

## ■ Exit strategies for unconventional measures

Central banks and governments around the world have taken extensive measures to maintain financial stability and mitigate the effects of the recession that arose in the wake of the global financial crisis, which became very serious in September 2008. As the financial sector is stabilising and the economies are showing signs of recovery, the need for such measures is declining. An international discussion is now underway about exit strategies, in other words how and when these measures can be phased out in an orderly way. This article briefly discusses the measures that the Riksbank has taken and the conditions governing when and how they may be phased out. Unlike many other central banks, the Riksbank has not purchased securities and this will make the phase-out relatively uncomplicated.

### The measures taken by governments and central banks

The global financial crisis became very serious when the US investment bank Lehman Brothers filed for bankruptcy in September 2008. Since then, central banks and governments around the world have taken extensive measures to maintain financial stability and counteract a long recession. The governments' have taken fiscal policy measures that mainly comprise:

- State guarantees for the banks' borrowing
- Capital injections for the banks to strengthen the capital base
- Assuming the credit risk for the central banks' purchase of securities
- Stimulus packages to promote household and corporate demand
- Infrastructure investments

The central banks' measures can mainly be divided into two kinds: unconventional monetary policy measures that aim to stimulate the economy when the possibilities to do so using conventional monetary policy methods have been exhausted following substantial cuts in the policy rates, and measures designed to maintain financial stability. The unconventional monetary policy measures mainly comprise:

- Announcing that the policy rate will be kept at a low level for a long period of time
- Purchasing government securities
- Purchasing interest-bearing securities issued by mortgage institutions and companies
- Lending at longer maturities than normal

The measures taken to maintain financial stability consist above all of measures to facilitate the liquidity management and funding of solvent banks and measures to promote the functioning of seriously-disrupted financial markets. For example:

- Swap agreements between central banks to make it possible to offer counterparties loans in foreign currencies
- The acceptance of additional types of security as collateral for loans from central banks
- A wider circle of counterparties that may receive loans from the central banks
- Lending at longer maturities
- Purchasing interest-bearing securities issued by mortgage institutions and companies

The effects of the different measures are interlinked. Measures that improve financial stability also affect market rates and thus have a monetary policy effect.

### **The need for international coordination is under discussion**

The improvement of the situation on the financial markets and the return of growth have sparked an international discussion about how and when the redirection of the fiscal and monetary policy stimulation measures should begin. If this is done too soon the recovery of the economy may be put at risk. If it is done too late it may lead to excessive inflationary pressures. The different countries must weigh up these factors in the light of the economic situation and inflation pressures in the respective countries.

One of the points sometimes raised regarding the extraordinary measures to promote stability is whether there is a need to coordinate the phase-out of the measures internationally. It is not self-evident that the phase-out should be coordinated as the situation differs in the different countries. However, it can be argued that the exit strategies for the phase out of the support to the banking sector should be coordinated. Otherwise there is a risk that competition could be distorted if some countries retain their fiscal policy stimulus measures while others phase them out. For example, banks will be subsidised to some extent in those countries where bank support programmes are retained in contrast to countries where such programmes are phased out.

### **The Riksbank's measures**

What measures has the Riksbank taken to mitigate the effects of the financial crisis and the subsequent recession? The Riksbank has reduced the repo rate to 0.25 percent in a rapid series of cuts and then communicated that the repo rate will remain at this level for some time to come. Some time to come means, given the current forecasts, until the autumn of 2010. For monetary policy reasons, the Riksbank has also provided loans to the banks at a fixed interest rate for 12 months. This has been accompanied by other measures designed to safeguard financial stability:

- The Riksbank has provided SEK and USD loans to the banks at longer maturities
- The Riksbank has entered into swap agreements with the Federal Reserve (the US central bank) to make it possible to swap Swedish krona for US dollars and then lend these dollars to the banks and with the ECB to enable EUR/SEK swaps when needed
- The Riksbank has decided that more types of security can be accepted as collateral for loans from the Riksbank has been extended
- The Riksbank has widened the circle of counterparties permitted to participate in fine-tuning operations
- The Riksbank has introduced a new category of counterparty, referred to as restricted monetary policy counterparties, who may participate in certain measures

### **The measures will be phased out when they are no longer needed**

The Riksbank has followed two basic principles in the design of these measures. The first is that the measures must not take the place of markets that are functioning effectively and the second is that loans should be granted against collateral and at an interest rate corresponding to the repo rate with a certain addition. The measures have thus been designed so that they can be easily phased out when they are no longer needed.

Once the situation in the financial sector can be regarded as normal and the real economy no longer requires stimulus in the form of unconventional measures, then these measures will be phased out. The Riksbank's exit strategy is based on it being possible to achieve the inflation target and maintain financial stability. This also entails the Riksbank clearly communicating when and how quickly the measures will be phased out.

### **Some measures will phase themselves out**

Although the design of the measures follows the same basic principles, there are certain differences between them regarding the extent to which they will phase themselves out when they are no longer needed. Several of the unconventional measures have a more or less built-in exit strategy. This applies to the swap agreement with the Federal Reserve and the provision of SEK loans at longer maturities. The swap agreement with the ECB is a standing agreement that allows the Riksbank to borrow euros when necessary in EUR/ SEK swap. Although the agreement was drawn up during the crisis, it will remain in place even when the situation returns to normal as it is a standing agreement.

It can be noted that the demand for US dollar loans from the Riksbank has dried up. It is quite simply cheaper for the banks to borrow dollars on the market than to borrow dollars from the Riksbank. The swap agreement with the Federal Reserve has a time limit and applies up to and including 1 February 2010. This measure will thus phase itself out when the agreement expires.

When the situation in the financial sector stabilises and the conditions in the interbank market return to normal it ought to be cheaper for the banks to borrow Swedish kronor at longer maturities on the market than from the Riksbank. The demand for loans from the Riksbank will then decline, assuming that the addition to the repo rate is at a reasonable level. The addition should be such that under normal conditions in the financial markets it is more expensive to borrow from the Riksbank than on the market. This does not necessarily mean, however, that the Riksbank will phase out the measures immediately when there is no longer a demand for them. Merely knowing that the measures are in place, even though they are not being used, will help to stabilise the financial markets. It is only when the Riksbank deems that the situation on the financial markets has been stable for a satisfactory period of time that it will be time to phase out the loans by no longer offering them. The Riksbank will clearly communicate in good time when the measures will be phased out so that the change does not come as a surprise.

The restricted monetary policy counterparties are permitted to participate in the Riksbank's programme for SEK loans at longer maturities. When the Riksbank stops issuing these loans, the restricted monetary policy counterparties will no longer be interested in remaining as counterparties, especially as there is a charge for this.

### **Some measures will require active decisions**

The exit strategies for the remaining measures – the number of counterparties that may participate in the fine-tuning operations and the list of securities accepted as collateral for loans from the Riksbank – will require more active decisions on the part of the Riksbank. However, it is not self-evident that these measures will be phased out. The issues relating to these measures are more technical in nature and will be studied more closely before any decisions are made on whether to phase them out or retain them.