Summary

At its monetary policy meeting on 6 September, the Executive Board of the Riksbank decided to hold the repo rate unchanged at −0.50 per cent and to continue purchasing government bonds during the second half of 2016, according to the plan adopted in April. Not until the second half of 2017 does the Executive Board consider it appropriate to begin slowly increasing the repo rate. There is still a high level of preparedness to make monetary policy even more expansionary if this is needed to safeguard the inflation target.

It was noted at the meeting that the Executive Board agreed on the picture of the economic development and the inflation outlook described in the draft Monetary Policy Report. Since the monetary policy meeting in July, economic developments both in Sweden and internationally have been largely in line with the Riksbank's forecast. Recovery abroad is continuing at a moderate pace supported by very expansionary monetary policy. There is still considerable economic policy uncertainty abroad, however, as a result of factors such as the outcome of the United Kingdom EU referendum and weaknesses in the European banking system.

In Sweden, the Riksbank has successively cut the repo rate to –0.50 per cent and undertaken comprehensive purchases of government bonds, which has had a broad impact and pushed many interest rates down. This has contributed to a positive development in the Swedish economy with solid growth, falling unemployment and rising inflation. Resource utilisation in the economy is rising, which normally affects the rate of price increase with a certain time lag. Inflation is expected to reach 2 per cent during 2017. The outlook for economic activity and inflation in Sweden is largely the same as in July and the Executive Board was in agreement that it is important for inflation to continue to approach the target and that confidence in the inflation target does not weaken. Now, as then, continued expansionary monetary policy is therefore needed.

The Executive Board agreed unanimously to hold the repo rate unchanged at –0.50 per cent and to continue to purchase government bonds in the second half of 2016 in line with the plan adopted in April. The Executive Board deems that the repo rate will start to be slowly increased during the second half of 2017. Until further notice, maturities and coupons from the portfolio of both nominal and real government bonds will be reinvested.

The Swedish economy is well equipped but there may be negative surprises along the way. There are many sources of uncertainty as regards the inflation forecast, not least the Swedish krona's development. For this reason, the Executive Board also agreed that it is important to continue to have a high level of preparedness to make monetary policy even more expansionary, even between the scheduled monetary policy meetings, if need be to safeguard confidence in the inflation target.

Interest rates need to be low at present to safeguard the inflation target. But the low level of interest rates is associated with risks and a combination of measures is required within various policy areas to ensure long-term sustainable economic development in Sweden. This is not least true for developments on the housing market and with household debt.

SVERIGES RIKSBANK
SE-103 37 Stockholm
(Brunkebergstorg 11)

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

MINUTES OF MONETARY POLICY MEETING
Executive Board, No. 6

DATE: 6 September 2016

TIME: 09.00

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

Susanne Eberstein, Chairperson of the General Council
Michael Lundholm, Vice Chairperson of the General Council

Claes Berg
Sophie Brauner
Charlotta Edler
Paul Elger
Heidi Elmér
Mattias Erlandsson
Lina Jacobson (§ 1-3A)
Jesper Johansson
Cecilia Kahn
Ola Melander
Pernilla Meyersson
Ann-Leena Mikiver
Marianne Nessén
Kasper Roszbach
Maria Sjödin
Ingvar Strid
Lena Strömberg (§ 1-3A)
Ulf Söderström
Sara Tägtström
Anders Vredin

It was noted that Paul Elger and Sara Tägtström would prepare draft minutes of the monetary policy meeting under Sections 2 and 3.

§1. Economic developments

Lina Jacobsson from the Markets Department began by presenting the latest developments on the financial markets. After strong fluctuations surrounding the referendum in the United Kingdom (UK), developments on the financial markets have been relatively calm. Stock exchanges have risen and many of them are now on a higher level than before the referendum. In Europe, rates for bank shares have increased following the publication of the European Banking Authority's (EBA's) stress tests, strong quarterly reports and some bank-specific news. But levels are still lower than they were before the referendum. Government bond yields both in Sweden and abroad fell markedly after the referendum and remain at low levels. The yield spread between Swedish and German government bonds has fallen slightly, especially for longer maturities. The krona has continued to depreciate after the referendum in the UK. Prior to today's monetary policy meeting, a majority of analysts expected an unchanged monetary policy.

Mattias Erlandsson, Acting Deputy Head of the Monetary Policy Department, began by presenting the draft Monetary Policy Report which, in the assessment of the Monetary Policy Department, would gain the support of the majority of the Executive Board members. Compared to when the July Monetary Policy Report was published, he noted that developments in the global economy have been more or less in line with the picture painted at the time. The global recovery is continuing, against the backdrop of, among other factors, the expansionary monetary policy being conducted. The pace of recovery is moderate, and compared with the forecast in July, global growth is largely unrevised. He also commented on the risk outlook, and said that there was still considerable economic policy uncertainty. In the UK, uncertainty has increased after the British people voted to leave the EU, but it is still too early to judge the overall effects of the referendum result. Weaknesses in the European banking system constitute another risk abroad.

Inflation is still low abroad, but is expected to pick up in the period ahead as energy prices rise slightly and resource utilisation gradually increases in many countries. Monetary policy abroad is expected to remain very expansionary to support the recovery and boost inflation.

The krona depreciated in conjunction with the UK referendum and has remained weaker than expected during the summer. The forecast is that the krona will strengthen gradually and in an orderly manner. Compared with the forecast at the July meeting, the krona will be slightly weaker in nominal terms during the entire forecast period, but the difference is small.

Growth is high in the Swedish economy. The forecast envisages a gradual slowdown in growth to more sustainable levels. GDP growth amounted to 4.2 per cent in 2015. This year, growth is expected to be 3.2 per cent and then slow to 2.2 per cent in 2017. The downward revision of 0.4 percentage points this year is due to weaker GDP outcome than expected in the second quarter. The high growth has led to an increase in resource utilisation, which is deemed to be normal and expected to continue to rise in the coming years. The development in resource utilisation is reflected, among other things, in the continuing fall in unemployment. At the same time, household debt is rising at a rapid rate. In the forecast, household indebtedness will continue to rise and the debt-to-income ratio will reach 194 per cent in the third quarter of 2019.

Inflation in Sweden is rising as a trend. Measured in terms of the CPIF, inflation has been rising since the beginning of 2014. Two outcomes for inflation have been published since the meeting in July. The latest outcome was for July and showed CPIF inflation to be 1.4 per cent, just over 0.1 percentage points higher than the Riksbank's forecast. The weak krona has been important for the upturn in inflation in recent years. This effect will subside in the period ahead as the krona instead starts to strengthen slightly. The continued upturn in inflation will therefore be driven to a greater extent by higher resource utilisation. There are already signs of such a development; the faster rise in prices for services being one of them. Rising resource utilisation provides the prerequisites for this development to continue in the period ahead. CPIF inflation is expected to reach 2 per cent in 2007, but this upturn is still fitful.

The forecasts in the draft Monetary Policy Report are based on the assumption that the repo rate will be held unchanged at –0.50 per cent at today's monetary policy meeting. The repo rate path reflects the fact that it is still possible to cut the rate further, and not until the second half of 2017 is an initial increase in the repo rate expected. In addition, it is assumed that the purchases of government bonds will continue according to the plan adopted at the monetary policy meeting in April.

Mr Erlandsson then noted that the forecasts in the draft report were discussed by the Executive Board at meetings held on 17, 23, 25 and 29 August. The draft Monetary Policy Report was tabled at a meeting of the Executive Board on 31 August.

As important issues in the monetary policy drafting process this time, he highlighted the economic policy uncertainty abroad, the depreciation of the Swedish krona during the summer and the preconditions for a continued upturn in inflation.

The monetary policy decision in July was taken relatively soon after the British people voted to leave the EU. As a consequence of the referendum result, the Executive Board chose to revise down the growth forecasts in July, above all for the UK, but also for the euro area and for Sweden. At the time, the Executive Board pointed out the major uncertainty in the assessments. An important issue in the drafting process this time has therefore been to monitor how the referendum result has affected the economy in the UK and in other countries. This analysis is described in the draft Monetary Policy Report.

Over the summer, the Swedish krona has been weaker than expected. The discussion has broached possible explanations for this development.

In conclusion, Mr Erlandsson outlined the issues raised by the Executive Board and analysed in the work on the inflation forecast. These include, for example, how inflation is affected by exchange rate fluctuations and how high resource utilisation in the economy needs to be to generate more permanently higher domestic price pressures. A related issue discussed is with how much of a time lag resource utilisation affects prices and wages. Several Executive Board members have pointed out that it is important to monitor how domestic price pressures develop, in particular prices for services. Furthermore, several Executive Board members have discussed structural developments on the labour market and thereby what the conditions are for a continued fall in unemployment. The forecast for wages, and the risks associated with this forecast have also been discussed, an issue presented in an article in the draft Monetary Policy Report. The conclusions drawn in the discussions are reflected in the draft Monetary Policy Report.

§2. The economic situation and monetary policy

Deputy Governor **Per Jansson** began by saying that, as usual, he wanted to start by commenting on current inflation conditions. Since the monetary policy meeting in July, two new inflation outcomes have been reported, for June and July. Compared with May, CPIF inflation has increased slightly while CPIF inflation excluding energy prices has remained basically unchanged. In July, both CPIF inflation and CPIF inflation excluding energy prices amounted to 1.4 per cent. Comparing the outcomes with our forecasts, we overestimated inflation slightly in June, while the opposite is true of the July outcome. Overall, however, the forecasting errors have been quite small. HICP inflation can be used to compare Sweden with other European countries. In terms of this measure, Swedish inflation amounted to just over 1.1 per cent in July. This puts Sweden in second place in the EU inflation league table after Belgium, Mr Jansson noted.

Since the July meeting, two new outcomes for inflation expectations have also been reported, he continued. These are from Prospera's monthly surveys of money market participants in July and August. The general picture for the two months is that expectations have fallen slightly, by about 0.1 percentage points over all time horizons.[1] The important expectations of inflation in five years' time, which can be regarded as a measure of confidence in the inflation target, stood at 1.90 per cent in August, compared with 1.98 per cent in June. Mr Jansson pointed out that the downturn is certainly small and therefore does not change his interpretation that the Riksbank's inflation target is credible. But the tendency is in the wrong direction, which is slightly worrying, especially considering that a large number of wage agreements are to be renegotiated shortly. In light of this, he felt that it will be important to carefully monitor the development of inflation

[1] According to TNS Sifo Prospera, see http://www.prospera.se/inflation-expectations/.

expectations in the period ahead and to ensure that they do not start to exhibit a falling trend again.

Mr Jansson noted that, with these reasonably stable inflation conditions as a starting point, the draft Monetary Policy Report does not propose any major revisions of the forecast for inflation. Disregarding the short-term effects of a few adjustments in initial conditions, the economic outlook for both Sweden and the rest of the world is largely unchanged as well. The only forecast revision that Mr Jansson saw reason to comment briefly on is the one proposed for the UK growth rate in 2017. The proposal here is a further downward revision of growth next year.

As has been pointed out in the draft Monetary Policy Report, it is still not possible to quantify the effects of the referendum result with any greater precision. Great uncertainty will prevail for a long time, particularly as regards the slightly longer-term effects. It will really not be until the UK has concluded its various negotiations with other countries and the consequences of the various alternative solutions can be seen that it will be possible to make a reasonably reliable quantification of the overall economic effects, Mr Jansson reasoned. In light of this, he does not see the forecast revisions for UK growth in 2017 as a sign that the Riksbank now much better understands the significance of the referendum result. Instead, it relates to the fact that the forecast in July was made very shortly after the referendum. Compared with the assessment made then, the Riksbank today has access to slightly more information and has had more time to work through the consequences for all parts of the forecast. Our overall revisions are well in line with how other forecasters, such as the Bank of England, have adjusted their assessments.

With these comments, Mr Jansson supported the forecast in the draft Monetary Policy Report. He also supported the assumptions for monetary policy, including the description of the Riksbank’s preparedness to make monetary policy even more expansionary. Mr Jansson went on to say that this time he did not have so much to add to what has been presented in the draft report. It is therefore a good opportunity to raise a couple of questions that may become important later in the autumn. One of these concerns the exchange rate. And the other concerns the Riksbank's purchases of securities.

The Riksbank, like many other analysts, has long assumed that the real exchange rate – that is, the relative price between foreign and domestic goods and services measured in Swedish kronor – will appreciate over the long term. The facts that the Swedish economy has relatively good growth prospects and that Sweden’s current account shows large surpluses have been important arguments to underpin this assumption. However, Sweden has had faster growth than its competitors for a number of years without this leading to any greater appreciation of the real exchange rate. In the years to come, this difference in growth is expected to narrow, according to forecasts from both the Riksbank and other analysts. Moreover, the current account surplus has been large for a long time but has gradually decreased since the financial crisis, from 9 per cent in 2007 to just under 5 per cent in 2015.

Mr Jansson concluded that the arguments suggesting a future appreciation of the real exchange rate have thus gradually been weakened. While a certain appreciation is, of course, still possible, it may not be as large as we have thought so far, he continued. The issue is important for several reasons. If one, for example, incorrectly assumes too large an appreciation of the real exchange rate, a development of the nominal exchange rate in line with the forecast may be an indication that Swedish inflation will be lower than expected in the period ahead. Lower inflation is one way of achieving a weaker real exchange rate, when it does not occur via the nominal exchange rate.

Mr Jansson said that whereas he does not recommend any immediate adjustment of the forecast for the nominal krona exchange rate, these circumstances mean that he would not now feel entirely comfortable with a development of the krona's nominal exchange rate in line with the Riksbank's forecast. He also pointed out that he hopes that the market does not interpret the forecast as scope for appreciation, within which there are no risks to the development of inflation. The Riksbank, according to Mr Jansson, has every reason to return to this issue, preferably as early as in conjunction with the work on the next Monetary Policy Report in October.

He then proceeded to discuss the second question, the one that concerns the Riksbank's purchases of securities. The decision taken by the Executive Board in April was to extend the purchases of securities with a further SEK 45 billion so that the purchases will amount to SEK 245 billion in total by the end of 2016. Mr Jansson noted that the Executive Board had hereby not taken a stance on whether the purchases should continue or should cease next year. The Executive Board must, of course, return to this issue during the autumn, but bearing in mind that speculations have already started, he wished to comment on a few things.

Some people have pointed out that problems with market liquidity would make it difficult for the Riksbank to further extend its purchases, at least for nominal government bonds. Mr Jansson stressed that it is obviously the case that the supply of bonds in the market decreases when the Riksbank makes its purchases. The fact that this happens is not a problem, however, but is precisely the point of the purchases, he underlined. When supply decreases, the price of bonds goes up and the interest rate falls. Problems only occur if the functioning of the market deteriorates in some significant way, for example as a result of interest rates starting to rise because of premiums. Fortunately, there are currently no signs of such a development being imminent.

Another issue that has been raised is when the Riksbank will be able to "cut ties with the ECB". Cutting the ties completely is obviously not possible as the Swedish economy is small and open and has a lot of trade with euro area countries, Mr Jansson said. The Riksbank's scope for deviating from the ECB may, however, be greater or smaller depending on the circumstances. In recent years, when the connection between domestic demand and inflation has been quite weak and international monetary policy very expansionary, the scope has clearly been limited. Even if inflation is now rising more quickly than before, there is a clear risk that the scope will remain significantly limited for a while longer, he concluded.

Deputy Governor **Martin Flodén** began by saying that he supports the proposal to hold the repo rate unchanged at today's monetary policy meeting and to continue bond purchases during the autumn in accordance with the earlier plan. He also backed the draft of the Monetary Policy Report and the forecasts contained within it.

Economic developments abroad have largely been in line with the assessments made by the Riksbank in connection with the monetary policy meeting in July. Possibly, some of the risks we then highlighted seem a little less worrying today, said Mr Flodén.

Mr Flodén continued by noting that the meeting in July was characterised by the outcome of the referendum in the UK on EU membership. At that time, great economic and political turbulence was prevailing, with major fluctuations on the stock markets and in exchange rates. The political turbulence has subsided since then and the British economy has been supported by a weak exchange rate and monetary policy easing. The stock markets have now recovered and confidence indicators, which initially fell sharply, have turned upwards. But the UK, together with the rest of the EU, is still facing important economic and political choices and the only actual clarity we have obtained over the last two months is that no decision about these choices will be taken any time soon. Mr Flodén therefore sees the Riksbank's assessment of a relatively strong slowdown in the British economy over the next year as reasonable, if still subject to great uncertainty.

The acute visible symptoms of problems in the European banking sector have decreased since the Executive Board's meeting in July. But the underlying problems remain and are a continued concern for the recovery of economic activity in the euro area. In the United States, the picture of strong economic development followed by rising wage and inflationary pressures has been strengthened.

In Sweden, Mr Flodén continued, inflation has become marginally higher than in the Riksbank's July forecast, while most real economic outcomes and forward-looking confidence indicators have been slightly weaker than expected. The view that the Swedish economy is developing strongly still holds, and resource utilisation is expected to become increasingly strained over the next year even though GDP growth is falling. This is creating the conditions for inflation to continue rising.

All in all, the view of economic development remains more or less unchanged since the monetary policy meeting in July. Mr Flodén therefore considered it fairly obvious that, at the present meeting, the Executive Board should maintain the monetary policy plan announced in July. This means that the repo rate is expected to remain at –0.50 per cent until the second half of 2017 and that the Riksbank will continue to purchase nominal and real government bonds until the end of 2016. Mr Flodén still considers that this monetary policy will be sufficient, in a main scenario, to maintain the upward inflation trend and for confidence in the inflation target to continue to strengthen.

Mr Flodén thought a more interesting question is that of how prepared the Riksbank is to manage a development in which Swedish inflationary pressures become weaker than in the current forecast. One possible strategy to manage such a development is to wait and see, and hope that inflation eventually rises to higher levels regardless. But this is not an appealing strategy when inflation has already been below target for a long time and confidence in the inflation target has been damaged. Nevertheless, such a passive strategy must be weighed against the alternatives, which are not necessarily appealing either. This involves valuing the monetary policy tools and assessing which intended effects and unintended side effects these tools would have in the current situation of the Swedish economy.

The expansionary monetary policy the Riksbank has conducted over the last two years has been effective, said Mr Flodén. It has contributed towards inflation and inflation expectations now being higher and there being stronger confidence that the Riksbank is safeguarding and prioritising the inflation target. The higher inflation and stronger confidence are giving monetary policy a slightly larger breathing space today than it had one or two years ago. Nevertheless, Mr Flodén's assessment is that both the rising inflation and the confidence are still on shaky ground and need the continued support of an expansionary and active monetary policy.

At the same time, Mr Flodén pointed out, the increasingly expansionary monetary policy has meant that the use of some tools, at least, has come closer to those levels at which the intended effects become weaker or can start to be counteracted by undesired side effects. The Riksbank is, of course, evaluating the impact the various monetary policy tools have had and is attempting to analyse the effect further measures, with the same or other tools, would have. But this evaluation and analysis is an ongoing process in which it is difficult to look too far into the future.

In conclusion, Mr Flodén sees working with relatively short time horizons and taking any monetary policy measures in small, exploratory steps as unavoidable in this environment. This means that the Riksbank cannot be as transparent now as it is under more normal circumstances about its monetary policy rule, that is, about how monetary policy will react to various future developments. For Mr Flodén, this means that many alternatives are on the table ahead of coming monetary policy meetings. This applies to both the appropriateness of deciding on new expansionary monetary policy measures if inflationary pressures are deemed too low and the tools that would be most useful in that situation.

Governor **Stefan Ingves** supports the description of international developments presented in the draft Monetary Policy Report. He noted that only minor adjustments have been made compared to the July forecasts. In light of this, he considered it most appropriate not to change the monetary policy stance.

The recovery abroad is continuing at a moderate pace approximately as expected. In advanced economies, the recovery is being supported by very expansionary monetary policy. Something which also affects the Swedish economy. In the euro area, GDP growth was slightly lower in the second quarter than the Riksbank's prediction in July, but confidence indicators for the current situation have in general held up relatively well after the referendum in the UK. The conditions still prevail for growth to strengthen somewhat in the long term as we anticipated in July, Mr Ingves said.

In the United States, GDP growth has been revised down slightly for 2016 as a result of a weak start to the first half of the year. However, this was mostly caused by what are deemed temporary effects. More recently, economic activity has strengthened again and growth for next year has been revised up. High domestic demand, increased employment and higher asset prices will contribute to solid growth in the real economy in the US over the next few years.

Inflation abroad has been very low for some time. But the Riksbank expects a rising oil price in the period ahead to enable energy prices, which have suppressed inflation, to make a positive contribution to inflation next year. In addition, resource utilisation abroad is expected to increase gradually, which will cause inflation to slowly rise.

Mr Ingves pointed out that the result of the referendum in the UK is contributing to continued uncertainty in a longer-term perspective. It is true, however, that unease on the financial markets has softened in the short-term perspective. And the uncertainty is mainly a question of how the UK economy will cope cyclically. But in a longer perspective, it is a matter of introducing new regulatory frameworks with structural changes, whose effects on the real economy are difficult to predict. We cannot rule out spillover effects to other countries that will be larger in the slightly longer term, said Mr Ingves.

Neither can we rule out greater uncertainty abroad for other reasons, he continued. Global trade has shown weak growth as a result of both temporary and structural factors. Investment, for example, has been weak in the euro area, partly as a result of weak banking systems and a high proportion of non-performing loans in several countries. The process for repairing banks' balance sheets in the euro area after the crisis has been sluggish, which is perpetuating the risks to financial stability in Europe and to the capacity of Swedish banks to obtain funding.

A gradual slowdown in GDP growth in China has been noted, but the high level of indebtedness in the corporate sector constitutes a risk factor. For a long time, China has acted as a driver for trade and growth in many countries and it can be important for the global economy if India were able to play a similar role going forward. This would at least be able to counteract slightly lower growth in China, Mr Ingves said.

As regards the Swedish economy, GDP growth this year has been revised down slightly since the July forecast. But the Riksbank still expects GDP growth to normalise later on after a period of high growth. The expansionary monetary policy is contributing to strong domestic demand. There will be further impetus next year, assuming that the rest of the world recovers as expected. Resource utilisation is continuing to increase and will be higher than normal during the forecast period.

CPIF inflation has risen since 2014 and is now close to 1.5 per cent. He noted that since the previous meeting, inflation has increased slightly more rapidly than the Riksbank had expected. Inflation is expected to gradually rise towards the target as increasing domestic resource utilisation has an impact and as price pressure abroad increases. An important factor, according to Mr Ingves, is prices for services that need to continue to rise at a steady pace. Without such a rise, it is difficult to push up inflation, he said. Overall, the inflation forecast has been revised up marginally compared with the previous meeting due to tax effects. Inflation is expected to reach 2 per cent in 2017, measured in terms of both the CPI and the CPIF.

Monetary policy abroad is very important for a small, open economy with its own currency like Sweden, continued Mr Ingves Just now, monetary policy abroad is in the balance and even for this reason, today's monetary policy meeting is more what might be termed an interim meeting.

During the summer, the Bank of England has shifted monetary policy in a more expansionary direction, which has helped weaken sterling and counteract the slowdown in the UK economy. At this point in time, we cannot know with any certainty when monetary policy in the US will be made less stimulative or whether the ECB will introduce more quantitative easing, said Mr Ingves. We must be prepared for developments to be different to the main scenario. Not this time, but further down the line we will once again need to position ourselves in a fairly uncertain world, he continued.

Mr Ingves pointed out that our plan for monetary policy has actually worked better than many had expected a few years ago. If the Riksbank's forecasts are realised, the inflation target will be met next year. Inflation expectations have also picked up. But the low level of inflation in Europe constitutes a challenge for us, he underlined. Will we manage to keep inflation in Sweden on a level with or above inflation in the euro area? The conditions for growth seem to be better in Sweden. This has contributed to an extremely unusual combination of macrofinancial variables in Sweden. Resource utilisation is now normal, but next year the output gap is expected to be positive, with a high level of employment, while inflation will be at 2 per cent. With such a forecast, it is, of course, remarkable that the repo rate is at –0.50 per cent. But this depends to a large degree on the low interest rate level abroad, which is spilling over on us without us being able to influence it, he said. The low global interest rates largely depend on an underlying downward trend in the real interest rate. They are also due to expansionary monetary policy abroad. We cannot change this.

Mr Ingves then went on to discuss the krona and inflation. The krona depreciated after the UK referendum and has remained on weaker levels during the summer. The forecast for the krona is therefore somewhat weaker at the start of the forecast period compared with the forecast in July. The krona in competition-weighted terms (KIX) is expected to strengthen slowly during the forecast period. He wished to stress the importance of this happening slowly. Otherwise, we risk facing an uphill slope that will be too steep when it comes to pushing up inflation, he said. It is, however, very difficult to make exchange rate forecasts, however. In addition, inflation is currently below the target. Therefore, there is still a risk that a strengthening of the exchange rate would counteract the upturn in inflation which we expect will happen. The exchange rate will therefore continue to be a central variable to consider in monetary policy. If the interest rate is raised too early, the exchange rate risks being too strong for us to be able to reach the target in the near future.

The generally low interest rate level also poses a risk for increased vulnerability in the financial system. The Swedish housing market is highly valued in a historical perspective. High housing prices and increasing household indebtedness pose risks to economic stability. The expansionary monetary policy presupposes that the risks on the housing market are addressed by other policy areas. Finansinspektionen has taken some measures, but more is required to mitigate the risks. It is of pressing importance that macroprudential policy and other measures restrict the accrual of debt by households.

Mr Ingves rounded off by presenting his conclusions regarding monetary policy. A highly expansionary monetary policy is needed to provide continued support to the Swedish economy and rising inflation. He also supported the proposal to leave the repo rate unchanged at –0.50 per cent and leave the forecast for the repo-rate path unchanged. The Riksbank's purchases of nominal and real government bonds will continue in the second half of 2016 in accordance with what was decided in April. If there is a need to conduct an even more expansionary monetary policy by, for example, extending purchases of securities after the turn of the year 2016/17, we will have to return to the issue later on. For his part, he thinks that the security purchases have worked well and contributed to the currently low interest rates. In any event, we need to have continued preparedness to take further measures to safeguard the inflation target, he said. At the same time, in the prevailing circumstances, the continued accrual of household debt is not sustainable. In this respect, we are living dangerously in Sweden, he concluded.

Deputy Governor **Cecilia Skingsley** opened by saying that, just as with the July decision, her considerations ahead of the meeting focused on understanding the consequences of the UK's intention to leave the EU.

Initially, the financial markets reacted strongly to the outcome of the referendum. A hasty change of government and several stimulus decisions from the British central bank have subsequently led to a certain amount of stability. So far, we mostly have financial movements and confidence indicators to take account of, while it will be some time until data on economic activity gives us a better overview.

Confidence indicators among companies have recovered. Ms Skingsley considered that it was difficult to know how to interpret this. Are the improvements due to the Bank of England's efforts to stabilise the economic cycle, she asks, or is it a matter of the depreciation of sterling compensating, in terms of profit, for less certain future prospects? It is also highly unclear which starting point the respondents are taking in the confidence surveys when they assess their economic future. Is the starting point that an exit from the EU will not occur, or that it is too far off to have any effect on the current situation, or because EU membership is assumed not to have any significance for the country's economic development? She noted that it is not easy to know and that several years of uncertainty over the future economic relationship between the UK and the rest of the world can apparently be expected. This is hindering our understanding of the consequences of a British exit from the EU.

Ms Skingsley continued by saying that there will be several political events over the autumn with the potential to again increase volatility on the financial markets. In particular, she was thinking of the presidential election and elections to the House of Representatives and Senate in the United States, as well as the referendum on the constitution in Italy. However, she said that she had become more optimistic over the year about the global financial system's ability to manage dramatic events. Both at the start of the year, when the global outlook was revised downwards, and after the British referendum, the financial markets have been able to manage large trade volumes in a short time. It may be that the financial markets are becoming better at absorbing shocks to the economy instead of exacerbating them.

From here, she went on to discuss the Swedish economy. Her assessment of economic activity in Sweden is about the same as in July, which is to say there is strong domestic demand, even if growth has become successively more subdued compared with 2015. Some questions can be raised about how strong it is after the second quarter's somewhat less positive outcome, but, for her, the risk outlook for the Swedish growth forecast continues to be balanced.

As regards inflation prospects, international price pressures remain weak and inflationary pressures are therefore dependent on resource utilisation in Sweden. Skingsley said that she notes that prices for services are developing well, in line with the historical average, and that rising resource utilisation can support continued price increases.

In the assessment of price pressures over the longer term, the labour market will be decisive. She therefore wished to make the following observations. The labour market shows increasing segmentation. For those born in Sweden, aged 15 to 74, unemployment has fallen to just under 5 per cent. But for those born abroad, unemployment remains high, about 15 per cent. These depressing figures are already applicable, before the refugees received in recent years enter the labour force. Ms Skingsley went on to note that measurements by the National Institute of Economic Research indicate that all branches of the business sector are now showing labour shortages above their historical averages. Total labour shortages have not reached these levels since 2007. According to Skingsley, these observations, taken as a whole, are a clear indicator of the need for reforms that also make it easier for those born abroad to find work.

There is no monetary policy and no negative interest rate, no matter how negative, that alone can cure this high unemployment. The overall economic policy therefore needs to focus on reforms within education and the functioning of the labour market to take advantage of the labour force that is underutilised at present. The increasing population is giving Sweden a historical chance to increase its prosperity but it needs to be managed so that the 2010s are not seen in retrospect as the decade of lost opportunities.

The Riksbank's wage forecasts are based on expectations regarding the economic outlook and how wages normally tend to develop given a similar course of events. Initiatives to get those born abroad to enter the labour market more quickly would be a change to which monetary policy could react.

Ms Skingsley wished to conclude by saying a few words on the monetary policy strategy in the period ahead. Since the Riksbank first took the repo rate into negative territory and began bond purchases in February 2015, inflation has gradually come closer to the target of 2 per cent. This was a necessary policy to show that the role of the inflation target as an anchor in the economy is worth defending. In the situation prevailing then, it was important for Sweden not to deviate too much from international monetary policy, against the risk of experiencing an uncontrolled appreciation of the krona, which would have impaired Sweden's recovery.

The situation is now better in Sweden, she continued, while growth prospects continue to be dampened for the euro area countries and there will probably be a continued need for monetary policy stimulation in the euro area for a long time to come. This has brought to the fore the issue of whether a small, open economy like Sweden can deviate in its monetary policy and if so, by how much. Ms Skingsley's starting point when assessing the room for manoeuvre is that the so-called "trilemma" holds, namely that a country has scope for both autonomous monetary policy and open capital markets, on condition that the exchange rate is floating, as it is in Sweden.[2] She elaborated her reasoning by saying that current monetary policy, compared to, say, 2015, can be conducted with a greater degree of freedom in relation to the policies conducted by other central banks because Swedish inflation expectations have risen back towards the target. The Riksbank expects a gradually strengthening of the krona during the forecast period, and Ms Skingsley's assessment is that the economy will continue to see solid growth with such a development in the exchange rate.

[2] A more detailed rationale can be found in http://www.riksbank.se/Documents/Tal/Skingsley/2016/tal_skingsley_160519_sve.pdf

Were there to be substantial forecast revisions, either abroad or for the Swedish economy, this may spark the need for further monetary policy stimulus. But this does not currently seem to be the case, according to her.

Ms Skingsley concluded by saying that she supported the forecasts and the proposal for monetary policy in the draft Monetary Policy Report.

First Deputy Governor **Kerstin af Jochnick** began by supporting the assessment in the draft Monetary Policy Report with regard to developments both in Sweden and abroad. She also supports the proposal to leave monetary policy unchanged with a repo rate of –0.50 per cent and continue purchases of government bonds in accordance with the programme adopted by the Riksbank in April.

Ms af Jochnick began by noting that developments abroad continue to improve at a moderate rate. There are many indications that global growth this year will be slightly lower than in the Riksbank's assessment in July, but thereafter, the forecast is basically unchanged. The global development in inflation is weak, leading many central banks to continue with very expansionary monetary policy.

She noted that uncertainty surrounding international developments is continuing.

In recent months, statistics for the United States have indicated relative strong economic development and market expectations on the Federal Reserve to increase the interest rate have strengthened. Last week's weak outcomes in the Purchasing Managers' Index and worse-than-expected labour market figures might suggest that growth isn't developing as strongly as the Riksbank expects in the second half of the year, she said.

As regards Europe, there are a number of uncertainties that can affect developments in the coming year. Here, she pointed to political risks in the wake of the referendum in the UK and elections in several countries that are creating unease for the future.

The result of the referendum has not yet made any strong impression on the UK's macrostatistics. What we can see, is that confidence indicators give a mixed picture of developments in the UK but that it is otherwise difficult to see any clear effects of the referendum, Ms af Jochnick said. The weakening of the pound sterling and expansionary fiscal and monetary policy are helping to counteract the pessimistic currents after the referendum. Only when we start to see the results of Brexit negotiations, and the effects of the UK's own reforms become clearer, will we be able to make a better assessment of the effects.

The problems in the European banking sector are burdening the euro area and hampering economic development. Even though the results of the European Banking Authority's (EBA's) stress tests were well received by the markets, it is obvious that banks in several countries are suffering from bad profitability and a high proportion of non-performing loans, Ms af Jochnick noted.

As far as Sweden is concerned, the forecast for GDP growth has been revised down slightly for the current year. In the first six month, exports and final domestic demand developed more weakly than the Riksbank previously expected. Weak global trade has led to a slowdown in exports. New export orders suggest that exports will grow slightly slower than the historical average rate in the coming period. But as economic activity abroad is expected to strengthen next year, exports will increase more rapidly.

Households are less optimistic than firms, and in August consumer confidence fell further. Consumption is expected to increase at a moderate pace in the coming quarters. At the same time, households' real wages have developed strongly and their wealth, above all in the form of housing, has increased. The expansionary monetary policy also contributes to strong domestic demand in the period ahead. Overall, consumption is therefore expected to increase at a good pace, historically speaking, in the coming years.

High output and a resource utilisation that is now close to normal and will later increase during the forecast period will cause employment to rise and unemployment to fall, she continued. The situation in the labour market can therefore be regarded as healthy as more people are finding work and job opportunities are increasing.

However, precisely as Ms Skingsley had done previously, Ms af Jochnick wished to highlight the fact that there are underlying problems that require measures and reforms in order not to create problems later on. Firstly, unemployment among those born outside Europe has risen sharply in recent years. There is considerable likelihood that this development will continue and that the figures will increase substantially when the high number of migrants who have arrived in Sweden in recent years begin to be included in the labour market figures. And secondly, an increasing number of companies are saying they having difficulties finding the right skills. Recruitment periods are increasing and the proportion of companies reporting labour shortages has risen to a relatively high level.

Inflation measured in terms of the CPIF is now close to 1.5 per cent, which is relatively high compared with other countries. Despite continued uncertainty over a number of international factors, there are nevertheless many indications that inflation in Sweden will continue to rise and reach 2 per cent in 2017.

Ms af Jochnick stressed that it is important to continue to safeguard the inflation target and have a high level of preparedness in case of setbacks that may require additional monetary policy stimulus. It is important in the period ahead that inflation expectations really do stabilise around 2 per cent in a slightly longer-term perspective. Of crucial importance for such a development is probably that the inflation target can continue to provide a starting point for the social partners in their wage negotiations. Against the backdrop of inflation now approaching the target and resource utilisation in the Swedish economy being expected to continue to rise, at the same time as labour shortages are becoming apparent in some sectors, the conditions should be in place for a development towards more normal wage increases, she said.

Finally, Ms af Jochnick wished to comment on developments in the housing market and household indebtedness. Last week, the IMF presented its conclusions from the latest assessment of the Swedish financial sector (Financial Sector Assessment Program) and it pointed out once again the need of additional measures to reduce the imbalances in the housing market and the need to limit household indebtedness.

The rate of increase for housing prices seems to have slowed slightly, but is still high. It is good that the construction of new homes has increased rapidly and is currently at its highest level for 20 years. Construction needs to continue at this rate for several years in order to satisfy the need for new homes. Unfortunately, however, it looks as though growth in housing investment is set to decrease in the period ahead, partly as a result of capacity limitations. This means that there will still be imbalances in the housing market, which risks fuelling price increases.

Growing imbalances in the housing market and rising indebtedness in the household sector increase the risks to the economy further down the line. Monetary policy needs to be expansionary for several years in order to support the Swedish economy. This presupposes that other policy areas help to keep the accrual of debt and price increases in the housing market in check.

Long-term sustainable development therefore places great demands on housing and tax policies, as well as macroprudential policy, to test well-considered measures that in combination contribute to stable development of the Swedish economy, Ms af Jochnick concluded.

Deputy Governor **Henry Ohlsson** began by saying that he supported the proposal to hold the repo rate unchanged at –0.50 per cent and to also hold the repo-rate path unchanged. Furthermore, he considers that asset purchases should continue according to the plan previously adopted.

He wished to comment on a number of important economic indicators. Firstly, the trend for inflation is continuing to rise. The monthly measurements are substantially affected by temporary factors. This means that the measurements are varying in an irregular manner. In some months, the outcomes are higher than expected, and in other months they are lower. The upward trend is still clear, however. In the July measurement, the CPIF showed an annual rate of increase of 1.4 per cent. The inflation target is a cornerstone of economic policy. It is important for the credibility of monetary policy that the target is attained.

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

Thirdly, GDP is now growing rapidly in Sweden. It is true that a there has been a slowdown in growth over the current year, according to the latest quarterly outcome. But calendar-adjusted growth will amount to about 2.5 per cent per year over 2017 and 2018 according to the forecast in the draft Monetary Policy Report.

Fourthly, the labour force surveys (LFS) for July 2016 reported an unemployment rate of 6.3 per cent (not seasonally adjusted). This indicates a continued declining trend in unemployment, which is a welcome development. In Mr Ohlsson's opinion, however, unemployment is still too high. The picture is fragmented, however, with large differences between different groups. Those born abroad have it significantly tougher on the labour market than the domestic-born. Unemployment insurance fund members can be considered to have a relatively strong position on the labour market. The proportion of openly unemployed members of unemployment funds was around 2.5 per cent in July. This proportion has certainly decreased over the year, but only marginally. The level today is the same as before the financial crisis.

Mr Ohlsson’s conclusion from these indicators is that overall resource utilisation in the Swedish economy is now at normal levels and is expected to be even higher in the next few years. Inflation should rise as resource utilisation increases.

At the monetary policy meeting in July, Mr Ohlsson said that there were a number of indicators that, in his opinion, taken together, would indicate that monetary policy could become slightly less expansionary. But the outcome of the UK referendum on membership of the EU initially led to shocks and uncertainty. This then argued against a change to a less expansionary direction.

So far, the worst doomsday scenarios following the British referendum have not materialised, said Mr Ohlsson. But his assessment is still that Brexit will lead to permanently negative effects for the British economy. UK consumers’ real purchasing power will decline in the long run. In contrast, he considers that the effects on other economies will be more temporary in nature. Initially, the financial markets reacted very negatively but recoveries have since been noted on many asset markets.

The indicators from July that suggested that monetary policy could become slightly less expansionary are still present. At the same time, he considers that such a shift remains out of the question. There are good reasons to wait a while longer. He therefore thinks that the repo rate should now be held unchanged. Furthermore, he considers that the previously decided repo rate path, with initial increases in the second half of 2017, should also be held unchanged. Asset purchases should continue according to the previously decided plan. Finally, Mr Ohlsson supported the draft Monetary Policy Report.

§3. Discussion

Deputy Governor **Martin Flodén** wished to comment on the connection between the monetary policy conducted by the Riksbank and monetary policy in other countries. This is not only an issue that we frequently return to ourselves and that several others have already touched upon in today's discussion, but also something often discussed by analysts outside the Riksbank, Mr Flodén said. This connection is described in different ways; for example as the Riksbank having limited room for manoeuvre and sometimes as the Riksbank not being able to conduct an independent monetary policy. Such descriptions are perhaps not incorrect, but Mr Flodén argued that the discussion needs a little more perspective.

To begin with, the globalised world economy and financial market mean that all central banks need to take global developments into account. It is clear that even central banks in the largest economies are influenced by monetary policy in other countries, so to speak, spilling over from one economy to another, mainly via the exchange rate.

But central banks are not only affected by the monetary policy conducted in other countries but also by international economic and structural developments. For example, weak economic development in the euro area, which is the largest Swedish export market, leads both the ECB and the Riksbank to conduct an expansionary monetary policy regardless of which monetary policy the other central bank chooses to pursue.

This comovement between monetary policy in different countries becomes even clearer, according to Mr Flodén, when structural changes cause underlying, "natural" interest rates to change. The natural interest rate is one of the building-blocks behind the policy rate set by a central bank, and a great deal suggests that natural interest rates covary strongly between countries. This is not surprising, since capital can move relatively freely between developed economies and thereby to some extent even out the expected return on capital. The comovement is seen, for example, for the development of short- and long-term real interest rates in graphs often presented and referred to by the Riksbank and others, and it is also confirmed in studies that estimate the natural interest rates using empirical methods.[3]

---

[3] See Armelius, H., P. Bonomolo, M. Lindskog, J. Rådahl, I. Strid and K. Walentin (2014) "Lower neutral interest rate in Sweden?", Economic Commentaries no. 8 2014; King, M. and D. Low (2014), "Measuring the 'World' Real Interest Rate",

The comovement between different central banks' monetary policies thus largely depends on the fact that the economies are being influenced by the same economic and structural developments, Mr Flodén said. But there are, of course, country-specific developments that should result in monetary policy not being identical in the various countries. Economic cycles are far from perfectly synchronised between countries and neither do developments in inflation expectations or confidence in monetary policy targets have to go hand in hand. This is evident in the Riksbank's current monetary policy. Swedish resource utilisation is significantly higher than in the euro area and inflation is more clearly on the way up. This has enabled the Riksbank to reduce the pace of its asset purchases at the same time as the ECB has increased the pace of its purchases. And both our repo rate path and market expectations indicate that we can start to increase the policy rate much earlier than the ECB can, he continued.

This is not to say, however, that we will conduct an entirely different monetary policy to other central banks, he pointed out. In all probability, the repo rate will continue to be low and it will only be possible to increase it at a slow pace in the period ahead as long as underlying international real interest rates are low and the ECB's policy rate is negative, Mr Flodén concluded.

Governor **Stefan Ingves**, in connection with Mr Flodén's statement, wished to remind the meeting that the idea of the natural interest rate is not a new concept but was launched over 100 years ago by the Swede Knut Wicksell, who was also advisor to the Riksbank Governor for a time.

Deputy Governor **Henry Ohlsson** wanted to make a couple of comments prior to the forthcoming wage bargaining round. There is an article about the wage bargaining round in the current Monetary Policy Report. It contains a few laudable and prudent points that are important to highlight, he said.

The Riksbank makes forecasts for total wage increases in the Swedish economy. This is a necessary part of an integrated forecast for the Swedish economy, otherwise the various parts would not hold together. But Mr Ohlsson wished to underline that it is important to remember that this is a question of wage forecasts and not wage recommendations. In the Swedish model, the social partners negotiate wages while the Riksbank takes care of monetary policy. That is how it has been, and so it should be in the future.

Governor **Stefan Ingves** then summarised the discussion. He noted that the Executive Board agreed on the picture of the economic development and the outlook for inflation described in the draft Monetary Policy Report. Since the monetary policy meeting in July, economic developments both in Sweden and internationally have been largely in line with the Riksbank's forecast. Recovery abroad is continuing at a moderate pace supported by very expansionary

---

NBER Working Paper 19887; and Holston, K., T. Laubach and J. C. Williams (2016), "Measuring the Natural Rate of Interest: International Trends and Determinants", Federal Reserve Bank of San Francisco, Working Paper 2016-11.

monetary policy. There is still considerable economic policy uncertainty abroad, however, as a result of factors such as the outcome of the United Kingdom EU referendum and weaknesses in the European banking system.

In Sweden, the Riksbank has successively cut the repo rate to –0.50 per cent and undertaken comprehensive purchases of government bonds, which has had a broad impact and pushed many interest rates down. This has contributed to a positive development in the Swedish economy with solid growth, falling unemployment and rising inflation. Resource utilisation in the economy is rising, which normally affects the rate of price increase with a certain time lag. Inflation is expected to reach 2 per cent during 2017. The outlook for economic activity and inflation in Sweden is largely the same as in July and the Executive Board was in agreement that it is important for inflation to continue to approach the target and that confidence in the inflation target does not weaken. Now, as then, continued expansionary monetary policy is therefore needed.

The Executive Board agreed unanimously to hold the repo rate unchanged at –0.50 per cent and to continue to purchase government bonds in the second half of 2016 in line with the plan adopted in April. The Executive Board deems that the repo rate will start to be slowly increased during the second half of 2017. Until further notice, maturities and coupons from the portfolio of both nominal and real government bonds will be reinvested.

The Swedish economy is well equipped but there may be negative surprises along the way. There are many sources of uncertainty as regards the inflation forecast, not least the krona’s development. For this reason, the Executive Board also agreed that it is important to continue to have a high level of preparedness to make monetary policy even more expansionary, even between the scheduled monetary policy meetings, if need be to safeguard confidence in the inflation target.

Interest rates need to be low at present to safeguard the inflation target. But the low level of interest rates is associated with risks and a combination of measures is required within various policy areas to ensure long-term sustainable economic development in Sweden. This is not least true for developments on the housing market and with household debt.

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

The Executive Board decided

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

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

• to publish the Monetary Policy Report and interest rate decision above with the motivation and wording contained in a press release at 9.30 a.m. on Wednesday 7 September 2016, and

• to publish the minutes of today's meeting on Wednesday 21 September 2016 at 9.30 a.m.

This paragraph was verified immediately.

Minutes taken by

Sophie Brauner

Verified by:

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