Minutes of monetary policy meeting

FEBRUARY 2014

Summary

At the monetary policy meeting on 12 February, the Executive Board of the Riksbank decided to leave the repo rate unchanged at 0.75 per cent and to not change the forecast for the repo-rate path adopted at the monetary policy meeting held in December.

It was noted at the meeting that the Executive Board agreed on the picture of economic prospects and the inflation outlook described in the draft Monetary Policy Report. The economic prospects and the inflation outlook in Sweden and abroad are well in line with the assessments in the December Monetary Policy Update. After just over a year of weak GDP growth, the prospects look good for 2014. Economic activity is strengthening abroad, the confidence of Swedish households and companies is higher than normal and employment is increasing. GDP growth is expected to pick up during the year and there will be a rather tangible improvement on the labour market by the end of the year.

Despite the improvement in economic activity, inflation is expected to remain low in the year ahead. Once international and domestic demand strengthens, however, there will be a gradual increase in inflationary pressures and CPIF inflation is expected to reach 2 per cent in 2015. The low inflationary pressures justify the continued conduct of an expansionary monetary policy. At the same time, the indebtedness of Swedish households is still high and is expected to increase somewhat during the forecast period, a factor that continues to pose a risk to long-term sustainability. Several policy areas need to cooperate to reduce the risks linked to indebtedness.

Given the low inflationary pressures, all of the members of the Executive Board considered that it was appropriate to leave the repo rate unchanged at 0.75 per cent until the recovery reaches firmer ground and inflation picks up. According to the forecast, it will be appropriate to begin slowly raising the repo rate in early 2015. In this way, monetary policy will contribute to CPIF inflation reaching 2 per cent in 2015.

Other topics discussed at the meeting were the need for further analysis of the low inflationary pressures and the need to adjust monetary policy if the development of inflation proves to be weaker than in the forecast. The effects of the exchange rate on inflation were also discussed in connection with this. The discussion also touched upon aspects of conducting monetary policy in a small, open economy with substantial capital flows, extensive imports and exports and a high level of household indebtedness. The need to implement macroprudential policy measures was emphasised. Global risks to economic development stemming from financial unease relating to imbalances in certain emerging economies were also discussed.

MINUTES OF MONETARY POLICY MEETING
Executive Board, No. 1

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DATE: 12 February 2014

TIME: 09.00

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

Hanna Armelius
Meredith Beechey Österholm
Claes Berg
Charlotta Edler
Mattias Erlandsson
Eric Frieberg
Kerstin Hallsten
Mia Holmfeldt (§ 1)
Ann-Christine Högberg
Martin W Johansson
Lisa Marklund (§ 1)
Ann-Leena Mikiver
Marianne Nessén
Bengt Pettersson
Marcus Pettersson (§ 1)
Maria Sjödin
Ulf Söderström
David Vestin
Anders Vredin
Fredrik Wallin (§ 1)

It was noted that Hanna Armelius and Bengt Pettersson would prepare draft minutes of § 3 and 4 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 the Monetary Policy Update was published in December, the situation has been marked by unease about economic developments in a number of emerging economies. However, this unease has diminished in recent weeks and uncertainty, measured as volatility on the stock and bond markets in the United States, has declined. Share prices have also risen around the globe in connection with this decline in uncertainty. The Swedish krona has strengthened in trade-weighted terms since December. Analysts believe that the repo rate and the repo-rate path will be left unchanged at today's meeting. These expectations can also be discerned in market pricing and survey responses.

Lisa Marklund of the Financial Stability Department gave an account of recent developments in Sweden and the United States with regard to government bond yields and access to funding, profitability and capital ratios for Swedish banks.

Marianne Nessén, Head 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 27 and 28 January and on 3 February. The draft Monetary Policy Report was tabled at a meeting of the Executive Board on 6 February.

Economic developments in Sweden and abroad have been roughly in line with the forecasts made by the Riksbank in connection with the previous monetary policy decision in December. New statistics received since the December meeting support the picture of a continued gradual recovery in the global economy, although the situation of a number of emerging economies has deteriorated. The currency turbulence that has arisen has had limited contagion effects on the rest of the global economy. The krona has strengthened in trade-weighted terms, while interest rates for households and companies in Sweden have fallen slightly. Credit growth is relatively unchanged. Expectations of Swedish monetary policy are relatively unchanged compared to those in December. Indicators for the Swedish economy suggest that the general mood is better than normal. However, figures for business-sector production and household consumption were somewhat weak in December. Unemployment was 7.9 per cent in the fourth quarter, in line with the forecast in the December Monetary Policy Update. In the forecast in the draft Monetary Policy Report, a more marked decrease in unemployment is not expected until the end of this year.

The forecast for GDP growth in Sweden in the fourth quarter of last year has been revised downwards slightly, while the forecast for the first quarter of this year has been revised upwards somewhat. The forecast for unemployment in the years ahead has been revised upwards as the forecast for the supply of labour has been revised upwards. The forecast for household debt as a percentage of household disposable income has been revised upwards. Incomes are expected to increase somewhat more slowly going forward and the statistics for debts in 2013 have been revised upwards in the Financial Accounts.

Inflation is still low both in Sweden and abroad. The outcome for the CPI in Sweden in December was somewhat higher than expected in the forecast in the December Update. The near-term inflation forecast has therefore been revised upwards somewhat, while the forecast for 2015 has been revised downwards somewhat as a result of the strengthening of the krona that has taken place. Given the expected ongoing improvement in global economic activity, it is predicted that GDP growth will pick up in Sweden. Increased resource utilisation will thus contribute to CPIF inflation rising to 2 per cent in 2015.

Given the low inflationary pressures, monetary policy needs to remain expansionary for CPIF inflation to rise to 2 per cent, according to the draft Monetary Policy Report. The assessment is that the repo rate will remain at 0.75 per cent for around one year. It is predicted that the Riksbank will begin to slowly raise the repo rate in early 2015. Inflation will then have picked up and the recovery will be on firmer ground. The repo rate will be at 2.7 per cent at the beginning of 2017.

§2. The economic situation and monetary policy

Deputy Governor **Martin Flodén** began by pointing out that incoming economic statistics largely support the forecast made by the Executive Board in connection with the monetary policy meeting in December. He therefore saw no reason to change the repo rate at today's monetary policy meeting. He thus supported the decision to leave the repo rate and the repo-rate path unchanged. He also supported the forecast for the general development of the economy presented in the draft Monetary Policy Report.

The largest deviation from the December forecast probably relates to the strong development of the krona. The development of the exchange rate means that the inflation forecast is as low as in December, despite the fact that other new information on the development of the Swedish economy has mostly been positive. He therefore thought, as at the previous monetary policy meeting, that lowering the repo rate to 0.50 per cent was an alternative that must be considered.

A lower repo rate would bring CPIF inflation closer to the target in the years ahead. However, in contrast to the situation at the monetary policy meetings held some quarters ago, it is no longer entirely clear that a repo-rate cut would entail better balanced resource utilisation going forward, which among other things can be seen in Figures 2:14 and 2:18 in the draft Monetary Policy Report. The good preconditions that are already in place for a recovery indicate that the timing is wrong for making monetary policy even more expansionary.

Mr Flodén reminded the meeting that he had previously argued that the low inflation of recent years makes it increasingly important to ensure that inflation does not become entrenched at a level far below the target of 2 per cent. It is therefore possible to argue that monetary policy should be designed with an extra focus on avoiding low inflation. On this basis one could find arguments in favour of a cut today, although the Executive Board expects to see positive economic developments in the period ahead.

Nevertheless, Mr Flodén said that an unchanged repo rate appeared to be the most appropriate decision today. But he pointed out, as at the previous meeting, that not much new negative information is needed for him to advocate a repo-rate cut at the next monetary policy meeting. By negative information he meant particularly information that would lead to a lower forecast for future inflation.

Finally, he wished to comment on how the repo-rate decision and the repo-path relate to the risks associated with household indebtedness. The draft Monetary Policy Report says that the the repo-rate path takes such risks into account. Mr Flodén said that monetary policy cannot take such factors into account over a long period of time, at least not if this means that inflation deviates from the target for many years. Tools or measures other than the repo rate must then be used to counteract the development of a worryingly high level of indebtedness. The fact that he supported the repo-rate decision and the repo-rate path presented in the draft Monetary Policy Report thus meant that he believed the repo-rate path in the draft Report to be well balanced even if one does not allow monetary policy to be affected by risks associated with household indebtedness.

Deputy Governor **Cecilia Skingsley** began by saying that she supported the picture of economic developments, the assumptions and the forecasts presented in the draft Monetary Policy Report. Since the Monetary Policy Update was published in December, the economic recovery has continued more or less as expected. One element of international uncertainty that has increased since the monetary policy meeting in December is the financial turbulence that has arisen in connection with developments in a number of emerging economies. Falling exchange rates and interest rate movements of course have consequences for several of these countries, but given developments so far it is reasonable to assume that this will not have any significant impact on the Swedish economy.

Ms Skingsley therefore went on to speak about the Swedish economy. There has been a general improvement in confidence indicators among companies and households. She particularly noted the fact that the latest Business Survey conducted by the Riksbank shows that companies believe that risks concerning the development of the economy have weakened significantly, which should make a positive contribution to growth prospects in the period ahead.

In Sweden, the households continue to act as an engine in the economy, but a gradual improvement abroad is also helping to improve conditions for the Swedish economy. Export market growth, that is the demand for imports in the most important countries for Swedish exports, has begun to increase again and Swedish exports should pick up in the period ahead.

Ms Skingsley also noted that the decline in industrial production seems to have bottomed out and that there is a slight upward trend again. However, this is a question of a movement from very low levels. Surveys of the companies' employment plans indicate mixed, but mainly positive, tendencies for the labour market. The number of redundancy notices is still low and the number of newly-registered vacancies is at a rather high level in a Swedish perspective.

She wished to point out that all of the circumstances relating to the state of the economy she had now mentioned were within the scope of what was expected in the forecast for the development of the economy in the Monetary Policy Update published in December. Here assessment was therefore that the risk outlook in the forecast in the draft Monetary Policy Report was well balanced. As inflation has been low for some time, it is important to use monetary policy to support the recovery and to work for a rate of inflation in line with the inflation target. The repo-rate path is low for a long time with the aim of attaining the inflation target within a period of two years.

The forecast for the trade-weighted krona exchange rate in accordance with the trade-weighted KIX index has been revised in the draft Report. Contrary to the forecast in December, when a slight weakening of the krona was expected to follow the repo-rate cut and the downward adjustment of the repo-rate path, the krona has strengthened instead. Ms Skingsley said that this could serve as an illustration of the fact that in a small open economy like the Swedish economy it is difficult for monetary policy to have any substantial impact on the exchange rate. A marginal downward revision of the inflation forecast for a year ahead has been made in the draft Report. She said that this could be a reason for lowering the repo-rate path by a few basis points, but her assessment was nevertheless that the revision of the forecast for inflation was too small to require any further adjustment of the repo-rate path.

Ms Skingsley emphasised in this context that she felt it was important to conduct further analyses of the reasons for the low rate of inflation. She did not believe that this could be solely regarded as an expression of low demand. Growth in Swedish household consumption is high, redundancy notices are limited, the companies' employment plans indicate increases and the number of new job vacancies is rising. The reasons for the low rate of inflation must therefore be sought by taking a wider view. The fact that some major economies are still experiencing low demand as a result of the financial crisis is helping to keep global price pressures low. However, there are also good reasons for conducting a more in-depth analysis of the situation in Sweden. Ms Skingsley pointed out that at the monetary policy meeting in December she took up the hypothesis of a more flexible supply side in the production of services, and the fact that services, like goods, have a growing element of international determinants, which may be one explanation of the low rate of inflation. She said that it was important to analyse why inflation is so low in more detail. This applies in particular to the ability of the companies to set prices. The Riksbank has previously made great advances in this field of analysis and she though that it was time for an update.

Ms Skingsley reminded the meeting that one of the Riksbank's tasks as a central bank is, without setting aside the inflation target, to support the general objectives of economic policy with the aim of achieving sustainable growth and high employment. Given the Executive Board's responsibility to contribute to a long-term sustainable development of the economy, Ms Skingsley welcomed the publishing of analyses of the risks associated with household balance sheets and the effects of monetary policy on household indebtedness. She noted that on the basis of the analysis in the article in the draft Report there is a link between the level of the interest rate and debts. The next step is to determine how much this in turn can affect the risks of unfavourable outcomes in the future and the costs of a financial crisis.

She welcomed the work in the new Financial Stability Council and the recent meeting at which representatives of the Riksbank, Finansinspektionen, the Ministry of Finance and the National Debt Office discussed financial-stability issues. Work is underway to implement an international regulatory framework for macroprudential policy indicators and instruments. Sweden also faces the challenge of continuing the more operational work of analysing and developing measures to avoid the risks posed by household indebtedness while at the same time maintaining an economy that is sustainable in the long term.

This work is full of challenges, both nationally and internationally. Most of the macroprudential instruments that have been developed are untried and untested, and an extensive international regulatory framework will also set conditions for the measures adopted in Sweden. But there are also purely domestic challenges. She mentioned the difficulty of reaching consensus, both on the extent of the problems and on the most appropriate measures. However, Ms Skingsley said that it is positive that the work is progressing, that the division of responsibility between the authorities has been made clear and that viewpoints can be presented in published minutes.

Deputy Governor **Karolina Ekholm** began by saying that she shared the view presented in the draft Monetary Policy Report that the economic prospects were largely unchanged compared to the Monetary Policy Update that was published in December. She noted that no new information had been received that significantly altered the view of the economic outlook the Executive Board had in December. Forward-looking indicators for the Swedish economy are relatively strong and point to a clear recovery, while actual outcome data is still somewhat disappointing. It appears that industrial production remained practically unchanged in the fourth quarter of 2013 and, as mentioned by Marianne Nessén, figures for services production have been weaker than expected. The figures for inflation in December were actually marginally higher than expected, but this does not change the picture of very low inflationary pressures. The krona has strengthened since the monetary policy meeting in December, which was not forecast and is a factor that holds back inflation through lower import prices.

For a central bank with an inflation target the low rate of inflation is of course troublesome. Rising resource utilisation in the period ahead should eventually lead to a rising rate of inflation. However, as inflation abroad is expected to be relatively low in the period ahead – above all in the euro area – domestic resource utilisation will need to rise to such an extent that it really drives up the rate of increase in wages and prices if we are to attain an inflation rate of 2 per cent. This also presupposes that the exchange rate is not persistently strengthened to a level beyond that forecast in the draft Monetary Policy Report.

Ms Ekholm believed that the low rate of inflation has become something of a risk factor that needs to be dealt with as such in the monetary policy decision. Getting inflation to rise relatively quickly towards the target is important in order to retain confidence in the inflation target. It is also important to avoid the risk of an unforeseen negative development of economic activity, or of an unforeseen strengthening of the krona, pushing down inflation to a level where it actually leads to significant real economic costs. In a situation in which household debts are high, a certain level of inflation is required to reduce the real value of the debts and to reduce the level of debt in relation to disposable incomes. Getting inflation to rise towards the target is therefore also important to counteract financial imbalances linked to household indebtedness.

Today's decision entails taking a stance on whether the proposal to leave the repo rate and the repo-rate path unchanged will be sufficient to bring inflation up to 2 per cent quickly enough to manage these risks. Ms Ekholm considered that this was the case in December when the Executive Board lowered the repo-rate path to the one that, according to the proposal, should now be left unchanged. As there has been no significant change in the economic prospects there are no obvious reasons for thinking differently at the moment. However, she pointed out that she was clear in December that she thought there were in principle good reasons for an even larger repo-rate cut. In her opinion, therefore, the alternative of a lower repo rate and an even lower repo-rate path still needed to be considered carefully.

From the analysis of alternative repo-rate paths in Chapter 2 of the draft Monetary Policy Report one can conclude that a lowered repo rate would constitute a better-balanced monetary policy in the sense that it would better stabilise CPIF inflation around 2 per cent and resource utilisation around a long-run sustainable level. Although resource utilisation measured in other ways than by unemployment tends to be "too" strong with a lower repo rate towards the end of the forecast horizon, her view was that there is no risk of overheating in the Swedish economy and that a lower repo rate can therefore be expected to provide better target attainment as it should lead to a more rapid rise in inflation.

Despite this, she supported the proposal for an unchanged repo rate at today's meeting. She pointed out that in order for her to advocate a further repo-rate cut in a situation in which the economy is recovering there would need to be incoming information that led to a further downward revision of inflationary pressures. Such information has not really appeared between December and now, even though the stronger exchange rate has led to a marginal downward revision of the inflation forecast further ahead. However, she said that if it turns out that inflation is significantly lower or the exchange rate significantly stronger than forecast, then it is highly likely that she will advocate further repo-rate cuts.

The exchange rate, in particular, is a critical part of the forecast as trend movements in the exchange rate can have a major impact on inflation. In her opinion, there has been tension between the repo-rate path and the exchange rate forecast recently. The repo-rate path has implied a much larger interest rate differential in relation to the rest of the world during the later part of the forecast period than has been expected by the market, and she found it hard to believe that a large, unexpected increase in the interest rate differential could go hand in hand with with an exchange rate that does not change very much. Following the downward revision of the repo-rate path in December this tension has eased somewhat, but is still there. The difference between the Riksbank's forecast interest rate differential in relation to the rest of the world and market expectations based on implied forward rates has decreased by one or two tenths of a percentage point, but is still rather substantial. Ms Ekholm said that this is not primarily a question of implied forward rates being generally depressed but rather of market participants assuming that the Swedish policy rate cannot differ too much from policy rates abroad, probably because they expect that this would give rise to movements in the krona that are not compatible with a reasonable target attainment.

Her assessment was, as in December, that the repo-rate path is still somewhat too steep to be realistic. However, nor did she think it was realistic to believe that the repo rate would be significantly lower than the level of 2.7 per at which the path now ends in early 2017 if the forecast holds good and CPIF inflation is then at 2 per cent and unemployment at just under 6.5 per cent. She would actually prefer to cut a few tenths from the end of the repo-rate path, but as in December her assessment was that the differences of opinion about this are too small to justify a reservation. She therefore supported the proposed repo-rate path this time too.

In conclusion, Ms Ekholm wished to comment on what had been said about how household indebtedness should be taken into account in today's monetary policy decision. She made it clear that she believes monetary policy should not be used to manage potential risks relating to household indebtedness in a situation where inflation is below the target and has been so for rather a long time. She said that holding up the repo rate in order to dampen the growth of debt in such a situation risked undermining confidence in the inflation target. She did not really buy into the description of this as a trade-off between attaining the inflation target in the short or long term. Ms Ekholm said that it was a question of focusing monetary policy more or less clearly on attaining the inflation target and that there was a potentially high price to pay for doing so less clearly. Conducting a kind of leaning-against-the-wind policy can probably be done without negative consequences if inflation is fairly stable around the target. However, if inflation is significantly below the target it will become apparent to the rest of the world that the focus of monetary policy is not on quickly bringing inflation back to the target and this will damage the credibility of the inflation target. This may make it difficult to stabilise inflation around the target in both the short and long term.

Deputy Governor **Per Jansson** began by saying that he supports both the macro forecast and the monetary policy presented in the draft Monetary Policy Report. The adjustments now made to the forecasts are relatively minor, and the risk outlook regarding household debt is also largely the same as in December. This means that the monetary policy plan adopted in December, that is to now leave the repo rate unchanged at 0.75 per cent and to aim to begin slowly raising the repo rate in early 2015, can now continue.

Mr Jansson said that the fact that only minor adjustments have been made to the forecast, risks, and monetary policy, gives the monetary policy meeting today the opportunity to highlight a few issues of a somewhat more fundamental nature. As the time for the first repo-rate increase approaches it will become increasingly important to be clear about what conditions and circumstances need to be met to be able to take this step. The repo-rate path and the economic assessments in the draft Monetary Policy Report of course provide a lot of information with regard to this kind of guidance. However, Mr Jansson pointed out that the information in the draft Monetary Policy Report nevertheless represents a compromise and does not therefore perfectly reflect the preferences of the individual members of the Executive Board. He therefore wished to take this opportunity to clarify his view of what state the economy should be in for it to be appropriate to begin raising the repo rate.

The forecast in the draft Monetary Policy Report is based on the assumption of a slowly increasing repo rate as of the first quarter of 2015. CPIF inflation is then expected to be approximately 1.6 per cent and to be clearly rising. At the same time, GDP growth will have been high for over a year and be increasing by around 3.5 per cent, calculated as an annual rate, in the first quarter of 2015. Unemployment will have fallen somewhat and be at 7.5 per cent in seasonally-adjusted terms.

Mr Jansson stressed that in this context he himself would primarily focus on the development of inflation. More specifically, he said that he will not vote for a repo-rate increase until CPIF inflation picks up and rises above 1.5 per cent. And if further progress is made in managing the risks associated with household debt he could imagine voting for an unchanged repo rate at today's low level even with a CPIF inflation rate well over 1.5 per cent.

Inflation has now been well below 2 per cent for more than two years, Mr Jansson continued. The longer this period with very low inflation persists, the more important it becomes to aim for a rising inflation rate. Mr Jansson wished to make it clear that for him this will be the overriding priority in his monetary policy considerations in the year ahead. Against this background, he also thought that it would be necessary to consider further repo-rate cuts if the expected increase in inflation fails to materialise.

Mr Jansson went on to say that it is much more difficult to be specific about the state of the real economy in connection with the first repo-rate increase. Experience with forward guidance in terms of specific figures for unemployment in the United States and the United Kingdom underlines that it is very difficult to establish strong links between individual real economic indicators and the policy rate. If growth increases and unemployment falls, the time for a repo-rate increase, all else being equal, will of course come closer and, vice versa if growth declines and unemployment goes up. But making more precise statements in terms of concrete levels for a particular real variable does not appear advisable.

A monetary policy that to a greater degree must prioritise the short-term development of inflation of course places a greater responsibility on other policy areas for managing the risks associated with the high and growing indebtedness of households. A factor of importance here is that the Riksbank's need to prioritise short-term stimulus measures to a greater extent will in itself lead to an increase in household debt. As the Riksbank has previously stressed many times, and as it does again in this draft Monetary Policy Report, it is also possible that the interest-rate expectations of households are too much affected by today's extremely low interest rates. If this is the case, households are underestimating the size of their future interest expenditure and this may eventually have rather tangible negative consequences for consumption and the macroeconomy at large.[1]

Mr Jansson said that a problem with taking measures to manage financial imbalances is that it is very difficult to know when the imbalances have become so substantial that something must be done about them. There are no numerical targets here, and

[1] See the article "The effects of monetary policy on household indebtedness" on page 43 of the draft Monetary Policy Report for a discussion of how changes in the repo rate can affect household debt.

determining when a certain deviation has begun to be abnormal is far from easy. A relevant factor in this context is also that decision makers in this field are hardly likely to win a popularity contest.[2] All this risks leading to what is referred to as an "inaction bias", that is that decision makers wait too long to take action.

Mr Jansson pointed out that avoiding such an inaction bias was easier said than done. But one could perhaps move some way in the right direction if one gave up the idea that it was a question of attaining a specific point in the development to justify taking measures. Instead, one should put the focus on risk indicators and the need to gradually take action as these indicators show an increase in the level of risk. It is then not a question of attaining a particular point in the development when it is time to do something, but of a process where measures are taken gradually as the risk outlook worsens.[3]

If one looks at the Swedish situation with high and growing household indebtedness from this perspective, it becomes easier to understand how one can perceive there to be a need to take further measures to dampen risks. The debt ratio for the whole population is now, as is well known, at just over 170 per cent. This is high both from a historical and an international perspective. And the forecast in the draft Monetary Policy Report is for the debt ratio to continue rising. According to the Riksbank's new bank data[4], the average debt ratio for those in debt is moreover much higher, a good bit over 300 per cent. A rising debt ratio makes households increasingly vulnerable as their liquidity margins decline. If this is allowed to continue, it is really only a question of time before an unfavourable shock triggers a need for households to reduce their debt. And the higher the debt ratio has become, the smaller the shock triggering the negative adjustment needs to be and the larger the necessary debt consolidation threatens to be. The consequence can be a substantial fall in consumption in the household sector and a sharp rise in unemployment, argued Mr Jansson.

Mr Jansson concluded by saying that, given this, his opinion is that Sweden during this year needs to take or announce further measures to reduce the risks linked to household debt. Analysing which measures are most effective and producing a suitable implementation plan for them should be a high-priority task for the new Financial Stability Council and Finansinspektionen (the Swedish Financial Supervisory Authority).

Governor **Stefan Ingves** began by saying that he also shared the view of international economic developments and the Swedish economy presented in the draft Monetary

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[2] For a more detailed discussion of these aspects, see Per Jansson (2013), "How do we stop the trend in household debt? Work on several fronts", speech at SvD Bank Summit, Stockholm.

[3] Michael Woodford (2012), "Inflation targeting and financial stability", Sveriges Riksbank Economic Review 2012:1, uses a variation of this view, where he argues that it is both possible and appropriate to take financial imbalances into account in monetary policy.

[4] This refers to credit data from the eight largest banks, which the Riksbank has collected through UC in 2013.

Policy Report. He also supported the proposal to hold the repo rate unchanged, and the repo-rate path used as a base for the remainder of the forecasts.

He looked back to summer 2013, when the discussions on the consequences of the Federal Reserve's coming tapering were central to international analyses. The forecasts in the July Monetary Policy Report assumed that the Swedish economy was on the way to a recovery and this appears to be the case. The forecasts for GDP growth in Sweden's most important trading partners (the so-called KIX index) made then have proved to be fairly accurate. However, inflation is now expected to be lower in the euro area and the United States than was expected in the July forecast.

GDP growth in the United States is now expected to remain high and a recovery is expected in the euro area in the coming years. In Europe, the work on improving competitiveness and managing high sovereign debt and weak banks is continuing.

In Sweden, indicators point to GDP growth being somewhat lower in 2013 than was expected in the forecasts made in July 2013, while employment has proved to be somewhat stronger than forecast. The real economy in Sweden has begun an upturn. But inflation has slowed down more than was expected in July, as has also happened in a number of other countries. The draft Monetary Policy Report contains an article that shows there has been a broad downturn in inflation. The Riksbank’s interpretation of this is that it has been more difficult than normal for companies to pass on their cost increases to households.

For some time now, there has been a partly new situation abroad, as the Federal Reserve has now actually begun tapering its monthly bond purchases. This has contributed to adjustment problems in some emerging markets. Many emerging markets currently have larger foreign currency reserves than they had during the Asian financial crisis 1997-1998. However, many emerging markets are also more integrated into the global economy and dependent on capital inflows. Those that are particularly vulnerable are countries with large current account deficits and/or debt in foreign currencies. At the same time, better economic prospects in the United States are essentially positive for the recovery in many areas. The conclusion is that the contagion effects from the financial unease in a number of emerging markets are limited as long as growth conditions improve in the larger developed economies.

With regard to the forecast for the Swedish economy, the economic prospects are bright. Indicators for both the corporate sector and the household sector are positive. The starting point for the draft Monetary Policy Report is that there has been a clear upward swing in the economy. But despite the strengthening of the economy, the forecast in the draft Monetary Policy Report includes low inflation in the coming year. The repo rate is expected to need to be low until inflation begins to pick up. However, the long-term risks resulting from household debt still remain. The trade-offs have by no means disappeared.

There is still, on the whole, considerable uncertainty over what form the recovery in the international economy will take and how it will affect the Swedish economy. There are, as always, both upside and downside risks. Mr Ingves concluded his contribution to the discussion by saying that the Executive Board needs to be prepared for the possibility of changes in the assessments prior to future monetary policy decisions. However, so far, the indications are that the recovery in the economy will be as described in the draft Monetary Policy Report. The forecast is that demand will strengthen both in Sweden and abroad.

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. The differences are fairly small, compared with the assessment made by the Executive Board in the December Monetary Policy Update. The new information received since the meeting in December has been well in line with the forecast made in December. Given this, she supports the proposal for the repo rate to remain at 0.75 per cent to stimulate the Swedish economy and to bring CPIF inflation back to 2 per cent in 2015. She also supports the proposal to hold the repo-rate path unchanged.

Ms af Jochnick considered that a central issue for Sweden, and at a global level, is the assessment of GDP growth in 2014 and 2015. It is essential that the demand for Swedish goods and services picks up for the Swedish economy to be able to grow and for inflation to gradually rise to 2 per cent again. GDP growth in the KIX countries, that is, the countries most significant to the Swedish economy, began to recover roughly as expected during the second half of 2013. Developments are particularly positive in the United States, where GDP growth has been relatively high and is expected to remain high in the coming period. It is also good that the potential problem with the debt ceiling for public finances appears to have been resolved, at least for the coming year. But the recovery in the euro area is proceeding much more slowly, which is as expected, given the structural problems that have had a dampening effect on developments. In the euro area, the growth rate is expected to increase slowly as the adjustment process continues and confidence improves. In addition, the forecast in the draft Monetary Policy Report is for a clear recovery in the United Kingdom and Denmark, and subdued but rising growth in Norway.

Another factor that creates uncertainty is what effects the assumed monetary policy normalization in large currency areas might have in the coming years. Given the large degree of integration of the financial markets, it is important to analyse developments and as far as possible to understand what might happen as we move forward. This applies in particular to the consequences for certain emerging markets. Several emerging markets' currencies have weakened and volatility has increased as a reaction to the Federal Reserve beginning to taper its asset purchases. However, it does not appear to be general problems that have triggered unease in some emerging markets, but rather several different types of background problem in these countries that have contributed to the turbulence. Some countries have been living above their means for a long time. Others are struggling with the after-effects of the financial crisis. A third group have domestic challenges of a more political nature that risk affecting economic stability.

Seen from a Swedish perspective, we have so far not been very much affected. There are reasons to assume the contagion effects of the currency turbulence in the emerging markets will be limited as long as the recovery continues in developed countries. However, Ms af Jochnick thought that the analysis of what is happening in emerging markets now is complex. It is important to continue careful monitoring of the emerging markets and their effects on global growth going forward.

In the case of the Swedish economy, the prospects are good. An increasing number of indicators point to the recovery having begun, but there remains some uncertainty over the strength in GDP growth. With regard to new information received since the meeting in December, Ms af Jochnick wished to mention the National Institute of Economic Research's Economic Tendency Survey, which in January was at its highest listing since June 2011; a sign that the economy is beginning to turn upwards. Households were somewhat more negative regarding their personal finances in January, but more positive about developments in the Swedish economy. The retail trade has developed well and car sales are increasing. It is also positive that the labour market is showing stable development and that the number of jobs is increasing, as well as the number of employed.

The picture of a slow recovery is supported by the results in the Riksbank's Business Survey. The risks from abroad have weakened and companies are therefore more hopeful about developments in the period ahead than they were before. The survey respondents can see the light at the end of the tunnel, but they say that expectations of a broader economic upswing lie further ahead, possibly towards the summer. Inflation in Sweden is currently low. This is probably linked to the weak demand and to companies experiencing difficulty in passing on their cost increases to consumers. The fact that the profit share in the business sector is low supports this picture.

There are still few companies stating in the Riksbank's Business Survey that they see an opportunity to raise their prices in the short term. On the other hand, companies are expecting to make at least minor price increases gradually, as demand picks up. However, the Business survey shows considerable uncertainty with regard to the pace at which companies will be able to raise their prices. Many retail companies are planning for price increases below two percent, while the manufacturing companies' plans are even more modest. Average planned price increases for the year ahead are often around one per cent. This supports the assumption that inflation will remain low during 2014. If we are to bring inflation up to 2 per cent in 2015, it is important that demand for Swedish goods and services increases during 2014 and that companies can gradually increase their profit margins to more normal levels.

Given that inflation has now been low for a long time, short-term inflation expectations have fallen. However, inflation expectations five years ahead are close to 2 per cent. The repo rate needs to remain at its current low level until the economic recovery is on firmer ground and inflation picks up. An even more expansionary monetary policy could lead to inflation attaining the target earlier, but at the same time the Executive Board must take into account the risks linked to high household indebtedness, which would then increase further, and Ms af Jochnick felt that this possibility could not be ignored.

The development of household debt has been largely in line with the forecast made in December. Compared with the assessment made in December, the debt ratio has been revised up somewhat, partly as a result of the assumption that incomes will increase at a slightly slower rate and that the forecast in the Financial Accounts for debt in 2013 has been revised upwards. Housing prices are continuing to rise. In the Stockholm region, prices of tenant-owned apartments rose by 13.5 per cent in 2013. There are no direct signs of a slowdown at the beginning of this year. As lending follows price developments relatively well, there is reason to believe that indebtedness will continue to increase. Her view was that the risks linked to household indebtedness would remain high.

As Ms af Jochnick has said at earlier meetings, a broad palette of measures is probably needed from several different policy areas for household indebtedness to develop in a healthier manner. Households' high level of indebtedness is a potential problem for the development of the Swedish economy and the Riksbank's possibility to carry out its assignment efficiently. It is good that the Financial Stability Council has now had its first meeting. One important question for the Council will be to discuss the financial stability situation and the need to take measures to reduce risk and to make the financial system more robust.

§3. Discussion

Deputy Governor **Cecilia Skingsley** began the discussion by observing that the Executive Board has regularly discussed at its meetings the differences between the market pricing of future interest rates abroad and those in Sweden and the Riksbank's interest rate forecasts, and what significance they have for the Riksbank's exchange rate forecast. She thought that if a central bank makes its own forecast of, for instance, future monetary policy in Sweden and abroad, or other variables that can also be read in the financial markets, it is natural that there will be differences between the market forecast and the internal forecast from time to time.

Ms Skingsley pointed out that relying on market pricing as input to interest-rate forecasts is not without its problems. During the years 2005 to 2007, the Riksbank used the forecast assumption that the repo rate would develop in line with market expectations, as expressed in implied forward rates. But it then turned out that using these market expectations was not without problems, as they can change without anyone really knowing why. Changes in market pricing also led to undesirable and difficult-to-interpret effects on the macro forecasts between the monetary policy meetings and the Riksbank sometimes had to dissociate itself from the effects of the market pricing. She did not think that this forecast approach contributed to increased predictability with regard to future monetary policy. After that, in spring 2007, the method was changed, and the Riksbank began to publish its own repo-rate paths instead. Ms Skingsley felt that this forecasting method functions better.

As she had the impression that Ms Ekholm was critical of the Riksbank's forecasting method, she wanted to know whether Ms Ekholm thought it would be more appropriate if the Riksbank instead relies entirely on market pricing of future interest rates as input into its assessments. Ms Skingsley herself believed that changing over to using market pricing would entail problems that would be more difficult to manage than the tensions prevailing now.

Moreover, Ms Skingsley wanted to comment on Ms Ekholm's contribution to the discussion where she said it was not appropriate to use monetary policy to counteract imbalances while inflation was below the target and has been so for a long time. Following the global financial crisis, it is possible to divide opinions on the management of financial imbalances in the monetary policy framework into three groups: Those who want to make few or no changes in relation to the situation before the crisis, those who see price stability and financial stability as inseparable, and a middle way, where the inflation target takes precedence, but where monetary policy may need to be used to support various macroprudential policy measures that are taken in addition to monetary policy.[5] Ms Skingsley's impression after the crisis years was that many leading central banks have moved on to taking greater account of the risk of financial imbalances in their monetary policy decisions.

As she understood Ms Ekholm, she did not want to use monetary policy as part of the risk management of household indebtedness. She therefore wanted to ask Ms Ekholm how she considers the circumstance that households' expectations of interest rates five years ahead, which empirical research shows have a high correlation with the current and historically-low interest rate, can prove to be incorrect in the future. What will happen to the economy if households realise that their expectations were too low and adapt to higher future interest rates.

[5] Sveriges Riksbank Economic Review no. 3/2013 Frank Smets "Financial Stability and Monetary Policy: How Closely Interlinked?"

Governor **Stefan Ingves** pointed out that inflation is currently low. The forecast for inflation was revised down last year, but he thought that the analysis in the article and the rest of the draft Monetary Policy Report indicates that the period with a broad downturn in inflation is now over. Contributing to this is the fact that monetary policy remains expansionary to help ensure that resource utilisation increases and inflation picks up. Increased resource utilisation should, in turn, contribute to a gradual rise in the rate of wage increases. Moreover, the possibilities for companies to raise their prices also increase. Inflationary pressures will thus gradually increase during the forecast period. However, inflation will remain low for a further period of time and then increase fairly quickly towards the end of 2014, when the factors holding it back disappear.

The conditions are thus right for inflation to increase. Earlier experiences and relationships indicate that this will be the case. Unit labour costs have for a long time been increasing more than consumer prices and companies' profit shares are lower than normal. All in all, this should lead to price increases being passed on to consumers as demand rises. The assumption now is that this will lead to rising inflation, but other factors may also play a part, which requires further analysis. The Riksbank will continue to examine the inflation outcomes in detail. It will be particularly important to follow developments in services prices. Services prices comprise a fairly large percentage of the CPI and they increased by less than expected last year. Mr Ingves felt that the Riksbank should therefore try to extend its analysis of services prices.

In addition, there is the question the Executive Board has lived with for a long time now; the trade-off between attaining the inflation target and taking into account the more long-term risks linked to the development in household debt. This trade-off has not disappeared. Prices on the housing market are expected to continue rising, which means that household debt will increase. The household debt ratio is already high, both from an historical and an international perspective, and the Riksbank is assuming that debt will increase faster than income during the forecast period. This is worrying in itself and the trend needs to be turned around. Mr Ingves said that the best solution would be if the financial sector could resolve the problem on its own, but he doubted that this would happen. Further regulations are therefore needed to safeguard the stability of the financial sector. Cooperation between several policy areas is required to rectify the debt problems. Monetary policy will contribute to this when the repo rate is raised further ahead, according to the forecast. The problems with household debts are closely linked to the situation on the housing market. However, it is not primarily monetary policy or new financial regulations that should ensure that the housing market begins to function better. Both the demand for, and supply of, housing need to be affected by other political measures in the longer run.

Mr Ingves went on to say that the situation on the labour market improved gradually last year. The Riksbank is also assuming that the labour market will continue to improve in the coming period. However, developments are marked by factors that pull in different directions. On the one hand, the number of redundancies in the labour market is now down at an historical average level. In such situations, the real interest rate is not usually negative, but it is now. On the other hand, there are clear matching problems between job vacancies and the unemployed. The labour force currently consists to a greater degree of groups that are further from the labour market than before. This includes, for instance, people with only compulsory school education level. It has contributed to the average period of unemployment increasing in recent years. The change in the composition of unemployment is a structural problem that arises outside the scope of monetary policy, which can instead be managed by labour market, education and integration policies. However, it is important for monetary policy to continue to analyse the situation on the labour market, particularly for the assessment of what is a long-run sustainable level for unemployment.

First Deputy Governor **Kerstin af Jochnick** pointed out that the Executive Board is assuming that the labour market will continue to improve in the coming period. When economic activity strengthens, the demand for labour will rise. The Riksbank has also made a slight upward adjustment to its assessment of long-run labour force participation and the employment rate in relation to the December forecast. But she nevertheless wished to highlight some potential problems on the labour market. The matching problems have increased in recent years. It has become more difficult for those who are unemployed to find work. This will partly counteract the downturn in unemployment to which the very expansionary monetary policy contributes. She pointed out that there was an article about these questions in the Monetary Policy Report published in October 2013.

One example of the matching problems is shown in the Swedish Public Employment Service's most recent forecast. This shows that unemployed people with a weak position on the labour market, what are normally called vulnerable groups, have difficulty being matched to job vacancies, where the educational requirements are often are high. The access to jobs for people with only compulsory school education is showing a falling trend. This has contributed to a change in the composition of unemployment, with an increased share of unemployed with labour market problems that are difficult to resolve. Monetary policy is not able to influence such structural problems. But Ms af Jochnick said that there were nevertheless good reasons why the Riksbank should have an increased focus during the coming year on the functioning of the labour market in a broad perspective and the assessment of what is regarded as long-run sustainable unemployment.

Ms af Jochnick went on to emphasise the importance of the Riksbank developing the analysis of household indebtedness further and of the Riksbank trying as far as possible to develop the statistical data. It is clear that better statistical data are required to produce better bases for decisions. One example is Anna Hedborg's inquiry that analysed the perspective of the individual household, and where some of the conclusions are quite different from those the Riksbank has drawn on a similar statistical data set. Ms af Jochnick considered there should be sufficiently good statistics to illustrate the risks linked to household indebtedness in an adequate matter, so that decision-makers have access to reliable material so that a common view of the problem can emerge.

Deputy Governor **Karolina Ekholm** responded to the questions Ms Skingsley had put to her, which she considered important to explain. She began with the first question, which concerned foreign policy rates and exchange rates. Ms Skingsley referred to a tension between market pricing of future interest rates abroad and in Sweden and the Riksbank's interest rate forecasts. She emphasised that at present there was no clear tension between market pricing of future interest rates abroad and the Riksbank's forecast. However, there were tensions a few years ago. Then, the Riksbank's forecast for policy rates abroad was much higher than market expectations according to implied forward rates. The forecast for the difference between the repo rate and policy rates abroad did not differ from what was expected by the market, however. The reason for this was that the forecast for the level of the policy rate was much higher than market expectations were for Sweden as well. So while both forecasts were at higher levels than market expectations, the difference between them was in line with these expectations.

Today, the forecast looks different. The clearer communication from the central banks in the large currency areas regarding their own future rate-setting has led to the forecasts for policy rates abroad being anchored more firmly both in the Riksbank's forecasts and on the markets. So the difference between the Riksbank and the markets is currently fairly small. However, the Riksbank's repo-rate path is still at a much higher level than the corresponding market expectations, which means that the Riksbank's own forecast for the interest rate differential compared with other countries is now much larger than market expectations. At the same time, the exchange-rate forecast is based on the assessment that this relatively large and unexpected interest rate differential will not lead to a significant strengthening of the exchange rate. It was this assessment she was sceptical towards. The tensions Ms Ekholm mentioned in her first contribution to the discussion concerned the fact that she finds it difficult to see that a large increase in the interest rate differential compared with other countries, that is not priced on the market, can go hand in hand with an exchange rate where the value of the krona appreciates only marginally. She was certainly not against the Riksbank making its own forecast of both its own policy rate and policy rates abroad. However, she was sceptical to the assumed effects of the interest rate differential on the exchange rate.

The other question concerned Ms EKholm's view of the role of monetary policy with regard to counteracting potential risks to financial stability. Ms Skingsley referred to a paper by Smets, in which he describes three different views represented in the international discussion. Ms Ekholm said that what she had said in her initial contribution to the discussion might put her in the view he calls "the modified Jackson Hole consensus", where monetary policy does not play a clear role in preventing financial crises. He himself advocates what he calls a leaning-against-the-wind policy. But at the same time, he is clear that he considers that with this aim for monetary policy it is important to point out that the primary objective is price stability in the medium term.

Ms Ekholm shared Ms Skingsley's view that several central banks had recently begun to communicate more openly their intention to take into account financial stability in their monetary policy decision-making than was the case prior to the financial crisis. However, inflation in these countries has been closer to the central bank's inflation target than is the case in Sweden. Ms Ekholm's impression was that where inflation has begun to be pushed down below the target, the willingness to conduct a leaning-against-the-wind policy had been fairly small.

Ms Ekholm pointed out that she herself had in various contexts stated that she was not, in principle, against the idea of conducting a policy where the policy rate was used to slow down an ongoing credit boom. There may be justification in some situations for cutting the policy rate more slowly or raising it more quickly than otherwise, if inflation is fairly close to its target level. What she was critical to was conducting this type of policy when inflation has fallen far below the target and remained there for a relatively long period of time. She then believed that a leaning-against-the wind policy damages confidence in the inflation target.

Ms Ekholm then turned to the question about her view of potential risks linked to households' expectations of mortgage rates five years' ahead, which are lower than is compatible with the Riksbank's assumption of the long-term repo rate. She thought that there were two moderating circumstances to take into account in this context. One is that these expectations may not be so unrealistic, given the uncertainty of forecasts for 5 years ahead. Given how low interest rates are expected to be around the world during the entire forecast period of three years, it may not be entirely unrealistic to have expectations of mortgage rates of 4 per cent in five years' time.

The second circumstance is that households' perhaps unrealistically low interest rate expectations can only affect the demand side with regard to credit. There is also a counterpart, who is responsible for supply. Just because a household wishes to increase its indebtedness in the belief that the interest rate will be low for a long period of time, there is nothing to say that a bank should automatically grant this request. If a proper regulatory framework is in place and the banks make thorough credit assessments, then households' low interest rate expectations need not mean that lending to this sector entails higher risk. This is where macro prudential policy measures come in, such as the introduction of a mortgage ceiling of 85 per cent and a risk weight floor for mortgages of

15 per cent. Ms Ekholm felt that these measures should affect the supply side for credit and have a restraining effect.

Deputy Governor **Per Jansson** first wanted to express his support for what Mr Ingves said regarding the need for extended inflation analyses. He considered that the article on low inflation in the draft Monetary Policy Report was good, and said that this was probably as far as one could take the analysis using official data. Of course, it takes some time to carry out analyses with different information and newly-gathered survey data. But he considered it important that the Riksbank does this so that further light can soon be shed on the issue. Making these new inflation analyses is one of the most important tasks in the near term.

Mr Jansson next wished to emphasise, as he had done before, that it is extremely important that the Riksbank acquires further information to improve its understanding of households' interest-rate expectations. Here, too, it might be a possibility to gather new information by means of surveys. And here, too, the information is needed urgently to make progress.

Finally, Mr Jansson also wanted to express his support for Ms af Jochnick's contribution to the discussion, where she said it was important to clarify how the Riksbank's new bank data contrasts with the data the Hedborg inquiry collected. The Riksbank has access to a much more comprehensive material than the Hedborg inquiry. It is very important to publish these data soon and to discuss how they differ from the data used in the Hedborg inquiry.

Deputy Governor **Martin Flodén** wanted to first follow up the discussion on how monetary policy should take financial risks into account. He shared Ms Skingsley's view that after the financial crisis there has been more discussion about the possibility of monetary policy "leaning" against credit booms or rapidly-rising house prices. This applies both to academic research and policy. But as Ms Ekholm mentioned, other central banks have not faced the same trade-off between low inflation and financial risks as the Riksbank has in Sweden. Mr Flodén could not think of any other country that had in practice allowed its monetary policy to be affected by financial risks over a long period of time. He therefore thought that on this question one must regard Swedish monetary policy as a pioneer, or perhaps a preliminary experiment.

Mr Flodén referred back to his earlier contribution to the monetary policy discussion and said that he does not believe that monetary policy can take financial risks into account over a long period of time if inflation is at the same time deviating from the target. The fulfilment and credibility of the inflation target would then be questioned. Research indicates that credit cycles are longer, probably much longer, than normal business cycles. In practice, this probably means that a strategy where monetary policy systematically tries to moderate the credit cycle is not compatible with an inflation target that is precisely defined. But these are questions that need further analysis and they are being discussed on various international arenas. He did not think these questions could be answered here and now.

Another point Mr Flodén wanted to take up was the article on the effects of monetary policy on household indebtedness in the draft Monetary Policy Report. He thought it was good that the Riksbank could now report an estimate of how the repo rate affects household indebtedness. This is important, as the repo-rate path takes into account risks linked to indebtedness. The alternative scenarios for the repo-rate path reported in Chapter 2 of the Monetary Policy Reports are more complete when they also present an estimate of the effects on household indebtedness.

Finally, he wanted to mention the relationship between monetary policy and the exchange rate. He thought that this was an important question that could affect future monetary policy. It is well known that exchange rates are very difficult to forecast, even in the short run. The exchange rate can fluctuate rapidly and for reasons that are not always entirely clear. But the fact that the exchange rate is volatile and “noisy” does not mean that monetary policy lacks any effect on the exchange rate. Indeed, we are fairly certain that monetary policy has a clear effect on the exchange rate. If the Executive Board had not cut the repo rate in December, the krona would most probably have been even stronger than it is now.

He did not see any reason why monetary policy would have less effect on the exchange rate in small countries than in large countries. However, there are numerous indications that the effects of the exchange rate on inflation are greater in small, open economies. The development of the exchange rate is therefore of considerable significance for monetary policy in Sweden. If the krona appreciates more in the coming months than is forecast in the draft Monetary Policy Report, there is a risk that inflation will be too low. He would see this as a strong reason to conduct a more expansionary monetary policy, partly because a weaker krona exchange rate would contribute to higher inflation.

Deputy Governor **Cecilia Skingsley** said that she thought Ms Ekholm's comment that there were no objections in principle to attaining the inflation target slightly more slowly on condition that this does not jeopardise the inflation target was interesting. Ms Skingsley thought it was probably the case that different members of the Executive Board made different assessments regarding both the size of the risks and how long it was possible to deviate from the 2 per cent inflation rate without jeopardising confidence. There does not appear to be a general answer regarding how quickly the target should be attained.

However, Ms Skingsley thought that Ms Ekholm's comment on households' mortgage rate expectations perhaps not being entirely unrealistic gave rise to a further question. She wondered whether Ms Ekholm considered that the Riksbank's assessment of the long-run normal repo rate, which was estimated in 2010 to be within an interval of 3.5-4.5 per cent, was actually lower now.

Deputy Governor **Karolina Ekholm** wished to clarify that she did not have a different view of the long-run repo rate, that is, what applies in the steady state, than the 3.5-4.5 per cent the Riksbank has announced previously. What she had said was that it was perhaps not so realistic to believe that the economy would be in a normal situation in five years' time. However, she thought that the question of where one believes the repo rate will be in five years' time was an important one for the Executive Board to discuss.

Governor **Stefan Ingves** then summarised the discussion. It was noted at the meeting that the Executive Board agreed on the picture of economic prospects and the inflation outlook described in the draft Monetary Policy Report. The economic prospects and the inflation outlook in Sweden and abroad are well in line with the assessments in the December Monetary Policy Update. After just over a year of weak GDP growth, the prospects look good for 2014. Economic activity is strengthening abroad, the confidence of Swedish households and companies is higher than normal and employment is increasing. GDP growth is expected to pick up during the year and there will be a rather tangible improvement on the labour market by the end of the year.

Despite the improvement in economic activity, inflation is expected to remain low in the year ahead. Once international and domestic demand strengthens, however, there will be a gradual increase in inflationary pressures and CPIF inflation is expected to reach 2 per cent in 2015. The low inflationary pressures justify the continued conduct of an expansionary monetary policy. At the same time, the indebtedness of Swedish households is still high and is expected to increase somewhat during the forecast period, a factor that continues to pose a risk to long-term sustainability. Several policy areas need to cooperate to reduce the risks linked to indebtedness.

Given the low inflationary pressures, all of the members of the Executive Board considered that it was appropriate to leave the repo rate unchanged at 0.75 per cent until the recovery reaches firmer ground and inflation picks up. According to the forecast, it will be appropriate to begin slowly raising the repo rate in early 2015. In this way, monetary policy will contribute to CPIF inflation reaching 2 per cent in 2015.

Other topics discussed at the meeting were the need for further analysis of the low inflationary pressures and the need to adjust monetary policy if the development of inflation proves to be weaker than in the forecast. The effects of the exchange rate on inflation were also discussed in connection with this. The discussion also touched upon aspects of conducting monetary policy in a small, open economy with substantial capital flows, extensive imports and exports and a high level of household indebtedness. The need to implement macro prudential policy measures was emphasised. Global risks to economic development stemming from financial unease relating to imbalances in certain emerging economies were also discussed.

§4. 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 Thursday, 13 February 2014, at 9.30 a.m.,
- to hold the repo rate at 0.75 per cent and that this decision would apply from Wednesday, 19 February 2014,
- to publish the decision above at 9.30 a.m. on Thursday 13 February 2014 with the motivation and wording contained in a press release, and
- to publish the minutes of today's meeting on Wednesday 26 February 2014 at 9.30 a.m.

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