Monetary policy minutes

December 2018

S V E R I G E S   R I K S B A N K

Summary

At the monetary policy meeting on 19 December 2018, the Executive Board of the Riksbank decided to raise the repo rate by 0.25 percentage points to –0.25 per cent. The forecast for the repo rate indicates that the next rate rise will probably occur during the second half of 2019.

A majority of the Executive Board supported the picture of the economic outlook and inflation prospects described in the draft Monetary Policy Report. Internationally, the outlook for economic activity is still good and largely unchanged since October. In Sweden, resource utilisation remains high, even though outcomes for GDP growth and inflation have been weaker than expected. The labour market is continuing to develop strongly. CPIF inflation and inflation expectations are close to or slightly above 2 per cent.

Several members noted that even though the inflation forecast for the next few years has also been revised downwards slightly, the conditions are still good for inflation to remain close to the inflation target. As inflation and inflation expectations have become established around 2 per cent, the need for a very expansionary monetary policy has decreased slightly and in light of this, a majority of Executive Board members considered it appropriate to now raise the repo rate by 0.25 percentage points to −0.25 per cent.

Board members stressed that the risks regarding developments abroad remain since the last monetary policy meeting in October. They also noted the uncertainty over the strength of inflationary pressures in light of recent, lower-than-expected inflation outcomes. In this context, the importance of monetary policy being adapted to the outlook for the economy and inflation was underlined. The forecast for the repo rate indicates that the next repo rate rise will probably occur during the second half of 2019.

A few board members also emphasised the risks associated with the Swedish housing market and the high level of household indebtedness.

Deputy Governor Per Jansson entered a reservation against the decision to raise the repo rate and did not support the repo-rate path in the Monetary Policy Report. Mr Jansson referred to the considerable uncertainty remaining over the strength of the more persistent rate of inflation and given this sees no need to raise the repo rate at present, considering it better to await further information and proceed cautiously with an unchanged repo rate for now.

MINUTES OF MONETARY POLICY MEETING
Executive Board, No. 6

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DATE: 19/12/2018

TIME: 09.00

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

Susanne Eberstein, Chairperson, General Council of the Riksbank
Michael Lundholm, Deputy Chairperson, General Council of the Riksbank

Meredith Beechey Österholm
Vesna Corbo
Hans Dellmo
Charlotta Edler
Paul Elger
Heidi Elmér
Mattias Erlandsson
Eric Frieberg
Jesper Hansson
Jens Iversen
Kristian Jönsson
Maria Kindborg
Pernilla Meyersson
Ann-Leena Mikiver
Marianne Nessén
Amanda Nordström (§ 1-3A)
Åsa Olli Segendorf
Henrik Siverbo
Maria Sjödin
Ulf Söderström
Fredrik Wallin (§ 1-3A)
Ingrid Wallin Johansson (§ 1-3A)
Gary Watson
Anders Vredin

Dmytro Solohub, Deputy Governor, National Bank of Ukraine,
Olexandr Petryk, Member of the General Council, National Bank of Ukraine

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

§1. Economic developments

Market developments since the last monetary policy meeting

Amanda Nordström from the Markets Department began by presenting the latest developments on the financial markets. Since the monetary policy meeting in October, political risks, trade conflicts between the United States and China and concern over a possible slowdown in global growth have been in focus.

In Europe, the Brexit negotiations have increased the volatility of the British pound. The Italian budget deficit is still higher than the EU's requirement, even though it has been revised down in the latest budget proposal from the Italian government, which has been a factor in Italian government bond yields being somewhat lower after a sharp upturn earlier in the year. French long-term interest rates have also increased somewhat in the wake of the budget deficit being revised upwards for 2019. The spillover effects of developments in Italy and France to other long-term interest rates in Europe are minor.

Given the greater concern about a global slowdown, volatility on, for example, the equity market has increased. The oil price has also fallen as a consequence of supply being expected to exceed demand. Moreover, there is concern about the effects of the trade conflict between the United States and China, although the countries have agreed not to escalate the conflict any further for the time being. In addition, the EU and Japan have ratified a trade agreement. In the wake of a general deterioration in risk sentiment, investors have fled to safer assets such as government bonds, which has contributed to pushing down bond yields around the world. Swedish yield differentials in relation to Germany have risen somewhat during the autumn. The market attributes this to the Riksbank being close to an imminent rate rise while expectations of an initial rise from the ECB have been delayed. On the whole, monetary policy expectations have fallen slightly internationally. Concern over growth, market stress, and communication from the Federal Reserve about a slower rate of increase of the target interval in the Fed funds rate have contributed to downwardly revised expectations in the United States.

Prior to this monetary policy decision, most market participants are expecting an increase in the repo rate but they have become less convinced in the wake of outcomes for GDP and inflation that have been below the Riksbank's expectations in October and market expectations. The most common perception among market participants is that an increase in the repo rate will occur in combination with a lowered rate path.

The current monetary policy drafting process – new data and forecasts

Jesper Hansson, Head of the Monetary Policy Department, began by presenting the forecast that the Monetary Policy Department judged would gain the support of a majority of the Executive Board. The monetary policy drafting process has included discussions with the Executive Board regarding the forecasts and the monetary policy assumptions at meetings on 7, 11 and 14 December. The draft monetary policy report was tabled at a meeting of the Executive Board on 13 December.

There is still uncertainty about developments abroad. GDP growth in the United States is high while, for the euro area, we have seen another quarter of surprisingly weak growth. The assessment is that this is mainly temporary, due in part to problems in the automotive industry, where new regulations on emission testing have been introduced. Despite good economic activity, inflationary pressures are relatively low and different measures of core inflation are mostly below central bank inflation targets. Total inflation is higher, in part due to the upturn in energy prices, but has been revised down for 2019 after the recent decline in the oil price. The forecast for the KIX-weighted policy rate has been revised down in the longer term in line with forward rates.

In Sweden, too, temporary effects contributed to GDP growth in the third quarter being surprisingly weak. Household consumption fell, partly on the back of weak development in passenger car purchases following amendments to tax regulations. This contributed positively to consumption in the second quarter, but negatively in the third quarter. Underlying consumption growth in 2018 is quite weak, however, while housing investment is falling in line with the forecast. The decline in housing investment is expected to slow down gradually in 2019, bolstered in part by a slight increase in housing prices in virtually every month in 2018. Unemployment has fallen more than expected and in October and November was at a level just above 6 per cent. Almost all indicators point to continued high demand for labour, but there are matching problems on the labour market and unemployment is expected to rise weakly going forward.

In November, CPIF inflation was 2.1 per cent, which is around 0.3 percentage points lower than the forecast in October. The forecast for 2019 has been revised down by 0.2 percentage points, and slightly less for the CPIF excluding energy. After that, the revision is even less and inflation is expected to be close to the target for virtually the whole of the forecast period. The resource utilisation indicator, which summarises a large number of different measures of resource utilisation, remains on a very high level. The high level of resource utilisation indicates a rise in inflation. Furthermore, the ongoing rent negotiations indicate more rapid rent increases in the period ahead, which will also drive up inflation. At the same time, most measures of core inflation are lower than 2 per cent.[1]

The draft forecast is based on the monetary policy that is expected to gain a majority at today's monetary policy meeting. This means that the repo rate will now be raised by 0.25 percentage points to −0.25 per cent. The forecast indicates that the next repo rate rise will probably not be

[1] The measures referred to here can be found in the Monetary Policy Report published in December 2018, in Figure 3:2.

until the second half of 2019 and the repo rate path has been revised down in the longer term. At the end of November, the Riksbank's government bond holdings amounted to almost SEK 350 billion, expressed as a nominal amount. The forecast is based on principal payments and coupons being reinvested until further notice. This will be carried out at an even rate until the end of June 2019, in accordance with the decision from December 2017.

§2. The economic situation and monetary policy

Deputy Governor Cecilia Skingsley:

I support the proposal for the new Monetary Policy Report, the proposal to raise the repo rate by 25 basis points and the new proposed repo rate path. In addition, I would like to make more detailed comments on global financial conditions, the outlook for inflation in Sweden and my thoughts on monetary policy.

The monetary policy decision now in December 2018 is being made in the light of global economic activity having matured and moving towards a more subdued GDP growth. This phase in the economic cycle means that participants reconsider their valuations of financial assets on a number of markets and it has led to an increase in volatility and to falling equity prices and government bond yields in many countries.

The financial conditions in a number of economies are expected to continue to be tightened, partly through less expansionary monetary policy. On the other hand, this tightening is expected to be slower going forward. All in all, I regard the financial sequence of events since the previous meeting as acceptable with regard to the economic cycle and I do not envisage the changed market conditions observed so far to be the start of a downturn in the global economy. But I will return to this when discussing my views on the risks to the forecasts.

Data received on the Swedish economy confirms a continuing high level of resource utilisation. From a demand perspective, the weak consumption in the third quarter mostly concerned temporary effects, but viewed over a longer period of time, household consumption appears to be somewhat more subdued going forward, in line with the revised forecast in the report. On the other hand, the labour market outcome has been a positive surprise. Continued high resource utilisation is important for the forecast of an inflation rate close to the target to hold. The figures regarding labour shortages are the highest since the Economic Tendency Survey began reporting these figures for the entire business sector more than 20 years ago. With regard to wages, the outcomes have contributed to a marginal downward adjustment in the expected rate of wage growth going forward. But according to the Riksbank's most recent Business Survey, companies are saying that the shortages are now at such a level that wage increases in addition to the centrally-agreed increases are being given to experienced workers and specialists. This points to rising wage growth in broader labour market groups, seen over the forecast period, which the Riksbank is expecting to happen.

From the financial and macroeconomic assessment I shall now move on to my monetary policy assessment. At the Executive Board meeting in October, we forecast that the repo rate could, given the inflation outlook observed then, be raised at either the meeting in December or the meeting in February. I would like to make it clear that this forecast was not any autopilot move, but that prior to today's meeting I have considered without any preconceptions whether it is better to raise the repo rate at today's meeting or to hold it unchanged.

I can see that target attainment for inflation is good and has been so for more than a year now. Inflation expectations with regard to various financial prices and questionnaire responses have been stable around the target for a long time. Resource utilisation has been high for a long period of time, which indicates a continued upturn in prices and wages. The need for monetary policy to support this development has thus declined somewhat. I therefore support the proposal to raise the repo rate to −0.25 per cent.

Although inflation data has recently been on the weak side, the forecast has not been revised to an extent where I see it as a problem. CPIF inflation will fall back in line with the expected development in energy prices, but on the other hand CPIF inflation excluding energy prices is expected to rise gradually in the coming years. With anchored inflation expectations, these circumstances are expected to be able to pass without requiring a different monetary policy.

The continued monetary policy conducted will, as always, depend on the inflation outlook. In Sweden, the main risk to economic activity is developments on the housing market. International risks were described as having increased in the October assessment, and nothing has happened since then to make me see the risks as lower. The political conflicts about various trade relations have been going on for some time now, and in recent months they are increasingly put forward as explanations for both poorer financial market development and weaker confidence in several large economies. A more lasting downturn in global trade, confidence and financial prices could rapidly require a change in the Riksbank’s monetary policy assessment. A disorderly withdrawal from the EU by the United Kingdom and fiscal policy showdowns in Italy also pose a risk to the economic development of the EU, and thereby also to Sweden.

International risks could justify waiting with today’s rate rise, but inflation tends to come late in the economic cycle and sometimes with surprising strength. Combined with our overall forecast, I consider the balance to be in favour of an increase today. An increase today can also be evaluated properly before there is justification for another increase in line with the forecasts. If the outlook for inflation were to change significantly, I would support adjusting the timing and scope of the forecasted increases.

First Deputy Governor Kerstin af Jochnick:

I would like to start by saying that I support the assessments made in the draft Monetary Policy Report, and I support the proposal to raise the repo rate by 0.25 percentage points to –0.25 per cent and at the same time revise down the forecast for the repo rate somewhat.

Today's meeting is historical, in the sense that after almost four years with a negative repo rate we are now discussing a proposal to raise the rate. Our message at the meetings in September and October was that the repo rate could be raised at this meeting or at the meeting in February next year, on condition that the economic outlook and inflation prospects held good.[2] The important question as I see it to take a stance on today is whether the outlook for inflation is in line with our assessment in October.

With regard to international growth, the forecast has not changed significantly since our previous monetary policy meeting. Growth is now slowing down in many countries, but KIX-weighted GDP growth is nevertheless expected to remain at a good 2 per cent in the coming years. The risks we have mentioned earlier, and which could entail poorer global developments, still remain. The risks of increased trade barriers having a negative impact on global trade and growth or that we in Europe will suffer negative effects in the wake of Brexit require continued monitoring. The same applies to the uncertainty following in the wake of the discussions between the EU and the Italian government on the Italian budget.

With regard to Sweden, GDP figures for the third quarter of 2018 point to weaker growth than we were expecting in October. It is noteworthy that GDP fell between the second and third quarters. But our assessment is that this is largely explained by temporary factors, and this is supported by the fact that several indicators of sentiment in the economy are stronger than normal. This applies to the NIER's Economic Tendency Survey, for instance. But I would also like to say that resource utilisation in the Swedish economy is still higher than normal and the labour shortages at record high levels. At the same time, the employment rate is at a historically high level. The situation on the Swedish labour market is thus still strong, which has significance for the inflation outlook.

One factor that could have a negative effect on demand in relation to our forecast is that households have a less positive view of the economy than before, which is confirmed, for instance, by the NIER confidence indicator. Households have probably been affected by the uncertain developments in the housing market and the fact that the stock market has been volatile. At the same time, households' disposable incomes are expected to continue growing at a good pace, so I assess that the forecast regarding private consumption is reasonable. Our

[2] In the September Monetary Policy Report we expressed this as meaning that the economy should have developed as expected and in the October Report that the economy should develop in a way that continued to support the inflation outlook.

assessment entails GDP growth slowing down in the coming years and being slightly below the historically normal level.

When it comes to inflation, one cannot ignore the fact that the two most recent outcomes for October and November were disappointing. But at the same time, I consider it very important to look beyond the individual monthly outcomes. CPIF inflation has been close to 2 per cent since the beginning of 2017, and we can see looking ahead that it will also be around 2 per cent towards the end of the forecast period. Between now and then it is expected to vary somewhat, which is quite natural. Almost half of the recent contribution to CPIF inflation has constituted rising energy prices. When this contribution no longer holds up CPIF inflation, there will be a temporary fall.

Our forecast for the CPIF excluding energy does not vary as much, but follows a simpler pattern: Inflation rises towards the target, and then remains there. In the short term, higher rents and higher food prices will contribute, as will positive effects on import prices from the krona being weak in 2018. This means that CPIF inflation excluding energy is expected to reach 2 per cent next year. So what indicates that it will remain there?

The most important factor, which I have already mentioned, is the strong development on the Swedish labour market. Such a development usually exerts – with a time lag – upward pressure on wages, which is reflected in our forecast. Despite the wage forecast being revised down somewhat in relation to October, the forecast for productivity has at the same time been revised down substantially, which has resulted in the assumption that unit labour costs will rise faster than we had forecast in October.

Although inflation outcomes in recent months have been disappointing, I think there is clear support for our forecast that inflation will be close to the target further ahead. Another important element in my stance is that Prospera's survey show that inflation expectations have remained stable around 2 per cent. And a contributory factor to this is in turn probably what I mentioned earlier, namely that we have a long period with CPIF inflation close to the target behind us.

All in all, I think that developments in the Swedish economy are in line with our earlier forecasts, in the important sense that they continue to support the outlook for inflation remaining close to target. In this way, the criteria we have set earlier for beginning slow increases in the repo rate have now been met. I have therefore decided to support the proposal for a decision to raise the repo rate by 0.25 percentage points, and I also support the proposed repo-rate path. The somewhat lower path in relation to October reflects continued uncertainty regarding the strength of inflationary pressures and a need to proceed with caution regarding rate increases. If developments do not prove to be as we have forecast, we will need to review the repo-rate path.

I would in conclusion like to once again highlight the risks linked to household indebtedness and the problems in the Swedish housing market, which we describe in more detail both in the draft Monetary Policy Report and in our Financial Stability Report, which was published in November. It is essential that these risks are managed to ensure that economic developments in Sweden remain good in the longer perspective.

Deputy Governor Martin Flodén:

I support the proposal to raise the repo rate by 0.25 percentage points today. I also support the draft Monetary Policy Report, the forecasts described in the draft and the assessment of what constitutes an appropriate level for the repo rate going forward.

The new information received since the monetary policy meeting in October has mostly surprised on the downside. This applies both to developments in Sweden and abroad. Internationally, there is still considerable uncertainty over future trade relations between the United States and China, as well as the conditions for the United Kingdom's withdrawal from the EU. There are now more question marks regarding the strength of global economic activity. Growth has slowed down in the euro area. This is probably mostly due to temporary effects in the car industry, but forward-looking indicators have also weakened. The subdued optimism around the world, combined with expectations of more cautious monetary policy tightening have caused government bond yields to fall. Moreover, stock prices and the oil price have fallen.

In Sweden, the negative surprises have been even clearer. Both GDP growth in the third quarter and inflation in October and November were considerably lower than expected. But despite weak GDP figures, the labour market is still developing strongly. Unemployment has fallen and employment has risen and companies are continuing to report a large labour shortage. Resource utilisation is still high.

Monetary policy in Sweden has been very expansionary over the past four years. The repo rate is at −0.50 per cent and the Riksbank has also purchased large volumes of government bonds and communicated about potential foreign exchange interventions to prevent the krona from becoming too strong. The background to this expansionary monetary policy is that we are coming from a period where inflation has for many years, primarily 2011-2015, been far too low, which has weakened confidence in the inflation target. Developments have turned since then, and inflation has been close to the target for the past two years. Inflation expectations have risen and confidence in the inflation target and monetary policy has strengthened.

At the monetary policy meeting in October I assessed that confidence in the inflation target and monetary policy had strengthened sufficiently and that the outlook for inflation remaining at a healthy level going forward was good enough for us to be able to take a step away from the most expansionary monetary policy. I therefore advocated that the repo rate be increased to −0.25 per cent. I stand by this assessment, despite the fact that we are now revising down the forecasts for both growth and inflation. Our forecast is that resource utilisation will remain high and that inflation will be close to two per cent in the coming years if monetary policy is conducted according to the plan in the draft Monetary Policy Report.

One circumstance that I would like to highlight here is that the market is relatively well prepared for the repo rate being raised at today's meeting. The rate increase together with the plans for future monetary policy indicated in the draft report will therefore hardly be a tightening compared with the monetary policy we have communicated earlier. On the other hand, if we were to restrain from raising the repo rate today, I think it would create unnecessary uncertainty as to how monetary policy will be conducted going forward.

The monetary policy challenges have thus declined in recent years. The opportunities to conduct a slightly more flexible monetary policy and to take a small step away from the most expansionary monetary policy have thus improved. This contributes to my assessment that it is appropriate to raise the repo rate today.

But at the same time, it is worrying that the inflationary pressure has remained weak for a long time, despite the high level of resource utilisation and the expansionary monetary policy. The surprisingly low inflation outcomes in recent months amplify this worry. It is clear that inflation still needs a lot of support from an expansionary monetary policy and that rate rises in the period ahead must not be too rapid. This is reflected in the forecast for the repo rate presented in the draft Monetary Policy Report. The repo-rate path corresponds well to my assessment of which monetary policy will be appropriate in the coming years. But which interest rate development is appropriate will depend on how the inflationary pressure and economic activity develop going forward, and on what impact the repo-rate increases have on market prices and on the economy as a whole.

To summarise, I support the proposal to raise the repo rate by 0.25 percentage points today and I also support the forecast presented in the draft Monetary Policy Report.

Deputy Governor Henry Ohlsson:

To begin with, I would like to say that I support the proposal to raise the repo rate by 0.25 percentage points to −0.25 per cent. I also support both the proposed repo-rate path and the outlook and forecasts in the draft Monetary Policy Report.

This is my 24th ordinary monetary policy meeting. That makes two dozen. I will in my contribution to the meeting make some personal reflections and draw conclusions from my first four years on the Executive Board of the Riksbank. This does not mean I am starting to write my memoirs. On the other hand, these reflections and conclusions have significance for my personal monetary policy reasoning and conclusions at this meeting.

The CPIF has been the target variable for monetary policy since last year. The most recent inflation figure in November showed an annual rate of increase in the CPIF of 2.1 per cent. The corresponding figure in November 2014 showed an annual rate of increase in the CPIF of 0.6 per cent. The upturn is 1.5 percentage points; that is a significant rise. Over the past four years, the rate of inflation has thus gone from being far away from the inflation target to being right on target. CPIF inflation has been around the inflation target for a long time. Over the last 20 months, it has been in the interval 1.7 – 2.5 per cent. The average rate of inflation over these 20 months has been 2.1 per cent. According to the forecast in the draft Monetary Policy Report, the annual rate of inflation will be 2.1 per cent in 2018. In 2019, the CPIF is expected to increase by 1.9 per cent as an annual rate. Target achievement is good!

This year's December survey of inflation expectations one year ahead among money market participants was at 2.1 per cent. In December 2014, expectations one year ahead were at 0.7 per cent. The upturn is 1.4 percentage points; that is a significant increase. If we look at the December reading of five-year inflation expectations among participants on the money market, the mean value was 2.0 per cent. Over the last 36 months, the mean value of five-year expectations has been 1.9 per cent or higher. If two-year expectations are examined, the view of inflation expectations being at the two per cent target becomes stronger. In December, these expectations were at 2.1 per cent. Inflation expectations are well anchored!

Unemployment according to the labour force surveys (LFS) was 5.5 per cent (not seasonally-adjusted) in November this year. The corresponding figure for November 2014 was 7.4 per cent. The downturn is 1.9 percentage points; that is a significant decline. The employment rate was 68.9 per cent in November 2018. This was an increase of 2.7 percentage points compared to November 2014. That is a significant increase.

Over the past year, the LFS unemployment figures have only fallen by 0.3 percentage points, however. The conclusion is that LFS unemployment is on the way to bottoming out. Unemployment insurance fund members can be considered to have a relatively strong position on the labour market. In November 2018, the percentage of openly unemployed members of unemployment insurance funds was 2.6 per cent. This is slightly higher than in the same month one year ago, when the proportion was 2.4 per cent. Some tenths of one per cent here or there makes no great difference, but qualitatively, it is interesting that the downward trend that we have seen for several years has now been broken. The break in the trend emphasises that unemployment has now bottomed out.

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

In the monetary policy day-to-day life it is rare to have a horizon that stretches as far as four years. Day-to-day life instead consists of a constant flow of new data, new figures. Many others, like the Executive Board of the Riksbank, have the task of interpreting this flow as part of their jobs. If any figure deviates in any sense from what is expected, even only slightly, it can make the news headlines. It is so easy to forget the uncertainty linked to these figures, and the often wrong sense of exactness that arises. How easily do we forget that many figures come from surveys based on small samples? How easily do we forget that the underlying data may be inadequate? Furthermore, seasonal patterns may change so that it becomes difficult to adjust for them and human error can lead to incorrect figures. And in many cases, the figures we receive are preliminary, they may be adjusted several times over a long period before the figures are considered definite.

I coined the expression the tyranny of the tenths in a speech two years ago. If one allows monetary policy to be steered by individual outcomes for inflation, inflation expectations, unemployment, growth and similar outcomes that for various reasons differ a tenth here or there without any fundamental changes, then the tyranny of the tenths prevails.

My starting point is that monetary policy cannot be governed by inflation varying a few tenths of a percentage point around 2 per cent in individual months. Inflation has now been close to the target of 2 per cent for a longer period of time, both with regard to outcomes and expectations. The forecast for inflation in the draft Monetary Policy Report also shows continuing good target attainment. This is the decisive argument for me that it is time – yes high time – to start raising the repo rate. After accelerating and reaching marching speed, we can now take our foot off the gas a little.

To summarise, I support the proposal to raise the repo rate to -0.25 per cent. I also support both the proposed repo-rate path and the outlook and forecasts in the draft Monetary Policy Report.

Dixi!

Deputy Governor Per Jansson:

I do not support the proposal in the draft Monetary Policy Report to now raise the repo rate from −0.5 to −0.25 per cent. As I advocate an unchanged level for the repo rate, then nor do I support the repo-rate path described in the draft report, since it is based on a higher interest rate level. In what follows I shall describe in somewhat greater detail the reasons for my stance.

In the October Monetary Policy Report, the Executive Board communicated that “If inflation prospects hold up, it will soon be appropriate to start raising the repo rate”, or more precisely that the inflation forecast made then was based on “the repo rate being raised by 0.25 percentage points at the monetary policy meeting in either December or February”. The main question to consider now is thus whether inflation prospects really have remained the same since our monetary policy meeting in October. In trying to answer this question, it is natural to, in relation to the situation at the monetary policy meeting in October, both examine what has happened in terms of outcomes for inflation and discuss whether there is any reason to change the forecast for future inflation. I shall begin by reviewing the inflation outcomes.

Since our meeting in October, two new inflation outcomes have been published. They refer to October and November. Unfortunately, both of the outcomes, and in particular the one for November, were quite disappointing. In October, CPIF inflation was just above 2.4 per cent, which can be compared to a forecast of a good 2.5 per cent. Our forecast for November was that inflation would remain close to 2.5 per cent, but instead it fell back to just above 2.1 per cent. Compared with October, therefore, the overestimation of inflation increased further in November, from a forecasting error of about 0.1 percentage points to an error slightly higher than 0.3 percentage points. Although the outcomes for CPIF inflation were in a strict sense closer to the inflation target than we had expected, the main take-away here is, as I see it, rather that there are questions regarding the strength of the underlying, more persistent rate of inflation.

It is in this context important to note that the surprisingly low CPIF inflation was not to any great extent due to an unexpectedly weak development in energy prices. CPIF inflation excluding energy prices, which the Riksbank uses as one of its measures of underlying inflation, was in October almost two tenths of a percentage point below the forecast in the Monetary Policy Report and in November the deviation rose to close to three tenths. Instead of increasing somewhat over the past two months, as we believed it would, inflation excluding energy prices has thus declined quite substantially, from a good 1.6 per cent in September to around 1.4 per cent in November.

Unfortunately, it is not just the outcomes for CPIF inflation excluding energy prices that document further question marks regarding the strength of the rate of underlying inflation. With one single exception, the rate of increase in all of the Riksbank's other measures of underlying inflation also declined from September to November. The median for the measures of underlying inflation was just over 1.6 per cent in November, which can be compared with a good 1.7 per cent in September. The two measures that have been shown in an empirical evaluation to be best at predicting future CPIF inflation, UND24 and CPIFPC, were also around one tenth of a percentage point lower than in September and amounted to slightly less than 1.8 and just over 1.6 per cent respectively.[3]

A small glimpse of light in the inflation picture is that the rate of increase in service prices is remaining fairly stable a couple of tenths of a percentage point above its historical average since 2010. The outcome in November was just under 1.9 per cent, largely unchanged compared to September. The underlying rate of service price inflation declined, however, both in October and

[3] See the article "Why measures of core inflation" in the October Monetary Policy Report.

November.[4] After a couple of months of rising rapidly, it has dampened from around 2.4 per cent in September to somewhat under 2.2 per cent in November.

With this I move on to discuss the forecast for inflation. It is difficult in the light of the weak inflation outcomes, in particular for the different measures of underlying inflation, not to draw the conclusion that we are seeing a fairly clear deterioration in the current inflation picture, compared with the monetary policy meeting in October. This also seems to be the point of departure in the draft Monetary Policy Report, where the forecast for CPIF inflation excluding energy prices has been revised down by 0.1-0.2 percentage points up until late summer next year. The reason why the forecast is not being lowered further is that the outcome figures for October are assessed to have been affected by certain unusually large temporary price cuts, at the same time as both rent increases and the rate of increase in food prices over the coming six months are expected to be higher than before. This means that inflation excluding energy prices, despite the downward revisions now being made to the forecast, is still expected to be close to 2 per cent from the first half of 2019, albeit a few months later than in the October Monetary Policy Report. The development of CPIF inflation is assessed to be more uneven, affected by the substantial rises and falls in energy prices, but from around the middle of 2020 it is the more underlying trend in inflation that is decisive, making the difference between CPIF inflation and CPIF inflation excluding energy prices small.

The low inflation outcomes imply that it is hardly likely that CPIF inflation excluding energy prices will have the scope in the near term to surprise on the upside to any great extent, compared with the assessment in the draft Monetary Policy Report. On the contrary, the risks must probably be assessed to be on the downside. But it is primarily in the slightly longer term that the downside risks begin to be particularly bothersome. This is underlined by the fact that both GDP and wage growth have been lower than expected and that the forecasts for these important determinants of inflation are now being revised down quite substantially in the draft report. I consider it particularly worrying that the rate of wage growth is a negative surprise once again, and thus the misgiving remains, that I have now taken up a number of times in our monetary policy discussions, that price-setting and wage formation are still not fully contingent on the inflation target, despite the measured inflation expectations being close to 2 per cent for some time now. In addition to all this, we have the large downside risks to economic developments at the international level, but which are very difficult to quantify in a forecast.

The conclusion I draw from the new inflation outcomes and proposals to revise the forecast for future inflation is that there is at present no urgent need to raise the repo rate. This conclusion is strengthened by my belief that the downside risks dominate with regard to the prospects for inflation in both the shorter and, above all, the slightly longer perspective. There are fairly

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

concrete arguments in favour of rising inflationary pressures in the coming half-year, but developments so far this year underline the fact that there is a risk of disappointments and one hardly needs to worry that the upturn will be excessively rapid anyhow. I thus think that it is better in this uncertain and fairly shaky situation to await further information and proceed cautiously with an unchanged repo rate for now. The fact that the repo-rate path in the draft Monetary Policy Report enters a waiting mode for around six months after the increase at today's meeting is justified precisely by saying there is a need for the uncertainty to disperse and to proceed cautiously with monetary policy. But one might then wonder, whether there is not a better, more natural way of achieving a repo-rate path that in summer next year reaches a level of the repo rate that is 0.25 percentage points higher than today.

As I mentioned at the start, the fact that I do not support the proposal to raise the repo rate now also means that I cannot support the repo-rate path proposed in the draft Monetary Policy Report. This is quite simply unavoidable as the proposed repo-rate path departs from a higher level of the repo rate, −0.25 instead of −0.5 per cent. But given that the proposal to raise the repo rate is supported by a majority of Executive Board members at today's meeting, I would nevertheless like to say that I think it is a good idea to now have a repo-rate path that refrains from making further rate increases during the first half of next year. It is at present very difficult to predict whether it will be possible in the future to make around two increases in the repo rate every year, of 0.25 percentage points on each occasion. I do not wish to rule this out, but what I have already said shows that it is very possible that the increases will need to be made at a slower pace than this. Of importance in this context is not least what happens in the risky and complex world around us, where there are dark scenarios that could lead to much lower growth and inflation and to a long delay in the normalisation of monetary policy. The most important thing for Sweden here is, of course, events that affect the euro area and thus also play a role for the monetary policy conducted by the ECB.

Governor Stefan Ingves:

Let me start by saying that I support the forecasts for and assessments of economic developments in Sweden and the rest of the world as described in the draft Monetary Policy Report. I support the proposal to raise the repo rate by 0.25 percentage points to −0.25 per cent. The repo rate path has been revised down slightly compared with the Monetary Policy Report in October and indicates that the next rise will probably occur in the second half of 2019. The monetary policy also includes the Riksbank's reinvestments of principle payments and coupons in the government bond portfolio, which will continue according to plan. These reinvestments have so far worked well and will continue until further notice and at an even rate until June 2019, in accordance with the Executive Board's earlier decision. The Monetary Policy Report reiterates well the arguments for why it is now time to reduce the monetary stimulus slightly.

The assessments of economic developments abroad and in Sweden, made in the draft Monetary Policy Report, largely coincide with the assessment made in October, with a few differences that I will return to later.

International developments remain good. The global economy has grown rapidly for several years in a row, and is now entering a phase of slightly lower GDP growth. But there are regional differences. In the United States, the high GDP growth continues and there are strong confidence figures among households and companies. Growth in the United States is expected to be around 2.5 per cent next year. In the euro area, however, growth has slowed. In the period ahead, a GDP growth rate of around 1.5 per cent a year is expected there, in line with the forecast in the October report. For the world as a whole, GDP growth is expected to be a good 3.5 per cent in the coming years. This is in line with the assessments made in the Monetary Policy Report in October.

But there are risks in the short and the long term that may lead to significantly different developments to those described in the draft Monetary Policy Report. The ongoing trade conflict between the United States and China may escalate. In the euro area, uncertainty lingers around the sustainability of Italian government finances. And the forms for the United Kingdom's withdrawal from the European Union are still unclear. Major uncertainty factors remain, therefore, and they may affect the forecasts going forward depending on developments. At present, there is a kind of doubleness in developments; on the one hand the global economy is doing well, but, on the other, there is major political uncertainty in many countries. Perhaps this is a consequence of the benefits of thriving global trade not being evenly spread among everyone.

In the Swedish economy, there is still high activity. Sweden has had a few years of high growth and the growth rate is now expected to slow. The forecast for next year's GDP growth is 1.5 per cent, which is lower than our assessment in October. But in the years after that, growth is expected to rise again, to around 2 per cent, that is to say the growth rates we had in the October report. The years of high growth have had a clear impact in the labour market, which continues to be strong. Employment and the labour force participation rate are increasing rapidly and are at historically high levels.

Inflation continues to develop in line with our target of 2 per cent. Since the monetary policy meeting in October, Statistics Sweden has published two new outcomes for the CPI, for October and November. They were slightly lower than the forecasts we had in the Monetary Policy Report in October. But CPIF inflation was 2.1 per cent in November and target attainment is good. Inflation expectations continue to indicate that confidence in the inflation target is good. Since the last monetary policy meeting, we have received results from the broader survey of inflation expectations, performed once per quarter. Expectations of CPIF inflation 1, 2 and 5 years ahead are all at 2.0 per cent.

Due to the lower outcomes, the inflation forecast has been revised downwards for the next few months in the draft Monetary Policy Report, and the figure for CPIF inflation for 2019 as a whole is now 1.9 per cent, which is lower than the assessment in the Monetary Policy Report in October. At the same time, the longer-term inflation forecast is unchanged, and the forecast for 2021 of 2.0 per cent remains the same. With the strong economic activity, rising cost pressures in Sweden and abroad, the conditions for inflation to continue to develop in line with the target are favourable. With these prerequisites, it is reasonable to increase the record-low repo rate at today's meeting.

There is reason to cast our minds back a few years and remember what the situation was like when, in early 2015, the Riksbank began using "unconventional measures" – a negative policy rate and government bond purchases – to increase monetary stimulus. Inflation had been too low for too long, inflation expectations had also begun to fall in the longer term and there were concerns that inflation would get stuck around zero per cent, or that we might even get deflation. The situation today is entirely different. Admittedly, it has taken longer to bring up inflation to the target than we first thought. But today, inflation is stable around 2 per cent and inflation expectations indicate good confidence in the inflation target.

We would do well to remember this when considering the current proposal in the draft Monetary Policy Report to increase the interest rate. The rate cuts implemented in 2015 and 2016 were naturally not intended to be permanent, and we have constantly anticipated gradually increasing the repo rate when the conditions are right.

In more concrete terms – over the last six months, the forecasts and assessments that have formed the basis for our monetary policy decisions have been based on the assumption that the repo rate would be increased towards the end of 2018. This has been clear from our communication and has been visible in the repo rate paths. And now, when we can note that economic developments have been more or less as expected, with good economic growth in Sweden and abroad and inflation in line with the target, it is therefore natural for me to vote for a rate rise at today's meeting. The revisions made are not large enough to say that we are heading in a different direction to what we previously thought.

Another factor to consider is where monetary policy is heading in other countries. The Federal Reserve has increased rates several times this year, and is ahead of other major central banks in the tightening cycle. The ECB does not seem to be close to a rate rise but is concluding its Asset Purchase Programme now in December, which might be interpreted as making monetary policy slightly less expansionary. With these international developments, it is reasonable for Swedish monetary policy to also move in a less expansionary direction. Especially as Sweden has higher growth, higher inflation and lower unemployment than in the euro area.

It is important to point out that even with a repo rate rise today, monetary policy remains expansionary. The level of –0.25 per cent is well below a long-term normal level. And the real repo rate continues to be negative, which is clear from Figure 1:8 in the draft Monetary Policy Report.

But, as I touched on earlier, there are international risks and there is uncertainty in our forecasts and assessments. Particularly significant is the inflation forecast which is based on our assessment that the strong economic activity and rising cost pressures will have an impact in the form of gradually increasing wages and rising consumer prices. In this context, the development of the krona is important. It is reasonable to expect the krona to appreciate in the years to come, but it is still important for it not to strengthen too quickly. If inflation develops more weakly than is now expected, it may affect monetary policy.

In summary, I support the proposal to raise the repo rate by 0.25 percentage points to −0.25 per cent. But as I mentioned, it is a question of cautious and slow increases in the repo rate. In my assessment, and as things look at present, the next rise will not be until the second half of 2019. In my opinion, this is, all things considered, a continuation of the monetary policy we have been discussing for a long time. The repo rate path indicates that from 2020, it may be a question of about 0.50 percentage points in rate rises per year.

To conclude, let me say that even from a housing market perspective, it is now beneficial to increase the interest rate as it may help reduce debt growth among households, which in turn will contribute to keeping the financial risk in the economy more under control. However, the interest rate cannot solve the structural problems on the Swedish housing market. In a longer-term perspective, we are now entering a phase of slowly rising interest rates in the foreseeable future when, on the one hand, government debt is low but, on the other, households have more debt than ever before and, what is more, at a variable interest rate. This is a situation that we have not had to deal with previously and that will certainly overshadow many discussions about economic policy in the period ahead, and that unfortunately comprise a great many risks.

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

The Executive Board decided

- to adopt the Monetary Policy Report according to the proposal, Annex A to the minutes.
- to increase the repo rate to −0.25 per cent and that this decision will apply from Wednesday 9 January 2019.

Deputy Governor Per Jansson entered a reservation against the decision to raise the repo rate and did not support the repo-rate path in the Monetary Policy Report. Mr Jansson referred to the considerable uncertainty remaining over the strength of the more persistent rate of inflation and given this sees no need to raise the repo rate at present, considering it better to await further information and proceed cautiously with an unchanged repo rate for now.

§4. Other decisions

The Executive Board decided

- to publish the Monetary Policy Report and decisions under Section 3 with the motivation and wording contained in a press release at 9.30 a.m. on Thursday 20 December 2018, and
- to publish the minutes from today's meeting at 9.30 a.m. on Wednesday 9 January 2019.

This paragraph was verified immediately.

Minutes taken by

Maria Kindborg

Verified:

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

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