

The Role of Alternative Scenarios in Monetary Policy Communication

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S V E R I G E S R I K S B A N K

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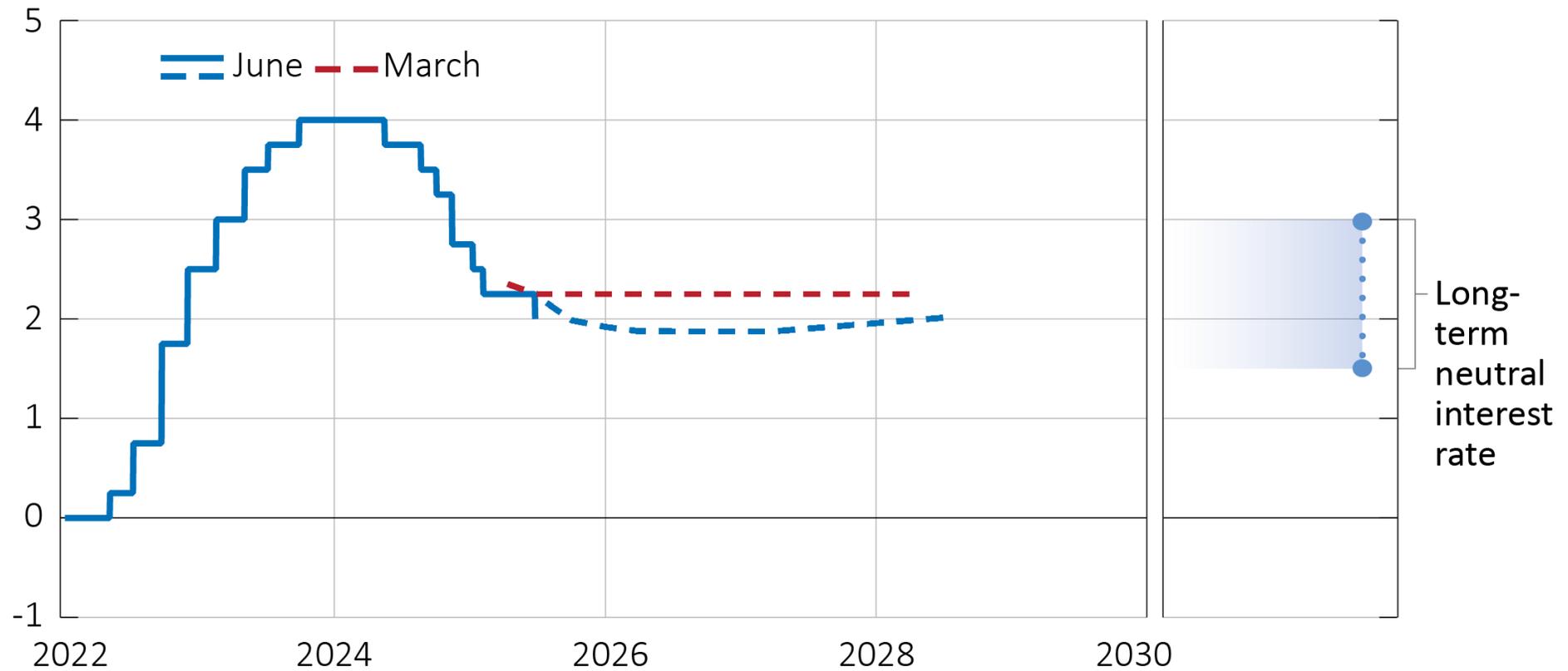
Introduction

- The Riksbank has chosen a path of transparency
 - Highly independent. Transparency conducive to accountability.
 - Makes monetary policy more efficient
- Try to convey the Executive Board's reaction function by publishing
 - A policy rate forecast (since 2007)
 - Alternative scenarios
 - Attributed minutes shortly after each policy decision

Baseline policy: the policy rate path

- Reflects the majority view of the Executive Board
- Ensures our objectives are met
- Consistent with our assessment of the long-run neutral interest rate
- The monetary policy embodied in the path should be
 - Efficient
 - Robust
 - Predictable
- Revised as new shocks hit the economy: Delphic/contingent guidance

The policy rate path



Note. Per cent. Solid line refers to outcome and dashed line refers to the Riksbank's forecast. The shaded area shows the assessed interval for the neutral policy rate in the long run. Outcomes are daily rates and the forecasts refer to quarterly averages.

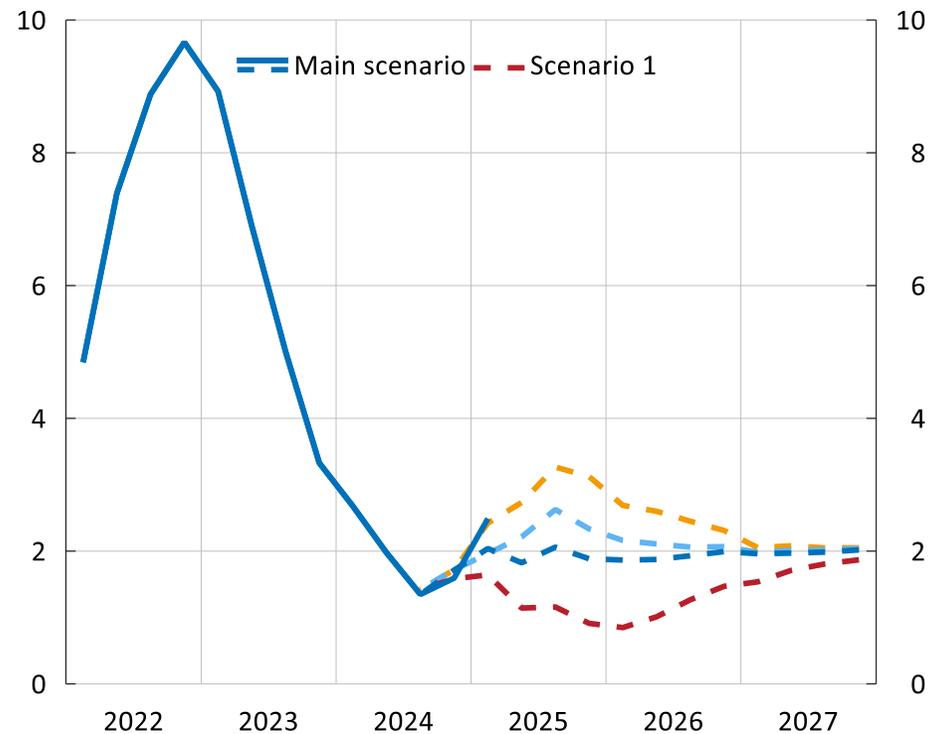
Source: The Riksbank.

Policy rate path complemented by alternative scenarios

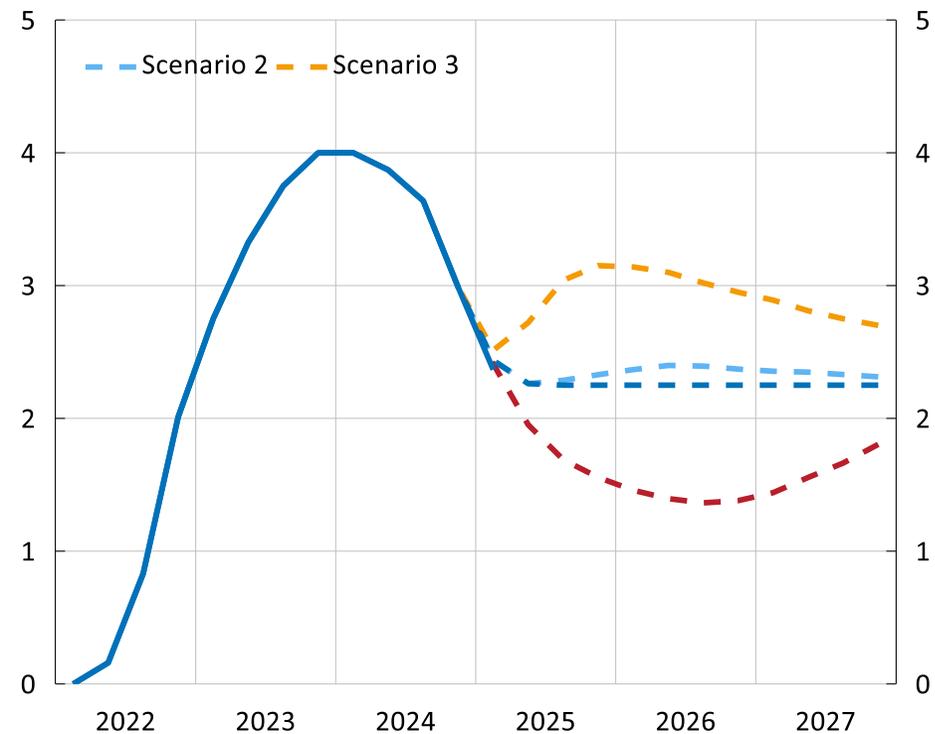
- A scenario comprises:
 - A sequence of different types of shocks
 - A set of modelling assumptions
 - Alternative projections obtained when subjecting main model to shocks
- Scenarios convey:
 - Which risks the Executive Board perceives as important
 - The Executive Board's reaction function
- Useful for assessing policy robustness

Narrative important

Inflation



Policy rate



Note. Annual percentage change (left) and per cent (right). Scenarios from the Monetary Policy Report in December 2024. Inflation refers to the CPIF. Solid line refers to outcomes and stretches to the first quarter of 2025. Data refers to quarterly averages.

Sources: Statistics Sweden and the Riksbank.

Challenges when working with scenarios

- How to choose them
- Should they be close to the baseline or more extreme?
- How specific and detailed should they be?
- Should ideally receive as much attention as the baseline projection (the policy rate path)

Do scenarios work?

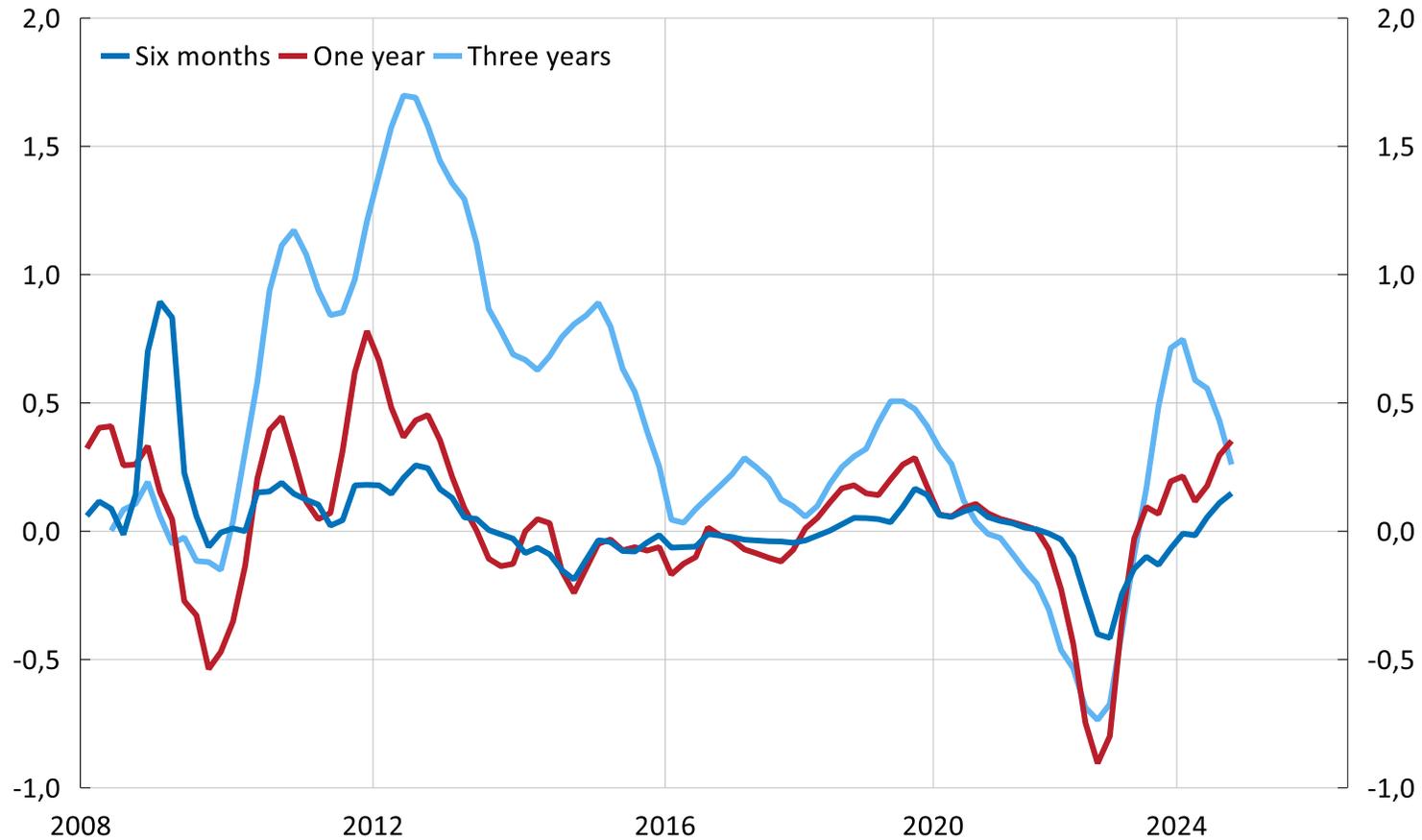
- Difficult to evaluate
- Anecdotal evidence that expectations at times have been more in line with our scenarios than with our policy rate path
- Market participants do study our alternative scenarios

Concluding remarks

- The policy rate path and scenarios convey our reaction function
- On scenarios:
 - Particularly useful when uncertainty is high
 - Not obvious how extreme or detailed they should be
 - Commenting on past scenarios in the Monetary Policy Report likely to promote credibility
- Data consistent with this communication strategy being successful

Extra

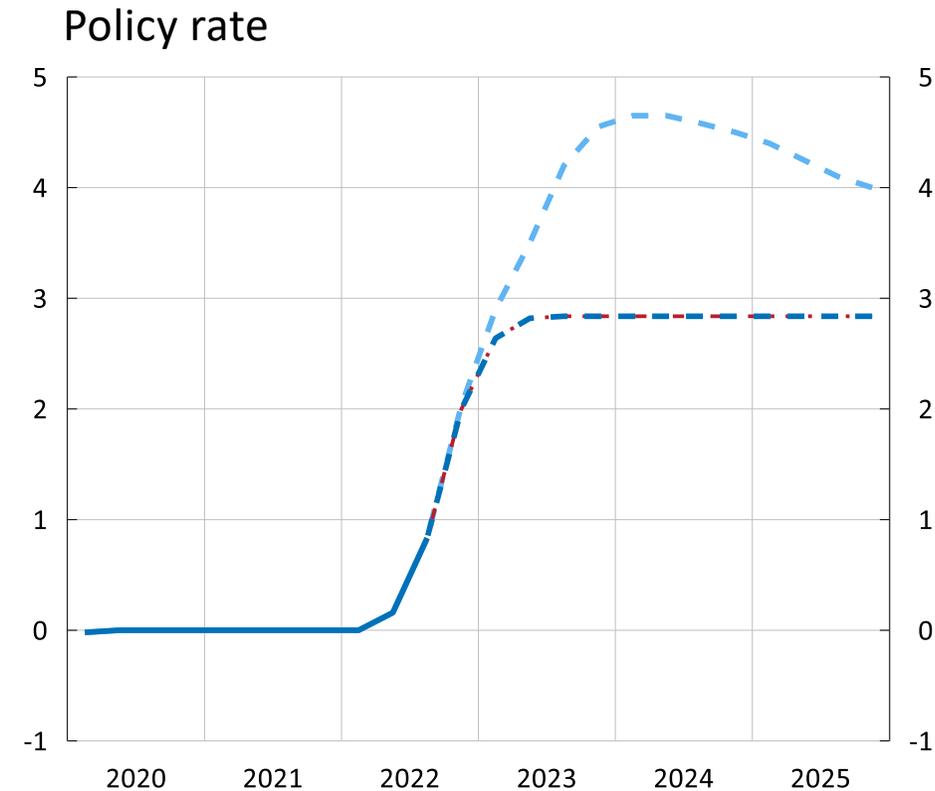
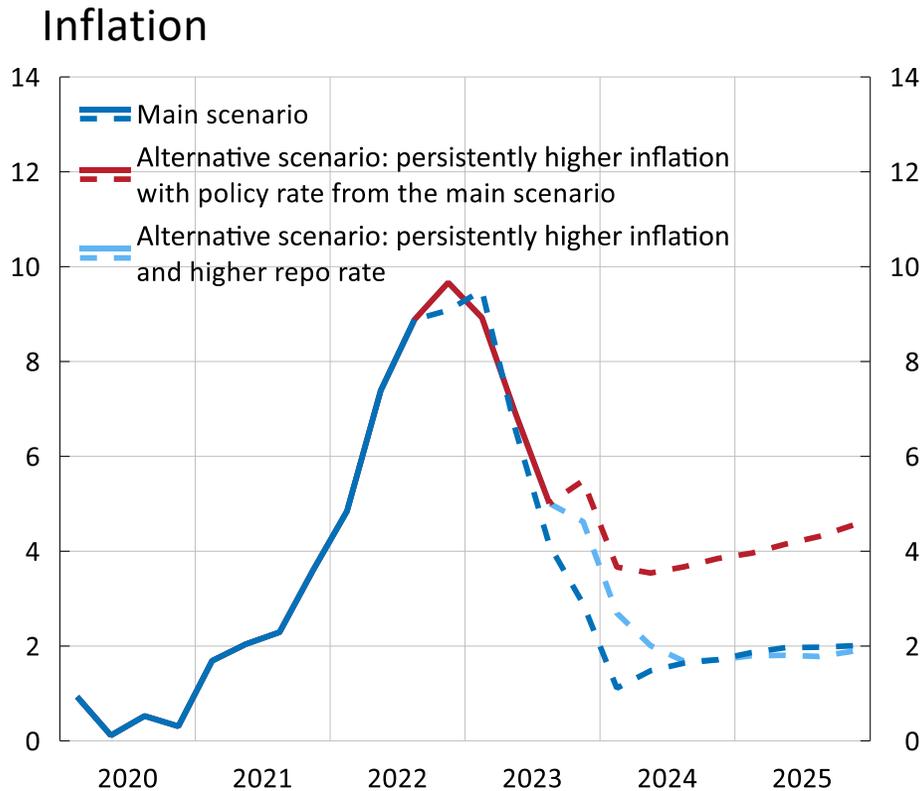
The policy rate path influences market rates in the short term



Note. Difference between the Riksbank's policy rate forecasts and market expectations. Series smoothed by moving averages.

Source: The Riksbank.

Scenarios often but not always symmetric around the main scenario



Note. Annual percentage change (left) and per cent (right). Scenarios from the Monetary Policy Report in November 2022. Inflation refers to the CPIF. Solid line refers to outcomes. Data refers to quarterly averages.

Sources: Statistics Sweden and the Riksbank.