Minutes of monetary policy meeting

OCTOBER 2013

Summary

At the monetary policy meeting on 23 October, the Executive Board of the Riksbank decided to hold the repo rate unchanged at 1.0 per cent and to make a marginal downward adjustment of the repo-rate path.

It was noted at the meeting that for some time now economic developments in both Sweden and abroad have been largely in line with the Riksbank's forecasts. GDP growth in Sweden was weaker than expected in the first half of the year, but is expected to pick up more speed next year as a result of improved economic activity abroad and stronger domestic demand. The labour market has continued to improve and a more tangible upturn in employment is expected next year.

Inflation has been low over a long period of time, but when economic activity strengthens, costs and prices are expected to rise faster. This means that CPIF inflation will increase to 2 per cent during 2015. Swedish households continue to be highly indebted, both in an historical and an international perspective, which makes the economy vulnerable to shocks.

The prospects for an upturn in economic activity appear to be good, but there are also causes for concern, for example the budget problems in the United Sates, the effect of a normalisation of US monetary policy on the rest of the world and the management of the problems in the banking sector in the euro area.

Given the low level of inflation and in order to support the upturn, the Executive Board agreed that monetary policy needs to continue to be expansionary. A majority of four members assessed that it was appropriate to hold the repo rate unchanged at 1 per cent until the end of 2014. The economy is then expected to have shown a more tangible improvement and inflation to have risen, so that it will be possible to begin raising the repo rate towards a more normal level. Although a repo-rate cut now could bring inflation back to 2 per cent somewhat more quickly, it could also increase the macroeconomic risks associated with the high level of household indebtedness. A majority considered that an unchanged repo rate over the next 12 months was an appropriate trade-off between the need for short-term stimulus to get inflation to rise towards the target and consideration of the risks associated with household indebtedness.

Two members advocated cutting the repo rate by 0.25 percentage points to 0.75 per cent to bring inflation to the target more quickly. These members assessed that such a cut would have little effect on the risks relating to household indebtedness. They then advocated slightly different rates of increase.

All of the members of the Executive Board agreed that once measures have been taken in the field of macroprudential policy then the preconditions for monetary policy will be affected.

However, there were slightly different views about to what extent macroprudential policy measures are already in place and how extensive they will ultimately be.

The meeting also discussed the differentials between the Swedish repo rate and policy rates abroad, the real interest rate and the type of data needed for a sound analysis of indebtedness. A discussion of how the repo-rate path should be adapted to new information arose when two members argued that it may not be necessary to change the repo-rate path even if the development of the economy proved to be better than in the main scenario.

MINUTES OF MONETARY POLICY MEETING
Executive Board, No. 5

SVERIGES RIKSBANK
SE-103 37 Stockholm
(Brunkebergstorg 11)

Tel +46 8 787 00 00
Fax +46 8 21 05 31
registratorn@riksbank.se
www.riksbank.se

DATE: 23 October 2013

TIME 09.00

PRESENT: Stefan Ingves, Chairman
Karolina Ekholm
Martin Flodén
Per Jansson
Kerstin af Jochnick
Cecilia Skingsley

Johan Gernandt, Chairman of the General Council

Meredith Beechey Österholm
Carl-Johan Belfrage
Claes Berg
Charlotta Edler
Mattias Erlandsson
Frida Fallan
Eric Frieberg
Kerstin Hallsten
Mia Holmfeldt (§ 1)
Ann-Christine Högberg
Violeta Juks
Lisa Marklund (§ 1)
Ann-Leena Mikiver
Marianne Nessén
Jonas Niemeyer
Christina Nyman
Ulf Söderström
David Vestin
Anders Vredin
Fredrik Wallin (§ 1)

It was noted that Carl-Johan Belfrage and Violeta Juks would prepare draft minutes of § 1, 2 and 3 of the Executive Board’s monetary policy meeting.

§1. Economic developments

Fredrik Wallin of the Monetary Policy Department began by presenting the latest developments on the financial markets. Since September, developments on the financial markets have been marked by the development of economic policy in the United States; both in terms of the Federal Reserve's decision to delay the tapering of its bond purchases and the problems surrounding the national budget and the debt ceiling. The market participants now expect that tapering will not begin until the end of the first quarter, or the beginning of the second quarter, of 2014. This new view of the actions of the Federal Reserve has led to a fall in government bond yields at longer maturities and these are now at the same levels as at the end of the summer. In Sweden, longer market rates have largely followed international trends. Expectations that the Federal Reserve will continue to provide monetary policy stimulus during the autumn and early next year have contributed to rising share prices in the United States, the euro area and Sweden. The US dollar has weakened significantly, while the Swedish krona has remained unchanged in trade-weighted terms since September. According to market pricing and survey responses, the repo rate is expected to be held unchanged at today's meeting. The first increase from the current level is not expected until the end of next year.

Lisa Marklund of the Financial Stability Department gave an account of recent developments in Sweden and the euro area with regard to government bond yields, the price of credit risk for banks and the Swedish banks' funding situation.

Marianne Nessén of the Monetary Policy Department presented the draft Monetary Policy Report which, in the assessment of the Monetary Policy Department, will gain the support of the majority of the members of the Executive Board. She began by noting that the forecasts in the draft report were discussed by the Executive Board at meetings held on 3, 8, 9 and 15 October. The text of the draft Monetary Policy Report was tabled at a meeting of the Executive Board on 18 October.

Economic developments in Sweden and abroad have been largely in line with the Riksbank's forecasts for some time now. GDP growth in Sweden was weaker than expected in the first half of the year, but is expected to pick up more speed next year as a result of improved economic activity abroad and stronger domestic demand. The indicators provide a mixed picture. The National Institute of Economic Research's Economic Tendency Survey supports the picture of stronger GDP growth, as do the Riksbank's business survey and the purchasing managers' index. At the same time, the foreign-trade statistics indicate that goods exports are still weak, while order stocks and new orders are still at lower levels than normal according to the Survey. The labour market has continued to improve, with a positive development of both employment and unemployment in the third quarter. A more tangible upturn in employment is expected next year.

Inflation has been low over a long period of time, but when economic activity strengthens, costs and prices are expected to rise faster. This means that CPIF inflation will increase to 2 per cent during 2015. Swedish households continue to be highly indebted, both in an historical and an international perspective, which makes the economy vulnerable to shocks. There are still risks to the recovery, for example the budget problems in the United States, the effects on other parts of the world when the United States begins to normalise its monetary policy and the problems in the banking sector in the euro area.

Given the low level of inflation and in order to support the upturn, monetary policy needs to continue to be expansionary. The repo rate will remain at 1 per cent until the end of 2014. The economy is then expected to have shown a more tangible improvement and inflation to have risen, so that it will be possible to begin raising the repo rate towards a more normal level. The repo-rate path has been marginally revised downwards in the slightly longer term compared to the path in September due to somewhat weaker prospects abroad.

§2. The economic situation and monetary policy

Deputy Governor **Karolina Ekholm** began by saying that for most of this year there have been minor revisions of the prospects for the Swedish economy. It was worth noting this time that there are some downward revisions of the figures for global growth in 2014 and 2015, and for inflation and unemployment in Sweden, based on outcomes. It appears that the recovery of the global economy is marginally more sluggish than indicated in earlier forecasts, not least because of the uncertainty about fiscal and monetary policy in the United States, but she saw no reason to doubt that the recovery will nevertheless continue.

Ms Ekholm supported the view of developments abroad and of the development of the Swedish economy as presented in the draft Monetary Policy Report. However, as previously, she believed that a lower repo rate was needed given that inflation is still well below the target and, according to the forecast, is expected to remain so until some point in 2015, at the same time as resource utilisation is low. The forecast of when resource utilisation will reach normal levels again depends on the choice of indicator, but on the basis of the GDP gap it will not be until the beginning of 2015 at the earliest, and on the basis of unemployment probably not until towards the end of the forecast horizon. Ms Ekholm said that lowering the repo rate to 0.75 per cent could be expected to provide better macroeconomic development during the forecast period, which is also shown in the analysis of alternative repo-rate paths in Chapter 2 of the draft Monetary Policy Report.

She continued by saying that she doubted whether the proposed repo-rate path is compatible with the proposed exchange-rate forecast. The main scenario is that the current positive interest-rate differential of approximately 0.8 percentage points in relation to the KIX-weighted policy rate abroad will increase and be more than twice as high, around 1.7 percentage points, towards the end of the forecast period. Such a lasting and increasing interest-rate differential in relation to the rest of the world would be very unusual from a historical point of view. This is now expected to happen without any significant strengthening of the exchange rate, according to the forecast in the draft Monetary Policy Report. At the same time, it is clear from the background material and data presented to the Executive Board that the expectations indicated by market pricing are entirely different, more precisely an unchanged interest-rate differential during the forecast period. The question we must ask ourselves is how do we think the market participants will react when they discover that the interest-rate differential is gradually increasing? Ms Ekholm believed that they will react by increasing the demand for assets in Swedish krona and thus contribute to a strengthening of the krona. By how much, and how quickly this would happen, is difficult to assess. A number of simulations have been carried out using the Ramses model which generate rather different results depending on the assumptions made about the formation of market expectations. With hindsight, she felt that it would have been more interesting to report these simulations in Chapter 2 rather than the alternative scenarios for developments abroad that are now presented there. This would have given external observers more relevant information on the actual form and content of the material and data on which the Executive Board's decisions are based, which is something to consider ahead of the next Monetary Policy Report.

Her conclusion was to advocate a repo-rate path similar to the one at the previous monetary policy meeting, although slightly pushed forward. She advocated a lowering of the repo rate to 0.75 per cent now and a path in which the repo rate stays at 0.75 per cent through the third quarter of 2014, and then rises to just under 2.5 per cent by the end of the forecast period. The aim of the cut in the near term would be to push up inflation and push down unemployment more quickly, while the slower raising of the repo-rate path would aim to hold down the interest-rate differential in relation to rates abroad. Ms Ekholm believed that her proposed repo-rate path would thereby be more consistent with the current exchange-rate forecast than the path proposed in the draft Monetary Policy Report.

The reason given for not cutting the repo rate in the draft Monetary Policy Report is the assessment that a lower repo rate would lead to a more rapid increase in household indebtedness. The aim of keeping the repo rate unchanged is said to be to hold back the rate of increase in debt and thereby reduce the risks of major fluctuations in inflation and resource utilisation in the future. Ms Ekholm noted that it was still not exactly clear what relationships this assessment is based on, or how the risk of a negative scenario further ahead is weighed against weaker macroeconomic development in the near term and a possible loss of credibility of the inflation target. She thought that there was a need to more precisely explain the belief that the repo rate affects household indebtedness and how this indebtedness then affects the risk of a situation in which there is a dramatic fall in housing prices and the households react by increasing their savings in a way that leads to low consumption growth over a long period of time.

She also thought there was a need to address the fact that many of the households' decisions have probably been made on the basis of incorrect expectations about how real values will develop when inflation remains below the target for a long time. It is not only the households' unrealistic expectations about what mortgage rates will be in the future that create risks, but also their perhaps unrealistic expectations of how much the real value of their debts will fall when what they believe will be an inflation rate of 2 per cent turns out to be significantly lower.

Ms Ekholm said that the basic problem with the way monetary policy has been pursued recently is that it has become less predictable, that is it does not provide any clear guidance on how changes in the prospects for the Swedish economy can be expected to affect the monetary-policy decisions. In her opinion, the main function of the repo-rate path is to provide the outside world with information on how the monetary-policy decisions are affected by changes in economic prospects. She therefore believes that it is important that there is a clear and systematic link between changes in the preconditions governing forecasts and changes in the repo rate and the repo-rate path.

However, she noted that this has hardly been the case recently. In April this year, for example, a rather significant downward revision of the inflation forecast was made but the repo rate was not lowered, only the repo-rate path further ahead. In July, a downward revision of the household debt ratio was not followed by a lowering of the repo rate.

A natural interpretation of the failure to lower the repo rate when forecast revisions are made that justify a marginally lower repo rate is that household indebtedness is perceived as a problem that lays a kind of floor for the repo rate. However, it is unclear which indicator of household indebtedness is decisive. Is it the debt ratio? If so, what level should the ratio be at for us to believe that the risks have declined? Must we see a fall in housing prices? Does the level of household wealth matter in the assessment of these risks? It can be seen in Figure 3:21 in the draft Monetary Policy Report that a substantial upward revision of household financial wealth has been made. However, this upward revision has not given rise to any change in the view of the risks associated with household indebtedness. Nor has the government's proposed framework for a strengthening of financial stability or the Swedish Bankers' Association's statement that it will work to get the banks to implement Finansinspektionen's (the Swedish financial supervisory board) proposal on amortisation plans.

Her view was that the revision of the figures for household wealth and the fact that other bodies have acted to dampen the increase in the households' debts mean that the disadvantages of holding the repo rate up to reduce the risks associated with these debts have clearly increased. Consequently, the arguments for lowering the repo rate have also become stronger.

Deputy Governor **Martin Flodén** said that he supported the picture of economic developments in Sweden and abroad presented in the draft Monetary Policy Report, but that he advocated cutting the repo rate by 25 basis points at today's meeting and that the repo rate should be kept at this lower level until the end of the third quarter of 2014 and then quickly approach the repo-rate path proposed in the draft Monetary Policy Report.

Since the monetary policy meeting in September, it has become even clearer that many obstacles remain to be overcome before the global economy can return to normal. The problems relating to fiscal policy in the United States have been resolved only temporarily. There is also uncertainty about how the Federal Reserve will taper its bond purchases and what consequences this tapering will have for the rest of the world. An even greater problem is the weak state of public finances in the euro area, and in particular the uncertainty about the state of the European banks' balance sheets.

Mr Flodén said that the reason for his stance was mainly the same as at the monetary-policy meeting in September. CPIF inflation has averaged 0.9 per cent over the last two years and according to the main scenario is expected to be 1.5 per cent over the next two years. A lower repo rate would lead to CPIF inflation moving towards 2 per cent more quickly.

He also pointed out that the monetary-policy decisions should not only take into account the development of inflation but also strive to achieve balanced resource utilisation and sustainable growth. A monetary policy that quickly pushes up inflation to 2 per cent is not desirable if it results in too high a level of resource utilisation, or if it leads to the build up of major financial risks and puts sustainable growth at risk. However, the inflation target takes precedence. How much scope there is to allow monetary policy to take other factors into account depends on the credibility of the inflation target and of monetary policy. During the 1990s, when the inflation target was new, credibility was low. Monetary policy then had to focus on attaining the inflation target and was not able to take the development of the real economy into account as much as it has been able to do since, once inflation expectations had stabilised around 2 per cent.

The inflation target is still credible, at least if we use long-term inflation expectations as an indicator. However, Mr Flodén said that he was concerned about what will happen to this credibility in the period ahead if inflation does not soon rise towards the target. The development of inflation stemming from the forecast in the draft Monetary Policy Report would probably not lead to any significant problems with regard to credibility. However, the future development of the economy is uncertain. The forecast assumes, among other things, that the global economy will gradually improve and avoid the obstacles along the path towards a normal situation.

Mr Flodén said that there are now reasons to focus more sharply on the inflation target and that monetary policy must therefore be designed so that it is robust to a development of the economy that turns out to be weaker than in the main scenario. A lower repo rate now would provide a greater stimulus to the economy and would be more likely to lead to an increase in inflation even if the economy is subjected to more negative shocks than in the main scenario. The repo rate should therefore be lowered and kept low until it is clear that inflation is rising.

Mr Flodén said that even if one disregards the credibility aspect there are strong reasons for cutting the repo rate. Resource utilisation is and is expected to remain weak, or at least not stronger than normal in the years ahead. He pointed out that a lower repo rate would therefore not only entail CPIF inflation moving more quickly towards 2 per cent, but also mean that resource utilisation would be more balanced, and referred to Figures 2:17-2:22 in the draft Monetary Policy Report.

This argument could possibly be countered by referring to the risks associated with household indebtedness. However, firstly, his assessment is that the repo rate probably has limited effects on household indebtedness. There are other instruments and measures that can be used if it is deemed that indebtedness is worryingly high. With the framework for macroprudential policy recently announced by the government it is clear that Finansinspektionen has the main responsibility for making decisions on such measures.

Secondly, a repo-rate cut today would accelerate the increase in economic activity and inflation and thus means that it would be possible to raise the repo rate towards more normal levels earlier than if the repo rate is left unchanged at today's meeting. It is conceivable that a low repo rate over a long period of time may lead to too low household expectations of the future level of interest rates, which may lead to unfounded increases in housing prices and indebtedness. If the risk of such incorrect expectations is the source of the concern about household indebtedness, it may be advantageous in the short term to pursue a more expansionary monetary policy precisely in order to avoid a prolonged period with a low repo rate.

Admittedly, preliminary assessments at the Riksbank, based on model calculations combined with empirical relationships, indicate that a large repo-rate cut now followed by faster increases in the future would entail a slightly higher level of household debt in relation to disposable income than if the repo-rate path in the main scenario of the draft Monetary Policy Report is followed. However, the difference in the level of indebtedness between these two alternatives is almost negligible. When the disadvantages of a slightly higher debt ratio are weighed against the advantages of an inflation rate that reaches the target more quickly and better-balanced resource utilisation, a repo-rate cut at today's meeting appears to clearly be the better alternative from Mr Flodén's point of view.

Mr Flodén went on to say that his argument thus far could be taken to mean that there are good reasons for cutting the repo rate by more than 25 points today. But the situation today is similar to that at the time of the previous monetary-policy meeting and the reasons for substantially lowering the repo rate are still not sufficient for him to advocate a major deviation from the monetary policy previously signalled by the Riksbank. Therefore, he instead advocated lowering the repo rate by 25 points at today's meeting, leaving the repo rate at 0.75 per cent until the end of the third quarter of 2014 and rapidly raising the repo rate towards the main scenario's repo-rate path from the beginning of the fourth quarter of 2014. More specifically, Mr Flodén advocated the lower repo-rate path shown in Figure 2:17 of the draft Monetary Policy Report.

First Deputy Governor **Kerstin af Jochnick** began by saying that she shared the assessments in the draft Monetary Policy Report with regard to developments abroad and in Sweden. Compared with the assessments in September, it is primarily the events in the United States that have made the international outlook somewhat more uncertain in her view. However, despite the slightly higher degree of uncertainty about the strength of the international recovery her assessment was that the new information received since the monetary-policy meeting in September is mainly in line with the forecast the Riksbank made at that time.

She therefore supported the proposal to leave the repo rate unchanged at 1 per cent in order to provide continued support to the upturn and to contribute to CPIF inflation rising towards 2 per cent in 2015. She also expressed her support for the proposal to adjust the repo-rate path downwards somewhat as a result of the somewhat greater uncertainty about developments abroad.

Despite the discussions concerning the budget and the debt ceiling in the United States in recent weeks, the assessment is that growth in the United States will gradually strengthen in the years ahead. However, one cannot disregard the fact that the prolonged political discussions could have negative effects on international confidence in the United States and on the growth of the US economy going forward. The situation on the financial markets has been relatively calm and restrained, however, despite the political uncertainty about public finances. Ms af Jochnick believed this indicated that the impact on confidence may be relatively limited.

However, a more open question is how the confidence of US households and businesses has been affected by the fact that the public sector was forced to shut down for several weeks. There is a risk that the shutdown and continued turbulence concerning budget policy will lead households and businesses to be more cautious about consumption and investment, which could lead to weaker growth in the United States than the Riksbank has predicted. Lower growth in the United States would have a negative impact on the development of the global economy. There will therefore continue to be a close focus on the discussions about budget negotiations and the debt ceiling in the United States in order to assess global growth in the period ahead. Another factor here is also the expected tapering of the Federal Reserve's relatively extensive bond purchases. The forecast assumes that the Federal Reserve will reduce its asset purchases as the US economy shows signs of recovery and that tapering will not stand in the way of a gradual international recovery.

Several emerging economies with current account deficits and/or substantial debts in foreign currencies have suffered capital outflows and weakening exchange rates when interest rates have risen in the developed economies. The GDP forecasts for some of the emerging economies have been revised downwards compared with the forecasts in September. However, it is assumed that as economic activity improves in the developed economies production will also increase in the emerging economies.

One of the most important signals from the euro area is that GDP began to grow again in the second quarter of 2013, which was already noted at the previous monetary-policy meeting. The picture of a turnaround is also reinforced by the fact that confidence indicators have now improved. The recovery in the euro area is positive for Sweden and will result in an increased demand for Swedish goods and services. However, the situation differs from country to country and average growth is expected to be lower than in the United States.

Work is underway to introduce reforms that will address imbalances in public finances, enhance the quality of the banks' balance sheets and improve the institutional framework for supervision and crisis management. Expectations are, quite rightly, very high that the review of the quality of the European banks' balance sheets conducted by the European Central Bank (ECB) and the European Banking Authority (EBA) will be carried out in a credible way and that solutions will be identified if it turns out that the banks are not robust. This process is very important to the credibility of Europe and to ensure that European banks are able to fund businesses and households and thus create higher growth.

All-in-all, the new information from abroad shows continued signs of recovery. This applies to the United States, even though there is some uncertainty about public finances, to the emerging economies, even though the GDP forecasts have been revised downwards for some countries, and to the euro area, even though a continued recovery presupposes that the reforms are implemented so that the financial sector can support investment and household consumption. As economic activity improves abroad, the demand for Swedish exports will increase during the forecast period. Together with increasing domestic demand this will contribute to higher growth, lower unemployment and to inflation rising towards 2 per cent.

Ms af Jochnick said that the low repo rate is supporting the Swedish economy and creating the preconditions for businesses to increase their investment as international demand increases. Her assessment was that the labour market will gradually improve so that unemployment falls. However, as outlined in the article "Perspectives on the development of the Swedish labour market" in the draft Monetary Policy Report, the underlying reasons for the high rate of unemployment are complex and largely structural. This means that even if monetary policy is highly expansionary over the next 12 months, other measures are required in order to come to terms with structural unemployment.

Household consumption plays a central role for the forecast for GDP growth in Sweden. The development of household incomes has been good, interest rates are low and employment is developing relatively well. However, Ms af Jochnick believed that there were still reasons to carefully monitor the development of household debt. Price increases for tenant-owned apartments in the major metropolitan areas have been relatively high during the autumn, which may mean that the debt ratio is even higher than can currently be seen in the statistics.

She referred to the memo on the risks associated with household indebtedness that an analysis group recently presented to the council for cooperation on macroprudential policy. This noted that there are fundamental factors that explain the increase in the household debt ratio, but that there is a risk that these factors will change, or that the households have unrealistic expectations of them, which could lead to problems for both the macro economy and the financial system.

The fundamental factors that are referred to when explaining the increase in the debt ratio are the fact that an increasing number of households own their housing, low interest rates, tax cuts and a later début on the labour market. The fact that the supply of housing is lower than the demand is another factor, especially in the metropolitan areas. Another cause for concern is that the households may have incorrect expectations of the development of the repo rate and thus incorrect expectations of mortgage costs.

Surveys show that the households do not expect mortgage rates to increase as quickly as the Riksbank estimates they will over the next few years. Higher interest rates in the future will mean that highly-indebted households may need to spend an increasing proportion of their incomes on interest-rate payments. Given that one in ten households among existing borrowers, or the borrowers of 15 per cent of total household debt, have less than SEK 3,000 in discretionary income each month, the households are vulnerable to changes in the conditions governing, above all, mortgages.

Ms af Jochnick's assessment was therefore that there are good reasons for considering further measures to limit the risks associated with the high level of household indebtedness. As long as indebtedness continues to be high and until the framework for macroprudential policy is in place she believed that the Executive Board should continue to take into account the risks associated with household indebtedness in the monetary-policy assessment.

With a repo rate of 1 per cent until the end of 2014, Ms af Jochnick's assessment was that the Riksbank will support the upturn and contribute to CPIF inflation rising towards 2 per cent at the end of the forecast period.

Deputy Governor **Per Jansson** began by saying that he supported the forecasts for both the macro economy and monetary policy presented in the draft Monetary Policy Report. All in all, the picture of economic developments remains roughly the same as in September. The proposed monetary policy entails, as previously, a trade-off between on the one hand the need to stimulate the economy and to contribute to rising inflation in the shorter term, and on the other hand the need to take the risks linked to high household indebtedness into account in the longer term. It is a question of stepping on the accelerator just enough to ensure that developments not only look fair in the short run but are also sustainable in the longer run.

According to the main scenario, CPIF inflation will begin to rise in a more sustained way during the latter part of next year and reach a rate very close to 2 per cent in approximately two years' time. Mr Jansson considered this to be a slow, but not unacceptably slow, adjustment of inflation. The claim that the adjustment of inflation is not unacceptably slow is also supported by the fact that inflation expectations one to two years ahead show rising rather than falling tendencies and that longer-term expectations are very close to 2 per cent.

The most important assumption in the forecast, according to Mr Jansson, is that a recovery is underway abroad. When this happens there are good prospects of an upturn in both exports and investment in Sweden. These factors will then act as complementary drivers of growth, which in the near term will mostly be kept up by household consumption. Household consumption is in turn benefiting from a number of factors, including large initial savings, interest rates that will remain low for a fairly long time and income tax relief in the Government's budget bill.

A recurring theme in Mr Jansson's comments at recent monetary-policy meetings has been that his view of economic developments has been somewhat more optimistic than the view reflected in the forecasts. However, he emphasised that he has been careful to point out that the differences have been rather small and not sufficient to call for a reservation. Nevertheless, he has felt a need to present them.

He noted that developments since July, when he presented his somewhat more optimistic thinking for the first time, have perhaps not yet really followed the more positive course that he believed possible. However, it is important to note that developments during this period have been affected by the uncertainty about when the Federal Reserve will begin tapering its asset purchases as well as by the political disagreement on fiscal policy in the US Congress. Both of these sources of uncertainty and concern have now been dealt with, at least for the moment. Although it cannot be ruled out that these problems will return, or that new problems will arise – for example in connection with the European review of the bank assets' quality and the conduct of the European stress test – he believed that the chances of his more optimistic scenario becoming a reality have nevertheless improved somewhat.

In a more optimistic scenario with a quicker recovery abroad, both exports and investment may develop somewhat more strongly than expected. However, he believed that it is above all household consumption that has the potential to deliver a positive surprise. Compared to previous periods of strong consumption growth the period ahead is special in the sense that it is not only marked by a relatively large increase in disposable income but also by low interest rates and a high initial level of saving. In addition, the net wealth of households is very high and the labour market has performed surprisingly well recently. Such a good initial position for households is rare and means that we cannot rule out that consumption will increase unexpectedly fast going forward.

At the previous monetary-policy meeting, Mr Jansson argued that a somewhat brighter forecast of economic developments does not necessarily have to have consequences for the decision on the repo rate now or the repo-rate path in the future. This is still his assessment and is also one of the reasons why he could nevertheless support the forecasts in the draft Monetary Policy Report. In a situation where inflation is still some way below target and the risks of overheating are small, the forecast for economic developments can tolerate some upward revision without needing to affect monetary policy.

Mr Jansson wished to make it clear that the scenario he had in mind differs from the alternative scenario entitled "Stronger international economic activity" in Chapter 2 of the draft Monetary Policy Report. There are of course some similarities with regard to the driving forces behind the stronger development, but in the scenario in the report it takes rather a long time before inflation begins to deviate more tangibly from the forecast and inflation also significantly overshoots the inflation target towards the end of the period. In the scenario he was talking about, inflation may instead be a little higher in the near term but at the same time in line with the target towards the end of the forecast period, or at least not significantly higher than 2 per cent.

Mr Jansson reminded the meeting that already at the previous meeting he was careful to stress that his argument that monetary policy need not be affected by a brighter forecast for economic developments assumes that the risks linked to the high debt level of households, which can ultimately pose a serious threat to macroeconomic stability, do not increase and can be managed.[1] This is also still his assessment.

He went on to note that the preconditions for being able to manage the risks associated with the high level of household debt have of course in some sense improved following the government's decision on the form of the framework for macroprudential policy in Sweden. However, making decisions in the field of macroprudential policy is not easy, although some commentators in the debate at least in the past have suggested that this is the case.

Mr Jansson pointed out that there is a very good article in the draft Monetary Policy Report, "Macroprudential policy and monetary policy" that, among other things, touches upon the difficulties associated with implementing macroprudential policy measures. The "objectives" of these measures are to strengthen resilience in the financial system and to prevent the build-up of financial imbalances. However, it is of course not easy to know when the system is sufficiently resilient or if some form of imbalance is building up. There are no numerical targets here, and determining when a certain deviation has begun to be "abnormal" is very difficult. In order to mitigate these problems, the European Systemic Risk Board (ESRB) recommends the EU countries to use a set of intermediary targets.[2] This will provide some guidance but does not solve the fundamental problems. An additional complication is that there is no historical pattern of macroprudential policy to take as a starting point. This means that, at least during a transitional period, there will be a lot of uncertainty about the effects of the measures taken.

Mr Jansson concluded by saying that all of this not only complicates matters for the authority that has been given the responsibility for deciding on macroprudential policy, that is Finansinspektionen, but also for other bodies who within their policy areas either need to complement macroprudential policy or at least take into account its impact on the economy. He could therefore do no less than agree with the conclusions drawn in the article, namely that macroprudential policy will affect monetary policy, but that it is difficult at the moment to determine in what way and how quickly.

Governor **Stefan Ingves** began by saying that he shared the view of international developments and the Swedish economy presented in the draft Monetary Policy Report. He also supported the proposal to hold the repo rate unchanged, and the repo-rate path that forms the basis for the forecast in the draft Monetary Policy Report.

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[1] See the article "Financial imbalances in the monetary policy assessment", page 42 of the Monetary Policy Report published in July 2013, and Per Jansson (2013), "Perspectives on the Riksbank's monetary policy", speech at the Centre for Business and Policy Studies, Stockholm, for a discussion of how and why the risks linked to households' high indebtedness are taken into account in monetary policy.

[2] See http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2013:170:0001:0019:EN:PDF.

Mr Ingves noted that the economic situation abroad has largely developed in line with the forecast in the Monetary Policy Update published in September. The recovery is continuing in the United States despite the political uncertainty about the management of the central-government budget. The underlying macro picture has not changed very much. This applies, for example, to the housing market and the labour market, and to the fact that the households have come a long way in the process of adjusting their balance sheets. However, there are still question marks relating to the political process concerning central-government finances. Once these issues are resolved, however, there is potential for good GDP growth in the United States in the years ahead. The process is reminiscent of the basic assumption about Europe –a gradual recovery, although accompanied by political turbulence. The discussion of the tapering of the Federal Reserve's asset purchases indicates a normalisation of monetary policy. This will probably contribute to rising long-term interest rates in the United States and other countries. The direction is a given, but the timing of the different steps to be taken in the future is a much trickier question.

The expansionary monetary policy in the United States and other major currency areas has contributed to substantial capital inflows to the emerging economies. When the normalisation of monetary policy begins in the United States, there is a risk that these inflows will slow down or reverse direction and become outflows. Several countries with substantial current-account deficits experienced capital outflows and a weakening of their exchange-rates already when the discussion of the tapering of complementary measures began.

Tighter external funding conditions may therefore lead to more volatile capital movements in the period ahead, especially in emerging economies with weak fundamentals. This means that several emerging economies will need to reconsider their economic policies. The need for measures may vary from country to country. But essentially it is a question of decisions that strengthen the macro economy and macroprudential policy. This would help to provide room for manoeuvre for monetary policy when interest rates rise around the world.

In the euro area, debt consolidation is underway in the public and private sectors. This is one reason why domestic demand is weak and the recovery is slow. However, the crisis countries have made further progress in the effort to adjust their costs. This has benefited exports, mainly to countries outside the euro area. Current accounts in the crisis countries have therefore improved, which has helped the euro area as a whole to achieve a surplus in its current account in relation to the rest of the world. Mr Ingves said that it was important to continue the internal adjustment process regarding budget deficits and relative costs. It is also important to deal with the problems in the banking sector. The financial sector in the euro area is fragmented. The banks' capital buffers are far too small. Without effective banks there can be no effective provision of credit. The monetary policy transmission mechanism is also disrupted. The planned review of the banks is therefore extremely important. This review and its policy conclusions will be important to both financial stability and monetary policy in the euro area.

All-in-all, global growth is expected to be fairly good during the forecast period and world trade continues to expand. The picture that emerged during the summer still holds good. However, there are major and varying challenges in the emerging economies, in the United States and, in particular, in the euro area that play a significant role for the Swedish economy. Providing that the challenges in different parts of the world are met, however, it is possible that developments abroad will be better than in the main scenario of the draft Monetary Policy Report. There are also downside risks to the forecast, for example as a result of political uncertainty which is very difficult to forecast.

In the main scenario, improved economic activity abroad and stronger domestic demand contribute to rising growth in Sweden in the period ahead. The forecast is rather similar to the one in the September Monetary Policy Update. The recovery abroad is expected to benefit Swedish exports. There is also good potential for significant growth in consumption. The need for new investment will also increase after a while. All-in-all, this will eventually lead to an improvement on the labour market. Rising resource utilisation will contribute to rising wages. The companies will have more scope to increase their prices. This will contribute to the currently low rate of inflation beginning to rise in 2014 and reaching approximately 2 per cent in 2015 measured in terms of the CPIF. This is roughly the picture one can expect to see in an upturn. For example, corporate and household confidence has improved, the Business Tendency Survey is close to its normal level, and the number of redundancy notices is at the same level as during previous periods of good economic development.

Mr Ingves said that monetary policy needs to continue to be expansionary in the present situation in order to boost resource utilisation and to get inflation to rise towards the target. The assessment in the draft Monetary Policy Report is that the repo rate will remain at its current low level for about a year and that repo-rate increases will begin at the end of next year.

However, he believed that monetary policy should be conducted with a long-term perspective. The Riksbank should not contribute to an unsustainable expansion of credit and a build-up of household debt that risk setting the scene for financial instability and macroeconomic disruptions in the longer term. Monetary policy therefore also takes into account the risks associated with financial imbalances. He pointed out that it has been noted many time before that it is difficult to put a figure on these risks and that events beyond the forecast horizon have been considered. If debts continue to increase it may also be necessary to consider what the risks look like within the forecast horizon.

Deputy Governor **Cecilia Skingsley** began by saying that she supported the picture of economic developments and the forecasts presented in the draft Monetary Policy Report, as well as the proposal to leave the repo rate unchanged.

She noted that the course of international macro developments since the monetary-policy meeting in September had been as expected but that some matters nevertheless deserve further comment. There is a sharp focus on monetary policy in the United States. According to Ms Skingsley, market reactions ahead of and following the Federal Reserve's announcement in September that monetary policy would remain unchanged until further notice represented a clear sign that the financial markets in large parts of the world are strictly governed by speculation about the actions of the US central bank. This has also been the case previously, but the difference now is that the Federal Reserve, through its commitment to regular bond purchases, is a major and active participant on the market. This represents a significant difference between the approaching normalisation of monetary policy and previous similar phases in history.

Ms Skingsley said that it is clear that the world of central banking faces a number of strategic and operational challenges over the next few years. At the strategic level, the previous international consensus about the superiority of the inflation target is now up for discussion. The new approach, attempting to steer long interest rates through so-called forward guidance, is raising questions among market participants and other analysts. In addition, the roles and responsibilities of the central banks with regard to financial stability and macroprudential policy and how these areas should relate to monetary policy represent uncharted waters.

There are also many questions on the operational side, the main one probably being the choice between, on the one hand, an early but slow normalisation process and, on the other hand, a more decisive normalisation process that carries the risk of more rapid tightening further ahead.

Several of these questions are currently more relevant to other central banks than to the Riksbank, which following the extraordinary measures adopted in the crisis years 2008-2010 has been able to return to traditional monetary policy using the repo rate. It was nevertheless Ms Skingsley's assessment that future so-called exit processes leading back to a more traditional monetary policy will be very different in character in the different major economies. We can therefore expect to see periods of high volatility on important markets in the years ahead when the market participants attempt to price a more restrained stimulation policy. This is something the Riksbank will have to live with when formulating Swedish monetary policy.

According to Ms Skingsley, her reasoning suggests that the forecasts of future interest rate developments abroad will probably have to be revised several more times. Consequently, for her, the Riksbank's forecasts for foreign interest rates thus have a fairly limited value as an argument for conducting a specific monetary policy in Sweden. In addition, the Riksbank's own assessments of the link between national interest rate differentials and exchange rates show different results depending on which assumptions are used. Instead, you have to gradually adapt in this area.

The economic outlook for the United States still stands, with a gradual recovery driven by improved balance sheets for households, among other factors. The recent uncertainty over fiscal policy has not been positive for the recovery and Ms Skingsley believes that we will have to endure fluctuating statistics for some time to come. But she bears in mind that both corporate confidence, measured as the purchasing managers' index for the manufacturing industry, and household confidence, measured by the Conference Board, are at their highest levels in several years and that a tolerance for a certain temporary decline in confidence and hard data is included in the forecast in the draft Monetary Policy Report.

Ms Skingsley went on to turn her attention to the Swedish economy and observed that incoming data has been somewhat weaker than expected since the monetary policy meeting in September. More specifically, the revision of GDP for the first six months and the new inflation statistics indicate that the recovery is proceeding slightly more sluggishly than the Riksbank had expected, even though, on the other hand, the development of the labour market has been stronger than expected.

As regards the low inflation figures, Ms Skingsley pointed out that, as the Riksbank does not conduct a price level policy in which historical inflation shortfalls are compensated, it is the forward view and the forecasts that are significant. The view of a successive recovery in Sweden still stands, but is clear that monetary policy will need to be stimulatory for a long time to come, in line with the proposed repo-rate path in the draft Monetary Policy Report.

With the Riksbank's low inflation forecast and a low risk of overheating, Ms Skingsley considers that future upward revisions of the macro forecast can be made without this directly needing to affect monetary policy.

At the monetary policy meeting in September, Ms Skingsley observed that the labour market seemed to be on the way to developing more positively than in the then proposed forecast. She considered that this view has been confirmed by recent labour market statistics and she supports the view that the decline in unemployment may accelerate in 2014.

Furthermore, Ms Skingsley noted that short-term inflation expectations in Sweden, as measured by Prospera, are rising again, at the same time as expectations five years ahead remain at the 2-per cent target.

With its policy rate at a continued low 1 per cent, the Riksbank is supporting the economic recovery, while also considering the parallel task of promoting the stability of the financial system.

Ms Skingsley noted that the work of developing analyses and tools for macroprudential policy is continuing and she looks forward to seeing the Riksbank take its place on the new financial stability council. The article on macroprudential policy and monetary policy in the draft Monetary Policy Report explains how monetary policy can and should relate to efforts in macroprudential policy. But there is still a lot of work to do, according to Ms Skingsley. She welcomed the measures that the Riksbank's representatives recommended to the Council for Cooperation on Macroprudential Policy on 1 October, more specifically the proposals for individual amortisation plans, harmonised mortgage assessments and a further raising of the risk-weighting floor for mortgages. She also said that the rate of introduction of these measures could be discussed, but that the important thing was the direction taken.

Another current issue concerns the possibility of coordinating monetary policy and macroprudential measures. Experiences of macroprudential measures and their effects are limited, which suggests that we should proceed cautiously. Ms Skingsley deemed that this will form the starting point for the Riksbank as it conducts its monetary policy in the future.

§1. Discussion

Deputy Governor **Per Jansson** started by saying that he wished to address two matters touched on in earlier comments.

The first of these was the matter of the significance of the interest-rate differential for the exchange rate. Mr Jansson explained that he had understood this as a fairly decisive factor for Ms Ekholm's monetary policy conclusion, that a lower interest rate was needed to avoid a serious appreciation of the krona exchange rate. As we all know, it is very difficult to assess the connection between, on the one hand, Sweden's interest-rate level compared with the interest-rate level abroad and, on the other, the exchange rate. But an exercise that Mr Jansson thought may be of some interest is to use the Riksbank's macro model Ramses to investigate how the model has historically translated interest-rate spreads into effects on the exchange rate, and then to compare the result with what has actually happened with the exchange rate. Ramses, of course, has a kind of interest-rate parity condition, which Mr Jansson assumes is what Ms Ekholm is basing her conclusions on. No doubt, this kind of exercise gives no certain answers but may, at any rate, contribute one piece of the puzzle to the Executive Board's continued discussions.

The other matter is that of how the risks inherent in the high household indebtedness are analysed and how this ultimately connects with monetary policy. Mr Jansson said that it is important that the Executive Board's discussions make clear that intensive work is underway on these issues in the Riksbank's policy departments. Of course, these questions are very difficult, but Mr Jansson deemed that the Riksbank had made significant progress nonetheless. One illustration of this is the article on financial imbalances and monetary policy that the Riksbank published in the monetary policy report in July. And this was just an initial progress report from a larger internal project, which is continually advancing.

Mr Jansson considered that the Riksbank's good progress in this area could also be seen in the discussions the Executive Board had the opportunity to hold with various representatives of the Federal Reserve who recently visited the Riksbank. Mr Jansson also wished to emphasise that the reasoning advanced by the Riksbank over how risks inherent in high household indebtedness, or more generally financial imbalances, should be considered in monetary policy is not home-made but well in line with how a number of other central banks and researchers[3] are reasoning. Examples of central banks using similar reasoning to the Riksbank are the Bank of Canada and Norges Bank.

Deputy Governor **Cecilia Skingsley** began by noting that household indebtedness and the Riksbank's attitude to it is a recurring subject. Those who are critical towards weighing indebtedness into policy also often agree that the analytical material is insufficient and/or that circumstances make the situation sustainable. Furthermore, a common argument is that, even if indebtedness is not sustainable, it is still not an area that the Riksbank should manage.

Ms Skingsley pointed out that if the current trend towards rising house prices and credit expansion continues, at the same time as disposable incomes develop as expected, the debt ratio will continue to increase. Against this background, she explained that she would like to put the following questions to Ms Ekholm and Mr Flodén:

If the current situation is not of concern as regards indebtedness, under what circumstances could indebtedness become a problem? How much more can debts increase before we reach a serious situation that will have to be dealt with in some way? Or is it the situation that Sweden's economy has unique qualities that mean that indebtedness as a proportion of disposable income can continue to increase without danger? If so, what are these qualities?

Ms Skingsley argued that she is the first one to agree that analytical material can always be better, but that she does not consider that waiting for further analysis is an adequate reason for passiveness, particularly in the analysis of an area that the whole world's central banks admit is difficult.

[3] See, for example Frank Smets (2013), "Financial stability and monetary policy: How closely interlinked?", Economic Review 2013:3, under publication, Sveriges Riksbank.

Deputy Governor **Martin Flodén** began by agreeing with Ms Ekholm's desire for further analysis of the way in which the differential between the Swedish repo rate and foreign policy rates influences the exchange rate. This is an issue that will become increasingly important if the Riksbank starts to raise its interest rate ahead of other central banks. Mr Jansson's suggestion for how this could be done may be a way to proceed.

Mr Flodén also wished to develop the reasoning surrounding inflation expectations as regards Ms Skingsley's remark that short-term inflation expectations have risen. He emphasised that he does not see low inflation expectations as a tangible problem at present. Inflation expectations one year ahead are low according to various surveys. They are at just above one per cent. But such expectations are completely in line with the Riksbank's own inflation forecast.

Expectations two years ahead may possibly have increased, but they are still far below the forecast in the main scenario – they are more than one percentage point lower. But Mr Flodén believes this is because many survey respondents are not considering the interest rate effect that pushes up CPI inflation when the repo rate starts to rise, a circumstance he does not see as particularly problematic. On the other hand, it is worth noting that market and household inflation expectations ought to rise as time goes by and the moment for increases of the repo rate approaches.

Finally, Mr Flodén explained, in response to Ms Skingsley's question on how the analytical material surrounding household indebtedness should be taken into account in the monetary policy decisions, that he considered it to be self-evident that all information should be used, even uncertain analytical material. However, his assessment is that the analytical material does not support holding the repo rate high at present in response to household indebtedness.

Deputy Governor **Karolina Ekholm** wished to comment on two issues brought up in earlier contributions: how expansionary monetary policy is at present and the members of the Executive Board's views on the repo-rate path.

As regards the current stance of monetary policy, Ms Ekholm pointed out that, in connection with Figure 1:5 of the draft Monetary Policy Report, it was said that monetary policy is clearly expansionary as the real repo rate is negative at present. The figure shows the real interest rate ex post, which is to say that, as far as possible, it is based on interest rate and inflation outcomes. This differs from Figure 1:32, which shows the real interest rate ex ante, which is to say the real interest rate obtained when the main scenario interest rate forecast is set against the main scenario inflation forecast. Figure 1:5 makes clear that the real interest rate was actually positive during the period when economic activity in Sweden really was weak, which is to say in 2012 and the start of 2013. Of course, this is related to the fact that inflation has been low despite the relatively low repo rate in nominal terms.

Two conclusions can be drawn from this. The first is that a low nominal interest rate does not necessarily reflect an expansionary monetary policy as low inflation holds up the real interest rate. The other conclusion is that when monetary policy is to be assessed, it may be useful to compare what the real interest rate actually was ex post with the real interest rate ex ante that the monetary policy decision-makers considered to be appropriate given the development of the economy. If the real interest rate ex post differs from what was considered appropriate ex ante, it may be instructive to clarify why this was so. Was it that the economy developed in a way that led the decision-makers to change their minds and consider that more or less stimulus was needed? Or was it that inflation developed in such a way that the real interest rate became higher or lower than was intended when the decision was taken?

Ms Ekholm explained that her impression was that inflation has often turned out to be so low that the monetary policy stimulus in reality was less than what was intended when the decisions were taken. But she was uncertain of whether circumstances have really been this way and proposed an analysis of the matter. The Monetary Policy Report from February of this year states that the real repo rate at present was expected to be about -0.8 per cent, but according to Figure 1:5 it now seems instead to be quite close to zero. As only marginal revisions have been made to the forecast during this time, this difference does not seem justified by the Swedish economy having developed significantly better than forecast in February. Ms Ekholm emphasised that she thinks that there is reason to examine this more closely. It could be an important contribution to the material presented ahead of the Riksdag Committee on Finance's assessment of monetary policy and to answer the question of whether the monetary policy implemented has been well-balanced.

As regards her view of the repo-rate path, according to Ms Ekholm it seems as though there are decisive differences within the Executive Board. She interprets Mr Jansson's contribution as though, for him, there is not only a floor for the repo rate - which is based on his assessment of the risks associated with household indebtedness - but also a ceiling insofar as the repo rate is assumed to be unchanged even if more than marginal upward revisions are made of the economic prospects. Ms Ekholm also interpreted Ms Skingsley's contribution to mean that she has a similar view on how changed conditions could conceivably influence the repo rate.

Ms Ekholm said that this approach differed quite considerably from the one she herself advocates, in which changed forecast conditions regularly and systematically lead to changes to the repo-rate path. The fact that the various members of the Executive Board take different approaches to the repo-rate path may possibly itself contribute towards less predictability in monetary policy. Therefore, according to Ms Ekholm, there may be reason to clarify how the individual Executive Board members see the connection between the repo-rate path and forecast conditions.

Ms Ekholm next addressed Ms Skingsley's explicit question on Ms Ekholm's view of developments as regards household debt and whether she does not find it troubling now and if not, when she would feel that it was starting to form a problem. Ms Ekholm explained that her main objection to holding the repo rate up in consideration of risks associated with household debt is not that these debts are unproblematic, but that, like Mr Flodén, she does not consider that a marginally higher repo rate would affect these debts to any great extent. The question is what should then be done to manage the problem of high household debts. It has been said that macroprudential policy is still not in place and that this is a reason to hold the repo-rate up to dampen the increase of household debts. But Ms Ekholm considered that a number of measures have been adopted by Finansinspektionen, most recently the announcement of a requirement of established amortisation plans. Ms Ekholm explained that she interpreted Ms Skingsley's first contribution as meaning that she wanted to see further measures from Finansinspektionen's side. However, if the Riksbank wants other authorities to adopt measures, she thought it was important to be able to show how these measures could be expected to influence the economy. She did not consider that the Riksbank was able to do this at present as no thorough analysis has been made of how, for example, a further raising of the risk weights on mortgages could be expected to affect the development of the Swedish economy.

First Deputy Governor **Kerstin af Jochnick** wished to start by emphasising that the repo rate, both nominal and real, is very low at present. The impression could be gained from the Executive Board's discussions that the members share little common ground in their assessments of what forms a well-balanced monetary policy, but it is really a matter of a difference of 25 basis points in a situation with a very low repo rate.

She went on to point out that, regarding household indebtedness, the Executive Board has long discussed the risk of imbalances arising in the household sector. Her assessment is that this open discussion has come to influence not only other authorities but also lenders and borrowers. There is a broad view today that household indebtedness is high from both a historical and an international perspective. There is also a broad perception that there is a need for a healthier culture as regards the formulation of mortgage loans.

One reason that further measures are not being adopted is that there are different views of how vulnerable households actually are. Some consider that households have such large assets that high debts should not be a problem. However, there is an amount of research here that indicates the importance of households not only having assets but that these assets must be liquid enough for the households' behaviour not to change in the direction of reduced consumption and increased saving when asset prices, such as housing prices, decrease.

Ms Af Jochnick went on to say that one problem in assessing the Swedish economy is that information on individual households is insufficient or absent. Since 2007, there has been no access to individual data on households' assets and debts. More detailed information on households' assets and debts is needed to act as supporting documentation to improve analyses. More analyses are also needed of households' behaviour when the conditions of household loans change, for example when there are changes in fixed-term periods, interest rate levels, amortisation and the value of collateral.

Improving the monetary policy analytical material requires better data and a better analysis of the risks in the financial system aimed at counteracting, as far as is possible, an accumulation of risk that would impede the implementation of monetary policy.

Governor **Stefan Ingves** started by commenting on Ms Ekholm's contribution on the predictability of monetary policy. As the Executive Board is a committee consisting of six individuals and not a mechanical mathematical model, it is completely possible that it can take a decision on exactly the same repo-rate path on the basis of two different sets of forecast conditions.

Mr Ingves then noted that there has been a discussion of macroprudential policy for a longer period in Sweden. He therefore considered that it was positive that the Government had announced that measures were on the way. But it is too early to say how monetary policy will be affected by future measures in this area. It is difficult to attach figures to the overall effect of different types of macroprudential instruments. Decisions on macroprudential policy measures are taken *ex ante* to avoid future instability in the financial system. This target is more difficult to quantify in advance than the inflation target. At present, as household debts are in focus, different macroprudential policy measures are aimed at influencing household borrowing costs one way or another without having an equivalent effect on the corporate sector.

In addition, macroprudential policy measures are aimed at dampening the financial cycle, which is significantly longer than the traditional business cycle. Calculating the effect of macroprudential policy on inflation and resource utilisation will always be genuinely difficult. Even after the introduction of macroprudential policy instruments, monetary policy deliberations will remain. Mr Ingves reached the conclusion that until these measures are in place and are deemed to have started to have an effect, the repo rate will have to be higher than it would otherwise. The interplay of macroprudential policy and monetary policy will be an important issue to return to, as emphasised by the article on it in the draft Monetary Policy Report. Once a large stock of debt has been built up, it takes time to reverse the trend, so the matter of debt will probably remain relevant for the foreseeable future.

Mr Ingves concluded with a few words on the repo-rate forecast in the draft Monetary Policy Report. He said that it was difficult to argue for lowering the repo rate now and then raising it faster in the future. It is also difficult to justify lowering the repo rate in light of the expected Swedish interest rate differential from the rest of the world. An estimated interest rate differential from the rest of the world a couple of years ahead varies far too much to be usable, according to Mr Ingves. Among other reasons, this is because it is presently difficult to assess the effects of a possible decrease in asset purchases in the United States combined with a banking sector in the euro area that is still not working. The Riksbank therefore makes an exchange rate forecast that does not slavishly follow the future estimated interest rate differential.

According to Mr Ingves, the interest rate path is well balanced given the Swedish economic and inflation forecasts. As he noted earlier, redundancy notices are now down at levels usually prevailing in good times. Even so, unemployment is high, which, according to Mr Ingves, largely seems to be due to structural factors. Matching between jobseekers and vacant jobs has deteriorated recently. The labour force also consists to a greater degree of groups that are further removed from the labour market than previously. Against this background, Mr Ingves drew the conclusion that this is largely a matter of structural problems on the labour market that monetary policy cannot fix.

Deputy Governor **Per Jansson** commented on Mr Flodén's stance that there was nothing in the internal analytical material on the risks inherent in household debt and monetary policy to suggest holding the repo rate high. Mr Jansson started by agreeing with Ms af Jochnick when she pointed out that the repo rate is not actually high. At present, the repo rate amounts to 1 per cent, with the plan being to have a negative real repo rate until the start of 2015. In addition, Mr Jansson pointed out that there is not only uncertainty about how monetary policy affects household debt and the risks associated with it. There is also significant uncertainty associated with how monetary policy influences the labour market and inflation. He considered that this was also very relevant when deciding on an appropriate monetary policy.

Furthermore, Mr Jansson wished to emphasise that the work on analysing the risks associated with the high indebtedness of households and how this is connected with monetary policy has not proceeded so far as to allow any clear conclusions to be drawn. One factor that could suggest that monetary policy plays a fairly important role is that an expansionary monetary policy over a longer time period could influence households' interest-rate expectations towards becoming unrealistically low. If this were to be the case, as is also discussed in the draft Monetary Policy Report, the argument for using monetary policy to counteract such risks would become significantly stronger.

Mr Jansson then commented on Ms Ekholm's argument that Ms Skingsley and Mr Jansson seemed to have a 'ceiling' for the repo-rate path and that the members of the Executive Board seem to have very different opinions on how monetary policy should react to new information. Against the background of Ms Ekholm's comments, Mr Jansson wished to emphasise that he had been clear that his argument that the current monetary policy can remain unchanged despite positive surprises in economic developments depends on the risks associated with the high indebtedness of households not increasing and being manageable. If these risks do not increase and can be managed, the argument of 'leaning against the wind' disappears, making it entirely consistent, for him at least, for monetary policy to remain unchanged, even in the presence of somewhat stronger economic developments. Having said this, Mr Jansson nevertheless agreed with Ms Ekholm that it seems to be the case that there are a number of fundamental differences between how active the members of the Executive Board wish to be as regards interest rate policy. He suspected that there would be reason to return to this issue in future discussions.

Deputy Governor **Karolina Ekholm** commented on the issue of the interest rate differential and exchange rate forecast and wanted to clarify that her objection focused on the circumstance that the Riksbank's own forecast is now based on an already positive interest rate differential successively increasing until, at the end of the forecast horizon, it reaches a level unseen since the years following the crisis of the 1990s. She agrees with Mr Jansson that it may be valuable to use Ramses to examine how changes in interest rate differentials have affected the exchange rate in the past. But as the forecast includes interest rate differentials that have, in principle, never been encountered under the prevailing monetary policy regime, perhaps it would be wise not to expect too much from such an analysis. However, it seems to be unanimous that this is an area that may be worth closer study.

Ms Ekholm went on to argue that it is important for the assessment of monetary policy to clarify what one is trying to achieve with monetary policy as regards household indebtedness.

Deputy Governor **Cecilia Skingsley** commented on Ms Ekholm's contribution on the differences between the various Executive Board members' views of the connection between the interest rate path and forecast conditions. As Ms Skingsley sees it, there is a correlation between revisions of the macro forecast and revisions of the repo-rate path, but it is not absolute. Repeatedly fine-tuning the repo-rate path on the basis of revisions to the macro forecast gives the impression that the repo-rate path is a precise instrument capable of powerfully steering expectations and she does not consider that it is quite so precise.

As regards her questions on household indebtedness and monetary policy's usefulness in this respect, Ms Skingsley went on to note that Mr Flodén is correct that the Riksbank's analytical material points in different directions. In the article "Financial imbalances in the monetary policy assessment" in the Monetary Policy Report from this July, already mentioned in the day's discussions, the Executive Board states, after model estimates of the short-term correlation between the repo rate and household indebtedness, that the effects are relatively minor on average. But Ms Skingsley wished to emphasise that the article also notes that the effects on indebtedness will be significant if households overestimate how long the repo rate will remain low. She therefore considered that the monetary policy decision cannot just be based on the current effects of the repo rate on indebtedness, which are probably minor, but also on what may happen in the future, when the effects will be greater, according to research.

Deputy Governor **Martin Flodén** wished to develop and clarify his thoughts on the points on household indebtedness raised by Ms Skingsley and taken up by several others in the discussion.

Mr Flodén noted that a couple of members of the Executive Board reacted to his earlier statement that the repo rate was being held up due to household indebtedness. What he meant, of course, was that the repo rate was being held above the level it would be at if the risks associated with household indebtedness were disregarded. Mr Flodén said that every member of the Executive Board completely agreed that this was the case.

In response to Ms Skingsley's question regarding at which level of household indebtedness Ms Ekholm and Mr Flodén would start to become uneasy, Mr Flodén wished to make clear that every member of the Executive Board had expressed unease, perhaps in different ways and to different extents, over households' high and rising indebtedness. He had expressed such unease himself on several occasions, including in his published speech of 24 September.

According to Mr Flodén, a more relevant question is whether and how monetary policy, via the repo rate, should be affected by this unease over households' high indebtedness. He said that he had clearly expressed the opinion that monetary policy, in principle, should take account of financial risks and that this would be compatible with the Riksbank's mandate. This is particularly true if the financial risks are caused by monetary policy. On the other hand, he does not agree with the majority’s conclusions on how monetary policy should take account of this in practice. This, of course, depends on the effects the repo rate has on the risks considered to be of concern.

Mr Flodén went on to point out that, both in his speeches and previously during the day’s meeting, he had taken up household interest-rate expectations as a risk factor relevant to the present situation. It is possible that a low repo rate for a prolonged period would result in households’ expectations of the future interest-rate situation becoming too low and that this, in turn, would lead to an unjustified increase in housing prices and indebtedness. But if this is what is causing unease over household’s high indebtedness, he said that it could be justifiable to conduct an even more expansionary monetary policy in the short term to ensure that economic activity picks up and that inflation starts to rise towards the target. The repo rate could then be raised more quickly towards normal levels.

Regarding Ms Skingsley’s comments on which approach to take towards the analytical material on household debts, Mr Flodén pointed out that the members of the Executive Board, in the monetary policy process, get to see a large amount of material linked to financial risks and other subjects. Part of this analysis suggests that the repo rate should be held higher than would be the case if these risks were disregarded. And some of the analysis indicates that the repo rate should, in practice, be set as if these risks were being disregarded.

Mr Flodén went on to note that, during the day's discussions, several members of the Executive Board had referred to the article on financial imbalances in the monetary policy assessment that was included in the Monetary Policy Report in July. At the moment, work linked to that article is underway in the Riksbank to analyse how the repo rate affects household indebtedness and how household indebtedness affects the likelihood of an "unfavourable macroeconomic scenario" or, in other words, a crisis linked to this high indebtedness. This analysis is being developed and is thus associated with a number of uncertainty factors. The analysis is based on empirical estimates from earlier episodes of debt accumulation and financial crises. As experience and data is limited concerning such episodes, the analysis will necessarily involve great uncertainty even when it is more complete. One can choose to attach more or less importance to attach to this analysis. But Mr Flodén noted that the analytical material the Executive Board has so far examined indicates that the repo rate has a minor effect on household indebtedness and that a small increase in household indebtedness has a minor effect on the risk of a crisis arising. When these minor effects are balanced against the desire to stabilise inflation around two per cent and achieve balanced resource utilisation, it seems clear to him that a more expansionary monetary policy, which is to say a lower repo rate today, would give better target fulfilment.

Deputy Governor **Karolina Ekholm** agreed with Mr Flodén that it is important to make progress on the analytical material so that the possible advantages of holding the repo rate up to dampen the increase of household debt can be balanced against the costs in terms of impaired target fulfilment as regards inflation and resource utilisation during the forecast horizon. She considered it unsatisfactory that, in the material presented, it was only possible to see the costs in terms of inflation below target and higher unemployment without being able to gain an appreciation of the scale of the advantages. But, at the same time, she considered that this supporting material must be processed until it reaches a point where the Monetary Policy Department deems that it meets the Department's quality criteria. Until then, there is nothing to prevent individual members of the Executive Board from explaining their judgement of the scale of the gains. As her earlier comments made clear, she does not consider that monetary policy can influence indebtedness to any great degree, at least not without risking large costs in terms of impaired macroeconomic development. She considered that this conclusion was supported by the analyses so far made by the Riksbank.

As regards the manner in which indebtedness affects the likeliness of a negative macro scenario with falling housing prices and reduced consumption growth, Ms Ekholm explained that this is uncertain. Indebtedness is presently high, but, at the same time, there are a number of aspects to the Swedish economy that distinguish Sweden from the countries that have been through such episodes. Saving is high, house construction is low and additionally there is a large surplus in the current account. The typical pattern preceding a crash on the housing market is that saving is low, that price increases for property have led to a boom in the construction sector and that there is a deficit in the current account.

Governor **Stefan Ingves** summarised the discussion. He opened by noting that the Executive Board is unanimous on the view of economic and inflation prospects given in the Monetary Policy Report.

For some time now economic developments in both Sweden and abroad have been largely in line with the Riksbank's forecasts. GDP growth in Sweden was weaker than expected in the first half of the year, but is expected to pick up more speed next year as a result of improved economic activity abroad and stronger domestic demand. The labour market has continued to improve and a more tangible upturn in employment is expected next year.

Inflation has been low over a long period of time, but when economic activity strengthens, costs and prices are expected to rise faster. This means that CPIF inflation will increase to 2 per cent during 2015. Swedish households continue to be highly indebted, both in an historical and an international perspective, which makes the economy vulnerable to shocks.

The prospects for an upturn in economic activity appear to be good, but there are also causes for concern, for example the budget problems in the United Sates, the effect of a normalisation of US monetary policy on the rest of the world and the management of the problems in the banking sector in the euro area.

Given the low level of inflation and in order to support the upturn, the Executive Board agreed that monetary policy needs to continue to be expansionary. A majority of four members assessed that it was appropriate to hold the repo rate unchanged at 1 per cent until the end of 2014. The economy is then expected to have shown a more tangible improvement and inflation to have risen, so that it will be possible to begin raising the repo rate towards a more normal level. Although a repo-rate cut now could bring inflation back to 2 per cent somewhat more quickly, it could also increase the macroeconomic risks associated with the high level of household indebtedness. A majority considered that an unchanged repo rate over the next 12 months was an appropriate trade-off between the need for short-term stimulus to get inflation to rise towards the target and consideration of the risks associated with household indebtedness.

Two members advocated cutting the repo rate by 0.25 percentage points to 0.75 per cent to bring inflation to the target more quickly. These members assessed that such a cut would have little effect on the risks relating to household indebtedness. They then advocated slightly different rates of increase.

All of the members of the Executive Board agreed that once measures have been taken in the field of macroprudential policy then the preconditions for monetary policy will be affected. However, there were slightly different views about to what extent macroprudential policy measures are already in place and how extensive they will ultimately be.

The meeting also discussed the differentials between the Swedish repo rate and policy rates abroad, the real interest rate and the type of data needed for a sound analysis of indebtedness. A discussion of how the repo rate path should be adapted to new information arose when two members argued that it may not be necessary to change the repo-rate path even if the development of the economy proved to be better than in the main scenario.

§2. Monetary policy decision

The Executive Board decided after voting

- to adopt the Monetary Policy Report according to the proposal, Annex A to the minutes,
- to publish the Monetary Policy Report on 24 October 2013, at 9.30 a.m.,
- to hold the repo rate unchanged at 1.00 per cent and that this decision would apply with effect from 30 October 2013,
- to publish the decision above at 9.30 a.m. on Thursday 24 October 2013 with the motivation and wording contained in a press release, and
- to publish the minutes of today's meeting on Wednesday, 6 November at 9.30 a.m.

Deputy Governor Karolina Ekholm entered a reservation against the decision to maintain the repo rate at its current level and against the repo-rate path in the Monetary Policy Report. She advocated a lowering of the repo rate to 0.75 per cent and a repo-rate path that stays at 0.75 per cent through the third quarter of 2014, and then rises to about 2.4 per cent by the end of the forecast period. This was justified by her assessment that a repo-rate path that is associated with a higher forecast of CPIF inflation and a lower forecast of unemployment constitutes a better-balanced monetary policy.

Deputy Governor Martin Flodén entered a reservation against the decision to hold the repo rate unchanged and against the repo-rate path in the Monetary Policy Report. He advocated cutting the repo rate to 0.75 per cent, holding it at this level until the end of the third quarter of 2014, and then rapidly raising it with effect from the fourth quarter of 2014 towards the repo-rate path in the main scenario of the Monetary Policy Report. More specifically, he advocated the lower repo-rate path shown in Figure 2:17 of the draft Monetary Policy Report. This is justified by his assessment that this repo-rate path would entail a forecast where CPIF inflation returns to 2 per cent sooner and resource utilisation is better balanced. Moreover, it would reduce the risk that it would be a long time before the repo rate can be raised from the current low levels.

This paragraph was verified immediately.

Minutes by

Ann-Christine Högberg

Verified by:

Karolina Ekholm	Stefan Ingves	Per Jansson
Kerstin af Jochnick	Martin Flodén	Cecilia Skingsley