

DECISION

DATE: 18 September 2023
DEPARTMENT: Markets Department
DNR: 2023-00863
INFORMATION CLASS: RB PUBLIC

Decision on hedging part of the foreign exchange reserves

The Riksbank's decision

1. As from 25 September 2023, the Riksbank will commence transactions to hedge part of the foreign exchange (FX) reserves. This hedging will involve the Riksbank selling USD 8 billion and EUR 2 billion against SEK and then entering into FX swaps with the same amount in the FX market. The sale of USD and EUR shall be fully completed within four to six months from the commencement of transactions. The Riksbank will continue the hedging via FX swaps until the Riksbank decides otherwise.
2. With the right to delegate the task to another, the Head of the Markets Department is instructed, after consultation with the Executive Board, to establish a plan for implementation of the hedging and to decide on the exact times, amounts and appropriate maturities for the transactions.
3. The Head of the Markets Department, or person to whom the Head of the Markets Department has delegated the task, shall regularly inform the Executive Board about the implementation, including the effects, of the hedging.
4. This decision will be published at 09:30 on 21 September 2023.

Background

The Riksbank, like most other central banks, holds foreign exchange (FX) reserves to be able to perform its statutory tasks. The FX reserves shall be used to provide temporary liquidity support to banks operating in Sweden, to intervene in the FX market and fulfil Sweden's part in the IMF's international lending. As per 31 August 2023, the value of the FX reserves amounted to just over SEK 430 billion.

To ensure the Riksbank has ample preparedness to use the foreign currency reserve, it consists mainly of assets in such currencies required to be able to be used for the purposes above. The FX reserves further consist of assets that can be rapidly converted into liquid funds, mainly government bonds in US dollars and euro.

According to Chapter 9, Section 1 of the Sveriges Riksbank Act (2022:1568), 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 FX reserves shall be managed at low risk, taking into account the Riksbank's status as a central bank and the purpose of the asset holdings. Within this level of risk, the Riksbank should strive to achieve a reasonable return on its investments. It is up to the Riksbank to make an independent assessment of how the strategy for the management of the FX reserves is to be designed and how it can be changed without violating the purpose and principles of asset management.¹

On 29 June 2023, the Riksbank publicly announced its intention to investigate the prerequisites for reducing the currency risk in the FX reserves within the framework of asset management, and that this investigation is expected to be finished in early autumn 2023. The investigation has led to the current decision, according to which the Riksbank shall hedge about a quarter of the FX reserves on the FX market.

As a result of this decision, the Riksbank is adjusting its financial risk and investment policy as well as a few associated underlying rules.

Grounds for the decision

The value of the FX reserves in Swedish kronor is affected by changes in market prices such as exchange rates and interest rates. A depreciation of the krona causes the FX reserves to increase in value while an appreciation of the krona instead leads to a reduction in the value of the reserves. The latter exposes the Riksbank to currency risk. Currency risk constitutes a large share of the Riksbank's total financial risks.

To manage its financial risks, the Riksbank needs to have sufficient loss-absorbing capital that can form a buffer against future losses. When the Riksbank decided in 2021 to change over to entirely self-financed foreign exchange reserves, the risks and drawbacks of borrowing foreign currency from the Swedish National Debt Office were weighed against increased financial risks. The Riksbank observed that

¹ Compare Chapter 9, Sections 13 and 15 of the Instrument of Government, which states that the Riksbank is responsible for holding and managing FX reserves, and that no authority may determine how the Riksbank shall decide in the management of the FX reserves and that the Riksbank may neither seek nor take instructions from anyone in such issues.

“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 against future losses 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 because of the sharp increase in bond yields.³

In order to maintain sound risk management in accordance with Chapter 9, Section 1 of the Sveriges Riksbank Act, the Riksbank deems it appropriate to reduce the currency risk within the framework of asset management by hedging part of the FX reserves. 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, realised exchange rate gains amounted to SEK 10 billion in 2022 and unrealised exchange gains on the revaluation account increased by SEK 27 billion to just over SEK 48 billion.

The hedging should be conducted in a way that gives the Riksbank ample preparedness, where necessary, to swiftly be able to use the FX reserves to execute its task in accordance with the Sveriges Riksbank Act. The Riksbank assesses that USD 8 billion and EUR 2 billion should be hedged, corresponding to roughly one-quarter of the FX reserves. The hedging shall involve the Riksbank selling US dollars and euro against Swedish kronor and then entering into FX swaps in the FX market in order to maintain the size of the FX reserves.

The Riksbank may implement some of the hedging by exchanging so-called EU payments⁴, whenever possible. This means that the Riksbank buys Swedish kronor against euro corresponding to the EU payment of a central bank within the EU. The Riksbank can thus use EU payments to achieve part of the currency hedge. This allows the hedging to occur more quickly, lowers the transaction costs and, all else equal, reduces the risk of volatility in the krona exchange rate.

The hedging poses a refinancing risk as the Riksbank constantly needs to finance itself in US dollars and euro in the FX swap market. The hedging also increase costs in the form of transaction costs and may also lead to lower interest income from the FX reserves. However, the Riksbank’s assessment is that the advantages

² See “Financing of the foreign exchange reserves – consequences for the Riksbank’s balance sheet and financial risks”, Sveriges Riksbank, 12 January 2021.

³ See the Riksbank’s 2022 Annual Report for a detailed description of this.

⁴ Sweden’s EU membership entails monthly contributions to the EU budget. These are made in Swedish kronor by the Swedish state and normally exchanged into euro in the FX market by a recipient central bank within the EU. The recipient central bank needs to exchange Swedish kronor into euro and primarily the Riksbank is offered to exchange the amount and then buy kronor via a bilateral FX transaction.

of the hedging in the form of a lower currency risk still outweigh the disadvantages, not least given that the Riksbank expects the krona to appreciate going forward.

The Riksbank assesses that the hedging should start as soon as possible. It shall therefore commence on 25 September 2023. The rate of sales should be adjusted to market conditions and without counteracting the Riksbank's objectives and other tasks. The Riksbank expects the sale to take four to six months. The Riksbank will continue the hedging via FX swaps until the Riksbank decides otherwise.

Instructions for hedging

With the right to delegate the task to another, it is incumbent on the Head of the Markets Department, after consultation with the Executive Board, to establish a more detailed plan for implementation of the hedging and to decide on the exact times, amounts and appropriate maturities for the transactions.

The Head of the Markets Department, or person to whom the Head of the Markets Department has delegated the task, shall regularly inform the Executive Board about the implementation, including the effects, of the hedging.

The principle of proportionality

After closer analysis of the issue, the Riksbank has assessed that hedging in accordance with the above can be assumed to lead to the intended result, i.e. to reduce the currency risk in the FX reserves and thus also reduce the Riksbank's financial risks. The increased refinancing risk caused by the hedging has a negative effect on the Riksbank's preparedness to use the FX reserves. However, the Riksbank assesses that the advantages of reduced currency risk outweigh the reduction in preparedness in foreign currency that the hedging entails, and that the preparedness will nevertheless be sufficiently high. The measure is assessed not go beyond what is necessary to reduce the Riksbank's financial risks. The intended result of the hedging is also assessed to be in reasonable proportion to the costs and risks (such as increased transaction costs and a potentially lower interest income for the FX reserves) that the measure entails for the finances of the Riksbank and central government. The Riksbank therefore considers the measure to hedge part of the FX reserves to be compatible with the principle of proportionality in Chapter 1, Section 8 of the Sveriges Riksbank Act.

The decision has been taken by the Executive Board (Governor Erik Thedéen, First Deputy Governor Anna Breman and Deputy Governors Per Jansson, Martin Flodén and Aino Bunge) following a presentation by Anders Gånge, acting Head of the Markets Department.