

To Mr. Eccles

From Mr. Edmiston

Recent Swedish Monetary Policy

Brief Survey of Swedish Economic Activity

Sweden has a population of about 6,000,000. In normal times about 38% of the population are engaged in agriculture and fishing while 31% are engaged in industries, including forestry and mining. Trade and transport occupies 13% of the population with the rest economically inactive or scattered among the professions and handicraft industries. Foreign trade plays a very large part in the Swedish economy. Its chief exports are iron ore and iron products and lumber and wood products. Also there is a certain amount of animal products, such as butter and bacon, which are exported. The most important imports are food stuffs, luxuries and textiles. The foreign trade is principally concerned with European markets with Great Britain being the largest market for Swedish products, while Germany imports more goods to Sweden than any other country. Because of this large foreign trade and because England is so important in it, it is not surprising that Sweden has followed the lead of England in going off gold and has kept its monetary unit tied relatively closely to the pound in the last few years.

The Swedish Banking System

Before going into a discussion of the recent monetary policy of the country it is well to have a general picture of the characteristics of the Swedish banking system within which this policy must operate.

The Central Bank

The central bank of Sweden, the Riksbank, holds a unique place among the world central banking institutions. It is completely owned by the State, but is a bank directly supervised by the Parliament, and not administered by the executive Government.

Management -

The management of the bank is in the hands of a Board of Governors, six members of which are appointed by the Parliament, while the seventh, who is designated as chairman, is appointed by the Crown. Their term of office is three years. Although the Board is appointed by Parliament it has a considerable amount of independence in action and this freedom is guarded carefully by both Parliament itself and by the Board of Governors. However, the Bank's operations are examined periodically by 12 auditors who are nominated by Parliament and governed by special instructions.

Note Issue Powers -

The Riksbank has the sole power of note issue. It has authority to issue notes up to twice the amount of its gold reserve and also under emergency circumstances may issue an additional 125 million kronor currency backed by specified security.

Powers of the Bank -

The Riksbank is purely a banker's bank. Although under the law it does have power to accept private deposits, this power has never been used. The deposits of the Bank consist of bankers' balances and Government non-interest bearing deposits.

Power to control the credit situation.

The Riksbank's power here centers around its discount rate. As the banks of the country are normally indebted to the Riksbank any changes in the rediscount rate (particularly upward) tend to have a considerable affect upon the rates in the open market and hence give the Bank considerable control of the general credit situation. Also the bank has the power to purchase and sell Government securities. However, these operations are seldom undertaken by the Bank except in times of emergency. The Riksbank holds the gold reserves of the country and also deals in foreign exchange.

These transactions in foreign exchange serve as a substitute, at least in part, for open market operations. In case the Bank is purchasing foreign exchange it means that funds are placed into the hands of the commercial banks to use for expanding credit for domestic needs. On the other hand, if the bank is selling foreign exchange, it usually means that funds are flowing abroad to meet commercial or capital payments and the banks of the country are forced to pay the Riksbank to meet these withdrawals thus curtailing their domestic loaning power.

Other Financial Institutions

The Commercial Banks

There are two types of commercial banking institutions. The first, the so-called "aktie" banks which are institutions in which the liability of the shareholders is limited to the original paid-in capital. Half of the country's banking business is done by the three largest of this type of banks, which have branches throughout the country. The other class of banks are the "enskilda" banks which are private institutions with unlimited shareholder liability.

The commercial banks of Sweden have always experienced difficulty in increasing deposits because of the relative scarcity of circulating capital in the country. Therefore, they have set up various classifications of deposit accounts so as to best satisfy the desires of various classes of depositors and thus keep deposits at a maximum. The proportionate line-up of deposits is: long term money (four months) 57%; short term money (two to four weeks), 8%; demand deposits, 12%; and savings deposits (one week's notice), 23%. Thus about 80% of the total deposits are of a long-term variety. On the credit extension side Swedish banks have also gone into the long term market to a considerable extent and provide a large amount

of funds for capital purposes to industry. Another noteworthy feature of the Swedish banks is that they are consistently over-loaned, in that their total loans exceed deposits by some 25%. However, inasmuch as the Swedish law requires a ratio of capital to deposits of one to five this large capital holding provides a buffer against difficulties arising from this over-loaned condition. Moreover the Swedish banks have very small holdings of cash in relation to their deposits. However, inasmuch as the majority of their deposits are on a long term basis and the commercial banks have recourse to the Riksbank bank in case of need, this situation is not particularly serious.

The Savings Banks

In addition there are some 500 savings banks over the country which have deposits approximately equal to those of the commercial banks. These savings banks compete with the commercial banks especially in acquiring deposits. They have been, on the whole, conservative institutions and have been more prevalent through the rural areas of the country. In recent years, however, they have become more important in urban centers. Approximately 50% of the savings banks' loans are on real estate mortgages.

Also there are a small number of mortgage institutions which loan on rural and urban real estate.

Survey of Sweden's "Managed Currency"

Sweden abandoned the gold standard in September 1931. Undoubtedly this suspension was chiefly due to the abandonment of the gold standard by Great Britain a week previously. The situation was that Sweden had an excess of imports over exports, and along with many other countries was at this time undergoing a withdrawal of foreign capital, which had been placed in Sweden in previous years, and which now lead to an adverse bal-

ance of payments position for the country. These adverse payments could not easily be met by the Riksbank because its holdings of foreign exchange had already been drawn down to a very low level and it was losing gold at a comparatively rapid rate. In order to maintain the gold reserves of the country the Swedish Government, failing to obtain loans from foreign sources was forced to abandon gold and to declare an export embargo on gold.

First declaration of future monetary policy.

In conjunction with the suspension of gold payments the Government declared that its future monetary policy was to have as its objective the "preservation of the domestic purchasing power of the krona". The change in the monetary standard was met with general approval throughout the country, but it was recognized that the program was one of emergency character as Sweden had been forced off gold and as the Minister of Finance had announced that it was the desire of the Government to return to gold as soon as the conditions abroad would permit it. In order to preserve the internal purchasing power of the krona the Government took immediate steps to remove all fears of monetary inflation and to show that abandonment of the gold standard did not mean that there would be a relinquishment of all control over the Swedish currency. The first step was to raise the rediscount rate from 6 to 8%, which it was hoped would have two effects. First, to prevent a severe decline in the krona internationally and second, to curtail any speculative purchasing of securities and commodities. While ordinarily a raise in the rediscount rate in this way is a signal that difficulties are ahead and hence often leads to a rapid withdrawal of foreign funds from the country's market, this was not of any great significance in Sweden as already foreign balances held there had been drawn down to negligible amounts. This of course was an abnormally high rate and it

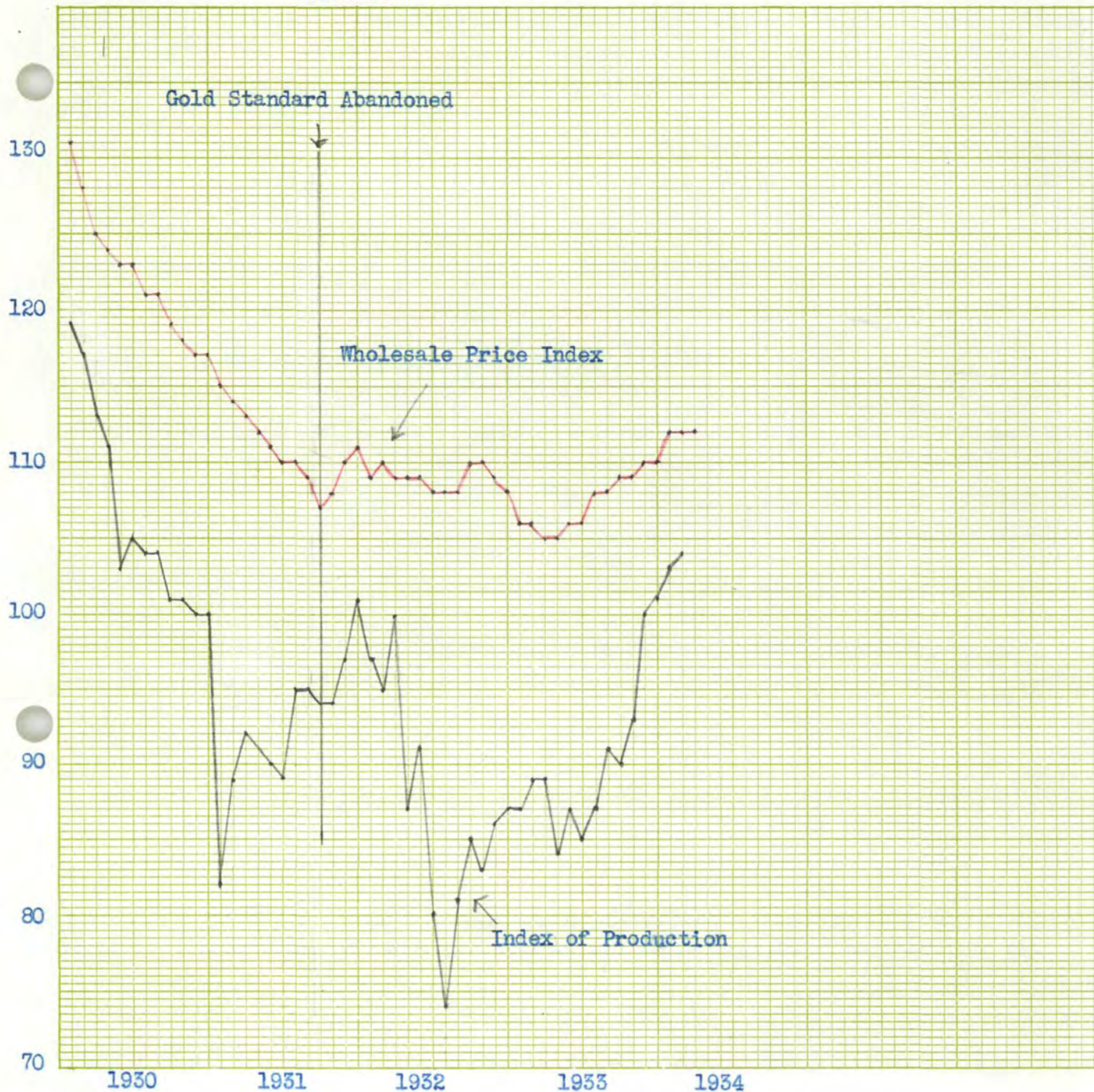
was soon lowered, as the risk of deflation was seen to be greater than the risk of inflation. The next step was for the Riksbank to enter into an agreement with the important commercial banks of the country wherein the latter banks agreed to be extremely cautious in their extension of credit and to particularly avoid credits which were intended for import purposes. The immediate effect of these measures was to reestablish the confidence of the public in the country's monetary unit and as shown by the accompanying chart a small rise in wholesale prices and in the index of production followed.

The Monetary Policy of 1932.

When Parliament convened in January 1932 the Minister of Finance proposed a revision of the monetary policy. He suggested that it would be wise for the Riksbank to make a public statement as to the future monetary policy of the Government and to attempt through monetary control to achieve a slow rise in wholesale prices in order to stimulate the industry and commerce of the country. It was also proposed that the Riksbank should limit so far as possible the fluctuations in foreign exchange. This had been attempted to some extent in 1931, but now the Riksbank was in much better position to cope with the program of limiting such fluctuations because of its larger holdings in foreign exchange and its better reserve position in general.

Subsequently the Governors of the Riksbank made a public statement in February 1932 which set up the aims of the monetary policy which the Bank was to follow substantially along the lines which were suggested by the Minister of Finance which were outlined above. In reality, the objective of the program was to adjust the wholesale price level to the prevailing costs of production, thereby increasing the possibilities of profit and

SWEDEN



WHOLESALE PRICE INDEX

Swedish Board of Trade

(1913 - 100)

All commodities

Month	<u>1930</u>	<u>1931</u>	<u>1932</u>	<u>1933</u>	<u>1934</u>
Jan.	131	115	109	106	112
Feb.	128	114	110	106	112
March	125	113	109	105	112
April	124	112	109	105	
May	123	111	109	106	
June	123	110	108	106	
July	121	110	108	108	
Aug.	121	109	108	108	
Sept.	119	107	110	109	
Oct.	118	108	110	109	
Nov.	117	110	109	110	
Dec.	117	111	108	110	

Source of data — Skandinaviska Kreditaktiebolaget.

INDEX OF PRODUCTION

According to Federation of Swedish Industries

(1913 - 100)

Month	<u>1930</u>	<u>1931</u>	<u>1932</u>	<u>1933</u>	<u>1934</u>
Jan.	119	82	97	87	103
Feb.	117	89	95	89	104
March	113	92	100	89	
April	111	97	87	84	
May	103	90	91	87	
June	105	89	80	85	
July	104	95	74	87	
Aug.	104	95	81	91	
Sept.	101	94	85	90	
Oct.	101	94	83	93	
Nov.	100	97	86	100	
Dec.	100	101	87	101	

Seasonal change removed - Revised Figures.

Source of data - Skandinaviska Kreditaktiebolaget.

consequently the volume of physical production. There was no desire to tie the krona to any particular foreign currency, but because of the fact that England was so important as a market for Swedish goods it is to be noted that the krona was in effect tied fairly closely to the pound although there were certain deviations for limited periods. In order to carry out this proposed policy, the Riksbank continually lowered its re-discount rate until on March 3rd of 1932 it had reached the rate of 5%. On June 3rd the rate was lowered to 4% and in August 1932 it was quoted at $3\frac{1}{2}\%$. It is shown in the accompanying chart that the level of wholesale prices stayed fairly constant throughout the year of 1932. However, industrial production fell off from the first quarter very rapidly until July of that year. This can be accounted for in several ways. In the first place, mounting obstacles were being placed in the way of Swedish export industries by the aggravation of the world depression and the general rise of tariff barriers during the first part of this year. In addition, there was a strike in the paper pulp industry, which is one of the most important in the country, and labor difficulties lasted throughout the entire second quarter of the year. But probably of most importance was the Kreuger crisis of March 1932 which caused a temporary shock to confidence in the Swedish economic situation both at home and abroad. Thus, the Swedish monetary policy appears during the course of this year not to have been particularly effective. But this is not surprising considering the general uncertainty which hung over the country following the Kreuger crisis and the continual aggravation of the world depression up to the middle of the year. The price level as noted above tended slightly to decline if anything and while it may have been possible to, as some observers like Professor Ohlin have held, have obtained a certain rise in prices provided the central bank had purchased Government securities, and in con-

junction the Government itself had started an effective public works program. However, the later measure was not inaugurated. The bank actually bought approximately 200,000,000 kronor of Government securities during the spring of 1932. These purchases were evidently not intended as a means to raise the price level but rather to aid the banking system to meet the shock of the Kreuger failure.

Secondary vision of the Swedish monetary policy - 1933

Because of the large volume of unemployment and the fall in the wholesale price level from October 1932 through the first quarter of 1933, it was decided that more definite instructions in regard to the Swedish monetary policy should be given by the Parliament in the year of 1933. Accordingly, therefore the Government appointed a committee of representatives of industry, agriculture and banking, along with experts in economics to make a study of the problems facing the country and to consider what steps should be taken by the Government in view of the probable development abroad. In its deliberation the committee proceeded from two assumptions. The first of these was that a rise in the world price level would actually be brought about by cooperative action on the part of the central banks of the world following the World Economic Conference to be held in June of that year. If such action was taken it was deemed desirable for Sweden to tie their currency with those of the leading nations and to assist and cooperate in carrying out the program for raising the price level throughout the world. On the other hand if no such joint action was to be forth-coming the committee thought that Sweden should continue to follow an independent policy of regulating the internal purchasing power of the krona and to hold down the value to which the krona had been driven by speculation in the foreign exchange markets of the world. There was to be no attempt, however, to de-

value the krona with a view of gaining commercial advantages because the committee thought that competition in depreciation of foreign values of currencies below their purchasing-power parities had in the last few years contributed more disastrously perhaps than any other single factor to the continuous decline in the world economy. As the means to be used to bring about a rise in the domestic price level the committee recommended further decreases of the bank rate and grants of credit. It was proposed also that Riksbank should intervene actively for the stated purpose of aiding in the financing of expenditures for the relief of unemployment. As there is no established market for short-term State bonds in Sweden the Riksbank does not have the same opportunity for pushing out funds as exists in England and the United States, but it was thought that the Treasury could issue short term bills which would be readily taken by the commercial banks inasmuch as these banks had large reserves of cash and the Riksbank would be prepared to rediscount these bills so that commercial banks could at any time get funds to meet any needs which might come from commerce and industry with an expansion of business activity. It was hoped also that the Government would start a program of public works and in this way put funds out into the hands of spenders and thus affect the price level favorably. The lines of the monetary program outlined above were embodied in the bill submitted by the Government to Parliament on the 26th of May. The Parliament approved the recommendations. The results of the policy which was set up are to some extent difficult to trace. From the middle of the year 1933 there has been a continual increase in the wholesale price level as shown by the accompanying chart, as well as a considerable increase in the volume of production. However, this was a time of general business revival throughout the world and it was to be expected that Sweden would follow along with this general improvement. There was no appreciable expansion of public works during this

period and hence this feature the policy did not actually have a trial. Also, there was never throughout the whole period of the depression any budgetary inflation of considerable amounts, as shown by the table below:

Total public debt of Sweden

<u>June 30 -</u>	<u>In million Kronor</u>	<u>In million dollars (Converted at par)</u>
1929	1,835.2	482.6
1930	1,800.9	494.6
1931	1,845.6	577.6
1932	2,155.3	632.1
1933	2,358.5	632.6
1933 (Dec.31)	2,360.6	629.9
1934 (Jan.31)	2,350.5	

This table shows that the public debt was increased slightly up to the middle of 1933 but from then on it has been relatively stationary and in fact slightly declined during January 1934. It is true that the policy followed by the Riksbank in purchasing foreign exchange has put funds into the hands of the commercial banks. Consequently, the banks have paid off their entire indebtedness to the Riksbank and have large excess reserves. The money market has been eased and was characterized by a surplus in funds which has led to a marked reduction of money rates, but the mere existence of these surplus funds has led to no greater increase in the loans of the commercial banks.

Summary and Conclusions

There has grown up a rather widespread superstition in many circles regarding the Swedish "managed currency". The impression has been given in some quarters that the Swedish experience proves that by monetary manipulation it is possible to move price levels about almost at will. However, in the Swedish situation there are many complicating factors and it is difficult to say with assurance just how effective the monetary program has been. Moreover, among the various writers on the subject there is no strik-

ing unanimity of opinion as to the results of the "management". Thus it is with considerable trepidation that I set down the following conclusions.

(1) Sweden was clearly forced off gold. The action was not as a result of any voluntary policy seeking to attain a healthier monetary situation.

(2) Sweden is a small country and largely dependant upon foreign trade. Therefore her price level and economic prosperity is greatly dependant upon **conditions** over which she can exert relatively slight control. Of necessity she had to tie rather closely to the English pound in monetary affairs, but it is to the credit of the authorities that they saw this and acted accordingly.

(3) By formulating and publishing a definite monetary policy the Swedish Government has set a good example for other countries. Fears of inflation were quickly allayed in the first instance. Later this policy served to maintain confidence in the future value of the krona.

(4) The process of deflation was halted and this in itself was a great achievement considering the rapid deflation which had taken place before gold was abandoned. Swedish wholesale prices maintained relative stability at a time when gold prices were continuing to fall. Thus the situation in Sweden was improved in spite of trying times of strikes and the period of unrest attending the Kreuger failure.

(5) Undoubtedly the Riksbank, by holding down the value of the krona to the level it had been driven by speculation in foreign exchange markets, by its purchases of large amounts of foreign exchange, eased the situation in Sweden and tended to hold up the general price level. Here its policies in influencing the price level have been more successful than by its discount rate action.

(6) The attempts to raise the level of domestic wholesale prices cannot be said to have attained much success. While funds were placed in the hands of banks, they were not used to make loans and thus initiate a credit expansion. Instead the banks of Sweden, as those in other countries, paid off indebtedness (which is quite unusual for Swedish banks), and strengthened their position generally. The lowering of the Riskbank rediscount rate accompanied by decline in open-market rates merely eased the money market and to some extent stimulated the bond market. The rise in prices and production which has been noted in the last half of 1933 and the first part of 1934 must however be attributed to the general improving business outlook throughout the world rather than to the Swedish monetary policy. However the Swedish policy has aided and abetted the possibility of such improvement.