SPEECH

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SPEAKER: Deputy governor Martin Flodén

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Communicating future monetary policy – reflections after eleven years as member of the Riksbank's Executive Board *

Thanks for the invitation to come here!

As this is one of the last speeches I will give before I leave the Riksbank, I would like to take this opportunity to look back over time as member of the Executive Board. It has been an eventful eleven years, which of course cannot be easily summarised in one brief speech. I will therefore focus on something that throughout this period has been central to our work, namely our monetary policy communication. More specifically, I am thinking here about how we use the forecast for the policy rate and the minutes of the monetary policy meetings, where the Riksbank has chosen a different path from many other central banks.

Our aim is to communicate as clearly as possible both about the motives behind the monetary policy we are conducting now, and about how it may develop going forward. This is not an easy task. The economy is constantly being subjected to new shocks to which we must adapt. Our communication must relate to monetary policy navigating its way in an uncertain world, but without being void of content. Today I shall try to illustrate some of the problems we have faced, and some of the lessons learned from occasions when we ought perhaps to have communicated more effectively.

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From secrecy to transparency

Let me first take a few steps back in time. Common to almost all central banks is that their communication changed completely in the 1990s and early 2000s. Previously, monetary policy was linked to secrecy and mystery.[1] Two quotations are often used to illustrate this:

“Never explain, never excuse” by Montagu Norman, Governor of the Bank of England 1920-1944.

“Since becoming a central banker, I have learned to mumble with great incoherence. If I seem unduly clear to you, you must have misunderstood what I said” by Alan Greenspan, Chairman of the Federal Reserve 1987–2006.

Today, things look quite different. Following the collapse of the Bretton Woods system, and the ensuing high inflation in the 1970s and 1980s, central banks were given a clearer mandate to independently ensure price stability, often focusing on a specific inflation target.

Both the delegation to independent central banks and the transition to inflation targeting put new demands on the central banks. Their endeavours to attain greater openness and clearer communication are partly explained by the need for *accountability* that follows on from the central banks’ increased independence, and partly by the importance of *expectations* for monetary policy in an inflation targeting regime.

Independence and accountability are two sides of the same coin

Independent central banks need to be evaluated, both by the political system and by the citizens. Building confidence, creating legitimacy and popular understanding are necessary to ensure that the general public supports the central bank’s independence. And to attain this, the central banks must show that they are “doing their job”; they must be evaluated and made accountable for their decisions.

One means of evaluating a central bank's work that may appear reasonable at first sight is through target attainment. If inflation is at the target, monetary policy has been successful, otherwise not. But it is not that simple. Monetary policy has an impact with a time lag, and the economy is constantly being subjected to new shocks that affect both inflation and economic activity. The work of the central banks must therefore be evaluated on the basis of the conditions applying when the decisions were taken.

Transparency, insight and openness are fundamental conditions for such an evaluation. What information were the decisions based on? How was this information analysed and assessed? What deliberations did the decision-makers face? Were the analysis, deliberations and decisions reasonable given this information?

Monetary policy impact through expectations

The central banks’ most concrete tool is the policy rate, that is, the interest rate on a liquid and safe asset with a short maturity. This rate is important in itself, but

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[1] See, for example, Goodfriend (1986) and Blinder (2004).

the indirect effects that it has are even more important. One such effect is that households and companies that make decisions must be able to form an idea not only of what the interest rate is now, but also of how both the interest rate and the value of money – the price level – will develop over time.

In other words, monetary policy to a large degree has its impact through expectations. A central bank can try to affect expectations by communicating how it will probably manage the policy rate and other monetary policy measures going forward. Communication is thus an integral part of the monetary policy strategy. If the communication of monetary policy is transparent, factual and clear it also makes it easier for economic agents to make good economic decisions. Monetary policy thus functions better and more efficiently when a central bank is clear about its objectives and the reasons for its decisions.

The Riksbank's transparency and communication stand out

The changes in the Riksbank's transparency and communication culminated in 2007, when the bank began to publish attributed minutes of the monetary policy meetings and also a forecast for the development of the policy rate a few years ahead.

The Riksbank had gone in a short time from being a relatively closed central bank to becoming one of the world's most open central banks.[2] One could say that the bank went from "say as little as possible and say it cryptically" to "say as much as possible in plain language".[3]

These changes, which were made a few years before I came to the Riksbank, have characterised my eleven years on the Executive Board. Communication has always been a central part of our monetary policy work. In an international comparison, the Riksbank's *minutes from monetary policy meetings* and *forecast for the policy rate* stand out as rather special. Some say that the openness may have gone too far. I don't think so. But the communication needs to be constantly evaluated and updated. Communication that has not been carefully considered and properly planned can be damaging rather than beneficial.

Today I would like to share some thoughts regarding the minutes and the policy rate forecasts. I will try to explain why I think that they are so important and useful in the Swedish context, where we need to communicate both the Riksbank's overall view and the views of the individual board members. But I will also mention some pitfalls that I hope future Executive Boards will be able to avoid.

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[2] The Riksbank is still considered one of the most transparent central banks. For example, Dincer, Eichengreen and Geraats (2022) rank the Riksbank as the most transparent of the 112 central banks they examine.
[3] See Meyersson and Petrelius Karlberg (2012).

The minutes facilitate both scrutiny and decision-making

In Sweden, each Executive Board member has an individual responsibility.[4] It is therefore important for each and every one of us on the Executive Board to explain and motivate our individual monetary policy stance and the deliberations behind it.

The Riksbank has been publishing minutes from the monetary policy meetings since 1999, where it is possible to read whether and why a member of the Executive Board has entered a reservation against the monetary policy decision. With effect from 2007, the members' personal reasoning was attributed to them in the minutes and we now publish these minutes around one week after the decision. The minutes provide an exact reproduction of what each Executive Board member has said, with minimal editing.[5]

The fact that the minutes are published in this way has meant that we Executive Board members carefully prepare our contributions. There is therefore rarely any spontaneous exchange of views at the meeting. The important discussions and exchanges of views tend to take place instead at a number of meetings between the Executive Board and the bank employees in the weeks prior to the monetary policy meeting.[6] However, this does not mean that the monetary policy meetings are uninteresting or unimportant. The minutes with our statements at the monetary policy meetings, fulfil several important functions.

Clarify each member's individual responsibility

To begin with, the minutes of the meetings clarify the Board members' individual responsibility for the monetary policy decisions. Each member of the Executive Board needs to account for their own views on monetary policy and on which forecasts, deliberations and analyses these are based.

If one Board member has views that differ to a significant degree from the majority decision, then he or she should of course enter a reservation against the decision. The minutes then become a platform where one can explain and justify in greater detail how one's own analysis differs from the majority.

An outlet for opinions that facilitates joint decision-making

Another important function of the minutes is that they facilitate our joint decision-making. The monetary policy decisions do not only concern the current policy rate, the Executive Board also decides on the forecasts and the monetary policy reports with all the analyses and deliberations presented in them.

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[4] For example, the Sveriges Riksbank Act states that the minutes of the monetary policy meetings shall represent the stances the members have expressed.
[5] Other central banks that describe their monetary policy committee's monetary policy discussions in detail usually publish these accounts with a long time lag, often five or ten years. It is, however, common that central banks publish a brief summary of the discussion at the monetary policy meeting soon afterwards, but (with the exception of the Czech central bank) without stating what individual members have said.
[6] The minutes also contain a brief summary of the discussions held during the preparatory meetings. The minutes are published on our website in Swedish and translated into English.

Of course, not all of the Executive Board members have identical opinions on all of this, but it is not reasonable that we should enter reservations on details in the underlying reports or that each one of us should produce his or her own monetary policy report.[7] The decision is therefore always to some extent a compromise. And this compromise becomes easier to accept when we have an outlet where we can discuss the nuances of the underlying reports.

Stability and consistency over time

Moreover, the minutes force the members to take responsibility for their own stances over time. It becomes more difficult for a member to quickly and without good justification change their opinion on a question on which they have earlier communicated a particular stance. This can be both a good thing and a bad thing, but I believe that the advantages outweigh in that monetary policy becomes a little more consistent and predictable.

Regular and synchronised communication to the markets

A further advantage with the minutes is that they contribute to clearer communication, particularly towards the financial markets. As the contributions to the monetary policy meetings function in the same way as published speeches on monetary policy, the market receives a regular and synchronised update on each Board member's views on monetary policy.

The contributions to the minutes then form a basis for the various monetary policy speeches that we hold between the monetary policy meetings. When holding these speeches we can try to further explain and clarify how we see monetary policy, but the idea is that they should not be about new assessments or stances.

We do this to make it clear that the decisions are taken at the monetary policy meetings, and not on random occasions in between. It is at the monetary policy meetings that Executive Board members formulate and document their views on monetary policy and the considerations they are facing. This means that we avoid the “signalling by degrees” that was previously common in connection with the Executive Board’s speeches.[8]

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[7] Blinder (2007) highlights related problems experienced by the Bank of England. Their monetary policy committee is, just like the Riksbank's, what Blinder calls “individualistic”. On some occasions the members have been unanimous with regard to the formulation of monetary policy, but not to the motives for the decision.

[8] See Meyersson and Petrelius Karlberg (pp. 54-55). What they mean with “signalling by degrees” is that the members regularly provide new information in their speeches between the monetary policy meetings on what monetary policy they will advocate at the next meeting. The monetary policy decisions then become more predictable, but communication does not become clearer or more effective. For example, it becomes unclear when the decisions are made and what analyses they are based on. There is also a risk that different actors will receive information at different points in time. Moreover, at the meetings the members may feel bound by the statements they have already made and thus be less receptive to the bank employees’ analyses and their colleagues’ reasoning.

The interest rate forecasts characterise the Riksbank's monetary policy process

Different central banks have chosen to communicate their future monetary policy in different ways. The Riksbank is one of few central banks that publishes a forecast for the policy rate that all or a majority of the Executive Board supports.[9]

There are of course other ways of communicating the future policy rate. Every method has its pros and cons. The method that is the most appropriate for each respective central bank can depend, for example, on the size and composition of the monetary policy committee.

Let me focus on the forecasts for the policy rate that we at the Riksbank use. This is the method that I am most familiar with, and moreover it characterises the Riksbank's entire monetary policy work. I think that it characterises the work in a positive way, but with some potential pitfalls that I hope can be avoided going forward.

I will return to the pitfalls in a moment, but first I would like to mention the most positive consequence of producing and publishing forecasts for the policy rate.

More intelligent conversations on monetary policy

We publish forecasts for inflation and the real economy. How these variable develop depends on what monetary policy is conducted. A forecast that does not show which monetary policy it is based on is therefore incomprehensible.

The fact that it is the Executive Board that stands behind the Riksbank's forecasts means that we are forced to discuss the relationship between monetary policy and the rest of economic policy during the monetary policy drafting process. The Riksbank's external discussions also benefit from these relationships being clarified.

One illustration of this is that inflation in our forecasts is almost always close to the target in two or three years' time. This is no law of nature, but a consequence of what we regard as well-balanced monetary policy. If we instead were to see that inflation in the forecast deviates from the target for a long period of time, it would probably be appropriate to change the monetary policy plan.

This also works in reverse. If someone, for example in our monetary policy drafting process or in an external discussion, were to advocate a different monetary policy plan, one would also need to explain why that plan is better. Does one have a different view of what outcome is desirable? Does one have a different view of what impact a particular monetary policy will have on inflation and the real economy? Or does one have a different view on other parts of the forecast?

[9] The central banks in Norway and New Zealand also publish forecasts for their policy rates. Unlike the Riksbank, their monetary policy committees are what Blinder (2007) calls "collegial". All of the members support the decisions, and they do not report their individual views of the monetary policy.

The communication of interest rate forecasts is difficult

Our policy rate forecasts often receive a lot of attention. They are discussed both in the media and on the financial markets. It is good that this discussion arises, and sometimes it has shown that we have not used the forecast in the right way or that our communication has been unclear. Allow me to now discuss some of the pitfalls and problems that the policy rate forecasts have faced.

A few years ago we evaluated the experiences of publishing interest rate forecasts and we could then conclude that the experiences were essentially positive. The general public had gained greater insight into monetary policy, and interest rate forecasts had created better opportunities for open discussion and evaluation of monetary policy externally. Moreover, few of the concerns raised when policy rate forecasts were introduced in 2007 had been realised.[10]

However, we did also identify some problems. One was that policy rate forecasts had not been particularly accurate. Another was that there had periodically been major differences between the policy rate forecasts made by the market and those made by the Riksbank. These problems remain, but there are further challenges in forecasting interest rates that I would like to comment on.

The tail-end lacks strength

Rosenberg (2007) stated that the main reason for beginning to publish our own policy rate forecast was that it would make it easier for the central bank to steer expectations of future monetary policy.

In practice, this has proved difficult. Policy rate forecasts have not become a powerful addition to the Riksbank's toolbox. The Riksbank’s policy rate forecasts have often been very different from market expectations, and when the forecast has been changed, it has usually been in the direction the market was already expecting. Although several studies show that market rates have been affected by changes in the Riksbank’s policy rate forecasts, the impact on market rates has been marginal and primarily concerned shorter horizons.[11]

My conclusion from this is that the policy rate forecasts should not be regarded as a substitute for actual policy rate decisions. Communication of how monetary policy is expected to develop in the coming period does affect market expectations and is an important complement to the policy rate decisions. But most central banks communicate this type of information in some way, with or without an interest rate forecast. The method the Riksbank uses, with an explicit forecast, functions well in that the communication becomes clear and straightforward.

To influence expectations in the slightly longer run, communication needs to be stronger than a forecast; it needs to be more of a promise. The Riksbank has been cautious with this type of information, and in my view very wisely so.[12]

[10] See Sveriges Riksbank (2017).
[11] See Åhl (2017), Iversen and Tysklind (2017) and also Hofmann and Xia (2022).
[12] I do not want to enter into a discussion today on the pros and cons of *forward guidance*, but I note that the experiences of this are not solely positive for central banks that have tried to make binding commitments regarding future monetary policy.

On some occasions we have nevertheless communicated as if changes in the tail-end of the policy rate forecast, that is, the part of the forecast furthest in the future, meant that monetary policy became more or less expansionary. One example of this is the meeting in April 2013, just before I joined the Executive Board. Then, the forecasts for inflation and the policy rate were revised down substantially, but the policy rate was left unchanged at 1 per cent. In December 2014 we also communicated that a plan to hold the interest rate at zero for a longer period of time meant that monetary policy became more expansionary.[13]

In both cases, I believe that there was an unwillingness, for different reasons, to cut the policy rate but that we nevertheless wanted to show an ability to take action. Then we regarded changes in the policy rate forecast as a means of describing monetary policy as more expansionary despite the policy rate not being cut. It would have been better to explain clearly why we did not consider that the policy rate should be cut, despite the inflation forecast being worryingly low.[14]

Unwillingness to change the policy rate forecast

One concern that was mentioned when policy rate forecasts were introduced was that they would be perceived as binding commitments. Some said that it would be regarded as a failure by the central bank if it deviated from the earlier forecast. A fear of this could lead to the Executive Board following the policy rate forecast in its decisions, even if new information indicated that there was motive for other decisions.

However, there is little to indicate that this concern has been realised. It has always been made clear in the Riksbank's communication that the policy rate forecast is not a promise, and the forecast has not in practice prevented the Executive Board from making new decisions.[15] This is most clearly illustrated in the monetary policy decision in April 2022. We then raised the policy rate, despite the forecast at the previous meeting in February 2022 being for the rate to remain at zero per cent for the coming two years.

On the other hand, I have noticed a similar problem: an unwillingness to change the policy rate *forecast*. Central banks want monetary policy to be predictable. To give economic agents time to adapt to new conditions, it is preferable to make gradual and small changes to the interest rates.[16] The theoretical arguments for this type of

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[13] The motive given in April 2013 was: "The repo rate needs to remain at around 1 per cent until the second half of 2014, to stimulate demand and ensure that inflation rises towards the target. This is almost a year longer than was forecast in February." In December 2014 the motive was: "For inflation to rise towards the target sufficiently quickly and to reduce the risk of longer-run inflation expectations continuing to fall, monetary policy needs to become more expansionary. The Executive Board of the Riksbank therefore assesses that the repo rate needs to remain at zero per cent for a somewhat longer period than was forecast in October."

[14] In their evaluation of the Riksbank's monetary policy 2010-2015, Goodfriend and King (2016) expressed similar criticism. They said that the Executive Board members had focused too much on forecasts for the policy rate further ahead in time, rather than how it should be set in the near term.

[15] The decision in December 2018 is a possible exception. A divided Executive Board then raised the policy rate from -0.50 to -0.25 per cent, despite new information since the previous meeting indicating both lower inflation and weaker economic activity. The Governor then stated at the meeting that "[W]e have constantly anticipated gradually increasing the repo rate when the conditions are right. In more concrete terms – over the last six months, the forecasts and assessments that have formed the basis for our monetary policy decisions have been based on the assumption that the repo rate would be increased towards the end of 2018. This has been clear from our communication and has been visible in the repo rate paths."

[16] For example, Rosenberg (2007) expressed this as a principle for the Riksbank.

interest rate smoothing may not be entirely convincing, but in practice it is a sound principle.

But this unwillingness also seems to apply, perhaps even more so, to communication regarding future policy rates. The unwillingness applies to both large and small changes. Between every monetary policy meeting we always receive new information on how the economy is developing. As a result, we almost always change our forecasts for inflation and the real economy, even if the revisions are very small. But the interest rate forecast is an exception. We have often chosen to publish a forecast that is identical with the previous one.

The argument for not making small changes in the policy rate forecast is typically that this would indicate that monetary policy reacts to noise or unimportant new information. One risk I see here is that this "noise" accumulates into something more significant over time. Finally, we have a policy rate forecast that deviates far from what the market, and perhaps even we ourselves, believes. And in this situation it can be difficult to make a major revision to the forecast, as there is no important new information to attach the revision to.

In our most recent Monetary Policy Report we only highlighted our forecast for the policy rate in the coming three quarters in connection with the monetary policy deliberations at the beginning of the report. The forecast for the policy rate during the remainder of the forecast period was presented later on in the report. This division will hopefully make it easier to allow new information to affect the forecasts for the policy rate beyond the next couple of meetings, even if it can be regarded as noise.

An expected value does not always appear to be a reasonable scenario

The Riksbank's policy rate forecasts in autumn 2023 have been called into question, particularly by participants in the financial markets. In November last year, our forecast was that the policy rate would remain at around 4 per cent until the middle of 2025. The criticism we received was in two parts. One was a claim that it was difficult to understand why the policy rate should remain unchanged at a tightening level when the forecast for inflation was that it would fairly soon be at the target level. The other was a claim that the forecast was unrealistic, as both pricing on the financial markets and the forecasts of several other analysts indicated that the policy rate would be cut by at least one percentage point during the same period.

I think it is fairly easy to dismiss the first part of this criticism. Our forecasts are normally expected values, and the expected values for various scenarios do not necessarily appear to be a reasonable scenario in themselves.

Last year, we were worried that inflation had repeatedly been much higher than both we and other analysts had expected, at the same time as the real economy showed surprising strength. Another way of expressing this is that our interest rate hikes had become less contractionary than expected.[17] One can see our forecast as the average of two scenarios for how much the policy rate would need to be raised

[17] A further way of expressing this is that the short-term so-called neutral interest rate was higher than we believed.

to be sufficiently contractionary.[18] In one scenario, the policy rate would need to continue to be raised, while in the second scenario, it could soon begin to be cut. However, in both scenarios inflation would fairly soon be brought back to the target and developments for the real economy would also be similar.[19]

The second part of the criticism is a little more difficult to deal with. Many people probably believe that we Executive Board members tried to use the tail-end of the interest-rate forecast horizon to signal a monetary policy we didn't really believe in. It is true that we have been worried that the discussions on interest rate cuts may mean that monetary policy becomes unjustifiably expansionary. I nevertheless think that such concerns were not the motive behind our interest-rate forecasts in the autumn. We were genuinely uncertain over whether monetary policy had become sufficiently contractionary for inflation to fall back to the target within a reasonable period of time.

In general, I think that some of this uncertainty remains today, despite inflation prospects looking brighter and our interest rate forecast having been lowered significantly. Our forecast at the monetary policy meeting in March was that the policy rate can probably be cut at one of the next two monetary policy meetings. But this is not a promise.

At the meeting, I pointed out several risks that could put a spanner in the works for early policy rate cuts: a continued weakening of the krona, a continued strong US economy, rising commodity prices and a rapid increase in demand in the Swedish economy, too. We have seen signs of all of this in recent weeks. But we have also received a new inflation outcome, for March. Inflation was much lower than our forecast, which reinforces the picture that inflationary pressures will soon have normalised and that we can begin to ease our monetary policy. We will return to the implications of all this for the policy rate decisions in a few weeks' time, at the next monetary policy meeting.

The forecast has sometimes been a main scenario rather than an expected value

On some occasions, I believe that we ourselves have contributed to confusion by thinking of the policy rate forecast as a main scenario, that is, the most likely scenario, rather than an expected value. I am thinking in particular of when the interest rate was at or close to its lower bound.

The monetary policy meeting in February 2022 is an example here. The policy rate was then at zero per cent. Although we have previously shown that it is possible to cut the policy rate to lower levels, many probably consider that fairly strong reasons would be needed to return to a negative policy rate. Moreover, at the beginning of

[18] In the Monetary Policy Report published in November 2023, we showed two scenarios similar to those I am describing here. The average of the scenarios implies that the forecast for the policy rate is fairly flat at the same time as inflation moves towards the target, roughly as in our forecast. However, to fit my description here the cause of the scenario with high inflation ought to have been either that monetary policy had a smaller than expected impact or that economic activity was unexpectedly strong.

[19] A similar discussion was held with regard to international monetary policy last year. The question was asked whether the development of the interest rate should be more similar to the Matterhorn (steeply upwards and then steeply downwards) rather than Table Mountain (become stuck on a high plateau). My point is that the forecast can be similar to a Table Mountain when one moves upwards even though one knows that developments *ex post* will look similar to the Matterhorn; if one does not know how high the mountain is, one doesn't know how long one will need to climb before going downwards again.

2022 there was nothing to indicate that monetary policy would need to become more expansionary. The discussion instead concerned how one should interpret the high US inflation and the rising energy prices in Sweden and abroad. How long would the US inflation last? What risks were there that it would also spread to Sweden? Would the high energy prices spread to other prices?

Our analyses at the Riksbank concluded that the risk of inflation accelerating in Sweden had increased. However, the inflation outcomes we had received indicated that inflationary pressures were still weak. For instance, underlying inflation had fallen to 1.7 per cent in the most recent outcome. Although some service prices rose quickly, they seemed to be prices that were restored to normal after falling during the pandemic. And Russia had not yet begun its full-scale invasion of Ukraine.

A reasonable *scenario* was therefore that the environment of the past decade or so with weak inflationary pressures and low interest rates both in Sweden and abroad would persist. This was reflected in our policy rate forecast, where we assessed, as before, that it would be appropriate to hold the policy rate at zero per cent for several years. But at the same time, the risks linked to this scenario had changed and were fairly clearly on the upside with regard to inflation. However, the changed risk outlook was not reflected in the forecast for the policy rate. The forecast we presented was thus hardly unbiased, but rather the most likely outcome. We should have made this clear both to ourselves and externally.

With hindsight, it is also easy to see that the alternative scenario we analysed in the Monetary Policy Report should have been based on a larger change in inflationary pressures. The starting point could instead have been that inflation began to accelerate in Sweden in the same way as in the United States.[20]

Interest rate forecast becomes a natural starting point for alternative scenarios

The Riksbank realised early on that one can illustrate several aspects of monetary policy if the policy rate forecast is used as the starting point for alternative scenarios. One can illustrate the trade-offs between inflation and economic activity by showing how the economy would develop in the forecast if one planned for a more or a less contractionary policy rate going forward. One can also illustrate the monetary policy reaction function by showing how the interest rate forecast would change if the economy were subjected to a specific shock. And more generally, one can illustrate that uncertainty is not isolated to individual variables, but that they covary and are also affected by the monetary policy stance.

When the policy rate forecast was first published in the January 2007 Monetary Policy Report, a whole chapter of the report was therefore aimed at analysing scenarios in which the economy was subjected to unexpected shocks and where

[20] Hassler, Krusell and Seim (2023) criticised the Riksbank in their evaluation of monetary policy 2022 for not having analysed a scenario where inflation began rising rapidly at the beginning of the year. The alternative scenario in the February 2022 Monetary Policy Report was that the high energy prices would affect inflation expectations and wage formation. Inflationary pressures a few years ahead would then become higher, and the policy rate would have begun to be raised in spring 2023 instead of in 2024.

monetary policy was made more or less expansionary. This is how the reports looked until summer 2014. After that, alternative scenarios have been used in different ways at different points in time.

The Riksbank's alternative scenarios have recently been highlighted as an international role model.[21] But presenting scenarios with meaningful content is not easy. The monetary policy process is intensive and complicated. The Executive Board shall decide on the policy rate here and now, but it should also take a stance on the forecast, including the policy rate forecast, and all analyses presented in the Monetary Policy Report. In this process it is difficult to devote the same amount of attention to the alternative scenarios. The scenarios therefore often became to a large extent the result of model analyses with our forecast – "the main scenario" – as starting point.

This led to a number of problems that I believe together contributed to our giving the scenarios less scope for a number of years.

The Executive Board needs to take responsibility for the scenarios

The first problem is that the scenarios become misleading if the Executive Board has not taken a stance on them. The forecast, and particularly the forecast for the policy rate, is to a large degree the result of assessments. Therefore, a scenario that is to a greater degree based on model analyses risks becoming misleading. If developments begin to be similar to those in the scenario, the Executive Board may not want to react at all as the scenario indicated.

Difficult to analyse and agree on relevant scenarios

To ensure the model analysis does not become too dominant, the Executive Board needs to take an active interest in the scenarios to be presented. Which scenarios are the most relevant? And how does the Executive Board think that monetary policy should react to them?

Further problems arises here. It is not possible in practice to analyse the conditions for a hypothetical scenario in the same amount of detail as for a real situation that one is experiencing. The scenario therefore cannot be as well-developed as the forecast. Moreover, as I said, the decision-making process is already complicated. The Executive Board can have difficulty agreeing on which scenarios are most relevant to show and how monetary policy should react in these scenarios.

Relevant risks have been difficult to analyse in scenarios

A recurring question during my first years on the Executive Board, around 2013 and the beginning of 2014, was how one would balance monetary policy stimulus against the risk of financial imbalances building up. It was pointed out already in connection with the first scenarios in the 2007 Monetary Policy Report that such risks are difficult to quantify with the Riksbank's forecasting methods. The question became increasingly controversial between members of the Executive Board, which contributed to making it more difficult to work with the scenarios.

[21] See Financial Times U.K. edition, 3 April 2024, "BoE faces 'once in generation' forecasting reform".

A similar, and to me more important, problem that has been prominent in the past decade is how to manage expectations and confidence in the inflation target in the scenarios. We struggled for many years with an inflation rate that was too low. In recent years our concern has instead been over an excessively high inflation rate.

It has been difficult in these situations to quantify and analyse the relevant risks and trade-offs in scenarios. For example, the relevant alternatives one year ago did not stand between on the one hand our planned monetary policy and on the other hand a slightly softer monetary policy that would mean it took slightly longer for inflation to fall back to the target, but that economic activity would be slightly better.

The risk we have worried about and needed to manage is that the inflation target would lose credibility. Unfortunately, there are no models that can analyse how different rules of action affect the risk that the inflation process will go off the rails, or how the development of the real economy would look in these scenarios.[22] The scenarios we have analysed have therefore become too trivial and void of content in certain situations, and sometimes we have therefore refrained from publishing them.

Concluding thoughts

In one month's time I will be leaving the Executive Board of the Riksbank. New members will decide on how future monetary policy communication will be formulated, but allow me to nevertheless conclude by trying to summarise some of my thoughts on how we, together and individually as members of the Executive Board, communicate monetary policy decisions.

Turning points and breakpoints are particularly difficult

First, it is clear from my review above that the communication of monetary policy's turning points and breakpoints has been particularly difficult to manage. For example, the interest rate forecasts in December 2014 did not indicate that a negative interest rate was imminent, and the interest rate forecast in February 2022 did not indicate that the time of the zero and negative interest rates could soon be over.

During these episodes it appears, somewhat surprisingly, to have been more difficult for us to change the forecasts for future monetary policy than to actually change the direction for monetary policy by changing the interest rate when it became necessary.

Interest rate forecasts in the long term cannot replace interest rate decisions here and now

Second, we have sometimes had to face difficult trade-offs, where we have wished we had more tools to work with. We are fooling ourselves then if we believe that

[22] On some occasions, for instance in April 2022, we have presented scenarios in which we have used manual intervention to force the model to include unusually large, unfavourable effects on inflation expectations when inflation begins to deviate from the target. Such scenarios are not about the inflation target losing its role as nominal anchor for the economy, and nor are they about analysing the consequences of an entirely different monetary policy reaction function.

communication of the policy rate in the distant future is a useful tool. We mainly have one monetary policy tool to work with, which is the policy rate here and now.

Communication is nevertheless an important part of monetary policy. It can sometimes reinforce the monetary policy message and prepare economic agents for changes in the policy rate. In this way, communication functions as a complement to interest rate decisions but the decisions also need to be taken. The communication cannot replace the decisions.

Interest rate forecasts need to be revised regularly

Third, our interest rate forecasts have often deviated from market expectations, and moreover they have often proved to be less accurate than those of the market. One reason could be our unwillingness to regularly adjust the interest rate forecast to new information. There is probably a value in changing the actual interest rate gradually in small steps in normal circumstances, and not changing it back and forth, up and down as soon as new information is received. But this does not mean that the policy rate forecasts need to be dealt with in the same way. Forecasts beyond the next couple of meetings in particular should be treated in the same way as forecasts for other variables.

When our forecasts differ significantly from market pricing and other agents' forecasts, we should also be able to explain why. Do we, for instance, have differing views on how economic activity will develop, on the impact of monetary policy or on how conflicts of objectives shall be managed?

Choose scenarios with care

Fourth, we need to continue to develop the work on scenarios. This is easier said than done. In recent years, we have tried to revive the alternative scenarios. The main idea is that they will illustrate the uncertainty surrounding the forecasts. Some of the scenarios have worked really well and facilitated our communication – here I am thinking in particular of the scenarios in November 2023 – but I do not think we have managed to fully reach the desired result. Shall the scenarios only illustrate that inflation, and thereby the policy rate, can become higher or lower than the forecast? Or shall they illustrate specific developments that we have discussed, and that are either part of the forecast or outside of the forecast?

I would like to see the scenarios trying to turn the question around: Is there a development for monetary policy that we see as unlikely but not unthinkable? One starting point could be, for instance, the monetary policy expected by financial market agents if these expectations deviate significantly from our own. What conditions could motivate such a monetary policy?

For the scenarios to become relevant, the Executive Board needs to become involved in the work early in the process so that the scenarios reflect questions that the Board considers to be current and relevant.

The committee members cannot always have the same view

Fifth, I have observed that the Executive Board has been able to make decisions, despite the decisions not only concerning the policy rate here and now, but also a forecast for monetary policy three years ahead and a Monetary Policy Report containing analyses and forecasts. I have also noted that the minutes of the meetings function as an outlet for opinions that facilitates our joint decision-making. But this does not mean that we can always agree on a joint decision.

The fact that the Executive Board consists of several members is precisely because the decisions are difficult and multi-faceted. The members of the Executive Board have different areas of competence, different experiences and can have different views on the trade-offs we face. It is therefore entirely natural and expected that the members sometimes choose to enter reservations against the majority decision.

According to my calculations, I have attended 62 ordinary monetary policy meetings, and I have entered reservations at 19 of these meetings, seven times against the actual policy rate decision and twice solely against the forecast for the policy rate.[23] This is by no means a "record". Eva Srejber, Lars E O Svensson and Karolina Ekholm all managed to make more reservations against interest rate decisions, despite a shorter period of office on the Executive Board. And if I discount the two newest members of the Executive Board, all of the current and previous members have entered a reservation against at least one monetary policy decision, with only one exception.[24]

The reservations have become slightly fewer in recent years. Communication becomes clearer if the Executive Board is unanimous, as the message is less fragmented. But I see no sign that unanimity strengthens the Riksbank's credibility. For instance, the difference between market expectations and the Riksbank's policy rate forecasts has been unusually large recently. In the long run, it would probably appear strange, and hardly credible, if the Executive Board was always unanimous in its view of such difficult issues as the Riksbank faces.

"Uncertainty and expectation are the joys of life. Security is an insipid thing"[25]

Finally, a message for future Executive Boards: Carry on flying the flag of transparency and clarity! But remember that transparency and clarity do not mean that the forecasts will be accurate.

There will always be some uncertainty there. Constantly adjusting monetary policy to new circumstances is essentially the core of the Executive Board's work. The challenge for monetary policy communication is to send a clear message that also captures the uncertainty.

[23] In addition, I have entered a reservation or made a special comment at further Executive Board meetings on other questions than monetary policy.

[24] The Executive Board has had 21 different members since it was established in 1999. The only one who has never entered a reservation during his time was Urban Bäckström, but he did use is casting vote as Governor on one occasion. Cecilia Skingsley entered reservations against the Riksbank's purchases of government bonds on several occasions, but never against an interest rate decision.

[25] William Congreve (1670-1729).

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