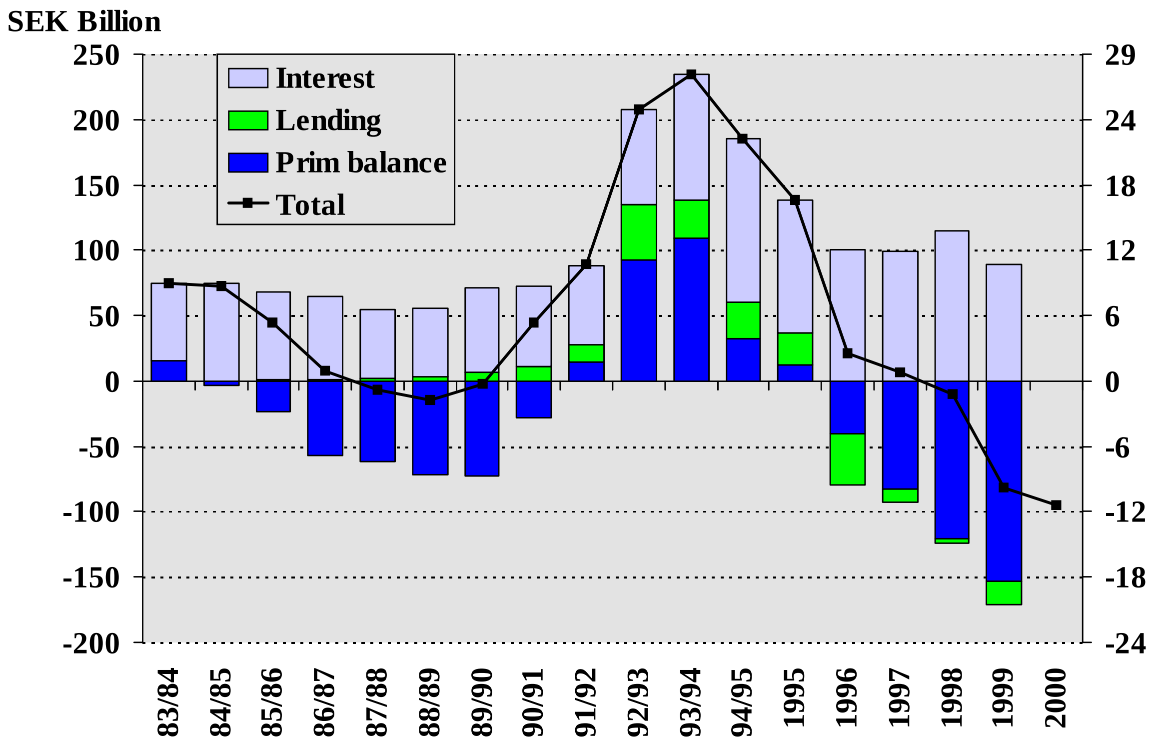
Budget Surplus and Borrowing Strategy

1 Borrowing Requirement

1.1 Net Borrowing Requirement in 2000

Sweden started to repay debt in 1998, and will continue to do so in the coming years. The Debt Office forecasts a surplus of SEK 90-100 billion for 2000. This surplus is to a large extent due to temporary factors; adjusted for these the estimated surplus is approximately SEK 5-15 billion. The major temporary effects are related to sales of government assets, and to factors connected with the reform of the public pension system.

Chart 1 Net Borrowing Requirement 1983/84 to 2000



1.2 Revenues from Sales of Government Assets

The forecast for 2000 includes revenues from sales of government assets, including Telia, of SEK 95 billion. The government has announced its intention to privatise Telia (the Swedish telecom). According to a government proposal 49% of the company will be privatised, but probably not all at once. It is expected that 20-30% of the company will be sold before the summer. There is still a great deal of uncertainty regarding the value of Telia; estimates in the press vary from SEK 300 to 600 billion. The value is a function of the development on the stock market, and large changes in the valuation can affect the timing of the sale.

1.3 The Public Pension System

The new Swedish public pension system is partly funded, in contrast to the previous system that was entirely a pay-as-you-go system. Also, the construction of the new system is more stable than the previous ATP system. This implies that the AP Fund, which is used as a buffer for future pension payments, is too large. Therefore, the AP Fund will be reduced by SEK 245 billion during the period 1999 to 2001.

In 1999 and 2000, cash in an amount of SEK 45 billion a year have been, and will be, transferred from the AP Fund to the state budget, lowering the borrowing requirement and reducing central government debt. Moreover, in 2001 the AP Fund will transfer treasury and mortgage instruments worth SEK 155 billion to the central government budget. About 2/3 of this is expected to consist of treasury instruments, and will cause an immediate reduction of the outstanding debt by approximately SEK 100 billion. The reduced debt will imply a lower gross borrowing requirement in the coming years, and also lower interest payments. The mortgage bonds will improve the borrowing requirement and reduce the outstanding debt at the time the bonds are redeemed. In the meantime the bonds will be held by the Debt Office, and the budget balance will benefit from the interest earned on the bonds. The exact composition of the transfer in 2001 with respect to the balance between treasury and mortgage instruments and with respect to maturities, is not yet settled. A committee, including representatives from the Debt Office and the AP Fund, will discuss these matters during the coming months. The final decision will be taken by the government in the autumn.

Since 1995 payments made to the funded part of the pension system have been managed by the Debt Office. During the autumn of 2000 amounts accumulated up until 1998 will be transferred to funds chosen by the individuals. The payments made in 1995 to 1998 have improved the budget balance during these years. Consequently, the borrowing requirement will increase as a result of these means now being transferred to private funds. The net effect of premium payments this year is an increased borrowing requirement of approximately SEK 40 billion. From next year, the net effect will be close to zero, as premium payments only will be kept at the Debt Office for approximately one year, before being transferred to private funds.

1.4 Long Term Borrowing Requirement

According to the targets laid down by the parliament, public sector financial savings shall show a surplus of 2 percent of GDP over a business cycle. This is close to what the National Institute of Economic Research forecast in their March report for the period 2000 to 2005. The pension system is expected to show a surplus exceeding 2 percent, which implies that the central government budget, given an overall public sector surplus of 2 percent, in fact is showing a small deficit. This is, however, in accordance with a shrinking government debt expressed in relation to GDP, and will have consequences for the borrowing strategy in the coming years. A decreased supply of bonds means that the scarcity value of government bonds will become more and more pronounced.

2 Funding

2.1 Borrowing Strategy in 2000

Nominal Bonds and Treasury Bills

If the present assessment of the net borrowing requirement remains unchanged, it will imply a relatively low supply of government issues this year. However, the Debt Office intends to manage the surplus in a way that allows auction activity to be kept at levels that does not undermine market liquidity. This means that auctions of nominal bonds and treasury bills will be held according to the normal pattern, although the issue volume temporarily might be relatively low.

Since the turn of the year, issue volumes of nominal treasury bonds have amounted to SEK 2 billions per month. Given current projections of the borrowing requirement the Debt Office does not expect any substantial further decrease of this level during the year.

As far as regular issues are concerned, issues of treasury bills is the major means the Debt Office has for quick reductions of the issue volumes. Accordingly, the issue volumes of treasury bills will decrease in connection with large revenues from asset sales being paid to the budget. However, because of the size of the surplus, and the fact that a large amount is expected to be paid on one single occasion, the supply of treasury bills is not large enough to offset the surplus. Moreover, the Debt Office has a duration target to follow. If issue volumes of treasury bills are cut strongly, the duration would increase and exceed the duration target.

Therefore, decreases of the issue volumes must be supplemented by repurchases of nominal bonds. By doing so, the Debt Office can keep on issuing loans that are attractive to investors, and at the same time buy back loans that, for example, are less liquid. Also, decreased issue volumes of treasury bills in combination with repurchases of bonds, makes it possible to offset a surplus in a more duration-neutral way. Exactly which bonds that will be subject to repurchase will be further analysed and communicated to the market later on. However, the buybacks will probably be spread over several loans.

Foreign Currency Borrowing and Kronor/Foreign Currency Swaps

The mandate for the foreign currency borrowing, which prescribes a net amortisation of the foreign currency debt of SEK 25 billion during 2000, has a flexibility of ±15 billion. By this flexibility the foreign currency borrowing can be adjusted for changes in the net borrowing requirement. With the present forecast, the Debt Office aims at an amortisation of approximately SEK 25 billion over the year. If the forecast for the borrowing requirement changes, for example because of new information about the sale of Telia, this will be offset in part by changes in the foreign currency borrowing, which will help make the domestic issue activity more stable than it otherwise would have been.

Since 1995, the Debt Office has swapped parts of the krona borrowing into foreign currency exposure. Besides being a cost efficient alternative to other types of foreign currency borrowing, these swaps support issue volumes on the domestic market. In an environment with large surpluses this is one important means to maintain liquidity in the domestic bond market.

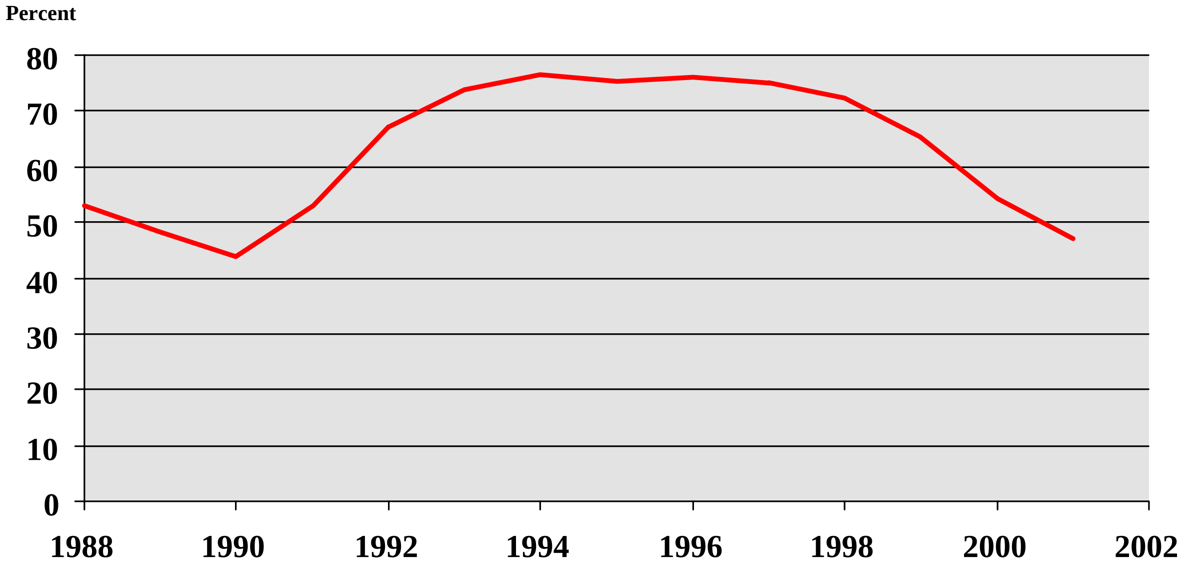
2.2 Borrowing Strategy in a Longer Perspective

With decreasing borrowing requirement the number of loans will have to be reduced if liquidity is to be maintained. As a first step, the Debt Office has announced that there will be no introduction of a new ten-year bond, with maturity in 2010, this year. This is a step away from a borrowing strategy aiming for a yield curve with redemptions every year up to ten years. It is also possible that further repurchases and exchanges of loans will take place.

The Debt Office will make further analysis of the long term borrowing strategy, for example regarding which loans and maturities the issues should be focused on. Factors that will be considered are for example if loans are trading as market benchmarks, and guidelines regarding the duration of the debt. The borrowing strategy should be seen as a gradual, long-term adjustment of the debt composition to an environment with lower borrowing requirement. As usual, the Debt Office will communicate its plans to the market once this analysis is completed.

A more consolidated debt, with fewer and larger loans, is also in line with the organisation of electronic trading systems. In future electronic trading systems, trading will probably focus on different segments, for example 2, 5 and 10 years. This development can be seen in EuroMTS, where outstanding volumes also have to exceed EUR 5 billion for the loans to be admitted into the system.

Chart 2 *Gross Debt in relation to GDP 1988-2001*



Source: Statistics Sweden, National Institute of Economic Research

3 Borrowing Strategy in an EMU Context

At the Social Democratic Party congress in March the Party took a decision in favour of a future EMU-membership. According to this, the timing will, among other things, depend on Swedish wage agreements and the business cycle being in line with those in the EMU. The question of membership will be decided in a referendum. The parliament has not yet decided about the procedure, but the general view is that there will be a referendum after the next election, which takes place in September 2002. This probably means that Sweden can enter the EMU in 2004 at the earliest.

The Debt Office's borrowing strategy includes measures for a smooth changeover to an EMU-membership. The Debt Office tries to broaden the investor base in various ways. A stable investor base contributes to lower borrowing costs. Therefore, it is desirable to build up an international investor base as a preparation for a possible, future EMU-membership.

Sweden has an advantageous starting point, as there is already a large number of foreign investors among the holders. About 30 percent of the kronor debt is owned by foreigners. Adding the foreign currency debt, which is about 30 percent of the outstanding debt, more than 50 percent is in foreign portfolios, a high number compared to other countries in the EU.

In order to improve the international distribution further, the Debt Office has international banks among the authorised dealers of domestic bonds. Moreover, web site information, road shows, presentations etc. are used to improve investor relations and information about the Debt Office.

The Debt Office also has issued benchmark bonds in Euro, for the purpose of attracting new groups of investors. The two most recently introduced benchmark bonds - loan 1043 (5%, Jan. 2009) and loan 1044 (3,5%, Apr. 2006) - are parallel bonds with exact copies denominated in Euro.