SPEECH

DATE: 2 July 2025

SPEAKER: Deputy Governor Anna Seim

VENUE: 2025 ECB Forum on Central Banking, Sintra, Portugal

The Role of Alternative Scenarios in Monetary Policy Communication[*]

Thank you for inviting me to speak today. While it is widely recognised that effective communication is a key part of monetary policy, communication strategies differ greatly across central banks. This is likely due to differences in institutional features that influence the possibilities and constraints that we face.

Since adopting a regime of flexible inflation targeting in 1995, the Riksbank has chosen a path of high transparency.[1] One reason for this is the fact that we are highly independent, and with that independence comes a need for accountability that is facilitated by transparency. A second rationale is that transparency can make monetary policy more effective if we succeed in managing the expectations of companies, households and markets.

To this end, we aim to convey the Executive Board's reaction function by publishing (i) a policy rate forecast (since 2007), (ii) alternative scenarios capturing perceived risks and how monetary policy will respond to different developments, and (iii) attributed minutes shortly after each policy decision.[2]

In my remarks today, I will briefly comment on our policy rate path but focus on our work with alternative scenarios in the Monetary Policy Report.

---

[*] Remarks made at the Panel on "Central bank communication: current challenges" at the 2025 ECB Forum on Central Banking in Sintra, Portugal. I would like to thank Matilda Kilström, Mika Lindgren and Maria Sjödin for excellent help writing the speech. I would also like to thank Charlotta Edler, Calum McDonald and Emelie Nordeman for proofreading, and other employees at the monetary policy department for their valuable comments.

[1] The Riksbank is consistently ranked as one of the most transparent central banks in the world, see, for example, Dincer, Eichengreen and Geraats (2022) for a relatively recent assessment.

[2] For a more comprehensive descriptions of the monetary policy communication of the Riksbank, see, for example, Thedéen (2025) and Breman (2025).

Baseline policy: the policy rate path

Let me start with some background. Since 2024, we hold eight monetary policy meetings per year. At four of these we publish Monetary Policy Reports (MPRs) containing new forecasts. At the other four meetings there are no new forecasts but a Monetary Policy Update (MPU) that describes our assessments and motives for the monetary policy decision. A monetary policy decision consists of two parts: our decision on the current policy rate and our monetary policy assessment as conveyed in the MPRs and the MPUs.

We are one of few central banks publishing a forecast for the policy rate that reflects the majority view of the Executive Board. Figure 1 shows our most recently published policy rate paths. The policy rate path is consistent with the rest of our economic projections. Our other forecasts are thus contingent on the policy rate path. The path ensures that our inflation target of 2 per cent is met over a horizon that we deem reasonable, while taking the evolution of the real economy into account. It is also consistent with our assessment of the long-run neutral interest rate.[3]

To arrive at the baseline path, we estimate and simulate different models, pursue sensitivity analysis and consider various alternative developments during the monetary policy process. By doing this we want to ensure that the policy embodied in the path has some key properties. One such property is that monetary policy should be *efficient*. We evaluate different paths to ensure that there exists no other policy rate path that would stabilise inflation and the real economy at a lower cost. We also assess if monetary policy is *robust*, i.e., if the policy rate path gives rise to acceptable outcomes even if developments that we assign low probabilities were to materialise. We also want monetary policy to be *predictable*. To ensure that our baseline projection has these features, we are working with a checklist indicating how a particular path performs in terms of these key criteria.

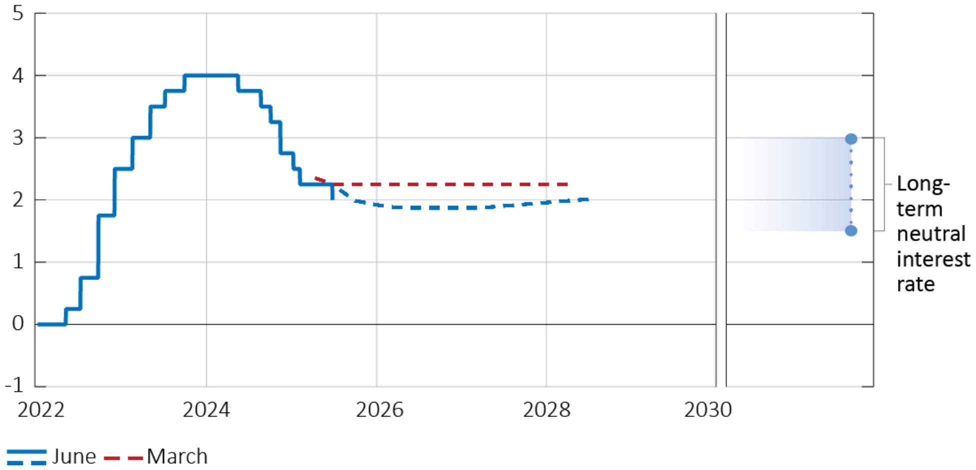
The policy rate path is our best estimate of the policy we would pursue if events unfold as we foresee, i.e., if no new shocks hit the economy. The path is therefore an example of contingent – or *Delphic* – forward guidance. *It is a forecast, not a promise*.[4] When shocks hit the economy, the path is revised. After almost 20 years of publishing policy rate paths, our assessment is that this strategy has been successful in managing expectations in the sense that there is a high degree of alignment between the policy rate path and market rates in the short term.

[3] In my speech ”Neutral interest rate – meaning, limitations and assessment” (Seim, 2024) I discuss the concept of the neutral rate and the Riksbank’s latest assessment of the long-term neutral rate.

[4] For a discussion of this principle see, for example, Thedéen, (2025) and Seim (2025).

Figure 1. Policy rate forecast

Per cent



Note. 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

Since the only thing we can be sure of is that the future will not unfold as we expect, we complement the policy rate path with alternative scenarios.

At the Riksbank we have a long-standing tradition of working with and publishing alternative scenarios.[5] Scenarios have been part of our internal analysis as well as our external communication on and off since 2007, when we started publishing the policy rate path. Since 2023, they have been a more regular and prominent feature of the MPR.

It is easy to say that inflation can be higher or lower than in the baseline, but we can add clarity by being more specific. A scenario comprises a sequence of different types of shocks that materialise in a model universe made up of specific assumptions about, for example, the strength in the monetary policy transmission, price stickiness, and the state of the global economy. Each scenario produces a path of monetary policy that signals that this is how we are likely to react if the events described would occur.

To construct scenarios, we add shocks to the central projections. When called for, we also revise our assumptions about the workings of the economy. The scenarios

[5] The usefulness of scenarios both for the purpose of sensitivity analysis and communication was highlighted by Leeper already in 2003, when evaluating the Inflation Reports by the Riksbank.

are often, but not always, symmetric in the sense that they capture both upside and downside risks to the policy rate forecast.[6] The monetary policy response can also be more or less symmetric.[7] Unlike fan charts, which visualize uncertainty based on historical forecast errors, scenarios are coherent macroeconomic narratives that enable us to be more precise about the possible developments that we envision.[8]

The main purpose of these scenarios is to highlight uncertainty surrounding the overall outlook and the policy rate path, communicate which risks the Executive Board perceives as important, and convey our reaction function.

Scenarios can also be useful when assessing the robustness of the baseline policy. If we think of a stylised world where there are three plausible states - baseline and alternative scenarios 1 and 2 - it is possible to compute the optimal policy path obtaining in each of these environments and apply it to each state, to assess which choice gives rise to the most acceptable outcomes in all three cases.[9]

Narrative important

As I already discussed, the specifics of each scenario matter and the devil is often in the details.

Let me give one concrete example from the beginning of this year as shown in Figure 2. In December 2024, we published an alternative scenario in which rising tariffs and trade tensions would lead to higher inflation and weaker economic activity. The policy response in that scenario was to hike the policy rate to counteract second-round effects and the risk of inflation expectations becoming unanchored. Three months later, inflation outcomes were indeed higher, and in line with those in the December scenario. But the drivers of the higher inflation were fundamentally different: the increase was caused by temporary food-price shocks and the annual reweighting of the CPI, i.e., a “basket effect”. [10] The underlying inflation outlook and economic activity were largely unchanged, so rather than tightening as in the scenario, we stayed the course set out in the

[6] For example, in 2022 and 2023, the Riksbank published several alternative scenarios focusing on upside risks to inflation.

[7] For example, if inflation is already high to begin with, the costs are higher if inflation surprises on the upside than if inflation is lower than expected. Monetary policy may therefore respond more forcefully in a scenario with higher inflation.

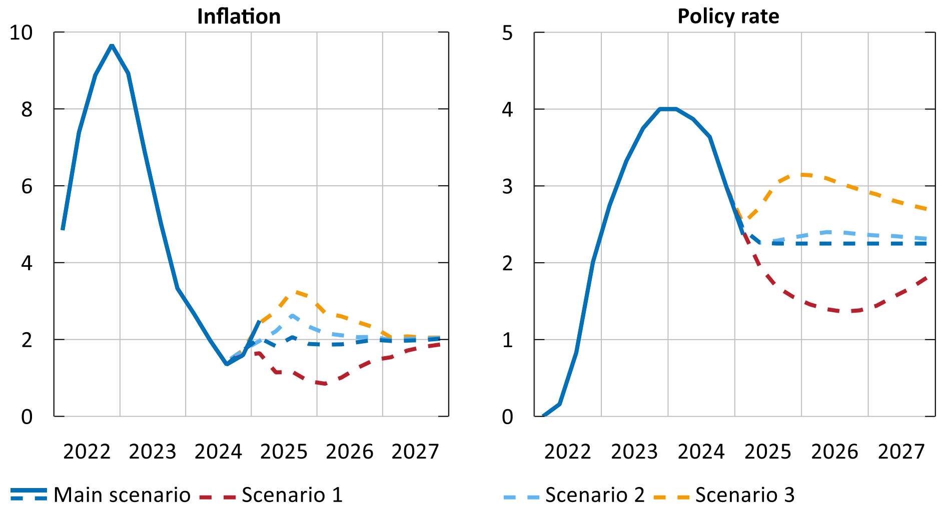
[8] This type of scenario analysis was suggested in the Bernanke review of the Bank of England (Bernanke, 2024) and in Bernanke’s proposal to improve Fed communications (Bernanke, 2025).

[9] See, for instance, Lane (2024) for a discussion of how to assess robustness in the face of uncertainty.

[10] For more information see the fact box “Inflation effects of new weights in the CPIF” in the Monetary Policy Report from March 2025.

policy rate forecast from December. This example highlights the importance of details and that following up on previous scenarios in subsequent MPRs may promote credibility.

Figure 2. Forecast and alternative scenarios for inflation and the policy rate
Annual percentage change (left) and per cent (right)



Note. 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

Constructing useful scenarios is not trivial. A key question is how to choose them, which involves identifying the Executive Board's view of relevant risks. This may prove difficult. One example is the beginning of 2022, when, in hindsight, a useful scenario would have been one where inflation increased more rapidly and persistently than in the main scenario, and monetary policy had to respond more forcefully.[11] But given the long period of low inflation and policy rate close to the lower bound that preceded these events, it seemed unlikely that inflation would increase to levels not seen since the inflation target was introduced. The Riksbank was not alone in making this assessment.

It is also not obvious whether scenarios should be close to the baseline or more extreme, or *how* specific and detailed they should be. These two questions are

[11] We did publish an alternative scenario with higher inflation in February 2022, focusing on the indirect and second-round effects of high energy prices, but it did not capture the risk that inflation would continue to increase during 2022.

related. Scenarios closer to the baseline are arguably easier to address with our model apparatus, but as stated above with reference to the December 2024 scenario, details then become crucial. If we opt for more extreme scenarios, finding appropriate tools for proper analysis may be more challenging. For instance, many of our econometric models rely on historical patterns, but in times of radical uncertainty, patterns can change. At present it is clearly very difficult to assess the economic effects of higher tariffs, and the general-equilibrium implications are not easily addressed in standard models. Another difficulty may be that highlighting certain developments can be sensitive, if there is a risk that expectations become self-fulfilling.

Since the Executive Board assumes responsibility for the scenarios and the policy responses that they entail, scenarios should ideally receive as much attention in the policy process as the baseline projection. But since the main scenario is central for our policy assessment, it is natural that it receives more attention.[12] In addition, we know that it is mainly the policy rate path that will be scrutinized and studied.

Do scenarios work?

A key objective of scenarios is to highlight important risks and to signal that policy may well deviate from what is embodied in the policy rate path. We would like to avoid surprises and pave the way for alternative policy choices should they be warranted. Testing empirically to what extent scenarios actually make monetary policy more predictable is, however, not straightforward. One way to do this is by studying the deviation of market expectations of the policy rate from our baseline path. In the short term they are small, but there are episodes where deviations are larger, and markets seem not to believe the policy rate forecast. For example, during the inflation surge of 2022 expectations were more in line with the path communicated in one of the alternative scenarios. Of course, this does not necessarily mean that markets were affected by our scenario, but at the very least it seems they considered that scenario realistic.

We also know that market participants study our scenarios. In the beginning of this year some of them picked up on the fact that we did not act in accordance with our December 2024 scenario, despite inflation outcomes being very similar. As explained above, details were then helpful, and we have since started to revisit earlier scenarios in the MPR, with the aim of ultimately promoting credibility.

[12] Flodén (2024) also notes that the policy process at the Riksbank tends to focus on the baseline projection, with scenarios typically receiving less attention.

Concluding remarks

In conclusion, the policy rate path and carefully crafted alternative scenarios, are crucial communication tools that aim to paint a comprehensive picture of our reaction function.

In my view, scenarios are particularly useful when uncertainty is high. In more stable times, we can be more confident in our central projections. But when there is substantial uncertainty about where we are heading, it is natural to put more emphasis on “what ifs”.

In terms of scenario design, it is not obvious how extreme or detailed they should be. But the closer we are to the baseline, the more important it may be to describe in more detail the mechanisms and driving forces that we assess to be central. Just focusing on the development of a few key variables may be too vague a narrative. We have also learned from experience that revisiting past scenarios in our MPRs is an opportunity to shed further light on our reaction function and, by doing so, to promote credibility.

Anecdotal evidence and data suggest that our monetary policy communication, which aims to make monetary policy more predictable, has been relatively successful in managing expectations, even in times of great uncertainty.

Thank you for listening!

References

Bernanke, Ben S. (2024), “Forecasting for monetary policy making and communication at the Bank of England: a review”, Bank of England.

Bernanke, Ben S. (2025), “Improving Fed Communications: A Proposal”, Hutchins Center Working Paper No. 102, Brookings Institution.

Breman, Anna (2025), “Daring to be different - the Riksbank’s communication strategy”, keynote address at the Bank of England’s conference “Transforming Monetary Policy: How should we think about uncertainty and risks?”, London June 25, 2025.

Dincer, N. Nergiz, Barry Eichengreen and Petra Geraats (2022), “Trends in Monetary Policy Transparency: Further Updates”, *International Journal of Central Banking*, Vol. 18, No. 1, pp. 331-348.

Flodén, Martin (2024), “Important to communicate clearly despite constant uncertainty”, speech at Nordea, Stockholm April 17, 2024.

Lane, Philip (2024), “Monetary policy under uncertainty”, keynote speech at the Bank of England Watchers’ Conference 2024, King’s College London, London November 25.

Leeper, Eric M. (2003), “An Inflation Reports Report”, NBER Working Paper 10089.

Seim, Anna (2024), “Neutral interest rate – meaning, limitations and assessment”, speech at the Riksbank, Stockholm November 26, 2024.

Seim, Anna (2025), “The Interest Rate Path of the Riksbank”, presentation at Federal Reserve Board’s “2nd Thomas Laubach Research Conference”, Washington May 16, 2025.

Thedéen, Erik (2025), “Monetary policy communication in practice”, speech at the Swedish Economic Association, Stockholm June 2, 2025.