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# CENTRAL BANK MONITORING – SEPTEMBER

2013

Monetary and Statistics Department
Monetary Policy and Fiscal Analyses Division

CNB CZECH NATIONAL BANK

## In this issue

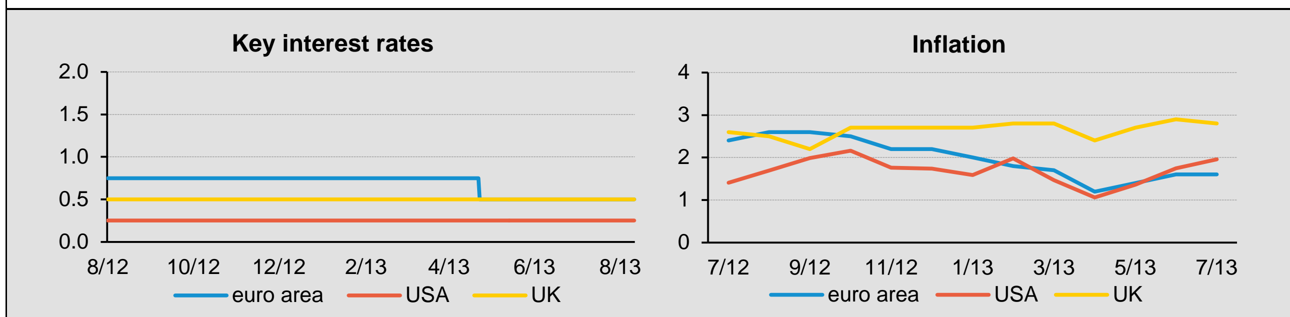
*The three major central banks made no changes to their monetary policy in the past quarter. However, the ECB and the BoE followed the Fed in issuing announcements about future policy conduct. The financial markets are responding sensitively to new information in expectation of a possible scaling down of the Fed's quantitative easing programme, but the Fed's outgoing chairman Ben Bernanke has not expressly promised such a move as yet. The Reserve Bank of New Zealand introduced a new limit on the LTV ratio on new mortgage loans, thereby joining the growing number of central banks that have introduced macroprudential tools (e.g. Norway and Switzerland). The central banks of Poland and Hungary cut their rates further, as they still have enough room for conventional monetary policy. However, Hungary reduced its rate by an unusual 0.20 pp in August and the MNB is expected to lower rates further. The current* Spotlight *focuses on intensified cross-border capital flows fostered recently by, among other things, the monetary policy of central banks in advanced economies. In our* Selected Speech, *Riksbank First Deputy Governor Kerstin af Jochnick notes that too easy monetary policy may increase the risk of financial crisis.*

## 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)** | 4 Jul (0.00)<br>1 Aug (0.00)<br>5 Sep (0.00) | 18–19 Jun (0.00)<br>30–31 Jul (0.00) | 3–4 Jul (0.00)<br>31 Jul–1 Aug (0.00)<br>4–5 Sep (0.00) |
| **Current basic rate** | 0.50% | 0–0.25% | 0.50% |
| **Latest inflation** | 1.3% (May 2013)[3] | 2.0% (Jul 2013) | 2.8% (Jul 2013) |
| **Expected MP meetings** | 2 Oct<br>7 Nov<br>5 Dec | 17–18 Sep<br>29–30 Oct | 9–10 Oct<br>6–7 Nov<br>4–5 Dec |
| **Other expected events** | 5 Dec: publication of forecast | 16 Oct: publication of Beige Book | 13 Nov: publication of Inflation Report |
| **Expected rate movements[4]** | → | → | → |

[1] ECB definition of price stability; [2] January 2012 definition of inflation target; [3] flash estimate; [4] direction of expected change in rates in coming quarter taken from Consensus Forecast survey.




The **ECB** left its key rate unchanged at 0.50%, although the monetary policy meeting discussed a rate cut. Moreover, ECB President Mario Draghi stated in July (and confirmed in the following months) that key interest rates would remain at present or lower levels for an extended period of time. Following six quarters of decline, real GDP rose by 0.3% quarter on quarter in Q2, with leading indicators suggesting a gradual economic recovery. The ECB's current forecast expects GDP to decline by 0.4% in 2013 and to increase by 1.0% in 2014. Inflation is forecasted at 1.5% in 2013 and 1.3% in 2014. Medium-term inflation expectations remain firmly anchored.

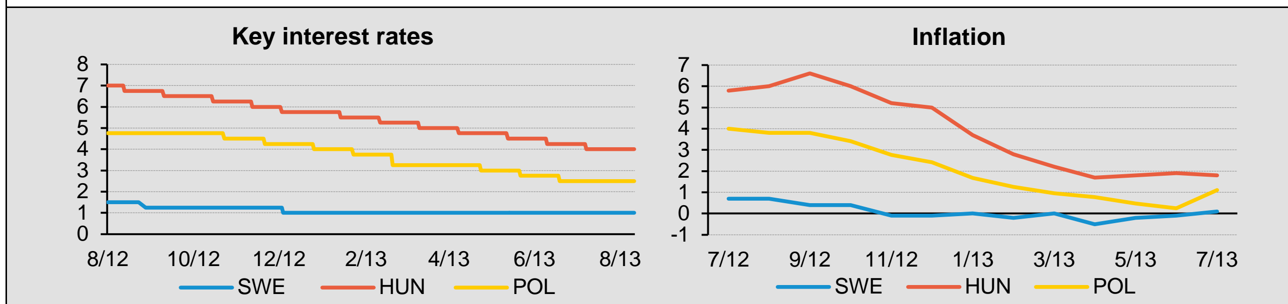
The **Fed** left its key interest rate unchanged and confirmed its commitment to keep rates at the current level at least as long as the unemployment rate remains above 6.5%, the inflation outlook remains no more than 0.5 pp above the longer-run goal, and longer-term inflation expectations continue to be well anchored. The Fed is continuing to purchase mortgage-backed securities (MBS) at a pace of USD 40 billion per month and long-term government bonds at a pace of USD 45 billion per month. Financial market participants are speculating about a scaling down of QE3 after the Fed admitted this possibility, although it has not confirmed such a move as yet. Labour market conditions have improved, but the unemployment rate remains elevated at 7.4%.

The **BoE** left its key interest rate unchanged at 0.50% and its asset purchase programme at GBP 375 billion. It also decided to reinvest GBP 1.9 billion in income on bonds maturing in September (see here for details). In August, the BoE published an announcement about the future conduct of monetary policy: the BoE's rate will not be raised while the unemployment rate remains above 7% (see *News* for details). A gradual economic recovery is apparent in the UK. The estimate for GDP growth in Q2 is 0.6%. Inflation is still above the BoE's 2% target.

**Selected central banks of inflation-targeting EU countries**

| | Sweden (Riksbank) | Hungary (MNB) | Poland (NBP) |
|---|---|---|---|
| **Inflation target** | 2% | 3% | 2.5% |
| **MP meetings (rate changes)** | 2 Jul (0.00)<br>4 Sep (0.00) | 25 Jun (-0.25)<br>23 Jul (-0.25)<br>27 Aug (-0.20) | 2-3 Jul (-0.25)<br>20 Aug (0.00)<br>3-4 Sep (0.00) |
| **Current basic rate** | 1.00% | 3.80% | 2.50% |
| **Latest inflation** | 0.1% (Jul 2013) | 1.8% (Jul 2013) | 1.1% (Jul 2013) |
| **Expected MP meetings** | 23 Oct<br>16 Dec | 24 Sep<br>29 Oct<br>26 Nov | 1–2 Oct<br>5–6 Nov<br>3–4 Dec |
| **Other expected events** | 24 Oct: publication of Monetary Policy Report | 27 Sep: publication of Quarterly Report on Inflation | mid-Nov: publication of Inflation Report |
| **Expected rate movements[1]** | → | ↓ | → |

[1] Direction of expected change in rates in coming quarter taken from Consensus Forecast survey.




The **Riksbank** left its key interest rate unchanged at 1% and does not expect to raise it until the end of 2014. Inflation is very low and the Riksbank expects it to increase only very slowly, reaching the 2% target in 2015. The Riksbank did not lower rates further in light of risks related to high household debt. The Swedish economy is showing signs of a gradual recovery. Low interest rates and rising employment have fostered growth in income, creating conditions for further steady growth in consumption. As the global economy improves, the Riksbank expects Swedish exports to rise and GDP growth to strengthen in late 2013.

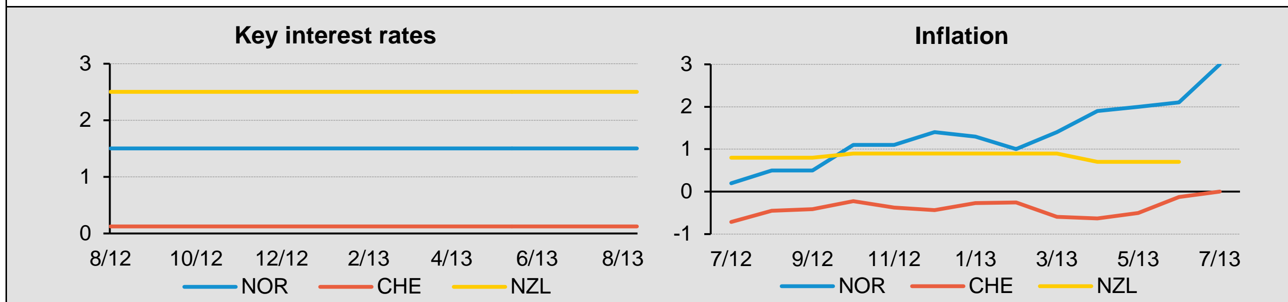
The **MNB** lowered its monetary policy rate three times again in the last quarter: twice by 0.25 pp and then by 0.20 pp, i.e. by a total of 0.7 pp to the current level of 3.80%. The MNB cut the rate by an unusual 0.20 pp in light of the significant previous reduction in interest rates and taking into account developments in perceptions of the risks associated with the Hungarian economy. The current inflation rate stands at 1.8% and remains at historical lows. The Hungarian economy has recovered from recession this year, but economic activity remains weak overall and domestic demand is recovering only very slowly.

The **NBP** lowered its monetary policy rate by 0.25 pp to 2.50% at the start of July, but left it unchanged at the following two meetings. Quarter-on-quarter GDP growth picked up slightly in Q2, from 0.2% to 0.4% (economic activity increased by 0.8% year on year), but the economy remains well below its potential. Net exports were the main contributor to GDP growth. Private consumption increased slightly, while the decrease in investment was larger than in the previous quarter. Data on industrial production, construction output and retail sales in July point to a gradual improvement in business conditions. Consumers' inflation expectations dropped to a record low – the respondents expect inflation of 0.2% over the next 12 months.

### Other selected inflation-targeting countries

| | Norway (NB) | Switzerland (SNB) | New Zealand (RBNZ) |
|---|---|---|---|
| **Inflation target** | 2.5% | < 2% | 2% |
| **MP meetings (rate changes)** | 20 Jun (0.00) | 20 Jun (0.00) | 13 Jun (0.00)<br>25 Jul (0.00) |
| **Current basic rate** | 1.50% | 0–0.25% [1] | 2.50% |
| **Latest inflation** | 3.0% (Jul 2013) | 0.0% (Jul 2013) | 0.7% (2013 Q2) |
| **Expected MP meetings** | 19 Sep | 19 Sep | 12 Sep<br>31 Oct |
| **Other expected events** | 19 Sep: publication of Monetary Policy Report | 26 Sep: publication of Monetary Policy Report | 12 Sep: publication of Monetary Policy Report |
| **Expected rate movements[2]** | → | → | → |

[1] Chart displays centre of band; [2] direction of expected change in rates in coming quarter taken from Consensus Forecast survey or, in the case of New Zealand, from RBNZ survey.




**Norges Bank (NB)** left its key interest rate unchanged at 1.50%. Monetary policy remains loose because domestic inflation is low and because interest rates abroad are very low. Capacity utilisation in the Norwegian economy has returned to normal. Wage growth has slowed. The policy rate is low, but the spread between it and client rates of households and corporations is elevated. The Norwegian economy is growing at a slightly lower rate than expected by the Norges Bank. A countercyclical capital buffer is expected to be introduced at the meeting on 19 September (more information here).

The **SNB** is still maintaining rates in the lower part of the 0–0.25% target range and its commitment to enforce a minimum exchange rate of CHF 1.20/EUR is also unchanged. Although real GDP rose significantly in 2013 Q1, the SNB expects growth to weaken in Q2. However, the outlook for GDP growth is unchanged at 1.0–1.5% for 2013 as a whole. According to the SNB forecast, inflation will increase only very gradually in the years ahead. The inflation rate will reach -0.3% in 2013, 0.2% in 2014 and 0.7% in 2015.

The **RBNZ** left its key interest rate at 2.50% and does not expect it to change until the end of 2013. Inflation remains below the lower boundary of the central bank's target range and is likely to remain below the target in the remainder of the year. Growth in the New Zealand economy is picking up and is becoming more widespread across sectors. Rapid house price inflation persists due to reconstruction and investment activity in Canterbury, to which the RBNZ has responded with macroprudential tools, specifically limits on new mortgages with LTV ratios of over 80% (more information here and here). This measure is designed to curb mortgage lending, thereby preventing excessive house price inflation. The RBNZ believes this will reduce the risk of a future substantial downward correction in house prices, which would damage the financial sector and the broader economy. The RBNZ expects to keep the key interest rate unchanged through the end of the year.

## 2. NEWS

### BoE provides explicit guidance about its future conduct of monetary policy

The Bank of England's Monetary Policy Committee (MPC), headed by Governor Mark Carney, published an announcement that it intends to maintain the highly stimulative stance of monetary policy at least until the unemployment rate has fallen to a threshold of 7%. The unemployment rate reached 7.8% in the second quarter. However, the BoE's commitment is subject to three conditions: (1) inflation expected by the MPC 18–24 months ahead must not exceed 2.5%, (2) medium-term inflation expectations need to remain sufficiently well anchored, and (3) the Financial Policy Committee (FPC) must not judge that the stance of monetary policy poses a significant threat to financial stability that cannot be contained by other measures.

### Croatia's central bank becomes 28th member of ESCB

Croatia joined the European Union on 1 July. The country had applied for EU membership back in 2003, the accession treaty had been signed in 2011, and in a referendum held in January 2012, 66% of Croatian voters had supported Croatia's accession to the EU. On Croatia's entry into the EU, its central bank (Hrvatska narodna banka, HRN) became a member of the European System of Central Banks (ESCB) and its governor a member of the General Council. At the same time, Croatia committed itself to introducing the euro in the future and will do so once it has fulfilled the relevant requirements. Due to the EU enlargement the ECB's capital subscription key has been adjusted.

### SNB opens branch in Singapore

The Swiss National Bank opened a branch in Singapore in July to ensure more efficient management of its assets in the Asia-Pacific region. Owing to the SNB's exchange rate policy, its foreign exchange reserves have increased substantially and the SNB is aiming to diversify its investments. The SNB has expanded its basket of reserve currencies to include Asian-Pacific region currencies. Besides the japanese yen, Australian and Singapore dollars and South Korean won have been added.

### Adjustments to ECB's collateral eligibility rules allow for new treatment of ABS

Under its regular reviews the ECB adjusted its collateral eligibility rules for monetary policy operations. The adjustments apply, among other things, to asset-backed securities (ABS) – the rating requirements were loosened and the applicable haircuts were reduced. The ECB is also considering the possible acceptance of ABS linked to small and medium-sized enterprises.

### BoE and PBC sign swap agreement

The Bank of England and the People's Bank of China signed an agreement to establish a three-year sterling/renminbi currency swap line. The maximum value of the swap is RMB 200 billion, or GBP 20 billion.

### IMF publishes External Sector Report

The International Monetary Fund published its second Pilot External Sector Report. The document assesses developments in 2012 and focuses mainly on current account imbalances, capital flows, reserve accumulation and trade protectionism. As the IMF concludes, external sector imbalances narrowed in 2012, but capital flows have been volatile and pose risks and difficult policy challenges to recipient economies. The issue of capital flows is examined further in *Spotlight*.

## Economic policy symposium in Jackson Hole

The annual economic policy symposium took place in Jackson Hole, Wyoming, in August. As this year's title – *Global Dimensions of Unconventional Monetary Policy* – suggests, the main topic was the impacts of unconventional measures on the global economy. Exit strategies were discussed.

## BoI currently without governor

After the departure of Stanley Fischer from the Bank of Israel at the end of June, the position of BoI governor remains vacant. Even though the ex-governor handed in his notice at the beginning of this year, a successor has still not been appointed. The central bank is thus being run by Deputy Governor Karnit Flug for the time being.

## 3. SPOTLIGHT: UNDESIRABLE CAPITAL FLOWS

*Until very recently the easy monetary conditions in advanced countries were intensifying the financial flows on global markets. Capital inflows can be welcome because of their manifold benefits, especially in emerging economies. On the other hand, they can have destabilising effects, create risks to financial stability and introduce dilemmas into local economic policies. The possibility of a sudden reversal in "investor sentiment" and a fast massive outflow is an unpleasant risk. A massive inflow of investment into emerging economies has prevailed in recent years despite a temporary reversal of capital flows immediately after the fall of Lehman Brothers. Countries have tried to confront the negative impacts of these capital inflows with various measures. The frequently used tools have included foreign exchange interventions and tailor-made measures to limit capital flows. Speculation about the exit from the quantitative easing programme in the USA is currently leading to a rapid withdrawal of investments from emerging markets, pointing at further possible problems associated with the discontinuation of unconventional monetary policy tools in the future.*

The very easy monetary conditions in advanced countries – as typified by a long period of very low interest rates and a wide range of unconventional tools – are leading to excess liquidity in the financial system. Investors are seeking opportunities to earn higher yields, and not only in their home economies. Part of the liquidity that has poured into advanced economies is thus spilling over to foreign markets. However, the resulting intensification of capital flows may have far-reaching consequences for the economies and economic policies of the recipient countries. Investors are being attracted mainly to emerging economies (Latin American countries, Asian emerging economies and Eastern European countries), which have long been growing much faster than advanced countries and whose higher interest rates are providing bigger yields. Changes in the regulation of financial institutions and markets may foster further capital movements. The effect is being amplified by carry trades.

Inflows of foreign capital are a generally desirable resource for emerging economies. They reduce the cost of capital (both private and public), supporting investment and consumption and thereby fostering growth. Moreover, they can help develop financial markets and be accompanied by transfers of technology and managerial skills (especially in the case of foreign direct investment). However, too much capital flowing into an economy puts appreciation pressure on the local currency, making domestic exporters less competitive on global markets. Squeezed long-term bond yields can make monetary policy less effective. What is more, a fall in government borrowing costs can cause fiscal discipline to worsen. If capital inflows are volatile and short-term, they can have an impact on macro-financial stability. They can push up asset prices, foster excessive credit growth, distort financial markets and motivate financial institutions to take on too much high risk. A sudden halt in the capital inflow – or even a massive capital outflow – can have particularly unfortunate consequences by causing a sharp depreciation of the domestic currency, a liquidity shortage or a slump in asset prices. In the event of a sustained lack of confidence, the problems can even snowball into a deep economic crisis. Countries with less developed financial markets tend to be hardest hit by the serious consequences of excessive capital flows, as they are not always able to absorb massive amounts of liquidity flexibly. However, as recent experience has shown, advanced economies can also face major impacts (e.g. Switzerland, Iceland and Japan).

The massive pre-crisis inflow of capital into emerging economies halted temporarily after the fall of Lehman Brothers, when large amounts of capital had flowed out of these countries. Financial flows have been building up again since mid-2009, but in contrast to previous waves they have been dominated by portfolio investment, which is less stable and has been getting increasingly volatile in recent years. However, the financial markets are being rocked by speculation about the exit from the quantitative easing programme in the USA and the risk of a massive outflow is again rearing its head. On top of that, the introduction of measures to

regulate short-term capital movements, which tend to increase investors' fears about the future repatriation of their funds, has paradoxically contributed to the recent withdrawal of investors from many economies.

The optimum economic policy response to excessive capital flows is not clear and often conflicts with a country's main economic objectives. Where an economy is facing extremely large capital inflows, monetary policy can help by lowering interest rates, but this is only possible if the economy is not overheating and there is no risk of inflationary pressures or asset market bubbles. Excessive appreciation of the domestic currency can cause a dilemma for the central bank. A significantly overvalued currency can pose a risk to the real economy, but efforts to curb the appreciation using foreign exchange interventions can undermine the credibility of monetary policy in inflation-targeting countries. Foreign exchange interventions can be associated with high sterilisation costs, and the subsequent exchange rate movement can cause large losses. Economic policy can face further dilemmas in the event of an excessively fast outflow of capital from the country.

The main monetary policy objective is thus often temporarily abandoned in light of the above risks to financial stability stemming from capital inflows. In some countries (e.g. Indonesia and Turkey), interest rates have been set at lower levels than implied by the inflation risks. (Sterilised) foreign exchange interventions have been used frequently (especially in Brazil, Indonesia, Peru and Thailand). Increasing use has been made of regulatory and macroprudential tools, such as special capital requirements for banks holding foreign assets (Peru), taxes on capital inflows (Brazil), a tax on non-residents' interest income (Thailand), a minimum period for holding selected domestic securities (Indonesia), caps on banks' foreign currency positions (South Korea), higher reserve requirements (Brazil and Peru) and tools to prevent capital outflows (South Africa and Ukraine). Fiscal policy measures have been the exception rather than the rule, although fiscal restrictions have been used to dampen capital-induced stimuli in Peru and South Africa.

The largest Latin American economy – ***Brazil*** – has been one of the main recipients of capital. High domestic interest rates are a key factor attracting foreign investors to the country – over the last five years the central bank's monetary policy rate (*selic*) has been fluctuating between 7.25% and 13.75% amid relatively fast economic growth. The pre-crisis inflow was interrupted by a significant reversal in capital flows at the end of 2008, accompanied by a fall in the value of the real against the dollar of more than 50%. Foreign investors' interest subsequently began to rise quickly again, especially in the case of portfolio investment, and the renewed inflow soon exceeded the previous high levels. Monetary policy, operating under an inflation-targeting regime, thus faced a dilemma where the rise in inflation risks implied a further rise in rates but this step would at the same time motivate further capital inflows. Brazil thus phased in other measures. The central bank increased the reserve requirement and introduced a requirement for special reserves for foreign currency holdings, increased the capital requirements for most consumer credit, intervened in foreign exchange markets and imposed a special tax on capital inflows, which was gradually increased to 6%. In recent years, Brazil has succeeded in largely replacing the inflow of short-term portfolio investment with longer-term and direct investment.

High domestic rates have also lured capital to ***Indonesia***, mainly into government bonds and central bank securities (SBIs). While investment in government bonds is long-term and relatively stable, the highly volatile portfolio flows into SBIs are causing large swings in the exchange rate of the Indonesian rupee, which the central bank is trying to counter with foreign exchange interventions. However, to sterilise them it has been using SBIs, whose high yields (over 8%) have again been attracting foreign investors. In response, the central bank has introduced an obligatory minimum period for SBI holdings and has extended the maturity of new SBIs. It has also capped banks' short-term foreign borrowings and put in place a higher reserve requirement for their foreign currency holdings. More recently it has introduced a regulation under which Indonesian exporters may receive export income only through

domestic banks. The capital movements reversed at the end of 2011 and the central bank responded with foreign exchange interventions against the depreciation of the domestic currency and purchases of government bonds on secondary markets. Intensive outflows have been seen again this year, the depreciation pressure on the rupee has increased, and stock prices have been falling and bond yields rising. For this reason, the central bank has reduced the allowed period for holding SBIs and intervened against the depreciation of its currency. A recent hike of the key policy rate to 7% might also help to curb the adverse trends.

***South Africa*** has been recovering more slowly from the impacts of the global crisis than most emerging economies. Despite this, it has been exposed to relatively high financial inflows. This may have been due partly to the fact that South Africa (like Indonesia) was included in the major global indices, whose composition many investors try to reflect in their portfolios. South African institutions have introduced a new strategy consisting of easier monetary policy – aimed at weakening the exchange rate of the rand to a more competitive level and reducing cost of capital – and tighter fiscal policy, with inflation pressures dampened by anti-wage growth tools. Moreover, the central bank has purchased the foreign currency pouring into the country on the foreign exchange market in order to stop the rand appreciating further. South Africa has applied tools to limit capital movements primarily on the outflow side and, unlike other countries, has eased rather than tightened its regulations in recent years. The various limits imposed on residents relating to investment abroad have gradually been reduced (the limit for investment by individuals has been raised to ZAR 4 million, or about USD 400,000, and the limits for institutional investors have been increased similarly). Other measures to limit the outflow of investment from the country have also been relaxed, the only exception being an extension of the list of regulated transfers to include intellectual property.

In the case of ***South Korea***, bank lending rather than portfolio flows has been the main risk. Its banking sector, which is dependent on financing from abroad, accumulated huge short-term external debts before the crisis, motivated by speculative contracts in expectation of appreciation of the won and by the interest rate differential. Following the global liquidity crisis in late 2006, local banks got into difficulties as they were unable to roll-over the maturing debt. Korean public institutions provided banks with foreign exchange liquidity from official reserves and also from a swap agreement with the Fed. The foreign exchange reserves dropped by USD 64 billion in just a few months and the stock market fell by 70%. Later, Korea introduced rules aimed at reducing banks' short-term foreign currency debt and increasing the quality of their foreign currency portfolio management. For example, it introduced rules to limit the maturity mismatch of foreign currency liabilities and brought in a 125% ceiling on forward contracts between banks and exporters. Banks' LTD ratio must drop to 100% over time. The caps on banks' foreign derivative positions were tightened and taxes were imposed on foreign currency liabilities other than deposits and on purchases of domestic stabilisation bonds by foreign investors.

The issue of excessive capital flows was discussed in the past at a meeting of the G20. Representatives of these countries agreed that capital flow management measures may be useful in combating economic shocks, but should not be used to delay necessary adjustments in the economy or to gain a competitive advantage. Countries that can affect others through their policies, especially the reserve currency states, should also take these (cross-border) impacts into account in their decisions. The International Monetary Fund has also reversed its stance in this respect. It now admits the possibility of using various measures to limit financial flows, something which it had previously rejected strongly. The issue is being opened again by current developments on financial markets linked with the expected scaling down of the Fed's stimulus (the QE3 exit). The August symposium in Jackson Hole discussed, among other things, exit strategies and large and volatile capital flows.

## 4. SELECTED SPEECH: MONETARY POLICY AND THE CURRENT ECONOMIC SITUATION

*The First Deputy Governor of the Swedish Riksbank, Kerstin af Jochnick, gave a speech on 22 September about current economic conditions and the stance of monetary policy. Among other things, the speech focused on the impact of monetary policy on household debt. The fear that too loose monetary policy could increase the risk of financial crisis may explain why the Riksbank has not lowered its policy interest rates further.*

In her speech, Kerstin af Jochnick considers the current economic situation in Sweden and discusses the Riksbank's monetary policy settings. She mentions the first signs of recovery both in Europe and in the domestic economy. Inflation (as measured by CPI growth) meanwhile remains close to zero, far below the 2% target. Jochnick also praises the recently increased use of explicit forward guidance by the world's major central banks, mentioning that the Riksbank was one of the first to publish explicit forecasts of interest rates.

Her speech pays considerable attention to the impact of monetary policy on household debt and its implications for financial stability. As the Deputy Governor notes, the current monetary policy stance of the Riksbank takes into account the indebtedness of Swedish households, broadening the traditional scope of inflation targeting. With the present monetary policy stance, inflation will hit the target in two years' time. If monetary policy had taken a more expansionary stance, Kerstin af Jochnick admits that the inflation target could have been attained earlier. On the other hand, easier monetary conditions could lead to an increase in the risks linked to household debt, fuelled by expectations of persisting low rates. This, in turn, would contribute to cheaper loans (mortgages, most importantly) and lead to further growth of debt. Because of the related increase in housing demand, real estate prices could rise further, building up a risk of a sudden collapse. The resulting financial or economic crisis would cause unemployment to rise sharply and complicate the fulfilment of the inflation target in the future.

Kerstin af Jochnick acknowledges that monetary policy is neither the main nor the most efficient tool for maintaining financial stability – this role should be played by newly created macroprudential tools such as loan to value (LTV), loan to income (LTI), financial leverage regulation or capital adequacy regulation. For proper implementation of these tools, however, a more detailed analytical base is needed, namely the use of individual datasets instead of aggregate indicators or data samples. There is work in progress on implementing these tools in Sweden, but in the meantime their role has to be substituted by monetary policy, according to Jochnick. The Deputy Governor closes by concluding that until macroprudential policy has been established, the Riksbank will continue to conduct a flexible monetary policy that enables it to take into account a number of different factors, such as household debt.

By interpreting monetary policy this way, the Riksbank joins the growing stream of central banks which are conducting more flexible inflation targeting than earlier. Some commentators (i.e. Bloomberg, 22 August) even label the monetary policy of the Riksbank as contemporary targeting of household debt. Former deputy governor Lars E. O. Svensson was explicitly critical of the currently relatively strict monetary policy of Sweden. This disagreement was one of the reasons which led him not to apply for another term in office when his first term ended in June 2013. Further examples of central banks which, for various reasons, are interpreting inflation targeting in a more flexible way and tolerating deviations from inflation targets can be found in the *Spotlight* section of the June 2013 issue of Central Bank Monitoring.

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