less than the borrowing requirement depends, among other things, on the strengthening of the krona during the year and on the foreign currency debt consequently having lost value when converted into krona.

The central government's finances

The central government's borrowing requirement can be divided up in two parts: primary borrowing requirement and interest payments on the central government debt. In 2004 the primary borrowing requirement was SEK 0.7 billion. This is SEK 3 billion lower than in 2003. At the same time, interest payments increased by SEK 10 billion to 52.6 billion. All in all, the borrowing requirement thus amounted to SEK 53.3 billion.

Both tax income and expenditures increased

On the income side, taxes increased by SEK 40 billion. This is mostly a result of the payments of salary and consumption taxes having increased.

On the expenditure side, payments increased to pensioners and families with children. Other areas where expenditures increased were unemployment compensation, the EU fee, railways and the area subsidy to farmers. The latter does not however represent a true increase of the area subsidy, but is only an effect of some payments not being made in 2003. The reason is that the area subsidy for 2003 was paid out as early as in 2002.

The interest on the central government debt increased

That interest payments on the central government debt increased by SEK 10 billion compared with 2003 can be partly explained by capital losses in connection with the repurchase of bonds being SEK 7 billion higher in 2004, and partly by the issuance premiums having decreased by SEK 4 billion. The reason is that the Debt Office issued three new bonds during the year and that these were introduced through exchanges with older bonds. As the bonds that were repurchased had higher coupon interest rates than the market interest rate - and thereby were traded at a premium - the repurchases gave rise to capital losses. At the same time, the new loans had lower coupon interest rates, which led to the premiums being reduced compared with 2003.

The central government debt increased

The central government debt increased by SEK 29 billion to SEK 1 257 billion in 2004. As a proportion of GDP, the share is 50 per cent. This remains unchanged from 2003.

Figure 1. CENTRAL GOVERNMENT BORROWING REQUIREMENT 1995-2004
SEK billion

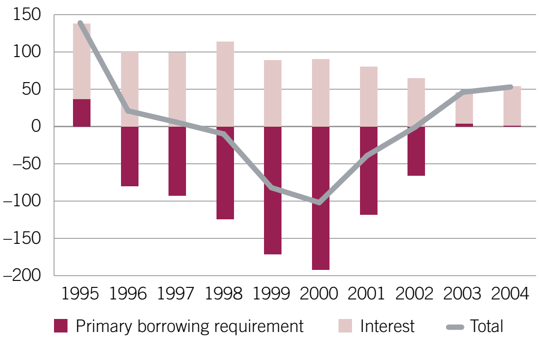
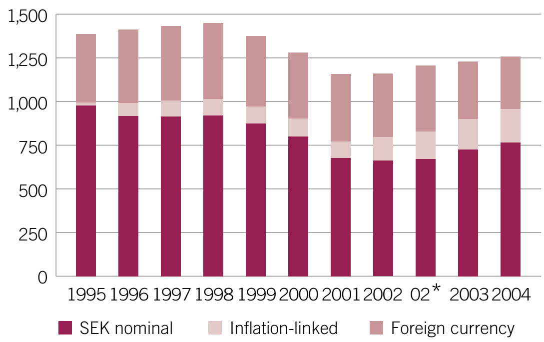
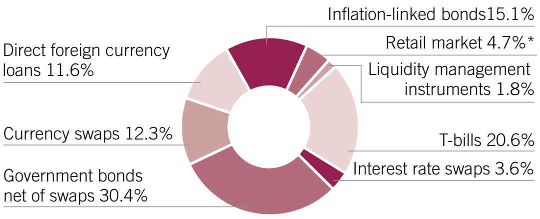


Figure 2. THE CENTRAL GOVERNMENT DEBT 1995-2004
SEK billion



* *A new measure of the central government debt was introduced in the beginning of 2003.*

Figure 3. CENTRAL GOVERNMENT DEBT INSTRUMENTS
December 31, 2004



* *Nominal debt.*

The main reason for the debt having increased by less than as corresponds to the borrowing requirement during 2004 is that the krona was strengthened during the year. This caused the foreign currency debt, stated in krona, to decrease in value.

Another reason is that we reduced our short-term assets. At the beginning of 2003 we had approximately SEK 7 billion in short-term assets. These were used during the year in order to finance part of the borrowing requirement. Thereby, the government debt increased by SEK 7 billion less than the borrowing requirement.

Finally, we realized about SEK 5 billion in exchange rate losses. These increased the borrowing requirement. The effect on the debt had however already been taken into consideration since the foreign currency debt is continuously accounted for at the current exchange rate.

Funding and debt management

In 2004 the central government's borrowing requirement as a result of the budget deficit amounted to SEK 53 billion. Refinancing of maturing loans is added to this. The gross borrowing requirement was therefore SEK 84 billion. This is financed through borrowing in krona (nominal bonds, Treasury bills and other short-term instruments), inflation-linked bonds and foreign currency. The borrowing is mostly effected by the Debt Office selling government securities in our auctions.

FACTS

The economic development 2004

Good growth but few new jobs in Sweden
Economic growth in Sweden was good in 2004. According to the forecast of the National Institute of Economic Research, the gross domestic product, GDP, increased by 3.2 per cent during the year. It was primarily exports that carried the growth. Productivity within business and industry increased by 3.9 per cent. At the same time, the open unemployment rose to 5.3 per cent.

Lower market interest rates and low inflation
At the start of 2004, the Riksbank lowered the repo rate by a total of 0.75 percentage points to 2 per cent. Also long interest rates fell during the year. Consumer prices increased by 0.4 per cent.

Intermixed picture of the surrounding world
In the surrounding world growth was strong in North America and Asia, while growth in most EU countries was low.

The European Central Bank's repo rate was steady at 2 per cent during 2004. In the United States, the Federal Reserve increased the repo rate to 2.25 per cent during the year.

The dollar continued to fall. In 2003 and 2004 the Euro has gained 30 per cent against the dollar, while the krona has strengthened by 32 per cent. The krona has thus gained some also against the Euro during the period.

The current account deficit in the United States continued to increase and became over 600 billion dollars during 2004. It was financed to a large extent through central banks in Asia having bought American government securities.

Germany implemented number of changes on the labor market during 2004 in order to increase competitiveness in the long run. The United States and Germany are Sweden's largest export markets.

Nominal krona borrowing

In 2004, the Debt Office issued three new bond loans. These had a maturity of 5, 10 and 17 years. In total, we issued nominal krona bonds in the amount of SEK 91 billion. At the end of the year, the portfolio of government bonds was SEK 437 billion.

Treasury bills are primarily used to parry seasonal variations in the borrowing requirement. Therefore, the issue volume may vary between SEK 7.5 and 30 billion per auction. The Treasury bill portfolio was at year-end SEK 259 billion. As a proportion of the central government debt, this is marginally higher than in 2003.

During the year, we changed our liquidity management somewhat by reducing the proportion of overnight loans. These were replaced by short-term borrowing with a maturity of up to a week.

Increase of the proportion of inflation-linked loans

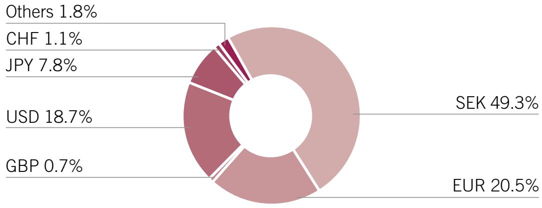
The demand for inflation-linked bonds was good in 2004. The portfolio increased by 17 billion to SEK 190 billion. The proportion of inflation-linked bonds increased from 14 to 15 per cent of the central government debt.

Since inflation-linked bonds were introduced in 1994, they are estimated to have resulted in an aggregate savings of SEK 12.5 billion. In 2004 the result was SEK 2.3 billion. This is mostly attributable to inflation having been low during the year. The final result will however depend on how inflation develops during the entire period until each respective loan falls due.

Lower foreign currency debt

The foreign currency debt was amortized by SEK 25 billion. Because the krona was strengthened during the course of the year, the debt recalculated in krona fell by just over SEK 29 billion. At the end of the year, the debt amounted to SEK 301 billion. As a proportion of the total central government debt, the debt fell from 25 to 24 per cent.

Figure 4. FUNDING OF FOREIGN CURRENCIES
December 31, 2004



The Debt Office board has fixed a benchmark for the distribution of currencies in the foreign currency debt. This is in order to reduce the risk for variations in the value of the debt measured in krona. But we are also to take costs into consideration. The funding of the foreign currency debt therefore has another composition and maturity than the benchmark.

In order to achieve an exposure in line with the benchmark we undertake derivative transactions using forwards, interest rate futures and interest rate swaps. For example, we borrow in krona and swap to foreign currency debt.

Active management of the foreign currency debt

By taking positions on the international interest and currency markets, the Debt Office lowered the cost of the foreign currency debt. In 2004 the cost was reduced by SEK 195 million through the active management. During the past five years, the cost has in total decreased by almost SEK 900 million.

THE DEBT OFFICE BORROWING SCORES HIGH IN CLIENT SURVEY

Investors and primary dealers give the Debt Office high grades in several areas. This applies to our information on borrowing requirements and funding as well as to our professionalism. At the same time, both investor contacts and the borrowing in inflation-linked bonds are areas for improvement. These are some of the results of the survey that Prospera, a survey institute, has carried out on behalf of the Debt Office. The survey is a part of our strategy to develop and improve our operations.

Good investor and primary dealer relations are an important part of the borrowing policy of the Debt Office. Good investor relations contribute to creating a broad and stable investor base with good liquidity for our borrowing instruments. Investor relations are, just as our borrowing policy in general, to be characterized by openness, transparency and predictability. Ultimately, our borrowing policy aims to achieve low borrowing costs.

It is the first time that the Debt Office in this manner has surveyed how satisfied our counterparties and investors in the institutional market are. The survey targets Swedish and international investors in Swedish government securities as well as primary dealers and other sellers of government bonds . The survey focuses on our information, borrowing techniques, auction procedures, professionalism in our conduct and the functioning of the market. Surveys of this kind will be a recurrent tool in the efforts to continuously improve the debt management.

The response frequency was 93 percent, which is considered very high. In total, 27 Swedish investors, 20 foreign investors, 7 primary dealers and 5 other sellers of Swedish government bonds, were interviewed. The interviews were carried out during the period December 13, 2004 to January 26, 2005.

The survey is available in pdf format on our website *www.rgk.se.*

Communication and issuances are important

The demands of Swedish investors and primary dealers on the Debt Office are high. The survey shows that all factors underlying the evaluation (see fact box) are significant to confidence. It is of primary importance that the Debt Office provides clear information on borrowing requirements and funding, acts clearly and consistently when cutting auction volumes and that the information provides good predictability with respect to the issuance plans.

A majority of Swedish investors, primary dealers and other sellers, have good knowledge of the Debt Office. Foreign investors are somewhat less acquainted with the Debt Office.

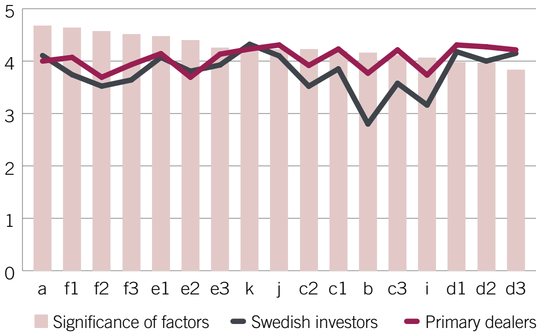
Professionalism, good information but insufficient contacts

Information is clear and provides good predictability

Investor confidence in the Debt Office is good and that of primary dealers and other sellers of government securities is excellent. Most are of the opinion that competence has developed favourably or at least remained unchanged: the Debt Office is considered as more professional, open and sensitive than before.

The most important results are set forth in figure 1 and 2. The columns show how the interviewed

Figure 1. EVALUATION OF THE DEBT OFFICE – SWEDISH PARTICIPANTS

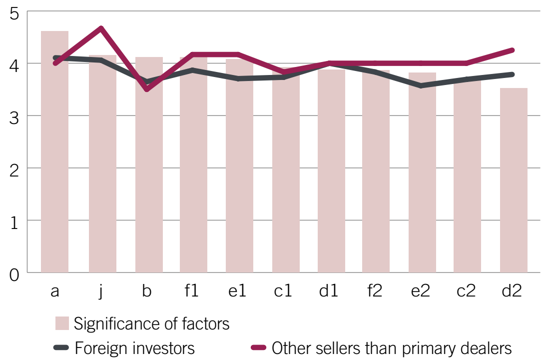


The grading scale runs from 1 to 5. Values over 4 are interpreted by Prospera as excellent or very significant and values of less than 3 as failing.

Source: Prospera

[1] *Investment banks in London trading in Swedish government securities.*

Figure 2. EVALUATION OF THE DEBT OFFICE – FOREIGN PARTICIPANTS



The grading scale runs from 1 to 5. Values over 4 are interpreted by Prospera as excellent or very significant and values of less than 3 as failing.
Source: Prospera

The same is valid for our information on issuance volumes and terms. The Debt Office is very highly evaluated in an international comparison, especially by the international participants.

The sale of government securities is considered good. This applies both to the frequency and selling techniques as well as to the conduct in cutting auction volumes. The grades are somewhat lower when it comes to the selling techniques for and the conduct in connection with the auctions in inflation-linked bonds and treasury bills. Our primary dealers are satisfied with the auction technology and value the repo facilities we offer to reduce squeezes in the market.

persons assess the significance of the different factors, while the curves show how they assess the Debt Office. In the graphs, the factors are ranked according to significance. The factors covered by the survey are set forth in the box below.

Our information, ability to act professionally and the choice of points in time and intervals for auctions appear to be our strengths. The information on borrowing requirements and funding is generally considered excellent and provides good predictability.

Swedish investors not satisfied with the contacts

The Debt Office gets poor grades in one area, i.e., in contacts with investors. Primary dealers and other counterparties consider the contacts to be fairly good, but Swedish investors consider their direct contacts with us unsatisfactory. A clear majority of the investors express a fairly large or great interest in meetings with us.

Investors think, moreover, that we are not very sensitive to their requirements. The grades are

FACTS

Areas covered by the survey

Communication and information
a Clear information on borrowing requirements/ funding
b Good contacts with investors and primary dealers

Borrowing
Good selling techniques:
c1 nominal bonds
c2 inflation-linked bonds
c3 treasury bills

Appropriate timing/ time intervals for auctions
d1 nominal bonds
d2 inflation-linked bonds
d3 treasury bills

Good information on volumes and other terms
e1 nominal bonds
e2 inflation-linked bonds
e3 treasury bills

Clear/consistent cutting of auction volumes
f1 nominal bonds
f2 inflation-linked bonds
f3 treasury bills

General
i Sensitivity to market requirements

Professional conduct
j International comparison
k Comparison to Swedish mortgage institutions

certainly passing, but not high. The deficiencies in sensitivity seem to have some connection to our inflation-linked bonds and treasury bills auctions.

Secondary market gets mixed reviews

Swedish investors and primary dealers view the liquidity in the secondary market for nominal bonds as fine. This applies to the volumes, the spread as well as to the transparency in the nominal bond market. The international participants give passing or average grades. The market for treasury bills is also assessed as relatively good.

The inflation-linked market, however, gets consistently low grades. Liquidity and information on prices are not considered satisfactory and the interest rate spread, i.e. the difference between the bid and ask rates, is too wide.

The primary dealers consider the broker trading as the best contribution to liquidity in the interbank market. Telephone trading also plays an important role. The electronic interbank market (EIM, Saxess Trading) is considered to be an excellent instrument for price transparency. Electronic trading between primary dealers is considered to be very important for price information, while risk management between banks is primarily handled through brokers.

The investors claim that they deal primarily in government bonds via telephone. Only 10 per cent use primarily an electronic trading system.

No reason to settle down

The Debt Office will use the results of the survey to improve its conduct and strengthen confidence. Since the survey is intended to be carried out yearly, we will also have the opportunity to follow any changes in the perception of us.

In several respects we have received good or satisfactory comments. It is inspiring – not in the least because we seem to have moved in the right direction in later years. However, this does not mean that we can settle down. It is especially important to improve our activities in the areas where we are perceived as weak.

One such area for improvement is investor contacts. We are happy to see this. During last year, we have intensified the investor visits and we will successively work for a closer and more systematic dialogue. It is also clear that we should continue to develop the information whereof, e.g., the web site constitutes an important channel for investors.

Even if borrowing in nominal bonds is perceived in a positive manner, the investors are less satisfied with inflation-linked bonds and treasury bills. In the spring we will discuss a possible improvement in our selling techniques.

Some feel that we are not always so sensitive to investors. This issue is not entirely simple. We have a clear mission to finance the central government's deficit by borrowing as cheaply as possible and defined objectives for e.g. maturities and debt allocation. Consideration of the market situation and sensitivity to the investor requirements are important for us both to be able to borrow at lower cost and for the market to function well. However, our mission and our goals are determinative for borrowing, which means that we cannot always satisfy all requirements from investors.

In order to improve our transparency and predictability, feedback on our borrowing policy is important. Is also important for us to be able to convey how our objectives affect borrowing. The survey that has now been carried out provides us with a good starting point for continuous efforts to develop our operations as well as the relations with our investors and other counterparties.

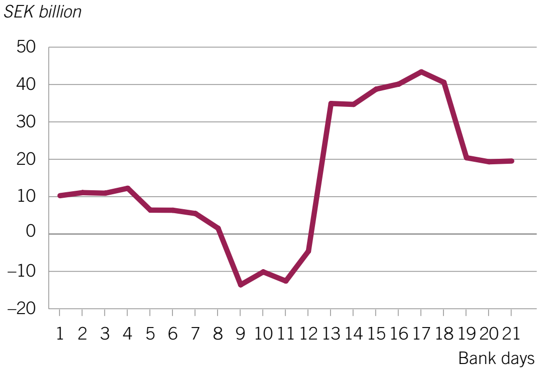
Maria Norström, Debt Manager

THE STATE'S LIQUIDITY MANAGEMENT

The Swedish National Debt Office's liquidity management is intended to secure that the state's payments are made on time and is carried out at as low costs as possible and with limited risk taking. The management is also to promote liquidity in the market and be designed in order to limit any disturbances. Borrowing with short-term Treasury bills, repos and bank deposits are the most important instruments. The use of short-term Treasury bills and repos creates preconditions for accurate and flexible planning at the same time as the refinancing risk is limited.

The Debt Office funds on average a daily cash deficit of SEK 15-20 billion. This means that approximately 1.4 per cent of the central government debt is funded by short-term instruments in the liquidity management. The daily balance is however subject to large fluctuations. One fourth of the days, a surplus which frequently amounts to SEK 10-15 billion is invested, but on certain days the surplus may be as much as SEK 30-40 billion. The deficits are on some days as large as SEK 40-50 billion.

Figure 1. DAILY BORROWING NEED FOR A TYPICAL MONTH (MARCH 2003)



The central government's budget balance has a normal pattern with a deficit at the beginning and end of each month. During three to four days in mid-month, when the large tax payments normally occur, the state enjoys a surplus. When the liquidity is paid for the Treasury bill that matures during the course of the month, normally on the third Friday of the month, the balance again turns into a deficit.

The central government's long-term budget deficit is mainly funded by bonds in Swedish and foreign currency and by Treasury bills. This funding has no direct connection in time to actual payments. In its liquidity management, the Debt Office is to ensure that the state's payments are made on time. The purpose of the liquidity management is to parry the state's actual and expected daily cash flows so that the state's balance at the end of each day is zero.

A common instrument for short-term funding is bank deposits. This borrowing and investment form has the disadvantage that great amounts must be turned over each day, at the same time as great credit exposure may arise in deposits. The Debt Office therefore to a great extent uses issuances of Treasury bills with a short maturity and currently also repos in order to reduce the refinancing and credit risks.

From a long-term forecast to settlement of payments

The liquidity management does not constitute a separate operation within the borrowing, e.g., limited to certain maturities, but is an integrated part of the other borrowing. Borrowing forecasts and planning of all borrowing is used to create efficient management of the state's cash flows.

With the assistance of accurate forecasts, funding can be planned in advance and executed without unnecessary transaction costs. The Debt Office makes its own independent forecasts of the borrowing requirement in both the long and short-term perspectives. We fund not only the budget deficit but also handle the refinancing of the central government debt, i.e., we repay matured loans.

Forecasts by month are made on a rolling one- to two-year basis. These are supplemented with forecasts by day on a rolling three-month basis. The forecasts are quite accurate. It is primarily in February and to a certain extent in December that the uncertainty in the daily forecasts is at its greatest. Deviations of SEK 3 billion for a single day may occur. This can to a great extent be explained by large and hard-to-predict payments of back-taxes and supplementary taxes in these months.

Deficits in a 12-month perspective are funded by issuances of bonds and Treasury bills. In the planning of these issuances, part of the fluctuations that arise in the liquidity may be adjusted. By adapting the Treasury bill borrowing to seasonal variations in the borrowing requirement, e.g. great investment requirements may be reduced by smaller issuance volumes. Government security borrowing may be planned so that there is a remaining borrowing requirement of SEK 15-20 billion on average per day.

Generally, the state has great borrowing requirements in January and the months of international standard due dates (the so-called IMM days or the third Wednesday in March, June, September and December) at which point a great volume of Treasury bills mature.

The funding requirement that remains after government security funding, mainly cash variations during the course of a month, is handled by the instruments for liquidity management.

The Instruments

The liquidity management is in principle undertaken so that greater deficits and surpluses are limited by issuances of short-term Treasury bills (in addition to issuances at regular auctions) and repos. By funding, well in advance, great deficits in this manner, the requirement of extensive funding via bank loans (deposits) is reduced.

On tap sales of short-term Treasury bills

Treasury bills are mainly issued in our auctions. This borrowing is an important part of the regular debt management and the volumes are controlled by the long-term borrowing requirement and our duration target (a measurement of maturity).

Treasury bills are also used in the liquidity management. Within the framework of this we issue on tap the two Treasury bills that have the shortest remaining maturity. This borrowing is supplemented by Treasury bills with tailor-made maturities (so-called liquidity bills). These issuances are also made on tap.We display our interests in the form of maturity, volume and prices via Reuters. Sales are made by telephone and results are immediately published.

The on-tap sales are dependent on the market situation. If the demand for short-term interest instruments is strong, we may issue larger volumes, but in the reverse situation, the interest in short-term bills may be limited. In such case we use repos and deposits to a greater extent.

Repos

Repos, or repurchase agreements, means that we are selling government securities to a counterparty while at the same time making an agreement regarding their repurchase after a certain number of days. Repos used to be made only at the initiative of our primary dealers. During the autumn of 2004, this policy was changed and the Debt Office presently acts actively on the repo market and borrowing through repos is these days made entirely on market terms.

Deposits (see below) used to be the most important instrument for liquidity management. By using repos to a greater extent, the credit and refinancing risk may be reduced and great parts of the forecasted borrowing requirements may be covered in advance. Improved advance planning provides a greater scope for action. Repos normally also mean that investments are made against security since reverse repos mean that we are purchasing an interest-bearing security at the same time. We are also able to carry out reverse repos with other interest-bearing securities issued by other issuers or repurchase outstanding Treasury bills with a short remaining maturity.

Our repos are normally carried out with maturities of 2-5 days, since the state does not usually have a borrowing requirement for more than five days in a row. During longer periods with great borrowing requirements we try to sell Treasury bills. These are preferable both from a management and risk point of view. Repos therefore principally constitute a replacement for deposits rather than an alternative to borrowing in short-term Treasury bills.

Our aim to borrow at as low a cost as possible means that we try to exploit variations in demand for different maturities, since ”deficit situations” give rise to lower interest rates. In order to create reasonable stability and preconditions for the repo market we however limit the extent of our repos with longer maturities than one year to SEK 2 billion per government security and maturity. Otherwise, there would be a risk of reduced predictability and unnecessary insecurity on the market.

Management of foreign currencies

The Debt Office does not handle payments in krona only. Maturing foreign currency loans and interest on the foreign currency debt must be paid in a foreign currency. In case of such payments, short-term borrowing in krona is changed into the appropriate foreign currency. The liquidity management thus parries also in- and outflows on our foreign currency accounts.

The liquidity management is normally carried out in Swedish krona and settled in the Riksbank's settlement system. This means that short-term balances in a foreign currency are changed and then managed in the krona market. Foreign currency loans are thus changed into krona even if we later need the foreign currency in order to pay maturing foreign currency loans.

One difference between liquidity management in krona and foreign currency is that funding of a deficit in krona is closed in "arrears", i.e. at the end of the day. In case of payments in a foreign currency, there must be coverage for the payments as early as at the outset of the day.

Short-term borrowing in a foreign currency (e.g., commercial paper or deposits) may in principle also be used in the liquidity management. Normally this is not however cost-effective, but it is available as an alternative if the short-term krona market for some reason would fail.

At forecasted surpluses greater than SEK 15 billion, the surplus amount is if possible invested in the deposit market in euro. This is effected in the spot market two days before the surplus appears, but can also be effected later. In that manner, the credit exposure may be dispersed among several counterparties.

The Debt Office both purchases (upon maturity and interest payments) and sells (when foreign currency loans are taken) foreign currency. In order to limit the risk that foreign currency exchanges are made at an unfavorable exchange rate, the net of the foreign currency exchange is distributed relatively evenly over time. For example, in case of large amounts maturing, foreign currency in forward contracts (staggered payment) is purchased well in advance of the time when payment is due.

Bank Deposits

The deficit or surplus that remains after short-term Treasury bills and repos have been used will, depending on demand and market situation, be covered by deposits. Transactions in the deposit market are made with a group of counterparties, consisting of foreign as well as Swedish banks. The transactions are normally made overnight, but longer maturities do exist.

Aims and restrictions

The overall purpose of the liquidity management is to make payments at the right time. This assignment is to be carried out so that the borrowing costs, with due consideration to risk, are as low as possible.

We adapt the maturities in the liquidity management so that the daily forecasted balances are evened out. For example, borrowing that markedly increases a forecasted surplus is avoided. The

FACTS

Payment and settlement

The state's payments are handled by the banks that our public authorities use for payments. All payment flows in krona are consolidated on the state's account with the Riksbank and are funded by the Debt Office. This system means that the state funds or invests only the *net* of all payments. In that manner, funding via third parties is minimized and the cash management may be performed efficiently without unnecessary transaction costs. This is an example of what is usually called a "Treasury Single Account"

Payment and settlement are then made in the Riksbank's system for payment and settlement. At the end of each day when all payments are to have been made, the balance shall be zero vis-à-vis the Riksbank. According to the EU treaty and Swedish law, there must be no deficit vis-à-vis the Riksbank at the end of the day, i.e., the state may not borrow from the Riksbank in order to avoid the suspicion that the state might use "funding by the money presses" for its expenses.

All state payments are made through three master agreement banks with, at present, three daily settlement times. The daily forecasted balance is updated on a current basis twice a day. At the end of the day we obtain a final balance, at which point our account has neither a deficit nor a surplus vis-à-vis the Riksbank.

instruments and maturities that are used for the management of the surplus or deficit are thus dependent on the forecast for the cash trend over time. This is a way to reduce risks, which may also be seen as a restriction on the daily liquidity management.

The Debt Office's role as a player in the repo market must be handled with care. The reason is that we are at the same time an issuer of the securities that are the subject of the repos. If we always and to a great extent would carry out repos with maturities with particularly low interest rates, great variations may as a result of the deficit situation arise in the availability of such securities: a great increase when we have a borrowing requirement and a drastic reduction of the supply when we have a surplus. The result would be an undesirable volatility in supply and prices, with ensuing increased insecurity and diminished predictability.

In our quantitative evaluation of the liquidity management, we use the Riksbank's repo rate as the benchmark interest rate, since overnight loans on the deposit market are as a rule made at this interest level. The scope for borrowing at interest levels under the repo rate is however limited. As mentioned before, the liquidity management is controlled to a great extent by how the state's cash flows vary over time, the restrictions that follow from us desiring to avoid unnecessarily great surpluses or deficits and by a desire to contribute to well-functioning markets. Also qualitative criteria should therefore be taken into consideration upon a comprehensive evaluation of the liquidity management.

Maturing foreign currency loans and foreign currency borrowing are not evenly divided over time. But we ensure that the net of the foreign currency exchanges are relatively evenly distributed. In practice it is done as follows. A forecasted requirement of net exchanges is distributed evenly between the months that remain of a calendar year. We are however allowed to depart from this benchmark by ±SEK 500 million during any month. We have this policy, not only to reduce the risk of unfavorable exchange rates, but also in order to fulfill the Government's benchmarks for an evenly distributed exchange pace. In that manner, predictability is achieved in the foreign currency market. Since we change on a net basis approximately the same amount each month, the market knows in advance in broad strokes the amount of krona that will be sold on a net basis on the market. Unnecessary speculation regarding possible market effects on the krona exchange rate can therefore be avoided.

FACTS

Liquidity management – an overview

Borrowing forecast and planning of regular auctions create manageable cash flows

↓

Borrowing with short-term Treasury bills On tap issuances of short-term Treasury bills (up to two months) aside from regular auctions

Issuances of liquidity bills (short-term Treasury bills with tailor-made maturities which are sold on a current basis)

↓

Repos (issuance of government securities with repurchase agreement) and reverse repos

↓

Bank deposits in krona or possibly in a foreign currency

Currency exchanges in the spot market or using forwards in order to secure payments in a foreign currency and collect the management in krona

Above is a schematic description of the instruments in the liquidity management. Primarily, instruments with a relatively long maturity are used (Treasury bills with up to two months' maturity) and repos. The remaining borrowing requirement is covered by short-term funding in the banking system.

International perspective

The liquidity management is mainly carried out in Swedish krona. In relation to the state's cash flows, the short-term krona market is limited in volume and depth. Large countries and members of the Euro zone have access to markets of an entirely different depth and size. These debt offices have, e.g., access to a significantly greater number of counterparties and the smaller countries are not dominating players in the manner that the Debt Office is on the Swedish market. This creates other preconditions when it comes to refinancing risks and flexibility.

The debt offices in other countries do not most frequently use repos in their liquidity management. Great Britain is an exception. The Netherlands and France do use the repo market as well, but only when investing surpluses. Belgium has a smaller portfolio of its own of government bonds with short maturities that they use for repos. Finland intends to increase its use of repos.

Some debt offices in the Euro zone actively use the depth of the short-term interest market in order to control their interest rate exposure. In the Netherlands, which is a clear example, T-bills are issued that are then swapped to short-term interest rate exposure. The desired interest rate exposure, up to twelve months' maturity on the so-called Eonia market for short-term swaps [1], is then selected based on an assessment of the European Central Bank's (ECB's) upcoming interest rate decision.

It is in principle the same comparison norm as our own: the Riksbank's repo rate provides a measure of profit or loss in relation to the deposit market. However, we refrain from changing our interest rate exposure with the assistance of the derivative market and creating active positions. This would require extensive transactions on the FRA and/or Stina market [2]. Much indicates that these markets could not without being affected absorb transactions of the scope that would make such action interesting for us. It is likely simpler for smaller debt offices in the Euro zone to act on the basis of assessments of the monetary policy that is decided in Frankfurt than it would be for us to act according to assessments of decisions that are made at Brunkebergstorg.

Conclusion

The Debt Office uses borrowing forecasts, borrowing planning and available instruments in the liquidity management in order to parry the central government's cash flows at as low funding costs as possible and with limited risk taking. The liquidity management is therefore an integrated part of the more long-term borrowing. In order to limit the exposure on the overnight loan market, and thereby the refinancing risks, we attempt to use short-term funding with on tap sales of Treasury bills and repos. This creates preconditions for accurate and flexible planning. This has so far proved to be a successful strategy.

Anna Sjulander, Debt Manager

[1] *On the Eonia market swaps in euro with short maturities (up to a year) are traded.*

[2] *FRA means Forward Rate Agreement. The contracts that are traded are futures for bank deposits or loans with a maturity of 3 months. The Stina market is the Swedish correspondent to the Eonia market, i.e. trade in short-term swaps in krona.*

FACTS

Market support

The Debt Office uses repos as a part of the liquidity management. These repos are made at market prices. As there is a mutual interest in such repos we contribute to the liquidity in government securities in our regular borrowing. Repos are however only of interest when we have a deficit to fund.

In order to support the market, the Debt Office offers repos in government securities on request. The aim is to reduce the risk of deficit situations on the markets for government securities. Such repos are made in nominal government bonds, Treasury bills and inflation-linked bonds and are offered at a fixed premium within the framework of our market support.

The terms for market repos and other facilities are described in greater detail on our homepage: *www.rgk.se*

CREDIT CARDS AND PURCHASING CARDS - A GOOD DEAL FOR THE STATE

The state handles about 11 million invoices a year. The cost for this amounts to approximately SEK 5.5billion. Moreover, the state continues to use costly procedures such as cash advances, vouchers and requisitions. In order to make the public authorities' purchase and payment processes more efficient, the Swedish National Debt Office therefore recommends an increased use of credit and purchasing cards. During 2004, the Debt Office procured new master agreements for credit and purchasing cards. They may be used by Parliament as well as by public authorities and business agencies.

Within the state, two types of cards are used: credit cards and purchasing cards. The credit cards are primarily intended to be used for purchases in connection with travel and entertainment, while the purchasing cards are to be used for purchases in the daily operations.

Credit cards

When a government employee has used a credit card in the course of his or her duty, the main principle is that the employee has personal payment liability for the invoice from the card issuer. Only in exceptional cases will a company card, for which the authority is responsible for payments, be used. Normally, the employee will expeditiously account for the underlying documentation in order to get paid from the employer before the card invoice falls due. This reduces the risk of late travelling expense accounts, at the same time as the individual employee does not have to put up his or her own money. With the use of credit cards, it is also possible in a simple manner to depart from the handling of advances, vouchers and requisitions.

Travel accounts are a part of the master agreements for credit cards

A travel account is a joint invoicing service of the card issuer, which means that purchases of travel via different travel agencies, airlines etc. are collected on one invoice. This causes the number of invoices, and thereby the handling costs thereof, to be reduced. In order to further simplify the administration, the card issuer also offers a number of different optional services in connection with the invoicing service, which facilitate reconciliation, output of statistics etc.

Before the travel account service was a part of the master agreements for credit cards, several public authorities procured such services separately when they entered into agreements with travel agencies. Now that the travel account is a part of the credit card services, this generally broadens the supply of available travel companies. Moreover, the card companies are continuously tying an increasing number of cooperation partners to their travel account services.

Use of credit cards abroad

Public authorities with personnel stationed in different parts of the world have great demands on the credit cards they use having good coverage in the relevant countries and regions. In some countries,

FACTS

Usage within the state is low

Despite the great advantages in using credit cards, only about 10 percent of state employees have access to credit cards. In the National Audit Office's review 2002 of public authorities' use of credit cards it was established that in many cases there exist "cultural obstacles" to an increased use of these. The view among several of the authorities is that credit cards are only intended for managers in the organisation, which also seems to be reflected in the authorities' rules for credit cards. This, however, is a perception that the Debt Office would like to change. Given the cost savings that card use entails, it should be the authorities' and the employees' need of simple and safe means of payment that governs whether an employee should be offered a credit card. Rules concerning credit cards should be included as a part of an authority's travel regulations.

cards may even be the only efficient way of handling the supply of cash. The Debt Office has therefore collated the coverage of the different card networks so that the public authorities may take their specific needs into consideration when choosing the card to use. The public authorities may also choose to use several credit cards, connected to different card networks, in order to achieve maximum coverage.

Service of the card companies

All card companies offer a plethora of services in connection with their cards. These may include anything from discounts at petrol companies to 24-hour stop service, customer support etc. The available services and the prices payable for these, if any, are set forth in the master agreements.

Purchasing cards are new within the state

The public authorities have a strong interest in simplifying and rationalizing the purchasing process, since the administration of petty cash, advances and invoices is burdensome and costly. The intention behind the purchasing cards is to facilitate continual purchases through, inter alia, reducing the number of invoices.

A purchasing card is to be used by persons at the public authority who handle purchasing in daily operations. This may include consumables, purchase of service materials etc. The purchasing card is intended to be used in connection with purchases in Sweden and via the Internet. The purchasing card is however not suitable for travel abroad or for cash withdrawals.

The use of purchasing cards is a relatively new phenomenon also in business and industry. In Sweden there are only an estimated couple of thousand corporate cards out on the market, primarily in larger companies with a great degree of automation in the management of their order, inventory and invoicing systems. The use increases however rapidly and the companies' resultant opportunities for savings are very good.

In comparison with credit cards, purchasing card users are a new category of cardholders at the public authorities. Just like the credit card, the purchasing card is personal, but it is the public authority that has payment liability. This means that the authority has the responsibility for approving and paying the card invoice on the due date.

Efficient purchases and better follow-up

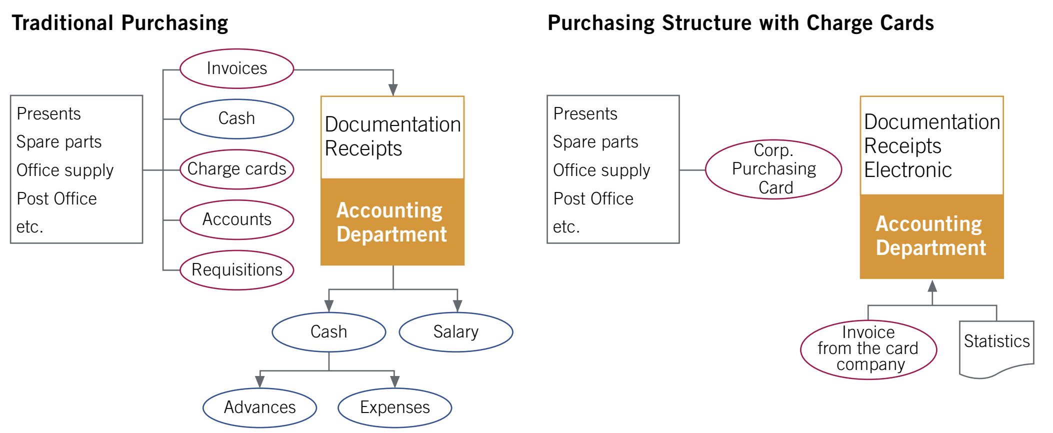
The authority can place several limitations on the purchasing card, such as purchasing limits, blocks so that the card is valid only with certain selected suppliers or in a certain industry etc. The public authority's follow-up and control will also be improved through the use of purchasing cards since the card companies offer good reporting of purchasing statistics.

New master agreements apply from 1 January 2005

The Debt Office has entered into new master agreements in the card area during 2004. Among the news in the master agreements are travel accounts and purchasing cards. Another novelty is that a materially

FACTS

From an administratively burdensome purchasing process to an efficient one



greater number of authorities than before have the possibility of availing themselves of the master agreements.

In the autumn of 2004, the Debt Office has informed the public authorities of the new master agreements. Detailed information is available at *www.rgk.se* on the agreements and their applicability.

Favorable master agreements

The new master agreements contain very favorable terms for the state. In general, a currency exchange surcredit and a fee for cash withdrawals are the only fees that the card companies invoice the public authorities. One of the card issuers does not even credit for cash withdrawals. This means that the issuance of cards, card use, invoicing and most associated services are entirely free of credit for the authorities.

Four ranked master agreements for credit cards

The Debt Office has entered into agreements with four suppliers of credit cards; these are ranked in order as follows:

1. SEB Kort AB, for Eurocard/MasterCard,
2. American Express Services Europe Ltd., for American Express
3. FöreningsSparbanken, for Visa Business Card/Visa
4. Nordea Finans AB, for First Card/Master Card

As a main rule, each public authority shall use the most highly ranked supplier. It is only if the highest ranked card issuer cannot offer the requested service that an order may be placed with another card issuer and then in accordance with the ranking. The Debt Office has developed a form that the public authority may use for this purpose.

Two master agreements for purchasing cards which are both ranked in first place

With respect to the purchasing cards, the Debt Office has entered into an agreement with two suppliers. These are both ranked in first place.

- SEB Kort AB, for Eurocard Corporate card/ MasterCard
- American Express Services Europe Ltd., for American Express Corporate card/American Express

Term

The agreement term for the master agreements is two years. Thereafter, the Debt Office has an option to extend the term by a maximum of two additional years. The master agreements are valid for not longer than 31 December 2008.

Anna Schönbeck, Cash Management

FACTS

Facts on master agreements

The Swedish National Debt Office is responsible for the procurement of master agreements for payment mediation services to and from the state. A master agreement is an agreement between a procuring unit and one or more suppliers with the aim to determine all conditions (functionality and price) for a certain service or product during a certain period. Those authorities that are comprised by the master agreement may then order services at pre-determined conditions with reference to the master agreement. They also enter into written agreements with the card issuers concerned whose services they wants to use. The master agreements are to meet all authorities' needs regardless of how large they are or how extensive their payment activity is.

FACTS

Use by the state of credit cards under the master agreement 2003[1]

Number of users:	app. 270 public authorities	Number of credit cards:	app. 20 000
Number of master agreements:	3 banks/card issuers	Total purchasing volume:	app. SEK 1 billion

[1] *Only public authorities under the Government have been able to order under master agreements until 2004.*

MARKET INFORMATION

Source: The Swedish National Debt Office, unless otherwise stated

SWEDISH GOVERNMENT DEBT

GOVERNMENT BONDS, OUTSTANDING VOLUMES, JANUARY 31, 2005

Nominal bonds			(Nominal amount)
Maturity date	Coupon %	Loan no.	SEK m
2006-04-20	3.50	1044	91,603
2007-08-15	8.00	1037	68,892
2008-05-05	6.50	1040	54,783
2009-01-28	5.00	1043	71,554
2009-12-01	4.00	1048	41,492
2011-03-15	5.25	1045	49,532
2012-10-08	5.50	1046	44,696
2014-05-05	6.75	1041	69,772
2015-08-12	4.50	1049	39,481
2020-12-01	5.00	1047	36,702
Total benchmarks			568,507
Non-benchmarks			21,300

T-BILLS, OUTSTANDING VOLYMES, JANUARY 31, 2005

Maturity date (nominal amount)	SEK m
2005-02-16	25,790
2005-03-16	80,829
2005-04-20	25,041
2005-06-15	59,310
2005-09-21	60,013
2005-12-21	29,986
Total Treasury bills	280,970

INFLATION-LINKED BONDS, OUTSTANDING AMOUNTS, JANUARY 31, 2005

Maturity date	Coupon %	Loan no.	SEK m
2008-12-01	4.00	3101	33,529
2014-04-01	–	3001	18,957
2015-12-01	3.50	3105	60,362
2020-12-01	4.00	3102	37,839
2028-12-01	3.50	3103	3
2028-12-01	3.50	3104	38,875
Total inflation-linked bonds			189,565

RATING

	Debt in SEK	Foreign currency debt
Moody's	Aaa	Aaa
Standard & Poor's	AAA	AAA

GOVERNMENT BONDS, AUCTION DATES

Nominal bonds		
Announcement date	Auction date	Settlement date
2005-02-16	2005-02-23	2005-02-28
2005-03-02	2005-03-09	2005-03-14
2005-03-16	2005-03-23	2005-03-30
2005-03-30	2005-04-06	2005-04-11
2005-04-13	2005-04-20	2005-04-25
2005-04-26	2005-05-03	2005-05-09
2005-05-11	2005-05-18	2005-05-23
2005-05-25	2005-06-01	2005-06-07
2005-06-08	2005-06-15	2005-06-20
2005-06-22	2005-06-29	2005-07-04
2005-07-27	2005-08-03	2005-08-08
2005-08-10	2005-08-17	2005-08-22
2005-08-24	2005-08-31	2005-09-05

T-BILLS, AUCTION DATES

Announcement date	Auction date	Settlement date
2005-02-23	2005-03-02	2005-03-04
2005-03-09	2005-03-16	2005-03-18
2005-03-23	2005-03-30	2005-04-01
2005-04-06	2005-04-13	2005-04-15
2005-04-20	2005-04-27	2005-04-29
2005-05-04	2005-05-11	2005-05-13
2005-05-18	2005-05-25	2005-05-27
2005-06-01	2005-06-08	2005-06-10
2005-06-15	2005-06-22	2005-06-24
2005-06-29	2005-07-06	2005-07-08
2005-07-20	2005-07-27	2005-07-29
2005-08-03	2005-08-10	2005-08-12
2005-08-03	2005-08-24	2005-08-26

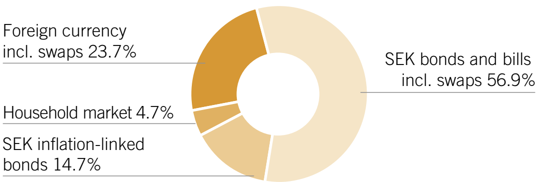
INFLATION-LINKED BONDS, AUCTION DATES

Announcement date	Auction date	Settlement date
2005-02-24	2005-03-03	2005-03-08
2005-03-10	2005-03-17	2005-03-22
2005-03-24	2005-03-31	2005-04-05
2005-04-07	2005-04-14	2005-04-19
2005-04-21	2005-04-28	2005-05-03
2005-05-04	2005-05-12	2005-05-17
2005-05-19	2005-05-26	2005-05-31
2005-06-02	2005-06-09	2005-06-14
2005-08-18	2005-08-25	2005-08-30

SWEDISH GOVERNMENT DEBT

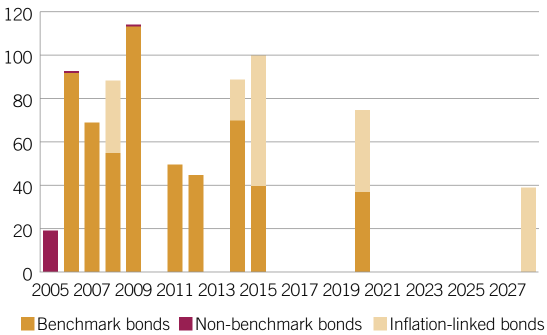
DEBT STRUCTURE

Total debt SEK 1,287 billion *January 31, 2005*



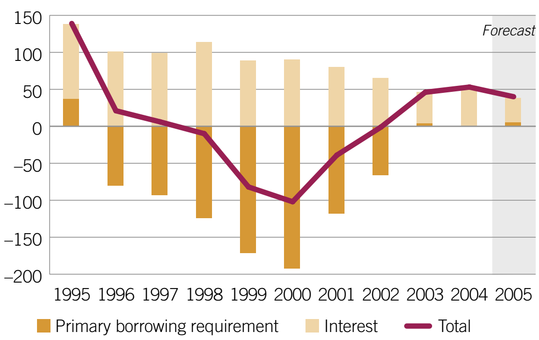
MATURITY PROFILE,
SEK NOMINAL AND INFLATION-LINKED BONDS

SEK billion *January 31, 2005*



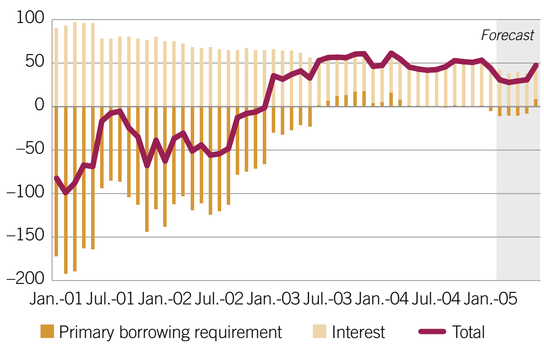
CENTRAL GOVERNMENT BORROWING REQUIREMENT
1995-2005

SEK billion



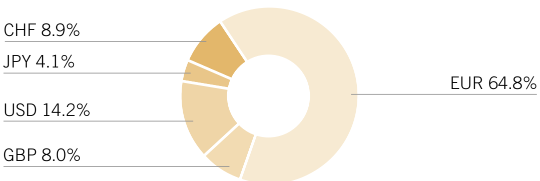
SWEDISH GOVERNMENT BORROWING REQUIREMENT,
12 MONTHS

SEK billion



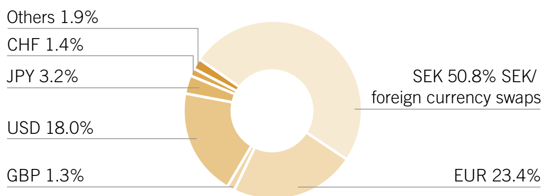
FOREIGN CURRENCY EXPOSURE,
INCL. DERIVATES

January 31, 2005



FUNDING IN FOREIGN CURRENCIES

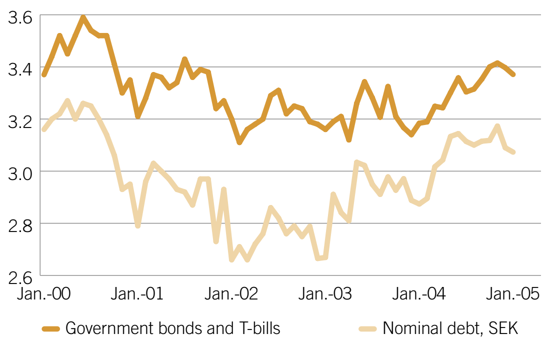
January 31, 2005



SWEDISH GOVERNMENT DEBT

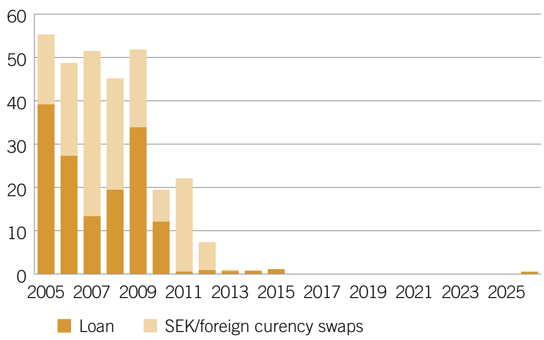
DURATION OF NOMINAL DEBT

Years *January 31, 2005*



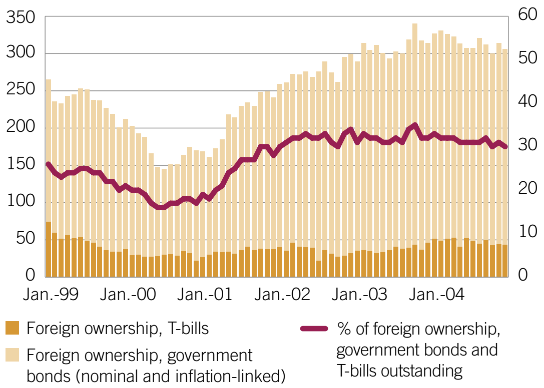
MATURITY PROFILE, FOREIGN CURRENCY LOANS EXCL. CALLABLE BONDS

SEK billion *January 31, 2005*



FOREIGN OWNERSHIP OF GOVERNMENT BONDS AND T-BILLS

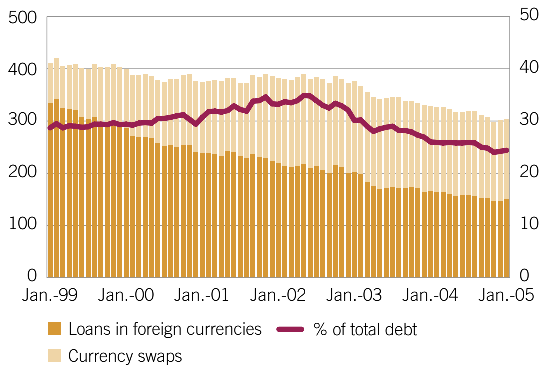
SEK billion *%*



Source: The Riksbank

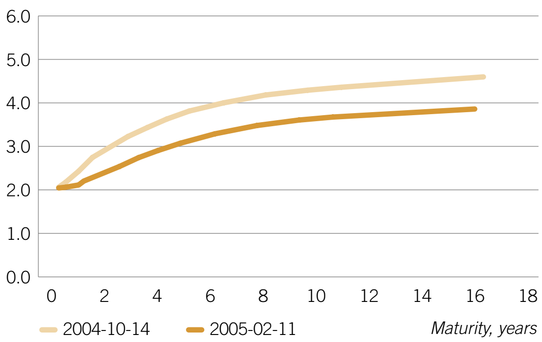
CENTRAL GOVERNMENT DEBT EXPOSURE IN FOREIGN CURRENCIES

SEK billion *%*



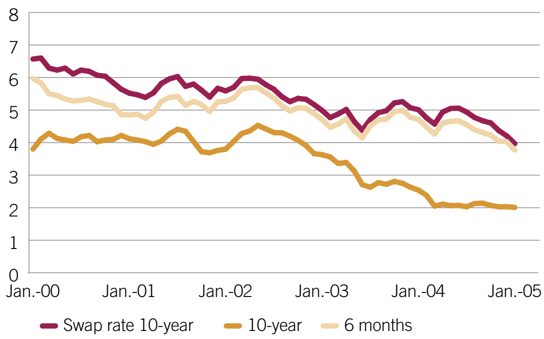
YIELD CURVE, SWEDISH GOVERNMENT SECURITIES

%



INTEREST RATE DEVELOPMENTS

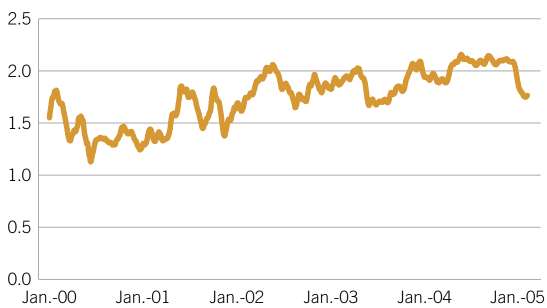
%



Source: Ecowin

BREAK-EVEN INFLATION

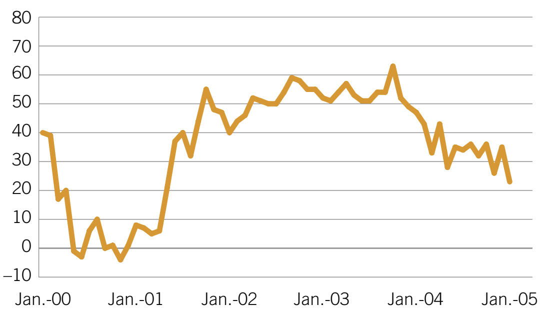
% *Loan 1041-3105*



Source: Ecowin

INTEREST RATE SPREAD VS GERMANY – 10-YEAR

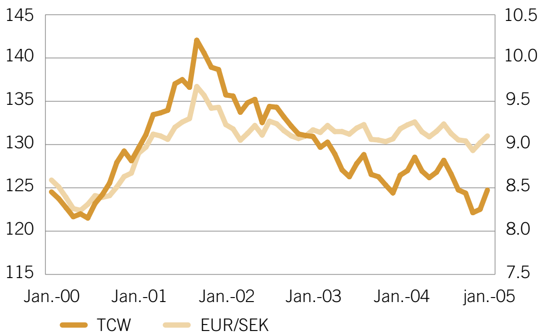
Basis points



Source: Ecowin

HISTORICAL EXCHANGE RATES

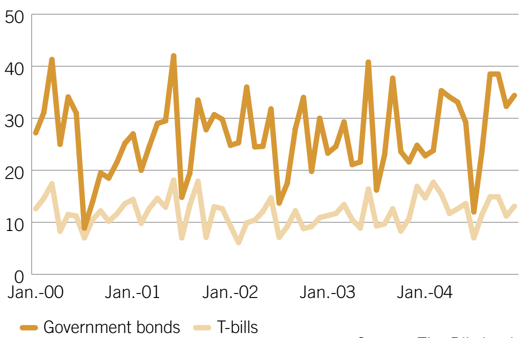
TCW – Trade-weighted index *EUR/SEK*



Source: Ecowin

TRADING VOLUME, SWEDISH GOVERNMENT SECURITIES

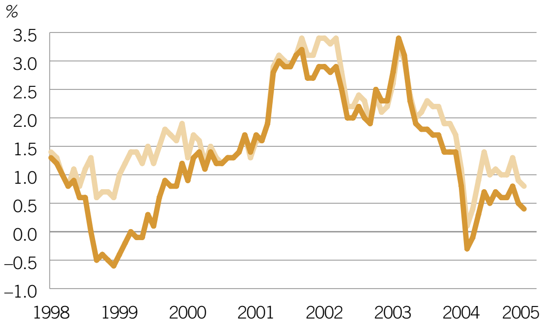
SEK billion



Source: The Riksbank

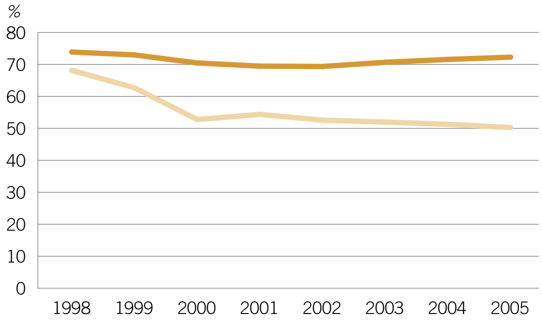
SWEDISH ECONOMY

INFLATION INDEX:
UND1X AND CPI IN SWEDEN 1998–2005



Source: Statistics Sweden

GENERAL GOVERNMENT DEBT IN RELATION TO GDP



Source: Statistics Sweden, OECD

NATIONAL ACCOUNTS, PERCENTAGE CHANGE

Supply and demand	2003	2004	2005	2006
Gross domestic product [1]	1.5	3.8	3.2	2.8
Imports	4.9	7.1	9.5	7.7
Household consumption expenditure	1.5	2.1	2.7	3.2
Government consumption expenditure	0.8	0.7	1.4	0.5
Gross fixed capital formation	–1.5	5.7	8.0	7.7
Stock building	0.4	–0.4	0.4	0.0
Exports	5.0	10.7	7.3	6.2

Selected statistics	Sep.-04	Dec.-04	2003	2004	2005	2006
CPI, year-on-year		0.4	1.4	0.5	1.8	2.6
Unemployment rate		5.3	4.9	5.5	5.0	4.4
Current account	8.8		5.9	6.4	5.9	5.2

[1] *SEK 2 438 billion (current prices 2003).*

Sources: Statistics Sweden, The Riksbank; forecasts: National Institute of Economic Research.

PRIMARY DEALERS

	Telephone	Reuter-page
ABN Amro Bank NV	08-506 155 00	PMAA
Danske Consensus	08-568 808 44	PMCO
E Öhman J:or Fondkommission AB	08-679 22 00	PMOR
FöreningsSparbanken	08-700 99 00	PMBF
Nordea	+45-33-33 17 58	PMUB
SEB	08-506 23 151	PMSE
Svenska Handelsbanken AB Publ.	08-463 46 50	PMHD

The next issue of Central Government Borrowing: Forecast and Analysis will be published on Wednesday June 15, 2005, at 9.30 am.

For more information:

Borrowing requirement and government debt:	Lars Hörngren	+46-8-613 47 36 or +46-8-613 47 40
Funding:	Thomas Olofsson	+46-8-613 47 82

Articles published earlier	Author	Issue
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Retail borrowing in Sweden and comparisons to other countries	*Malin Holmlund*	2004:3
The lending of the state should be regulated	*Sara Bergström and Christina Hamrén*	2004:2
A new budget target for long-term sustainable central government finances	*Per Franzén*	2004:2
Common maturity dates for nominal bonds		2004:1
Inflation-linked bonds – an instrument for risk diversion	*Joy Sundberg and Thomas Wigren*	2004:1
Active management of the foreign currency debt – an asset on the liability side	*Lars Boman*	2004:1
New risk indicator for central government debt – Cost-at-Risk	*Anders Holmlund*	2004:1
The inflation-linked market is growing – Italy is now issuing inflation-linked bonds		2003:3
Strategic EUR/USD position closed – foreign currency- and interest gain of 4.5 billion		2003:3
Market development work in Sweden and a few other European countries	*Anders Holmlund*	2003:3
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The state payment system and new framework agreements	*Lennart Sundquist*	2003:3
Small borrowers in the euro zone	*Eric Morell and Thomas Wigren*	2003:2
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The Debt Office's method for risk analysis	*Johan Palm*	2003:1
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Foreign currency exchanges in the market		2002:2

RIKSGÄLDS KONTORET
THE SWEDISH NATIONAL DEBT OFFICE

Visiting address: Norrlandsgatan 15 • Postal address: SE-103 74 Stockholm, Sweden
Telephone: +46-8-613 45 00 • Fax: +46-8-21 21 63 • E-mail: rgk@rgk.se • Internet: www.rgk.se

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