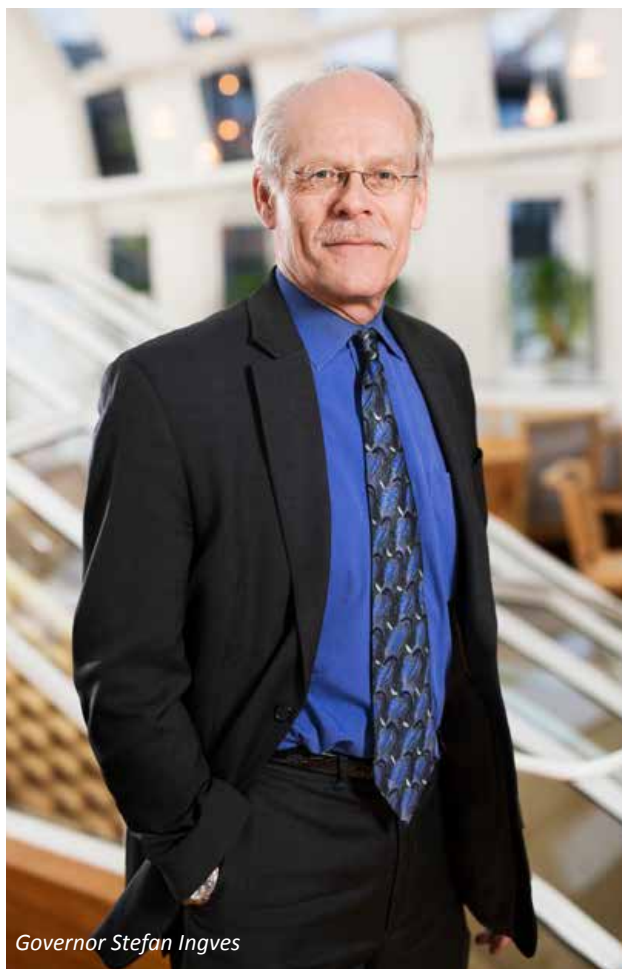


Statement by the Governor



Governor Stefan Ingves

During 2016, monetary policy in Sweden has been characterised by low inflation, considerable uncertainty over international economic developments and low global interest rates. Given this, monetary policy has become increasingly expansionary to safeguard the role of the inflation target as nominal anchor for price-setting and wage formation. At the same time, the low interest-rate environment has entailed risks, such as increased household indebtedness. The risks linked to household indebtedness need to be managed with targeted measures in macroprudential policy, housing policy and tax policy.

The cash changeover continued during the year. The withdrawal of the old banknotes functioned well, and we introduced the new 100-krona and 500-krona banknotes and the new coins. Another important issue for us was to contribute to the discussion on the role and tasks of the Riksbank, partly as a result of the Riksdag's evaluation of monetary policy 2010–2015.

More expansionary monetary policy to safeguard the inflation target

The Riksbank is currently conducting an unusual monetary policy. The repo rate, which was cut below zero for the first time in 2015, was cut further during the year and at the end of 2016 the repo rate was –0.50 per cent. The Riksbank also continued purchasing government bonds. At the end of 2016, the Riksbank had decided on purchases of government bonds in a nominal value of SEK 275 billion.

Monetary policy is being conducted against a background of considerable uncertainty over economic developments abroad. Sweden, which is a small, open economy, is affected to a large extent by events abroad. Global interest rates have fallen over the past decades, and policy rates around the world are very low. In this type of environment, and in a situation where inflation in Sweden has undershot the target over a number of years, it has been necessary to conduct an increasingly expansionary monetary policy.

The aim of the expansionary monetary policy is to push up inflation and stabilise it around the target of 2 per cent and to help keep inflation expectations in line with the inflation target. It is important to preserve confidence in the inflation target. A credible inflation target lays the foundation for efficient price-setting and wage formation and hence promotes good economic development.

The expansionary monetary policy has been a contributory factor in growth in Sweden maintaining a good level despite the weak developments abroad. During 2016, inflation measured both in terms of the CPI and the CPIF, as well as inflation expectations, approached 2 per cent.

Risks in the financial system must be managed

A low interest rate environment also entails risks. Particularly in a situation with low interest rates over a long time, there is a risk that households and companies will make decisions based on an unrealistic perception of the long-term development of interest rates. There is then a risk of inflated asset prices that may eventually need to be adjusted. Such a situation could mean that consumption and production decline and have a negative effect on the economy.

The Riksbank has for a long time now highlighted the unsustainable development on the Swedish housing market as one of the most serious risks for the Swedish economy. The problems on the housing market are essentially due to factors that are not connected to monetary policy. Supply is not able to meet demand, and a number of reforms are needed to boost construction. The tax system also needs to be reviewed to reduce households' incentives to incur debt. The conditions for mortgage borrowers in Sweden are

remarkable from an international perspective. As shown in the Riksbank's Financial Stability Reports, many households borrow at a variable interest rate, amortise to a small extent and have a high level of indebtedness. This is a development that began even before monetary policy was made very expansionary. But with very low interest rates, the risks become greater. The Riksbank has, over the course of the year, highlighted a number of possible measures to restrain the risky developments in two reports (Financial Stability Report 2016:1 and 2016:2).

Effects on the Riksbank's balance sheet

Another question is how monetary policy affects the Riksbank's balance sheet. From an economic perspective, the effect on the Riksbank's balance sheet is of relatively minor significance. But it is, of course, essential that we make clear how the negative repo rate and bond purchases affect the Riksbank's finances. The size of the Riksbank's profits and losses affect the dividends we can deliver to central government. The Riksbank also needs to have a balance sheet that does not undermine its financial independence.

The Riksbank's balance sheet has increased substantially over the past two years, which in itself increases the risks. It creates scope for both larger profits and larger losses. The Riksbank has conducted a policy that entails pushing down market rates, for instance through bond purchases. This has succeeded, and with lower market rates the value of the Riksbank's bond portfolio has also increased. But it is important to be aware that this situation will change. The Riksbank's interest-rate forecasts indicate future losses and thereby lower, and sometimes even no, dividends paid to the Treasury. At the same time, we assess that the Riksbank's financial position, despite the higher risks, is still satisfactory.

Contribution to the discussion on the role of central banks

The financial crisis and its consequences have led to an international discussion on the way the financial system works and what regulations are necessary. The Riksbank has contributed to the discussion in several ways. I myself devoted a lot of time in 2016, in my capacity as chairman of the Basel Committee on Banking Supervision, to the formulation of the new regulatory framework for banks, Basel III.

There are also discussions in many countries, in the wake of the financial crisis, on the role of the central banks. In Sweden, Professor Marvin Goodfriend and Lord Mervyn King presented their review of the Riksbank's monetary policy during the period 2010–2015, which was commissioned by the Riksdag, in January 2016. The Executive Board and

the General Council sent in their consultation responses to this review in April, and the Riksbank took part in hearings by the Committee on Finance. In addition to the evaluation, the Riksbank arranged a conference in June, to which international experts were invited to discuss the central banks' mandate. We look forward to continuing discussions during the coming year.

Cash changeover going according to plan

The banknote and coin changeover continued in 2016. The older 20, 50 and 1,000-krona banknotes became invalid after 30 June. The withdrawal was preceded by a large-scale advertising campaign to make the general public aware of which banknotes were becoming invalid. At the end of the year, 84 per cent of the value of the older 20, 50 and 1,000-krona banknotes had been handed in to the Riksbank. In October 2016, the new 100-krona and 500-krona banknotes, together with new 1, 2 and 5-krona coins were introduced. At the same time, a campaign was launched to inform the public of the second stage of the changeover.

While the cash changeover was going on, the use of cash in society declined relatively rapidly. It is clear that the Swedish payments market is undergoing a change. The Riksbank pointed out during the year that this structural transformation is positive, but that it needs to proceed at a pace that does not cause problems for certain groups or exclude anyone from the payments market. We also analysed how the future payments market might look and what role the Riksbank may play there. For instance, should the central bank issue electronic money, and if so, how? This entails analytical work that will proceed during several years.

Good working environment and investment in leadership and employeeship

The Riksbank works continuously on improving the working environment. In 2016, the Riksbank implemented a major investment in leadership and employeeship. All employees were offered a programme where they learned to coach themselves and their colleagues. The programme also provided tools to manage stress. It is my hope that our development work will strengthen the Riksbank as an organisation so that we remain an attractive workplace that will recruit and retain many competent employees.



Stefan Ingves