# 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

    - Bergholt and Sveen (2014), Bergholt (2015), Alpanda and Aysun (2014), Gars and Olovsson (2017)

    - 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