SPEECH

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Credibility and flexibility going forward*

My time as a member of the Executive Board of the Riksbank has been quite special, with two extreme periods in terms of how inflation has developed. The first period had already started before I joined the Executive Board in 2012. During this time, inflation had been below target more or less consistently for more than half a decade, sometimes very much below. The problem, which we shared with many other central banks, was how to get inflation to rise towards the target. After a few years of better target attainment in 2017−2019, the global pandemic hit and was followed by a period in which inflation rose sharply and was far above the target, for the first time since its introduction some thirty years ago (see Figure 1). In other words, the problems we have had to deal with during this time have been of very different kinds.

What these periods have had in common, however, is that monetary policy has reacted clearly and decisively to bring inflation back to the target. This has required quite specific, and in some cases unique, measures. First, negative policy rates and large-scale securities purchases, something that had not been tried before. After that, the fastest and largest rate hikes during the inflation targeting period.

I believe there may be some merit in the fact that inflation targeting has now been tested both during a period of too low inflation and during a period of too high inflation − and of course that it has proved to pass the test. The investment in credibility that we have thus made could pay off in the form of making it slightly easier to conduct monetary policy in the future. More specifically, it could mean that we can allow ourselves to act a little less forcefully than we have done so far

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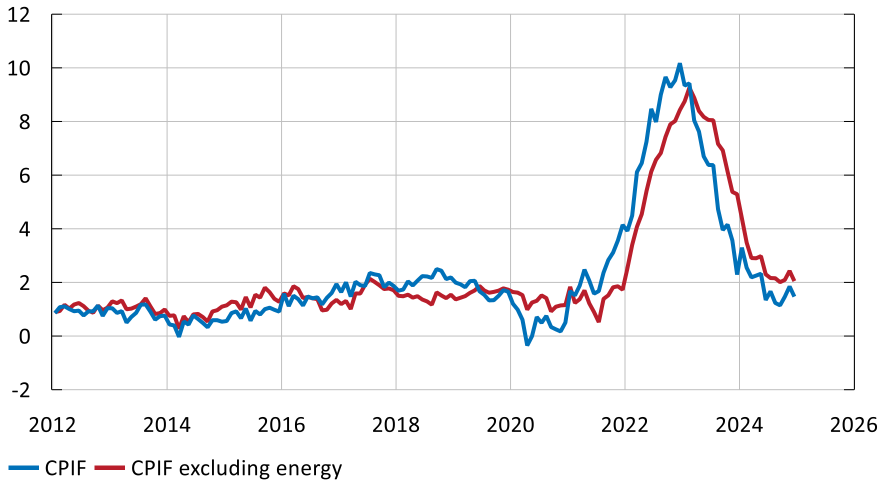
with the interest rate. But a prerequisite for this is that economic actors really see the target as credible and worth upholding, and act accordingly. This is what I intend to talk about here today.

Diagram 1. CPIF and the CPIF excluding energy

Annual percentage change



Sources: Statistics Sweden and the Riksbank.

Monetary policy a trade-off but under constraint

The former head of the US Federal Reserve, Ben Bernanke, has said that "monetary policy is 98 per cent talk and only two per cent action".[1] There is a lot of truth in this and I agree that the importance of monetary policy communication is often underestimated. But that doesn't tell the whole story. It is essentially the actions that make the communication credible, and especially during these periods, with lasting and large deviations from the target, the actions themselves have been particularly important. It would hardly have been enough if the Riksbank had communicated that we have an inflation target of 2 per cent that we intend to meet – and then not acted at all in accordance with it. Perhaps a more apt quote in this context is therefore that of the Swiss psychiatrist Carl Gustav Jung: "You are what you do, not what you say you will do."[2]

Monetary policy affects inflation through a number of channels, which also affect different parts of the economy. Not all of these effects are perceived as positive by households and businesses. If, for example, the Riksbank raises the policy rate

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[1] Bernanke (2015).

[2] Although the quote is attributed to Jung, it is difficult to find an exact reference. What is clear, however, is that Jung expressed many similar ideas about the importance of action and that it is people's actions that reflect their inner reality, rather than their words.

to curb high inflation, it is seen as positive when inflation eventually falls back. But the temporary increase in interest rates also raises the cost of borrowing and dampens demand in the economy, which is usually seen as a negative. It could also cause the krona to strengthen, which is a good thing for tourists abroad but not for exporters of Swedish products. A low policy rate to bring inflation up to target is often welcomed, as it reduces loan costs and boosts demand. But it can also contribute to higher-than-usual increases in the prices of housing and other assets, which is not always seen as positive, at least by those outside the housing market or not active in the asset markets concerned. Thus, monetary policy always has both desired and undesired effects, seen from a more general perspective.

When conducting its monetary policy, the Riksbank tries to balance desired against undesired effects. But this must be done under the restriction that confidence in the inflation target can be maintained, as this is a prerequisite for the target to function as a benchmark for price setting and wage formation in the economy – that it can fulfil its role as what is called a nominal anchor. The inflation target does not exist by chance, but because there is a conviction among economic policy-makers, and hopefully also among the general public, that an economy develops better over time if it has such a nominal anchor. This is why the formulation of monetary policy in the Sveriges Riksbank Act is that "the overriding objective of the Riksbank is to maintain sustainably low and stable inflation".[3]

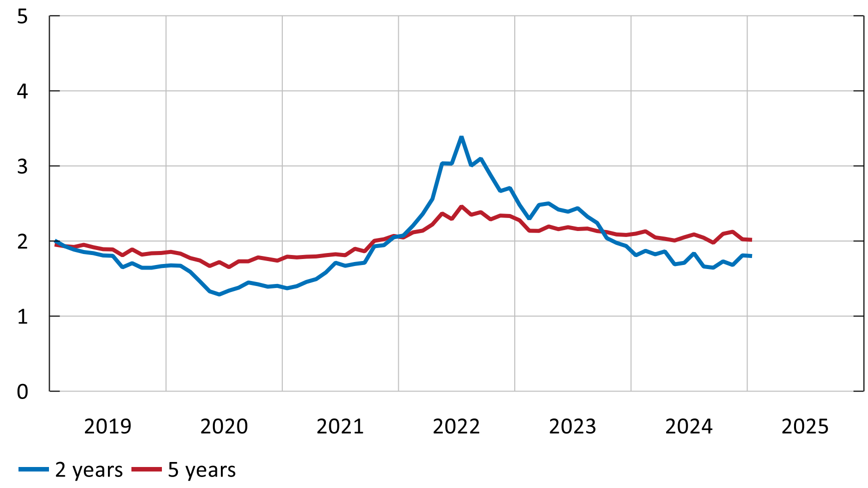
Under the constraint of maintaining confidence in the inflation target, we thus try to strike a reasonable balance and ensure that the undesired effects are as small as possible. It is, of course, difficult to quantify all the effects of monetary policy, but our overall assessment is that the desired effects have outweighed the undesired ones. That we thought so when we took the measures is of course obvious, but I also believe that, in retrospect, it can be said that the policy we have conducted has on the whole been successful.

The most important desired effect is, of course, that the credibility of the Swedish inflation target has been high and remains so. This is illustrated, for example, by the fact that long-term inflation expectations have been fairly consistently close to the inflation target (see Figure 2). This has been particularly striking recently, with inflation well above target.

[3] Chapter 2, Section 1 of the Sveriges Riksbank Act.

Diagram 2. Inflation expectations

Per cent



Note. Expectations refer to the CPI. Money market agents.

Source: Origo Group.

Cooperation with wage formation and fiscal policy

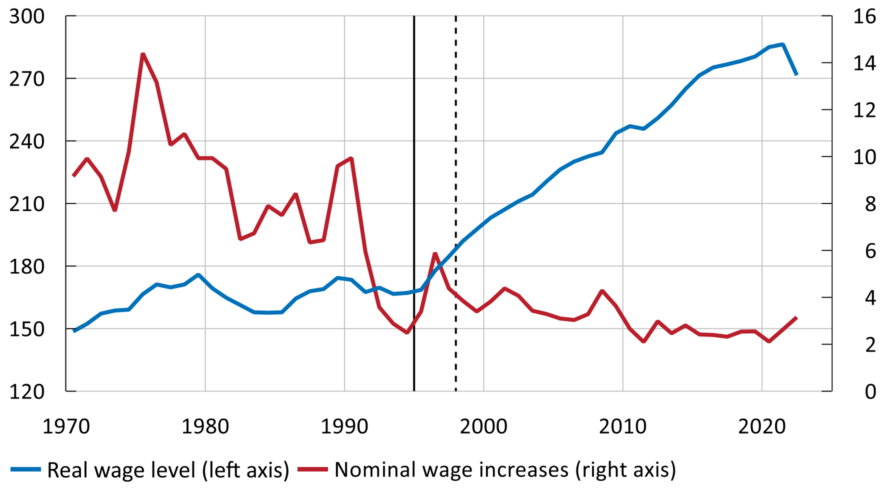
Although I believe that it has been very important that the Riksbank has acted as resolutely as it has, both when inflation was previously too low and when it has more recently been too high, factors other than monetary policy have of course also played a role in inflation and in the fact that confidence in the target has been, and still is, high.

One advantage for Sweden in this context, which I have emphasised on many occasions, is how our wage formation has worked. Despite the high inflation, wage settlements have remained moderate and responsible and in line with the inflation target. We have now had well-functioning wage formation for almost thirty years and, compared with how wage formation functioned previously, this has been rewarded with a very favourable development of real wages (see Figure 3).

However, it should be emphasised that this order has not been bestowed on us by higher powers, meaning that it would never change whatever happens. If, for example, inflation were to be above the target for an extended period, it is of course highly likely that demands would increase for wages to be based on the higher inflation rather than on the inflation target. The fact that wage formation has been so firmly anchored to the inflation target cannot be taken as an excuse for monetary policy not needing to react when inflation rises, or for that matter when it falls. Causality does not always work so that wages affect prices, it can also be the other way around, that prices affect wages.

Diagram 3. Real and nominal wage development

Index, 1 January 1960 = 100 (left), and annual percentage change (right)



Note. Real wages are based on the CPI. The solid line indicates the date on which the inflation target takes effect. The dotted line indicates the date of application of the Industrial Agreement.

Sources: Statistics Sweden, the National Mediation Office and the Riksbank.

Another aspect is that it is quite some time ago, more than thirty years, since we experienced serious problems with wage-price spirals and persistently high inflation. This is of course positive in itself, but it also means that fewer people have personal experience of these problems. Although wage formation has just now once again proved its worth during a very challenging period, I think it is worth bearing in mind that there may be a risk that the “institutional memory” of past problems could slowly fade over time. It is important that we all work together to ensure that it does not.

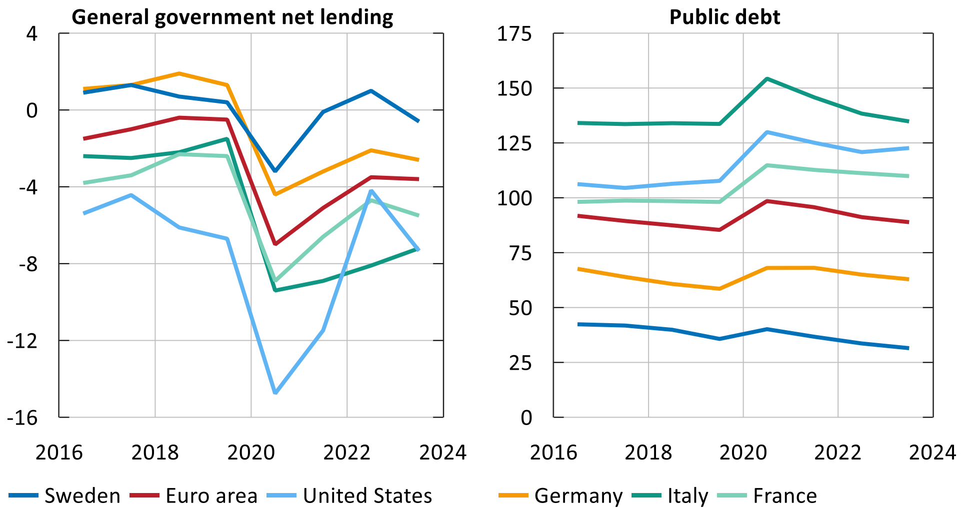
A further aspect is that it is quite common for voices on the employers’ side to question whether the inflation target should have any particular significance for wage formation.[4] It is therefore also rather unclear what role these voices envisage that the inflation target should be playing at all.

The way in which fiscal policy is conducted is also central to the possibilities of maintaining confidence in the inflation target. During the recent upturn in inflation, the interaction between fiscal policy and monetary policy worked well, in the sense that fiscal policy did not reinforce inflationary impulses through broad stimulus. In that case, the Riksbank would have had to raise interest rates more than it did.

[4] See, for example, Hallsten and Grath (2024).

The interaction between fiscal policy and monetary policy more generally is an interesting and internationally debated issue, which I have also raised earlier.[5] My view here is that fiscal policy should provide a little more support to monetary policy than it has done in recent decades, especially in situations where the policy rate is already low and the scope for further interest rate cuts is limited. In the recent upswing in inflation, it is clear that fiscal policy has recognised the importance of helping to bring inflation back to target. I believe that inflation should continue to play a role for fiscal policy, even in more normal situations, and that we could thus achieve a better policy mix more generally.[6]

Figure 4. General government net lending and public debt in Sweden and abroad
Per cent of GDP



Sources: Eurostat and the European Commission.

While it is clear that our strong public finances have served us well, there is now undoubtedly scope in Sweden to conduct fiscal policy somewhat more flexibly than in recent decades. From an international perspective, our public savings are high and our debt low (see Figure 4).

A simple coordination mechanism is that fiscal policy moves in the same direction as monetary policy, with the direction of changes in the policy rate being the starting point. There are some promising initiatives that can hopefully contribute to a better policy mix looking ahead. The Ministry of Finance and the Riksbank

[5] See Jansson (2021).

[6] In this context, it is of course important to analyse and continuously improve knowledge regarding the effects of fiscal policy on inflation. This applies especially in small open economies such as Sweden, where effects via the exchange rate may matter.

now have a more continuous dialogue and the Fiscal Policy Council has begun to discuss fiscal policy and monetary policy in a common context.

Question marks over the role of price setting

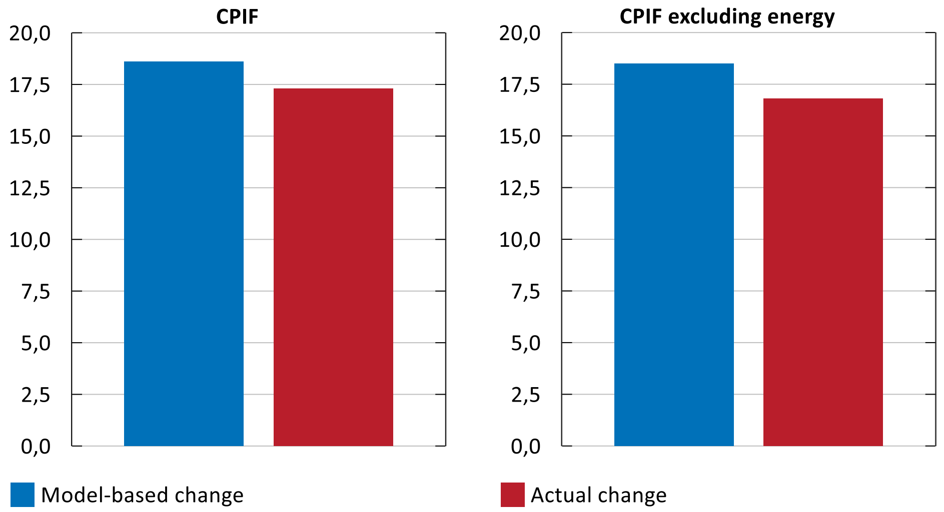
It is not only wage formation and fiscal policy that matter for inflation, but also how firms set their prices. One reason why inflation rose so quickly and to such high levels was that rapid cost increases and the strong post-pandemic recovery created the conditions for a change in the price-setting behaviour in the economy, from that which had dominated for a long time. In the past, many firms found it very difficult to raise prices, as competition was perceived as fierce and customers risked shifting their purchases to other firms.

But the rapid recovery from the pandemic, the energy crisis in Europe and the global price increases associated with Russia's invasion of Ukraine changed the context. Cost increases could now be passed on to consumers more quickly and to a greater extent, even though it was fairly obvious that they were not permanent. Consumers also seem to have accepted this to a greater extent than before. In two studies, the National Institute of Economic Research (2022, 2023) has shown that the recent very rapid rise in inflation can be reproduced very well if one assumes that firms during this period had a pricing behaviour that was based on a complete pass-through of cost increases (see Figure 5).[7]

[7] This changed pricing behaviour is also evident in the Riksbank's Business Survey, where the difference between the March 2021 and March 2022 surveys is striking. Moreover, reports from the National Institute of Economic Research (2023) and the Swedish Competition Authority (2024) conclude that consumer food prices have increased *more* than can be explained by the increased costs. The Swedish Competition Authority (2024) writes that "grocery retailers have, to varying degrees and due to market power, been able to increase their profit margins in SEK by applying oligopolistic pricing strategies towards consumers. In practice, this means that for some goods, the increase in the mark-up applied by retailers is greater than can be justified by the increase in purchasing costs" (p. 8, translated from Swedish). Representatives of food producers in particular have reacted to the Riksbank's statements on this (see Hellman and Eckerdal, 2024), despite the fact that the conclusions concern pricing at the consumer level – which is the Riksbank's natural focus – and not the food industry as a whole.

Figure 5. Model-based and actual inflation developments

Percentage change for the period Q2 2019 to Q2 2023



Note. The figures show the National Institute of Economic Research's model-based calculations of consumer price developments under the assumption of full pass-through of the increase in production costs to prices compared with actual consumer price developments over the same period. The profit share is kept constant in the calculations.

Sources: Statistics Sweden and the National Institute of Economic Research.

It is usually said that the inflation target is intended to act as an anchor for price setting and wage formation. The role of the inflation target in wage formation, and vice versa − the role of wage formation in the ability to maintain the inflation target − is a subject of frequent and lively debate. This is not the case for business pricing. In a way, this is natural. Wage formation is a collective process and, of course, price setting is not. But central banks' inflation targets are formulated in terms of consumer prices, not wages, so how pricing works is of course also very important.

Nor is it just the case that firms' pricing decisions affect inflation. The monetary policy that has to be conducted when inflation rises has negative repercussions for businesses too. When interest rates have to be raised due to higher inflation, firms' financing costs rise and demand in the economy falls.[8] Thus, firms also benefit if sharp interest rate hikes can be avoided, and gain in the long run from the economy developing well, with a stable nominal anchor as a basis.

I therefore believe that there is a need for more discussion of the macroeconomic consequences of pricing as well – especially in situations where prices in large parts of the economy suddenly start to be set in a different way than normal. I think it would be valuable for businesses to participate in such a discussion,

[8] See, for example, Daunfeldt (2024), who notes that the interest rate increases were also felt by firms.

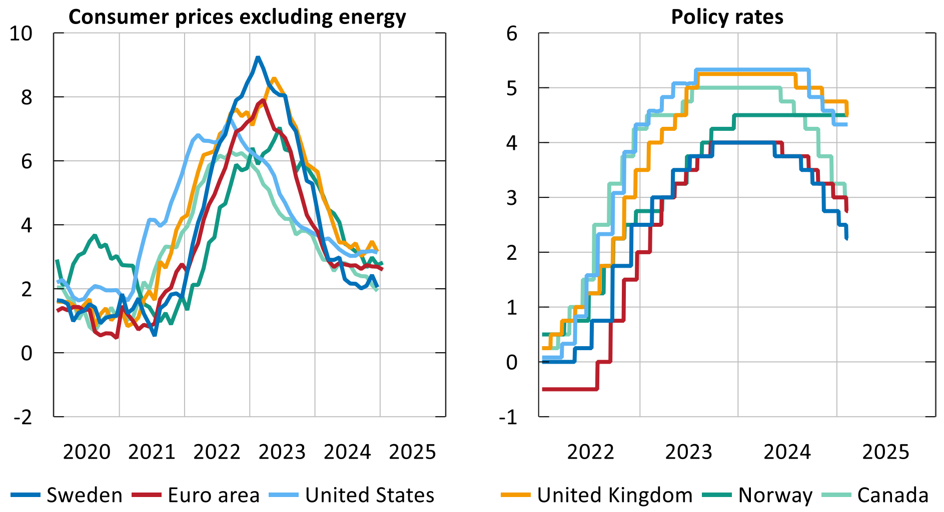
particularly of course if it is done through organisations at a central level. I would like to emphasise that I am not, of course, advocating that pricing should in future take place in some kind of collective process, like wage formation, and I do recognise the importance of the price mechanism and the role of relative prices in the allocation of resources in the economy. But I also see no reason why the discussion about the inflation target and its role as an anchor in the economy should only be about wage formation and not at all about price setting.

Thus, while the inflation target works well as an anchor for wage formation, there are some questions about its role in price setting. Now pricing seems to have returned to more normal, but after this episode the question is how stable it is. One concern is that it could change again relatively quickly as the economy strengthens, or new cost shocks occur.

All in all however, I think it can still be said that the conditions for managing an upturn in inflation are favourable in Sweden, compared with many other countries. A monetary policy with a very clear focus on maintaining confidence in the inflation target, well-functioning wage formation based on the inflation target and a fiscal policy that has not been heavily stimulative during the period of high inflation have contributed to long-term inflation expectations being better anchored than in many other countries.

Figure 6. Consumer prices excluding energy and policy rates abroad

Annual percentage change (left) and per cent (right).



Note. Consumer prices are measured in terms of the CPIF for Sweden, the HICP for the euro area and the CPI for the United States, the United Kingdom, Norway and Canada.

Sources: Eurostat, Statistics Sweden, Statistics Canada, Statistics Norway, U.K. Office for National Statistics, US Bureau of Labor Statistics and national central banks.

In addition, the interest rate sensitivity of the Swedish economy is relatively high in an international perspective. This is due to high levels of private sector debt, particularly among households, and a significant share of variable rate debt, which means that changes in the policy rate are transmitted rather quickly. Together, this has meant that the Riksbank has been able to content itself with raising the policy rate to a fairly modest level by international standards, despite the relatively large upturn in inflation, and we were also one of the first central banks to initiate rate cuts (see Figure 6).

Confidence in the target requires active monetary policy

One can also reflect on the fact that the common perception before the global rise in inflation was that inflation was more or less dead. Now it turned out that this was not the case. Would it not be fair, then, to say that the monetary policy conducted in the past to bring inflation up to target was unnecessary? After all, things self-corrected, so to speak.

According to this view, inflation sometimes goes up and sometimes goes down and you don’t have to worry about it getting stuck too low – or too high, for that matter. There are two problems with this reasoning. First, after a long period of very low inflation, it is of course risky to rely on the assumption that a pick-up in inflation will indeed materialise quite soon on its own. After all, virtually all observers were surprised when inflation rose so sharply around the world a few years ago. There were several interacting factors that could hardly have been predicted, not least the unexpectedly rapid recovery from the pandemic and Russia’s invasion of Ukraine. If these events had not occurred, it might just as well have been another five to ten years when inflation would have remained very low.

Second, and partly related, it ignores the fact that persistent deviations from the inflation target sooner or later affect expectations about what level of inflation is normal in the economy. Expectations, in turn, affect actual pricing and make it harder to get back on target. In addition, of course, if the Riksbank had not pursued such an expansionary policy as it did, but had kept the policy rate higher, inflation would have been even lower, and the deviation from the inflation target even greater than it was. There would then have been an obvious risk that economic agents would have begun to regard inflation significantly below 2 per cent as normal.[9] In that case, the inflation target would no longer be the anchor.

[9] It could be argued that this was also to some extent what happened, even with the Riksbank’s more expansionary policy. Average nominal wage increases of only just over 2 per cent could be regarded as an indication that there was a lack of confidence in the inflation target. The National Institute of Economic

If inflation were then to rise, it is not clear that this would help much either. Doubts would have already arisen as to whether the central bank is really able to, or even has the ambition to, keep inflation at 2 per cent. Of course, such doubts apply both ways. If inflation could stay below the target for a long time, why couldn't it also stay above it for a long time? We would then reach a situation where the inflation target is no longer the benchmark for price setting and wage formation that it is intended to be, and inflation and inflation expectations will vary more. We have then also moved away from the fundamental purpose that the inflation target is intended to fulfil, namely to ensure that the economy develops better in the long term by providing such a benchmark.

Key aspects often missing from the debate

Before I continue, let me make a digression here that concerns the inflation target as a benchmark and important aspects that have often been missing from the Swedish debate.

It is of course positive that monetary policy is discussed and scrutinised, not only in the Committee on Finance's public assessments but also in the general debate in the media. But for the debate to be meaningful, the arguments put forward should be based on an understanding of the conditions under which monetary policy operates, what the Riksbank's de facto task is and why it has that task. I believe that all too often this is not the case. This is a problem that I believe has not been sufficiently recognised, and which I raised in a speech a little over a year ago.[10]

For example, it is a fundamental and necessary condition that the inflation target is recognised in the discussion. After all, the main task given to the Riksbank by the Swedish parliament, the Riksdag, is to ensure that inflation does not deviate from the target for too long, so that confidence in it can be maintained and the inflation target can actually function as a nominal anchor in the economy. It would therefore be very odd to completely ignore how inflation and inflation expectations can be expected to develop with the alternative monetary policy that one thinks should instead be pursued, or should have been pursued. Unfortunately, this is very common in the debate. And even if inflation and inflation expectations are mentioned, these variables, which are absolutely crucial

Research (2024) makes the assessment that a long-term nominal rate of wage increase of 3.5 per cent is compatible with the inflation target.

[10] See Jansson (2023). See also Apel and Jansson (2023), which had the same message, and the debate in the journal Ekonomisk Debatt that followed this article.

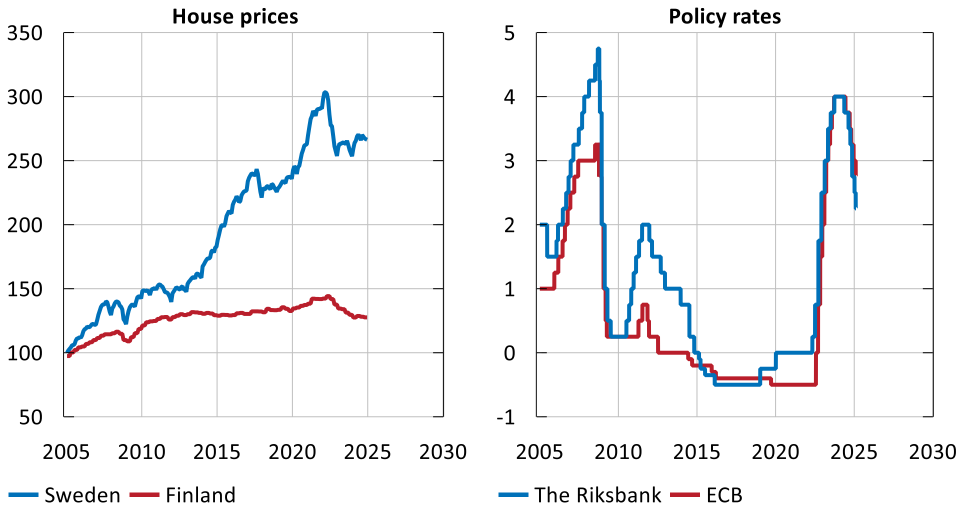
to monetary policy, are downplayed in a way that makes it hard to take the alternative policy proposals seriously.

A fairly common criticism has been that it is the Riksbank's monetary policy that is the main reason why house prices and household debt are currently high. Here it is argued that the Riksbank should have kept the policy rate much higher in an attempt to slow the rise in house prices and household debt. However, it is rare that anything is said about how much higher the interest rate would have needed to be to actually achieve this, or what the effects of such a policy would have been on inflation, inflation expectations, unemployment, and the economy in general.[11] This is a good example of what I was just talking about, that the variables that are decisive for monetary policy are not included at all, or at least not sufficiently, in the reasoning.

Moreover, house prices are affected by much more than monetary policy. Firstly, it is about how well the housing market functions, that is, basically how well the supply and demand for housing can be made to match each other. Decisions on housing policy and tax policy are central to this. There are countries that have had roughly the same interest rate development in recent decades as Sweden, such as Finland, where house prices have not risen at all in the same way (see Figure 7). Monetary policy in Finland is conducted by the European Central Bank, whose policy rate has tended to be lower than that of the Riksbank, and whose securities purchases have been more extensive. From this fact alone, one should be able to conclude that the development of house prices and debt is about much more than monetary policy.

[11] An exception is Coglianese et al. (2023) which turns the question on its head. They analyse the effects of the 2010-2011 rate hike, which they argue was driven entirely by the Riksbank's concerns about debt and house price developments. My view is that this interpretation is not entirely correct and that the increases were also justified on the basis of forecasts for the economy and inflation made at the time by the Riksbank and other analysts, including the National Institute of Economic Research, see Jansson (2014). Still, it is clear that a monetary policy that tries to counteract a rise in debt and house prices can cost a lot in terms of output and employment.

Figure 7. House prices and policy rates in Sweden and Finland
Index (left) and per cent (right)



Note. House prices are measured in terms of the HOX house price index for Sweden and prices for dwellings in housing companies for Finland, January 2005 = 100.

Sources: ECB, Statistics Finland, Valueguard and the Riksbank.

It is also about the general interest rate level in the economy and what is considered a normal policy rate, that is, an interest rate that neither stimulates the economy nor has a contractionary effect. A concept often used here is the neutral interest rate. This interest rate is not determined by monetary policy, but mainly by savings and investment patterns at the global level, which in turn are strongly influenced by demographic factors.[12] Of course, if the level of the neutral interest rate changes, this could affect house prices. But the effect then does not go via monetary policy.[13]

In my speech a little over a year ago, I noted that discussions of the neutral interest rate and how it has developed have often been absent from the media debate on the Riksbank and monetary policy. This ignores, among other things, the fact that the neutral interest rate has fallen globally over some thirty years to very low levels. The problems associated with this have long been discussed in academia and among central banks.[14] This downward trend in general interest rates has without doubt played a greater role than limited periods of

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[12] For a review of the determinants of the neutral interest rate, see for example Lundvall (2023). Seim (2024) presents the Riksbank's assessment of the long-term neutral interest rate.

[13] In the evaluation of monetary policy commissioned by the Committee on Finance, Hassler et al. (2023) recognise this mechanism as central. They also argue that the negative interest rate was an appropriate policy.

[14] This is also an important theme in the Long-Term Survey 2023 (Ministry of Finance, 2023), which argues that fiscal policy should take greater responsibility for stabilisation policy, as the historically low interest rates and the proximity to the lower bound of the policy rate are hampering monetary policy.

expansionary monetary policy in the rise in housing prices and indebtedness in Sweden, which has also run parallel to this development more or less continuously since the mid-1990s.

I find it difficult to see a very different alternative to the policy pursued by the Riksbank, given that the neutral interest rate was historically low and inflation was starting to move towards zero. If interest rates had been kept at a higher level, inflation would of course have been even lower and would have remained low for an even longer period of time, as I have just noted. It would then actually have been quite surprising if confidence in the inflation target had not been affected.

The problems with this are well known and I have talked about them many times. Let me therefore just briefly note that the main issue is that if inflation is persistently very low, say close to zero per cent, then there is very little scope to cut the policy rate to counteract recessions. The policy rate hits its lower bound quickly and needs to stay there for longer periods. So if one doesn't like zero or negative interest rates, then one should be particularly eager to maintain confidence in the inflation target. This is a line of thought that is surprisingly often overlooked.

Fortunately, over the past year, the concept of a neutral interest rate has begun to attract more attention in the Swedish media debate as well.[15] Hopefully, this will contribute to a more nuanced and constructive discussion of monetary policy – and to the debate in the future being conducted a little bit more on the same playing field, as I put it in my speech a good year ago.

Confidence in the target a precondition for flexibility

So, to return to my main track and to summarise so far, the inflation target and the Riksbank's ability and determination to meet it have been tested on the downside and, relatively recently, on the upside, too. And in both cases, monetary policy has succeeded in maintaining confidence in the target. Can we benefit from this? Yes, maybe we can.

Confidence is not a so-called binary variable − a variable with only two possible outcomes − where you either have complete confidence or none at all. But the

[15] See, for example, Carlström (2024) and Munkhammar (2024). The film "Skuldfeber" (Debt Fever), which was broadcast on SVT at the end of last year, is however a quite remarkable example of a piece that completely disregards the arguments I have presented here. Without investigating any other possible causes, it puts forward the argument that it is monetary policy that is the main explanation for the high level of housing prices and household debt today. It thereby ignores, for example, the evaluations of the Riksbank and monetary policy carried out over the years by academic experts on behalf of the Riksdag Committee on Finance, which have not at all raised any such criticism (see, for example, Flug and Honohan, 2022, and Hassler et al., 2023).

conditions are still different if confidence is high compared to if it is low. In virtually all areas, if confidence is low, you have to work a little harder to show that you are really living up to your commitments. In monetary policy, “work harder” is equivalent to changing the policy rate more.

If, on the other hand, confidence is high, then participants trust that the Riksbank has both the ambition and the ability to bring inflation back to target after a deviation. They therefore know that the deviation is temporary and that they do not have to worry about inflation remaining, for example, above target for a long time to come. As a result, they do not need to compensate themselves much for higher inflation by raising prices and wage demands. This in turn means that the Riksbank does not need to change the policy rate as much as would otherwise have been necessary. If confidence in the inflation target is high, it is thus also possible to allow slightly larger and slightly longer deviations from the target without monetary policy having to react fast and forcefully. It’s the other side of the coin.

In the media debate, criticism has sometimes been levelled that the Riksbank has changed the interest rate too much and too sharply over the years and that the interest rate fluctuations themselves have created problems. Instead, these critics would like to see a more even development of the policy rate, preferably at a relatively high level. In practice, this means that the development of the *means*, that is, the policy rate, to influence the *target variable*, that is, inflation, is considered to be a goal in itself.

However, one cannot assume that monetary policy has this room for manoeuvre right from the start when it comes to setting the interest rate and allowing inflation to deviate from the target. That would be like “putting the cart before the horse”. If interest rates are set in such a way that inflation can be more or less anything, we will sooner or later end up in a situation where there is no longer a nominal anchor. It is only when agents trust that the Riksbank can and will bring inflation back to the target after a deviation that monetary policy can *allow* itself to be more flexible. Confidence in the target is thus a precondition for flexibility.

Greater room for monetary policy manoeuvre going forward?

At the same time, there is of course nothing inherently positive about large and frequent fluctuations in the policy rate. Although their purpose is to stabilise inflation, they can give rise to various types of uncertainty in the economy. Firms may find it more difficult to make informed investment decisions if their financing is closely linked to the behaviour of a widely fluctuating policy rate, and consumers may find it harder to make decisions about their housing or to plan purchases, particularly of capital goods. Large and, in particular, unexpected changes in interest rates can also lead to volatility in financial markets, affecting stock prices, bond yields and exchange rates. Of course, large changes in the policy rate can also have major effects on the real economy that one would prefer to avoid. If confidence in the inflation target can be maintained with relatively limited variations in the policy rate, this is therefore preferable to larger and more forceful interest rate changes.[16]

In this context, the Swedish krona is a special chapter. The development of the exchange rate has proven to be genuinely difficult to understand.[17] It can exhibit trends over fairly long periods that run counter to what are known as fundamentals, that is, basic factors that *should* matter for the exchange rate, such as how well a country's economy is performing relative to the rest of the world. There is therefore no guarantee that smaller fluctuations in interest rates would reduce movements in the exchange rate, especially the more trend-like ones. But if a more even development of the policy rate would nevertheless contribute to the krona fluctuating a little less, that would of course be positive.

It is possible that – after inflation targeting has now been tested on both the upside and the downside, and passed the test – we may now have moved another notch up the credibility scale. If that is the case, which I believe and hope it is, it may create some opportunities. We may have reached a point where we could at least *start* to test the waters and see if the room for monetary policy manoeuvre going forward is now a bit greater than it has been in the past. More concretely, it would mean that, at least at the margin, we could allow slightly larger deviations from the inflation target and slightly smaller changes in the policy rate on average. One could say that there might be an opportunity to make flexible inflation targeting even more flexible.

But I would like to emphasise that it is not only, and perhaps not even primarily, up to the Riksbank whether monetary policy can take a step in this direction. This presupposes that wage formation continues to be based on the inflation target, that the target also plays an important role in price setting and that it is taken into account more regularly in fiscal policy. It would of course also help if the debate on monetary policy were based to a greater extent than hitherto on the

[16] This is partly related to Milton Friedman's (1968) argument that the central bank should avoid large swings in monetary policy. One difference, however, is that Friedman thought that such fluctuations were very rarely needed and that monetary policy itself was often the source of excessive fluctuations in the economy. Instead, it was assumed that price stability could be achieved with a constant rate of increase in the money supply. Monetary targeting was tested in various countries, with limited success, in the 1970s and 1980s and started to be abandoned in favour of inflation targeting in the 1990s (see, for example, Mishkin, 2006).

[17] See, for example, Flam and Persson (2024).

Riksbank's main task being to maintain the inflation target. The more people who help to emphasise the importance of having an inflation anchor in the economy in the debate and in actual economic decisions, the more relaxed the attitude of monetary policy towards short-term deviations from the inflation target can be. For my part, I am prepared to try such an approach. But it will need to be empirical, with the effects on credibility very closely monitored. Let's see if we are ready to take such a step.

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