2014

GUIDELINES FOR CENTRAL GOVERNMENT DEBT MANAGEMENT 2014

Decision taken at the Cabinet meeting
November 14 2013

LONG-TERM PERSPECTIVES   COST MINIMISATION   FLEXIBILITY

REGERINGSKANSLIET

Contents

Summary

Direction of debt policy unchanged
The guideline decision for 2014–2017 leaves the direction of central government debt policy unchanged. The debt shares and interest rate refixing periods for central government debt remain unchanged. The Debt Office's mandate for positions in foreign currencies is reduced by a third.

The composition of the debt is to be steered towards:

- Foreign currency debt: 15 per cent
- Inflation-linked krona debt: 25 per cent
- Nominal krona debt is to account for the remainder (60 per cent).

The maturity of the three types of debt is to be steered towards:

- Foreign currency debt: Interest rate refixing period of 0.125 years
- Inflation-linked krona debt: interest rate refixing period of 7-10 years
- Nominal krona debt:
  - instruments with a maturity of up to 12 years: interest rate refixing period of 2.7-3.2 years
  - instruments with a maturity of more than 12 years:
    long-term benchmark for the outstanding volume of SEK 70 billion.

Clarification of the long-term benchmark for instruments with a maturity of more than 12 years
The guidelines clarify that the benchmark for the outstanding volume is a long-term benchmark. Previously the word long-term was only included in the reasons for the guideline.

Reduced mandate for foreign currency positions
The mandate for positions in foreign currencies is reduced from SEK 450 million to SEK 300 million, measured as daily Value-at-Risk with a 95 per cent probability. In 2011 the mandate was reduced from SEK 600 million to 450 million. The mandate has thus been halved since the end of 2010. The reduced mandate limits the risk of losses at the same time as the position-taking operations can still contribute to cost savings. However, the potential for cost savings will be smaller. The positive effects that the position-taking operations are deemed to contribute to, in terms of a greater market focus and broader expertise in financial matters among Debt Office employees, remain.

The mandate for strategic positions in the krona exchange rate is retained unchanged at SEK 7.5 billion. The guidelines make some clarifications of the terms that describe position-taking operations.

Change in the steering of the currency debt to wait
The Debt Office's proposed guidelines for 2014-2017 propose that the steering of the currency debt be altered by replacing the fixed share of 15 per cent with a ceiling of the same share.

The Government chooses to wait to change the model for steering the currency debt. Such a change should await the report of the Review of Central Government Debt Policy (terms of reference 2013:17), which is to present its report by 15 January 2014, as well as decisions on the Inquiry on the Riksbank's financial independence and balance sheet. Nor are there judged to be strong reasons to indicate that it would be unfavourable at present from a cost perspective to retain the present share for the currency debt. The Debt Office states in its proposed guidelines that it intends to retain the present currency share in 2014 even with the proposed steering model.

Basis for the guideline decision
The basis for the decision on the guidelines is the statutory objective that central government debt is to be managed in such a way as to minimise the long-term cost of this debt while taking account of the risk in its management.

The debt is to be managed within the framework of monetary policy requirements.

A further consideration is the size of the debt and its expected development. The unconsolidated central government debt was SEK 1 201 billion (33 per cent of GDP) at the end of Ocrober 2013. Forecasts by the Government, the Debt Office, the National Financial Management Authority and the National Institute of Economic Research indicate that the corresponding debt will be between SEK 1 225 and 1 366 billion (28 and 31 per cent of GDP) at the end of 2017. For Sweden the Maastricht debt was 38.2 per cent of GDP at the end of 2012. At the same point in time the corresponding share for the EU as a whole was 87.2 per cent and for the Euro zone it was 93.1 per cent. Sweden's central government finances are therefore to be regarded as strong from both a historical and an international perspective.

Costs of the debt

The objective for the management of central government debt means that the guidelines are to be based on a trade-off between long-term cost and risk. The costs of central government debt are primarily affected by the size of the debt and the interest rate levels when the interest rates on the debt instruments are fixed. Exchange rate movements also affect the cost of the debt since part of the debt is exposed to foreign currencies. Similarly the inflation-linked debt is affected by the development of the CPI.

Falling market interest rates and Sweden's strong central government finances have meant that, in recent years, borrowing costs have fallen to record low levels. For 2012 interest costs for the central government debt were SEK 18 billion. In the Budget Bill for 2014 interest costs are calculated at SEK 20 billion for 2013. The interest costs are expected to rise successively in 2014–2017 and reach SEK 30 billion at the end of the period. The rise is due to expectations of higher market interest rates.

Risks in debt management

At a general level the risk in central government debt is defined as its contribution to variations in the budget balance and the debt. There is no single measure that describes the overall risk in the management of the debt. Instead benchmarks for different types of risk are used, the most important being the interest rate refixing risk, the refinancing risk and the financing risk.

The steering of maturities in the guidelines is aimed at the interest rate refixing risk. The interest rate refixing risk means the risk that the interest rate on the debt will rise rapidly on account of higher market interest rates. Since the Debt Office uses derivatives, interest rate refixing does not only occur when new loans are raised. The refinancing risk refers to the risk that it will turn out to be difficult or expensive to replace maturing loans with new ones. In general, the refinancing risk appears at the same time as the need for new borrowing rises sharply (financing risk). The best insurance against both refinancing risk and financing risk is therefore strong and sustainable central government finances. The refinancing risk reflects the time remaining to maturity, i.e. when the debt needs to be refinanced.

The Debt Office's strategies for borrowing and market maintenance take account of the refinancing risk in the management of the debt in several different ways. The bulk of the borrowing is done in government bonds that are spread over several loans with different maturity dates. Borrowing takes place continuously across small, regularly held auctions. In recent years borrowing at longer maturities than twelve years has also increased, which means that the dates when the debt reaches maturity are spread over a longer period of time. Through its foreign-currency borrowing the Debt Office has an established channel to international capital markets. This loan channel provides the potential to borrow large volumes in a short period of time. A new point was introduced in the guidelines for 2013 stating that the Debt Office is to take account of refinancing risks in the management of central government debt. In the evaluation of its management of central government debt the Debt Office is to report in what way it has lived up to the requirement to take account of refinancing risks.

At the end of 2012 the average interest rate refixing period of the whole central government debt was 5.1 years and the average remaining time to maturity was 5.4 years.

Guideline decision and debt policy objective
In the guideline decision, the Government exercises general control over the expected cost of and risk in the debt. The Debt Office is then responsible for taking strategic decisions within the framework of the guidelines and for the implementation of these decisions in the operational management of the debt.

The guideline decision has to be taken by the Government no later than 15 November each year. The Debt Office has to submit proposed guidelines no later than 1 October each year. The Government has to allow the Riksbank (Swedish central bank) to comment on the Debt Office's proposed guidelines.

1 Decision on guidelines for central government debt management in 2014

Summary: The guideline decision for 2014 leaves the direction of central government debt policy unchanged. The decision is preliminary for 2015–2017.

The debt shares and interest rate refixing periods for central government debt remain unchanged. The share of foreign-currency debt will be steered towards 15 per cent and the share of long-term inflation-linked krona debt towards 25 per cent. The remaining share (60 per cent) is to consist of nominal krona debt.

The maturity of central government debt is governed in terms of interest rate fixing periods. The interest rate refixing period will be 0.125 years for foreign-currency debt and 7–10 years for inflation-linked krona debt. The steering of the nominal krona debt is divided into instruments with outstanding maturities of less than and more than 12 years. For instruments with outstanding maturities of up to twelve years the interest rate refixing period will be 2.7–3.2 years. For instruments with outstanding maturities of more than 12 years, the long-term benchmark for the outstanding volume will be SEK 70 billion. The guidelines clarify that the benchmark for the outstanding volume is a long-term benchmark.

The mandate for the Debt Offices' positions in foreign currency is reduced from SEK 450 million to SEK 300 million, measured as daily Value-at-Risk with a 95 per cent probability. The mandate for strategic positions in the krona exchange rate is retained unchanged at SEK 7.5 billion.

In cases where this decision means changes compared to the Debt Office's proposal or compared to previous guidelines, this is stated. In order to provide an overview of the regulations that govern debt management the relevant parts of the Budget Act (2011:203) and the Ordinance (2007:1447) containing Instructions for the National Debt Office have been included.

1.1 The objective of central government debt management

1. Central government debt is to be managed in such a way as to minimise the long-term cost of the debt while taking risk in its management into account. The debt is to be managed within the framework of monetary policy requirements. *Budget Act (2011:203).*

1.2 The Debt Office's remit and the purpose of borrowing

2. The Debt Office's remit is to raise and manage loans for the central government in accordance with the Budget Act. *Ordinance (2007:1447) containing Instructions for the National Debt Office.*

3. Under the Budget Act the Debt Office may raise loans for the central government to:
   1. finance current deficits in the central government budget and other expenditure based on decisions of the Riksdag (Swedish Parliament);

2. provide credits and perform guarantees decided by the Riksdag;
3. amortise, redeem and purchase central government loans;
4. in consultation with the Riksbank, meet the need for central government loans at different maturities; and
5. satisfy the Riksbank's need for foreign currency reserves.

1.3 The guideline process

4. The Debt Office has to submit proposed guidelines for central government debt management to the Government no later than 1 October each year. *Ordinance containing Instructions for the National Debt Office.*
5. The Government has to allow the Riksbank to comment on the Debt Office's proposed guidelines. *Budget Act.*

6. The Government has to adopt guidelines for the Debt Office's management of the central government debt by 15 November each year. *Budget Act.*

7. The Debt Office has to submit information for the evaluation of the management of central government debt to the Government no later than 22 February each year. *Ordinance containing Instructions for the National Debt Office.*

8. Every second year the Government has to evaluate the management of the central government debt. The evaluation has to be presented to the Riksdag no later than 25 April. *Budget Act.*

9. The Debt Office has to establish principles for the implementation of the guidelines for central government debt management decided by the Government. *Ordinance containing Instructions for the National Debt Office.*

The Government's decision	Debt Office proposal	Comment
10. The Debt Office has to establish internal guidelines based on the Government's guidelines. The decisions have to concern deviation intervals for the maturity benchmarks decided by the Government for each type of debt, the use of the position mandate, the foreign currency distribution in the foreign currency benchmark and principles for market and debt maintenance.	In line with the Government's decision.	Amended wording, see section 3.4.

1.4 Composition of central government debt – debt shares

The Government's decision	Debt Office proposal	Comment
11. The share of *inflation-linked krona debt* in the central government debt is to be 25 per cent in the long term.	In line with the Government's decision.	Corresponds to current guideline.

12. The share of *foreign currency debt* is to be 15 per cent of central government debt. The control range around the benchmark is to be ±2 percentage points	The Debt Office proposes replacing the steering of the share of currency debt with a ceiling of 15 per cent, see section 3.2.	Corresponds to current guideline.
If the foreign currency share moves outside the control interval, the share of foreign currency debt is to be returned to the benchmark or to inside the range if the deviation is due to exchange rate movements.	In line with the Government's decision.	Corresponds to current guideline.
13. The Debt Office is to set a benchmark for the distribution of the foreign currency debt among different currencies.	In line with the Government's decision.	Corresponds to current guideline.
14. In addition to inflation-linked krona debt and foreign currency debt, central government debt is to be composed of *nominal krona debt*.	In line with the Government's decision.	Corresponds to current guideline.

1.5 The maturity of the central government debt

The Government's decision	Debt Office proposal	Comment
15. The maturity of the nominal krona debt for instruments with maturities of up to twelve years is to be 2.7–3.2 years.	In line with the Government's decision.	Corresponds to current guideline.
16. For nominal krona instruments with maturities over twelve years, the long-term benchmark for the outstanding volume is to be SEK 70 billion.	In line with the Government's decision.	Clarified guideline, see section 3.3.
17. The maturity of the inflation-linked krona debt is to be between 7 and 10 years.	In line with the Government's decision.	Corresponds to current guideline.
18. The maturity of the foreign currency debt is to be 0.125 years.	In line with the Government's decision.	Corresponds to current guideline.
19. The maturity of the types of debt may deviate temporarily from the maturities given in points 15, 17 and 18.	In line with the Government's decision.	Corresponds to current guideline.

1.6 Cost and risk

The Government's decision	Debt Office proposal	Comment
20. The trade-off between expected cost and risk is primarily to be made through the choice of the composition and maturity of the debt.	In line with the Government's decision.	Corresponds to current guideline.
21. The main cost measure is to be the average cut-off yield.	In line with the Government's decision.	Corresponds to current guideline.
22. The main risk measure is to be the average cut-off yield risk.	In line with the Government's decision.	Corresponds to current guideline.
23. The Debt Office is to take account of refinancing risks in the management of central government debt.	In line with the Government's decision	Corresponds to current guideline.
24. The shares of the various types of central government debt are to be calculated using a measure that takes account of all cash flows in the debt, i.e. including future coupon payments and expected compensation for inflation.	In line with the Government's decision	Corresponds to current guideline.
25. The maturity is to be measured by the average interest rate refixing period that includes all the cash flows including expected compensation for inflation. Cash flows are not to be discounted.	In line with the Government's decision	Corresponds to current guideline.
26. Positions taken are not to be included in the calculation of debt shares and maturities.	In line with the Government's decision	Corresponds to current guideline.
27. When taking positions, market values are to be used as the measure of the costs and risks in managing the debt.	In line with the Government's decision	Corresponds to current guideline.

1.7 Market and debt maintenance

The Government's decision	Debt Office proposal	Comment
28. The Debt Office is to contribute, through market and debt maintenance, to the effective functioning of the government securities market in order to achieve the	In line with the Government's decision.	Corresponds to current guideline.

long-term cost minimisation objective while taking account of risk.		
29. The Debt Office is to adopt principles for market and debt maintenance.	In line with the Government's decision.	Corresponds to current guideline.

1.8 Position-taking

The Government's decision	Debt Office proposal	Comment
30. The Debt Office may take positions in *foreign currency* and the *krona exchange rate*.	In line with the Government's decision.	Corresponds to current guideline.
Positions in foreign currency may only be taken using derivative instruments.	In line with the Government's decision.	Corresponds to current guideline.
Positions may not be taken in the Swedish fixed income market.	In line with the Government's decision.	Corresponds to current guideline.
Positions refer to transactions that are intended to reduce the costs of the central government debt taking account of risk and that are not motivated by underlying borrowing or investment requirements.	In line with the Government's decision.	Corresponds to current guideline.
Positions may only be taken in markets that permit the management of market risk through liquid and otherwise well-developed derivatives and that are potentially a borrowing currency in the context of debt management.	In line with the Government's decision.	Corresponds to current guideline.
31. Positions in *foreign currency* are limited to SEK 300 million, measured as daily Value-at-Risk with a 95 per cent probability.	The Debt Office proposes an unchanged V-a-R mandate, i.e. SEK 450 million.	Amended guideline, see section 3.4.
The Debt Office is to decide how much of this scope may be used at most in its ongoing management.	In line with the Government's decision.	Amended wording, see section 3.4.
32. *Positions* in the krona exchange rate may not exceed a maximum of SEK 7.5 billion. When the positions are built up or wound down, this is to be done gradually and announced in advance.	In line with the Government's decision.	Amended wording, see section 3.4.
The Debt Office is to decide how much of this volume that may be used at most in ongoing management in connection with exchanges between the krona and other	In line with the Government's decision.	Amended wording, see section 3.4.

currencies. This volume shall be of a limited size and the positions do not need to be announced in advance.		

1.9 Borrowing in the retail market

The Government's decision	Debt Office proposal	Comment
33. Through retail market borrowing the Debt Office is to contribute to reducing the costs of central government debt compared with equivalent borrowing in the institutional market.	In line with the Government's decision.	Corresponds to current guideline.

1.10 Borrowing to meet the need for central government loans

The Government's decision	Debt Office proposal	Comment
34. The possibility of raising loans to meet the need for central government loans under Chapter 5, Section 1 of the Budget Act may only be used if required on account of threats to the functioning of the financial market.	In line with the Government's decision.	Corresponds to current guideline.
The Debt Office may have outstanding loans with a maximum nominal value of SEK 200 billion for this purpose.	In line with the Government's decision.	Corresponds to current guideline.
35. Investment of funds raised through loans taken to meet the need for central government loans should be guided by the principles set out in the Government Support to Credit Institutions Act (2008:814).	In line with the Government's decision.	Corresponds to current guideline.

1.11 Management of funds, etc.

36. The Debt Office is to deposit its funds, to the extent that they are not needed for disbursements, in an account at the Riksbank, a bank or a credit market company, or in government securities or other debt instruments with a low credit risk. Deposits may be made abroad and in foreign currency. *Ordinance containing Instructions for the National Debt Office.*

37. The Debt Office is to cover the deficits that occur in the Government central account. *Ordinance containing Instructions for the National Debt Office.*

38. The management of exchanges between Swedish and foreign currency (currency exchanges) is to be predictable and transparent. *Ordinance containing Instructions for the National Debt Office.*

1.12 Consultation and collaboration

39. The Debt Office is to consult the Riksbank on matters concerning the components of its borrowing operations that may be assumed to be of major importance for monetary policy. *Ordinance containing Instructions for the National Debt Office.*

40. The Debt Office is to consult the National Institute of Economic Research and the National Financial Management Authority on matters concerning Debt Office's forecasts of the central government borrowing requirement. *Ordinance containing Instructions for the National Debt Office.*

41. The Debt Office should obtain the Riksbank's views on how the funds borrowed to meet the need for central government loans under the Budget Act are to be invested.

1.13 Evaluation

42. Evaluation of debt management is to be carried out in qualitative terms in the light of the knowledge available at the time of the decision. Where possible, the evaluation is also to include quantitative measures.

43. The evaluation of the operational management should include borrowing and management of the different types of debt, market and debt maintenance measures and management of currency exchanges.

44. The realised cost difference between inflation-linked and nominal borrowing is to be reported for inflation-linked borrowing.

45. The cost saving compared with alternative borrowing is to be reported for retail market borrowing.

The Government's decision	**Debt Office proposal**	**Comment**
46. The result of positions within a given position mandate shall be recorded continuously and evaluated in terms of market value.	In line with the Government's decision.	Amended wording, see section 3.4.

2 Basis for the Government's guidelines

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

A further consideration is the size of the debt and its expected development. The unconsolidated central government debt was SEK 1 201 billion (33 per cent of GDP) at the end of October 2013. Forecasts indicate that the corresponding debt will be between SEK 1 225 and 1 366 billion (28 and 31 per cent of GDP) at the end of 2017.

The Government adjusts the level of risk in debt management via annual guideline decisions. In general, strong government finances and a low central government debt mean that the scope for risk-taking increases in return for lower expected costs. The trade-off between cost and risk is primarily to be made through the choice of the maturity of the debt. If a shorter maturity is chosen, the average cost is expected to be lower, while the risk in management rises (and the other way round). This is because it is assumed that the slope of the yield curve is positive over time at the same time as short-term interest rates vary more. These variations have a greater effect on interest costs when the interest rate on a large part of the debt is refixed in every period. In exceptional cases the absolute level of interest rates can be taken into account.

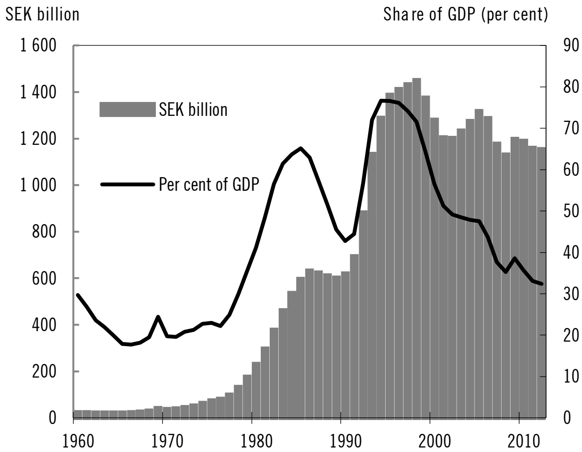
The size of the debt and its expected development over the next few years are taken into account in formulating the guidelines. In exceptional cases the situation on loan markets and the Swedish krona exchange rate may also be of importance in formulating the guidelines. In order to reduce the cost of the central government debt the Debt Office is able to take decisions on deviations from the benchmarks within the mandates it has been given. Derivatives are used for these deviations, which are defined as positions. These positions are evaluated separately and must not be taken in the Swedish fixed income market.

2.1 Central government debt

Historical development of the debt

Central government debt has been built up because historically the central government budget has shown larger deficits than surpluses. Budget deficits are financed by new borrowing, while budget surpluses are used to amortise the existing debt. The development of the budget (and therefore of central government debt) is greatly affected by the development of the economy and by political decisions. In some years the development of the debt is also affected by one-time events such as the sale of shares in state-owned companies or borrowing in order to strengthen the Riksbank's currency reserve.

Figure 1. Unconsolidated central government debt 1960–2012



Source: Debt Office

Changes in reporting as of the start of 2012 increased unconsolidated central government debt by almost SEK 50 billion.

Central government debt has increased sharply as a percentage of GDP in two periods. The first period was from the mid-1970s to the mid-1980s and was a result of a downturn in the international economy and sharp increases in oil prices. The second period of a sharp rise in the debt occurred in the first half of the 1990s. That time the debt increase was caused by the domestic financial and property crisis. In krona terms the unconsolidated central government debt was largest in 1998. Then the debt was SEK 1 449 billion (72 per cent of GDP). As a share of GDP the debt has decreased in principle every year since 1996. However, the exception was 2009 when the debt rose partly because the Debt Office raised foreign currency loans corresponding to almost SEK 100 billion on behalf of the Riksbank. The purpose of the borrowing was to strengthen the currency reserve.

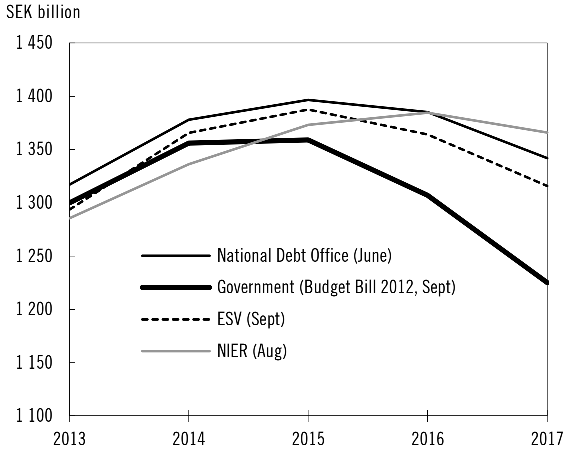
At the end of October 2013 unconsolidated central government debt was SEK 1 201 billion (33 per cent of GDP). This is an increase of SEK 48 billion since the start of the year. Out of the calculated increase in the debt more than SEK 100 billion is due to further lending to the Riksbank in order to strengthen the currency reserve. At the same time sales revenue has reduced central government debt by SEK 42 billion so far this year.

Forecasts for the development of the debt until 2017

In addition to the Government, the following agencies make forecasts of public finances and therefore of the development of central government debt: the National Financial Management Authority (ESV), the National Institute of Economic Research (NIER) and the Debt Office. These forecasts are made for different purposes using different methods and with different time horizons. In general the forecasts cover the current year and the next four years. However, the regular forecasts made by the Debt Office only cover the next two years.

Figure 2 presents the forecasts made by the different agencies of unconsolidated central government debt in 2013–2017. The purpose of the different forecasts and which forecasts have been used from the agencies are then set out below.

Figure 2. Unconsolidated central government debt 2013–2017



Source: Debt Office, ESV, NIER, Government

The Government's forecasts form the basis for Riksdag decisions on taxes and expenditure and are therefore an important part of the political process. The Government's forecast has been taken from the Budget Bill for 2014 (Govt Bill 2013/14:1).

The National Financial Management Authority's forecasts form a basis for decisions and discussions in fiscal policy. Its forecasts are based on decisions taken and legislative proposals as well as, in some cases, measures announced by the Government and the Riksdag. The National Financial Management Authority's forecast is taken from its September forecast. This means that the reforms announced in the Budget Bill for 2014 are included in the forecast. The forecasts made by the Government and the National Financial Management Authority are similar and can be viewed as impact calculations given unchanged regulations and a particular macroeconomic development. One difference is that the Government makes a standard assumption of sales income of SEK 15 billion per year.

The National Institute of Economic Research makes forecasts of the development of the real economy in national accounts terms. Its forecasts also report the consolidated central government debt. The National Financial Management Authority's forecast of government agencies' holdings of government bonds has been used to calculate the unconsolidated debt. The National Institute of Economic Research's forecast has been taken from the publication *Konjunkturläget (The Swedish Economy)* in August.

The Debt Office makes forecasts in cash-flow terms. The Debt Office's forecasts form the basis of its borrowing plans. These forecasts also report what loan instruments will be used, which contributes to greater transparency in relation to market actors. For the forecasts for 2015 to 2017 the loan need has been estimated using a simplified method. For the years mentioned the Debt Office and the National Institute of Economic Research have used very similar methods, which means that public sector net lending is assumed to increase when the economy moves towards balance. The Debt Office forecast has been taken from its proposed guidelines for 2014–2017.

The forecasts show a range for unconsolidated central government debt at the end of 2017 of between SEK 1 225 and 1 366 billion (28 and 31 per cent of GBP).

Risk of weaker development predominates

The development of the economy has a strong impact on central government finances and the development of central government debt. In the Budget Bill for 2014 GDP is forecast to increase by 2.5 per cent in 2014, 3.6 per cent in 2015, 3.9 per cent in 2016 and 2.9 per cent in 2017. This forecast is based on an international economic upturn and continued strong growth of consumption among households. However, there is uncertainty about both these factors, so growth can be both worse and better than forecast. But the overall assessment is that the risks of a weaker development of the economy will continue to dominate. However, the risk of a severe downturn, of the kind that hit the world economy in 2008 and 2009, is assessed as being much lower than has been the case in recent years.

The uncertainty about the upturn in the international economy is mainly linked to political developments in the euro zone and the development of fiscal and monetary policy in the United States. If political support for fiscal policy in the crisis countries in Europe falters, this may make crisis management and reform policy more difficult. At present the financial markets in Europe are relatively calm. This calm is due to a great extent to the commitments made by the European Central Bank to buy bonds when required. Another risk factor in the euro zone is that it may be difficult to reach crucial decisions regarding crisis management. Many parties are involved and it has turned out to be difficult to strike a balance between these interests. The result has been that decisions have often taken a long time. Moreover the US is facing major challenges in the management of its public finances. The direction of monetary policy in the US is also a source of uncertainty. The attempts by the US Federal Reserve (central bank) to prepare the market for a possible reduction of purchases of government bonds has contributed to a distinct increase in interest rates in large parts of the world. There is still a risk that the international interest rates will rise more than expected.

Household consumption is assessed to contribute to a large part of the growth in the Swedish economy than in previous upturns. A higher international level of interest rates would also have negative consequences for the Swedish economy, both through negative external demand and via higher financing costs for households and companies. This would dampen both household consumption and business investment. In addition to a higher level of interest rates, the higher level of household indebtedness is a risk, as is the development of housing prices. The forecast assumes that housing prices will continue to rise in the next few years, but at a moderate pace.

On the other hand, it is also possible that the upturn in the international economy will be stronger than expected. In such a scenario demand for Swedish exports may rise more rapidly than forecast. This would also benefit household consumption and business investments.

Maastricht debt

The *Maastricht debt* refers to general government consolidated gross debt and is used in comparisons of the public indebtedness of EU countries. For Swedish conditions, this definition means that the central government debt and the local authority sector's capital market debts are added together and the AP Fund holdings of Swedish government bonds are deducted.

For Sweden the Maastricht debt was 38.2 per cent of GDP at the end of 2012. At the same point in time the share for the EU as a whole was 87.2 per cent and for the Euro zone it was 93.1 per cent.

Different measures of central government debt

There are several different measures of central government debt. The different measures are used in different contexts depending on the purpose of the measure. The official measure is called *unconsolidated central government debt* and corresponds to the debt managed by the Debt Office. This section uses that measure. In the Budget Bill, the Government mainly uses the measure consolidated central government debt, which shows central government debt to outside parties. The difference between unconsolidated and consolidated central government debt is government agency holdings of government securities. At the end of 2012 these holdings amounted to SEK 33 billion. Both unconsolidated and consolidated central government debt show the future central government commitments in terms of aggregate] nominal final amounts for the various outstanding Debt Office loan instruments – with and without government agency holdings respectively.

The measure used for the control of the central government debt is the consolidated cash flow of the debt (the CCF measure). This measures the risk in the central government debt by including the central government's future commitments in terms of cash flows. It also includes coupon payments and inflation compensation in addition to the nominal final amounts. Another important difference compared with the measures unconsolidated and consolidated central government debt is that the CCF measure includes the cash flows from assets in the Debt Office's debt management. On-lending to the Riksbank is a topical example of this type of asset. The steering shares for the composition of the central government debt and the maturity benchmarks for the different types of debt are based on the CCF measure.

Conclusions

At the end of October 2013 unconsolidated central government debt was SEK 1 201 billion, or 33 per cent of GDP. At the end of 2017 forecasts show a range for unconsolidated central government debt of between SEK 1 225 and 1 366 billion (28 and 31 per cent of GBP). The forecasts include the SEK 200 billion that the Debt Office has raised on behalf of the Riksbank in order to strengthen the currency reserve.

For Sweden the Maastricht debt was 38.2 per cent of GDP at the end of 2012. At the same point in time the corresponding share for the EU as a whole was 87.2 per cent and for the Euro zone it was 93.1 per cent. Sweden's central government finances are therefore to be regarded as strong from both a historical and an international perspective.

Economic developments are of great importance for central government finances and therefore for the development of the debt. The Government expects a relatively strong economic recovery over the next few years. However, uncertainty is associated with this growth forecast and the development of the economy may be both worse and better than forecast. The risks of a weaker cyclical development are judged to predominate. At the same time, the risk of a severe downturn, of the kind that hit the world economy in 2008 and 2009, is judged to be much lower than in the past.

Overall, the scope for risk-taking in the management of central government debt is judged to be largely the same as before.

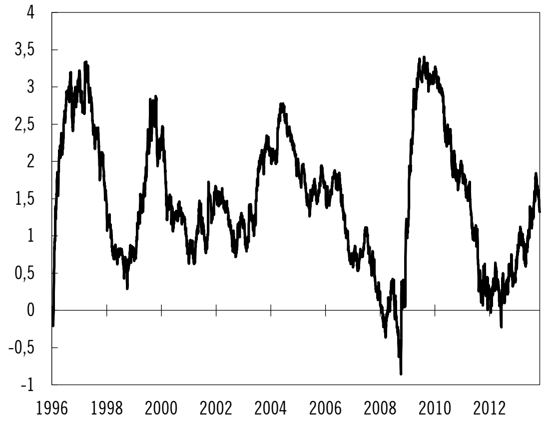
2.2 Loan markets

The yield curve slope

The slope of the yield curve affects the trade-off between cost and risk. When the yield curve has a steep positive slope, the cost saving from borrowing at shorter maturities increases. However, borrowing at shorter maturities means that an interest rate rise has a quicker impact on interest costs since the debt is refinanced more often. Borrowing at short maturities therefore leads to a rise in the expected variation in interest costs (and payments).

One way of reporting the yield curve slope is to describe the difference between the interest rate level of the ten-year government bonds and the three-month treasury bills. On 31 October 2013 the ten-year government bond interest rate was 1.3 percentage points higher than the interest rate on three-month treasury bills (2.3–1.0 per cent).

Figure 3. Diference between ten-year and three-month Swedish governmemt borrowing rate as of 1996



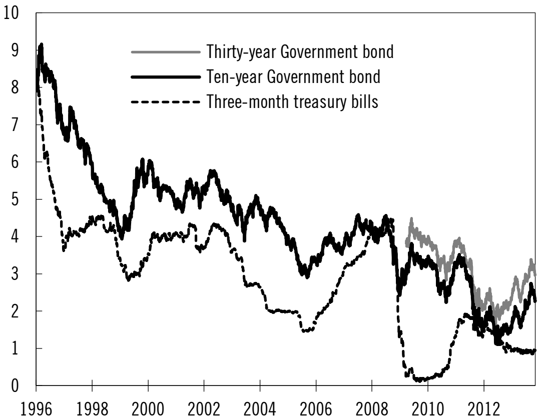
Källa: Reuters EcoWin

As shown in figure 3 the yield curve has gradually become steeper in 2013. Short-term interest rates remain at low levels as a result of the retention of the monetary policy stimulus, while long-term interest rates have risen as a result of greater expectations of economic recovery.

The yield curve level

The yield curve level is of less importance in the long-term choice of maturity. Considering that increases and decreases in the interest rate offset each other in the long run, the gain from having a long-term debt when interest rates rise is reduced by a loss that can be said to arise when interest rates fall again. However, in some extraordinary cases, the interest rate level has affected the steering of maturities. This happened, for example, in spring 2009 when the Government made it possible for the Debt Office to issue a 30-year bond, partly with the aim of locking in low interest rates.

Figure 4. Swedish government borrowing rate as of 1996



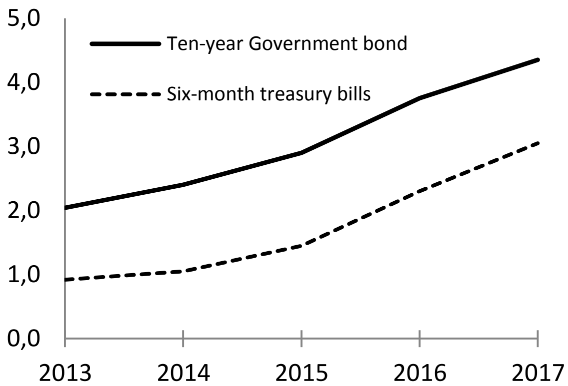
Källa: Reuters EcoWin

Government forecast of interest rate developments

In the Budget Bill for 2014 the Government expects the Riksbank to continue to pursue an expansive monetary policy over the next few years. The assessment is that resource utilisation will be weak, unemployment high and inflation low in 2013 and 2014. The repo rate is therefore expected to remain at 1 per cent for the whole of 2014. As resource utilisation and inflation rise, the Government expects a normalisation of the repo interest rate to commence. The Government expects the repo rate to be raised to 1.75 per cent at the end of 2015, 2.75 per cent at the end of 2016 and 3.25 per cent at the end of 2017.

The European debt crisis and Sweden's strong central government finances have made Swedish government securities appear to be an increasingly secure investment. Along with low inflation expectations and low international interest rates, this has meant that the interest rate of Swedish government securities has fallen to record low levels in recent years. In 2013 long-term interest rates have risen and they are expected to rise further over the next few years. The low starting position means that long-term interest rates are expected to be more than twice as high at the end of the calculation period as they are today.

Figure 5. Government forecast of the Swedish government borrowing rate, annual average, 2013–2017



Source: Budget Bill for 2014 (Govt Bill 2013/14:1)

Conclusions

In general, shorter interest rate refixing periods lead to lower expected costs since the yield curve can be assumed to have a positive slope over time. However, shorter maturities mean that the interest rate refixing risk increases.

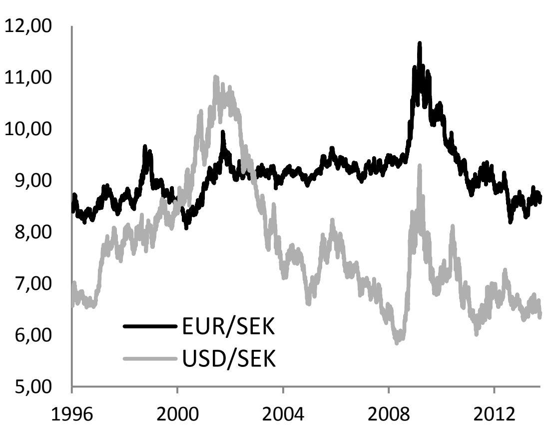
Decisions on how assessments of the development of the interest rate are to affect the ongoing management of the central government debt have been delegated to the Debt Office within the framework of the position-taking mandates assigned to it. However, the Debt Office must not take positions in the Swedish fixed income market. The reason is to avoid concerns that the Debt Office could exploit information about its own future actions to take positions actively.

2.3 The Swedish krona

The strength of the Swedish krona in relation to the currencies in which the currency debt is exposed affects the size of the currency debt in krona terms. Since summer 2008 the currency debt share has been steered toward the benchmark of 15 per cent. Previously the Government steered the size of the currency debt by setting an annual amortization amount.

The historical development of the Swedish krona
The krona weakened sharply during the financial crisis in 2008 and 2009 when investors moved into the major currencies. In summer 2009 the krona strengthened as financial markets stabilised and when the signals about economic developments became more positive. In 2010 the krona was traded at much the same levels as before the financial crisis and at the start of the debt crisis in 2011 the krona was only weakened marginally. Figure 7 shows the development of the krona in relation to the euro and the dollar since 1996. Such summer 2012 the trend has been for the krona to be strengthened in trade-weighted terms.

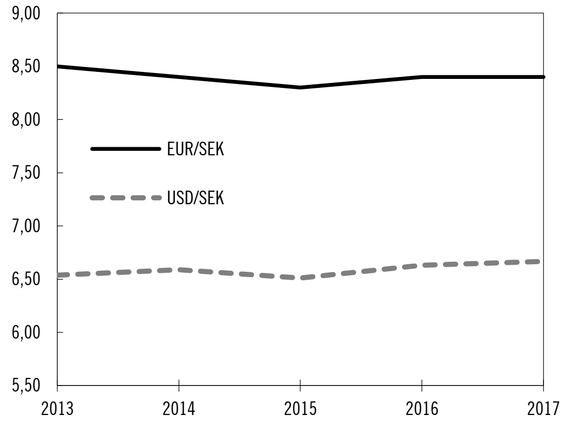
Figure 6. The development of the krona as of 1996



Source: Reuters EcoWin

Government forecast of the development of the krona
In the Budget Bill for 2014 the Government expects the value of the krona against the euro and dollar to be largely unchanged during the calculation period. The value of the krona against the euro is forecast at 8.50 at the end of 2013 and at 8.40 at the end of 2017. The value of the krona against the dollar is forecast at 6.54 at the end of 2013 and at 6.67 at the end of 2017. Figure 7 shows the development of the krona in relation to the euro and the dollar according to the Government's forecast in the Budget Bill for 2014.

Figure 7. Government forecast for the krona at year-end



Källa: Budget Bill for 2014 (2013/14:1)

Conclusion
In certain cases the guidelines for debt management have been affected by the expected development of the Swedish krona. In May 2009 the krona was judged to be severely undervalued in connection with the financial crisis. The mandate for positions in the krona exchange rate was then raised from SEK 15 billion to SEK 50 billion.

Decisions on how assessments of the development of the krona will affect the ongoing management of the central government debt have been delegated to the Debt Office within the framework of the position-taking mandates assigned to it.

2.4 The Riksbank's comments on the Debt Office proposal

The Government shall request an opinion from the Riksbank on the proposal of the National Debt Office for guidelines for the management of the central government debt (Chapter 5, Section 6 of the Budget Act).

The opinion submitted by the Riksbank states that the proposals made by the Debt Office in its guidelines for the administration of the central government debt in 2014-2017 are considered to be compatible with the requirements set by monetary policy. The Riksbank has no objections to the Debt Office's proposed guidelines.

3 Reasons for the Government's decision

3.1 Trade-off between cost and risk in debt management

The objective for the management of the central government debt states that the guidelines are to be based on a trade-off between long-term cost and risk. In principle a low central government debt means that the scope for risk-taking increases in return for lower expected costs. A smaller central government debt results in lower costs and therefore smaller variations in costs (expressed in kronor).

At the end of October 2013 unconsolidated central government debt was SEK 1 201 billion (33 per cent of GDP). The Government's and the agencies' forecasts indicate that the corresponding debt will be between SEK 1 225 and 1 366 billion (28 and 31 per cent of GDP) at the end of 2017. The development of central government finances and central government debt are highly dependent on economic developments. In the forecast in the Budget Bill for 2014 the risks of a weaker development of the economy are judged to be predominant. At the same time, the risk of a severe downturn, of the kind that hit the world economy in 2008 and 2009, is judged to be much lower than in the past. Overall, the scope for risk-taking in the management of central government debt is judged to be largely the same as before.

Costs of the debt

The costs of the central government debt are primarily affected by the size of the debt and the interest rate levels when the interest rates on the debt instruments are fixed. Exchange rate movements also affect the cost of the debt since part of the debt is exposed to foreign currencies. Similarly the inflation-linked debt is affected by the development of the CPI.

Falling market interest rates and Sweden's strong central government finances have meant that in recent years borrowing costs have fallen to record low levels. For 2012 the interest costs for the central government debt were SEK 18 billion. In the Budget Bill for 2014 interest costs are calculated at SEK 20 billion for 2013. According to those calculations, interest costs are expected to rise successively and reach SEK 30 billion at the end of the period. The increase is due to expectations of higher market interest rates.

The cost of the central government debt is measured as the average cut-off yield. This measure reflects the average interest rate for the Debt Office's borrowing of the outstanding debt.

Risks in debt management

At a general level the risk in central government debt is defined as its contribution to variations in the budget balance and the debt. There is no single measure that describes the overall risk in the management of the debt. Instead benchmarks for different types of risk are used, the most important being the interest rate refixing risk, the refinancing risk and the financing risk.

The steering of maturities in the guidelines is aimed at the interest rate refixing risk. The interest rate refixing risk means the risk that the interest rate on the debt will rise rapidly on account of higher market interest rates. Since the Debt Office uses derivatives, interest rate refixing does not only occur when new loans are raised. The interest rate refixing risk reflects the exposure of central government debt.

The refinancing risk refers to the risk that it will turn out to be difficult or expensive to replace maturing loans with new ones. In general, the refinancing risk appears at the same time as the need for new borrowing rises sharply (financing risk). Strong and sustainable central government finances are therefore the best insurance against both refinancing risk and financing risk. The refinancing risk reflects the time remaining to maturity, i.e. when the debt needs to be refinanced. The refinancing risk is taken into account in several different ways in the Debt Office's strategies for borrowing and market maintenance. The bulk of the borrowing is done in government bonds that are spread over several loans with different maturity dates. The borrowing is spread continuously across small, regularly held auctions. The borrowing is mainly carried out in the 10-year government bond, where the investor base is largest. In recent years borrowing at longer maturities than twelve years has also increased, which means that the dates when the debt reaches maturity are spread over a longer period of time. Through its foreign-currency borrowing the Debt Office has an established channel to international capital markets. This loan channel provides the potential to borrow large volumes in a short period of time. A new point was introduced in the guidelines for 2013 stating that the Debt Office is to take account of refinancing risks in the management of central government debt. In the evaluation of its management of the central government debt the Debt Office is to report how it has lived up to the requirement to take account of refinancing risks.

At the end of 2012 the average interest rate refixing period of the whole central government debt was 5.1 years and the average remaining time to maturity was 5.4 years.

3.2 The composition of the central government debt

At present the Government sees no reason to alter the shares of the various types of debt. The share of foreign currency debt is to be 15 per cent and the share of inflation-adjusted krona debt 25 per cent. The remaining share (60 per cent) is to consist of nominal krona debt.

The Debt Office's proposed guidelines for 2014 propose that the steering of the currency debt be altered by replacing the fixed share of 15 per cent with a ceiling of the same share. The background is that an deeper analysis has not be able to show that a fixed share of currency exposure reduce the risk in terms of cost variation. Under the proposal, the Debt Office would be given the possibility of adapting currency exposure under the ceiling in the light of long-term structural correlations like the analysis of the interest rate refixing period of the debt. According to the proposal, temporary movements in the interest rate and currency market will not affect the analysis and the choice of currency exposure.

However, the proposed guidelines state that the Debt Office expects to keep the currency share (15 per cent) unchanged in 2014. The Debt Office gives two reasons for this: first, decisions on the Riksbank's financial independence and balance sheet should be awaited and, second, at present there are not deemed to be strong reasons that indicate that it would be unfavourable from a cost perspective to wait before making changes in the currency share.

The Government judges that no change of the model for steering the currency debt should be made now for the two reasons given by the Debt Office for retaining the currency share unchanged in 2014. A third reason for not making the proposed change is the ongoing Review of Central Government Debt Policy (terms of reference 2013:17). The inquiry is to present its report by 15 January 2014.

The Government wishes to gather further analysis of the consequences associated with the proposed change of the model for steering the currency debt. The Government's ambition is therefore to have the National Financial Management Authority analyse the proposed model for steering the currency debt in connection with the evaluation of central government borrowing and debt management for the period 2009–2013. The relationship between the Debt Office's position-taking operations and the above proposal should also be analysed.

The background to the Debt Office's proposal to change the model for steering the currency debt is the commission the Government gave the Debt Office in spring 2010. The commission was to analyse what shares different types of debt should have in the case of much higher and much lower central government debt and how maturities should be managed in these cases. The commission was given because the present debt shares are based on an analysis carried out by the Debt Office in 2004 when central government debt was 50 per cent of GDP.

The Debt Office's proposed guidelines for 2012 presented a qualitative analysis of the issue and the Debt Office's proposed guidelines for 2013 presented a renewed analysis of the currency debt share in particular. The proposed guidelines for 2013 concluded that a deeper analysis of cost and financing risk aspects linked to the currency debt was required before reconsidering the currency share. The Debt Office's proposed guidelines for 2014 contain a deeper analysis of cost and financing risk aspects linked to the currency debt. In the analysis the Debt Office presents two reasons for raising currency loans. The first is to reduce the financing risk. A presence on international capital markets provides the opportunity to borrow large sums in a short period of time. The second reason is that in situations when the loan requirement rises sharply there is reason to spread borrowing across several types of debt. Further types of debt reduce the risk that the interest rate on Swedish government bonds will be pushed up as a result of a strong increase in supply.

3.3 The maturity of the central government debt

The Government sees no reason to alter the interest rate refixing period in the central government debt. The interest rate refixing period will be 0.125 years for foreign-currency debt and 7–10 years for inflation-linked krona debt. The steering of the nominal krona debt is divided into instruments with outstanding maturities of less than and more than 12 years. For instruments with outstanding maturities of up to twelve years the interest rate refixing period will be 2.7–3.2 years. For instruments with outstanding maturities of more than 12 years, the long-term benchmark for the outstanding volume will be SEK 70 billion. Point 16 of the guidelines clarifies that the benchmark mentioned for the outstanding volume is a long-term benchmark. In the guideline decision for 2013 this is only stated in the reasons for the guideline. As before, the rate of increase in relation to the volume guideline shall be weighed against the development of demand for long bonds and the cost of borrowing at other maturities, taking account of risk. The Debt Office shall also take account of the development of central government finances in the sense that a strong increase in the borrowing need, compared with the present forecast, can justify greater issues of long bonds. At present SEK 53 billion is outstanding in the maturity segment for nominal krona bonds. The Debt Office's handling of borrowing in long bonds is valuated within the regular evaluation process.

3.4 Position-taking

Reduced mandate for foreign currency positions
The Debt Office is able to decide on deviations from the benchmarks within the mandates it has been given, with the exception of the Swedish interest-rate market. The purpose is to reduce the cost of central government debt. Derivatives are used for these deviations, which are defined as positions.

The Government decides to reduce the mandate for positions in foreign currency from SEK 450 million to SEK 300 million, measured as daily Value-at-Risk (V-a-R) with a 95 per cent probability. In 2011 the mandate was reduced from SEK 600 million to 450 million, which means that the mandate has been halved since the end of 2010, the reduced mandate limits the risk of losses at the same time as the position-taking operations can still contribute to cost savings. However, the potential for cost savings will be smaller. The positive effects that the position-taking operations are deemed to contribute to, in terms of a greater market focus and broader expertise in financial matters among Debt Office employees, remain.

The mandate for strategic positions in the krona exchange rate is kept unchanged at SEK

7.5 billion. In 2013 the mandate was halved from SEK 15 billion.

The terms for position-taking operations are made clearer

For the purpose of clarification the wording “Positions may be strategic (long term) or operational (current)” has been removed from point 30 of the guidelines. The term strategic positions can be interpreted as being linked to the strategic portfolio, which is not the case. The strategic portfolio refers to the composition that central government debt should have according to the guidelines in the form of benchmarks for shares and maturities. The tactical portfolio is used to reduce the expected cost by taking advantage of specific market movements. It is for these operations that the Government assigns mandates for positions decided by the Board of the Debt Office and for ongoing management. The wording of point 10 of the guidelines is changed from “distribution of the risk mandate” to “the use of the position-taking mandate”. Moreover, point 31 of the guidelines is clarified by replacing the term ‘operational management’ with ‘ongoing management’. In point 32 of the guidelines the wording ‘Strategic positions in the krona exchange rate’ is replaced with ‘Positions in the krona exchange rate’. In the same point the wording ‘Limited operational positions in kronor relative to other currencies may be taken in connection with exchanges between the krona and other currencies. The Debt Office is to state the maximum permitted extent’ with ‘The Debt Office is to decide how much of this volume may be used at most in ongoing management in connection with exchanges between the krona and other currencies. This volume shall be of a limited size and the positions do not need to be announced in advance’. In point 46 of the guidelines the wording “The result of strategic and operational positions within a given position mandate shall be recorded continuously and evaluated in terms of market value” is replaced with “The result of positions within a given position mandate shall be recorded continuously and evaluated in terms of market value”.

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