



# SPEECH

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## ■ Monetary policy and house prices

I would guess that all of us here have at least two things in common. One is that our professional life in recent years has largely revolved around dealing with the effects of a global financial crisis. The other is that we would rather not do it again. Most of you represent the investment fund branch or unit trust investors in one way or another. And a reasonable guess is that recent years have been turbulent for many of you.

It is fairly natural that the Riksbank should have been in the eye of the storm during the crisis. Our main tasks are to safeguard financial stability and to keep inflation low and stable, at the same time as contributing to stabilising production and employment. Managing the effects of the crisis and carrying out our statutory tasks in the best possible way has required a number of creative and unusual solutions.

And it is not all over yet. The financial markets have recently been shaken up once again. Now the problem is mainly due to Greece, but to some extent also other EU countries such as Spain and Portugal, having serious problems with their government finances. The Swedish banks are not directly exposed to the countries in southern Europe to any great extent. However, this does not mean they will not suffer contagion effects via the financial markets. Two weeks ago, the EU member states and the International Monetary Fund presented an aid package worth a total of EUR 750 billion to bail out EU countries with serious budget problems. At the same time, the European Central Bank decided to make support purchases of government bonds. Hopefully, this will be sufficient to create and maintain confidence that the countries which have been hardest hit will actually be able to get their public finances on an even keel again. We will be following these developments very closely.

Now, however, I am not intending to talk about the most recent financial market turmoil. What I intend to spend the next half hour or so talking about is an old debate theme that has been given new life during the crisis; should central banks use the interest rate to try to influence asset prices and credit growth? Should they try to prevent or alleviate imbalances that begin to grow, or wait until the bubble has burst and it is time to clean up the mess it has left behind? The crisis has changed many people's views on monetary policy in this respect.

## ■ Asset prices and "bubbles"

The question of how monetary policy should relate to asset prices has been discussed for many years, not least by central banks and academics. Nor could one claim that there has been a lack of opinion – views that have often been diametrically opposed. The core of the discussion is that house prices and lending sometimes develop in a way that does not appear sustainable – in a way that entails risks that are difficult to quantify or to even capture in analyses and forecasts. These are risks of events that often have a low probability of occurring, but if they do occur could have very serious consequences for the economy. So what is so special about asset prices rising and why do "bubbles" arise?

### *Rising asset prices are not necessarily a bubble...*

The prices of many assets, such as houses or shares, rise and fall in cycles. And asset prices can rise substantially without this entailing an over-estimation or a financial bubble. A bubble is among other things based on speculation and a strongly over-optimistic view of the future.

If, for instance, property prices increase substantially this may actually be justified on the basis of fundamental driving forces and realistic views of the future. Factors such as growth, incomes, construction and housing costs may develop favourably. And if one does not, for instance, build new housing at the same rate as the demand for housing increases, then it is not exactly surprising that the price of the existing housing should rise.

Even if prices soar during a brief period, grey reality usually catches up before a bubble has arisen. When this happens prices usually adjust without any great drama and do not have any major effects on the rest of the economy. However, if unrealistic expectations of the future push up prices on a more lasting basis it can lead to serious problems.

### *...but if they are pushed up by unrealistic expectations and lending...*

Expectations of the future, "mood" and attitude to risk are very important factors with regard to the prices of most assets. During the course of history investors have from time to time behaved as though prices on a particular market would keep on rising for ever. Exaggeratedly optimistic expectations of the future may entice investors into a particular market, prices will then rise, which will attract even more investors in the belief that prices will go on rising. Unless the spiral is broken reasonably early, a bubble will arise. If exaggerated optimism and a high risk propensity over a long period of time have pushed up prices, there is also a considerable risk that the fall from the inflated price level will be very hard once the mood changes. And this will probably have a negative effect on the rest of the economy.

It is probably necessary to be most on our guard regarding what developments can be considered sustainable when things appear to be going well. By this I mean times with a high level of growth in the economy and in household incomes, good investment opportunities and low loan losses in the banks. It has happened more than once that a normal economic upturn inspires excessively optimistic expectations of economic developments and the price of risk thus

■ becomes unreasonably low. Afterwards it often appears fairly obvious that certain price movements were not rooted in reality. However, during an upturn phase in the economic cycle it is obviously easy to get carried along on a tide of optimism and leave common sense on the shore. Many may be pulled in by others acting as though the trend of large profits will continue – assuming that “so many” investors surely can't be wrong, even though the fundamental forces indicate otherwise. An investor may also consider it costly to go against the tide and act on the basis of a view that does not appear to be shared by others. In this situation, being the one who points out that current developments are not sustainable and that the expectations are unrealistic may be rather like trying to stop a runaway train with your bare hands. At least, if one lacks the right tools.

*...the consequences can be severe when the bubble bursts.*

Not all bubbles that arise have serious consequences for the rest of the economy. So are there any common denominators in the worst scenario cases? Yes, these cases often involve a loan-financed price upswing in the property market that has accelerated at an untenable rate over a long period of time. And when this kind of bubble bursts, it almost always does so with a bang rather than with a whimper.

Compare, for instance, the IT bubble at the beginning of the 2000s with the current crisis, where a bubble in the US housing market played a key role. Although the IT bubble resulted in heavy stock market falls and hit many investors hard, the crash did not have major effects on the real economy, which stands in sharp contrast to the effects of today's crisis. The same applies in a comparison with the Swedish financial crisis at the beginning of the 1990s. A decisive difference between a stock market bubble and a property market bubble is that the latter is almost always linked to an untenable credit boom. When house prices rise, the value of the underlying assets increases, which gives scope to borrow even more with this asset as collateral. At the same time, increased lending provides more purchasing power, and this contributes to prices rising even more. It becomes a self-reinforcing spiral that can be very powerful – both in the upward phase and the downward phase.

When the upward spiral is broken, there is a turnaround and a rapid downward spiral, which is probably much quicker than the upturn. Prices fall, the mood becomes increasingly negative and lenders and borrowers become increasingly unwilling to take on risk. The banks' loan losses increase. The result may be a long period when households and companies hold onto their money more firmly to reinforce and balance their finances. Consumption and investment are weak and lending is restricted. Fluctuations in house prices and lending can in this way reinforce fluctuations in production and employment.

In short, rising property prices often go hand in hand with an increase in lending. This means that problems in the property market often have greater effects on the financial system and the economy as a whole than do problems in, for instance, the stock market. And it is therefore important to be particularly vigilant with regard to the property market when discussing monetary policy and asset prices. I should also add that it is mainly commercial property, and not residential property, that usually causes this type of problem.

## ■ "Lean or clean" – act sooner rather than just later?

Let us say that property prices and credit volumes are increasing at a rate that does not appear sustainable. How should a central bank react? This is an "old" debate that has been given new life by the recent crisis. And it mainly concerns how the central bank should act when asset prices rise. In these situations it is often difficult to assess whether the current developments are reasonable or whether they are the result of over-optimistic expectations and speculation. It is also difficult to estimate the effects on the real economy and inflation. Moreover, it is difficult to judge when a potential bubble might burst. When property prices fall heavily, the real economy is often weaker and inflation lower. In this type of situation it is more obvious how the central bank should react. It is also obvious that the central bank must react to be able to carry out its tasks. So the way a central bank should react afterwards, once the bubble has burst, has not been debated as much as the question of how to act prior to this.

### *Leaning against the wind – act sooner, not just later...*

This debate has previously been somewhat "polarised" between two stances – to "lean against the wind" or to "clean up afterwards". The former stance involves the central bank raising its policy rate if property prices and lending increase at an alarming rate, even if an interest rate increase is not obviously justified on the basis of the forecasts for the real economy and inflation. One usually says that the central bank should "lean against the wind".

The basic idea is that keeping the policy rate higher than it would otherwise have been contributes to holding back the rise in property prices and ensuring that the fall in prices that comes sooner or later is much milder. A more balanced development in property prices also leads to more stable developments in the real economy and inflation. Although growth may be slightly lower in the upturn phase, there is on the other hand less risk that property prices will fall dramatically later on, which could contribute to a severe downturn. This is in some ways similar to an insurance policy: By accepting slightly weaker growth in the short term, one reduces the risk of much more negative developments further ahead.

However, the strategy of "leaning against the wind" is not entirely without problems, even if it may sound fairly simple. Many economists have criticised this strategy. The main critics considered, at least prior to the crisis, that although it may indeed involve an imbalance, the best strategy was for the central bank to confine itself to "cleaning up afterwards" once the bubble had actually burst. In their view, "leaning against the wind" often would not lead to more stable developments, but instead risks amplifying fluctuations. Three main arguments have been raised by critics against the policy of "leaning against the wind".

### *Difficult to identify a bubble and to do so in time?*

To begin with, it must be possible to identify the imbalance or potential bubble and to do so at a sufficiently early stage. The critics claim that this is very difficult and they often use the term "bursting bubbles" when talking about monetary policy and asset prices. The idea of bursting a bubble has much more dramatic associations than the expression "leaning against the wind". If the developments

■ that are judged to be unbalanced are actually justified by the fundamental driving forces, then a higher interest rate would curb growth unnecessarily. It could also cause problems if one fails to identify the imbalance sufficiently early and tries to remedy it too late. Then there is a risk of larger fluctuations in both asset prices and economic activity, completely contrary to the initial aim.

Is this criticism justified? Yes, it is difficult to identify an imbalance at an early stage. The fact that exaggerated optimism and high risk propensity can push up property prices and lending does cause problems, for instance. It is difficult to capture this type of factor in the models used to analyse the economy, as they are often based on everyone acting rationally, at least on average. Moreover, it is difficult to capture the risk of a bubble bursting and the consequences this might have. The idea behind “leaning against the wind” is that the actual probability of the shock occurring can be reduced by the policy the central bank is conducting today. It is difficult to incorporate this into the formal analysis.

However, the scope for identifying an imbalance is probably better in the property market, which goes hand in hand with credit growth, than in other asset markets. The financial crisis has also contributed to central banks and other authorities now working even harder to better capture financial variables in their models and other analyses. Constructing early warning systems that signal imbalances in, for instance, the property market is also part of this work. However, it is difficult to say today how much we will eventually achieve here.

But even if the criticism is justified – is it sufficient argument for not “leaning against the wind”? One must compare what the central bank can reasonably be expected to win and lose by taking action with the possible effects of not doing anything until a potential bubble has burst. I will return to this in a moment.

### *A too weak and blunt weapon?*

Another argument against “leaning against the wind” concerns the effectiveness of the interest rate in this context. To “lean against the wind” one must be able to count on dealing with the imbalances by making reasonable increases to the policy rate. One hypothesis is that the optimistic mood often prevailing during a boom in the property market means that significant increases in the policy rate are required to have an effect. Otherwise it would be rather like trying to bring down an elephant with a pea-shooter. The critics claim that the severe monetary policy tightening that would be needed could have serious effects on the rest of the economy. Here we also have the problem that the interest rate is a blunt weapon that affects the entire economy and cannot be aimed at an individual market. If you use a shotgun to take aim at a mosquito in a swarm you will probably also hit those around it, even if you weren’t aiming for them. From this aspect, there is a risk that the central bank could do more harm than good.

I think the critics have a point here. As I mentioned earlier, trying to dampen a spiral of over-optimism and rising prices may be like trying to stop a runaway train with one’s bare hands. I usually mention an example from the 1990s crisis when talking about this phenomenon; in 1989 the requirement for direct return on the commercial property market was around 4 per cent. A risk-free five-year government bond provided up to 12 per cent interest. But the market preferred to invest in an unsecured property asset to a covered bond with a return of 8 per cent more! It takes a lot to defeat that kind of optimism.

■ But the exact size of the increases in the policy rate that are necessary would probably vary from situation to situation. Under certain circumstances it may even be enough to make very small increases. In the world of theory, everyone tries to stay well-informed with regard to for example the most probable development of the interest rate. But this does not mean that things always work out this way in reality. Smaller interest rate increases combined with successful communication can function as a clear signal that the central bank regards the current situation to be untenable. It can contribute to correcting or at least dampening irrational behaviour.

If a central bank were to judge that developments in property prices and lending were beginning to give cause for concern, it would also be rather strange, in my opinion, if the governor or governors were to just sit there and not do anything on the grounds that the policy rate would probably need to be raised a lot. The policy rate is probably not the most effective weapon in this context, but it is more powerful than a pea-shooter.

However, the shotgun and the mosquito comparison holds up fairly well. The policy rate is not a precision instrument, it affects the entire economy. This is why the strategy of “leaning against the wind” can have some negative effects in parts of the economy that the central bank does not wish to affect. If one wants to tackle an excessive growth in the property market, there may well be instruments with better precision than the policy rate. I will return to this in a moment.

### ***Not “sufficiently” serious consequences?***

A third counter-argument was, at least earlier, that the negative effects of a bubble bursting need not be so dramatic. Rather, they could be managed fairly easily, for instance through more expansionary monetary policy. But as I recall, this argument was primarily put forward when the IT bubble was the crisis most fresh in our memories. Since then a global crisis has had dramatic effects – much more serious and more widespread than I believe anyone had actually predicted. And this latter point is a nuance in the debate that I would like to highlight. It is not just difficult to estimate the probability of a bubble arising and when it will burst, as I described recently. It is also very difficult to assess how serious the consequences might be after a bubble has burst. Elements of “irrational behaviour” such as over-optimism and speculation are not just difficult to capture in models and other analyses during an upturn phase. They are also hard to capture during a downturn phase.

The Swedish crisis in the 1990s is a very good example of a self-reinforcing downward spiral, the effects of which had unforeseen serious consequences – with a drastic fall in property prices, large loan losses that threatened the financial system and a deep recession. In the most recent crisis, too, confidence and mood played an important role in developments. We probably all underestimated the force in the mechanisms that were able to drag the world economy down into the worst recession since the 1930s.

This has, of course, also had an impression on the debate on monetary policy and asset prices. It seems as though several advocates of the strategy of “cleaning up afterwards” have modified their view, primarily because the potential profits of limiting bubbles appear to be greater than they previously assumed. The well-

known American professor Alan Blinder also notes in an article this year that it appears as though even the advocates of “cleaning up afterwards” are beginning to support the opinion that central banks should at least do *something* when they suspect that a loan-driven imbalance is building up. However, this does not necessarily mean raising the policy rate, even if there now appears to be greater acceptance for this, too, if it is supplemented with other measures. My interpretation is that the advocates of “leaning against the wind” consider that the central issue is that *something* should be done – and this does not necessarily mean raising the policy rate. So it would appear that we are approaching some form of consensus. At least to the extent that most people now seem to consider it more dangerous to do nothing than to do something.

Given the proportions the debate on monetary policy and asset prices has taken on, it would be easy to believe that there are a whole number of practical examples of “leaning against the wind”. However, this is not the case – with regard to either successes or failures. One of the few examples usually taken up is the policy conducted by the Reserve Bank of Australia (RBA) 2002-2004. The RBA adjusted its policy rate to try to dampen house price rises that were fairly clearly of a speculative nature. The fact is that this type of strategy is relatively untested. And we cannot refer to practical experiences where central banks have systematically and over a long period of time tried to apply the principle of “leaning against the wind”.

### **Other and better weapons?**

Most people probably agree that the interest rate cannot do the whole job if we want to try to slow down developments in the property and credit markets that appear to be getting out of control. So, in brief – if the policy rate is not the only and best weapon, what else do we have available in our arsenal? And which authority should have its finger on the trigger?

One of the problems the crisis has brought to light is that there was too little focus on overall risks that could threaten the financial system as a whole – systemic risks. In many parts of the world they are now working on introducing a framework aimed at preventing such risks. This could contribute to preventing imbalances that would have consequences “merely” from a monetary policy perspective, even if this is not the explicit aim.

One means of preventing an exaggerated upturn in house prices and lending, for instance, is to cut the permitted loan-to-value ratio – how much it is possible to borrow in relation to the market value of the underlying collateral. Another means may be to introduce an amortisation requirement. Two weeks ago, Finansinspektionen (the Swedish financial supervisory authority) presented a proposal for a recommended ceiling for the loan-to-value ratio for housing of 85 per cent of the property’s market value.

### ***Division of responsibility and other problems***

I asked earlier who should have their finger on the trigger. It is not entirely clear who should have the power of authority to introduce the type of measure I just mentioned. There may be good reasons to delegate this to the central bank, at least with regard to measures that affect the macro economy and are not aimed at individual banks. On the other hand, authorities like Finansinspektionen may

■ need to take the same type of measure for their task of protecting the consumer. Their proposal for a ceiling for loan-to-value ratios, for instance, is based on consumer interests. The question of how responsibility and roles should be divided between the different authorities will probably be discussed in detail in Sweden and abroad in the coming period. And it is important to find a system that works efficiently.

Some of the criticism of the strategy of "leaning against the wind" with the policy rate also applies to alternative measures. If the central bank or another authority takes such measures, one must have a good understanding, as with the policy rate, that the measures are really being implemented at the right point in time. Otherwise there is a risk that the fluctuations in the banks' credit granting will be greater rather than smaller.

### **Monetary policy and house prices**

Credit volumes and house prices are *not* targets for monetary policy. They are indicators that should affect monetary policy if they are expected to affect inflation and resource utilisation in the economy. But my assessment is that there may also be occasions when indicators such as house prices and credit growth contain information on future economic developments *over and above* what we can capture in our quantified forecasts. If we knew a very good way of calculating the probability of a bubble growing and bursting at some point in the future and of calculating how great an effect it would have, then we would of course have already put this calculation into our models. But unfortunately we have not got there yet, although intensive work is being carried out, not least by the Riksbank, to better capture financial variables in our analyses and forecasts. However, there is a long and difficult road ahead before we achieve what we want.

### ***Practical problems and important considerations***

Let us assume, for instance, that we were to find ourselves in a situation where there is a major risk that a loan-driven bubble in the property market will collapse further ahead and that it will then contribute to a heavy fall in GDP. How should we react to this? If we knew with certainty that this would happen, then it is likely that most of the models we have now would indicate that we ought to *cut* the policy rate to alleviate the effects on inflation, production and employment. But if we were to cut the rate in such a situation we would also risk blowing up the bubble even more before it burst. This would in turn contribute to the ensuing fall being from an even more over-valued level and the consequences would be even more serious than if we had not cut the repo rate. It is no easy task to build this type of mechanism into our models, or even the part of the analysis based on assessments.

Allow me to alter the time perspective somewhat and assume that a loan-driven bubble in the property market has burst and had serious consequences for the rest of the economy. There are some questions that I would like to be able to give the "right" answer to if I were standing in this situation looking back over the developments leading up to it, perhaps looking back a year. Would we then be able to claim with certainty that our interest rate policy did not contribute to developments becoming unbalanced and getting out of control? Would we be

■ able to say with certainty that we did not suspect that these developments were untenable and that there would soon be a collapse? And would we be able to say with certainty that conducting a slightly stricter monetary policy than was justified by the forecasts had not helped? I consider it essential for the credibility of every central bank to be able to provide good answers to these questions. And for me it is natural to also take into account the type of factor I have now spoken about – that is so difficult to quantify – when I assess what is the best-balanced monetary policy.

Other weapons than the interest rate are probably more effective with regard to preventing loan-financed house price bubbles from building up. But I do not rule out the interest rate as a weapon in this context. And I do not believe that it is a small pea-shooter we are using if we try to dampen an untenable development. Not if the conditions are right. A small policy rate increase combined with a clear message that the Riksbank regards developments as a cause for concern could work well – as an alarm signal for those with overly optimistic expectations. The interest rate increase will reinforce the message that something is not right.

Obviously, it is a challenge to be clear in our communication and to act in a predictable manner with regard to these issues. The possibility to do so is to some extent linked to our analysis in this field improving – so that we can quantify more of the risks we are discussing here. But if those around us are to understand why we make our interest rate decisions, we must be able to explain clearly how we assess various risks. This also applies to the risks of a bubble arising and what consequences this may have, given that we choose a particular interest rate policy. If we succeed in communicating this it is also more likely that our actions will have the desired effects.

### ***When should the central bank "lean against the wind"?***

In my opinion, a good checklist for a policy-maker on monetary policy issues is what Donald L. Kohn at the Federal Reserve has put forward on several occasions. He considers that three conditions I mentioned earlier must be met before central banks "lean against the wind". And these are the three arguments I mentioned earlier. The first condition is that it must be possible to identify a bubble sufficiently early and with sufficient certainty. Secondly, the assessment must be that there is a good chance that a slightly higher interest rate will really slow down the untenable developments. Finally, one must count on being able to gain "enough" by preventing a bubble in relation to what a tighter monetary policy might cost in the short term. I believe that most people will agree that these are sound conditions to use as a foundation. However, the views regarding when the conditions are actually met can vary.

Professor Kohn's first condition probably entails the greatest difficulty. Although we are constantly developing our forecasting methods and models and they are becoming increasingly sophisticated, I do not expect that we will be able to reach a stage in the foreseeable future where we can be entirely sure that something we assess as an incipient bubble actually is a bubble. This is largely due to the nature of things, or rather the nature of the bubble.

So when it comes to making assessments of what risks becoming a bubble, I believe that we must continue to make use of our experience combined with a dose of the sort of conclusion referred to in English-speaking circles as a "duck

test"; if it looks like a duck, swims like a duck and quacks like a duck, then it probably is a duck. Of course what we are talking about here is much more difficult to identify than a duck. But if there are sufficiently strong indications that developments are untenable, then there is a good probability that this is the case. And if this is expected to affect inflation and developments in the real economy, I consider the interest rate to be a possible weapon if others are not available or not sufficient – if not to prevent a bubble, then at least to tone down the bubble and its consequences.

### **House prices today and in the coming period**

So what does this reasoning entail for my views on developments in house prices and lending today? Firstly, the crisis has meant that the repo rate has long been adjusted to try to alleviate the effects of the financial crisis on inflation, production and employment and to give support to the economic recovery. The repo rate is still at the historically low figure of 0.25 per cent, but the Executive Board of the Riksbank is assuming that it will be time to leave the crisis rate and to conduct a monetary policy that is adapted to a “normal” downturn when we reach the summer or the early autumn.

The low interest rates have probably contributed to households borrowing and investing more in housing than they would have done otherwise. But this was to some extent the intention, and a means of maintaining economic demand. We have quite simply conducted, and are conducting, the policy we consider necessary to attain the inflation target and to give sufficient support to production and employment.

### ***Swedish house prices have developed surprisingly strongly***

Swedish house prices have grown surprisingly strongly during the crisis, and also during the years prior to the crisis. House prices have risen fairly quickly, both in nominal and real terms. And it is not surprising that eyebrows may be raised when house prices are rising and bank lending to households is increasing fairly substantially, at the same time as unemployment is still high and growth has not yet begun to pick up. But in an international comparison things may not look quite so remarkable. During the years prior to the crisis real house prices in many other countries increased more than those in Sweden. During parts of 2006 house prices in Denmark, for example, rose at an annual rate of more than 20 percentage points, which was way above the Swedish increase. In the countries where real house prices had previously increased more rapidly than in Sweden, they have in most cases experienced fairly large price falls in connection with the crisis. For instance, in Denmark real house prices have fallen by around 20 per cent since the peak levels in 2007.

So are developments in the Swedish credit and housing market cause for concern? My view is – not in the short term. But nor do I believe that the growth we have seen in household borrowing and house prices over the past decade is sustainable in the long term. The reason I do not believe developments to be a problem right now is that there are nevertheless reasonable explanations for the price increases. Recently it is probably the case that factors such as the fact that it is still cheap to borrow, and that households and companies according to

■ indicators are regaining confidence, have contributed to the nevertheless strong development.

There has also been relatively little new housing built in recent years, at least in relation to demand. The housing market is what one might call "regionally segregated" and migration to metropolitan areas has put upward pressure on house prices in these areas. Prices have also increased by far the most in Stockholm, Göteborg and Malmö. And then we do not have the same element of speculation in the Swedish housing market as in, for instance, Australia and to some extent the United Kingdom. What I mean here is the phenomenon that households buy housing as a financial investment and then rent it out, which may contribute to imbalances building up. This type of activity is not profitable in Sweden in the same way. There are several reasons for this, but the most important ones are probably the tax system and rent legislation. In Sweden we usually buy a house to live in rather than as a financial asset.

However, having said this I would nevertheless like to say a word of caution. It is quite right to wonder whether the developments in recent years are actually sustainable. Households' debts in relation to incomes peaked at around 120 per cent in connection with the crisis in the 1990s. Today this figure is almost 170 per cent! Also at the beginning of the 1990s many models and fundamental driving forces behind house price developments pointed to there not being a serious over-valuation in the property market. Nevertheless prices fell in many areas by around 30 per cent! Such a development could affect the real economy and thereby also the conditions for monetary policy.

### *Untenable in the long run*

Although I cannot see any problems right now, I do not believe that nominal house prices can continue to increase by an average of well above 7 per cent a year as they have done since the start of the 2000s. This is not sustainable in the long term. And when we now consider when is the best time to begin raising the repo rate, my colleagues and I will be carefully examining variables such as house prices and lending. As I pointed out, for instance, in connection with the monetary policy meeting in February, I believe that during the interest rate increase phase ahead of us it might be appropriate to "lean against the wind" – to emphasise some concern by raising the repo rate slightly sooner than we might otherwise have done. But as I also said then, monetary policy is not the most effective means if one wishes to slow down, for instance, house price developments slightly. I then said I would like to see measures such as Finansinspektionen setting a limit for the loan-to-value ratio for new mortgages. Now they have presented a proposal for this and we will carefully monitor its effects.

Leaning against the wind concerns, in my view, avoiding large fluctuations in inflation and the real economy – what provides the best-balanced monetary policy. It is thus about monetary policy, not financial stability. As shown in a survey made by Finansinspektionen earlier this year, there are many indications that the households taking on loans are those that can afford to borrow. The Riksbank has also drawn this conclusion so far in its Financial Stability Reports. I therefore find it difficult to believe that the developments in the housing and credit markets at present would constitute any danger to the banks and thus to financial stability.

## ■ *Concluding remarks*

In connection with dramatic events like the recent financial crisis, proposals for radical changes tend to crop up in the general debate. But I do not see a radically-different monetary policy ahead of me. I am still convinced that flexible inflation targeting is the best monetary policy solution for Sweden. The repo rate is not the most effective weapon for trying to prevent or alleviate an imbalance in, for instance, the property market, but this does not mean it is completely ineffective.

We must become better at analysing financial conditions and not least at capturing variables such as house prices and credit growth in our forecasts. And this is something we are working hard to achieve, both at the Riksbank and in many other areas. We must become better at clearly explaining how we assess the risks of a bubble given a particular repo rate policy, and what consequences a bubble may have if it bursts. And we need, and will most probably also obtain, better support from the framework for financial stability that we and others are now working to develop both in Sweden and abroad. When this project is complete, it will contribute to monetary policy more rarely needing to take into account untenable developments in the housing and credit markets. But I do not think we can achieve an entirely “bubble-free” world.