MEMORANDUM

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DEPARTMENT: Markets Department

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Financing of the Foreign Currency Reserve

Similar to other central banks, the Riksbank maintains a foreign currency reserve. At the end of October, this amounted to approximately SEK 450 billion. Under the Riksbank Act, the Riksbank is required to manage its assets to ensure it can fulfil its duties and powers, and to generate sufficient returns to finance its own operations. Furthermore, the assets in the foreign currency reserve shall be managed with low risk, taking into account the Riksbank's position as a central bank and the purpose of the holding.

The size and composition of the foreign currency reserve are largely determined by the Riksbank's mandate. The foreign currency reserve also affects the Riksbank's exposure to currency risk in its profit and loss account and balance sheet. The foreign currency reserve is primarily intended to provide liquidity support in foreign currency to, for example, banks operating in Sweden, to intervene in the foreign exchange market, and to fulfil Sweden's obligations under the International Monetary Fund's (IMF) Special Drawing Rights (SDR) system.

The assets in the foreign currency reserve are allocated as follows:
70 per cent USD, 17.5 per cent EUR, 5 per cent GBP, 5 per cent AUD, and 2.5 per cent NOK.

Riksbank Act and financing

The foreign currency reserve may be financed either through equity or borrowed capital. Borrowed capital may take the form of loans in Swedish kronor (for example, banknotes and coins or monetary policy debt) or loans in foreign currency (for example, FX loans).

Pursuant to Chapter 10 of the Sveriges Riksbank Act, the Riksbank may decide to borrow in foreign currency via the Swedish National Debt Office to finance the foreign currency reserve. At the time of the decision, total borrowing may amount to a maximum of 5 per cent of GDP. Where there are exceptional circumstances,

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the Riksbank may, with a view to temporarily strengthening the foreign exchange reserves, decide to undertake a larger borrowing operation.

Management of currency risks and the foreign currency reserve

Currency risk currently represents the single largest risk on the Riksbank's balance sheet. The scale of this risk is determined by the size of the foreign currency reserve and the method of its financing. For a given size of the foreign currency reserve, currency risk can be reduced by borrowing in the same currency as the assets. When both assets and liabilities are in the same currency, exchange rate fluctuations offset one another.

In 2021, the Riksbank decided to self-finance the borrowed portion of the foreign currency reserve and phase out foreign currency borrowing from the Swedish National Debt Office. This meant that assets in the foreign currency reserve held in foreign currency were offset by liabilities in Swedish kronor.[1]

One method of reducing currency risk is the use of FX swaps. In September 2023, the Riksbank decided to hedge approximately one quarter of the foreign currency reserve using FX swaps to reduce financial risks.[2]

Current market situation and future measures

The Swedish krona has recently exhibited significant volatility, particularly against the US dollar, where the 12-month change in the exchange rate has occasionally exceeded 20 per cent. A general strengthening of the krona by 20 per cent would result in a financial loss for the Riksbank of approximately SEK 70 billion in the foreign currency reserve, or approximately SEK 48 billion for the dollar component alone, despite the current FX swaps.

Given the balance sheet's sensitivity to exchange rate movements, the Riksbank is reviewing the financing of the foreign currency reserve, including the use of FX swaps.

A preliminary assessment indicates that it is desirable to further reduce currency exposure by approximately SEK 100 billion via foreign currency loans from the Swedish National Debt Office.

The preliminary assessment is that, starting in 2027, and given stable market conditions, the Riksbank will borrow foreign currency via the National Debt Office equivalent to approximately SEK 200 billion. Implementation would consist, on

[1] The Riksbank begins transition to a wholly self-financed foreign exchange reserve| Sveriges Riksbank
[2] The Riksbank reduces the currency risk in the foreign exchange reserves | Sveriges Riksbank

the one hand, of the sale of foreign currency for Swedish kronor and, on the other hand, of the replacement of existing FX swaps. Each part currently amounts to around SEK 100 billion. Full implementation is expected to take 12–18 months.

Reducing currency risk through FX loans will require the Riksbank to sell foreign currency for Swedish kronor. Purchases of kronor may potentially have an impact on the krona exchange rate. The transactions will therefore be spread evenly over the period to minimise the impact on the exchange rate.

The purchase of kronor and the settlement of FX swaps will result in the banking system's liquidity surplus towards the Riksbank being reduced by a corresponding amount.

The planned change is not intended to affect the long-term size of the foreign currency reserve and does not serve any monetary policy purpose. The use of foreign currency loans through the Swedish National Debt Office also affects consolidated gross debt (Maastricht debt). The latter does not include the Riksbank's gross debt. If this was also included, it would not affect the public sector's gross debt, as the measure reduces the Riksbank's gross debt by the same amount as the Maastricht debt increases.

The plan is to provide further details and a final decision on the matter in connection with the monetary policy decision in December.