Monetary policy minutes

SEPTEMBER

SVERIGES RIKSBANK

Summary

At the Monetary Policy Meeting on 5 September 2018, the Executive Board of the Riksbank decided to hold the repo rate unchanged at −0.50 per cent. The forecast for the repo rate indicates that it will also be held unchanged at the monetary policy meeting in October, and then raised by 0.25 percentage points, either in December or February.

A majority of the Executive Board supported the picture of the economic outlook and inflation prospects described in the draft Monetary Policy Report. Global economic activity continues to be favourable and the Swedish economy has developed strongly for some time. Inflation is close to the target of 2 per cent. In the longer term, the forecasts are unchanged in principle. Several members emphasised the uncertainty over international developments, among other things due to signs of increasing trade barriers.

Inflation is close to 2 per cent largely because of rapidly rising energy prices. Different measures of underlying inflation indicate that inflationary pressures are still moderate. Several members raised the question of what this will mean for the development of inflation later on, when the contribution from energy prices tails off. It was noted that a necessary condition for inflation to remain close to 2 per cent is for monetary policy to continue to be expansionary.

Against this backdrop, a majority of the Executive Board considered it appropriate to leave the repo rate unchanged now. At the same time, it was emphasised that the conditions are good for inflationary pressures to rise: economic activity remains strong in Sweden and abroad and inflation expectations are close to 2 per cent. If the economy develops as expected, there will therefore soon be scope to slowly reduce the support from monetary policy. The repo rate path indicates that the rate will also be held unchanged at the monetary policy meeting in October and then raised either in December or February. The Executive Board was clear about the appropriateness of rate rises being made in increments of 0.25 percentage points when they do happen. It was emphasised how important it is to proceed cautiously when support from monetary policy is reduced. A couple of members reminded the meeting about the structural problems on the Swedish housing market and the risks that this entails to economic development in Sweden.

Martin Flodén entered a reservation against the repo rate path. He advocated a repo rate path indicating the likelihood that the repo rate will be raised by 0.25 percentage points at the monetary policy meeting in October, but which coincides with the repo rate path in the draft Monetary Policy Report as from the third quarter of 2019. He felt that the communication of such a repo rate path would entail sufficient tightening of monetary policy today. Henry Ohlsson entered a reservation against the decision to hold the repo rate unchanged and against the repo rate path in the draft Monetary Policy Report. He advocated raising the repo rate to −0.25 per cent with reference to the strong economic growth in Sweden and abroad.

MINUTES OF MONETARY POLICY MEETING
Executive Board, No. 4

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DATE: 05/09/2018

TIME: 09.00

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

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

Mattias Ankarhem
Meredith Beechey Österholm
Vesna Corbo
Charlotta Edler
Mattias Erlandsson
Anders Gånge
Jesper Hansson
Jens Iversen
Kristian Jönsson
Maria Kindborg
Sofia Kåhre
Pernilla Meyersson
Ann-Leena Mikiver
Marianne Nessén
Carl-Fredrik Pettersson (§ 1-3A)
Henrik Siverbo
Maria Sjödin
Ulf Söderström
Fredrik Wallin (§ 1-3A)
Anders Vredin

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

§1. Economic developments

Market developments since the last monetary policy meeting

Carl-Fredrik Pettersson, Markets Department, began by presenting the latest developments on the financial markets. Since the monetary policy meeting in July, developments have been characterised by resilient markets in developed economies, while assets and currencies in developing market economies have been weighed down by trade conflicts, sanctions and a strong US dollar. Countries with large current account deficits, including Turkey and Argentina, are particularly vulnerable. Commodity prices have also come under pressure, partly due to the stronger US dollar and partly due to unease over the consequences of the trade conflict between the United States and China. Bond yields in Sweden and Germany have followed developments in the United States, where the level has not changed appreciably since the monetary policy meeting in July. Neither have monetary policy expectations abroad changed appreciably – despite unease over trade, developments in emerging market economies and unease over the development of public finances in Italy.

Ahead of the day's monetary policy decision, it is expected that the repo rate will be held unchanged but a majority of market participants expect the repo rate path to be adjusted downwards. Over the month of August, there has been a rapid weakening of the Swedish krona against the euro. It is difficult to interpret this development but it could be linked to a weaker outcome for underlying inflation compared with the forecast in July. Uncertainty about the outcome of the Swedish general election and international developments may also have been significant.

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 20, 21 and 27 August. At a meeting with the Executive Board on 29 August, the draft Monetary Policy Report was discussed and tabled.

Three issues in particular have been discussed in detail during the drafting process. The first concerns uncertainty over economic developments abroad. There has been an escalation of the conflict on trade restrictions between the United States and, above all, China, while uncertainty continues to prevail in Italy over whether the new government's upcoming budget proposals will be compatible with the EU's budgetary framework. In addition, market confidence in the economic development of countries such as Turkey and Argentina is failing. The other question concerns the weakening of the krona exchange rate. It is not easy to know what has driven depreciation in recent months, but it is likely that it is a combination of many factors such as unease abroad and weak underlying inflation in Sweden. The assessment is that the krona will strengthen but that it will take slightly longer than previously expected. The third question concerns inflationary pressures in Sweden. Different measures of underlying inflation have continued to show relatively weak development and the forecast for wage growth has been revised downwards for this year and next year, despite the unchanged high level of resource utilisation on the labour market.

Mr Hansson went on to discuss how new information received since the monetary policy meeting in July has affected the economic outlook and inflation prospects abroad and in Sweden. GDP growth abroad is slowing in line with the forecast from July but GDP is still growing at such a rate that resource utilisation is rising. Despite a good economic outlook, inflationary pressures are relatively low and most measures of underlying inflation are only rising slowly. Total inflation abroad is significantly higher, which can largely be explained by earlier increases in the price of oil. There have been very small movements in expectations of future policy rates. Consequently, the forecast for the weighted average of international policy rates is basically unchanged.

In Sweden, economic activity remains strong and inflation is close to the target of 2 per cent. GDP growth in the second quarter was surprisingly strong but this can partly be explained by temporary factors, which is why growth for the third quarter has been revised downward slightly. However, confidence indicators point to continued higher than normal growth in the quarters ahead. In the new draft forecast, growth for the year has been revised upwards to 2.9 per cent. At the same time, most indicators point to continued good demand for labour, but matching problems on the labour market mean that unemployment is not expected to fall any further.

The most recent inflation outcome was slightly higher than in the previous forecast and the rate of inflation measured using the CPIF was 2.2 per cent in July. Higher energy prices and a weaker-than-expected exchange rate have contributed towards the upward revision of the inflation forecast for the coming year. Thereafter, the inflation forecast is more or less unchanged at around 2 per cent. This forecast is based on the assumption that cost pressures in Sweden will rise slowly in the years ahead. Wage growth is expected to increase gradually from 2.6 per cent this year to 3.4 per cent in 2020. The development of the krona exchange rate has been weaker than expected but a gradual strengthening of the exchange rate is expected over the forecast period, which will restrain inflation in the longer term.

In conclusion, Mr Hansson emphasised that the draft forecast presented 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 be held unchanged at −0.50 per cent and that it will be raised by 0.25 percentage points at the monetary policy meeting either in December 2018 or February 2019. At the end of August, the Riksbank's government bond holdings amounted to just over SEK

330 billion, expressed as a nominal amount. The forecast is that maturities and coupon payments will be reinvested until further notice in accordance with the decision from December 2017.

§2. The economic situation and monetary policy

Deputy Governor Martin Flodén:

Developments after the monetary policy meeting in July have mainly been in line with our forecast. This applies particularly to international developments, where economic activity has continued to strengthen at the same time as there continue to be both signs of rising trade barriers and of tangible risks linked to developments in individual countries.

Ahead of the monetary policy meeting in July, inflation in Sweden was surprisingly high, at the same time as indicators of future inflationary pressures had developed surprisingly weakly. The development of the exchange rate had also been surprisingly weak. These tendencies have now been repeated. Energy prices have risen at a surprisingly fast pace, which has contributed towards CPIF inflation coming into line with the forecast despite underlying inflation and wage increases having been slightly lower than expected. And the krona has become significantly weaker than in the forecast in July.

As at the monetary policy meeting in July, I think that this development means that the conditions are good for now taking a step towards a slightly less expansionary monetary policy. Many questions certainly remain over inflationary pressures in the long run, but, in recent years, confidence in the inflation target has strengthened as inflation has risen and has now been close to target for some time. Combined with inflation being expected to be held up by high energy prices and a weak krona over the coming year, this means that I judge that the risks of a somewhat tighter monetary policy in the near future are limited.

My arguments for a slightly tighter monetary policy in the near future than that proposed in the draft Monetary Policy Report are the same as those I put forward at the last monetary policy meeting. Firstly, a monetary policy with negative interest rates is perceived as unconventional. I think it is good to start moving towards a somewhat more normal monetary policy as soon as it can be done without weakening confidence in the inflation target. This would improve understanding of our long-term monetary policy strategy.

Secondly, our forecast for the timing of the first increase of the repo rate has been repeatedly postponed. There are expectations on the market that we will continue to postpone the first rate increase. Monetary policy has thus become more expansionary than we intended. I think that it is important that we show that the repo rate will actually start to be raised in the near future, but that we are clear, at the same time, that a first rate rise does not necessarily mean rapid rate rises thereafter.

Thirdly, the krona has continued to weaken from levels that we deem are weaker than the long-term equilibrium rate. The weakened exchange rate will contribute towards holding up inflation in the near future. Such a short-term inflationary impulse may be important in a situation where inflation is too low and confidence in the inflation target is threatened. My assessment is that we now have a fairly comfortable margin against such a situation. Questions over inflation now primarily concern how it will develop over the longer term when the contribution from energy prices subsides. In our assessment, the weaker exchange rate today will lead to a stronger appreciation of the krona in the future and thereby a stronger downward pressure on inflation in the longer term. In light of this, I see no major problems in a monetary policy leading the krona to become a little stronger in the near future. It is possible that such a monetary policy could instead contribute towards reducing the downward pressure of the exchange rate on inflation in the longer term.

At the last monetary policy meeting, I advocated a repo rate path indicating an initial rate rise of 0.25 percentage points, either at the meeting today or at the coming monetary policy meeting in October.

In many ways, I judge the conditions for a rate rise today to be good. But both analyses in various market newsletters and pricing on the financial markets indicate that an initial rate rise is not expected until December at the earliest and that the market sees a significant likelihood that it will occur even later. It is therefore not improbable that the market would overreact to a rate rise today. Instead, I advocate a repo rate path that indicates that the repo rate will very probably be raised at the meeting in October. In light of the market's current expectations, even this repo rate path, if communicated in a credible manner, would lead to monetary policy immediately becoming less expansionary. I judge that a tightening of that magnitude is sufficient for today.

As I have already mentioned, I see continued question marks over the strength of the upturn in inflation when the effects of rising energy prices and the weakened krona tail off. I therefore judge, just as the proposed repo rate path indicates, that rate rises over the longer term need to be slow. If, in the coming months, we receive indications that inflationary pressures are becoming even weaker, I would not necessarily see this as a reason to delay the moment for the first rate rise. Rather, it would indicate that monetary policy needs to proceed at an even slower pace when the rate is raised thereafter.

To sum up, I support the proposal to leave the repo rate unchanged at −0.50 per cent. However, I do not support the proposed repo rate path. I advocate a repo rate path that indicates that it is likely that the repo rate will be raised by 0.25 percentage points in October of this year, but which coincides with the repo rate path in the draft Monetary Policy Report from the third quarter of next year. With these reservations concerning the monetary policy considerations, I support the draft Monetary Policy Report. Conditional on the monetary policy that seems to be supported by a majority of the Executive Board, I also support the forecast in the draft Monetary

Policy Report. Conditional on the monetary policy I advocate, I believe that the exchange rate would be stronger in the near future and that inflation would be somewhat lower in the coming year, but that the forecast differences would otherwise be small.

Deputy Governor Per Jansson:

Since the monetary policy meeting in July, two new outcomes for inflation and inflation expectations have been published. The most recent inflation outcome, for July, reported a CPIF inflation rate of just above 2.2 per cent. This was a tenth of a percentage point higher than the forecast in the Monetary Policy Report in July. Adjusted for energy prices, the outcome was just under 1.3 per cent. And this in turn was just over a tenth of a percentage point lower than expected.

The propensity for CPIF inflation to surprise on the upside while inflation excluding energy prices develops unexpectedly weakly therefore continues. Regarding the latter measure, we have now overestimated the outcome for six out of seven months this year. As yet, no improvement can be detected in the development of service prices either. Although a certain stabilisation in price growth could be noted for June, the July outcome unfortunately revealed a new downturn, to a low 1.6 per cent. With this, except for March and June, the rate of increase in service prices has been declining for all months since August last year. Another negative piece of news is that underlying service price inflation continues to decrease rapidly, and is now in both June and July below the rate of increase in total service prices for the first time since last summer.[1] The fact that this is happening at all is unusual and, apart from now in June and July, it has only occurred on two occasions since January 2010.

The question marks regarding the strength of the more underlying inflation rate relate not only to the development in CPIF inflation adjusted for energy prices and the trends in service price growth. The Riksbank regularly calculates a large number of measures of underlying inflation, which more or less in unison indicate that trend inflation has fallen during the autumn last year and so far this year. The median for the various measures is slightly lower than at our last monetary policy meeting and amounted to about 1.6 per cent in both June and July.[2]

Neither CPIF inflation excluding energy prices nor any other measure of underlying inflation is a target variable for monetary policy. But this type of measure of trend developments in inflation often provides a good indication of where inflation is heading in the slightly longer run. The fact that almost all of these measures have been showing a negative trend for some time and are well below 2 per cent points to there being a risk of CPIF inflation not necessarily remaining close to the inflation target going forward, as the rate of increase in energy prices slows. A necessary

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

[2] CPIF inflation excluding energy prices has been excluded from the median calculation.

condition for the Riksbank to manage to reverse the negative inflation trend and hence keep inflation around the target is for service price developments henceforth to clearly increase in strength.

A positive element in the inflation picture, on the other hand, is that the signs of weakness in underlying inflation have so far not spread to inflation expectations. Admittedly, Prospera has, prior to this monetary policy meeting, not published any new outcome for the inflation expectations of labour market organisations, which I feel are particularly important for the Riksbank to follow. But the new surveys of money market participants in July and August indicate continued well-anchored expectations very close to 2 per cent for all time horizons. What now remains is for this also to be reflected in a somewhat more convincing way in price-setting and wage formation. This too, I believe, is a necessary condition for being able to stabilise inflation close to the inflation target going forward.

The draft Monetary Policy Report proposes a certain downward revision to the forecast for CPIF inflation excluding energy prices up until the summer of next year. This revision, which is in the order of 0.1 to 0.2 percentage points per month, is the result of both the continued unexpectedly weak outcomes and a slightly more depressed outlook for wage developments. The Swedish krona exchange rate is weaker than in the assessment in the Monetary Policy Report in July but this cannot prevent the increase in trend inflation from occurring somewhat more slowly, with CPIF inflation excluding energy prices now close to 2 per cent as from the spring of next year instead of at the turn of the year.

Despite the slightly weaker developments in the more underlying inflation rate, the forecast for CPIF inflation has been adjusted upwards in the shorter-term perspective. This has to do with energy prices now being expected to be higher than previously for the rest of this year and some way into next year. Just as in the July report, this new assessment, which is between one and three tenths of a percentage point higher per month, implies that CPIF inflation will peak in January next year, but now at just below 2.7 per cent instead of 2.5 per cent. From mid-2019, however, the forecast for CPIF inflation for a few months has instead been revised down and is some way below 2 per cent, as the rate of increase in energy prices slows down quite sharply and more than previously estimated. Thereafter, CPIF inflation rises again and remains reasonably close to the inflation target during the rest of the forecast period.

The development of CPIF inflation is thus expected to be characterised by quite sudden and dramatic changes and to lead to inflation clearly exceeding the target level of 2 per cent for a period. It must be borne in mind, however, that this is a result of sharply fluctuating energy prices, in part due to the unusually hot and dry summer.

The current inflation picture and the revisions to the outlook for inflation excluding energy prices that are now proposed in the draft Monetary Policy Report make clear that it will be far from easy to meet the inflation target going forward. But I still perceive the arguments suggesting that the situation is set to improve, approximately in line with the picture outlined in the draft report, to be fundamentally strong.

It is a question of a Swedish economy that has already been showing unusually rapid growth for a number of years and that has good conditions for continuing to develop well in the years ahead. Although wage developments are still subdued, I perceive it to be neither reasonable nor likely in the prevailing and expected economic situation that wages will continue to rise by only just over 2 per cent. The fact that inflation expectations are well-anchored around 2 per cent, both in the short and long term, is a strong argument for higher wage growth. In addition, several more short-term indicators, such as companies' price plans according to the National Institute of Economic Research's Economic Tendency Survey and various price indices for producer prices, suggest that inflationary pressures are soon set to increase.

And it is also a question of an increasing number of countries around us having better conditions for higher inflationary pressures, especially within the euro area. Here, too, a number of positive signals can be noted as regards wage increases in the period ahead, for example in Germany. Naturally, if inflationary pressures abroad rise, then the probability of this also happening in Sweden will also increase.

The continued fundamentally favourable conditions for an inflation rate in line with the target suggest that now is not the time to make any major changes to the monetary policy plan. However, lingering question marks as to the strength of the more underlying inflation rate, which have now also resulted in a proposed downward revision in the forecast for CPIF inflation excluding energy prices in the year ahead, mean that I share the view in the draft report that it is appropriate to marginally delay the first rate rise. The fact that we must manoeuvre ourselves through a risky and complex international environment is also an argument for this. Several risks abroad could potentially be "game-changers", including if the ongoing trade conflict between the United States and China escalates or spreads to other countries, or if the euro area encounters serious difficulty as a result of problems concerning the sustainability of public finances in Italy. Naturally, a slightly delayed rate rise in Sweden cannot reduce these risks but there is value in buying some time and proceeding cautiously, especially for a small, open, export-heavy economy like Sweden. It reduces the risk of us having to reverse a premature increase in the repo rate and at the same time we will come a little closer to the time when the ECB is set to initiate its monetary policy normalisation, which should make a substantial and rapid appreciation of the krona less likely.

I thus support both the monetary policy and the forecast in the draft Monetary Policy Report. The new, slightly lower repo rate path means that the likelihood of being able to implement the first rate rise towards the end of this year is about the same as it happening at the beginning of next year. It is therefore in line with the lower interest rate paths that I have discussed at our previous meetings this year.

I would like to end by pointing out that, as usual, it is important to note that our plan for monetary policy is conditional on our forecast for the macro economy. In the current situation, it is of particular importance that inflation excluding energy prices develops approximately as we believe it will going forward. If this does not happen, there must be preparedness to adjust monetary policy so that inflation remains close to the target of 2 per cent. But if the forecast is about right, my sights are now firmly set on it being possible to implement the first rate rise in either December or February.

First Deputy Governor Kerstin af Jochnick:

I support the assessments in the draft Monetary Policy Report, and I also support the proposal to hold the repo rate unchanged at –0.5 per cent, and to marginally revise down the repo rate path so that slow increases are due to start in either December or February.

On the whole, my view of the Swedish economy and inflation prospects has not changed significantly since the monetary policy meeting in July. Our forecast is for monetary policy to remain expansionary, and if our forecasts are correct, we are approaching the time for a first increase in the repo rate. The factors that could still upset our forecasts are the international risks that are described in the draft Monetary Policy Report and the risk that underlying inflation in Sweden will not rise at the pace we are expecting.

International economic developments still look good. Growth in the United States is somewhat stronger than we have assumed, which is positive for global growth. In the euro area, GPD has been somewhat more subdued. According to our forecast, the international growth rate, measured in terms of the KIX, has now peaked, although we foresee continued relatively good growth in the coming years. Inflation is now close to 2 per cent in many countries, but as in Sweden, underlying inflation is lower as energy prices account for a considerable share of the upturn in inflation.

With regard to the international risks we highlight in the draft Monetary Policy Report, it is primarily the discussions on trade barriers that concern me. Although no major effects have yet been noted on world trade and international growth, I think that the current discussions both create uncertainty among economic agents as to what ground rules apply and also ultimately risk damaging confidence in the political system. In this way, the discussions can in the long term lead to clearly negative effects on trade and investment.

At present, the risks abroad do not appear to be affecting economic activity in Sweden to any great extent. The National Institute of Economic Research’s Economic Sentiment Indicator instead points to a much stronger sentiment than normal. It is interesting to note that the Indicator is very strong for the manufacturing industry. The only sector that showed weaker signals in August in relation to July was the services sector. I also note that the employment plans in the Indicator point to continued strong growth in employment in the near term.

The positive picture is also confirmed by strong growth figures for the first half of the year, although the National Accounts for the second quarter are so far only preliminary. Resource utilisation in Sweden is still at a very high level. The slowdown on the housing market will not be clearly visible in housing investment until 2019, according to our forecast.

Developments on the Swedish housing market are an important factor for the future development of the Swedish economy. I think that the price adjustments that have been made in some housing segments and the slowdown in the construction of exclusive tenant-owned apartments have so far contributed to a healthier market. According to the assessment in the draft Monetary Policy Report, housing prices in Sweden are as a whole in a stabilisation phase. But this assessment is associated with considerable uncertainty.

If housing prices in Sweden were to fall heavily going forward, the negative effects on the Swedish economy could be substantial. The link between the housing market, the high level of household indebtedness and the banks’ funding of covered bonds in foreign currencies mean that the risks are substantial. As we have mentioned in earlier reports, measures are needed in several policy areas for the long-term management of the structural problems on the housing market and high household indebtedness.

I will now focus on inflation in Sweden. Measured in terms of the CPIF, it has been close to 2 per cent for a long period of time, and according to the most recent outcomes, it has even been slightly above 2 per cent. It is therefore not unreasonable to wonder why there is not a proposal for a monetary policy decision to raise the repo rate now. One important argument for me is to continue to safeguard confidence in our inflation-targeting policy; given that inflation has undershot the target over a long period of time, it is important that we do not begin the increases in the repo rate too soon. A further argument is that there is continued uncertainty regarding the strength of underlying inflation. A third argument is that we also need to consider what other central banks are doing - I am thinking here mainly of the European Central Bank's very expansionary monetary policy in the euro area.

At the previous monetary policy meeting, I pointed out that the rate of increase in service prices had fallen, which worried me as these prices are an important component of the CPIF. My fears remain as services prices continued to show weak development in June and July. As we report in the draft Monetary Policy Report, around one percentage point of the increase in the CPIF in July is explained by rising energy prices. When these price increases drop out, price increases on other goods and services must increase so that inflation does not fall too low. A relevant question is then of course where these price increases are expected to come from. One important factor is wage development. We have gradually revised down our wage forecasts in the light of surprisingly low outcomes. The statistics received as recently as last week from the National

Mediation Office show that during the first half of the year, wages largely increased at the same pace as for the year 2017 as a whole. Despite this, I think that there are several factors indicating a rise in wage growth going forward. The high level of resource utilisation and the shortage of labour in several sectors in Sweden comprise one such factor, and the signs of a rise in wage growth abroad, for instance in Germany, comprise another.

All in all, I think that our forecast for wage growth in 2018 and 2019 appears reasonable and confirms the assessment that underlying inflation will rise. In this way, CPIF inflation can remain around 2 per cent in the coming years, even when the currently high energy price increases drop out of the statistics.

Another important factor in the assessment of inflation is the weak krona and its effects on import prices. It appears reasonable to believe that the weak krona we have observed will lead to higher underlying inflation in autumn 2018. Our forecast is for the krona to strengthen gradually going forward, which will instead have a dampening effect on import price increases and inflation. It is important that the krona appreciation is gradual for inflation to remain close to the target, and this is why we must take into account monetary policy abroad.

As I mentioned earlier, our assessments of economic developments in Sweden have not changed in any fundamental way during 2018. If developments continue along the path we have now presented in the draft Monetary Policy Report, it is reasonable to prepare ourselves for an initial repo rate increase in December or February, which entails a small postponement compared with the forecast in July.

Deputy Governor Cecilia Skingsley:

Monetary policy finds itself at a crossroads. We have a history of six years in which the inflation target has not been reached and in which inflation expectations have become de-anchored from the target. For the past year or so, however, both inflation and inflation expectations have been brought back to the target. But this has taken a long time to achieve and has required greater-than-expected monetary policy expansion. At the crossroads where we now find ourselves, it is a matter of not implementing rate rises too quickly and thereby running the risk of cutting short the economic expansion. It is also a matter of not rushing into rate rises as a downturn in inflation will be more difficult to manage than previously, bearing in mind the current historically low interest rate levels. But nor should we act too late or too slowly and run the risk of an overheated economy.

At the monetary policy meetings in April and July, I have supported the repo rate path for which there was a majority and declared myself ready to support a first rate rise in line with it. With this repo rate path as a basis, a rate rise would be brought into play at one of the meetings in October or December. But my position has been conditional on the assessment of economic developments at that time holding good. The draft Monetary Policy Report, which I support, describes the economic developments in detail, but prior to presenting my monetary policy position today, I would, in addition, like to say a few words about the prospects for inflation, the appropriate size of forthcoming rate rises and the significance of the exchange rate for monetary policy in the near term.

Since the monetary policy meeting in July, the CPIF target variable has, on the one hand, been revised up slightly, which suggests that there will soon be scope for increasing the repo rate. But on the other hand, measures of underlying inflation, which say something about the possibility of keeping inflation on target, have been revised down slightly. Taking account of a number of measures for underlying inflation, described in Figure 3:3 in the draft Monetary Policy Report, the median for these various measures has remained around 1.5 per cent for the entire year. It needs to be highlighted that a convincing upward trend for underlying inflation cannot be observed.

How significant then is underlying inflation bearing in mind that the CPIF target variable is close to 2 per cent? As far as I am concerned, the significance of the measures for underlying inflation being slightly on the low side diminishes with time. With anchored inflation expectations, there are good conditions going forward for inflation to nevertheless remain close to 2 per cent. I would therefore have preferred to see an unchanged repo rate path at today's meeting, but, making an overall assessment, I do not think that the proposed adjustment to the repo rate path is large enough to justify entering a reservation.

In the draft Monetary Policy Report, the Executive Board has specified that rate rises, when they happen, will be made in steps of 25 basis points. This is a tried and tested strategy within Swedish monetary policy and is therefore preferable to other sizes of step. The fact that the Executive Board changed the repo rate in smaller steps in 2015 and 2016 had to do with it being reasonable at the time to proceed cautiously, when the effects of the transmission mechanism from negative interest rates were still unknown. When we eventually move the repo rate in the other direction, I do not see the same need to do so in smaller steps than 25 basis points per meeting. The fact that I support making rate rises in 25-basis-point steps also means that I see an increase in December as the first feasible opportunity while October is no longer an option for me.

Since the monetary policy meeting in July, I would also like to comment on the development of the krona exchange rate in particular. The initial market reaction after the July decision was an appreciation, probably based on increased confidence in an initial rate rise becoming more likely at the end of this year. Thereafter, the krona has depreciated seen over the entire period up until now. At the July meeting, I highlighted the high likelihood that the themes currently weakening the krona exchange rate, including international downside risks and weak Swedish inflationary pressures, will dominate the krona exchange rate for a while longer. Even though I accept the exchange rate forecast in the draft Monetary Policy Report today, I still see it as highly likely that the krona will remain weaker than our forecast for some time to come, and this will provide marginal impetus to inflation. Against the backdrop of the high level of resource utilisation in the economy, price increases emanating from the krona should disperse through the economy, which would also provide justification for the Riksbank to be able to initiate rate rises at one of the upcoming monetary policy meetings.

In conclusion, I would like to say that I support the description of economic developments and the forecasts in the draft Monetary Policy Report, as well as the proposal for a new repo rate path and repo rate decision.

Deputy Governor Henry Ohlsson:

To begin with, I would like to say that I do not support the proposal to hold the repo rate unchanged at −0.5 per cent. It is my opinion that the repo rate should be increased by 0.25 percentage points to −0.25 per cent. As a consequence of this, I also am of the opinion that the interest rate path should be brought forward so that it is consistent with my proposed repo rate increase.

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

The economic situation abroad is good. One expression of this is that global trade in goods is increasing. Over the past 12 months, the annual rate of increase has been just over 4.5 per cent. Increased trade is of crucial importance for a small, open economy like Sweden's. The dawning protectionism therefore gives cause for concern. At the same time, it remains to be seen what consequences new tariffs and sabre-rattling about new trade barriers will have on world trade.

Annual growth abroad, KIX-weighted, is expected to amount to 2.6 per cent in 2018 according to the draft Monetary Policy Report. For 2019, the forecast is 2.4 per cent. The KIX-weighted inflation rate is expected to be 2.1 per cent in both 2018 and 2019.

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

Let me now move on to Sweden. Since the autumn, the target variable for monetary policy has been the CPIF. The annual rate of increase of the CPIF was 2.2 per cent in the most recent inflation reading in July. CPIF inflation has been around the inflation target for a long time. In the last 16 months, CPIF inflation has been in the interval 1.7–2.4 per cent. The average rate of inflation over these 16 months has been 2.0 per cent. According to the forecast in the draft Monetary Policy Report, inflation will be 2.2 per cent on average in 2018. This is an upward revision compared with the forecast in the July Monetary Policy Report. In 2019, CPIF is expected to increase by 2.1 per cent on average. Target achievement is good!

The August reading of five-year inflation expectations among money market participants was 2.0 per cent. Over the last 32 months, the mean value of five-year expectations has been 1.9 per cent or higher. The impression that inflation expectations are at the two-percent target is strengthened if we look at expectations two years ahead. In August, these expectations were at 2.1 per cent. Looking back, two-year expectations have been 1.9 per cent or higher for the last 20 months. For the twelfth month in a row, expectations for one year ahead were at 1.9 per cent or higher. Inflation expectations are now well anchored!

I will now move on to a discussion of the situation on the labour market. The official measure of unemployment in Sweden is given by the Labour Force Surveys (LFS). According to the most recent labour force survey, unemployment was 6.0 per cent (not seasonally adjusted) in July. This is lower than the corresponding month one year earlier, when LFS unemployment was 6.6 per cent. At the same time, I think it is important to also look at the other two measures when interpreting the LFS.

Unemployment insurance fund members can be considered to have a relatively strong position on the labour market. In July 2018, the percentage of openly unemployed fund members was 2.6 per cent. This is somewhat higher than the same month one year previously. Then, the percentage of unemployed fund members was 2.5 per cent. A few tenths of one per cent here or there makes no great difference, but qualitatively, it is interesting that the downward trend that we have seen for several years has now been broken. The break in the trend emphasises that unemployment has now bottomed out.

This is also suggested by the outcomes for unemployment as measured by Arbetsförmedlingen (Af), the Swedish public employment service. The sum of registered, openly unemployed and those participating in labour market programmes as a proportion of the register-based labour force was 6.9 per cent in July 2018. This can be compared to 7.3 per cent in the same month last year. But what is really interesting about Af's statistics is the comparison that can be made between the development for those born in Sweden and those born abroad. For those born in Sweden, unemployment in July was 3.6 per cent, according to Af's statistics. The same month one year ago, the figure was 3.9 per cent. This is certainly a decrease, but not a large one. For those born abroad, the corresponding unemployment figure was 19.9 per cent in July 2018 and 21.8 per cent in July 2017. My interpretation is that the decrease in unemployment above all reflects a decrease for those born abroad. For those born in Sweden, on the other hand, this reinforces the image of unemployment having 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 for general demand policy but rather labour market policy measures to strengthen the human capital of unemployed persons and cut the cost of employing them.

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

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

But it is important that such analyses do not eclipse the target for monetary policy. The introduction of the variation band was also based on the fact that there can always be unexpected events, white noise and uncertainty, making it not always possible to exactly attain the inflation target. If one chooses to discount certain prices, one risks excluding relative price changes. Since the end of 2015, energy prices have shown an increasing trend that is faster than other prices in the CPIF.

Of course, it can be interesting to study the CPIF excluding energy prices. However, there are also prices on other goods and services groups that are equally volatile. If one wishes to exclude volatile prices, there may be reason to exclude all prices that are very volatile and not merely energy prices. And it is still important to take into account relative price changes.

Overall, these monetary policy considerations mean that I cannot support the monetary policy conclusions in the draft Monetary Policy Report. To summarise, it is my opinion that the repo rate should be increased by 0.25 percentage points to −0.25 per cent. As a consequence of this, I also am of the opinion that the interest rate path should be brought forward (but with the same slope as in the draft Monetary Policy Report) so that it is consistent with my proposed repo rate increase.

Governor Stefan Ingves:

Let me start by saying that I share the view of economic developments in Sweden and internationally as described in the draft Monetary Policy Report. This means that I support the proposal to leave the repo rate at −0.50 per cent, and to adjust the repo rate path slightly. The repo rate path indicates that the repo rate may be increased by 0.25 percentage points in either December or February, given that developments in Sweden and abroad are approximately as expected. I think that it is in itself worth mentioning in particular the 0.25 percentage point step. Smaller steps have no major economic relevance. I would also like to mention that the Riksbank's reinvestments of redemptions and coupon payments in the government bond portfolio are continuing in line with the plan adopted in December last year. These reinvestments have so far worked well and will continue until 2019 in accordance with the Executive Board's earlier decision. The reinvestments are a precautionary measure and strengthen monetary policy as we now head towards a gradual normalisation of interest rates.

Economic developments abroad remains good. Growth abroad, KIX-weighted, is expected to be around 2.5 per cent this year and next year, which is above-trend. It is particularly important for us in Sweden that GDP growth in the euro area has improved in the past year. And expected GDP growth in the United States looks robust. But there are significant risks that can alter these forecasts in both the near-term and longer-term perspective. For example, there is still uncertainty regarding the long-term sustainability of Italian public finances, were the unfunded reforms that have been signalled to be implemented. The trade conflict between the United States and its major trading partners continues. And several emerging market economies are struggling with acute economic problems as well as with inflation rates far from and much higher than common inflation targets. According to our assessments so far, these risks will not have any decisive impact on international growth. But as always, these kinds of risks are difficult to assess and to quantify. They are therefore not always visible in the forecasts, but may nevertheless affect policy later on.

If we now turn to economic developments in Sweden, the situation still looks good. According to the preliminary outcome for the second quarter this year, growth in the Swedish economy was surprisingly high. Some of this we assess to be of a temporary nature and growth in the next few quarters is set to slow. But overall, our forecast for the whole of 2018 – almost 3 per cent – is stronger than the forecast in July. In 2019 and 2020, growth will slow to around 2 per cent per year, partly in conjunction with a slowdown in housing investment. The situation in the labour market continues to be strong. The employment rate is historically high after several years of good economic activity and is expected to increase further during the forecast period. Unemployment has fallen to levels not seen since before the financial crisis ten years ago. Times are good, especially among "ins" - that is among those who are established on the labour market and have simultaneously benefited from a dysfunctional housing market.

Inflation continues to develop in line with our target of 2 per cent. Two monthly outcomes have been published by Statistics Sweden since the last monetary policy meeting and they were a tenth or so below and above our previous forecast respectively. The latest outcome for CPIF inflation, for July, was 2.2 per cent. At the same time, inflation expectations continue to indicate good confidence in the inflation target. If we consider our inflation forecast, which I support, the trend of constantly rising inflation has now been broken. The forecast indicates a new pattern of inflation close to our target. Inflation expectations suggest a similar pattern. But there are causes for concern as regards the development of inflation going forward. Different measures of underlying inflation have developed weakly. The rate of increase in service prices, which make up 45 per cent of the CPIF, has slowed in the past year and is now below the average since 2000. Prices for goods including food, which also make up 45 per cent of the CPIF are also well below target. In light of this, it is not so strange that different measures of underlying inflation tend to be below two per cent. Wage development, one of inflation’s more important determinants, continues to be subdued in relation to the strong labour market. This means that monetary policy needs to continue to provide support to the economy. One the one hand, this involves downside risks for inflation but on the other hand, the risk of deflation is now clearly absent.

The task for monetary policy going forward is to ensure that inflation continues to develop in line with the target of 2 per cent. Here, several external factors play a major role. A key factor, perhaps the most important, as regards Swedish inflation developing permanently in line with the target, is rising underlying inflationary pressures abroad. With today's well-intermeshed goods and services market, it is difficult to envisage Swedish inflation deviating permanently from international inflation. In our forecasts, international inflationary pressures are expected to rise. But there is uncertainty in this assessment, as underlying inflationary pressures in many countries are low despite strong economic activity. International monetary policy is also a key factor for the monetary policy conducted in Sweden. In recent years, the ECB’s extensive monetary policy stimulus, in the form of large asset purchases and a negative interest rate, have been important when designing Swedish monetary policy. With higher growth and inflation than in the EMU, it seems natural to also have a higher interest rate in Sweden than the ECB’s interest rate. How much higher is an open question and no doubt an important one in the period ahead.

Another important factor is the development of the krona exchange rate, where too rapid an appreciation of the krona may make continued target achievement more difficult. However, the krona exchange has weakened since the monetary policy meeting in July, contradicting the forecast presented at that time. This is also a pattern we have seen many times before. If we look back at our krona forecasts, we can see that the Swedish exchange rate movement has been difficult to predict. The method used to develop exchange rate forecasts in the Monetary Policy Report is based on traditional theories that emphasise relative growth differentials and current account balances. According to this theory – which is also supported by long-term historical correlations – countries with high growth compared to other countries and a current account surplus tend to have currencies that appreciate. These theories could be considered to be real. At the same time we have seen that minor currencies, such as the Swedish krona, often depreciate in times of financial and geopolitical unease. It is possible that these forces, real and financial ones respectively, have their greatest impact on different time horizons. However, it is easy to gain the impression that financial flows in recent years have dominated over more real determinants, which have not been a disadvantage from an inflation perspective. The real forces seem to influence exchange rate movement more in the longer run.

Returning to monetary policy – if we look back over the last three and a half years, I think we can establish that it has required an unexpectedly large amount of effort to bring inflation up to 2 per cent. The repo rate has been negative for three and a half years, and our government bond purchases have meant that the Riksbank now owns about 40 per cent of the outstanding stock of nominal and real government bonds. The policy has been successful and target achievement has been good for more than a year. As I mentioned earlier, the ECB's expansionary policy in recent years has been particularly important when designing Swedish monetary policy. But this can change, and bearing in mind that economic developments in Sweden look more favourable than in the euro area overall, it is reasonable for Sweden to have slightly higher interest rates. Despite the presence of downside risks, it is now time to announce a test of that hypothesis later on.

My conclusion for monetary policy is that the time for a cautious normalisation of monetary policy is approaching. Inflation is now well in line with the target, the economy is favourable in both Sweden and abroad. It would be odd if a negative real repo rate were also required going forward in order for inflation to continue to develop in line with the target. If inflation and economic developments in general follow the forecasts made in the draft Monetary Policy Report, it will soon be time to raise the interest rate, according to the forecast, in December or February. Given the fairly long period of negative interest rates we have had, I also think that it is a good idea for us to indicate, in an orderly fashion, where we are heading. In conclusion, it is worth noting that if our forecast is correct, the interest rate will rise slowly in the foreseeable future, something which may be particularly important on the housing market with all its problems and large number of variable-rate loans.

§3. Discussion

Deputy Governor Cecilia Skingsley:

I would like to return to my contribution about monetary policy having been at a crossroads at the last few meetings. In more concrete terms, the choice lies between starting to raise the repo rate or waiting a little longer. In retrospect, it will be easy to see what would have been the best choice, but we have to take decisions in advance and theory and empirical data can only help us part of the way.

As these minutes will be examined not only by our contemporaries but also by later generations, I would like to clarify one opinion about good and less good arguments for rate rises.

I believe that we are in agreement in the Executive Board that a good argument for a rate rise is when inflationary pressures start to accumulate. A less good argument for a rate rise, however, is the idea that moving away from a negative repo rate has an inherent value of its own. A very critical view can be taken of negative interest rates; they can be described as somewhat unconventional, extreme and experimental. I would therefore like to remind the meeting that the degree of monetary policy expansion is determined by the level of the actual interest rate (such as the current repo rate of −0.25 per cent) in relation to what can be considered a neutral interest rate, which is to say one that neither stimulates nor restrains the economy.

The Riksbank's assessment is that the neutral interest rate has fallen, from the assessment of 3.5 to 5.0 per cent before the global financial crisis, to the interval of 2.5 to 4.0 per cent according to an estimate from February 2017. Similar assessments have been made by other central banks.

With lower real interest rates worldwide and given an unchanged monetary policy task, to stabilise inflation around 2 per cent, the repo rate will have to be cut to below zero at recurring points in the future. This is a situation to which both economic agents and economic policy decision makers will have to relate.

If we wish to avoid new periods of negative interest rates in the future, a number of different measures need to be taken:

A policy contributing to higher global real interest rates is required. Without taking a stance myself here and now, higher inflation targets could also be considered as a way of creating a greater distance to nominal negative interest rates. Finally, future monetary policy decision makers may rely on other measures than negative interest rates, such as asset purchases and currency interventions.

When we strive to improve understanding of monetary policy, it is important to clarify that this several-year period of negative interest rates could be repeated if nothing else is changed.

Deputy Governor Martin Flodén:

As regards Cecilia Skingsley's comments, I have described, both at the meeting today and at the last monetary policy meeting, the perception of current monetary policy as unconventional as one of many reasons for which I would like to see a slightly earlier rate rise. I would like to clarify not only that I do not see avoiding negative interest rates as having its own inherent value but also that an important precondition for my argument is that confidence in the inflation target is sufficiently strong and that inflation in the period ahead remains on sufficiently high levels even with the repo rate path I advocate. There are limits for how expansionary monetary policy can be made, for example with repo rate cuts or asset purchases, before various forms of negative side-effects emerge. When the repo rate is close to its lower bound, I thus consider that there is a certain value in moving towards more normal levels as soon as this can be done without again damaging confidence in the inflation target, assuming that the risk of monetary policy again being forced back to its most expansionary levels is small.

I would also like to ask Henry Ohlsson a question. In your contribution, you described how recent years' Swedish monetary policy, including the monetary policy future planning communicated by the majority of the Executive Board, has resulted in both inflation expectations and inflation being close to the target for quite some time. You said that target achievement is good. At previous monetary policy meetings, you have stated that you do not support the economic forecasts in the Monetary Policy Report. Could you explain how your forecast deviates from the forecast in the draft Monetary Policy Report?

First Deputy Governor Kerstin af Jochnick:

Several members have reported their opinion of the size of the steps in which it may be possible to raise the repo rate and I would therefore like to add my view of this. I share the assessment that a normalisation of monetary policy can be made in steps of 0.25 percentage points. Using smaller steps could possibly be justified as a means of testing the effects on the market in the same way we did when cutting the repo rate to negative levels in 2015. However, my assessment is that those conditions are not comparable to the current situation, not least as we are now moving away from the lower bound of the repo rate. And even a rate rise of 0.25 percentage points would have to be seen as relatively small. Talking in advance about our view of the size of a first rate rise creates transparency and predictability in monetary policy.

Deputy Governor Henry Ohlsson:

I have no alternative forecast of my own. However, I do have two important starting points for my view of monetary policy's effects on macroeconomic key variables. The first of these is that monetary policy takes effect with a time lag. The second is that the exchange rate affects inflation with a time lag. According to the Riksbank's models, exchange rate fluctuations have their strongest impact on the rate of inflation with a delay of four to five quarters. This means that the rate rise I advocate will not have so much impact in the near future but rather in about a year or so. The uncertainty band in the draft Monetary Policy Report one year ahead is significant. I consider that developments following a repo rate rise now will fit into these uncertainty bands. The variation band is also an expression of the uncertainty associated with the effects of monetary policy.

Governor Stefan Ingves:

I agree with Cecilia Skingsley that the repo rate should not be raised for the purpose of being able to cut it later on. There has to be something in the development of the economy that justifies an increase.

Deputy Governor Henry Ohlsson:

Just to make myself clear: I share the opinion that 25 basis points is the appropriate size for rate rises. Smaller steps would be meaningless. We differ when it comes to the issue of when the repo rate should be raised, not the matter of how large the steps should be.

§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,

• to hold the repo rate at −0.50 per cent.

Deputy Governor Martin Flodén entered a reservation against the repo rate path in the Monetary Policy Report. He advocated a repo-rate path that indicates a likelihood of the repo rate being raised by 0.25 percentage points at the monetary policy meeting in October, but which coincides with the report's repo rate path as from the third quarter of 2019. He felt that the communication of such a repo rate path would entail sufficient tightening of monetary policy today.

Deputy Governor Henry Ohlsson entered a reservation against the decision to maintain the repo rate at its current level and against the repo rate path in the Monetary Policy Report. He advocated raising the repo rate to −0.25 per cent with reference to the strong economic growth in Sweden and abroad.

§5. Other decisions

The Executive Board decided

• to publish the Monetary Policy Report and decisions under Section 4 with the motivation and wording contained in a press release at 09.30 on Thursday 6 September 2018, and

• to publish the minutes from today's meeting at 09.30 on Monday 17 September 2018.

This paragraph was verified immediately.

Minutes taken by

Maria Kindborg

Verified:

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

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