

SPEECH

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Monetary policy decision-making¹

The Riksbank has a mandate from the Swedish parliament, the Riksdag, to maintain price stability. If inflation deviates from the target, the policy rate is our main tool to bring inflation back to target over time.

To justify and explain our monetary policy decisions, we need to “translate economic theory into practical policy in difficult economic situations”². I am deeply honoured to be awarded an honorary doctorate from the Lund University School of Economics and Management, and I am especially touched that you highlight specifically the ability to translate economic theory into practical policy in your award nomination.

The past few years are an example of translating theory into practice: The Riksbank raised the policy rate sharply in 2022 and 2023 to counteract high inflation. The negative effects came quickly and hit many households and businesses hard. But, only now are we seeing the positive effects in the form of lower inflation, higher real wages and stronger purchasing power. It takes time from when we make a monetary policy decision until it has a positive effect, and during that time, changes take place in the economy. This can make it difficult to see the link between the decision and the outcome.

Economic theory and research is difficult and often technically complex, but it is also rewarding, relevant and exciting. Communication is also difficult but rewarding. Explaining monetary policy decisions when there is great uncertainty about the future is therefore difficult, but also rewarding – and important. Communication is part of the monetary policy toolbox.

In my current position as a policy-maker, I am grateful to have experience both from research and teaching in economics and from working in the financial sector.

¹ I would like to thank Björn Lagerwall for excellent work on this speech, Charlotta Edler, Susanne Meyer Söderlind and Caroline Jungner for valuable comments and Gary Watson for polished translation.

² [Leading U.S. economist and First Deputy Governor of the Riksbank new honorary doctors | Lund University School of Economics and Management.](#)

A central bank is a public authority, but it is also a bank and part of the research community.

One of the strengths of central banks as policy-makers is that we have our own research departments and interact with the research community.³ It supports us in the work that constantly needs to happen, namely “the development of the monetary policy discussion by introducing new aspects, such as the climate issue”, which you also highlight in your award nomination.

Three major issues in recent years – the pandemic, geopolitics and climate change – are not typical central bank issues. They do, however, affect price stability.⁴ Central banks need to be able to analyse everything that affects economic developments and inflation to make well-balanced monetary policy decisions. Too narrow a view of what central banks should analyse can lead to poor guidance in the monetary policy decision-making process and, in the worst case, to ill-founded decisions.

The question I wish to focus on today is therefore: how we can ensure that monetary policy decision-making is characterised by high quality analysis and an openness to introducing new issues as the world around keeps changing. I will focus on three aspects of monetary policy decision-making that are closely interlinked:

- Central bank governance – what is the intention behind having monetary policy decisions made by a committee?
- The risk of groupthink – how do we avoid it in monetary policy decisions?
- Preparing for future challenges – how do we foster an open and constructive discussion on monetary policy?

The Riksbank’s governance - independence, collective decision-making and external evaluation

Let me start by explaining the governance structure of the Riksbank. There is an important similarity with academia, which is that both central banks and university faculties make decisions collectively.

The Riksbank is led by the Executive Board, consisting of five people. The Executive Board votes on monetary policy. But, it also collectively decides on decisions of strategic importance on the central bank operations including

³ Like many other central banks, we have our own research department. We organise and participate in conferences involving monetary policy-makers and researchers, and we have close contacts and exchanges with universities. So we always have the opportunity to learn about new research. And this creates the conditions for a good discussion before and after our decisions.

⁴ The pandemic and the war in Ukraine are the main reasons for the high inflation of recent years. And a growing body of research shows that climate change affects inflation. For research references, see, for example, Apel (2022), Breman (2020) and Schnabel (2022).

decisions on financial stability, cash provision and payment systems. At present, as the security policy situation has deteriorated after Russia's illegal invasion of Ukraine, there is an increased focus on the central bank's role in maintaining payments during peacetime crises and states of heightened alert. The new Sveriges Riksbank Act gives the Riksbank greater responsibility and new tools to deliver on this task.

The Riksdag is a public authority under the Swedish Parliament, the Riksdag, and has been since the Riksbank was founded in 1668, just two years after Lund University. However, the governance of the Riksbank has changed over the centuries. The high inflation of the 1970s and 1980s and the deep economic crisis of the early 1990s led to the introduction of an inflation target. In 1999, the Riksbank was granted constitutional independence.

The Riksdag appoints the General Council of the Riksbank, which has eleven members. The composition of the Council changes after each election to reflect the composition of the Riksdag. The Council appoints the five members of the Executive Board, i.e. the Governor and the deputy governors. The General Council meets with the Executive Board every month and has full insight into all of the Riksbank's activities. The committee members have five- or six-year terms of office that are longer than the parliamentary terms to ensure political independence to decide on monetary policy.

With a high degree of independence comes the need for transparency and evaluation. The work of the Riksbank, both monetary policy and other activities, is scrutinised and evaluated by several bodies: the General Council's auditors, the Swedish National Audit Office and the Riksdag Committee on Finance. In addition, starting in 2023, the Committee on Finance now evaluates monetary policy annually with the support of external academic assessors. And about every five years, an evaluation is also carried out by international academics and policy-makers.

On governance, the institutional structure does provide independence to make difficult decisions on monetary policy, but we are evaluated and accountable for our decisions.

The monetary policy decision-making process

Let me move on to the decision-making process. There are three facts that characterise monetary policy-making. First, it takes time from when we make a monetary policy decision until it has a positive effect. Second, there is always considerable uncertainty about the future. Third, our decisions can have a major impact on households and businesses. The central bank therefore makes monetary policy decisions based on observations of – and forecasts for – economic developments.

Under such circumstances, collective decision-making has both strengths and weaknesses. It is a strength to be able to seek advice and learn from other decision-makers, but at the same time, this risks leading to groupthink. Let me therefore discuss the monetary policy decision-making process from a psychological perspective, focusing on the work of the decision-making committee.

My reflections are based on a new Economic Commentary that I have written with my colleague at the Riksbank, Björn Lagerwall, Senior Adviser in the Monetary Policy Department. It discusses the role of psychological factors in monetary policy more generally and the subject of behavioural economics, which integrates psychology and economics.⁵ An important part of behavioural economics is how we view risk and uncertainty⁶, which is highly relevant for monetary policy decision-making. It is a question of understanding both your own decisions and how households and businesses act when there is great uncertainty about the future.

My own doctoral thesis was in the field of behavioural economics. My interest in economics was born during the 1990s crisis and deep recession in Sweden.⁷ When I started my PhD in the autumn of 2001, I planned to focus on macroeconomics and international economics, but the macroeconomic models of the time were based on representative rational agents, often referred to as *homo economicus*.⁸

Instead, I became interested in decision-making under risk and uncertainty. My thesis built on experiments and empirical research based on theories from behavioural economics.⁹ I have benefited from my knowledge of decision-making

⁵ See Breman and Lagerwall (2024).

⁶ In a 1979 article, Daniel Kahneman, together with Amos Tversky, launched the so-called *prospect theory*, which is about how we deal with risk and uncertainty. See Breman and Lagerwall (2024) for a longer discussion of prospect theory and its link to monetary policy.

⁷ I discussed the 1990s crisis in detail in a speech a few years ago; see Breman (2022).

⁸ The period is known as the Great Moderation, but came to an abrupt end with the onset of the financial crisis in 2008.

⁹ See, for example, Breman (2011).

under risk and uncertainty during my time on the Executive Board. Let me elaborate on what we know about this from research and practical experience.

Groupthink risks shaping monetary policy decisions

It is a dominant practice among central banks to have a committee make monetary policy decisions.

Traditional economics literature often mentions a few reasons why groups make better monetary policy decisions than individuals.¹⁰ One argument is that the amount of information available increases when more people participate. Another is that an average of several people's decisions tends to be better than a single person's decision. Finally, decisions tend to be less extreme if they are taken by several people.

One question to ask is why there are five members of the Executive Board and not more or fewer. As you may know, the new Riksbank Act that entered into force at the beginning of 2023 reduced the number from six to five. The inquiry into a new Riksbank Act discussed this issue¹¹, referring to research indicating that group decision-making seems to work best when there are about five people involved. In a balanced assessment, the inquiry proposed a reduction from six to five members.

However, the social psychology literature has also shown several pitfalls to be aware of when making decisions in groups.¹² And they can apply to monetary policy decisions within a committee as well.¹³ Let's say a committee is faced with a choice between two monetary policy options: keeping the policy rate unchanged or cutting it by 0.25 percentage points. If one member leans towards the option of cutting the policy rate by 0.25 percentage points, but all other members prefer an unchanged rate, *conformity* may cause the member to also vote in favour of an unchanged rate – against their own convictions. *Groupthink* could arise from the committee becoming very close-knit, ignoring dissenting views both inside and outside the central bank.

To reduce the risk of groupthink in the monetary policy decision-making process, it is important that members of the policy committee have different backgrounds and experiences. Members should be able to express differing opinions, and discussions should be characterised by respect and willingness to listen to others.

¹⁰ See for example Blinder (2007) and Rieder (2022).

¹¹ See SOU 2019:46.

¹² See, for example, Breman and Lagerwall (2024) for a discussion.

¹³ See Sibert (2005).

The possibility to enter a reservation against majority decisions is key. It is an important mechanism to encourage constructive discussion in committees. In recent years, the debate on social psychology aspects of monetary policy decision-making has gained renewed momentum, partly as a result of the high and sharp rise in inflation in 2021 and 2022.¹⁴

In our Commentary, we also discuss how *life experiences can influence economic decisions*.¹⁵ Dramatic economic events affect individuals for a long time. This also applies to episodes of high inflation.¹⁶ For example, there are indications that members of the Federal Reserve's Monetary Policy Committee who had experienced the Great Inflation in the 1970s and 1980s favoured tighter monetary policy than younger members who had not.¹⁷

Let me give two concrete examples from recent years of how decisions may have been influenced by groupthink and life experiences: one positive and one negative. Both are related to decisions we made in the context of the pandemic.

At the start of the pandemic, there were few historical examples and models to use to analyse the impact of a pandemic on the economy and inflation. There was also uncertainty about how long the pandemic would last, and if and when any vaccines might become available. At the same time, there was a strong need to act to avoid a financial crisis and counteract the negative economic effects of the pandemic on the economy. While learning from other central banks is important, there is a risk of groupthink between and within central banks when facing decisions under great uncertainty.

The Federal Reserve and the ECB both bought assets extensively during the pandemic. The Riksbank also did so, to prevent the pandemic from triggering a financial crisis and a deep economic downturn, and to contribute to price stability. In Sweden, inflation fell below zero in April 2020.

The Executive Board decisions in March 2020 and also the decisions to increase asset purchases in June 2020 were consensus decisions. However, I entered a reservation against the additional asset purchases in November 2020, as did my colleague Martin Flodén. This is a positive example of avoiding groupthink on asset purchases.

The negative example is from February 2022. In the aftermath of the pandemic, global energy prices were increasing and inflation had started to rise, mainly in the United States but also CPIF inflation in Sweden. Core inflation, CPIF excluding

¹⁴ See Blanchflower and Levin (2023).

¹⁵ For a longer overview, see, for example, Malmendier (2021).

¹⁶ See Salle et al. (2024).

¹⁷ See Malmendier et al. (2020).

energy, remained low. The Executive Board decided to leave the policy rate unchanged at our meeting in February, and our forecast was that the policy rate would remain unchanged for a couple more years.

My assessment is that the international debate on “transitory inflation” influenced our decision and we did not sufficiently appreciate how much supply-demand imbalances could affect inflation going forward.

In addition, the experience of many years with below-target inflation may also have caused us to underestimate the risk of inflation rising. We should have changed the policy rate path to reflect the changed risks to the inflation outlook. The decision on the policy rate and the policy rate path was unanimous. Still, we again managed to avoid groupthink on the asset purchases at that same meeting. Three of six members (myself, Henry Ohlsson and Martin Flodén) entered reservations against continued reinvestment of assets and wanted to see a faster tapering of holdings.

In hindsight, it is easy to be self-critical. Evaluations of monetary policy should always be based on the information available at the time of the decision. At the February 2022 meeting, we had information on inflation from December 2021 when core inflation was falling. In addition, this was before Russia’s illegal invasion of Ukraine. Moreover, Swedish GDP has been revised upwards subsequently, so demand now looks to have been much stronger than according to the information we had at the time of the meeting. But, we should have taken better account of the special circumstances that prevailed after the pandemic, just as we always need to recognise that, going forward, historical correlations will not always be a good guide in a changing world.¹⁸ These are examples of the lessons learnt from the pandemic, a topic extensively discussed at the Executive Board. I very much appreciate my colleagues in the Executive Board as well as the constructive cooperation we currently enjoy.

Let me conclude my comments on groupthink by emphasising the importance of academic research to avoid groupthink in policy-making. It is important for us to both have pressure from researchers within our central bank – to sharpen the internal debates and act as “devil’s advocates” – and from outside the central bank – as part of the public debate and to keep us accountable for our decisions. And, researchers are crucial for the last point I want to discuss on “preparing for future challenges – how do we foster an open and constructive discussion on monetary policy”.

¹⁸ This is also discussed in the section “Lessons learned from the rise in inflation 2022” in Account of monetary policy in 2022; see Sveriges Riksbank (2023).

Developing the monetary policy debate and introducing new aspects

Research in economics has evolved after crises. After the financial crisis, there was an increased focus on financial markets and how they should be included in theoretical models to better understand the link between the real economy and the financial economy.

Economic policy frameworks also tend to change after crises. The current frameworks in Sweden were established after the crisis of the 1990s. The inflation target, the industrial agreement and the fiscal policy framework have been the cornerstones of Swedish economic policy ever since. Politicians who were themselves involved in managing the crisis of the 1990s often reiterate the need for stable public finances and the value of low and stable inflation. This is in line with the importance of life experience for economic decisions, which I discussed earlier.

Currently, intensive academic work is underway to understand the high inflation of recent years. This has led to a wave of new research, often empirical, analysing, among other things, the pricing behaviour of firms and the behaviour of households. How households perceive inflation is important for their behaviour and this in turn affects inflation. I recently gave a speech on the psychology of inflation based almost entirely on recent new research.¹⁹

Still, it is unfortunate that we have to go through a serious crisis to get a better understanding of how households perceive inflation²⁰ and form their inflation expectations. It is also problematic that we had to experience a global financial crisis before research focused on new models that better link the real economy and financial markets. And it would have been better if Sweden had not had to endure a prolonged crisis to implement the economic reforms of the 1990s. Despite several economists putting forward such proposals for a long time, it was only in the wake of the crisis that they were realised.

That said, it is very easy to draw a parallel with central banks and the climate issue. In my first speech at the Riksbank in 2020, I said that “other policy areas certainly have more effective tools than central banks to reduce carbon emissions and limit global warming”. The idea that climate change is of importance to central banks is not to replace actions by governments that have better and more efficient tools to deal with the issue. However, central banks can contribute within their mandates: firstly, through research on the impact of climate change on the

¹⁹ See Breman (2024).

²⁰ See Afrouzi et al. (2024).

economy and inflation and the adjustments needed to address it, and secondly, by managing risks from climate change to the assets on their own balance sheet.

I would like to emphasise that my ambition to bring new aspects of monetary policy to the fore is not about mission creep, that is, taking on tasks that are not within our remit. *Our mandate is price stability*. To achieve price stability, we need to understand climate-related risks in order to make accurate forecasts going forward.

As I mentioned earlier: “The central bank makes monetary policy decisions based on observations of – and forecasts for – economic developments.” However, the forecasts often rely on backward-looking data to estimate historical correlations. In some areas, historical correlations provide little guidance, whether we need to deal with the economic impact of a pandemic, geopolitical conflicts or climate change. Then we need new research, supported by economic theory, to guide forward-looking monetary policy. And again, this is an area where close collaboration between the research community and central banks is needed.

Concluding thoughts

Today, I have emphasised that it is a strength for central banks as policy-makers to be close to the research community. We can incorporate new findings and collaborate with researchers to improve models and provide advice on decisions. Researchers improve monetary policy decision-making by contributing to a constructive discussion.

Lund University has a long tradition of contributing to the monetary policy debate and economic policy in Sweden, from Knut Wicksell to the present-day faculty. I would encourage all students and young researchers to continue this tradition. In an environment with geopolitical tensions and new technical tools that can spread and amplify misinformation, your voice is needed more than ever.

I would like to conclude by emphasising how honoured and grateful I am to be awarded an honorary doctorate by the Lund University School of Economics and Management. My aim is to continue to try to contribute to the development of the monetary policy debate and to introduce new aspects, whether it is climate change and behavioural economics, or other topics that give new perspectives on monetary policy.

For me as a policy-maker, I personally believe that one of the greatest privileges is the access I have to high quality research, from our own research department at the Riksbank, at international conferences where policy-makers and researchers meet, and when I get the opportunity to visit and learn from researchers and students at universities.

The Riksbank is both a public agency and a bank. And, we are also part of the research community. This is what enables our work to “translate economic theory into practical policy in difficult economic situations”. That is the essence of monetary policy decision-making.

Thank you.

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