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Information supplementing the analysis for proposed guidelines

On 22 September 2023, the Debt Office submitted its annual proposed guidelines for central government debt management to the Government. The Ministry of Finance has subsequently requested that the Debt Office supplement this with documentation and related analysis that form the basis for the proposal to continue to phase out the foreign currency exposure of the central government debt.

The supplementary information is provided in light of the Riksbank's recently presented consultation response on the proposed guidelines.[1] In this, the Riksbank first writes that that the proposed guidelines are consistent with the requirements imposed by monetary policy. They also write that the phase-out of the central government debt's foreign currency exposure is not expected to have any major direct effects on the exchange rate.

The Riksbank nevertheless finds that the Government and the Debt Office "at present should consider pausing or at least reducing the pace of the phasing out of the central government debt's foreign currency exposure". One reason that the Riksbank presents is that it may be difficult for investors to understand an arrangement by which the Debt Office sells kronor at the same time as the Riksbank buys kronor in a situation in which, for a long time, the krona has depreciated in an unjustified manner. In the following, the Debt Office wishes to clarify the reasons for continuing to phase out the foreign currency exposure according to plan.

That the Debt Office currently sells kronor and buys foreign currency is a consequence of last year's decision to phase out the foreign currency exposure of the central government debt. The decision is based on analysis demonstrating that the foreign currency exposure poses higher risk without being expected to generate any cost advantage over time, and it is made on the basis of the statutory objective for central government debt management.

The fact that the Riksbank and the Debt Office have contradictory needs in terms of trading in kronor has to do with the agencies' foreign currency risks falling on different sides of the central government's overall balance sheet. The Riksbank's currency risks are on the asset side, as they pertain to the foreign currency reserve. The Debt Office's currency risks are on the liabilities side since some part of the central government debt is exposed to foreign currency. Whereas the Riksbank decreases its currency risk through buying kronor and selling foreign currency, the Debt Office does the opposite to decrease its foreign currency risk.

We have examined the possibility of satisfying the agencies' respective needs to decrease foreign currency risk by conducting transactions with each other, but the legal conditions involved in such a solution are uncertain. According to the Sveriges Riksbank Act, it is clear that the Debt Office may borrow currency for the Riksbank.

The Debt Office still considers that the foreign currency exposure of the central government debt should continue to be phased out at the pace presented in last year's proposed guidelines. In this context, we wish to emphasis that judging the pace of the phase-out is not based on a view of whether the krona is undervalued or overvalued. A view of the krona's value only forms the basis for decisions that the Debt Office makes within the mandate we have for taking positions in the Swedish krona[1].

Phase-out over four years involves a prudent pace

The Debt Office considers a prudent period for the phase-out to be four years. This entails a reduction in foreign currency exposure (sale of kronor) of approximately SEK 25 billion annually on average from 2023 to 2026 inclusive.[2]

What can be considered an appropriate phase-out pace depends on a number of factors. On the one hand, a slow phase-out pace means that the risks would remain for a longer time and, moreover, be greater. On the other hand, a rapid phase-out pace means that the need to sell kronor would be so great that it could potentially affect the krona rate. In addition, the risk of the bulk of the phase-out occurring when the krona is temporarily weak increases. A

[1] Point 30 on page 7 of the Government's guidelines for central government debt management in 2023.
[2] The Debt Office's proposed guidelines for central government debt management 2023

strengthening of the krona over the phase-out period would entail lower cost for the central government debt, as part of the foreign currency exposure remains.

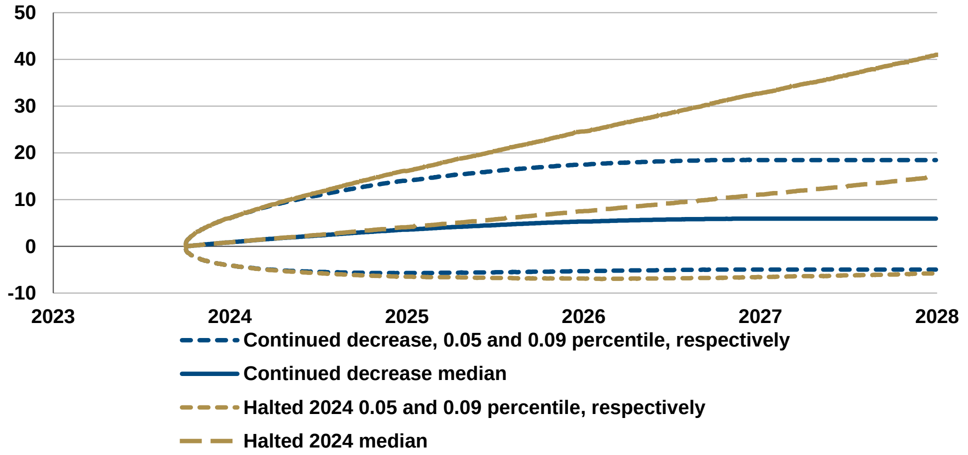
As stated in last year's proposed guidelines, the Debt Office considers the current phase-out pace to not affect the krona rate. The assessment is, among other things, based on the Riksbank's analysis of its then sales of kronor to fund the foreign currency reserve. The analysis from 2022 showed that a five times higher pace can be implemented without any worth mentioning effect on the kronas exchange rate. The Riksbank also writes in its consultation response that the phase-out "is not expected to have any major direct effects on the exchange rate".

In terms of how the phase-out pace affects the currency risk of the central government debt, the figure on the next page shows that the risk of higher interest expenses increases if we pause or slow down the pace of the phase-out compared with if we continue as currently.

If the phase-out is halted as of 2024, there is a risk that the cumulative cost for central government debt until the end of 2026 would increase by at least SEK 14 billion if the outcome ends up within the poorest 5 per cent of the exchange rate simulations (the difference between the top lines in the figure). By the end of 2027, it would be at least SEK 22 billion. With a maintained reduction at the current pace, the foreign currency exposure would be phased out at the end of 2026 and hence not provide any further exchange gains or losses thereafter. If the phase-out were to be stopped instead, the currency risk would remain.

Diagram 1 Cumulative cost for exchange gains/losses between October 2023 and December 2027

SEK billion



Note. The diagram shows the cumulative cost of exchange gains/losses for two different scenarios. In the first, the reduction in foreign currency exposure continues (blue) and in the second, the reduction is halted as of 2024. As of 2027, no currency exposure remains in the first scenario and hence the cumulative cost will be unchanged. For each scenario, the median is shown as well as the 0.05 and 0.95 percentiles based on 100,000 exchange rate simulations. The simulations are based on daily observations between October 2013 and September 2023.

Source: Swedish National Debt Office

Altogether, the Debt Office's assessment is that four years is a prudent period for phasing out the central government debt's foreign currency exposure. The transactions are considered to be so small that they do not affect the krona rate and the period of time is sufficiently long for preventing the entire phase-out occurring when the krona is temporarily weak. Simultaneously, we avoid the risk of higher costs remaining for a long time.

The decisions in this matter have been made by Director General Karolina Ekholm following a presentation by Head of Debt Management Klas Granlund.

THE SWEDISH NATIONAL DEBT OFFICE

Klas Granlund, reporting	Karolina Ekholm, decision