

Monetary and Statistics Department  
Monetary Policy and Strategy Division

*Half of the eight central banks monitored left their rates unchanged (MNB, NBP, NBS and the Fed), while the other half increased them (ECB, SR, BoE and RBNZ). Sweden's Riksbank took the record this time, raising its rates in two steps by a total of 0.50 percentage point. The other central banks all raised their rates by 0.25 percentage point. In Spotlight we take a look at the changes in monetary policy-making in Sweden. Our selected speech is Jarle Berge's address on Norway's interest rate projection experience.*

### 1. Developments since the last issue of Monitoring (December 2006) and expected future information

	Inflation target <sup>1</sup>	Latest inflation	Current basic rate	MP meeting date/rate change/ expectation <sup>2</sup>	Next MP meeting/ expectation <sup>3</sup>	Other expected events
<b>Euro area</b> (European Central Bank, ECB)	< 2.0%	1.8% (Feb 2007) <sup>4</sup>	3.75%	11 Jan/0.00 8 Feb/0.00 8 Mar/+0.25 ↗	12 Apr 10 May 6 Jun ↗	6 Jun: publication of new forecast
<b>Sweden</b> (Sveriges Riksbank, SR)	2.0%	1.9% (Jan 2007)	3.25%	14 Dec/+0.25 14 Feb/+0.25 ↗	29 Mar 3 May ↗	
<b>United Kingdom</b> (Bank of England, BoE)	2.0%	2.7% (Jan 2007)	5.25%	10–11 Jan/+0.25 7–8 Feb/0.00 7–8 Mar/0.00 ↗	4–5 April 9–10 May 6–7 June ↗	16 May: publication of IR <sup>5</sup>
<b>Hungary</b> (Magyar Nemzeti Bank, MNB)	3.0%	7.8% (Jan 2007)	8.00%	18 Dec/0.00 22 Jan /0.00 26 Feb/0.00 →	26 Mar 23 Apr 21 May →	21 May: publication of IR <sup>5</sup>
<b>Poland</b> (Narodowy Bank Polski, NBP)	2.5%	1.7% (Jan 2007)	4.00%	19–20 Dec/0.00 30–31 Jan/0.00 27–28 Feb/0.00 →	27–28 Mar 24–25 Apr 29–30 May →	30 Apr: publication of IR <sup>5</sup>
<b>Slovakia</b> (Národná banka Slovenska, NBS)	< 2.0%	2.2% (Jan 2007)	4.75%	19 Dec/0.00 30 Jan/0.00 27 Feb/0.00 →	27 Mar <sup>6</sup> 27 Apr 29 May →	Monetary survey issued on given MP meeting dates
<b>USA</b> (Federal Reserve System, Fed)	n/a	2.1% (Jan 2007)	5.25%	12 Dec/0.00 30–31 Jan/0.00 ↘	20–21 Mar 9 May →	25 Apr: publication of Beige Book
<b>New Zealand</b> (Reserve Bank of New Zealand, RBNZ)	2.0%	2.6% (2006 Q4)	7.50%	25 Jan/0.00 8 Mar/+0.25 →	26 Apr 7 June →	

<sup>1</sup> Inflation target valid for the current period (or, in the case of Slovakia, the year-end target).

<sup>2</sup> The direction of the expected change in rates in the past quarter is taken from the Consensus Forecasts survey (or, in the case of New Zealand, from the RBNZ's own survey).

<sup>3</sup> Provisional meeting dates. The direction of the expected change in rates in the coming quarter is taken from the Consensus Forecasts survey (or, in the case of New Zealand, from the RBNZ's own survey).

<sup>4</sup> Preliminary estimate.

<sup>5</sup> Inflation Report.

<sup>6</sup> The NBS decides on rates once a week; the given dates correspond to the discussion of the Situation Report.

## 2. News

### [Slovenia joins the euro area...](#)

On 1 January, the euro was introduced in Slovenia. Slovenia thus became the 13th EU Member State to adopt the single currency and hence the first of the new Member States to join the European Economic and Monetary Union. As a result of the adoption of the euro by Slovenia, Banka Slovenije is now a full member of the Eurosystem, with the same rights and obligations as the 12 national central banks of the other EU Member States that have adopted the euro. In accordance with Article 49 of the Statute of the European System of Central Banks and of the European Central Bank, Banka Slovenije paid up the remainder of its contribution to the capital of the ECB. Banka Slovenije transferred its contribution to the foreign reserve assets of the ECB.

### [...Bulgaria and Romania join the EU...](#)

On 1 January 2007, the European Union was enlarged through the accession of two new Member States – Bulgaria and Romania. As from this date, the national central banks of these countries were integrated into the European System of Central Banks (ESCB), and their respective Governors became members of the General Council of the ECB. In addition, experts from these NCBs in the ESCB Committees have member status whenever the committees meet in ESCB composition. Bulgaria joined the EU with the currency board arrangement in place, which it intends to apply until it joins the euro area. A joint [strategy of the government and the central bank for the adoption of the euro](#), drawn up in 2004, assumes Bulgaria's entry into ERM II as soon as possible after EU accession. Romania has been applying inflation targeting combined with a floating exchange rate since 2006. It has not yet prepared a euro adoption strategy, because it states in its [Convergence Programme](#) that considering the need to implement reforms it will not be able to join ERM II sooner than 2012.

### [...the ECB sets a new key for subscriptions to its capital...](#)

Pursuant to Article 29 of the Statute of the ESCB and of the ECB, the shares of the national central banks in the ECB's capital key are weighted according to the shares of the respective Member States in the total population and the gross domestic product of the EU, in equal measure, as notified to the ECB by the European Commission. These weights are adjusted every five years and whenever new Member States join the EU. On 1 January 2007 the ECB's capital key was changed on account of the Bulgarian National Bank and Banca Națională a României joining the European System of Central Banks (ESCB). In accordance with Article 49.3 of the Statute of the ESCB, the ECB's subscribed capital is automatically increased when a new Member State joins the EU and its national central bank joins the ESCB. Therefore, on 1 January 2007 the subscribed capital of the ECB increased to EUR 5,761 million.

### [...and Cyprus and Malta request Convergence report](#)

Cyprus (13 February) and Malta (27 February) officially applied to join the euro area on 1 January 2008. By May 2007, the European Commission and the ECB will draw up an extraordinary convergence report for these countries, which will assess whether Cyprus and Malta fulfil the conditions for the adoption of the single currency.

### **Sveriges Riksbank starts publishing forecast of monetary policy rates**

At its meeting on 16 January 2007, the Executive Board adopted some measures to enhance monetary policy transparency and effectiveness. As of February 2007, the previous Inflation Report has been renamed the Monetary Policy Report, which has a different structure and a partly revised content. The interest rates in the previous forecast derived from market yield curves have been replaced by the Riksbank's own projection of monetary policy rates based on the current forecast and the Executive Board's current view of the future interest rate path. See Spotlight for more details of these changes.

### **UK's MPC celebrates 10th birthday**

Ten years ago, in June 1997, monetary policy-decision making in the United Kingdom was delegated to a newly established Monetary Policy Committee (MPC). A publication released to mark this occasion charts the history of UK monetary policy, focusing on the changes that followed the creation of the MPC.

### **The NBP has new president...**

On 10 January 2007, the lower house of the Polish parliament appointed Sławomir Skrzypek as the new President of the Polish central bank. In 2002–2005, Mr Skrzypek was Deputy Mayor of Warsaw, responsible, *inter alia*, for financial policy, investment projects and corporate governance. As from December 2005, he worked in management boards and supervisory boards of commercial banks. In May 2006 he became Chairman of the Supervisory Board of Polish Television.

### **...and is to publish more information from MPC meetings**

Starting from the January Inflation Report, the chapter on monetary policy offers a more detailed account of discussions at MPC meetings. Starting from May 2007, the minutes of MPC meetings will be published and the format of the press release published after the meeting will be modified.

### **Ben Bernanke – globalisation significantly affects U.S. inflation process**

In a speech given on 2 March 2007 at the Fourth Economic Summit at the Stanford Institute, the Fed Chairman discussed the implications of globalisation for monetary policy, financial markets and inflation in the USA. He concludes that globalisation has not reduced the ability of the Fed to influence financial conditions and to conduct monetary policy in the USA. On the other hand, it significantly affects inflation. Increasing imports of manufactured goods from China, India and other developing countries are stabilising or reducing some consumer prices, but the developments in these countries are dramatically increasing global prices of energy and other commodities.

### **RBNZ mulls mortgage interest levy**

The RBNZ and the Treasury have jointly prepared a report discussing the possibility of using additional demand management instruments. The RBNZ is in a specific situation where it faces high domestic demand as a result of rising property prices and is thus being forced to maintain a high level of interest rates. However, in an environment of low interest rates in other global economies, this is tending to lift the exchange rate of the New Zealand dollar, which has an adverse effect on the tradables sector. The RBNZ is thus considering the possibility of introducing a special mortgage interest levy. Such a tax could be used only under such exceptional circumstances as an additional demand management instrument and might help reduce fluctuations in key interest rates and the exchange rate.

### 3. Spotlight: Changes in monetary policy-making in Sweden

At its meeting on 16 January 2007, the Riksbank Executive Board adopted several measures heading partly along the same route as the recommendations made in the report “[An Evaluation of Swedish Monetary Policy between 1995 and 2005](#)” written by [Francesco Giavazzi](#) and [Frederic Mishkin](#) in 2006 and commissioned by the Swedish parliament’s (Riksdag) Committee on Finance in November 2005 (see the December issue of Central Bank Monitoring). However, no direct link between the report and any of the adopted measures was mentioned. On the contrary, the Riksbank had announced its intention to publish its own interest rate forecast before the evaluation was published.

On 22 February 2007, the Executive Board sent a [detailed written response](#) to the evaluation to the Committee on Finance. The Board states that the Riksbank is positive to most of the recommendations proposed in the report, adding that it had started developing the measures ahead of the publication of the evaluation. The Riksbank rejected only two of the recommendations:

- persistent undershooting or overshooting of the inflation target should be compensated by a subsequent deliberate overshooting or undershooting of the corresponding amount;
- the inflation target should be defined in terms of a price index other than the CPI.

A [speech](#) on the issue was given by the Riksbank Governor Stefan Ingves in the Riksdag Committee on Finance.

The measures adopted by the Executive Board can be summed up as follows:

- Starting from February 2007, the Inflation Report has been renamed the Monetary Policy Report. [The first Monetary Policy Report](#) was published on 15 February 2007.
- The interest rates in the existing forecast derived from market yield curves have been replaced by the Riksbank’s own projection of monetary policy rates, based on the current forecast and the Executive Board’s current view of the future path of interest rates.
- Starting from February, the Executive Board can thus change the interest rate forecast generated by the Riksbank’s forecasting system. To this end, the *printed* version of the Monetary Policy Report will be published two days after the Executive Board meeting. The *Internet version* of the Monetary Policy Report will be published as previously, on the day following the Executive Board meeting.
- The repo rate path thus constructed is published in the Monetary Policy Report in fan chart form with a three-year horizon and also in the form of a table for individual quarters.
- Compared to the previous Inflation Report, the content and structure of the Monetary Policy Report have been changed to enhance the effectiveness and transparency of communication. A page of information on monetary policy in Sweden has been inserted before the Contents section. The report opens with the minutes of the preceding Executive Board meetings. Chapter 1 of the report discusses the forecast and its revision compared to the previous report. Chapter 2 deals with alternative scenarios and risks. Chapter 3 assesses the current economic situation. The colour of the cover has been changed from white to green.
- The [minutes](#), which will be published as previously about two weeks after the meeting, contain a detailed passage on the discussion of the future repo rate path. Reservations expressed about the rate forecast are not published with names, as is the case with the voting on the current rate setting.

#### 4. Selected speech: Jarle Bergo on the interest rate projection in theory and practice

*In this section we summarise a speech entitled “[Interest rate projections in theory and practice](#)” given by Jarle Bergo, Deputy Governor of the Norges Bank, at a seminar of the Association of Norwegian Economists at Sanderstølen on 26 January 2007.*

Jarle Bergo focused his speech on the experience with publishing an interest rate path in a flexible inflation targeting regime, the determinants of interest rates and optimal monetary policy-making in terms of rules versus discretion.

Deputy Governor Bergo opened his speech with a summary of the current attributes of monetary policy in Norway. Policy is oriented towards low and stable inflation (CPI growth close to 2.5%) in a flexible inflation targeting regime, which builds a bridge between the long-term objective of anchoring inflation expectations and the short-term objective of stabilising economic developments and employment. According to Mr Bergo, the more than one-year experience of publishing the interest rate path using fan charts has been positive. Expectations regarding future developments in the monetary policy rate affect the consumption and investment decisions made by economic agents. To be successful, monetary policy must be able to influence these expectations.

When preparing a forecast, it is vital to have a view of what the normal level of interest rates is. The normal long-term nominal interest rate level in Norway is in the range of 5-6%. Preferences for higher saving and for lower investment around the world, combined with the orientation of Asian central banks (particularly China) towards buying US dollars and US government bonds, are among the frequently cited reasons for the currently low level of long-term interest rates. Mr Bergo also recalled that according to economic theory, the long-term real interest rate is determined mainly by productivity and population growth and households’ long-term saving preferences. In the short- and medium-term, however, the economy is regularly exposed to shocks that influence economic developments, and thereby also the interest rate. We might thus see deviations of actual interest rates from the theoretical rates over longer periods.

Mr Bergo subsequently mentioned the contribution of Kydland and Prescott to economic theory. Kydland and Prescott argued in favour of a rule-based policy due to the “time inconsistency problem” of discretionary policy. For a rule-based policy to be successful, it must be credible. Economic agents must fairly safely assume that decision-makers will actually follow their announced response pattern. The ten-year Norwegian experience (in the 1970s and 1980s) showed that discretionary policymaking can lead the economy onto a suboptimal path.

Mr Bergo concluded by noting that central bankers face more challenges in practice than they can address within the confines of economic models. For example, models cannot fully identify the uncertainties and risks surrounding future developments. Models are also based on the assumption that the inflation target is credible, but in practice such credibility must often be defended. Models and theory thus can never provide a perfect recipe for how to set the interest rate – they are only tools.

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