Modelling monetary policy – A Swedish perspective

SUERF workshop on "Macroeconomic models and monetary policy: State of play and way forward"
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A Swedish perspective

• Independent monetary policy with an inflation target
  • Need to form a consistent view of the macro economy, financial markets and monetary policy
  • Need a good grasp of the monetary transmission mechanism

• Six-member Executive Board with individual accountability
  • May need to cater to many different preferences and views

• Small open economy
  • Need to model international spillovers

• High degree of transparency
  • The Riksbank publishes forecasts for 50+ variables, including forecasts for monetary policy
  • High ambition to explain monetary policy

• Large-scale asset purchases since 2015
  • Current holdings approx. 18% of annual GDP
International spillovers

• International developments are important for the Swedish economy (Lindé and Reslow, 2017)
  • Real, financial and monetary policy spillovers

• Justiniano and Preston (2010): Structural (DSGE) models imply weak international spillovers

• Main focus of recent review of Riksbank DSGE model
  • Introduced global trends (productivity growth, interest rates) and correlated shocks
  • Not unreasonable, but no “deep understanding” of spillovers

• Not a huge literature, but some promising avenues
  • But not easily incorporated in standard policy models

• Weak spillovers not only for international shocks
  • A challenge to get co-movement right in DSGE models
  • Need many shocks (Corbo and Strid, 2020), in contrast to empirical evidence of very few driving forces (Angeletos et al, 2020; Giannone et al, 2004)
Forward guidance

• Riksbank publishes forecast of policy rate since 2007
  • Transparency and consistency
  • Manage expectations
  • Has improved monetary policy discussions

• Challenge to get credible effects of shifting future policy rate in macro models
  • Forward guidance puzzle

• Large area of research

• Riksbank approach
  • Discounting and partly anticipated shocks (with empirical weights)

• Still a challenge to evaluate what effects are reasonable
Asset purchases

• Still not much consensus on how asset purchases work
  • Which channel is most important?
  • Time-varying? State-dependent? Yes, probably
  • Asymmetric? Possibly

• The devil is in the institutional details
  • Long-term interest rates may not be very important in Sweden
  • Private asset markets work differently in different countries

• More difficult assess transmission mechanism and effects
  • And therefore difficult fine-tune policy

• Riksbank approach
  • Calibrate open-economy DSGE model (Kolasa and Wesolowski, 2020) using financial market response to QE announcements

• Much research is being done, but may need to be country-specific
To wrap up

• Need to improve our understanding of
  • Driving forces and propagation
  • Expectations
  • How institutional details matter for monetary transmission
Thank you