

Monetary policy challenges – weighing today against tomorrow

Swedish Economic Association,
Stockholm

16 May 2017

S V E R I G E S R I K S B A N K

Governor of the Riksbank
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Unusual times create new challenges

Low inflationary pressures, low policy rate but strong economic activity

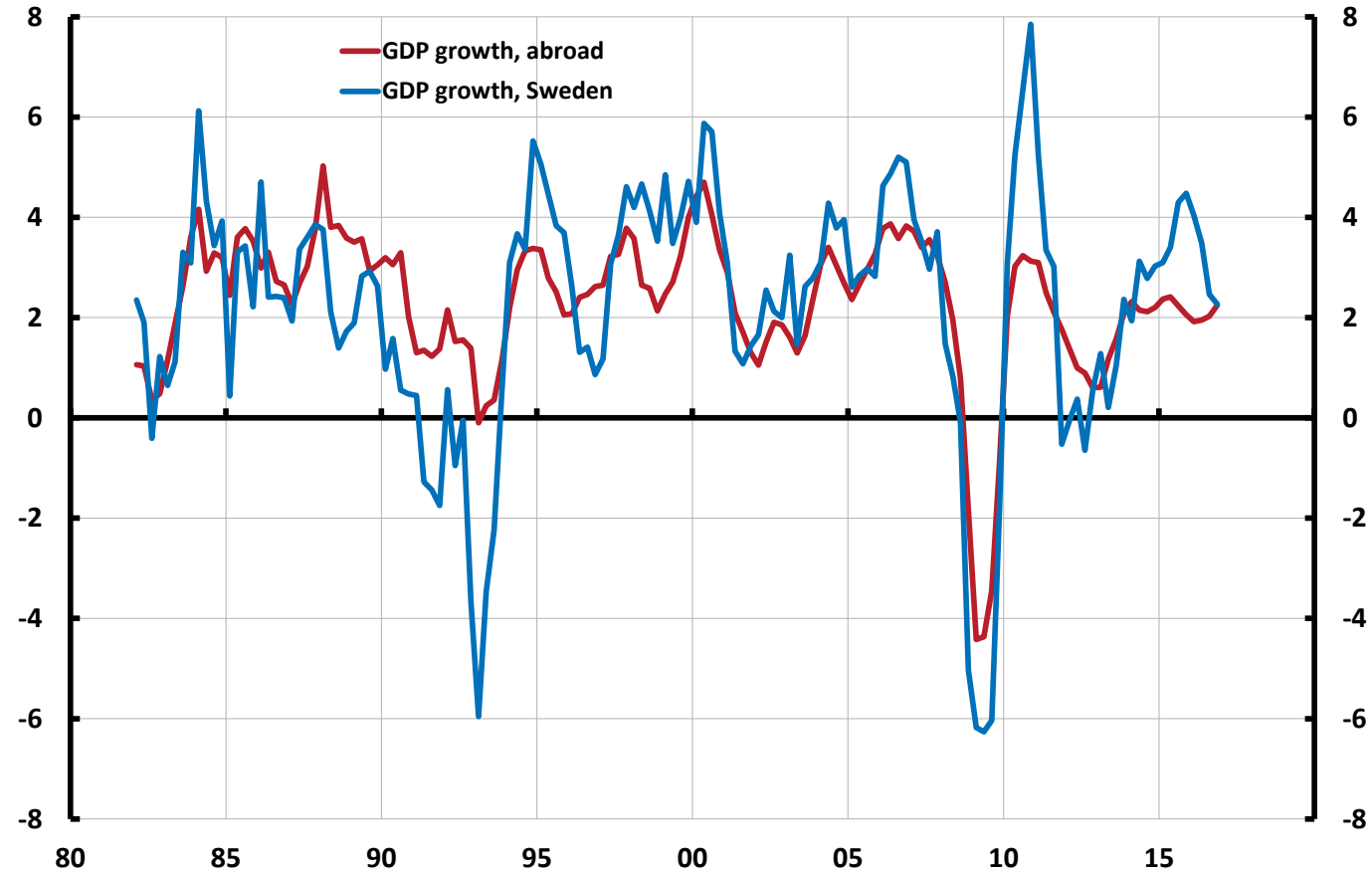
Persistent low global real interest rates and large international capital movements

- Risks to financial stability
- Restricted scope for monetary policy

What is needed?

- Other monetary policy tools
- Macroprudential policy
- Clarification of the Riksbank's responsibility for financial stability
- A sufficiently large foreign currency reserve

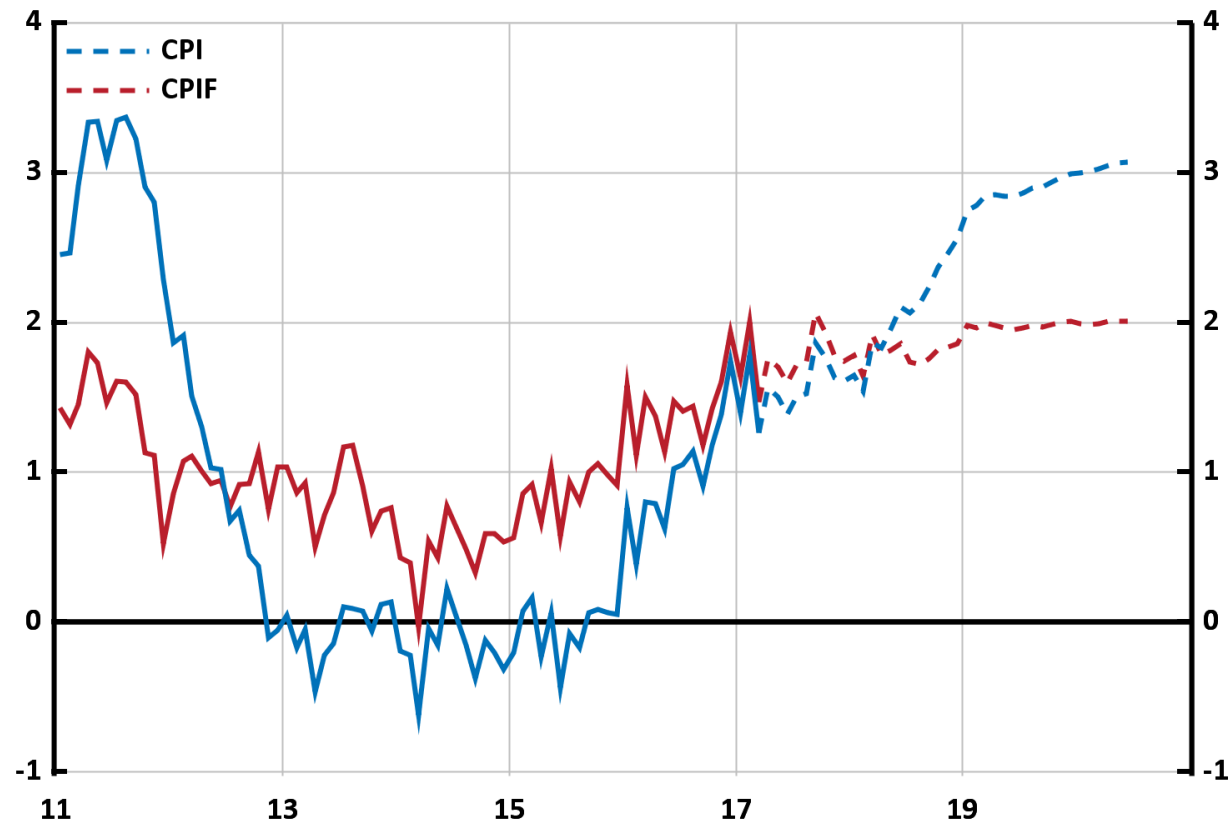
Strong Swedish economic activity



Note. Annual percentage change. GDP abroad is KIX weighted.

Sources: National sources, Statistics Sweden and the Riksbank

Slow upturn in inflation

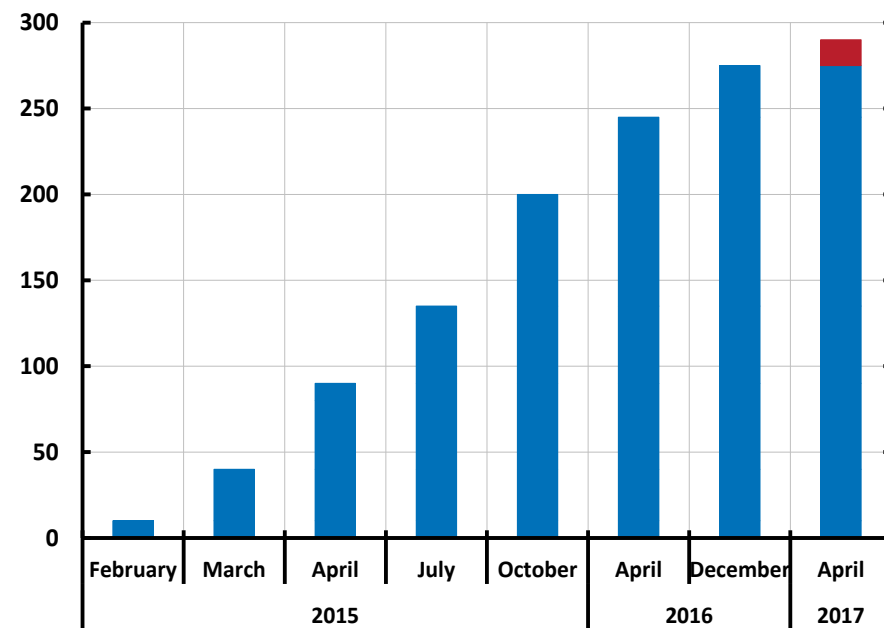


Note. Annual percentage change. The CPIF is the CPI with a fixed mortgage rate.

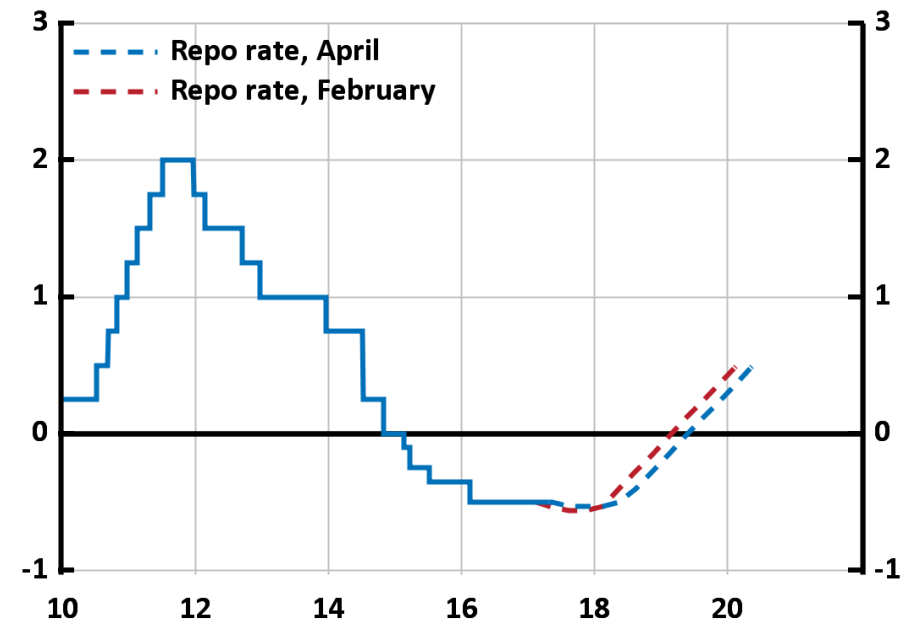
Sources: Statistics Sweden and the Riksbank

To support the upturn in inflation

Extend purchases of government bonds



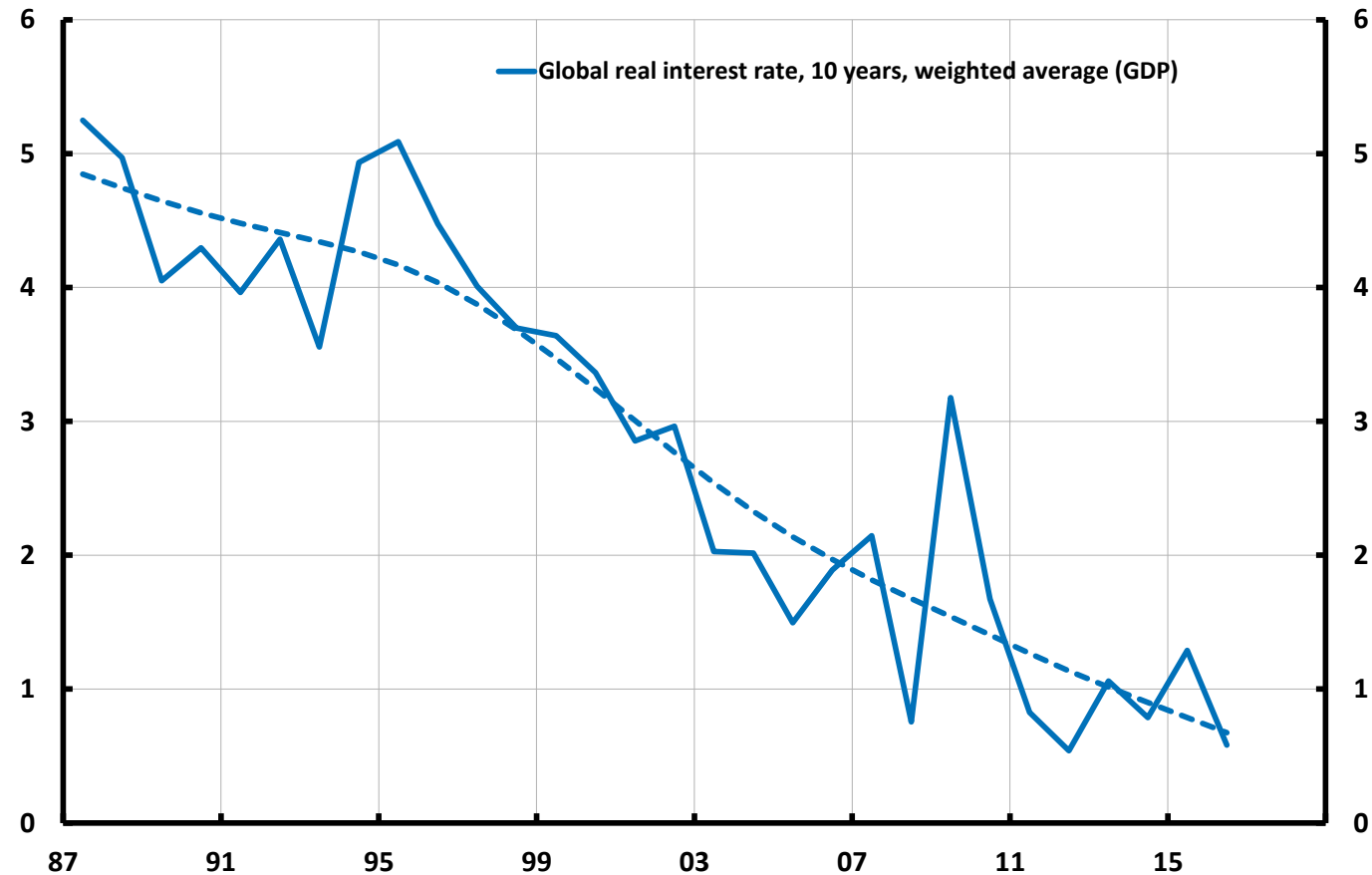
Repo rate expected to be raised later



Note. SEK billion and per cent.

Source: The Riksbank

Falling global real interest rate



Note. Per cent. The real interest rate is calculated as nominal government bond yields minus actual inflation. The calculation of the global real interest rate includes the euro area (as of 1995), Japan, Canada, the United Kingdom and the United States. The broken trend line has been calculated using the HP filter.

Sources: Bureau of Economic Analysis, Eurostat, Japanese Statistics Bureau, Macrobond, OECD, Office for National Statistics and Statistics Canada

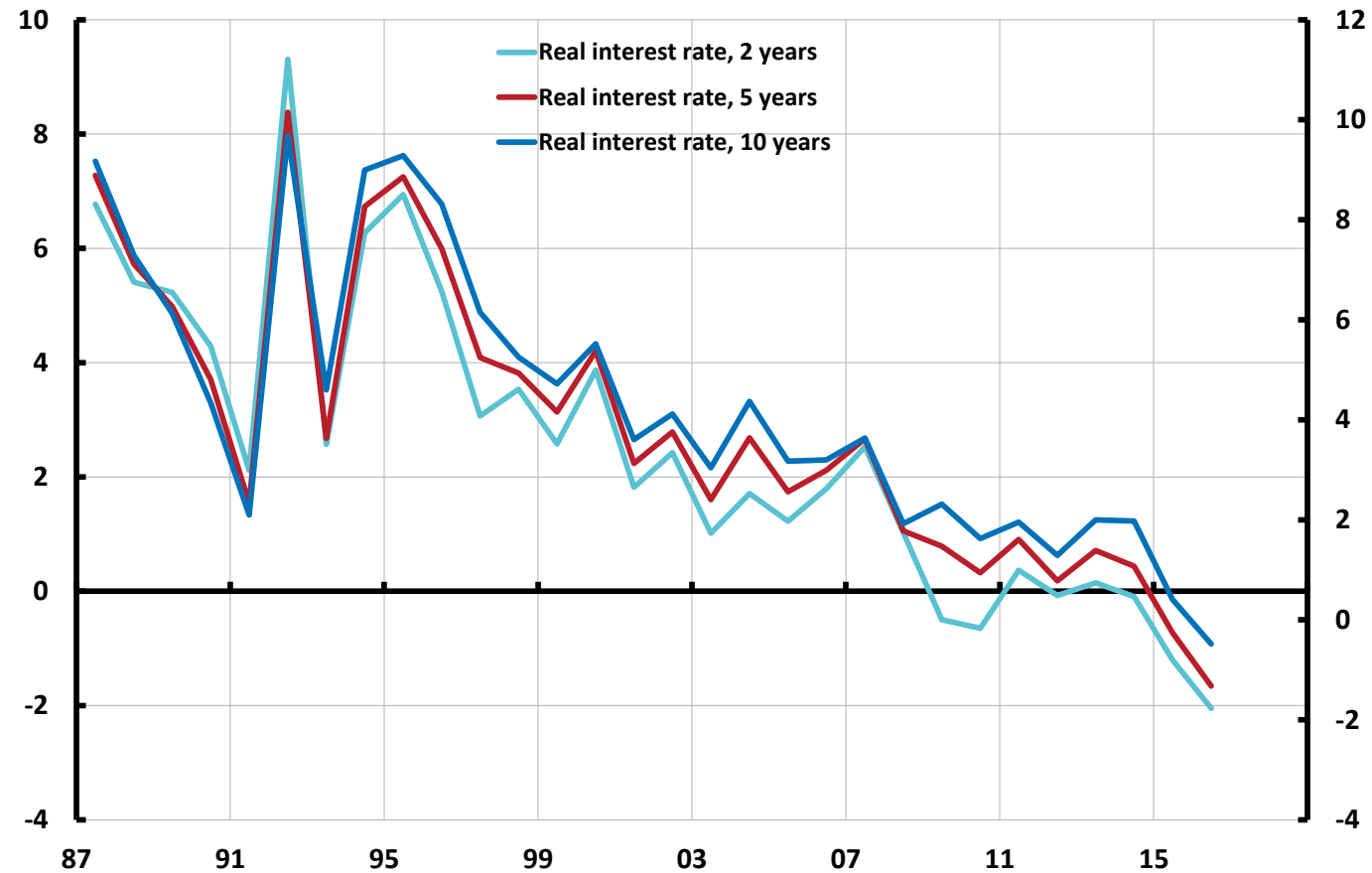
What is this due to?

Increased propensity to save and decreased willingness to invest

Why?

- Demographics
- China and other Asian emerging market economies
- Reduced innovativeness
- Increased demand for safe assets

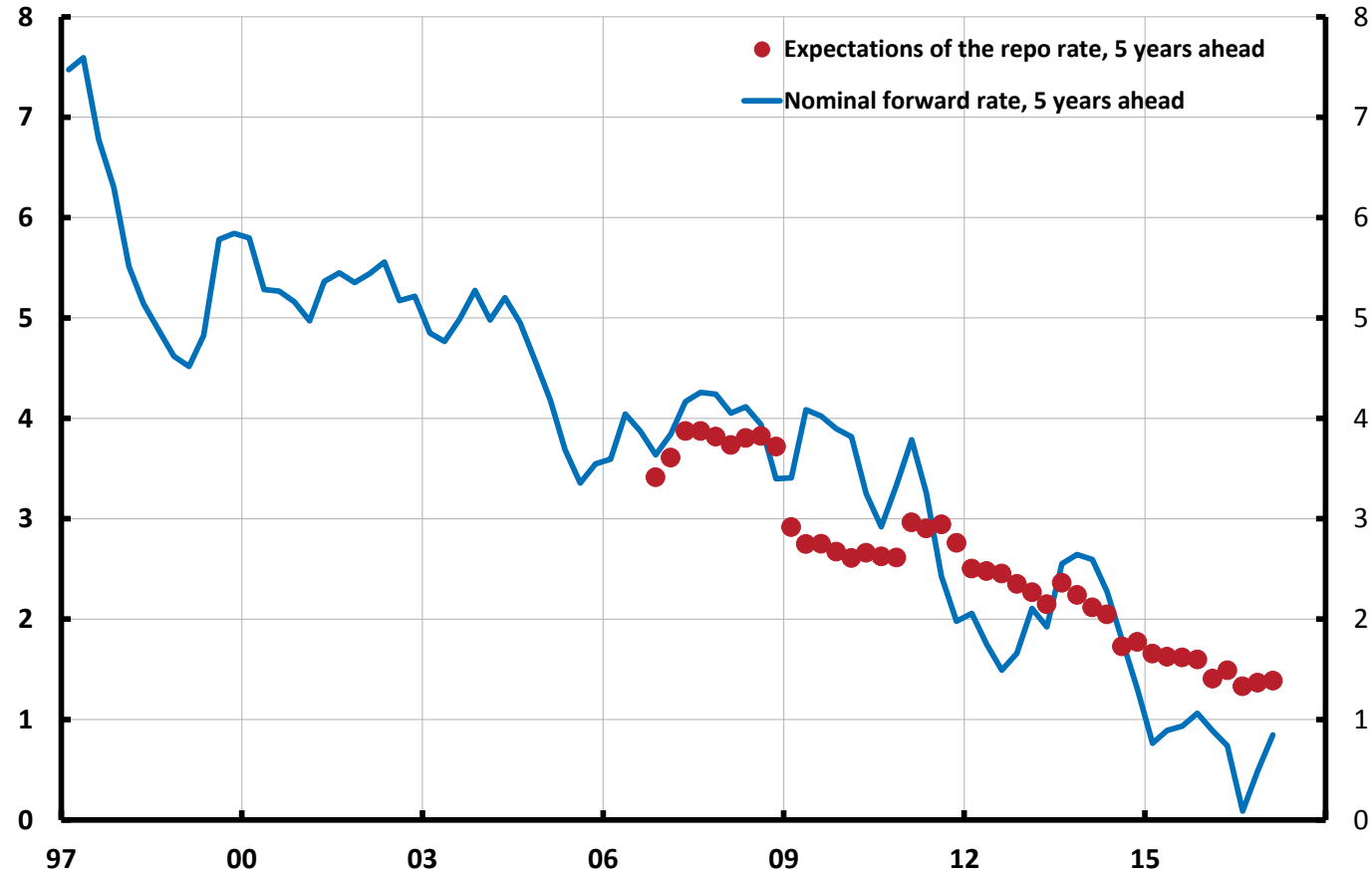
Falling real interest rates in Sweden



Note. Per cent. 10-Year government bond yields minus actual inflation, measured in terms of the CPIX (CPI in 1987).

Sources: Macrobond and Statistics Sweden

Continued low interest rates - a challenge



Note. Per cent.

Sources: TNS Sifo Prospera and the Riksbank

The consequences of low interest rates over a long period of time

- Greater dependence on other monetary policy tools
- Increased risks to the financial system
- Mortgage borrowers more sensitive to interest rate changes

Monetary policy increasingly restricted

- More difficult to reconcile an independent monetary policy with the free movement of capital
- Global financial cycle affecting housing prices and indebtedness in small open economies
- Monetary policy needs to be complemented by macroprudential policy measures

The Riksbank's responsibility for financial stability needs to be clarified.



- Expensive to clean up after financial crises
- Financial stability and monetary policy closely interlinked with each other
- Monetary policy should take account of the risks of a financial crisis – some central banks with inflation targets do this

The importance of independent macroprudential policy

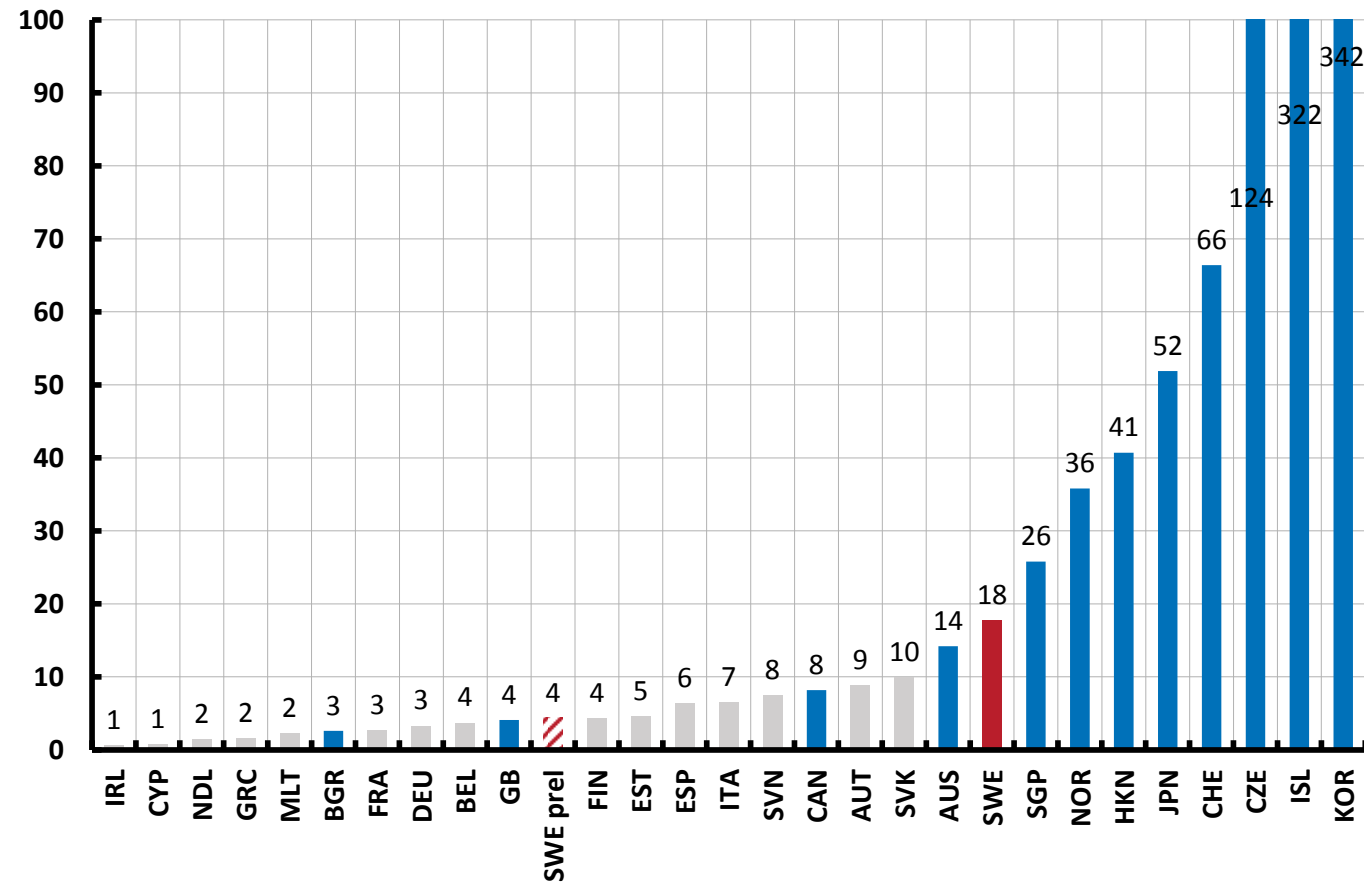


- The time inconsistency problem is common in economic policy
- Monetary policy delegated to an independent central bank
- Time inconsistency is also a problem within macroprudential policy – delegate macroprudential policy to independent authority
- Good if the Riksbank can receive increased mandate for preventing financial crises and is allocated a few macroprudential policy tools

The foreign currency reserve needs to be readily available in the event of a crisis

- The Government proposes halving the foreign currency reserve – high risk proposal
- Borrowing money at the height of a crisis may take time and be expensive
- The foreign currency reserve can act preventively
- Should be seen as an insurance policy and be paid for by the banks
- Present level or higher is appropriate

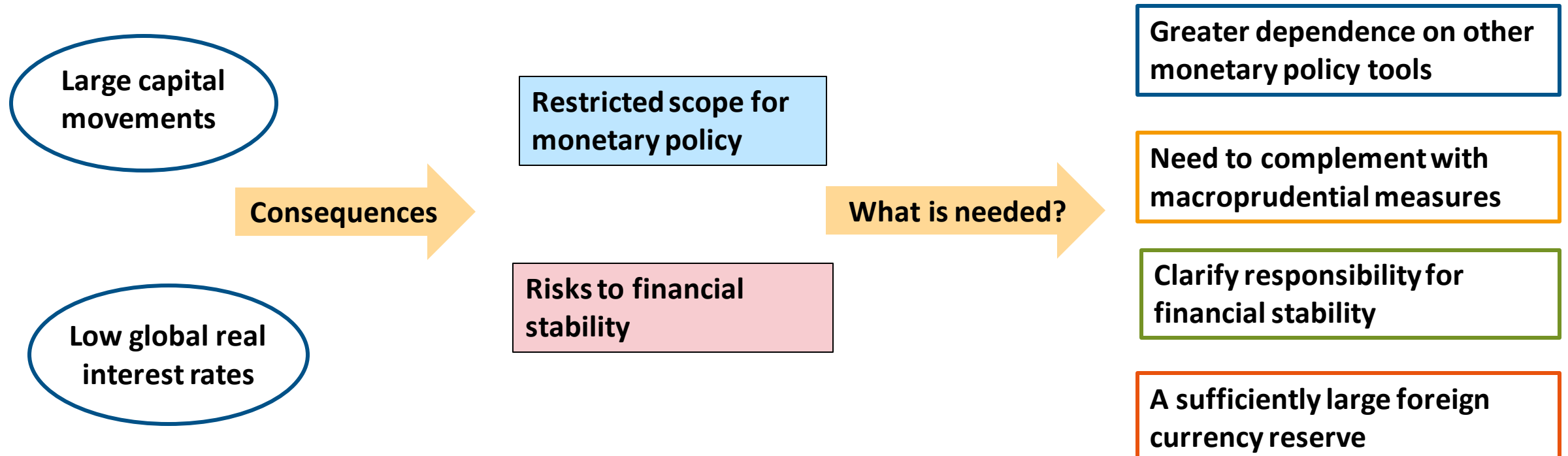
The foreign currency reserve is also becoming low from an international perspective



Note. Per cent. Grey-coloured countries belong to the euro area.

Sources: IMF and the Riksbank

Monetary policy challenges – some conclusions



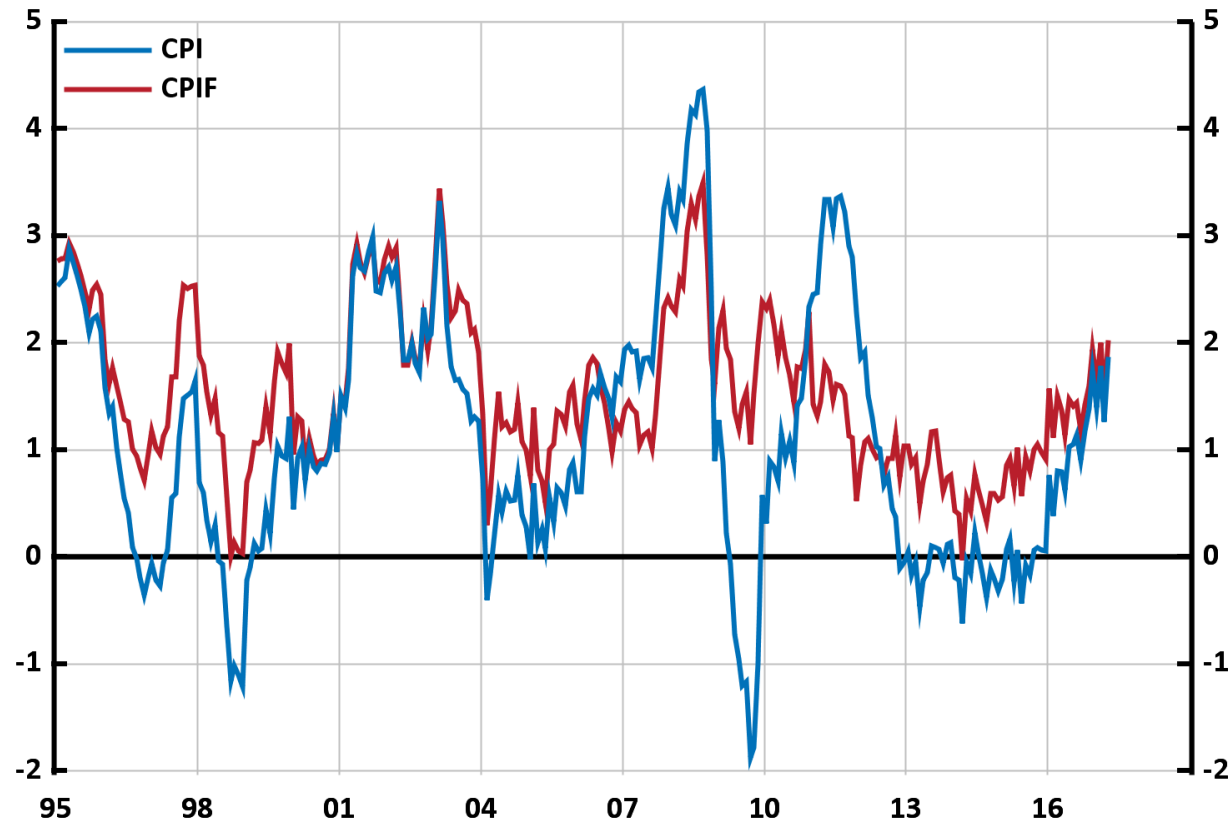
Change of target variable and introduction of a variation band



The Riksbank is considering:

- Changing target variable, from the CPI to the CPIF
- Introducing a variation band to illustrate uncertainty

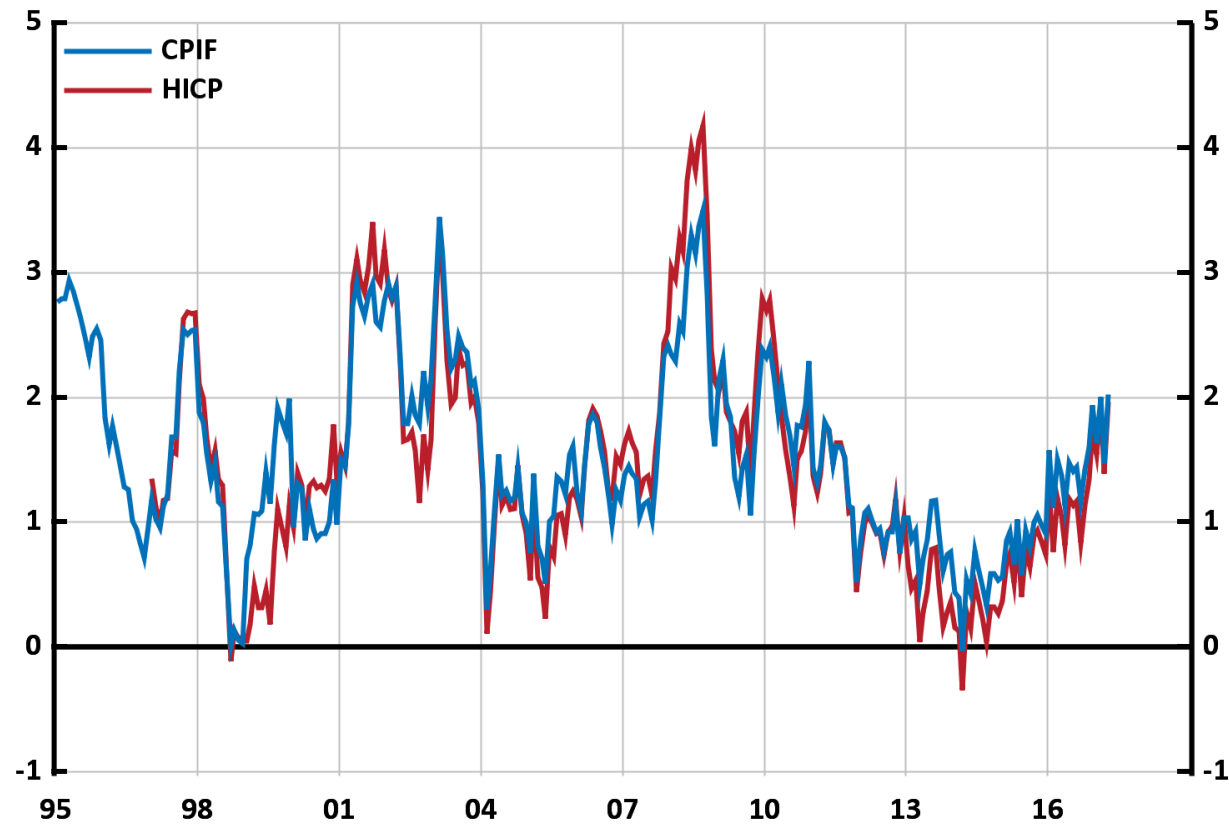
For a more clear monetary policy – change to CPIF



Note. Annual percentage change. The CPIF is the CPI with a fixed mortgage rate.

Source: Statistics Sweden

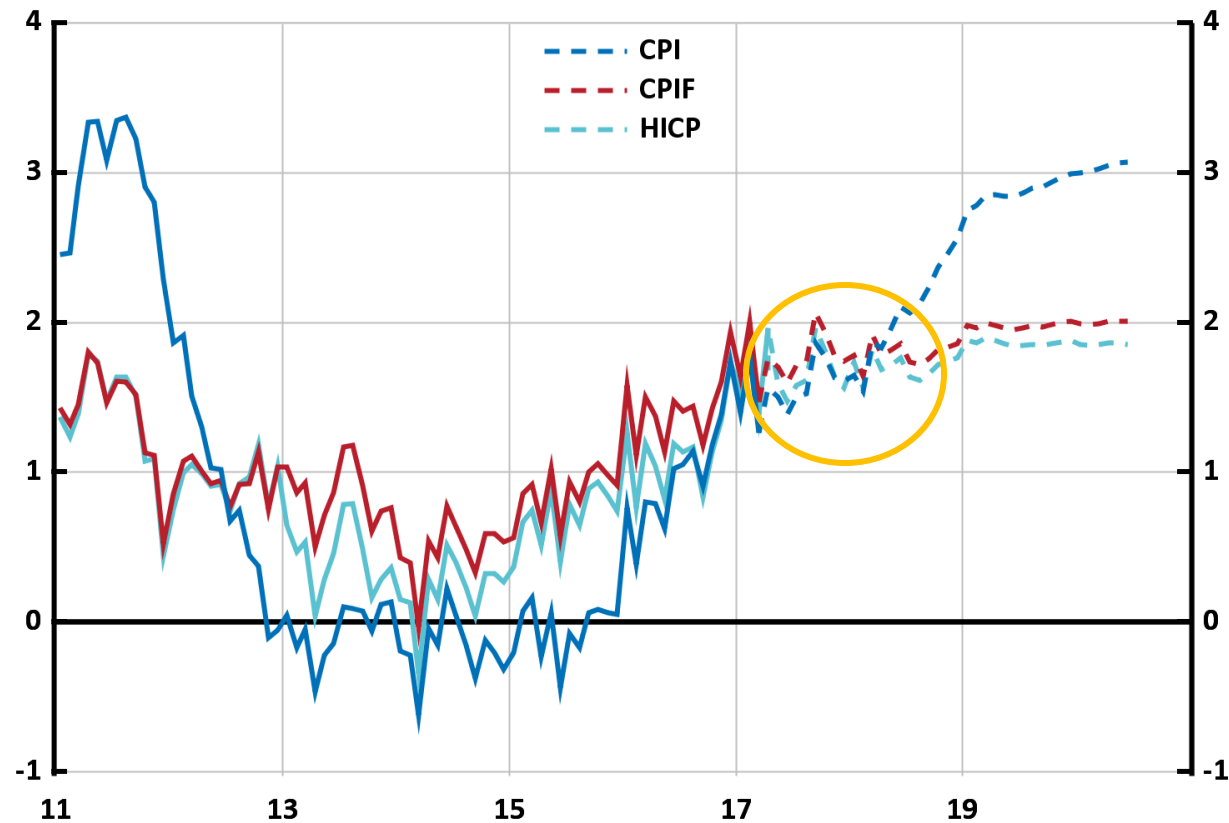
Small differences between CPIF and HICP



Note. Annual percentage change. The CPIF is the CPI with a fixed mortgage rate and the HICP refers to the EU-harmonised index for consumer prices.

Source: Statistics Sweden

Now is a good time to change the target variable

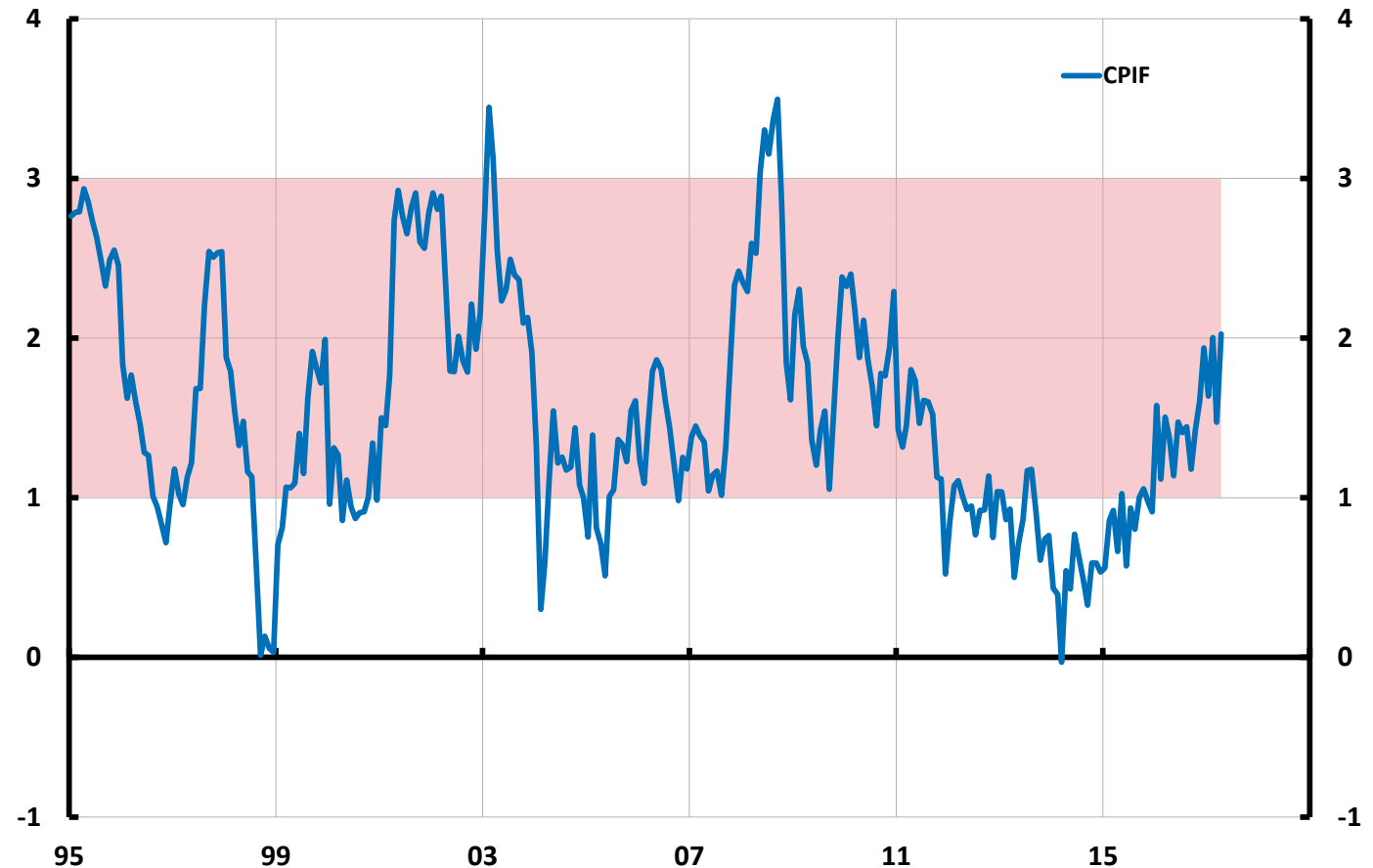


Note. Annual percentage change.

Sources: Statistics Sweden and the Riksbank

Variation band illustrates uncertainty

- To illustrate uncertainty
- Based on historical development
- Not a 'target range' – monetary policy aims at 2 per cent regardless of whether inflation is inside or outside the band

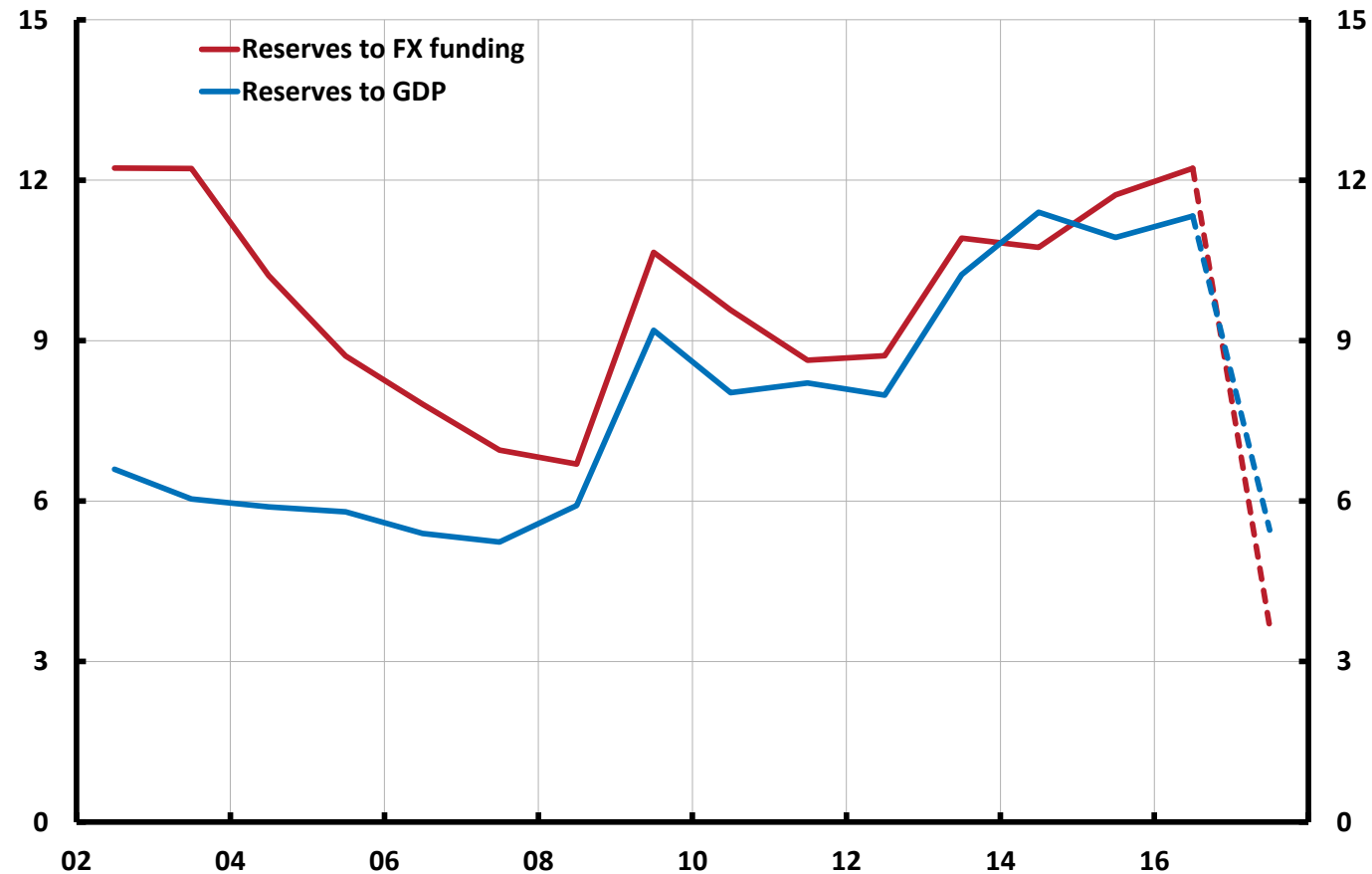


Note. Annual percentage change. The CPIF is the CPI with a fixed mortgage rate.

Source: Statistics Sweden

Thanks!

The foreign currency reserve would be at a historically low level if the Government's proposal were to be implemented



Note. Per cent. Note. Foreign funding refers to Swedish banks' (including Swedish subsidiaries but excluding foreign subsidiaries) market funding and deposits in foreign currency. The broken part of the line represents the Riksbank's forecast based on the reduction of the currency reserve proposed in the draft.

Sources: Statistics Sweden and the Riksbank