

# Inflation targeting for nearly 30 years: a robust framework for all times?

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# Almost 30 years of inflation targeting – a robust framework for the next 30 years?



What are the basic prerequisites?



What are the challenges?



What can be improved?

# From copper standard to inflation targeting

1624: Copper standard



1777: Silver standard



1873: Scandinavian Coin Union  
(gold standard)

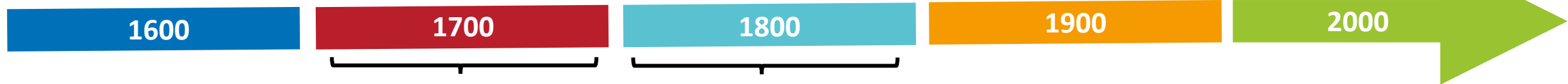
1951: Bretton Woods  
(gold standard)



1973: Currency snake  
(fixed exchange rate)

1931: Price stability target

1993– 1995: Inflation targeting decided and introduced



1656: Stockholms Banco is founded

1668: Sveriges Riksbank is founded



War and inflation

The banking system is developed



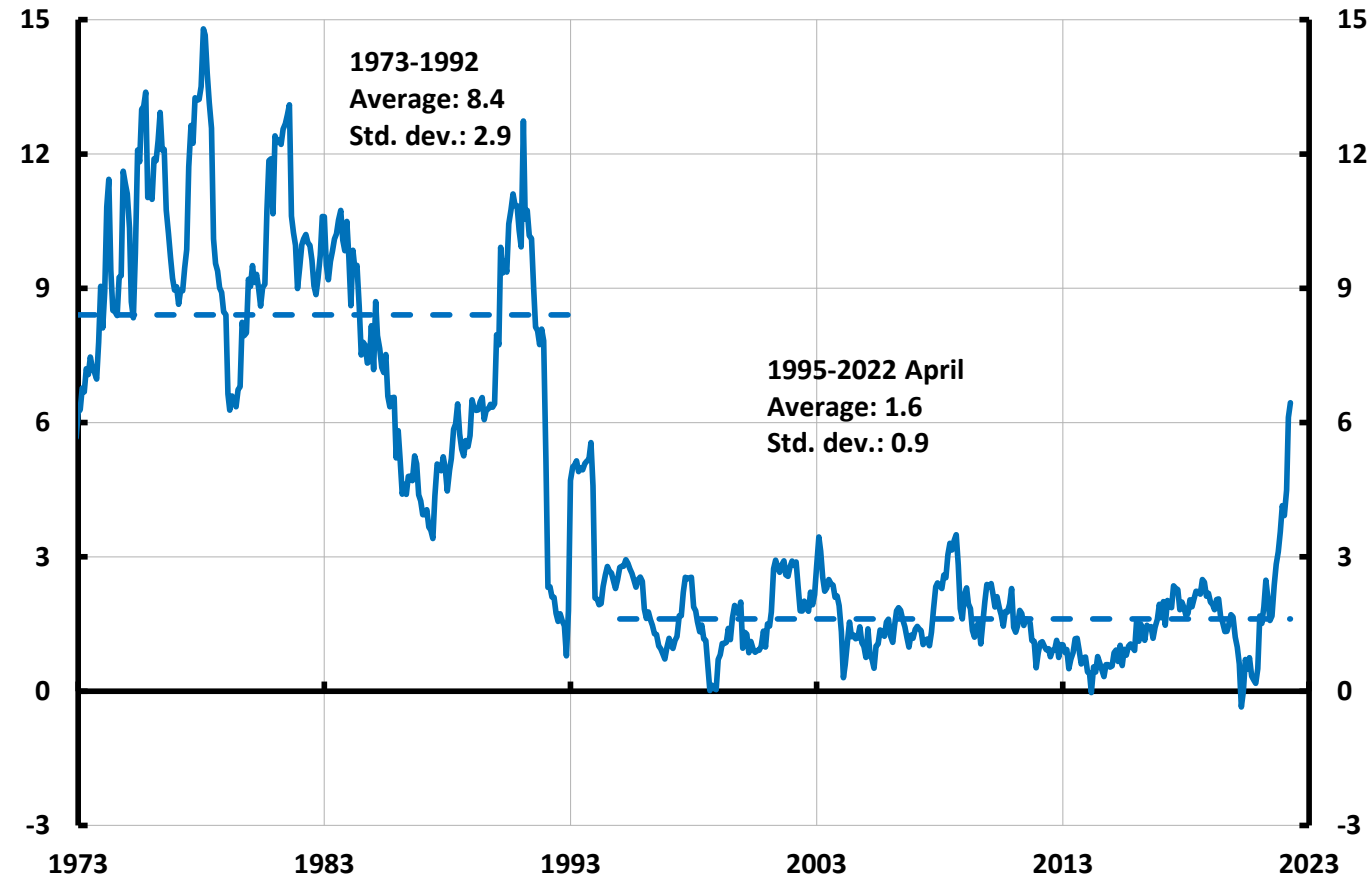
1992: The Riksbank raises the repo rate to 500%



2008– 2009: Global financial crisis

2020: Pandemic

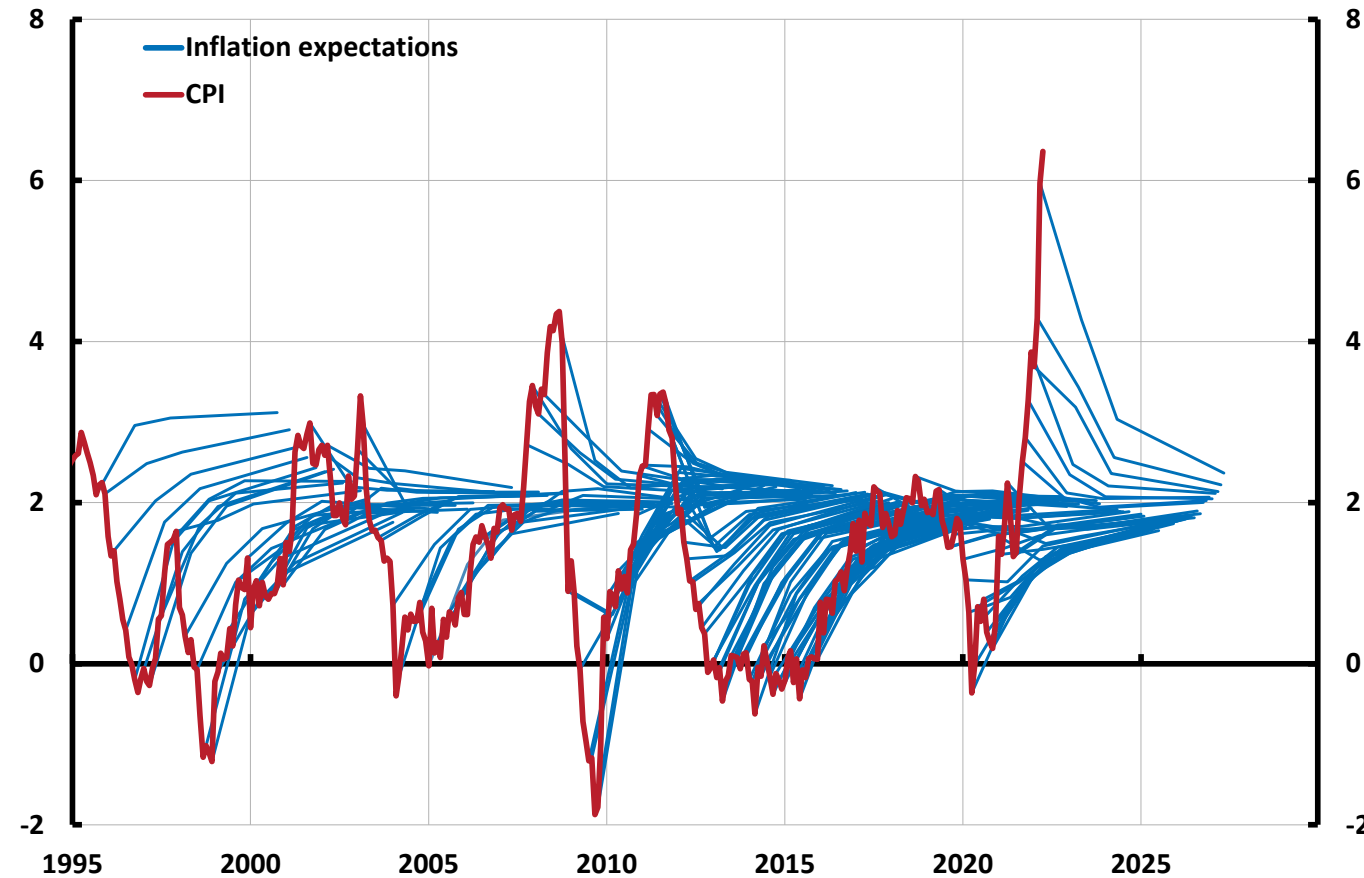
# Inflation target 1995 – 2022: Low and stable inflation



Note. The CPIF, annual percentage change. 1973–1987, refers to CPI excl. interest.

Sources: Statistics Sweden and the Riksbank.

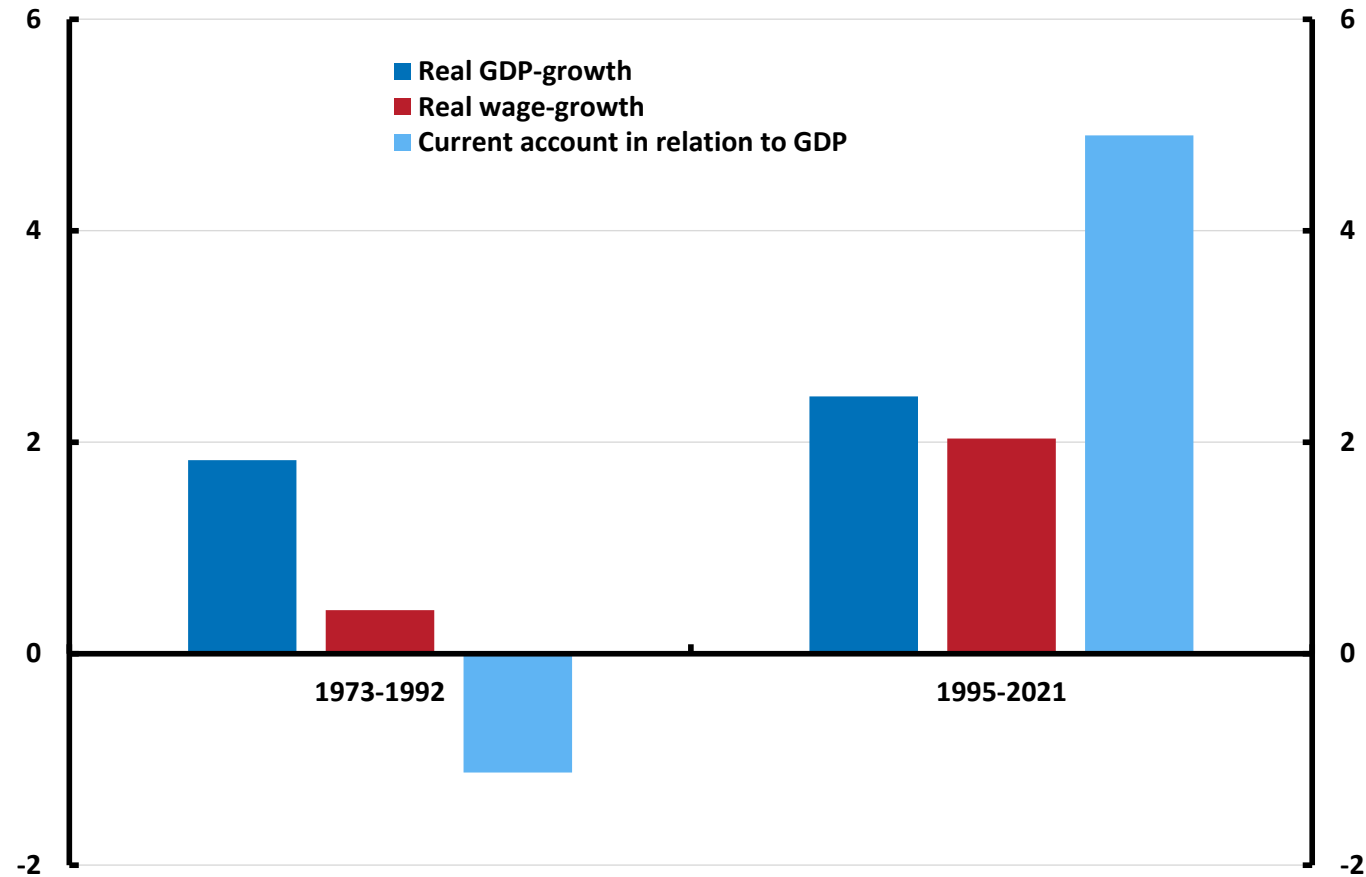
# Inflation target 1995–2022: inflation expectations close to target



Note. Per cent. Inflation expectations CPI among money market participants (1, 2 and 5 years).

Sources: Kantar Sifo Prospera and Statistics Sweden.

# Inflation target 1995 – 2022: Good economic development



Note. Per cent. Real GDP (GDP at constant prices) has been adjusted for price changes with the GDP deflator. Real wages have been adjusted with CPI.

Sources: National Mediation Office, Statistics Sweden and the Riksbank.

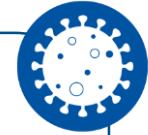
# Inflation targeting policy tested in two crises – and managed both

## Global financial crisis 2008–2009



- Maintained credit supply and confidence in inflation target
- Secured functioning of the financial system in general
- Reduced the costs of the crisis

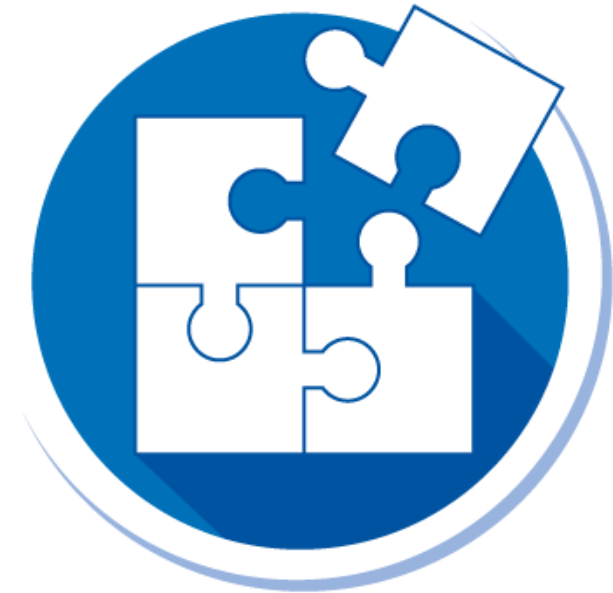
## Pandemic 2020



- Acted quickly, broadly and on a large scale
- Secured liquidity
- Ensured monetary policy impact and low interest rates

# What are the basic prerequisites?

- A well-functioning payment system
- Stable public finances
- An effective toolbox





# Difference between money and money

- Reduced cash use (central bank money)
- State-owned means of payment creates confidence in commercial money
- Own currency needed for monetary policy to function
- Cryptocurrencies – an additional competitor to national currencies?



# The e-krona – new digital state money

- Riksbank investigating possible design for e-krona
- Important project in today's world where the Swedish krona exposed to competition

E-krona pilot



# Stable public finances important – but larger role for fiscal policy stimulus?



- Policy rate near lower bound – limits possibilities to stimulate economy
- Current fiscal policy framework has been important
  - Confidence in fiscal policy
  - Contributed to low and stable inflation
  - Contributed to successful management of global financial crisis and pandemic
- Both too tight and too lax fiscal policy have consequences for inflation targeting policy

# More active fiscal policy

## Possibilities

- Low indebtedness
- Low long-term real interest rate

## Risks

- Confidence can be weakened
- High private indebtedness
- The long-term real interest rate may rise

# Monetary policy tools need to be flexible

- Financial markets growing and changing – increased risks in financial system
- Balance sheet increasingly important for monetary policy
- The new Sveriges Riksbank Act
  - Artificial division of different tools for price stability and financial stability
  - Advocates a specific order in which tools shall be used



# What are the challenges?

- The inflation target has not been tested in an environment with sharply rising prices
- Climate change – more analysis of the economic impact is needed

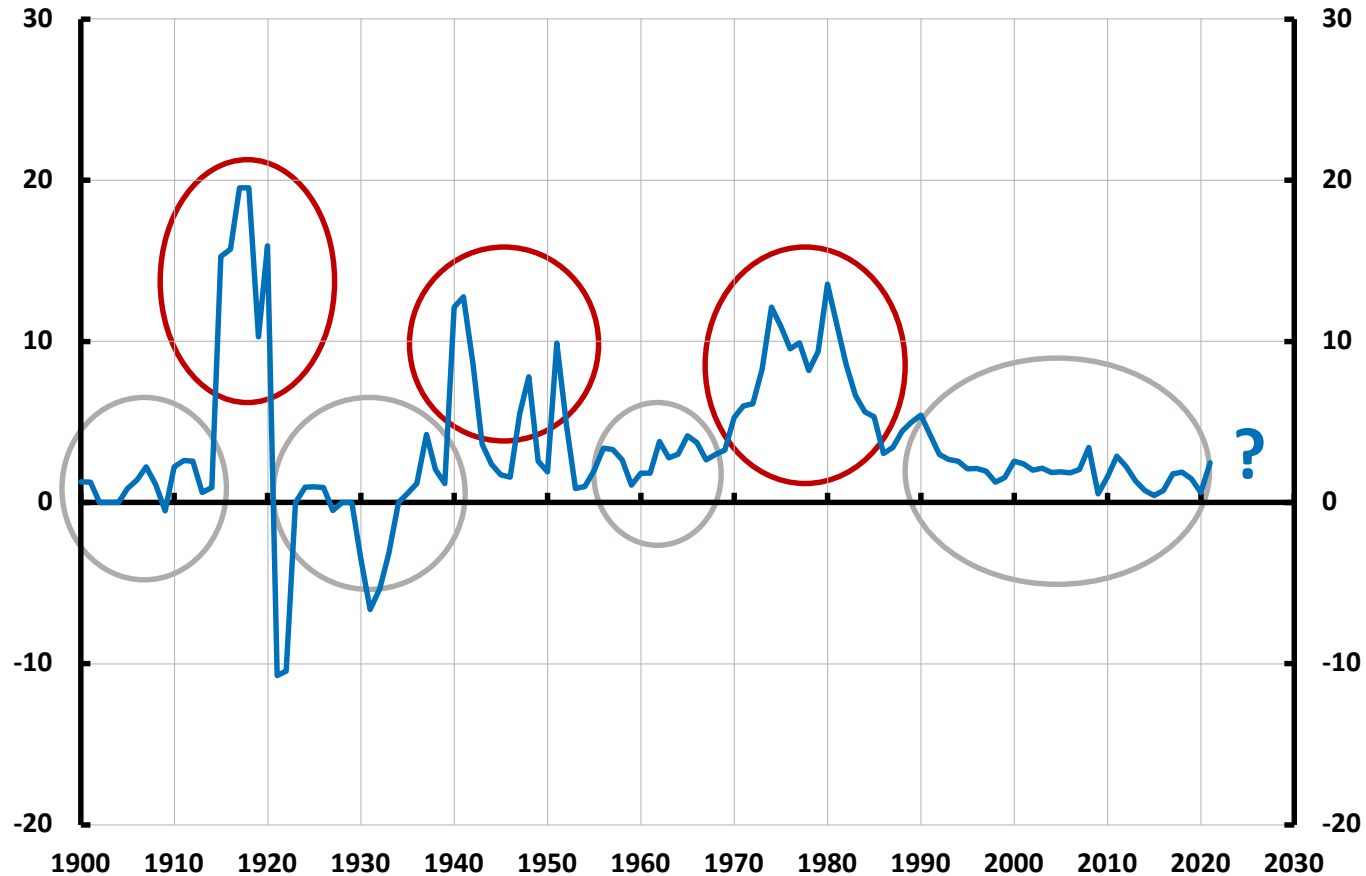


# New monetary policy environment?

- Period 1995-2021 characterised by low inflation
  - Digitalisation and globalisation
  - Economic policy reforms
  - Demographic factors
- High inflation environment ahead?
  - High inflation outcome – recovery after pandemic and rising energy and food prices
  - Russia’s invasion of Ukraine – short and long-term consequences



# Low inflation environment cannot be taken for granted



Note. Per cent. The median value of average annual inflation in twelve countries including Australia, Germany, France, Sweden, the United Kingdom and the United States.

Source: J. Ha, A. Kose and F. Ohnsorge, "One-Stop Source: A Global Database of Inflation", Policy Research Working Paper 9737, World Bank, 2021.



# Similarities and differences between today and 1970s

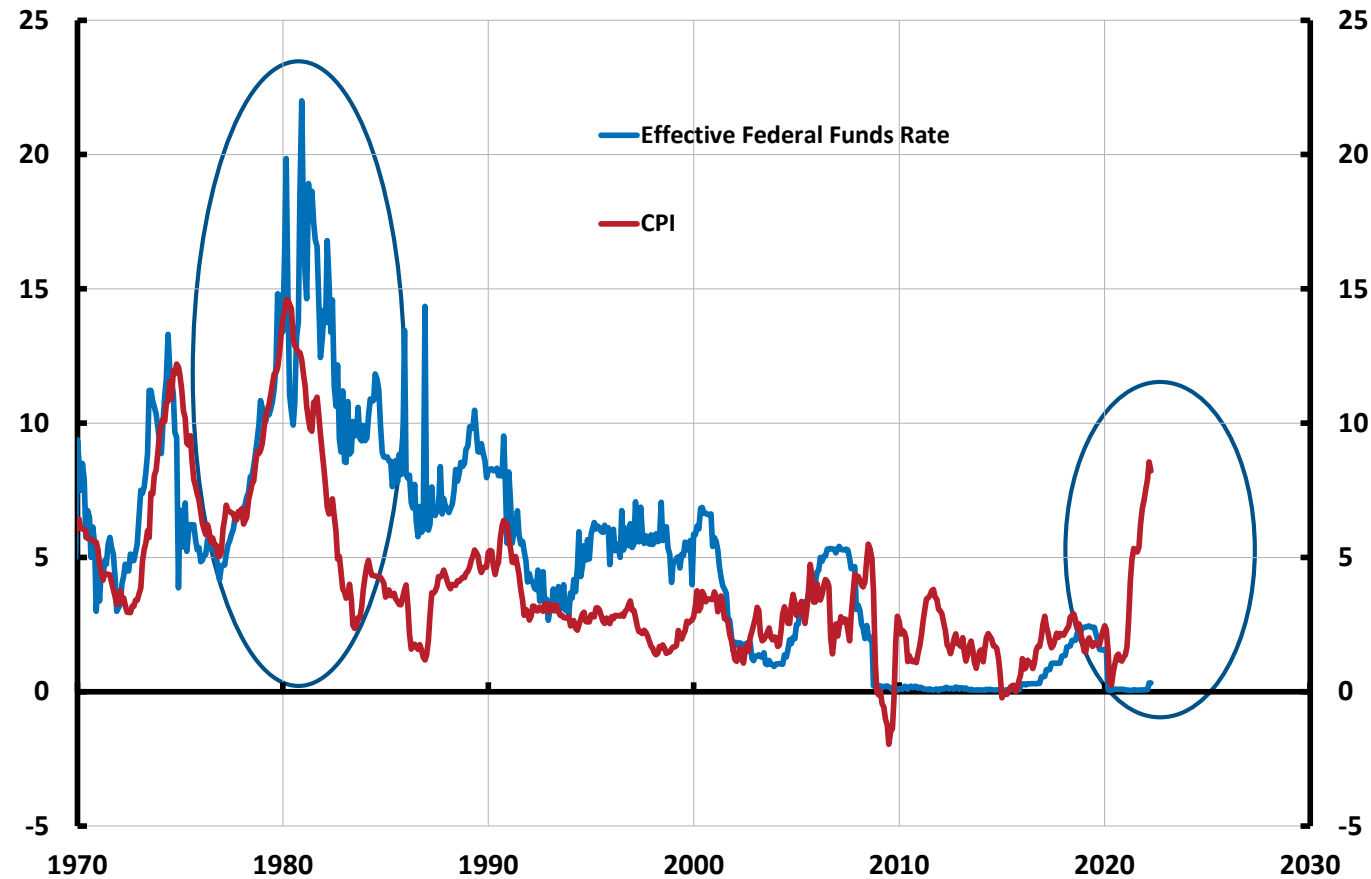
## Similarities

- War abroad
- High energy prices

## Differences

- Inflation target
- Fiscal policy
- Wage formation

# Interest rate quadrupled between 1976 and 1981 – inflation fell from 15 per cent to around 3 per cent in the United States



Note. Per cent and annual percentage change respectively.

Sources: Federal Reserve and U.S. Bureau of Labor Statistics.

# 1970s lesson – costly bring down inflation

Monetary policy must act when  
inflation begins rising

Active monetary policy to avoid  
losing credibility

Basic principles of inflation targeting

# Climate change – more analysis of economic effects needed

- Climate change a challenge for society
  - Physical risks in the form of extreme weather
  - Transition risks in the form of higher taxes and emission rights
  - Risks of tipping points in various ecosystems
- For central banks it is a question of
  - How the possibilities to meet price stability and financial stability targets are affected
  - How to support the transition to a less fossil-based economy

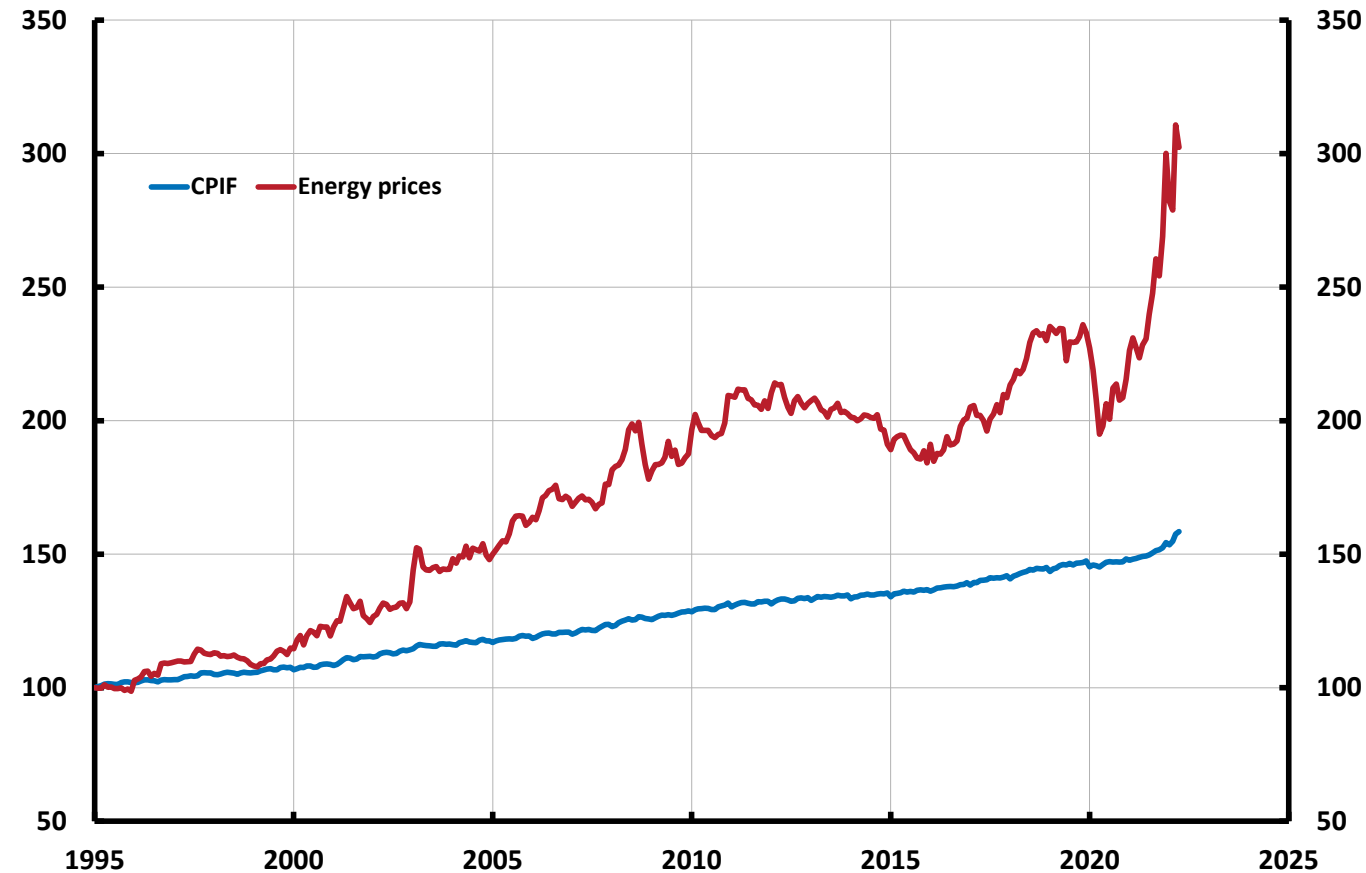


# Scenario analysis can illustrate macroeconomic risks



- NGFS scenarios show possible effects on inflation in Sweden
- Great uncertainty – differences relatively large in different scenarios
  - See Bylund and Jonsson (EK 2021) and NGFS website for more info
- Only increased energy prices – relative price change – need not affect inflation

# Historically energy prices have risen faster than CPIX – higher tax on energy



Note. Index, January 1995 = 100.

Sources: Statistics Sweden and the Riksbank.

# What can be improved?

- Some macroprudential policy tools should lie with the Riksbank
- Financial stability should be an independent monetary policy objective



# Macroprudential policy should be independent

Time inconsistency – both in both  
monetary policy and financial  
regulation

Follow-up, control and accountability  
should be adapted to macroprudential  
policy



# Coordination and financial dominance



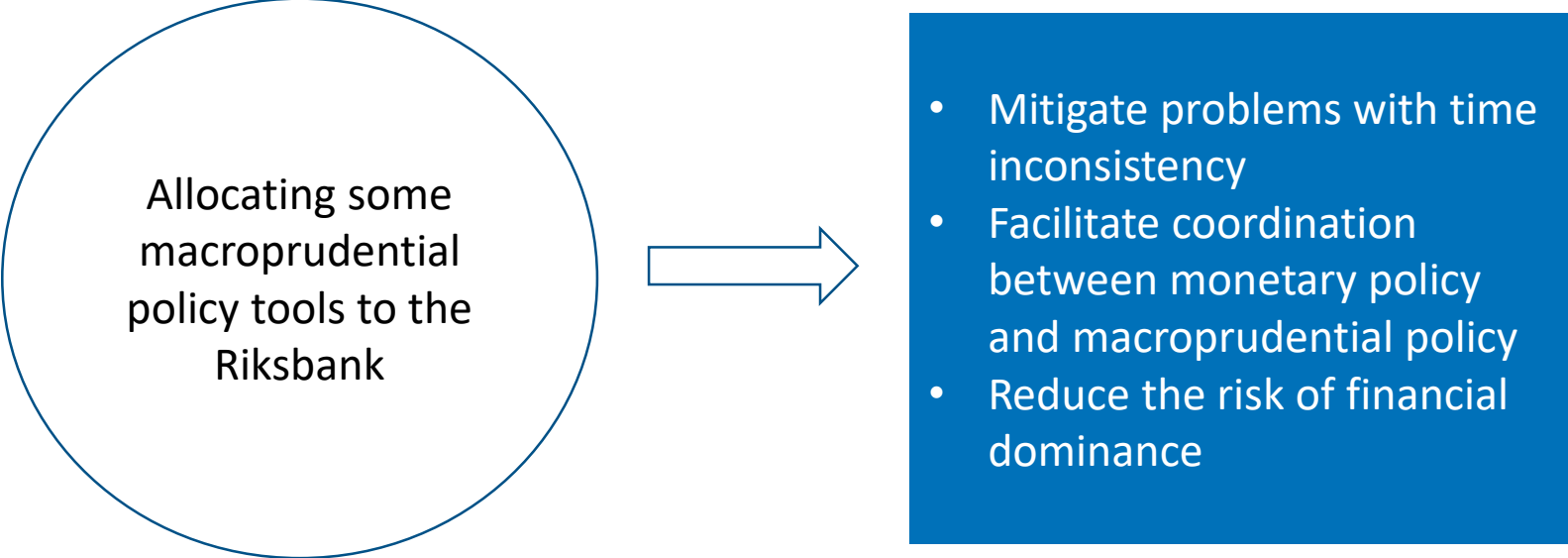
Monetary policy more effective if combined with effective macroprudential policy

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High and growing mortgage debts and consumption debts  
– financial dominance

# Some macroprudential policy tools should lie with the Riksbank



Allocating some  
macroprudential  
policy tools to the  
Riksbank

The diagram consists of a white circle on the left containing the text 'Allocating some macroprudential policy tools to the Riksbank'. A white arrow points from this circle to a blue rectangular box on the right. Inside the blue box is a bulleted list of three items: 'Mitigate problems with time inconsistency', 'Facilitate coordination between monetary policy and macroprudential policy', and 'Reduce the risk of financial dominance'.

- Mitigate problems with time inconsistency
- Facilitate coordination between monetary policy and macroprudential policy
- Reduce the risk of financial dominance

# Monetary policy should play a role in counteracting financial crises



- Price stability requires financial stability, at the same time monetary policy affects financial stability
- Imperfections on the financial markets have become larger
- Central banks with inflation targets give consideration to financial stability – Norges Bank, Bank of England, Bank of Canada, Reserve Bank of New Zealand

# The new Sveriges Riksbank Act



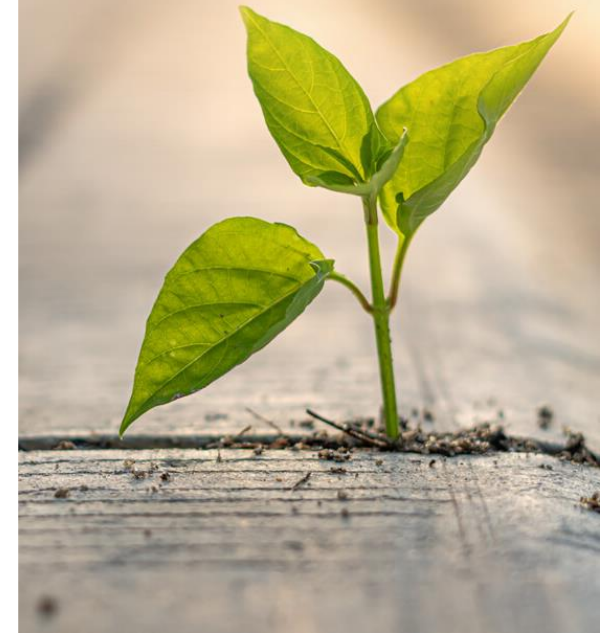
*“Monetary policy should take account of financial imbalances in the credit market and, if necessary, adjust the time frame within which the price stability objective is to be attained”*



*“Counteracting financial imbalances should not be an independent, subordinate objective of monetary policy”*

# The new Sveriges Riksbank Act risks making the mandate less clear

- The target for financial stability can be formulated in a similar way to the objective of supporting economic developments
- ***In addition to price stability, the Riksbank should place a certain emphasis on financial stability and economic developments in monetary policy decisions, that is, financial stability should be an argument in the Riksbank's objective function***



# Inflation targeting – a robust framework for the next 30 years?



Inflation-targeting policy resilient and adaptable – both in normal times and crises



A “killer app” – but updates need to be downloaded

- Some macroprudential policy tools should lie with the Riksbank
- Financial stability given weight in monetary policy decisions



With these updates: “the killer app” the next 30 years!

# Inflation target for almost 30 years: A robust framework for all time?