



Memorandum

DATE: 29 June 2023

DOCUMENT SECURITY RB PUBLIC

CLASSIFICATION

SVERIGES RIKSBANK
SE-103 37 Stockholm
(Brunkebergstorg 11)

Tel +46 8 787 00 00
Fax +46 8 21 05 31
registratorn@riksbank.se
www.riksbank.se

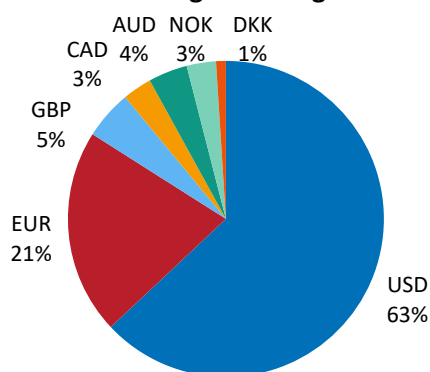
DNR 2023-00863

Managing the risks in the foreign exchange reserves

Like most other central banks, the Riksbank has foreign exchange reserves. As per 30 April 2023, the value of the foreign exchange reserves amounted to about SEK 410 billion. The foreign exchange reserves are used to provide temporary liquidity support to banks active in Sweden, to fulfil Sweden's part in the IMF's international lending and to intervene on the foreign exchange market.

The Riksbank's preparedness to use the foreign exchange reserves at short notice places strict demands on the composition of the foreign exchange reserves. Consequently, the foreign exchange reserves are mostly composed of assets in the currencies required by banks in need of liquidity support and assets that can rapidly be converted into liquid funds, primarily government bonds in US dollars and euros.

Figure 1. Assets in the foreign exchange reserves by currency, 30 April 2023



The Riksbank shall manage its assets in order to fulfil its tasks and powers and generate sufficient income to finance its activities. The assets in the foreign exchange reserves shall be managed with low risk and taking into account the Riksbank's status as a central bank and the purpose of the asset holdings.¹ Within this level of risk, the Riksbank should strive to achieve a reasonable return on its investments. It is up to the Riksbank

¹ Pursuant to Chapter 9, Section 1 of the Sveriges Riksbank Act.

to make an independent assessment of how the strategy for the management of the foreign exchange reserves is to be designed and how it can be changed without violating the purpose and guiding principles for the asset management.

The value of the foreign exchange reserves is affected by changes in market prices such as exchange rates and interest rates. A weakening of the krona means that the foreign exchange reserves increase in value in krona terms. A strengthening of the krona means that the foreign exchange reserves fall in value in krona terms. The latter means that the Riksbank is exposed to currency risk - and currency risk makes up a large part of the Riksbank's total financial risks.

To manage currency risk and the other financial risks, the Riksbank needs to have sufficient loss-absorbing capital to form a buffer against future losses. When the Riksbank decided in 2021 on changing over to entirely self-financed foreign exchange reserves, risks and problems with borrowing foreign currency from the Swedish National Debt Office were weighed against increased financial risks. The Riksbank observed that "In the Riksbank's assessment, the increased financial risk entailed by self-financed foreign exchange reserves is not a long-term problem, given that the Riksbank has sufficiently large loss-absorbing equity to safeguard the Riksbank's long-term earnings capacity."² However, the Riksbank's buffer capital has decreased significantly since the Riksbank reported a large loss in 2022 due to its holdings of bonds in both the Swedish bond portfolio and the foreign exchange reserves having decreased in value when bond yields increased.

Ensuring sound risk management makes it appropriate to investigate, within the framework of asset management, the conditions for reducing the Riksbank's currency risk. This is particularly the case in light of the Riksbank's assessment that the krona will appreciate in the period ahead. The recent years' krona depreciation has led to the Riksbank making exchange gains. For example, the realised exchange rate effect amounted to SEK 10 billion in 2022 and the unrealised exchange gains on the revaluation account increased by SEK 27 billion to over SEK 48 billion.

One measure within the framework of asset management that can be taken to reduce currency risk is to hedge part of the foreign exchange reserves with the help of foreign exchange forwards and currency swaps. The size of the amount would need to be the subject of an inquiry but the starting point should be approximately one quarter of the foreign exchange reserves. An amount of that magnitude is deemed reasonable given that the transactions are spread out over an appropriate period of time. The aim of hedging part of the foreign exchange reserves is to reduce the Riksbank's financial risks and thus it has no monetary policy purpose.

The factors the inquiry should consider include the costs that any measures to reduce currency risk may entail and the Riksbank's continued preparedness to carry out its remit under the Sveriges Riksbank Act. Any measures must be designed with conditions on the market as a basis. To ensure this, it is necessary for the Riksbank to open a dialogue with relevant market participants and to make certain practical preparations. This inquiry may be completed by early autumn 2023.

² See "[Financing of the foreign exchange reserves – consequences for the Riksbank's balance sheet and financial risks](#)", Sveriges Riksbank, 12 January 2021.