The central bank's objectives and means throughout history – a perspective on today's monetary policy

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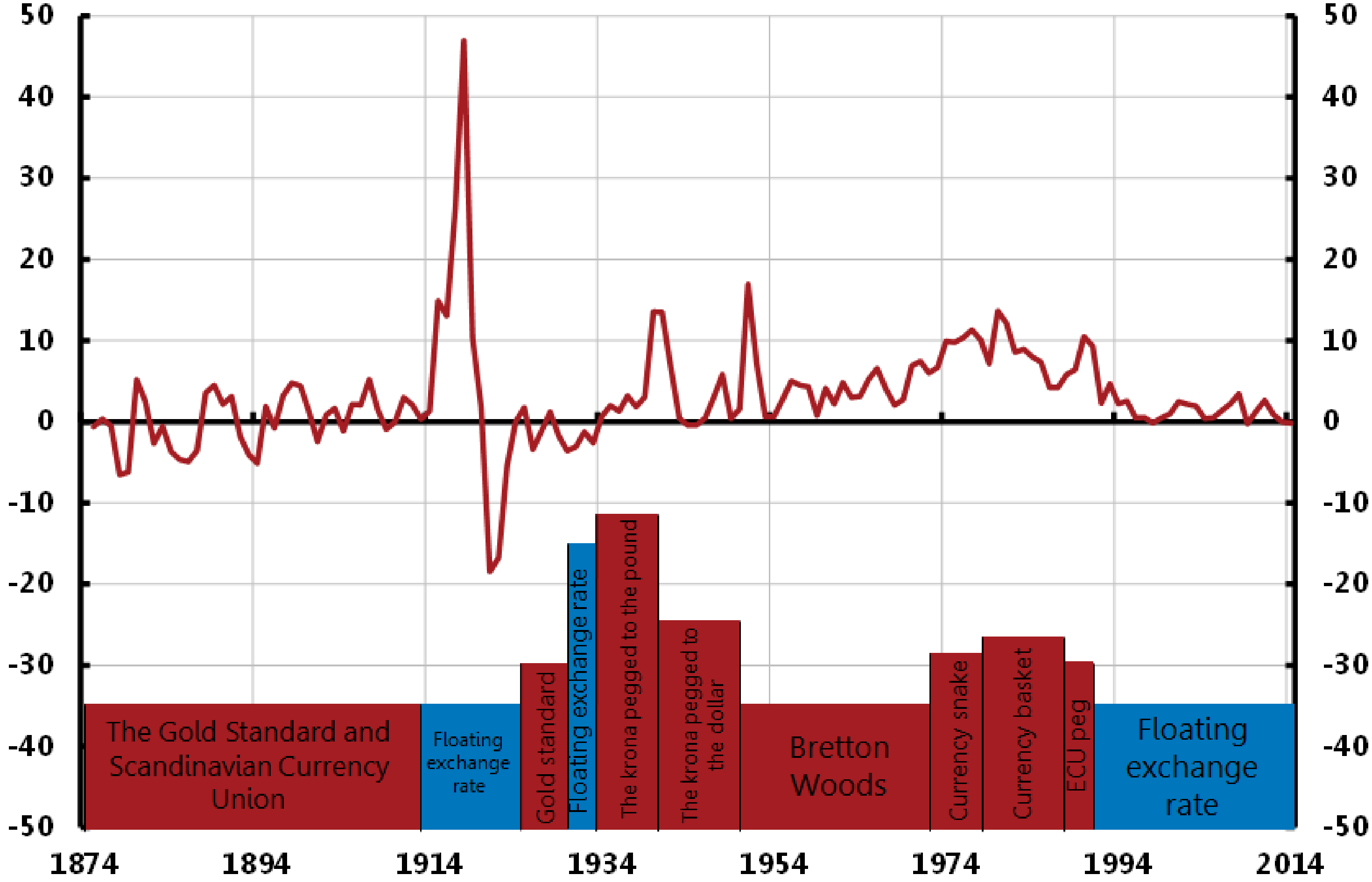
Today's presentation

- Historical perspective on today's monetary policy
  - The Riksbank's objectives and means have been influenced by developments in society
- Lessons from the crisis of the 1990s
- Lessons from the global financial crisis
- Monetary policy in a small open economy
- Current monetary policy

Historical perspective on today's monetary policy

Sweden's inflation and exchange rate regimes



Note. The figure shows annual CPI inflation in per cent, and the breadth of the squares corresponds to the time period for the respective currency regime.

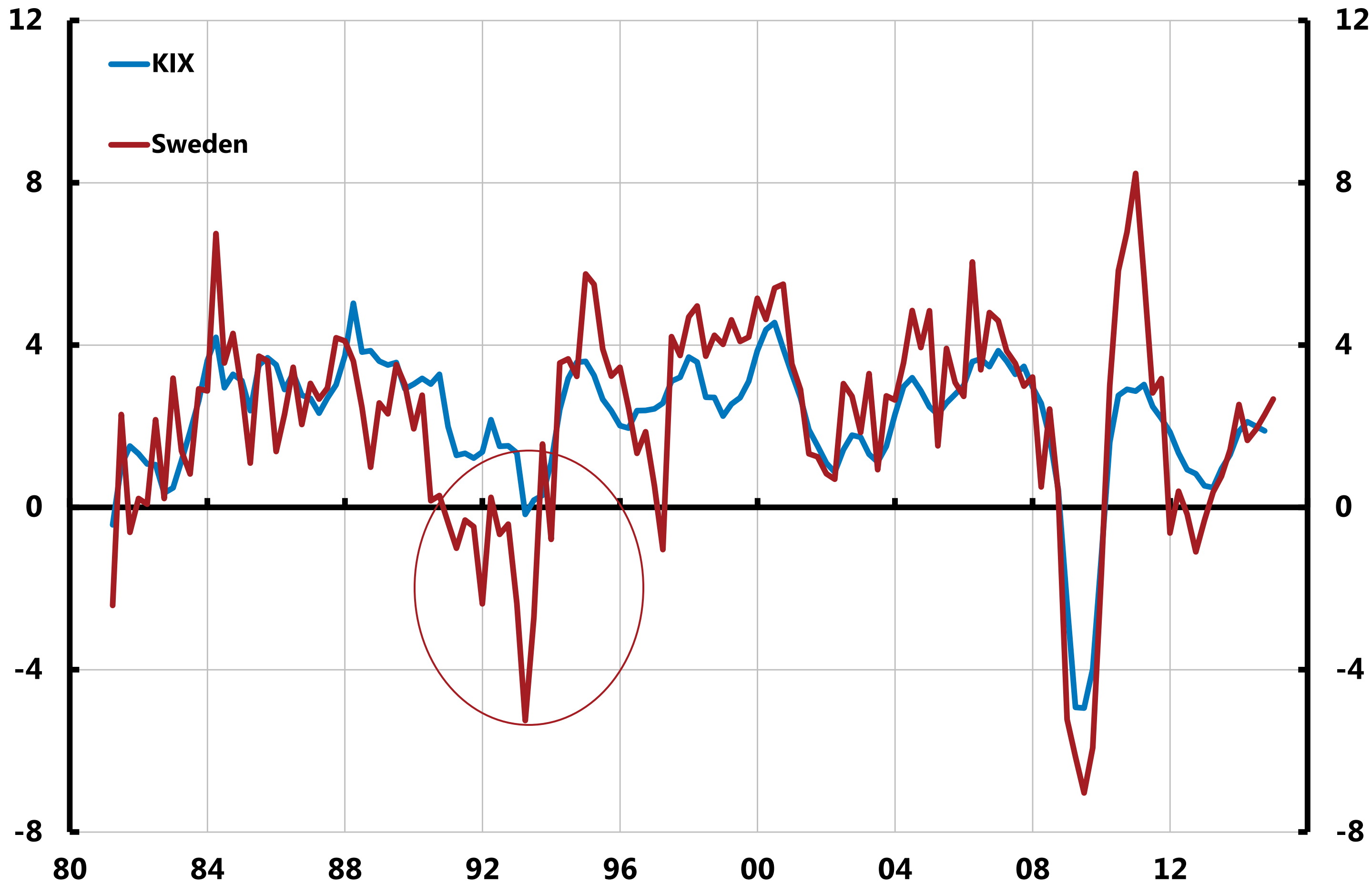
Sources: Statistics Sweden and the Riksbank

1990s crisis: ”Things abroad were quite OK, but Sweden was not OK”

- Inflation too high in relation to other countries for a long time
- Deregulation of credit market combined with too expansionary monetary policy
- Financial crisis, exchange rate crisis and public finance crisis
- Several lessons to be learned, not least for monetary policy

GDP growth in Sweden and abroad

Annual percentage change



Note. GDP abroad is KIX weighted.

Sources: Statistics Sweden and the Riksbank

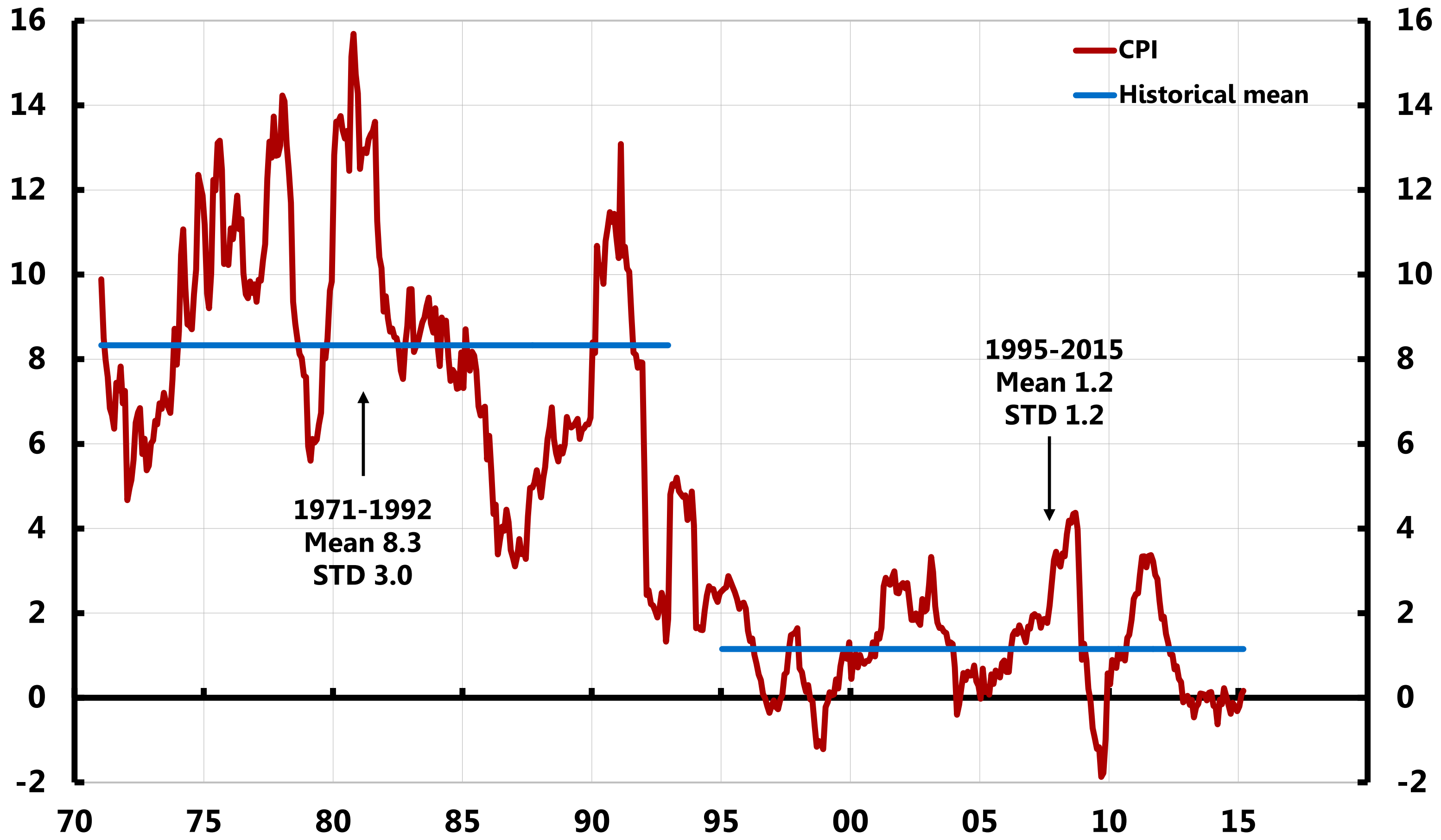
After the 1990s crisis

- Important lesson – increased elements of ”standard thinking” and importance of credibility for the nominal anchor
  - Inflation target and an independent Riksbank

- Long period of economic stability following introduction of inflation targeting

- ”The great moderation”
  - Overconfidence in central banks' fine-tuning ability
  - Lack of financial markets and frictions in model analysis

The inflation target has worked well



Note. Data up to the end of March 2015.

Sources: Statistics Sweden and the Riksbank

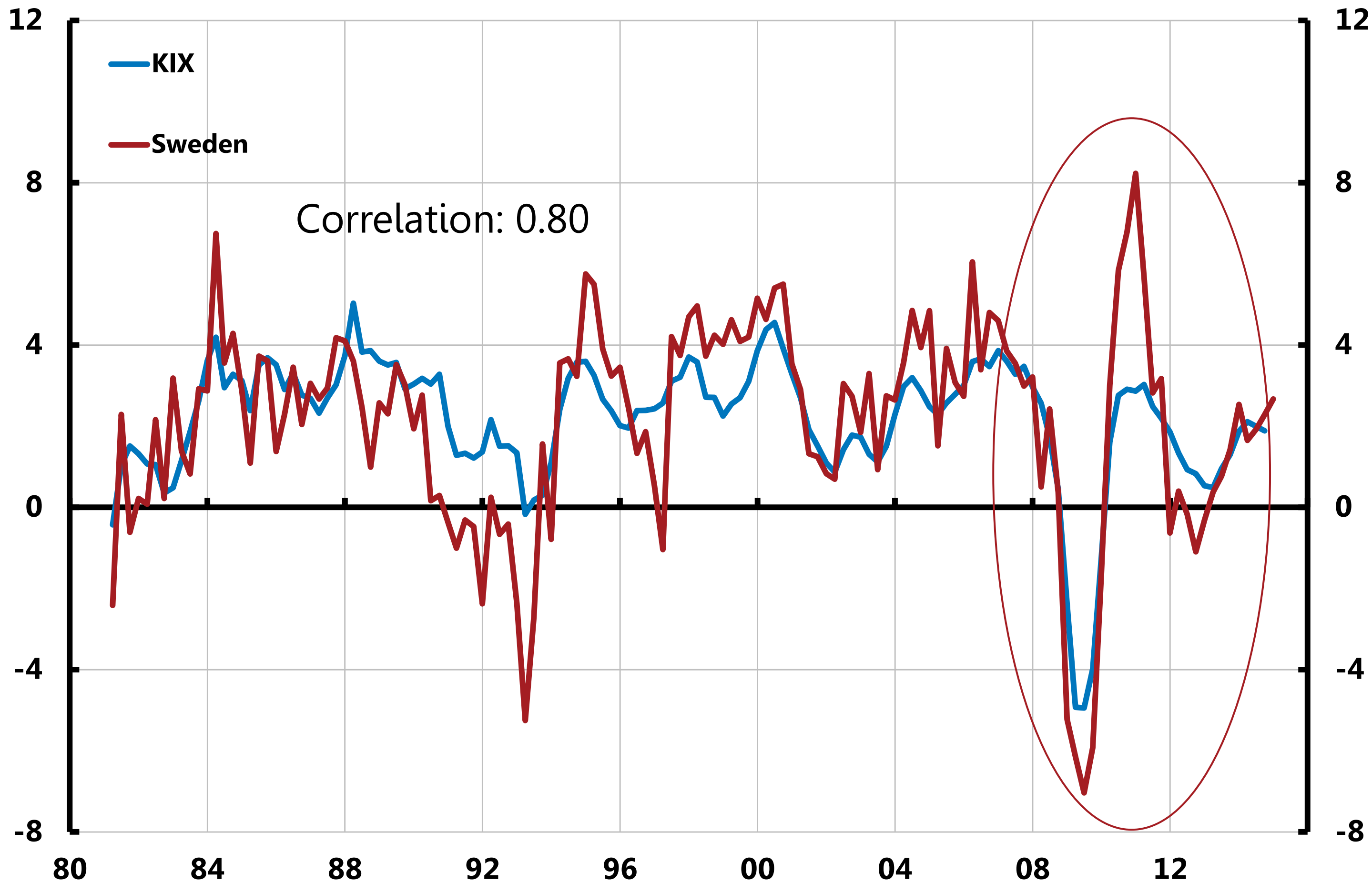
The financial crisis: ”Things abroad were not OK, but Sweden was OK”

- The Swedish economy in better shape than many others to manage the global financial crisis
  - Public finances very strong
  - Banks' loan losses were limited, but small proportion in Sweden

- But we were hit anyway – Sweden is a small open economy
  - Weak export demand
  - Liquidity crisis at the banks during acute phase of the crisis

GDP growth in Sweden and abroad

Annual percentage change



Note. GDP abroad is KIX weighted.

Sources: Statistics Sweden and the Riksbank

After the financial crisis

- Before the crisis: "Jackson Hole consensus"
  - Monetary policy manages financial crises when they arise
- After the crisis: reassessment
  - The financial crisis illustrates the costs of "cleaning up afterwards"
- New policy area - macroprudential policy

New but familiar challenges for macroprudential policy

- To some extent, movement back towards a greater degree of regulation of the credit markets, as in the 1950s-1980s
- Challenges partly the same
- In the 1980s: Combination of loan cap and negative real interest rate created "grey" credit market
  - Reason for deregulations
- Today: Macroprudential policy creates a "shadow interest rate" in a sector, which can be related to the policy rate
  - How can we prevent "leakage" to other sectors?

Financial stability and price stability are interlinked

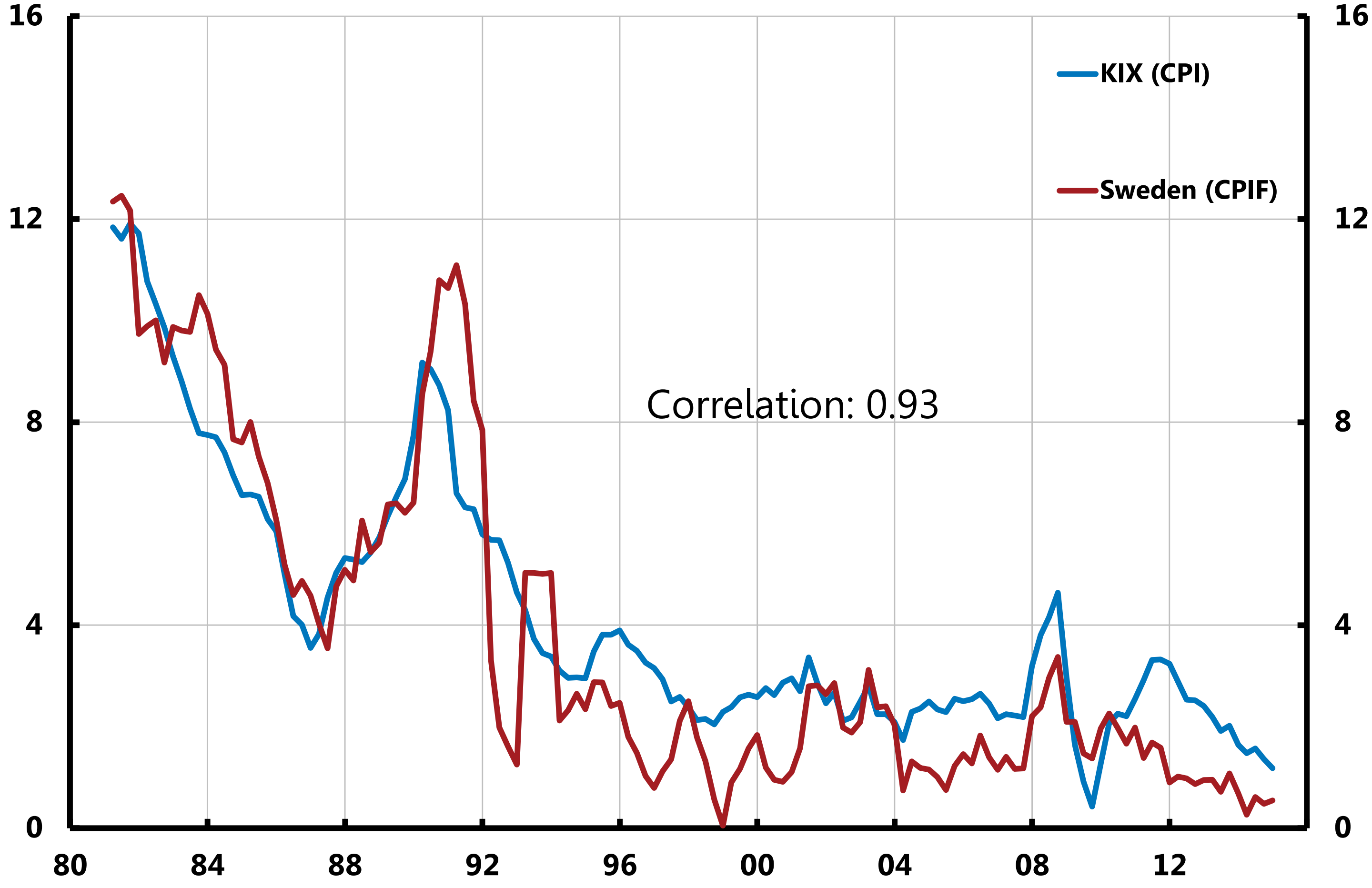
- Financial crises lead to
  - weak economic development and difficulties in controlling inflation
  - weakening of the monetary policy transmission mechanism
- A central bank can never discharge itself of responsibility
  - Many tools for managing banks in distress
  - The interest rate affects housing prices, credit and risk-taking

- But taking financial stability into account in the policy-rate decisions presupposes
  - well-anchored inflation expectations
  - inflation rate fairly close to the target

Sweden is a small open economy – monetary policy is affected by events abroad

Inflation in Sweden and abroad

Annual percentage change

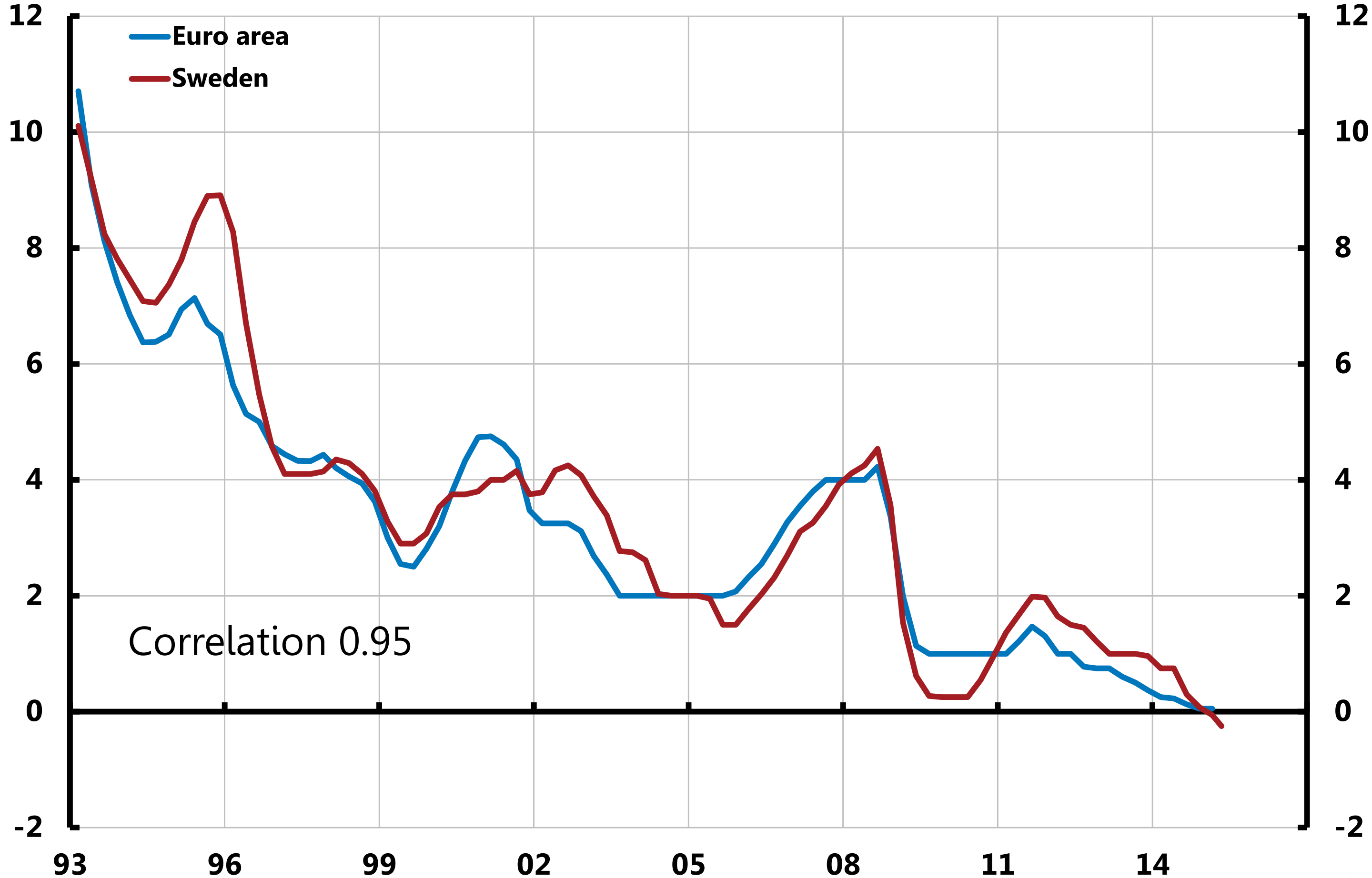


Note. GDP abroad is KIX weighted.

Sources: Statistics Sweden, national sources and the Riksbank

Policy rates in Sweden and the euro area

Per cent, quarterly averages



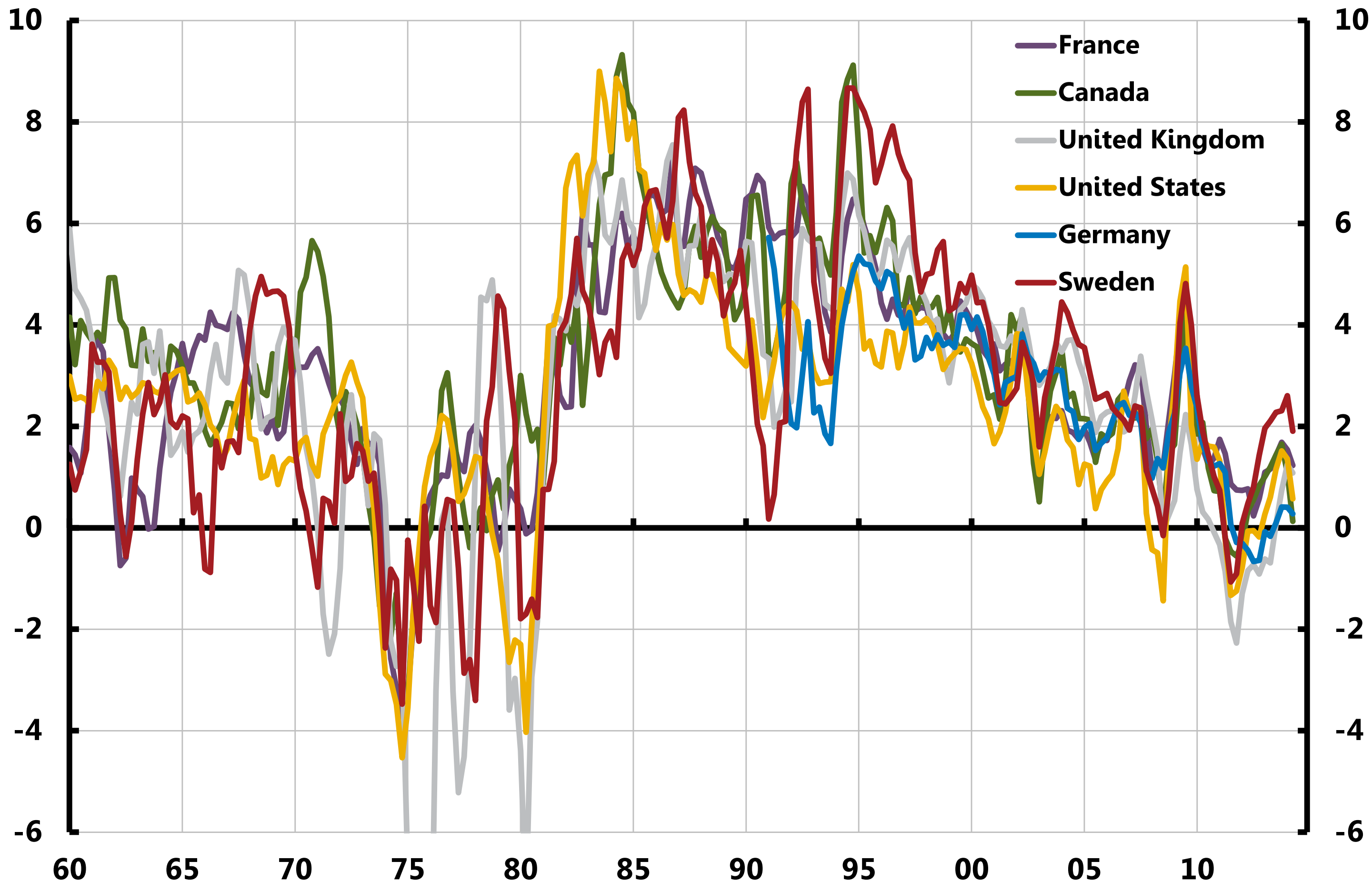
Sources: Euro Area Business Cycle Network (EABCN), Eurostat, Jacobson et al. (2002) and the Riksbank

Note. For Sweden data up to 1987 Q2 is used from Jacobson, T., Jansson, P, Vredin, A. & Warne, A., "Identifying the Effects of Monetary Policy Shocks in an Open Economy," Working Paper, Sveriges Riksbank, 2002. For the euro area, data up to 1999Q1 is used from the Area-wide Model (AWM).

Expansionary monetary policy abroad affects Sweden

- Can be illustrated using the Mundell-Fleming model
  - With an unchanged monetary policy in Sweden, a lower international interest rate has a tightening effect on Sweden's economy
  - Stronger currency $\Rightarrow$ lower net exports and GDP
- Current example: ECB's QE programme
  - Good for Sweden in the long term
  - But creates appreciation pressure on the krona in the short term
  - Dampens inflation in Sweden through lower import prices

High degree of covariation in international real interest rates



Note. Real interest rate is calculated as nominal rate – CPI inflation.

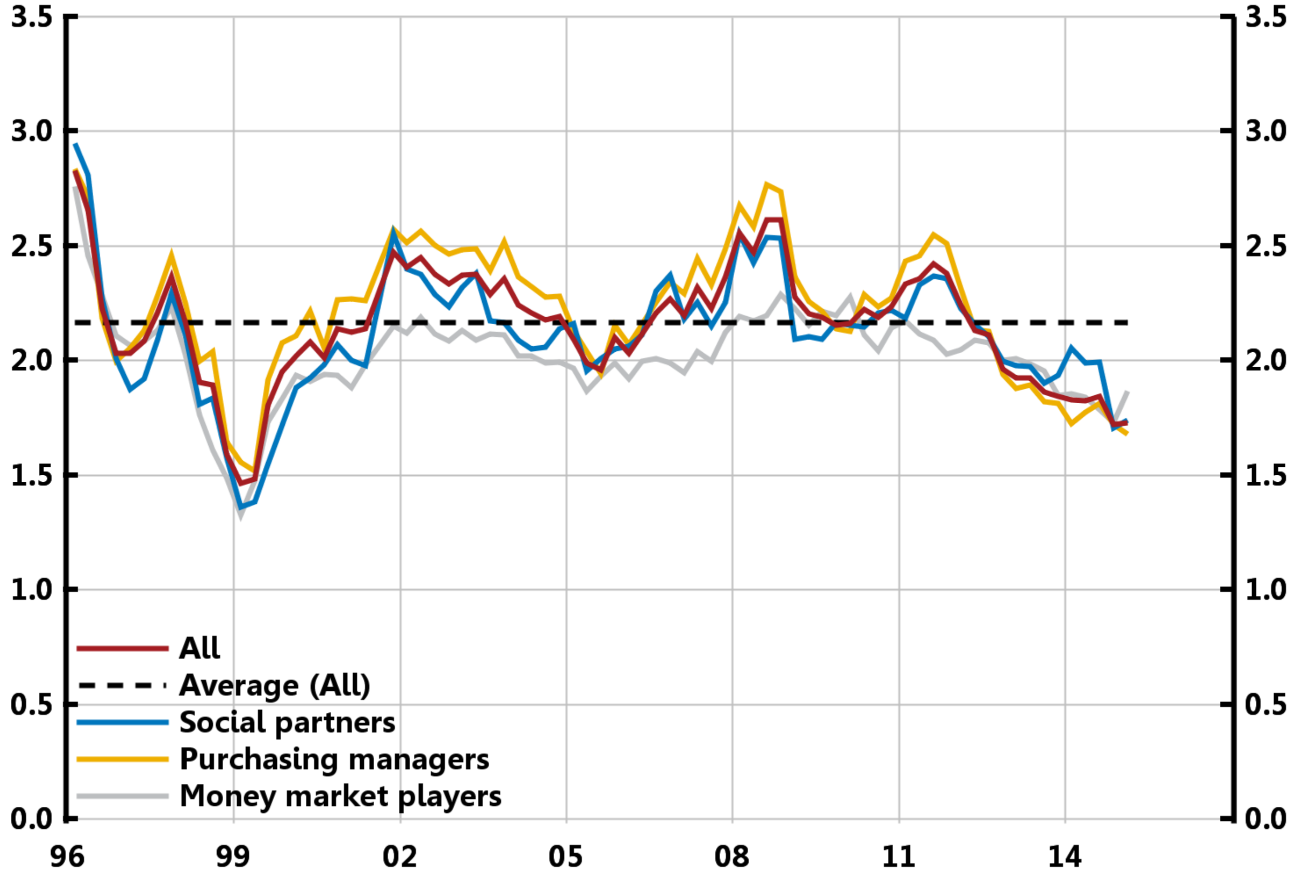
Sources: OECD and the Riksbank

Current monetary policy reflects earlier lessons

Lessons learned from history

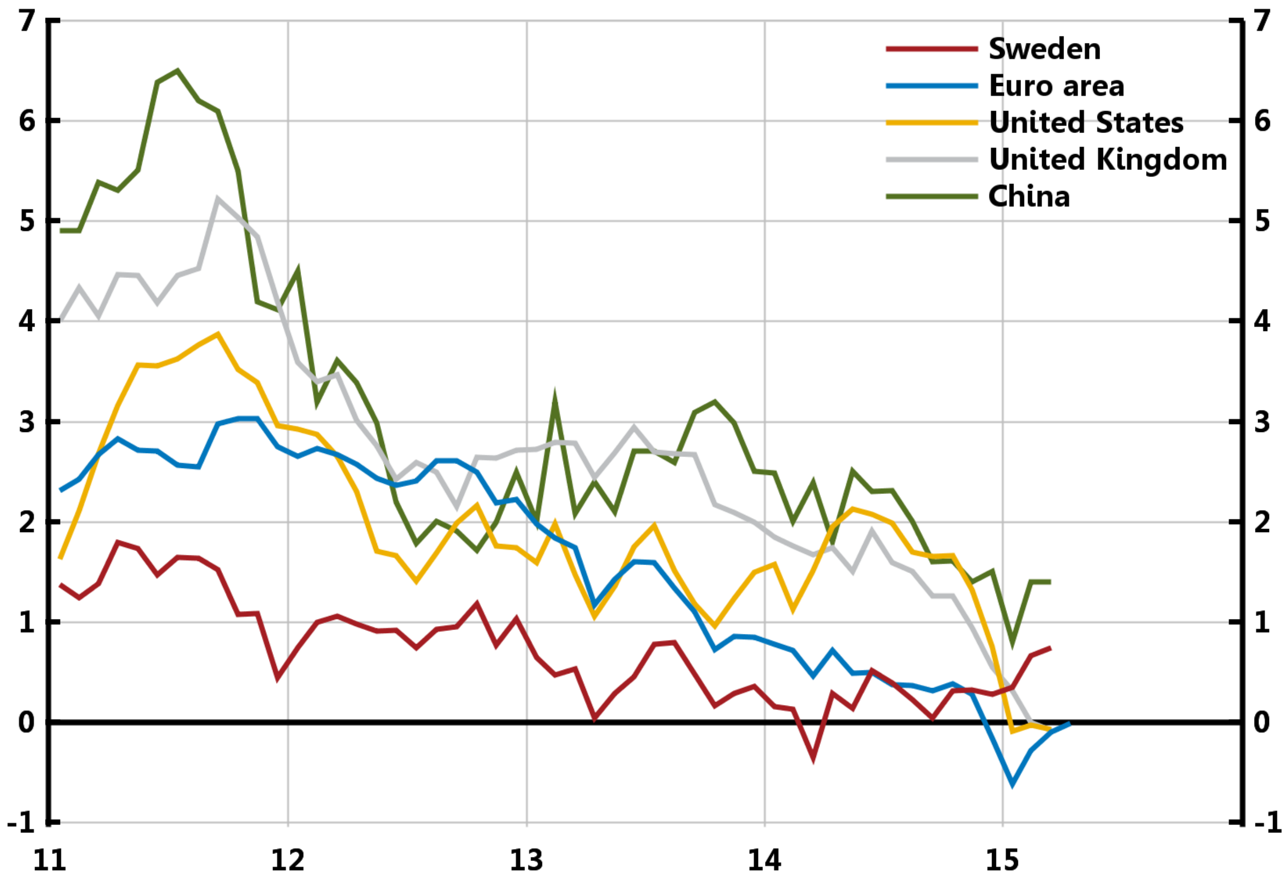
- The credibility of the nominal anchor
- Importance of financial stability
- Developments abroad important to Swedish monetary policy

Inflation expectations have fallen



Sources: Prospera and the Riksbank

Inflation is low in many countries

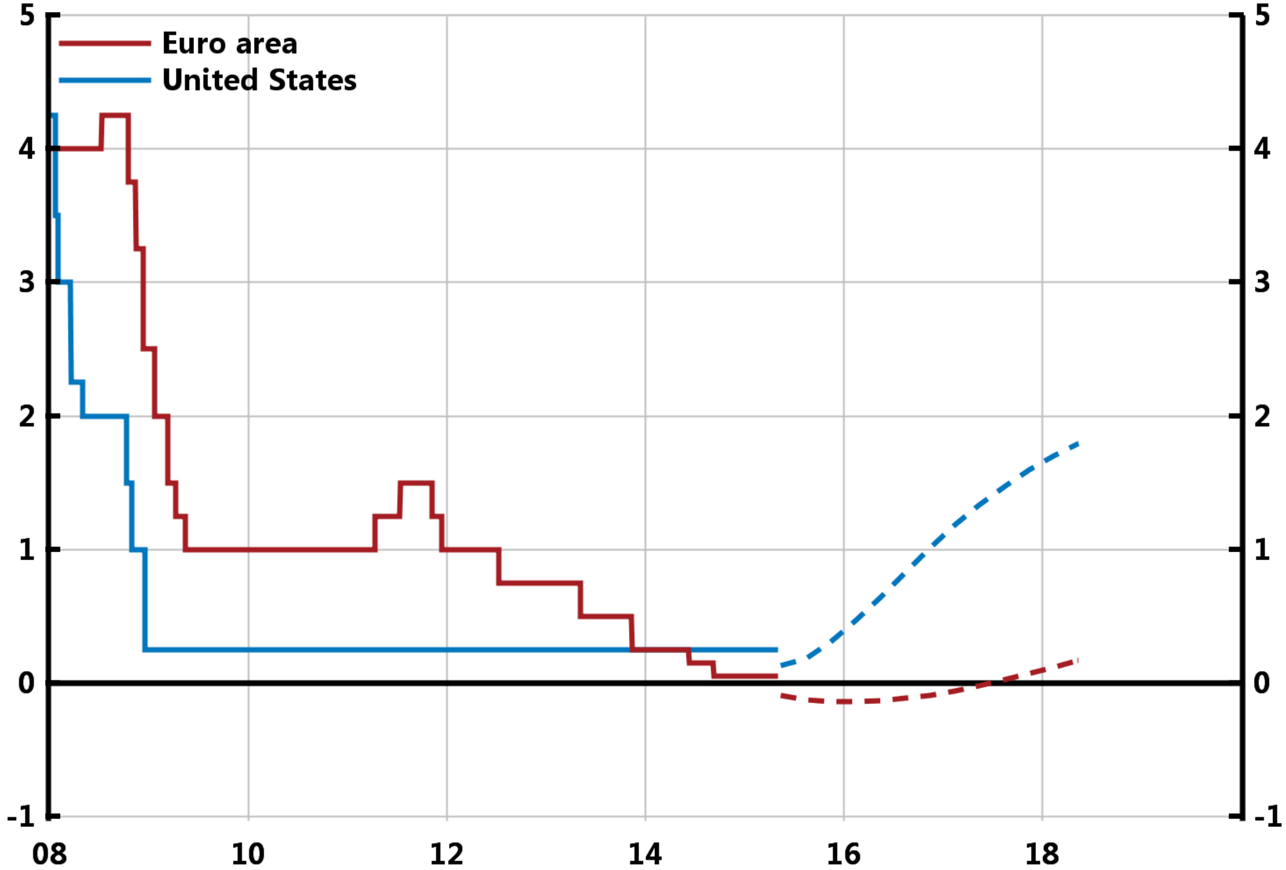


Note. CPI inflation. Sweden and the euro area refers to HICP inflation.

Sources: Eurostat, Bureau of Labor Statistics, Office for National Statistics, State National Bureau of Statistics of China, Statistics Sweden and the Riksbank

Expansionary monetary policy abroad

Policy rates and interest-rate expectations according to forward pricing, per cent

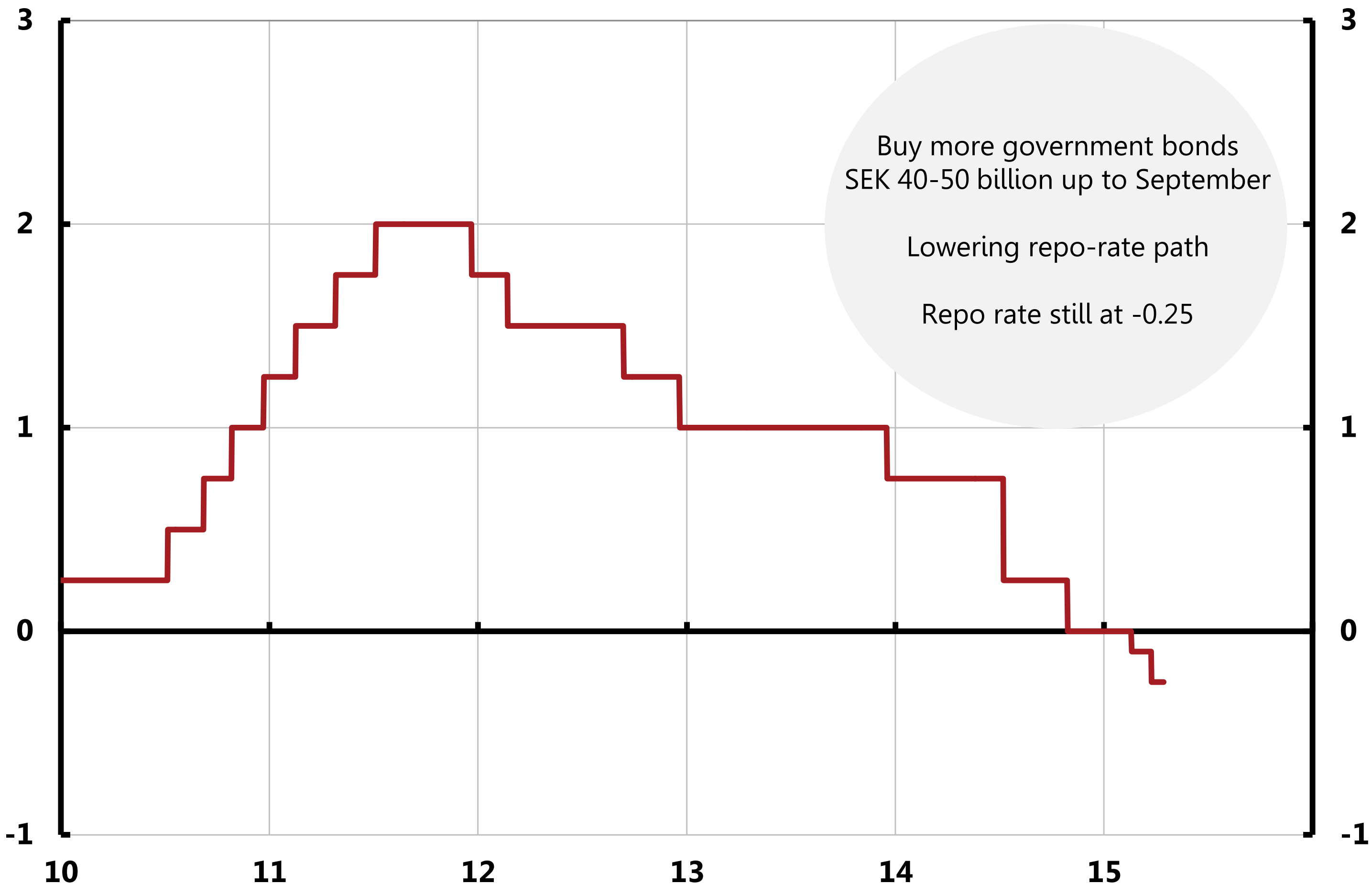


Note. Forward rates describe expected overnight rate, which does not always correspond to the official policy rate.

Sources: Macrobond and the Riksbank

Negative repo rate necessary for inflation to rise towards the target

Repo rate, per cent

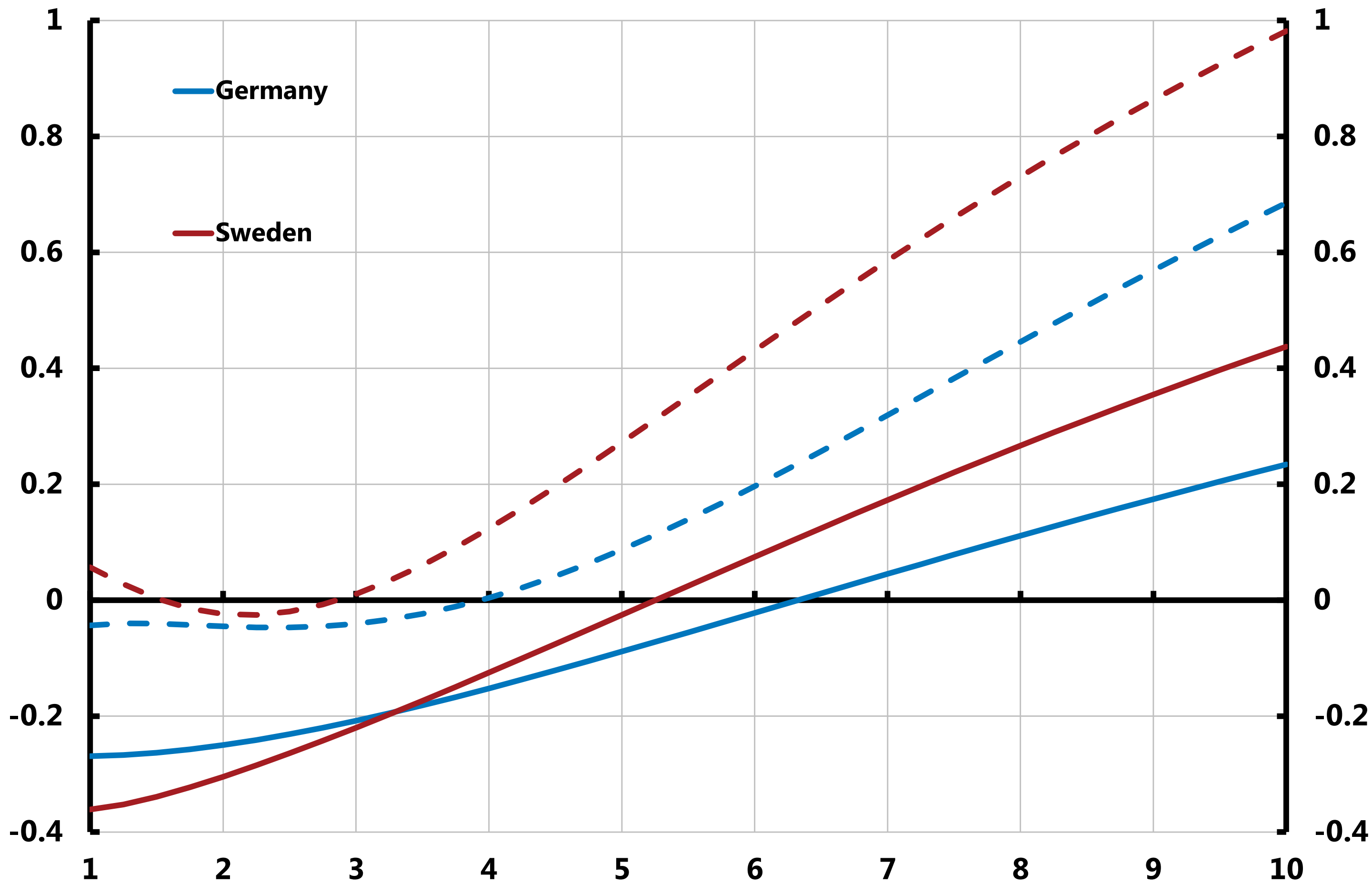


Source: The Riksbank

Complementary monetary policy measures act through different channels

- Reduce the general level of interest rates
  - Direct effect on long-term government bond yields
  - Portfolio choices also affect higher-risk assets
- Increase the amount of money in the economy
  - Increase wealth among those owning the above assets
  - More liquidity among the banks may lead to increased lending

Purchases of government securities affect yield curves



Note. Horizontal axis shows maturities this year. Yield curves are zero coupon yields interpolated from bond prices using the Nelson-Siegel method. Unbroken lines are estimated 29/04/2015, broken lines 15/12/2014.

Source: The Riksbank

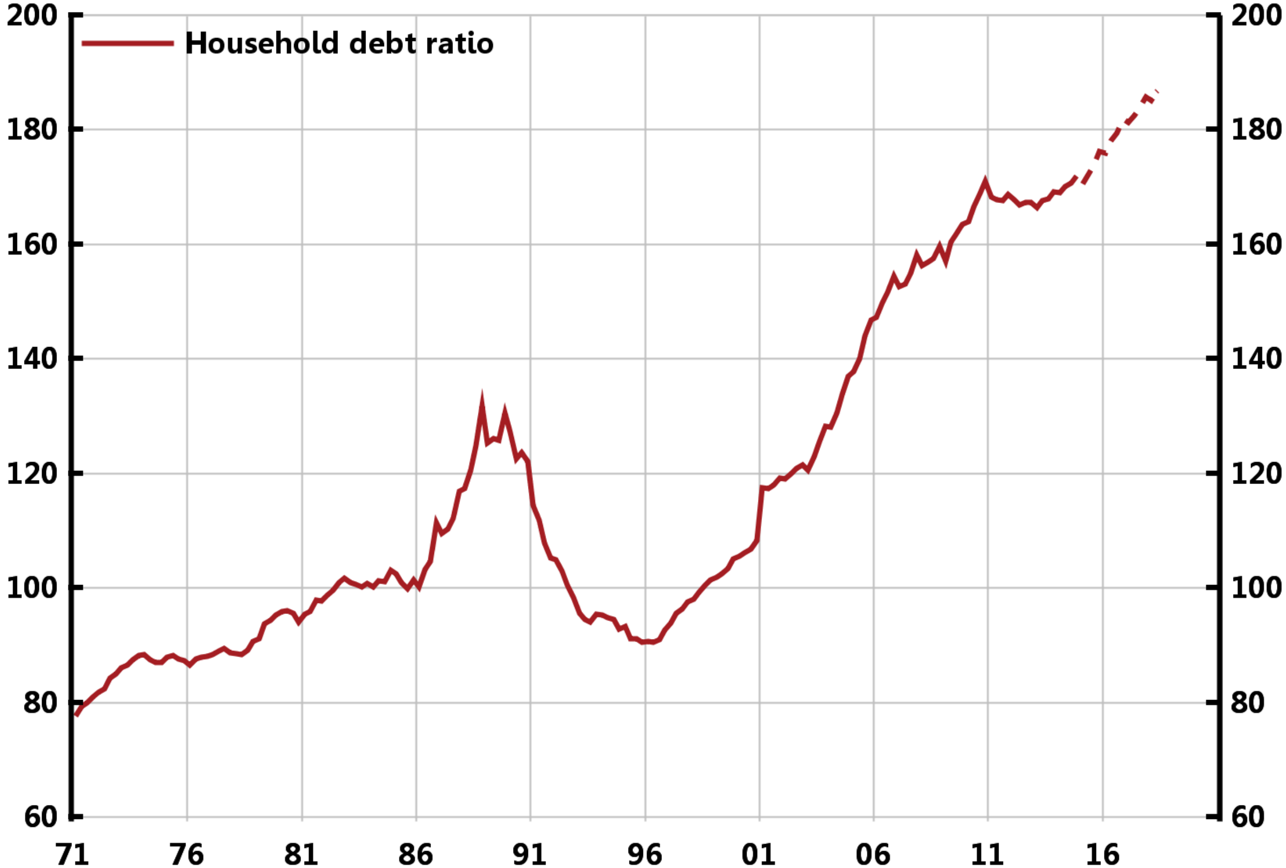
If more is required, we will do more

- If needed to get inflation to rise towards the target
  - Extend purchases of government bonds
  - Cut the repo rate and lower the repo-rate path
  - Lend to companies via banks
  - Foreign exchange interventions

- All of this can be done rapidly on a large scale

High and growing household indebtedness must be managed

Household debt as a percentage of disposable income, per cent



Note. Broken line represents the Riksbank's forecast.

Sources: Statistics Sweden and the Riksbank

Concluding thoughts

- Today's monetary policy is learning the lessons of history
- Negative repo rate and bond purchases – to safeguard the credibility of the inflation target
  - Preconditions affected by monetary policy abroad
- Important that household debt is managed – financial stability a precondition for attaining the inflation target in the long run