A Nordic pioneer of negative interest rates gets cold feet

Sweden's central bank has come under fire for weakening the krona, Dec 12th 2019.

THE WORLD'S oldest central bank, Sweden's Riksbank, is a trendsetter. In July 2009, in the depths of the financial crisis, it was the first central bank to cut interest rates below zero. It set the global record, of minus 1.25%, for the lowest interest rate on deposits parked with it by domestic banks. Now, however, it looks set to bring the experiment to an end. On December 19th it is widely expected to leave negative territory, raising rates from minus 0.25% to 0%.

Since the economy is in the doldrums, the rationale is unclear. Inflation is 1.7% and forecast to stay below the target of 2% for some time. Meanwhile, the most recent figure for annualised GDP growth was a paltry 1.1%, and the purchasing-managers index, a measure of business activity, is at its worst since the euro-zone crisis of 2012. The words and actions of the Riksbank's five voting members seem to be all over the place. At the most recent meeting, in October, all expressed concerns about the economy. Stefan Ingves, the governor, argued for a more expansionary monetary policy, noting that Sweden is particularly exposed to weakening global trade. Yet he and his colleagues agreed to the plan to raise rates at the next meeting, on December 19th.

Lars Svensson of the Stockholm School of Economics, a former member of the Riksbank, attributes the move back up to zero to ratesetters who have an "irrational fear of negative interest rates". But the most recent monetary-policy report, in October, assessed negative rates and concluded that they have been a success for Sweden. If neither the economy nor economists seem to demand an end to negative interest rates, where does the demand come from? The minutes of the latest monetary-policy meeting hint at a possible answer: the general public. Henry Ohlsson, a member of the committee, commented that "it has become very clear that those who are not economists believe it is strange that interest rates can be negative."

Moreover, the Riksbank is under fire for its perceived role in causing Sweden's currency to weaken. In February the krona hit its lowest level ever in real trade-weighted terms, notes Henrik Unell of Nordea, Scandinavia's largest bank. In March Mr Ingves brushed off such criticisms. He wrote in *Dagens Nyheter*, a daily newspaper, that the central bank "cannot, and should not, stabilise both inflation and the exchange rate". Since Sweden's inflation target of 2% is in line with most other countries', he added, there was no reason to think the krona would weaken indefinitely. The currencies of other small countries with substantial foreign trade had also suffered, he said.

But the pressure continued. "It's embarrassing and painful to see how the Swedish crown continues to weaken against the euro," tweeted Carl Bildt, Sweden's prime minister from 1991 to 1994. Goran Persson, one of Mr Bildt's successors, has complained publicly about how cheap Swedish assets have become for foreign investors.

Perhaps the Riksbank has been worn down by all the criticism. It is one of five central banks withs negative policy interest rates—including two giants, the European Central Bank and the Bank of Japan. Nearly a quarter of global GDP is supported by negative rates. If the Riksbank's experience is anything to go by, the great experiment with negative rates will continue to unsettle people all over the world.■

Sweden set to end sub-zero rates; ECB and others far behind

Monday, December 16, 2019 9:13 a.m. EST. By Simon Johnson

Sweden's central bank is expected to become the first in the world to claw its way out of negative interest rates on Thursday, as worries about the unwanted side-effects of such a policy trump signs of slower growth at home and a shaky global outlook. On Thursday, if analysts are right, the Riksbank will hike its benchmark repo rate to zero from -0.25%, making it the first to return to more normal territory.

But with below-target inflation and a slowing economy - activity in the industrial sector at its lowest level since 2012 - many question why the Riksbank is in such a hurry.

"Exiting negative rates is the main reason," said Torbjorn Isaksson, economist at Nordea. "It's hard to see that inflation or growth would be too high if they did not hike. All the risks point in the other direction." On the face of it, negative rates - which hit -0.50% in 2016 - have worked well in Sweden. The economy has grown above trend rate for years, unemployment has dropped and inflation - which basically disappeared in 2014 - has bounced back to close to the Riksbank's 2% target.

But the Riksbank is worried about the long-term effects. In neighboring Denmark, where the certificate of deposit rate is -0.75%, banks have paid a heavy price for negative rates, around 4 billion Danish crowns ($590 million) since 2012 according to Nordea. Savers have suffered at the expense of borrowers. In Denmark, banks are now charging for holding deposits of over 750,000 crowns, while some house buyers are being paid to take a mortgage. In Sweden, house prices and borrowing have soared. Ultra-cheap borrowing also means uncompetitive companies are being given a life-line, reducing economic efficiency, while low yields make it harder for pension funds and life insurance firms to meet their long-term commitments without taking on higher risks.

With the economic case for rate hikes even less convincing in other countries with negative rates, the Riksbank is unlikely to set a precedent. Denmark's central bank Governor Lars Rohde, for example, said late in November the country could be sub-zero for another five to 10 years.

But a hike would add fuel to a global debate about whether the extreme monetary policy has really helped. Years of extraordinary policy measures - including negative rates and bond purchases - have not pushed up inflation in the euro zone. Even in Sweden, much of the rise in inflation has been driven by a weak crown, which is seen as a temporary effect. Many economists believe negative rates are the wrong tool for fixing economies beset by structural problems or for tackling more fundamental economic trends such as an aging population. That means governments will have to take a bigger role in the longer term.

"We have to talk about fiscal policy. Monetary policy isn't going to be able to solve this alone," Magnus Billing, CEO of pension firm Alecta said at a panel debate on negative rates in October. Given the parlous state of government finances in many countries in Europe and the debt ceiling imposed by the EU's stability and growth pact, that will be difficult.

In the meantime in Japan...