

# Statement by the Governor

*In many respects, things went well for Sweden in 2014. Growth was relatively strong and the credit system continued to work well. But there were two major challenges – low inflation and increasing household debts. Over the year, the Riksbank gradually lowered the repo rate to zero to boost inflation. However, the low interest rate is increasing the risks that debts among Swedish households will rise further from their already high level. It is therefore urgent that measures are taken in other policy areas so that this development can be halted.*

*The Riksbank made preparations for the approaching bank-note and coin changeover that will start in 2015 and progress until 2017. An organisational change was carried out within the Riksbank to support our vision of being among the best as regards quality and efficiency.*

## **Expansionary monetary policy to reach the inflation target**

In 2014, we noticed that the Swedish economy was being impacted by the sluggish recovery of the euro area, easily our largest export market. Demand in the euro area was restrained partly by the euro area countries working to reduce their high levels of indebtedness and partly by the geopolitical uncertainty resulting from the conflicts in Ukraine, Syria and Iraq. The weak development of the euro area meant that Swedish exports grew more slowly than normal, even though demand was rising in the United States and Asia. However, Swedish households' economy and consumption developed relatively well. Swedish inflation continued to be low.

In 2014, we continued to pursue the expansionary monetary policy that the Riksbank has conducted for the last few years. We could see that inflation was becoming lower than we had expected and therefore lowered the repo rate successively to zero per cent. At the same time, we adjusted our interest rate forecast, the so-called repo-rate path, downwards. The repo rate is expected to remain at this level until inflation really picks up. Our assessment is that it will be appropriate to begin gradually increasing the repo rate in the second half of 2016. It is important that inflation rises towards the target of 2 per cent as the inflation target acts as an anchor for price and wage formation. Even if inflation can deviate from target over relatively long periods, it is crucial that long-term inflation expectations remain well-anchored around the target.

## **Measures are increasing the resilience of the Swedish financial system**

We assessed that Sweden had a secure and effective payment system in 2014: the financial system functioned well, the financial infrastructure was highly secure and efficient and the Riksbank's payment system for large-value payments (RIX) also functioned well.

Swedish banks, companies and households had good funding opportunities over the year. Profitability in the banks was high and borrowers' debt-servicing ability was strong. Our previous recommendations to the banks contributed towards them further strengthening their buffers. Several measures were also adopted in recent years to increase the resilience of the Swedish banking system and reduce the risks that could threaten financial stability.

However, we could see that there were still vulnerabilities in the Swedish financial system, as the Swedish banks' assets are over three times the size of Sweden's GDP and a large part of their funding is obtained abroad. The banks are thus closely linked to the international markets, but they are also linked to each other through their funding and other connections. Problems in one bank can therefore rapidly spread through the entire banking system. These vulnerabilities mean that we need to act to achieve a high level of resilience in the Swedish financial system. In 2014, we were able to identify several measures that could increase resilience, for example we recommended Finansinspektionen (the Swedish Financial Supervisory Authority) to introduce a leverage ratio requirement for the banks.

We continued to deem that the greatest domestic risk that could threaten financial stability in Sweden over the long term was Swedish households' high and increasing indebtedness. We therefore recommended that more measures should be considered to counteract this development. Among these, we considered that Finansinspektionen should introduce an amortisation requirement for households.

## **Unsustainable development of household indebtedness**

In my opinion, households' high and rising indebtedness is a problem in Sweden, from the perspective of both monetary policy and financial stability. The lessons of history show us that a rapid growth in debt, together with optimistic expectations of housing costs and housing prices, is a pattern that has often preceded financial crises. It is therefore important to slow down the increase of household indebtedness. This point of view is also shared by several international experts, such as the International Monetary Fund (IMF), the Organisation for Economic Cooperation and Development (OECD) and the European Commission.

We could choose from among a series of measures to reduce household indebtedness, for example amortisation requirements, limiting the proportion of variable interest-rate loans, abolishing tax relief and lowering the cap on the loan-to-income ratio. I think it is natural to demand the amortisation of mortgages, but complementary measures are needed if Sweden is to achieve a more sustainable development of debt. In the prevailing zero interest-rate situation, other policy areas must reduce the risks linked with household debt as a matter of urgency. Both measures aimed directly at households' demand for credit and reforms to improve the functioning of the housing market are needed.



Governor Stefan Ingves

### Changes in the provision of cash

In 2015, the major changeover of banknotes and coins will start and run until 2017. We have an extensive task ahead of us and we worked intensively on various preparations in 2014. A first step on the way is the reduction of the number of banknotes and versions of banknotes ahead of the changeover. It stopped being possible to pay with the older versions of the 50-krona and 1 000-krona banknotes (without foil strip) after 31 December 2013. Our office for banknote handling in Sigtuna Municipality was completed in 2014. With this, we receive, issue and destroy banknotes at only one place in Sweden.

We have noticed that a clear trend that is affecting central banks is the rapid development of various digital payment methods that are gradually replacing cash as a means of payment. Sweden is at the forefront of this development. At the Riksbank, we are monitoring and analysing this development to understand how it will affect the financial system and our role in it. The declining usage of cash is also contributing towards a change in the Riksbank's financial position. This is because banknotes and coins form an interest-free debt that the Riksbank has towards the general public and that funds the Riksbank's financial assets to a certain extent.

### A 350-year old at the forefront

Our vision of being among the best in terms of quality and efficiency in order to maintain a high level of public confidence places demands on the development of operations. We set up a partially-new organisation on 1 March to help deepen and expand our analyses in certain areas. We also introduced a committee structure to allow us to develop the forms for cooperation between our departments, thereby making it easier for us to address the new issues needing to be analysed.

During the autumn, we also adopted a new strategic plan aimed at our jubilee year in 2018. We want the world's oldest central bank, almost 350 years old, to be in the forefront and contributing to the stable economic development of households and companies. In brief, the plan means that our operation will be in line with the times and will produce a high-quality result that we communicate in an accessible and clear manner.

Stefan Ingves