



Sveriges Riksbank

ANNUAL REPORT 1997





SVERIGES
RIKSBANK



1997 in brief

- *In the system for interest rate control, the Riksbank moved in April from reverse repos to repos*
- *The elimination of the Riksbank's forward liability position from 1992 was completed in September*
- *The Riksbank's repo rate was raised 0.25 basis points in December, from 4.10 to 4.35 per cent*
- *The final report of the enquiry into Riksbank acquisitions of gold from Germany during World War II was presented to the Riksbank in December*
- *Four inflation reports were published during the year*
- *The first report in a new series – Financial Market Report – was published in November*
- *The Riksbank's 2 per cent inflation target is supported by 63 per cent of the population*
- *Distribution of the 100 kronor banknote with a repeating watermark began at the turn of 1996*
- *The Riksbank issued in June coins to commemorate the 600th anniversary of the Kalmar Union*
- *A new version of the 20 kronor banknote was introduced on 15 September*
- *An Internet home page (<http://www.riksbank.se>) was opened by the Riksbank on 17 March*
- *New advisors to the Riksbank's managerial group: Göran Lind and Kerstin Mitlid*
- *New head of International Secretariat: Christina Nordh Berntsson*
- *New head of Auditing Department: Gunilla Werner Carlsson*
- *New head of Organisation and Administration Department: Agneta Rönström*

Selected statistics	1995	1996	1997
Year-end figures:			
Exchange rate (TCW)	117.77	117.83	121.51
SEK/DEM	4.6164	4.4325	4.4185
SEK/USD	6.6177	6.8859	7.9082
Bond rate (ten-year, per cent)	8.41	6.68	5.95
Money rate (three-month, per cent)	8.44	3.61	4.49
Repo rate (per cent)	8.91	4.10	4.35
Annual figures:			
CPI change (per cent)	2.8	0.8	0.9
GDP growth (per cent)	3.9	1.3	1.9 *
Unemployment (per cent)	7.7	8.1	8.0
Balance on current account (SEK bn)	39	44	55 *
Balance of trade in goods (SEK bn)	115	121	131 **
Government borrowing requirement (SEK bn)	139	21	6

* Forecast by National Institute of Economic Research
 ** Preliminary figure

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Riksbank's status clearer



Governor Urban Backström in a discussion of the Riksbank's operational plans for 1998.

Financial markets in Sweden, like economic development in general, have become increasingly stable in recent years. This trend continued during 1997. The course of international events, however, took a more dramatic turn towards the end of the year on account of problems in Asia. Another feature of 1997 was the work on monetary integration in Europe.

DELEGATING MONETARY POLICY

A highly important event in 1997 was the five-party agreement on amendments to laws on the functions of the Riksbank and to regulations for the performance of these functions. The Riksbank already has a high degree of independence; in the new legislation this is formulated more clearly. The amendments, which are intended to apply as of 1999, are already affecting the work of the Riksbank.

The changes are briefly as follows.

- Firstly, the Riksbank is made clearly responsible for maintaining price stability.
- Secondly, ultimate responsibility for exchange rate policy is transferred to the Government. At present, the Instrument of Government states that the Riksbank is responsible for currency and credit policy and shall promote a sound and efficient payment system. The amended formulation states instead that the Riksbank is responsible for *monetary policy*. The objective of the activities is specified in the amended Riksbank Act as being to *maintain a fixed value of money*; in addition, the Riksbank is required to *promote a safe and efficient payment system*. In exchange rate policy the function of the Riksbank will be to implement the exchange rate system the Government has chosen.
- Thirdly, a new Executive Board is to take over tasks from the Governing Board, not least as regards monetary policy de-

cisions. The Governing Board will continue to be appointed by the Riksdag (Sweden's Parliament), so that their mandates will continue to coincide, but it will consist of eleven members instead of eight. The Executive Board is to have six members, appointed by the Governing Board for overlapping periods of six years, so that one new member is appointed each year; members will thus have a longer mandate than members of the Governing Board.

- Fourthly, Riksdag instructions to the Riksbank are to be statutory, no authority will be entitled to decide how the Riksbank is to conduct monetary policy and members of the Executive Board may neither seek nor take instructions. Furthermore, neither the Governor nor other members of the Executive Board may be dismissed by the Governing Board on grounds other than serious misconduct or no longer fulfilling the conditions required for the performance of duties.

THE RIKSBANK IS NOT 'UNACCOUNTABLE'

The Riksbank, as the Swedish central bank, will still be an authority under the Riksdag. It is therefore misleading to say that the Riksbank is independent in the sense of being unaccountable. But the Riksbank's independence is enhanced and its responsibility for price stability is laid down in law – two changes that are closely connected.

Independence can be seen as a logical consequence of a clearly formulated assignment: once the Riksdag has specified what it wants the Riksbank to do, there is to be neither a reason, a mandate nor a practical opportunity of directly influencing how this assignment is carried out. At the same time, the decision to enhance the



Bank's independence has made a clear formulation of its objective all the more important. This is necessary so that the Riksdag – and people in general – can rest assured that the enhanced independence does in fact render monetary policy more effective.

The amendments to the statute of the Riksbank partly constitute an legislative adaptation to changes that have already occurred in the field of monetary policy. When the fixed exchange rate was abandoned in November 1992, monetary policy needed a new benchmark. In January 1993 the Riksbank decided that from 1995 onwards monetary policy would target a stabilisation of inflation around an annual rate of 2 per cent. This policy has subsequently attracted broad support, formally from the Riksdag and the Government as well as from the general public.

In the Maastricht Treaty the EU countries have undertaken to give their central banks the independence that the EMU plans require. Sweden's membership of the European Union has therefore been an important cause of the legislative amendments. The requirements will then be fulfilled whenever Sweden does choose to adopt the single currency. Moreover, as a small country with a history of high inflation, Sweden has had an additional need to make its monetary policy credible, particularly as Sweden has decided not to join the euro area for the time being.

PROMOTING STABILITY

The Riksbank's monetary policy measures for meeting the price stability target (interest rate policy) and assessments of inflation (as formulated above all in *inflation reports*) are the activities that attract most attention from media but the price stability objective is not the Riksbank's sole concern.

Both the current law and the amended form from next year require the Riksbank to 'promote a safe and efficient payment system'. Such a system is vital for today's highly-developed transaction economies. This assignment involves supplying Sweden with banknotes and coins and overseeing the financial system's overall stability.

Market economies are exposed to risks of financial crises, the management of which may call for various forms of state intervention. Besides the recent example of the bank crisis in Sweden, there are plenty of other instances of crises elsewhere that, unlike the bank crisis in Sweden, generated problems for the global economy. At present there are problems in Asia. It is in the public interest that central banks deploy monetary policy instruments in such a way that the negative effects of financial crises can be countered. In addition, it is up to the central banks to oversee the financial system so that financial crises can be avoided.

The Riksbank's work on promoting financial stability takes many forms. Developments in financial markets are analysed and commented on continuously. The first *financial market report*, which the Riksbank published in 1997, was received very favourably in Sweden as well as internationally. The Riksbank also participates very actively in the implementation of the changes that are needed in financial markets so that the European monetary union can function as intended. Moreover, the Bank has played an active part in the international cooperation for stabilising developments in Southeast Asia.

INCREASED TRANSPARENCY

The Riksbank's greater independence may be one way of making the objective of price stability easier to fulfil. International comparisons show that the greater the central

bank's independence, the lower inflation tends to be.

The fact that five political parties are in favour of giving the price stability objective the force of law and making the Riksbank more independent goes to show that the objective of a stable value of money now has broad public support, as has the opinion that this objective is fulfilled most effectively with a central bank that is highly independent. At the same time, the enhanced confidence in the Riksbank and its policy requires more of the Bank. The Riksbank is indeed controlled democratically but the perceived legitimacy of its policy is also contingent on the particular way in which its activities are *controlled, evaluated and rendered transparent*.

The amended Riksbank Act stipulates that, prior to taking monetary policy decisions of major importance, the Riksbank is to inform the Government-designated cabinet minister and that a written report on monetary policy is to be presented by the Bank to the Riksdag at least twice a year. The Riksbank also needs to motivate and explain its policy so that persons outside the Riksdag and the Government perceive it as legitimate, too. The Riksbank is working intensively in various ways to achieve this. The better the analytical foundation, the easier it becomes to formulate, motivate and explain policy. The Riksbank therefore devotes resources to research and advanced development work. Efforts are also made to provide greater insight into and knowledge about the Bank and its policy.

STOCKHOLM, MARCH 1998

URBAN BÄCKSTRÖM
GOVERNOR OF SVERIGES RIKSBANK

Low-inflation policy established

During 1997 Sweden's economy continued to adapt from high inflation to a stable situation with low price increases. Since 1994 the annual price rise has averaged less than 2 per cent. This has been accompanied by an average real growth rate of around 2.5 per cent. While the low rate of inflation is partly explained by low capacity utilisation after the deep recession in the early 1990s, the difference compared with inflation in the 1970s and '80s is notable. Moreover, expectations of future inflation are now well inside the inflation target's tolerance interval.

After the repo rate had been lowered substantially during 1996, from 8.91 per cent at

the beginning of the year to 4.10 per cent from 18 December, monetary policy entered a considerably quieter phase. The repo rate was unchanged at 4.10 per cent for virtually the whole of 1997. Towards the end of the year, however, the Riksbank signalled a realignment to a less expansionary stance and on 17 December the repo rate was raised 25 basis points to 4.35 per cent.

During 1997 there was thus no major change in the direction of monetary policy. The situation in financial markets was also comparatively stable. For monetary policy, however, the year was still significant on account of the Government's and the Riksdag's positive position on two matters of

major importance in this context. For one thing it was made clear that Sweden would not adopt the single currency when the third stage of the European Economic and Monetary Union (EMU) started in 1999. For another, a Government bill, based on a five-party agreement, was presented with proposals that aim to strengthen the status of the Riksbank, partly as an adaptation to EU requirements.

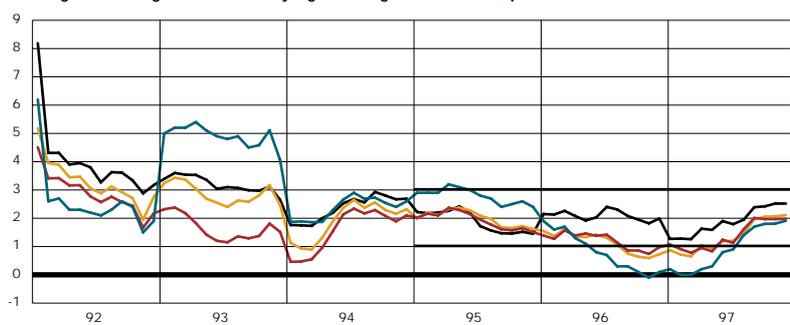
INFLATION LOW BUT RISING

The average rate of CPI inflation in 1997 was 0.9 per cent, which is just outside the lower limit of the inflation target's tolerance interval. The trend behind this average rate was upwards during much of the year, after a virtually unchanged price level in the early months of 1997, however, the rate of price increases levelled out. In December 1997 the 12-month change in the CPI was 1.9 per cent. The indicators of underlying inflation¹ were more stable in 1997, with average levels that ranged from 1.4 to 1.9 per cent.

The low inflation during 1996 and 1997 was largely a consequence of the fall in house mortgage interest costs. This item will continue to hold back the general price rise for some time to come but its impact will go on diminishing as a growing proportion of house mortgage loans will already have been renewed at lower interest rates. The rate of domestic inflation (price increases excluding imported products and effects of altered interest costs) rose by degrees during 1997 and was 3.5 per cent in December, of which 1.0 percentage points came from increased indirect taxes.

¹ UND1, UND2 and UNDINH. The first two both represent the CPI excluding house mortgage interest costs and effects of changes in indirect taxes and subsidies; UND2 also excludes petroleum and petrol prices. UNDINH (underlying domestic inflation) is calculated as UND1 excluding prices of goods that are mainly imported.

Diagram 1: Registered, underlying and targeted inflation, per cent



Note. The bold horizontal lines from 1995 onwards represent the tolerance interval for the CPI change.

Diagram 2: Components of inflation, per cent

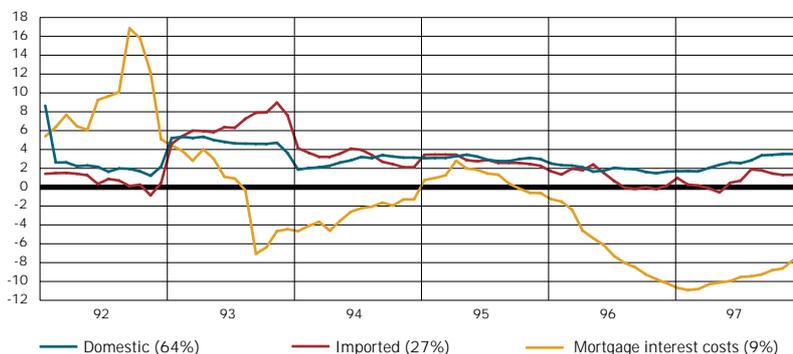




Diagram 3: Inflation expectations of households and industry, per cent



Expectations of future inflation play a central part in the inflation process as a basis for pricing and wage-setting. These expectations are now broadly in line with the inflation target, which indicates that confidence in a policy for price stability has been established. An upward tendency in inflation expectations was discernible during 1997. Even in an economy where the credibility of price stability has been established, inflation expectations are likely to fluctuate with the level of activity. In that economic activity was rising, the upward tendency in inflation expectations was therefore natural.

FIRMER RECOVERY

After a short slowdown, economic activity in Sweden had begun to recover towards the end of 1996. During 1997 the upward tendency became clearer, though growth still seems to have been comparatively subdued. From 1996 to 1997 it is estimated that GDP rose almost 2 per cent.

Export growth in 1997 was stronger than the year before, mainly as a result of good international activity but also because a comparatively weak exchange rate and high productivity helped to maintain a favourable competitive position. Import growth was also stronger than the year before but foreign trade continued to be a primary force behind growth.

The upswing in private consumption that had begun in the third quarter of 1996 continued during 1997. On account of the consolidation of government finances, the growth of household income remained weak; the growth of consumption therefore entailed decreased saving. It was mainly the consumption of durable goods that rose; after a period of uncertainty with low purchases, households probably had an accumulated need to renew certain capital

Diagram 4: Inflation expectations of bond investors, per cent

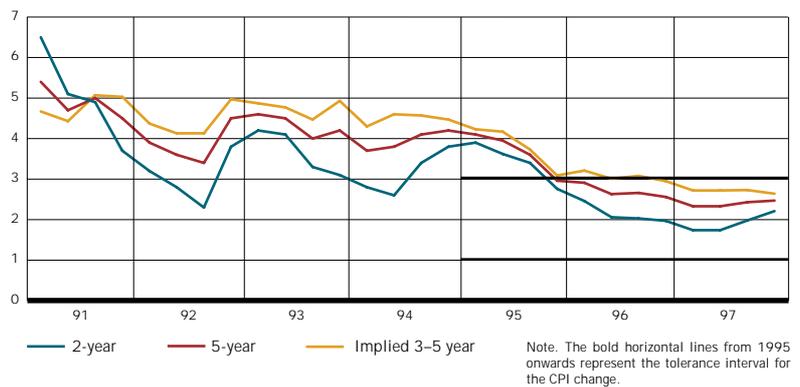
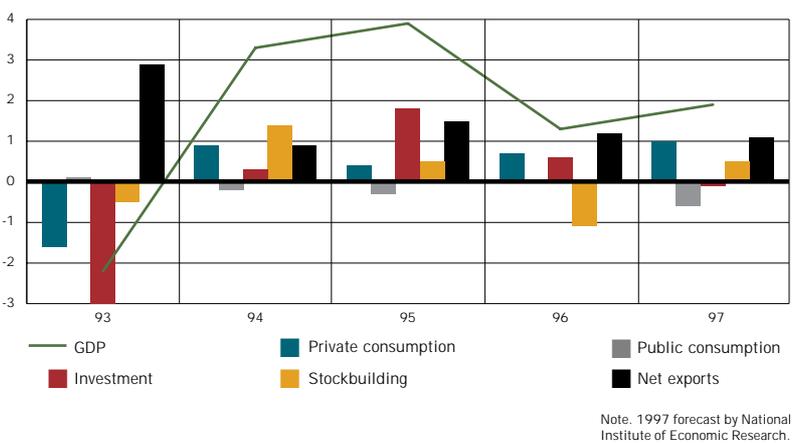


Diagram 5: GDP growth and its components, per cent (GDP) and percentage points



goods. Increased demand for household credit suggests that the low interest rates and rising asset prices helped to stimulate private consumption, which has become an increasingly important force behind economic growth.

Growth in 1997 was held back, on the other hand, by a weak tendency in gross fixed capital formation and cuts in public activities. Residential construction in particular fell sharply again when the temporary subsidies for new housing and recon-

struction had come to an end in December 1996. After three years with very strong increases, industrial investment was also comparatively subdued during 1997.

The surplus on trade in goods in 1997 showed some improvement from the record level the year before: SEK 131 billion as against 121 billion. As a result, the surplus on current account remained substantial; its level in 1997 is calculated to have been around 3 per cent of GDP. The surplus was mainly reflected in investment in

foreign shares and interest-bearing securities. As in 1995 and 1996, the level of investment in foreign shares was considerably higher than in earlier periods.

Despite the expansion of activity during 1997, employment remained weak. The reduction in public sector employment more than countered a rising tendency in the private sector excluding construction. During 1997 total employment decreased by 42,800 persons. Even so, registered unemployment declined from around 9 per cent in July to around 7 per cent in December, largely as a result of the drive for educa-

tion. To some extent, the fact that rising activity did not generate higher employment has to do with problems in the Swedish labour market. One such problem is that, despite high unemployment, wage increases have tended to be comparatively large; another lies in the indications of difficulties in filling job vacancies.

MONETARY POLICY REALIGNMENT

On account of the considerable lag before monetary measures affect inflation, policy has to be forward looking. Swedish as well

as international experience indicates that the main effect of monetary measures on price movements occurs after twelve to twenty-four months. Price forecasts are therefore important in the construction of monetary policy. In order to promote an understanding of monetary measures and clarify the analysis behind them, since 1993 the Riksbank has been presenting its assessments of future inflation in a series of inflation reports.

In the Inflation Report in December 1996 the Riksbank had considered that the monetary stance was relatively well balanced and that time was required to analyse the situation after the repo rate cuts in the course of the year; these cuts had been very substantial both historically and in an international perspective. In the Inflation Report in March 1997 the Riksbank did not rule out the possibility of somewhat more stimulatory monetary conditions but considered – in view of the exchange rate tendency – that further repo rate cuts were not called for. In the period after that, a comparatively weak exchange rate represented a further economic stimulus and there were no further reductions in the repo rate. In the Inflation Report in June the Riksbank considered that the monetary stance was well balanced.

In a long-term perspective, economic fundamentals suggest that the krona is still under-valued. After an appreciation during the summer, the krona weakened again towards the end of the year. This was accompanied by a low level of real interest rates for long as well as short maturities. The combined effect of the comparatively weak exchange rate and the low interest rates was expansionary throughout 1997. On account of monetary policy's lagged effect, this will tend to stimulate demand in the coming years. As the unutilised re-

Diagram 6: Total and registered unemployment and labour market (AMS) programmes, 1000s of persons

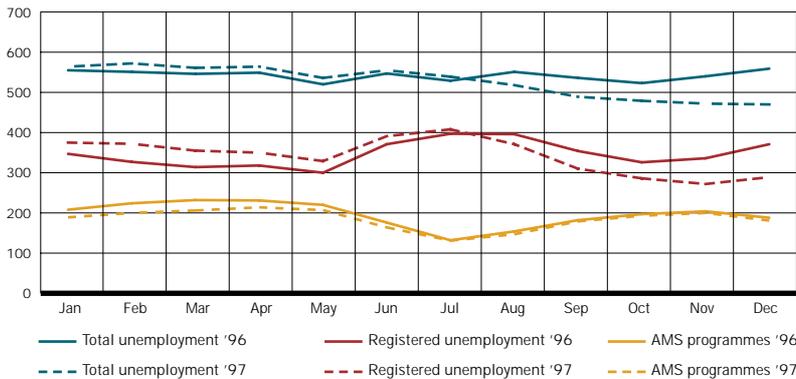
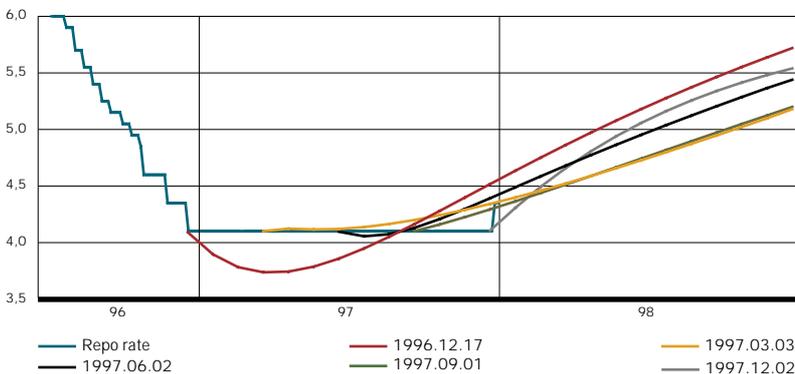


Diagram 7: Repo rate and expected rate implied by forward rates, per cent

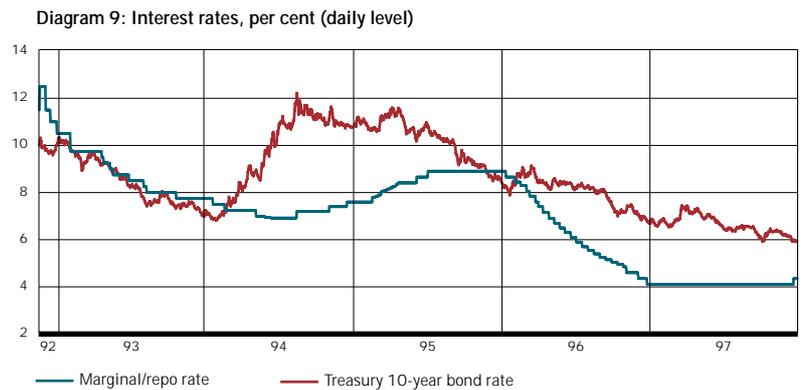
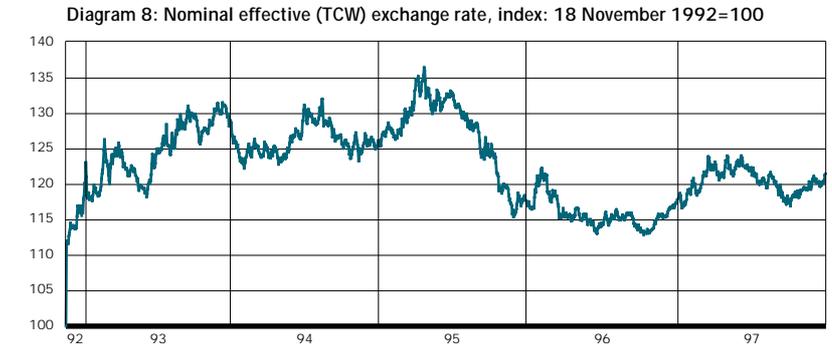


sources that have helped to limit price increases in recent years are activated, inflationary pressure will accordingly grow by degrees. Monetary policy cannot stimulate demand throughout the business cycle to the same extent as in 1997 without jeopardising price stability.

In the Inflation Report in December 1997 the Riksbank considered that a realignment to a less expansionary monetary stance was called for to prevent the inflation target from being exceeded during 1999. On 17 December the repo rate was therefore raised 25 basis points to 4.35 per cent. With the successive economic recovery and higher short interest rates in Europe, together with the Riksbank's signals in statements and earlier inflation reports, during 1997 the short market rates had gradually adapted to a realignment of monetary policy. The market had accordingly anticipated that the repo rate would be increased.

One way of describing the policy realignment is to say that the Riksbank 'took its foot off the gas' at an early stage so as to avoid having to 'slam on the breaks' in the nick of time. In this way, conditions are created for more sustained increases in production and employment. A longer delay might have resulted in rising inflation expectations and the reinstatement of inflationary mechanisms in the Swedish economy. A monetary policy realignment at a later stage might then have had to be more stringent, with a risk of negative effects on the real economy.

The aim is to avoid dramatic shifts in the monetary stance and ensure that comparatively limited adjustments to the instrumental rate are sufficient to keep price movements in line with the inflation target. The feasibility of this is indicated by the enhanced confidence in overall economic pol-



icy and the fact that the inflation target is anchored more firmly than before. There are also good arguments for an appreciation of the krona in the coming years so that the real exchange rate approaches its long-term equilibrium level. That would contribute to less expansionary monetary conditions.

INTERNATIONAL DEVELOPMENTS AND THE CRISIS IN ASIA

The level of activity in the British and US economies, which are leading the business cycle, has been high for some time. The Bank of England had already begun to tighten its monetary stance at the end of 1996 and the Federal Reserve raised its instrumental rate in the spring of 1997. The overall economic tendency in the EU area was upwards during 1997 and signs of rising inflation occasioned increased instrumental rates in all the other Nordic countries as well as in Germany, France, Austria and the Benelux countries. In the countries in Southern Europe, where inflation had previously been high, economic policies for price stability had led to a fall in both inflation and inflation expectations, which meant that instrumental rates could be lowered from previously high levels.

During 1997 it became increasingly clear that the third stage of EMU would begin as planned on 1 January 1999. This was a major factor behind the appreciable fall in interest rates in countries with previously high inflation that clearly declared an intention of adopting the single currency from the start. Although economic activity in the OECD area is likely to rise, inflation in the coming years is expected to remain low.

During the summer of 1997 Thailand and other countries in Southeast Asia experienced repeated attacks on their currencies that finally obliged them to abandon links to the US dollar. The crisis spread from country to country in the region. In connection with speculation against the Hong Kong dollar at the end of October, share prices plummeted on the Hong Kong exchange and the unrest spread to stock exchanges and credit markets throughout the world. In Europe and the United States, however, share prices soon recovered. Towards the end of November there was a new wave of financial market unrest in connection with the failure of a number of Japanese banks. South Korea was obliged to apply to the International Monetary Fund, which provided support in the form of massive loans.



<p>In the Inflation Report in December the Riksbank pointed to the risk of the crisis in Asia becoming more profound, with ripple effects that might appreciably weaken international activity. At that time, however, it was considered that the crisis would not become so extensive that a realignment of Swedish monetary policy in a less expansionary direction was called for. The ultimate magnitude of the crisis and its repercussions on the rest of the world are still unclear.</p> <p style="text-align: center;">SWEDEN OUTSIDE THE EURO AREA IN 1999</p> <p>The position of the Government and the Riksdag on EMU is one of the political decisions in 1997 that appreciably affects the future conditions for monetary policy. In June the Minister of Finance announced that in view of weak public support, Sweden was not contemplating participation in the euro area from the start in January 1999. The Government bill to this effect that was submitted to the Riksdag in October also noted that freedom of action should be maintained so that Sweden's participation at a later date would be feasible, though the matter should be submitted to the national opinion. The Riksdag approved the bill at the beginning of December.</p> <p>The Riksbank has been in favour of adopting the single currency from the start, as was clear from the Governing Board's submission on the EMU enquiry in February 1997.</p> <p>Even if Sweden is not an initial participant in the euro area, the Riksbank will maintain a state of high readiness so that Sweden can join at short notice. The goal is for the Riksbank to need not more than one year to cope with the changes that will be required in order to participate in the single monetary policy. To this end and in order to benefit from the experience of</p>	<p>other EU countries, the Riksbank decided to continue its participation in the preparatory work for EMU together with other national central banks. The work of consulting with and informing the Swedish financial sector is also continuing.</p> <p style="text-align: center;">THE RIKSBANK'S STATUS STRENGTHENED</p> <p>In January 1993 the Governing Board decided to focus monetary policy on an explicit inflation target and specified that, as of 1995 and measured in terms of the consumer price index, the rate of inflation was to be limited to 2 per cent a year, with a tolerance interval of ± 1 percentage point. Experience from the three years with an inflation target policy must be regarded as favourable: inflation close to the targeted rate has been combined with economic growth that has been comparatively high for Sweden. Experience has also been good in other countries where monetary policy has been conducted with an explicit target for inflation.</p> <p>It is the Riksbank that has undertaken to adhere to the inflation target, though both the Government and the Riksdag have expressly supported monetary policy's focus on price stability as well as the Riksbank's target. In November 1997, however, the Riksdag received a Government bill on the status of the Riksbank, based on a departmental memorandum that had been drafted earlier in the year by a working group with representatives of all the political parties in the Riksdag. Five of the parties support the proposals, which partly represent an adaptation to the requirements of EU cooperation but are also well motivated in purely economic terms. One of the proposals is that the price stability objective be given the force of law by amending the Riksbank Act so that the</p>	<p>function of the Riksbank is specified as being to maintain a fixed value of money. This decision confirms that Sweden's permanent commitment to a policy for low inflation.</p> <p>The bill also proposes that the Governing Board be given a controlling function and that in future the Riksbank is to be managed by an Executive Board with six full-time members who are to decide all matters to do with monetary policy. Moreover, authorities are to be prohibited from influencing the Riksbank's monetary policy decisions and members of the Executive Board may neither seek nor take instructions in the performance of their monetary policy duties. Ultimate responsibility for exchange rate policy matters is to be transferred from the Riksbank to the Government in that it is proposed that the exchange rate regime is to be chosen by the latter. The Riksbank will decide the central rate and band width in a fixed exchange rate regime, as well as the practical implementation of exchange rate policy in a regime with a flexible exchange rate. With all these proposals, the status of the Riksbank will be appreciably strengthened, which should enhance the credibility of the low-inflation policy.</p> <p>The grounds for delegating monetary policy from the national parliament to an independent central bank are that this ensures that the intended policy will in fact be implemented. It should be also underscored that the Riksbank's objective will still be laid down by the Riksdag. The proposals do not make the Riksbank independent in the sense that it will be free to conduct whichever monetary policy it chooses. The intention instead is to create the best possible conditions for the Riksbank to implement a monetary policy that fulfils the objective prescribed by the Riksdag.</p>



Good stability

The Riksbank has the statutory function of promoting the stability and efficiency of the payment system. It is the payment system that makes it possible to arrange payments via accounts instead of having to use cash. The function of the overseer is to ensure that the payment system operates soundly and smoothly so that it 'oils the wheels of the whole economy'.

An efficient payment system leads to lower costs and smaller risks in the production of goods and services, thereby promoting economic growth and employment. By the same token, a disturbance in the functioning of the payment system can have negative consequences for the economy as a whole. Crises in the payment system may tend to bring economic developments into a vicious circle of falling output, rising unemployment and deflation. Such a course of events impairs the conditions for the central bank's primary function – conducting monetary policy.

In November 1997 the Riksbank presented the first report in a new series. The purpose of the biannual Financial Market Report is to present the Riksbank's appraisal of developments in the financial system. In the first report the Bank explained its functions as the overseer of payment system stability and how the work in this field is undertaken. This was accompanied by an analysis of the competitive situation in the Swedish bank sector. The conclusion from the report was that the stability of the financial system is good.

Oversight by the Riksbank covers two fields that correspond to the two components of the payment system: infrastructure and financial firms.

The *infrastructure* consists of the technical and administrative systems whereby payments can be made between financial firms as well as between these firms and

other economic agents. The infrastructure can also be said to include systems whereby transactions in financial assets can be made and completed.

The infrastructure comprises:

- market places for financial assets
- clearing systems for payment orders, and
- settlement systems for the registration and final settlement of financial asset ownership and pledging.

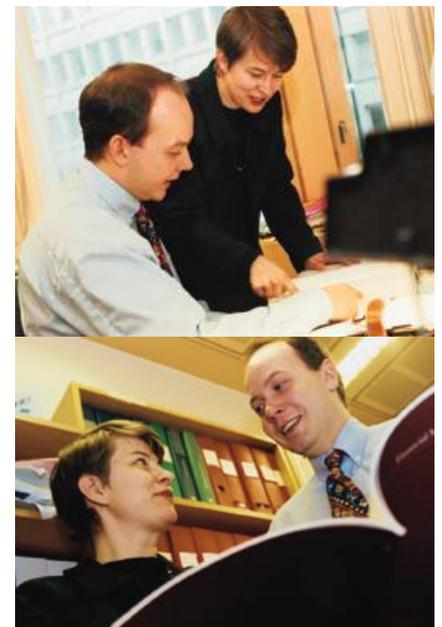
It is only certain *financial firms* – banks and certain clearing houses that administer and execute payments – that normally have access to the payment system infrastructure. Individuals and firms wishing to use the system have to turn to these institutions. In that it is these financial firms which support the infrastructure, the analysis of the operations of the financial actors with direct access to the payment system is essential to the understanding of developments affecting the payment system and financial stability. Moreover, the legal framework refers in the first place to the financial firms, not to the systems that constitute the infrastructure.

The central enterprises in the payment system are the banks and it is therefore these institutions, particularly the four major bank groups, that are the focal point of the Riksbank's analysis of the financial system. Systemic crises are liable to be triggered by a bank, for some reason, being unable to meet its commitments, so that financial problems spread through the payment system. It is this risk that the Riksbank needs to analyse and endeavour to preclude.

PAYMENT SYSTEM INFRASTRUCTURE

General analysis and oversight

The work of the Riksbank on payment sys-



The Riksbank's first Financial Market Report was produced by Martin Andersson and Felice Marlor together with ...



<p>tem infrastructure aims to reduce systemic risks and enhance the system's efficiency. Large-value payments, which are handled in the RIX system, involve exposure to substantial risks, so that for stability it is important that the Riksbank essentially concentrates its analysis on this segment. The large payments also make it necessary to monitor developments in systems that handle securities. Besides handling transactions for very large amounts, these systems are crucial for the functioning of the securities market and thereby for the Riksbank's other main function – monetary policy. The relevant Swedish securities systems¹, operated by OM and VPC (Central Securities Depository), handle large values and settlement is arranged in the RIX system. Shortcomings in systems of this type can have substantial negative effects on financial markets.</p> <p>As regards VPC, the Riksbank also has an interest in a rapid and reliable transfer of ownership and pledging. This is important because all borrowing from the Riksbank normally has to be fully collateralised and the collateral consists of securities deposited with VPC.</p> <p>The Riksbank has a more limited function as the overseer of retail payments (payments by households and firms), above all as regards systems that are directly linked to the RIX system, in particular BankGiro and Data Clearing.² The Riksbank sees to it that the general construction of such systems fulfils reasonable requirements for stability as well as for transparency of costs and the time required to complete payments. This is important for maintaining public confidence in the payment system. If confidence, for some reason, were to be eroded so that households and firms ceased to use certain mediators and transaction techniques, there would be a risk of a suc-</p>	<p>cessive decline in the efficiency of the payment system, with social costs that would be substantial.</p> <p><i>The RIX system</i></p> <p>Extensive work was done in 1997 on improving the RIX system in terms of stability as well as efficiency. This work will continue during 1998.</p> <p>The current on-line registration is being replaced by a new technique that handles messages with Swift communication. This makes it possible to integrate the participants' systems with the RIX system and it will be easier for a participant to process a larger volume of payments. The central banks in the European Union have chosen the same technique for the TARGET system.</p> <p>During the autumn of 1997 work was initiated on removing the debiting function from the RIX system. Previously, participants were able to debit (withdraw money from) another participant's account but in future it will only be possible to credit a counterparty's account. The removal of debiting from the RIX system will require changes in the exchange of information between participants, for instance as regards the settlement of cheques and card transactions.</p> <p><i>RIX and TARGET</i></p> <p>Sweden will not be joining the euro area initially and will therefore not participate in the single monetary policy but the Riksbank will still be included in the TARGET system. The RIX system will continue to function as at present and settle payments in kronor; this K-RIX system will be paralleled by a separate system for payments in euro, E-RIX. Tests of the latter system are due to begin in the spring of 1998 and the system will be ready for production by 1 January 1999.</p>	<p><i>Electronic money</i></p> <p>Cards that are 'loaded' with electronic 'money' have been in use for many years, for instance for public telephones.</p> <p>More recently, systems have been developed with general-purpose cards that can be reloaded in a manner similar to cash withdrawals at an automated teller machine or, in certain cases, with a specially equipped telephone.</p> <p>Another type of electronic money that has been gaining ground involves transferring funds from a bank account to the hard disk of a personal computer and using them for transactions by telephone or purchasing over the Internet, for example.</p> <p>These developments raise a number of issues for central banks and other supervisors. The new instruments for electronic payments will affect the use of banknotes and coins and thereby central bank seignorage income, with possible consequences for the construction of monetary policy. Other issues concern the financial stability of issuers, the technical security of systems and their legal foundations.</p> <p>These matters were studied in detail by central banks during 1996 and 1997, in the context of G-10 cooperation as well as in the EMI. The institutional requirements for issuer status and the minimum standards in this respect were discussed from the viewpoint of supervisors. An EU directive that regulates such matters is expected in 1998.</p> <p>Early in 1997 the Government appointed a committee to consider whether exist-</p> <p><small>1. OM's system for the registration of derivative contracts that are quoted on the OM Group's exchanges and VPC's system for interest-bearing securities and shares listed on the Stockholm Stock Exchange.</small></p> <p><small>2. Data Clearing has a number of important functions in the Swedish market for retail payments, for example in inter-bank transfers and in transactions by card or cheque. Data Clearing and Bank Giro are both administered by BankGiro Centre (BGC).</small></p>



... Martin Blåvarg and Anders Bjällskog in the Payment System Department.

ing laws and regulations should be amended to cover these new systems and, if so, to propose appropriate provisions. The committee is expected to complete its work in the first half of 1998.

The Riksbank has also analysed and discussed aspects of electronic money, particularly those that are pertinent for central banks. Such matters include the impact of electronic money on central-bank seignorage income, the need to adapt the way in which monetary policy is constructed, and questions of systemic stability. The internal discussions and analyses resulted in a report³ that the Riksbank published towards the end of 1997.

Trials with a card-based system for electronic money (Cash Card) were in progress during 1997 in a number of Swedish cities. This system has been developed jointly by Nordbanken, S-E-Banken and FöreningsSparbanken. A national launch is planned for 1998.

Structural changes in exchange and clearing markets

Proposals for merging OM and the Stockholm Stock Exchange were presented in November 1997. The payment system infrastructure is not affected directly because share and derivative transactions will continue to be settled in the existing structure, share transactions in VPC and derivative transactions in OM.

A matter of importance for the infrastructure is the tendency to integrate exchanges in the Nordic area. This was accentuated during 1997. OM has established links with the Norwegian and Finnish derivative exchanges, which means that members of one of these exchanges are also in a position to trade and/or clear equity and interest related derivatives on the other exchanges. Cooperation has been initiated,

moreover, between the stock exchanges in Stockholm and Copenhagen with a view to creating a joint trading system.

This integrational tendency, which may be accentuated by a merger between OM and the Stockholm Stock Exchange, suggests that conditions should exist for a fully integrated Nordic system for exchange trading.

BANKS

General analysis and oversight

During 1997 the Riksbank broadened and developed its analysis of the banks. This analysis has three components: *markets, risks and readiness*.

The analysis of *markets* focuses on future earning power in the bank sector. An unsatisfactory level of earning power implies the risk of a loss of financial strength that induces banks to take increased risks. This could result in a serious threat to the financial system's stability. A general survey of the competitive situation of Swedish banks was presented in the first Financial Market Report.

The analysis of *risks* focuses on the banks' financial risks. For banks, to a greater extent than for other firms, long-term viability is crucially dependent on the balance sheet and on assets in particular. A matter of special concern is the credit positions to which banks are exposed through their lending, as well as through the 'Herstatt risk' associated with currency transactions.

The functioning of the payment system can be threatened by disturbances in a single institution but the systemic threat is considerably more serious if many institutions are hit simultaneously or if confidence in the financial system as a whole is shaken. Experience has shown that such threats arise in the first place in connection with sizeable changes in the economic en-

vironment in which the financial enterprises operate. One of the main components of the risk analysis is therefore the continuous monitoring of macroeconomic indicators that point to the existence of potential problems.

The Riksbank concentrates in the first place on:

- drawing attention to signs of a crisis as early as possible,
- contributing as far as possible to preventing crises, and
- mitigating negative effects if they do occur.

The Riksbank's state of readiness includes detailed plans for the Riksbank's response in the event of crises in the financial system and the organisation of cooperation with the Ministry of Finance and the Financial Supervisory Authority. The analyses of markets and risks are the foundation for the information that the Riksbank needs in the event of a critical situation in the financial system.

Herstatt risk

Herstatt risk⁴, more accurately known as cross-currency settlement risk, is the risk that a party to a currency transaction pays out the sold currency without receiving the purchased currency. This risk exists because of the time lag between payment and delivery in the different stages of a currency transaction. A report from the central banks of the G-10 countries in March 1996 gave the bank sector a period of two years in which to produce a solution that

3. Gabriela Guibourg (1997), Elektroniska pengar och elektroniska betalningar (Electronic money and electronic payments), Riksbank Studies 1, November.

4. The epithet comes from Bankhaus Herstatt, a German merchant bank that failed in 1974, causing losses for its counterparties in the final settlement of currency transactions.



<p>reduces Herstatt risks. The report underscored the importance of banks measuring these risks correctly. The reduction of the risks can be achieved with a three-track strategy that comprises actions by individual banks, bank industry groups and central banks, respectively. Examples of measures that reduce the risks include netting amounts that are due for settlement and shortening the interval between payment and delivery.</p> <p>In the autumn of 1997 the Riksbank undertook a study of the four major Swedish banks as a follow-up of the earlier study in 1996. Similar studies have been made in the other G-10 countries. Their aim is to provide the central banks with a picture of how the bank sector is managing so-called Herstatt risk in order to determine whether further steps should be taken by the authorities.</p> <p><i>The bank groups</i></p> <p>Sweden's bank sector is dominated by four major bank groups (S-E-Banken, Handelsbanken, Nordbanken and FöreningsSparbanken). They account for about 80 per cent of total lending by credit institutions to the non-bank sector. The Riksbank's analysis therefore concentrates in the first place on these groups.</p> <p>The profitability of the groups in 1997 was satisfactory, though lower than the year before. The decline was a consequence of multiple factors that are expected to go on acting in the future, leading to lower group profits.</p> <p>The main factors are:</p> <ul style="list-style-type: none"> ■ narrowing interest margins on account of growing competition, as well as diminishing margins on both lending and deposits, ■ loan losses that are relatively low at pre- 	<p>sent (below the level that can probably be maintained in the long run) and are likely to rise in the event of an economic slowdown, and</p> <ul style="list-style-type: none"> ■ falling interest rates, which gave a lower return on the banks' securities portfolios in 1997 compared with 1995 and 1996. <p>The banking sector's capital adequacy and core capital ratio are both satisfactory. The capital adequacy ratio was around 12 per cent for all bank enterprises except Handelsbanken, for which it was 10 per cent. The four major bank groups are all well above the statutory capital adequacy ratio of 8 per cent.</p> <p>Bank lending to the non-bank sector rose during 1997 by about 15 per cent. Lending by house mortgage institutions hardly changed but turnover remained high and price competition in this market is strong.</p> <p>Deposits from the resident non-bank sector have fallen since the turn of 1996. This reflects decreased business deposits as well as a continued household preference for other forms of saving. Households have shifted from interest-bearing bank savings to various types of mutual funds, mainly equity funds and insurance saving. New saving in mutual funds in the first three quarters of 1997 was twice as high as a year earlier and insurance saving premiums rose 40 per cent.</p> <p>All the major Swedish banks were involved in mergers or takeovers in the course of 1997:</p> <ul style="list-style-type: none"> ■ In December 1996 Handelsbanken made an offer for Stadshypotek. The owners of Stadshypotek accepted the bid, the necessary authorisations were obtained and during 1997 Stadshypotek was integrated with Handelsbanken. 	<ul style="list-style-type: none"> ■ In February 1997 the boards of Swedbank and Föreningsbanken jointly proposed a merger of the two banks under the name of FöreningsSparbanken and the Government approved the merger in October. ■ In October 1997 Nordbanken proposed a merger with Meritabanken in Finland; the new bank is to be named Merita-Nordbanken. This is the first example of a cross-border merger of two large Nordic universal banks. ■ In October 1997 the boards of S-E-Banken and Trygg-Hansa, an insurance company, proposed a merger of these two companies that was subsequently approved by the owners as well as the authorities. This will be the first significant merger in Sweden of a bank and an insurance company. <p>Three new players joined the Swedish bank market in 1997. They are HSB Bank AB, GE Capital Bank (a subsidiary of General Electric Company) and a branch of Avco Trust PLC. Moreover, by acquiring Östgöta Enskilda Bank, Den Danske Bank now has a sizeable presence in the Swedish markets for private customers and for small businesses, segments where foreign competition has been low.</p> <p>The competitive situation and competitiveness of Swedish banks were analysed in the first Financial Market Report. It was concluded that competitive pressure in the bank sector has grown, mainly because the market has become more international at the same time as traditional bank products like deposits and lending are now encountering stronger competition from other financial products. However, the banks do seem to be well equipped to meet this increased competition.</p>



Sweden outside the euro area

The Riksbank participates in the cooperation between national central banks in the EMI. The main objectives of the EMI, laid down in the Maastricht Treaty, are to prepare for the establishment of the ECB and the ESCB and to strengthen cooperation between the national central banks. Moreover, the national central banks are, together with the ministries of finance, represented on the Monetary Committee, a consultative body that reports to the Ecofin Council and the Commission. The national central bank governors participate in the biannual informal meetings of the Ecofin Council.

THE EMU PROCESS DURING 1997
At the Amsterdam meeting in June, the European Council agreed on the final construction of the Stability and Growth Pact. The objective of this Pact is to guarantee national budget discipline in the future economic and monetary union. The Council also agreed on the main features of the new exchange rate cooperation between countries that do and do not adopt the euro from the start. The construction of the legal framework for the single currency was also finalised.

The informal Ecofin meeting in Mondorf in September agreed that the bilateral conversion rates that are to apply from 1 January 1999 are to be announced already in the spring of 1998 in connection with the decision on which countries will be participating in the euro area from the start. This is intended to reduce financial market uncertainty.

On 17 November the Ecofin Council agreed that banknotes and coins in the single currency are to be introduced in January 2002. Previously it had been stated that banknotes and coins were to be introduced by this date at the latest.

In December the Luxembourg meet-

ing of the European Council adopted a resolution on the principles and terms for strengthening economic coordination between the countries in the euro area as well as between them and the member states that do not adopt the euro from the start. The economic policy coordination is to be centred on the Ecofin Council but the finance ministers of the euro countries are able to meet informally. If the informal meeting concerns matters of common interest, however, ministers from all the member states are to participate. The resolution also dealt with the implementation of foreign exchange policy for the euro, how the monetary union is to be represented and the organisation of the dialogue between the Council of Ministers and the ECB.

SWEDEN'S POSITION
Sweden's EMU Commission presented its report in the autumn of 1996. Starting from arguments on three grounds – economic efficiency, stabilisation policy and political consequences – the Commission concluded that Sweden should participate in the monetary union but not from the start.

The Commission's reasons for postponing participation were – in addition to the high level of unemployment – the uncertain situation for government finances, the need for further discussion and the probability that a limited number of countries would be joining from the start.

The Riksbank, however, reached a different conclusion. In its submission in February 1997, the Governing Board considered that the Commission had exaggerated the stabilisation policy costs of adopting the single currency, while both the economic and the general political benefits had been underestimated. The high unemployment as such was not an argument for remaining outside initially. Tackling the



Gustaf Adlercreutz, Eva Julin and Fredrika Lindsjö working on EU questions in the International Secretariat.



<p>problem of unemployment is primarily a matter of reforming the labour market and wage formation. The submission also drew attention to the costs which remaining outside for a period are likely to entail for the financial sector. The Riksbank concluded that Sweden ought to be a full participant in the monetary union from the start.</p> <p>On 4 December the Riksdag decided that Sweden is not to adopt the single currency from the start on 1 January 1999. But participation later on has not been ruled out and preparations are to be made so that Sweden will be in a position to join the euro area at short notice.</p> <p>EMI PREPARATORY WORK</p> <p>The establishment of the ESCB will affect activities of the Riksbank even though Sweden will not be joining the euro area from the start. The Riksbank will, for example, participate in the system for cross-border euro payments (TARGET) and adopt the harmonised rules for statistical and other reports. In other respects the Riksbank is participating in the preparatory work of the EMI in such a way that freedom of action can be maintained to a high degree.</p> <p>During 1997 the EMI prepared the legal, organisational and logistical regulations that are necessary for the ESCB's functions. The formal decisions on these matters will be made by the ECB Governing Council. In a number of fields the preparatory work has resulted in detailed regulations as well as implementation procedures for the national central banks. In some fields the EMI Council has presented alternative formulations of the regulations and left it to the ECB Governing Council to make the final decision. The preparations have been undertaken so that it will be possible to implement the final choice in time for the start of the monetary union.</p>	<p><i>Monetary policy framework</i></p> <p>During 1997 the EMI published two reports on the construction of the ESCB's monetary policy framework. Both reports contain relatively detailed accounts of the instruments that the EMI has prepared for this purpose, counterparty eligibility criteria, tender procedures, asset eligibility criteria, and so on. The system that is planned for the ESCB resembles the Riksbank's current arrangements in several respects. A repo rate will be set inside a corridor of fixed but adjustable deposit and lending rates. The primary instrument for controlling liquidity is to be regular, short-term repo transactions. These can then be fine-tuned as required with various transactions so that the overnight rate is at the desired level. The need for such fine tuning will depend, for example, on whether or not the ESCB implements minimum reserves. This is still an open question.</p> <p><i>Foreign reserve assets and exchange rate cooperation</i></p> <p>During 1997 the EMI also worked on regulations for the ESCB's management of foreign reserves. Besides the forms for the management of the foreign reserve assets which the national central banks are to transfer to the ECB at the start of the monetary union, this involves drawing up regulations for the management of the foreign assets which are not pooled in this way, as well as for the foreign exchange transactions of public authorities.</p> <p>The EMI has prepared an agreement on central bank cooperation in connection with the new exchange rate mechanism (ERM 2) that is to replace the current cooperation in the European Monetary System (EMS) at the start of Stage Three of EMU. Under ERM 2, central rates are to be set between the euro and each of the</p>	<p>currencies of the member states that do not join the euro area and choose to participate in ERM 2. Membership of ERM 2 will be voluntary but outside countries can be expected to join.</p> <p><i>Payment system</i></p> <p>The EMI has issued a second progress report on the TARGET project, specifying how this system is intended to function. The Institute has also continuously monitored the forms for the settlement of private ecu transactions.</p> <p>Participation in TARGET will enable the Riksbank to mediate euro payments via other EU national central banks. A RIX system for euro transactions, E-RIX, is being established for this purpose, while the RIX system for kronor (K-RIX) will continue to be available as long as Sweden remains outside the euro area and the euro has not fully replaced the krona as the currency unit. The ECB Governing Council will be deciding the extent to which access to central bank intra-day credit in euro is to be restricted for central banks in countries outside the euro area.</p> <p>Collateral will be required on all loans from the central banks, both in connection with the implementation of monetary policy and for intra-day credits in the payment system. In a report published in 1997, the EMI presented the procedures that it is planned to use for cross-border securities transactions in the ESCB.</p> <p><i>Statistics</i></p> <p>The EMI published a preliminary list in 1997 of the institutions that are to submit data on their financial operations to the ECB. Additions will be made to this list, in the first place as regards money market funds, from which statistical reports will also be required.</p>



Banknotes and coins

Following the presentation of designs for the euro banknotes that are to be introduced on 1 January 2002, the EMI has gone on working on the designs and presented detailed printed proofs in 1997. The coins in euro and cents that are to be introduced on the same date are being designed in cooperation with the competent authorities in the EU countries. At the Amsterdam meeting of the European Council the member states agreed on the design for the uniform face of these coins.

Legal convergence

Progress in legal convergence – the adaptation of national laws that is required to bring them into line with the Maastricht Treaty – has also been examined by the EMI. The main requirements in this respect concern the independent status of central banks and the maintenance of price stability as the statutory objective. A progress report on this legal adaptation was published by the EMI in October. The EMI has been consulted by national authorities concerning draft legislation in the Institute's field. In Sweden the Ministry of Finance, for example, obtained the opinion of the EMI on the Council on Legislation's advice as to the status of the Riksbank, prior to the Riksdag's treatment and decision.

PREPARATIONS FOR EURO

Preparations for the start of the monetary union are also needed in the private sector, not least by financial institutions. This work is monitored above all by the national central banks but the EMI coordinates certain matters of oversight, besides having its own contacts with financial sector representatives.

Euro coordination in the Government Office

The practical preparations for an introduc-

tion of the euro in Sweden are coordinated by the Ministry of Finance. A Euro Coordination Function was set up under this Ministry in August 1996. The work of compiling preparations that are in progress in Sweden and mapping the need of various measures in the event of an adjustment to the euro is being undertaken in five working groups: on the business sector, citizens' issues, legislation, the financial sector and the public sector, respectively. The Riksbank has contributed to this work as regards preparations in the financial sector. Two reports have been presented; both considered the two situations with Sweden inside or outside the euro area.

In December 1997 the Government decided to appoint a reference group on Swedish preparations for the euro. The group is to oversee Swedish adaptation to the euro when Sweden is outside the monetary union, oversee the production of a Swedish plan for the eventuality that Sweden joins at a later date, and develop the dialogue with interested groups that are affected by the introduction of the euro. The Minister of Finance is to head the reference group and its other members include the Riksbank Governor, the Ministers for Consumer Affairs, Labour Market and Commerce, as well as representatives of the business sector and labour market organisations. The group is to be assisted by the Euro Coordination Function.

Consultation and information with the financial sector

The Riksbank's cooperation with the financial sector on transitional matters continued during 1997. This work has mainly been arranged in the group for Consultation and Information with the Financial Sector (SIFS), which consists of a managerial group and five sub-units.

The managerial group includes representatives from the financial sector: the Federation of Insurance Companies, Postal Giro Bank, VPC, the Stockholm Stock Exchange, the Bankers' Association, the Association of Finance Houses, the Securities Dealers Association, the Mutual Funds Association and BankGiro. The Ministry of Finance, the National Debt Office and the Financial Supervisory Authority also participate in the work. Five working groups are active at present: on monetary and exchange rate policy, statistics, banknotes and coins, payment system, and legal matters.

In connection with this cooperation, three reports on the euro were presented in 1997: a progress report on the euro in Sweden's financial sector, a report on the payment system and a presentation of shared opinions in the progress report.

When the progress report on the euro in Sweden's financial sector was presented, the issue of whether or not Sweden would join the euro area from the start had not been settled. The report was based on the premise that participation from the start in 1999 could not be ruled out and it therefore concentrated on the preparations that would be needed so that the financial sector would be in a position to participate from the start. Following the decision by the Riksdag, work has started on analysing what will happen in Sweden's financial sector in an outsider position.

Cooperation with the Government Office

Riksbank representatives participated in 1997 in a number of groups that are working on EU and EMU issues: the Ministry of Finance's working group for EU and EMU issues, the Euro Coordination Group, the reference group for EU economic policy cooperation and preparatory meetings with reference to the Monetary Committee.

THE GOVERNING BOARD

Eight Delegates

The Governing Board:

Left to right, front row: Urban Bäckström, Johan Gernandt, Bengt K.Å. Johansson, Ingegerd Troedsson and Bengt Westerberg; back row: Birgitta Johansson, Kjell-Olof Feldt and Berit Löfstedt.



The Riksbank, the Swedish central bank, is an authority under the Riksdag and is directed by a Governing Board with eight Delegates.

Seven of the Delegates are appointed by the Riksdag, not necessarily from among its members, for the same term as the Riksdag. These seven elect a Chairman and one or more Vice Chairmen from among their number and also appoint the eighth Delegate, who is then the Governor of the Riksbank, for a period of five years. Deputy Governors, whose number is limited to two, are appointed for a term of five years by the Governing Board from outside its number. The Deputy Governors are Alternates for the Governor on the Governing Board.

SEAT IN STOCKHOLM

The seat of the Governing Board is the

head office of the Riksbank in Stockholm. The Governing Board is required to meet at least once every fortnight; the quorum is six members.

Matters to be decided by the Governing Board are specified in the Riksbank Act. Other matters are decided by the Governor.

DELEGATES

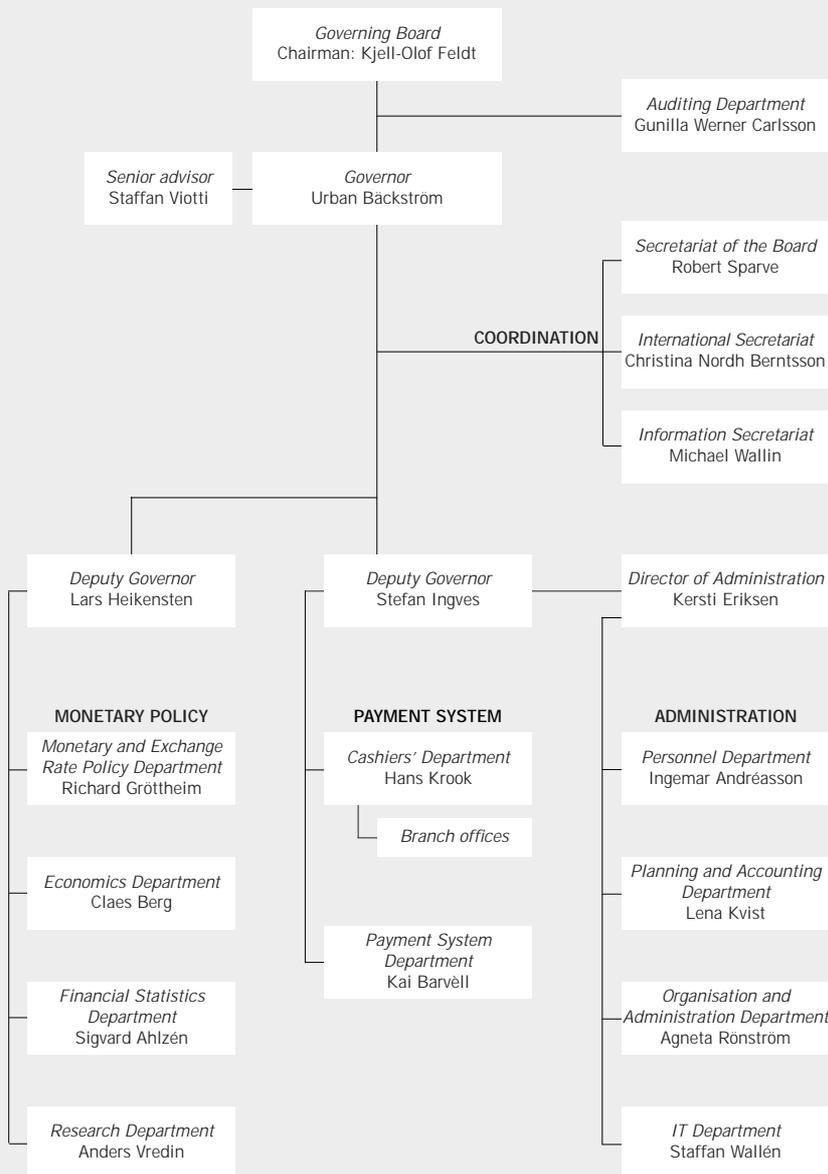
Kjell-Olof Feldt (Chairman), Bengt Westerberg (Vice Chairman), Urban Bäckström (Governor), Birgitta Johansson, Johan Gernandt, Bengt K.Å. Johansson, Berit Löfstedt and Ingegerd Troedsson.

DEPUTIES

Inge Carlsson, Sinikka Bohlin, Stephan Tolstoy, Lars Hedfors, Carin Lundberg, Peter Egardt, Agne Hansson and the Deputy Governors: Stefan Ingves and Lars Heikensten.



New managerial structure



A new internal managerial structure for the Riksbank was introduced as of July 1997, when the existing directorate was terminated. The new structure is designed for making most decisions in the line organisation, with a high degree of delegation, together with some staff fora for discussions and certain decisions.

The Governor's decision-making group is a forum for decisions by the Governor on proposals to the Governing Board, the repo rate, certain policy matters, guidelines for operational plans, major investments, et cetera. The Riksbank's managerial body is a forum for the discussion of matters of common interest by the Governor, the two Deputy Governors and the Director of Administration together with the heads of departments. In addition there are subject-related groups for drafting and decision-making, as well as a managerial forum for joint discussions with and information to all the Bank's managerial personnel.

THREE NEW HEADS OF DEPARTMENT
In the course of 1997, three new heads of department at the head office were appointed. The Governing Board appointed Gunilla Werner Carlsson to head the Auditing Department as of 15 September and Agneta Rönström to head the Organisation and Administration Department from 1 September. The Directorate appointed Christina Nordh Berntsson to head the International Secretariat as of 1 February.

At end 1997 the Riksbank had 744 employees (782). Of this total, 57 per cent were women and 43 per cent men.

The Gävle branch of the Riksbank was closed on 1 February 1997. This completed the series of branch closures that was decided by the Governing Board in 1993. Including the Stockholm branch, the Riksbank now has eleven branches.

The year in review

The Riksbank will continue to evaluate the effects of the interest rate cuts that were implemented during 1996. As pointed out on many occasions in the past year, we will also be keeping a close watch on the future development of economic activity, inflation expectations and the exchange rate. *Deputy Governor Lars Heikensten, Stockholm Chamber of Commerce and Veckans Affärer, 29 January.*

The best way in which monetary policy can contribute to an economy that functions better, with increased employment and growth, is by keeping inflation low and stable. Most things suggest that traditional demand policy is not capable of lowering unemployment appreciably. *Governor Urban Bäckström, Swedish Economics Association, 6 March.*

The repo rate was lowered most recently last December. Since then we have frequently declared that the monetary stance is well balanced. This still applies. At present the Riksbank sees no need to alter the repo rate. *Urban Bäckström, the Riksdag's Standing Committee on Finance, 15 May.*

In practice the room for an active stabilisation policy is circumscribed by the uncertainty about future inflation. Another important complication relates to the policy's credibility. Increased monetary policy credibility creates more room for both rapidly shifting policy credibility in a more expansionary direction in situations of weakening demand and deferring interest rate hikes. Measures to strengthen central bank independence should inter alia be seen in this light. *Lars Heikensten, Monetary Policy Forum, 26 May.*

Measures must be taken to improve the functioning of the labour market. For further favourable economic development it is also essential that the efforts to reduce government debt are continued. The condi-

tions for monetary policy in the years ahead will then be improved and greater freedom of action will be created for economic policy in the longer term. *Lars Heikensten, Centre Party's Economics Seminar, 15 June.*

The Riksbank considers that at present the monetary stance is well balanced. With a monetary policy focused on a price stability target, the need for interest rate adjustments is determined primarily by domestic economic tendencies and the assessment of future inflation in Sweden. Thus we are not directly affected by whether interest rates are raised or lowered in other countries. This was apparent earlier when other countries lowered their interest rates and the Riksbank continued with a higher level; it is also clear at present, when the instrumental rate has been raised in Finland and we leave the rate unchanged. *Urban Bäckström, Swedish Bond Promotion and Dagens Industri, 30 September.*

In the light of the rising activity, the main difficulty in assessing future inflation currently lies in an uncertainty about developments on the supply side, wage formation in particular. It is difficult to foresee how the Swedish economy will react to a broad economic upswing. It is therefore important, not least on that account, to analyse incoming information. *Lars Heikensten, Sweden Financial Forum in Örebro, 15 October.*

For savers and investors in the market, the question is not whether but when the Riksbank will raise its instrumental rate. An expected increase in the repo rate is, in fact, discernible in the structure of market interest rates. The general opinion among financial agents seems to be that an increase in the repo rate is probable some time in the coming winter. *Urban Bäckström, Swedish Shareholders Association in Stockholm, 19 November.*



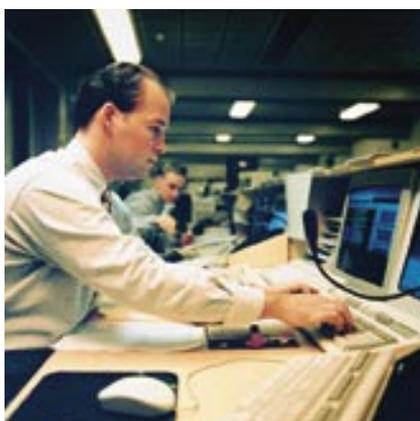
Inflation Report 1997:4 was presented by Lars Heikensten, Claes Berg and Hans Lindblad at a press conference on 9 December.

MONETARY AND EXCHANGE RATE POLICY DEPARTMENT

HEAD: RICHARD GRÖTTHEIM
DEPUTY HEAD: CHRISTINA LINDENIUS

FOUR DIVISIONS:
ANALYSIS, TRADING,
INVESTMENT, SECRETARIAT
NO. OF EMPLOYEES: 32

Important link for information



Joakim Friis is a currency trader in the Monetary and Exchange Rate Policy Department.

The staff employees of the Monetary and Exchange Rate Policy Department are in daily contact with financial market agents. Money and bond traders in the Department obtain information about factors and events that affect interest rates in Sweden through their contacts with players in the Swedish market. Information about exchange rate development is obtained by the foreign exchange dealers, who are in continuous contact with players in Sweden and abroad. Daily transactions undertaken in the management of the foreign reserves also provides important knowledge about the fixed income markets in Europe, the United States and Asia. The information that the Department collects and analyses is an important foundation for monetary policy decisions. Through the Department, market agents in turn can obtain information about the Riksbank and monetary policy.

LIQUIDITY DEFICIT

For a number of years the Swedish bank system had a structural liquidity surplus that the Riksbank withdrew by arranging reverse repos. With the reduction of the Riksbank's forward foreign currency position during 1997, this liquidity surplus became a deficit. The Riksbank therefore changed to carrying out repos in order to supply liquidity. These repo transactions, which are announced each Tuesday, are managed by this Department.

AGENT OF THE NATIONAL DEBT OFFICE

In its capacity as the currency agent for the National Debt Office, the Riksbank decided that the equivalent of SEK 20 billion in foreign currency, which would be needed in 1997 for interest payments on government external debt, would be obtained through a continuous series of daily market transac-

tions. This procedure is to be continued during 1998, when the equivalent of SEK 45 billion in foreign currency will be purchased directly in the market to cover the NDO's foreign-currency debt and repayment.

INTENSIVE EMU WORK

The EMI work of constructing systems for interest rate control and a decentralised management of foreign reserves in the monetary union was in an intensive phase in 1997. The Riksbank set up project organisations to investigate the necessary changes in the Swedish system of interest rate control and foreign reserve management in order to participate in the monetary union, as well as the changes that may be called for in an outside position.

In 1998, the ECB's systems for interest rate control and foreign reserve management are to be implemented by those central banks that will participate in the monetary union. The Riksbank aims to take an active part in this implementation, under the auspices of the EMI, even though Sweden will not adopt the single currency from the start. The Riksbank and this Department will thereby obtain more knowledge about the systems that are built up in the ECB and thus be better prepared in the event of future participation by Sweden.

CHANGES IN FINANCIAL MARKETS

Major changes are to be expected in financial markets in the years ahead. By far the most important factor here is the establishment of the monetary union. Other factors are the rapid pace of technical development and the ongoing internationalisation. More and more will be required of the Department in the way of qualified analyses of financial markets to enable the Riksbank to interpret tendencies and foresee the likely responses to the conduct of monetary policy.

Monetary policy recommendations

ECONOMICS DEPARTMENT

HEAD: CLAES BERG
DEPUTY HEAD: HANS LINDBERG
FOUR DIVISIONS:
MACRO ECONOMIC ANALYSIS,
MONETARY ANALYSIS,
PRICE ANALYSIS AND
INTERNATIONAL MACRO ANALYSIS
NO. OF EMPLOYEES: 35

The primary function of the Economics Department is to contribute to the foundation for monetary policy decisions so that the Riksbank meets the monetary policy target, which is to keep the annual rate of inflation to 2 per cent, with a tolerance interval of ± 1 percentage point. As it takes one to two years for monetary measures to affect inflation, monetary policy has to be based on inflation forecasts. As a rule, these forecasts presuppose an unchanged repo rate. A forecast that leads to the assessment that inflation is likely to be above (below) the targeted rate in the target horizon of twelve to twenty-four months accordingly implies that the repo rate should be increased (decreased).

Economic theory and practical experience indicate that in this time horizon inflation is affected by four factors: international inflation, the relationship between domestic demand and supply, cost shocks (changes in oil prices and indirect taxes, for instance) and inflation expectations. A continuous analysis of these four factors is therefore a central feature of work in this Department.

CLEARER INFLATION REPORTS

The major part of the Department's work is published in inflation reports, which aim to present a thorough analysis in a simple, educational way, thereby clarifying monetary policy and stimulating public debate. The inflation reports are written not only for financial market agents, whose work involves following monetary policy, but also for a wider public. To make the reports more educational, a number of changes were introduced in the issue of December 1997. One of these is that the inflation forecast for the coming twenty-four months is now presented as a path over time flanked by intervals for uncertainty.

INTERNATIONAL WORK

The Department represents the Riksbank in a number of EU and EMI committees, which involves a considerable amount of work on the preparation of Sweden's positions in European cooperation. While Sweden's decision not to join the euro area from the start in January 1999 does affect this work, European cooperation is still of central importance. Even as a non-participant, Sweden will be affected by the construction of this monetary cooperation. Moreover, a good state of readiness needs to be maintained for a future situation in which Sweden might become a full participant.

ANALYSES OF CONSEQUENCES

Besides the direct cooperation, it is important to analyse various consequences for Sweden's economy related to developments in the coming euro area. Cyclical trends in the euro area and changeover effects in connection with the start of the monetary union are two central aspects of the international outlook. In 1997, conceivable consequences for the Swedish economy of the financial turbulence in Asia were also analysed.

DEVELOPING ANALYSES

Continuous development work is undertaken to improve forecasting techniques and knowledge about effects of monetary policy. A number of models of different sizes have been constructed by the Department to support this work. RIXMOD, a model for macroeconomic simulation, became operational in 1997 and NIGEM, an international model, was used to analyse effects of the turbulence in Asia.

These two models are undergoing further development, together with work on smaller models for analysing how inflation and growth are affected by interest rates and the exchange rate.



Hans Lindblad, a member of the Economics Department, coordinates work on the Riksbank's inflation reports.

FINANCIAL STATISTICS DEPARTMENT

HEAD: SIGVARD AHLZÉN

DEPUTY HEADS: GUNNAR BLOMBERG AND
BJÖRN HASSELGREN

FIVE DIVISIONS:

CURRENT ACCOUNT STATISTICS,

FINANCIAL ACCOUNT STATISTICS,

METHODS AND PUBLICATIONS,

FINANCIAL MARKETS AND CREDIT INSTITUTIONS

NO. OF EMPLOYEES: 44

Statistics adapted to international norms



Mirja Rudnik, Annelie Bernström and Jan-Olof Elldin work with credit market statistics in the Financial Statistics Department.

The Financial Statistics Department produces, presents and explains statistics on the balance of payments and financial markets. The statistics are used as a foundation for the Riksbank's monetary and exchange rate policy decisions, as well as in the oversight of financial system stability.

METHODS AND PUBLICATIONS

A reorganisation of this Department was undertaken early in 1997. Resources in the form of three posts, which had been available for financial analysis based on balance-of-payments statistics, were transferred to the Monetary and Exchange Rate Policy Department's analysis division in the interests of efficiency and coordination. Moreover, the Analysis and Publication Division was closed down and replaced by a new Methods and Publications Division, with resources drawn from the balance-of-payments divisions and with functions that include the work of adapting statistics for the balance of payments. Other steps were also taken to focus on the extensive work of international harmonisation.

In the ongoing work of adapting statistics to international standards, the Department is an active participant in working groups for Eurostat (the statistical arm of the European Union) as well as for the EMI and its preparations for the economic and monetary union (EMU).

NEW STATISTICS

The reorganisation of statistics from October 1997 completed the first stage of the work on the balance of payments. Statistics based on the new definitions were published in January 1998. The second stage of this work is to be completed by the turn of 1998. In the case of financial market statistics, a new, EMU-adapted form of reporting by monetary financial institutions (MFI)

was introduced as of January 1998 and development work here will also continue in the coming year.

EMI work on statistical preparations has been extended by degrees and the Department has been involved in such fields as financial accounts and general economic statistics, for example. Preparations are also in progress so that continuous reporting of statistics can start in the middle of 1998.

The bank statistics that are reported to BIS were also scrutinised; changes are to be introduced in stages during 1998. Preparations were made, moreover, for two large international surveys that are scheduled for the spring of 1998. These are a BIS study of derivatives and an IMF study of securities.

A continuous aspect of the work on statistics is the enhancement of efficiency. The reporting of primary data by financial enterprises to the Riksbank is mainly based on EDP. EDP routines have now been developed for non-financial enterprises and extensive work has begun on informing these firms and incorporating them in the new reporting system.

STATISTICS ON THE INTERNET

The presentation of the statistical reports is being reviewed, accompanied by a more efficient distribution via the Internet. A major rearrangement of the balance-of-payments reports was completed for the publications in January 1998. Moreover, reports and time series are now accessible on the Internet and can be downloaded as required. Corresponding preparations are being made for the financial market statistics. The existing reports are to be replaced by a single publication in the first half of 1998. The distribution of these statistics on the Internet is also planned for the spring.



Long-term analysis and research essential

RESEARCH DEPARTMENT

HEAD: ANDERS VREDIN
NO. OF EMPLOYEES: 5

Developments in the rest of the world are continuously modifying conditions for the Riksbank's two primary objectives: price stability and financial stability. Tendencies in financial markets and macroeconomic developments in general are continuously analysed in a number of the Riksbank's departments. This is complemented by more long-term research in order to provide the Riksbank with a sufficiently high degree of knowledge about new methodology in the field of monetary policy. Since the beginning of 1997, some of this work is undertaken in the new Research Department.

NEW DEPARTMENT

The activities of the Research Department were initiated in the course of 1997. The head of the Department and two more researchers were recruited externally. Two economists at the Bank were relieved of their regular duties to work in the Research Department on projects formulated by them. Swedish and foreign guest researchers have also been attached to the Department.

RESEARCH PROJECTS

The main function of the Department is to undertake high quality research in fields of relevance to the Riksbank. One project that was started in 1997 concerns the formulation of a so-called vector-autoregressive model that can be used to discuss empirical issues of importance for monetary policy in a consistent manner; for example: How closely can inflation be forecast? How long does it take for monetary policy measures to affect inflation? Can one identify an 'equilibrium exchange rate' that can be used in a meaningful way in exchange-rate and inflation predictions? Other projects concern the macroeconomic consequences of an inflation target policy, models for

credit assessments of bank lending to households, and the relationship between inflation and the degree of competition in the economy.

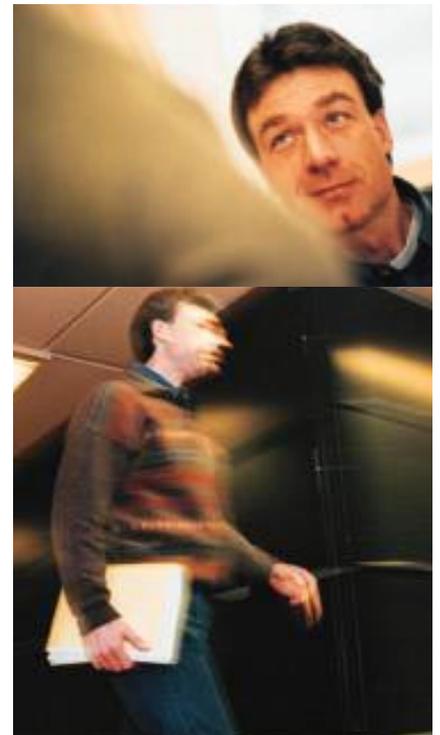
SUPPORT FOR OTHER DEPARTMENTS

Another function of the Research Department is to support the work of other departments. Besides joint research projects, this support is provided in many other ways. Members of the Department participate in policy groups in which Riksbank policy is discussed. They also read, comment on and discuss reports produced in other departments and undertake work on behalf of the Riksbank's managerial body.

CONTACTS WITH THE ACADEMIC WORLD

The Department participates in the planning of Riksbank seminars. This also enables the researchers to perform their third function at the Riksbank: maintaining close contacts with the academic world. This is important for the successful conduct of the Department's own research as well as for maintaining the general competence of the Riksbank. Members of the Department also participate in international research conferences as well as in university education for undergraduates; moreover, they supervise research students and act as referees in international scientific journals.

The work of building up the Department will continue for a few more years. New research projects are being initiated continuously. Also, efforts are made to further deepen the collaboration with other departments at the Riksbank, as well as with researchers at other institutions in Sweden and elsewhere, not least at other central banks.



Tor Jacobson, a member of the Research Department, is engaged in the work of constructing a monetary model for interest rates and inflation.

PAYMENT SYSTEM DEPARTMENT

HEAD: KAI BARVÉLL

DEPUTY HEAD: MARGARETA KETTIS

FOUR DIVISIONS:

FINANCIAL SYSTEMS, RIX SYSTEM,

BACK OFFICE AND PAYMENTS AND

ANALYSIS AND CONTROL

NO. OF EMPLOYEES: 44

Stable and efficient payment system



Gabriela Guibourg works in the Payment System Department and is the woman behind the report on electronic money and electronic payments which was published in November 1997.

The RIX Division develops, maintains and operates the Riksbank's system for the settlement of clearing systems and interbank payments. During 1997 the RIX system's linkage in TARGET reached the stage of completed interlinking with the systems of other EU central banks. Work started on the development of a separate E-RIX system for euro transactions. New clearance regulations were also drawn up for the RIX system in accordance with the requirements for European harmonisation.

A new technique for the reporting of payments was installed in the system, whereby participants can automatically integrate their systems with RIX. By the end 1997 about half of the RIX participants were sending payments via message routines. All participants are to have this facility by the middle of 1998. A queuing system for RIX has also been developed, whereby a payment is either settled immediately or placed in a queue for later settlement.

The resilience of the RIX system to technical disturbances was appreciably improved in 1997 in that a complete back-up system, located outside the Riksbank building, became operational.

NEW FRONT OFFICE SYSTEM

The monetary and exchange rate policy transactions of the Riksbank are administered by the Back Office and Payments Division, which also handles the collateral that banks are required to pledge for RIX credits. During 1997 a new front office system was introduced, together with a system for handling the Riksbank's derivative transactions. Under the new arrangements for RIX credit collateral, the Riksbank now accepts collateral in the form of foreign securities. The Division has constructed methods for the market valuation of securities.

The EMU preparations will culminate

in 1998; the system must handle euro and convert currencies that are replaced by euro.

The risks and profitability of the Riksbank, mainly in the management of foreign reserves, are controlled by the Analysis and Control Division. The internal book-keeping and external accounts of the Riksbank are also inspected by this Division on a continuous basis. During 1997 systemic support was strengthened with the introduction of a new front office system that has improved the monitoring and measurement of market risks in the management of foreign reserves.

A uniform accounting standard has been produced for use in all EU member states. During 1998 the Riksbank will be adapting its accounts to the ECB reporting requirements and make it possible to handle euro in its internal systems.

NEW REPORT SERIES

The earlier divisions for payment system analysis and institutional and structural issues were amalgamated in 1997 to form the Financial Systems Division. This Division presented the first Financial Market Report in November. In this biannual series, the Riksbank will present its appraisal of developments in the financial system.

In connection with the G-10 work on 'Herstatt' risks, a study of the four major Swedish banks was undertaken in the autumn of 1997. It is intended that the central banks should form an opinion of how these risks are managed by the bank sector in order to determine whether the authorities need to take additional measures.

The Division participates in a number of EMI working groups and is also involved in the Riksbank's coordination of the financial sector's preparations for a changeover to the euro (the project for Consultation and Information with the Financial Sector).

Cash management scrutinised

CASHIERS' DEPARTMENT

HEAD: HANS KROOK
DEPUTY HEAD: TOM DAGNE
ELEVEN BRANCHES, IN:
FALUN, HÄRNÖSAND, JÖNKÖPING, KARLSTAD,
LINKÖPING, LULEÅ, MALMÖ, MÖLNDAL,
STOCKHOLM, VÄXJÖ AND ÖREBRO
NO. OF EMPLOYEES: 334

The supply of banknotes and coins in Sweden is managed by the Cashiers' Department. The branches and depots of the Riksbank supply banks and post offices with banknotes and coins at the level of services specified by the Riksbank. The major part of the activities of this Department is financed from income.

REVIEW OF CASH MANAGEMENT

A review of cash management was undertaken by the Department in 1997. A report with proposals on matters of principle is to be presented early in 1998. The purpose of the review is to involve personnel on a broad front in the construction of goals for the cash management system in Sweden in 2002 and produce a foundation and proposals for the future allocation of responsibilities, functions and costs between the Riksbank and other agents in the cash management system. One of the intentions is to create a readiness for future changes and gain time for a gradual adjustment to new requirements.

The review also mapped the significance for cash management of the Riksbank's primary function of 'promoting a safe and efficient payment system'. This raises the issue of how the Riksbank, as a central bank, formulates and shoulders its responsibility for the cash management system. Central questions here include what the Riksbank must do actively in the system and which functions can be assigned in a general economic perspective to other agents under the Riksbank's supervision.

In this context the Department has studied various aspects of the ways in which other central banks define and fulfil their assignments. The review attempted to construct profiles for other central banks as a foundation for its own deliberations. The

profiles compare the extent to which central banks are accountable for, or even actively perform, controls of banknote quality and integrity, the pricing of services, the provision of cash services in the bank system and so on. Other important aspects are valuation regulations and different forms for the external production of services.

READINESS FOR ADOPTING THE EURO

In view of the possibility of Sweden adopting the euro and the short time that would be available between a decision to this effect and its implementation, a state of readiness must be created for a changeover from Swedish kronor to euro at short notice. A workshop with other agents of importance for cash management was arranged by the Riksbank in 1997.

BANKNOTES AND COINS

The total value of banknotes and coins in circulation at the end of 1997 was about SEK 83 billion, an increase during the year of 2.6 per cent. The number of banknotes in circulation rose 0.7 per cent.

During 1997 the Department was actively engaged in raising the quality of current banknotes. Efforts were also made to promote the use of the 50 kronor note. The earlier 20 kronor note was replaced by a smaller version with a modified colour scale to reduce the risk of confusion with the 100 kronor note. The change from a fixed to a repeating watermark for the 100 kronor note continued. Coins in two denominations, 1000 and 200 kronor, were issued in 1997 to commemorate the 600th anniversary of the Kalmar Union.

Development work was begun on a new computer system for the administration of premium bonds and is scheduled for completion early in 1998.



The Riksbank's branches are responsible for the reception, sorting and distribution of banknotes and coins.

Special competence

SECRETARIAT OF THE BOARD

HEAD: ROBERT SPARVE

NO. OF EMPLOYEES: 14

INTERNATIONAL SECRETARIAT

HEAD: CHRISTINA NORDH BERNTSSON

NO. OF EMPLOYEES: 12

INFORMATION SECRETARIAT

HEAD: MICHAEL WALLIN

NO. OF EMPLOYEES: 12

AUDITING DEPARTMENT

HEAD: GUNILLA WERNER CARLSSON

NO. OF EMPLOYEES: 9

PERSONNEL DEPARTMENT

HEAD: INGEMAR ANDRÉASSON

NO. OF EMPLOYEES: 13

PLANNING AND ACCOUNTING DEPARTMENT

HEAD: LENA KVIST

NO. OF EMPLOYEES: 9

ORGANISATION AND ADMINISTRATION DEPARTMENT

HEAD: AGNETA RÖNSTRÖM

NO. OF EMPLOYEES: 99

IT DEPARTMENT

HEAD: STAFFAN WALLÉN

NO. OF EMPLOYEES: 52

SECRETARIAT OF THE BOARD

The legal function of the Secretariat is responsible for ensuring that the regulations and contracts on which Riksbank activities are based are of good quality and are amended as conditions for the activities change. The lawyers also serve the managerial body and individual departments, besides being responsible for preparations and formalities connected with meetings of the Governing Board and the Governor's decision-making group.

During 1997 the lawyers participated in EMI work on the construction of the regulations under the coming European System of Central Banks (ESCB). They also took part in national legislative work to present the opinion of the Riksbank on future Swedish laws.

In 1998 the legal function will continue to participate in the work of drafting a legal framework for the ESCB and take part in legislative work on the Riksbank Act, for example. The legal documentation of monetary policy operations is also to be reviewed and updated. Moreover, the strategic direction of the legal work will be developed.

The archive function involves maintaining a proper standard of public records and providing both internal and external services for personnel and researchers so that they are in a position to gain access to the Riksbank's public documents.

During 1997 the archive function assisted the independent inquiry into acquisitions of Nazi gold and in 1998 it will need to assist the Commission on Jewish assets in Sweden at the time of World War II. During 1998, moreover, the archive function will complete the description of the archive and continue to develop its EDP search system.

The secretariat function maintains good services in its field for the managerial body as well as for this Secretariat in general, while

the expert function provides the expert advice that the managerial body requires.

INTERNATIONAL SECRETARIAT

The Riksbank's participation in international cooperation is prepared and coordinated by this Secretariat. The Riksbank's international policy group, which is the core of this coordination, consists of the two deputy governors and representatives of the departments which the international work concerns. The Secretariat convenes meetings and sets the agenda.

The work of the International Secretariat on EU matters is strongly bound to meetings of the EMI and the Monetary Committee. Matters for discussion at these meetings are prepared and coordinated internally by the Secretariat, which also coordinates with the Ministry of Finance as the latter is also represented at meetings of the Monetary Committee. A member of the Secretariat has the function of alternate on the EMI Council. Since 1997 the head of the Secretariat has had alternate status on the Monetary Committee.

The International Secretariat also participates in the work on domestic preparations for the establishment of the euro area.

The Riksbank's relations with the International Monetary Fund (IMF) are assigned to the International Secretariat. In 1996 and 1997 the Riksbank drafted and coordinated Nordic positions on items on the agenda of the IMF Executive Board.

The Riksbank also participates in the work of the G-10 forum for international cooperation between industrialised countries. Matters on the G-10 agenda are prepared by the Secretariat, which also coordinates with the Ministry of Finance.

In 1997 the Secretariat initiated a review of the Riksbank's international work as regards its arrangement as well as the

part played by the Secretariat. The purpose is to obtain a better picture of Riksbank participation in international cooperation and on this basis draw up priorities for the Riksbank's engagements in the international field. Results from this project are to be presented in 1998.

INFORMATION SECRETARIAT

The Riksbank launched a home page on the Internet (www.riksbank.se) in March 1997. During the year, more and more information about the Riksbank became accessible on this electronic channel for information. One of the great advantages of this channel is that financial market agents, media, students, teachers and people in general can communicate with the Riksbank directly. More insight, information and dialogue are needed for the satisfactory performance of the Riksbank's functions.

The Riksbank has the statutory function of promoting the stability and efficiency of the financial system. The importance of this function has grown with the increasingly rapid pace of changes in financial markets. In 1997 the Riksbank therefore began to present its appraisal of developments in the financial system in a new series of publications, Financial Market Report, that will be published twice a year.

Another new report series, Riksbank Studies, was also initiated. The first number was about electronic money. The series is intended to provide information about and stimulate a discussion of matters pertaining to activities of the Riksbank.

The drive for the electronic distribution of information is to continue in 1998. The home page will be further developed to cover a broader field, with a more extensive and detailed content.

A new series of seminars on the consequences of the monetary union is planned

for 1998. The Riksbank courses for journalists will also be resumed, accompanied by extended contacts with members of parliament and university students. With these and other measures for increased transparency, the Riksbank will be working to maintain good contacts with financial markets, media and the general public.

AUDITING DEPARTMENT

This Department is accountable to the Governing Board for scrutinizing activities at the Riksbank. The Department sees to it that the accounts are true, fair and in accordance with generally accepted accounting principles, inspects internal controls with particular reference to safeguarding the valuables of the Riksbank, and ensures that the Bank maintains a fully satisfactory quality of information and systems security in accounting, statistical and other information systems. Moreover, the Department promotes efficiency and goal fulfilment.

During 1997 the Department scrutinised the annual and quarterly accounts, the day-to-day accounts and the foreign reserves. All the Riksbank branches and depots have been visited to ensure that the cash management regulations are being observed. In the IT domain the Department inspected both the security of system and operating environments and the development and management of systems. With recourse to EMI check-lists/questionnaires, the Department has participated in the scrutiny of the TARGET system for central bank payments in the EU area.

In 1998 the Auditing Department will focus its scrutiny on, for example, the adaptation of Riksbank reports to ECB requirements and the introduction of new systems and methods for the control of risks in activities at the Monetary and Exchange Rate Policy Department.



Ulla Hargefjell works on account auditing and Lillemor Schüssler on IT system auditing – both are in the Auditing Department.



Suat Boynukisa and Urban Bendtz work in the Organisation and Administration Department's printing centre, where many of the Riksbank's reports are printed.

PERSONNEL DEPARTMENT
The Department supports the development of managerial and other personnel by working in an integrated manner with training, recruitment, work environment and rehabilitation.

A new work environment organisation was introduced in 1997 whereby work in this field is included as a natural component of the activity in question, with simplified forms for joint consultation with trade union representatives.

As regards competence, the main development work has concerned training in languages and IT. Training programmes linked to the Riksbank's international activities have also been carried out, as well as continued efforts for managerial competence.

PLANNING AND ACCOUNTING DEPARTMENT
Methods for directing and monitoring activities are developed and coordinated by this Department.

In 1997 efforts focused on improving the forms for this work and constructing a good, long-term foundation for assigning priorities to activities and resources seen in an overall perspective.

The Department also has an overall responsibility for the Riksbank's general accounts, closing accounts, invoicing routines and other accounting administration. As a part of the ongoing work of improving and developing the Bank's accounts, the checking and control routines were scrutinised in 1997.

The Department also participated in 1997 in the EMI's joint preparations in the field of accounting. Work is in progress on adapting Riksbank accounts to the principles and systems that will apply for accounting in the European System of Central Banks (ESCB) and to the principles that apply in general to the financial sector in Sweden.

ORGANISATION AND ADMINISTRATION DEPARTMENT
Premises, services and equipment are provided by this Department so that other Riksbank operations can be undertaken efficiently. The Department supports the work of organisational and administrative development and rationalisation and manages the journal, real estate, transport, security and other internal services.

Alterations to the head-office building were made in 1997 in connection with the ongoing work on a new security facility.

The Department has reviewed the rules and policies for security as well as transportation and has also examined the possibilities of procuring certain services externally in order to cut costs.

IT DEPARTMENT
Work at this Department in 1997 was marked by adaptations to EMI requirements. The Riksbank's payment system, RIX, is to be incorporated in the common European TARGET system and a separate system is being constructed so that statistics can be reported to the EMI on a continuous basis.

The Bank's computer centre was transferred to new premises in 1997 and a new reserve computer centre outside the Riksbank building came on stream. The objective is that, in the event of a failure, the RIX system will be operational again after not more than two hours.

The operative system in the PC environment at the Bank is being changed at present to NT. This work, which is a heavy burden on the Department, is scheduled for completion by the middle of June 1998.

A project has been initiated to prepare IT systems for the turn of the millennium. The inventories that have been made show that no major problems exist in applications which have been developed internally.



The annual accounts

ACCOUNTING PRINCIPLES

The purpose of the Riksbank accounts is to provide relevant information about the Bank's activities. With the exception of gold and fixed assets, the assets and liabilities are booked at market values.

The holding of securities is valued at the market buying rate, including interest due at 31 December 1997. Rates on 30 December 1997 have been used for Swedish securities, rates on 29 and 30 December 1997 for foreign securities. Claims and liabilities in foreign currency are valued at the Riksbank's official listed buying rate on the accounting day.

Latent exchange gains/losses are credited/debited to the net operating result under 'Revaluation of exchange rates'. This item also includes the valuation of the forward position.

After the market valuation, interest receipts on securities include the aggregate return in the form of interest and realised as well as latent price gains and losses. Partly on account of this, changes in domestic and international interest rates may lead to fluctuations in the reported net revenue.

Repurchase agreements

Gross accounting is used for repurchase and reverse repurchase agreements (repos and reverse repos) in Swedish as well as for foreign currencies.

Reverse repos for foreign operations are booked under 'Foreign banks, securities' and repos under 'Other foreign liabilities'. Reverse repos for domestic operations are booked under 'Advances, banks' and repos under 'Deposits, banks'.

Securities pledged by the Riksbank as collateral for deposits under repos are valued in accordance with the principles for the Riksbank's other holdings of securities.

Securities received by the Riksbank under reverse repos are not assigned a market value because they constitute loan collateral and are not owned by the Riksbank.

Payment-day/Transaction-day accounting

The payment-day principle is used for Riksbank's accounts. Transactions in money and capital market instruments are registered on the trade day and treated as off-balance-sheet liabilities up to the settlement day. Changes in the value of off-balance-sheet items are incorporated from the trade day. Currency transactions that straddle a year-end are valued and their exchange effect is included in 'Revaluation of exchange rates' (cf. note 32).

At end 1997 the gross total of unsettled transactions was about SEK 400 million. As these transactions consist of sales as well as purchases under the same item of account, their effect on turnover would be only marginally different in a transaction-day accounting system. Estimates indicate that the overall effect on net revenue in 1997 would be SEK -74 million (1996: -47 million).

Fixed material assets

All real estate owned by the Riksbank is booked at procurement values and written off in accordance with sound accounting practice (50 years). Write-downs are made for depreciation that is considered to be permanent. Inventories are booked at procurement values and written down according to plan (see note 11).

Personnel costs for internal development work on EDP investments are included in the assets' procurement values.

FINANCIAL RISKS

The management of foreign exchange reserves involves different types of financial



	<p>risk, the most important being interest rate risks, exchange risks, liquidity risks and credit risks. Various methods are available for quantifying these risks.</p> <p>Financial risks normally arise from an imperfect match between assets and liabilities. The liabilities in the Riksbank's balance sheet are not directly related to the financial assets in the form of foreign exchange reserves; the latter can therefore be regarded as a portfolio.</p> <p>Other important types of risk, such as legal risks and administrative risks, are difficult to quantify and express in monetary terms.</p> <p><i>Interest rate risks</i></p> <p>Interest rate risk can be indicated with reference to a portfolio's duration, that is, to the average time to maturity of all its payments (coupons plus principal). At end 1997 the duration of the foreign exchange reserves was 3.5 years (4.5 years).</p> <p>Another measure of interest rate risk is modified duration, which stands for the percentage change in a portfolio's value when market rates move by 1 percentage point. At end 1997 the modified duration of the foreign exchange reserves was 3.3 per cent (4.3 per cent).</p> <p><i>Exchange rate risks</i></p> <p>Exchange risk stems from an imbalance between assets and liabilities in a particular currency. For the Riksbank, exchange risk arises from the component of foreign exchange reserves that is placed in foreign currency securities and deposit/nostro accounts but booked in the balance sheet in Swedish kronor. This risk is managed by stipulating normal proportions for different currencies and maximum deviations from these standards. The holding is concentrated to the most liquid currencies in</p> <p>accordance with a stipulated standard portfolio.</p> <p><i>Liquidity risks</i></p> <p>Liquidity risk refers to situations in which a specific holding cannot be disposed of without entailing an appreciable price loss. Low turnover may have a negative effect on the price. For securities, liquidity risk is mainly a function of the liquidity of the market in which it is traded, the issuer and the terms involved in the particular construction of the security.</p> <p>The Riksbank limits this risk by investing only in instruments for which there are large, liquid markets.</p> <p><i>Credit risks</i></p> <p>Credit (counterparty) risk is the risk of a counterparty failing to meet obligations as regards payments of interest or principal in accordance with the original terms of an instrument. The creditor or holder runs the risk of obtaining interest or invested capital after the due date or not at all.</p> <p>The foreign exchange reserves largely take the form of securities issued by national treasuries and other institutions for which credit risk is considered to be nil. Other investments are limited (maximum 15 per cent) in relation to the total market value of the reserves and diversified across institutions with the highest current external credit rating.</p> <p><i>Value-at-Risk</i></p> <p>The aggregate exposure of financial operations to market risks can be calculated with a method known as Value-at-Risk. During 1998 the Riksbank will be attaching growing importance to this indicator of risk. The Value-at-Risk method will be developed so that it features more and more prominently in internal reports on risk.</p>

Proposed allocation of net revenue for 1997

GUIDELINES FOR THE

DISPOSITION OF NET REVENUE

Guidelines for the Riksbank's balance-sheet allocations and the transfer of funds to the Treasury were set forth by the Governing Board in the Annual Report for 1988.

As the assets and liabilities of the Riksbank are booked at market values, sizeable shifts in interest or exchange rates may have a very marked effect on the net revenue for a particular year. In order for the Treasury to obtain a stable share, the base of this share is to be 80 per cent of the average of the annual results, before balance-sheet allocations, for the most recent five years. The sum is then rounded to the nearest one hundred million kronor. The annual allocation to the Contingency Fund is to be 10 per cent of the same base, with the proviso that the current year's profit before balance-sheet allocations is at least as large as the result of this calculation. The remainder of the annual net revenue after these allocations is to be placed in or withdrawn from a Balancing Account.

Effects on annual revenue from any write-up/down of the value of the krona, or of exchange rate effects occasioned by a flexible exchange rate regime, are not to affect the base for the Treasury's share. Annual revenue is therefore adjusted for the exchange rate effect by making the appropriate transfer from or to the Contingency Fund.

Besides the share of the annual result as described above, the Treasury shall receive a return on the special deposits in the Riksbank. As of 1988 this return corresponds to the rate for six-month treasury bills. This outlay, which is booked under 'Interest expenditure' in the profit and loss account and under 'Other domestic liabilities' in the balance sheet, shall be transferred to the Treasury in January of the year after

the accounting year. In that no new deposits are being made, the return to the Treasury is diminishing year by year.

PROPOSAL CONCERNING NET

REVENUE FOR 1997

The guidelines for the appropriation of net annual revenue stipulate that the annual average on which the transfer to the Treasury is based shall not be affected by either a write-up/down of the Swedish krona or by exchange rate effects of a flexible exchange rate regime. The intention is to avoid utilising a result generated by sizeable exchange rate revaluations of assets and liabilities.

The Riksbank's net revenue for 1997 before balance-sheet allocations and excluding exchange rate effects is SEK 10,894 million. This figure has been incorporated in the base for the calculation of the Treasury's share.

	Net revenue before balance-sheet allocations ¹ (SEK million)	Transferred to Treasury (SEK million)
1993	22,713	9,500
1994	-12,449	6,200
1995	23,379	8,100
1996	13,689	8,100
1997	10,894	9,300 ²

1. Adjusted for the year's exchange rate effect.
2. Proposed.

For the period 1993-97 the average result before balance-sheet allocations is SEK 11,645 million. Rounded to the nearest one hundred million, 80 per cent of this is SEK 9,300 million. The proposal is that this amount be transferred to the Treasury. The guidelines state that of the same five-year average, 10 per cent, that is, SEK 1,165 million, is to be allocated to the Contingency Fund.

The exchange rate effect, which for 1997 is positive at SEK 3,786 million, is also transferred to the Contingency Fund, which gives a total transfer of SEK 4,951 million. The proposal is that the remainder, SEK 429 million, of net revenue in 1997 before balance-sheet allocations be transferred to the Balancing Account.

In addition to the proposal to transfer SEK 9,300 million to the Treasury, the interest earned on special deposits in the Riksbank (investment reserves, et cetera) is due the Treasury. The amount for 1997, SEK 2 million (1996: 23 million), was transferred in January 1998.

Provided the Riksdag (Sweden's parliament) approves the proposed transfer of annual net revenue, a total of SEK 9,302 million will accordingly be transferred to the Treasury.

Balance sheets

AT END OF ACCOUNTING PERIOD

Assets; SEK million	Note	1997	1996	1995
Gold and foreign assets				
Gold	1	909	905	925
Special Drawing Rights in the IMF	2	2,962	1,978	2,956
Reserve position in the IMF	3	6,280	4,476	3,816
ECU claim on the EMI	4	10,598	10,578	11,764
Foreign banks, securities, et cetera	5	70,239	122,304	151,859
Gold and foreign exchange reserves		90,988	140,241	171,320
Other foreign assets	6	2,461	-	5
Domestic assets				
Treasury securities	7	53,088	59,045	71,025
Advances, banks	8	4,117	9,638	2,607
Monetary policy repos	9	36,216	-	-
Other domestic assets	10	1,124	2,501	11,480
Fixed assets				
Fixed assets	11	1,175	1,169	864
Total assets		189,169	212,594	257,301
Liabilities; SEK million				
Foreign liabilities				
Net allocation of special drawing rights in the IMF	2	2,641	2,448	2,457
Other foreign liabilities	12	3,983	4,135	3,484
Domestic liabilities				
Deposits, banks	8	1,961	1,467	1,295
Deposits, other	13	7	6	17,640
Deposits		1,968	1,473	18,935
Riksbank liquidity bills	14	-	32,040	75,142
Special accounts	15	34	121	586
Other domestic liabilities	16	3,864	4,254	3,466
Notes and coins in circulation				
Notes	17	78,986	77,135	73,064
Coins	18	3,809	3,656	3,596
Notes and coins in circulation		82,795	80,791	76,660
Balancing account and capital				
Balancing account	19	47,422	46,993	42,419
Capital	20	32,211	26,283	29,606
Balancing account and capital		79,633	73,276	72,025
Result for the year		14,251	14,056	4,546
Total liabilities and capital		189,169	212,594	257,301

Off-balance-sheet items, see note 32.

Profit and loss accounts

1995–1997

SEK million	Note	1997	1996	1995
Foreign operations				
Interest received	21	7,919	9,439	23,291
Interest expenditure	22	- 458	- 150	- 182
Revaluation of exchange rates	23	3,786	4,941	- 4,563
Total foreign operations		11,247	14,230	18,546
Domestic operations				
Interest on Treasury securities, et cetera	24	3,602	9,659	11,169
Interest on loans to banks, et cetera	25	496	93	163
Interest expenditure	26	- 197	- 4,946	- 10,666
Total domestic operations		3,901	4,806	666
Administrative revenue	27	149	145	144
Administrative expenditure	28	- 633	- 541	- 533
Other income	29	21	3	0
Other expenditure	30	- 5	- 13	- 7
Result before balance-sheet allocations		14,680	18,630	18,816
Balance-sheet allocations				
To balancing account	31	- 429	- 4,574	- 14,270
Net revenue		14,251	14,056	4,546

Comments and notes on the Annual Accounts for 1997

OVERVIEW

General

In the Riksbank's accounts the concept 'Foreign operations' (foreign exchange reserves) stands for holdings of foreign currency securities, deposit/nostro accounts, drawing rights and gold. The Riksbank's gold reserve is by definition not included in the foreign exchange reserves. 'Domestic operations' covers deposits by and loans to the Swedish banking system, monetary policy repos, SEK treasury securities and housing bonds, and other SEK denominated assets and liabilities.

Administrative revenue and expenditure are generated in operations that are not directly connected with the financial flow. The result of administrative operations is detailed on pp. 40-41.

The accounts

For 1997 the year-end balance-sheet total is SEK 189,169 million (1996: 212,594 million), an overall decrease of SEK 23,425 million (44,707 million). The foreign exchange reserves were reduced by SEK 49,257 million (31,079 million), mainly due to loan repayment on the forward ledger.

The Riksbank's net revenue for 1997 before balance-sheet allocations amounts to SEK 14,680 million (18,630 million). Relative to the size of the financial holding, income from foreign operations is in line with the previous year's return. A downward interest rate tendency across the whole yield curve in foreign operations resulted in a positive price effect.

No dramatic interest rate shifts occurred as regards the principal currencies in the foreign reserves. During 1997 the Swedish kronor tended to depreciate against the core currencies in the Riksbank's foreign reserves, which gave a positive valuation effect of SEK 3,786 million (4,941 million).

Domestic interest rate tendencies in 1997 – rising for maturities of up to five years, falling for longer maturities – had a negative overall price effect.

Interest income on domestic operations decreased in 1997. For the domestic financial balance this is partly offset by decreased interest expenditure, mainly because certificate issues entailed lower interest costs.

Administrative income is much the same as in 1996. The increased administrative expenditure is mainly explained by larger procurements of banknotes and coins together with increased asset write-downs and write-offs.

Significant changes in assets and liabilities

The average level of the foreign exchange reserves in 1997 was about SEK 117.7 billion (153.4 billion).

The balance for 'Foreign banks, securities, et cetera' decreased markedly during 1997, mainly because part of these funds was used to repay the remainder of the forward position that had been built up in the autumn of 1992 in connection with the defence of the fixed exchange rate. During 1997 the net external position (spot plus forward) decreased by about SEK 5.7 billion. In earlier years, market valuation of the forward position also affected 'Other domestic assets' and 'Other domestic liabilities'; balances for 1997 are not affected in this way.

The volume of the items 'Advances, banks', 'Monetary policy repos' and 'Riksbank liquidity bills' is liable to fluctuate greatly from year to year on account of the financial sector's liquidity position. The annual changes in these items mirror factors to do with monetary policy.

The holding of treasury securities decreased during 1997, from SEK 59.0 billion to 53.1 billion, and averaged 55.0 billion (68.0 billion).



<p><i>Monetary policy repos</i> As a consequence of the above-mentioned reduction of the Riksbank's forward position, with repayments that totalled SEK 44,142 million, during 1997 liquidity in the banking system swung from a surplus to a deficit. Deposits against Riksbank liquidity bills have accordingly been succeeded by advances through monetary policy repos. At the end of 1997 these advances totalled SEK 36,216 million.</p> <p><i>Banknotes and coins</i> The volume of notes and coins in circulation varies with the demand for these means of payment. The volume of banknotes normally peaks around the turn of the year, partly in connection with the increased retail turnover. At SEK 82.8 billion, the total value of banknotes and coins in circulation at the end of 1997 was approximately SEK 2 billion higher than at the end of 1996 (80.8 billion) and SEK 6.1 billion higher than at the end of 1995.</p> <p><i>Loan to South Korea</i> Together with the other G-10 countries¹, as well as Australia and New Zealand, Sweden has declared a readiness to provide South Korea with financial support in the form of a 'second line of defence'. The maximum amount of this international borrowing facility is USD 24.1 billion and Sweden's contribution, which is financed by the Riksbank, is limited to USD 312.5 million. The facility is a component of an IMF-supported financing programme totalling about USD 59 billion. Towards the end of 1997 the countries that are contributing to this second line of defence declared that they were prepared to pay out one-third (about</p> <p><small>1. Belgium, Canada, France, Germany, Great Britain, Holland, Italy, Japan, Switzerland, and the United States.</small></p>	<p>USD 8 billion) of their combined undertaking, provided the international banks voluntarily arrange a substantial prolongation of loans to South Korean financial institutions. The payment of this instalment is expected to occur early in 1998, which for Sweden would involve providing an initial loan of about USD 104 million.</p> <p style="text-align: center;">FIXED ASSETS</p> <p>During 1997 the value of the Riksbank's real estate was written down by SEK 8.0 million. The write-down is booked under the Contingency Fund.</p> <p>A property in Visby with a book value of SEK 1.3 million was disposed of during the year.</p> <p style="text-align: center;">FORWARD CURRENCY TRANSACTIONS</p> <p>The forward currency position at the turn of 1997 represents existing commercial bill transactions for settlement in 1998. The Riksbank had purchased foreign currency, net, for the equivalent of SEK 155 million at transaction values. Valuing the year-end stock of forward foreign currency contracts at market prices has entailed a write-down of the Riksbank's commitments by SEK 34 million. This amount is included in net revenue for 1997.</p> <p>For 1997 the Riksbank had, on average, a negative forward foreign currency position of about SEK 15.7 billion (70.1 billion). The average level of spot and forward foreign currency holdings was about SEK 102.0 billion (83.3 billion).</p> <p>The holding of derivative instruments is a natural feature of the Riksbank's financial management and is used to adjust and limit risks in the portfolio. Like traditional securities, the derivative instruments are valued at market prices and risks are contained by setting limits.</p>	<p style="text-align: center;">BALANCE-SHEET ALLOCATIONS</p> <p>The transfer of funds from the Riksbank to the Treasury is in accordance with guidelines established in 1988 (Riksdag resolution 3 May 1989, FiU 1988/89:27 and 1993/94:FiU14). See the section 'Proposed allocation of net revenue for 1997', p. 31.</p> <p style="text-align: center;">NOTES TO THE ACCOUNTS</p> <p style="text-align: center;">NOTE 1. GOLD</p> <p>The gold reserve is valued as previously at USD 42.22 per ounce, equivalent to SEK 6,190.08 per kilogram. The dollar rate used here is the most recent central rate (SEK 4.56/USD), formally annulled in 1978. A review is in progress under EMI auspices to construct uniform rules for the valuation of gold reserves by European central banks. The increase in the holding from 1996 comes from some reduction of the gold portion of the swap agreement with the EMI. The total holding of gold at end 1997 weighed 185.4 tonnes, which gives a market value of about SEK 13.7 billion.</p> <p style="text-align: center;">NOTE 2. SPECIAL DRAWING RIGHTS (SDRs) IN THE IMF; NET ALLOCATION OF SDRs IN THE IMF</p> <p>The holding of SDRs is booked as an asset and Sweden's allocation of SDRs as a foreign liability. The net allocation amounts to SDR 247 million. SDRs are booked at the year-end market value.</p> <p style="text-align: center;">NOTE 3. RESERVE POSITION IN THE IMF</p> <p>Sweden's capital contribution to the Fund totals SDR 1,614 million. The reserve position comprises the amount paid in the form of reserve currencies (equivalent to SDR 364 million) as well as the net amount used by the</p>

Fund for lending in Swedish kronor to member states. The amount in foreign currencies is converted at year-end market rates.

**NOTE 4. ECU CLAIM
ON THE EMI**

This item represents the Riksbank's ecu claim on the EMI, arising from the mutual swap agreement in 1995, and amounts to SEK 10,598 million (see note 16). In that the swap is arranged at market prices, the gold involved in the agreement has likewise been valued at the market price. Equivalent deductions have been made under the items 'Gold' and 'Foreign banks, securities, et cetera'.

**NOTE 5. FOREIGN BANKS,
SECURITIES, ET CETERA**

The greater part of this item in the foreign exchange reserves consists of foreign treasury securities and government guaranteed securities, plus credit balances such as deposits and nostro accounts in foreign banks.

The average holding during 1997 is about SEK 93.1 billion (137.4 billion).

**NOTE 6. OTHER
FOREIGN ASSETS**

This item includes the Riksbank's claim in the IMF's financial support for South Korea (cf. 'Loan to South Korea', p. 35).

NOTE 7. TREASURY SECURITIES
This item comprises treasury bills and bonds as well as a small number of other bonds.

**NOTE 8. ADVANCES/
DEPOSITS, BANKS**

The item 'Advances, banks' comprises overnight loans as well as advances to banks on their accounts for the Riksbank's

system for interest rate management. Banks' deposits on the latter accounts are booked under 'Deposits, banks'. During 1997 these advances and deposits averaged about SEK 0.1 billion (0.1 billion) and about 0.1 billion (0.1 billion), respectively, which is in accordance with the Riksbank's policy that in terms of liquidity the banking system should aim for a level as close as possible to zero.

The transactions in the overnight market, which aim to fine tune liquidity in the banking system, averaged about SEK 0.8 billion (1.0 billion) for advances and about 0.8 billion (1.8 billion) for deposits.

**NOTE 9. MONETARY POLICY
REPOS**

Advances in the form of monetary policy repos are booked here. The year-end total was about SEK 36.2 billion.

**NOTE 10. OTHER
DOMESTIC ASSETS**

SEK million	1997	1996	1995
Counterpart of exchange gains in forward position	-	-	8,056
Claim on RRV (EU)	933	2,339	3,238
VAT claims	19	13	9
Staff loans	152	141	140
Other	20	8	37
Total	1,124	2,501	11,480

The item 'Claim on RRV (EU)' balances funds credited to and remaining on the Riksbank account of the EU Commission. When payments are charged to this account, the equivalent amount is debited to the Treasury account.

Employees at the Riksbank are able to obtain staff loans on normal banking terms. The loans are managed by agreement with Nordbanken.

NOTE 11. FIXED ASSETS

The Riksbank's fixed assets were incorporated in the balance sheet in 1994. The assets were booked at acquisition values less depreciation for the years for which the asset had been held (see also note 28).

Fixed assets

	Book value, SEK million		
	1997	1996	1995
Shares, rights (nominal value)	475	475	221
AB Tumba Bruk 860,000 shares à SEK 100	43	43	43
S.W.I.F.T 13 shares à BEF 5,000	0	0	0
EMI 2.9 per cent of total rights	165	165	165
BIS 16,021 shares à 2,500 gold francs	267	267	12
	1997	1996	1995
Real estate			
Procurement value	793	778	758
Accumulated planned depreciation	-263	-255	-235
Accumulated write-downs on sales during the year	1	13	0
Annual depreciation	-20	-20	-20
Booked value	511	516	503
Machinery and inventories			
Procurement value	469	422	360
Accumulated planned depreciation	-244	-220	-179
Accumulated write-downs on sales during the year	12	17	0
Annual depreciation	-48	-41	-41
Booked value	189	178	140

Write-off times are 50 years for buildings, 10-15 years for other real estate and 3-7 years for inventories.

Based on a market valuation in 1989, adjusted for an approximate estimate of subsequent annual price changes for equivalent properties, for 1997 the market value of the Riksbank's real estate is SEK 966 million (981 million).



NOTE 12. OTHER FOREIGN LIABILITIES

This item includes the Riksbank's SEK accounts with other central banks and international organisations (loro accounts). As of 1995 repos with nonresidents are also booked here.

Moreover, the item now includes the Riksbank's commitment in the IMF's financial support of SEK 2,461 million for South Korea (cf. 'Loan to South Korea', p. 35).

NOTE 13. DEPOSITS, OTHER

Accounts with staff associations, Riksbank employees, et cetera are booked here. Prior to 1996 the item also included funds deposited for the Nuclear-Power Inspectorate.

NOTE 14. RIKSBANK LIQUIDITY BILLS

The Riksbank issues these bills to steer liquidity in the bank system. At the end of 1997 no such bills were outstanding.

NOTE 15. SPECIAL DEPOSITS

This item comprises statutory deposits by companies, mainly in the form of investment reserves. During 1997 the total in these deposits decreased by SEK 86 million to 34.3 million. The deposits in these accounts are to be returned to the companies and taxed not later than in the 1996 tax year (the 1997 tax year for companies that are not assessed for tax in 1996). The amount remaining consists of deposits that have not yet been returned because of uncertainty about the depositor.

The Treasury has received interest on the funds deposited for special reasons (see Guidelines for the disposition of the Riksbank's net revenue, p. 31).

NOTE 16. OTHER DOMESTIC LIABILITIES

SEK million	1997	1996	1995
Reserve for exchange losses on the forward position	34	692	-
Balanced exchange effect of EU swap	3,315	3,368	3,368
Liabilities with the Treasury	2	23	69
Clearing payments outstanding	6	1	2
Suppliers' claims	27	48	15
Liability with National Debt Office	247	102	0
Other liabilities	21	20	12
Valuation of claim on EMI (cf. note 4)	212	-	-
Total	3,864	4,254	3,466

Reserves to cover exchange losses on the forward position as a result of the year-end valuation at market prices are booked here. The exchange rate effect is included in the Profit and Loss Account.

The swap agreement concluded with the EMI in 1995 is arranged at market prices; in order to avoid an effect on the annual result, the discrepancy between the market rate and the historical value of gold is balanced here.

The liability with the Treasury consists of interest on special deposits (see note 14). The liability, SEK 2 million, was settled in January 1998.

Suppliers' claims comprise expenditure invoiced in 1997 and unpaid at the turn of the year.

The liability with the National Debt Office consists of incoming payments that had not been transferred to the Office by the turn of the year.

Other liabilities consist of unsettled payments.

NOTE 17. NOTES IN CIRCULATION
The item denotes banknotes in circulation at the year-end, which is the period when the volume peaks. The year-end totals (in SEK million) comprise:

Denomination	1997	1996	1995
1,000 kronor	39,226	38,637	37,842
500 kronor	27,157	25,565	22,316
100 kronor	9,906	10,332	10,649
50 kronor	962	913	185
20 kronor	1,366	1,309	1,679
10 kronor	277	286	299
5 kronor	92	93	94
Total	78,986	77,135	73,064

NOTE 18: COINS IN CIRCULATION
The year-end totals (in SEK million) comprise:

Denomination	1997	1996	1995
10 kronor	1,371	1,306	1,321
5 kronor	863	831	811
2 kronor	9	8	9
1 krona	843	810	783
0:50 krona	200	192	185
Commemoration coins	523	509	487
Total	3,809	3,656	3,596

NOTE 19. BALANCING ACCOUNT
In the annual accounts for 1996 the sum of SEK 4,574 million was deposited in this account. For 1997 it is proposed to deposit SEK 429 million.

NOTE 20. CAPITAL ACCOUNT
The capital account comprises:

SEK million	1997	1996	1995
Capital	1,000	1,000	1,000
Reserve fund	500	500	500
Contingency fund	30,711	24,783	28,106
Total	32,211	26,283	29,606

Allocations to and withdrawals from capital and the reserve fund have to be authorised by the Riksdag. The most recent allocations were in 1978: SEK 900 million to Capital and 400 million to the Reserve Fund. Decisions about the Contingency Fund are taken by the Governing Board. When the Riksbank's holdings of real estate were incorporated in the balance sheet in 1994, the amount (SEK 654 million) was credited to the Contingency Fund; this sum is distributable only to the extent that the real estate is written down.

In 1997 SEK 5,956 million was allocated to the Contingency Fund from the result for 1996, of which 4,941 million derived from the positive exchange rate effect in that year.

Real estate write-downs of SEK 28 million have also been booked under the Contingency Fund.

A total of SEK 869 million in the Contingency Fund is not distributable.

NOTE 21. INTEREST RECEIVED, FOREIGN OPERATIONS

This item consists of received and periodised interest, and realised and latent profits and losses on securities. Compared with the previous year, income here fell in 1997 by SEK 1,520 (-13,852 million).

The year-end valuation at market prices means that the result includes latent profits and losses in the holding of foreign securities.

NOTE 22. INTEREST EXPENDITURE, FOREIGN OPERATIONS

The greater part of this item consists of interest on the net allocation of Special Drawing Rights in the IMF. The item also includes interest on the Riksbank's lora accounts with foreign banks and organisations as well as expenditure for stockbroking fees and charges for safekeeping and

accounts in the management of the foreign exchange reserves. The latter charges, SEK 13 million (13 million), have been booked as interest expenditure since 1996.

NOTE 23. REVALUATION OF EXCHANGE RATES

The net write-up by SEK 3,786 million (4,941 million) includes latent as well as realised exchange-rate effects on foreign assets and liabilities. The item also includes the forward premiums obtained by the Riksbank on forward foreign currency sales. The positive balance is a combined result of exchange rate movements and the composition of the foreign reserves. Expressed in kronor, the value of the Riksbank's net holding of foreign currency has risen.

NOTE 24. INTEREST ON TREASURY SECURITIES ET CETERA, DOMESTIC OPERATIONS

This item consists of all coupon interest as well as realised and latent profits and losses in the holding of domestic securities.

The year-end valuation at market prices means that the result includes latent profits and losses in the holding of domestic securities.

Interest income in 1997 fell from 1996 by SEK 6,057 million (+1,510 million), because interest rates fell more slowly and this affected the holding of domestic bonds. The average size of the Riksbank's holding also decreased.

NOTE 25. INTEREST ON LOANS TO BANKS ET CETERA, DOMESTIC OPERATIONS

SEK million	1997	1996	1995
Banks	488	83	153
Other	8	10	10
Total	496	93	163

Interest income from banks includes interest from repos and credit balances. The change is explained by higher activity in repo transactions.

NOTE 26. INTEREST EXPENDITURE ET CETERA, DOMESTIC OPERATIONS

SEK million	1997	1996	1995
Banks	54	178	218
Treasury, for special deposits	2	23	69
Nuclear-Power Inspectorate	0	37	1,632
Riksbank liquidity bills	141	4,708	8,747
Total	197	4,946	10,666

Interest expenditure to banks consists of interest on repos, deposits and credit balances on account.

Interest at the rate for six-month treasury bills is paid to the Treasury on the balance of special accounts.

NOTE 27. ADMINISTRATIVE REVENUE

Main category, SEK million	1997	1996	1995
Commercial sector: premium bonds	12	11	13
Commercial sector: notes and coins	88	89	92
Clearing and settlement	10	9	6
Rent, et cetera	10	10	6
Other income	29	26	27
Total	149	145	144

NOTE 28: ADMINISTRATIVE EXPENDITURE

Main category, SEK million	1997	1996	1995
Operating expenses	401	391	378
Notes and coins	164	89	94
Depreciation	68	61	61
Total	633	541	533



<p>As of 1996, expenditure on safekeeping and account charges in the management of foreign exchange reserves is booked under 'Interest expenditure, foreign operations'.</p> <p>NOTE 29. OTHER INCOME Income that is not assignable to the Riksbank's current operations or administration is booked here. The sizeable items are reversed allocations from sales of inventories.</p> <p>NOTE 30. OTHER EXPENDITURE Expenditure that is not assignable to the Riksbank's current operations or administration is booked here.</p> <p>NOTE 31. BALANCE-SHEET ALLOCATION For 1997, the allocation to the Balancing Account amounts to SEK 429 million.</p> <p>NOTE 32. OFF-BALANCE-SHEET ITEMS Items not included in the balance sheet are:</p> <table border="1"> <thead> <tr> <th>SEK million</th> <th>1997</th> <th>1996</th> </tr> </thead> <tbody> <tr> <td>Loan to staff holiday association</td> <td>3</td> <td>3</td> </tr> <tr> <td>The Riksbank's collection of coins and medals</td> <td>-</td> <td>-</td> </tr> </tbody> </table> <p>Forward interest rate contracts outstanding with a positive value at end 1997 totalled SEK 5,221 million (1,137 million) in nominal terms and SEK 5 million (7 million) at market prices. Such contracts with a negative value totalled SEK 5,260 million (5,054 million) in nominal terms and SEK -4 million (-4 million) at market prices.</p> <p>Credit facilities</p> <p>Mutual agreements on short-run exchange support: with the Federal Reserve Bank of New York for up to USD 300 million;</p>	SEK million	1997	1996	Loan to staff holiday association	3	3	The Riksbank's collection of coins and medals	-	-	<p>with Nordic central banks for up to ECU 2,000 million, with the credit provided by any one central bank limited to ECU 1,000 million, except that for the Icelandic central bank the limits are ECU 200 million and 100 million.</p> <p>Mutual agreements on short-run exchange support with two central banks.</p> <p>Agreement under the General Arrangement to Borrow (GAB) concerning the lending facility to the IMF for up to SDR 382 million.</p> <p>Stand-by credits with foreign banks.</p> <p>Contingent liabilities</p> <p>Undertaking to provide the Nobel Foundation with funds for the annual award of a prize in economic sciences.</p>	
SEK million	1997	1996									
Loan to staff holiday association	3	3									
The Riksbank's collection of coins and medals	-	-									

Administration report

ADMINISTRATIVE REVENUE

Administrative revenue in 1996 and 1997 is presented below under six main categories, together with the figures budgeted for 1997. Revenue in 1997 totalled SEK 149 million (1996:145 million).

Category SEK million	Outcome 1997	Budget 1997	Outcome 1996
Commercial sector:			
premium bonds, et cetera	12	9	11
Commercial sector:			
notes and coins	88	87	89
Clearing and settlement	10	9	9
Rent, et cetera	10	10	10
Share dividends	26	25	22
Other	3	2	4
Total administrative revenue	149	142	145

Commercial sector: premium bonds, et cetera

The Riksbank participates in the sale of premium bonds, the redemption of premium loans, the registration of winnings, et cetera. The Riksbank is also active in the secondary bond market. Revenue in 1997 totalled SEK 12 million (11 million).

Commercial sector: banknotes and coins

Income from services performed for post offices, banks and other customers in 1997 totalled SEK 88 million (89 million). The services include the counting, quality-sorting and packing of banknotes and coins.

Clearing and settlement

Mainly fees from banks, et cetera for participation in the Riksbank's clearing and settlement system (the RIX system). Receipts in 1997 totalled SEK 10 million (9 million).

Rent, et cetera

Some of the premises in a number of the Riksbank's office buildings are rented out to external tenants. Rent in 1997 totalled SEK 10 million (10 million).

Share dividends

Dividends in 1997 were SEK 22 million (18 million) on the Riksbank's shares in BIS and SEK 4 million (4 million) on the shares in AB Tumba Bruk.

Other administrative revenue

For 1997 this item totalled SEK 3 million (4 million).

ADMINISTRATIVE EXPENDITURE

Administrative expenditure in 1996 and 1997, together with the budgeted figures for 1997, is presented in the table under three main categories. During 1997 the Governing Board approved additional expenditures, including increased procurements of banknotes and coins, for a total of SEK 45 million; this amount is included in the 1997 budget.

Administrative expenditures in 1997 totalled SEK 633 million (541 million), which is 102 per cent of the budgeted amount.

Category SEK million	Outcome 1997	Budget 1997	Outcome 1996
Operating expenses			
Staff	270	276	274
Information, hospitality	11	10	9
Transport, travel	18	16	16
Consultant and other services	16	16	8
Machinery, inventories	7	6	5
Office expenses	17	16	15
Real estate management	22	24	23
EDP expenses	27	32	26
Economics Prize, et cetera	13	13	15
Total operating expenses	401	409	391
Banknotes and coins	164	163	89
Depreciation	68	48	61
Total administrative expenditure	633	620	541



<p>Operating expenses</p> <p><i>Staff</i> Staff expenditures in 1997 amounted to SEK 270 million (274 million). Including personnel costs that are assigned to the procurement value of EDP investments booked as assets, staff expenditures in 1997 totalled SEK 277 million. The former total is 6 million less than budgeted mainly because many vacancies were not filled. While a total of 693 person-years was budgeted for 1997, the actual number is only about 670.</p> <p><i>Information, hospitality</i> This item includes expenses for the Riksbank's regular publications (for example annual report, statistical yearbook, quarterly review, inflation reports, financial market reports), information projects (EMU brochure), the staff magazine Bancoposten, et cetera. The total outlay in 1997 was SEK 11 million (9 million).</p> <p><i>Transport, travel</i> Expenditures in 1997 on travel and transport totalled SEK 18 million (16 million), of which 10 million for foreign travel, 7 million for travel in Sweden and the remainder for miscellaneous transport.</p> <p><i>Consultant and other services</i> Operating expenses on consultant and other services during 1997 amounted to SEK 16 million (8 million). Consultant fees that are included in the procurement value of assets in the form of real estate and EDP investments are also booked here. The combined total for 1997 is SEK 35 million. In addition, the item includes expenditure on payment services (costs for communication and portfolio management), which amounted for 1997 to SEK 1 million (1 million). For 1997 the expenditures on pay-</p>	<p>ment services are largely included in 'Interest expenditure, foreign operations' (see note 22).</p> <p><i>Machinery, inventories</i> Expenditures in 1997 on repairs and minor purchases of machinery and inventories totalled SEK 7 million (5 million).</p> <p><i>Office expenses</i> Expenditures in 1997 on office materials, telephones, telex, postage, and so forth totalled SEK 17 million (15 million).</p> <p><i>Real estate management</i> Expenditures comprise rental expenses and repairs and maintenance of buildings and security installations. The total for 1997 is SEK 22 million (23 million).</p> <p><i>EDP expenses</i> Expenses for software, communications, supplies, external services, et cetera amounted in 1997 to SEK 27 million (26 million).</p> <p><i>Economics Prize, et cetera</i> The total for this item in 1997 was 13 million (15 million). This includes SEK 12 million for the administration of the Nobel Foundation's Prize in Economic Sciences.</p> <p>Banknotes and coins Expenses for banknotes and coins in 1997 totalled SEK 164 million (89 million), of which 119 million for banknotes, 18 million for commemoration coins and 27 million for other coins.</p> <p>Depreciation Write-downs in 1997 totalled SEK 68 million (61 million). Investment expenditure, excluding personnel costs in connection with EDP investments, totalled SEK 77 million in 1997.</p>	

NOBEL MEMORIAL PRIZE
IN ECONOMIC SCIENCES

Managing risks

LAUREATES SINCE 1969,
THE YEAR OF THE FIRST AWARD:

- 1969 R. FRISCH AND J. TINBERGEN
- 1970 P. SAMUELSON
- 1971 S. KUZNETS
- 1972 J.R. HICKS AND K.J. ARROW
- 1973 W. LEONTIEF
- 1974 G. MYRDAL AND F.A. VON HAYEK
- 1975 L. KANTOROVICH AND T.C. KOOPMANS
- 1976 M. FRIEDMAN
- 1977 B. OHLIN AND J. MEADE
- 1978 H.A. SIMON
- 1979 T.W. SCHULTZ AND A. LEWIS
- 1980 L.R. KLEIN
- 1981 J. TOBIN
- 1982 G. STIGLER
- 1983 G. DEBREU
- 1984 R. STONE
- 1985 F. MODIGLIANI
- 1986 J.M. BUCHANAN
- 1987 R.M. SOLOW
- 1988 M. ALLAIS
- 1989 R. HAAVELMO
- 1990 H. MARKOWITZ, M. MILLER AND W. SHARPE
- 1991 R. COASE
- 1992 G.S. BECKER
- 1993 R.W. FOGEL AND D.C. NORTH
- 1994 J.C. HARSANYI, J.F. NASH AND R. SELTEN
- 1995 R.E. LUCAS JR.
- 1996 J.A. MIRRELES AND W. VICKREY
- 1997 R.C. MERTON AND M.S. SCHOLES



Professor Robert C. Merton and Professor Myron S. Scholes meet the press at the event arranged by the Nobel Committee for the laureates on 7 December.

The Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel, instituted in 1968 in connection with the tercentenary of the Riksbank, is awarded annually for work in economic sciences of the outstanding importance referred to in Alfred Nobel's will dated November 27th, 1895.

The award is made by the Swedish Academy of Sciences in accordance with the principles for the Nobel Prizes instituted under the terms of that will. The prize equals the amount fixed for each of those prizes.

THE 1997 LAUREATES

For 1997 the Sveriges Riksbank Prize in Economic Sciences was awarded to Professor Robert C. Merton, Harvard University, Cambridge, USA, and Professor Myron S. Scholes, Stanford University, Stanford, USA, for a pioneering formula for the valuation of stock options. Their methodology has paved the way for economic valuations in many areas. It has also generated new types of financial instruments and facilitated more efficient risk management in society.

In a market economy it is essential that firms and households are able to select an appropriate level of risk in their transactions. This is done in financial markets, which redistribute risks to agents who are willing and able to assume them. Markets for options and other derivative instruments have an important function here but efficient risk management requires that the instruments are valued correctly. A new method to determine the value of derivatives stands out among the foremost contributions to economic sciences in the past quarter-century.

This method was developed by the 1997 laureates, Robert Merton and Myron Scholes, in close collaboration with Fischer Black, who regrettably died in 1995. These three scholars worked in close contact on the same problem: option valuation. In 1973 Black and Scholes published what has come to be known as the Black-Scholes formula, which is now used daily by thousands of financial market players to value stock options. Robert Merton devised another method to derive the formula that turned out to have very wide applicability.



www.riksbank.se

RIKSBANK
INFORMATION

The Riksbank opened an Internet home page in March 1997. This gives access to the Riksbank's organisation, history, and information on monetary policy, the payment system and bank-notes and coins. Press releases, statements by the managerial body, minutes of meetings of the Governing Board are also presented. Other items are the Riksbank's weekly report, interest rate statistics, exchange rate index and, as of January 1998, balance of payments statistics.

The Internet can also be used to access the Riksbank's inflation reports, financial market reports and Working Paper series. These publications are also available in PDF file for direct downloading.

Riksbank publications in English

Periodical publications

- Annual Report (1/year)
- Statistical Yearbook (1/year)
- The Swedish Financial Market (1/year)
- Financial Market Report (2/year)
- Inflation Report (4/year)
- Quarterly Review (4/year)

Ad hoc publications

- The Euro in the Swedish Financial Sector – A Situation Report 1997
- The Sveriges Riksbank Act (1988:1385) – issued on December 8, 1988, as amended up to and including July 1, 1997
- Direct Investment in 1996 – December 1997

Working Paper series (1997)

- Optimal Structure of the Financial Intermediation Industry; Sonja Daltung, no. 36
- Monetary Policy and Leading Indicators of Inflation in Sweden; Josef Baumgartner, Ramana Ramaswamy and Göran Zettergren, no. 37
- Inflation Target Instability and Interest Rates; Stefan Mellin, no. 38
- New Techniques to Extract Market Expectations from Financial Instruments; Paul Söderlind and Lars E.O. Svensson, no. 39
- Inflation Targeting: Some Extensions; Lars E.O. Svensson, no. 40
- System Estimates of Potential Output and the NAIRU; Mikael Apel and Per Jansson, no. 41

- Rational Expectation in a VAR with Markov Switching; Märten Blix, no. 42
- Real Exchange Rates and Fundamentals: Evidence from 15 OECD countries; Annika Alexius and Jonny Nilsson, no. 43
- Openness and the Exchange Rate Exposure of National Stock Markets: a note; Richard Friberg and Stefan Nydahl, no. 44
- Value at Risk for Derivatives; Lina El Jahel, William Perraudin and Peter Sellin, no. 45

All these publications are available free of charge from the Riksbank's Information Centre:

Internet: www.riksbank.se

E-mail: info@riksbank.se

Fax: +46 8 787 05 26

Telephone: +46 8 787 01 00



Annica Svensson and Susanne Meyer, colleagues at the Information Secretariat, are responsible for the Riksbank's home page.

Repo rate raised once

2 JANUARY

The *official discount rate* (reference rate) is confirmed by the Riksbank at 2.5 per cent with effect from 3 January 1997.

1 APRIL

The *official discount rate* (reference rate) is confirmed by the Riksbank Governor at 2.5 per cent (unchanged).

1 JULY

The *official discount rate* (reference rate) is confirmed by the Riksbank Governor at 2.5 per cent (unchanged).

1 OCTOBER

The *official discount rate* (reference rate) is confirmed by the Riksbank Governor at 2.5 per cent (unchanged).

11 DECEMBER

The *fixed repo rate* is increased by the Riksbank Governor from 4.10 per cent to 4.35 per cent with effect from 17 December 1997. On account of the public holidays at Christmas as well as the New Year, the repo to be arranged on 16 December is to run for four weeks, maturing on 14 January 1998.

Claes Berg

