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■ **The Executive Board's consultation response to the report  
"Evaluation of the Riksbank's monetary policy and work with  
financial stability 2005-2010" (2010/11:RFR5)**

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**Summary**

*The Executive Board welcomes the evaluation and notes that the evaluators' overall assessment of the Riksbank's monetary policy and work with financial stability in the period 2005 to 2010 is predominantly positive. The Executive Board also welcomes the fact that the evaluation addresses both monetary policy and the work with financial stability. In the case of financial stability, the Executive Board shares the evaluators' view that there are shortcomings in the institutional framework and the legislation. However, the Executive Board notes that most of these shortcomings are currently the subject of an inquiry by the Financial Crisis Commission and that the Committee on Finance intends to review the Sveriges Riksbank Act after the Commission has presented its proposals. In the case of monetary policy, the Executive Board shares the evaluators' view of the importance of clearly communicating the uncertainty about the future course of economic development, but rejects the proposal to base the repo-rate forecast in the longer term on market expectations rather than on the assessment of the Executive Board itself. Nor does the Executive Board agree that the announcement of the repo-rate decision should be brought forward, or that there is a need to discuss what the purpose of the monetary policy meetings should be.*

**1 Introduction**

The Riksbank has been given the opportunity to comment on the report "Evaluation of the Riksbank's monetary policy and work with financial stability 2005-2010" (2010/11:RFR5). The Riksbank's comments will be submitted in two separate consultation responses. This response concerns the questions that fall within the Executive Board's sphere of activity. The General Council will at the same time issue a consultation response regarding the issues that belong to its sphere of activity.

■ The Executive Board's comments cover certain introductory general views and comments on the recommendations in the final chapter, and also some of the questions raised by the authors of the report in earlier chapters. This response is divided up as follows. Section 2 provides some general views on the evaluation. Section 3 presents the Executive Board's stance on the recommendations concerning financial stability, and the reasons for this stance, while section 4 does the same for monetary policy.

## **2 General views**

The Executive Board welcomes the evaluation and notes that the evaluators' overall assessment of the Riksbank's monetary policy and work with financial stability in the period 2005 to 2010 is predominantly positive, particularly with the global financial crisis that occurred in 2007-2008 in mind. The Executive Board also welcomes the fact that the evaluation addresses both monetary policy and the work with financial stability.

## **3 Recommendations concerning financial stability**

### **3.1 Institutional framework and allocation of responsibilities**

*The evaluators recommend that the relevant Swedish authorities should form a working committee to draft the necessary changes in legislation needed to clarify the powers and responsibilities of the Riksbank, the SFSA, the SNDO and the Ministry of Finance, in terms of crisis management and crisis prevention (page 99).*

As the government has set up the Financial Crisis Commission to draft such changes in the legislation, the Executive Board believes that there is no need to form a special working committee.

In a joint submission to the Riksdag, the General Council and the Executive Board have previously pointed out the need for an effective institutional framework to prevent and manage financial crises. In this submission, the Riksbank highlights a number of areas in which the allocation of responsibility is unclear.

One such area is that of macro-prudential policy, which in principle relates to mitigating risks to the financial system as a whole. At present, there is no institutional framework for the conduct of macro-prudential policy. The Riksbank considers that it has a broad responsibility for financial stability with a focus on the systemic level. However, the Riksbank has no binding statutory tools that can be used to mitigate systemic risks. On the other hand, given that its mission is to conduct micro-prudential policy and consumer protection, Finansinspektionen has tools that could be used for macro-prudential policy. However, although Finansinspektionen's instructions give the authority the mission of working for a stable and efficient financial system, there is no explicit legal support for using these tools for the purposes of macro-prudential policy. In addition, new tools that are specifically-designed for macro-prudential policy, for example countercyclical buffers, have been developed in the wake of the crisis. There is therefore a need for a framework that allocates

responsibilities, powers and resources in a way that enables effective decision-making and the effective implementation of macro-prudential policy. The Executive Board returns to this issue in section 3.2.

Another area in which the boundaries are unclear concerns the possibility of the Riksbank and the Support Authority (Swedish National Debt Office) to provide emergency liquidity assistance and what division of responsibilities this implies. The basic division is that the Riksbank can provide emergency liquidity assistance to institutions that are subject to supervision by Finansinspektionen and that are illiquid but not insolvent. If the institution has obvious solvency problems then it is instead the Support Authority that should provide emergency liquidity assistance.

There are good reasons, as the evaluators also point out, for such a division of responsibility regarding the provision of emergency liquidity assistance. As Sweden's central bank, the Riksbank can quickly create a sufficient amount of kronor. This is why the Riksbank is the authority responsible for liquidity supply and thus also for providing emergency liquidity assistance. The Riksbank can use a variety of tools to manage liquidity shortages. These may relate to general measures, such as changing the conditions governing lending in the RIX payment system, or individual measures, such as emergency liquidity assistance. The assessment of what is most appropriate in each specific case relates to access to collateral and the need to prevent contagion effects, for example in the form of general losses in confidence. Irrespective of the tools used, coordination with monetary policy is required. This is because providing emergency liquidity assistance entails an addition of liquidity that affects the implementation of monetary policy.

However, in the case of emergency liquidity assistance or other forms of support to institutions with solvency problems, the government assumes a credit risk to a greater extent. This also means that the government may use budget funds for more long-term commitments. This type of support should therefore be coordinated by the government or by the Support Authority delegated to do so by the government.

Although this division is clear at an overall level, there are unclear points that need to be dealt with in the legislation. What happens, for example, if it is assessed that an institution has the capacity to survive in the long term (that is it is assessed as being solvent) when the Riksbank provides emergency liquidity assistance, but the institution then becomes insolvent? What happens if, in such a situation, the Support Authority does not share the Riksbank's assessment that the company is systemically important? A lack of clarity on these issues entails an extra degree of uncertainty over and above the risk that the Riksbank carries when providing emergency liquidity assistance. This uncertainty can be avoided with greater clarity.

A third area in which the division of responsibility is unclear relates to the responsibilities of the Riksbank and the National Debt Office for the Riksbank's borrowing for the foreign currency reserve. The Riksbank may need to add liquidity in a currency other than the krona in order to safeguard financial

■ stability in Sweden. As the Riksbank cannot itself create euros or dollars, for example, the Riksbank's foreign currency reserve is an important instrument for being able to quickly add liquidity in another currency. At present, the limits of the Riksbank's borrowing entitlement and the extent of the National Debt Office's obligation to assist the Riksbank's borrowing for the foreign currency reserve are not clear. The Executive Board notes, however, that the government has appointed a special commission of inquiry (terms of reference 2011:89) to analyse this and other issues.

### **3.2 Recommendations concerning macro-prudential policy**

*The evaluators recommend that the Swedish authorities select one of two possible options. The first option would be to share macro-prudential policy responsibility and instruments between these several agencies and to create a Systemic Risk Council in charge of coordinating the actions of these agencies. A second option would be to give all macro-prudential responsibilities and instruments to the Riksbank, but to create, within the Riksbank, a Financial Stability Council, independent of the Monetary Policy Council, and comprising high level representatives of the other agencies in charge of other aspects of financial stability (page 99).*

The Executive Board declines to take a stance on this recommendation as it is an issue that is under consideration by the Financial Crisis Commission.

In this context, however, the Executive Board would like to point out several issues of principle that it is important to take into account when setting up an institutional structure for macro-prudential policy.

Historical experience – from the recent crisis as well as from recurring “bubbles” on various asset markets – has clearly demonstrated how difficult it is for the authorities concerned to make the necessary decisions in the field of what we would now define as macro-prudential policy. The most important reasons for this are:

- *Responsibilities and powers concerning macro-prudential policy have not been clearly defined*, which should partly be understood by considering that it is only in recent years that macro-prudential policy has begun to emerge as a policy area.
- *Decision-making concerning macro-prudential measures is vulnerable to external pressure*. Macro-prudential measures often entail increased costs for financial players and/or poorer or more expensive access to credit for private individuals or companies. This may lead to lower growth in the short term if, for example, a market that is experiencing a strong upturn is cooled down. Decisions on macro-prudential measures are therefore seldom popular. Furthermore, the fact that the benefit of these measures – that is avoiding a financial crisis – will often be in dispute and difficult to measure, makes the decision-making process vulnerable to external pressures.

Given this background, the Executive Board believes that an effective institutional structure for macro-prudential policy should be characterised by:

- *The power to make decisions.* This presupposes a clear mandate and effective and clearly defined tools. As macro-prudential policy is a policy area that is still developing, the legislation also needs to comprise forms that will make it possible to complement the available tools with new tools in a structured way.
- *Independence.* The body that is given responsibility for macro-prudential policy should be free from external pressure, both from the political sphere and from the financial sector. In this respect, macro-prudential policy, which is about preventing systemic risks, differs from the management of crises once they occur. In the latter situation the government needs to play a central role as the crisis-management measures may burden the central-government budget. There are thus good reasons for having different structures for macro-prudential policy and crisis management.
- *Accountability.* If the macro-prudential body is given a considerable degree of independence, then clear forms for the exercise of accountability will also be required. This is important, not least because it will make it possible to demand that the macro-prudential body take action. A precondition for effective accountability is that the mandate and the tools are clearly defined. However, the possibility to hold the macro-prudential body accountable may also include demands that it take action, or publicly explain why it refrains from taking action, when certain predetermined levels for key variables are passed. Other means of holding the body accountable may include strict demands for a high degree of transparency and for reporting, for example to the Riksdag.
- *Analytical capacity.* Substantial and sustainable capacity is also required to analyse risks to the financial system as a whole and what the appropriate measures for preventing such risks may be. Robust funding of the macro-prudential body is required to ensure the provision of this capacity over time.

Macro-prudential policy will also to a great degree affect, and be affected by, other closely-related policy areas, mainly monetary policy and micro-prudential supervision, and there is therefore a need to find forms for the exchange of information between those responsible for these policy areas and the body responsible for macro-prudential policy. The need for co-ordination and any exchange of information will depend on the situation or on the tools that are used. In the case of monetary policy, the Riksbank needs to particularly take into account the macro-prudential measures that have a more direct impact on the supply of credit, for example decisions concerning so-called countercyclical capital requirements.

Irrespective of the model chosen for macro-prudential policy, the Executive Board believes that it must include a central role for the Riksbank. The

■ Riksbank's responsibility for monetary policy, liquidity supply and the payments system means that it must continuously analyse threats to financial stability and intervene against them when necessary. This is largely the same analytical capacity that is needed for macro-prudential policy. From the point of view of economic efficiency, it is therefore reasonable to use the analytical capacity that has already been developed at the Riksbank for macro-prudential policy too.

Apart from these general aspects, the Executive Board also wishes to emphasise the importance of a body for macro-prudential policy being able to take effective action internationally, above all within the framework of the European Systemic Risk Board (ESRB). Giving the Riksbank a central role will also make good use of the opportunities the Riksbank has to act internationally; for example it is the Riksbank, as a central bank, that has voting rights in the ESRB.

*The evaluators also recommend transferring control of maximum loan-to-value ratios (LTV ratios) from Finansinspektionen to the Riksbank (page 38) and that the authorities involved in stability work – the Riksbank, Finansinspektionen, the National Debt Office and the Ministry of Finance – consider setting up a Financial Stability Committee (page. 39).*

The Executive Board declines to take a stance on these recommendations as both of these issues lie within the remit of the Financial Crisis Commission.

### **3.3 Recommendations concerning the Sveriges Riksbank Act**

*The evaluators recommend that the Sveriges Riksbank Act be modified in the following directions:*

- *Specifying in more detail the exact mandate of the Riksbank in terms of "promoting financial stability";*
- *Specifying in more detail the instruments that the Riksbank is entitled to use for this matter, e.g. to apply varying reserve ratios and to control foreign exchange swaps;*
- *Specifying in more detail the internal governance of the Riksbank on financial stability activities and the sharing of responsibilities and tasks with other public agencies also in charge of some aspects of financial stability, in particular the SFSA (Finansinspektionen), the SNDO (National Debt Office) and the Ministry of Finance (page 100).*

The Executive Board shares the view that there is a need to modify the Sveriges Riksbank Act. The Riksbank has previously pointed this out in a submission to the Riksdag. The Executive Board also notes that these issues are being studied by the Financial Crisis Commission and that the Committee on Finance intends to review the Sveriges Riksbank Act after the Commission has presented its proposals. In the case of the specific modifications proposed by the evaluators the Executive Board agrees with most, but not all, of them.

The Executive Board agrees that the Act should be modified so that the Riksbank's mandate to "promote financial stability" is more clearly specified. In connection with this, steps should also be taken to make sure that the role of the Riksbank in macro-prudential policy is explicitly defined. There are also good reasons for considering within the scope of this work whether a clearer

■ definition of the term “financial stability” should be introduced in the legislation.

The Executive Board also agrees in principle that the instruments the Riksbank should have to promote financial stability should be specified in more detail. Any review of this matter should take into account that risks to financial stability can arise in different parts of the financial system and that this system also changes over time. It is therefore not possible to exactly specify in advance what instruments will best be able to limit the development of risks in all situations. It is therefore necessary that the legislation allows for a certain degree of flexibility regarding the instruments that can be used in this work.

Given the role that the Riksbank has at present, the Executive Board does not believe that there is any need to introduce regulations on the internal governance structure with regard to financial stability issues. This may of course change in the light of the proposals of the Financial Crisis Commission and the changes in the powers and responsibilities of the Riksbank that these proposals may lead to.

*The evaluators also recommend that an appropriate revision to the Sveriges Riksbank Act is made to widen and clarify the conditions under which the Riksbank can provide ELA (page 33).*

The Executive Board agrees that there is a need to investigate whether the demand that financial companies should be subject to supervision by Finansinspektionen in order to be able to receive emergency liquidity assistance prevents the Riksbank from averting a systemic threat by providing such assistance to other institutions. As a result of internationalisation, financial companies may be systemically important in Sweden but be subject to supervision in another country. For example, there are now clearing organisations that are participants in RIX, the Riksbank's central payments system, and that may use the intraday credit facility associated with such participation, but that cannot be granted emergency liquidity assistance because they are not subject to Swedish supervision. This example should only be seen as an illustration of the problems that can arise, in a world where financial integration is steadily increasing, because the legislation requires a company to be subject to supervision by Finansinspektionen before it can be considered for emergency liquidity assistance.

However, the Riksbank does not support the evaluators' recommendation that the circumstances under which the Riksbank may provide emergency liquidity assistance should be clarified in the Sveriges Riksbank Act. There are three reasons for this:

- i) *The Act has worked well when applied in practice.* In 2008, the Riksbank provided emergency liquidity assistance to two institutions, Kaupthing Bank Sverige AB and Carnegie Investment Bank AB and the Act worked as intended in both cases.
- ii) *In its actions and communication the Riksbank is clear about under what circumstances it grants emergency liquidity assistance.* The Riksbank's two central assessment criteria when deciding on emergency liquidity

■ assistance are that the institution concerned must be systemically important and that it should not be evidently insolvent. The assessment of systemic importance involves assessing whether assistance is necessary to avoid disruptions to the financial system that may lead to substantial economic costs. The assessment of whether a company is solvent or not is conducted because the Riksbank should not provide assistance to an institution that lacks the ability to survive in the long term or, as it is expressed in bill 1997/98:164, to an institution that is evidently insolvent. Both of these criteria can be traced back to the basic aim of emergency liquidity assistance, which is to avoid economic costs by helping an otherwise robust company to overcome temporary liquidity problems.

It should perhaps be pointed out, however, that there may be a need to clarify the word “insolvency” as the meaning of the word shifts depending on the context. Sometimes it refers to a company’s financial strength, that is usually that the company has negative equity or that its equity is below a certain stipulated level. In other contexts it refers to the company’s inability to rightfully pay its debts in the long term.

- iii) *The term “exceptional circumstances” provides the necessary flexibility.* There may be exceptional circumstances for several reasons, of which systemic importance is one. Systemic importance is a central assessment criterion in all situations in which the provision of emergency liquidity assistance may be considered. However, it is not possible in advance to predict all the situations in which emergency liquidity assistance would fulfil its basic aim, that is to minimise the economic costs when an institution suffers a temporary shortage of liquidity. In the case of small institutions, the economic costs of a default primarily depend on the prevailing situation, for example whether there is a crisis or not. There are therefore good reasons why the legislation should not exclude the possibility of the Riksbank to provide assistance on grounds other than systemic importance.

### ***3.4 Recommendations concerning the management of institutions in crisis***

*The evaluators recommend that the relevant Swedish authorities should form a working committee to draft the necessary legislation for a special resolution regime that could well include aspects relating to both Living Wills and Bail-Ins (page 29).*

The Executive Board agrees that there is a need to draw up legislation on these issues but notes that this is also part of the remit of the Financial Crisis Commission.

The Executive Board shares the evaluators’ view that both Living Wills and Bail-Ins (that is the write-down or conversion of debts) are interesting tools that can be used to manage a bank in crisis and at the same time avoid a government takeover as long as possible. An advantage of Bail-Ins is that not only the bank’s shareholders but also its creditors are forced to bear losses in



■ connection with the resolution of a bank. This gives the creditors a greater incentive to monitor the banks' risks and price them correctly. However, several practical issues and issues of principle remain to be resolved regarding Bail-Ins. Moreover, experience gained in Denmark, for example, shows that introducing the option to use Bail-Ins is a difficult and costly process for a small open economy acting on its own. Such an introduction therefore needs to be harmonised at the global level, or at least at the European level, to limit the disadvantages.

However, the Executive Board wishes to emphasise that Bail-Ins and Living Wills do not eliminate the need for a government takeover in situations where there are serious systemic threats. Regulations should therefore be stipulated in advance for this.

*The evaluators recommend that an exercise be done jointly by Finansinspektionen and the Riksbank to draw up Living Wills for all systemically-important financial institutions, including of course the four main banks (page 28).*

The Executive Board refrains from commenting on this recommendation as the form of the international regulatory framework concerning Living Wills is still not clear.

### **3.5 Other recommendations**

*The evaluators recommend that the Riksbank maintain a watching brief on the development of macro models that incorporate banking and financial sectors as essential elements, as well as newly developed models of systemic financial stability (page 99).*

The Executive Board agrees with this recommendation. The Riksbank already monitors such development and participates in international development work. In the autumn of 2011, the Riksbank also developed a macro model that incorporates banks and bank capital. Also in the autumn of 2011, the Executive Board amended the mission of the Riksbank's Research Division so that it now has a clearer responsibility to support the work with financial stability. The staff of the Research Division will be increased as a result of this. It should be borne in mind, however, that it is not technically simple to develop practically-applicable models for the analysis of financial stability and monetary policy.

*The evaluators recommend that the Riksbank runs, on a regular basis, stress tests in which wholesale markets close down and the Fed and the ECB **do not** make swap lines in US dollars and euros available (page 100).*

The Executive Board agrees with this recommendation. The Riksbank was the first central bank in the world to publish stress tests of the liquidity of the major banks; this was in Financial Stability Report 2010:2. In the autumn of 2011, the Riksbank developed these tests so that they also include scenarios similar to those suggested by the evaluators.

#### ■ **4 Recommendations concerning monetary policy**

The Riksbank conducts what is usually referred to as flexible inflation targeting, which means that in addition to stabilising inflation around the inflation target the Riksbank also strives to stabilise output and employment around long-term sustainable paths.<sup>1</sup> The Executive Board notes that the evaluators agree that this is an appropriate foundation for the work of a central bank with an inflation target. The evaluators' overall assessment is that "the Riksbank has been at the leading edge of professional competence in its primary and essential task of aiming at flexible inflation targeting." They make a number of recommendations concerning the Riksbank's monetary policy strategy and decision-making process and how these can be changed. The Executive Board comments on these recommendations below.

##### **4.1 Recommendations concerning the measures of inflation**

*The evaluators recommend that the Riksbank sticks with the current definitions of the CPI (and its target rate of 2%) and the CPIF for the indefinite future. They also recommend that the Riksbank sticks to its practice of using the CPI index as its target for medium-term analysis, while using the CPIF index for assessing the shorter-term progress for the achievement of the inflation target (page 100).*

The Executive Board agrees with these recommendations. The Riksbank's inflation target is defined such that inflation, measured as the annual change in the consumer price index (the CPI), should be 2 per cent per year. The main reasons why the inflation target is defined in terms of the CPI are that it is a broad price index that represents normal purchases and that it is well known to the general public. In addition, the CPI statistics are of good quality, are not normally revised and are published soon after the end of the month.

Although the inflation target is formulated in terms of the CPI, the Riksbank also regularly analyses measures of underlying inflation, that is inflation measures in which price changes for certain goods or services have been excluded. One measure of underlying inflation that the Riksbank has highlighted recently is the CPIF (that is the CPI with a fixed mortgage rate). When the Riksbank changes the repo rate this has a direct effect on CPI inflation through the households' mortgage costs, which are a component of the CPI. In the CPIF measure, mortgage rates are held constant, which means that they are not directly affected by the Riksbank's repo-rate changes. This can therefore be used to indicate how the Riksbank's own repo-rate changes will affect CPI inflation in the long term.

The repo-rate changes implemented since the autumn of 2008 and that are predicted for the years ahead in the latest Monetary Policy Report mean that CPI inflation and CPIF inflation will differ for an appreciable period of time. However, the two measures will coincide when the effects of the repo-rate changes have waned and mortgage costs have stabilised. If monetary policy is conducted so that the CPIF is close to 2 per cent, then the CPI will also

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<sup>1</sup> The Riksbank's monetary policy strategy is described in the document "Monetary Policy in Sweden".

■ approach this level in the long term. The CPIF can thus be seen as an indicator of how the CPI will develop in the longer term. As long as the forecasts for the CPI and the CPIF differ throughout the forecast period, and this is primarily due to the Riksbank's own monetary policy, it is natural to highlight the CPIF as a measure of underlying inflation. This does not mean that the definition of the inflation target has changed.

However, the question of which measure of inflation is most appropriate for an inflation target is an issue of some debate. With this in mind, it is important to regularly review whether CPI inflation is still the best specification of the inflation target, and the Riksbank has conducted such reviews several times since the inflation target was announced in 1993.<sup>2</sup>

#### **4.2 Recommendations concerning the repo-rate path**

*The evaluators recommend that a little more self-doubt be expressed by the Riksbank in putting forward its proposed paths for policy rates, either by a greater emphasis on the uncertainty of such forecasts, or basing them beyond some horizon on some formula that incorporates the market yield curve (page 100).*

The Executive Board shares the evaluators' view of the importance of clearly communicating uncertainty about the future course of development and when necessary the Executive Board is open to increasing its efforts in this respect.

The Riksbank was keen to illustrate and communicate the fact that the future development of the economy is associated with a high degree of uncertainty already when it began to include forecasts in its Inflation Reports in 1997. In the current Monetary Policy Reports and Monetary Policy Updates, figures that show uncertainty bands for the repo rate, inflation and GDP are among the first figures presented, and uncertainty is also emphasised in the description of the main scenario's forecasts. In the Monetary Policy Reports, alternative scenarios are presented that aim, among other things, to highlight the uncertainty that prevails regarding the future course of development. The Executive Board also regularly emphasises that the published repo-rate path is a forecast, not a promise. The Executive Board's view is that this communication has yielded results and that at present there is a high degree of understanding among both market participants and the general public that the course of development in the long term is uncertain.

It takes time for repo-rate changes to have their full impact on the economy and monetary policy is therefore guided by forecasts of inflation and the real economy. These forecasts must be based on an assumption concerning the development of the repo rate. The Riksbank has tried the assumption that the repo rate will remain constant throughout the forecast period and the assumption that the repo rate will follow market expectations as expressed in forward pricing. Since 2007, however, the Executive Board has decided to base

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<sup>2</sup> See for example L. Heikensten and A. Vredin, "The Art of Targeting Inflation", *Sveriges Riksbank Economic Review*, 4/2002, and B. Wickman-Parak, "The Riksbank's inflation target – The CPI, other measures of inflation and phasing out the CPIX", speech held on 9 June 2008.

the forecasts on its own assessment of the development of the repo rate. This assessment is uncertain, as are the forecasts for the economy as a whole, but at the same time the repo-rate path performs an important educational function. It illustrates the development of the repo rate that the Executive Board sees as the most well-balanced at the time the decision is made, given the information that is available at that time. The Riksbank's own repo-rate path therefore has considerable advantages as a communication instrument.

The evaluators suggest that one way for the Riksbank to express a little more self-doubt in its presentation of the repo-rate path could be to base the forecasts in the longer term on some type of formula that incorporates market expectations of the development of the repo rate. The Riksbank previously tried basing the forecasts on market expectations but decided to abandon this approach. The Executive Board's view is that measures of market expectations contain important information that it is necessary to take into account in various ways in the forecasting process, but that there are disadvantages to basing the forecasts in a main scenario on these expectations.

If the forecasts are based on market expectations the Executive Board will only be able to express its view of the future development of the repo rate indirectly through its assessment of the market expectations. Communication will then be less clear compared to the Riksbank publishing its own forecast for the repo rate. Market expectations can also vary considerably over time and can change quickly, which means that the market participants may be unclear about which expectations the Executive Board is referring to in its communication. Another dilemma is that there is no clear-cut method for measuring market expectations of the repo rate. In addition to this there are the difficulties that the evaluators themselves mention. These stem from the fact that the forecasts for inflation and the real economy that the Riksbank makes on the basis of market expectations of the development of the repo rate will not necessarily correspond to the forecasts for inflation and the real economy that the market makes given this development of the repo rate.

To sum up, the Executive Board does not support the proposal to base forecasts of the repo rate in the longer term on some formula that incorporates market expectations rather than on the Riksbank's own expectations of the future course of development.

#### ***4.3 Recommendations concerning the internal forecasting and decision-making process***

*The evaluators recommend that the announcement of the current level, and intended future path, of official rates be made after the Executive Board meeting a few days after the second monetary policy group meeting (named Stor-PBG2 in the internal process). The evaluators recommend that the announcement should normally be accompanied by a short statement giving the main lines of argument and identifying the voting pattern. The Monetary Report/ Update would then be published on the same timetable as now (page 76).*

■ The Executive Board does not support the recommendation to bring the announcement of the repo-rate decision forward.

The Riksbank's current forecasting and decision-making process is designed to enable the Executive Board to decide on the level of the repo rate and on the repo-rate path at the monetary policy meeting and to enable a comprehensive analytical report giving the reasons for the decision to be published the day after the meeting at the same time as the decision is announced. The decision is the result of a process in which the stances of the individual members of the Executive Board develop gradually as the material on which the decision is based develops and is complemented by forecasts and analyses.

During the course of this process, there are group meetings at which the members of the Executive Board have the opportunity to comment on conceivable repo-rate paths and other forecasts and discuss them with staff from the Monetary Policy Department and with each other. This is a necessary step in the work in which each member of the Executive Board forms an opinion on the repo-rate path he or she prefers. This does not mean that the members have opted for a certain repo-rate path and that the repo-rate decision has thus in practice been made a couple of days after the group meeting the evaluators refer to. The Executive Board can change the repo-rate path and all the other forecasts up to, and above all at, the monetary policy meeting, which is the meeting at which the decision is formally made. How individual members will reason and argue does not become apparent before the meeting itself.

The forecasting and decision-making process is designed to make it possible to manage a situation in which the repo-rate path is changed at the monetary policy meeting. There are thus resources in readiness that make it possible for a Monetary Policy Report to be revised following a monetary policy meeting and to be still published on the following day. There is nothing particularly dramatic about this. The main scenario's forecasts are presented in specific sections, which makes it relatively simple to identify the sections of text that need to be revised. Nor does the forecasting process need to go back to square one. With the methods the Riksbank uses in its forecasting work it is entirely possible in a short time to modify the main scenario in line with another repo-rate path and to change the forecasts in a consistent way.

It is important to the Executive Board to be able to present a comprehensive analytical report in connection with the announcement of the repo-rate decision. The adoption of the evaluators' recommendation would mean that the Executive Board would not be able to provide a comprehensive picture of the background to the repo-rate decision at the same time as the decision is announced. If the Monetary Policy Reports/Updates are not published on the same day as the announcement of the repo-rate decision but with a time lag, then the analyses and forecasts will not be as up-to-date and there is a risk that the Reports/Updates will be less relevant as a basis for the monetary policy debate.

■ However, the Executive Board shares the evaluators' view that the process entails risks that it is important to pay attention to, for example the risk of leaks. Although the repo-rate decision is not actually made until the monetary policy meeting, there are a number of Riksbank staff who help to produce the Executive Board's decision-making material who during the course of the process are aware of information that must be characterised as market-sensitive. The Executive Board is aware of the risks associated with this and several measures have been taken to reduce the risk of such information being disseminated outside the Riksbank. At the same time, the Executive Board wishes to emphasise that the current process, which is based on the high moral character and great sense of responsibility of the Riksbank staff, has worked very well. Furthermore, in the view of the Executive Board the evaluators' recommendation would not reduce the risk of leaks because it would only entail a shift in the timetable for the current decision-making process.

*The evaluators recommend that the Executive Board of the Riksbank should meet to discuss what the purpose of the monetary policy meeting should be and whether its title, function and remit should be changed (page 100).*

The Executive Board does not agree with this recommendation. According to the evaluators, there is a risk in the Riksbank's current process that the monetary policy discussion will be negatively affected by the fact that the members of the Executive Board adopt their stances during the process and then present and explain these stances in detail at the monetary policy meetings. To begin with, the Executive Board wishes to emphasise that one of the aims of the current process and the choice to base the forecasts on its own repo-rate path is to facilitate a constructive and informative monetary policy discussion. An important part of this is that the material produced as a basis for the Board members' monetary policy deliberations facilitates such a discussion. At present, an extensive project is also underway to review and further develop this material.

At the same time, the Executive Board wishes to emphasise that the process that leads to a repo-rate decision is also the process that leads to the monetary policy meeting. It is therefore unavoidable, and also necessary, that the individual members form an opinion on what monetary policy they prefer before the monetary policy meeting. The Riksbank's process is probably very similar that of other central banks in this respect. What is important is that the members have the freedom to change their minds during the discussion at the monetary policy meeting and that at the meeting they can propose and vote for the monetary policy of their choice.

It is important for the general public's understanding of monetary policy, for the evaluation of the Riksbank by its principal – the Riksdag – and for the Riksbank's accountability that the reasons for the repo-rate decisions and the stances of the individual members of the Executive Board are presented clearly. Accountability is also facilitated by the fact that the minutes of the monetary policy meetings are attributed; that is they specify which member said what.



- The fact that the members present their stances in detail at the monetary policy meetings must therefore also be seen against this background.

On behalf of the Executive Board:

Svante Öberg

Sigvard Ahlzén

Taking part in the decision: Svante Öberg (chair), Karolina Ekholm and Barbro Wickman-Parak.

Presenters: Eva Julin, Erik Lenntorp and Björn Andersson.