Monetary policy minutes

October 2016

Summary

At the monetary policy meeting on 26 October, the Executive Board held the repo rate unchanged at −0.50 per cent and assessed that the repo rate needs to be held at this level for six months longer than was forecast in September. The probability that the repo rate will be cut further has increased. The purchases of government bonds will continue during the second half of 2016, as decided in April. Prior to the monetary policy meeting in December, the Executive Board is prepared to extend the purchases of government bonds.

It was noted at the meeting that the Executive Board was unanimous on the picture of economic developments and the outlook for inflation described in the draft Monetary Policy Report. Since the monetary policy meeting in September, real economic developments in Sweden and abroad have been largely in line with the Riksbank's forecasts. The recovery abroad is continuing at a fairly moderate pace and inflation is rising from a low level, supported by very expansionary monetary policy. However, international developments are still marked by uncertainty.

Monetary policy has contributed to strong economic activity in Sweden and to a rise in inflation and inflation expectations. The conditions are good for a continued rise in inflation. However, the weak inflation outcomes in recent months illustrate the uncertainty over how quickly inflation will rise. The Riksbank now assesses that it will take longer for inflation to reach 2 per cent. The upturn in inflation therefore needs continued strong support.

The Executive Board were unanimous that the repo rate should be held unchanged at –0.50 per cent and assessed that it needed to remain at this level for six months longer than was forecast in September. The probability of the repo rate being cut further has also increased.

The Riksbank will continue buying government bonds during the second half of 2016 in accordance with the plan the Executive Board decided on in April. Until further notice, maturities and coupon payments on the holdings in the government bond portfolio will be reinvested. Moreover, prior to the monetary policy meeting in December, the Executive Board is ready to extend the bond purchases, but as the current programme runs until the end of the year, there is scope to await further information that can affect the decision.

The recent developments in inflation were also discussed at the meeting. The relationship between resource utilisation and inflation was also mentioned. It was noted that the Swedish economy is better-equipped now than it was one year ago, with stronger economic activity, higher inflation and inflation expectations close to 2 per cent. But Sweden is a small, open economy and we therefore need to relate to what is happening in the world around us. Events there can lead to monetary policy needing to be adjusted to safeguard the upturn in inflation. Moreover, concerns were expressed regarding the growing household indebtedness and it was pointed out that there is still a need to combine measures

within different policy areas to obtain a long-run sustainable economic development in Sweden. In addition, there were comments on various aspects of the formulation of monetary policy.

MINUTES OF MONETARY POLICY MEETING

Executive Board, No. 7

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: 26 October 2016

TIME: 09.00

PRESENT: Stefan Ingves, Chair
Martin Flodén
Per Jansson
Kerstin af Jochnick
Henry Ohlsson
Cecilia Skingsley

Michael Lundholm, Vice Chairperson of the General Council

Mattias Ankarhem
Sophie Brauner
Charlotta Edler
Heidi Elmér
Mattias Erlandsson
Kerstin Hallsten
Lina Jacobson (§ 1)
Jesper Johansson
Ola Melander
Ann-Leena Mikiver
Marianne Nessén
Henrik Siverbo
Maria Sjödin
Ingvar Strid
Ulf Söderström
Anders Vredin

It was noted that Mattias Ankarhem and Henrik Siverbo would prepare draft minutes of the monetary policy meeting.

§1. Economic developments

Lina Jacobson from the Markets Department began by presenting the latest developments. It has been relatively quiet on the financial markets. Stock markets have developed marginally positively. Companies in the United States are largely reporting better results than market participants had expected. Commodity prices have also increased somewhat, primarily due to higher oil prices. Government bond yields in both Sweden and abroad fell clearly after the referendum on EU withdrawal in the United Kingdom and in several countries they have remained at low levels. In the United Kingdom, however, interest rates have risen markedly following statements by Prime Minister May that indicate tougher positions in the negotiations on withdrawal. Although the ECB's monetary policy announcement on 20 October did not get any major initial reactions, interest rates in Sweden and Germany have fallen somewhat since then. In Sweden, the krona has continued to weaken in recent weeks. With regard to today's meeting, a majority of analysts are expecting an announcement of extended bond purchases.

Marianne Nessén, Head of the Monetary Policy Department, began by presenting the draft Monetary Policy Report which, in the assessment of the Monetary Policy Department, would gain the support of the majority of the Executive Board members. She noted the developments in the global economy have largely been in line with the picture painted in the September Monetary Policy Report. The forecast for international growth remains largely unchanged. As in earlier assessments, a continued moderate recovery is expected abroad, with growth just over 2 per cent in the coming years.

Inflation is still low abroad, but is expected to pick up in the period ahead as energy prices rise and resource utilisation increases in many countries. Monetary policy abroad is expected to remain very expansionary to support the recovery and boost inflation. With regard to the euro area, there are expectations that the ECB will not entirely cease its bond purchases when the current asset purchase programme expires in March 2017.

Concerning the risk outlook, there is still considerable uncertainty over economic policy. The process for the United Kingdom's withdrawal from the EU remains very uncertain. And approaching national elections and referendums are also creating unease about the future political direction. Weaknesses in the European banking system constitute another risk to economic developments abroad.

The krona has weakened continuously since the UK referendum. No individual factor explains the weaker krona, but it could be partly due to new investment patterns among investors. The forecast is that the krona will strengthen gradually and in an orderly manner. A stronger krona is justified by the current account surplus and good economic growth. Compared with the monetary policy meeting in September, the krona is expected to be weaker throughout the forecast period.

Following very strong growth in the Swedish economy during 2015, a gradual slowdown to more normal levels is expected. GDP growth amounted to 4.1 per cent in 2015. This year, inflation is expected to be 3.3 per cent and then slow to 2.0 per cent in 2017. The high growth has led to an increase in resource utilisation, which is deemed to be normal and expected to continue to rise in the coming years. The development in resource utilisation is reflected, among other things, in the fall in unemployment over a long period of time. However, this development has recently slowed down somewhat. Unemployment is expected to continue to fall going forward and then to rise again as new arrivals enter the labour force to a greater extent.

Household debt is growing at a rapid pace. The forecast is for household indebtedness to continue rising and for the debt-to-income ratio to reach 192 per cent in the fourth quarter of 2019.

Two new inflation outcomes have been published since the Monetary Policy Report in September. The most recent one is for September, when CPIF inflation was measured at 1.2 per cent, which was lower than expected. It was mainly service prices that were lower than expected. Service prices are normally sluggish and the lower inflation is therefore expected to endure for some time to come. In the long run, rising resource utilisation and gradually higher inflation abroad mean that inflation will continue rising. CPIF inflation is expected to reach 2 per cent in 2018.

The forecasts in the draft Monetary Policy Report are based on the assumption that the repo rate will be held unchanged at −0.50 per cent and that the repo-rate path is shifted so the first raises are expected to be at the beginning of 2018. After that, the raises are expected to be made at a slow pace. The repo-rate path also indicates a higher probability than before of the repo rate being cut further. In addition, the purchases of government bonds are expected to continue according to the plan decided on at the monetary policy meeting in April. The forecasts also reflect a probability that the Executive Board may decide at the monetary policy meeting in December to extend the bond purchases.

Ms Nessén then noted that the forecasts in the draft Monetary Policy Report were discussed by the Executive Board at meetings held on 5, 12, 14 and 17 October. The draft Monetary Policy Report was tabled at a meeting of the Executive Board on 19 October.

Important issues highlighted in the monetary policy drafting process on this occasion were the inflation outcomes in recent months, the depreciation of the Swedish krona and the economic policy uncertainty abroad.

As a result of the weak inflation outcomes in recent months, one important question in the drafting process was how the unexpectedly weak outcomes should be interpreted and how they would influence the forecast going forward. The link between resource utilisation and inflation was also discussed. New analyses of this are described in an article in the draft Monetary Policy Report.

The Swedish krona has been weaker than forecast recently. The preparations have included discussions of possible explanations for this and what significance it has for inflation. The question of the long-term real exchange rate was also raised, as was the link to the trade and current account balances.

The Monetary Policy Department is continuing to analyse questions concerning the low inflation, the link between resource utilisation and inflation and the development of the real exchange rate in the longer run and the results of these analyses will be reported regularly.

There is considerable uncertainty over developments abroad and during the drafting process the board also discussed political uncertainty and how the financial markets have increased their focus on political events, including the presidential election in the United States and coming parliamentary elections in Germany and France. Monetary policy abroad has also been in focus and will continue to be so, as future information from the Federal Reserve and the ECB is important to Sweden as a small, open economy.

§2. The economic situation and monetary policy

Deputy Governor **Martin Flodén** began by saying that he supports the proposal to hold the repo rate unchanged at today's monetary policy meeting and to wait to decide whether to extend the bond purchases beyond the end of the year. He also supported the draft Monetary Policy Report.

The most important development for monetary policy since the Executive Board meeting in September is of course that the inflation outcomes for August and September were much lower than the Riksbank and other forecasters had expected, said Mr Flodén. Unfortunately, there is not much to indicate that the surprisingly low inflation was caused by temporary factors, he went on to say. It rather appears that underlying inflationary pressures will be lower than expected for some time to come. Measured by the CPIF excluding energy, underlying inflation rose from 0.7 per cent on average in 2014 to 1.4 per cent last year. With the Riksbank's new forecast, this inflation is expected to remain at 1.4 per cent both this year and next year.

Mr Flodén pointed out that it is important now to assess how probable it is that inflation will in the long run nevertheless continue rising and what, if any, monetary policy reactions are appropriate to support a continued rise in inflation. In brief, recent developments give cause for concern, but not for alarm, in his opinion. Given the current monetary policy situation, Mr Flodén thought that the most appropriate reaction at today's monetary policy meeting was to leave the repo rate unchanged, but to be prepared that it may be necessary to take a decision in December to continue the purchases of government bonds. He then elaborated on his thoughts regarding this.

It is of course worrying that the forecast for underlying inflation is being revised down quite substantially. The upwards trend appears to have levelled off and it is now expected to take a year before inflation begins rising again. There is a risk that the even longer period with weak inflationary pressures could undermine the credibility of the inflation target and make it even more difficult to really get inflation to continue upwards further ahead, said Mr Flodén.

However, he went on to say that concern over this is alleviated by several factors. First, inflation expectations have risen significantly in recent years. If expectations can be held at this level, it will be easier for inflation to rise. Second, headline inflation, measured for instance in terms of the CPIF, is held up at reasonable levels by the fact that energy prices have recently turned upwards. Rising headline inflation will make it easier to hold inflation expectations at the current level and to maintain confidence in the inflation target. And third, the Swedish economy is still performing well, with good growth and a continued rise in resource utilisation, which of course also contributes to higher inflation going forward. Taking all this into account, Mr Flodén repeated that he regards the recent weak inflation outcomes as worrying, but not alarming.

What, if any, monetary policy reactions are then appropriate to manage the recent weak inflation outcomes? The repo rate is now –0.50 per cent. There are no clear signs that this level has entailed any significant problems for market functioning, but it also appears that the Riksbank's two most recent rate cuts, that is, the cut from –0.25 per cent to –0.35 per cent in July 2015 and the cut to –0.50 per cent in February have at most had a marginal effect on lending rates to households and companies. Mr Flodén therefore considers it unlikely that a further cut to the repo rate now would have an impact through the so-called interest-rate channel.

On the other hand, a repo-rate cut would probably have a more normal impact on interest rates on assets traded in the financial markets and thereby on the exchange rate. Mr Flodén's assessment is therefore that a repo-rate cut could still be a usable measure, but that would be in a situation where the krona was approaching unjustifiably high levels. He considered this type of situation to be unlikely at present and said that the probability of a repo-rate cut implicitly inherent in the Riksbank's repo-rate forecast was therefore too high to reflect his own view of an appropriate repo-rate decision in the coming months.

A monetary policy decision that Mr Flodén considered to be more likely is to extend the purchases of government bonds. But he did not think that a decision on such an extension needed to be taken at today's monetary policy meeting. The current programme extends beyond the next ordinary monetary policy meeting in December. Developments up until that meeting can affect how an extension of the purchases should be formulated. The inflation outcomes for October and November could possibly change the view of recent inflation outcomes and the assessment of underlying inflationary pressures. In addition, there are expectations of, but also uncertainty surrounding, the monetary policy decisions by the ECB and the Federal Reserve before the Board's meeting in December. Mr Flodén considered that these decisions could have clear effects on the development of the international financial markets and thus on how monetary policy in Sweden can best be formulated.

He said that there was also some uncertainty as to how the Swedish market for nominal government bonds would be affected by the Riksbank buying an increasingly large share of the outstanding stock. Up to December we will receive further information on this development and the Executive Board can thus make better deliberations, for instance regarding the size of further bond purchases and how they could best be allocated between real and nominal bonds. There are thus many factors indicating that a decision on continued bond purchases can be taken on better grounds in December than at today's monetary policy meeting, noted Mr Flodén.

The proposal for a monetary policy decision implies that the first increase in the repo rate, according to the forecast for the repo-rate path, is postponed by around six months until early 2018. Mr Flodén commented that he did not believe that the shifted repo-rate path makes current monetary policy more expansionary to any tangible extent. He argued that postponing the first increase was more a case of making a good forecast than changing the stance of monetary policy. Inflationary pressures appear to be lower than the Riksbank was previously assuming, at the same time as the Executive Board is refraining from applying further stimulus at today's monetary policy meeting. It will then take longer before the inflation upturn has become sufficiently strong for the Executive Board to be able to begin raising the repo rate. He said that in a different monetary policy situation, and with more efficient tools to hand, it would have been better to make monetary policy more expansionary in the near term to reduce the risk that inflation expectations will begin falling and hamper the rise in inflation. Such a strategy would also have made it possible to avoid the period with low interest rates becoming too protracted.

First Deputy Governor **Kerstin af Jochnick** began by saying that she shared the assessment of developments in Sweden and abroad presented in the draft Monetary Policy Report. She also supported the proposed repo-rate path.

Ms af Jochnick noted that the Riksbank's forecasts for macroeconomic developments in Sweden and abroad were roughly that same as those at the September meeting and that the Riksbank is expecting a moderate recovery abroad that provides support for economic activity in Sweden. The Swedish economy remains strong, but growth has slowed down to more normal levels, following the high growth last year. This year, developments are mainly driven by domestic demand, while exports are weak. During 2017, the recovery abroad is expected to contribute to higher demand for Swedish goods and services. Exports are expected to rise gradually over the forecast period, when investment increases in Sweden's most important export markets.

At the same time, there remains the question of how strong developments abroad are, said Ms af Jochnick. The Riksbank has long talked about the uncertainty abroad as a negative factor for corporate and household behaviour. The uncertainty regarding, for instance, national elections, referendums and presidential elections could be substantial and affect economic decisions for a period of time. There are also examples of political events triggering more complicated processes that contribute to uncertainty over a long period of time, said Ms af Jochnick. She was there referring, for instance to the economic effects of a British withdrawal from the EU, which are difficult to estimate as the forms for the withdrawal are not yet clear. There are also examples of protracted economic policy decision-making processes that increase uncertainty for consumers and companies. One example is that the management of problems in the banking sectors of several countries in Europe has delayed too long, which creates uncertainty about the recovery in the euro area. The risk is that such uncertainty factors ultimately hamper demand for Swedish goods and services too and lead to lower growth and lower inflation than the Riksbank has forecast.

With regard to inflation abroad, it is still high, noted Ms af Jochnick. The Riksbank can therefore assume that monetary policy abroad will remain very expansionary to support the recovery in economic activity and bring up the low inflation. Inflation in Sweden has shown a rising trend since spring 2014. But sometimes inflation can be unstable, which is because it is affected by so many other factors and some of them, including commodity prices and the exchange rate, can change quickly and more than expected. The outcome figures for August and September were lower than expected, which is indicative of the difficulties in making forecasts and capturing reality in a relevant way. Service prices in particular have increased more slowly than expected, which indicates that underlying inflationary pressures are somewhat weaker than the Riksbank previously assessed. However, a number of indicators point to inflation continuing to rise towards two per cent, but that it will take longer to reach the target. Increased resource utilisation and an increase in the percentage of companies reporting labour shortages mean that the rate of wage increase will become gradually higher in the coming years. Increased resource utilisation makes it easier for companies to raise their prices. In the short term, rising energy prices and a weak krona should contribute to higher inflation, said Ms af Jochnick.

As described in the article in the Monetary Policy Report, historical correlations indicate that inflation will continue rising, but that it is uncertain how quickly it will rise, she continued. There is also a possibility that more structural factors could hold back the upturn in inflation. There are many indications that globalisation and new technology have contributed to increased competition that can change companies’ pricing behaviour. She did not consider it improbable that Sweden, which is a small open economy, where companies and consumers are very interested in new technology would note a change in pricing behaviour in some sectors. The Riksbank's most recent Business Survey, published in September 2016, notes for instance that retail sector companies said they had difficulty in passing to their customers increased costs that were due to stiff competition and a high structural transformation pressure.

All in all, Ms af Jochnick assessed that the Riksbank must maintain continued preparedness to make monetary policy more expansionary if the Riksbank estimates that inflation prospects are deteriorating and confidence in the inflation target is waning. It is still important that long-term inflation expectations remain anchored around 2 per cent. She shared the assessment in the draft Monetary Policy Report that there are reasons for revising down the repo-rate path and signalling that the probability of a further repo-rate cut has increased and that the first repo-rate increase is expected to come in early 2018. Prior to the monetary policy meeting in December the Executive Board will have more information to use as a base for the decision on further measures. There will be two further inflation outcomes for Sweden, we will know the outcomes of a number of political events and we will be able to take into account the monetary policy conducted by other central banks during the autumn, concluded Ms af Jochnick. She also considered that the Executive Board should be prepared to extend the government bond programme to safeguard a good development in the Swedish economy and support the rising trend in inflation.

Finally, Ms af Jochnick wished to say a few words about the risks of low interest rates over a long period of time. The proposal for a decision at today's monetary policy meeting indicates that it will take longer to attain the inflation target of 2 per cent and that interest rates in Sweden will be low for a longer time than the Riksbank previously assessed. The risks of high indebtedness in the household sector may now increase unless further measures are taken. This means, she said, that measures need to be taken urgently in other policy areas to limit the risk of imbalances leading to negative effects on the Swedish economy further ahead.

Deputy Governor **Per Jansson** began by saying that recent inflation outcomes had been a clear disappointment. Two new outcomes have been published since the September monetary policy meeting, for August and September. Inflation was already lower than expected in August. In that month both CPIF inflation and CPIF inflation excluding energy prices were around 0.15 percentage points below the forecast produced in September. Mr Jansson emphasised that although this was of course a poor outcome, the forecast deviation could on this occasion be largely attributed to a couple of specific factors and there was little indication that the more underlying inflation rate was about to deteriorate.

But the overestimation worsened in September, he noted. The forecast for September was that CPIF inflation and CPIF inflation excluding energy prices would be 1.63 and 1.50 per cent respectively. However, the outcomes instead came out at 1.18 and 0.96 per cent respectively. This increased the forecasting error to around 0.5 percentage points. And it was then no longer possible to explain the error with specific factors; price developments surprised on the negative side in several areas. It was primarily service prices that were weaker than expected, but food prices also contributed to the forecasting error. The fact that there are thus signs of lower underlying inflationary pressures, caused primarily by negative surprises in service prices, is of course worrying in a situation where the part of inflation driven by domestic demand is supposed to increase gradually, highlighted Mr Jansson. HICP inflation was also weak, amounting to

0.84 per cent in September. With this, Sweden has in September fallen to sixth place in the EU inflation league, from second place in both August and July.

He went on to say that since the monetary policy meeting in September, two new outcomes for inflation expectations have also been published. These are Prospera's large quarterly survey in September and the smaller monthly survey, where only money market participants are questioned, in October. The general picture for the two surveys is that expectations have risen somewhat, particularly one and two years ahead. The important expectations of inflation five years ahead, which can be regarded as a measure of the credibility of the inflation target, have also risen in general. When rounded off to a decimal, it is now only purchasing managers in the manufacturing industry and money market participants who are not expecting inflation to be 2 per cent or higher in five years' time. However, the five-year inflation expectations are very close to 2 per cent even for these respondents, at a good 1.9 per cent. Mr Jansson said that prior to the imminent wage bargaining rounds, it is particularly positive that the social partners now perceive the inflation target to be entirely credible. The most recent quarterly survey in September shows that employees' organisations are expecting inflation in five years' time to be 2.10 per cent, while the corresponding figure for employers' organisations is 2.23 per cent.

Mr Jansson observed that it is pleasing and important that inflation expectations are rising. However, the lower than expected inflation in both August and September means that there is a risk of new falls in expectations. It should of course be mainly inflation expectations in the short term that are affected by fluctuations in the current inflation rate. But as there are signs that underlying inflation has slowed down, we cannot rule out the possibility that expectations in the slightly longer run will also be affected negatively. It is therefore important to carefully monitor the development of inflation expectations in the period ahead and to ensure that they do not start to show a falling trend again, he emphasised. This applies in particular to the more long-term inflation expectations. Having a credible inflation target as a base is very important for the 2017 wage bargaining rounds.

Mr Jansson went on to point out that, given the poorer current inflation conditions, it is now proposed in the draft Monetary Policy Report that the forecast for inflation in the coming years is revised down tangibly. As the assumption is that we are dealing with lower underlying inflationary pressures, all inflation measures are affected by the forecast revision. With regard to CPIF inflation excluding energy prices, the adjustment is largest in the middle of 2017, when it amounts to almost 0.6 percentage points. The revision to CPIF inflation is a little smaller and the largest effect comes somewhat later, towards the end of 2017. This is because energy prices are expected to increase somewhat faster than before, which affects CPIF inflation, but of course not CPIF inflation excluding energy prices. The exchange rate is now notably weaker throughout the whole forecast period than was previously assumed, but this is by no means sufficient to counteract the lower underlying inflationary pressures, he said. All in all, these forecast revisions mean that inflation is now expected to be in line with the inflation target in the middle of 2018 instead of the second half of 2017, as previously assumed.

To counteract the effects of the lower underlying inflationary pressures, and the possible negative consequences for the credibility of the inflation target, it is also proposed in the draft Monetary Policy Report that monetary policy should be made more expansionary. Mr Jansson underlined that this is done in several ways. Firstly there is a greater probability that the repo rate will be cut at the next monetary policy meeting. If the starting point is a cut in the repo rate of 10 basis points, then the probability is now twice as large as in the September forecast and amounts to 60 per cent. Secondly, the first increase in the repo rate has been postponed, until the beginning of 2018 instead of the second half of 2017. Thirdly, it is stated that the Executive Board is ready to extend the purchases of government bonds after the end of the year. He added that it is also emphasised that, in addition to these measures, there is still a high level of preparedness to make monetary policy even more expansionary if the rising trend in inflation were to be threatened.

Mr Jansson supported both the forecast and the monetary policy presented in the draft Monetary Policy Report, but wanted to elaborate somewhat on how he perceives the changes now being made to monetary policy. He said that a natural question to ask is why the Riksbank does not take the decision at today’s meeting to cut the repo rate and extend the purchases of securities. After all, it is a fact that inflation has been much lower than expected and that the downturn is broad-based. Also, the ECB has already decided to continue its purchases until March 2017 and moreover made it clear that the purchases will probably continue even longer. For his part, Mr Jansson could very well have considered taking these decisions now, at the present meeting. But at the same time, he agreed that there were advantages to waiting.

When it comes to extending the asset purchases, the Riksbank is still implementing the purchases decided on earlier and these will continue until the end of the year. It is therefore not necessary for the Executive Board to hasten a decision on further purchases, it is possible to wait while the earlier purchase programme is still going on. The major advantage of waiting is that the Board can then take a better decision based on a richer information set, not least with regard to what other central banks are doing. Another factor is that a decision on new asset purchases in 2017 would probably only help to a small extent in counteracting a negative inflation shock here and now, reasoned Mr Jansson.

Mr Jansson's conclusion was that it is best to wait and see before taking a decision on further asset purchases, and he felt that this also meant it was best to wait before cutting the repo rate. This is because there is an advantage to taking decisions on combinations of measures, as the measures jointly can be expected to have a mutual strengthening effect. For example, a new repo-rate cut creates better conditions for extended asset purchases to push down short government rates at the same time as larger purchases in turn mean that a lower repo rate can have a more tangible and broader effect on interest rates, which can be beneficial for the effects on the krona exchange rate, for instance. It is also important to remember that the Executive Board always has the possibility to take decisions between ordinary monetary policy meetings. He pointed out that, in an acute situation, it would thus be possible to decide to cut the repo rate and to extend the bond purchases before the monetary policy meeting in December.

Finally, Mr Jansson wanted to return to a question he raised at the previous monetary policy meeting, namely the real exchange rate's long-term scope for appreciation. Back at the meeting in September, he reasoned that the arguments in favour of a future appreciation of the real exchange rate have become weaker and that he therefore would not feel entirely comfortable with a development of the krona's nominal rate in line with the forecast as it was then. Although the krona forecast is now being revised in a clearly weaker direction, the overall expected appreciation during the forecast period is nevertheless roughly the same as before, 5-6 per cent. Mr Jansson said that this means that he is still doubtful over the forecast for the exchange rate, even if it is now weaker than before, and he maintains that the Riksbank needs to return to this issue as soon as possible.

Deputy Governor **Cecilia Skingsley** began by saying that she supports the draft Monetary Policy Report and the forecasts and proposals it contains. In addition, she wished to comment on the economic situation - starting with international developments in inflation in relation to developments in Sweden.

Ms Skingsley observed that inflation in Sweden has not been at the 2 per cent target since 2011. This deviation has been explained by some to be due to the earlier monetary policy, which was criticised for being too tight. Since spring 2014, inflation in Sweden has gradually moved upwards again, partly as a result of the very stimulative monetary policy. At the same time as inflation in Sweden has shown an upturn, international inflation has instead fallen. In a selection of 120 countries around the world, more than 85 per cent of them have a measured inflation rate below long-term inflation expectations. Inflation is below 1 per cent, which is lower than in Sweden, in almost half of these countries, while 20 per cent of the countries are experiencing deflation. This is according to the IMF's most recent World Economic Outlook. Despite monetary policy easing in a large number of countries, one can thus note that Sweden is not alone in dealing with the challenge of low inflation, said Ms Skingsley. She did not consider it probable that all of these countries would have conducted the wrong monetary policy, it was more likely that other forces were at work. The optimistic interpretation is that the low inflation, which is currently a world phenomenon, is mostly due to the earlier fall in the oil price and the remaining effects of the global financial crisis. A more pessimistic interpretation, which Ms Skingsley does not find improbable, is that there are deeper structural forces holding back price pressures and that monetary policy is not able to deal with this.

Internationally, there is an intensive debate on the reasons why the recovery is so slow, on the so far weak effects of economic policy stimulus, and how the division of labour should be between different policy areas going forward. Ms Skingsley did not intend to render all of the lines in the debate, but said that it was largely a question of falling real interest rates over many years, also in economic booms, having reduced the strength of the central banks' capacity for stimulation. Low long-term real interest rates are a signal, for instance, of weak growth conditions, which can seriously undermine the creation of welfare. Low interest rate are also a threat to financial stability, as they contribute to bubbles on various asset markets when investors are seeking higher yield. New financial crises are in turn even worse for growth prospects. To improve the more long-term growth conditions with the purpose of increasing the scope for monetary policy stimulus, measures are needed in political areas that are beyond the central banks' control. This entails questions, partly regarding what monetary policy can achieve and partly regarding how much a small, open economy like Sweden can deviate from the rest of the world over time. While this debate is going on, the Riksbank needs to take a new monetary policy decision.

Ms Skingsley further noted that developments in Sweden have been more or less as expected, with one exception that is very important to monetary policy: The two most recent inflation outcomes, and particularly the one for September, were a reminder that there is no reliable trend in inflation. The rate of price increase on goods has fallen back to the trend level that has applied since 2000, that is, goods prices are generally falling. Service prices have also weakened. The unexpectedly weak krona does benefit rising import prices, but on the other hand inflation abroad is low, as Ms Skingsley mentioned earlier. Of course the Executive Board has never expected a straight and simple path back to the 2 per cent target, but has long been prepared to take further measures. Nevertheless, the deviations in relation to the Riksbank's forecast can only be described as temporary to a small extent, and it is worrying that the setbacks were in several different services, so it is difficult to explain the development and we cannot expect to reverse it. Ms Skingsley said that this strengthens her in her opinion that the Executive Board did the right thing in setting a negative interest rate from the beginning of 2015 and making a number of asset purchases to hold interest rates down and in this way support resource utilisation. In an elusive inflation environment with declining inflation expectations and if one is serious about the price stability target for monetary policy, it would not have been appropriate to wait and see and hope that a policy rate of, say, zero would have been sufficient, she said.

Prior to today's meeting, the decision has mainly been a question of whether and if so, to what extent, monetary policy needs to be made more expansionary. Given the downward revision to the inflation forecast, Ms Skingsley found it reasonable to also adjust the repo-rate path and postpone the first repo-rate increase. On the other hand, she considered, in line with the report, that there is scope to wait for a while before deciding whether to extend the asset purchases. Ms Skingsley has previously said this year that she is prepared to support further monetary policy easing only if significant revisions are made to the forecasts. This assessment was also based on the assumption that the international recovery would continue. With time, however, she has become less convinced of the strength of the international recovery. The more time that passes with a weak recovery abroad, the more important it is to supplement the expansionary monetary policy with a broad economic policy reform work, with the aim of improving growth prospects. This will not be achieved with any individual reforms and not by any individual country, but requires efforts from many directions.

With regard to Sweden, the economic prospects are still favourable, said Ms Skingsley. But Sweden also needs to make an effort. The IMF’s Concluding statement from the Article IV-consultation supports the low-interest rate policy but also gives the clear advice that Sweden needs to improve its housing market and put greater financial effort into integrating new arrivals. For instance, there is a recommendation that municipalities make greater efforts with regard to education and the IMF says that there is scope for this given the medium-term economic prospects. Going forward, both Sweden and a number of other countries need an appropriate combination of structural policy, fiscal policy and monetary policy. It will require an overall approach if it is to be possible to once again increase potential growth and raise global real interest rates again and in this way give monetary policy greater room for manoeuvre to carry out its tasks and attain price stability, concluded Ms Skingsley.

Deputy Governor **Henry Ohlsson** began by saying that he supports the proposals to hold the repo rate unchanged at –0.50 per cent and to shift the repo-rate path forwards. Furthermore, he considered that the asset purchases should continue until the end of the year according to the plan previously adopted.

Mr Ohlsson then went on to comment on a number of important real economic indicators. He noted that GDP in Sweden is now growing rapidly. It is true that there has been a slowdown in growth over the current year, according to the latest quarterly outcome. But calendar-adjusted growth will amount to about 2.4 per cent per year in 2017 and 2018 according to the forecast in the draft Monetary Policy Report. The labour force surveys (LFS) for September 2016 report an unemployment rate of 6.1 per cent (not seasonally adjusted). This represents a fall of 0.6 percentage points compared to the corresponding month last year, Mr Ohlsson noted. In Mr Ohlsson's opinion, however, unemployment is still too high. There are also major differences between different groups. Those born abroad have it significantly tougher on the labour market than those born in this country. Unemployment insurance fund members can be considered to have a relatively strong position on the labour market. The proportion of openly unemployed members of unemployment funds was around 2.3 per cent in September. This proportion has certainly decreased over the year, but only marginally. The percentage of unemployed members of unemployment funds has not been so low since before the financial crisis, observed Mr Ohlsson. The conclusion from these indicators, in his opinion, is that overall resource utilisation in the Swedish economy is now up on normal levels and can be expected to be even higher in the next few years.

The most recent measurement in October showed the expected annual rate of inflation five years ahead to be 1.9 per cent, according to money market participants. It is satisfying that these expectations are now basically back on the inflation target, said Mr Ohlsson. At the same time, we can also see that inflation expectations one and two years ahead are showing a rising trend but are still below the inflation target.

Inflation should rise as resource utilisation increases. However, the most recent measurement is a disappointment; in September the CPIF showed an annual rate of increase of 1.2 per cent. However, the monthly measurements are substantially affected by temporary factors. The measurements are varying in an irregular manner. In some months, the outcomes are higher than expected, and in other months they are lower. The trend for the inflation rate is nevertheless still rising, in any case according to some measures. The question is whether the historical correlations between resource utilisation and inflation are no longer valid. It is very important to examine this closely, said Mr Ohlsson. The inflation target is a cornerstone of economic policy. He pointed out that it is important for the credibility of monetary policy that we attain the target.

Mr Ohlsson's monetary policy conclusion was that the repo-rate path must be shifted so that the first increase of the repo rate is postponed. According to the new repo-rate path, the increases in the repo rate will begin in early 2018. Otherwise, he considered that potential further monetary policy measures could wait until the monetary policy meeting in December. This is emphasised by the fact that the asset purchase programme decided on earlier runs until the end of the year. In December we will also have further information such as some further months' outcomes for domestic macroeconomic key variables and, internationally, monetary policy decisions by important central banks.

Mr Ohlsson considered it to be an entirely open question at present whether it was desirable to continue with new bond purchases during 2017. He considered it important in this context to mention the Executive Board's earlier decision to reinvest maturities and coupon payments on the government bond portfolio. During 2017, these will amount to around SEK 30 billion.

Mr Ohlsson felt it was also an open question as to whether the repo rate should be cut further. He considered there to be strong indications that the repo rate is no longer such an effective tool as it was earlier. Global real interest rates are very low, which is a significant restriction for monetary policy. This is the result of a high level of global saving meeting weak investment demand. The disadvantages of low and negative policy rates also become increasingly clear as time passes. This must be weighed against the advantages of low and negative policy rates, considered Mr Ohlsson.

To summarise, Mr Ohlsson supported the proposal to postpone the first increases in the repo rate until early 2018. Furthermore, he considered that asset purchases should continue according to the plan previously adopted. Finally, Mr Ohlsson said he supported the draft Monetary Policy Report.

Governor **Stefan Ingves** began by noting that real economic developments in Sweden and abroad had been in line with the Riksbank's forecasts in the September Monetary Policy Report. The assessment of growth prospects remains largely unchanged. However, in Sweden inflation has slowed down in recent months, after rising since early 2014, and of course this is a disappointment. The situation is very unusual, said Mr Ingves, and thought that the Riksbank now needs to provide strong support for the upturn in inflation in Sweden, in a situation where economic activity is good and international inflation is low but expected to rise. It is a special challenge in Sweden to maintain both inflation and growth higher than the European average. But so far we appear to be managing it, partly because growth conditions are better in Sweden than in many European countries that still need to adapt after the crisis.

The forecast for GDP growth for the countries that are most important for the Swedish economy (KIX weighted), is largely unchanged compared with the forecast in September. Growth is expected to rise slowly during the forecast period from 2.0 per cent this year to 2.3 per cent in 2019. Inflation abroad has been low for a long time. In the near term, however, rising energy prices are expected to contribute towards some increase in inflation. Resource utilisation is also expected to rise, which will contribute to rising prices. Inflation abroad (KIX-weighted) is expected to be 1.1 per cent in 2016, 2 per cent in 2017 and then to increase slowly during the forecast period to just over 2 per cent in 2019.

For Sweden's part, resource utilisation in the economy is roughly normal at present, noted Mr Ingves. In the years ahead, monetary policy will continue to be expansionary, which means that both GDP and the number of hours worked will increase more quickly than trend. This means that resource utilisation will rise and be higher than normal. Inflation has been rising since the beginning of 2014, and long-term inflation expectations are close to 2 per cent. However, the inflation outcomes for both August and September were lower than was forecast in September. This entails increased uncertainty about how rapidly inflation will rise going forward. The subdued inflation in Sweden is probably affected by developments abroad, which are also marked by low inflation. Nevertheless, growth in Sweden has been high, or very high, and the labour market has improved over a number of years. This should give good conditions for inflation to rise.

Mr Ingves pointed out that the Riksbank, given the weak inflation outcomes in recent months, has on the whole revised down the forecast for inflationary pressures in the coming years. Service prices in particular have increased at a slower pace than expected. This indicates that the underlying inflationary pressures are somewhat weaker than the Riksbank has estimated and the assessment now is that it will take longer for inflation to reach 2 per cent. Inflation is now expected to reach 2 per cent in the middle of 2018, measured in terms of both the CPI and the CPIF.

Mr Ingves further noted that it is uncertain how quickly resource utilisation will affect inflation and how large the effect will be, and he pointed out that the draft Monetary Policy Report contains an article on this subject. The analysis there indicates that the link between resource utilisation and inflation has been fairly stable in recent decades. This indicates that rising resource utilisation will contribute to inflation rising in the way the Riksbank is forecasting. At the same time, it is important to note that inflation expectations, as measured by Prospera, have increased since early 2015. This contributes to the inflation target functioning as an anchor for the Swedish economy in the longer run, even in times of structural change in the economy.

The krona exchange rate is another important factor that affects inflation. So far this year, the exchange rate has been weaker than expected and the Riksbank is now expecting a somewhat weaker krona rate during the forecast period than in the September forecast. However, the Riksbank still assesses that the exchange rate will gradually strengthen going forward. An overly rapid appreciation of the krona could lead to prices of imported goods and services increasing more slowly. Such a development would make it more difficult for the Riksbank to bring up inflation. Mr Ingves assessed that the Riksbank needs to be prepared to return to an analysis of how the impact of exchange rates changes on inflation works in practice. This applies in particular during times of structural transformation, with a slower growth in world trade and an increasing exports/imports of services.

All in all, it means that the upturn in inflation still needs strong support. Mr Ingves supported the proposal at today's monetary policy meeting to hold the repo rate unchanged −0.50 per cent, where the first increase is expected to be six months later than was assumed in the September Monetary Policy Report. The probability of a further cut in the repo rate in December is now greater than before. This means that the repo rate is held at the current level or lower until early 2018. The purchases of nominal and real government bonds will continue so that these amount to SEK 245 billion at the end of 2016. Until further notice, maturities and coupon payments will also be reinvested in the government bond portfolio. During 2017, these will amount to around SEK 30 billion.

Prior to the monetary policy meeting in December, Mr Ingves said that he is also prepared to extend the purchases of government bonds. He consider the asset purchase programme to have been successful and an important component in the monetary policy now being conducted. As the current asset purchase programme runs to the end of the year, the Riksbank can await further information on inflation, economic activity and see how other central banks act to calibrate an appropriate continuing policy.

Mr Ingves pointed out that it is important to follow the decisions taken by the Federal Reserve and the ECB in the coming months. If the Federal Reserve raises its policy rate and if inflation rises in the euro area, the probability that the Riksbank's strategy will stand firm increases. Otherwise, the Riksbank needs to be prepared to take a new stance some time next year and be prepared to take further measures to safeguard the inflation target. The Riksbank has in earlier reports described a catalogue of measures that are possible to use, if necessary.

The expansionary monetary policy in Sweden and other countries is necessary in order to stimulate economic growth and counteract the risks of excessively low inflation. But we also know that low or negative interest rates can contribute to increased risk taking in the economy, highly-valued assets and increased indebtedness, which contribute to increased vulnerability in the financial system. A central issue for many countries within the EU is how lasting the low interest rate situation will be. For example, a scenario where interest rates and GDP growth remain low for a long time is conceivable, while another possible scenario is that interest rates gradually rise towards normal levels.

In the first case, there are clear risks to financial stability resulting from a profitability squeeze, said Mr Ingves, with increased vulnerability and a high degree of risk-taking in the financial sector. Financial institutions with long-term and guaranteed commitments such as life insurance companies and pension funds can become particularly vulnerable if they do not review their business models. European banks with poor profitability become even more vulnerable than they are now through reduced net interest income and reduced lending. If interest rates instead begin to rise gradually, the financial stability risks need not be as great as in the first scenario, if the interest rate is raised as a result of resource utilisation and inflation increasing. Rising GDP growth can then contribute to reducing the vulnerability of the financial system.

Mr Ingves said that one important conclusion is that the authorities in the EU with responsibility for macroprudential policy need to take into account the expansionary monetary policy and low interest rates in their work on implementing new regulatory frameworks with regard to life insurance companies and pension funds.

Here in Sweden there remain risks on the housing market. We all know that the valuation of the Swedish housing market is high from a historical perspective. At the same time, households' debts are expected to continue rising during the forecast period. High housing prices and households' rising indebtedness will contribute to high risks in the economy. Mr Ingves pointed out that he has said it before but that it is worth repeating. The expansionary monetary policy presupposes that the risks on the housing market are managed by other policy areas. Finansinspektionen has taken some measures, but more is required to mitigate the risks. It is essential to implement targeted measures within macroprudential policy, housing policy and fiscal policy to limit the accumulation of debt by households. Without such measures there are clear risks to long-run economic stability in Sweden, concluded Mr Ingves.

§3. Discussion

Deputy Governor **Martin Flodén** started the discussion by commenting on the statements by Ms Skingsley and Mr Ohlsson. Mr Flodén said that Mr Ohlsson's question about whether the relationship between resource utilisation and inflation has weakened is, of course, important. However, at the same time, he doubts whether we will ever be able to answer it in real time. This is because the relationship has never been strong, clear or immediate. So analyses of the relationship demand quite a lot of historical data and it will probably not become possible to see if the relationship has changed until afterwards, said Flodén.

However, he went on to say that the studies carried out, for instance in Sweden in the article in the Monetary Policy Report, and for a large number of countries in the IMF's latest World Economic Outlook, do not indicate that the relationship has changed. On the contrary, they highlight weak resource utilisation as an important explanation for the low inflation in recent years.

Then of course resource utilisation is not the only factor affecting the development of inflation. Other important factors include the credibility of monetary policy, for instance, as captured by inflation expectations, and developments in the exchange rate and global prices. The IMF study also indicates that the expectations of central banks' capacity to influence inflation are hampered by policy rates close to their effective lower bounds. Inflation expectations then appear to be affected more by actual inflation, which could imply that low inflation becomes more persistent.

This also ties in with Ms Skingsley's comments, said Mr Flodén. His impression was that Ms Skingsley doubted the ability of monetary policy to influence inflation, as inflation has become low in almost all countries. Mr Flodén argued that one could nevertheless see that monetary policy and other economic policy has had an effect. One example is the United States, where monetary policy during and after the financial crisis was more clearly and systematically expansionary than in many European countries, and where they were moreover quicker to recapitalise the banking system. There, they managed to avoid underlying inflationary pressures falling too far. They are now in a situation where the policy rate has already been raised and where further increases are expected, while we in Europe still see a need for continued, and perhaps extended, monetary policy measures.

Mr Flodén noted that Ms Skingsley had highlighted in her contribution to the debate the need for fiscal policy measures through both economic stimulus and structural reforms in Sweden and other countries. Given this, Mr Flodén said that it was unclear to him whether the need for such policies in Sweden was motivated by the Riksbank needing help to bring up inflation or whether the motive was a more general need to improve either economic activity or the Swedish economy's long-term growth potential.

Deputy Governor **Henry Ohlsson** then responded to Mr Flodén's question. He said that when the Riksbank's assessments prove to be incorrect, we must dare to ask why. We must also dare to ask whether there are other approaches than those so far used to analyse questions such as the link between resource utilisation and inflation. If everyone uses the same approach it is not so strange that one reaches similar conclusions. Mr Ohlsson considered there was a lot to be gathered from studying cross-section information with the aid of microdata instead of studying aggregate time series. He felt that we must come closer to understanding which factors are decisive for the people who actually set prices. Mr Ohlsson considered that the most recent Business Surveys by the Riksbank have made promising attempts to come closer to these issues.

Deputy Governor **Cecilia Skingsley** returned to Mr Flodén's comments regarding the functioning of monetary policy. With regard to the extensive monetary policy stimulus in many countries she assessed that it has led to better recovery potential than if the stimulus had not been done. She agreed with the assessment that there was still a link between monetary policy, resource utilisation and inflation. On the other hand, she questioned how strongly and quickly monetary policy could have an impact and said that she was not alone in doing so. The fact that we have recurring expansions and extensions to various expansionary measures both in Sweden and abroad is a sign that the effects have been weaker than expected. She said that one can of course, as Mr Flodén described in his first statement, wish that there was still a substantial scope for monetary policy expansion, but her assessment is that further repo-rate cuts in Sweden, for instance, would have very little impact on interest rates in the economy.

In the prevailing international situation, on which developments in Sweden are dependent, it is therefore necessary to have a broader reform work, according to Ms Skingsley, which covers both structural policy and fiscal policy as well as monetary policy to improve the long-run global growth conditions.

With regard to Ms Skingsley's view of Sweden's part in this, she views the IMF's recommendations with regard to housing policy and efforts to attain better integration as examples of economically possible reforms. They are justified not primarily to facilitate a faster recovery in inflation, but because Sweden also needs to improve its long-term growth conditions when international growth is as weak as it appears to be, both in the short and long term.

Governor **Stefan Ingves** agreed with Mr Flodén that shifting the repo-rate path forward so that the first increase in the repo rate is postponed is more a case of making a good forecast than changing the stance of monetary policy. He also agreed with Mr Jansson regarding the composition of monetary policy. Mr Ingves considered it most appropriate to think of monetary policy as a combination of measures rather than a set of individual ones.

Finally, Mr Ingves commented on Mr Flodén's discussion of the banking sector's significance for monetary policy and how problem banks are managed in other countries. Mr Ingves observed that if the transmission mechanism does not function properly, this will entail problems for monetary policy. Well capitalised banks lend money while poorly-capitalised banks do not. He said that there is thus a high return on resolving the problems in the banking sector and he considered it regrettable that the euro area was opposed to recapitalising the banks.

Governor **Stefan Ingves** then summarised the discussion. He noted that the Executive Board was unanimous on the picture of economic developments and the outlook for inflation described in the draft Monetary Policy Report. Since the monetary policy meeting in September, real economic developments in Sweden and abroad have been largely in line with the Riksbank's forecasts. The recovery abroad is continuing at a fairly moderate pace and inflation is rising from a low level, supported by very expansionary monetary policy. However, international developments are still marked by uncertainty.

Monetary policy has contributed to strong economic activity in Sweden and to a rise in inflation and inflation expectations. The conditions are good for a continued rise in inflation. However, the weak inflation outcomes in recent months illustrate the uncertainty over how quickly inflation will rise. The Riksbank now assesses that it will take longer for inflation to reach 2 per cent. The upturn in inflation therefore needs continued strong support.

The Executive Board were unanimous that the repo rate should be held unchanged at –0.50 per cent and assessed that it needed to remain at this level for six months longer than was forecast in September. The probability of the repo rate being cut further has also increased.

The Riksbank will continue buying government bonds during the second half of 2016 in accordance with the plan the Executive Board decided on in April. Until further notice, maturities and coupon payments on the holdings in the government bond portfolio will be reinvested. Moreover, prior to the monetary policy meeting in December, the Executive Board is ready to extend the bond purchases, but as the current programme runs until the end of the year, there is scope to await further information that can affect the decision.

The recent developments in inflation were also discussed at the meeting. The relationship between resource utilisation and inflation was also mentioned. It was noted that the Swedish economy is better-equipped now than it was one year ago, with stronger economic activity, higher inflation and inflation expectations close to 2 per cent. But Sweden is a small, open economy and we therefore need to relate to what is happening in the world around us. Events there can lead to monetary policy needing to be adjusted to safeguard the upturn in inflation. Moreover, concerns were expressed regarding the growing household indebtedness and it was pointed out that there is still a need to combine measures within different policy areas to obtain a long-run sustainable economic development in Sweden. In addition, there were comments on various aspects of the formulation of monetary policy.

§4. Decision on the Monetary Policy Report and the repo rate

The Executive Board decided

• to adopt the Monetary Policy Report according to the proposal, Annex A to the minutes, and

• to hold the repo rate at –0.50 per cent,

• to publish the Monetary Policy Report and interest rate decision above with the motivation and wording contained in a press release at 9.30 a.m. on Thursday 27 October 2016, and

• to publish the minutes of today's meeting on Wednesday 9 November 2016 at 9.30 a.m.

This paragraph was verified immediately.

Minutes taken by

Sophie Brauner

Verified by:

Stefan Ingves	Martin Flodén	Per Jansson
Kerstin af Jochnick	Henry Ohlsson	Cecilia Skingsley

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