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ISSN: 18151973 (online) | https://doi.org/10.1787/18151973

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Interest Rate Pass-through During the Global Financial Crisis

The Case of Sweden

A stable relationship between monetary policy rates and bank lending and deposit rates faced by consumers and companies is essential for the effective transmission of monetary policy decisions. This paper studies how changes in the policy rate set by the Swedish central bank, the Riksbank, have been transmitted to money market rates and, in turn, to retail rates before and during the financial turmoil that erupted in summer 2007. Historically, the Riksbank has been successful in effectively controlling money market rates, but during the financial turmoil the transmission of impulses from the policy rate to money market rates appears to have been weakened by elevated and volatile risk premia, although these increased less in Sweden than in the euro area, United Kingdom and United States. The pass-through from money market rates to retail rates is found to have been complete, but sluggish, before the turmoil. Pass-through was also faster into short-term loan rates for non-financial companies than for households. During the turmoil the pass-through from money market to lending rates has been preserved at short maturities, but not at longer maturities. Lack of access to long-term funding has likely played a role.

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Keywords: interest rate pass-through, monetary transmission, Sweden, financial crisis

JEL: E43: Macroeconomics and Monetary Economics / Money and Interest Rates / Interest Rates: Determination, Term Structure, and Effects; E52: Macroeconomics and Monetary Economics / Monetary Policy, Central Banking, and the Supply of Money and Credit / Monetary Policy

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08 Apr 2011

39 **pages**

No. 855

https://doi.org/10.1787/5kgdx1j025ln-en