The links between monetary policy, financial stability and fiscal policy

Swedish National Economic Association
23 may 2023

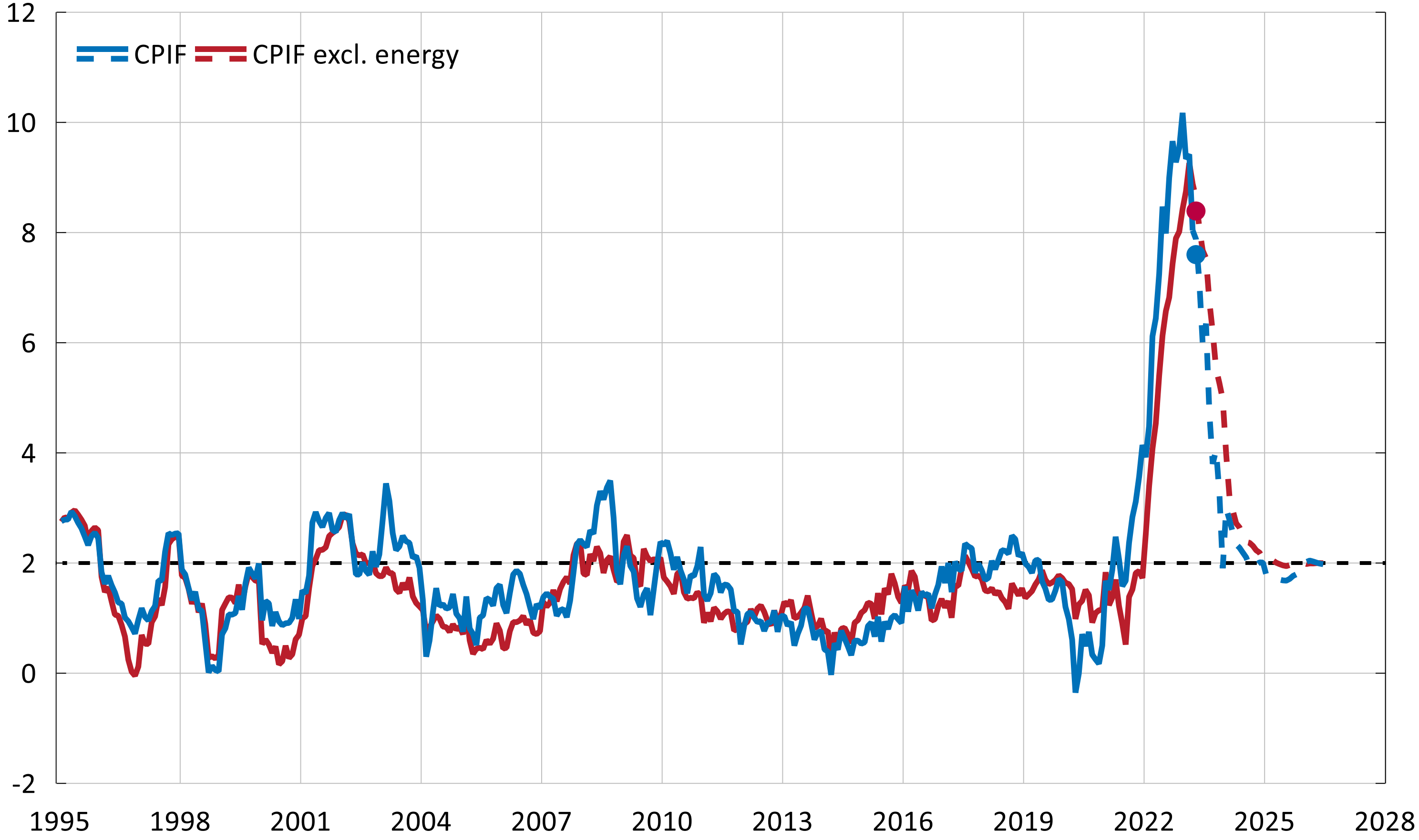
S V E R I G E S R I K S B A N K

Erik Thedéen
Governor of the Riksbank

My main messages

- High inflation and risks in the financial system – inflation targeting is put to the test
- Monetary policy can in certain situations prevent the build-up of financial imbalances – but the basic assumption should be that preventive measures are not managed with monetary policy
- We can and should have an exchange of information with, for example, the Riksdag Committee on Finance and the Ministry of Finance on issues relating to the conditions for monetary policy
- The policy rate should be the main monetary policy tool

High inflation but expected to fall back during the year



Note: Annual percentage change.
Dashed lines refer to monetary policy forecast April 2023.

Sources: Statistics Sweden and the Riksbank.

Banks in distress in the spring

SILICON VALLEY BANK

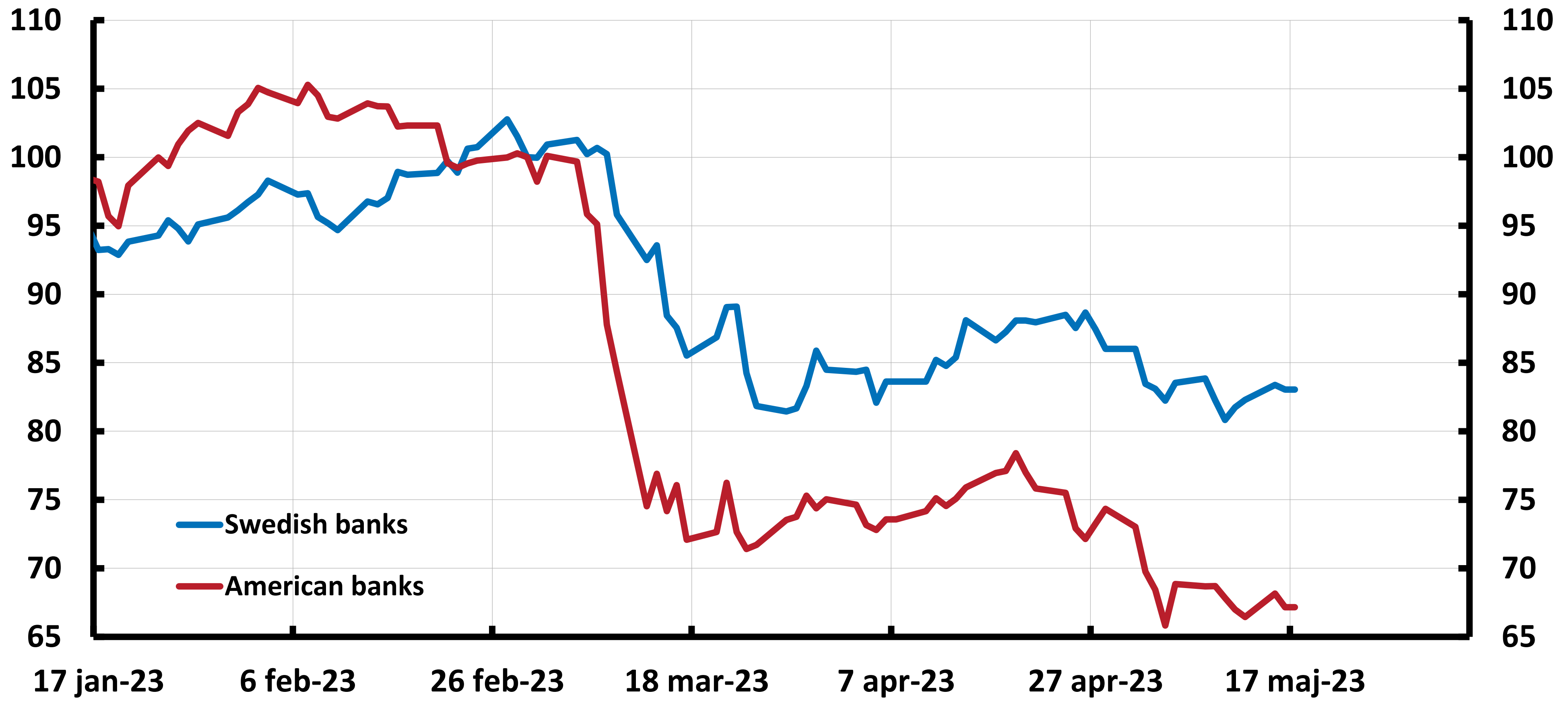
SIGNATURE BANK

FIRST REPUBLIC BANK

CREDIT SUISSE

Stock prices for banks plummeted...

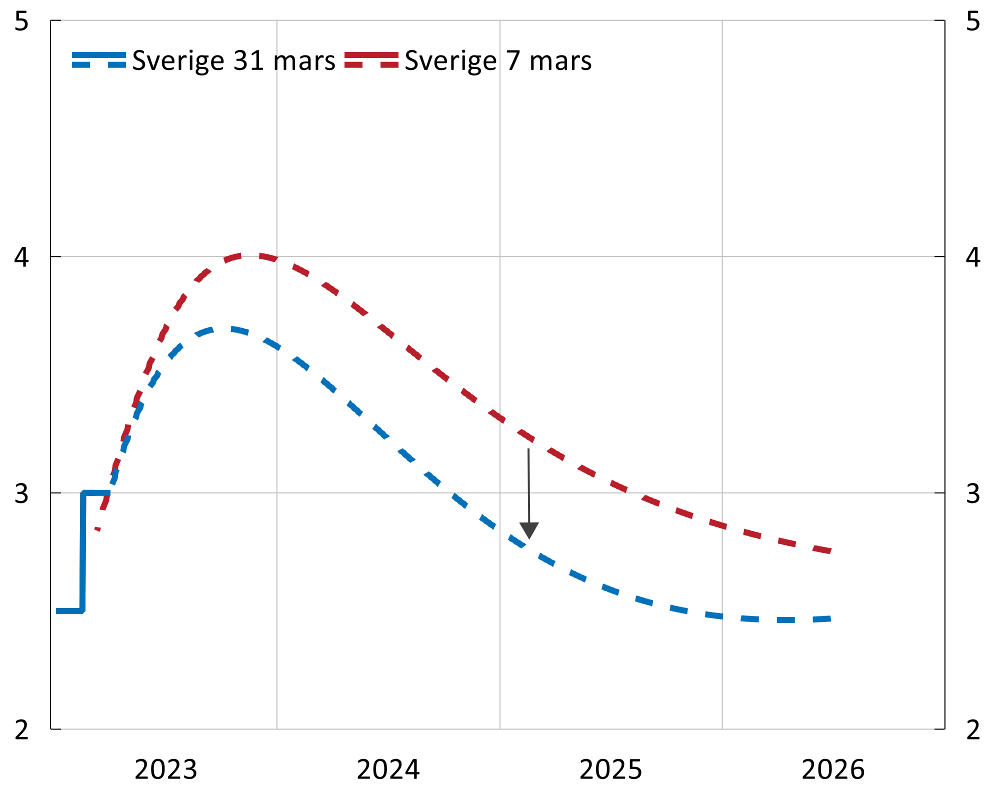
Index 01 March 2023 = 100

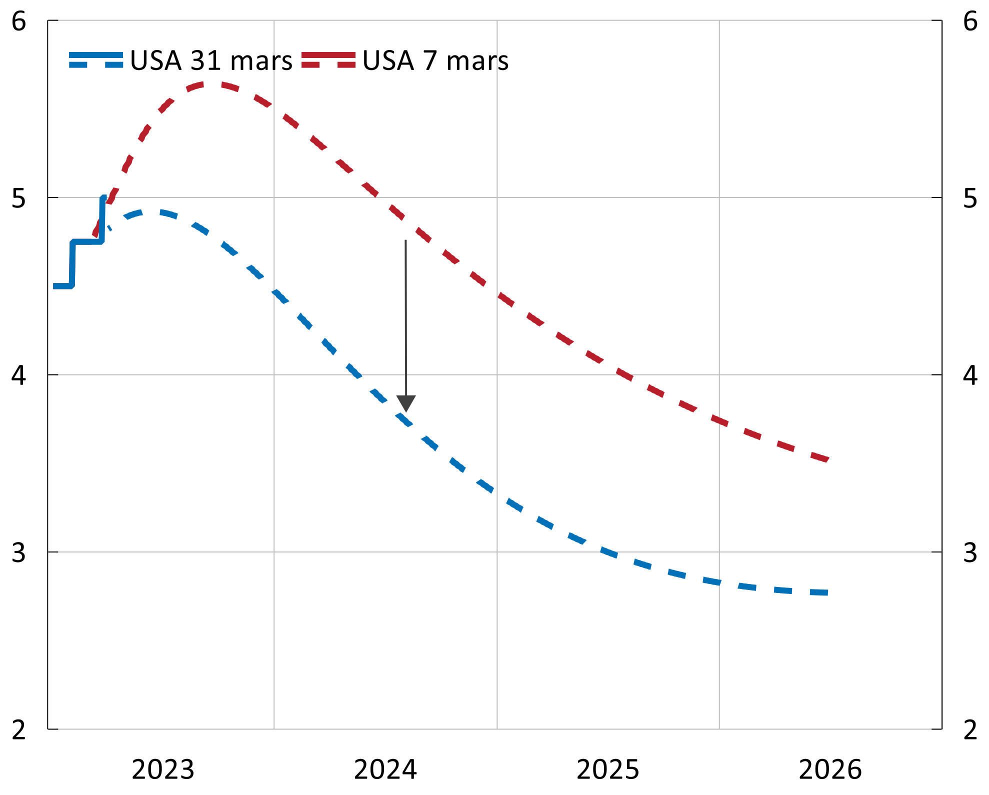


Note: Refers to OMX Stockholm Banks BI for Swedish banks and KBW Bank Index for the United States.

Source: Bloomberg.

...interest rate expectations fell





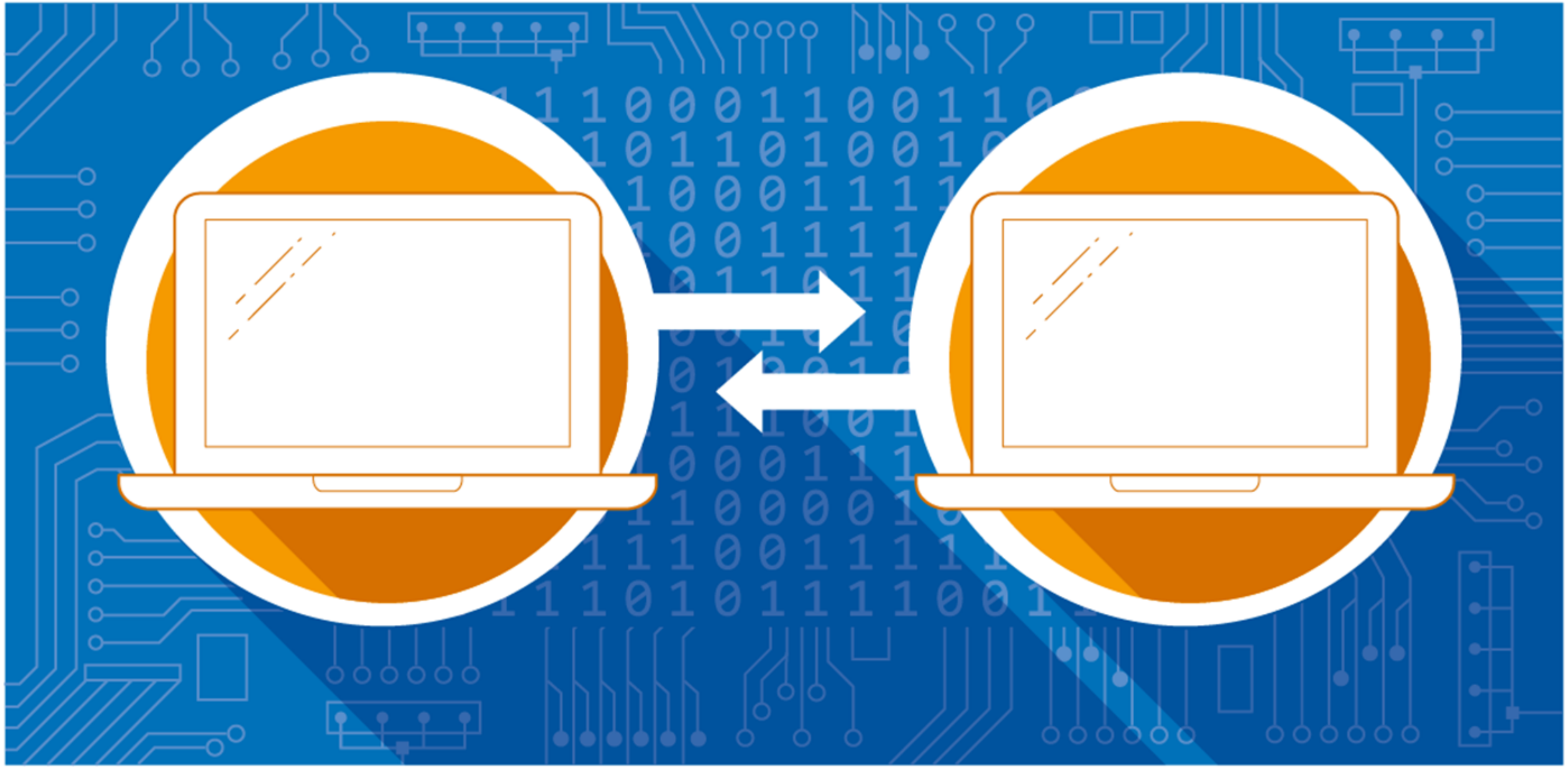
Note: Solid lines refer to key interest rates, dashed lines refer to market-based expectations of future policy rates.

Sources: Federal Reserve and the Riksbank.

Back to fundamentals

- Banks are important, but they involve risks
- Trust is essential
- ...but trust can disappear quickly
- Global standards/regulations are needed and affect Sweden

This spring's bank runs raise questions about changes in global regulations



High inflation combined with risks in the financial system

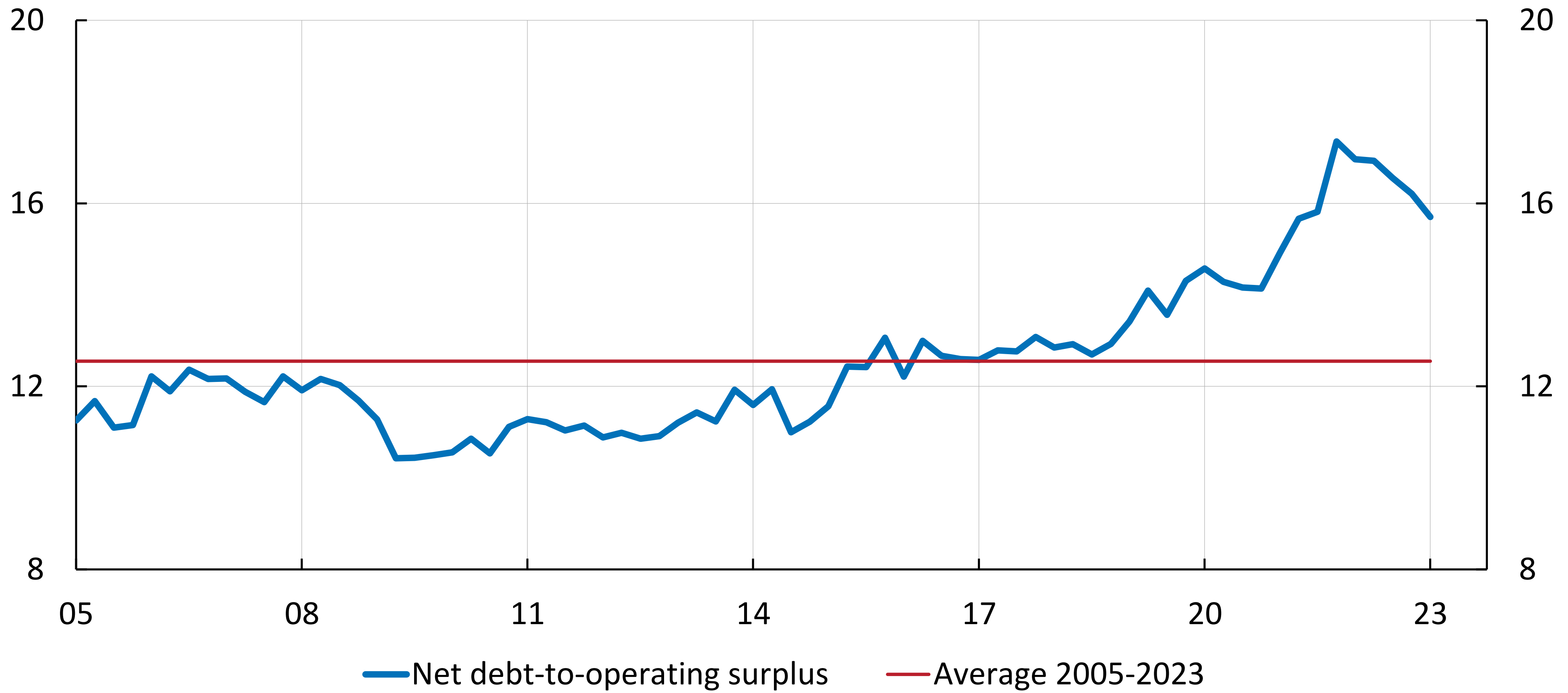
- Monetary policy and financial stability are interdependent

- Inflation targeting being put to the test

- Financial dominance: Taking risks into account in the financial system limits monetary policy’s ability to combat inflation – may undermine the credibility of the inflation target

- We need to continuously monitor developments and take action

Low interest rates over a long period of time can increase the risks – rising indebtedness for real estate companies



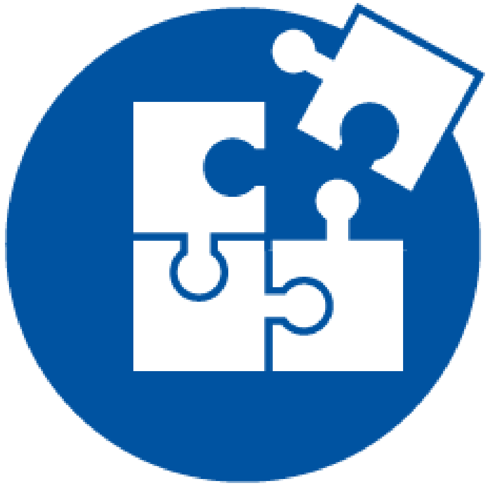
Note. Interest-bearing loans (net) in relation to operating profit/loss. Data up to the end of Q1 2023.

Sources: Sedis, the Riksbank and Catella.

Responsibility for financial stability shared between different authorities

- Macroprudential policy is effective when one knows where the risks in the financial system are built up – but the policy rate affects the financial markets broadly

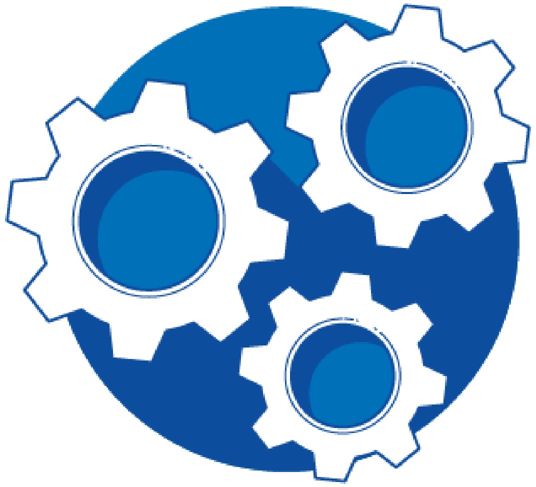
- Monetary policy can in certain situations prevent the build-up of financial imbalances – but the basic assumption should be that preventive measures are not managed with monetary policy
    - When other policies fail to fully limit the risks
    - As long as the credibility of the inflation target is not threatened



Interaction between monetary and fiscal policy also in the short term

- A more expansionary fiscal policy can help bring up inflation when low interest rates for a long time have not succeeded

- Some form of information exchange between monetary and fiscal policy may be desirable in matters concerning the conditions for monetary policy



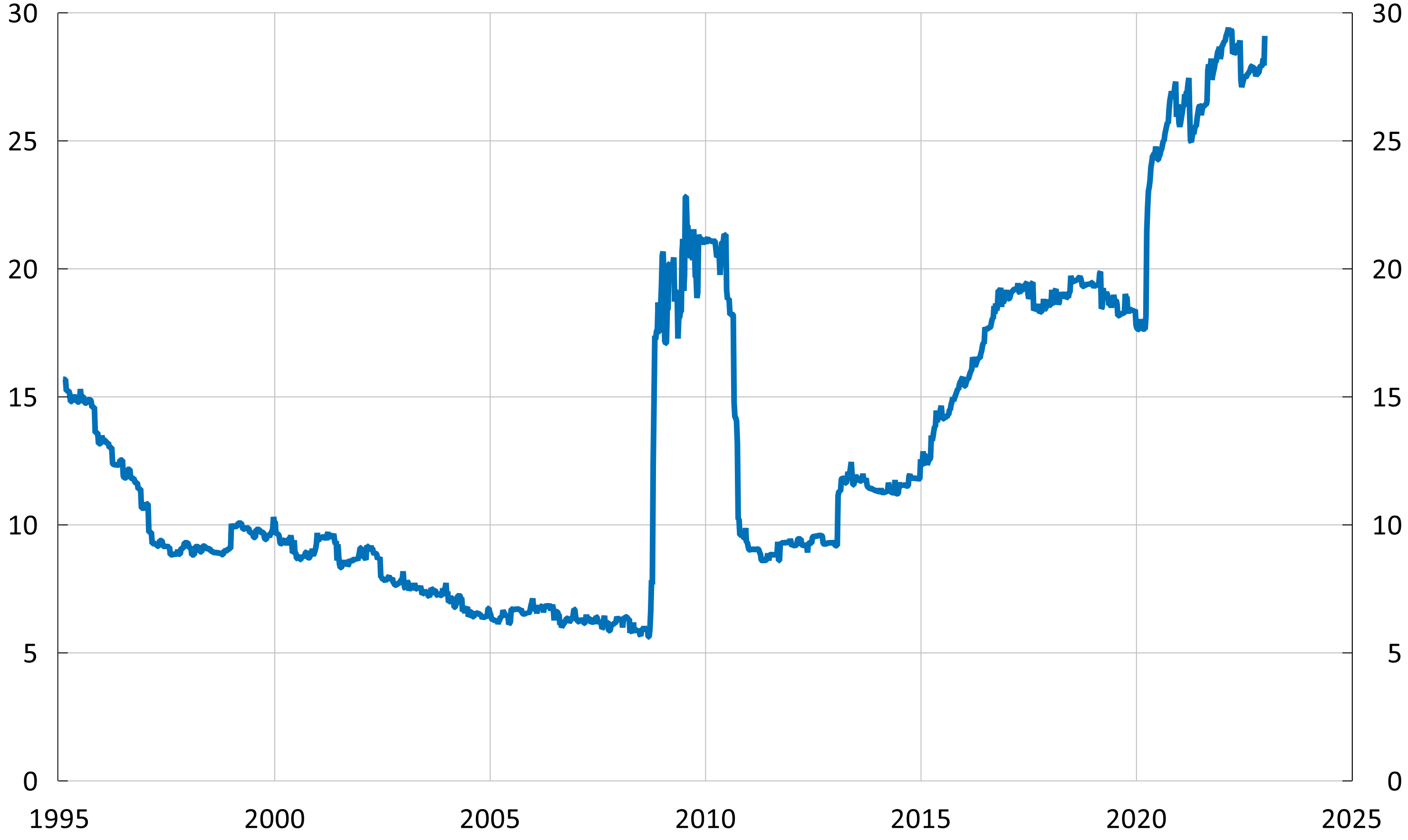
The main monetary policy tool should be the policy rate.

- Asset purchases particularly effective in financial crises and when markets are not functioning well

- Negative side-effects of asset purchases

- Securities purchases shall be included in our toolbox
  - But should be used with caution

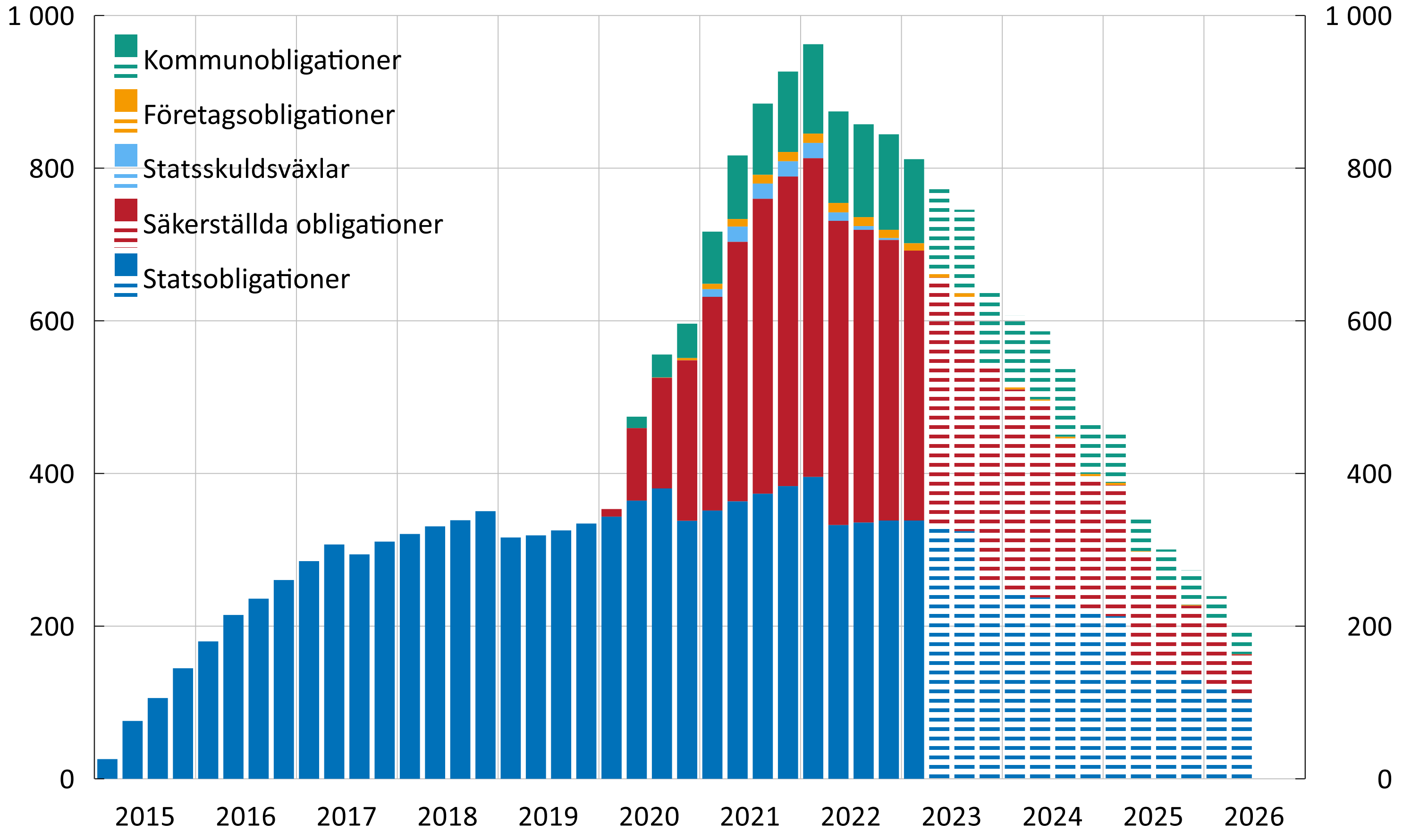
Large balance sheet – more analysis of the impact of asset purchases is needed



Note: Per cent. Balance sheet total as percentage of GDP.

Source: The Riksbank.

Normalisation of the Riksbank's securities portfolio has begun



Note: SEK billion. The striped bars represent a forecast based on maturities and decisions that no asset purchases will be made after 2022 and that government bonds will be sold for a nominal value of SEK 3.5 billion per month.

Source: The Riksbank.

The links between monetary policy, financial stability and fiscal policy