Marchés Nordiques: Investir en l´an 2000

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Swedish Debt Policy

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1 Borrowing Requirement

The forecast for the central government net borrowing requirement for 2000 indicates a surplus of SEK 20-30 billion. Adjusted for temporary factors the indicated balance is close to zero. For 1999, the borrowing requirement showed a surplus of SEK 82 billion, which adjusted for temporary factors corresponded to a surplus of approximately SEK 35 billion. Compared to a few years ago the net borrowing requirements are much lower, which, of course, has consequences for the funding. However, a net borrowing requirement close to zero, still gives a considerable gross borrowing requirement due to redeeming bonds. Also net redemption is made of the foreign currency debt, which contributes to gross borrowing on the domestic market. A great deal of the foreign currency funding (exposure) is achieved trough domestic borrowing and cross currency swaps, which also contributes to liquidity on the domestic market.

Beyond the shrinking underlying borrowing requirement, there is also a significant uncertainty, primarily regarding privatisation of state-owned companies. The government have announced its intention to privatise parts of Telia (the Swedish telecom-company). During the spring preparations will be made to facilitate a privatisation, although this does not necessarily mean that Telia will be sold immediately. Today, according to some market analysts published in the press, the estimated value of Telia is approximately SEK 300 billion. It has not yet been decided, however, how much of the company the government will sell in the first round. Telia is the largest single privatisation object, but there are also other state holdings that can be sold.

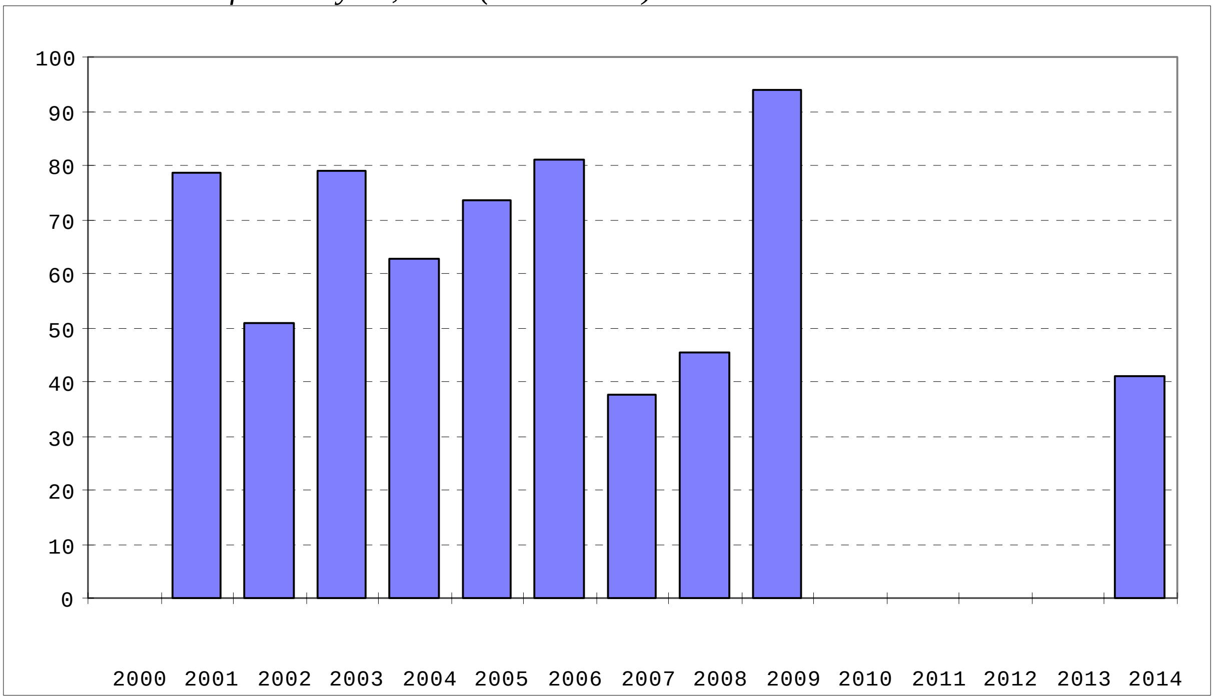
A second uncertainty regarding next year is that the AP Fund (the Swedish state pension fund), due to the new pension system, will be reduced[1]. 1999-2000 SEK 45 billion a year in cash has gone to the central government budget and contributed to a lower borrowing requirement. In January 2001, a final transfer, amounting to a market value of SEK 155 billion, according to the September 1999 Swedish Budget Bill , will be made. This is expected to consist of treasury instruments, mortgage bonds and maybe cash, but the final composition is not yet settled. Delivery of treasury instruments causes an immediate reduction of the outstanding debt, but does not affect the net borrowing requirement. Cash and mortgage bonds[2], on the other hand, affect the debt indirectly through a reduced borrowing requirement.

[1] The new pension system was introduced in 1994 and is partly funded, in contrary to the previous system that was completely a transfer system. This means that the AP Fund can be reduced, as parts of the future pensions will be covered by individual savings.
[2] Mortgage bonds will be managed by the Debt Office to redemption, and will improve the budget only through interest payments and at redemption.

2 Nominal Bonds

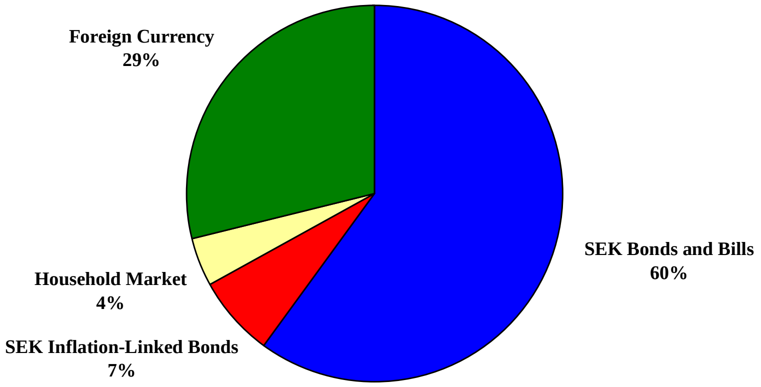
The Debt Office's borrowing strategy has, for several years, been aimed at creating a yield curve with liquid loans, with a distribution over different maturities that reduces refinancing risk. As a state issuer, the Debt Office's borrowing strategy plays an important role on the domestic market. Therefore, the Debt Office tries to act with a high degree of predictability and transparency.

Chart 1 Maturity profile for nominal benchmark bonds, as of January 31, 2000 (SEK Billion)



Since two years ago the government issues annual guidelines, on the basis of proposals put forward by the Debt Office, regarding the management of the debt. In light of the forecasted budget balance development, the government has stipulated that the duration of the nominal debt during this year should be reduced from approximately 3,0 years to 2,7 (±0,3) years. The reduction will be achieved through shorter duration in the foreign currency debt, as well as the kronor debt. The nominal kronor debt makes up about 2/3 of the total debt, as can be seen in chart 2 below. The reduction of duration aims to lower the borrowing cost, as the yield curves tends to be positively sloped. With budget surpluses the slighter higher risk is worth taking.

Chart 2 Outstanding debt, as of January 31, 2000



The Debt Office has drawn out the issuance profile and debt management for the year to meet this duration target and adapt to lower borrowing requirements. For example, there will be no introduction of a new 10-year bond, with redemption 2010, this year. This is a deviation from the strategy practised for the last years, when new benchmark bonds have been introduced yearly in the purpose to achieve a maturity profile with maturing loans each year up to ten years, and one longer loan. With a lower borrowing requirement it is a necessity to reduce the number of outstanding loans if liquidity is to be maintained.

The funding and debt management for the coming years are likely to be strongly impacted by the borrowing requirement factors mentioned above: low underlying borrowing requirement, privatisation and transfer of AP Fund means to the central government budget. Decisions regarding privatisation might cause extensive changes to the funding activities already this year. Further, the issuance profile and debt management next year might be affected by the AP Fund delivery. The transfer of treasury instruments might affect the choice of issued maturities, as well as require the need for debt management measures in the form of repurchases and exchange transactions, if the delivery is not completely portfolio neutral. Also, transfer of mortgage bonds and cash might have implications for the borrowing strategy, in case it strongly improves the borrowing requirement / net surplus.

3 Inflation-linked Bonds

3.1 Background

The Swedish National Debt Office began issuing inflation-linked bonds in 1994. Today there are seven loans outstanding, of which three are zero coupon bonds and four coupon bonds, as can be seen in table 1 below. The nominal value of the inflation-linked debt as of January 31, 2000 was SEK 129 Billion, or SEK 97 billion in discounted amount. This makes the Swedish market one of the largest in the world.

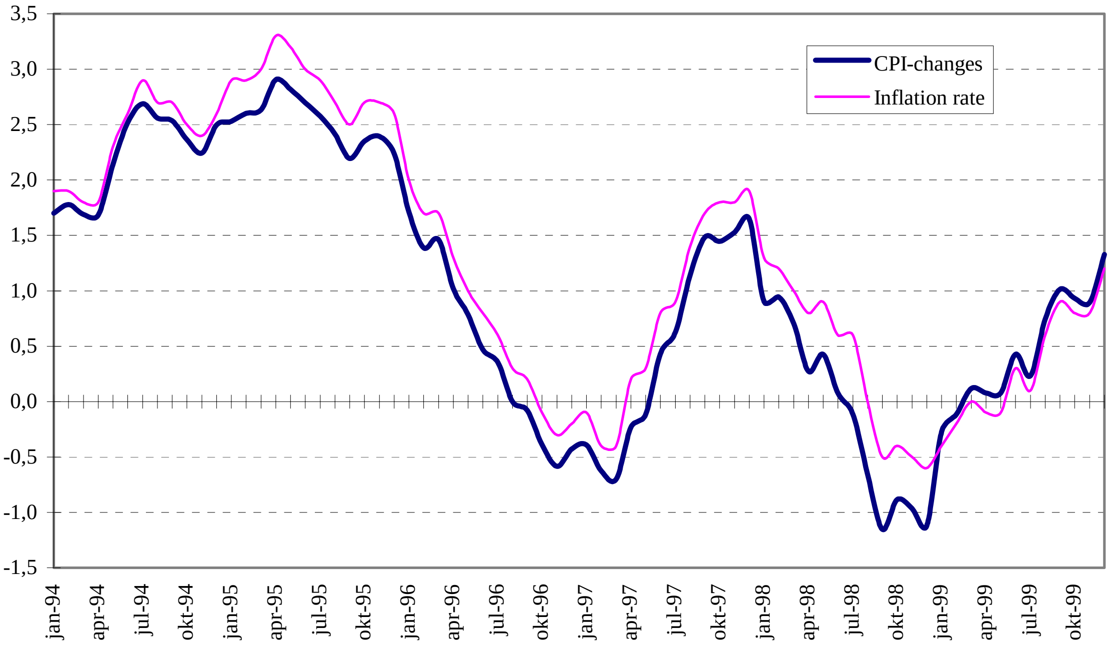
Table 1 Outstanding volumes of inflation-linked bonds, as of January 31, 2000 (SEK Billion)

Loan	Redemption	Coupon	Nominal volume	Discounted volume	Deflation guarantee
3003	2001	Zero	2,9	1,8	No
3002	2004	Zero	21,0	15,1	No
3101	2008	4%	34,4	24,4	No
3001	2014	Zero	45,0	20,1	No
3105	2015	3,5%	2,8	2,8	Yes
3102	2020	4%	29,2	29,2	No
3104	2028	3,5%	3,1	3,1	Yes
Total			*128,6*	*96,5*	

3.1.1 Consumer price index (CPI) and inflation rate

Statistics Sweden presents two measures that are of interest for the Swedish inflation-linked market; CPI and the inflation rate. CPI is a chain index, constructed from a series of long-term chains back to 1980, and a short-term chain for the prevailing year. CPI is never revised once it has been established and published. It is by the change in this index that the inflation-linked bonds are uplifted. Also an official inflation rate is calculated, based on the CPI, but different from a straightforward twelve-month comparison of the index series. In contrast to the CPI, the inflation rate is sometimes changed retroactively. As the inflation-linked bond are uplifted with the changes in CPI itself, and not with the official inflation rate, there sometimes occur differences between the official inflation rate and the uplift of the inflation-linked bonds, which is illustrated by chart 3.

Chart 3 Changes in CPI and the inflation rate 1994-1999



3.1.2 Deflation guarantee

Loan 3104 (3,5%, Dec. 2028) and 3105 (3,5%, Dec. 2015) have a deflation guarantee, implying that in the case of deflation the bonds are redeemed at par value. This feature was introduced as an international harmonisation of the Swedish inflation-linked market in 1999. The guarantee was not introduced retroactively; it only applies to the loans introduced in 1999, and to future loans. Also, the guarantee only applies to redemption amounts, and does not affect interest rate payments.

3.2 New dealersystem

Starting this year, the Debt Office have introduced a new dealer and commission system for inflation-linked bonds. At the end of December 1999, the agreement arrangements with the previous authorised dealers were ended. As of February 2000, the Debt Office have appointed MeritaNordbanken, SEB, Swedbank and Öhman Fondkommission as authorised dealers in inflation-linked bonds during this year, according to the new system.

In contrast to the previous system, these new contracts run only for one year at the time and will expire automatically at the end of the year. The choice of dealers is based on a combination of their submitted business plans for the year to come, and their historical performance on the inflation-linked market. The new system is an ongoing process, in which contracted dealers are reviewed based on their performance during the year and in which new candidates may seek to be appointed as dealers for the upcoming year.

The new dealer agreements do not stipulate obligations for the dealers to submit bids in all auctions, or to uphold certain market shares in the secondary market, as the old agreements did. Instead, what the Debt Office considers most important is that the dealers promote liquidity on the primary as well as the secondary market, and acts to broaden the investor base. This must be evaluated in a broader perspective, and not only in terms of market shares. With this new resale system the Debt Office hopes to get more focused dealers. The commissions will also be higher than in previous years.

The most important task for the Debt Office, together with the dealers, is to attract new investors to the market for inflation linked bonds. Retail, municipalities and international investors are three examples of important groups of investors that should have reasons to diversify into inflation-linked bonds.

3.3 Primary market activities during 2000

Auctions of inflation-linked bonds during 2000 will take place monthly. In contrast to the auctions of nominal bonds and treasury bills, auctions of inflation-linked bonds will be held in the form of auction periods, of one or more days in a row. One week ahead of the first day of the auction period announcements will be made regarding number of auction days, loans, volumes and type of transactions (issues, exchanges or buybacks). The first auction period this year will start on Wednesday March 1st. Details regarding the auction period will be announced on Wednesday afternoon, February 23rd.

As is illustrated by chart 2, inflation-linked bonds amount to 7% of the total debt. Despite the low borrowing requirement, the debt of inflation-linked bonds should not, according to the government guidelines for 2000, decrease during the year. An exception to this guideline is that minor decreases may be accepted as a result of debt management measures. Transactions on the inflation-linked market can be characterised merely as debt management, as the issues are almost entirely driven by market demand. Therefore, nominal borrowing covers the bulk of the gross borrowing requirement, while inflation-linked bonds are an important diversification complement. This year the element of debt management is higher than it has been in previous years, when the activities were more concentrated on regular issues.

The Debt Office have stated that the maximum net increase of the inflation-linked debt in discounted amounts during the year will be SEK 5 billion. This creates more certainty about the supply and should promote a stable market. The activities will consist of issues, exchange transactions as well as buybacks, which means that the gross volumes are likely to be more than SEK 5 billion, maybe as much as up to SEK 10-20 billion. However, the actual volumes, both gross and net, will be a result of market demand and how well different transactions are received by investors. Issues will mainly focus on coupon bonds, and buybacks mainly on zero-coupon bonds. Moreover, in line with the guidelines decided by the government, issues will be in 8 year maturities or longer.

When issuing, exchanging or buying back, the Debt Office will consider the pricing on each occasion. Transactions should be cost effective and made from a debt management perspective; i.e. if the break-even inflation is unreasonable in a bond being issued or bought back, with respect to general inflation expectations and the break-even levels of other bonds, the Debt Office will cancel the auction. As an example, and in line with this policy, an auction was cancelled in August last year, when the pricing was negatively affected by the upcoming auction. The same views are of course applicable to buybacks.

Another change compared to previous years is that the Debt Office will obtain information from the authorised dealers and investors regarding their views on what should be offered in the auctions. The purpose of this gathering of information is to maximise the probability that the conducted transaction meet with current market demand.

The Debt Office also makes on tap exchanges of minor amounts of inflation-linked bonds, as a debt management service to the market. Normally, each authorised dealer is offered the possiblity to make one exchange a day, up to a maximum value of approximately SEK 50 million.

3.4 Inflation-linked bond in an EMU-perspective

The Debt Office believes that Swedish inflation-linked bonds also have good prospects if Sweden joins the EMU. In case of a Swedish EMU-membership, the inflation-linked bonds will still be linked to the Swedish CPI. Inflation-linked bonds linked to different domestic CPIs can be an advantage within the EMU, as bonds from different areas with different inflation rates can be traded. This should stimulate the inflation-linked market, as it offers the investors possibilities to diversify their portfolios.

4 Electronic distribution

The Debt Office considers electronic primary market distribution of treasury instruments one of the key issues for the future debt management and the fixed-income market. An efficient distribution contributes to lower costs. Further, electronic distribution will help to broaden the investor base - large institutional investors, as well as smaller institutions and retail investors, can buy the same type of instruments.

A group consisting of the authorised dealers and the Debt Office, co-ordinated through the Swedish Dealers Securities Organisation, is discussing issues regarding electronic systems for bond trading on the secondary market. An interesting question is what role the issuer should take in setting up electronic market places. The Dutch treasury, for example, opted for a very active role. This might be necessary to get a system in place, as the banks tend to have difficulties agreeing on such things as trading rules, for example.

The main electronic systems presently being discussed for the Sw
edish market are OM:s Saxess-system and the Italian MTS-system. Saxess is the system used on the equity market on the Stockholm Stock Exchange, and will be used in the Danish equity and bond markets from the second quarter this year.

The prospects for using the Internet for distribution and trading are also very promising. Internet-based issues are very promising when it comes to possibility to reach new groups of investors, including retail. This is how the Debt Office hopes to take advantage of Internet and electronic distrubution channels.