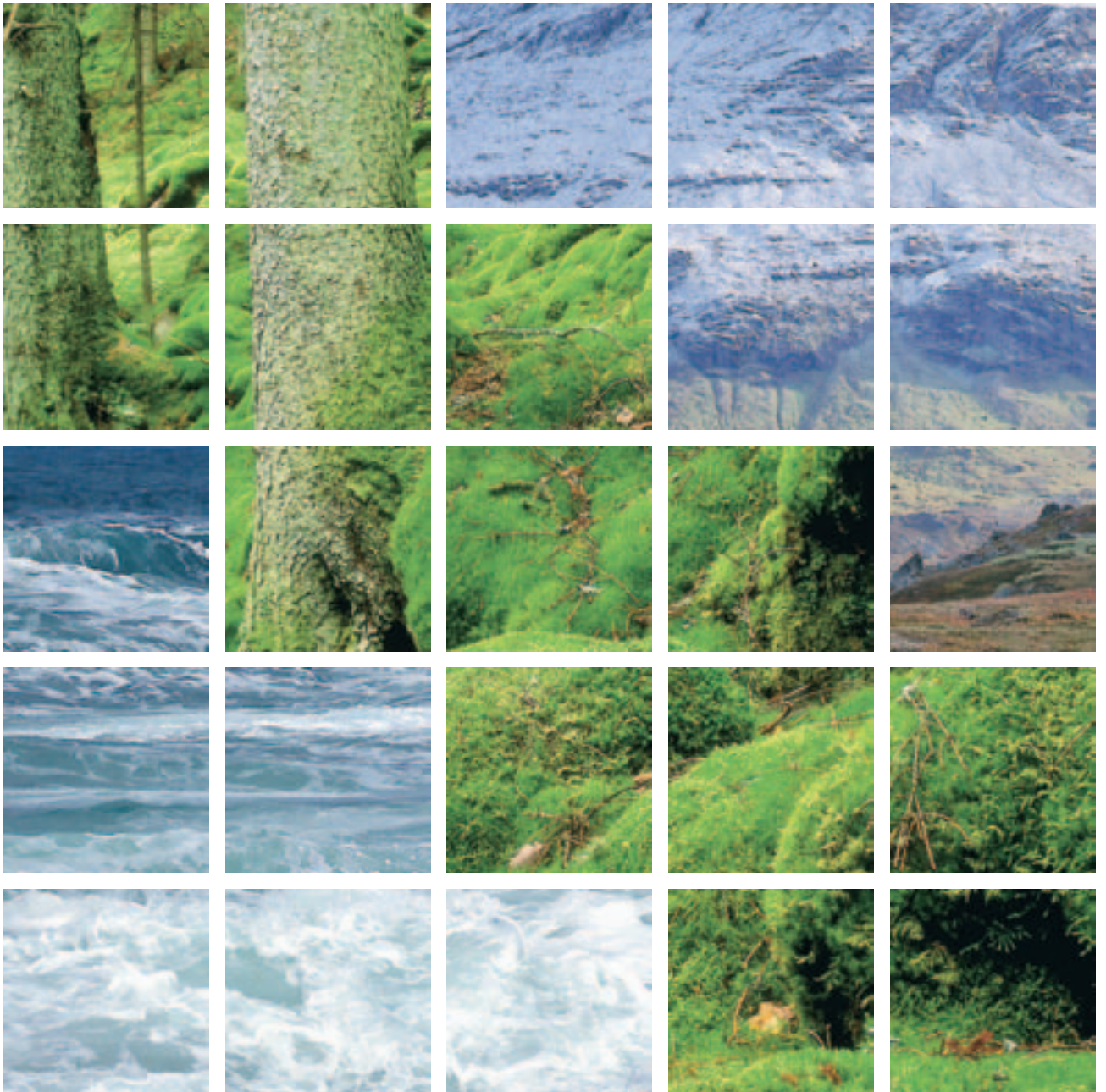


Annual Report 2004



Sveriges Riksbank is Sweden's central bank and a public authority under the Swedish parliament. The Riksbank is responsible for the conduct of Swedish monetary policy with the objective to maintain price stability. The Bank is also entrusted with the task of promoting a safe and efficient payment system.

The Riksbank has some 400 employees and is governed by an Executive Board consisting of the Governor, Lars Heikensten, and five deputy governors. The members of the Executive Board are appointed by the General Council of the Riksbank on a rotating basis for a period of six years.

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MAINTAINING THE VALUE OF
MONEY – PRICE STABILITY



A SAFE AND EFFICIENT
PAYMENT SYSTEM
– FINANCIAL STABILITY



FINANCIAL STRUCTURE,
RESERVE MANAGEMENT
AND RISK CONTROL



■ 2004 in brief

- Inflation, in terms of the change in the consumer price index (CPI) and the commonly used measure of underlying inflation UNDEX, averaged 0.5 per cent and 0.9 per cent, respectively, during the year. Economic growth in Sweden stood at 3.6 per cent, according to the Riksbank's most recent estimate.
- The stability of the financial system continued to be sound.
- The Riksbank decided on 5 February to lower the repo rate by 0.25 percentage points to 2.5 per cent. On 31 March the Bank decided to cut the repo rate by 0.5 percentage points to 2.0 per cent.
- During the year the Riksbank published four Inflation Reports and two Financial Stability Reports.
- The overhaul of the Riksbank's cash management activities, begun in 1997, entered its final stages. The activities at Pengar i Sverige AB were wound up and the operational activities at Svensk Kontantförsörjning AB (SKAB) were transferred to the Bank.
- The Riksbank reported a loss for the year of SEK 2.8 billion. The appreciation of the krona had a negative impact of SEK 5.6 billion.

■ The year in figures

THE YEAR IN FIGURES

Key data	2004	2003	2002
<i>At year-end</i>			
Result for the year (SEK billion)	-2.8	-9.3	-0.1
Gold and foreign exchange reserves (SEK billion)	163	159	166
Number of employees (full-time equivalents)	434*	426	440
Repo rate (per cent)	2.0	2.75	3.75
Short-term interest rate (three-month T-bills, per cent)	1.99	2.65	3.57
Long-term interest rate (ten-year government bonds, per cent)	4.03	4.78	4.71
<i>Annual averages</i>			
GDP (percentage change)	3.6**	1.5	2.0
Unemployment (per cent)	5.5**	4.9	4.0
Headline inflation, CPI (percentage change)	0.5	2.0	2.4
Underlying inflation, UND1X (percentage change)	0.9	2.3	2.5

* of which 33 relate to previous employees of SKAB

** forecast in Inflation Report 2004:4

■ Statement by the Governor

In 2004 I visited a number of different places in Sweden prior to the Riksbank taking interest rate decisions. The aim of these visits was to meet local representatives of the business community, public administration and the general public, both to understand what is going on in the economy and to inform the public about the Riksbank's work. Gaining a picture in this way of the economic situation in different parts of the country is an important aspect of my work.

Many of those I have met have reported that activity has been high over the past year. This has also been confirmed by official data, which point to economic growth of around 3.5 per cent. It therefore seems that 2004 will be one of the best years in terms of growth in the past three decades. Among the factors contributing to this performance is a relatively expansionary economic policy, including historically low interest rates.

INFLATION BELOW TARGET

Despite the firm economic growth, inflation has remained low. In terms of the CPI and UNIDX (the measure that the Riksbank has normally used in its conduct of policy in recent years) inflation was 0.5 per cent and 0.9 per cent, respectively, in 2004. The sharp drop in the rate of price increases was expected, since electricity prices had driven up inflation temporarily at the start of 2003. But the total fall was larger than forecast. The low inflation in Sweden has mainly been a result of low domestic cost pressures, owing to robust productivity growth, but also weak imported inflation.

We do not know with certainty what has been driving the rise in productivity. One likely factor is the tough competition that more and more companies and industries are facing; another is the increasing use and spread of information technology. I myself have witnessed both phenomena during many of my visits to different companies.

The strong productivity gains have been reflected in a weak labour market, where a pick-up has been delayed compared with what is normal at this stage of the business cycle. A debate has thus arisen in the public domain regarding possible measures to boost employment as well as regarding the effects of monetary policy in this context.

THE RIKSBANK CAN CONTRIBUTE TO FAVOURABLE CONDITIONS FOR GROWTH

By maintaining price stability the Riksbank can help lay a solid foundation for economic growth and high employment in the long term. That is because it is easier and more secure for households and firms to make economic decisions when their calculations are not distorted by swings in inflation.

In addition the Riksbank can often contribute to smoothing the business cycle when trying to stabilise the value of money. There are indications that real economic developments in recent decades have become more stable in many countries that have adopted a monetary policy regime targeting low inflation. However, that does not mean that we can expect to be able to completely avoid fluctuations in growth and employment. We simply don't know enough about how the economy functions to be able to do so.

Nor is it possible to attain an inflation rate of exactly two per cent every year, as demonstrated by the outcomes in Sweden and other countries over the past ten years. That is largely due to the fact that monetary policy affects inflation with a lag, which means that we have to base our repo rate decisions on forecasts.

What the Swedish people can count on is that we are always aiming to ensure that inflation is on target. It also seems that we have got this message across; the expected rate of inflation a couple of years ahead has remained stable around 2 per cent.

It is also worth observing that the fluctuations in inflation since the end of the 1990s have largely been due to supply shocks that have not had any markedly adverse effects on demand developments in the economy. Instead, what we are seeing at the moment – robust productivity growth and low import prices – has rather had a positive impact. In terms of growth Sweden's performance has been considerably better since

the mid-1990s, when economic policy was reformed and inflation stabilised.

DEBT LEVELS AND HOUSING PRICES A SOURCE OF CONCERN

For about the last ten years the Riksbank has also been monitoring and analysing financial stability in the economy. One much-debated issue in 2004 was the continued rise in both Swedish household debt and housing prices. A few question marks were raised over households' debt-servicing ability as well as regarding the risks of a decline in the housing market, with possible repercussions for the banking system and Sweden's economic performance in general. This led to calls from some quarters for higher interest rates to check the developments.

The Riksbank's analyses indicate that the indebted households on average have relatively good financial margins to cope with rising interest rates. The prices of owner-occupied housing also appear to be explainable by reasonable economic models, suggesting that there is not a more general speculative bubble in the housing market. We have not found any cause for concern over the stability of the banking system. Nevertheless, there are many indications that issues related to housing prices and household debt will attract attention in the coming years as well, especially if interest rates remain low due to a continued favourable inflation outlook.

MORE EFFICIENT WORK METHODS

The Riksbank continued to rationalise its work methods in 2004. This has been reflected in many tangible ways.

The change in the Bank's cash management activities was essentially concluded with the sale of Tumba Bruk, the winding up of Pengar i Sverige and the integration of the activities at Svensk Kontantförsörjning AB into the Riksbank's organisation. What remains to be done now is to put the final touches to the new structure in cooperation with the Swedish banks and other market participants. On the whole, these changes have entailed a reduction in the number of employees (in full-time equivalent terms) at the Riksbank and its subsidiaries from 1,281 to 423 over the past two years.



Lars Heikensten, Anna Bernström and Viktor Åkerblom Nilsson during the production of the Riksbank's film for upper secondary school students.

Following a reorganisation of the Bank the number of departments has been reduced, and further responsibility for the day-to-day tasks has been delegated to the department heads. The changes in the organisation and management structure have clarified the lines of responsibility at the Bank, created conditions for more coherent governance and enabled the Executive Board to focus to a greater extent on overall strategic issues.

In conclusion, I would like to thank all of the Bank's staff for their excellent work over the year. I would also like to thank my colleagues on the Executive Board and the members of the General Council for a fruitful cooperation.

Lars Heikensten

■ The tasks and role of the Riksbank

Sveriges Riksbank is Sweden's central bank and a public authority under the Swedish parliament (the Riksdag). The Riksbank is responsible for the conduct of Swedish monetary policy with the objective to maintain price stability. The Bank is also entrusted with the task of promoting a safe and efficient payment system.

MAINTAINING THE VALUE OF MONEY

– PRICE STABILITY

The Riksbank's price stability objective, laid down by the Riksdag, requires the Bank to keep inflation at a low and stable rate. This lays the foundations for a favourable, sustainable rate of economic growth.

The Riksbank has defined its price stability objective in terms of keeping inflation (the rate of price increases), as measured by the consumer price index (CPI), at 2 per cent per year. This target has been supplemented with a fluctuation band of ± 1 percentage point. The purpose of the band is to clarify that deviations from target are likely but that the Riksbank aims to limit these deviations. In practice, monetary policy is often based on measures of underlying inflation, i.e. measures from which the effects of temporary shocks have been excluded. The most commonly used measure in this regard has been UNDEX, which excludes the effects of mortgage interest expenditure and the direct effects of changes in indirect taxes and subsidies.

The repo rate is the Riksbank's key instrument for influencing inflation. The rate determines what the commercial banks must pay when borrowing funds from the Bank, thereby affecting the interest costs of households and firms.

It takes time for an interest rate adjustment to have its full impact on the rate of price increases. The greater part of this impact is estimated to occur with a lag of one to two years. As a result the Riksbank bases its policy decisions on a forecast of inflation developments a couple of years ahead.

A SAFE AND EFFICIENT PAYMENT SYSTEM

– FINANCIAL STABILITY

The Riksbank has interpreted its task of promoting a safe and efficient payment system to mean that it should foster stability in the entire financial system. The task also includes responsibility for providing the country's banknotes and coins.

Furthermore, the Bank has operational responsibility for the system that enables banks to safely execute large-value payments with each other.

The Riksbank publishes a bi-annual report on the stability of the Swedish financial system. The report assesses mainly the risks of problems arising in major Swedish banks and in the central financial infrastructure, since these are considered to be crucial for the stability of the system as a whole. Financial stability is also an important precondition for the Riksbank's ability to maintain price stability. However, the Bank does not have an instrument such as the repo rate for directly influencing the stability of the financial system. It can, on the other hand, provide emergency liquidity assistance to banks under certain conditions in the event of a crisis.

THE RIKSBANK'S INDEPENDENCE

The Riksbank is a public authority under the Riksdag. The Riksdag appoints the eleven members of the Riksbank's General Council. The General Council appoints the six members of the Riksbank's Executive Board on a rotating basis for a period of six years. Otherwise, the role of the General Council is to oversee and scrutinise the work of the Executive Board.

The Riksdag voted at the end of the 1990s to give the Riksbank independent status. This means that the Executive Board of the Riksbank is responsible for making decisions regarding Swedish monetary policy without taking instructions from other parties. The aim of formally delegating the task of price stability to the Riksbank was to give monetary policy a long-term perspective and to enhance the prospects for attaining credibility for the monetary policy objective. The Chairman and Vice Chairman of the General Council have the right to attend Executive Board meetings and to express an opinion, but not to make proposals or participate in the decision-making.

OPERATIONAL FOCUS

In recent years the Riksbank's work has been guided by an explicit focus on efficiency and on the Bank's core activities, an endeavour to attain transparency and a continual improvement of the professional competence of the organisation.

The Riksbank has a central role in the economy and an independent status. As a result it is important that the Bank's activities be conducted efficiently. The Bank's focus on its core tasks aims to ensure efficiency in its activities. In recent years the Riksbank has endeavoured to concentrate its activities on analytical work in the fields of monetary policy and financial stability. The Riksbank's independent status requires a high degree of openness and clarity. In order for the Bank's monetary policy to be credible and have wide support in society, it is important that it can be understood by the general public, that it is discussed openly and that it can be evaluated. Openness and clarity are guiding principles for the Riksbank's other activities as well.

A high degree of professional competence is necessary within all the Riksbank's spheres of activity. Competent analyses are a precondition for well-founded decisions and the Riksbank works continuously to develop its understanding of issues related to monetary policy and the payment system. To this end the Bank aims for close links between the practical application of analysis and theoretical and empirical research.



■ Maintaining the value of money – price stability

Inflation in 2004 averaged 0.5 per cent in terms of the increase in the consumer price index. Underlying inflation, measured as the change in UND1X, was 0.9 per cent on average. The low rate of price increases was mainly due to developments in electricity prices, but also to weak imported inflation and surprisingly high productivity growth. The Riksbank lowered the repo rate a total of 0.75 percentage points in 2004, and at year-end the rate stood at 2.0 per cent.

DESCRIPTION OF THE ACTIVITIES

According to the Sveriges Riksbank Act the objective of the Riksbank's activities is to maintain price stability. The Riksbank has specified this objective as keeping inflation at 2 per cent a year, with a tolerance for deviations of ± 1 percentage point. The purpose of the tolerance band is to clarify that deviations from target are likely but that the Bank's ambition is to try to limit these deviations. The inflation target has been defined in terms of the change in the consumer price index (CPI). The CPI measures the price of a basket of goods and services for household consumption and is calculated every month by Statistics Sweden. The Riksbank's monetary policy is usually based on measures of underlying inflation which are assumed to provide a better picture of underlying, cyclical inflationary pressures. The most commonly used measure is UND1X, which excludes households' mortgage interest expenditure and direct effects of changes in indirect taxes and subsidies.

THE TRANSMISSION MECHANISM OF MONETARY POLICY

The Riksbank controls inflation by adjusting its key policy rate – the repo rate. This is changed with a view to influencing other interest rates in the economy, which in turn affect economic activity and inflation. But it is not just the level of the repo rate that determines the impact of monetary policy. Households' and firms' expectations regarding future interest rate developments and inflation are other significant factors.

The way in which repo rate adjustments affect inflation and the rest of the economy is usually called the transmission mechanism of monetary policy. This mechanism is actually composed of several different interacting mechanisms. Some of these act on inflation more or less immediately whereas others take longer to have an effect. It is

generally held that a repo rate adjustment has its greatest impact on inflation after one to two years.

The Riksbank steers the market's shortest interest rate – the overnight rate – by meeting the banking system's demand for loans from the Riksbank at the repo rate. Once a week the banks can obtain funds from the Riksbank through repurchase agreements. In the intervening period the banking system can borrow or deposit funds at the Riksbank at a rate of interest close to the repo rate. That essentially enables the Bank to control the market's overnight rate.

Short-term market interest rates of up to a year or so are strongly influenced by expectations of how the overnight rate will evolve, and thereby also by expectations of how the Riksbank's repo rate will develop. Longer-term interest rates are also affected by other factors such as expectations of future inflation and growth, as well as interest rate developments abroad. The quantitative effect that a repo rate adjustment has on other interest rates depends, among other things, on how expected the change is. The Riksbank aims to prepare the general public and market players in good time for future changes in monetary policy through speeches and other communication.

Thus, the commercial banks' lending rates as well as interest rates on securities are influenced by both the actual and expected repo rate. If the repo rate is expected to be raised, market rates will normally rise before the actual rate hike. The subsequent rate hike will not necessarily have any further impact on market rates if it merely confirms what the market was expecting.

So monetary policy has an effect through the repo rate on the interest rates offered to the general public, and thereby also on factors such as consumption, debt levels and investment. That in turn affects aggregate demand and resource



utilisation in the economy. The key channels through which monetary policy works are the interest rate channel, the credit channel and the exchange rate channel. The relative importance of these channels can vary considerably over time. For example, higher interest rates do not always result in a stronger exchange rate.

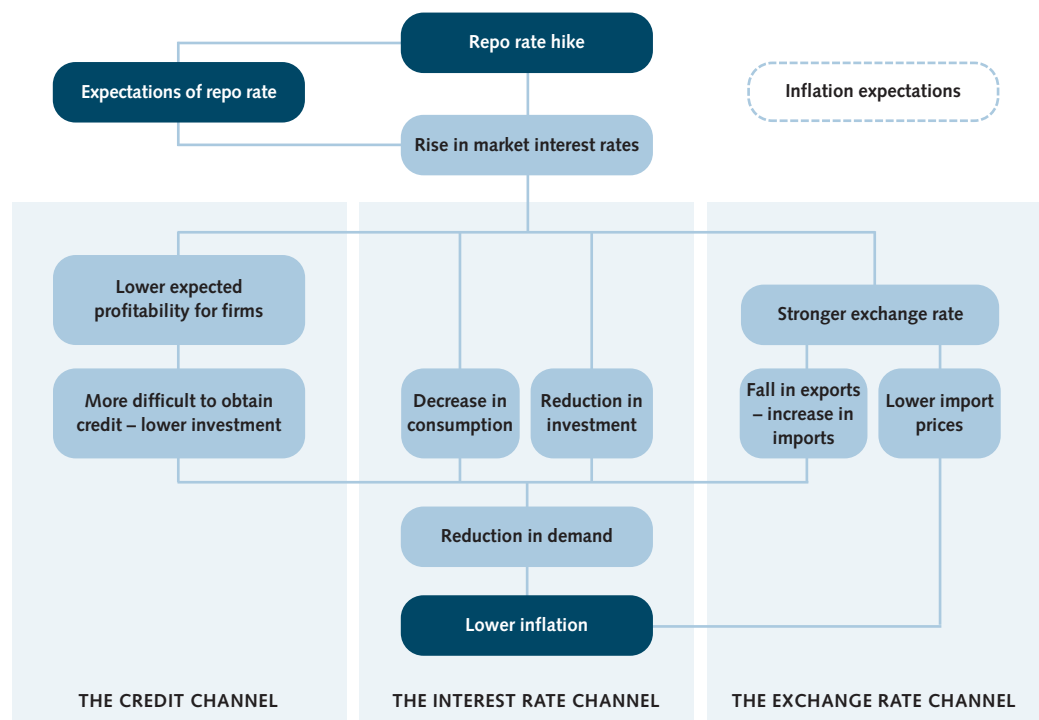
MONETARY POLICY DECISION-MAKING AND COMMUNICATION

The Riksbank aims to explain the analytical framework that governs its conduct of monetary policy and to present and account for the forecasts and assessments on which it bases its policy. The Bank does this mainly in its Inflation Report, which is published four times a year, but also through press conferences and speeches, the minutes of rate-setting meetings and newspaper articles. The purpose of the Inflation Report is to make it easier for external parties to follow and understand the Bank’s monetary policy, as well as to encourage discussion of monetary policy issues. Since monetary policy affects inflation with a lag the Riksbank must base its decisions on

forecasts of future developments. Both the Inflation Report and the Executive Board’s monetary policy discussions focus on a forecast of inflation one to two years ahead.

The Inflation Report gives an overview of the determinants of inflation and an account of how the Riksbank arrived at its inflation forecast. In recent times the Report has usually begun with an assessment of financial market developments, such as movements in the exchange rate and interest rates. That is then followed by an assessment of international economic activity and inflation. International price developments and the exchange rate are important determinants of imported inflation. Subsequently, there is an analysis of Swedish economic developments, which is an important determinant of domestic inflation. Inflation expectations are also studied here. That is because they affect inflation through their impact on price and wage formation, but also because the expectations themselves are influenced, for example, by the Riksbank’s monetary policy signalling and macroeconomic developments in general. Coupled with an assess-

FIGURE 1
Outline of the transmission mechanism of monetary policy.



ment of various temporary shocks to inflation, such as sharp swings in energy prices, the assessment of imported inflation and domestic inflation results in an inflation forecast in a main scenario.

When making monetary policy decisions the Bank also takes account of any uncertainty surrounding the forecast. The risks that inflation will turn out higher or lower than in the main scenario are assessed and weighed up. The inflation forecast in the main scenario may then be adjusted up or down depending on whether the upside or downside risks carry more weight.

If inflation is forecast to overshoot the target one to two years ahead the Riksbank normally raises the repo rate. Correspondingly, the repo rate is usually lowered when inflation is forecast to fall short of the target one to two years ahead. There may be situations, however, when the Bank sees reason to depart from this simple policy rule. Firstly, inflation may be affected by factors that are not deemed to have any significant long-term impact on inflation or the inflation process. In such a case the Riksbank may decide against trying to counter the disturbance. Secondly, as a result of a shock, inflation may be deviating sharply from target. Here, the Riksbank may choose to bring inflation back to target over a slightly longer period than the normal one to two years so as to avoid excessive fluctuations in economic activity.

THE WORK PROCESS UNDERPINNING MONETARY POLICY

The Executive Board usually holds eight scheduled monetary policy meetings a year. Four of these coincide with the publication of an Inflation Report. At the other four meetings the Executive Board makes its decision on the basis of a shorter internal report that presents the new information received since the previous meeting. If necessary the Board may call extra monetary policy meetings in addition to those scheduled.

The process of producing an Inflation Report begins about six weeks before the publication date. The Bank uses both small, partial models and large econometric models in its work and combines them with assessments from sector experts. This is then summarised in an internal report that describes the expected future situation. The

report is presented to the Executive Board and revised into an Inflation Report that reflects the Board's view of the economic and inflation outlook.

The Executive Board convenes for a monetary policy meeting the day before the Inflation Report is published. The Board forms an opinion on the basis of the Report and decides on the level of the repo rate. The Inflation Report and interest rate decision are released the following day. The interest rate decision comes into force at the time of the next monetary policy repo transaction. About two weeks after the monetary policy meeting the Bank publishes the minutes of the meeting, which recount the Executive Board's discussion. The minutes also show whether one or more of the Board members entered a reservation against the decision and why.

INTERNATIONAL WORK, RESEARCH, STATISTICS PRODUCTION AND CONSULTATION PAPERS

The Riksbank follows and contributes to the analysis of current monetary policy and exchange rate policy issues in central bank circles and in international organisations. The members of the Riksbank's Executive Board participate in international meetings arranged by the EU, the European System of Central Banks (ESCB), the Bank for International Settlements (BIS), the International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD). As regards the field of monetary policy the aim of the Riksbank's international work is firstly to obtain information for the Bank's monetary policy analysis, and secondly to contribute with the Bank's own experiences and analyses in issues concerning the international monetary and financial system.

With a view to enhancing the material underpinning its monetary policy decisions, the Riksbank carries out empirical and theoretical research in the area of price stability.

The Riksbank is required by the EU Treaty to produce Sweden's balance of payments statistics and some financial statistics. The Bank uses these statistics in its monetary policy analysis.

The Riksbank also serves as a consultation body for many economic policy issues.

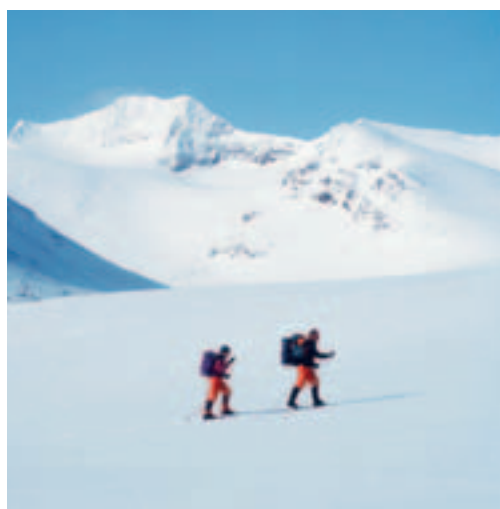


ACTIVITIES IN 2004

Sweden's economic performance during the year was characterised by high growth and markedly low inflation. At the start of 2004 it became increasingly clear that the Swedish economy was beginning to recover after a relatively mild slow-down. Household consumption was growing steadily, partly as a result of expansionary fiscal policy and low interest rates. Also, a revival in world trade was contributing to strong export activity, although this slackened somewhat towards the end of the year. The moderation in export growth was offset in some measure by an upturn in investment. The robust demand developments were estimated in Inflation Report 2004:4 to have resulted in GDP growth of 3.6 per cent in 2004.

Sweden's nature has always been an important asset. Now it is also an important factor for the tourist industry. Tourism is one of the fastest growing industries in Sweden. Between 1995 and 2002 its export value rose by 72% and employment in the industry increased by 34%.

Source: Swedish Tourist Authority



Monetary policy decisions

In February the repo rate was lowered by 0.25 percentage points to 2.5 per cent. The decision reflected the Bank's forecasts of weak domestic and international cost pressures. Activity in the Swedish labour market was still low, even when taking account of the fact that employment has tended to react with some lag to changes in output. As a result the rate of wage increases was forecast to be somewhat more subdued than previously assumed. Meanwhile, productivity had turned out surprisingly strong, which also contributed to dampening inflation prospects. So even though it had become increasingly evident that the international cyclical upswing had picked up as expected and that economic activity had strengthened in Sweden as well, there was reason to lower the repo rate.

At the monetary policy meeting in March the Riksbank observed that electricity prices, as anticipated, had contributed to a sharp fall in the inflation rate in early 2004. The drop in inflation was bigger than expected, though, despite the increasingly evident cyclical upswing. This had gradually contributed to a change in the Bank's outlook on domestic wage and price pressures. The reason for the subdued inflation was lower import prices, a weaker labour market and higher productivity growth than forecast. Inflation was projected to rise gradually as resource utilisation picked up, but on average it was expected nonetheless to be sharply lower than target in the coming two years. Against that background the Executive Board decided to cut the repo rate by 0.5 percentage points to 2 per cent.

The Bank's outlook on the Swedish economy became more optimistic during the second half of the year, and the growth forecast was revised up. New information indicated that the strong performance would continue in the coming years. Given that economic activity was expected to develop favourably there was reason to assume that inflationary pressures would gradually increase. That suggested that monetary policy would sooner or later need to be tightened. Even though inflation was forecast to be low in the years ahead it was expected to rise in line with a pick-up in resource utilisation. At the same time, favourable

cost conditions were anticipated to contribute to keeping the rise in inflation at a modest level.

The inflation forecasts after the repo rate cut in March still pointed to an inflation rate consistent with the target at the end of the two-year period. Consequently, the repo rate was left unchanged for the rest of 2004.

*International work, research, statistics
production and consultation papers*

The Riksbank has continued to take an active part in monetary policy issues in the international domain. The Bank does so as a member of international organisations and through bilateral contacts with other central banks. During the year, for example, the Bank exchanged experiences with the central banks of the new EU member states with inflation targets. Some of the issues discussed at international meetings during the year included the effect of oil price levels on the world economy, how to manage the current global financial imbalances, whether the ample supply of liquidity entails risks for financial stability, and how to improve the EU's Stability and Growth Pact.

The Riksbank's research activities in 2004 concentrated on enhancing the methods used in monetary policy analysis. For example, the Bank's researchers have developed general equilibrium models based on theoretical and empirical research, both for the euro area and Swedish economies. The purpose of this work is to strengthen the links between the Bank's monetary policy analysis and current research, but also to provide the Executive Board with tools that can efficiently manage the complex issues that arise in the practical conduct of monetary policy. Parallel with these development activities, which will gradually affect the Bank's work with monetary policy data in the coming years, the Bank has invested resources in documenting and systematising the data, methods and forecasts on which the analysis so far has been based. The aim is to facilitate the comparison and evaluation of different forecasting methods.

As regards the production of statistics the increasing financial integration, which has been evident, for example, in cross-border mergers in the financial sector, has resulted in more intensi-

ve cooperation in the statistics field between the Nordic central banks.

In 2004 the Riksbank issued six responses to consultation papers in the field of economic policy. See the Bank's consultation responses on pages 65 - 66.

**FOLLOW-UP OF THE RIKSBANK'S
MONETARY POLICY**

Target deviations in 2004

Even though the economic upswing that began in the second half of 2003 was increasingly consolidated in 2004, inflation turned out considerably lower than the Bank's target of 2 per cent. The CPI rose by 0.5 per cent on average, implying a target deviation of 1.5 percentage points. The Riksbank's monetary policy is usually based on different measures of underlying inflation as these are assumed to provide a better picture of cyclical inflationary pressures. According to the most

Interest rate decisions in 2004

- 5 February: The repo rate was cut by 0.25 percentage points to 2.5 per cent. Kristina Persson entered a reservation against the decision, favouring a rate cut of 0.5 percentage points. Among other things, Ms Persson observed that the inflation forecast in December had already pointed to scope for a rate cut and that developments since then had indicated even weaker price pressures.
- 31 March: The repo rate was lowered by 0.5 percentage points to 2.0 per cent. Villy Bergström and Eva Srejber entered a reservation against the decision, believing instead that the rate should be cut by 0.25 percentage points. The two deputy governors recommended greater caution with the monetary policy stimulus, partly to avoid encouraging a build-up of household debt. Another reason put forward was the uncertainty over the strength and durability of the productivity growth and increasing international competition that had been keeping inflation down in spite of expansionary economic policy in several parts of the world.
- 28 April: The repo rate was left unchanged at 2.0 per cent.
- 27 May: The repo rate was left unchanged at 2.0 per cent.
- 23 June: The repo rate was left unchanged at 2.0 per cent.
- 19 August: The repo rate was left unchanged at 2.0 per cent.
- 13 October: The repo rate was left unchanged at 2.0 per cent.
- 8 December: The repo rate was left unchanged at 2.0 per cent.



commonly used measure, UNDI_X, inflation stood at 0.9 per cent in 2004. Thus, the deviation from target was less for this measure than for the CPI. The bulk of the UNDI_X deviation was due to the fact that UNDI_X fell more than expected in 2004. Another important reason for CPI inflation being significantly lower than the UNDI_X measure was that the relatively substantial monetary easing that began at the end of 2002 held down households' mortgage costs.

Developments during the year were characterised by an initial sharp fall in inflation. From a rate of 1.4 per cent in December 2003 the twelve-month change in the CPI (the change in relation to the corresponding month a year earlier) dropped to -0.3 per cent in February 2004. The fall in inflation between February 2003, when the twelve-month change in the CPI was 3.4 per

cent, and February 2004 is the largest in any single year since the inflation target was introduced. Inflation then rose in the spring, but remained at a low level.

Why was inflation so low in 2004?

The rapid drop in inflation in early 2004 was partly a recoil from the temporary rise in energy prices at the beginning of 2003. Such an effect had been forecast by the Riksbank as early as the first Inflation Report in 2003. Since the fluctuations in energy prices were predicted to only affect inflation temporarily, the Bank did not deem the rise in inflation in early 2003 or the forecast decline at the start of 2004 to give cause for any monetary policy measures. With a view to clarifying that actual and forecast inflation were being heavily affected by temporary shocks to energy prices and could therefore be expected to deviate from target, the Riksbank decided to base policy during most of 2003 and the beginning of 2004 on forecasts of inflation excluding energy prices – the inflation measure UNDI_X excluding energy.

In spite of the increasingly evident cyclical upswing, domestic cost pressures remained weaker than expected in 2004. One key reason for this was that productivity was growing stronger than expected by both the Riksbank and many other economic forecasters. The causes of the high productivity gains are not fully understood but there are some indications that at least part of the gain is permanent. One hypothesis supporting such a view is that the large-scale IT investment in many sectors at the end of the 1990s is now beginning to pay off. Another theory argues that Sweden is a highly open economy and is therefore benefiting from global structural change. Reflecting the high productivity growth was an expectedly weak performance in the labour market. At the same time that resulted in somewhat lower wage increases than anticipated. The weak domestic cost pressures helped dampen the rate of price increases for domestically produced goods.

Imported inflation, too, was low in 2004. Developments in imported inflation depend on a number of circumstances that are often difficult to predict, such as variations in the exchange rate and developments in international price pressures. Conditions in Sweden also have an impact on

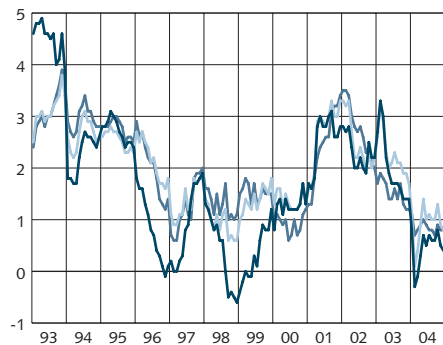
TABLE 1
Comparison of different inflation measures.
Annual percentage change

Source: Statistics Sweden.

	Annual average	
	2004	1995-2003
CPI	0.5	1.5
UND1 _X	0.9	2.0
UNDIMPX	-0.6	0.7
UNDINHX	1.7	2.5
UND1 _X excluding energy	0.8	1.9

DIAGRAM 1
CPI, UNDI_X and UNDI_X excluding energy, 1993-2004.
Annual percentage change

— CPI
— UNDI_X excluding energy
— UNDI_X



Sources: The Riksbank and Statistics Sweden

imported inflation, for instance because foreign exporters' prices to Swedish importers may be governed by the Swedish demand situation and because importers' pricing decisions may be influenced by changes in competition in the Swedish market. The fact that the prices of imported consumer goods (excluding oil) have fallen since spring 2003 is probably mainly due to low international price pressures and the strengthening of the exchange rate in recent years. Imported inflation rose during the autumn, chiefly as a result of the rise in oil prices. The krona's appreciation against the dollar, however, helped dampen the oil price increase in krona terms.

Changed competitive conditions in the Swedish economy may also have contributed to the low inflation during the year. That is especially true of the Swedish retail food sector, where several low-price chains have sprung up in recent years. The resultant increase in competition has probably subdued the price increases for both domestically produced and imported products.

Forecasts in 2002-2003

Since the effects of monetary policy are exerted with a lag, inflation in 2004 was mainly affected by the policy conducted in 2002 and 2003. An analysis of monetary policy should therefore primarily focus on the forecasts and repo rate decisions in these two years.

One difficulty when following up the Riksbank's forecasts is that they are based on the assumption of an unchanged repo rate. Since the repo rate is usually adjusted during the Bank's forecast period it is not possible on the basis of the published forecasts to get an exact idea of their accuracy. It is usually possible, however, to form a fairly good, qualitative picture of how successful the Bank has been in its forecasting.

GDP growth in 2003, which can be assumed to have affected the inflation outcome in 2004, was overestimated to a relatively large degree in the Bank's forecasts at the start of 2002. The overestimation reflected the delay in the global cyclical upswing, which was partly due to concerns over the war in Iraq. The growth forecast was gradually revised down during the year, however, as it became increasingly clear that Swedish and international economic activity would not be as

strong as previously forecast. At the start of 2003 the forecast was in line with what proved to be the actual outcome. Since monetary policy affects the economy with a lag it is likely that the Riksbank's rate cuts in 2003 had a relatively limited impact on the GDP outcome that year.

The Bank's reappraisal of its shorter-term economic outlook at the start of 2003 resulted in a slight downward revision of the inflation forecast for 2004 as well. The subsequent forecasts in 2003 for underlying inflation in 2004 were relatively consistent with the final outcome. The fact that the forecasts were based on the assumption of a constant repo rate while the rate in actual fact

Different measures of inflation:

- Consumer price index (CPI): The change in the CPI measures how the prices of goods and services for private consumption evolve over time.
- Underlying inflation (UND1X): CPI inflation excluding household mortgage interest expenditure and direct effects of changes in indirect taxes and subsidies.
- Imported underlying inflation (UNDIMPX): UND1X excluding mainly domestically produced goods and services.
- Domestic underlying inflation (UNDINHX): UND1X excluding mainly imported goods and services.
- Harmonised Index of Consumer Prices (HICP): An EU-harmonised index that was developed to measure inflation in the EU and that enables comparisons between EU countries. A significant part of the changes in housing costs that are included in the CPI are not included in the HICP. However, the HICP includes certain components that are currently excluded from the CPI, such as charges for childcare and care of the elderly.

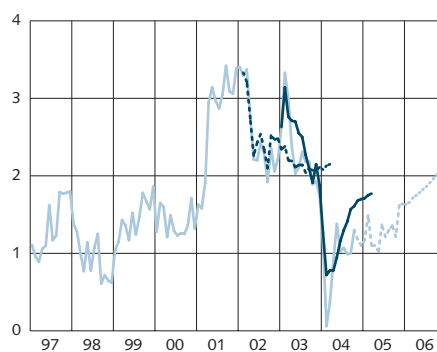


DIAGRAM 2
Forecasts for UND1X at
different times and actual
outcome.
Annual percentage change

— UND1X, outcome
- - - Inflation Report 2004:4
— Inflation Report 2003:1
· · · Inflation Report 2002:1

Sources: Statistics Sweden (outcome) and the Riksbank (forecasts)



was lowered a total of one percentage point in 2003 indicates nonetheless that the forecasts produced in 2003 overestimated inflation developments.

The inflation forecast for 2004 was revised down a second time at the beginning of 2004. The inflation outcomes at the time had proven even lower than predicted despite the increasingly strong cyclical upswing. That led to a reappraisal of domestic and international cost pressures and a further easing of monetary policy in the first quarter of that year. The reappraisal partly reflected a stronger outlook for productivity growth and a comparatively sharp downward revision of the forecast for imported inflation. The forecasts for domestic cost developments were revised down further during the course of 2004, while that for imported inflation was revised up somewhat, partly against the background of the steep rises in oil prices. That meant that the forecast for UNDEX inflation in 2004 was back at roughly the same level as in 2003 and in line with the final outcome.

Both the economic slowdown at the end of 2002 and the low international and domestic cost pressures appear to have surprised the majority of forecasters. If we study an average of the forecasts of some twenty forecasters we find a similar pattern as in the Riksbank's projections. The forecasts for GDP growth in 2003 were revised down gradually in the second half of 2002 and beginning of 2003. That also resulted in a downward revision of the inflation forecasts for 2004. The Riksbank was one of the first forecasters to revise down its inflation estimates. A couple of forecasters, however, did predict somewhat earlier than the Riksbank that 2004 inflation would come in below the Bank's lower tolerance band. Nevertheless, at the end of 2003 most forecasters still overestimated the actual inflation outcome in 2004 to a relatively large degree.

The Executive Board's monetary policy decisions in 2002-2003

At the beginning of 2002 the repo rate stood at 3.75 per cent. It was then raised in the spring in

TABLE 2
The Riksbank's forecasts and outcomes for some variables of importance.
Annual average

Sources: Statistics Sweden, OECD, International Petroleum Exchange (outcomes) and the Riksbank (forecasts)

	IR02:1	IR02:2	IR02:3	IR02:4	IR03:1	IR03:2	IR03:3	IR03:4	IR04:1	IR04:2	IR04:3	IR04:4	Outcome
GDP growth 2003	3	2.7	2.3	2.1	1.7	1.2	1.5	1.5					1.5
GDP growth 2004	2.6	2.5	2.1	2.3	2.4	2.4	2.4	2.4	2.8	2.9	3.6	3.6	
GDP growth 2005					2.4	2.4	2.5	2.5	2.6	2.8	3.2	3.0	
GDP OECD 19 2003	2.7	2.6	2.4	2.2	2.0	1.7	1.9	2.0					2
GDP OECD 19 2004	2.8	2.7	2.8	2.7	2.7	2.5	2.8	2.9	3.2	3.3	3.5	3.4	
TCW	123.7	123.8	125	125	124.5	124	124	124	124.5	126.5	126.7	126.2	125.92
Oil price USD	22	22	22.5	22.2	22.4	22.3	25.2	25.6	31.5	32.9	37.3	38.4	38.2
Private consumption	2.5	2.4	2	2.1	1.8	2.1	2.3	2.3	2.6	2.6	2.5	2.4	
Wages in business sector	4.3*	4.3*	4.2*	4	3.7	3.5	3.6	3.5	3.4	3.3	3.2	3.1	
Labour productivity in business sector	1.9*	1.8*	1.8*	2.3	2.3	2.3	2.1	2.2	2.7	3.2	3.5	3.4	
Unit labour costs in business sector	2.4*	2.4*	2.4*	1.7	1.6	1.5	1.8	1.6	0.2	-0.4	-0.8	-0.9	
International export prices**	1.4	1.4	1.3	1.2	1.4	1.3	1.7	1.7	1.4	1.4	2.3	2.4	
UNDINHX				2.7	2	1.8	2	2.2	1.7	1.7	1.7	1.7	1.7
UNDIMPX				0.2	-0.3	-0.3	-0.5	-1.1	-1.6	-0.6	-0.5	-0.5	-0.6
UND1X				1.9	1.2	1.1	1.2	1.1	0.6	0.9	1.0	1.0	0.9
UND1X excluding energy						1.8	1.7	1.6	0.9				0.8
CPI				2.2	1.5	1.3	1.1	1.1	0.4	0.4	0.5	0.5	0.5

* whole economy

** international producer prices from Inflation Report 2004:1

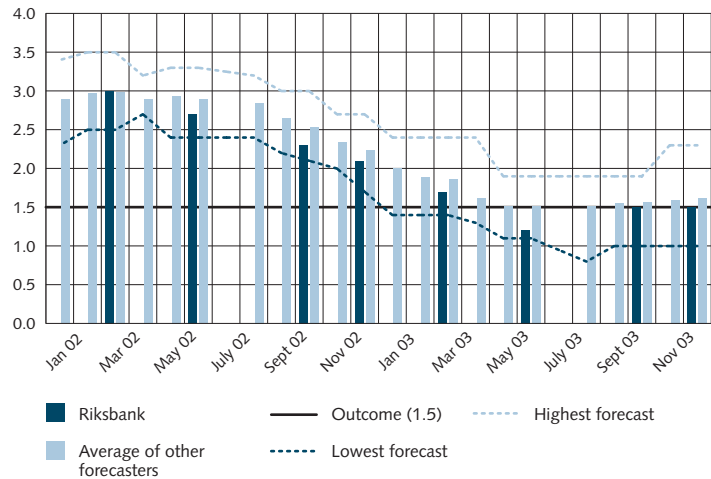
two steps to 4.25 per cent. At the start of November that year the Bank began a gradual easing of monetary policy. The repo rate was cut in five steps, to 2.75 per cent in July 2003.

Rates were hiked in spring 2002 because the expansionary policy that followed the terrorist attacks in the us in September 2001 was deemed to have laid the foundation for a relatively stable upswing in the international economy. In addition there were indications of a nascent recovery in both Sweden and abroad. The gradual rise in underlying inflation, coupled with unexpectedly high wage increases in mainly the service industries, seemed to point to higher resource utilisation in the Swedish economy than the Bank had assumed in previous assessments. The growth in wages and domestic prices also raised questions regarding the inflationary tendencies in the Swedish economy.

The end of 2002 saw the beginning of the easing cycle that continued into 2004. The reason for the change in monetary stance was that the international economic upswing had begun to lose pace amidst heightening concerns over the situation in Iraq. Manufacturing activity had deteriorated once more both in Sweden and abroad, while persistent unease in the financial markets, including sharp falls in equity prices, meant that the confidence of households and firms had begun to fall again in many countries. The weaker demand in Sweden and abroad, as well as an expected appreciation of the krona, was judged to imply more subdued inflation developments than previously forecast.

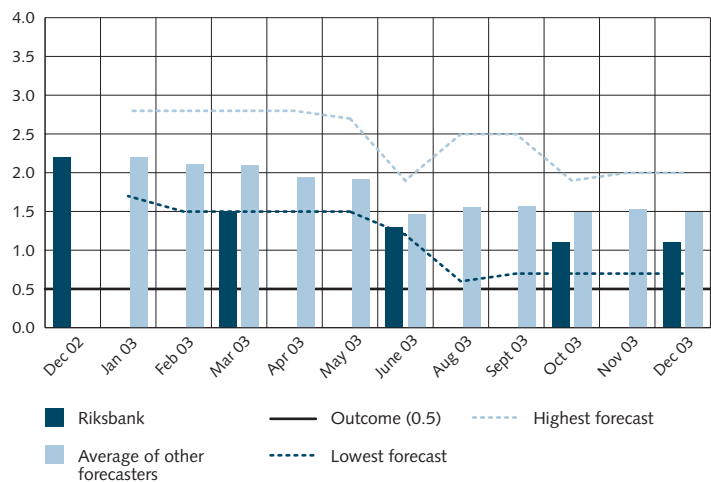
In 2003 the Riksbank continued to ease monetary policy, lowering the repo rate in March, June and July by 1 percentage point in total. The background to the rate cuts was that the international and Swedish economic outlook had gradually continued to deteriorate and that the still expected recovery had been postponed. Among other things the developments appeared to confirm fears that the adjustment of households' and firms' balance sheets following the dramatic equity market decline since 2000 would be drawn-out and that it would hamper consumption and investment for a relatively long period. At the beginning of the year geopolitical concerns, which resulted in high

DIAGRAM 3
Forecasts of GDP growth in 2003 at various times:
the Riksbank and an average of forecasters.
Annual average



Sources: Consensus Inc., Statistics Sweden and the Riksbank

DIAGRAM 4
Forecasts of CPI inflation in 2004 at different times:
the Riksbank and an average of forecasters.
Annual percentage change



Sources: Consensus Inc., Statistics Sweden and the Riksbank



Reindeer herding is not just a way of making an income, it is also the bearer of a long cultural tradition and of Sami identity. Reindeer herding generates about SEK 150 million a year.



Source: The National Association of Swedish Lapps

Repo rate decisions 2002

- 7 February: The repo rate was left unchanged at 3.75 per cent. Eva Srejber entered a reservation against the decision, believing instead that the repo rate should be raised by 0.25 percentage points. According to Ms Srejber, the uncertainty over international developments that had motivated the rate cut in September no longer existed and there was therefore reason to tighten the monetary policy stance to ensure that also future inflation expectations were anchored at the Bank's inflation target.
- 18 March: The repo rate was raised by 0.25 percentage points to 4.0 per cent. Villy Bergström entered a reservation against the decision, proposing instead that the rate be hiked 0.5 percentage points. Among other things Mr Bergström cited high wage outcomes and the risk of compensation demands in the wage bargaining round.
- 25 April: The repo rate was raised by 0.25 percentage points to 4.25 per cent.
- 5 June: The repo rate was left unchanged at 4.25 per cent. Eva Srejber entered a reservation against the decision, favouring a rate hike of 0.25 percentage points. Ms Srejber argued that economic policy in most countries was already highly expansionary and that the recovery in the Swedish economy was occurring from a position where resource utilisation was already high and where inflation and inflation expectations were above target.
- 4 July: The repo rate was left unchanged at 4.25 per cent.
- 15 August: The repo rate was left unchanged at 4.25 per cent.
- 16 October: The repo rate was left unchanged at 4.25 per cent. Kristina Persson entered a reservation against the decision, believing that the repo rate should be lowered by 0.25 percentage points. According to Ms Persson, the outlook in the Inflation Report gave good grounds for a rate cut, while there were large risks of an even weaker performance in Sweden and abroad due to the security policy situation in the Middle East, continued unease in the financial markets, softer domestic demand and a lower fiscal stimulus.
- 14 November: The repo rate was cut by 0.25 percentage points to 4.0 per cent.
- 4 December: The repo rate was lowered by 0.25 percentage points to 3.75 per cent. Eva Srejber entered a reservation against the decision, proposing that the repo rate be kept unchanged. According to Ms Srejber, it was likely that the inflation risks from the labour market and wage formation had been underestimated.

oil prices in connection with the hostilities in Iraq, also fuelled expectations of weaker performance.

After the rate cut in July 2003 the Bank held off on further monetary easing. In short, this reflected the Executive Board's view that the delayed recovery had now begun, partly underpinned by the previous repo rate cuts. Inflation was in line with the Bank's forecasts and, excluding the energy price effects, it was expected in the period ahead to develop according to paths that could normally be anticipated during a cyclical upswing. As mentioned earlier, however, the inflation outcomes at the start of 2004 were even lower than expected, prompting the Riksbank to reappraise its view of underlying inflationary pressures. It seemed that these pressures were lower than anticipated, in spite of somewhat more robust economic activity. Consequently, the repo rate was cut a further 0.75 percentage points in total between February and March 2004.

In order to clarify the developments in the Executive Board's interest rate decisions in 2002 and 2003 the adjacent boxes give a detailed account of the decisions and of individual Board members' reservations against the decisions.

Relationship between interest rate decisions and forecasts

One important question when following up Swedish monetary policy is whether the Riksbank's rate adjustments have been easy to understand, given its forecasts. In those cases where the inflation forecast was above target the Riksbank should normally have raised the repo rate, whereas inflation forecasts below target should normally have resulted in a rate cut.

Diagram 5 illustrates the relationship between repo rate decisions and forecast deviations two years ahead, measured in terms of risk-adjusted $UNDIX$ (that is, $UNDIX$ adjusted up or down depending on whether the risk of higher or lower inflation is larger) in the period 2002-2004. When the Bank's rate-setting meetings do not coincide with an Inflation Report the Bank does not publish an inflation forecast. Instead, it presents a more qualitative inflation assessment in a press release. Table 3 summarises the qualitative assessments and the interest rate decisions at these rate-setting meetings. There is a positive relationship between

forecast deviations and interest rate decisions. Small forecast deviations have not always resulted in a change in the repo rate, however, and the forecast deviations have to be sizable for the rate to be adjusted by more than 0.25 percentage points, which has been the most common adjustment in recent years.

As the diagram and table show, the repo rate was left unchanged on a number of occasions even though risk-adjusted *UNDIX* inflation a couple of years ahead was forecast to undershoot the Bank's target. That was because the fluctuations in energy prices were assumed to have a sharp but temporary impact on inflation, which was not predicted to fully subside within two years. As a result the Riksbank decided for a period to focus on an inflation measure that had been adjusted for energy prices, *UNDIX* excluding energy. The forecast for this measure was in line with the inflation target two years ahead on those occasions when the repo rate was left unchanged even though the forecast for *UNDIX* fell short of the target. At the rate-setting meeting in March 2004 the Executive Board's assessment was that the temporary effects of the energy price fluctuations would subside from mid-2005 and that there was no longer any reason to exclude energy prices from the conduct of policy.

This illustrates that there is normally a fairly strong relationship between interest rate decisions and inflation forecasts, but also that it can be difficult to describe and communicate monetary policy in terms of a very simple policy rule at all times. On a number of occasions the Riksbank has departed from its normal pattern by focusing on a different inflation measure than *UNDIX*. One possible alternative would have been to retain the focus on *UNDIX* inflation but instead illustrate its expected path by extending the forecast somewhat further ahead in time. Since the effects of the energy price fluctuations were predicted to be temporary, *UNDIX* could be expected to be in line with the inflation target beyond the normal two-year horizon.

Inflation expectations

Inflation expectations can be seen as a measure of the general public's confidence that the Riksbank will meet its inflation target. When inflation falls

Repo rate decisions 2003

- 6 February: The repo rate was left unchanged at 3.75 per cent.
- 17 March: The repo rate was lowered by 0.25 percentage points to 3.5 per cent.
- 24 April: The repo rate was left unchanged at 3.5 per cent. Lars Nyberg and Kristina Persson entered a reservation against the decision, favouring instead a rate cut of 0.25 percentage points, partly because the Bank's policy rule pointed to such a move and because the international downside risks to inflation could be assumed to slightly outweigh the domestic upside risks.
- 4 June: The repo rate was lowered by 0.5 percentage points to 3.0 per cent.
- 3 July: The repo rate was lowered by 0.25 percentage points to 2.75 per cent.
- 14 August: The repo rate was left unchanged at 2.75 per cent.
- 15 October: The repo rate was left unchanged at 2.75 per cent. Kristina Persson entered a reservation against the decision, proposing that the rate be lowered by 0.25 percentage points. Ms Persson argued that the labour market was still weak and that it would be another while before firms began to hire new staff and the economic upturn stabilised.
- 4 December: The repo rate was left unchanged at 2.75 per cent. Villy Bergström and Kristina Persson entered a reservation against the decision, favouring a rate cut of 0.25 percentage points. Among other things the two deputy governors argued that Swedish economic activity risked turning out weaker than forecast in the Inflation Report.

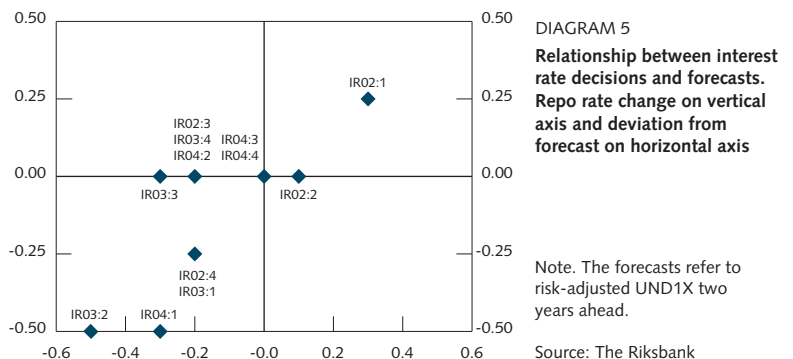
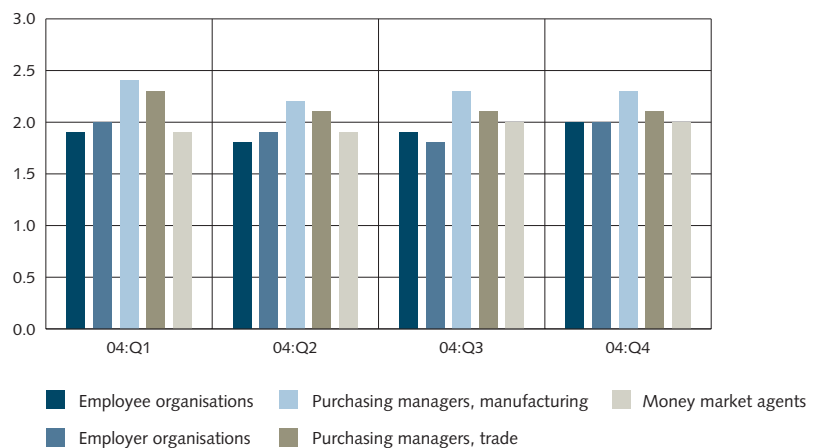


DIAGRAM 6
Different players' expectations in 2004 regarding 2006 inflation. Per cent



Sources: Prospera, National Institute of Economic Research and the Riksbank



short of the target as much as it did in 2004, it is reasonable to ask whether economic agents expect the Bank to succeed in bringing inflation back to target in a couple of years. Diagram 6 shows different economic agents' expectations of inflation in 2006. The currently low inflation does not appear to have affected their confidence in the inflation target. All the agents expect inflation a couple of years ahead to be close to 2 per cent.

TABLE 3
Inflation assessments and interest rate decisions at rate-setting meetings that did not coincide with the publication of an Inflation Report.

Source: The Riksbank

Date	Qualitative assessment	Interest rate decision
7 Feb 2002	Inflation forecast in line with target	unchanged
25 Apr 2002	Inflation forecast above target	rate hike of 0.25 percentage points
4 July 2002	Inflation forecast in line with target	unchanged
15 Aug 2002	Inflation forecast in line with target	unchanged
14 Nov 2002	Inflation forecast below target	rate cut of 0.25 percentage points
6 Feb 2003	Inflation forecast in line with target	unchanged
24 Apr 2003	Inflation forecast below target	unchanged
3 July 2003	Inflation forecast below target	rate cut of 0.25 percentage points
14 Aug 2003	Inflation forecast in line with target	unchanged
5 Feb 2004	Inflation forecast below target	rate cut of 0.25 percentage points
28 Apr 2004	Inflation forecast in line with target	unchanged
27 May 2004	Inflation forecast in line with target	unchanged
19 Aug 2004	Inflation forecast in line with target	unchanged

Summary

The drop in inflation in 2004 was largely due to factors that the Riksbank had foreseen in 2002 and early 2003, but also to factors that had unexpectedly depressed the rate of price increases. The anticipated component of the decline was mainly a result of the fact that the price level at the end of 2002 and beginning of 2003 had been pushed up unusually high, primarily by a sharp temporary rise in energy prices. As a result there was reason to expect inflation to turn out unusually low at the start of 2004. Since these swings in energy prices were not assumed to have any lasting effects on inflation or the inflation process the Riksbank did not deem it warranted to try to counter them with monetary policy measures, in line with the Bank's clarification of monetary policy formulation that was published in 1999. The main reason for the rate cuts between November 2002 and July 2003 was instead a deterioration in the economic outlook.

The component that proved more difficult to predict can briefly be described as a result of both unexpectedly low domestic cost pressures and surprisingly weak developments in the prices of imported goods. The low domestic cost pressures were not due to unexpectedly weak economic growth, however. Instead, GDP growth proved stronger than forecast by the Riksbank. Employment, however, did not increase as quickly as it usually does at this stage of the business cycle. That meant that firms' costs were kept down, partly by high productivity growth and partly by weak labour market conditions that helped subdue wage increases. The low imported inflation was due to a number of factors. One explanation is the krona's appreciation in recent years, but it is likely that other factors such as tougher international competition have played a part. Both the Riksbank and other forecasters failed to predict that these factors would push down 2004 inflation as much as they did.

Thus, the low inflation out-turn in 2004 was partly a development that the Riksbank had foreseen but chosen not to try to counter, owing to the sharp fluctuations in inflation that were being caused by temporary shocks. It was also in some measure a result of unexpected developments on the supply side of the economy that turned out differently than forecast. It is worth pointing out that the surprisingly low inflation was due to a large extent to factors that essentially are positive for the Swedish economy and that also contributed to growth turning out stronger than expected.

When it became clear that the low inflation was not only attributable to the swings in energy prices the Riksbank reappraised its view of underlying inflationary pressures in the economy. That resulted in a further easing of monetary policy at the start of 2004, even though economic prospects appeared very favourable at the time.

Several factors contributed to a difficult decision-making climate for the Riksbank in 2004. One was the sharply rising oil price and how economic activity and inflation would be affected by it. Although this did lead to some revisions of the international outlook the Riksbank judged that the effects of the oil price rise would not be sufficiently large to have any crucial significance for the formulation of monetary policy.

The combination of a more evident cyclical upswing, low interest rates and weak inflationary pressures also gave rise to questions regarding the appropriate policy stance. In 2004 it became increasingly clear that the rate cuts in 2003 had achieved their goal and helped to boost domestic demand. Consumption grew steadily during the year and investment rebounded after a number of years' negative growth. So the additional rate cuts at the start of 2004 came at a stage when demand was already firm, something that complicated the Bank's policy deliberations.

The Bank lowered the repo rate nevertheless, as discussed above, on the grounds that weaker

labour market developments and higher productivity growth than expected were holding back cost pressures. In addition, imported inflation turned out surprisingly low. This, too, gave cause for some consideration since it can sometimes be risky to use monetary policy to compensate for low imported inflation by generating higher domestic inflation. That can help to establish excessively high domestic price pressures at the same time as imported inflation quickly picks up again.

An additional factor that was discussed was the risks that the low interest rate levels had contributed to a large build-up of household debt and a fast increase in house prices. Although this was not a decisive factor in the Riksbank's monetary policy decisions it has nonetheless advocated a certain amount of caution as regards further monetary stimulus.



Sweden has been a significant producer of minerals and metals since the Middle Ages. Commodity prices have risen sharply in recent times, partly due to high global demand.





■ A safe and efficient payment system – financial stability

The Sveriges Riksbank Act states that the Riksbank shall promote a safe and efficient payment system. In addition to regular surveillance of the financial system and crisis management this task involves a legal responsibility to provide Sweden's banknotes and coins as well as an operational responsibility for the system that enables banks to securely execute large-value payments with each other.

This section first describes the Riksbank's work to prevent and manage financial crises. It then discusses the Bank's operational functions as regards the payment system and the provision of notes and coins.

Financial stability

DESCRIPTION OF THE ACTIVITIES

In light of its central role in the financial system the Riksbank has been entrusted with the task of promoting a safe and efficient payment system.

This function is also closely related to the Riksbank's objective of maintaining price stability; if the payment system does not function efficiently it may be difficult to safeguard the value of money.

A central bank's traditional role in the payment system is to issue banknotes and coins as well as to provide accounts that enable banks to securely execute payments with each other. However, financial companies and markets have become increasingly important for the functioning of the payment system. For that reason the Riksbank has

interpreted its task to include fostering stability and efficiency in the entire financial system.

The functions of the financial system consist of converting savings into investment, facilitating payments and managing financial risks. An inefficient financial system gives rise to considerable costs in the economy. That creates a strong incentive for the state to safeguard stability and promote efficiency in the financial system, for example through legislation and by monitoring the companies that operate in the system.

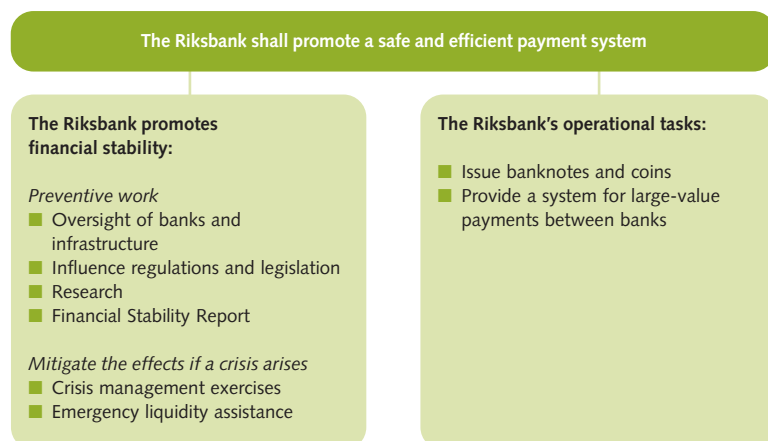
The banking system's significance to the payment system

The payment system is especially important because all economic activities presuppose the ability to make payments. The most significant form of payment today is the electronic transfer of funds between bank accounts. The banking system has therefore a pivotal role in the payment system. Were the whole banking system to fail, the payment services provided by banks could not be carried out by other players.



FIGURE 2

The Riksbank's activities to promote a safe and efficient payment system.



Owing to the large volume of interbank payments there is a risk that a crisis in one bank will spread to other banks via the payment system. Other reasons that problems can spread easily between banks are that they borrow from one another, they are exposed to the same borrower categories and they obtain funding in the same markets. At the same time, banks are inherently unstable due to the fact that both their deposits from the general public and their loans from other banks could quickly be withdrawn in a crisis situation, whereas it takes longer for them to realise their assets.



Forestry is a key part of the Swedish economy. An abundance of woodland resources in relation to the population provides the foundation for a highly export-oriented industry. Forest products accounted for some 12 per cent of Swedish goods exports in 2004.

Source: Statistics Sweden

Oversight of the financial system

The Riksbank's task to promote a safe and efficient payment system involves overseeing the financial system as a whole. Because banks hold such a unique role in the payment system, the Riksbank mainly concentrates its oversight on them, in particular the major banks, as well as on the payment infrastructure. The payment infrastructure includes the technical systems, rules and routines that apply to payments for securities, currencies, goods and services. The primary aim of this oversight is to prevent financial crises.

The Riksbank's oversight of the financial system has much in common with the activities of Finansinspektionen (the Swedish Financial Supervisory Authority), which supervises individual institutions that operate in the Swedish financial markets. For that reason the two authorities have come to an agreement delineating their areas of responsibility.

Crisis management

Should a crisis arise in spite of the Riksbank's preventive work the Bank must act to limit the economic costs of the crisis. To ensure readiness for effective crisis management the Riksbank organises and participates in crisis management exercises with Swedish and foreign authorities.

In the event of a crisis the Riksbank can provide emergency liquidity assistance to a bank or other financial institution under the supervision of Finansinspektionen that has encountered payment problems. For a bank to be able to borrow from the Riksbank without putting up the required collateral it must firstly be solvent and secondly there must be a risk that the financial system will be so seriously disrupted that its functions cannot be maintained without liquidity assistance. The fact that a bank is large is not sufficient reason in itself to obtain assistance from the Riksbank. The Bank's preventive oversight is a precondition for being able to make such assessments in a crisis situation.

The work process for the Financial Stability Report

The Riksbank's capability to prevent disruptions in the banking system and the payment infrastructure is primarily based on its ability to identify risks and to influence the players that are impor-

tant to the stability of the financial system. These players include banks, the systemically important infrastructure, legislators and international institutions. In order to be able to exert influence it is vital that the Bank enjoys high credibility. This requires a high level of professional competence and openness at the Riksbank.

The Riksbank presents its assessment of financial system stability in its Financial Stability Report, which is published twice-yearly. The report aims to facilitate a discussion of stability issues and to influence the players of significance to stability. The recurrent chapters present assessments of international risks that may affect the banking system, the ability of different borrower categories – in Sweden and abroad – to service debt, and the resilience of the Swedish banks. The important systems in the financial infrastructure are evaluated on a regular basis.

The reports also contain articles on subjects of relevance to the stability and efficiency of the financial system.

International activities, research and consultation papers

Payment flows across national boundaries have risen considerably in the past decade, making the international financial system increasingly integrated. Cross-border banking and jointly owned infrastructures have become more prevalent. In order to create common regulations and routines, thus ensuring the stability of financial systems, there is an extensive international cooperation in place. As far as the Riksbank is concerned the cooperation in the EU/ECB and the Bank for International Settlements (BIS) is of particular importance. The Riksbank also collaborates with central banks and supervisory authorities in above all the Nordic countries, where the same banks and infrastructure are systemically important. The Riksbank's position as Sweden's point of contact with the International Monetary Fund (IMF) entails good opportunities to monitor financial stability developments in other countries and in the international monetary and financial system.

With a view to enhancing professional competence and maintaining a high analytical level the Riksbank conducts research in areas of relevance to financial stability.

As a consultation body the Riksbank can influence the design of the regulations governing Swedish financial institutions.

ACTIVITIES IN 2004

The two Financial Stability Reports published during the year gave a fairly bright picture of developments in the banking system. The major Swedish banks improved their profitability and thereby their ability to meet unexpected losses. Their Tier 1 capital, which acts as a buffer if large losses should be incurred, grew during the year. The Riksbank's assessment was that the favourable economic outlook reduced the risk that the banks' borrowers would cause them substantial loan losses in the near term. That applies to the banks' customers in both Sweden and the rest of Europe.

The continued strong build-up of household debt was in focus throughout 2004, prompting the Riksbank to carry out a number of in-depth analyses of this issue. The bulk of this debt seemed to be used to finance housing purchases, as reflected by the fact that house prices rose in line with household borrowing. Rising incomes and low interest rates were seen as the principal driving forces behind the high demand for loans and housing. At the end of 2004 households' debts



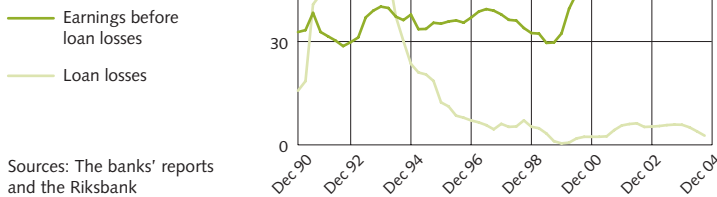
amounted to 120 per cent of their disposable incomes, which is high in a historical perspective but lower than the early 1990s. The low levels of interest rates meant, however, that households' post-tax interest expenditure comprised a relatively small share – less than four per cent – of their disposable incomes. Neither did households' indebtedness rise in relation to their real and financial wealth during the year. Households' debts increased but so did their assets, mainly due to developments in residential property prices. The ability of households to service debt was deemed to be good owing to both low interest

costs and high real and financial wealth. A study based on a sample of households confirmed that this picture also applied when examining the indebted households only. The study showed that the highly indebted households also had substantial margins and that not even sharp rises in interest rates or unemployment were deemed to greatly increase the risks in the banking system.

The second report of 2004 discussed the consequences of Swedish banks' increasing dependence on funding from the international capital markets as their deposits from the general public decrease. This development, which has been going on for some time, has meant that the banks have diversified their funding, which in itself may have reduced their vulnerability. But the ability to obtain credit in the international capital market can quickly disappear if suspicions arise over a bank, as shown by the experiences of the Swedish banking crisis in 1992. Were foreign lenders to lose faith in a specific Swedish bank it could have repercussions for the entire banking system.

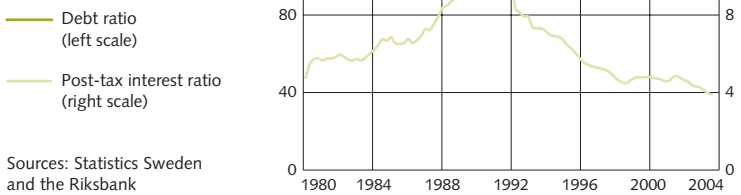
In 2004 the Riksbank continued its assessment of the financial infrastructure. The Stockholm Stock Exchange was evaluated fully for the first time. The Bank concluded that the regulations and technical systems essentially met the internationally agreed standards. Following the previous assessments of the Riksbank's payment system RIX, of BGG (the bank giro centre) and VPC (the central securities depository), all central systems in the financial infrastructure have now been evaluated once. The intention is to regularly follow up these evaluations.

DIAGRAM 7
Earnings before loan losses and loan losses (net) in the major banks. Summed up over four quarters, SEK billion, 2004 prices



Sources: The banks' reports and the Riksbank

DIAGRAM 8
Households' debts and interest payments in relation to disposable incomes. Per cent



Sources: Statistics Sweden and the Riksbank

The second Financial Stability Report in 2004 presented an assessment of the krona's first year as a participant in Continuous Linked Settlement (CLS). CLS is a system for settling foreign exchange transactions. The assessment showed that certain risks had increased after the introduction of CLS, for example that tight pay-in schedules place high demands on the participants' liquidity planning and their management of operational risks. The new risks are small, however, compared with the considerable benefits in terms of security that the new settlement system has entailed.

A crisis management exercise was carried out in 2004 with Finansinspektionen in order to identify the problems that arise when a cross-border bank is hit by a disturbance. The exercise helped clarify the Riksbank's and Finansinspektionen's different roles in the event of a crisis.

International activities, research and consultation papers

After many years of preparation the central bank governors and heads of bank supervisory authorities in the G10 countries endorsed in June 2004 a new capital adequacy framework for banks (Basel II). The intention is that the new framework be implemented from the beginning of 2007. Basel II will put greater responsibility on the banks to develop and introduce comprehensive systems for measuring and managing risks and capital. The new framework will increase the demands on banks, central banks and supervisors.

During the year the Riksbank participated in various EU forums to discuss the potential problems facing central banks and supervisory authorities now that banking and infrastructure ownership is becoming increasingly cross-border in nature. A representative from the Riksbank currently heads a working group for issues related to the management of financial crises in cross-border banks.

Riksbank representatives head a number of BIS and G10 working groups that focus on different countries' methods to finance housing, oversight of the financial infrastructure and reviews of standards for banking supervision.

The Riksbank also conducts practically oriented research in the area of payment system efficiency. One study of Swedish banks' costs in

connection with the production of payment services shows that the fees the banks charge do not fully reflect their production costs. This undermines one of the key tasks of the price mechanism, that is to say, to give consumers the information they need to make rational choices. The results indicate that the banks' pricing may have encouraged consumers to use cash, for example, instead of bank cards when making payments. This analysis is presented in the year's second Financial Stability Report. In August 2004 the Riksbank organised an international research conference on the theme "Banking, financial stability and the business cycle". The aim was to illustrate the interaction between the financial system and monetary policy. In recent years there has been growing interest in academic circles in the linkages between the banking sector and the macroeconomy and their consequences for financial stability.

In 2004 the Riksbank issued 18 responses to consultation papers from the government, including the supervisory authority, and its staff took part in six government inquiries in areas related to financial stability and efficiency. See the Riksbank's consultation responses on pages 65-66.

FOLLOW-UP OF THE RIKSBANK'S WORK TO PROMOTE FINANCIAL STABILITY

There is no easy way to judge whether the Riksbank has fulfilled its task in the area of financial stability. The financial system is stable as long as it can carry out its key functions in the economy. It is only if a serious disturbance arises that one can say that the task has not been fulfilled. Nevertheless, the absence of significant crises does not necessarily mean that the Riksbank has



carried out its task since it can take a very long time before systemic risks give rise to a crisis. As a result it is also important to evaluate whether the Bank's stability analysis has focused on the right issues and come to the right conclusions, whether its communication has been satisfactory and whether it is considered to be in a position to manage a financial crisis efficiently.

In 2004 the Riksbank asked a group of external experts to assess the Financial Stability Report. The group, which consisted of a professor from the University of Pennsylvania, an experienced IMF official and an executive from a Swedish commercial bank, presented their views in a report. Their conclusion was that the Riksbank's stability work is relevant and that it focuses on the right issues. The report revealed that the major Swedish banks have been influenced by the analyses in the Stability Reports.



Forestry companies have been identified as a strong cluster in Sweden. They cooperate with suppliers in the engineering sector, the chemicals industry, the transport sector, the IT industry, the construction sector, and the research and education system. The forestry-based cluster accounts for 25-30 per cent of Swedish industry.

Source: Swedish Forest Industries Federation

The experts' recommendations for improvements have been discussed and some were taken into account in the second Stability Report of 2004. These include a clearer description of the Riksbank's financial stability objectives and of the boundaries in relation to Finansinspektionen's activities.

The recommendation that the group considered most important was that the Riksbank should introduce a chapter on current policy developments that affect stability in the financial system. The Riksbank shares this view and is considering including such a chapter in the Stability Report each year.

Another recommendation was that the Riksbank's oversight should be broadened to cover other aspects of the financial system than the major banks and the central infrastructure. That is something the Bank intends to do if relevant to its stability analysis. But the banks must continue to be the focal point of the analysis of financial stability. A more comprehensive focus on international conditions was another recommendation that is in keeping with the Riksbank's plans.

The crisis management exercise in 2004 clarified the different roles of the Riksbank and Finansinspektionen in the event of a crisis. The exercise also demonstrated how cross-border banking can give rise to uncertainty over the roles of different countries' authorities. The lessons learned here have therefore helped to improve the Bank's state of preparedness to manage a crisis.

Payment system

DESCRIPTION OF THE ACTIVITIES

The Riksbank's system for settling payments, RIX, can be said to be the hub of the Swedish payment system. All payments between banks and other players are processed finally in RIX. RIX currently has 19 participants.

The RIX system consists of two parallel systems: one for settling payments in Swedish kronor (K-RIX) and one for settling payments in euro (E-RIX). E-RIX is linked to the payment system of the European System of Central Banks, TARGET, which enables payments to be made between banks throughout the EU. Payments in RIX are settled on a real-time gross settlement (RTGS) basis. The Riksbank has set the following targets for the RIX system:

- The system should be accessible for 99.9 per cent of its opening hours during a calendar year.
- Customer satisfaction should be above the average for public authorities.
- The costs for K-RIX should be covered by the participants' fees.

ACTIVITIES IN 2004

The daily turnover in 2004 averaged SEK 421 billion in K-RIX and EUR 7 billion in E-RIX. Turnover in K-RIX fell somewhat in relation to the year before, mainly because of changed payment patterns due to the Swedish krona's inclusion in Continuous Linked Settlement (CLS), a global system for settling foreign exchange transactions.

In 2004 the Bank completed a project to introduce new technology for SWIFT communication in the payment system. SWIFT is an internationally agreed format for electronically transferred payment messages.

The RIX system was put into operation in 1990 and needs to be replaced by a more modern design. As a result the Bank launched a project in 2004 with the aim of replacing the current system for krona payments (K-RIX) by 2007 at the latest. It is hoped that the new system will better match users' requirements and be more cost-efficient in the long term as well as have at least the same level of security as the present system. The system requirements are being drawn up in close cooperation with the participant institutions in RIX.

During the year the Riksbank also took part in an ESCB project with the aim of replacing the current TARGET system for settling euro payments with a new central settlement system for the EU countries' central banks.

FOLLOW-UP OF THE RIKSBANK'S PAYMENT SYSTEM ACTIVITIES

Accessibility in the RIX system was 99.7 per cent in 2004, somewhat lower than the set target of 99.9 per cent. The lower figure was mainly due to some disruptions in connection with the introduction of new technology, such as that for SWIFT communication. The Riksbank last measured customer satisfaction in 2003 and the results were considerably higher than the established target. The goal of full cost coverage for K-RIX was achieved in 2004.

Banknotes and coins

DESCRIPTION OF THE ACTIVITIES

According to the Sveriges Riksbank Act the Riksbank is responsible for supplying Sweden's banknotes and coins. The Bank has the exclusive right to issue notes and coins and to determine their design. The Swedish cash management market has undergone major change in recent decades. Consistent with the Bank's strategy to focus on its core activities, and with a view to attaining a more efficient cash management process in society, the Riksbank has gradually scaled back its involvement in the operational activities.



ACTIVITIES IN 2004

Cash management

In 2004 the Riksbank decided to further rationalise the cash management process and to streamline the Bank's role in it. A task group at the Bank established guiding principles for the Bank's role in the cash management process. In accordance with the group's recommendations it was decided to limit the Riksbank's responsibilities to the following:

- Provision of a system of accounts (the banks' accounts at the Riksbank)



Sweden is the largest exporter of sawn wood products to the European market.

Source: Swedish Forest Industries Federation

- Development and design of banknotes and coins
- Procurement of banknotes and coins
- Keeping stocks of banknotes and coins
- Transportation of cash to the Riksbank's stocks
- Authenticity checks, especially in connection with the destruction of banknotes
- Maintaining satisfactory banknote quality
- Redemption of defect and invalid banknotes and coins
- Destruction of worn out banknotes

On 1 October 2004 the activities of the Riksbank's subsidiary Svensk Kontantförsörjning AB (SKAB) were transferred to the Riksbank with a view to coordinating them with the Bank's own activities in the cash management field. For more information about the Riksbank's subsidiaries see pages 48 - 49.

From having had offices in almost all Swedish counties at the start of the 1980s, and in eleven locations as late as 1998, the Riksbank has now reduced the number of offices with operational cash management activities to four: Stockholm/Tumba, Mölndal, Malmö and Härnösand.

In accordance with the task group's recommendations a decision was also taken to wind up the offices in Härnösand and Malmö in 2005. At the same time the Riksbank decided to offer banks the opportunity to set up private depots for depositing and distributing cash. It has been proposed that the banks receive interest compensation from the Riksbank for the cash held in these depots. This procedure is similar to the present value dating process, whereby the banks avoid interest costs when they return cash to the Riksbank. By providing the banks with interest compensation for cash in these depots the Riksbank will avoid unnecessary deliveries to and from its local offices. The banks have collaborated with the Riksbank in this work. In autumn 2004 work began on analysing the need for cash depots.

Banknotes and coins

Swedish banknotes are forged on a relatively small scale by international standards. However, since the security features of the 100- and 500-krona notes were improved there has been an increase in the number of counterfeit 50-krona notes. 1000-krona notes have also been subjected to

forgery at times. As a result the Riksbank decided in 2004 to raise the security level of 50- and 1000-krona banknotes. The Riksbank also decided to issue a 20-krona banknote on more durable paper. The aim here is to enhance the quality of the 20-krona notes, which tend to wear out faster than other notes.

In 2004 the Bank also decided that three banknotes would become invalid at the end of 2005: the older versions of the 100- and 500-krona notes (without a foil strip) and the older, larger version of the 20-krona banknote. The old, silver-coloured 50 öre coins will also become invalid at the end of 2005.

The Riksbank issued a commemorative coin during the year to celebrate the 250th anniversary of the Royal Palace in Stockholm.

FOLLOW-UP OF THE RIKSBANK'S CASH MANAGEMENT ACTIVITIES

The Riksbank's cash management activities are currently being restructured. The restructuring process will take another few years to conclude.

In 2004 the cash management activities functioned smoothly. The stock of banknotes and coins in circulation has shown a trend increase of about three to four per cent a year in the last ten-year period, although the rate of increase

declined at the end of 2004. At year-end the stock was more or less the same as a year earlier, approximately SEK 109 billion.

In February 2003 there was a change in the terms and conditions for inward and outward deliveries of cash at the Riksbank's/SKAB's offices. The purpose of the change was to achieve more efficient cash management in society by lowering the economic incentive for banks to deposit notes at the Riksbank overnight with the sole aim of receiving interest on the amount deposited. That resulted in a sharp drop in the amount of cash deposited at and delivered from the Riksbank's/SKAB's offices. The low deposit and delivery frequency continued in 2004.





■ Financial structure, reserve management and risk control

On the basis of the Riksbank's different tasks the Bank's balance sheet can be divided into four items: banknotes and coins, capital, the gold and foreign exchange reserve and krona-denominated assets. The first two are found on the liability side of the balance sheet and the latter two on the asset side.

FINANCIAL STRUCTURE

In practice, the liability side of the Riksbank's balance sheet cannot be influenced in the short term. The volume of banknotes and coins in circulation is determined by public demand, and the size of the Riksbank's capital by the Bank's reported financial result and dividend to the State. The liability side of the balance sheet thus governs the size of the Bank's total assets.

Banknotes and coins

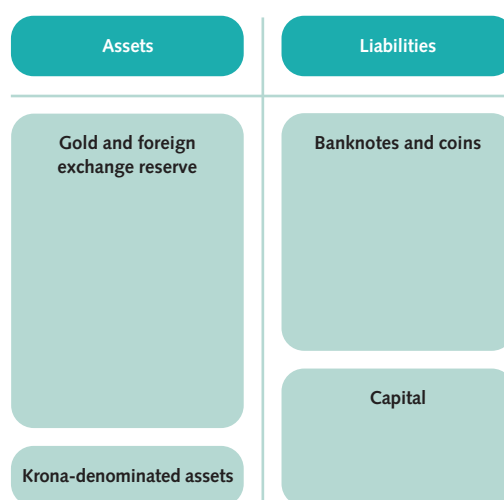
The Riksbank is responsible for providing Swedish banknotes and coins. The Bank also has the sole right to issue these notes and coins. There is no target for the size of this item; instead, it is determined entirely by public demand for cash. This demand is in turn influenced in the short run by interest rate levels and in the long run by the structure of the cash market as well as the availability and cost of alternative methods of payment. The stock of notes and coins in circulation totalled some SEK 109 billion at the end of 2004. The stock is largest ahead of major holidays and monthly salary payments, when public demand for cash rises.

Capital

In order for the Riksbank to be able to conduct its activities credibly and independently it is vital that the Bank has sufficient capital so that it is not dependent on injections of funds. The Riksbank therefore needs capital to meet its operating costs and to cover any losses incurred in its activities.

Such losses can arise in conjunction with providing emergency liquidity assistance to avert a threat of a disturbance in the payment system. Emergency liquidity assistance can only be granted to solvent banks or Swedish companies that are supervised by Finansinspektionen (the Swedish Financial Supervisory Authority). In a crisis situation, however, there may be a risk that a liquidity problem will develop into a solvency

FIGURE 3
Functional breakdown of the Riksbank's balance sheet.



issue. That in turn entails a risk of the Riksbank incurring losses.

Losses can also stem from the Bank's management of its gold and foreign exchange reserve, which chiefly comprises debt securities denominated in currencies other than the krona. As the Riksbank values its assets at market prices their value is influenced by changes in exchange rates and market interest rates. It is very seldom, however, that such changes in value are realised due to the Bank selling securities and exchanging currencies for kronor. Unrealised losses do have an impact on the Bank's capital, though. If, for example, the krona appreciates, the value of the currencies in the foreign exchange reserve falls. This results in an unrealised loss. If the Riksbank previously had made unrealised gains, the losses should be offset against these gains. But if the unrealised gains in the balance sheet do not cover the losses, the losses must be charged to the financial result for the year, which in turn reduces the Bank's capital.

Since the Riksbank holds foreign currency assets for the purpose of carrying out its policy tasks, the Riksdag has normally decided to exclude



exchange rate effects when calculating the dividend payable to the State. Such effects are instead recorded in the Riksbank's balance sheet. As a result the Bank accumulated large reserves of unrealised currency gains during the krona's period of depreciation in the 1990s. Some of these unrealised gains were transferred to the State following the Riksdag's decisions in 2001 and 2002 to request an additional dividend. The appreciation of the krona in recent years has resulted in unrealised exchange rate losses that have led to a further reduction of the accumulated reserves. So the Bank's financial result can vary sharply from year to year, mainly owing to fluctuations in the krona exchange rate. The Riksbank's interest income is more stable even though there are also variations in the valuation of the Bank's security holdings.



The debate on fishing quotas and the environment has brought the fishing industry into focus more than ever. Today the industry is regulated both at national and European level. In 2004 the total catch from Swedish sea fishing was 252,930 tonnes. This was worth some SEK 820 million at the first point of sale.

Source: Preliminary facts from the National Board of Fisheries

Guidelines for the allocation of the Riksbank's net income were adopted by the General Council in 1988. In accordance with the guidelines, 80 per cent of the Bank's average income for the past five years, excluding exchange rate effects, is normally transferred to the State, with the remainder being put in funds. The Riksbank's capital, in other words its capital and reserves as well as the financial result for the year, amounted to around SEK 64 billion at the end of the year.

Gold and foreign exchange reserve

For the purpose of conducting exchange rate policy the Riksbank is required to hold assets in foreign currency, foreign receivables and gold. The primary aim of holding a gold and foreign exchange reserve is to enable the Bank to intervene in the foreign exchange market if necessary. The reserve can also be used in a crisis to provide emergency liquidity assistance in foreign currency to the banking system.

Currency market intervention is most common under a fixed exchange rate. Since 1992 Sweden has had a floating exchange rate, which means that the value of the krona in relation to other currencies is determined in the market. Interventions may also occur, however, under a floating exchange rate with a view to counteracting exchange rate movements that threaten price stability. The Riksbank did not intervene in the market in 2004.

More information about the Riksbank's asset management can be found on page 37. At year-end the gold and foreign exchange reserve was valued at approximately SEK 163 billion.

Krona-denominated assets

The Swedish banking system normally has an overall borrowing requirement in kronor in relation to the Riksbank. The size of this requirement is determined by the structure of the Bank's balance sheet. The important items in this regard are the capital and the foreign exchange reserve, which are relatively stable over time. This means that under normal circumstances the banking system's need to borrow from the Riksbank will vary mainly with the public's demand for cash. These loans are booked as an asset on the Bank's balance sheet.

The bulk of the lending to banks is carried out through the Bank's main refinancing operations, also known as monetary policy repos. This type of repo means that the Riksbank meets the banks' borrowing requirement by buying securities from them and simultaneously agreeing to re-sell the securities to them after a certain period. The term of the repo is usually one week. The amount of the repo is decided on the basis of a forecast of the payments or flows that pass between the Riksbank and the banks and that affect the relevant items on the Bank's balance sheet. In addition to lending via repos, some deposit and lending activities are carried on with banks via accounts. At year-end, lending to the banks totalled SEK 17 billion.

MANAGEMENT OF THE GOLD AND FOREIGN EXCHANGE RESERVE

The gold and foreign exchange reserve consists of gold and securities denominated in foreign currency, as well as Special Drawing Rights with the International Monetary Fund (IMF). The Riksbank manages these assets with a view to generating the highest possible return, given the guidelines set by the Executive Board and without compromising the Bank's ability to carry out the statutory tasks assigned to it by the Riksdag. As regards the gold and foreign exchange reserve this refers mainly to the Bank's ability to intervene in the foreign exchange market. Currency market intervention means that the Riksbank purchases and sells foreign currency in exchange for Swedish kronor with the aim of influencing the exchange rate.

To enable currency market intervention the foreign currency assets must be liquid, which means that the liquidity and credit risks in the portfolio of assets need to be low. As a result the foreign currency reserve is mainly invested in government-backed securities. In addition to government bonds the Riksbank can also invest in bonds issued by government-backed institutions, international organisations and us Agencies. These holdings generate a higher return than government bonds and can only comprise a maximum of 35 per cent of the foreign exchange reserve. The Riksbank's foreign reserve assets are denominated in six different currencies as follows: us dollars (37 per cent), the euro (37 per

cent), British pounds (11 per cent), Japanese yen (8 per cent), Canadian dollars (4 per cent) and Australian dollars (3 per cent).

The Riksbank actively manages the interest rate risk in its assets, which involves taking positions in relation to a benchmark portfolio consisting of a series of government bonds. For example, the positions may entail buying or selling government bonds with a view to generating a higher return than that of the benchmark portfolio. The Riksbank lends some of its securities in exchange for collateral via three custody banks, with the aim of increasing the Bank's return.

The Riksbank manages its gold assets in accordance with the Central Bank Gold Agreement (CBGA), a framework established by 15 European central banks that originally entered into force on 27 September 1999. The agreement, which was renewed in 2004, runs until 2009 and allows the Riksbank to sell up to 60 tonnes of gold over the agreement period. The Bank sold a total of 15 tonnes of gold during 2004 and the start of 2005, reducing its holding to around 170 tonnes in January 2005. The proceeds from the sale were reinvested in the foreign exchange reserve, i.e. in foreign currency securities. The CBGA also sets a cap on gold lending. As a result the Riksbank only lends some of its gold reserve.

Receivables from the IMF are not actively managed, generating instead the return set by the IMF's regulations on return, allocation of the IMF's costs and the SDR interest rate.

In 2004 the Riksbank initiated a review of its reserve management. The aim is to increase the risk-adjusted return on the Bank's financial assets.

FINANCIAL RISK MANAGEMENT

The Riksbank's financial risks stem mainly from its management of the gold and foreign exchange reserve, its implementation of monetary policy operations and from transactions in the payment systems. Financial risks refer to the possibility of incurring losses due to the Bank's exposures to credit risk, market risk, liquidity risk and operational risk. Managing these risks is an integral part of the Riksbank's activities. Prudent risk-taking within set boundaries, coupled with established risk management methods, helps safeguard the Bank's independence and reputation.



Some 90 per cent of all Swedish exports and imports are transported by cargo ship and ferry.



The Executive Board adopts the overall framework for managing the Bank's financial risks. The department heads are responsible for ensuring that the risks in their respective activities are managed in a satisfactory way. The Risk Control Division independently monitors the Riksbank's financial risks and also evaluates the results of the Bank's asset management. The Internal Audit Department audits and evaluates the efficiency and integrity of the risk management framework.

Liquidity risk is the risk of the Bank incurring losses or significantly higher costs than estimated due to its failure to meet its payment obligations on time. To reduce liquidity risk the Riksbank only invests in securities for which there are large, liquid markets and does so in several different currencies.

Credit risk is the risk of incurring losses due to the inability of a counterparty to fulfil its obligations in relation to the Riksbank. Credit risk stems from claims that arise on other financial institutions when executing financial transactions. The Bank manages credit risk by setting qualitative standards (such as credit ratings) for its counterparties and for the securities it accepts as collateral when lending to financial institutions. When lending against collateral the Riksbank generally requires additional margin above the lent amount.

Market risk is the risk of incurring losses owing to changes in the price of gold, in exchange rates or interest rates. The Riksbank's market risk is high because its assets chiefly comprise the gold and foreign exchange reserve, which is invested

in gold and debt securities in foreign currency.

In terms of Swedish kronor the Riksbank's currency risk was the single biggest risk at the end of the year. This risk is managed by investing the currency reserve in assets with a well-diversified currency composition. The allocation between the different currencies is decided by the Executive Board. A change of 10 per cent in the value of the krona would have had an impact at the end of the year of SEK 14 billion on the Bank's financial result. Interest rate risk is managed through the Bank's choice of duration, which is a measure of the sensitivity of the reserve's market value to changes in interest rates. The Riksbank uses modified duration to this end, which gives the interest rate sensitivity in per cent. The Executive Board has set the modified duration at 4 per cent, with an allowance for deviations of ± 1.5 percentage points from that level. This means that a 1 per cent rise in interest rates in the markets in which the Bank invests would lower the value of the portfolio by 4 per cent, corresponding at the end of the year to SEK 4.7 billion.

These risk measures are supplemented by other measures such as Value-at-Risk (VaR) and stress and scenario analyses. The VaR model is capable of handling different market risks homogeneously, thus enabling comparisons between, and summation of, various kinds of risks such as those related to currencies, the price of gold and interest rates. The Riksbank's average VaR was SEK 2.8 billion in 2004, of which currency risk comprised 61 per cent, interest rate risk 21 per cent and gold price risk 18 per cent. The risk level has decreased somewhat since last year, mainly due to lower volatility in some of the currencies in which the Bank invests.

Operational risk is the risk of incurring losses due to incidents, other than market events, inside or outside the Bank, such as contractual problems, fraud, insufficient knowledge or weakness in the Bank's internal controls. The risks of operational losses are mainly countered by ensuring that the Bank's staff is both competent and risk-conscious. Further contributing to this end are internal regulations and an explicit delineation of responsibilities. The level of the operational risks in the Bank's financial activities is measured and evaluated annually.

■ Organisation

The guiding principles for work at the Riksbank in recent years have been to improve efficiency and focus on the bank's core activities, to strive for openness and clarity and to continually improve the professional competence of the organisation.

Focus on the core activities

The focus on the core activities aims to ensure efficiency in the bank's work. In recent years, the Riksbank has endeavoured to refine its activities to analytical work in the fields of monetary policy and financial stability. In this process the bank's former operations in the fields of cash management and production of statistics have been transferred to other bodies. New IT support for financial activities has also contributed to increased efficiency. As part of the endeavour to keep costs down, the Executive Board decided in 2003 to reduce the number of posts by ten per cent over a three-year period. Great restraint has been practiced when refilling vacant posts and when making new recruitments. Over the past decade the number of employees at the Riksbank has declined by more than 300, measured as full-time equivalents. Including the Riksbank's subsidiaries, the reduction in the number of employees has been even greater, approximately 700.

Openness and clarity

The Riksbank's independent status requires a high degree of openness and clarity. To ensure there is confidence in the Riksbank's monetary policy in Swedish society, it is important that a broad general public can understand the policy, that it is discussed openly and that it can be evaluated. Carefully-prepared analytical frameworks and policy rules are one way of increasing clarity. For instance, the Executive Board has specified how the price stability target should be interpreted, which time horizon is considered most relevant for monetary policy decisions and how various types of shock should be managed. Correspondingly, the bank makes available descriptions of the bases for the bank's analyses of financial stability and the conditions under which the Riksbank could provide emergency liquidity assistance to the banks.

The Riksbank considers it very important to explain its work in regular reports, speeches, press

releases and other publications produced regularly. An Inflation Report is published four times a year, aiming to make it easier for external parties to follow and understand monetary policy as well as to encourage discussion of monetary policy issues. A Financial Stability Report is published twice a year, with the aim to create a debate on stability issues and to influence agents who are important to financial stability. The separate minutes of the Executive Board's monetary policy meetings are also published regularly and provide a detailed account of the discussion on which the interest rate decisions are based.

Professional competence

Skilled analytical work is necessary for making well-founded decisions and the Riksbank constantly strives to improve professional competence in its fields of analysis. This is achieved partly by endeavouring to establish close links between the practical application of the analysis and the theoretical and empirical research activities.

Participation in international cooperation also contributes to greater professional competence.

Over the past few years a comprehensive renewal of the professional competence within the Riksbank has taken place. Analytical competence in economics has been extended, while the need for administrative and operational staff has declined as a result of the Riksbank's activities being made more efficient and certain activities being transferred to other bodies.

ORGANISATION AND MANAGEMENT FORMS

The Riksbank is organised into seven departments and a secretariat for the General Council. Three of the departments work directly with the Bank's main tasks: the Monetary Policy Department, the Financial Stability Department and the Market Operations Department.

In 2004 a number of improvements were made in the Riksbank's management and governance.

The first change was made on 1 June 2004, when the number of departments was reduced from eleven to seven. Three smaller departments – the International Department, the Communications Department and the Secretariat of the Executive Board – were merged to form a General Secretariat. The Research Department was transferred to the Monetary Policy Department and the Risk Management Department was moved into the Financial Stability Department.

In December 2004, further changes were decided, which would apply from 1 January 2005. These changes are aimed at clarifying the allocation of responsibility between the members of the Executive Board and the heads of department and at achieving a more coherent governance of the Riksbank:

- The Executive Board members' responsibility for the departments was discontinued. This meant that the heads of department's responsibility for daily activities was made clearer.
- The Executive Board allocated special responsibility to individual members for each of the following areas: monetary policy issues, financial stability issues, asset management, responses to consultation documents, and strategic information and communication issues. The

responsibility delegated to the members entails presenting proposals for decisions by the Executive Board and taking decisions within a predetermined framework. At the same time, it was decided that the Governor has management responsibility for all heads of department.

- A Management Group was established, consisting of the heads of the six largest departments and with the head of the General Secretariat as chairman. The head of the General Secretariat was also given responsibility for interdepartmental coordination.

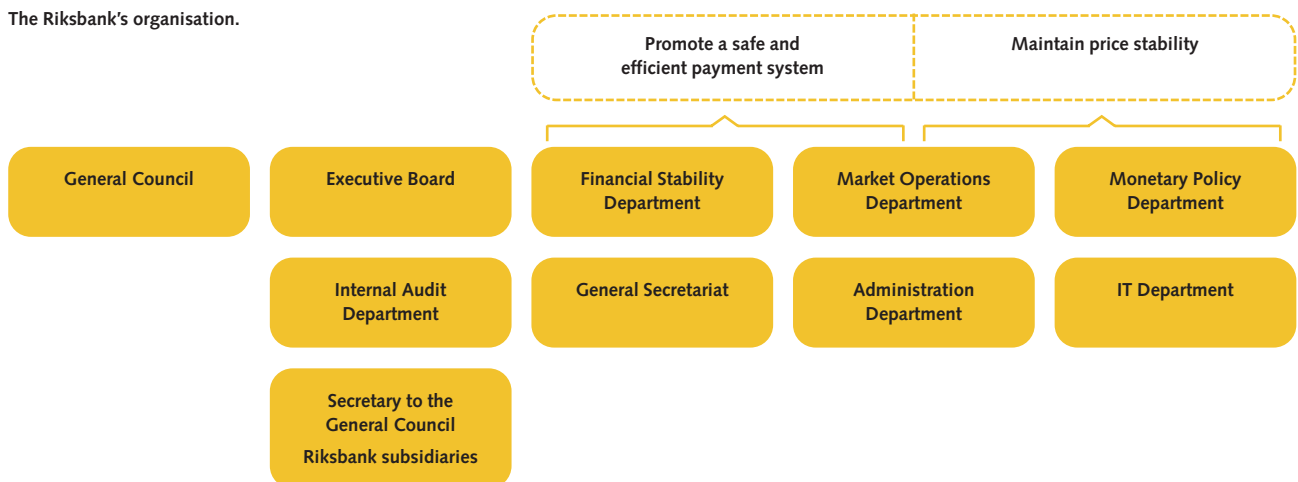
The changes mean that the Executive Board is given greater scope to focus its work on the Riksbank's core functions, i.e. the conduct of monetary policy and the promotion of a safe and efficient payment system, as well as the strategic governance of the Bank's activities.

THE DEPARTMENTS OF THE RIKSBANK

The Monetary Policy Department

Responsible for the monetary policy analyses that provide a basis for the decisions made to meet the price stability target. The department monitors and analyses price developments and is responsible for financial market and balance of payments

FIGURE 4
The Riksbank's organisation.



statistics. This department also comprises the Riksbank's Research Division.

Head of Department: Anders Vredin

Number of employees: 79

The Financial Stability Department

Responsible for analysing the stability of the financial system, which provides a basis for decisions made to meet the objective of promoting a safe and efficient payment system. The department monitors and analyses the payment system infrastructure, major individual banks and the private sector's cash management. The department is also responsible for controlling the risks that arise in the Riksbank's financial activities.

Head of Department: Martin Andersson

Number of employees: 33

The Market Operations Department

Implements monetary and foreign exchange policy measures with the aim of influencing the interest rate or exchange rate according to the monetary policy decisions. In addition, the department manages the Riksbank's assets in foreign currency and compiles statistics on interest rates and foreign exchange markets. The department is also responsible for the operation of the Riksbank's payment system for large-value payments between banks and for the supply of banknotes and coins.

Head of Department: Kai Barvell

Number of employees: 82

The Administration Department

Responsible for development of personnel and professional competence, office services, building maintenance, transport, security, business planning and budgets, accounting, wages and financial systems and financial administration.

Head of Department: Agneta Rönström

Number of employees: 104

General Secretariat

Responsible for coordinating daily activities and supporting the Executive Board's management and strategic development of the Bank's activities.

The secretariat coordinates the Riksbank's communications activities and international work and is responsible for legal issues.

Head of Department: Mats Galvenius

Number of employees: 52 (including the Executive Board)

The IT Department

Administers and maintains the Bank's IT infrastructure, and develops and purchases new applications.

Head of Department: Marie Rudberg

Number of employees: 78

The Internal Audit Department

Examines and evaluates the bank's activities and contributes to making the work at the Riksbank function in an efficient and secure manner.

Head of Department: Ulrika Bergelö

Number of employees: 5

In addition, there is a secretariat for the General Council that is also responsible for winding-up the Riksbank's subsidiaries. The head of this function is Björn Hasselgren.

The number of employees refers to the number of full-time equivalents at the end of the year.

Staff

In 2004 the Riksbank's personnel work has mainly aimed at providing support to managers during the changeover work, including the incorporation of SKAB's cash management activities into the Riksbank. The Personnel Division has also worked in various ways to increase internal mobility and provide employees with opportunities to progress in their professional roles. During 2004 there has also been focus on extending the systematic work to promote the working environment at the Riksbank.

Managers at the Riksbank have taken the second part of a special management course. The course primarily focused on communication and the managers have been trained in active listening and clear communication. The course also dealt with the fundamental requirements and expectations that employees have regarding their manager, as well as what is expected of managers in their role as employer. The aim is for managers to develop their own leadership skills and also to create a common approach to leadership at the Bank.

DEVELOPMENT OF PROFESSIONAL COMPETENCE

In a knowledge-intensive organisation like the Riksbank, the development of professional competence is particularly important. A major part of this development comes through learning from one another in work. The Riksbank also provides in-house courses within various fields. Employees

also have the opportunity to participate in external courses, both nationally and internationally, with a view to gaining more in-depth knowledge of specialist areas. Seminars, participation in international committees and working groups, and exchanges with other central banks provide excellent opportunities for employees to attain a deeper and broader understanding of their own work areas.

EQUALITY AND DIVERSITY

It is the Riksbank's ambition that all employees should be assessed on the basis of performance and personal attributes, and not according to other characteristics such as gender or ethnicity. For a long time now the Riksbank has worked successfully to improve gender equality. It is a long-term effort that is based on increasing awareness of, and changing attitudes to, equality and diversity. The gender distribution is currently relatively even (44 per cent women and 56 per cent men). At management level the distribution is 40 per cent women and 60 per cent men. The distribution is equal in the Riksbank's Executive Board; three men and three women. As part of the Bank's equality plan, there have been continued efforts to even out unwarranted pay differences. Attitudes to equality and the different communication methods used by men and women have been taken up in the management training programme. The Personnel Division has reviewed the recruitment process from a diversity perspective, and managers at the Riksbank have received training in what the legislation on diversity and the employer role involve in this field.

WORKING ENVIRONMENT

The Riksbank endeavours to be a workplace where employees can combine private life and high professional ambitions. Efforts to improve the working environment at the Riksbank aim to increase employees' motivation, job satisfaction and efficiency. Personal development talks and

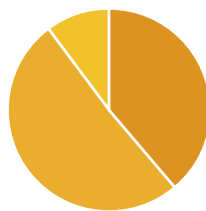


DIAGRAM 9
Educational level.

- Compulsory school or upper-secondary school
- University degree
- PhD or licentiate

Note. Around 60 per cent of the Riksbank's employees are graduates.

Source: The Riksbank

exit interviews are used to form a picture of how employees perceive their work situation. In this way the Riksbank can identify areas for improvement and set goals for a better working climate. In 2004, the systematic working environment work has been extended.

The Riksbank offers extensive keep-fit activities that include different forms of physical exercise, relaxation and nutritional advice. The building also houses a well-equipped gym.

STAFF TURNOVER AND ABSENTEEISM

The average number of employees amounted to 420 full-time equivalents (FTE) in 2004, consisting of 189 women and 231 men. At the end of the year the number of employees was 434 FTEs, which included 33 people previously employed by SKAB. There has been a large reduction in the number of employees over the past ten years. In 1995, the Riksbank had an average of 755 employees in FTE terms.

Staff turnover decreased somewhat in 2004, from 9 to 8 per cent. The average period of employment was 10 years.

The total absenteeism due to illness as a share of total hours worked amounted to 6.0 per cent for women and 3.0 per cent for men.

TABLE 4
Average number of employees (FTEs)

	1995	2002	2003	2004
The Riksbank	755	437	439	420
of which the Cashier's Department	390	–	–	–
of which incorporated from SKAB	–	–	–	33
The Riksbank's subsidiaries	381	844	540	3
of which SKAB/PSAB	–	555	540	3*
of which AB Tumba bruk/Crane AB	381	289	**	–
Total	1136	1281	979	423

* at the end of the year

** the company was sold at the end of the year



Governance

THE EXECUTIVE BOARD OF THE RIKSBANK

The Riksbank is led by an Executive Board with the following six members:

Lars Heikensten,

term of office of six years from 1 January 2003

Lars Heikensten is Governor of the Riksbank and Chairman of the Executive Board. In 2004 Mr Heikensten was responsible for preparing matters relating to the General Secretariat and the Internal Audit Department. He is a member of the General Council of the ECB and a member of the Board of Directors of the Bank for International Settlements (BIS). He is also Sweden's governor in the International Monetary Fund. He has previously worked as chief economist at Svenska Handelsbanken and the Swedish National Debt Office, and he has also been head of the economics department at the Ministry of Finance. Mr Heikensten has a PhD in economics and was Deputy Governor during the period 1995-2002.

Eva Srejber,

term of office of six years from 1 January 2003

Eva Srejber is First Deputy Governor and First Vice Chairman of the Executive Board. In 2004 Ms Srejber was responsible for preparing matters relating to the IT Department and the Market Operations Department. Ms Srejber is the Governor's alternate on the ECB General Council and a member of the EU's Economic and Financial Committee. She is also a member of the International Relations Committee of the ESCB. Ms Srejber is an economist and has previously been head of the Riksbank's Monetary and Foreign Exchange Policy Department, a member of the Executive Board of the IMF, and Deputy CEO of Swedbank, where she was responsible, among other things, for EMU issues.

Villy Bergström,

term of office of six years from 1 January 2002

Villy Bergström is Deputy Governor and was responsible in 2004 for matters concerning the Riksbank's research and for the Riksbank's opinions on consultation documents. Mr Bergström represents the Riksbank in the OECD's Working

Party Three. He is an associate professor in economics and has previously been Head of the Trade Union Institute for Economic Research (FIEF), member of the SNS economic council and editor-in-chief of the Dala Demokraten newspaper.

Lars Nyberg,

term of office of six years from 1 January 2000

Lars Nyberg is Deputy Governor and was responsible in 2004 for preparing matters relating to the Financial Stability Department. Mr Nyberg is also a member of the Board of Finansinspektionen (the Swedish Financial Supervisory Authority) by appointment of the Government. He is the Riksbank's representative in the group of deputies for the G10 Ministers and Governors, and he is a member of the Banking Supervision Committee of the ESCB. Mr Nyberg is an associate professor in economics and has previously been Deputy CEO at Svenska Handelsbanken and Swedbank and CEO of Länsförsäkringsbolagens förening.

Kristina Persson,

term of office of six years from 1 May 2001

Kristina Persson is Deputy Governor and was responsible in 2004 for preparing matters relating to the Administration Department and for IMF issues. Ms Persson is a graduate in business administration, has been governor of the county of Jämtland, and has worked at the Ministry of Finance, the Institute for Futures Studies, and as economist at the Swedish Confederation of Professional Employees (TCO). She has also been a Member of Parliament and its Committee on Finance, a member of the Riksbank's General Council and a member of the European Parliament.

Irma Rosenberg,

term of office six years from 1 January 2003

Irma Rosenberg is Deputy Director and was responsible in 2004 for preparing matters relating to the Monetary Policy Department and for matters concerning the ownership of the Riksbank's subsidiaries. Ms Rosenberg participates in BIS meetings together with the Riksbank Governor. She has a PhD in economics and has worked as chief economist at the mortgage institution SBAB and at Sweden Post and Postgirot Bank. Prior to

this, Ms Rosenberg was head of research and head of forecasting at the National Institute of Economic Research.

The Executive Board's tasks

The Executive Board is responsible for the bank's entire activities, i.e. monetary policy, issues of financial stability, market operations and the payments system. The Executive Board is also responsible for the Bank's administration and budget. In 2004 the Board members were responsible for preparing matters relating to the various departments. As of 1 January 2005, this responsibility has been discontinued and replaced with a responsibility for different subject areas to be decided by the Executive Board, as follows:

Lars Heikensten is responsible for presenting proposals regarding appointments to posts decided by the Executive Board and for management of the heads of department.

Eva Srejber is responsible for presenting proposals in the field of asset management.

Villy Bergström is responsible for presenting proposals regarding consultation opinions involving major principles and for making decisions in other matters relating to consultation documents.

Lars Nyberg is responsible for presenting proposals for Financial Stability Reports and on measures aimed at ensuring the stability and efficiency of the payments system.

Kristina Persson is responsible for presenting proposals regarding strategic information and communication issues.

Irma Rosenberg is responsible for presenting proposals for Inflation Reports and for decisions on monetary and exchange rate policy measures. She is also responsible for issues relating to the Riksbank's subsidiaries.

The Executive Board makes decisions collectively at its meetings, which are usually held on alternate Thursdays. The Chairman and Vice Chairman of the General Council have the right to attend and speak at Executive Board meetings, but not the right to make proposals or to vote. Prior to making important monetary policy decisions, the Riksbank is required to inform the Government. In 2004 the Board held 30 meetings, eight of which were monetary policy meetings.



*Lars Heikensten,
Eva Srejber*



*Villy Bergström,
Lars Nyberg*



*Kristina Persson,
Irma Rosenberg*

The Executive Board in 2004

In 2004 the members of the Executive Board made around fifty public speeches. These covered subjects such as current monetary policy and the economic situation, financial stability and general political issues, such as globalisation and demography.

One Executive Board meeting each year is held outside of Stockholm. The purpose of this is to give greater opportunity to discuss economic developments with representatives of various industries and regions in the country, as well as to obtain views on the Riksbank's activities. The Executive Board meeting on 9 June 2004 was held in Härnösand.

The Executive Board presents a written report on monetary policy to the Riksdag Committee on Finance twice a year. The Inflation Report was used as the report to the Riksdag and supplemented with two public hearings in the Committee on Finance attended by the Governor of the Riksbank.

THE GENERAL COUNCIL

The General Council consists of eleven members and as many alternates. They are appointed by the Riksdag (the Swedish parliament) for the same period as members of parliament. The General Council elects from among its number a Chairman and a Vice Chairman.

The members of the General Council are Jan Bergqvist (Chairman), Johan Gernandt (Vice Chairman), Sinikka Bohlin, Susanne Eberstein, Peter Egardt, Kenneth Kvist, Lennart Nilsson, Kjell Nordström, Mats Odell, Karin Pilsäter and Bengt Westerberg. The alternate members are Marianne Carlström, Camilla Dahlin Andersson, Lars U. Granberg, Siv Holma, Sonia Karlsson, Maria Larsson (who replaced Göran Hägglund according to a parliamentary decision on 29 April 2004), Carin Lundberg, Stephan Tolstoy, Margareta af Ugglas, Göte Wahlström and Tommy Waidelich.

The General Council's tasks

The General Council appoints the members of the Executive Board and decides on their salaries and other terms of employment. It also adopts

the Riksbank's Rules of Procedure and decides on the design of banknotes and coins.

The General Council, appointed by the Riksdag, functions as a bridge between the Riksdag and the Riksbank. The General Council has the task of regularly monitoring the Riksbank's activities and how the Executive Board conducts its business. One of the ways the General Council can exercise control is through the Chairman and Vice Chairman having the right to attend the Executive Board meetings. The General Council also has an Audit Unit that examines how members of the Executive Board exercise their duties and examines the calculation of the Riksbank's profits in the procedures for closing the accounts. The Audit Unit's work is carried out by an external chartered auditor.

The General Council may present opinions within its field of competence on issues officially referred to the Riksbank for consideration. In consultation with the Executive Board, the General Council may present proposals to the Riksdag and the Government regarding statutory amendments or other measures in its sphere of responsibility.

The General Council presents proposals to the Riksdag and the Swedish National Audit Office regarding the allocation of the Riksbank's profits.

General Council in 2004

In 2004 the General Council met on eleven occasions. The Chairman and Vice Chairman usually attended the meetings of the Executive Board. The Council received regular reports on activities from the Executive Board.

The General Council decided in 2004 on the design of a coin to commemorate the 250th anniversary of the Royal Palace in Stockholm and also decided to issue a special banknote in 2005 to commemorate the 250th anniversary of the founding of Tumba Bruk banknote paper mill.

The General Council's Audit Unit mainly focused on ensuring that the Riksbank's Rules of Procedure and Internal Instruction do not contradict one another and that they were observed, as well as on how the Executive Board members discharged their duties and on the Riksbank's proposals for allocation of profits. Their examination did not give rise to any criticism.



*Jan Bergqvist,
Johan Germandt,
Sinikka Bohlin and
Susanne Eberstein*



*Peter Egardt,
Kenneth Kvist,
Lennart Nilsson and
Kjell Nordström*



*Mats Odell,
Karin Pilsäter and
Bengt Westerberg*

■ The Riksbank's subsidiaries

The Riksbank owns – directly or indirectly – a total of eight public limited companies. All of these companies are the result of the restructuring implemented in the field of cash management and are since 2004 in the process of being wound up.

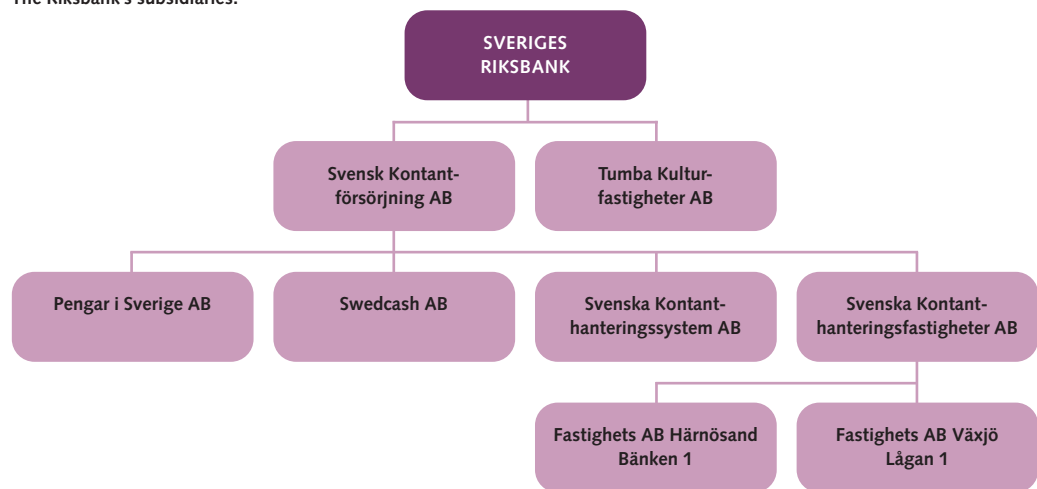
Svensk Kontantförsörjning AB (SKAB) is parent company to six companies in the SKAB Group. This includes, as well as Pengar i Sverige AB, a further five public limited companies, two of which are dormant. The two larger companies, SKAB and Pengar i Sverige AB, have undergone major changes during 2004. The other three companies manage two former Riksbank properties, which are being sold. Tumba Kulturfastigheter AB manages some land from the former AB Tumba Bruk, located in Botkyrka municipality, outside of Stockholm.

The Riksbank decided in 1998 to transfer operations and personnel from what was then the Cashiers' Department to a wholly-owned subsidiary, Pengar i Sverige AB. The purpose of this was to develop and restructure operations to make the Riksbank's cash management more efficient and contribute to greater efficiency in cash man-

agement in society. A new owner for the company would be found as quickly as possible.

However, it proved more complicated to change operations than the Riksbank had estimated. To achieve sufficient breadth and turnover in the operations, cash-in-transit operations were built up during 2002. It was still not possible to achieve profitability in the company, and the Riksbank chose to split the company into two parts in 2002. One part contained the task more closely related to central banking of providing four depots in different regions of Sweden for cash storage and for receiving and distributing banknotes and coins. This part of the operations was put into the company SKAB. Other parts of the original company were transferred to the "new" Pengar i Sverige. Pengar i Sverige AB conducted only commercial activities after the split in September 2002. These mainly took the form of counting services

FIGURE 5
The Riksbank's subsidiaries.



for banks and the retail trade, and cash-in-transit operations.

The Riksbank has been working on selling Pengar i Sverige AB since 2002. Extensive measures were taken in 2002 and 2003 to restructure the company's operations. However, these were not sufficient to achieve profitability. In 2004 the sales work intensified and was aimed at finding owners for the company's assets when it became clear that there was no prospective buyer willing to acquire the shares in the company.

An agreement to sell the majority of the assets in Pengar i Sverige AB to Securitas Värde AB was signed at the beginning of 2004. The transfer was reported to the Swedish Competition Authority, which in May 2004 announced that it intended to conduct a special investigation into the transfer. Securitas Värde then decided to cancel the agreement. Consequently, Pengar i Sverige AB arranged a tender, offering all of the company's assets for sale. Following an assessment of all the tenders received, an agreement was signed with Securitas Värde AB in July 2004 covering the majority of the assets. The Swedish Competition Authority announced in August 2004 that it did not intend to examine this transfer, which was therefore effected on 1 October 2004.

All of Pengar i Sverige's customer agreements were cancelled during spring 2004 and all of the approximately 250 employees were given notice of redundancy with effect from 1 July 2004. Activities in Pengar i Sverige AB were thus wound up at the beginning of July 2004 and the activities of SKAB were transferred to the Riksbank on 1 October 2004. Parallel with this the Riksbank has decided on a new structure for cash management, which will be introduced during 2005.

During autumn 2004 the work has consisted of terminating the company's remaining customer agreements and obligations to suppliers, as well as closing down premises. The rental agreement for the property in Malmö rented by SKAB, where the Riksbank currently conducts operations, has been transferred to the Riksbank with effect from 1 January 2005. The former staff of the company has been given redundancy payments. The aim has been to wind up as much of the remaining operations as possible by the end of 2004.

■ Accounting principles

The balance sheet and the profit and loss account for the Riksbank have been compiled pursuant to the Sveriges Riksbank Act and in accordance with the Rules for Bookkeeping and Annual Accounts at Sveriges Riksbank adopted by the Executive Board.

CHANGES IN ACCOUNTING PRINCIPLES

In December 2003 the Executive Board decided, with effect from the financial year 2004, to replace the Accounting Instruction for the Riksbank with Rules for Bookkeeping and Annual Accounts at Sveriges Riksbank. The accounting rules are taken from the Bookkeeping Ordinance (SFS 2000:606) and the rules for annual accounts from the Guideline of the European Central Bank on the legal framework for accounting and financial reporting in the European System of Central Banks (ECB/2002/10). This change was made possible when a new accounting system was introduced. The decision entailed the following important changes in the Riksbank's accounting:

- Unrealised price and exchange rate gains and losses are reported separately. Unrealised gains are no longer reported in the profit and loss account but entered directly in a special revaluation account in the balance sheet. Unrealised losses are reported in the profit and loss account if they exceed unrealised gains booked in the balance sheet, see note 22.
- Accrued interest is reported under special balance sheet items.
- Capital is reported in the balance sheet items Capital and Reserves, which means that the reserve fund, contingency fund and balancing account are included in the Reserves item.
- When securities are purchased and sold, the amounts are reported in the balance sheet as of the settlement date instead of the trade date, which means that the items claims for securities settlement proceeds and liabilities on securities settlement proceeds will be omitted.

The comparison figures in the balance sheet as of 31 December 2003 have been converted with regard to the change in accounting principles, see note 38. The effect of reporting unrealised gains and losses in special revaluation accounts is reported in comparison with future figures as

it cannot be established with reasonable precision for previous years.

BASIC ACCOUNTING ASSUMPTIONS

The following fundamental accounting principles have been applied:

- Accounting shall reflect the economic reality and be characterised by transparency.
- The valuation of assets and liabilities, like the recognition of income, shall be carried out prudently.
- Assets and liabilities shall be adjusted to take into account events that occur between the end of the financial year and the date the annual accounts are adopted by the Executive Board, on condition that these events have affected the value of the assets or liabilities on the closing day.
- When assessing assets and liabilities, it must be assumed that the activities will continue.
- Income and expenditure will be reported as income and expenditure during the accounting period they were earned or arose, regardless of when payment is made.
- The criteria for estimating balance sheet items and for the profit and loss account should be applied consistently.

RECOGNITION OF ASSETS AND LIABILITIES

Assets and liabilities are only reported in the balance sheet if it is probable that any future financial results connected to the asset or liability will comprise a flow to or from the Riksbank and that in principle all risks and rights related to the asset or liability have been transferred to the Riksbank.

TRADE-DATE ACCOUNTING

Foreign exchange transactions and securities transactions are registered on the trade date in off-balance sheet accounts. On the settlement date the amount is transferred from these accounts to the balance sheet accounts. Realised gains and losses from net sales are booked on the trade date.

BALANCE SHEET VALUATION RULES

Marketable assets are valued at the market rates and market prices applying on the closing day.

REPURCHASE AGREEMENTS

Repurchase agreements are reported as loan transactions and therefore do not affect the holdings of securities and gold. A repurchase agreement is an agreement to sell assets, such as securities or gold, whereby the seller simultaneously undertakes to repurchase the assets at a specified price on a specific date in the future.

Assets pledged by the Riksbank as collateral for repos are still reported in the balance sheet and are valued in accordance with the applicable rules for the Riksbank's other holdings of securities and gold. An amount equivalent to the received purchase sum is reported as a liability, while the transferred assets are reported as memorandum items.

Assets received by the Riksbank under reverse repurchase agreements are not reported in the balance sheet because they constitute loan collateral. An amount equivalent to the paid purchase sum is reported as a receivable. The difference between the two payments in a repurchase agreement (spot and forward) is treated on an accrual basis over the term of the agreement.

Transactions carried out within the framework of agreements on automatic repurchase agreements are only reported in the balance sheet if collateral is pledged in the form of cash for the entire duration of the transaction.

BANKNOTES AND COINS

The balance sheet item "banknotes and coins in circulation" is calculated by deducting from the value of the banknotes and coins the Riksbank has received from the manufacturers both the value of the banknotes and coins the Riksbank has destroyed and the value of the banknotes and coins in the Riksbank's stocks.

RECOGNITION OF INCOME

Realised gains and losses are transferred to the profit and loss account.

Unrealised gains are transferred to the revaluation account in the balance sheet.

Unrealised losses are transferred to the profit and loss account if they exceed unrealised gains that may have been previously registered in the corresponding revaluation account. Unrealised losses that are transferred to the profit and loss

account may not be reversed during later years to offset new unrealised gains. Unrealised losses in a particular security, a particular currency or gold are not netted against unrealised gains in other security, currencies or gold.

Premiums and discounts on securities purchased are calculated and reported as part of interest income and are written off during the security's remaining time to maturity.

COST OF TRANSACTIONS

With regard to gold, instruments in foreign currencies and securities, the average method is used daily to establish the acquisition cost of items sold when calculating effects of exchange rates and prices. When net acquisitions of currency and gold are made, the average acquisition cost for the day's acquisition with regard to each individual currency and gold is added to the previous day's holdings to obtain a new weighted average of the exchange rate and the gold price respectively. To calculate net sales, the realised outcome is calculated on the basis of the average acquisition cost on the previous day for the holding in question.

OFF-BALANCE SHEET INSTRUMENTS

Off-balance sheet instruments with a positive net market value are reported as assets and those with a negative value as liabilities.

TANGIBLE AND INTANGIBLE FIXED ASSETS

The Riksbank's tangible and intangible fixed assets are booked at acquisition value and depreciated according to plan. Write-downs are made when the reduction in value is judged to be permanent. Write-ups are only allowed if the asset has a reliable and lasting value that significantly exceeds the book value. Buildings are depreciated over a period of 50 years, other fixed assets over 5-10 years. Machinery and equipment, including computers, is written off over 3-7 years. Direct staff costs attributable to IT investments developed in-house are included in the asset's acquisition value.

■ Balance Sheet SEK MILLION

Assets	NOTE	31-12-2004	31-12-2003
Gold	1	17 393	18 030
Claims on residents outside Sweden denominated in foreign currency			
Receivables from the IMF	2	10 148	12 241
Balances with banks and security investments	3	135 108	129 031
		145 256	141 272
Lending to monetary policy counterparties denominated in Swedish kronor			
Main refinancing operations	4	17 000	23 800
Fine-tuning operations	5	–	–
Marginal lending facility	6	2	0
		17 002	23 800
Other assets			
Tangible and intangible fixed assets	7	538	509
Financial assets	8	410	324
Prepaid expenses and accrued income	9	1 963	2 005
Other assets	10	294	291
		3 205	3 129
Total assets		182 856	186 231
Liabilities and capital	NOTE	31-12-2004	31-12-2003
Banknotes and coins in circulation			
Banknotes	11	103 452	103 675
Coins	12	5 442	5 265
		108 894	108 940
Liabilities to monetary policy counterparties denominated in Swedish kronor			
Deposit facility	13	86	49
Fine-tuning operations	14	527	491
		613	540
Liabilities to residents outside Sweden denominated in Swedish kronor	15	306	125
Liabilities to residents outside Sweden denominated in foreign currency	16	4 912	998
Counterpart of Special Drawing Rights allocated by the IMF	17	2 537	2 647
Other liabilities			
Off-balance sheet instruments	18	85	16
Accrued expenses and deferred income	19	100	81
Other liabilities	20	69	71
		254	168
Provisions	21	304	396
Revaluation accounts	22	1 523	–
Equity capital			
Capital	23	1 000	1 000
Reserves	24	65 317	80 697
		66 317	81 697
Result for the year		-2 804	-9 280
Total liabilities and capital		182 856	186 231

Memorandum items, see Note 37.

■ Profit and Loss Account SEK MILLION

	NOTE	2004	2003
Interest income	25	4 778	5 316
Interest expenses	26	-290	-121
Net result of financial operations	27	-6 317	-13 287
Fees and commission income	28	19	18
Fees and commission expenses	29	-9	-8
Income from equity shares	30	42	185
Other income	31	24	5
Total net income		-1 753	-7 892
Staff costs	32	-309	-323
Administrative expenses	33	-231	-228
Depreciation of tangible and intangible fixed assets	34	-69	-72
Banknote and coin expenses	35	-160	-244
Other expenses	36	-282	-521
Total expenses		-1 051	-1 388
Result for the year		-2 804	-9 280

Notes

SEK MILLION. FIGURES IN BRACKETS REFER TO 2003.

Note 1 Gold

	31-12-2004	31-12-2003
Quantity		
Troy ounces (million)	5.96	5.96
Price		
USD per ounce	439.05	416.50
SEK/USD	6.65	7.26
Book value	17 393	18 030

As of 31 December 2004, the Riksbank holds 5.96 million ounces (troy/oz) of gold, which is equivalent to 185.4 tonnes. During 2004 the Riksbank has carried out forward transactions corresponding to the sale of 384,000 ounces (12 tonnes) of gold by forward exchange agreements falling due in 2005. See also Notes 18 and 37.

Note 2 Receivables from the IMF

	31-12-2004	31-12-2003
Special Drawing Rights	1 387	1 430
Reserve position in the IMF	8 570	10 611
Other receivables	191	200
Total	10 148	12 241

The Riksbank holds Special Drawing Rights of SDR 135 million. The Riksbank's total capital contribution (quota) to the IMF amounts to SDR 2 395.5 million and is booked net with the IMF's account for Swedish kronor under the item Reserve position in the IMF.

The item Other receivables refers to an interest-free deposit with the IMF as manager of contributions to the IMF's share of the debt relief initiative HIPC (Heavily Indebted Poor Countries) and to the Fund's concessional lending. The deposit of a total of SDR 18.6 million shall be repaid by 1 January 2019.

Note 3 Balances with banks and security investments

	31-12-2004	31-12-2003
Balances with banks	13 270	8 329
Security investments	121 838	120 702
Total	135 108	129 031

This item consists mainly of foreign government securities and state-guaranteed securities as well as balances with foreign banks, such as deposits and nostro accounts. The securities are denominated in US dollars, euro, British pounds, Japanese yen, Canadian dollars and Australian dollars. The net balance of TARGET/E-RIX is also reported here.

Note 4 Main refinancing operations

The Riksbank's regular monetary policy repo operations are reported under this item. The decline is principally due to the fact that the dividend payment to the Treasury in 2004, totalling SEK 6,100 million, was financed through a reduction in the monetary policy repo.

Note 5 Fine-tuning operations

This item is used to report funds lent with a view to fine-tuning liquidity in the financial system.

Note 6 Marginal lending facility

This item is used to report overnight loans to banks on their K-RIX accounts at the Riksbank.

Note 7 Tangible and intangible fixed assets

	31-12-2004	31-12-2003
Land and buildings		
Acquisition value	340	331
Accumulated depreciation	-98	-90
Book value land and buildings	242	241
Machinery and equipment		
Acquisition value	532	492
Accumulated depreciation	-236	-224
Book value machinery and equipment	296	268
Total	538	509

The Riksbank owns two properties, the head office and Baggensnäs. The item Book value machinery and equipment includes application systems in an amount of SEK 121 million (SEK 129 million). When the Riksbank took over cash operations in Svensk Kontantförsörjning AB on 1 October 2004 the Riksbank acquired fixed assets from the company to a value of SEK 40 million. In addition, on 1 January 2005 the Riksbank acquired fixed assets to a value of SEK 13 million from the company in connection with taking over a rental contract for the office in Malmö.

Note 8 Financial assets

	31-12-2004	31-12-2003
Shares and participation rights		
Svensk Kontantförsörjning AB		
150 000 shares with a par value of SEK 100 each	61	0
Eskilstuna Penningsmedja AB		
1 000 shares with a par value of SEK 100 each	-	0
Tumba Kulturfastigheter AB		
1 000 shares with a par value of SEK 100 each	0	0
Swift		
33 shares with a par value of EUR 125 each	0	0
BIS		
16 021 shares with a par value of SDR 5 000 of which 25% has been paid up	267	267
European Central Bank		
7% (5) of 2.4133% (2.6537) of the total amount	82	57
Total	410	324

In 2004 the Riksbank has booked SEK 431 million, SEK 370 million of which has been paid as capital injections to Svensk Kontantförsörjning AB and Pengari Sverige AB, which initially increased the book value. The shareholding was thereafter written down by SEK 370 million, SEK 150 million of which was booked as a provision in the previous year.

Eskilstuna Penningsmedja AB was dissolved on 19 May 2004 in connection with the liquidator's final report.

The Riksbank's capital subscription to the European Central Bank increased by EUR 25 000 on 1 January 2004, due to a change in the capital key and by EUR 2.7 million on 1 May 2004 as a result of the Riksbank's capital subscription changing when ten new countries became members of the European Union.

Note 9 Prepaid expenses and accrued income

This item is used to report prepaid expenses and accrued income.

Note 10 Other assets

	31-12-2004	31-12-2003
Staff loans	252	245
Claim on Crane & Co. Inc.	25	24
VAT recoverable	13	17
Other	4	5
Total	294	291

The item Claim on Crane & Co. Inc. refers to part of the sale amount for Crane AB and will be settled by the payment of USD 1 million in 2008 and USD 3 million in 2011.

Note 11 Banknotes

The value of banknotes in circulation, by denomination:

	31-12-2004	31-12-2003
1 000 kronor	45 561	45 652
500 kronor	45 116	44 788
100 kronor	9 621	10 091
50 kronor	1 207	1 192
20 kronor	1 639	1 643
10 kronor	228	229
5 kronor	80	80
Total	103 452	103 675

Note 12 Coins

The value of coins in circulation, by denomination:

	31-12-2004	31-12-2003
10 kronor	2 150	2 051
5 kronor	1 171	1 156
2 kronor	8	8
1 kronor	1 195	1 159
0.50 kronor	288	276
Commemorative coins	630	615
Total	5 442	5 265

Note 13 Deposit facility

Overnight deposits from the banks in their K-RIX accounts at the Riksbank are reported here.

Note 14 Fine-tuning operations

This item is used to report deposits for the purpose of fine tuning liquidity in the financial system.

Note 15 Liabilities to residents outside Sweden denominated in Swedish kronor

Accounts in Swedish kronor that the Riksbank holds on behalf of other central banks and international organisations are reported here.

Note 16 Liabilities to residents outside Sweden denominated in foreign currency

Amounts corresponding to purchase amounts received in foreign currency for deposit repos are reported here.

Note 17 Counterpart of Special Drawing Rights allocated by the IMF

The Riksbank's liability corresponding to the special drawing rights allocated by the IMF is reported here. The accumulated amount granted totals SDR 246.5.

Note 18 Off-balance sheet instruments

	31-12-2004	31-12-2003
Gold forwards, negative value	22	–
Gold forwards, positive value	-9	–
FX swaps, negative value	150	94
FX swaps, positive value	-78	-78
Total	85	16

Off-balance sheet instruments with a negative net market value are reported here. The nominal amount of the off-balance sheet contract, which is reported as a memorandum item – see Note 37, is shown below:

	31-12-2004	31-12-2003
Gold forwards, negative value	683	–
Gold forwards, positive value	479	–
FX swaps, negative value	1 618	5 051
FX swaps, positive value	4 821	2 696
Total	7 601	7 747

Note 19 Accrued expenses and deferred income

This item is used to report accrued expenses and deferred income.

Note 20 Other liabilities

	31-12-2004	31-12-2003
Accounts payable - trade	47	55
Other	22	16
Total	69	71

Note 21 Provisions

	31-12-2004	31-12-2003
Pension liability	171	184
Other provisions	133	212
Total	304	396

Pension liability refers to pensioners and has been calculated by the National Government Employee Pensions Board (Statens pensionsverk).

The item Other provisions includes SEK 123 million for a capital injection that has not yet been paid to Pengar i Sverige AB and the estimated cost of managing the rental contract for the office in Malmö in connection with its winding up during 2005. There is also an allocation of SEK 7 million regarding a commitment to provide compensation to the National Property Board for neglected maintenance of the buildings donated by Tumba Kulturfastigheter in 2002. In addition, there is SEK 3 million concerning funds for competence development and competence renewal that were agreed in connection with the reduction of the fee to the Job Security Foundation.

Note 22 Revaluation accounts

	31-12-2004	31-12-2003
Price effect	1 500	–
Exchange rate effect	23	–
Gold valuation effect	–	–
Total	1 523	–

With effect from 2004, unrealised gains and losses are reported in special revaluation accounts. If the unrealised losses exceed the unrealised gains at the end of the year, the difference is reported in the profit and loss account. This calculation is made security by security and currency by currency.

Note 23 Capital

The Sveriges Riksbank Act states that the Riksbank shall have capital in an amount of SEK 1 000 million.

Note 24 Reserves

	31-12-2004	31-12-2003
Reserve fund	500	500
Contingency fund	36 396	49 056
Balancing account	28 421	31 141
Total	65 317	80 697

The Sveriges Riksbank Act states that the Riksbank shall have a reserve fund amounting to SEK 500 million.

The contingency fund and the balancing account have been used since 1988, according to guidelines for the Riksbank's allocation of net revenue adopted that year. The contingency fund has also been used for entering the amounts of asset write-ups. The Riksbank's gold reserve was written up to market value on 31 December 1998 and fixed assets were entered in the balance sheet in 1994 at acquisition value minus depreciation. During 2004, a transfer of SEK 2 million was made between the sub-items Write-up of fixed assets and Allocation of net revenue, due to the year's depreciation of written-up

fixed assets. The value of the BIS shares was written up in 1996 to correspond to the market value of the gold used as payment for the share allocation in that year. The above-mentioned allocations and write-ups are shown in the table below:

	31-12-2004	31-12-2003
Allocations of net revenue		
Exchange rate effects	11 938	24 418
Gold valuation effects	4 196	4 376
Other allocations of net revenue	7 223	7 221
Write-up of assets		
Gold reserve	12 686	12 686
Fixed assets	118	120
BIS shares	235	235
Total	36 396	49 056

The changes in the items Capital, Reserves and Result for the year are explained in the table below:

	Capital	Reserves	Result for the year	Total
Balance 31 December 2003	1 000	80 697	-9 280	72 417
Transfer to the Treasury			-6 100	-6 100
Transfer to/from				
Balancing account		-2 720	2 720	0
Contingency fund		-12 660	12 660	0
Result for the year			-2 804	-2 804
Balance 31 December 2004	1 000	65 317	-2 804	63 513

Note 25 Interest income

	2004	2003
Foreign assets	4 492	4 702
Main refinancing operations	274	598
Other	12	16
Total	4 778	5 316

This item primarily includes bond interest and interest received from the main refinancing operations.

Note 26 Interest expenses

	2004	2003
Foreign liabilities	-280	-112
Domestic liabilities	-10	-9
Total	-290	-121

Interest expenses mainly consist of interest on deposit accounts.

Note 27 Net result of financial operations

	2004	2003
Price effect	-109	-627
Exchange rate effect	-5 617	-12 480
Gold valuation effect	-591	-180
Total	-6 317	-13 287

The comparison figures include unrealised exchange rate gains, which are reported in special revaluation accounts with effect from 2004.

The price effect consists of realised gains and losses on securities amounting to SEK 128 million and unrealised gains and losses on securities amounting to a loss of SEK 237 million.

The exchange rate effect includes realised exchange rate gains and losses amounting to SEK 491 million and unrealised exchange rate gains and losses amounting to a loss of SEK 6 108 million. The realised exchange rate effect includes SEK 618 million regarding conversion of the IMF's account for Swedish kronor. The conversion arises because the account is hedged in SDR against the IMF and regulated through payment transactions in Swedish kronor on the account.

The gold valuation effect includes realised gold price gains and losses amounting to SEK 0.2 million and unrealised gold price losses amounting to SEK 591 million.

Note 28 Fees and commission income

This item mainly includes annual fees and transaction fees with regard to the RIX system.

Note 29 Fees and commission expenses

This item mainly includes expenses for securities custody accounts.

Note 30 Income from equity shares

Dividend has been received from BIS amounting to SEK 40 million (SEK 38 million). In addition, SEK 2 million was received from Eskilstuna Penningsmedja AB when it was liquidated.

Note 31 Other income

Other income refers both to settlement of SEK 4 million regarding the sale of Crane AB and to cancelling of reserves regarding this settlement amounting to SEK 7 million. In addition, SEK 5 million is included for banknote and coin delivery charges and SEK 4 million for compensation from Värdepapperscentralen, VPC (the Swedish central securities depository) for work on the Newclear project.

Note 32 Staff costs

	2004	2003
Salaries and benefits	-183	-173
Pension costs	-48	-74
Social security charges	-68	-64
Other	-10	-12
Total	-309	-323

Salaries and benefits to the members of the Executive Board amounted to SEK 10.1 million in 2004, broken down as follows.

	2004	2003
Lars Heikensten	1.5	1.4
Eva Srejber	1.8	1.8
Villy Bergström	1.8	1.7
Lars Nyberg	1.7	1.7
Kristina Persson	1.6	1.6
Irma Rosenberg	1.7	1.6
Summa	10.1	9.8

In addition, Lars Heikensten received SEK 0.6 million in remuneration during 2004, as in 2003, from the Bank for International Settlements.

The General Council has decided that during the statutory qualification period after the end of employment, members of the Board shall receive a full salary without a work requirement. However, deduction will be made for any income from other employment during this period.

According to a decision of the General Council on 21 May 1999 regarding guidelines for pension conditions for members of the Riksbank's Executive Board, the regulation (RFS 1996:4) issued by the Administrative Board of the Riksdag on the implementation of the ordinance on pensions for senior government officials, etc. (1995:1038) shall apply to members of the Executive Board. This regulation stipulates, however, that earlier provisions shall apply to persons covered by the regulations that were rescinded on 31 December 1996, which means that Eva Srejber and Lars Heikensten are covered by the earlier regulation (1991:1160) on pensions for senior government officials, etc., while the four other Board members are covered by the newer regulation (1995:1038). Lars Heikensten will also receive, according to the present system, a pension from the BIS. This pension is payable to board members who have held a commission at BIS for at least four years, but is not paid out until they reach the age of 65. The pension is calculated on the basis of the board fees paid, amounting to 1.82 per cent of these.

During 2004, staff costs attributable to IT investments developed in-house have been included in the acquisition value of the asset in an amount of SEK 3 million (SEK 15 million).

The average number of employees (FTEs) in 2004 totalled 420 (439), of which 189 (199) were women and 231 (240) men. The number of FTEs at the end of the year was 434 (426). Sick leave in 2004 corresponded to 4.4 per cent (4.3 per cent) of employees' total working hours. Sick leave over a continuous period of 60 days or more in 2004 corresponded to 63.5 per cent (66.8 per cent) of total sick leave. Women's sick leave in relation to total regular working hours for women amounted in 2004 to 6.0 per cent (6.3 per cent), while the corresponding figure for men in 2004 was 3.0 per cent (2.6 per cent).

The table below shows sick leave for each age group in relation to the total regular working hours for the group:

	2004	2003
29 years or younger	1.5%	1.6%
30-49 years	1.9%	2.2%
50 years or older	8.6%	8.9%

Note 33 Administrative expenses

	2004	2003
Information, hospitality	-11	-13
Transport, travel	-13	-18
Consulting assignments	-37	-41
Other external services	-38	-37
IT operation	-49	-51
Economics prize	-19	-17
Office and property maintenance	-47	-44
Other	-17	-7
Total	-231	-228

Information expenses include costs for the Riksbank's regular publications (Inflation Report, Financial Stability Report, Annual Report, Economic Review, etc.), special information projects, etc.

The largest individual item in Other external services consists of costs for statistics, mainly supplied by Statistics Sweden, corresponding to SEK 30 million (SEK 22 million). The result for Other external services in 2003 also included a fee of SEK 7 million to Svensk Kontantförsörjning AB for destruction and authenticity checks of banknotes, which for 2004 is reported under the cost group Other and amounts to SEK 9 million. These activities were incorporated into the Riksbank on 1 October 2004.

The Economics prize item includes the prize sum of SEK 10 million and administration costs for the prize of SEK 9 million. The administration costs have increased by SEK 2 million compared with 2003, because the Riksbank signed an agreement with the Nobel Foundation in 2004 that includes an annual payment of SEK 1 million and a one-off payment of SEK 1 million regarding the Internet-based Nobel Prize Museum the foundation has constructed.

Note 34 Tangible and intangible fixed assets

This item is used to report depreciation according to plan of tangible and intangible fixed assets.

Note 35 Banknote and coin expenses

Of the total cost for banknotes and coins of SEK 160 million (SEK 244 million), SEK 64 million (SEK 131 million) is in respect of the purchase of banknotes, SEK 84 million (SEK 99 million) for the purchase of circulation coins and SEK 12 million (SEK 14 million) for the purchase of commemorative coins.

Note 36 Other expenses

The item Other expenses refers to capital injections to Svensk Kontantförsörjning AB and Pengar i Sverige AB, and also the estimated cost for managing the rental agreement for the office in Malmö in connection with winding up the office in 2005.

Note 37 Memorandum items

Pledged collateral

Securities with a market value equivalent to SEK 4 876 million (SEK 991 million) have been pledged in connection with foreign securities repos.

Securities with a market value equivalent to SEK 199 million (SEK 64 million) have been pledged as marginal collateral.

Gold with a market value equivalent to SEK 3 643 million (SEK 9 972 million) has been lent.

Contingent liabilities

Agreements under GAB (General Arrangements to Borrow) and NAB (New Arrangements to Borrow) to provide the IMF with a credit facility of up to SDR 850 million (SDR 850 million).

Agreements where the Riksbank guarantees the value of Swedish government bonds, Treasury bills and mortgage bonds pledged as collateral for intraday credits between commercial banks and central banks in the euro area.

The nominal value of outstanding FX-swaps, whose market value is shown in Note 18, totalled SEK 6 439 million (SEK 7 747 million).

The nominal value of outstanding gold forwards, whose market value is shown in Note 18, totalled SEK 1 162 million (SEK 0 million).

An undertaking to pay KPA Pensionsförsäkring AB supplementary compensation if so required as a result of index-linking the pension benefits to which the insured is entitled. This undertaking refers to personnel transferred from the Riksbank to AB Tumba Bruk (now Crane AB) in 1971.

Undertaking to provide the Nobel Foundation with funds annually for the award of a prize in economic sciences in memory of Alfred Nobel and also administration costs for this prize. This undertaking amounted to SEK 19 million in 2004 (SEK 17 million).

Undertaking to pay BIS, if so demanded, the remaining 75 per cent of the nominal value of the Riksbank's shareholding in BIS. This undertaking corresponded to SEK 618 million at the end of 2004 (SEK 645 million).

Note 38 Converted comparison figures as of
31 December 2003

	31-12-2003 before conversion	1.	2.	3.	4.	31-12-2003 after conversion
<i>Asset items</i>						
Receivables from the IMF	12 267	-26				12 241
Balances with banks and security investments	130 809	-1 898		120		129 031
Main refinancing operations	23 826	-26				23 800
Prepaid expenses and accrued income	10	1 995				2 005
Claims for securities settlement proceeds	193			-193		-
Other assets	336	-45				291
Total	167 441	0	0	-73	0	167 368
<i>Liabilities and capital items</i>						
Counterpart of SDRs allocated by the IMF	2 654	-7				2 647
Accrued expenses and deferred income	6	7		68		81
Liabilities on securities settlement proceeds	73			-73		-
Other liabilities	535			-464		71
Provisions	-			396		396
Balancing account	31 141		-31 141			-
Equity capital	50 556		-50 556			-
Capital	-		1 000			1 000
Reserves	-		80 697			80 697
Total	84 965	0	0	-73	0	84 892

1. Transfer of accrued interest to the items "Prepaid expenses and accrued income" and "Accrued expenses and deferred income".
2. Transfer of the items "Balancing account" and "Equity capital" to the items "Capital" and "Reserves".
3. Transfer of the items "Claims for securities settlement proceeds" and "Liabilities on securities settlement proceeds" to the item "Balances with banks and security investments".
4. Transfer of provisions of SEK 212 million and pension liability of SEK 184 million, excluding reserved special employer's contribution, to the item "Provisions". In addition, transfer of reserved special employer's contribution regarding pension liability of SEK 44 million and transfer of holiday pay liability of SEK 24 million including reserved social security charges to the item "Accrued expenses and deferred income".

■ Five-year overview SEK MILLION

The five-year overview presents the balance sheet and profit and loss account in accordance with current accounting principles, with the exception of no translation being made for the years 2002-2003 with regard to reporting unrealised gains and losses in special revaluation accounts.

Balance Sheet

31-12-04 31-12-03 31-12-02 31-12-01 31-12-00

Assets

Gold 17 393 18 030 18 210 17 436 15 428

Claims on residents outside Sweden denominated in foreign currency

Receivables from the IMF 10 148 12 241 14 269 13 254 10 608

Balances with banks and security investments 135 108 129 031 133 659 132 321 139 038
145 256 141 272 147 928 145 575 149 646

Lending to monetary policy counterparties denominated in Swedish kronor

Main refinancing operations 17 000 23 800 29 179 65 030 40 817

Fine-tuning operations - - 1 415 3 986 2 284

Marginal lending facility 2 0 87 29 48
17 002 23 800 30 681 69 045 43 149

Securities of residents in Sweden denominated in Swedish kronor

- - - - 19 893

Other assets

Tangible and intangible fixed assets 538 509 455 406 372

Financial assets 410 324 382 617 667

Off-balance sheet instruments - - - - -

Prepaid expenses and accrued income 1 963 2 005 2 558 2 238 3 400

Other assets 294 291 226 215 207

3 205 3 129 3 621 3 476 4 646

Total assets 182 856 186 231 200 440 235 532 232 762

Balance sheet

cont. 31-12-04 31-12-03 31-12-02 31-12-01 31-12-00

Liabilities to residents outside Sweden denominated in Swedish kronor 306 125 207 161 159

■ The Riksbank's subsidiaries

SEK MILLION

Svensk Kontantförsörjning AB and subsidiaries

The group includes as well as Svensk Kontantförsörjning AB (SKAB) the subsidiaries Pengar i Sverige AB, Svenska Kontanthanteringssystem AB, Swedcash AB (dormant) and Svenska Kontanthanteringsfastigheter AB with two property management subsidiaries.

Pengar i Sverige AB has been up for sale for a long time. In February 2004 an agreement was reached with Securitas Värde AB on the transfer of the majority of the staff and assets. This agreement was examined by the Swedish Competition Authority, which announced in May 2004 that it intended to conduct a special investigation into the transfer. Securitas then decided to cancel the agreement at the beginning of June. It was therefore decided to wind up operations in Pengar i Sverige AB. The remaining staff were given notice of redundancy and the company's assets were sold by tender.

In August the Riksbank decided that the activities of SKAB would be transferred to the Riksbank with effect from 1 October, after which this company also began to be wound up. A decision was made to reduce the number of offices from four to two, which would be located in Tumba and Mölndal. During a transition period the offices in Malmö and Härnösand are also being run by the Riksbank.

The running of IT operations for SKAB was transferred from the subsidiary Svenska Kontanthanteringssystem AB to the Riksbank in July 2004. This company is being wound up.

The two property management companies with properties in Härnösand and Växjö are up for sale. Once they have been sold, Svenska Kontanthanteringsfastigheter AB will also be wound up.

SKAB's costs for winding up operations amounted to a net total of SEK 185 million for 2004, which includes all costs that have arisen after the decision to wind up the respective companies. The costs are primarily related to notices of redundancy and retirement of staff, write-down of fixed assets and early termination of agreements with customers. Earlier reserves for future rental expenses for unused premises have been restored, as some rental agreements have been transferred to external parties.

The rental agreement for the property in Svågertorp, Malmö, has been transferred from SKAB to the Riksbank with effect from 1 January 2005.

The Riksbank has over the year provided a capital injection of SEK 20 million to SKAB and issued a capital cover guarantee of SEK 275 million to Pengar i Sverige AB, SEK 261 million of which has been requisitioned.

Profit and Loss Account (consolidated), SEK million

	2004	2003
Operating income	143	292
Operating expenses	-413	-688*
Operating profit/loss	-270	-396*
Financial items	-9	-23
Profit/loss after financial items	-279	-419*
Tax on the year's result	-	-
Result for the year	-279	-419*

Balance Sheet (consolidated), SEK million

	31-12-2004	31-12-2003
Fixed assets	29	176
Current assets	111	524
Total assets	140	700
Equity capital	68	66*
Provisions	42	94*
Current liabilities	30	540
Total equity capital and liabilities	140	700

*These items have been changed in accordance with the adopted annual accounts.

Board of directors (parent company)

Björn Hasselgren, Chairman
Kai Barvell
Kersti Eriksen
Heine Andersson, employee representative

Address

Svensk Kontantförsörjning AB
Peter Mommas väg 2
SE-147 43 Tumba

Tumba Kulturfastigheter AB

The company is 100 per cent owned by the Riksbank and was acquired in December 2001 with the purpose of buying premises and equipment from AB Tumba Bruk (now Crane AB). The mill area in Tumba designated as cultural heritage, consisting of buildings and adjoining land, was transferred to the National Property Board in 2002, after approval by the Riksbank and the Riksdag. The purpose was to ensure that the unique mill environment with industrial and cultural heritage importance, along with the buildings and park should be preserved for future generations.

In 2004 the last of the company's four house plots was sold. There has been some investigation into a separate land area with the aim of planning for housing construction and later sale. The remaining land (arable and woodland) will be retained by the company until Botkyrka municipality begins planning this area for future housing construction. Alternatively, the land may be transferred to the Riksbank.

The National Property Board is currently converting and renovating premises to encompass a mill museum. A Tumba Bruk foundation (Stiftelsen Tumba Bruk) has been formed to finance the museum activities, following a decision by the Executive Board of the Riksbank and with the Riksdag's approval. The museum will be run by the Royal Coin Cabinet and will open in June 2005.

Once the museum has opened and the remaining land has been sold or transferred to the Riksbank, the aim is to wind up the company.

Profit and Loss Account, SEK million

	2004	2003
Operating income	0.4	1.8
Operating expenses	0.0	-0.1
Operating profit/loss	0.4	1.7
Financial items	0.0	-0.1
Profit/loss after financial items	0.4	1.6
Tax on the year's result	-0.1	-4.2
Result for the year	0.3	-2.6

Balance Sheet, SEK million

	31-12-2004	31-12-2003
Current assets	1.8	2.0
Total assets	1.8	2.0
Equity capital	1.8	1.5
Liabilities	0.0	0.5
Total equity capital and liabilities	1.8	2.0

Board of directors

Kersti Eriksen, Chairman
Björn Hasselgren

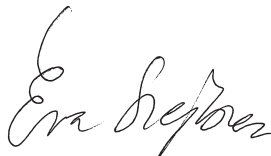
Address

Tumba Kulturfastigheter AB
c/o Sveriges Riksbank
SE-103 37 Stockholm

Stockholm, 10 February 2005



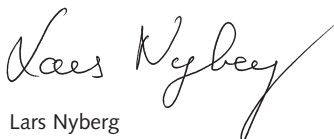
Lars Heikensten
Governor



Eva Srejber
First Deputy Governor



Villy Bergström
Deputy Governor



Lars Nyberg
Deputy Governor



Kristina Persson
Deputy Governor



Irma Rosenberg
Deputy Governor

■ Proposal for the allocation of profits for 2004

The Riksdag approved in connection with its consideration of the Riksbank's management for the year 2003 (2003/04 FIV23) that the allocation of profits for 2003 should be based on the 1988 principle of allocation of profits with the supplements to the principle made since then, which was the proposal put forward by the General Council. The principle of allocation of profits entails 80 per cent of the average profits for the past five years, excluding exchange rate and gold revaluation effects, being transferred to the Treasury. The General Council also applies this principle to the calculation of the allocation of profits for 2004.

Pursuant to Chapter 10, Article 3 of the Sveriges Riksbank Act (1988:1385), the General Council has received a report for the financial year 2004 from the Executive Board. The General Council has noted that in accordance with the Executive Board's decision, unrealised gains are no longer included in the Riksbank's reported financial result, with effect from 2004. This means that when the General Council has calculated the allocation of profits, it has added unrealised price effect gains to the Riksbank's reported financial result to achieve the same transfer proposal as if this change in accounting principles had not taken place.

In this context the General Council wishes to draw the Riksdag's attention to the fact that the accounting principles that have now been introduced at the Riksbank will enable a transition to a model for profit allocation that more clearly links the Riksbank's equity capital to its different tasks. The General Council would welcome a continued discussion of the question of future regulation of the Riksbank's allocation of profits with the aim of legislation on principles for profit allocation.

The Audit Unit of the General Council has examined the basis for calculating the profit allocation proposal. The Audit Unit did not find any reason for objections.

The General Council decided on 11 February 2005 to submit the following proposal for the allocation of the Riksbank's profits.

The result before appropriations for 2004 amounts to a loss of SEK 2,804 million. The General Council proposes that:

SEK million	
Transfer to the Treasury (according to the allocation of profits principle)	6 700
Transfer from the contingency fund	-6 208
Transfer from the balancing account	-3 296

■ Auditor's report

The Swedish National Audit Office (Riksrevisionen) has audited the Annual Report of Sveriges Riksbank, approved by the Executive Board of the Riksbank on 10 February 2005, for the financial year 2004.

The Executive Board of the Riksbank is responsible for the annual accounts.

It is the responsibility of Riksrevisionen to examine the Riksbank's Annual Report in accordance with generally accepted auditing standards with the aim of reaching an assessment of whether the Annual Report and the underlying documentation are reliable, that the accounts are true and fair, and whether the Executive Board's administration has observed applicable regulations and special decisions.

The audit has been carried out in accordance with generally accepted auditing standards. This means that the audit has been planned and performed with the aim of obtaining reasonable grounds for making an assessment of whether the Annual Report is true and fair. The examination has accordingly included a selection of significant transactions and administrative decisions.

The audit gives reasonable ground for the statements set out below.

The Annual Report has been prepared in accordance with the Sveriges Riksbank Act and with the application of the principles for bookkeeping and annual accounts adopted by the Executive Board of the Riksbank.

It is the opinion of Riksrevisionen that the Annual Report gives a true and fair picture of the Riksbank.

Riksrevisionen recommends to the Swedish Parliament (the Riksdag) that the balance sheet and the profit and loss account be adopted.

Furthermore, Riksrevisionen recommends to the Swedish Parliament that the General Council of the Riksbank be discharged from liability for its operations and that the Executive Board be discharged from liability for administration of the Riksbank in 2004.

The decision in this matter was made by Lennart Grufberg, Auditor General. The audit was presented by Filip Cassel, Audit Director.

Stockholm, 11 February 2005

Lennart Grufberg

Filip Cassel

■ Consultation responses

The following consultation responses were presented by the Executive Board in 2004. Unless otherwise stated, the decision was taken by Deputy Governor Villy Bergström, who is the Executive Board member responsible for preparing consultation responses.

European Commission

11-03-2004

Comments on the consultation document for the Commission concerning a New Legal Framework for Payments in the Internal Market (COM (2003)718).

Ministry of Finance

18-11-2004

Comments on the interim report of the Prospectus Inquiry regarding new regulations on prospectuses, etc. (SOU 2004:95).

15-10-2004

Comments on a consultation document containing the National Debt Office's proposals for guidelines for the management of the Swedish national debt.

13-10-2004

Comments on the report from the Market Abuse Inquiry (SOU 2004:69).

15-09-2004

Comments on the memorandum (Ds 2004:25) the Sixth AP Fund in the reformed pension system.

14-09-2004

Comments on the Ministry of Finance's memorandum on portability of pensions savings. A decision on this matter was taken by the Executive Board of the Riksbank.

27-08-2004

Comments on a consultation document regarding proposed directives for new capital adequacy rules and an invitation to a consultation meeting. A decision on this matter was taken by Björn Hasselgren, delegated by Villy Bergström.

29-06-2004

Comments on the Long-term Planning Commission's Report (SOU 2004:19). A decision on this matter was taken by the Executive Board of the Riksbank.

22-06-2004

Comments on the Ministry of Finance's memorandum on certain stamp duties.

15-04-2004

Comments on the ministry memorandum new principles for formulating the central government budget (Ds 2003:49). A decision on this matter was taken by the Executive Board of the Riksbank.

25-03-2004

Comments on a memorandum on stamp duties in connection with floating charges.

12-03-2004

Comments on the Ministry of Finance's proposals for regulations concerning reforming the rules for banking and financing businesses.

24-02-2004

Comments on the proposed regulation with measures for implementation regarding the Prospectus Directive.

03-02-2004

Comments on the memorandum on stronger protection for insurance policyholders in life assurance companies.

29-01-2004

Comments on the memorandum on special issues regarding financial companies that apply the International Accounting Standards, IAS.

19-01-2004

Comments on the proposal for changes in the provisions regarding recovery for retirement pension policyholders in Chapter 14 of the Act on income-related old age pension (1998:674) and the changes in Chapter 9, Article 2 and Chapter 12, Articles 2 and 3 of the same act.

16-01-2004

Comments on the Ministry of Finance's memorandum regarding changes resulting from the new rules for banking and financing businesses and deposit activities.

16-01-2004

Comments on the ministry memorandum stricter regulations against money laundering (Ds 2003:52).

Finansinspektionen (the Swedish Financial Supervisory Authority)

07-12-2004

Comments on the proposal for changed business regulations resulting from the IAS directive and new IAS-adapted legislation.

17-11-2004

Comments on a consultation document with proposals for changes in the capital adequacy provisions.

25-10-2004

Comments on a consultation document regarding proposed changes in Finansinspektionen's regulations and general guidelines (FFFS 2004:X) on annual reporting by credit institutions and securities companies and Finansinspektionen's regulations and general guidelines (FFFS 2004:Y) on annual reporting by insurance companies.

27-08-2004

Comments on a consultation document regarding changes in reporting of qualified holdings, subsidiaries and general register information. A decision on this matter was taken by Björn Hasselgren, delegated by Villy Bergström.

06-05-2004

Comments on a consultation document regarding Finansinspektionen's general guidelines on applying for a licence to conduct banking and financial business or to issue electronic money.

22-04-2004

Comments on Finansinspektionen's proposed regulations and general guidelines regarding secured bonds.

17-03-2004

Comments on a proposed change in Finansinspektionen's regulations and general guidelines (FFFS 2003:13) concerning annual reporting by insurance companies – improved information on remuneration and benefits to employees in prominent positions. A decision on this matter was taken by Björn Hasselgren, delegated by Villy Bergström.

20-02-2004

Comments on a proposal for Finansinspektionen's general guidelines on credit risks in credit institutions and securities institutions.

19-01-2004

Comments on a proposal to change Finansinspektionen's regulations and general guidelines (FFFS 2003:10) concerning capital adequacy and large exposures.

Ministry of Justice

29-09-2004

Comments on the report Confidence and Business (SOU 2004:47) and on the Swedish Code of Corporate Governance (SOU 2004:46). A decision on this matter was taken by the Executive Board of the Riksbank.

25-03-2004

Comments on a draft consultation document to the Council on Legislation, European insolvency.

The Swedish Emergency Management Agency

26-08-2004

Comments on a consultation document regarding the Agency's focus on the coming web-based planning tool.

29-06-2004

Comments on "SEMA's guidelines for emergency planning for 2006".

Ministry of Industry, Employment and Communications

14-09-2004

Comments on the interim report on society's need of basic cashier services (SOU 2004:52). A decision on this matter was taken by the Executive Board of the Riksbank.

National Post and Telecom Agency, PTS

29-09-2004

Comments on a consultation document on the need for confidentiality regarding information on premises used for electronic communications.

22-06-2004

Comments on a consultation document regarding the National Post and Telecom Agency's proposals for guidelines for electronic communications services for users of particular importance to society.

22-06-2004

Comments on a consultation document regarding the National Post and Telecom Agency's proposal to introduce prioritising in the telecommunications network.

Riksdag Administration

22-01-2004

Comments on the Riksdag Administration's consultation document regarding security in parliament, etc.

Ministry of Health and Social Affairs

18-06-2004

Comments on the memorandum proposing a qualifying deduction instead of an initial qualifying day for sick leave.

18-05-2004

Comments on the memorandum incentives for reduced sickness absence.

■ Glossary

Balance of payments The statistical reporting of a country's economic transactions with the rest of the world.

BIS The Bank for International Settlements. Sometimes known as "the central banks' bank" and acts as bank and cooperation organisation for the central banks in 55 countries. BIS has its head office in Basle.

Consumer price index (CPI) Official price index established each month by Statistics Sweden regarding price trends in private consumption. The change in the CPI forms a basis for the Riksbank's definition of its price stability target.

Currency market intervention When a central bank buys or sells currency in the currency market with the aim of influencing its own country's exchange rate.

Duration A measure of how the value of a securities portfolio changes when interest rates change.

ECB The European Central Bank. The ECB is the joint central bank for the twelve EU member states who have adopted the euro. The ECB is situated in Frankfurt.

EFC The EU's Economic and Financial Committee. It advises the ECOFIN Council on financial and economic policy issues.

EMU Economic and Monetary Union. Cooperation within the EU aimed at adopting the euro as single currency. Decisions on monetary policy are then transferred from the national central banks to the ECB Governing Council. Twelve of the EU member states have adopted the euro so far.

ESCB The European System of Central Banks. This is the generic term for the ECB and the 25 national central banks in the EU countries.

Eurosystem Term referring to the ECB and the national central banks in the twelve EU member states that have adopted the euro.

Exchange rate The price of a currency expressed in units of another currency.

Exchange rate policy A central bank's actions to influence its own currency's exchange rate against other currencies.

Foreign exchange reserve A central bank's holdings of foreign currency to enable intervention when necessary and to affect the value of the country's own currency in relation to other currencies.

G10 The Group of Ten. An association of industrial nations, eleven in total, to promote cooperation on international financial issues and to support the IMF with liquidity for its loans. Sweden is a member of the G10. Finance ministries, financial supervisory authorities and central banks are involved in various forms of cooperation. A number of G10 committees have secretariats in BIS and work on developing standards for financial activities that can strengthen international financial stability.

IMF The International Monetary Fund. The International Monetary Fund was formed in 1944 to promote trade and growth by fostering economic, monetary and financial stability. The organisation currently has 184 member countries and the Riksbank serves as the contact body for the IMF in Sweden.

Inflation General price rises that cause a reduction in the value of money. The opposite is known as deflation.

Key interest rates The interest rates the Riksbank sets for deposits from and loans to the banking system.

Long-term interest rate Interest on loans with a term of more than one year.

Monetary policy The Riksbank's actions to influence the interest rate level and, indirectly, the price level.

Money market A market consisting of banks and other financial institutions that accept short-term deposits and grant short-term loans for a period of one day up to one year.

Payment system The systems, routines and regulations needed to implement payments.

Price stability A fixed value of money. According to the Riksbank's definition, price stability means keeping CPI inflation at 2 per cent ± 1 percentage point.

Real-time gross settlement A settlement system where payments are mediated and settled in real time (continuously) as the orders are received (without netting).

Repo A repurchase transaction whereby the Riksbank lends money to the banks through so-called monetary policy repos. A monetary policy repo means that the Riksbank supplies funds to the banking system by buying securities from the banks and simultaneously agreeing to re-sell the securities to the banks after one week (among market participants this is known as a reverse repo). The Riksbank then receives back the funds, and the securities are returned to the original owner. The Riksbank usually carries out repos every week.

Repo rate The interest rate banks have to pay when borrowing from the Riksbank through a repo transaction.

Riksbank reference rate An interest rate set half-yearly by the Riksbank and corresponding to the Riksbank's repo rate at the end of the previous half-year, if necessary rounded off to the nearest half a percentage point.

RIX The Riksbank's system for the settlement of large-value interbank payments. The system settles payments both in kronor (K-RIX) and in euro (E-RIX) in accordance with the principle of real-time gross settlement. RIX is linked to TARGET (see below).

SDR Special Drawing Rights. An international reserve asset created by the IMF to supplement the existing official reserves of member countries. See the Riksbank's balance sheet. The value of the SDR is based on a basket of dollars, euro, yen and sterling.

Settlement The final regulation of a debt, that is to say, when money or assets are transferred from one party to another. In RIX, settlement occurs by transferring funds between two participants' accounts.

Short-term interest rate Interest on loans with a term of less than one year.

TARGET The EU's common payment system to which member countries' national payment systems for payments in euro are connected. It links together the central banks in the EU and around 5 000 commercial banks.

Underlying inflation A measure of cyclical inflation. The Riksbank usually uses UND1X as a measure of underlying inflation. UND1X is defined as the change in the CPI excluding household mortgage interest expenditure and the direct effects of changes in indirect taxes and subsidies.

Value dating A physical transaction whereby cash is placed in/distributed from the Riksbank's cash stocks on behalf of a bank or the Swedish Cashier Service (Svensk kassaservice). The cash is thereby deposited in/withdrawn from the bank's account at the Riksbank and the calculation of interest for the bank in question changes.

VaR (Value at Risk) A measure of the estimated market risk in a portfolio of assets, based on historical correlations and variations in the market value of different assets in the portfolio.

■ Publications

The Riksbank produces a number of publications each year. The most important are:

The Inflation Report is issued four times a year. The report forms a basis for monetary policy decisions. It is also intended to make the Riksbank's assessments generally accessible in order to stimulate interest in and facilitate understanding of monetary policy.

The Financial Stability report is issued twice a year. The report describes the Riksbank's views of developments in the financial system and what these developments entail for stability. The aim is to promote better stability in the financial system and to stimulate discussion regarding issues concerning the stability of the payment system.

Sveriges Riksbank Economic Review is issued four times a year. This quarterly journal contains in-depth articles on subjects in the Riksbank's field of operations.

The Annual Report provides an account of monetary and foreign exchange policy during the past year and of how the Riksbank has worked to promote a safe and efficient payments system. The Annual Report contains the Riksbank's annual accounts.

The Working Paper Series presents reports connected to the Riksbank's field of operations that are also considered to be of interest to parties outside the bank.

Publications from the European Central Bank (ECB).

Information material about the Riksbank.

All the Riksbank's publications are available on its website (www.riksbank.se). The majority of them are published in both Swedish and English. The simplest way to order them is through the order function on the website. The Riksbank also publishes press releases, speeches, articles and minutes from the meetings of the Executive Board and the General Council on its website.

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■ The Riksbank's Prize in Economic Sciences

Sveriges Riksbank's Prize in Economic Sciences in Memory of Alfred Nobel was awarded in 2004 to Finn E. Kydland at Carnegie Mellon University, Pittsburgh and University of California, Santa Barbara, USA, and Edward C. Prescott at Arizona State University, Tempe and Federal Reserve Bank of Minneapolis, USA. They received the prize for their contributions to dynamic macroeconomics: the time consistency of economic policy and the driving forces behind business cycles.

Sveriges Riksbank's Prize in Economic Sciences was established in connection with the Riksbank's 300th anniversary in 1968. In making its donation, the Riksbank committed itself to irrevocably and for all time to enable the prize to be awarded by putting at the disposal of the Nobel Foundation each year a sum for the prize money and a sum to cover the Foundation's costs for management and finance. The Government has established the statutes governing Sveriges Riksbank's Prize in Economic Sciences in memory of Alfred Nobel.

The prize is awarded every year to a person or persons in the field of economic sciences who have produced work of outstanding importance. The Royal Swedish Academy of Sciences appoints the prize-winner(s) according to the same principles as for the Nobel Prizes. The prize amount is also the same as for the Nobel Prizes, SEK 10 million, and is paid by the Riksbank. If there is more than one winner, the prize amount is shared equally between them.

The Riksbank provided support to the Nobel Foundation in 2004 to contribute to financing the further development of the website that the Foundation maintains for the Economics prize. The Riksbank is also going to develop, together with the Nobel Foundation, an interactive educational game that will illustrate the application of economic theory in the same way as has been done for the other prize areas.

■ Finn E. Kydland was born in 1943 in Norway (Norwegian citizen). PhD from Carnegie Mellon University, Pittsburgh 1973. Professor at Carnegie Mellon University and University of California, Santa Barbara, USA.

■ Edward C. Prescott was born in 1940 in Glen Falls, NY, USA (US citizen). PhD 1967 from Carnegie Mellon University, Pittsburgh. Professor at Arizona State University, Tempe and researcher at the Federal Reserve Bank of Minneapolis, USA.



Finn E. Kydland and Edward C. Prescott received Sveriges Riksbank's Prize in Economic Sciences in Memory of Alfred Nobel in 2004.

Previous prize-winners

The prize has been awarded every year from 1969 as follows:

1969	R. Frisch and J. Tinbergen	1987	R.M. Solow
1970	P. A. Samuelson	1988	M. Allais
1971	S. Kuznets	1989	T. Haavelmo
1972	J.R. Hicks and K.J. Arrow	1990	H.M. Markowitz, M.H. Miller and W.F. Sharpe
1973	W. Leontief	1991	R.H. Coase
1974	G. Myrdal and F.A. von Hayek	1992	G.S. Becker
1975	L.V. Kantorovich and T.C. Koopmans	1993	R.W. Fogel and D.C. North
1976	M. Friedman	1994	J.C. Harsanyi, J.F. Nash Jr and R. Selten
1977	B. Ohlin and J.E. Meade	1995	R.E. Lucas, Jr.
1978	H.A. Simon	1996	J.A. Mirrlees and W. Vickrey
1979	T.W. Schultz and A. Lewis	1997	R.C. Merton and M.S. Scholes
1980	L.R. Klein	1998	A. Sen
1981	J. Tobin	1999	R.A. Mundell
1982	G.J. Stigler	2000	J.J. Heckman and D.L. McFadden
1983	G. Debreu	2001	G.A. Akerlof, A.M. Spence and J.E. Stiglitz
1984	R. Stone	2002	D. Kahneman and V. L. Smith
1985	F. Modigliani	2003	R.F. Engle and C.W.J. Granger
1986	J.M. Buchanan Jr	2004	F.E. Kydland and E.C. Prescott



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