Guidelines for central government debt management 2022

Decision taken at the government meeting
3 November 2021

Government Offices of Sweden

Summary

The starting point for the Government’s guidelines decisions is the objective of central government debt policy adopted by the Riksdag, i.e. that the debt has to be managed in such a way as to minimise the cost of the debt over the long-term while taking risk in its management into account, and that the management of the debt has to be conducted within the framework of monetary policy requirements.

The central government debt has decreased as a share of GDP (gross domestic product) in 2021 after increasing temporarily in 2020. The recovery of the economy is expected to be faster than previously forecast and developments in 2021 are expected to involve a return to the earlier trend of a decreasing central government debt and borrowing requirement. The repayment of foreign currency loans by the Riksbank (the Swedish central bank) also has a negative effect on the borrowing requirement. A continued decrease in the central government debt is expected for 2022.

The guidelines decision for 2022 makes no changes to the steering of management compared with the preceding year.

The composition of the central government debt is to be steered towards:

- Foreign currency debt – the foreign currency exposure is to be unchanged.
- Inflation-linked krona debt – it is to be 20 per cent of the central government debt in the long term.
- Nominal krona debt – it is to make up the remaining share of the central government debt.

The term to maturity (in terms of duration) of the central government debt is to be steered towards 3.5–6 years.

The foreign currency exposure is, as in the preceding year, to be unchanged pending the Debt Office’s analysis of the strategic foreign currency exposure of the central government debt. One reason for doing so is that the analysis may show that there is reason to review the previous focus on reducing this exposure. The Government considers that it is very important that a final report on the analysis is made in the Debt Office’s proposed guidelines for 2023.

The Swedish government green bonds, which the Debt Office has issued, are covered by the general guidelines for the central government debt. To enable the Debt Office to issue additional green bonds as part of its management of the central government debt, a decision by the Government is needed on which green expenditures are to be considered eligible in the central government budget. A list of these expenditure can then be the maximum issue amount for a government green bond. The Government intends to adopt such a list of expenditure early in 2022.

The basis for this guidelines decision includes the Debt Office’s proposed guidelines. The Riksbank has stated an opinion on the Debt Office's proposed guidelines and has no objections to its proposal. The Government’s guidelines decision for 2022–2024 largely corresponds to the Debt Office’s proposal. The Debt Office has proposed removing the guideline that requires it to report the cost saving for lending in the retail market as part of its evaluation of the management of the central government debt. However, the Government considers that this report is

needed as input for the evaluation of the management of the central government debt in 2021 since the last lottery bond matures in December 2021.

Contents

1 Guidelines decision for central government debt management 2022

The following are the guidelines for 2022–2024; which is the horizon for calculations applied in the Budget Bill for 2022 (Govt Bill 2021/22:1). As in the case of the Budget Bill, the decisions for 2023–2024 are preliminary. In order to provide an overview of the regulations that govern the management of the central government debt, the relevant parts of the Budget Act (2011:203) and the Ordinance (2007:1447) containing Instructions for the National Debt Office are presented here.

The Government's guidelines decision corresponds to the Debt Office's proposal with the exception of point 42 which the Debt Office proposes removing but which the Government considers should be retained until the outcome of the last lottery bond has been reported.

1.1 Objective for the management of central government debt

1. The central government debt shall be managed in such a way as to minimise the cost of the debt over the long-term while taking risk in its management into account. The management of the debt shall be conducted within the framework of monetary policy requirements (Chapter 5, Section 5 of the Budget Act).

1.2 Debt Office's task and purposes of the borrowing

2. The task of the Debt Office is to raise and manage loans for central government in accordance with the Budget Act. (Section 2 of the Ordinance containing Instructions for the National Debt Office).

3. The Debt Office may raise loans for the central government in order to:

- finance current deficits in the central government budget and other expenditure based on decisions of the Riksdag (the Swedish Parliament);
- provide credits and perform guarantees decided by the Riksdag;
- amortise, redeem and buy back central government loans;
- meet the need for central government loans at different maturities in consultation with the Riksbank; and
- meet the Riksbank's need for foreign currency reserves.
  (Chapter 5, Section 1 of the Budget Act).

1.3 Guidelines process

4. The Debt Office shall submit proposed guidelines for central government debt management to the Government by 1 October each year (Section 26 f of the Ordinance containing Instructions for the National Debt Office).

5. The Government shall give the Riksbank the opportunity to state an opinion on the Debt Office's proposed guidelines (Chapter 5, Section 6 of the Budget Act).

6. The Government shall adopt guidelines for the Debt Office's management of the central government debt by 15 November each year (Chapter 5, Section 6 of the Budget Act).

7. The Debt Office shall submit information for the evaluation of the management of the central government debt to the Government by 22 February each year. (Section 26 f of the Ordinance containing Instructions for the National Debt Office).

8. The Government shall evaluate the management of the central government debt every other year. The evaluation shall be presented to the Riksdag by 25 April (Chapter 5, Section 7 of the Budget Act).

9. The Debt Office shall adopt principles for the implementation of the guidelines for central government debt management adopted by the Government (Section 15 of the Ordinance containing Instructions for the National Debt Office).

10. The Debt Office is to adopt internal guidelines based on the Government's guidelines. These decisions are to concern the use of the mandate for position taking, the term to maturity of individual debt types, the currency distribution of the foreign currency debt, and principles for market support and debt maintenance.

1.4 Composition of central government debt – debt shares

11. The share of inflation-linked krona debt is to be 20 per cent of the central government debt over the long term. The shares of the debt types in the central government debt are to be calculated as nominal amounts at the present exchange rate including accrued inflation compensation.

12. The foreign currency exposure of the central government debt is to be unchanged. The exposure is to be calculated in a way that excludes changes in the krona exchange rate. However, the foreign currency exposure is to be allowed to vary as a result of the Debt Office making currency exchanges in accordance with point 35.

13. The Debt Office is to set a target value for the distribution of the foreign currency debt among different currencies.

14. In addition to inflation-linked krona debt and foreign currency debt, the central government debt is to consist of nominal krona debt.

1.5 Term to maturity of central government debt

15. The term to maturity of the central government debt is to be between 3.5 and 6 years.

16. The Debt Office is to determine a term-to-maturity interval for the nominal krona debt, the inflation-linked krona debt and the foreign currency debt.

17. The term to maturity of the central government debt may deviate temporarily from the maturity interval stated in point 15.

18. Term to maturity is to be measured as duration.

1.6 Cost and risk

19. The trade-off between expected cost and risk is primarily to be made through the choice of the composition and term to maturity of the central government debt.

20. The main cost measure is to be the average issue yield. The cost is to be calculated using the valuation principle of amortised cost taking accrued inflation and exchange rate changes into account.

21. The main risk measure is to be the variation of the average issue yield.

22. The Debt Office is to take account of refinancing risks in the management of the central government debt, including by issuing instruments with more than twelve years to maturity.

23. Borrowing is to be conducted in a way that ensures a broad investor base and diversification in a range of funding currencies in order to maintain good borrowing preparedness.

24. Positions are not to be included in the calculation of debt shares and terms to maturity.

25. When taking positions, market values are to be used as the measure of the costs and risks in the management of the debt.

1.7 Market support and debt maintenance

26. The Debt Office is to contribute, through its market support and debt maintenance, to the effective functioning of the government securities market in order to achieve the objective of long-term cost minimisation while taking account of risk.

27. The Debt Office is to adopt principles for market support and debt maintenance.

1.8 Position-taking

28. The Debt Office may take positions in foreign currency and the krona exchange rate.

Positions in foreign currency may only be taken using derivative instruments. Positions may not be taken in the Swedish fixed income market.

Positions refer to transactions that are intended to reduce the costs of the central government debt while taking account of risk, or to reduce the risks for the central government debt while taking account of cost, and that are not motivated by underlying borrowing or investment requirements.

Positions may only be taken in markets that permit the management of market risk through liquid and otherwise well-developed derivative instruments that are also potentially a borrowing currency in the context of debt management.

29. Positions in foreign currency are limited to SEK 300 million, measured as daily Value-at-Risk at 95 per cent probability.

The Debt Office is to decide how much of this scope may be used at most in day-to-day management.

30. Positions in the krona exchange rate are limited to 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.

The Debt Office is to decide how much of this volume may be used at most in its day-to-day management in connection with exchanges between the krona and other currencies. This volume is to be of a limited size and the positions do not need to be announced in advance.

1.9 Borrowing to meet need for government loans

31. The possibility of raising loans to meet the need for government loans under Chapter 5, Section 1 of the Budget Act may only be used if necessary on account of threats to the functioning of the financial market.

The Debt Office may have outstanding loans with a maximum nominal value of SEK 200 billion for this purpose.

32. Investment of funds raised through loans to meet the need for central government loans should be guided by the principles set out in the Preventive Government Support to Credit Institutions Act (2015:1017).

1.10 Management of funds etc.

33. The Debt Office shall place its funds, to the extent that they are not needed for outgoing payments, 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. Investments may be made abroad and in foreign currency (Section 5 of the Ordinance containing Instructions for the National Debt Office).

34. The Debt Office shall cover the deficits that occur in the government central account (Section 7 of the Ordinance containing Instructions for the National Debt Office).

35. The management of exchanges between Swedish and foreign currency (currency exchanges) shall be predictable and transparent (Section 7 of the Ordinance containing Instructions for the National Debt Office).

1.11 Consultation and collaboration

36. The Debt Office shall consult with the Riksbank on matters concerning the components of its borrowing operations that may be assumed to be of significant importance for monetary policy (Section 12 of the Ordinance containing Instructions for the National Debt Office).

37. The Debt Office shall collaborate with the National Institute of Economic Research and the National Financial Management Authority on matters concerning the Debt Office's forecasts of the central government borrowing requirement (Section 11 of the Ordinance containing Instructions for the National Debt Office).

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

1.12 Evaluation

39. Evaluation of the management of the central government debt 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. The evaluation is to cover five-year periods.

40. The evaluation of the operational management is to include borrowing in and management of the different types of debt; market support and debt maintenance measures; and management of currency exchanges.

41. For inflation-linked borrowing, the realised cost difference between inflation-linked and nominal borrowing is to be reported.

42. For retail market borrowing, the cost saving compared with alternative borrowing is to be reported.

43. Gains and losses are to be recorded continuously for positions within a position-taking mandate and evaluated in terms of market values.

2 Basis for the Government's guidelines

2.1 Objective and steering

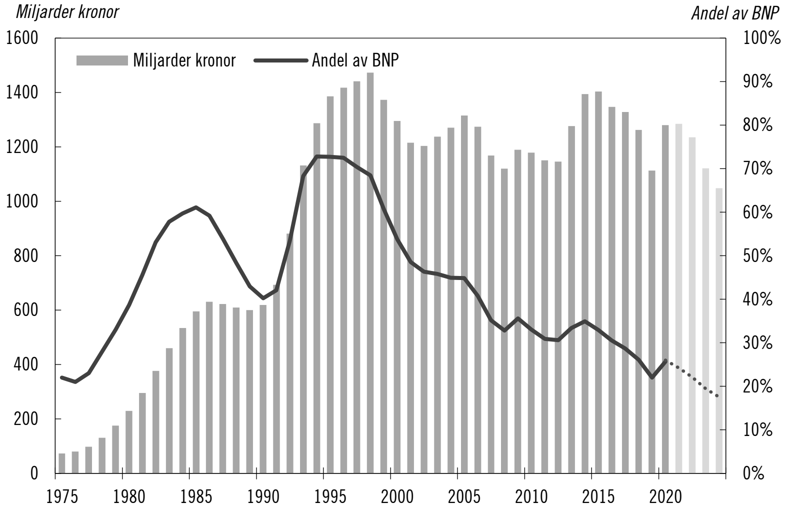
In its annual guidelines decisions the Government steers the trade-off between cost and risk at a general level in the management of the central government debt on the basis of the statutory objective of government debt policy. The objective is to manage the central government debt in such a way as to minimise the cost of the debt in the long-term while taking risk in its management into account. The debt is to be managed within the framework of monetary policy requirements. The trade-off is mainly made by choosing the term to maturity of the central government debt. Historically, a shorter term to maturity had led to a lower average cost than a longer term to maturity. In recent years the cost advantage of choosing shorter interest rates is judged to have decreased, and interest rate levels have also been very low. Other important parameters that affect the cost of the central government debt are the size and expected development of the central government debt and interest rate levels at the time when debt instruments are issued. Since part of the central government debt is exposed to foreign currencies, exchange rate movements also affect the cost of the central government debt, and the costs of the inflation-linked debt affects the development of inflation (measured as the consumer price index).

The Debt Office is able to decide on deviations from the target values 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.

2.2 Size of the central government debt

The central government debt is affected by the development of the economy and by decisions on economic policy. One-off events can also affect the development of the central government debt; examples are the sale of shares in state-owned enterprises and on-lending to the Riksbank.

Figure 2.1 Unconsolidated central government debt



Source: Debt Office and Budget Bill for 2022 (Govt Bill 2021/22:1) Note: Outcome 1975–2020, Government's forecast 2021–2024

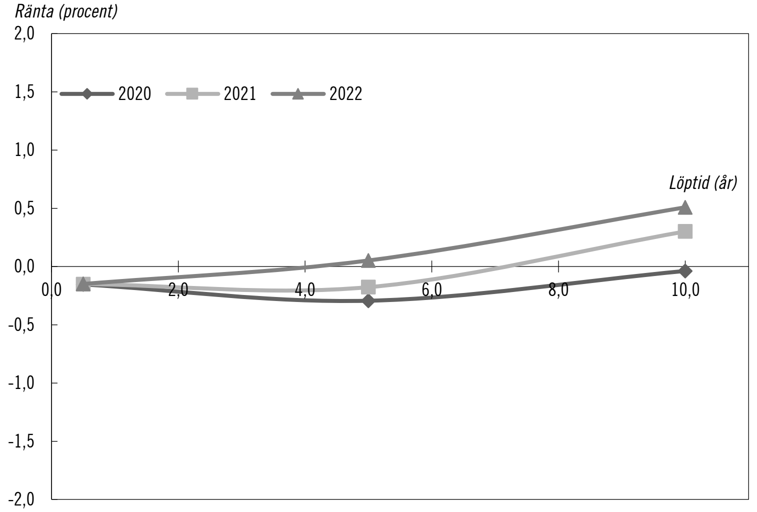
Figure 2.1 shows that the central government debt increased by four percentage points to 26% of GDP in 2020 as a result of the measures taken by the Government on account of the spread of COVID-19 and the recession brought on by the pandemic. However, its level as a share of GDP is very low from a historical perspective. The central government debt is estimated to decrease both as a share of GDP and in billion kronor during the forecast period. At the end of 2021 the central government debt is estimated at SEK 1 285 billion; after that it is estimated to decrease by around SEK 50–100 billion per year due to surpluses in the central government budget (Govt Bill 2021/22:1).

As a result of the pandemic and its consequences, the forecast in the Budget Bill for 2022 is more uncertain than usual. This also means that the forecast of the borrowing requirement is less certain than usual, since the borrowing requirement is greatly influenced by the development of the economy, partly through tax income.

2.3 Development of interest rates

Central government's cost for borrowing at different maturities can be described, in simplified terms, with the aid of the yield curve for Swedish government securities. It shows the graphic correlation between interest rates and maturities of government securities. The slope of the yield curve affects the trade-off between cost and risk. When the slope of the yield curve is positive, the interest rate for borrowing at short maturities (T-bills) is lower than that for borrowing at long maturities (government bonds). This therefore increases the cost saving, in relative terms, from borrowing at short maturities and vice-versa. At the same time, a rise in interest rates has a quicker impact on interest costs when borrowing has been at short maturities. This increases the risk of variations in interest costs. Since the slope of the yield curve has been relatively flat for a long time, the cost advantages of choosing short maturities have not been as strong as in the past.

Figure 2.2 Yield curve for Swedish government securities, annual average



Source: Budget Bill for 2022 (Govt Bill 2021/22:1) Note: Outcome 2020, forecast 2021 and 2022. Refers to interest rate on 6-month treasury bills, 5-year government bonds and 10-year government bonds.

In recent years interest rates have been at historically low levels and also negative at times. During the pandemic the Riksbank has conducted an expansive monetary policy and taken several measures to support the financial system. This has contributed to keeping Swedish interest rates at a low level. The difference between short and long rates was historically small in 2020. Even though interest rates on long bonds in 2021 and 2022 are expected to rise slightly in relation to interest rates on treasury bills, the slope of the yield curve remains relatively flat from a historical perspective (Govt Bill 2021/22:1).

2.4 The Swedish krona

The size of the foreign currency exposure expressed in Swedish kronor is affected by the value of the Swedish krona in relation to the currencies against which the foreign currency debt has exposure. Foreign currency exposure therefore means that the interest cost in Swedish kronor increases if the Swedish krona weakens and vice versa, and the risk in foreign currency exposure is therefore also affected by the volatility of the currency market. The exchange rate for the Swedish krona is affected by demand in the international currency market.

The Swedish krona weakened against several important currencies at the start of the pandemic in 2020, but has strengthened since then, partly due to less unrest in financial markets and lower interest rate differences in relation to other economies. The exchange rate is expected to be relatively stable in 2021 and 2022 (Govt Bill 2021/22:1). After increasing at the start of the pandemic, volatility volatility in currency markets has now returned to levels corresponding to those before the pandemic.

2.5 Riksbank's comments on the Debt Office's proposal

Under the Budget Act the Government has to give the Riksbank the opportunity to state an opinion on the Debt Office's proposed guidelines for the management of the central government debt (Chapter 5, Section 6). The Riksbank has no objections to the Debt Office's proposal for guidelines for the management of the central government debt in 2022-2025.

3 Reasons for the Government's decision

3.1 Trade-off between cost and risk in debt management

The trade-off between cost and risk is set in the annual guidelines and is, according to them, primarily to be made through the choice of the composition and term to maturity of the debt (point 19). The main cost measure is the average issue yield (point 20) and the main risk measure refers to the variation of this measure (point 21).

The decline in global and Swedish interest rates in recent years has contributed to substantially reduced costs for the central government debt. The level of interest rates is still very low and is expected to remain low in the next few years. In its guidelines the Government steers exposure to various risks, while giving the Debt Office flexibility about how to implement financing. The Debt Office can therefore borrow in the debt instruments with the maturities that are best in the circumstances and keep the risks within the guidelines via derivative instruments. In recent years the Government has refined this steering so as to clarify the overall level of risk. This flexibility is of particular importance in holding borrowing costs down when the borrowing requirement rises, especially if the decline is temporary, as in 2020, when the Debt Office had the possibility of borrowing large sums at short maturities without deviating from the term-to-maturity interval.

3.2 Swedish sovereign green bonds

The Debt Office issued a Swedish sovereign green bond on 1 September 2020 in accordance with a commission from the Government. The Swedish sovereign green bonds are covered by the general guidelines for the composition and term to maturity of the central government debt, and are part of the nominal krona debt. To enable the Debt Office to issue additional green bonds as part of its management of the central government debt, a decision by the Government is needed on which green expenditures are to be considered eligible in the central government budget. A list of these expenditures can then be the maximum issue amount for a sovereign green bond. The Government intends to adopt such a list of expenditures early in 2022, based on the preliminary annual outcome for central government expenditure in 2021 and the expenditure approved by the Riksdag for 2022.

3.3 Foreign currency exposure left unchanged

The guidelines decision for 2020–2023 determined that the currency exposure would be left unchanged compared with previous years' guidelines on reducing the foreign currency exposure. The background to this decision was that the Debt Office had notified in its proposed guidelines for 2020–2023 that it intended to conduct an analysis of the strategic size of the foreign currency exposure.

According to the Debt Office, the conditions that formed the basis for the previous analysis of the foreign currency exposure of the central government debt, which was conducted ahead of the guidelines decision for 2015, had changed. The analysis ahead of its proposed guidelines for 2015–2018 showed that the currency exposure could not systematically contribute to reducing the cost of the central government debt. The assessment made was therefore that there was no reason to take a currency risk if it did not result in any expected saving. In its guidelines for 2015–2018 the Government therefore decided that foreign currency exposure was to decrease gradually. According to the Debt Office's proposed guidelines for 2020–2023, there were signals of a structural shift in financial markets. The assessments of the advantages and disadvantages of foreign currency exposure in the central government debt might therefore have changed, so there was reason to analyse whether the strategic foreign currency exposure of the central government debt should be changed. Pending the Debt Office's analysis, the Government therefore decided to stop the decrease in foreign currency exposure.

In its proposed guidelines for 2021–2024 the Debt Office presented a first part of its new analysis. The analysis was based on historical data and confirmed the result of the previous analysis. According to the Debt Office, forward-looking aspects and conditions need to be taken into account to determine whether the foreign currency exposure should continue to decrease. This is included in the second part of the review, in which the Debt Office will make a forward-looking analysis of whether the historical correlations can also be presumed to apply in the future or whether the circumstances appear different. The result, which was to be presented in the Debt Office's proposed guidelines for 2022–2025, has not yet been completed, and will instead be presented in conjunction with the proposed guidelines for 2023–2026.

The Government considers that it is important that the choice of foreign currency exposure is based on a thoroughgoing analysis and that it is therefore important that the Debt Office completes and finalises the analysis of the foreign currency exposure. At the very latest, this should therefore be done in its proposed guidelines for 2023.

The risk in having foreign currency exposure is that its interest cost in Swedish kronor would increase if the krona weakened. In addition, the exposure translated into kronor would increase. According to the Government's forecast for the Swedish krona in coming years, there is no increased risk compared with previous years. This risk is also affected by fluctuations ('volatility') in foreign currency markets, which have now returned to their pre-pandemic levels following a sharp upturn at the start of the pandemic.

When the decrease in foreign currency exposure began in 2015, this exposure was around SEK 200 billion, and since then it has decreased by more than half and was just over SEK 90 billion in September 2021. Moreover, interest rates are at a very low level. The risk in retaining the present foreign currency exposure is therefore judged to be unchanged compared with previous years.

Against the background of what has been said above, the Government considers that it is appropriate to retain the present level of foreign currency exposure, pending the completion of the analysis.

3.4 Steering of term to maturity remains unchanged

Measured as duration, the term to maturity of the central government debt is to be between 3.5 and 6 years.

In recent years, the guidelines have been adjusted to refine this steering in order to clarify the overall level of risk. For more information about the gradual refinement of this steering, see the government communication Evaluation of central government borrowing and debt management 2015–2019 *[Utvärdering av statens upplåning och skuldförvaltning 2015–2019]* (Govt Comm. 2019/20:104). To be more transparent to market participants, the Debt Office sets separate target values for each type of debt.

The refined steering, and especially the common term to maturity for all of the central government debt, enables the Debt Office to adapt borrowing both to what demand looks like and to temporary fluctuations in the borrowing requirement so that it can keep borrowing costs down by doing so. This flexibility has been important particularly in the past year since uncertainty and fluctuations in the borrowing requirement have been greater than in previous years.

The yield curve is still relatively flat from a historical perspective, which means that the cost advantages of borrowing at short maturities are relatively small in relation to the increased risk entailed by short borrowing.

Therefore the Government does not consider that there are reasons to change the steering of the term to maturity.

3.5 Share of inflation-linked krona debt kept unchanged

The Government sees no reason to alter the steering of the composition of the krona debt. This steering means that the share of inflation-linked krona debt is to be steered towards 20 per cent over the long term (point 11). The remaining part of the central government debt (currently around 71.9 per cent) is to consist of nominal krona debt.

The share of inflation-linked debt has fluctuated around the long-term target of 20% in recent years and was below the target in 2021. The greater borrowing requirement in 2020 was met mainly through an increase in short-term borrowing in nominal instruments, even though the issue volume of inflation-linked bonds was also increased. This was because the Debt Office made the assessment that the market for inflation-linked bonds was unable to accommodate a rapid increase in issue volume, one reason being that liquidity is poorer. The share of inflation-linked debt therefore fell below its target value. At the end of 2020 the Debt Office took measures to steer the share of inflation-linked debt towards its target level. Even though the share of inflation-linked debt is below its target in 2021, it is important to remember that this is a long-term target, so the previous steering remains in place in the present situation.

By issuing inflation-linked bonds the Debt Office can reach investors who do not want to risk inflation eroding the value of their bonds. This borrowing needs to be large enough to enable liquid trading, but must not crowd out nominal bonds so that liquidity in that market deteriorates. Against this background, the Government sees no reason to change the steering of the share of inflation-linked debt.

3.6 Follow-up of cost savings for borrowing in the retail market

In 2018 the Debt Office decided to phase out its issuance of lottery bonds since lottery bonds were no longer able to meet the objective of decreasing the cost of the central government debt compared with borrowing in the institutional market. The last outstanding lottery bond matures in December 2021. In its proposed guidelines for 2022–2025 the Debt Office has proposed that the reporting of the cost saving for borrowing in the retail market should be deleted from the evaluation of the central government debt (point 43). However, the Government considers that this reporting should be retained for another year as part of the evaluation of 2021, since the last lottery bond matures in December 2021.