SPONSOR'S STATEMENT

Low credit risk with scarcity value

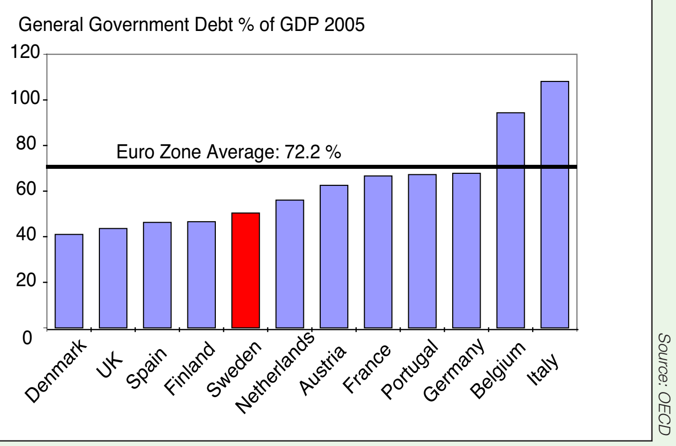
The Swedish National Debt Office is committed to a diversified funding strategy: while Swedish krona nominal government bonds is the core source of funding, foreign currency debt will account for 15% of the total and inflation-linked bonds will make up 20–25% over the long term. The improving economic situation makes up for fairly small borrowing needs increasing the scarcity value for Sweden's triple-A bonds

Low credit risk and strong finances

The Kingdom of Sweden, rated Aaa by Moody's and AAA by Standard & Poor's, is one of the strongest performers in the eurozone when it comes to balanced budgets and manageable debt levels. Structural reform of monetary and budget policy during the late 1990s, coupled with a robust pension reform, underpins a sustainable stable economic and budgetary outlook.

Sweden's medium-term budgetary framework was established in 1997, targeting an average general government surplus, including the pension system, equal to 2% of GDP over the business cycle. In order to gain better control over the budgeting process, a new law came into force 1997. Now a ceiling for government spending is decided each year in advance by the parliament, preventing excessive expansion of expenditures. The national pension system was reformed by a parliamentary decision in 1998, linking the rights of life-long income and pensions to wage income growth and demographic development.

Sweden compares favourably with credit peers



Open and predictable funding strategy

The Swedish National Debt Office (SNDO) pursues an open, transparent and predictable krona funding policy. By openly presenting forecasts for the borrowing requirement and funding plans and policies, the SNDO ensures that investors can make an informed analysis about the development of the supply of the Swedish government borrowing instruments.

Large and liquid bonds form the basis of the SNDO's funding strategy. Issuance is focused on a limited number of large, fungible, and liquid benchmark loans. This applies to nominal government bonds and inflation-linked bonds as well as T-bills.

The inflation target and floating exchange rate policy for the still-independent krona form a basis for investment and diversification opportunities for international investors in Swedish government bonds. These provide manageable uncertainty and are backed by the highest sovereign credit rating.

Commitment to diversified borrowing

The long-term structure of the debt is laid out in the Guidelines for Central Government Debt Management decided by the government. The guidelines give the overall framework for debt management that is independently implemented by the SNDO.

According to the guidelines, the share of foreign currency exposure shall be amortised down to a level of around 15% of total debt, from the current share of around 25%. The reason is that foreign currency debt is associated with an exchange rate risk, without any general cost advantages. Yet, borrowing in several currencies diversifies the interest-rate refixing risk by reducing the dependence on Swedish rates. Therefore, a certain level of foreign currency debt is motivated.

The portion of inflation-linked bonds in the central government's total debt will continue to increase from the present level of 15 to 20–25%. The argument is primarily that inflation-linked debt contributes to a more diversified central government debt compared with a portfolio composed entirely of nominal debt. This reduces the risk of excessive variations in the interest costs. The rate of increase of inflation-linked bonds depends on the growth in demand for inflation-linked bonds taking the borrowing costs into account.

The inflation-linked debt, at the targeted level, is assessed to have sufficient volume in order for the market to be liquid for investors and in order for the diversification effects to improve the government's debt portfolio. Combined with a lower ratio of foreign currency debt, it also creates the scope for a large and liquid nominal bond market, as the remaining gross borrowing needs will be covered by nominal krona borrowing. Nominal bonds and T-bills will remain the main funding instruments in future years.

The Debt Office abstains from long-dated bonds

Developments in the bond market have been eventful during the past year. Both short- and long-term interest rates have fallen to historically low levels. The question of issuing long-dated bonds has also been raised in connection with the growing need for investors to improve matching between assets and liabilities and changes in the supervision of the insurance companies. Long-dated bonds can only be issued if it is compatible with the debt management goal of long-term cost minimisation taking risk into account.

Despite long-term interest rates having fallen more than short-term rates, the yield curve still has a positive slope, ie, the direct short-term borrowing costs are lower than costs for long-term borrowing.

The changes that have so far occurred support the notion that it has become less costly to reduce the risk by extending the maturity of the nominal debt. The assessment is however uncertain, since the period of observation is short and, eg, the effects of the change of the supervision that is currently taking place for the life insurance companies cannot yet be overviewed. The benchmark for the average maturity of the aggregate nominal debt, decided by the government, is 2.5 years. The Debt Office's conclusion has been not to recommend the government to prolong the maturity in the debt. However, the dynamics of the relation between short- and long-term interest rates deserve special attention.

Smaller funding needs

The Debt Office funds the balance of the central government budget, ie, the general government budget excluding the pension system and the municipalities. SNDO produces an independent budget forecast based on macroeconomic developments and its own monitoring of the central government's budget flows.

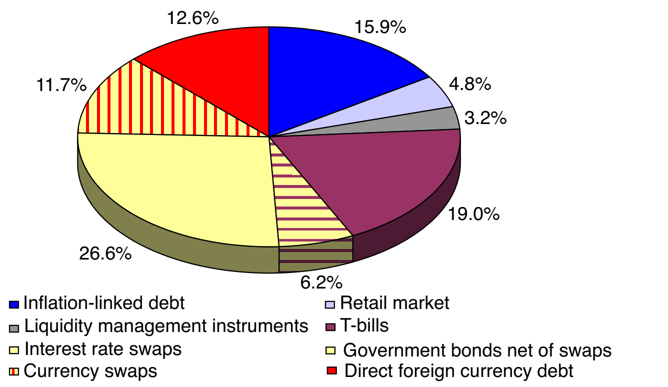
During 2005 the actual net borrowing requirement has, so far, been lower than expected. The forecast has been revised down from 38 billion kronor at the beginning of the year to 10 billion kronor in our latest forecast.

The Swedish economy continues to recover, after a slight slow down around the last turn of the year. Planned tax cuts will curb the improvement next year, although increasing tax revenues due to stronger growth will continue to improve the underlying budget development: employment and private consumption is estimated to grow next year. In spite of economic strengthening of the economy, larger interest payments and tax cuts curb the fiscal improvement next year: net borrowing requirement is projected to 26 billion kronor in 2006. Together with maturing loans, the total funding requirement in government securities will be 86 billion kronor.

Funding operations 2006

Nominal government bonds will finance most of the 60 billion kronor of the required funding in 2005. Nominal bonds are issued every second Wednesday by auctions of at present 2 billion kronor. Volumes are planned to increase to 3 billion in June 2006. Half of our issues are 10-year maturities, a few in the two and 15-year segments and the remaining are five-year maturities.

Structure of Swedish central government debt



The market for Swedish government bonds is a liquid and efficient market. Turnover in the spot market is around 20 billion kronor per day. A large and liquid repo market has a daily turnover of more than 50 billion kronor, supporting liquidity and reducing risk of squeezes.

As mentioned, the duration target for the nominal debt is fairly short. However, the Debt Office is able to borrow in longer maturities and achieve the duration target by swap transactions and other derivatives. By swapping nominal kronor bonds to short rates or foreign currencies, the size of the outstanding stock of bonds is larger than would otherwise be possible. The outstanding stock of nominal bonds is 555 billion kronor, or around 45% of total debt.

Inflation-linked bonds are issued at auctions every second Thursday, with around 750 million issued at each auction. The total amount issued this year is estimated to be some 14 billion kronor and next year's amount is expected to be about the same size.

While amortising the foreign currency debt at an annual rate of 25 billion kronor, redemptions are large enough to make up for substantial borrowing in the international capital market. Foreign currency borrowing will be close to 30 billion during 2005 and 2006.

Issues of eurodollar bonds have been an important part of the Debt Office foreign currency funding programme. During 2005 SNDO have issued two benchmark bonds in eurodollar.

Issues of eurobonds are based on market conditions and do not follow a predetermined funding plan. The projected size of foreign-currency-funding makes it possible for benchmark bonds to be part of future funding, as a complement to smaller private placements and retail-targeted deals. ■

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