Summary

At the Monetary Policy Meeting on 23 October 2018, the Executive Board of the Riksbank decided to hold the repo rate at −0.50 per cent. The forecast for the repo rate is unchanged since the monetary policy meeting in September and indicates that the repo rate will be raised by 0.25 percentage points either in December or February.

A majority of the Executive Board supported the picture of the economic outlook and inflation prospects described in the draft Monetary Policy Report. This picture has remained largely unchanged since September. The global economy continues to develop positively and economic activity in Sweden remains strong. CPIF inflation and inflation expectations are close to or slightly above 2 per cent.

Several members emphasised the uncertainty factors around developments abroad and that these can also have significant negative consequence for the Swedish economy in a bad scenario. Examples highlighted were the risks linked with escalated trade conflicts between the United States and the rest of the world, uncertainty over the long-term stability of the Italian public finances and the effects of the United Kingdom's exit from the EU.

Inflation in Sweden is slightly over 2 per cent largely because of rapidly rising energy prices. Different measures of underlying inflation are lower but there are signs that inflationary pressures are rising. Several members pointed out that the conditions are good for inflation staying close to target even when the rate of increase in energy prices slows.

Against this backdrop, a majority of the Executive Board considered it appropriate to leave the repo rate unchanged now. If the economy develops in a way that continues to support the outlook for inflation, it will also be, according to the Executive Board, appropriate to soon start raising the repo rate at a slow pace, either in December or February. The majority was not more specific about the timing but emphasised that developments going forward and how they affect the economic outlook and inflation prospects will determine when it is appropriate to raise the repo rate.

Several members stressed the importance of monetary policy being adjusted based on the prospects for inflation. The steps towards higher rate levels must be taken with caution so that inflation can continue to remain stable around the target in the years ahead. A few members also reminded the meeting about the risks on the Swedish housing market and indebtedness among Swedish households.

Deputy Governors Martin Flodén and Henry Ohlsson entered reservations against the decision to hold the repo rate unchanged and advocated raising the repo rate to −0.25 per cent. Mr Flodén referred to the upturn in inflation and the strengthened confidence in the inflation target and advocated a repo-rate path that coincides with the path in the report as from the third quarter of 2019. Mr Ohlsson referred to the strong economic development in Sweden and abroad and advocated bringing forward the repo-rate path with the same gradient as the repo-rate path in the Monetary Policy Report.

MINUTES OF MONETARY POLICY MEETING
Executive Board, No. 5

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DATE: 23 October 2018

TIME: 09.00

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

Susanne Eberstein, General Council
Michael Lundholm, General Council

Meredith Beechey Österholm
Vesna Corbo
Hans Dellmo
Charlotta Edler
Mattias Erlandsson
Eric Frieberg
Anders Gånge
Jesper Hansson
Jens Iversen
Kristian Jönsson
Maria Kindborg
Henrik Lundvall
Pernilla Meyersson
Ann-Leena Mikiver
Marianne Nessén
Åsa Olli Segendorf
Bengt Petersson
Carl-Fredrik Pettersson (§ 1-3A)
Maria Sjödin
Ulf Söderström
Fredrik Wallin (§ 1-3A)
Ingrid Wallin Johansson (§ 1-3A)

It was noted that Henrik Lundvall and Bengt Petersson would prepare draft minutes of the monetary policy meeting.

§1. Economic developments

Market developments since the last monetary policy meeting

Carl-Fredrik Pettersson, Markets Department, began by presenting the latest developments on the financial markets. Since the monetary policy meeting in September, developments have been characterised by significant falls on equity markets in the first part of October. It is difficult to find one individual factor that explains these falls, but they occurred when the rhetoric in the trade conflict between the United States and China intensified. In addition, both the oil price and long-term US interest rates increased. Basically, there is also concern for high equity valuations, a rapid slowdown in the Chinese economy and uncertainty about fiscal policy in Italy. Long-term Italian interest rates have risen and the credit rating agency Moody's has lowered the credit rating for the Italian government in light of the increased uncertainty about sustainability in its public finances. Bond yields have risen relatively substantially in the US since September as expectations of the future policy rate have been adjusted upwards and since the US economy continues to show strength. The rise in yields has been less in Sweden and Germany. Demand for German bonds, which are considered safe, has increased in light of the uncertainty over Italian fiscal policy, which has had a dampening effect on the upturn in yields in Germany. On the whole, monetary policy expectations have risen slightly internationally. In the United States, monetary policy communication and the monetary policy minutes have contributed to this and in the account from the European Central Bank's monetary policy meeting in September, the economic risk associated with Italy was toned down.

Prior to today's monetary policy decision, it is expected that the repo rate will be left unchanged but several market participants now believe, in light of the increased inflation in September, that the first repo rate rise will more likely take place in December than in February. Increased expectations about Swedish monetary policy have strengthened the krona both in KIX terms and against the euro.

The current monetary policy drafting process – new data and forecasts

Jesper Hansson, Head of the Monetary Policy Department, began by presenting the forecast that the Monetary Policy Department judged would gain the support of a majority of the Executive Board. The monetary policy drafting process has included discussions with the Executive Board regarding the forecasts and the monetary policy assumptions at meetings on 5, 8 and 12 October. The draft monetary policy report was tabled at a meeting of the Executive Board on 17 October.

There is still considerable uncertainty about economic developments abroad. The ongoing trade conflict between the US and China has, since the monetary policy meeting in September, been extended to include more goods. Furthermore, the US Government is now investigating the scope for increasing tariffs on all imports of vehicles and vehicle components. Such an escalation could have significant consequences for international economic developments. Another source of uncertainty is the direction of Italian fiscal policy and the associated conflict between the Italian Government on the one hand and the European Commission and several other governments in the euro area on the other.

The relationships that affect the krona's real exchange rate a few years ahead are another issue that has been in focus during the drafting process. An article in the draft report discusses the Riksbank's interval for the more sluggish real equilibrium exchange rate, in which the previous assessment from 2013 have been reviewed. Mr Hanson pointed out that this new assessment primarily affects our understanding of the historical development and that the consequences for the proposed inflation forecast are relatively minor.

The latest outcome from the National Accounts has led to Swedish GDP growth in 2016–2018 being significantly adjusted downwards, compared with previous estimates. This revision has also received particular attention in the drafting process and, among other things, has led to the picture for cost pressures now being somewhat higher, compared with the assessment in September.

Mr Hansson went on to discuss the new information received since the monetary policy meeting in September and how this has affected the economic outlook and inflation prospects abroad and in Sweden. GDP growth abroad is slowing in line with the forecast from September but GDP is still growing at such a rate that resource utilisation is rising. Core inflation abroad is only rising slowly, however, despite strengthening economic activity. Energy prices have, on the other hand, increased rapidly and the forecast for international inflation this year and next year has been adjusted upwards. At the same time, the forecast for the weighted average of international policy rates is basically unchanged.

As already mentioned, the outcomes for GDP growth in Sweden have been revised down in the latest publication from the National Accounts. But both outcomes and confidence indicators still suggest that the growth rate going forward will be higher than an historical average. As regards developments on the labour market, several indicators, including recruitment plans in the business sector and the number of newly registered job openings, point to continued good growth in employment and to a high labour force participation rate. However, unemployment is expected to rise somewhat in the period ahead, as matching between job openings and unemployed persons has deteriorated. CPIF inflation was 2.5 per cent in September, which was somewhat higher than the Riksbank's latest assessment.

Despite GDP growth being revised down, the assessment is still that resource utilisation in the Swedish economy is considerably higher than normal. Pointers such as the Riksbank's indicator of resource utilisation, which compiles a large number of measures of economic activity, suggest this. Despite little spare capacity, core inflation is rather low. Most measures indicate that core inflation rose during the period from 2014 to 2017 and that the increase has since slowed. The fact that CPIF inflation has risen this year is largely explained by rapidly rising energy prices. The upturn in energy prices is not expected to continue, however.

Continued high resource utilisation on the labour market is expected to lead to a gradual increase in wage growth in the period ahead and to a rise in unit labour costs by around 2 per cent a year. In the draft forecast, the krona exchange rate will appreciate, albeit from a relatively weak level. These factors together will contribute to inflation being close to 2 per cent in both 2020 and 2021.

The draft forecast are based on the monetary policy that is expected to gain a majority at today's monetary policy meeting. This means that the repo rate is now left unchanged at –0.50 per cent and that the repo rate will be increased by 0.25 percentage points at the monetary policy meeting in December or February, and that gradual raises will continue after this. At the end of September, the Riksbank's government bond holdings amounted to almost SEK 340 billion, expressed as a nominal amount. As part of the conducted monetary policy, the Riksbank will continue to reinvest principle and coupon payments until further notice according to the decision in December 2017.

§2. The economic situation and monetary policy

First Deputy Governor Kerstin af Jochnick:

I support the assessments made in the draft Monetary Policy Report, and I support the proposal to hold the repo rate at –0.50 per cent with an unchanged repo rate path.

It is only just over a month and a half since our last monetary policy meeting and the forecasts in the draft Monetary Policy Report are basically unchanged. And neither do I make any significantly different assessment of the inflation and economic outlooks and the monetary policy deliberations than I expressed at the meeting in September. Today, however, I would like to take up a number of risks that could change the picture in relation to our main scenario.

Developments abroad continue to look good, even if uncertainty over the strength of international economic activity has increased slightly. The effects of increased trade barriers continue to be an important risk that could affect global trade and, ultimately, the Swedish economy. But when it comes to international developments, we also emphasise a series of other uncertainty factors in the draft Monetary Policy Report, for example surrounding developments in Italy and the effects of the United Kingdom's withdrawal from the EU. For a small, foreign-trade dependent country such as Sweden, weaker international development may have significant effects on the economic outlook. Weaker development abroad would probably also make it more difficult to stabilise inflation in Sweden around the target.

The report includes an article on the development of the real krona exchange rate in the longer term.[1] I think it is a good idea that we regularly make in-depth analyses of the development of the krona in both the long and short term. However, history shows how difficult it is to predict the development of the krona. It also shows that calculation methods can play a major part in the assessment of the long-term real exchange rate.

The conclusions we draw in the article are that the real krona exchange rate 5–10 years ahead will be slightly weaker than we had previously expected. But, despite this, the krona should gradually strengthen from its current level.

We have long expressed concern that the krona may appreciate too quickly, which could hinder possibilities of reaching the inflation target. One important question to ask is how the krona will develop when we start to raise the repo rate. An article in the draft Monetary Policy Report describes what usually happens when the repo rate is raised.[2] Using this article as a basis, together with our regular monetary policy analyses, the krona should strengthen when monetary policy in Sweden is tightened. All in all, however, this argues for moving ahead cautiously with rate rises, just as our repo rate path indicates.

But, even if fundamental factors suggest a stronger krona over the forecast period, there is also uncertainty over the assessment of Sweden made by investors, which, in the event of financial unease, could lead to a lower valuation of the krona than we currently see ahead of us. One such factor is the political uncertainty surrounding the formation of a government, while another is the risks on the housing market and the link to the Swedish banking system.

Since the monetary policy meeting in September, we have received two more outcomes for CPIF inflation, regarding August and September. The outcome for September was in line with and even a little higher than our forecast. Measures of underlying inflation also rose in September. But the increase in energy prices continues to answer for a large part of the contribution to CPIF inflation. For inflation measured in terms of the CPIF excluding energy to be stabilised around 2 per cent, rising price increases will be needed across a broader field. It was therefore welcome news that the September outcome showed that the rate of price increases had risen in several categories of goods and services.

It is reasonable to assume that the weak krona in 2018 will now have an impact in the rate of increase in prices for goods. Prices for services are affected to a greater degree by domestic economic activity. In light of the high level of resource utilisation in the economy and the continued major shortage of labour, wages in Sweden should be able to rise slightly faster in the

[1] See the article "The krona's development in the longer term" in the draft Monetary Policy Report.

[2] See the article "What usually happens when the repo rate is raised?" in the draft Monetary Policy Report.

period ahead. This is also supported by the rising wage growth in both the United States and Germany, a factor to which the labour market parties usually attach importance.

All in all, I make the assessment that there are strong reasons that inflation could stabilise around 2 per cent even when the rising energy prices drop out of the twelve-month figures.

I think it is important that we also discuss today the risks on the housing market and indebtedness among Swedish households. Many analysts are now concerned that the level of interest rates will be raised and draw far-reaching conclusions about the effects on both the housing market and households' ability to keep up with their mortgages. We have been in an extreme situation with negative policy rates for more than 3 years, at the same time as economic activity in Sweden is strong. A normalisation of monetary policy is therefore desirable. The repo rate will be raised slowly and, from a historical perspective, will continue to be very low over the years ahead. The calculations that the banks make in conjunction with credit assessments of mortgage loans will include room for significantly higher interest rates than those reflected by the Riksbank's forecasts. As described in the article on what usually happens when the repo rate is raised, the rate rises in our forecast are modest from a historical perspective.[3] We also noted in an article in December last year that the effects on household cash flows of rate rises, in line with the Riksbank's forecast at that point, were fairly limited overall. But it is important to remember that the most heavily indebted households can be expected to be strongly affected by even moderate rate changes.[4]

As regards the development of the housing market in Sweden, my unease primarily focuses on the effects of a possible fall in housing prices. Even if we have seen signs of stabilisation over the year, history shows how difficult it is to assess price developments on the housing market. A fall in prices could have negative effects on both household consumption and housing investment and could, ultimately, threaten the good economic development we predict in our forecast. It could also have a bearing on the factors I mentioned earlier, namely households' mortgage rates and the development of the krona. My conclusion is that a fall in housing prices would risk considerably increasing uncertainty over economic activity and inflation in Sweden.

Allow me to round off with my monetary policy conclusions: Just as in September, I support the assessment that we are approaching the time for the first rate rise, assuming that economic development continues in line with our forecasts. As described in the draft Monetary Policy Report, the rate will be raised either at the next meeting in December or in February next year. At present, I an unwilling to take a stance regarding at which of these meetings the rate should be raised, but I consider it appropriate to wait until the December meeting for further information on the economic outlook and inflation prospects. As regards monetary policy a little

[3] See the article "What usually happens when the repo rate is raised?" in the draft Monetary Policy Report.

[4] See the article "How are households affected by rising interest rates?" in the December 2017 Monetary Policy Report.

further ahead, we need to move towards a higher repo rate with caution. It continues to be important that inflationary pressures in the economy are held up more lastingly so that inflation can stay stable around the target in the years ahead.

Governor Stefan Ingves:

I agree with the forecasts and assessments of economic development in Sweden and abroad described in the draft Monetary Policy Report. This means that I support the proposal to leave the repo rate at −0.50 per cent, and that the repo rate path is held unchanged. The repo rate path indicates that the repo rate may be raised by 0.25 percentage points in either December or February, assuming that developments in Sweden and abroad are approximately as expected. At the same time, the Riksbank’s reinvestments of redemptions and coupon payments in the government bond portfolio are continuing. This is a precautionary measure now that we are heading towards a gradual normalisation of interest rates.

Our assessment is that economic developments abroad and in Sweden are largely unchanged since the monetary policy meeting in September. International developments remain good. Growth is expected to slow down somewhat in the next few years, but economic activity remains strong in many developed economies. GDP growth in the euro area, our most important trading partner, has slowed down slightly over the first six months of the year and is expected to fall further in the third quarter. But high confidence figures and a strong labour market are expected to lead to growth there making a recovery. Growth is expected to continue to be good in the United States.

But there are risks in both the long and short terms that, should they materialise, may lead to less favourable development. In Europe, there continues to be great uncertainty over the long-term stability of Italian government finances, and over the forms of the United Kingdom’s withdrawal from the EU. In the global arena, the trade conflict between the United States and its major trading partners is continuing, with new measures and countermeasures being announced. And several emerging market economies are grappling with acute difficulties that are due to structural problems and imbalances. Some of these imbalances have become visible in conjunction with the Federal Reserve continuing to raise its policy rate, with a stronger dollar and capital outflows from several emerging market economies as a result. This is a pattern we can recognise from earlier episodes in which the Federal Reserve has raised its rate. So far, no clear signs are visible that these risks have affected international growth in a decisive way. But the uncertainty is significant and it may affect forecasts going forward.

For a number of years now, the Swedish economy has shown very good growth. However, the latest outcome of the National Accounts showed a downward revision of the historical growth for 2016 and 2017. Outcome for the second quarter of this year has also been revised down and our forecast for the full year of 2018 has therefore been lowered to 2.3 per cent. But the view still stands that economic activity in Sweden is strong and has been strong for a longer period. In 2019 and 2020, annual GDP growth is expected to be around 2 per cent. The development of the labour market continues to be strong. Employment and the labour force participation rate are continuing to be on historically high levels. Unemployment has also fallen in recent years. We are now seeing shortages that have not been seen since the start of the millennium.[5]

Inflation is continuing to show development in line with the target of 2 per cent. Since the previous monetary policy meeting, inflation outcomes have largely been in line with the forecasts we had in the September report. Inflation expectations are continuing to indicate that confidence in the inflation target is good. The powerful and unusual monetary policy of recent years has worked. But monetary policy is forward-looking and questions still remain about underlying inflationary pressures and thereby about how persistent the good development of inflation can be expected to be. With one exception, the different measures of core inflation included in the Monetary Policy Report are below two per cent. The rate of increase in prices for services, corresponding to 45 per cent of the CPIF, have fallen since last year. Neither does the rate of increase of prices for goods, which is a good bit below 2 per cent, meet the inflation target. And wage development, an important component in inflationary pressures, continues to be subdued in relation to the strong labour market. This means that monetary policy needs to continue to provide support to the economy. Nevertheless, despite the forecast's moderate wage increases, target fulfilment is good over the forecast period.

Our target variable, the CPIF, has been reasonably close to the target of 2 per cent for almost two years. And inflation expectations have been stable at around 2 per cent for just over one year. But our task is to ensure that inflation also develops in line with the target in the period ahead. How this goes depends partly on the decisions we in the Executive Board take on the shape of monetary policy and partly on a number of international factors. As I see it, the development of international inflation is a key international factor. Via well-integrated markets for goods and services, international price developments affect Swedish inflation. And it is difficult to see that the rate of inflation in Sweden can deviate more permanently from that of the rest of the world. Put another way, continued and sustained target fulfilment at home is conditional on international inflation being about 2 per cent over a longer time horizon. In this context, the moderate underlying inflationary pressures abroad, particularly in the euro area, are an uncertainty factor. But in the wake of rising resource utilisation abroad, underlying inflationary pressures are expected to rise.

The way monetary policy is designed in the major economies is also of central significance for Swedish monetary policy. The ECB's highly expansionary monetary policy has, in recent years, been particularly important for the design of Swedish monetary policy. But, with higher growth

[5] This refers to the proportion of companies in the business sector reporting labour shortages in the National Institute of Economic Research's Economic Tendency Survey.

and good target fulfilment here at home, conditions are in place for Sweden's policy rate to be higher than the ECB's policy rate.

The Federal Reserve is in a rate-rise cycle that was initiated cautiously in December 2015. So far this year, the policy rate has been raised three times, from the interval of 1.25–1.50 per cent to the interval of 2–2.25 per cent. The Federal Reserve is ahead of the central banks in the other major developed economies and was the first of them to normalise its interest rate policy after the global financial crisis 10 years ago. The Federal Reserve's interest rate policy is a further important factor for Sweden's monetary policy, not least because US long-term interest rates may pull long-term interest rates in Sweden and other parts of Europe up with them.

Allow me also to comment on the development of the krona. The krona exchange rate has weakened over the year, contradicting what we had expected in our Monetary Policy Reports over the year. Predicting the krona exchange rate has been very difficult. The methods we use to make exchange rate forecasts are based on traditional relationships that emphasise factors such as relative growth differentials and the development of the current account. Considering Sweden's relatively strong economic development in recent years, it thus seems reasonable to expect the krona to appreciate over the long term. This is how things ought to be, but, at the same time, according to the draft Report's article on the real exchange rate, empirical evidence suggests that the krona has depreciated in real terms. The road to a stronger krona may take many twists and turns, as financial flows can also push the krona exchange rate in a weaker direction. We must continue to dig into these questions and, as far as possible, attempt to separate pure technicalities from more structural changes that are affecting the real exchange rate.

The repo rate path included in the draft Monetary Policy Report indicates that the rate will be raised by 0.25 percentage points at the monetary policy meeting in either December or February. There is less than two months between these two meetings and, for our macroeconomic forecasts, it likely matters little whether the rate is raised in December or February. But on the financial markets there is, of course, great interest in exactly when a rate rise may arrive, among other things because prices for various financial instruments are typically affected when the Riksbank adjusts its policy rate. However, we will have to follow developments until December and then decide what would be the most appropriate decision. At the same time, my assessment is that rate rises, when they are initiated, will be implemented at a slow rate compared with previous rate-rise cycles. This is also illustrated by Figure 2:11 in the Report, which compares the current forecast for the repo rate, which is to say the repo rate path, with the actual rate rises that the Riksbank implemented in the three previous rate-rise cycles.

In summary, my assessment is that, if developments are as described in the draft Monetary Policy Report, the conditions will soon be in place to start raising the repo rate. The repo rate has been negative for over three and a half years and, expressed in real terms, it has been negative for over six years. It would be strange, to say the least, if such powerful monetary policy stimulation measures were to be needed for an even longer period in order for inflation to develop in line with target in the period ahead. According to our assessments, the underlying inflationary pressures indicate that it will soon be time to introduce a cautious normalisation of monetary policy. Households' increasing debts have long been a great source of unease and, in light of this too, a coming rate rise, together with subsequent further rate rises over the foreseeable future, would be a step in the right direction to restrain debt accumulation.

Deputy Governor Per Jansson:

Since the monetary policy meeting in September, two new outcomes for inflation and inflation expectations respectively have been published. The inflation outcomes are for August and September. After some disappointment in August, when inflation in terms of both the CPIF and the CPIF excluding energy prices was lower than expected, the September figures involved quite a significant, and, of course, very welcome upturn. CPIF inflation rose from just under 2.2 per cent to 2.5 per cent and adjusted for energy prices, the inflation rate increased from just under 1.2 per cent to just over 1.6 per cent. Although the outcomes were only marginally higher than the forecasts in the last Monetary Policy Report, all the overestimated inflation from August, and a little more besides, was recuperated. This is good news, of course.

But perhaps the most pleasing aspect is that there are now several signs that the longer-term trend in inflation is now starting to pick up. The fact that CPIF inflation excluding energy prices, which the Riksbank uses as one of its measures of core inflation, from August to September, increased by almost half a percentage point is one such sign. Another is that all the other measures of core inflation regularly estimated by the Riksbank also rose significantly in September. After staying around 1.5 per cent for a number of months and also having demonstrated a falling trend, the median core inflation measure rose to just over 1.7 per cent in September. The two measures that have been shown in an empirical evaluation to be best at predicting CPIF inflation in the future, UND24 and CPIFPC, were just over 1.8 and 1.7 per cent respectively in September.[6]

Another sign that inflation is increasing is that the rate of increase in service prices rose in both August and September. Service price inflation, a key indicator which makes up a whole 45 per cent of the CPI basket, has, after all, been characterised by a clear downward trend since the summer of last year, so this change of direction is particularly significant. The change has also been confirmed by the fact that underlying service price inflation also rose in both August and September.[7] For this measure, the upturn over the last two months has been very rapid, from

[6] See the article "Why measures of core inflation?" in the draft Monetary Policy Report.

[7] This refers to service price inflation excluding rents, foreign travel, telecommunications services and property tax and adjusted for the effects of tax changes (for example to tax credits for domestic services).

just under 1.6 per cent to around 2.4 per cent. As a result, underlying service price inflation is now also once again clearly higher than the rate of increase in total service prices, which feels reassuring in my opinion. The fact that the rate of price increase for goods and food turned sharply upwards in September and was the highest for 33 months obviously does no harm in this context.

With that I move on to the new outcomes for inflation expectations, as measured in Prospera's monthly and quarterly surveys. The new outcomes consist here of the monthly survey for October, which only applies to money market participants, and the larger quarterly survey for September, which also includes the inflation expectations of the labour market organisations, among others. The overall picture is that expectations have risen somewhat and are now either on the inflation target or slightly above it. As regards the labour market organisations' inflation expectations, which I deem to be especially important for the Riksbank to follow, expectations one, two and five years ahead are now in the interval 1.9–2.2 per cent, compared with 1.8–2.3 per cent in the previous measurement for June. Confidence in the inflation target among the labour market organisations therefore seems to have increased somewhat, which is of course very positive.

One aspect that has concerned me for a while as regards inflation expectations is that although the measured figures are close to 2 per cent, price and wage formation nevertheless does not seem to be fully contingent on the inflation target. A sign of this is that wage growth continues to be very moderate, around 2.5 per cent, particularly in light of the good economic situation and the fact that, at this juncture, inflation is actually overshooting the inflation target somewhat. The latter is probably also an important reason for why a number of figures in Prospera's measurements of inflation expectations, which I just touched upon, have recently started to be slightly above the inflation target. Modestly higher wage growth, in line with the Riksbank's forecasts, would in this situation, as I see it, not be a threat to competitiveness but on the contrary be good for the Swedish economy. And it is possible that this is now starting to happen. I note, in this context, that the Swedish Unions within Industry have recently stated that "our goal is that our members shall receive real wage increases" and that monetary policy "has ... produced results" with "inflation and inflation expectations ... back around the target".[8]

The conclusion I draw from the developments in inflation and inflation expectations is that the current inflation picture is slightly better than in September. But it is important to stress that this is also exactly what we had expected. However, the rapid increase in inflation in September, after the disappointment in August, in combination with rising core inflation and a change of direction in the rate of increase in service prices does, in this situation, give reason for a little extra optimism. At the same time, however, there is no denying that quite a lot of the positive picture

[8] See https://www.svd.se/inflationsmalet-ar-centralt-for-lonebildningen. The quotes have been translated from Swedish into English.

comes from figures for a single month. And question marks also remain regarding how well price and wage formation are actually contingent on the inflation target, despite the measured inflation expectations having been close to 2 per cent for some time now. It is therefore a question of the trend continuing in the period ahead. This leads me on to the forecast proposal of the draft Monetary Policy Report.

Overall, the forecast changes proposed in the draft report are minor. Certain shifts occur in the determinants of inflation but the various effects are ultimately deemed to basically cancel each other out. Just as in September, CPIF inflation excluding energy prices is thus expected to remain at approximately its current level for the rest of this year, and then to rise somewhat during the first half of 2019 to be close to 2 per cent. CPIF inflation will in turn remain around 2.5 per cent until the turn of the year and rise slightly further early next year. From mid-2019, the contribution to inflation from energy prices will weaken, resulting in CPIF inflation falling and being slightly under 2 per cent for a while. After these more short-term upward and downward variations, CPIF inflation is expected to be close to the inflation target.

This inflation forecast is contingent on the same monetary policy as in September, which involves the repo rate being increased by 0.25 percentage points in either December or February, and thereafter being further raised slowly, with approximately two increases per year of 0.25 percentage points each time. I support both the macro forecast and the monetary policy in the draft Monetary Policy Report. I would also like to emphasise that I share the view in the draft report that monetary policy in the period ahead must be designed carefully and constantly be adjusted with regard to the prospects for inflation. This applies to both the first and the subsequent increases.

It is, of course, not particularly difficult to understand that there are requests and hopes that we will clarify at today's monetary policy meeting whether we believe that the first increase of the repo rate will be able to be decided in December or whether we need to wait until February. For my part, I think that it is good that no such clarification is now proposed in the draft Monetary Policy Report. The uncertainty regarding the strength of inflationary pressures remains significant, despite the improvements I have discussed. Also, the world around us also continues to be risky and complex, with several risks that could potentially be game-changers. This applies, for example, if the ongoing trade conflict between the United States and China escalates further or spreads to other countries, or if the euro area encounters serious difficulty as a result of the new expansionary draft budget in Italy. In this situation, I do not perceive further clarification to what, in my opinion, is already a clear monetary policy plan to be particularly sensible. It would only make it even more difficult to change the plan and postpone the first increase if this were to prove necessary.

Deputy Governor Martin Flodén:

At the monetary policy meeting in September, I deemed that it would probably be appropriate to start raising the repo rate at the meeting today. Developments since the September meeting have strengthened my opinion. I therefore advocate that the repo rate be increased today by 0.25 percentage points to −0.25 per cent. My view of the appropriate level for the repo rate from the second six months of next year and on coincides with the proposal in the draft Monetary Policy Report.

Monetary policy over the last four years has been focused on managing weak inflationary pressures, excessively low inflation, low inflation expectations and generally weak confidence in the inflation target.

The expansionary monetary policy has had an effect and inflation has now risen substantially. CPIF inflation, which was 0.5 per cent in 2014, was 2.0 per cent last year and is expected to be 2.2 per cent this year. The Riksbank's forecast is that CPIF inflation will be 2.1 per cent next year if monetary policy is designed according to the proposal in the draft Monetary Policy Report.

Core inflation has also risen, even if not as clearly. Measured in terms of CPIF excluding energy, it was 0.7 per cent in 2014. It is expected to be 1.5 per cent this year and 2.0 per cent next year. Core inflation has repeatedly been surprisingly low. However, the increase to 1.6 per cent in September supports our assessment that the high resource utilisation in the Swedish economy will mean that inflationary pressures will be higher next year than this year. A closer examination of the various components behind the latest inflation outcome strengthens the view that there are good conditions for slightly stronger inflationary pressures in the period ahead.

Inflation expectations, which fell rapidly in 2014, have in recent years returned to levels compatible with the inflation target. Confidence in the inflation target may not have been completely restored yet, but it has strengthened.

In addition, inflation is expected to be held above two per cent for some time to come due to the high energy prices. I deem, therefore, that the risk is small that a rate rise today would result in setbacks reviving the confidence problems of recent years.

One factor supporting this assessment is that the financial markets are now fairly well prepared for a rate rise. It is true that there are no expectations that we will raise the repo rate today but, after our September meeting, the market participants have increasingly started to expect a rate rise in the near future. I therefore consider that a rate rise today, combined with clear signals that we see a continuing need for low interest rates would not entail an excessive tightening of monetary policy or the financial conditions.

I would like to emphasise and repeat that the conditions for monetary policy in Sweden have been problematic in recent years. It is relatively easy to conduct monetary policy when confidence in the inflation target is strong. Price-setting and wage formation are then based on expectations that inflation in the future will be close to 2 per cent and the inflation target then becomes almost self-fulfilling. The conditions are more problematic when confidence in the inflation target is weak. In this case, there is nothing that means that inflation will always automatically move towards 2 per cent in the long run. In such a situation, monetary policy must therefore focus clearly on the development of inflation and cannot be formulated as flexibly.

The Riksbank's choice has thus not been between a strategy that rapidly brings inflation back to 2 per cent and another strategy that takes greater account of the strong economic activity and allows inflation to move back to 2 per cent more slowly. Instead, the choice has been between attempting to restore strong confidence in the inflation target or dropping the inflation target's role as the economy's nominal anchor.

The situation is now becoming different as inflation has risen and confidence in the inflation target has strengthened. The challenges for monetary policy have thereby subsided and the possibilities for again conducting a flexible monetary policy have improved. But I am still more concerned that inflation will be too low in the period ahead than that it will be too high. Despite the high level of resource utilisation and the expansionary monetary policy, inflationary pressures have only risen slowly. It is clear that inflation still needs a lot of support from an expansionary monetary policy and that rate rises in the period ahead must not be too rapid.

In conclusion, allow me to say something about how monetary policy is linked to the economic outlook. Internationally, there are several large causes for concern that could, in less favourable scenarios, lead to comprehensive economic problems with spillover to the Swedish economy. I am mainly thinking, of course, of the risks we mention in the Monetary Policy Report: trade conflicts, the public finances in Italy, the negotiations around the United Kingdom's withdrawal from the EU, etc. In Sweden, where economic activity is strong and resource utilisation high, there are some signs that economic activity is starting to slow down. This applies particularly to the construction sector and to the housing market, where there are some risks that the slowdown could be rapid.

It may seem odd, in this situation, that I want to start tightening monetary policy. After all, monetary policy is supposed to be forward-looking. The explanation is connected with my reasoning around the possibilities of conducting a flexible monetary policy. In recent years, monetary policy in Sweden has focused on inflation and is not calibrated according to the level of economic activity. Even if resource utilisation falls in the years ahead, the level of economic activity in itself will hardly be an argument for such an expansionary monetary policy as we have conducted in recent years. On the other hand, the combination of continued moderate inflationary pressures and a weakening resource utilisation suggests that repo rate rises will be slow in the period ahead.

In summary, I thus advocate that the repo rate be increased today by 0.25 percentage points to −0.25 per cent. And I advocate a repo rate path that coincides with the one proposed in the draft Monetary Policy Report as of the third quarter of next year. With these reservations concerning the monetary policy considerations, I support the draft Monetary Policy Report. Conditional on the monetary policy that seems to be supported by a majority of the Executive Board, I also support the forecast in the draft report. Conditional on the monetary policy I advocate, I believe that the exchange rate would be slightly stronger in the near future and that inflation would be slightly lower in the coming year, but that the forecast differentials would otherwise be small.

Deputy Governor Henry Ohlsson:

To begin with, I would like to say that I do not support the proposal to hold the repo rate unchanged at −0.50 per cent. It is my opinion that the repo rate should be increased by 0.25 percentage points to −0.25 per cent. As a consequence of this, I also am of the opinion that the interest rate path should be brought forward so that it is consistent with my proposed repo rate increase.

I have, at the last four monetary policy meetings, argued that the repo rate should be raised. Nothing has happened since the September meeting to change my opinion. I thus consider on this occasion, too, that the repo rate should be raised. My reasons are as follows:

The economic situation abroad is good. One expression of this is that global trade in goods is increasing. Over the past twelve months, the average annual rate of increase has been just under 4.5 per cent. Increased trade is of crucial importance for a small, open economy like Sweden's. The dawning protectionism therefore gives cause for concern. At the same time, it remains to be seen what consequences new tariffs and sabre-rattling about new trade barriers will have on world trade.

Annual growth abroad, KIX-weighted, is expected to amount to 2.6 per cent in 2018 according to the draft Monetary Policy Report. For 2019, the forecast is 2.3 per cent. The KIX-weighted inflation rate is expected to be 2.2 per cent in both 2018 and 2019.

The good global macroeconomic conditions mean that, as regards international developments, there are expectations of less expansionary monetary policy. The Federal Reserve has increased its policy rate several times. According to the draft Monetary Policy Report, the weighted average of international policy rates is expected to rise, albeit at a slow pace.

Let me now move on to Sweden. The CPIF has been the target variable for monetary policy since last year. The most recent inflation figure in September showed an annual rate of increase in the CPIF of 2.5 per cent. CPIF inflation has been around the inflation target for a long time. Over the last 18 months, it has been in the interval 1.7–2.5 per cent. The average rate of inflation over these 18 months has been 2.1 per cent. According to the forecast in the draft Monetary Policy

Report, the annual rate of inflation will be 2.2 per cent in 2018. In 2019, the CPIF is expected to increase by 2.1 per cent as an annual rate. Target achievement is good!

The October reading of five-year inflation expectations among money market participants was 2.0 per cent. Over the last 34 months, the mean value of five-year expectations has been 1.9 per cent or higher. If two-year expectations are examined, the view of inflation expectations being at the two per cent target becomes stronger. In October, these expectations were at 2.1 per cent. Two-year expectations have been 1.9 per cent or higher for the last 22 months. In October, one-year expectations were at 1.9 per cent or higher for the fourteenth month in a row. Inflation expectations are now well anchored!

I will now move on to a discussion of the situation on the labour market. The labour force surveys (LFSs) provide the official measure of unemployment in Sweden. According to the most recent labour force survey, unemployment was 6.0 per cent (not seasonally adjusted) in September. This is slightly lower than the corresponding month one year earlier, when LFS unemployment was 6.2 per cent. But, in the seasonally adjusted series, a clear increase in unemployment during the third quarter this year can be seen. The conclusion is therefore that LFS unemployment has bottomed out.

At the same time, I think it is important to also look at other measures of unemployment when interpreting the LFS. Unemployment insurance fund members can be considered to have a relatively strong position on the labour market. In September 2018, the percentage of openly unemployed members of unemployment insurance funds was 2.6 per cent. This is slightly higher than in the same month one year ago, when the proportion was 2.4 per cent. A few tenths of one per cent here or there makes no great difference, but qualitatively, it is interesting that the downward trend that we have seen for several years has now been broken. The break in the trend emphasises that unemployment has now bottomed out.

In my opinion, however, unemployment is still too high. But today it is rather a matter of bringing down unemployment among those born abroad. And this is not primarily a question of managing aggregate demand but rather of labour market policy measures to strengthen the human capital of unemployed persons and cut the cost of employing them.

Against the backdrop of this reasoning, I would now like to move on to my monetary policy considerations. My starting point is that monetary policy cannot be governed by inflation varying a few tenths of a percentage point around 2 per cent in individual months. But inflation has now been close to the target of 2 per cent for a longer period of time, both with regard to outcomes and expectations. This is the decisive argument for me that indicates that it is high time to start normalising monetary policy. But instead, monetary policy has remained very expansionary in 2018, if we look at the real repo rate according to the draft Monetary Policy Report (see Figure 1:9).

The price stability target for monetary policy essentially concerns households' living costs not increasing too rapidly. This is why the consumer price index is used to measure inflation. In Sweden, it is the CPI that is the measure of living costs and the target for monetary policy is defined in terms of the CPI with a fixed interest rate, the CPIF. It is of course interesting to study different breakdowns of the CPIF. They could, for instance, concern the difference between goods and services. It could also be a case of comparing prices that develop as a result of a permanently ongoing development with prices that result from temporary changes.

But it is important that such analyses do not eclipse the target for monetary policy. The introduction of the variation band was also based on the fact that there may always be unexpected events, white noise and uncertainty, making it not always possible to exactly attain the inflation target. If one chooses to discount certain prices, one risks excluding relative price changes. Since 2016, energy prices have shown an increasing trend that is faster than other prices in the CPIF.

The Riksbank has recently published an Economic Commentary[9] discussing underlying measures of inflation. One desirable characteristic of such a measure is that its mean value, over a longer period, is the same as the mean value of the CPIF. On the basis of the data published in the Commentary, I draw the conclusion that most of the different underlying measures that the Riksbank calculates have mean values below the mean value of CPIF inflation. The underlying measure that is furthest from CPIF inflation is CPIF inflation excluding energy.

I furthermore draw the conclusion that most underlying measures are characterised by as much noise – not less noise – as CPIF inflation. There are exceptions, some measures of underlying inflation really do have less noise, but this applies to far from all.

I can support, in parts, the economic picture and the forecasts in the draft Monetary Policy Report. But, on the basis of my monetary policy considerations, I cannot support the monetary policy conclusions in the draft Monetary Policy Report.

To summarise, it is my opinion that the repo rate should be increased by 0.25 percentage points to −0.25 per cent. As a consequence of this, I also am of the opinion that the interest rate path should be brought forward (but with the same slope as in the draft Monetary Policy Report) so that it is consistent with my proposed repo rate increase.

Deputy Governor Cecilia Skingsley:

I support the draft Monetary Policy Report, the proposal to hold the repo rate unchanged and the proposed repo rate path.

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[9] Johansson, J., M. Löf, M. Sigrist and O. Tysklind, "Measures of core inflation in Sweden", Sveriges Riksbank, Economic Commentaries No. 11, 2018. One of the articles in the draft Monetary Policy Report summarises the Commentary.

In addition, I would like to make more detailed comments on international risks, the Swedish economy and my thoughts on monetary policy.

Since September, the economic outlook has been largely the same. Inflation is close to target and the conditions are good for it to be close to target over the entire forecast period.

Global economic developments continue to be positive, but the risks of less positive developments have increased somewhat. These risks derive, in particular, from ongoing trade conflicts between the United States and other countries and from difficulties in individual countries that are causing financial conditions to tighten. So far, contagion effects from these risk factors via financial markets and optimism seem to be limited. However, problems in global trade in particular look like being a persistent theme for the global economy. In the latest minutes from the monetary policy meetings of the Federal Reserve, some members noted that tariffs on steel and aluminium are holding back investments in the energy sector and that companies are attempting to realign their global value chains as a result of uncertainty over tariffs. Should the uncertainty over the ground rules for global trade be persistent, it will have a subduing effect on both the economic and structural growth prospects for Sweden, so caution will be necessary ahead of decisions on rate rises.

The Swedish economy is continuing to develop strongly, even though Statistics Sweden's revisions for 2016 and 2017 indicated weaker historical growth than has been reported previously. This explains the Riksbank's downward revision of growth for 2018.

But the economic assessment is based on significantly more facts than the growth data. Despite the revisions, capacity utilisation is nevertheless high and unemployment is comparatively low, and labour shortages are indicated in many sectors. Furthermore, corporate and household optimism remain high. However, the historical revisions imply lower productivity than previously reported, and this means that I have become somewhat less optimistic about long-term growth prospects for the Swedish economy.

Since the previous monetary policy meeting, it is also notable that inflation for September was slightly higher than expected and the price rises were allocated broadly, indicating that the forecast of inflation close to target is holding up. In addition, we have also had another month of inflation expectations signalling high confidence that inflation will be close to 2 per cent over the entire forecast horizon.

I will now move on to my monetary policy assessment.

As it takes time for monetary policy to have its full effect on inflation and the economy as a whole, monetary policy is based on forecasts. Another way of describing it is to say that it is the economic outlook and inflation prospects a little ahead that are the most relevant for monetary policy decisions.

During the years of inadequate attainment of the inflation target, the Executive Board was generally more than normally focused on statistics for the economic present. Tolerance for poor statistical outcomes compared to forecasts was low and, on several occasions, demanded significant adjustments to forecasts and decisions for further monetary policy expansion.

But now, this period seems to be behind us and, with inflation expectations anchored, monetary policy can again be conducted with its sights more clearly set on the future.

For me personally, this will mean a greater focus in the period ahead on inflation prospects in the slightly longer term, although still within the three-year forecast horizon the Riksbank uses. This means that the possible effects of the new statistics on the forecasts will be relevant, rather than the statistical outcome itself. It also means that I have greater acceptance of forecast deviations when they can be considered as mostly temporary or are not expected to affect inflation expectations.

At the same time, I would like to be clear that the published repo rate path does not entail a predetermined rate of increase, but is only a forecast on the basis of current economic prospects. We are leaving a period of excessively low inflation and inflationary pressures can hardly be described as worryingly high. The reduction of the monetary policy expansion therefore needs to take place gradually and without jeopardising confidence as it is measured in inflation expectations.

In the near future, the repo rate path reflects an even probability for a 25 point rate rise at one of the meetings in December and February. On the one side, international risk in particular may entail the possibility of waiting further, after the December meeting. On the other side, actual inflation has been on or above target for 11 of the last 21 months and underlying price pressures are on the advance, given that the economy is close to peak activity. However, a rate rise in December or February will not entail a significantly different monetary policy or lead to any macroeconomic effects. The inflation prospects at the coming monetary policy meeting will determine whether I support a rise in December or whether I wait until the following meeting.

As I said initially, I support the proposal in the draft Monetary Policy Report to hold the repo rate unchanged at today’s monetary policy meeting. A vote for a rate rise as soon as today’s meeting, if it received enough support from the Executive Board to be implemented, would be a major surprise for economic agents. Sometimes, rapidly shifting economic conditions require monetary policy decisions that entail surprise, but, at present, I see no circumstances in the inflation prospects that could justify a rise. In addition, the macroeconomic effects of choosing between the three different dates for a rise (today, in December or in February) are entirely negligible.

§3. 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,

• to hold the repo rate at –0.50 per cent and that this decision will apply from Wednesday 31 October 2018.

Deputy Governors Martin Flodén and Henry Ohlsson entered reservations against the decision to hold the repo rate unchanged and advocated raising the repo rate to −0.25 per cent. Mr Flodén referred to the upturn in inflation and the strengthened confidence in the inflation target and advocated a repo-rate path that coincides with the path in the report as from the third quarter of 2019. Mr Ohlsson referred to the strong economic development in Sweden and abroad and advocated bringing forward the repo-rate path with the same gradient as the repo-rate path in the Monetary Policy Report.

§4. Other decisions

The Executive Board decided

• to publish the Monetary Policy Report and decisions under Section 3 with the motivation and wording contained in a press release at 09.30 on Wednesday 24 October 2018, and

• to publish the minutes from today's meeting at 09.30 on Friday 2 November 2018.

This paragraph was verified immediately.

Minutes taken by

Maria Kindborg

Verified:

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