Minutes of Monetary Policy Meeting

July 2015

Summary

At the monetary policy meeting on 1 July, the Executive Board of the Riksbank decided to cut the repo rate by 0.10 percentage points to -0.35 per cent and to extend the purchases of government bonds by a further SEK 45 billion from September and until the end of the year. The repo rate is expected to be around -0.35 per cent for just over a year. The repo-rate path also reflects the fact that it is possible to cut the repo rate further. The expansionary monetary policy underlines the Riksbank's aim to safeguard the role of the inflation target as nominal anchor for price-setting and wage-formation.

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.

Inflation in Sweden has been rising for some time now, partly as a result of the krona weakening over the past twelve months. As economic activity grows stronger, however, domestic cost pressures also increase and it will be easier for companies to raise their prices. CPIF inflation is expected to be close to 2 per cent from the end of 2015. GDP is expected to grow more rapidly than normal in the years ahead and the labour market continues to improve.

Growth is also rising abroad, but uncertainty has increased as a consequence of the most recent events in Greece. The forecasts are based on the events in Greece not hampering recovery in the euro area.

Compared to the Riksbank's forecast in April, the krona has grown stronger, and its exchange rate thereby poses a risk to the upturn in inflation.

The Executive Board was in agreement that in this uncertain environment, monetary policy needs to be even more expansionary to ensure that inflation continues to rise towards the target of 2 per cent.

All the board members considered it appropriate to increase purchases of government bonds by a further SEK 45 billion. Five members also advocated a cut in the repo rate by 0.1 percentage points to -0.35 per cent, although one member wished to leave the rate unchanged at -0.25 per cent.

The board members ascertained that the Riksbank still had a high level of preparedness to make monetary policy even more expansionary if necessary, even between the ordinary monetary policy meetings.

The Executive Board stressed that because of the prevailing uncertainty surrounding events in Greece, the Monetary Policy Report had become a living document right up to the day before the monetary policy meeting.

Developments in the rest of the world, the urgent need to deal with the mandate and tools in the macroprudential policy area and the importance of measures in this area were other topics discussed at the meeting.

MINUTES OF MONETARY POLICY MEETING
Executive Board, No. 3

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DATE: 1 July 2015

TIME: 09.00

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

Michael Lundholm, Vice Chair of the General Council

Meredith Beechey Österholm
Charlotta Edler
Lena Eriksson
Mattias Erlandsson
Eric Frieberg
Tobias Helmersson (§ 1)
Mia Holmfeldt
Jens Iversen
Anna Lidberg
Pernilla Meyersson
Marianne Nessén
Christina Nyman
Cecilia Roos Isaksson
Maria Sjödin
Lena Strömberg (§1)
Ulf Söderström
Sara Tägtström
Anders Vredin

It was noted that Anna Lidberg and Sara Tägtström would prepare draft minutes of § 2, and 3 of the Executive Board's monetary policy meeting.

§1. Economic developments

Tobias Helmersson of the Markets Department began by presenting the latest developments on the financial markets. Market focus has been on the developments in Greece. Prior to the monetary policy meeting, Greece defaulted on a payment to the IMF and announced a referendum on its international creditors' proposed reform programme. So far, market reactions to the turbulence surrounding Greece have been tangible, but controlled. The spreads between government bond yields in periphery countries and those in Germany have increased somewhat. In Sweden, the financial markets are said to be functioning well, but the repo market is somewhat strained.

The krona has strengthened marginally over the past week. Since the April Monetary Policy Report, the krona has appreciated by 2.5 per cent, in KIX-weighted terms. The expectations of monetary policy according to survey and market pricing show a unanimous picture, with expectations of an unchanged repo rate in July. Going forward, the picture is more divided with different analysts having different views; some are expecting a repo-rate cut at one of the monetary-policy meetings in the autumn.

Marianne Nessén, Head of the Monetary Policy Department, presented the draft Monetary Policy Report which, in the assessment of the Monetary Policy Department, would 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 16, 17 and 22 June. The draft Monetary Policy Report was tabled at a meeting of the Executive Board on 26 June. On 30 June, the Executive Board held an extra meeting to discuss the Monetary Policy Report in the light of the most recent events in Greece.

Economic activity abroad has continued to improve gradually in line with the forecasts made by the Riksbank in April. How the course of events in Greece should be dealt with in the Monetary Policy Report and in the forecasts has been an important issue to the very last. The forecasts are based on the assumption that the course of events in Greece will not prevent the recovery in the euro area, but that the events of the past few days have increased the uncertainty of the forecasts.

Only minor revisions have been made to the forecasts for economic developments in Sweden. GDP growth slowed down as expected in the first quarter. Supported by the expansionary monetary policy, GDP is expected to grow at a faster pace than the historical average in the coming years. Unemployment will fall gradually from the current level of 7.8 per cent to just below 7 per cent at the end of the forecast period. The household debt ratio (debt as a percentage of disposable income) is expected to rise somewhat faster in the short term as debts are expected to rise faster and disposable incomes to show weaker development.

Inflation has been increasing for a while now. In May, CPIF inflation was 1 per cent and the CPIF excluding energy was 1.5 per cent. One explanation for the rising inflation is that the krona has weakened over the past year. The earlier weakening of the krona will continue to contribute to rising inflation for a further period. Expansionary monetary policy, rising resource utilisation, higher wages and higher demand that makes it easier for companies to raise their prices cause CPIF inflation to rise and reach 2 per cent from the end of 2015.

The Swedish krona has appreciated against several currencies recently, and the trade-weighted exchange rate, KIX, is therefore stronger than in the forecast from April. It is expected to weaken in connection with the announcement of the monetary policy decision. However, the uncertainty and the relatively strong fluctuations on the foreign exchange market are making it difficult to assess how the exchange rate will continue to develop. If the exchange rate is too strong in relation to the Riksbank's forecast, there is a risk that the upturn in inflation that has begun will be broken off. The forecasts in the draft Monetary Policy Report are contingent on the repo rate being cut by 0.1 percentage points to -0.35 per cent. The repo-rate path reflects the fact that it is possible to cut the repo rate further. It is considered appropriate to begin slowly raising the repo rate at the end of 2016. The forecasts are also contingent on the Riksbank extending the purchases of government bonds by a further SEK 45 billion until the end of the year. These purchases will begin in September when the current programme is completed.

§2. The economic situation and monetary policy

Deputy Governor **Cecilia Skingsley** began by saying that today's monetary policy decision is being made in an international environment that is difficult to assess with regard to financial markets and macroeconomic developments. Greece's acute financial problems and unclear economic future could well become a threat to the gradual economic recovery that has been taking place in the euro area during the spring.

This development is a reminder of two important rules that apply to all countries wanting to be a part of the global economy, said Ms Skingsley. Namely, having a clear framework for economic-policy decision-making and trying to hold economic developments on a course that is both sustainable in the long run and resilient to various types of shock.

In this context, she wished to draw attention to a significant weakness for Sweden, namely that there is still no functioning framework to be able to make decisions in the field of macroprudential policy, which is the area that aims to prevent financial imbalances that can cause new crises.

Ms Skingsley pointed out that ever since 2011, the IMF has on repeated occasions given Sweden clear recommendations regarding macroprudential policy. These recommendations have included ensuring that one single body is responsibility for this policy. The macroprudential policy body should have a clear mandate and should have an independent position. She feels that the fact that Finansinspektionen's mandate to manage macroprudential policy still lacks a legal basis, despite the fact that it is now four years since the IMF made its first recommendation in this field, does not tally with Sweden's normal ambitions and ability to implement important reforms.

Without any stipulated time limit, the government is looking into the question of Finansinspektionen's legal mandate regarding macroprudential policy. Ms Skingsley therefore wishes to point out that there is scope at any time for the Riksdag (Swedish parliament) and the Government to use legislation and fiscal policy tools to reduce the risks of a debt-driven economic development.

Ms Skingsley supported the forecasts and proposals for monetary policy decisions presented in the draft Monetary Policy Report. These forecasts show that the economic recovery in Sweden is continuing in line with the earlier assessment. The outcomes in different measures show a continuing rise in inflation. When adjusted for energy prices and interest rates, inflation reached the highest level in five years during the month of May.

The Riksbank's Business Survey shows that consumer-related companies are raising the level of their quantified pricing plans for the first time since 2013. Ms Skingsley assesses that the prospects for the inflation forecast to materialise are good. But she underlined that vigilance is still required. This is partly because international risks can jeopardize companies' willingness to raise prices and partly because various types of increase in supply are holding back price pressures. One example here is the new population forecast from Statistics Sweden in May, which once again shows a development with an even stronger growth in the working-age population. Population growth in Sweden is about to become the highest since 1860.

In addition, price pressures are currently being held back by many companies perceiving stiffer competition from abroad, that investment is mostly undertaken with the aim of increasing productivity and that technological advances are very rapid in many sectors.

One of several factors important to the upturn in inflation is the development of the exchange rate. At the monetary policy meeting in April, Ms Skingsley expressed the preference that if the krona appreciation forecast in KIX terms came sooner or was stronger than was anticipated, she was prepared to support further monetary policy expansion. The draft Monetary Policy Report forecasts a stronger krona rate in the near term and this is one reason why she supports today's monetary policy decision. She sees the need for further stimulus as independent of the course of events abroad over the past few days.

The repo-rate cut, the lower repo-rate path and extended bond purchases during the period September to December should be regarded as a whole, according to Ms

Skingsley. She does not believe that a 0.1 percentage point cut in the repo rate has decisive significance for the fulfilment of the inflation target. But as the Riksbank is gradually testing the question of the repo rate's lower bound, it is reasonable to work on reducing the actual level of the rate in smaller steps.

She noted that to some extent today's decision would surprise the financial markets, which were expecting small or no monetary policy relief on this occasion, according to various surveys and pricing. However, international risks and the ECB asset purchase programme implemented since the start of the year warrant a more flexible approach by the Executive Board, and this sometimes leads to surprises. She also wanted to point out that a number of market agents are expecting further monetary policy relief, albeit later in the year.

Finally, Ms Skingsley is hoping that today's decision will be perceived as showing that the Executive Board still has a strong ambition to bring back inflation to the target level as shown in the forecast in the draft Monetary Policy Report.

First Deputy Governor **Kerstin af Jochnick** began by saying that she largely shared the assessment of developments in Sweden and abroad presented in the draft Monetary Policy Report. She supports the proposal to cut the repo rate by 0.1 percentage points to -0.35 per cent and to adjust the repo-rate path. She also supports the proposal to extend the purchases of government securities by SEK 45 billion from September until the end of the year.

Ms af Jochnick notes that the assessments of economic developments in Sweden and abroad follow the forecasts from the April Monetary Policy Report fairly well. Growth has been revised down somewhat in the United States, but the US economy is increasingly strong, which is positive for the global economy. The picture is divided in the large emerging markets, with weaker developments in Russia and Brazil, some slowdown in growth in China and brighter economic prospects in India. The Riksbank has pointed out in earlier reports that a number of uncertainty factors abroad affect decisions by companies and households on consumption and investment. The Riksbank's most recent company survey also confirms that uncertainty over developments abroad has continued to affect export companies' investment decisions in particular.

Moreover, developments in Greece in the past week mean that the uncertainty has increased, said Ms af Jochnick. It is at present difficult to assess the consequences for the euro area and ultimately how the Swedish economy will be affected. The assessment depends on both the potential effects on growth in the euro area and how the krona develops.

Ms af Jochnick observed that there has been continuing high volatility on the fixed-income and foreign exchange markets since the monetary policy meeting in April. There are several factors that have affected this development. This has concerned both the effects of the ECB's extensive purchases of securities and the fact that there have been clearer signs of a recovery in the euro area. Another factor is the uncertainty in the market with regard to the timing of when the Federal Reserve begins to raise its policy rate.

At the same time, there has been a global upturn in long-term bond yields. However, Ms af Jochnick point out that it is not certain that this has counteracted the effects of the central banks' measures, as some have claimed. It could instead be the case that these measures and stronger macro figures in the euro area mean that the market assesses that the risk of inflation being too low – or of deflation – has declined. As a consequence of the upturn in global bond yields, the yield on long-term Swedish government bonds has also risen. It is too early to make a complete evaluation of the Riksbank's bond purchase. However, she agrees with the assessment in the Monetary Policy Report that the longer government bond yields would probably have been even higher if the bond purchases had not been made. The Riksbank's government bond purchases have also contributed to the yield spreads in relation to Germany, for instance, remaining fairly stable. Given these experiences, Ms af Jochnick assessed that the purchases of government bonds should be extended until the end of the year and that limited tolerance should be shown for the krona strengthening too rapidly in the near term. A rapid appreciation of the krona would not be welcome, as it would risk the upturn now envisaged in the underlying inflation rate.

Inflation in Sweden has developed in line with the Riksbank's forecasts and, given that no unforeseen events occur, Ms af Jochnick assessed that the target of 2 per cent should be attained at the end of 2015. However, she was aware that the Riksbank's inflation forecast is more optimistic than that of several other analysts. She noted nevertheless that the measures used by the Riksbank for underlying inflation were rising, for instance the CPIF excluding energy prices. It also appears as though inflation abroad has bottomed out and is beginning to rise again. As a result of the development of the krona over the past year and higher import prices, the prerequisites are in place for inflation to increase. It has long been difficult for companies to raise their prices, but as a result of the increased demand in Sweden in the construction, retail trade and services sectors, for instance, resource utilisation has increased. She felt that this should eventually lead to higher prices. This view is also supported by companies' pricing plans as described in the National Institute of Economic Research's Economic Tendency Survey and in the Riksbank's own Business Survey.

To summarise, Ms af Jochnick's view was that global economic activity, particularly in the United States, would continue to recover. Growth in the euro area is improving at the same time as there is considerable uncertainty over developments in Greece and the consequences they may have for other areas of Europe. The financial markets are showing considerable volatility, for several different reasons. In this environment it is the Riksbank's task to safeguard a stable development for the Swedish economy as far as this is possible. The uncertainty and the fairly large movements on the foreign exchange market make exchange rate forecasts difficult. However, a rapid and strong appreciation of the krona would mean that demand slows down and that prices of imported goods increase more slowly. This would risk breaking off the upturn in inflation that has begun. She thought that in this uncertain environment there was justification for cutting the repo rate by 0.1 percentage points, to -0.35 per cent in addition to the government bond purchases, to support the upturn in inflation and ensure that it gains a foothold and reaches 2 per cent at the end of 2015.

Ms af Jochnick also wished to emphasise that she supports the assessment that the Riksbank shall continue to have a high level of preparedness to make monetary policy even more expansionary if the Executive Board considers this necessary.

Finally, Ms af Jochnick, like Ms Skingsley before her, wished to emphasise the importance of the Government quickly ensuring that Sweden has a framework and clear mandate for Finansinspektionen with regard to macroprudential policy. It is now seven years since the global financial crisis broke out. One of the lessons learned from the crisis, in several international investigations, was that efficient macroprudential policy is important to identify vulnerabilities in an economy at an early stage and take measures early on. Macroprudential policy can and should fulfil an important role, particularly in conjunction with fiscal and monetary policy. She pointed out that there is broad agreement on what vulnerabilities have built up in the Swedish economy, but there is also now a so-called inaction bias, which means that no authority has been able to take appropriate action. However, the high level of indebtedness needs to be dealt with now. Otherwise, there is a risk that a future economic downturn will become deeper than normal, as a result of a self-reinforcing downward spiral, with falling housing prices, rapidly-increasing household saving and reduced consumption.

Deputy Governor **Henry Ohlsson** supported the proposal to extend the purchases of government bonds by SEK 45 billion. However, he did not support the proposal to cut the repo rate by 0.10 percentage points to -0.35 per cent and to adjust the repo-rate path. He considered that the repo rate should be held unchanged at -0.25 per cent and that the repo-rate path should also be held unchanged.

Mr Ohlsson said that we have seen increasing signs that the inflation rate has bottomed out and is beginning to rise. But there are several threats to the rise towards the inflation target. The unease linked to the Greek debt crisis is one such threat. This risks leading to the Swedish krona appreciating. At the same time, the expansionary monetary policy being conducted by the ECB could also be a threat. It was still not entirely evident to him that the inflation target would be reached within the intended period of time if monetary policy remained unchanged.

Inflation expectations are below the inflation target on all three time horizons surveyed. These expectations tended to fall at all time horizons during 2014. The most recent results can be interpreted as inflation expectations having begun to rise. The expected annual inflation rate five years ahead among money market participants is now just under 1.8 per cent. Expectations are thus below the inflation target of 2 per cent. This would also call for a more expansionary monetary policy. He emphasised that it is important that the inflation target is perceived as credible.

Unemployment has fallen somewhat over the year, but is still at a high level. In May 2015 unemployment was 8.0 per cent (non-seasonally-adjusted) according to the labour force surveys (AKU). This is the same level as the same month in the previous year. However, the picture of the situation on the labour market is divided, the differences between those with strong positions and those without are increasing.

One alternative to the labour force survey data is to look at those who qualify for unemployment benefit. Their position on the labour market is relatively strong. The percentage of openly unemployed members of unemployment funds was 2.4 per cent in May 2015, according to statistics from the Swedish Public Employment Service. This represents a fall of 0.3 percentage points compared to the corresponding month last year. In other words, total unemployment is relatively constant, while it is declining for those who have a strong position.

Mr Ohlsson considered that the still high rate of unemployment is another reason to make monetary policy more expansionary. At the same time, he emphasised that monetary policy's ability to affect unemployment is limited. There are considerable matching problems on the Swedish labour market. Statistics Sweden's figures for vacancies show that the number of job vacancies as a percentage of the labour force today is at the same level as prior to the financial crisis. On the other hand, current unemployment is almost 2 percentage points higher. The National Institute of Economic Research's Economic Tendency Survey also points to the problems of matching that exist today as a result of an increasing shortage of labour, among other things. However, other policy areas than monetary policy have a better opportunity to influence these matching problems.

So what monetary policy instruments are the most appropriate in the current situation? According to Mr Ohlsson, there are four main alternatives here: cutting the repo rate further, buying more government bonds, lending to companies directly via the banks or intervening in the foreign exchange market. After weighing up the advantages and disadvantages of these different measures, his conclusion was that the best alternative at present is to extend and prolong the purchases of government bonds. In his opinion, the results of the purchases made so far were good.

On the other hand, Mr Ohlsson considered that the repo rate should be held at its current level of -0.25 per cent. What are his reasons for this? At the Executive Board meeting in February he discussed three different types of problem that could arise with negative interest rates. First of all he was concerned that laws, regulations, contractual conditions and so on cannot always be designed for a reality with negative interest rates. Following some initial problems, his conclusion was that this is probably not a problem in the slightly longer term.

Secondly, he was concerned that the demand for cash would increase and thus reduce the monetary policy effects. This has not proved to be a problem at the current repo rate level. However, the lower the repo rate becomes, the greater will be the risk that demand for cash gradually begins to increase.

Thirdly, it was not entirely clear to him that economic agents would act in the same way in a minus world as in a plus world. Here he felt that there were risks that agents who have been facing falling minus rates in their search for yield would increase the risk in their portfolios more than they would if it had been plus rates that were falling. At the same time, households' deposit rates have not followed other interest rates into the minus world. This means that monetary policy has not come to have an impact via household deposits.

Mr Ohlsson's conclusion was that the repo rate should now be held unchanged. At the same time, he wanted to say that he understands how his colleagues on the Executive Board are reasoning, even if he does not entirely reach the same final conclusions.

To summarise, Mr Ohlsson considered that extended and prolonged purchases of government bonds are a well-balanced, expansionary monetary policy in the current economic situation in Sweden.

Deputy Governor **Martin Flodén** began by saying that he supports the economic forecast in the draft Monetary Policy Report and the proposals to cut the repo rate by 0.1 percentage points and to prolong the programme of bond purchases until the end of the year. Neither the decision to cut the rate nor the decision to prolong the bond purchases was obvious for him. There have been reasons to consider several different options and strategies concerning monetary policy in the present situation.

Economic developments since the monetary policy meeting in April have, on the one hand, provided some major surprises but, on the other, have overall been basically in line with the forecast presented at the time.

International developments have of course been dominated by Greece, Mr Flodén noted. The forecast in the draft Monetary Policy Report has not been fully able to take into account the manoeuvres and developments of the most recent days and hours. His current assessment is that the forecast is still valid despite the lack of a solution to Greece's acute funding problems. This can of course give rise to major and immediate economic and political problems in Greece, but it is not at all obvious how economic activity elsewhere in the euro area and in Sweden will be affected. The escalation of the problems in Greece brings with it greater uncertainty, but does not, according to Mr Flodén, mean that the Riksbank now has reason to revise the main scenario in the forecast for the Swedish economy.

Mr Flodén went on to point out that the other major international event since the monetary policy meeting in April is the rise in long-term interest rates. This is a development that can be interpreted in slightly different ways. The most favourable interpretation is that expectations regarding future inflation and growth rates have risen, he argued. But this is an interpretation that hardly stands up to closer scrutiny of the data. A more reasonable interpretation is that interest rate premiums were previously far too low and that pricing has now been corrected to some extent. The substantial falls in interest rates in connection with the ECB starting to buy government bonds in March have now been wiped out with some margin. It is conceivable that the markets previously overreacted to the ECB's asset purchases. This development leads to certain implications for the Riksbank's bond purchases, and Mr Flodén wanted to return to this issue in a moment.

Despite major surprises on a monthly basis, inflation in Sweden has on the whole developed in line with the Riksbank's forecast in April. There are now clear signs that the monetary policy stimulus in recent years has had the intended effect on prices, mostly perhaps with the help of a weaker krona. Inflation adjusted for mortgage rates and energy prices has now risen to 1.5 per cent, and other measures of underlying inflation also indicate an upward trend, Mr Flodén said.

But it is still uncertain how persistent this upturn in inflation will be. Inflation expectations seem to have stabilised but are still quite low, Mr Flodén noted. And the inflation target's credibility has been damaged after several years of excessively low inflation. If inflation expectations are low and credibility for the target has been weakened, one cannot count on inflation moving towards the target on its own steam.

After the monetary policy meeting in April, the exchange rate has been stronger than the Riksbank's forecast. The stronger krona, together with new assessments, has contributed to a slightly lower inflation rate forecast for 2016 and 2017. This is despite the forecast being based on a monetary policy that is now proposed to be slightly more expansionary.

Before Mr Flodén explained the monetary policy considerations that form the basis of his opinion of today's monetary policy decision, he wanted to bring up two more circumstances that have influenced his view of the decision.

To begin with, Mr Flodén ascertained that the cuts in the repo rate to negative levels have worked as expected. The cuts have had an impact on lending rates to both households and companies, as well as on other market rates, while the technical and practical problems that negative rates may in theory cause have been limited. This indicates that the monetary policy transmission mechanism is still functioning as normal and that the monetary policy is having effects via what is normally referred to as the 'interest rate channel'. His assessment was that the interest rate channel will work even if the interest rate is cut further, and that the problems associated with negative rates will continue to be limited. But since the interest rate in Sweden has never before been so low, it is of course not possible to say this with certainty. He saw this as a reason for changing the repo rate in smaller steps than usual.

Mr Flodén saw no reason to doubt that a repo rate cut will also have an effect via the exchange rate channel. He therefore expected that a rate cut today will weaken the krona and that this will contribute to higher inflation, both as a result of import prices rising and because a weaker exchange rate stimulates those sectors of the Swedish economy that are exposed to international competition. But it was important to him that this is not the only effect that is achieved by a more expansionary monetary policy. If monetary policy only has an effect via the exchange rate channel, this occurs at the cost of negative effects on inflation and economic activity in other countries, at least when monetary policy in the rest of the world is also restricted by the interest rate's lower bound. Mr Flodén felt therefore that it was important that a cut in the repo rate also has effects via the interest rate channel. And a similar argument is one of the reasons for him to, as before, have currency interventions a long way down his list of measures that may come into question if the Executive Board deems that further monetary policy stimulus is necessary.

The other circumstance that Mr Flodén wished to raise is the international increase in long-term rates and how this affects his view of the Riksbank's government bond purchases. For several reasons, he very much welcomes the rate increase. This may sound contradictory since the purpose with the bond purchases is to push down long-term rates. But at the last monetary policy meeting, he had been ambivalent and rather sceptical about the bond purchases. As Mr Flodén just mentioned, the international upturn in long-term rates may indicate that the markets initially overreacted when the ECB started its asset purchases in March. Interest rates fell further than he had expected and he saw this as a reason for the bond purchases presented by the Riksbank in March and April. The fact that long-term rates have now risen does not necessarily mean that the asset purchases have been entirely ineffective. Rates continue to be at historically low levels, and empirical studies indicate that risk and term premiums are unusually low despite having risen significantly in recent months.

Another indication that the Rikbank's bond purchases have nevertheless had a certain effect is, according to Mr Flodén, that the difference between Swedish and German long-term rates is lower than before purchases began. The fact that rates are being kept down in relation to foreign rates may be helping to prevent the krona from appreciating too rapidly.

But doesn't a higher level of long-term interest rates dampen economic recovery and in the long run slow down the upturn in inflation? Mr Flodén didn't think so, at least not since most of the upturn in interest rates can seemingly be explained by higher risk and term premiums rather than a upward shift in monetary policy expectations. In Sweden most lending to both households and companies is done at variable interest rates. It should therefore be these variable rates and expectations of how these will develop in the future that influence the decisions of households and companies.

There are however actors who probably benefit from rising interest rates. In this context, Mr Flodén alluded mostly to pension funds that may have promised fixed nominal returns and where regulations may require them to hold government bonds with long maturities. The fact that long-term rates have now risen slightly may mitigate the problems for these actors, and more generally reduce the risk of a search for nominal yield leading to unjustifiably high risk-taking in the economy.

The fact that long-term rates have been far too low had thus been one of the reasons why Mr Flodén has had his doubts about the bond purchases. As we know, the Riksbank has bought assets that, according to its own interest rate forecast, have been overpriced. He had thought that it was odd to try to push up the price of such assets even further, that the purchases have led to an unclear signal about the interest rate expectations the Riksbank wishes to see on the market, and that the purchases in anticipation have caused losses on the Rikbank's balance sheet. These objections have been alleviated or completed eliminated for Mr Flodén now that interest rates have risen.

What then do these arguments mean for his view of today's monetary policy decision? Mr Flodén ascertained that the answer was not obvious. There are clear signs that the monetary policy has had an effect and that inflation is now rising. He had therefore considered advocating both an unchanged repo rate and deferring a decision on further bond purchases. But the inflation forecast has nevertheless been adjusted downwards compared to the forecast in April and it is still uncertain how substantial the upturn in inflation will be. After several years of excessively low inflation, it cannot be taken for granted that inflation will continue to move towards the target. For Mr Flodén, this was a clear reason why the Riksbank needed to work actively with monetary policy both to directly push up inflation and to demonstrate its determination to safeguard the inflation target. This, in combination with the fact that previous rate cuts have had the intended effect, has led him to advocate a rate cut today. Without a cut, the inflation forecast would have to be adjusted downwards even further, and it would take even longer for CPIF inflation to reach2 per cent.

Mr Flodén was still not convinced that government bond purchases would markedly contribute to increasing inflation or stimulating the economy. Although at the same time, the costs and problems associated with bond purchases have subsided significantly now that long-term interest rates have increased in recent months. The positive effects of bond purchases will probably be greater if the Riksbank presents a long-term purchasing plan. The knowledge that the Riksbank will remain as a buyer on the market until the end of the year should hold down bond yields during this period of time. And this knowledge may be especially significant now in the light of the increased market uncertainty associated with events in Greece. He felt therefore that it was better to announce an extended bond purchasing programme today rather than wait until the monetary policy meeting in September. It is then reasonable to continue buying bonds at approximately the same rate as before, which is also approximately the same rate in relation to GDP as the ECB's bond purchases, he concluded.

Deputy Governor **Per Jansson** began by noting that since the Monetary Policy Report in April, two new inflation outcomes have been published, for April and May. While the April outcome was clearly below the Riksbank's forecast, the May outcome was a positive surprise. When the policy decision was taken in April, the assumption was that CPIF inflation for May would amount to 0.87 per cent. The outcome was 1.03 per cent, that is, nearly 0.2 percentage points higher than expected. The fact that inflation is now on the way up is also clear when adjusting for volatile energy prices. Excluding these prices, CPIF inflation amounted to 1.45 per cent in May, compared to the forecasted 1.36 per cent. He pointed out that one now has to go back to the end of 2010 to find such a high inflation figure.

Mr Jansson went on to note that the development in inflation expectations is also giving cause for optimism. Two new surveys have been published since April; one monthly and one quarterly. With regard to the five-year expectations of the social partners, which are only measured in the quarterly surveys, an upswing can be noted both among employer and employee organisations. For the former, five-year expectations of inflation increased from 1.76 to 1.89 per cent, while those of the latter rose from 1.72 per cent to 1.81 per cent. For all groups in the June quarterly survey, five-year expectations rose from 1.73 per cent to 1.78 per cent. The five-year expectations among money market participants, which are measured in both the monthly and quarterly surveys, have moreover remained stable at around 1.85 per cent since March.

Mr Jansson summarised the development in inflation and inflation expectations since the Monetary Policy Report in April as positive on the whole. It suggests that the Riksbank's expansionary monetary policy is having the intended effect. But it is of course important that this development continues and is not broken off. With an inflation rate of about 1 per cent and longer-term inflation expectations that still remain a few tenths under 2 per cent, monetary policy must continue to “look around the corner” and be designed to cope with various risks in a pre-emptive fashion. Just as previously, there are a number of large risks that are difficult to quantify and which, if materialized, could significantly change the conditions for economic development in the coming period. In light of this, Mr Jansson wanted to comment on a few of the risks to which he currently attaches particular importance.

He emphasised that the recent course of events in Greece are of course deeply worrying. Even though Sweden's direct exposure to the Greek economy is limited, it is dangerous to underestimate the indirect effects that an aggravated Greek crisis may bring. The Swedish banking system is large and closely interlinked. Furthermore, the major Swedish banks have a high proportion of market funding. This makes the banking system, and the financial system as a whole, sensitive to various economic shocks. In addition, there is considerable uncertainty regarding how the krona exchange rate might be affected, were the Greek crisis to escalate. Mr Jansson stressed that in this context, a fairly substantial appreciation of the krona cannot be ruled out, particularly against the euro. Major negative effects on confidence can also slow down economic developments and in a worst-case scenario delay the recovery in the euro area. All this would naturally make it much more difficult to keep inflation in Sweden on an upward curve.

Mr Jansson then stressed that the appreciation of the krona since the Monetary Policy Report in April illustrates that there also is a risk of the krona appreciating more than expected even if the crisis in Greece does not deteriorate further. Since April, the krona has strengthened by around 15 öre against the euro and around 30 öre against the US dollar. In light of the fact that the US economy has regained strength in recent months and the conditions for the Federal Reserve to cautiously start to increase the policy rate therefore have improved, it is perhaps the appreciation of the krona against the dollar that is the most surprising aspect, he said

For a small, open economy like Sweden's, the exchange rate channel is always of major importance. Furthermore, in a situation where domestic real economic conditions have not impacted inflation as expected, the exchange rate channel is even more significant. Bearing this in mind, it was important for Mr Jansson that the krona exchange rate does not appreciate further in the months ahead but instead weakens somewhat from its current level, as is also predicted in the draft monetary policy report. There is of course a major difference if the krona appreciates later on in the forecast period, when inflation and inflation expectations are close to 2 per cent, compared to if this happens more in the short term when this is not the case.

Another factor that would make it much more difficult to keep inflation on an upward curve is if the inflation target were no longer to constitute the basis of Swedish wage formation, Mr Jansson said. He pointed out that the risk of this happening is of course not independent of the threats to the upturn in inflation that he previously discussed. Judging from various statements put out by the employee organisations, however, there is now a risk of the inflation target not forming the basis of next year's wage negotiations even if the development in inflation is not affected by such negative circumstances. Mr Jansson emphasised that, in light of the fact that Swedish wage formation has been characterised by substantial stability since the inflation target was established as a nominal anchor, this would of course be deeply regrettable.

As far as he personally was concerned, Mr Jansson also found it difficult to understand why this needed to happen now, when the Riksbank's monetary policy is so clearly aimed at getting inflation to rise quickly. The fact that many continue to focus blindly on the currently low CPI inflation rate, which is to a large extent a consequence of the Riksbank's own interest rate cuts, does of course not make things any better, he pointed out. CPIF inflation, which now amounts to about 1 per cent, and CPIF inflation excluding energy prices, which currently stands at around 1.5 per cent, are in this context much better measures of inflation to consider than the current CPI inflation rate.

Mr Jansson believed that there was also a tendency in this debate to exaggerate competitiveness problems caused by unexpectedly rapid increases in real wages and weak growth in productivity in recent years. Sweden's unit labour costs have indeed risen more rapidly than company prices but the development is hardly dramatic in an international context. Contrary to what is often suggested in the debate, unit labour costs in Sweden have increased much more slowly than in, for example, the United States and Germany during this period of low inflation. Calculated in common currency, the increase in costs since the second quarter of 2011 has been just over 5 per cent in Sweden while it has been over 10 per cent in Germany and well in excess of 30 per cent in the United States. These are hardly figures that set the alarm bells ringing as regards developments in Sweden's competitiveness, he added.

Just as before, the fact that inflation has been low for an extensive period of time, in combination with the existence of significant risks that are difficult to quantify, means that Mr Jansson prefers monetary policy to err on the side of doing too much rather than too little. He has therefore concluded that it is appropriate now to cut the repo rate further and continue to buy government bonds until the end of the year. If the very expansionary monetary policy were in the longer run to result in an inflation rate somewhat above the target and the current forecast, this is something that Mr Jansson would have no problems living with.

Given this background, Mr Jansson supported both the forecast and the monetary policy presented in the draft Monetary Policy Report. He stressed that he also agreed with the view that the Riksbank must continue to have a high level of preparedness to implement further measures and that this may need to take place between the ordinary monetary policy meetings. Such measures include: intervening on the foreign exchange market if the upswing in inflation is threatened, for instance, by a very troublesome market development; cutting the repo rate further and postponing future increases in the rate; extending the purchases of government bonds and buying other securities; and launching a company lending programme via the banks.

Governor of the Riksbank **Stefan Ingves** began by saying that the description of economic developments in the Monetary Policy Report mirrors his own view of development in the Swedish economy and in the rest of the world. He supported the proposal to cut the repo rate by 0.1 percentage points to -0.35 per cent and to increase purchases of government bonds by a further SEK 45 billion and extend the programme until the end of the year. Cutting the repo rate slightly is not in itself of crucial economic significance but together with the decision on additional bond purchases, it sends a signal that the Riksbank is prepared to continue with the chosen monetary policy in an even more robust fashion if required to do so, he said. He also felt that purchasing government bonds at approximately the same rate as the ECB was appropriate under the present circumstances.

The forecasts for the real economy have not changed a great deal since the monetary policy meeting in April, Mr Ingves noted. In the rest of the world, the recovery is expected to continue, following a lull at the beginning of the year. In the euro area, where development has been weak for a long time, there are signs of stronger consumption and investment. This positive base scenario presupposes that the current disarray in Greece does not spread to other parts of Europe. In a strictly economic sense, the Greek tragedy will have no major effect on the Swedish economy but we may well be affected by contagion effects, he added. In the United States, GDP growth is expected to be higher than normal in the years ahead.

Mr Ingves then went on to discussing the development in inflation, which has been low for a time in the rest of the world and is less than inflation targets in several countries, as a consequence of, for example, lower oil prices. The effects of the decline in oil prices are now expected to subside. This has helped to nudge up inflation in the rest of the world. The KIX-weighted inflation rate is expected to rise from just under 1.5 per cent this year to just under 2.5 per cent in 2017. This development in inflation is also positive for Sweden, which is very much affected by what happens in other countries.

Inflation in Sweden has developed more or less as predicted in the April forecast but it is still low, Mr Ingves pointed out. Since the monetary policy meeting in April, the krona has strengthened slightly and wages have been slightly lower than expected. Taken together, this has led to the inflation forecast being adjusted downwards slightly. This in turn increases the risk of inflation rising too slowly, which gives credence to the monetary policy currently being pursued.

Mr Ingves then wanted to discuss some of the underlying risks. World trade is still rising more slowly than normal. It fell substantially in connection with the global financial crisis and recovered thereafter. During the first three months of the year, world trade was subdued, mainly as a consequence of developments in China and other Asian countries. Weak world trade has held back Swedish exports. This is a structural risk which is difficult to mitigate and it is hard to use monetary policy to compensate for these phenomena, he ascertained.

In addition to the Greece problem, which Mr Ingves has already mentioned, there are several more euro area countries with structural problems and far too weak government finances that risk not being sustainable in the long run. Furthermore, there is lingering geopolitical uncertainty in several parts of the world, including Russia/Ukraine and the Middle East, that may hamper the upturn. The downside risks of the forecast are therefore mostly associated with developments outside Sweden, he felt. Another factor that is difficult to assess is monetary policies in other countries, which continue to be very expansionary. In the United States, the policy rate has remained close to zero since the financial crisis. In the euro area, the policy rate has been reduced to almost zero and the ECB has this year begun extensive purchases of government bonds. This contributes to a rise in inflation and resource utilisation in the rest of the world, which benefits the recovery in Sweden. It also gives households and companies the chance to clear their balance sheets, which is a precondition of recovery in several countries.

But at the same time it can create an incentive for more unsound risk-taking and the mispricing of assets. Volatility on stock markets in the euro area has, for example, been higher in recent months than it was prior to the crisis.

Another example is that government bond yields have increased considerably since April, Mr Ingves pointed out. An upturn in global government bond yields, mostly German, has contributed to higher long-term interest rates in Sweden as well. The upturn seems primarily to have been affected by developments in the euro area. A possible interpretation is that the low inflation and the ECB's purchase of government bonds pushed down long-term interest rates to abnormally low levels at the beginning of the year. The recovery in the euro area is on a stronger footing and has together with increased inflation expectations contributed to the upturn in inflation. The difference between Swedish and German bond yields is still very small, and he thought that this was both positive and desirable. On shorter maturities, Swedish yield is lower than the German, and on longer maturities marginally higher, which probably reflects the expected monetary policy in Sweden in relation to the expected monetary policy in the euro area.

Mr Ingves pointed out that in a world with the free movement of capital, the room for manoeuvre for domestic monetary policy is affected by monetary policy in other countries. This underlines the importance of the Riksbank utilising its monetary policy manoeuvre room as effectively as possible, and it is important that the krona does not appreciate too quickly. The Riksbank has pursued and needs to continue to pursue a clearly expansionary monetary policy and send a signal that the Executive Board will react if inflation does not develop as forecast, he underlined. In today's uncertain world, it is however difficult ex-ante to foretell which combination of monetary policy measures is currently the most suitable but according to Mr Ingves, it is a question of combining interest rate adjustments, bond purchases as well as, potentially, currency interventions.

A sign that expansionary monetary policy actually works is if we compare unit labour costs in the whole economy in different countries in the same currency. Such a comparison indicates that unit labour costs have increased significantly more in the United States than in Sweden and slightly more in Germany than in Sweden since 2011. The difference can mainly be explained by exchange rate effects.

Essentially, the combination of solid growth, low inflation and very low interest rates points to an unusual though favourable economic situation in Sweden, Mr Ingves said. But the financial and monetary policy situation is hardly expected to be normal in 2016. In normal times, balance in the real economy tends to mean a nominal interest rate of between 3.5 and 4.5 per cent and a real interest rate of around 2 per cent. But we now expect the repo rate to remain at -0.35 per cent or lower over the next 12 months or so. The real repo rate is also expected to be negative throughout the forecast period, he pointed out.

In other words, the Swedish economy is going well, although macrofinancial normality is still some way off. Mr Ingves stressed that this is contributing to ever-greater risks on the mortgage market. Mortgage lending is increasing far too much. The real economic situation will normalise by the end of next year but this will happen at the cost of ever-greater risk-taking on the mortgage market. Sweden is therefore an example that demonstrates how domestic monetary policy comes under pressure if you have free movement of capital and a floating exchange rate. Our inflation target policy therefore needs to be supplemented with measures that stabilise the housing market so that the Swedish economy is not exposed to unmanageable risks further down the line. This requires measures to be implemented by policy makers elsewhere in the economy. An effective amortisation requirement is one of a range of measures that should be taken to reduce the risks associated with household indebtedness and to increase resilience in the Swedish economy. There is an entire menu of different potential measures that don't need to be repeated here, said Mr Ingves in summary.

All in all, it was Mr Ingves' assessment that the Executive Board should today decide to cut the repo rate, and increase and extend purchases of government bonds. This means that the Riksbank intends to continue to buy government bonds until the end of the year, although events in the rest of the world can happen that require a new assessment. Mr Ingves considers that the Riksbank has good preparedness to cope with unexpected events in an uncertain world.

§3. Discussion

Deputy Governor **Per Jansson** began by saying that, in order to save time in his previous contribution, he did not discuss the negative side effects associated with a very expansionary monetary policy. He therefore wanted to stress that he has not changed his mind as regards these effects; everything he said at the last monetary policy meeting in April still applies. And with further monetary policy easing, the risks will of course not diminish, he pointed out.

Fixing Sweden's framework for macroprudential policy is and will continue to be the most important thing for dealing with the negative side-effects, Mr Jansson continued. Like Ms Skingsley, he finds it worrying that the elected representatives do not seem to perceive this as a particularly large problem. The IMF, who will do its Article IV Consultation with Sweden this autumn, is in any case not likely to hold back on its criticism, he feared.

Deputy Governor **Cecilia Skingsley** wanted to point out that the Executive Board has made it clear that there are several possible ways of adding to monetary policy expansion. Different tools work in different ways and all of them have their limitations. She felt that it is reasonable for individual board members to have different preferences for how a particular tool can be utilised. In addition, the issue of the repo rate's lower bound is complex and our practical experience is limited.

Ms Skingsley noted that Mr Ohlsson today chose to enter a reservation against further monetary policy easing via the repo rate. This makes it clear that there are two parts to the Executive Board's assignment: firstly its institutional responsibility to fulfil the monetary policy task of maintaining price stability, and secondly one's personal responsibility as a board member giving each member the right to enter a reservation against a particular initiative.

As far as she is concerned, Ms Skingsley said that she does not believe there is one single level at which the efficacy of the repo rate ceases. It is a question partly of the repo rate's impact on deposit and lending rates, and partly of the negative interest rate at which actors prefer to start hoarding cash, which does not have any interest, instead of paying interest on their account. These changes are probably at different negative interest levels, she felt.

Ms Skingsley emphasised that it is difficult to know when these changes will occur, so it is therefore reasonable to work in small steps with the repo rate level if the Executive Board wishes to make the monetary policy even more expansionary at some point in the future. Her assessment is that there is only a limited amount of scope left for reducing the repo rate before the effects start to wane.

Governor **Ingves** wanted to clarify his view of current Swedish monetary policy. Negative interest rates are something that has only been practised for a short time and only by certain central banks. Monetary policy is therefore in uncharted territory and central banks are struggling in different ways to achieve the desired monetary policy effect. Mr Ingves also believed it probable that central banks will have to get used to the fact that it is a combination of several measures that together will provide the desired monetary policy stimulus. But exactly how that combination should look is very difficult to say ex-ante. As far as Sweden is concerned, the effects of the pursued monetary policy also depend on what other central banks do. In a small, open economy with large free capital movements, it was his assessment that it is not possible to influence the economy purely by adjusting interest rates at this present time.

In light of Mr Ohlsson's reservation against a further cut in the repo rate and adjustment of the interest rate path, Mr Ingves added that he had the utmost respect for the fact that board members came to different conclusions when considering the analysis. He felt that monetary policy is currently neither self-evident nor easy to manage.

In conclusion, Mr Ingves wished to comment on the fact that several members had brought up or touched on the problems relating to the Swedish housing market. This is not least true of the time aspect alluded to by Ms Skingsley in her contribution. He believed that it is a kind of collective "own goal" for the Swedish economy not to be able to manage these risks. For him, taking care of the risks associated with the housing market is of the utmost urgency.

Deputy Governor **Martin Flodén** wished to begin by saying that he agreed with what had been said by several board members regarding macroprudential policy: An efficient framework is needed for Swedish macroprudential policy.

Mr Flodén also had some reflections on what Mr Ingves said about how long it would take before the level of interest rates returned to normal. Mr Jansson also mentioned possible side-effects of expansionary monetary policy and low interest rates. Mr Flodén agreed with what had been said, but he also felt that it is important to point out that the low level of interest rates has relatively little to do with Swedish monetary policy. Low nominal interest rates are a global phenomenon. This is partly because inflation expectations are low and many central banks are pursuing an expansionary monetary policy in order to stimulate economic activity and inflation. But perhaps even more important is that real interest rates are low even in the long term. Despite a clear rate increase in recent months, market pricing in Sweden indicates that the five-year, five year forward real interest rate is expected to be around zero. And we can see similar real interest rates in other countries. These are very low levels in a historical perspective. And this applies to rates that are normally not assumed to be affected by monetary policy, even if the large asset purchases being made by central banks may have had some effect in recent years. It is difficult to know exactly what has caused the decline in interest rates, Mr Flodén said, but a possible explanation is low growth expectations as a result of demographic trends, for example.

Mr Flodén's point was in any case that Swedish monetary policy has to take the general fall in interest rates into consideration. It is now, in the short term, that monetary policy with the help of a low real interest rate must contribute to higher inflation and economic recovery. The repo rate is indeed extremely low, but in real terms, it is not that low in relation to long-term rates.

Governor **Ingves** then summarised the discussion. He noted that the Executive Board agreed on the picture of economic development and the inflation outlook described in the draft Monetary Policy Report.

Inflation in Sweden has been rising for some time now, partly as a result of the krona weakening over the past twelve months. As economic activity grows stronger, however, domestic cost pressures also increase and it will be easier for companies to raise their prices. CPIF inflation is expected to be close to 2 per cent from the end of 2015. GDP is expected to grow more rapidly than normal in the years ahead and the labour market continues to improve.

Growth is also rising abroad, but uncertainty has increased as a consequence of the most recent events in Greece. The forecasts are based on the events in Greece not hampering recovery in the euro area.

Compared to the Riksbank's forecast in April, the krona has grown stronger, and its exchange rate thereby poses a risk to the upturn in inflation.

The Executive Board was in agreement that in this uncertain environment, monetary policy needs to be even more expansionary to ensure that inflation continues to rise towards the target of 2 per cent.

All the board members considered that it was appropriate to increase purchases of government bonds by a further SEK 45 billion. Five members also advocated a cut in the repo rate by 0.1 percentage points to -0.35 per cent, although one member wished to leave the rate unchanged at -0.25 per cent.

The board members ascertained that the Riksbank still had a high level of preparedness to make monetary policy even more expansionary if necessary, even between the ordinary monetary policy meetings.

The Executive Board stressed that because of the prevailing uncertainty surrounding events in Greece, the Monetary Policy Report had become a living document right up to the day before the monetary policy meeting.

Developments in the rest of the world, the urgent need to deal with the mandate and tools in the macroprudential policy area and the importance of measures in this area were other topics discussed at the meeting.

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

The Executive Board decided after voting

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

• to cut the repo rate to -0.35 per cent and make the decision applicable from Wednesday, 8 July 2015.

to publish the Monetary Policy Report on Thursday 2 July.

Deputy Governor Henry Ohlsson entered a reservation against the decision to cut the repo rate. He considered that the repo rate and the repo-rate path should be held unchanged. Mr Ohlsson thought it is sufficient to extend and prolong the purchases of government bonds in the current economic situation.

§5. Decision to purchase government bonds

Meredith Beechey Österholm presented the agenda item.

The Executive Board decided in accordance with the proposal, Annex B to the minutes.

§6. Other decisions

The Executive Board decided

• to publish the decisions under §4 and §5 at 9.30 a.m. on Thursday 2 July 2015 with the motivation and wording contained in a press release, and

• to publish the minutes of today's meeting on Wednesday 15 July 2015 at 9.30 a.m.

§4 - 6 were verified immediately.

Minutes by:

Lena Eriksson

Verified by:

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