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Monetary Department
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CZECH NATIONAL BANK

In this issue

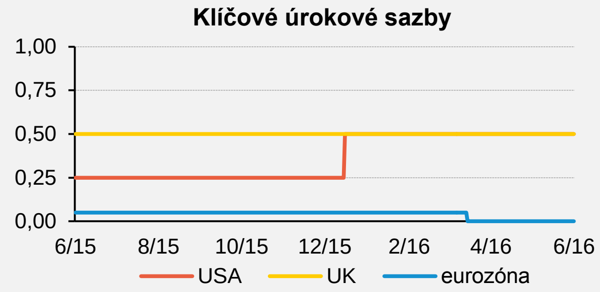
The Fed departed from the prevailing monetary policy trend in the countries we monitor by starting to increase its rates back in December 2015, and at its next meeting in June it will decide whether to raise them further. A rate hike would reflect the good performance of the US economy. By contrast, a large proportion of European central banks are facing low or negative inflation, falling or low inflation expectations, and hence pressures to ease monetary policy further. Inflation is still being affected by low oil prices. The ECB kept its policy rates unchanged. As announced earlier, as from June it will implement unconventional measures, i.e. it will start to purchase corporate bonds and announce another series of targeted longer-term refinancing operations. The Hungarian central bank took advantage of the sufficient room in its key monetary policy rate and lowered it further. It also reduced the lower bound of its rate range, i.e. the deposit rate, into negative territory. Sweden's Riksbank decided to raise its government bond purchases. Several central banks are to hold meetings in June, and New Zealand's RBNZ may cut its policy rates. The other central banks monitored left their conventional and unconventional measures unchanged in the past period. Spotlight *focuses on the significant economic risk of Brexit, i.e. Britain's potential departure from the EU. In our* Selected Speech*, Riksbank Executive Board member Cecilia Skingsley summarises Sweden's one-year experience of using negative interest rates.*

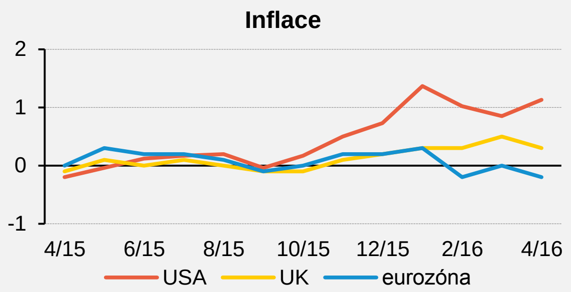
1. LATEST MONETARY POLICY DEVELOPMENTS AT SELECTED CENTRAL BANKS

Key central banks of the Euro-Atlantic area

	Euro area (ECB)	USA (Fed)	United Kingdom (BoE)
Inflation target	< 2%[1]	2%[2]	2%
MP meetings (rate changes)	21 Apr (0.00) 2 Jun (0.00)	15–16 Mar[5] (0.00) 26–27 Apr (0.00)	17 Mar (0.00) 14 Apr (0.00) 12 May (0.00)
Current basic rate	0.00%; -0.40%[3]	0.25–0.50%	0.50%
Latest inflation	0.1% (May 2016)[4]	1.1% (Apr 2016)	0.3% (Apr 2016)
Expected MP meetings	21 Jul 8 Sep	14–15 Jun[5] 26–27 Jul	16 Jun 14 Jul 4 Aug
Other expected events	8 Sep: publication of forecast	Jul 13: publication of Beige Book; July: publication of Monetary Policy Report	4 Aug: publication of Inflation Report
Expected rate movements[6]	→	↑	→

[1] ECB definition of price stability "below, but close to 2%"; [2] January 2012 definition of inflation target; [3] deposit rate; [4] flash estimate; [5] meeting associated with summary of FOMC economic forecasts and press conference given by FOMC Chairman; [6] direction of expected change in rates in next three months taken from Consensus Forecasts.





The **ECB** kept key interest rates unchanged at its April and June meetings; in June it confirmed that it expects them to remain at present or lower levels well past the horizon of its securities purchases. On 8 June, it will start buying corporate bonds under its corporate sector purchase programme, and starting on 22 June it will conduct a series of targeted four-year refinancing operations. The ECB also confirmed monthly bond purchases of EUR 80 billion until the end of March 2017, or beyond if necessary to hit the inflation target. The ECB expects GDP to increase by 1.6% this year and 1.7% in 2017 and 2018. Inflation will remain very low (0.2%) this year and rise to 1.3% in 2017 and 1.6% in 2018.

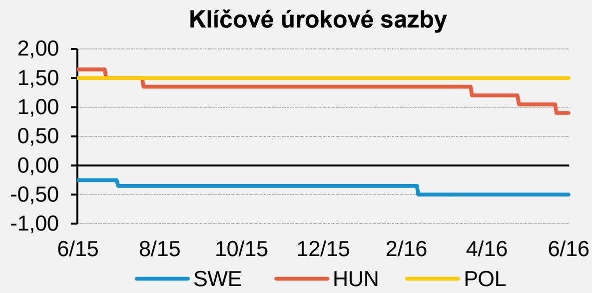
The **Fed** left interest rates in the range of 0.25%–0.50% in March and April. According to the Fed, the likelihood of a rate hike at the next meeting in June had increased, mainly because of strong labour market data, despite a slowdown in other economic indicators. However, the latest labour market data were less favourable (a drop in job positions according to the household survey) and, coupled with a slowdown in economic growth and uncertainty about the outcome of the referendum on the UK's membership in the EU, could delay the rate increase until the next meeting. Inflation will remain low in the near term and the Fed expects to attain the 2% target over the medium term.

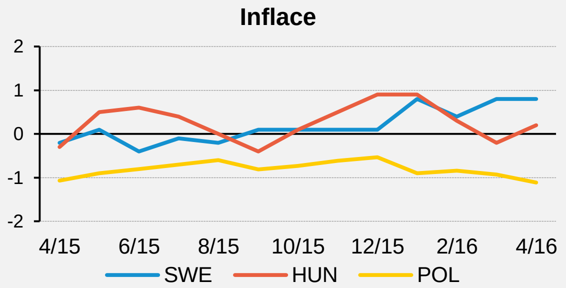
The **BoE** left its key interest rate at 0.50% and maintained the size of securities holdings at GBP 375 billion. Inflation is low but positive; in April it stood at 0.3%. The BoE expects it to go up gradually as the effect of low energy and food prices fades over the next year. It forecasts that inflation will reach the target by mid-2018. GDP increased by 2.0% year on year in 2016 Q1 but decreased in quarter-on-quarter terms. The BoE expects it to fall in Q2 as well. This drop is associated, among other things, with uncertainty about the outcome of the EU referendum (see *Spotlight* for more details).

Selected central banks of inflation-targeting EU countries

	[Sweden (Riksbank)]()	[Hungary (MNB)]()	[Poland (NBP)]()
Inflation target	2%	3%	2.5%
MP meetings (rate changes)	20 Apr (0.00)	22 Mar (-0.15) 26 Apr (-0.15) 24 May (-0.15)	10–11 Mar (0.00) 5–6 Apr (0.00) 12–13 May (0.00)
Current basic rate	-0.50%; -1.25%[2]	0.9%; -0.05%[2]	1.50%
Latest inflation	0.8% (Apr 2016)	0.2% (Apr 2016)	-1.1% (Apr 2016)
Expected MP meetings	5 Jul 6 Sep	21 Jun 26 Jul 23 Aug	7–8 Jun 5–6 Jul 6–7 Sep
Other expected events	6 Jul: publication of Monetary Policy Report	23 Jun: publication of Inflation Report	13 Jun: publication of Inflation Report
Expected rate movements[1]	→	→	→

[1] Direction of expected change in rates in next three months taken from Consensus Forecasts; [2] deposit rate.





The **Riksbank** left its key interest rate at -0.50% in April but decided to raise its government bond purchases by a further SEK 45 billion during 2016 H2 (to SEK 245 billion in total by the end of 2016). According to the Riksbank, this will mitigate the risk of the Swedish krona appreciating more quickly than forecasted and the risk of the upward trend in inflation halting. The Riksbank is ready to make monetary policy even more expansionary (by extending its government bond purchases and intervening in the foreign exchange market), even between monetary policy meetings (this power was delegated in early January – see the March CBM). According to the Riksbank, CPIF inflation will be 1.4% and CPI inflation 1.0% in 2016. Inflation is expected to hit the target in 2017 (CPI of 1.9% and CPIF of 2.0%).

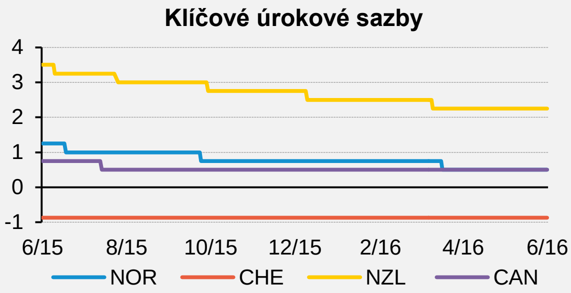
The **MNB** cut its interest rate three times in the past three months, each time by 15 pp, taking the rate to an all-time low of 0.9%. In March, the MNB also cut its deposit rate to -0.05%, where it left it at the following meetings. According to a flash estimate, Hungarian economic growth slowed to 0.9% year on year in 2016 Q1 (from 3.2% the previous quarter). The MNB's expectations that this would be due partly to a drop in government investment (related to a decrease in drawdown of EU funds) and a simultaneous slowdown in industrial production materialised. By contrast, retail sales increased. The MNB expects growth to pick up again due to an increase in exports, growth in consumption and growth-supporting programmes. It expects inflation to remain well below the 3% target and only approach it at the end of 2017.

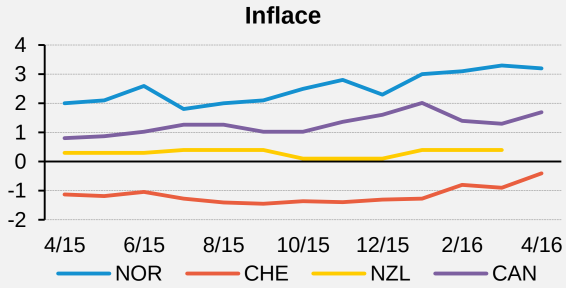
The **NBP** kept its interest rate unchanged at 1.50% in the spring. The robust 4% economic growth seen in 2015 Q4 slowed to 2.5% year on year in Q1, according to an estimate. The growth continues to be driven mainly by consumption, supported by a strong labour market. These main factors will continue to dominate in the rest of this year, with full-year growth of the Polish economy expected to reach 3.8%. Consumer price inflation and producer price inflation remain below zero and the NBP expects them to stay there in the coming quarters. Inflation expectations remain very low.

Other selected inflation-targeting countries

	Norway (NB)	Switzerland (SNB)	New Zealand (RBNZ)	Canada (BoC)
Inflation target	2.5%	0–2%	2%	2%
MP meetings (rate changes)	17 Mar (-0.25) 12 May (0.00)	17 Mar (0.00)	28 Apr (0.00)	13 Apr (0.00) 25 May (0.00)
Current basic rate	0.50%; -0.50 reserve rate[1]	from -1.25 to -0,25%[2]; -0.75%[3]	2.25%	0.5%
Latest inflation	3.2% (Apr 2016)	-0.4% (Apr 2016)	0.4% (2016 Q1)	1.7% (Apr 2016)
Expected MP meetings	23 Jun 22 Sep	16 Jun 15 Sep	9 Jun 11 Aug	13 Jul 7 Sep
Other expected events	23 Jun: publication of Monetary Policy Report	22 Jun: publication of Monetary Policy Report	9 Jun: publication of Monetary Policy Statement	2 July: publication of Monetary Policy Report
Expected rate movements[4]	→	→	↓	→

[1] Only on reserves exceeding quota; [2] chart displays centre of band; [3] negative sight deposit rate on account balances held at SNB; [4] direction of expected change in rates in next three months taken from Consensus Forecasts or, in the case of New Zealand, from RBNZ survey.





At its March meeting, the **NB** lowered its key interest rate by 0.25 pp to 0.50%, mainly because of weaker growth prospects for the Norwegian economy and an expected drop in inflation below the target. At its May meeting, the NB kept the rate unchanged, but Governor Øystein Olsen mentioned the possibility of a further cut and did not even rule out a reduction to negative values. Unemployment increased, particularly in oil regions. The NB expects a further rise in unemployment and lower wage growth in 2016. The countercyclical capital buffer rate of 1.5%, set in June 2015 and effective as from 30 June 2016, remains unchanged.

The **SNB** left the target range for its key monetary policy interest rate (3M LIBOR) at between -1.25% and -0.25%. The interest rate on sight deposits also remained unchanged at -0.75%. The negative rates and the SNB's willingness to intervene are serving to ease pressure on the overvalued franc. The SNB is projecting inflation of -0.8% for 2016 (compared with -0.5% in the December 2015 forecast), 0.1% for 2017 (compared with 0.3% in the December 2015 forecast) and 0.9% for 2018. Property price growth and mortgage volumes slowed, yet the imbalances on these markets persist. The SNB will assess the situation and take it into account in the countercyclical capital buffer rate.

The **RBNZ** left its key rate at 2.25% but did not rule out easing monetary policy further. Inflation is low and inflation expectations, especially short-term ones, declined. The property market in Auckland is showing signs of picking up again after a temporary cooling and house prices are rising in other regions of the country as well.

The Bank of Canada (**BoC**) left its key interest rate at 0.5%. Annual inflation reached 1.7% in April, nearing the target due to a rise in oil prices. The BoC expects inflation to stay slightly below the target this year. GDP growth was 2.4% in Q1 and is expected to slow in Q2 due to wildfires in Alberta. The BoC expects GDP to increase by 1.7% this year and 2.3% in 2017.

2. NEWS

Bank of England to provide banks with additional liquidity around EU referendum

The Bank of England (BoE) announced at the beginning of March that in the weeks around the approaching EU referendum (23 June) it will provide banks and other financial institutions with additional liquidity and offer three additional Indexed Long-Term Repo operations (ILTR) on 14, 21 and 28 June. The BoE is offering and will continue to offer liquidity through other standard facilities. It will continue to monitor market conditions carefully and keep its operations under review. At the May press conference, Governor Carney explained that by announcing the auctions months in advance the BoE wanted to avoid any misinterpretation that the auctions are a signal of potential stress in financial markets. (The current *Spotlight* focuses on the EU referendum.)

Bank of England reduces number of monetary policy meetings to eight a year

In line with its September 2015 announcement (see the September CBM), the BoE is reducing the number of its monetary policy meetings, as the Bank of England Bill received Royal Assent in May. The scheduled MPC meeting ending on 13 October 2016 will be dropped under the new arrangements. Starting in 2017, the MPC will have only eight scheduled meetings a year.

Riksbank and FSA discuss coordination in financial stability domain

Representatives of the Riksbank, the Swedish regulator (Finansinspektionen, FSA) and the Swedish government responded to (among other things) the financial stability part of the expert evaluation of the Riksbank's monetary policy conducted by Marvin Goodfriend and Mervyn King (see the March CBM). The Riksbank's representatives highlighted the need for a review of the current Swedish macroprudential policy framework. The General Council proposes to analyse without delay the present division of responsibilities and coordination between the government, the FSA, the Swedish National Debt Office and the Riksbank in the field of financial stability. The Executive Board considers that it is important that the area of financial stability is revised. However, as it will take a long time before an analysis is complete, the Executive Board suggests that the FSA should, without further delay, be given the legal powers and tools to be able to counteract financial stability risks. In his April speech, Riksbank Governor Stefan Ingves also stressed the importance of a complete rethink of Swedish macroprudential policy with its inefficiencies and vague mandates. The FSA agrees that it should be assigned more authorisations and tools, but it opposes the proposal that the FSA and the Riksbank should establish a joint committee for macroprudential policy and it suggests that the evaluation of macroprudential policy should be done at a later time. Swedish Minister for Financial Markets and Consumer Affairs and Deputy Minister for Finance Per Bolund commented in May on the possibility of integrating macroprudential policy under the Riksbank (i.e. merging the Riksbank and the FSA) and said that the government was not actively considering this radical reform option.

Adam Glapinski named new NBP Governor

Professor Adam Glapinski has been nominated by the Polish president to head the Polish central bank (NBP) for a six-year term starting on 11 June (for more information see the March CBM). The nomination has to be approved by the Polish parliament, but approval is widely expected as Professor Glapinski is linked to the ruling Law and Justice (PiS) party, which has a majority in both houses.

ECB Annual Report raises concerns about some of MNB's activities

The ECB in its 2015 Annual Report raised concerns about several programmes launched by the MNB which could be perceived as being potentially in conflict with the monetary financing prohibition. In the field of monetary policy, the MNB changed several of its monetary policy instruments to support its self-financing programme aimed at encouraging banks to shift from depositing liquidity at the central bank to purchasing government securities, and therefore at reducing the nation's reliance on foreign financing of government debt (see the March CBM). The ECB sees some of the changes as a means of circumventing the prohibition of privileged access (Article 124 of the Treaty on the Functioning of the EU) and has invited the MNB to review these operations. Outside monetary policy, the programmes seen as problematic by the ECB include the MNB's real estate investment purchases, its programme to promote financial literacy run through a network of six foundations, its programme of purchases of Hungarian artworks and its purchase of majority ownership of the Budapest Stock Exchange. The ECB sees this purchase as giving rise to monetary financing concerns, as the MNB used central bank resources to support an economic policy goal that is typically seen as a government competence.

Norwegian government withdraws money from oil fund managed by NB for first time

In a press release on its 2016 Q1 Quarterly Report, Norges Bank (NB), which manages the Government Pension Fund Global (GPFG, the "oil fund") on behalf of the Norwegian Ministry of Finance, stated that the Norwegian government had for the first time in history withdrawn more money from the fund than it had transferred into it from petroleum revenue. The net withdrawals amounted to NOK 24.7 billion in the first quarter of this year. According to the "fiscal (budgetary) rule", on average, the government's spending of oil revenue must not exceed the expected real return on the GPFG, estimated at 4% per year. The GPFG's market value is currently NOK 7.1 trillion, invested in equities, fixed-income investments and real estate outside Norway.

Governor Olson stays on as Governor of Norges Bank

The Norwegian government announced at the end of May that Øystein Olsen will be reappointed Governor of Norges Bank for a second six-year term from January 2017, winning against six other applicants. Olsen, governor of the NB since January 2011, said that he looked forward to a new term and to solving important tasks within the central bank's core areas.

3. SPOTLIGHT: THE IMPACTS OF BREXIT AS FORESEEN BY THE BANK OF ENGLAND AND OTHERS

On 23 June 2016, the people of Britain will decide in a referendum on whether or not the UK will remain a member of the EU. A decision to leave ("Brexit") would have major political and economic repercussions. However, the referendum has been having effects ever since it was announced in February. These include growing uncertainty among economic agents about future economic and political conditions, because if the UK decides to leave the EU it will have to renegotiate its trading relations with many of its major partners. The uncertainty among economic agents has also been sensed by the Bank of England (BoE), which is aware of the unreliability of the currently collected data relevant to its monetary policy decision-making. Given the seriousness and irrevocability of the potential decision to withdraw from the EU, the bank has decided to contribute its expertise as an independent authority. In October 2015, it issued an extensive publication about the effects of EU membership on the BoE's objectives. At its meetings, the BoE is commenting with increasing emphasis not only on the currently observed impacts of the referendum, but also on the potential impacts of Brexit on the UK economy. Like many other major institutions, it is warning of negative consequences, and it has been criticised by Brexit supporters for doing so. Even if the British vote to leave, the BoE stands ready to pursue its objectives in accordance with its mandate.

This article summarises why the EU referendum was announced in the UK, what consequences Brexit would have according to major institutions, and how the BoE stands on EU membership.

History leading up to the Brexit vote – why and how

The relationship between the UK and the EU has never been overly warm. In the 1950s, the countries of the nascent European Coal and Steel Community were relatively insignificant trading partners for the UK (accounting for just 10% of British exports). The UK did not join the subsequent negotiations to establish the European Economic Community (EEC), as it regarded the Commonwealth as more significant; moreover, it saw the EEC as a threat to its sovereignty. The UK initiated the establishment of the European Free Trade Association (EFTA) in 1960 as a counterbalance to the EEC. Although the UK applied to join the EEC in 1961, its entry was vetoed twice by France, so it did not become an EEC member until 1973 (when it simultaneously ceased to be an EFTA member). Its trade with EEC countries then surged.

The first EEC membership referendum was held back in 1975, based on the efforts of the governing party to negotiate better membership terms (67% of the electorate voted in favour of staying). The UK's fight for a reduction in contributions to the European budget started in 1979. The UK rebate entered into effect in 1984 and still applies. At the same time, however, the UK has strived constantly to improve the functioning of the common European market while seeking to maintain its competences in areas such as the currency and border controls (it has not adopted the euro and it is not a Schengen country).

After 2004, Britain saw a rise in Euroscepticism spearheaded by UKIP (the UK Independence Party). The party came second in the 2009 European Parliamentary election (and even won the 2014 one). Fearing a loss of votes, some Eurosceptic members of the Conservative Party of current Prime Minister David Cameron began to pressure their leader into taking a firmer stance on the EU. In 2011, the UK Parliament passed an EU Act (the European Union Act 2011).[1] Cameron announced in January 2013 that if he and the Conservative Party were to win the 2015 election, he would negotiate better membership terms with the EU and let the British

[1] Under this Act, a referendum has to be held on any change in European treaties that would imply a transfer of powers from the UK level to the EU level. However, as no European treaty has been amended, the Act might seem insufficient to the Eurosceptics.

public vote on the deal in a referendum. After the Conservatives scored an unexpected victory in 2015, action had to be taken.

In February 2016, Cameron struck a deal with the EU containing broadly the following economic provisions: (i) the EU acknowledged that EU Member States may have more than one currency; (ii) the euro area will not prevent the further development of a single market of all EU Member States, and non-euro-area states will not prevent deeper integration of the euro area; (iii) the UK (and other non-euro area countries) will be entitled to challenge any euro area decision with which it does not agree at an EU-wide summit; and (iv) the UK will not have to move towards further integration and will be able to apply its own rules for the regulation of the UK financial system. Under these conditions, a UK referendum on whether or not to remain in the EU was subsequently announced for 23 June 2016.

Sentiment towards the EU in Britain is more sceptical today than it was when Cameron started to talk about a referendum. The economic problems in many euro area countries and the refugee crisis have increased the British public's Eurosceptic views, and the voices for and against staying in the EU are now fairly balanced.

Brexit – possible impacts

In this situation, a number of prominent institutions have started to publish analyses of the likely economic impacts of potential Brexit. They include the Organisation for Economic Cooperation and Developments (OECD – impacts on the UK and the EU), HM Treasury (short-term and long-term impacts), the Centre for Economic Performance (CEP), the London School of Economics (LSE) and the National Institute of Economic and Social Research (NIESR). All these studies agree on the basic premises that Brexit would cause a sharp fall in the pound and a slowdown of the economy, resulting, in turn, in higher inflation and lower GDP than if the UK were to remain a member of the EU. The mechanism of effect and the negative message about the economic impacts of Brexit are the same in all studies. However, given the many uncertainties surrounding Britain's possible exit from the EU, the analyses differ in their quantification of the impacts, as they use different modelling techniques (although most are based on the NiGEM model) and attach different weights to different assumptions.

The short-term economic impacts of Brexit stem from the fact that the UK economy would – at least over the next two years – be exposed to a combination of increased uncertainty about future relations with the EU and other countries and about domestic legislative conditions, a gradual closing of the UK to foreign trade and investment, and an unstable financial environment due to a riskier perceptions of the UK among foreign investors.

The long-term economic impacts of Brexit would be due mainly to the future arrangement of the relationship between the UK and the EU and related relationships with other countries. Most analysts agree on the following three models: (I) UK membership of the European Economic Area (EEA, i.e. like Norway); (ii) relations with the EU governed by bilateral commercial and institutional agreements (as in the case, for example, of Switzerland, Turkey and Canada); and (iii) membership of the World Trade Organisation (WTO) without any further special agreements with individual countries (as with Russia and Brazil, for example). Brexiters also talk about negotiating a special agreement preserving free trade with the EU and not containing any negative aspects for the UK. However, it is hard to imagine Britain achieving such a good deal given the significantly frostier atmosphere that would probably exist between EU countries and the UK after a Brexit decision.

The following table shows the most important estimated short-term and long-term impacts of Brexit, broken down by institution and by the type of agreement on the foreign and economic position of the UK.

Short-term impacts (around 2020, UK Treasury 2018)									
	OECD	CEP LSE		UK Treasury			NIESR		
	WTO/bilateral agreements	EEA	WTO	all arrangements			EEA	bilateral agreements	WTO
GDP	-3.3%	-1.3 %	-2.6 %	-3.6% to +6.0%			-1.9%	-2.1%	-2.9%
Real wages				-2.8% to -4.0%			-2.3%	-2.6%	-4.2%
CPI inflation				+2.3% to +2.7%					
Unemployment	+1.5%			+1.6% to +2.4%					
GBP exchange rate	-4% to +6%			-12% to -15%			-20% (short-term)		
Long-term impacts (around 2030)									
	OECD	CEP LSE		UK Treasury			NIESR		
	WTO/bilateral agreements	EEA		EEA	bilateral agreements	WTO	EEA	bilateral agreements	WTO
GDP (mean)	-5.1%	-7.9%		-3.8%	-6.2%	-7.5%	-1.8%	-2.1%	-3.2%
GDP range	-2.7% to -7.7%	-6.3% to -9.5%		-3.4% to -4.3%	-4.6% to -7.8%	-5.4% to -9.5%	-1.5% to -2.1%	-1.9% to -2.3%	-2.7% to -3.7%
Real wages (mean)							-2.7%	-3.4%	-5.5%
Real wages (range)							-2.2% to -3.2%	-3.1% to -3.8%	-4.6% to -6.3%

Note: Differences compared to if the UK remains in the EU.

Besides describing these impacts and stating that Brexit would naturally also have consequences for other economies, the analytical studies contain a vast number of other warnings. For example, the NIESR warns that in the event of Brexit, the higher risk and uncertainty immediately after the referendum would cause the pound to fall by around 20%, setting off a wave of inflation pressures. According to the Treasury, if Britain were to leave the EU the UK economy would go into recession and the contraction in GDP would last four quarters. The IMF (through Christine Lagarde speaking at a press conference in London in early May) has warned that Brexit would cause equity markets to fall and property prices to go down and that panic among investors might trigger shock waves in the economy. According to the IMF, the UK's high debt and reliance on foreign financing would also make Brexit challenging for Britain. In an analysis of the impacts of Brexit on the UK financial sector, PricewaterhouseCoopers has estimated that Brexit could result in the loss of 80,000–100,000 financial services jobs. All these analyses also agree that if Britain remains in the EU, its economy will grow, starting as early as the second half of this year.

The Bank of England's position on Brexit

Like other prominent institutions, the Bank of England (BoE) is addressing the issue of the UK's membership of the EU. It has not published a quantification of the impacts of Brexit, but in October 2015 it contributed to the debate by issuing a document exploring the extent to which Britain's EU membership influences the BoE's ability to fulfil its mandate to maintain monetary and financial stability. It concluded that EU membership does not prevent it from achieving monetary stability, as a floating exchange rate and independent monetary policy enable it to absorb shocks. However, the BoE said that the size and complexity of the UK financial system made the pursuit of financial stability under the terms of EU membership much more challenging.[2] With regard to the processes going on in the EU, the BoE emphasised the need to ensure that the further deepening of integration in the euro area does not impair the BoE's ability to maintain domestic financial stability and the need to preserve clear principles to safeguard the interests of non-euro-area countries in the course of the future integration of the euro area and the development of the EU regulatory framework. This principle also figured in the negotiations between Prime Minister Cameron and the EU.

The BoE stated that, to the extent it increases economic and financial openness, EU membership reinforces the dynamism of the UK economy. However, high openness exposes the UK economy to economic and financial shocks from overseas. This was apparent during the euro area crisis. The BoE therefore emphasised that deepening the integration of the euro area and increasing its financial and economic stability were in Britain's interest as well.

At the meetings of its Monetary Policy Committee (MPC) and Financial Policy Committee (FPC) held since the referendum was announced, the BoE has gradually revised its assessment of the situation, which has been characterised by increasing uncertainty surrounding the June referendum. The BoE says this uncertainty is causing sterling to weaken and the economy to slow, affecting decision-making by economic agents and entering the central bank's monetary policy decision-making, as it is making economic data less reliable. As early as March, the BoE declared this uncertainty to be the biggest risk to domestic financial stability.

At these meetings the BoE has gradually started to discuss the potential impacts of a Brexit decision on economic variables and monetary policy decisions. According to the BoE, Brexit would change the outlooks for GDP and inflation, as it would probably cause a fall in aggregate demand and supply and a sharp depreciation of sterling, to which monetary policy would have to adapt. The BoE would be in a position of having to balance between stabilising inflation, supporting economic growth and reducing unemployment. The BoE has also warned that the Brexit effect would spill over to the euro area.

The negative message of the most recent analyses was underscored by Governor Carney at a subsequent press conference, at which, when quizzed by journalists, he conceded that Brexit might cause a technical recession in the UK (i.e. a fall in GDP in at least two consecutive quarters).

The BoE versus the Brexiters

Following Carney's mention of a possible recession, Brexit supporters[3] accused the governor and the central bank of meddling in politics, breaching the principle of independence, destabilising the financial markets and even causing a potential recession. There were even calls for Carney to resign. However, Iain Duncan Smith stated ironically that most BoE forecasts never materialise anyway.

In a subsequent interview for the BBC (on 15 May), Carney rejected the view that he had breached the principle of central bank independence by warning of Brexit-related risks. He said he had a responsibility to explain the risks, as ignoring a risk was not to reduce it. He added that he had not told voters how to vote in the referendum.

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[2] Although the UK's institutional framework for financial stability was substantially reformed after the global financial crisis to take account of the size, importance and openness of the UK financial sector, the BoE believes that high-quality institutions are not enough. Domestic stability also depends on high-quality regulation and supervision of the foreign financial institutions operating in the UK. Institutions from EU countries are supervised under single European legislation that the BoE was heavily involved in creating, but national regulators also need to have the requisite tools and the flexibility to apply them. The BMA believes this may be more of a challenge in the EU, as there is a movement away from setting minimum standards at EU and euro-area level in favour of "maximum harmonisation".

[3] For example, former Ministers Lord Lamont and Iain Duncan Smith, Treasury Select Committee member Jacob Rees-Mogg and Minister Andrea Leadsom.

At a hearing before the Treasury Select Committee on 24 May, Carney again defended the BoE's decision to warn about the economic risks of Brexit. According to Carney, it is important that the situation is understood not only by financial markets, but also by the general public. When asked by the committee whether the BoE was going to intervene further in the Brexit debate, for instance at its next monetary policy meeting (on 16 June, a week before the referendum), the governor said the bank had pointed to key Brexit-related issues and he did not expect any substantial change in communication. At the same time, Carney flatly rejected Jacob Rees-Mogg's accusation that the bank was taking sides or was under the influence of Chancellor George Osborne.

Conclusion

On 23 June 2016, the people of Britain will decide whether their country will remain a member of the EU. The result of the referendum is not at all clear in advance, and many experts, politicians and institutions have joined the debate ahead of the vote. The remainers include Prime Minister David Cameron and his Chancellor, leading representatives of many European countries, and the US President. However, the leavers camp contains numerous leading British politicians, among them the former Mayor of London Boris Johnson and former Treasury Ministers Lord Lawson and Lord Lamont, along with many politicians from other countries, especially those from Eurosceptic parties.

As the referendum result will be irrevocable, numerous prominent institutions have become involved in explaining the impacts of a Brexit so that voters have enough objective information in time and do not decide solely on the basis of impressions and feelings. The Bank of England ranks among these institutions. Its warnings about the potential negative economic impacts of Brexit are an objective assessment of the situation, yet they have automatically provoked critical reactions from opponents of the EU. However, the bank is maintaining its impartiality in the debate and strongly rejects any accusations that it has breached its independence mandate. It is meanwhile preparing for both possible outcomes so that it can continue to pursue its objectives of monetary and financial stability.

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4. SELECTED SPEECH: A YEAR OF NEGATIVE INTEREST RATES. WHERE DO WE STAND NOW?

Ms Cecilia Skingsley, Deputy Governor of Sveriges Riksbank, gave a speech at Danske Bank in Stockholm in April 2016 in which she described the practical experience of using negative interest rates and explained the reasons that led the Riksbank to introduce them.

The disappointing recovery following the global financial crisis has led many central banks to introduce previously unimaginable measures. In this context, Skingsley asks how we got into the current situation of low interest rates. She points out that, in the long run, the level of the real interest rate is determined by structural factors such as the conditions for growth and the willingness to save. As a small, open economy, Sweden has to accept the international real interest rate as given. Monetary policy is not able to affect the real interest rate to any great extent, but it affects inflation and inflation expectations.

The pessimists attribute the interest rate slowdown to secular stagnation, where savings have increased and willingness to invest has declined (as a result of the population composition and weak technological innovations). The optimists see the slowdown as being due to transitory remaining effects from the crisis, such as deleveraging and increased political uncertainty.

In recent years, not only have real interest rates fallen, but inflation has also shown a downward trend. Both of these facts must be taken into account in the monetary policy deliberations. Lower real interest rates and lower inflation and inflation expectations are pushing the nominal interest rate downwards. This means that the central bank has to take stronger action for monetary policy to have a stimulating effect.

Swedish monetary policy aims to stabilise inflation around the 2% target while keeping production and employment around sustainable paths. In 2014, CPIF inflation (the CPI with a fixed mortgage rate) was around 1% for some time and long-run inflation expectations had fallen below the 2% level. After several rate cuts the situation became critical as the fall in the oil price further dampened the already low inflation. On top of this, there were signals that the ECB was preparing a stimulation package for early 2015. The imminent increase of the interest rate differential could have contributed to a strengthening of Swedish krona and complicated attainment of the inflation target. Riksbank assessed the risks of a wait and see approach as greater than those connected to being proactive, as there was a risk that inflation expectations would fall further. In February 2015, the Executive Board decided to cut the repo rate below zero and start an asset purchase programme. Moreover, the Riksbank signalled a possibility of foreign exchange interventions if the krona appreciation were too strong and rapid.

According to Skingsley, the Riksbank's efforts have been successful. Growth is higher than expected (although not merely due to monetary policy) and inflation expectations are rising again. However, unconventional monetary policy is far from uncomplicated. Under negative rates it is more difficult to assess the impact of interest rate decisions on the transmission mechanism and to assess the stimulation effects of bond purchases. Moreover, low interest rates increase indebtedness among households in a way that increases vulnerability in the economy. In spite of this, Skingsley is convinced that the Riksbank chose the right solution, as the inflation target would have risked losing its role as anchor for price-setting and wage formation if the repo rate had not been cut. She states that central banks should normally take a longer view, but at the turn of 2014 and 2015 the Riksbank was in a situation that required greater focus on the present to uphold confidence in the inflation target.

Skingsley believes that the global conditions for growth will gradually improve and that the course of inflation will normalise. But this depends on decisions beyond the Riksbank's reach. Growth conditions in Sweden depend on the Swedish economy's ability to constantly transform. Monetary policy can function as a bridge over to a new normal situation.

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