

**An Evaluation of Swedish Monetary Policy between 1995 and 2005**  
**A Report for the Riksdag Committee on Finance by**  
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## **PRESS RELEASE**

In November 2005 the Riksdag Committee on Finance decided to assign an evaluation of Swedish Monetary Policy between 1995 and 2005 jointly to Professor Francesco Giavazzi at Bocconi University and Professor Frederic Mishkin at Columbia University.

We started our evaluation in January 2006. During the spring and summer of 2006 we visited Sweden on several occasions in order to collect information and discuss Swedish monetary policy with various stakeholders in Swedish society. Among others, we met representatives of the Riksbank, the social partners, academic life, the financial market, the Government and the Riksdag. Between April and June 2006, the public also had the opportunity to submit to us their views on Sweden's monetary policy, via the Riksdag website. In addition, some 20 referral bodies were invited to submit statements on Sweden's monetary policy directly to us. The substantial work on this report was completed before Professor Mishkin joined the Board of Governors of the Federal Reserve System on September 5, 2006.

Our evaluation of monetary policy in Sweden indicates that the Riksbank compares favourably with the best central banks in the world and that monetary performance has greatly improved from what occurred prior to the adoption of inflation targeting under an independent central bank. As a result not only the level and the volatility of inflation were significantly reduced, but the volatility of output has also diminished. This has been supported by a country that has good governance and government policies that have promoted fiscal responsibility, financial stability and growth in productivity.

However, in recent years the Riksbank has persistently undershot its inflation target; this has been associated with a loss in output and higher unemployment. The Riksbank also has been somewhat less effective in clearly communicating its strategy for the conduct of monetary policy. There is thus room for improvement in the Riksbank's performance.

We make *nine* recommendations that – along with a few other suggestions, in particular the staggering of Board appointments, rethinking responsibilities of Board members, making conflict of interest rules more stringent – we hope will help put monetary policy on an even sounder footing. We divide our recommendations into those that deal with the conduct of monetary policy and those that involve the governance of monetary policy.

### ***Recommendations***

#### **The Conduct of Monetary Policy**

**Recommendation 1:** The Riksbank should more clearly explain that flexibility in its inflation targeting regime implies that the conduct of monetary policy should try to reduce both inflation and employment (output) fluctuations.

**Recommendation 2:** The Riksbank should clarify that asset prices (housing prices, stock prices and exchange rates) are not independent targets for monetary policy.

**Recommendation 3:** Persistent undershooting of the inflation target suggests that monetary policy should lean towards more expansionary policy (while persistent overshooting should bias monetary policy to be relatively more contractionary).

**Recommendation 4:** The Riksbank should provide more information on the future path of policy rates that are used in producing its forecasts of inflation and the economy, but should make clear the uncertainty surrounding such a path.

**Recommendation 5:** The inflation target should be defined in terms of a price index that is not directly affected by the costs of housing.

**Recommendation 6:** There is no compelling reason to change the level of the inflation target from the 2% number. But further study of the appropriate level of the inflation target could be beneficial if it is conducted by technical experts.

### **Governance of Monetary Policy**

**Recommendation 7:** The dialogue between the Sveriges Riksdag and the Riksbank needs to be enhanced by separating the release of the *Inflation Report* from its discussion in the Finance Committee.

**Recommendation 8:** A main venue for public debates on monetary policy is in the parliament.

**Recommendation 9:** Individuals who are nominated to the Executive Board of the Riksbank should be asked to appear in parliamentary hearings before they are appointed.

### ***The structure of the report***

The terms of reference specified the following list of questions:

1. Are the Riksbanks overall objectives correctly formulated ?
2. Is the inflation target (IT) correctly formulated ?
3. Has the monetary policy pursued by the Riksbank achieved the inflation target during the period 1995–2005?
4. What methods of forecasting and analysis does the Riksbank use, and how is the Riksbanks decision-making process designed ?
5. Is the Riksbanks external communication effective and expedient ?
6. Does the Riksbank have the right instruments to achieve the inflation target ?
7. How does Sweden fare in comparison with other countries with respect to inflation targeting?

Our report comes in five Sections:

1. Introduction
2. The Science of Monetary Policy
3. How Well Has Swedish Monetary Policy Been Run?
4. An Evaluation of the Swedish Inflation Targeting Regime

## 5. Conclusions and Nine Recommendations

Section 2 examines what economic science tell us about how monetary policy should be conducted in nine key areas: 1) the importance of price stability and a nominal anchor to successful monetary policy, 2) fiscal and financial preconditions for achieving price stability, 3) central bank independence as an additional precondition, 4) central bank accountability as a necessary complement of independence, 5) the rationale for inflation targeting, 6) flexibility of inflation targeting, 7) central bank transparency and communications, 8) the optimal inflation target and 9) the role of asset prices in monetary policy.

Section 3 analyses how Swedish monetary policy has been run. In evaluating Swedish monetary policy over the past decade, we examine several questions: 1) whether it produced good economic performance in the long run, 2) were policy rates set appropriately, and 3) what has been the relationship between monetary policy and the exchange rate?

Section 4 addresses seven issues that in our opinion are key to an evaluation of the Swedish inflation targeting regime: 1) Is the institutional framework of the inflation targeting regime appropriate? 2) Is the technical expertise in the Riksbank of sufficiently high quality? 3) Is the level of the inflation target appropriate? 4) Is the inflation targeting regime sufficiently flexible? 5) Does it make sense to base forecasts on implicit market interest rates? 6) How well is the Riksbank communicating? 7) Is the Executive Board set up properly? In the final Section of the Report we make *nine* recommendations.