

## ARTICLE – The new Riksbank Act and the monetary policy framework

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Under the new Riksbank Act, which came into force at the turn of the year, the main task of the Riksbank, as previously, is to ensure low and stable inflation. The act clarifies that the Riksbank shall take account of developments in the real economy. It also details the circumstances under which the Riksbank may use certain monetary policy tools and the information the Riksbank shall submit to its principal, the Swedish Riksdag, and to the general public. In several respects, the new act is compatible with how the Riksbank already conducts monetary policy and therefore does not change the substance of the monetary policy framework. The act gives the Riksbank a strong and clear mandate to continue to conduct independent monetary policy in the future.

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A new Riksbank Act entered into force on 1 January 2023.<sup>28</sup> Under the new act, the Riksbank's main tasks remain the same. As previously, price stability is the overriding objective and without neglecting it, the Riksbank shall take account of developments in the real economy. The Riksbank shall also contribute to the stability and efficiency of the financial system and ensure that the public can make payments. But the new act changes the conditions for the Riksbank's various work areas to a certain extent and gives the Riksbank a new, important responsibility for ensuring that it is also possible to make payments during peacetime crisis situations and times of elevated preparedness. This article focuses on the monetary policy area and goes through the main changes in the new act and what they mean for the Riksbank's monetary policy work in practice.<sup>29</sup>

### The objective is low and stable inflation

The new Riksbank Act stipulates that “the overriding objective of the Riksbank is to maintain permanently low and stable inflation (the price stability target).”<sup>30</sup> The previous act formulated this objective as the Riksbank “maintaining price stability”. With this change, the wording is now more appropriate and it is now clearer that the objective concerns inflation.<sup>31</sup> The new act also makes it clearer that monetary policy shall be conducted so that the inflation target is credible in the longer term, as such

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<sup>28</sup> Sveriges Riksbank Act (2022:1568).

<sup>29</sup> The description of the Riksbank's Monetary Policy Report strategy, Monetary policy in Sweden – The Riksbank's strategy, which is at the beginning of each Monetary Policy Report has been updated to reflect the provisions of the new act.

<sup>30</sup> Chapter 2, Section 1, Sveriges Riksbank Act.

<sup>31</sup> It was clear from the preparatory work history of the old act that the aim of the wording “price stability” was a target for inflation, rather than a price level target (Government Bill 1997/98:40 p. 53).

confidence is a prerequisite for permanently low and stable inflation. Low and stable inflation is a prerequisite for good growth in the Swedish economy.

### **The Riksbank specifies the inflation target and the Riksdag shall approve this specification**

A slightly more significant change in the act concerns the specification of the inflation target – its level and the measure of inflation it shall relate to. The act now states that “The Riksbank shall, with the approval of the Riksdag, decide on the specification of the price stability target”.<sup>32</sup> As before, the Riksbank shall take the initiative to the specification. The difference is that the Riksdag shall approve this specification before it applies. Until further notice, the same specification as previously applies, i.e. that the annual change in the consumer price index with a fixed interest rate (CPIF) is to be 2 per cent.<sup>33</sup>

### **The Riksbank continues to have strong independence**

Decisions on monetary policy measures to achieve the specified target are subject to a ban on taking instructions in the new act, just as in the old act. This means that no public authority may determine how the Riksbank is to decide in issues concerning the formulation and implementation of monetary policy and neither may the Riksbank request or accept instructions from anyone on this. This does not prevent the Riksbank engaging in dialogue with the Government, administrative authorities and organisations on monetary policy issues.<sup>34</sup>

### **Monetary policy considers the real economy**

The new Riksbank Act states that the Riksbank shall take account of the real economy in its monetary policy decisions: “Without neglecting the price stability objective, the Riksbank shall also contribute to a balanced development of production and employment (consideration for the real economy)”.<sup>35</sup> Consideration of the real economy was not written into the earlier act. But the preparatory work history of the old act makes it clear that the Riksbank, as an authority under the Riksdag, should have an obligation to support general economic policy goals and that monetary policy can help to fulfil the objectives of sustainable growth and full employment.<sup>36</sup> For this and other reasons, the Riksbank already previously considered the development of production and employment – this is normally referred to as flexible inflation targeting.

The Riksbank assesses that the wording on balanced development of production and employment in the act has in practice the same implication as the earlier wording:

<sup>32</sup> Chapter 2, Section 3, Sveriges Riksbank Act.

<sup>33</sup> If the Riksdag were not to approve the Riksbank’s specification of the target, the Riksbank’s most recently adopted specification would continue to apply. In the Government Bill proposing the new Riksbank Act, the Government considered that a target for the annual change in the CPIF of 2 per cent could be a suitable specification for the meantime (Government Bill 2021/22:41, Chapter 8.1.4).

<sup>34</sup> Government Bill 2021/22:41, p.174.

<sup>35</sup> Chapter 2, Section 1, Sveriges Riksbank Act.

<sup>36</sup> Government Bill 1997/98:40, p. 53ff. From Article 127.1 of the Treaty on the Functioning of the European Union and Article 3.3 of the Treaty on European Union it is also clear that central banks shall consider developments in the real economy.

that the Riksbank strives to stabilise production and employment around development paths that are sustainable in the long term. The change therefore has no practical significance for the monetary policy strategy.

### **Flexible inflation targeting presumes confidence in the inflation target**

The Riksbank's inflation target shall act as a benchmark for price- and wage-setting in the economy – it shall constitute what is usually referred to as a nominal anchor. When inflation does not vary so much and economic agents have a collective picture of how prices will develop in the future, it becomes easier to plan for the long term. This, in turn, improves the possibility of achieving favourable economic developments with good and stable growth. The Riksbank's task is to ensure that inflation is close to 2 per cent and if inflation deviates from 2 per cent, the Riksbank shall adjust monetary policy so that inflation returns to close to 2 per cent within a reasonable time.

It is neither possible nor desirable to conduct monetary policy aimed at always maintaining inflation at exactly 2 per cent. Constant changes occur in the economy that make inflation vary in a way that cannot be predicted with great precision, or counteracted in the short term. As it also takes time before monetary policy has its full effect on the economy, monetary policy is guided by economic forecasts.

Under the act, monetary policy shall also consider the development of production and employment and thus be conducted flexibly. In many cases, the real economy and inflation move in the same direction; strong demand in an economic boom increases production and employment and inflation rises, while the opposite happens in an economic recession. Changes in monetary policy then help to stabilise both the real economy and inflation – there is no conflict between monetary policy that brings inflation back to target and one that provides a balanced development of the real economy. But in certain situations, economic shocks can cause the real economy and inflation to go in different directions.

In connection with each monetary policy decision, the Executive Board assesses which monetary policy is well-balanced. If inflation deviates from the inflation target, it is normally a question of finding a balance between how rapidly it shall be brought back to target and the effects on real economic developments. What is well-balanced can depend on factors such as the reasons why inflation deviates from the target, by how much and how long it has deviated and what the prospects are for the real economy. There is thus no general answer to the question of how quickly the Riksbank aims to return inflation to 2 per cent.<sup>37</sup>

But a prerequisite of flexible monetary policy is that there is confidence among households, companies and financial agents that deviations from the target will not be too prolonged and that inflation will return to target within a reasonable time perspective. The possibility for the Riksbank to maintain the inflation target is dependent on

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<sup>37</sup> The forecasts for inflation show the horizon over which inflation is expected to be on target given the monetary policy the Riksbank assesses to be well-balanced in connection with individual monetary policy decisions. According to the preparatory work of the new act, the Riksbank shall present the time frame within which the price stability target can be expected to be achieved (Government Bill 2021/22:41).

the existence of such confidence, and price stability is the overriding objective for monetary policy. If there is a risk of the confidence in the target being eroded, it may be necessary to direct monetary policy towards bringing inflation close to the target of 2 per cent rather quickly.

### **As before, the Riksbank takes into consideration risks associated with developments in the financial markets**

In its monetary policy, the Riksbank takes into consideration risks associated with developments in the financial markets. A source of such risks is imbalances in the financial markets that can contribute to longer-term unsustainable development in asset prices and the indebtedness of economic agents. This can create risks of sharp price movements and change agents' economic conditions. This in turn can have major negative consequences for economic developments in general and also lead to inflation being far from the target. Financial crises tend to create long and extended recessions.

To counteract the build-up of financial imbalances, well-functioning regulatory frameworks and efficient supervision of financial companies play a central role. According to the Government's proposal for the new Riksbank Act, the Riksbank should, within the framework of monetary policy, take account of financial imbalances in the credit market and, if necessary, adjust the time frame within which the inflation target is to be attained.<sup>38</sup> A pre-condition is that the Riksbank can maintain credibility in the inflation target. Another pre-condition is that the Riksbank can justify such a policy by stating that expected and overall target achievement regarding the inflation target including real economic consideration will be better.

If a risk materialises and shocks in the financial markets emerge, there is also a risk of serious consequences for the real economy and for attainment of and confidence in the inflation target. The Riksbank may then need to take monetary policy measures to mitigate or counteract such a development. At the same time, the new Riksbank Act provides scope for taking measures to counteract a severe shock in the financial system. In the event of major shocks in the financial markets, the Riksbank therefore needs to take a stand on the purpose of the measure.<sup>39</sup>

### **Requirement for exceptional grounds when trading assets other than government securities**

Like the previous Riksbank Act, the new act specifically states which tools the Riksbank may use for monetary policy purposes. However, the provisions were worded more generally in the previous act. One reason for the change is that the legislator has chosen to clarify the boundaries for the objectives, the tasks and powers

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<sup>38</sup> Government Bill 2021/22:41, Chapter 8.1.2.

<sup>39</sup> Government Bill 2021/22:41, p. 74 and p. 177.

within the Riksbank's various spheres of responsibility, both in relation to each other and in relation to the remits of other authorities.<sup>40</sup>

In relation to financial companies, the Riksbank may, under the new act, accept deposits, provide credit against adequate collateral and enter into repurchase agreements in financial instruments.<sup>41</sup> The Riksbank shall determine the policy rate for such transactions. The Riksbank may also enter into repurchase agreements in foreign currency and buy and sell Swedish government securities.<sup>42</sup> In addition, the Riksbank may carry out foreign exchange interventions, issue and renew debt instruments in Swedish krona and, if there are exceptional grounds, buy and sell financial instruments other than Swedish government securities.<sup>43</sup>

In practice, the Riksbank can use the same tools as previously but, according to the new act, there must be exceptional grounds for the Riksbank to be able to buy and sell financial instruments other than Swedish government securities for monetary policy purposes.<sup>44</sup> In the Government Bill containing the draft legislation, the Government justifies this by stating that this type of trading involves a much greater financial risk for the Riksbank and for state finances than changes in policy rates and purchases of government securities. Purchases of assets other than government securities should therefore only occur in exceptional circumstances, i.e. when there are exceptional grounds.<sup>45</sup>

The requirement for exceptional grounds means at the same time that purchases and sales of assets other than government securities may continue to be an option if, for example, the Riksbank considers that policy rate changes and the purchase of government securities, if they had been implemented, would not have the desired impact on the economy in the current situation.

### **The Riksbank's measures shall be appropriate and proportionate**

A new feature of the Riksbank Act is that it now includes a so-called principle of proportionality for the Riksbank's decisions, including its monetary policy decisions.<sup>46</sup> According to the principle, the Riksbank may take a measure only if it can be assumed to lead to the intended result, is not more far-reaching than needed and if the

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<sup>40</sup> Government Bill 2021/22:41, p. 72.

<sup>41</sup> A repurchase agreement is a contract for the purchase of securities with a simultaneous agreement that the purchase will be reversed at a certain later date at a predetermined price. The transaction is similar to a collateralised loan.

<sup>42</sup> See Chapter 2, Section 4, Sveriges Riksbank Act for the exact wording.

<sup>43</sup> Chapter 2, Section 5, Sveriges Riksbank Act.

<sup>44</sup> Some of the limitations to the monetary policy toolbox in the Riksbank Inquiry's proposal for a new Riksbank Act, and which the Executive Board of the Riksbank objected to in its consultation response, were not included in the final version of the act. This means, for example, that it is still possible for the Riksbank to decide to lend to banks on condition that the banks increase their lending to companies, which was one of the Riksbank's measures during the pandemic.

<sup>45</sup> Government Bill 2021/22:41, p. 95ff.

<sup>46</sup> If a measure entails an intervention in a private interest, the principle of proportionality in Section 5, third paragraph of the Administrative Procedure Act (2017:900) is applied.

intended result stands in reasonable proportion to the costs and risks that the measure entails for the finances of the Riksbank and the State.<sup>47</sup>

In the preparatory work of the act, the Government writes that there is a similar principle of proportionality in EU law (Article 5.4 in the Treaty on European Union) and that in Swedish law it can be said to be a general principle that administrative authorities shall not take more far-reaching or intrusive measures than are required to achieve a desired objective.<sup>48</sup> The principle is expressed in the Administrative Procedure Act, but there it is limited to interventions in private interests. Normally, monetary policy has limited effects on many areas of the national economy and these effects cancel each other out across an economic cycle. But the Government notes that certain measures that change the size and composition of the Riksbank's balance sheet may have major and rapid consequences. In light of this, a principle of proportionality has been introduced in the Riksbank Act.

According to the preparatory work of the act, risk-taking in the context of a financial crisis may be compatible with the principle of proportionality, given the high socio-economic values at stake. The proportionality assessment becomes relevant, for example, in the choice between different measures, or combinations of measures, which essentially lead to the same goal achievement. When making this choice, the Riksbank shall choose the least risky alternative from a public finances perspective.<sup>49</sup>

### **Transparency, analysis and communication remain in focus**

The Riksbank has a substantial independence that is specifically highlighted with regard to monetary policy. This places demands for transparency and openness in relation to the Riksdag, the Riksbank's principal, but also in relation to the general public. Furthermore, the communication of monetary policy can affect its impact on the economy at large and on inflation. The Riksbank therefore endeavours to ensure that its communication is open and clear.<sup>50</sup> This makes it easier for economic agents to make sound economic decisions and monetary policy will also be easier to evaluate.

The new Riksbank Act establishes that the Riksbank shall continue to conduct external monitoring, i.e. monitor general economic developments and developments in the financial markets.<sup>51</sup> This has always been an extensive and natural part of the drafting process leading up to monetary policy decisions. It includes monitoring and analysing different types of risk, including the risk of the economy developing in a way that is

<sup>47</sup> Chapter 1, Section 8, Sveriges Riksbank Act.

<sup>48</sup> Government Bill 2021/22:41, p. 81.

<sup>49</sup> Government Bill 2021/22:41, p. 210.

<sup>50</sup> In "Review of the Riksbank's monetary policy 2015–2020" (2021/22:RFR4), Karnit Flug and Patrick Honohan state that the Riksbank's monetary policy documents and official statements are clear and well suited to the wide range of target groups. They also note that the Riksbank has been at the top of the central bank rankings according to a transparency index.

<sup>51</sup> Chapter 1, Section 9, Sveriges Riksbank Act.

unsustainable, from an environmental perspective, for example, and that can in turn give rise to major negative effects on the economy further ahead.

Climate change and measures to promote the transition to a sustainable economy have consequences for all economic agents in society. They can affect both the efforts to achieve the price stability target and the task of contributing to stability and efficiency in the financial system, and thus the Riksbank's ability to fulfil its mandate. This is therefore an important issue for the Riksbank to monitor and analyse. However, the responsibility for putting in place policy measures against climate change lies primarily with the world's politicians.<sup>52</sup>

Chapter 11 of the new act specifies the information that the Riksbank shall submit to the Riksdag's Committee on Finance and to the general public. There was no equivalent provision in the old act. The new act establishes in principle the forms for and content of the information to the public and the reports to the Riksdag in accordance with the practice developed by the Riksbank.<sup>53</sup> In addition to the specification of the information that the Riksbank shall share with the Riksdag and the general public, the new act also increases the resources for scrutiny of the Riksbank. The scope of the Riksdag to monitor and evaluate the conducted monetary policy was already considerable but has been strengthened somewhat. The Riksdag Committee on Finance, the National Audit Office and the auditors of the Riksbank's General Council all receive increased funds.

### **The new Riksbank Act gives the Riksbank a continued strong mandate**

In summary, the new Riksbank Act changes the wording of the monetary policy mandate somewhat: for example, the objective for monetary policy is worded differently, and consideration for the real economy has been written into the act, the Riksbank's specification of the monetary policy objective shall be approved by the Riksdag and there is a requirement for "exceptional grounds" before the Riksbank is allowed to buy and sell assets other than government securities. On the whole, however, the new act does not change the substance of the monetary policy framework, as it is compatible with the way the Riksbank already conducts monetary policy in several respects. The act gives the Riksbank a strong and clear mandate to continue to act independently regarding monetary policy in the future.

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<sup>52</sup> In general, the new act has clarified the Riksbank's scope for contributing to Sweden's climate transition, see the Riksbank's Climate Report, January 2023.

<sup>53</sup> Chapter 11, Section 1 specifies when the Riksbank shall submit a report to the Riksdag's Committee on Finance and what the report shall contain in particular. Chapter 11, Section 3 specifies what the Riksbank shall inform the public about. The Riksbank currently provides information in accordance with these provisions in, for example, its publications Account of Monetary Policy and Monetary Policy Report. The Riksbank also publishes the minutes from the monetary policy meetings with content in accordance with Chapter 11, Sections 5 and 6.