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The interest rate effects of government bond purchases away from the lower bound*

Rafael B. De Rezende†

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Abstract

I analyze the recent experience of unconventional monetary policy in Sweden to study the interest rate transmission mechanisms of government bond purchases when interest rates are away from the lower bound. Using dynamic term structure models and event study regressions I find that government bond purchases have important portfolio balance and signaling effects. The signaling channel operates mainly by lowering short-rate expectations in the intermediate segment of the yield curve, while the portfolio balance channel is effective in lowering longer maturity term premia. In addition, I find that target interest rate policy and government bond purchases operate in different segments of the yield curve. This suggests that a combination of the two policies can be used to lower interest rates across the whole maturity spectrum, making monetary policy more expansionary.

Keywords: quantitative easing; signaling channel; portfolio balance channel; yield curve; dynamic affine term structure models; short rate expectations; term premium

JEL Classifications: E43; E44; E52

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1 Introduction

During the financial crisis of 2008 and the following years, a number of central banks reduced their target interest rates - the traditional tool of monetary policy - essentially to their lower bounds. In the face of deteriorating economic conditions and deflationary pressures, and with little scope for further cuts in target interest rates, central banks initiated unprecedented expansions of their balance sheets by purchasing large amounts of government debt and other types of assets across different maturities. While it is widely accepted that such policies have helped to reduce long-term interest rates (Gagnon et al. 2011; Christensen and Rudebusch 2012), the understanding of their interest rate transmission channels is at best partial and has become the topic of a growing literature.

The literature has focused mainly on two channels of transmission: the signaling and the portfolio balance channels. The first channel works through changing market expectations of future policy rates. For instance, by announcing asset purchases, the central bank may send a signal to market participants that it intends to keep policy rates low for longer than otherwise. The central bank may also influence market expectations by communicating its future monetary policy intentions and by providing forward guidance about its future policy rate path. The other is the portfolio balance channel, which arises from the reduction in the available supply of the assets purchased. In this channel, under the assumption that bonds of different maturities are not perfect substitutes and that maturity-specific bond demands by certain investors exist, central banks may be able to affect bond yields by changing the risk premia that investors require for holding the securities purchased.

Recent research, however, has shown that nominal bond yields have been constrained by the interest rate lower bound in different economies. For instance, Swanson and Williams (2014) discuss that intermediate-maturity Treasury yields seem to have been especially constrained from late 2011, around the time the FOMC started providing explicit calender-based forward guidance. Bauer and Rudebusch (2016) document that the wedge between the ten-year Treasury yield and the corresponding shadow yield, a measure of the tightness of the lower bound constraint, increased substantially over the period from 2009 to 2012, reaching its maximum in mid-2012 and then gradually decreased over 2013 and 2014, when macroeconomic conditions improved in the US. They discuss that this phenomenon is mainly due to the constraints the zero lower bound imposes on the expected path of policy rates and its conditional distributions, which affects the behavior of yields, depending on how long the lower bound is expected to be binding.[1] This implies that the signaling channel of government bond purchases may be weaker in a lower bound environment.

In this paper, I analyze the recent experience of unconventional monetary policy in Sweden to study the interest rate transmission mechanisms of government bond purchases when the policy rate

[1] Using shadow-rate term structure models the papers by Wu and Xia (2015), Bauer and Rudebusch (2016), Christensen (2015) and Lemke and Vladu (2014) have demonstrated that yields for different maturities have been constrained by the lower bound in several economies, mainly due to its effects on short-rate expectations.

is away from the lower bound. Unlike other central banks, the Sveriges Riksbank has been able to lower its target interest rate, the repo rate, deep into negative territory while government bond purchases have been announced. This makes it possible to study the effects of government bond purchases across the full yield maturity spectrum, without lower bound constraints. In addition, the Riksbank has not announced a lower bound for its policy rate, imposing no formal restrictions on expected policy rate paths.

In order to identify the channels through which the bond purchases may have operated I follow the literature and use dynamic term structure models combined with an event study approach. More specifically, I estimate discrete-time Gaussian dynamic affine term structure models (DATSMs) and decompose yield changes into changes to expected short-rate and term premium components for different maturities.[2] The expected short-rate component is then associated with monetary policy expectations, or the signaling effect, while portfolio balance effects are associated with the term premium component. One important aspect to consider, however, is that the Riksbank has announced its decisions about target interest rate and bond purchase policies at the same time, which means that it is necessary to separate the effects of the two policies on yields and components in order to study the interest rate channels of government bond purchases. In this paper, I use an event study regression approach. More specifically, I project changes in yields, the expected short-rate component and term premia onto expected and unexpected changes in the policy rate, the policy rate path and control variables for the period in which only conventional monetary policy was implemented, and use coefficient estimates to predict the effects of conventional monetary policy announcements on days in which the two policies were announced. I then use the regression residuals as measure of the effects of bond purchase announcements. The idea of this approach is to isolate the effects from each policy on yields and its components.

I document that Swedish interest rates did respond in the immediate aftermath of the announcements. Long-term government bond yields dropped by a cumulative total of around 46 basis points following the five Riksbank monetary policy announcements that involved bond purchases in 2015. Relative to the ten-year bond yield of 0.65 percent on the eve of the first announcement, 46 basis points represent a substantial and significant drop. Importantly, yields declined more strongly on announcements that involved changes in the repo rate and purchases of government bonds, with long-term yields declining more than short-term yields on net. This suggests that the combination of the two policies was effective in lowering interest rates.

Results also suggest that government bond purchases have important portfolio balance and signaling effects. The signaling channel operates by lowering the short-rate expectations component across maturities but mainly in the intermediate segment of the yield curve, while the portfolio

[2] Gagnon et al. (2011), Christensen and Rudebusch (2012) and Bauer and Rudebusch (2014) are among the previous studies that use term structure models to decompose yields and analyze the interest rate effects of bond purchase programs in the US and in the UK.

balance channel is more effective in lowering longer maturity term premia. In addition, I find that target interest rate policy and government bond purchases operate in different segments of the yield curve, being effective in lowering yields across the full maturity spectrum when implemented together. The policy announcement of July 2, 2015 is a good example of how the three channels seem to work and interact. On that day, the decisions to cut the repo rate by 10 basis point and to purchase government bonds for a further SEK 45 billion were largely unexpected by market participants. The surprise regarding the interest rate cut affected short-rate expectations strongly, driving the fall in short-term yields. At the same time, bond purchases contributed, to a large extent, to lower the short-rate expectations component and term premia in the 2-year to 5-year and in the 5-year to 10-year segments of the yield curve, respectively, suggesting that both the signalling and the portfolio balance channels seemed to have contributed to the observed fall in mid- and long-term bond yields.

The findings presented have important policy implications. They suggest that, when the policy rate is not constrained by the lower bound, it is possible to design bond purchase programs with the aim of influencing bond yieds across maturities, but especially in the mid and long segments of the yield curve. Furthermore, when implemented together, target interest rate policy and government bond purchases may be used by central banks to lower yields across the full maturity spectrum, making monetary policy more expansionary than otherwise. While interest rate policy may lower short-term yields mainly through policy rate rate expectations, government bond purchases are expected to operate by lowering mainly mid-horizon policy rate expectations and longer maturity term premia.

The remainder of this paper is organized as follows. The next section describes the Swedish experience of unconventional monetary policy and shows a preliminary analysis on the interest rate effects of government bond purchases. Section three introduces the affine term structure models that are used to decompose government bond yields into the short-rate expectations and term premium components together with event study framework. Section four describes the main results of the paper and the fifth section concludes.

2 The Swedish experience of unconventional monetary policy

In this section, I describe in more detail the Swedish program of government bond purchases launched in February 2015 and perform a preliminary analysis of its impact on interest rates.

2.1 The Riksbank's government bond purchase program

According to the Sveriges Riksbank Act, the Riksbank aims for price stability with conventional monetary policy being implemented by setting the repo rate, and by steering the overnight rate towards this rate through short-term market operations. The instruments that the Riksbank uses are daily fine-tuning transactions and weekly issues of Riksbank certificates.[3] The bounds for the overnight rate are set by an interest rate corridor equal to the repo rate plus/minus 0.75 percentage points. The exchange rate is floating and the Riksbank sets an inflation target rate of 2 per cent per year. This policy framework has been implemented since 1993.

This policy reached its limit in July 2009 when, in response to developments related to the financial crisis, the Riksbank reduced its target rate to 0.25 percent and lowered its repo-rate path. Further monetary policy easing continued to be desirable and, in connection with the interest rate decision, the Riksbank decided to launch a bank lending program with a fixed minimum auction interest rate of 0.4 percent and a maturity of 12 months. This was intended to contribute to lower interest rates on loans to businesses and households. By November 2009, SEK 296.5 billion had been auctioned, equal to approximately 9 percent of Sweden's GDP. The rapid recovery of the Swedish economy led the Riksbank to end its bank lending program by 2011 with the last variable-rate loans, also included in the program, maturing in January of that year. A large part of the increase in the Riksbank's balance sheet was absorbed. By the same time, the rapid recovery of the Swedish economy, followed by the increase of inflation above the target, led the Riksbank to raise interest rates.[4] However, the slower than expected recovery of foreign economies, together with the consequent drop in consumer prices, led the Riksbank to start lowering its policy rate again in December 2011.

Against this background and with considerable downward pressure on consumer prices, the Riksbank announced complementary monetary policy measures based on the purchase of government bonds in February 2015, which are the focus of this paper. The Executive Board of the Riksbank announced that the Riksbank would start buying nominal government bonds on the secondary market to the amount of SEK 10 billion. The purchases took place by means of auctions in which the Riksbank's monetary policy counterparties and the Swedish National Debt Office's primary dealers were able to participate. Later on, further monetary policy easing continued to be desirable, in particular due to concerns about the strengthening of the Swedish krona (SEK), and the Riksbank announced further extensions of its bond purchase program. At the same time, the repo rate was

[3] The fine-tuning transactions mean that, at the end of the day, the banks can deposit liquidity with the Riksbank overnight at the repo rate minus 0.10 percentage points. Alternatively, the banks can invest in the Riksbank certificates, which are issued at the repo rate with a maturity of one week.

[4] The rapid increase in Swedish household debt and housing prices that followed from the low interest rate environment were also considered by the Riksbank when deciding on raising the repo rate. This policy is commonly known as "leaning against the wind" (see Per Jansson 2014).

gradually lowered, reaching the levels of -0.35 percent in July 2015 and -0.50 percent in February 2016. Table 1 shows a description of the key monetary policy announcements that happened during 2015 and that are the main object of study of this paper.

One important aspect of the Swedish program is that it was not aimed at providing extra liquidity to restore the functioning of certain markets. The main goal was to lower interest rates in various markets as a means of avoiding a quick appreciation of the Swedish krona and of encouraging banks to lend, thereby stimulating the economy and making inflation return to its 2 per cent target. Purchases of Swedish government bonds were concentrated in the two- to eleven-year maturity sector, reflecting the availability of the outstanding debt (see Figure 1 - Panel A). In addition, the pace of the purchases evolved fairly smoothly over the course of the program with purchases being somewhat heavier in early 2015 and slowing down during the summer and the end of the year (see Figure 1 - Panel B). Purchases were also spread across maturities when we look from a time perspective, which reflects the idea that the Riksbank aimed at lowering interest rates across the whole maturity spectrum ranging from two to eleven years.

2.2 The responses of market interest rates: a preliminary analysis

A preliminary assessment of how interest rates reacted to the Swedish program can be performed by looking at how interest rates behaved in event windows around the monetary policy announcements. I use one-day windows as the baseline for the study, which is in line with the literature (see Gagnon et al. 2011, Christensen and Rudebusch 2012, Bauer and Rudebusch 2014, among others). The bond yields analyzed are zero-coupon yields constructed using a smooth discount function based on the Svensson (1995) parameterization and provided by the Riksbank staff.[5] In addition, I look at STIBOR (Stockholm Interbank Offered Rate) interest rates at different maturities, which is a reference rate that shows the average interest rate at which a number of active banks on the Swedish money market are willing to lend to one another, without collateral.

Table 2 shows one-day responses of Swedish government bond yields and STIBOR interest rates to the six Riksbank monetary policy announcements shown on Table 1. As noted, there is a negative interest rate response around most announcements, with interest rates declining more strongly on February 12, March 18 and July 2, when changes in the repo rate and purchases of government bonds were both announced. Moreover, long-term bond yields declined more strongly than short-term bond yields on net, with differences being particularly larger following the announcements of September 3 and October 28, when the Riksbank decided to keep the repo rate unchanged. Interestingly, on

[5]The Svensson (1995) yield curve model assumes the following functional form, $y_t^n = \beta_{0,t} + \beta_{1,t}\left(\frac{1-e^{-\lambda_{1,t}n}}{\lambda_{1,t}n}\right) + \beta_{2,t}\left(\frac{1-e^{-\lambda_{1,t}n}}{\lambda_{1,t}n} - e^{-\lambda_{1,t}n}\right) + \beta_{3,t}\left(\frac{1-e^{-\lambda_{2,t}n}}{\lambda_{2,t}\tau} - e^{-\lambda_{2,t}n}\right)$. The data used for estimation are the benchmark government bonds with maturities from 2 to 10 years and T-Bills with maturities (closest to) of 3, 6, 9, and 12 months, in addition to the repo rate.

these particular dates, market participants were surprised by the decision of not cutting the repo rate (see Figure 2), which helped to increase short-maturity bond yields as well as STIBOR interest rates. Following government bond yields, yield differentials against Germany also declined after most policy announcements, with long-term yield differentials declining more than their short-term counterparts. Another important reason for the decision to purchase government bonds was to avoid a large appreciation of the Swedish krona. As can be seen, there is a positive net Swedish krona response around announcements with large depreciations happening on February 12, March 18 and July 2, when changes in the repo rate and purchases of government bonds were both announced.

The transmission of negative interest rate policy to other interest rates in the economy has been mostly unaffected. Although banks have been somewhat reluctant to lower their deposit and lending rates to companies and households (see Figure 3 - Panel A), the transmission to market interest rates has functioned as if the repo rate was positive, with STIBOR and government bond rates following the decline in the repo rate, and reacting normally to interest rate cuts (see Figure 3 - Panel B). One interesting remark, however, is that the spreads between STIBOR and risk-free rates - the repo rate or the 3-month government bond yield - have decreased considerably since February 2015, which can be explained by the higher liquidity in the interbank market resulted from the Riksbank's bond purchase policy.

Another evidence suggesting that market rates have reacted normally to repo cuts into the negative territory can be obtained by testing for the presence of structural breaks in the relationship between changes in the repo rate and market rates. More specifically, we can estimate event study regressions as in Kuttner (2001) and Gürkaynack, Sack and Swanson (2005) and use structural break tests to verify whether coefficient estimates have remained stable after the repo rate turned negative. The estimated regression specification is the following,

$$\triangle R_t^n = \beta_0^n + \beta_1^n \triangle r_t^e + \beta_2^n \triangle r_t^u + \beta_3^n \triangle rpf_t^u + \varepsilon_t^n \tag{1}$$

where $\triangle R_t^n$ is the change in an n-maturity interest rate observed in a day of monetary policy announcement, $\triangle r_t^e$ and $\triangle r_t^u$ are the expected and unexpected changes in the repo rate and $\triangle rpf_t^u$ is a repo path factor constructed as the path factor Z_2 of Gürkaynack, Sack and Swanson (2005).[6] Results shown in Table 3 indicate the existence of no structural breaks in government bond and STIBOR interest rate regressions. Neither the fluctuation tests nor the F-tests, which assign the day in which the Riksbank set the repo rate at -0.10 percent as the break date, indicate the existence of

[6] $\triangle r_t^e$ and $\triangle r_t^u$ are constructed using the 1-month STINA (Stockholm Tomorrow Next Interbank Average) contract rates and a window of fifteen minutes before and two hours and forty five minutes after each policy announcement. $\triangle rpf_t^u$ is constructed as the path factor Z_2 of Gürkaynack, Sack and Swanson (2005) using $\triangle r_t^u$ and FRA (Forward Rate Agreements) contract rates with maturities of three, six, nine and twelve months. The repo path factor can be interpreted as all aspects of monetary policy announcements that move the path of future repo rates without changing the current repo rate. More details on the construction of $\triangle r_t^e$, $\triangle r_t^u$ and $\triangle rpf_t^u$ are provided in the Appendix.

parameter instability. This suggests that the transmission of negative interest rate policy to market rates has been mostly unaffected.

Interestingly, market participants have also expected the repo rate to go continuouly negative, which can be seen from repo rate forecast distributions obtained from surveys. Figure 4 shows probability distributions of the mean, minimum and maximum repo rate expectations published on October 14, 2015 and on February 17, 2016, when the repo rate was -0.35 and -0.5 percent, respectively.[7] Notice that, regardless of the forecast horizon, there is substantial probability mass below -0.5, -0.6 or even -0.8 percent. This is more evident for the minimum distribution, but is also noticeable for the mean and maximum forecast distributions. Interestingly, the distributions of the minimum are always way to the left compared to those of the mean and maximum, which suggests that repo rate expectations have not been particularly constrained.

3 Empirical analysis

In this section, I introduce the class of Gaussian term structure models that I use for decomposing bond yields into a short-rate expectations component and an associated term premium component, and proceed to find a preferred specification. I end the section by introducing the event study regression approach to disentangle the effects of conventional and unconventional monetary policy announcements. Finally, in Section 4, I provide the quantitative results and analyze the transmission channels of government bond purchases to interest rates.

3.1 Dynamic term structure models

Assessing the effects of government bond purchases on short-rate expectations and term premia components requires a model that is able to decompose bond yields. In this paper, I follow the literature since Ang and Piazzesi (2003) and use discrete-time Gaussian DATSMs to model zero-coupon bond yields as functions of pricing factors. More specifically, I assume that the $p \times 1$ vector of pricing factors X_t follows a VAR(1) process under the objective probability measure $\mathbb{P}$,

$$X_{t+1} = \mu + \Phi X_t + \Sigma \varepsilon_{t+1} \tag{2}$$

where $\varepsilon_t \sim iid\, N(0, I_p)$ and Σ is an $p \times p$ lower triangular matrix. The stochastic discount factor (SDF) that prices all assets under the absence of arbitrage is assumed to be conditionally lognormal

[7] These are provided by TNS Sifo Prospera and survey respondents are money market participants. TNS Sifo Prospera has been used by the Riksbank as the main source of survey expectations for several Swedish economic variables including inflation, GDP growth, repo rate, among others, since 1997.

$$M_{t+1} = exp\left(-r_t - \frac{1}{2}\lambda_t'\lambda_t - \lambda_t'\varepsilon_{t+1}\right) \tag{3}$$

where $\lambda_t = \lambda_0 + \lambda_1 X_t$ is a $p \times 1$ vector of risk prices. I allow the short rate to vary freely, without imposing any restrictions or asymmetries in the conditional distributions of short-rate expectations. The one-month interest rate is then affine in the pricing factors, $r_t = \delta_0 + \delta_1' X_t$. Under the risk-neutral measure $\mathbb{Q}$ the vector of pricing factors follows the dynamics,

$$X_{t+1} = \mu^{\mathbb{Q}} + \Phi^{\mathbb{Q}} X_t + \Sigma\varepsilon_{t+1} \tag{4}$$

where $\mu^{\mathbb{Q}} = \mu - \Sigma\lambda_0$ and $\Phi^{\mathbb{Q}} = \Phi - \Sigma\lambda_1$.

Under no-arbitrage bond prices are then exponential affine functions of the state variables, $P_t^n = exp(A_n + B_n' X_t)$, where A_n is a scalar and B_n is an $p \times 1$ vector that satisfy the recursions

$$\begin{aligned} A_{n+1} &= -\delta_0 + A_n + B_n'\mu^{\mathbb{Q}} + \tfrac{1}{2}B_n'\Sigma\Sigma' B_n \\ B_{n+1} &= \Phi^{\mathbb{Q}\prime} B_n - \delta_1 \end{aligned} \tag{5}$$

which start from $A_1 = -\delta_0$ and $B_1 = -\delta_1$. Model implied yields are computed as $y_t^n = -n^{-1} log P_t^n = -n^{-1}(A_n + B_n' X_t)$.

It is interesting to note that the functions A_n and B_n are computed under the risk-neutral measure $\mathbb{Q}$ and not under the objective probability measure $\mathbb{P}$. The difference is determined by the risk premium demanded by investors to invest in an n-year bond and that is embodied in X_t. Following this argument, the term premium is then defined as the return difference between buying and holding an n-year bond until maturity and rolling over the one-month interest rate,

$$TP_t^n = y_t^n - \frac{1}{n}\sum_{i=0}^{n-1} E_t^{\mathbb{P}}(r_{t+i}) \tag{6}$$

The specification described above is quite general and is suitable for a large number of models in the class of discrete-time Gaussian DATSMs. Here I focus on two models that have been popular in recent studies. The first model I consider is provided by Joslin, Singleton and Zhu (2011) (JSZ henceforth). Its main distinctive features are the inherent separation between the parameters of the $\mathbb{P}$ and $\mathbb{Q}$ distributions and the use of observable yield portfolios as pricing factors, $X = Wy$, with bonds being priced without error. As noted by JSZ, this feature of the model facilitates enormously its estimation with a near-instantaneous convergence to the global optimum of the likelihood function. In addition, I follow Bauer, Rudebusch and Wu (2012) (BRW henceforth) and consider a version of the JSZ model in which parameters of equation (2) are corrected for small-sample bias.[8] The idea

[8] In this paper, we use the bootstrap method of small-sample bias correction. Results are essentially the same as

behind this approach is to correct the downward bias in equation (2) that tends to underestimate the interest rate persistence so that short-rate expectations do not converge to its sample mean as quickly as the non-bias-corrected model, delivering estimates of the term premium and the short-rate expectations components that are more consistent with data and theory. Several papers have compared interest rate decompositions obtained from bias-corrected and non-bias-corrected models and conluded that results may differ considerably.[9] This is undesirable since conclusions regarding the evaluation of the interest rate transmission mechanisms of bond purchases may differ depending on what model is considered.[10] The approach I followed was then to combine the estimates generated from the two models in such a way that short-rate forecasting errors are minimized (Baumeister and Kilian 2014). Although simple, this approach is very effective as it eliminates the need to rely on one single model or on two or more models that may be subject to misspecifications. Moreover, several papers have favored the use of forecast combinations to deal with problems such as structural breaks, model misspecifications as well as unknown forecast loss functions (see Timmermann 2006 for a survey). In this paper, I combine two versions of each model, one with three pricing factors and one with four pricing factors, i.e. $p = 3$ and $p = 4$, in a total of four models.

The models are estimated using daily zero-coupon bond yields for fourteen maturities - one, three, six and nine-month, and one to ten-year - for the period ranging from December 1, 1998, to July 27, 2016. As can be seen from Figure 5, this sample is marked by three monetary tightening and easing cycles, with nominal yields showing a declining pattern over the whole sample period, following the international trend (see Wright 2011). For this sample period, the optimal model combination that minimized the quadratic forecast loss function for horizons equal to 2, 5 and 10 years was the one that attributed a weight of 0.19 to $JSZ_{p=3}$, 0.28 to $JSZ_{p=4}$, 0.22 to $BRW_{p=3}$ and 0.31 to $BRW_{p=4}$. I use this model combination to decompose yields.

Figure 6 shows the decomposition of the 5-year yield using the optimal model combination. As can be seen, both the term premia and the short-rate expectations components follow the decline in yields, with term premia declining more strongly. The estimated term premium on the 5-year government bond reached its lowest level of around -1 percent in July 2016.

There are at least four possible explanations for why long-term term premia have been compressed in Sweden. The first is the low inflation environment in Sweden, Europe and the United States observed since late 2013, which has led bondholders to be willing to accept less compensation for bearing inflation risk.[11] Another important factor is the low uncertainty about the near-term outlook for policy rates in Sweden and major economies. The low inflation environment increases

correcting the bias through indirect inference, but the estimation is faster.

[9]See Bauer, Rudebusch and Wu (2012), Bauer and Rudebusch (2014), Bauer, Rudebusch and Wu (2014) and Wright (2014) for a debate around this topic.

[10]See Bauer and Rudebusch (2014)

[11]Historically, the most important risk for long-term bondholders has been the risk of unexpected inflation rises, as they deteriorate the returns associated with a nominal bond

the likelihood that policy rates around the world will remain low for some time, lowering uncertainty about future policy rates and helping to compress term premia in long-term yields. It is likely that the zero-lower bound in the US policy rate also contributed to lowering uncertainty about future policy rates in the US, as investors were quite sure that the Fed would keep the fed funds rate at zero for some time. Another possible explanation for the observed decline in Swedish government bond term premia is the bond purchases in Europe, Japan and elsewhere. It is likely that bond purchases in foreign economies have possibly caused a "spillover" effect into the demand for Swedish bonds, pushing down their term premia. And lastly, it is important to note that government bonds typically work as a hedge against different types of risk that may hurt returns on other riskier assets, and may be especially demanded by certain institutional investors due to liquidity and regulatory reasons. Investors may then be willing to accept low or even negative compensation for holding long-term government bonds, which helps to explain why term premia have been negative more recently.

3.2 Event study methodology

Following other papers in this literature, I assess the interest rate effects of government bond purchases by using an event study methodolgy with a one-day window. Although a one-day event window may be too short to capture all of the announcements' effects on interest rates, it lowers considerably the likelihood that other events affect interest rates within the window, which would cloud the true effects of bond purchase announcements.

One important aspect to consider, however, is that the Riksbank has announced interest rate policy and government bond purchases at the same time, which means that the observed responses of yields and components on announcement dates cannot be interpreted as responses coming from bond purchase announcements only. This means that separating the effects from each policy is necessary in order to study the interest rate effects of bond purchases only. In this paper, this is done with the help of event study regressions.[12] More specifically, the approach I follow is to project changes in yields, the short-rate expectations component and term premia component onto expected and unexpected changes in the policy rate, a policy rate path factor and a foreign yield variable for the period in which only conventional monetary policy was implemented, and to use coefficient estimates to predict the effects of conventional monetary policy announcements for days in which the two policies were announced. The prediction errors are used as a measure that approximates the pure responses of yields and components to bond purchase announcements. The estimated event study regressions are a slightly modified version of equation (1),

[12] As noted from Table 2, yields and exchange rates reacted more strongly to the February, March and July policy announcements, which involved both changes in the repo rate and purchages of government bonds. This also motivates our analyses.

$$\triangle R_t^n = \beta_0^n + \beta_1^n \triangle r_t^e + \beta_2^n \triangle r_t^u + \beta_3^n \triangle rpf_t^u + \beta_4^n \triangle 5ykixyield_t + \varepsilon_t^n \tag{7}$$

where $\triangle R_t^n$ is now the change in an n-maturity yield, an n-maturity short-rate expectations component or in an n-maturity term premium observed in a day of conventional policy announcement, and $\triangle 5ykixyield_t$ is the change in the weighted average of foreign 5-year yields.[13] $\triangle 5ykixyield_t$ is included in (7) to control for movements in international yields, which tend to correlate strongly with Swedish interest rates.

This approach is similar to Bernanke, Reinhart and Sack (2004) who study the effects of central bank communication on asset prices. In Section 4, I show that this framework delivers very intuitive results and works as a good way of approximating the interest rate effects of bond purchases and studying their transmission mechanisms. Furthermore, it allows for studying how target interest rate policy and bond purchases operate across yields, short-rate expectations and term premium components of different maturities. The regression is estimated with data observed on days of conventional monetary policy announcements only, over a sample that ranges from February 07, 2003 to December 16, 2014. This is crucial for the framework to work since parameter estimates should reflect the effects of covariates $\triangle r_t^e$, $\triangle r_t^u$, $\triangle rpf_t^u$ and $\triangle 5ykixyield_t$ on yields and components when the repo rate as well as comunication were the only monetary policy instruments.

Table 4 shows the estimation results for regression (7). As commonly found in this literature, yields respond more strongly to unexpected changes in the policy rate. Moreover, reactions to repo rate surprises decline with maturities, with coefficients ranging from 0.661 to 0.162. Results imply that, on average and considering everything else constant, a surprise of 25 basis points tightening in the repo rate leads to a little more than 10 bp increase in the 2-year yield. Yields also react to the repo path factor, indicating that unexpected changes in the repo rate alone are not sufficient to describe the response of asset prices to monetary policy announcements. Interestingly, the repo path factor has a larger impact on mid-maturity yields, with a 1 percentage point innovation to the factor causing responses of 18 and 23 basis points in 1- and 3-year yields, respectively. Reactions reach maximum value at the 2-year maturity. Lastly, movements in foreign yields affect strongly the long-end of the Swedish yield curve with the 10-year yield moving, on average, 59 basis points for each 1 percentage move on the 5-year kix yield. Table 4 also reveals how short-rate expectations and term premium components react to changes in the repo rate, the repo path factor and foreign yields. Notice that the reactions of yields to changes in the repo rate and repo path factor are mainly a result

[13] The kix ("krona index") variable was originally created as a geometric index for exchange rates, where the weights are based on total flows of processed goods and commodities for 32 countries. The weights are computed by the Riksbank staff and take into account exports and imports, as well as third-country effects. They are updated each year, and are based on data with a time lag of several years. In this paper, we borrowed the idea behind the original kix and built the 5-year kix yield. This index is built as a weighted average of 5-year yields of four foreign economies: Euro Area, US, UK and Norway; with weights equal to 0.716, 0.12, 0.088 and 0.076, respectively.

of responses of short-rate expectations. Reactions of term premia are small and not significant in several maturities. Moreover, term premia do not react to changes in the repo path factor.

4 The responses of Swedish yields to bond purchase announcements

Now I analyze the transmission channels of the Riksbank's bond purchase announcements to Swedish yields using the results obtained from the event study regressions. Of course, there are issues that should be considered. Firstly, I have no reliable measures of what was expected prior to each Riksbank announcement about bond purchases, so I assume that the entire announcement was a complete surprise. In addition, the attempt to isolate the effects of bond purchase announcements using the regression framework may introduce estimation uncertainties. However, I believe that at the very least the results provide an approximation of the effects of bond purchase announcements that helps on the understanding of the transmission mechanisms of such actions.

The responses of yields on the six announcement dates are reported in Table 5 with Figures 7, 8 and 9 providing the same numbers in bar charts. The decomposition of the responses of yields into short-rate expectations and term premia are provided by Tables 6 and 7, respectively, with Figures 10, 11 and 12 providing the visualization of the results. We start our analysis by looking at the February announcement. This is perhaps the most important announcement as it stated that the Riksbank would start buying government bonds, even though the amount of SEK 10 billion was considered small. Moreover, the repo rate was lowered to -0.10 percent, informing the market that the Riksbank could set negative interest rates and make conventional monetary policy more expansionary. First, we note a fairly big response among yields due to the repo rate cut. On that particular day, the interest rate cut was largely unexpected by the market (-0.059 percent according to Figure 3) and the effects observed across maturities are very much in line with that number. The announcement of bond purchases also lowered yields considerably, with the larger effects being observed on the 3-year to 5-year segment. Here, it is important to note that the effects of the bond purchase announcement blend with those coming from the announcement that the Riksbank was breaking a possible zero lower bound. I consider that this announcement amplified the observed effects on interest rates and worked as an additional tool of unconventional monetary policy on February 12. The decomposition of the effects into short-rate expectations and term premia reveals that a large part of the effects were due to movements in short-rate expectations, suggesting that a great part of the transmission to interest rates occurred via the signaling channel. The effects on term premia were also present and become more important in the longer segment of the yield curve.

In March 18, between two regular monetary policy meetings, the Executive Board of the Riksbank decided to cut the repo rate by a further 15 basis points, to increase purchases of government bonds by SEK 30 billion and also to purchase bonds with maturities longer than five years. Before the announcement, market participants speculated that the rapid strengthening of the Swedish krona observed at the beginning of the month could lead the Riksbank to act prematurely, but there was no indication that a repo rate cut before the ordinary monetary policy meeting of April was expected. The repo rate cut was totally unexpected with a surprise of -0.145 percent. Interest rates fell sharply after the announcement of the decision, with effects being larger on the short and long-term segments of the yield curve. Figure 10 indicates that a large part of the movements in longer yields was due to movements in term premia. On that particular day foreign yields moved strongly ($\triangle 5y\, kix\, yield_t = -0.07\%$), which helped to lower term premia in the 3-year to 10-year segment. But still, we observe a faily large impact of bond purchases on term premia with stronger effects on longer maturities.

In April, we observe a positive response of government bond yields. The repo rate surprise measure marks 0.073 percent, indicating that the market was expecting an additional interest rate cut. New purchases of SEK 40-50 billion were announced, but market newsletters from that time suggest that the announced increment in purchases was expected to a large extent. As can be seen, fitted yields increased by 5 to 7 basis points with the larger movements being observed on longer maturities. Both Table 6 and Figure 12 indicate that a great part of the reactions observed in shorter yields can be explained by the unexpected cut in the repo rate that affected the short-rate expectations component. Movements in long yields were largely driven by term premia, which moved mainly due to the sharp increase in foreign yields ($\triangle 5y\, kix\, yield_t = 0.073\%$).

The decision announced on July 2 was to cut the repo rate by 10 basis points and to purchase government bonds for a further SEK 45 billion until the end of the year (SEK 135 billion in total). The rate cut was largely unexpected by market participants, with the unexpected part of the repo rate change marking -0.085 percent. Table 5 shows that the unexpected cut in the repo rate contributed largely to the fall in short fitted yields. Out of the -0.083 and -0.091 percentage changes observed in the 6-month and 1-year yields, respectively, -0.080 was due to effects coming from changes in the repo rate, repo path factor and foreign yields. Results suggest that bond purchases contributed, to a large extent, to lower bond yields in the 2-year to 10-year segment. The effects on short-rate expectations and term premia shown in Tables 6 and 7, and in Figure 11, reveal a similar message. The surprise regarding the repo rate cut seems to have contributed largely to the observed fall in short yields. Another important aspect is the fairly large effects of bond purchases on short-rate expectations and term premia. Results suggest that bond purchases caused a fall in short rate expectations by up to -0.047 percent. Term premia fell mainly in longer maturities with a -0.032 percentage change in the 5-year yield.[14] These results suggest that both the signaling and the

[14]Market newsletters from that time suggest that most market participants did not consider the announcement of the

portfolio balance channels have contributed to the transmission of the July decision. As expected, the portfolio balance effect operated mainly in the long end of the curve.

On September 3, we observe positive responses of yields with maturities of up to three years and negative responses of longer yields. The repo rate surprise measure marks 0.053 percent, indicating that the market was expecting an interest rate cut that did not materialize. As can be seen, fitted yields for maturities up to three years increased by up to 2.4 basis points, with a large contribution coming from the interest rate surprise, which mainly caused an increased in short-rate expectations (see Table 6 and Figure 12). Longer yields fell mainly as a result of term premia. Note from Table 7 that term premia fell across maturities, with the maximum fall being in the 10-year maturity. The assessments show that that fall was mainly a result of movements in foreign yields, which declined -0.038 percent according to the our 5-year foreign yield index.

The announcement of the additional purchase of SEK 65 billion on October 28 was, again, a big surprise.[15] Note from Table 6 that the 10-year fitted yield declined by -0.084 percent on that day, which was entirely attributed to the extension of the bond purchase program. Interestingly, results in Table 7 and Figure 12 suggest that the declines in yields were mainly caused by the term premium component, with only a small portion being attributed to short-rate expectations. These findings suggest that the portfolio balance channel played a very important role in the interest rate transmission mechanism of the decision in October 28.

To summarize the main findings, the key conclusion is that changes in both the short-rate expectations component and term premia appear to have been important in the reactions of government bond yields to the six key monetary policy announcements of 2015. These results suggest that bond purchases have important portfolio balance and signaling effects that lower term premia and expected future short-term interest rates, respectively. In addition, I find that interest rate policy and government bond purchases operate in different segments of the yield curve, being effective in lowering yields across the full maturity spectrum.

4.1 The responses of other interest rates

One additional aspect of the portfolio balance channel is the ability of bond purchases to also influence other asset prices in the economy. This occurs when individuals who sell their share of government bonds decide to buy other assets that are better substitutes for bonds than money, lowering interest rates more broadly in the economy. Table 8 shows the responses of several other Swedish interest rates. It reports the responses of the following instruments: (i) mortgage

bond purchase in value of SEK 45 billion as their main scenario.

[15]Market newsletters at that time suggest that market participants were expecting an extension of the bond purchases of around SEK 35-45 billion.

benchmarks, (ii) mortgage bonds, (iii) STINA, (iv) FRA and (v) implied policy rate paths.[16] Note that, following government bond yields, other interest rates reacted negatively to most monetary policy announcements. Reactions were stronger in the February 12, March 18 and July 2 decisions, which involved changes in the repo rate and purchases of government bonds. Note also that the announcement of the purchase of bonds on October 28, which was considerably larger than before (see Table 1), lowered long-term mortgage rates substantially. For instance, the ten-year mortgage bond yield declined 0.4 percent. Short-term rates, on the other hand, increased on October 28, given that financial market participants were surprised by the decision not to cut the repo rate (see Figure 2). These results show the spillover effects of bond purchases to other interest rates in the economy.

It is also interesting to look at how model-free expectations of future policy rates changed around announcement dates. Figure 13 shows the future-implied policy rate paths around the six monetary policy announcements. As observed policy rate expectations appear to have shifted in response to the monetary policy announcements. At the short end, considering all the announcements, the path has shifted down by about 25 basis points, while at longer horizons of one to three years the total decrease is around 20 basis points. As expected, the shifts observed at the short end are larger in the February, March and July policy decisions, which is a result of the surprises regarding changes in the repo rate (see Figure 2). The observed shifts in the expected policy rate paths on these dates were, however, mostly parallel, suggesting that market participants also revised longer expectations downwards. This is also observed in the October decision, where we see a twist in the forward curve with long run expectations decreasing relatively more than in the short run. These results confirm the findings described in Section 4 and suggest that short-rate expectations reacted to the announcements of interest rate and government bond purchase policies.

5 Conclusions

In this paper, I analyze the recent experience of unconventional monetary policy in Sweden to study the interest rate transmission mechanisms of government bond purchases when policy rates are away from the lower bound. Unlike other central banks, Sveriges Riksbank has been able to lower its target interest rate, the repo rate, deep into negative territory while government bond purchases have been announced, allowing one to study the effects of government bond purchases across the full yield maturity spectrum, without the presence of a lower bound constraint. I use dynamic term structure models together with event study regressions to measure the effects of bond purchase announcements on short-rate expectations and term premia. I find that government bond purchases

[16] Implied policy rate paths are constructed as implied forward-rate curves by the Riksbank staff using RIBA (Riksbank futures), FRA and interest-rate swap rates, and are commonly used by the Riksbank as an estimate of market expectations of future policy rates in Sweden. Mortgage bonds are debt instruments issued by mortgage institutions to finance their home mortgage lending and have become important in Sweden in the last few years.

have important portfolio balance and signaling effects. The signaling channel operates mainly by lowering short-rate expectations in the intermediate segment of the yield curve, while the portfolio balance channel is more effective in lowering longer maturity term premia. In addition, I find that target interest rate policy and government bond purchases operate in different segments of the yield curve, being effective in lowering yields across the full yield maturity spectrum when implemented together.

These findings have important policy implications. They suggest that, when the policy rate is not constrained by the lower bound, it is possible to design bond purchase programs with the aim of influencing bond yields across maturities, but especially in the mid and long segments of the yield curve. Furthermore, when implemented together with the more conventional target interest rate policy, central banks may be able to lower yields across the full maturity spectrum, making monetary policy more expansionary than otherwise.

Appendix

As in Kuttner (2001) the surprise component of the change in the repo rate, $\triangle r_t^u$, is given by

$$\triangle r_t^u = \left(stina_t - stina_{t-\triangle t}\right)\frac{D1}{D1-d1}$$

where $d1$ denotes the day of the announcement of a policy decision, $D1$ is the number of days in the month and $\left(stina_t - stina_{t-\triangle t}\right)$ is the change in the 1-month STINA rate around a window of fifteen minutes before and two hours and forty five minutes after the policy announcement.

The repo path factor, $\triangle rpf_t^u$, is estimated as the following. Given the matrix

$$M_t = [\triangle r_t^u \; \triangle FRA1q_t \; \triangle FRA2q_t \; \triangle FRA4q_t \; \triangle FRA8q_t]$$

it is assumed that each element of M_t has a factor structure,

$$M_{lt} = \lambda_l' F_t + e_{lt}$$

where F_t is an $s \times 1$ dimensional vector of factors, λ_l is a $s \times 1$ vector of factor loadings and e_{lt} denotes an idiosyncratic component. In matrix notation,

$$M = F\Lambda + e$$

where M is a $T \times 5$ matrix, F is a $T \times s$ matrix of latent factors, Λ is an $s \times 5$ matrix of factor loadings and e is a $T \times 5$ matrix of idiosyncratic components.

As F_t is not observed, it needs to be replaced by estimates $\widehat{F_t}$, which are obtained via standard PCA. I start by allowing for s factors in the estimation. Then, under the restriction that $\Lambda'\Lambda/5 = I_s$, the factor loadings matrix $\widehat{\Lambda} = \left(\widehat{\lambda}_1, ..., \widehat{\lambda}_5\right)$ is estimated by $\sqrt{5}$ times the eigenvectors corresponding to the s largest eigenvalues of the matrix $M'M$. The corresponding factor estimates are then given by $\widehat{F_t} = M\Lambda'/5$. As is usually recommended in factor analysis, all variables in M are standardized prior to estimation. As in Gürkaynack, Sack and Swanson (2005), I set the dimension s of $\widehat{F_t}$ as equal to two.

To allow for a more structural interpretation of these unobserved factors, I follow Gürkaynack, Sack and Swanson (2005) and rotate the factors so that the first factor corresponds to surprise changes in the current repo rate and the second factor corresponds to moves in interest rate expectations over the coming two years that are not driven by changes in the repo rate. In other words, I define a matrix Z as

$$Z = FU$$

where

$$U = \begin{bmatrix} \alpha_1 & \phi_1 \\ \alpha_2 & \phi_2 \end{bmatrix}$$

and where U is identified by four restrictions. First, the columns of U are normalized to have unit length (which normalizes Z_1 and Z_2 to have unit variance). Second, the new factors Z_1 and Z_2 should remain orthogonal to each other:

$$E(Z_1 Z_2) = \alpha_1 \phi_1 + \alpha_2 \phi_2 = 0$$

Lastly, the restriction that Z_2 does not influence the current policy surprise, $\triangle r_t^u$, is imposed as follows. Let γ_1 and γ_2 denote the (known) loadings of $\triangle r_t^u$ on F_1 and F_2, respectively. Since,

$$F_1 = \frac{1}{\alpha_1 \phi_2 - \alpha_2 \phi_1} (\phi_2 Z_1 - \alpha_2 Z_2)$$

$$F_2 = \frac{1}{\alpha_1 \phi_2 - \alpha_2 \phi_1} (\alpha_2 Z_1 - \phi_1 Z_1)$$

It follows that:

$$\gamma_2 \alpha_1 - \gamma_1 \alpha_2 = 0$$

Finally, Z_1 and Z_2 are rescaled so that Z_1 moves the current policy rate surprise $\triangle r_t^u$ one-to-one.

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Table 1: Monetary policy announcements by the Riksbank

Notes: This table describes the key monetary policy announcements by Riksbank during 2015.

Date	Announcement description
Feb 12, 2015	Riksbank cuts repo rate to −0.10 percent, buys government bonds for SEK 10 billion and is prepared to do more at short notice
Mar 18, 2015	Riksbank cuts repo rate to −0.25 percent and buys government bonds for SEK 30 billion
Apr 29, 2015	Riksbank buys government bonds for SEK 40-50 billion and lowers the repo-rate path significantly
Jul 2, 2015	Repo rate cut to −0.35 percent and purchases of government bonds extended by SEK 45 billion
Sep 3, 2015	Repo rate unchanged at −0.35 percent
Oct 28, 2015	The Riksbank purchases government bonds for a further SEK 65 billion and keep the repo rate at −0.35 percent for a longer time

Table 2: One-day responses of Swedish government bond yields and exchange rates

Notes: This table reports the one-day responses of Swedish government bond yields, government bond yields spreads against Germany, krona index, SEK per EUR and SEK per USD around the Riksbank monetary policy announcement dates. Yields changes are measured in basis points.

Maturities	Feb 12, 2015	Mar 18, 2015	Apr 29, 2015	Jul 2, 2015	Sep 3, 2015	Oct 28, 2015	Net chg
6-month gov bond	-0.105	-0.151	0.040	-0.084	0.010	0.006	-0.284
1-year gov bond	-0.096	-0.128	0.049	-0.093	0.026	0.000	-0.242
2-year gov bond	-0.123	-0.104	0.055	-0.114	0.027	-0.024	-0.283
5-year gov bond	-0.156	-0.118	0.067	-0.130	-0.022	-0.075	-0.434
7-year gov bond	-0.136	-0.132	0.069	-0.111	-0.033	-0.082	-0.425
10-year gov bond	-0.110	-0.147	0.069	-0.088	-0.036	-0.081	-0.393
1-week STIBOR	-0.040	-0.090	0.000	-0.060	0.010	0.010	-0.160
3-month STIBOR	-0.050	-0.130	0.020	-0.060	0.040	0.020	-0.160
6-month STIBOR	-0.080	-0.110	0.020	-0.060	0.030	0.010	-0.190
2-year Sweden-Germany	-0.120	-0.094	0.035	-0.102	0.036	-0.012	-0.257
5-year Sweden-Germany	-0.156	-0.098	0.027	-0.151	-0.012	-0.045	-0.435
10-year Sweden-Germany	-0.111	-0.148	0.009	-0.159	-0.046	-0.032	-0.487
Krona index (kix)	0.77%	0.26%	-0.61%	0.85%	-0.75%	-0.25%	0.27%
SEK per EUR	0.96%	0.28%	-0.40%	0.84%	-0.83%	-0.10%	0.75%
SEK per USD	0.72%	0.21%	-1.30%	1.33%	-0.61%	0.02%	0.37%

Table 3: Structural break test statistics

Notes: This table shows structural break test statistics for the regression $\triangle R_t^n = \beta_0^n + \beta_1^n \triangle r_t^e + \beta_2^n \triangle r_t^u + \beta_3^n \triangle rpf_t^u + \varepsilon_t^n$, where $\triangle R_t^n$ is the change in an n-maturity interest rate, $\triangle r_t^e$ and $\triangle r_t^u$ are expected and unexpected changes in the repo rate and $\triangle rpf_t^u$ is a repo path factor. The regression is estimated with data observed on days of monetary policy announcements over a sample that ranges from February 07, 2003 to July 6, 2016. The following test statistics are reported: Ploberger and Krämer (1992, "OLS-CUSUM" and "Rec-CUSUM"), Chu, Hornik and Kuan (1995, "OLS-MOSUM" and "Rec-MOSUM"), Andrews (1993, "SupF"), Andrews and Ploberger (1994, "aveF" and "ExpF"), Nyblom (1989) and Hansen (1992, "Nyblom-Hansen"). The tests are conducted at the 5% significance level.

	Gov. bond yield			STIBOR		
	3-month	6-month	1-year	3-month	6-month	1-year
Fluctuation tests						
OLS-CUSUM	1.025	1.346	1.338	0.789	0.791	-
Rec-CUSUM	0.625	0.453	0.693	0.379	0.452	-
OLS-MOSUM	1.166	1.264	1.342	1.262	1.312	-
Rec-MOSUM	1.227	1.868	1.733	0.94	1.026	-
F tests						
supF (Feb 2015)	0.943	0.711	1.207	0.549	0.671	-
aveF (Feb 2015)	0.657	0.377	0.500	0.485	0.593	-
expF (Feb 2015)	0.333	0.194	0.275	0.243	0.297	-
Nyblom-Hansen	0.874	1.248	1.164	1.073	1.077	-

Table 4: Separating conventional and unconventional monetary policy: regression results

Notes: This table shows estimation results of the regression $\triangle R_t^n = \beta_0^n + \beta_1^n \triangle r_t^e + \beta_2^n \triangle r_t^u + \beta_3^n \triangle rpf_t^u + \beta_4^n \triangle 5ykixyield_t + \varepsilon_t^n$, where $\triangle R_t^n$ is the change in an n-maturity yield, yield expectation or term premium, $\triangle 5ykixyield_t$ is the change in the weighted average of foreign 5-year yields, $\triangle r_t^e$ and $\triangle r_t^u$ are the expected and unexpected changes in the repo rate and $\triangle rpf_t^u$ is a repo path factor. The regressions are estimated with data observed on days of conventional monetary policy announcements over a sample that ranges from February 07, 2003 to December 16, 2014.

	Constant	r_t^e	r_t^u	rpf_t^u	$\triangle 5ykixyield_t$	$\overline{R2}$
6-month yield	−0.010*** (0.003)	0.125*** (0.014)	0.661*** (0.042)	0.097*** (0.020)	−0.126 (0.080)	0.90
1-year yield	−0.013*** (0.004)	−0.023 (0.021)	0.521*** (0.061)	0.183*** (0.021)	−0.134 (0.112)	0.75
2-year yield	−0.009*** (0.003)	−0.027* (0.014)	0.424*** (0.048)	0.240*** (0.026)	−0.032 (0.104)	0.79
3-year yield	−0.005** (0.002)	0.036*** (0.010)	0.386*** (0.045)	0.234*** (0.026)	0.108 (0.128)	0.81
5-year yield	−0.003 0.004()	0.073*** (0.012)	0.312*** (0.047)	0.187*** (0.037)	0.336** (0.146)	0.78
7-year yield	−0.005 (0.004)	0.040*** (0.012)	0.239*** (0.043)	0.147*** (0.034)	0.477*** (0.122)	0.70
10-year yield	−0.009** (0.004)	−0.017 (0.019)	0.162** (0.065)	0.110*** (0.030)	0.593*** (0.113)	0.53
6-month expectation	−0.006** (0.003)	0.184*** (0.012)	0.705*** (0.031)	0.107*** (0.019)	−0.227*** (0.076)	0.94
1-year expectation	−0.005* (0.003)	0.114*** (0.013)	0.615*** (0.039)	0.185*** (0.021)	−0.304*** (0.086)	0.89
2-year expectation	−0.002 (0.002)	0.062*** (0.017)	0.457*** (0.051)	0.236*** (0.019)	−0.302*** (0.107)	0.76
3-year expectation	−0.001 (0.002)	0.040** (0.016)	0.331*** (0.047)	0.217*** (0.018)	−0.216** (0.101)	0.71
5-year expectation	−0.001 (0.001)	0.024** (0.010)	0.205*** (0.032)	0.148*** (0.012)	−0.065 (0.070)	0.72
7-year expectation	−0.001 (0.001)	0.019*** (0.007)	0.166*** (0.023)	0.113*** (0.011)	−0.006 (0.058)	0.77
10-year expectation	−0.001 (0.001)	0.015*** (0.005)	0.139*** (0.019)	0.093*** (0.011)	0.028 (0.052)	0.79
6-month term premium	−0.004** (0.001)	−0.059*** (0.010)	−0.044** (0.021)	−0.010 (0.005)	0.102*** (0.038)	0.55
1-year term premium	−0.007** (0.003)	−0.137*** (0.021)	−0.094** (0.043)	−0.001 (0.011)	0.169*** (0.076)	0.63
2-year term premium	−0.007** (0.003)	−0.089*** (0.019)	−0.034 (0.045)	0.004 (0.008)	0.270*** (0.067)	0.43
3-year term premium	−0.004** (0.002)	−0.003 (0.010)	0.055 (0.035)	0.017 (0.015)	0.324*** (0.060)	0.35
5-year term premium	−0.003 (0.002)	−0.049*** (0.009)	0.107*** (0.032)	0.039 (0.027)	0.401*** (0.089)	0.59
7-year term premium	−0.004 (0.003)	−0.021* (0.011)	0.074* (0.044)	0.034 (0.027)	0.483*** (0.093)	0.44
10-year term premium	−0.007** (0.004)	−0.033 (0.020)	0.024 (0.061)	0.017 (0.021)	0.565*** (0.102)	0.28

Table 5: Effects of bond purchase announcements on yields

Notes: This table shows the effects of bond purchase announcements on fitted yields. "Fitted yield" is the observed fitted yield change on a day of monetary policy announcement. "Repo rate, repo path factor and kix yield" is the effect of repo rate change + repo path factor surprise + change in the 5-year kix yield. "Bond purchase" is the effect of a bond purchase announcement. "Repo rate, repo path factor and kix yield" is approximated by $\widehat{\beta}_0^n + \widehat{\beta}_1^n \triangle r_t^e + \widehat{\beta}_2^n \triangle r_t^u + \widehat{\beta}_3^n \triangle rpf_t^u + \widehat{\beta}_4^n \triangle 5y\,kix\,yield_t$ and "Bond purchase" is approximated by $\widehat{\varepsilon}_t^n$.

Event	Effect	6-month	1-year	2-year	3-year	5-year	7-year	10-year
	Fitted yield	-0.083	-0.096	-0.132	-0.153	-0.152	-0.135	-0.112
Feb 12	Repo rate, repo path factor and kix yield	-0.064	-0.065	-0.066	-0.066	-0.061	-0.056	-0.050
	Bond purchase	-0.019	-0.031	-0.066	-0.087	-0.091	-0.079	-0.062
	Fitted yield	-0.120	-0.108	-0.101	-0.105	-0.121	-0.134	-0.145
Mar 18	Repo rate, repo path factor and kix yield	-0.096	-0.076	-0.064	-0.065	-0.070	-0.072	-0.072
	Bond purchase	-0.024	-0.032	-0.037	-0.040	-0.051	-0.062	-0.073
	Fitted yield	0.041	0.054	0.060	0.061	0.064	0.068	0.073
Apr 29	Repo rate, repo path factor and kix yield	0.028	0.032	0.040	0.047	0.053	0.055	0.056
	Bond purchase	0.014	0.023	0.020	0.014	0.011	0.013	0.017
	Fitted yield	-0.083	-0.091	-0.118	-0.133	-0.129	-0.112	-0.090
Jul 02	Repo rate, repo path factor and kix yield	-0.080	-0.080	-0.077	-0.071	-0.061	-0.052	-0.045
	Bond purchase	-0.003	-0.011	-0.041	-0.062	-0.068	-0.059	-0.045
	Fitted yield	0.015	0.024	0.019	0.006	-0.017	-0.030	-0.041
Sep 03	Repo rate, repo path factor and kix yield	0.025	0.024	0.019	0.012	-0.002	-0.011	-0.020
	Bond purchase	-0.010	0.000	0.000	-0.006	-0.015	-0.019	-0.021
	Fitted yield	0.007	0.000	-0.027	-0.050	-0.073	-0.081	-0.084
Oct 28	Repo rate, repo path factor and kix yield	0.008	0.000	-0.002	-0.001	0.000	0.000	0.001
	Bond purchase	0.000	0.000	-0.025	-0.049	-0.074	-0.081	-0.085

Table 6: Effects of bond purchase announcements on short-rate expectations

Notes: This table shows the effects of bond purchase announcements on fitted yields. "Short-rate expectation" is the change in the estimated short-rate expectations component of yields on a day of monetary policy announcement. "Repo rate, repo path factor and kix yield" is the effect of repo rate change + repo path factor surprise + change in the 5-year kix yield. "Bond purchase" is the effect of a bond purchase announcement. "Repo rate, repo path factor and kix yield" is approximated by $\widehat{\beta}_0^n + \widehat{\beta}_1^n \triangle r_t^e + \widehat{\beta}_2^n \triangle r_t^u + \widehat{\beta}_3^n \triangle rpf_t^u + \widehat{\beta}_4^n \triangle 5y\,kix\,yield_t$ and "Bond purchase" is approximated by $\widehat{\varepsilon}_t^n$.

Event	Effect	6-month	1-year	2-year	3-year	5-year	7-year	10-year
	Short-rate expectations	-0.093	-0.111	-0.124	-0.114	-0.084	-0.068	-0.059
Feb 12	Repo rate, repo path factor and kix yield	-0.064	-0.064	-0.056	-0.046	-0.033	-0.028	-0.024
	Bond purchase	-0.029	-0.048	-0.068	-0.067	-0.051	-0.041	-0.035
	Short-rate expectations	-0.103	-0.078	-0.048	-0.035	-0.034	-0.035	-0.035
Mar 18	Repo rate, repo path factor and kix yield	-0.092	-0.071	-0.044	-0.030	-0.024	-0.023	-0.022
	Bond purchase	-0.011	-0.008	-0.004	-0.005	-0.010	-0.012	-0.013
	Short-rate expectations	0.032	0.034	0.032	0.028	0.024	0.023	0.021
Apr 29	Repo rate, repo path factor and kix yield	0.024	0.024	0.023	0.022	0.019	0.018	0.017
	Bond purchase	0.008	0.010	0.009	0.007	0.005	0.005	0.005
	Short-rate expectations	-0.093	-0.108	-0.115	-0.103	-0.074	-0.060	-0.051
Jul 02	Repo rate, repo path factor and kix yield	-0.081	-0.081	-0.070	-0.056	-0.038	-0.031	-0.026
	Bond purchase	-0.012	-0.027	-0.045	-0.047	-0.036	-0.029	-0.025
	Short-rate expectations	0.023	0.036	0.040	0.032	0.015	0.008	0.004
Sep 03	Repo rate, repo path factor and kix yield	0.031	0.035	0.033	0.026	0.013	0.008	0.005
	Bond purchase	-0.008	0.001	0.007	0.006	0.002	0.000	-0.002
	Short-rate expectations	0.013	0.009	-0.002	-0.011	-0.017	-0.018	-0.019
Oct 28	Repo rate, repo path factor and kix yield	0.009	0.004	-0.000	-0.002	-0.001	-0.001	-0.001
	Bond purchase	0.004	0.005	-0.002	-0.009	-0.016	-0.017	-0.018

Table 7: Effects of bond purchase announcements on term premium

Notes: This table shows the effects of bond purchase announcements on fitted yields. "Term premium" is the change in the term premium component of yields on a day of monetary policy announcement. "Repo rate, repo path factor and kix yield" is the effect of repo rate change + repo path factor surprise + change in the 5-year kix yield. "Bond purchase" is the effect of a bond purchase announcement. "Repo rate, repo path factor and kix yield" is approximated by $\widehat{\beta}_0^n + \widehat{\beta}_1^n \triangle r_t^e + \widehat{\beta}_2^n \triangle r_t^u + \widehat{\beta}_3^n \triangle rpf_t^u + \widehat{\beta}_4^n \triangle 5y\, kix\, yield_t$ and "Bond purchase" is approximated by $\widehat{\varepsilon}_t^n$.

Event	Effect	6-month	1-year	2-year	3-year	5-year	7-year	10-year
	Term premium	0.009	0.015	-0.008	-0.039	-0.069	-0.067	-0.053
Feb 12	Repo rate, repo path factor and kix yield	0.000	-0.001	-0.010	-0.019	-0.028	-0.028	-0.026
	Bond purchase	0.009	0.016	0.002	-0.020	-0.041	-0.039	-0.027
	Term premium	-0.017	-0.030	-0.054	-0.070	-0.087	-0.098	-0.110
Mar 18	Repo rate, repo path factor and kix yield	-0.004	-0.005	-0.020	-0.035	-0.046	-0.048	-0.050
	Bond purchase	-0.013	-0.025	-0.033	-0.036	-0.042	-0.050	-0.060
	Term premium	0.010	0.020	0.028	0.032	0.039	0.045	0.051
Apr 29	Repo rate, repo path factor and kix yield	0.004	0.008	0.017	0.025	0.034	0.037	0.039
	Bond purchase	0.005	0.012	0.011	0.007	0.005	0.008	0.012
	Term premium	0.010	0.016	-0.003	-0.030	-0.055	-0.052	-0.039
Jul 02	Repo rate, repo path factor and kix yield	0.001	0.001	-0.007	-0.015	-0.023	-0.022	-0.018
	Bond purchase	0.009	0.016	0.004	-0.014	-0.032	-0.030	-0.021
	Term premium	-0.008	-0.012	-0.021	-0.026	-0.032	-0.038	-0.045
Sep 03	Repo rate, repo path factor and kix yield	-0.007	-0.012	-0.014	-0.013	-0.015	-0.020	-0.026
	Bond purchase	-0.001	0.000	-0.007	-0.013	-0.017	-0.018	-0.019
	Term premium	-0.006	-0.010	-0.025	-0.039	-0.056	-0.063	-0.066
Oct 28	Repo rate, repo path factor and kix yield	-0.001	-0.004	-0.002	0.001	0.002	0.001	0.000
	Bond purchase	-0.004	-0.006	-0.023	-0.040	-0.058	-0.064	-0.066

Table 8: One-day responses of other Swedish interest rates

Notes: This table reports the one-day responses of Swedish mortgage benchmark rates, mortgage bond yields, STINA rates, FRA rates and implied future policy rate path rates computed by the Riksbank around the six key monetary policy announcements made during 2015. All interest rate changes are measured in basis points.

Maturities	Feb 12, 2015	Mar 18, 2015	Apr 29, 2015	Jul 2, 2015	Sep 3, 2015	Oct 28, 2015	Net chg
2-year mortg benchm	-0.093	-0.110	0.045	-0.095	0.020	-0.025	-0.258
5-year mortg benchm	-0.092	-0.115	0.080	-0.080	-0.020	-0.040	-0.267
2-year mortg bond	-0.088	-0.105	0.029	-0.106	0.031	-0.013	-0.252
5-year mortg bond	-0.097	-0.114	0.075	-0.075	-0.009	-0.048	-0.268
10-year mortg bond	-0.107	-0.101	0.045	-0.054	0.038	-0.041	-0.220
1-month STINA	-0.055	-0.140	0.064	-0.063	0.071	0.048	-0.075
6-month STINA	-0.056	-0.127	0.064	-0.053	0.060	-0.014	-0.126
6-month FRA	-0.075	-0.115	0.040	-0.090	0.021	0.005	-0.214
1-year FRA	-0.080	-0.095	0.035	-0.090	0.014	-0.005	-0.221
2-year FRA	-0.085	-0.071	0.045	-0.081	0.010	-0.025	-0.207
6-month impl-path	-0.072	-0.115	0.055	-0.077	0.035	0.016	-0.158
1-year impl-path	-0.080	-0.114	0.040	-0.080	0.037	0.003	-0.194
2-year impl-path	-0.077	-0.103	0.045	-0.069	0.032	-0.032	-0.203
3-year impl-path	-0.082	-0.097	0.061	-0.047	0.018	-0.049	-0.196

Figure 1: Volume and maturity of government bond purchases

Notes: Panel A shows the distribution of bond purchases by maturity. Panel B shows the volume (in SEK billions) and maturity of the bonds purchased over time.

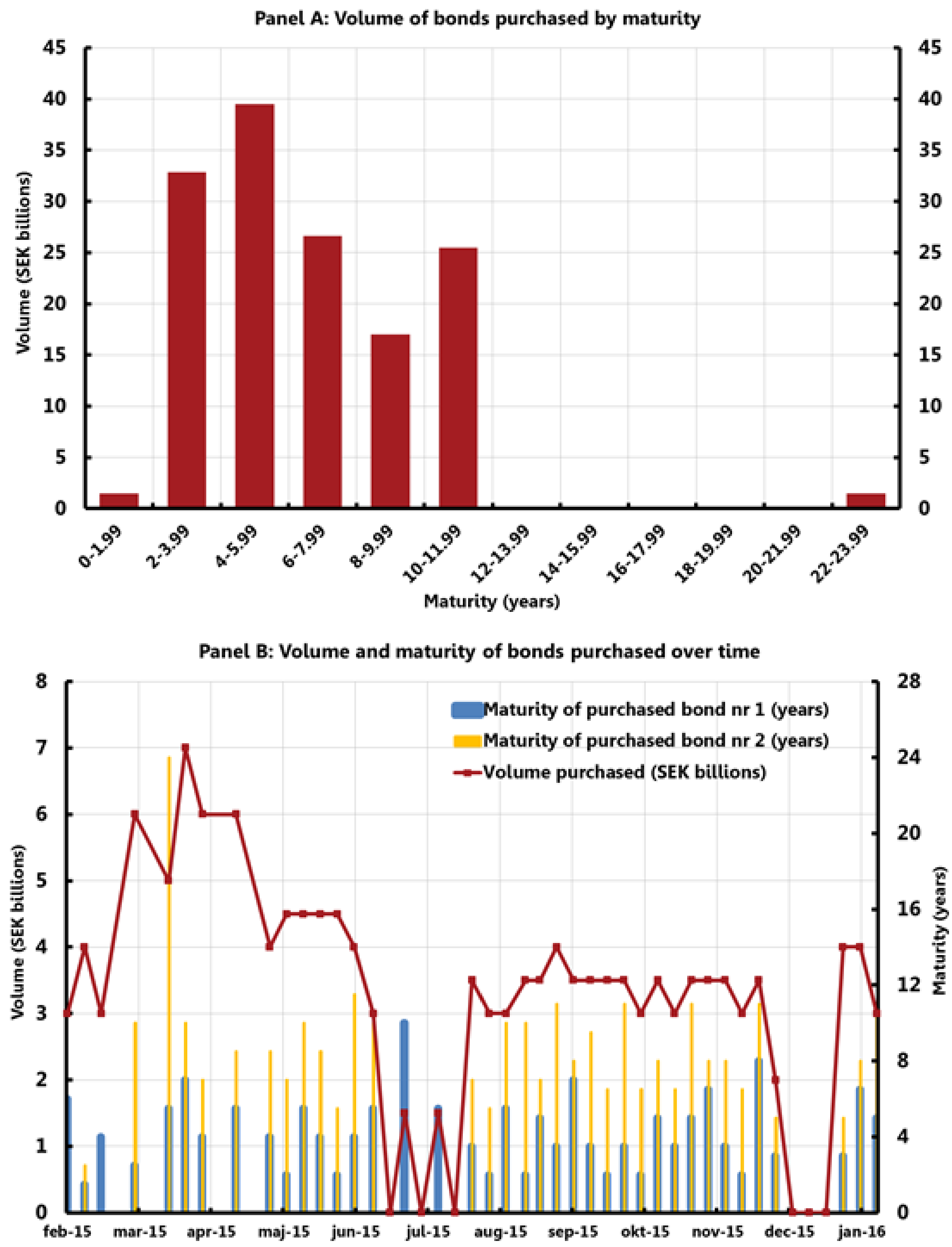


Figure 2: Expected and unexpected changes in the repo rate

Notes: This figure shows the decomposition of the announced repo rate changes into expected and unexpected changes. Unexpected changes in the repo rate are constructed using the 1-month STINA rates with a window of fifteen minutes before and two hours and forty five minutes after each monetary policy announcement.

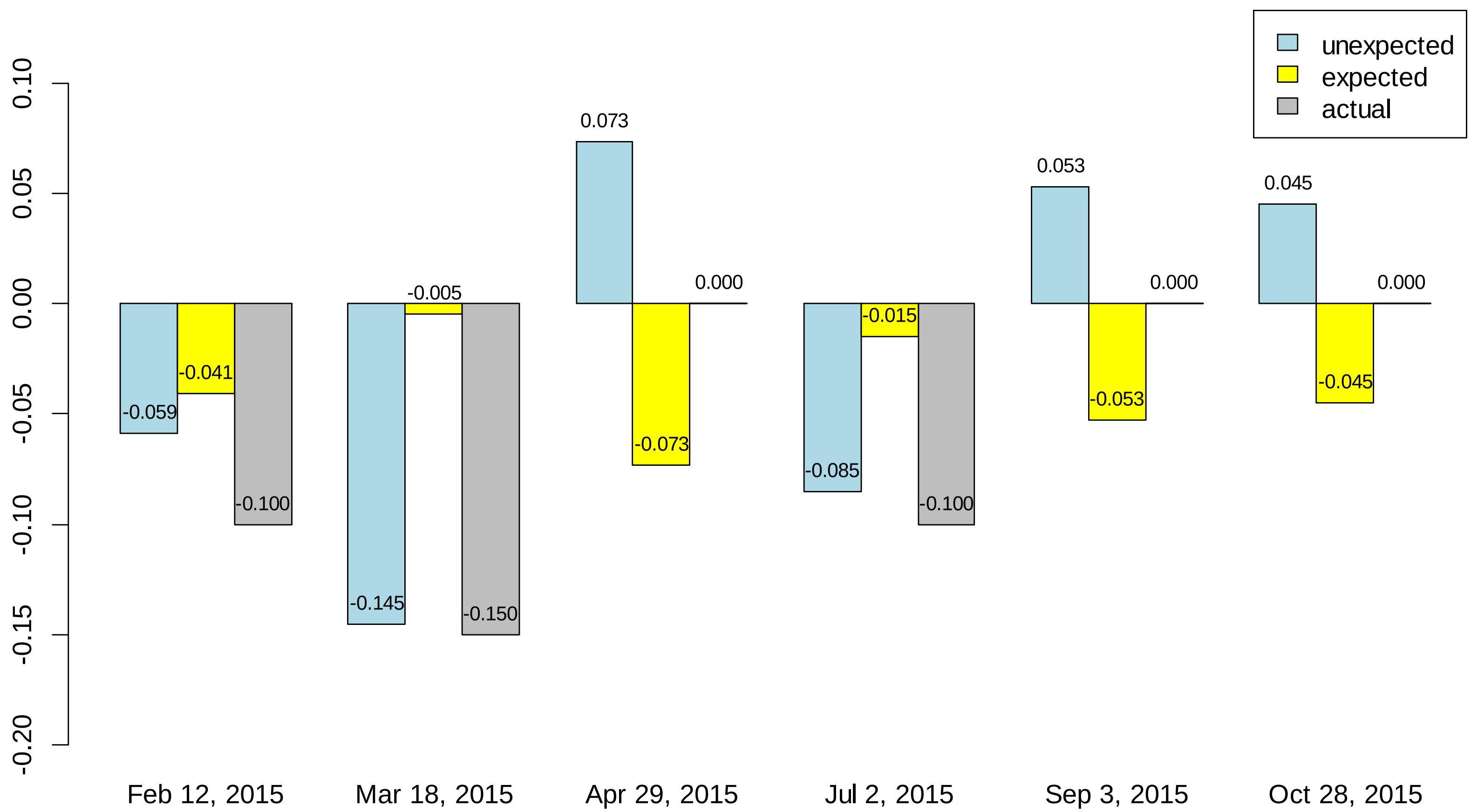


Figure 3: Repo rate, market rates, lending and deposit rates

Notes: Panel A shows the repo rate and the bank lending and deposit interest rates to households (mortgage rates) and non-financial corporations. Panel B shows the repo rate, STIBOR (Stockholm Interbank Offered Rate) and government bond interest rates.

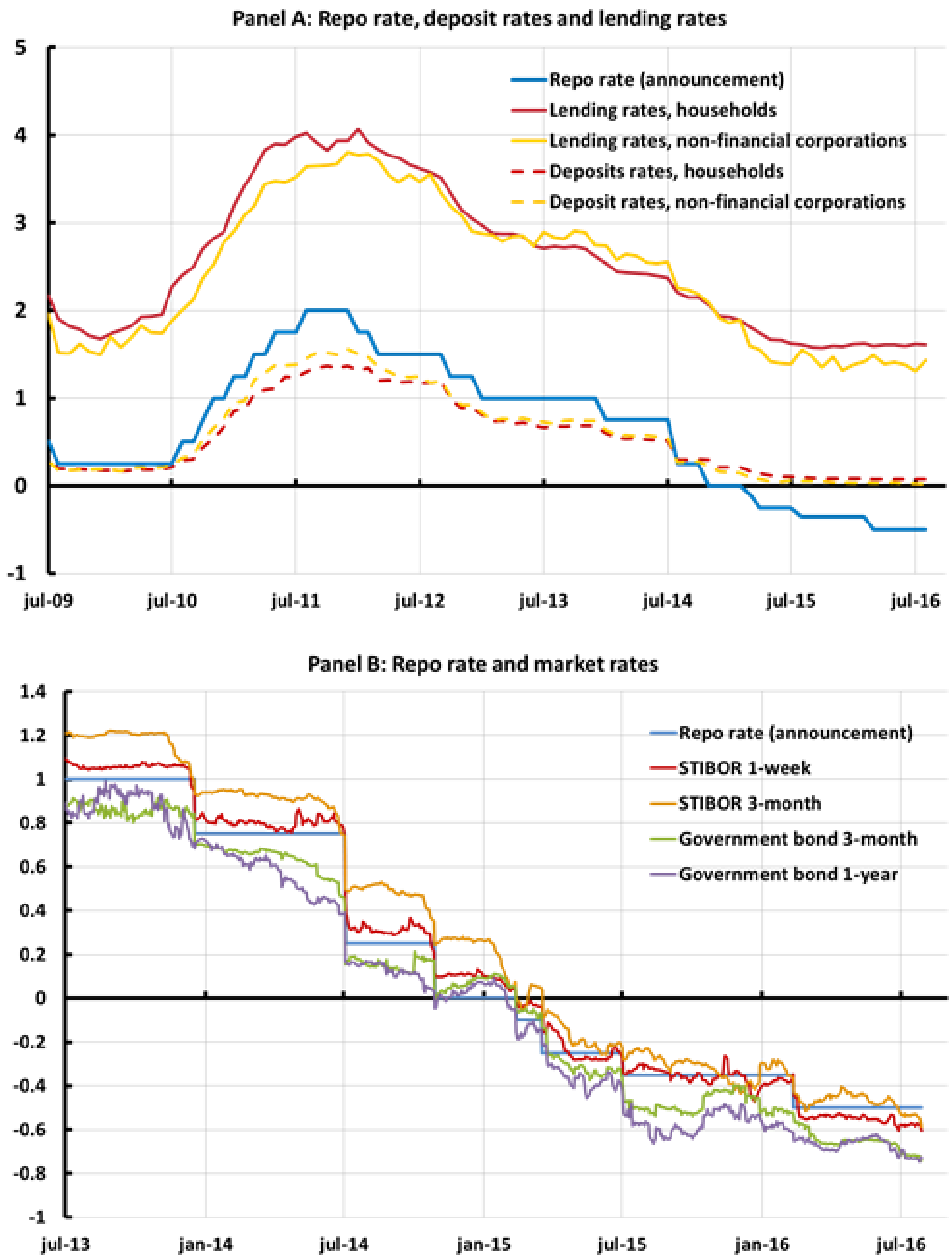


Figure 4: Repo rate forecast distributions from surveys

Notes: This figure shows repo rate forecast distributions obtained from surveys performed by TNS Sifo Prospera. Survey respondents are money market participants, who report their mean, minimum and maximum forecast for the repo rate 3-months, 12-months and 24-months ahead. The survey publication dates are October 14, 2015 and February 17, 2016.

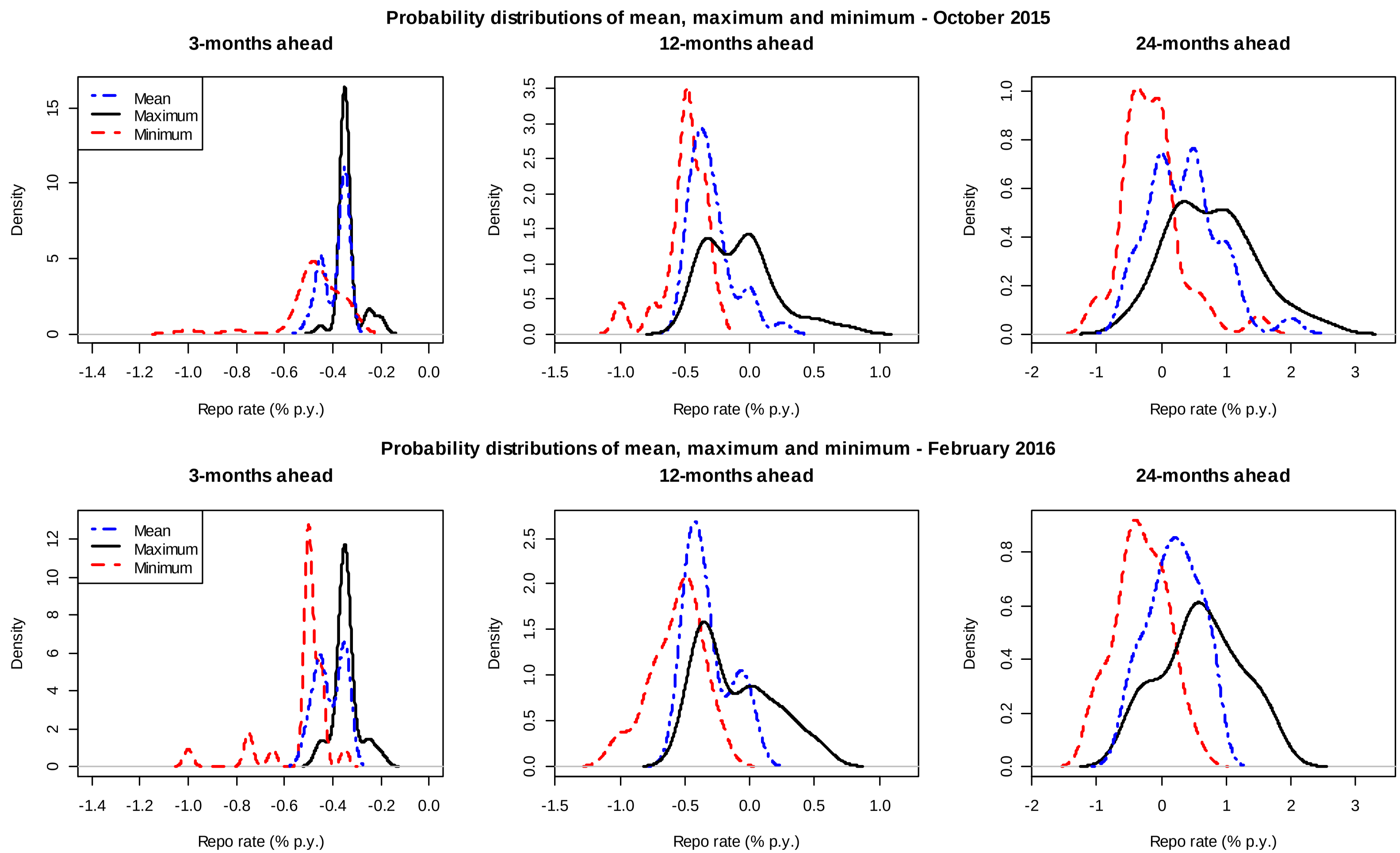


Figure 5: Swedish government bond yields

Notes: This figure shows the daily Swedish government zero-coupon bond yields covering the period from December 1, 1998, to July 27, 2016. The yields shown have maturities in 6-month, 1-year, 2-years, 3-years, 5-years and 10-years.

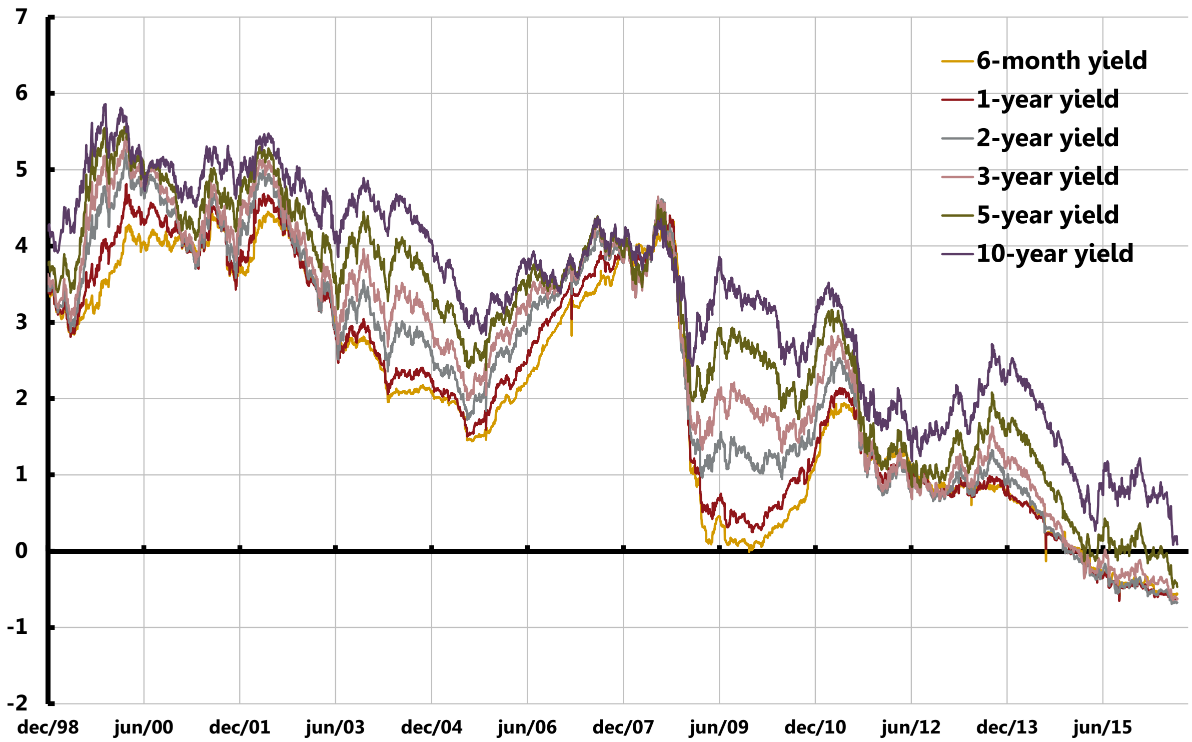


Figure 6: A decomposition of the 5-year Swedish government bond yield

Notes: This figure shows the decomposition of the 5-year daily Swedish government zero-coupon bond yield into short-rate expectations and term premium components for the period from December 1, 1998, to July 27, 2015. The decomposition is a weighted average of estimates from four models: Joslin, Singleton and Zhu (2011) with three and four factors and Bauer, Rudebusch and Wu (2012) with the bootstrap bias correction with three and four factors. The weights attributed to each model are: 0.19 to $JSZ_{p=3}$, 0.28 to $JSZ_{p=4}$, 0.22 to $BRW_{p=3}$ and 0.31 to $BRW_{p=4}$. These were obtained by minimizing a quadratic loss function of short-rate forecasts for horizons equal to 2, 5 and 10 years.

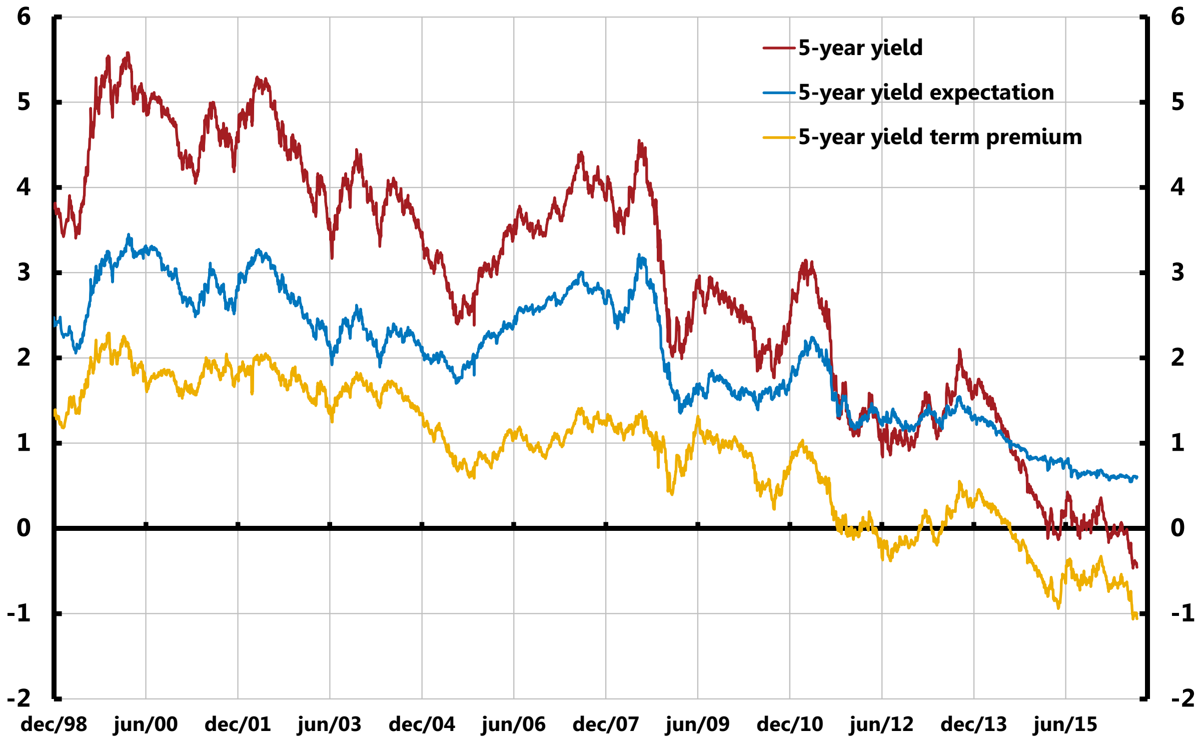
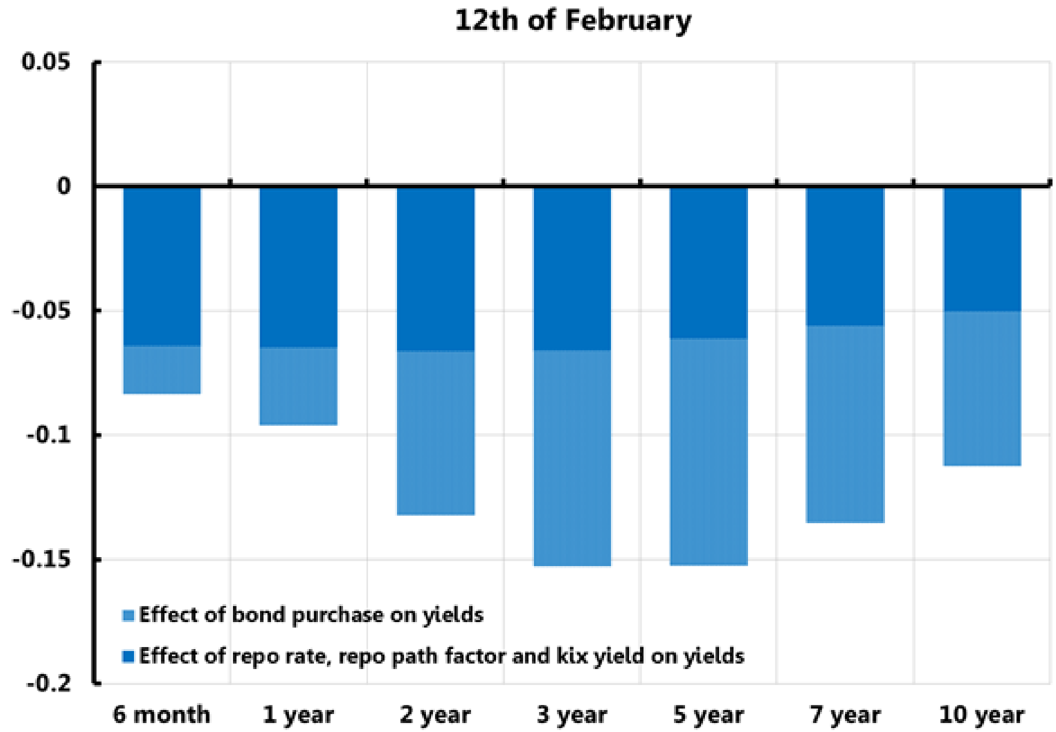


Figure 7: Monetary policy announcement effects - February and March

Notes: This figure shows the monetary policy announcement effects on yields for the announcements made on February 12, 2015 and March 18, 2015.



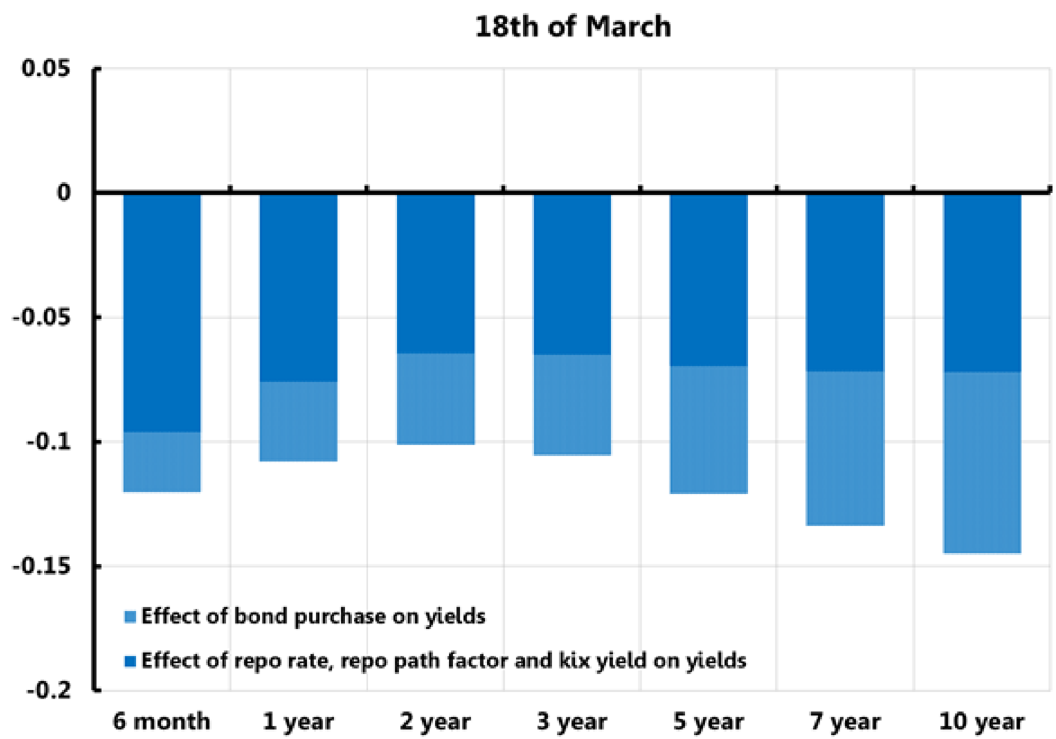


Figure 8: Monetary policy announcement effects - April and July

Notes: This figure shows the monetary policy announcement effects on yields for the announcements made on April 29, 2015 and July 2, 2015.

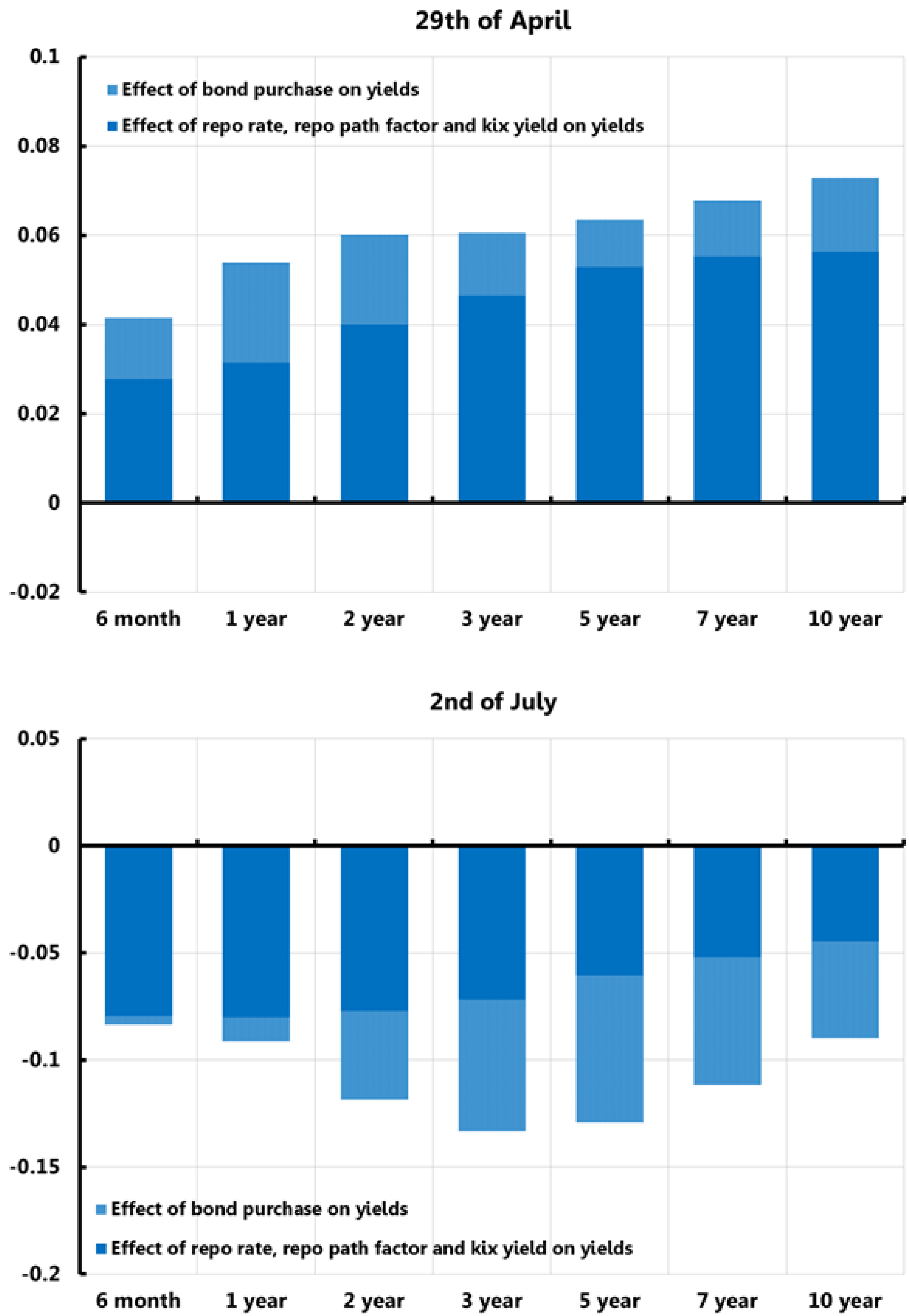


Figure 9: Monetary policy announcement effects - September and October

Notes: This figure shows the monetary policy announcement effects on yields for the announcements made on September 3, 2015 and October 28, 2015.

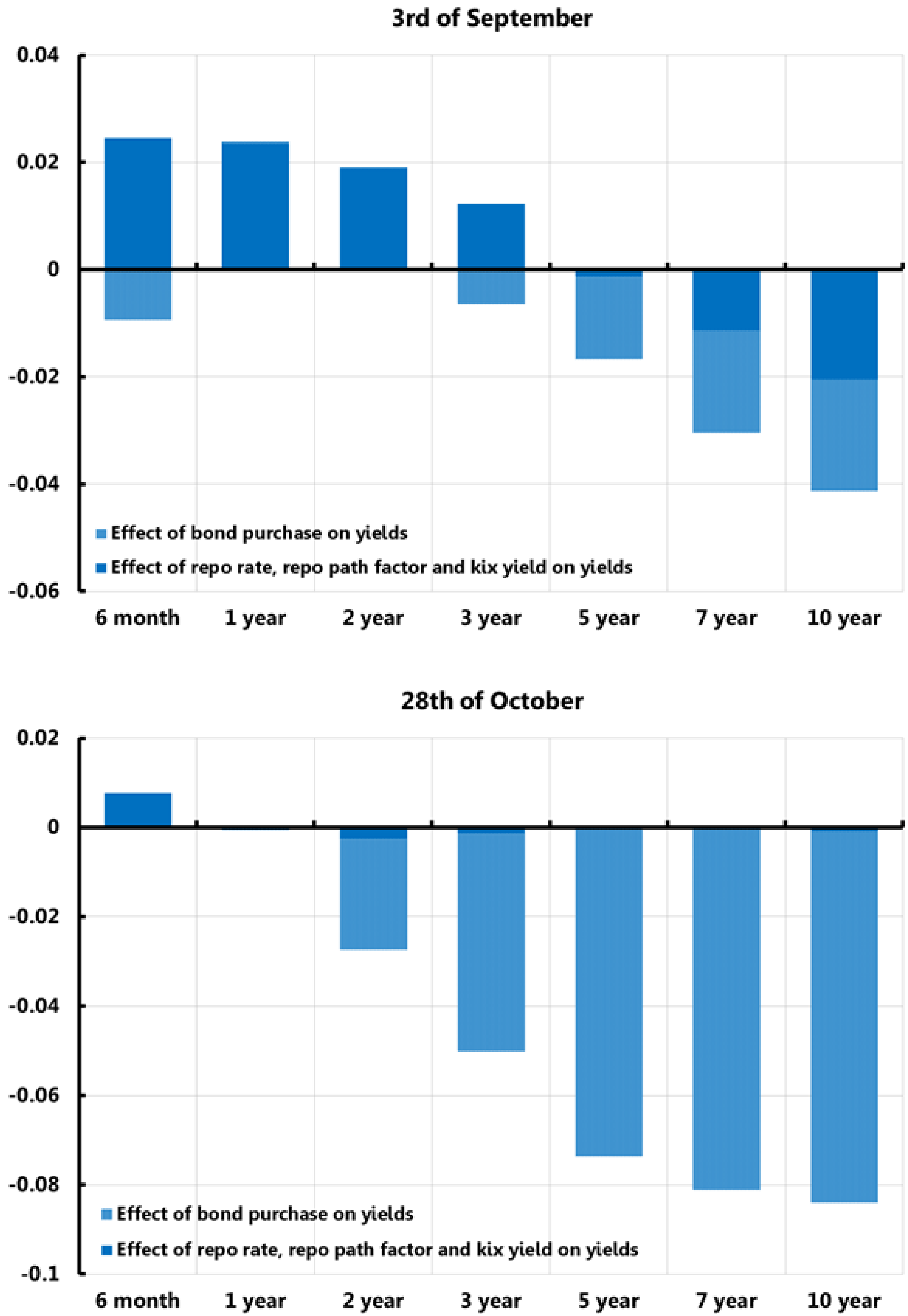


Figure 10: Monetary policy announcement effects - February and March

Notes: This figure shows the monetary policy announcement effects on short-rate expectations and term premium components for the announcements made on February 12, 2015 and March 18, 2015.

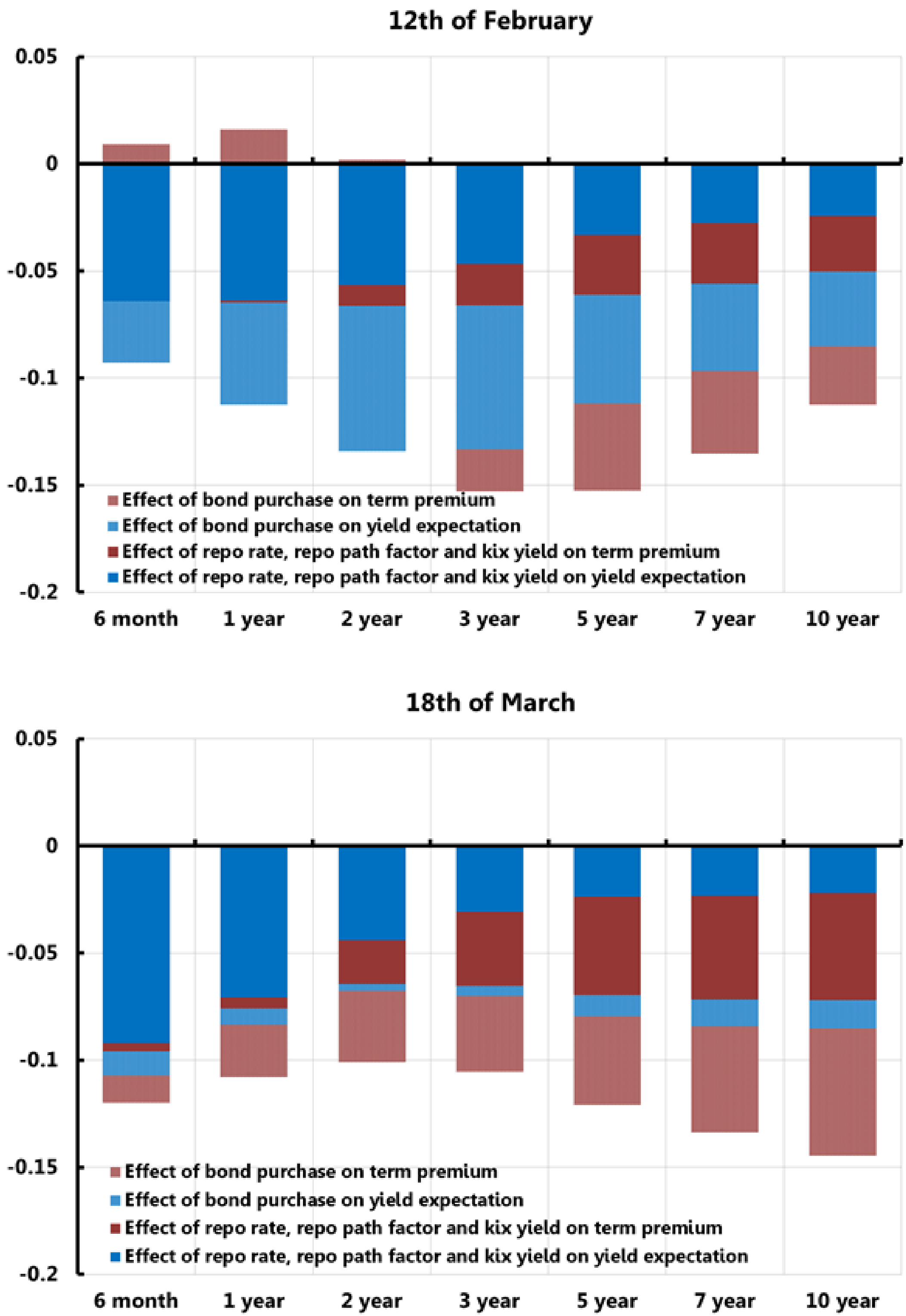


Figure 11: Monetary policy announcement effects - April and July

Notes: This figure shows the monetary policy announcement effects on short-rate expectations and term premium components for the announcements made on April 29, 2015 and July 2, 2015.

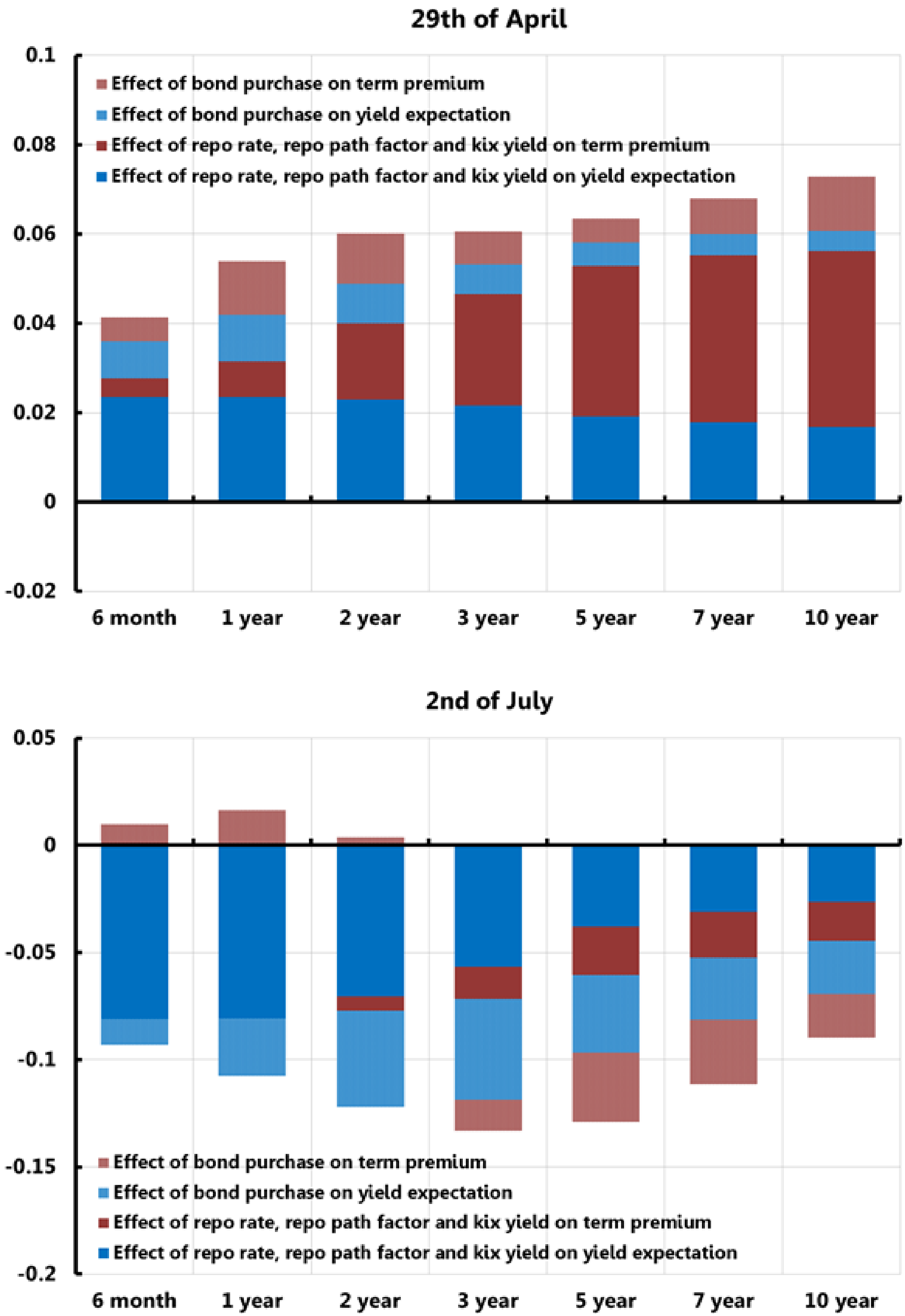


Figure 12: Monetary policy announcement effects - September and October

Notes: This figure shows the monetary policy announcement effects on short-rate expectations and term premium components for the announcements made on September 3, 2015 and October 28, 2015.

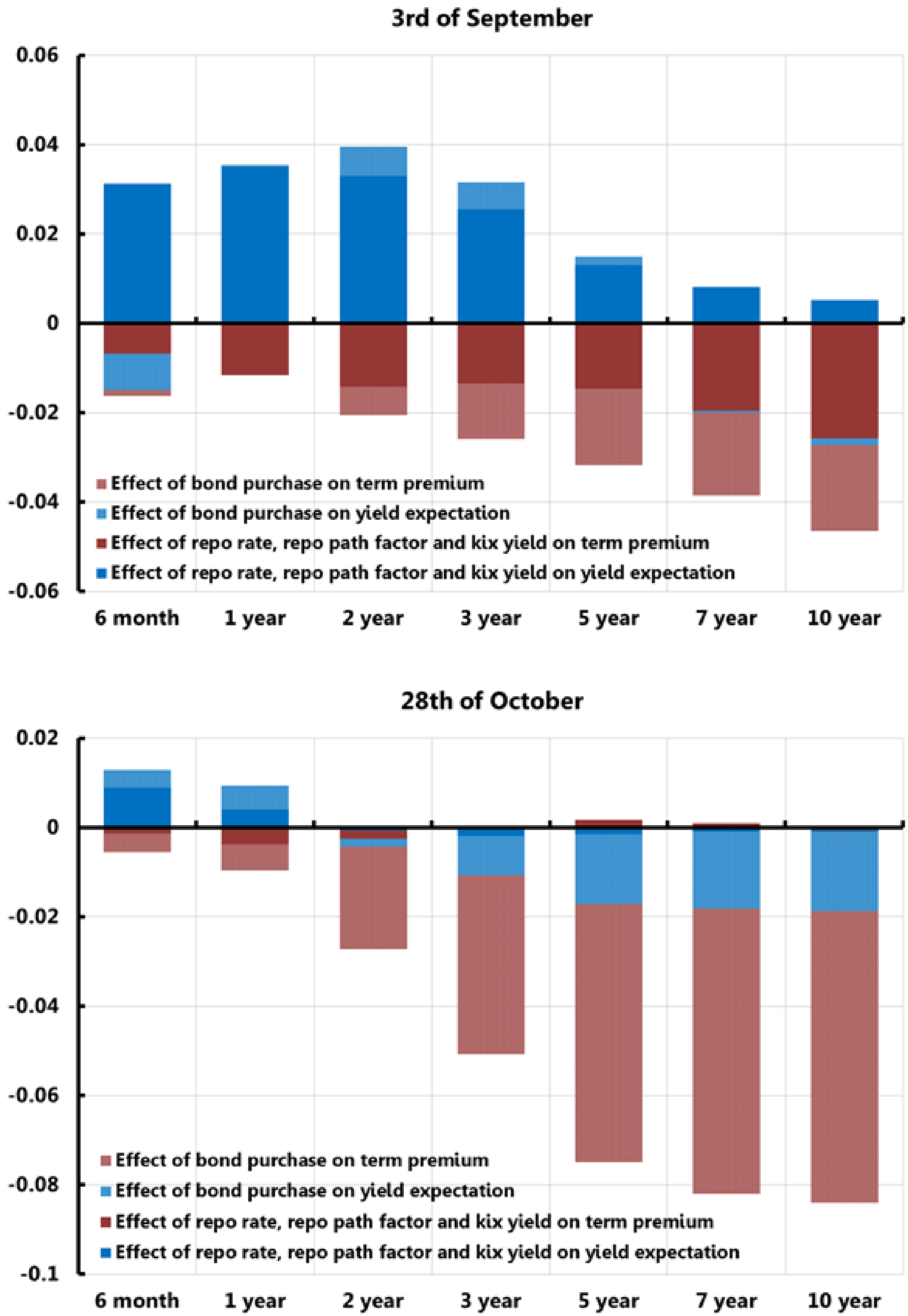
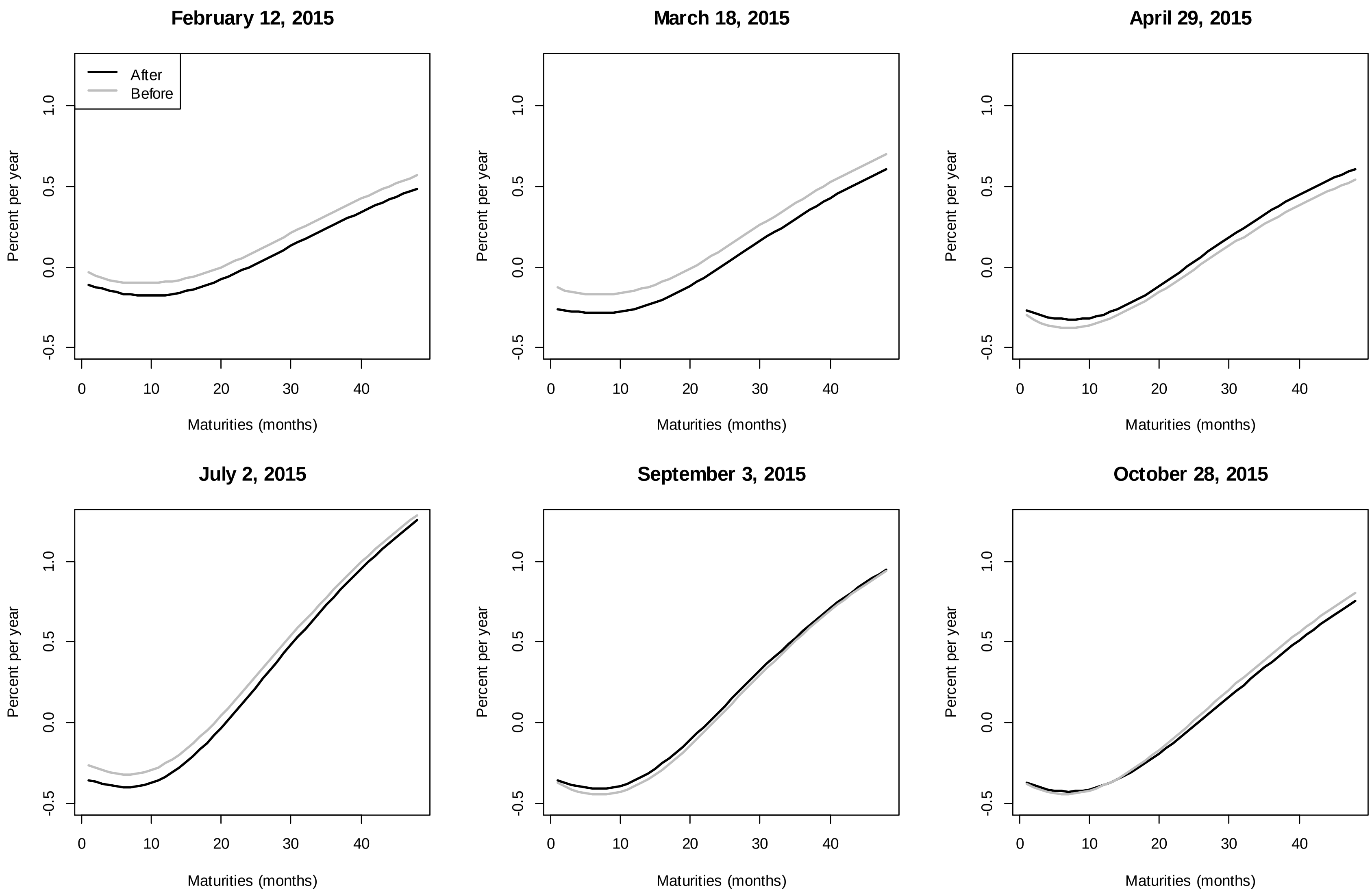


Figure 13: Shifts in expected policy rate paths around monetary policy announcement dates

Notes: This figure shows policy rate expected paths before and after six monetary policy announcements. They are constructed as implied forward-rate curves by the Riksbank staff using RIBA (Riksbank futures), FRA (Forward Rate Agreements) and interest-rate swaps.



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by Peter Sellin

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by Lawrence J. Christiano, Mathias Trabandt and Karl Walentin

Earnings Inequality and the Equity Premium 2007:215
by Karl Walentin

Bayesian forecast combination for VAR models 2007:216
by Michael K. Andersson and Sune Karlsson

Do Central Banks React to House Prices? 2007:217
by Daria Finocchiaro and Virginia Queijo von Heideken

The Riksbank's Forecasting Performance 2007:218
by Michael K. Andersson, Gustav Karlsson and Josef Svensson

Macroeconomic Impact on Expected Default Freqency 2008:219
by Per Åsberg and Hovick Shahnazarian

Monetary Policy Regimes and the Volatility of Long-Term Interest Rates 2008:220
by Virginia Queijo von Heideken

Governing the Governors: A Clinical Study of Central Banks 2008:221
by Lars Frisell, Kasper Roszbach and Giancarlo Spagnolo

The Monetary Policy Decision-Making Process and the Term Structure of Interest Rates 2008:222
by Hans Dillén

How Important are Financial Frictions in the U S and the Euro Area 2008:223
by Virginia Queijo von Heideken

Block Kalman filtering for large-scale DSGE models 2008:224
by Ingvar Strid and Karl Walentin

Optimal Monetary Policy in an Operational Medium-Sized DSGE Model 2008:225
by Malin Adolfson, Stefan Laséen, Jesper Lindé and Lars E. O. Svensson

Firm Default and Aggregate Fluctuations 2008:226
by Tor Jacobson, Rikard Kindell, Jesper Lindé and Kasper Roszbach

Wage Adjustment and Productivity Shocks 2011:253
by Mikael Carlsson, Julián Messina and Oskar Nordström Skans

Stylized (Arte) Facts on Sectoral Inflation 2011:254
by Ferre De Graeve and Karl Walentin

Hedging Labor Income Risk 2011:255
by Sebastien Betermier, Thomas Jansson, Christine A. Parlour and Johan Walden

Taking the Twists into Account: Predicting Firm Bankruptcy Risk with Splines of Financial Ratios 2011:256
by Paolo Giordani, Tor Jacobson, Erik von Schedvin and Mattias Villani

Collateralization, Bank Loan Rates and Monitoring: Evidence from a Natural Experiment 2012:257
by Geraldo Cerqueiro, Steven Ongena and Kasper Roszbach

On the Non-Exclusivity of Loan Contracts: An Empirical Investigation 2012:258
by Hans Degryse, Vasso Ioannidou and Erik von Schedvin

Labor-Market Frictions and Optimal Inflation 2012:259
by Mikael Carlsson and Andreas Westermark

Output Gaps and Robust Monetary Policy Rules 2012:260
by Roberto M. Billi

The Information Content of Central Bank Minutes 2012:261
by Mikael Apel and Marianna Blix Grimaldi

The Cost of Consumer Payments in Sweden 2012:262
by Björn Segendorf and Thomas Jansson

Trade Credit and the Propagation of Corporate Failure: An Empirical Analysis 2012:263
by Tor Jacobson and Erik von Schedvin

Structural and Cyclical Forces in the Labor Market During the Great Recession: Cross-Country Evidence 2012:264
by Luca Sala, Ulf Söderström and AntonellaTrigari

Pension Wealth and Household Savings in Europe: Evidence from SHARELIFE 2013:265
by Rob Alessie, Viola Angelini and Peter van Santen

Long-Term Relationship Bargaining 2013:266
by Andreas Westermark

Using Financial Markets To Estimate the Macro Effects of Monetary Policy: An Impact-Identified FAVAR* 2013:267
by Stefan Pitschner

DYNAMIC MIXTURE-OF-EXPERTS MODELS FOR LONGITUDINAL AND DISCRETE-TIME SURVIVAL DATA 2013:268
by Matias Quiroz and Mattias Villani

Conditional euro area sovereign default risk 2013:269
by André Lucas, Bernd Schwaab and Xin Zhang

Nominal GDP Targeting and the Zero Lower Bound: Should We Abandon Inflation Targeting?* 2013:270
by Roberto M. Billi

Un-truncating VARs* 2013:271
by Ferre De Graeve and Andreas Westermark

Housing Choices and Labor Income Risk 2013:272
by Thomas Jansson

Identifying Fiscal Inflation* 2013:273
by Ferre De Graeve and Virginia Queijo von Heideken

On the Redistributive Effects of Inflation: an International Perspective* 2013:274
by Paola Boel

Business Cycle Implications of Mortgage Spreads* 2013:275
by Karl Walentin

Approximate dynamic programming with post-decision states as a solution method for dynamic economic models *by Isaiah Hull* 2013:276

A detrimental feedback loop: deleveraging and adverse selection 2013:277
by Christoph Bertsch

Distortionary Fiscal Policy and Monetary Policy Goals 2013:278
by Klaus Adam and Roberto M. Billi

Predicting the Spread of Financial Innovations: An Epidemiological Approach 2013:279
by Isaiah Hull

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