

Swedish monetary policy experiences after the global financial crisis: What lessons are there for other countries?

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Three aspects – themes of my speech

- The Riksbank is one of few central banks that have “leaned against the wind” (LAW) - and possibly the only one that has had to abandon this, at least temporarily.
- The expansionary policy in order to maintain the inflation target has involved major communicative challenges
- The use of cash is declining rapidly in Sweden - and is lower than in any other country

Theme 1: “Leaning against the wind” (LAW) – different viewpoints in research and among central banks



Research weighs effects against each other

- How effective a tool is the policy rate?
- Negative effects on the rest of the economy of higher interest rates?
- How effective are other tools (prudential policy, regulatory frameworks)?
- How easy are they to circumvent?
- The costs for crises that are avoided or mitigated?
- The result depends on assumptions; not leaning clearly in any direction

Practical policy

- Some central banks skeptical of LAW (e.g. Fed)
- Others have integrated LAW into formal framework (e.g. Norges Bank)

Personally positive to LAW

Why the Riksbank stopped “leaning” (for now)

Prior to 2014: Slightly higher policy rate due to concern over rising debts and housing prices, i.e. LAW

But surprisingly low inflation

- Slower recovery due to e.g. debt crisis
- Increasingly long period with sub-target inflation

Falling inflation expectations

- Risk of weakened confidence in the inflation target

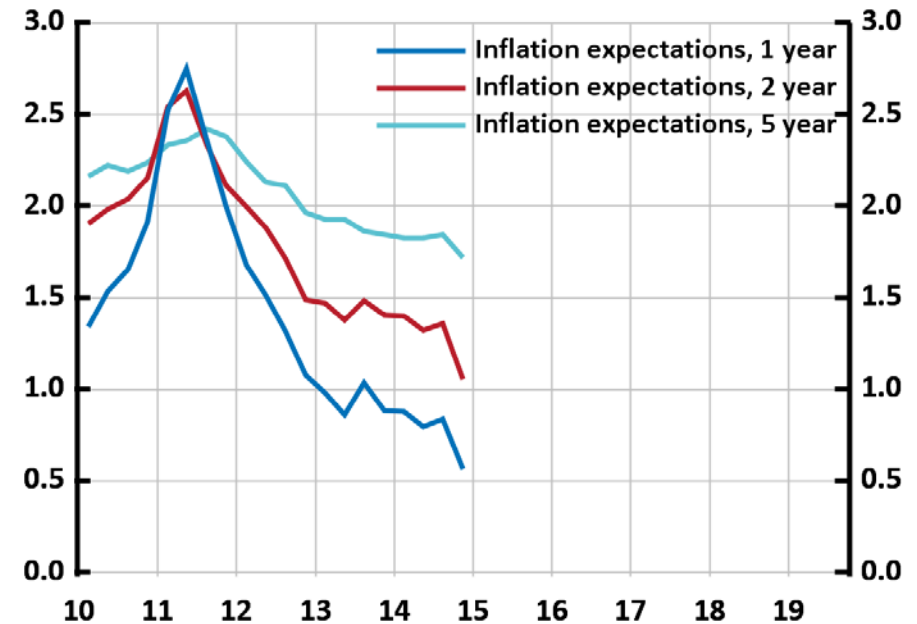
Risk of weakened confidence in the inflation target

Weak development of inflation...



Annual percentage change.

...and falling inflation expectations



Sources: Statistics Sweden and the Riksbank

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Important to bring up inflation to the target, no scope for LAW

- More expansionary policy, but the Riksbank has continued to stress the risks

Why the Riksbank stopped “leaning” (for now) (cont.)

Confidence aspect important difference compared with e.g. Norway

- Higher policy rate in Norway (1.5 per cent versus -0.25 per cent in Sweden)
- But confidence in the inflation target never under threat there in the same way as in Sweden

Conclusion: Difficult to apply LAW if confidence in the inflation target is threatened

Personally positive to LAW under normal circumstances

- A “fair-weather policy” – “windy but sunny”

The importance of maintaining confidence in the inflation target overlooked in the research?

- Cost of LAW normally: Lower inflation and growth in the short term
- But also costly to lose and re-establish confidence in the inflation target!

So how have things turned out?

- Inflation back on target in 2017
- Inflation expectations have risen at pace with inflation
- By and large good development of growth and employment
- But weaker development most recently

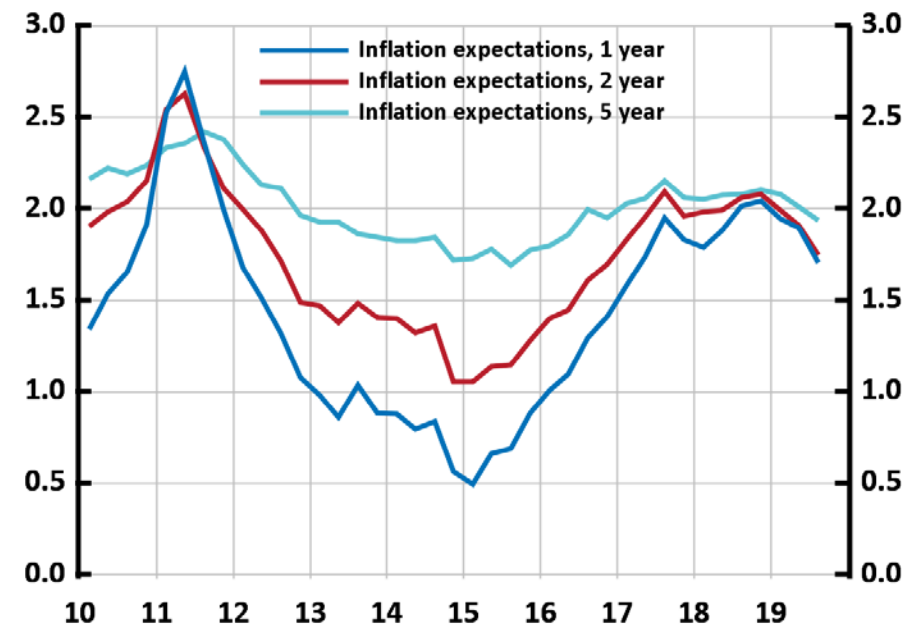
Inflation again near target and good development of the real economy

Inflation in line with target...



Annual percentage change.

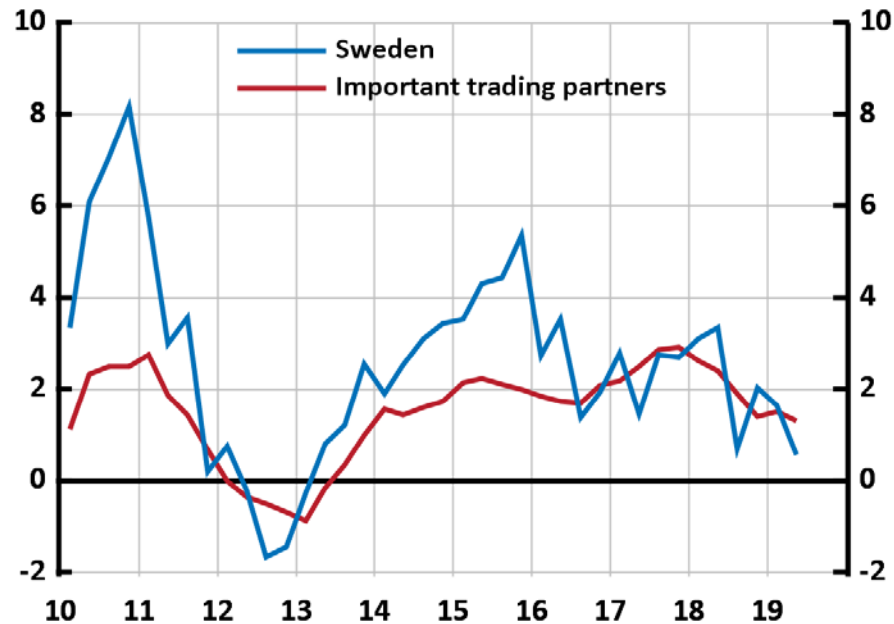
...and anchored expectations



Sources: Statistics Sweden and Sveriges Riksbank

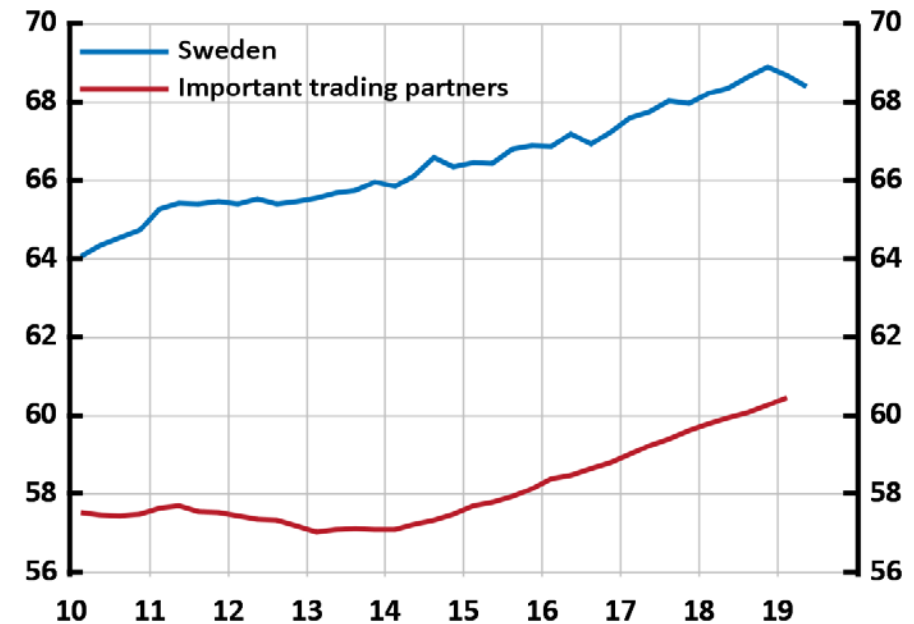
Inflation again near target and good development of the real economy

...with solid GDP growth...



Annual percentage change and percent of population aged 15-74 years old respectively.

...and high employment rate



Sources: Statistics Sweden and Sveriges Riksbank

Theme 2: Major communicative challenges posed by the expansionary policy

Intensive debate despite good target attainment and good development of the real economy

Probably due to major discrepancy between

- Policy required to maintain confidence in the inflation target
- Policy motivated by the economy at large, if the Riksbank had **not** needed to consider the inflation target

Two main themes in the criticism

- Before: “Expansionary policy exacerbates the problems of debt and housing prices”

Calmer developments on the housing market



House price index (HOX), January 2005 =100.

Sources: Valueguard and the Riksbank

Major communicative challenges posed by the expansionary policy

Intensive debate despite good target attainment and good development of the real economy

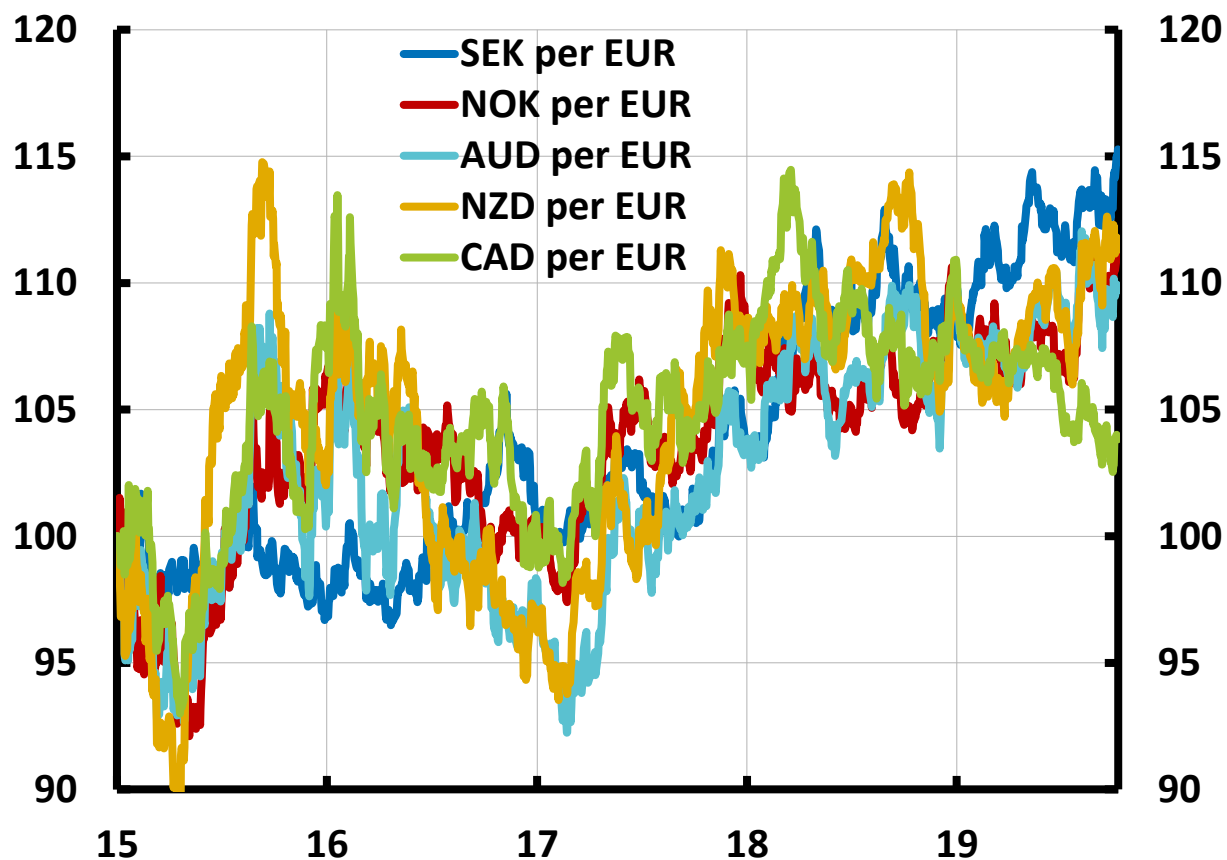
Major discrepancy between

- Policy required to maintain confidence in the inflation target
- Policy motivated by the economy at large, if the Riksbank had *not* needed to consider the inflation target

Two main themes in the criticism

- Before: “Expansionary policy exacerbates the problems of debt and housing prices”
- Recently: “The krona is depreciating too much”

Weaker krona



Index, 2 January 2015 = 100.

Source: ECB

Similar development in small open economies

- But SEK currently somewhat weak even in such a comparison

Almost all countries have an inflation target of 2 per cent

- SEK is hardly on a “slippery slope”

Can still be long-term trends in SEK

- Can depend on trends in the *real* exchange rate
- Structural causes, e.g. differences in productivity

Perspectives on the debate

The Riksbank has fulfilled its objective from the Riksdag well in recent years

Criticism seems therefore to be mainly of the objective itself – even though it is seldom put that way

The Riksbank has found it difficult to create sufficient understanding for

- Why we have needed to conduct the policy we have conducted
- Why we have the objective we have
- The advantages of an inflation target of 2 per cent compared with other targets

Perspectives on the debate (cont.)

The arguments for maintaining confidence in the target of 2 per cent are relatively abstract

- Some inflation “grease” for wage formation (easier to change relative wages)
- Permanently very low inflation means policy rates more often at the “lower bound”
 - More difficult for monetary policy to mitigate recessions
 - More of negative policy rates

Have to compete with more intuitive arguments

- Negative policy rates “unnatural”
- Policy rate negative for a long time, “crisis rate in a boom”
- Expansionary policy leads to a weak krona
- Expansionary policy leads to continued rising lending

Difficult communication!

Conclusion on the communicative challenges

Good with regular public reviews of central bank objectives

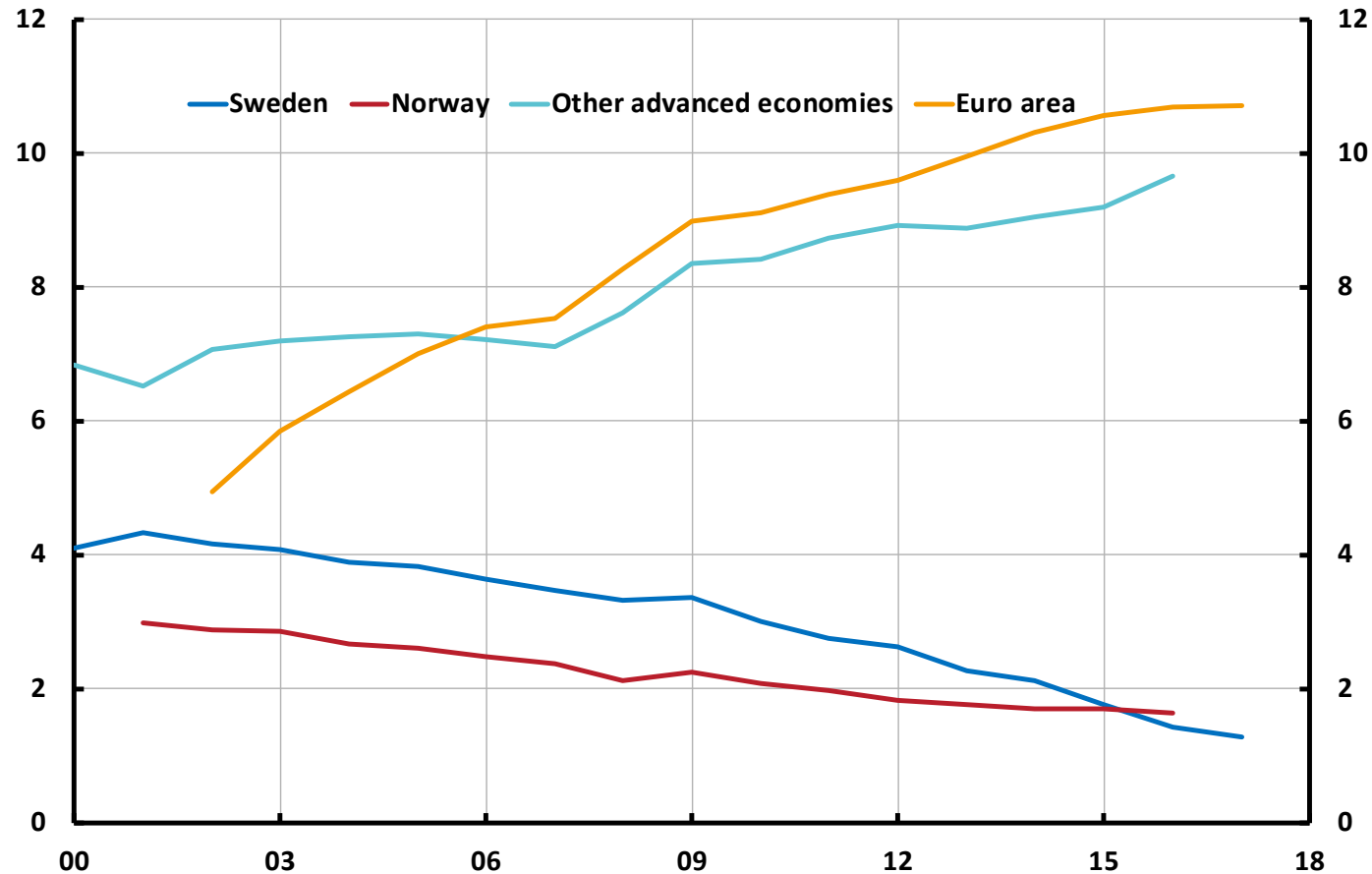
- Canada's "Inflation-Control Agreement" an example
- Perhaps not as often as every fifth year?

Better understanding and greater legitimacy for the policy the central bank needs to pursue

- Questions in the debate are regularly analyzed in an objective and scientific way
- Clarify that the central bank only does what it is supposed to do

Ways of counteracting forces internationally looking to make central banks less independent?

Theme 3: Rapidly declining use of cash in Sweden



Cash as a percentage of GDP.

Sources: BIS, ECB and Sveriges Riksbank.

Raises fundamental questions

If the trend continues, cash may soon no longer be generally accepted

There will no longer be a means of payment guaranteed by the state

- All means of payment issued and controlled by private actors

How does this affect the Riksbank's scope for successfully “promoting a safe and efficient payment system”?

The Riksbank considering an e-krona

The Riksbank is considering an e-krona

Far from alone: Cryptocurrencies like Libra, etc., putting pressure on all central banks

- But more acute for the Riksbank due to shrinking cash use

Two reports on the e-krona so far

Public inquiry required for a decision

- Swedish Government Offices currently penning terms of reference

Effects on monetary policy of an e-krona

Interest-bearing or not?

Non-interest-bearing e-krona probably raises the lower bound for the policy rate to zero

- Less costly than holding large volumes of cash (storage, transport, insurance)
- Negative policy rates of recent years not possible

Interest-bearing e-krona reduces the lower bound

- Negative return on the e-krona itself
- New monetary policy instrument
- Major change, legality unclear

Not so many lessons as of yet, ongoing process

Changes in the payment system pose major demands for innovation and adaptability – even though they seldom happen

Once the right conditions are in place, changes in payment patterns can happen quickly

- 2010: about 40 per cent of Swedes paid by cash (latest transaction)
- 2018: about 13 per cent

My vision of the Swedish payment system in the future

- Definition of legal electronic tender
- E-krona as legal tender
- Possible to make payments around the clock, all year round, in e-krona
- At least smaller transactions between currencies
- Electronic state ID documents
- Physical banknotes in different parts of the country as a contingency measure

Summing up

The Riksbank possibly the only central bank that has needed to stop “leaning against the wind”, at least temporarily

- Conclusion: Difficult to continue LAW in practice if confidence in the inflation target is threatened

Intensive debate on expansionary policy to bring inflation back to target

- Conclusion: Regular reviews of policy objective (e.g. Canada) create better understanding and legitimacy, counteract forces towards less independent central banks

Rapidly declining cash use

- Conclusion: Sensible for other central banks to prepare as the process can be rapid