Minutes of the Executive Board's monetary policy meeting, no. 1

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TIME: 9.00

PRESENT: Stefan Ingves, Chairman
Karolina Ekholm
Per Jansson
Kerstin af Jochnick
Barbro Wickman-Parak
Lars E.O. Svensson

Johan Gernandt, Chairman of the General Council (§ 1)
Sven-Erik Österberg, Vice Chairman of the General Council (§ 1)

Sigvard Ahlzén (§ 1)
Claes Berg
Carl Andreas Claussen
Charlotta Edler
Heidi Elmér
Frida Fallan
Johannes Forss Sandahl (§ 1)
Eric Frieberg
Ann-Christine Högberg
Martin W Johansson (§1)
Anna Lidberg (§1)
Tomas Lundberg (§ 2-4)
Pernilla Meyersson
Marianne Nessén
Christina Nyman
Lena Strömberg (§ 1)
Ulf Söderström
David Vestin
Staffan Viotti
Magnus Wiberg

It was noted that Carl Andreas Claussen and Magnus Wiberg would prepare draft minutes of § 1, 2 and 3 of the Executive Board's monetary policy meeting.

§1. Economic developments

Anna Lidberg of the Monetary Policy Department began by presenting the most recent developments on the financial markets. Market developments in January were characterised by increased risk propensity following various central-bank measures, including the three-year loans provided by the European Central Bank (ECB). This has led to higher asset prices and lower interbank rates. Share indexes in Sweden, the United States and the euro area have risen sharply since the turn of the year. The TCW-weighted exchange rate for the krona has strengthened by approximately 2 per cent since the previous monetary policy meeting on 19 December. Monetary policy expectations as indicated by forward pricing have risen since December but, still reflect a high probability that the repo rate will be cut by 0.25 percentage points at today's meeting and the likelihood that there will be further cuts during the year.

Johan Forss Sandahl of the Financial Stability Department began by presenting recent developments regarding financial stability with a focus on the situation regarding public finances in Europe. The Greek parliament has adopted new savings measures totalling EUR 3.2 billion. However, no agreement to write-down Greece's central government debt has yet been reached with private lenders and negotiations with the private lenders are continuing. The credit rating agency Moody's has downgraded the credit ratings for Italy, Portugal, Slovakia, Slovenia and Malta by one gradation and for Spain by two gradations. Despite this, government bond rates have continued to fall, above all for Portugal, Ireland and Italy. Issue volumes for the euro-area banks were high in the current quarter compared to previous quarters. The credit risk at the banks, measured in terms of the CDS premium, has fallen in Sweden, Europe and the United States since the turn of the year, and more European banks were able to borrow on the bond market in January. Large issue volumes are common at the start of the year, but the ECB's three-year loans in December may also have contributed to this to some extent.

Marianne Nessén, Head of the Monetary Policy Department, presented the draft Monetary Policy Report which, in the assessment of the Monetary Policy Department, will gain the support of the majority of the members of the Executive Board. She began by noting that the forecasts in the draft Report were discussed by the Executive Board at meetings held on 1, 2 and 6 February. The text was tabled at a meeting of the Executive Board on 9 February.

There have been mixed signals from the euro area since December. On the one hand, the financial markets have stabilised somewhat and government bond rates have fallen. On the other hand, growth prospects have deteriorated, partly as a result of further fiscal-policy consolidation. There are also signs of credit tightening in parts of the euro area. In the United States, however, growth prospects are a little brighter. Above all, the labour market and the housing market have improved.

In December, CPI inflation in Sweden was 2.3 per cent and CPIF inflation 0.5 per cent, calculated as an annual percentage change, which was in line with the Riksbank's forecast in the December Monetary Policy Update. Industrial output and goods exports have developed weakly and fell during the fourth quarter according to the monthly statistics.

On the other hand, the production of services and the retail index both increased in November and December. Unemployment reached 7.5 per cent in December, which was somewhat higher than expected. Both employment and the supply of labour increased more than expected.

Confidence indicators from December and January also present a mixed picture. Purchasing managers' indexes in both the manufacturing and service sectors increased somewhat, while the business tendency survey of the National Institute of Economic Research continued to fall in January.

The forecast in the draft Monetary Policy Report is based on the assumption that the European debt crisis will be managed in such a way that the acute crisis will subside this year. Household and corporate confidence may then return and growth begin to recover during the course of 2012. Compared to the forecast in December, weaker growth is now expected in the euro area, but slightly better growth in the United States. International policy rates have been revised downwards and are expected to remain low.

The weak development of the economy in the euro area is the main reason why the expected slowdown in Swedish growth will be somewhat more severe than expected. It is expected that GDP fell in the last quarter of 2011, and growth is expected to be low in 2012. The labour market will thus weaken somewhat more in 2012 than was forecast in December. Inflationary pressures will be low, with a CPIF inflation rate below 2 per cent up to the end of 2014. CPI inflation will fall rapidly over the coming year, mainly as a result of the lowering of the repo rate. CPI inflation will be just under 1.0 per cent at its lowest point in 2012. After that, CPI inflation will rise gradually to just over 3 per cent in 2014. The repo rate will be cut to 1.5 per cent and will remain at this level for approximately one year. The repo rate will then be gradually increased from mid-2013 to approximately 3 per cent at the beginning of 2015.

§2. Economic outlook abroad

Deputy Governor **Lars E.O. Svensson** said that an important piece of monetary policy history was made in January. Mr Svensson was referring to the fact that the Federal Reserve System, the US central bank, had published a strategy document entitled "Longer-Run Goals and Policy Strategy" and had also begun to publish policy-rate forecasts. The strategy document stipulates that the Federal Reserve has a target of 2 per cent for PCE inflation in the longer run. It also states that a further aim of the Federal Reserve is to stabilise employment and unemployment around normal and sustainable levels in the longer run. It is specifically stated that the FOMC members' current assessment of the normal rate of unemployment in the longer run is between 5.2 and 6 per cent. This can thus be interpreted to mean that the central bank stabilises inflation around 2 per cent and unemployment around a sustainable rate of 5.6 per cent, if one takes the mid-point of the central tendency as a point estimate. With the publication of the FOMC's strategy document and policy rate projections, together with the already previously published projections of inflation, growth and unemployment, one can claim that the Federal Reserve has now taken the lead in conducting a clear and consistent monetary policy that facilitates the decisions of economic agents, reduces uncertainty and increases transparency and accountability, in line with best international practice.

Mr Svensson then went on to comment on the draft Monetary Policy Report. He declared that the forecast for inflation and GDP in the euro area presented there is too optimistic, contains elements of wishful thinking – for example with regard to crisis management in the euro area – and is more optimistic than the forecasts of other major forecasters. The IMF revised its forecast for the euro area downwards in January. There are only negative risks in the IMF's report and these risks have increased during the autumn. A mean – that is, unbiased – unbiased forecast, which the Riksbank's forecast should strive to be, is probably therefore even lower than the IMF's published forecast.

During the autumn of 2011, the IMF also presented new and more reliable calculations of the effects of fiscal contraction, with better measures of contractions than previously and with data from many countries and periods.[1] These calculations show larger negative effects on GDP and employment than previously. There is nothing to support the idea that fiscal contraction would have a positive effect on confidence that in the short term dominates over the negative effects on GDP and employment. This means that the recession in the euro area risks being more severe than was previously believed. What the latest fiscal policy agreement in the euro area – the fiscal compact - actually entails and the impact it will have is not yet clear, and Mr Svensson did not believe it was a solution to the problems. The acute phase of the current crisis may very well last for considerable time, and it is highly possible that there will be several years of weak growth in the euro area.

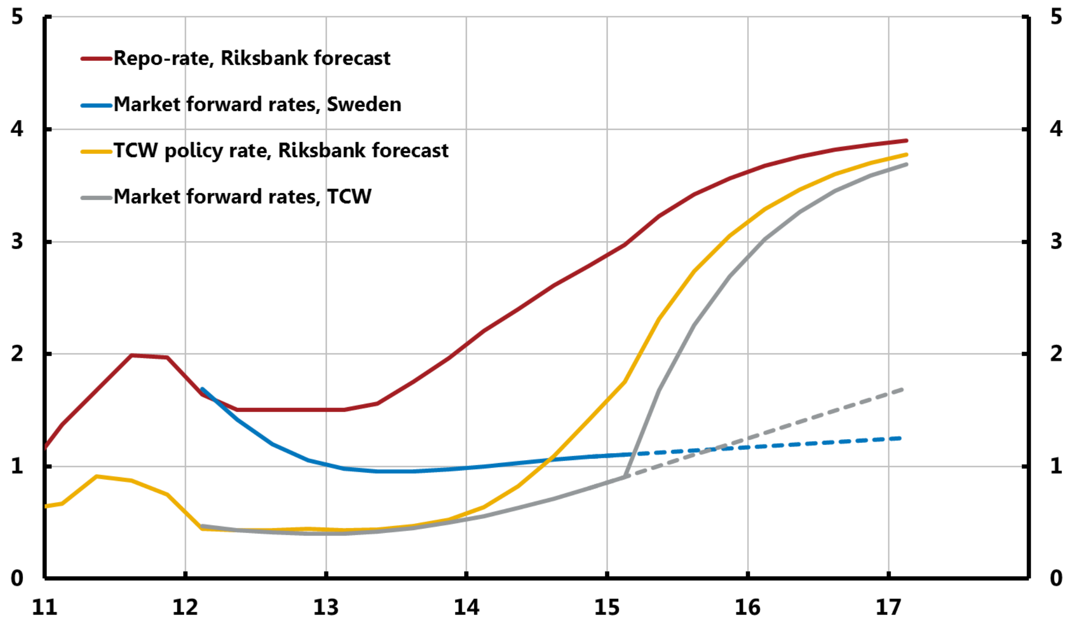
As before, he also saw problems with regard to the forecast for foreign policy rates. As he had demonstrated with the aid of a figure at the monetary policy meeting in July 2011, the forecast for foreign policy rates has systematically been too high for several years, with outcomes systematically lower than the forecast. A too high forecast for foreign policy rates leads systematically towards a too high repo-rate path, all else being equal. A higher foreign interest-rate path will, all else being equal, lead to a smaller difference between Swedish and foreign interest rates, and to a weaker krona. The Swedish repo-rate path must then be even higher to counteract this.

[1] Ball, Laurence, Daniel Leigh and Prakash Loungani (2011), Painful Medicine. *Finance & Development* 48 (3), p 20-23, and Guajardo, Jaime, Daniel Leigh and Andrea Pescatori (2011), Expansionary Austerity: New International Evidence. *IMF Working Paper* WP/11/58.

Mr Svensson referred to Figure 1 in the figures he had handed out. The yellow line in the figure shows the forecast for TCW-weighted foreign policy rates in the main scenario of the draft Monetary Policy Report. The upward curve beyond the three-year horizon shows how the policy-rate forecast is implemented in Ramses. The grey line shows TCW-weighted implied forward rates, adjusted by normal forward premiums, that is, 1 basis point per month. The dashed line beyond the three-year horizon indicates a more uncertain estimate. Further ahead, the forecast is significantly above the implied forward rates and, all else being equal, gives rise to a substantial upward shift in the Riksbank's repo-rate path. As previously, Mr Svensson regretted the absence of a proper discussion of these important matters in the draft Monetary Policy Report and a justification of the belief that the central banks in the euro area and the United Kingdom will conduct a monetary policy such that TCW-weighted policy rates begin to rise after 18 months and then rise at a rather rapid rate after two years. This is despite the fact that this has significant consequences for the Riksbank's repo-rate path. In the United Kingdom, the Bank of England's forecasts are based on a policy-rate path in line with forward rates and Mr Svensson said that there are no indications there of a need for a policy-rate path higher than the forward rates. As far as the euro area is concerned, Mr Svensson said that the ECB's three-year loans indicate that the Eonia rate may remain at its low level of 0.35 per cent for several years to come.

Figure 1. Repo-rate path, forward rates and forecast for TCW-weighted policy rate, February 2012

Per cent. Forward rates from 8 February



Sources: National sources, Reuters EcoWin, the Riksbank and own calculations

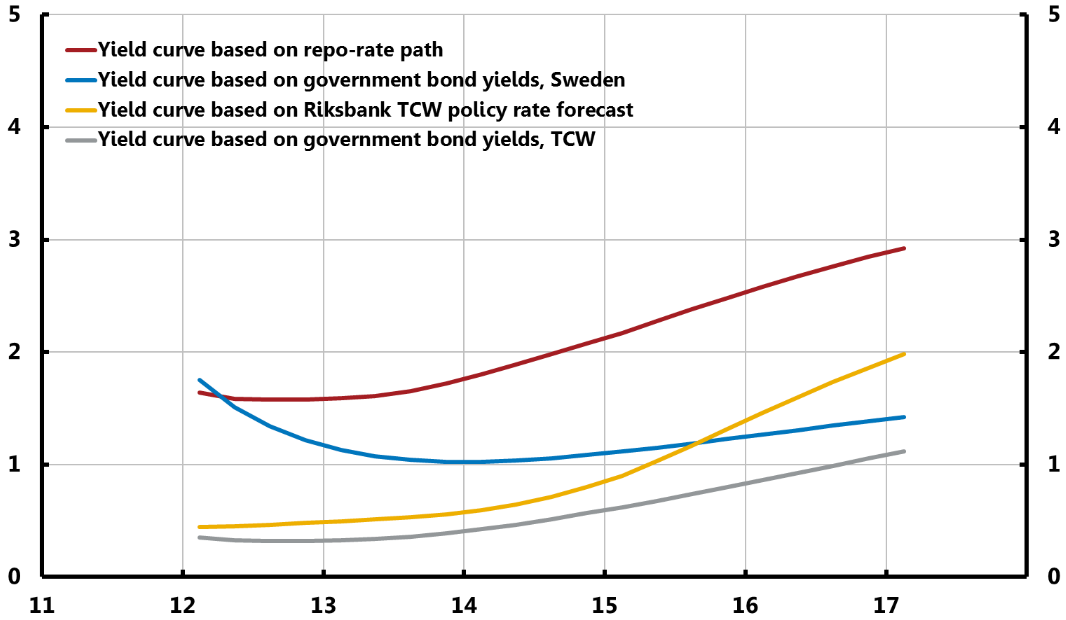
According to Mr Svensson, the Riksbank appears to be rather unique among central banks in making such high forecasts for foreign policy rates. As far as Mr Svensson was aware, other relevant central banks seem to base their forecasts on forward rates and then adjust these forecasts on the basis of further information about monetary policy in the countries concerned, which may give rise to forecasts that are lower than the forward rates.

In Figure 1, the solid grey upward curve beyond the three-year horizon shows how a forecast in accordance with forward rates is implemented in Ramses in practice. He intended to return to these forecast calculations.

The forecast for foreign interest rates can also be perceived as an assumption about and a forecast for foreign yield curves, that is, foreign interest rates for different maturities. In Figure 2 of the figures handed out by Mr Svensson, the grey curve shows the actual TCW-weighted foreign yield curve, while the yellow curve shows the foreign yield curve that is compatible with the Riksbank's forecast for foreign policy rates, but with the forward-premium adjustment removed to provide a better comparison. Mr Svensson noted that he had discussed these curves and the significance of the difference between them in greater detail previously.

Figure 2. Yield curves, February 2012

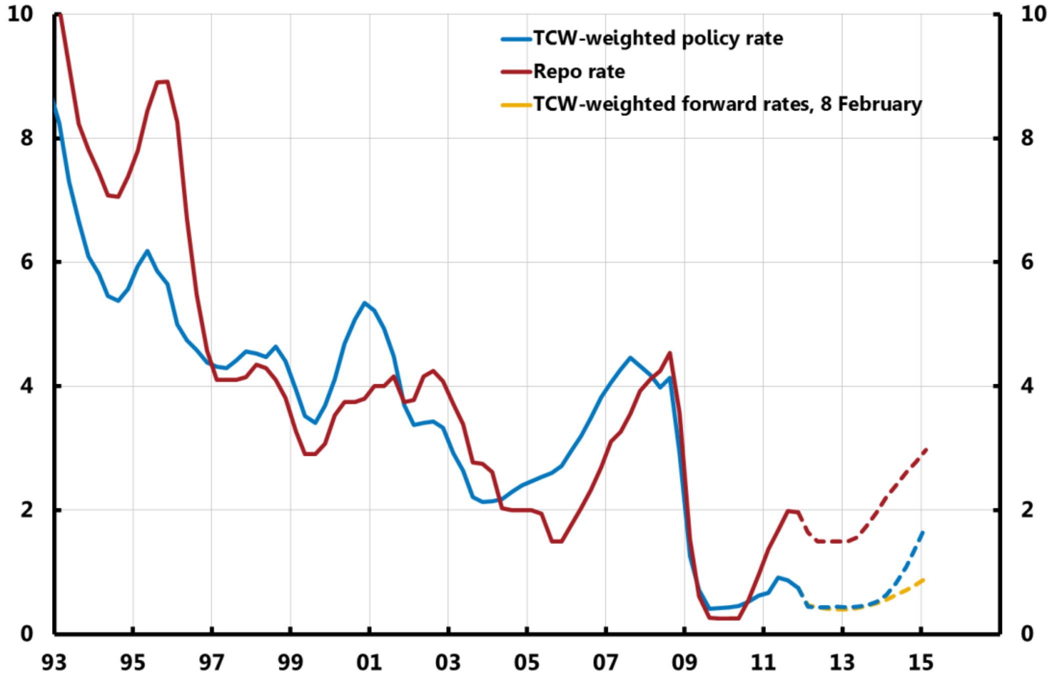
Per cent. Government bond rates from 8 February



Sources: National sources, Reuters EcoWin, the Riksbank and own calculations

Mr Svensson's third figure shows that there have previously been rather moderate differences between Swedish and foreign policy rates but that they there are now unusually large. The differences are particularly large when one compares the repo-rate path with foreign forward rates, that is the yellow dashed curve at the bottom right of the figure.

Figure 3. Policy rates in Sweden and abroad
Per cent



Note. Forward rates have been adjusted for risk premiums and describe the expected overnight rate, which does not always correspond to the official policy rate.

Sources: National sources, Reuters EcoWin and the Riksbank

To sum up, Mr Svensson's view was that the forecast for foreign policy rates and the forecast for growth in the euro area are both much too high and that this contributes to the repo-rate path being too high.

Deputy Governor **Karolina Ekholm** said that a central assumption for the international outlook this time, as on previous occasions, is that the euro crisis will be managed in a reasonably orderly way. Ms Ekholm said that this was a reasonable assumption that is supported to a certain extent by recent developments. The three-year loans offered by the ECB in December have made a significant contribution to reducing the acute stress on the financial markets. In themselves they are not a long-term solution, but they have provided a well-need breathing space. However, it is a major problem for the outlook in a longer perspective that large parts of the euro area have to pursue fiscal consolidation at a time when economic activity is weak. We can expect this consolidation to dampen growth for a long time to come and to exert expansionary pressure on monetary policy in the euro area.

In the forecast in the draft Monetary Policy Report, the figure for growth in the euro area has been revised downwards by around two-tenths for this year and by one-tenth for 2013 and 2014. The forecast is that growth will be -0.1 per cent in 2012, which as Mr Svensson has pointed out is somewhat higher than predicted by several other forecasters.

Like Mr Svensson, Ms Ekholm believed that this is a rather optimistic forecast given the weak development of economic activity in late 2011, with slow GDP growth, a fall in industrial output and new orders, increased unemployment and signs of credit tightening. There have, on the other hand, been somewhat more positive signals recently. Some confidence indicators have stopped falling at least. Ms Ekholm said that she was not quite as pessimistic about the future course of development as Mr Svensson, even though she believed that the forecast for growth in the euro area seems to be too high on the margin.

The situation in the United States has looked a little brighter recently and the figures for growth there in 2012 and 2013 have been revised upwards somewhat compared to December. Ms Ekholm thought this was reasonable. However, even in the United States the need to tighten fiscal policy in the future will put pressure on monetary policy, which can be expected to be highly expansionary in the period ahead. This applies to the United Kingdom as well.

However, Ms Ekholm declared that, like Mr Svensson, she is not prepared to support the forecast for monetary policy abroad. As previously, the forecast for foreign policy rates deviates from the implied forward rates in that the forecast rates are higher at the end of the forecast horizon. The difference is not as great as previously, but from the start of 2014 the TCW-weighted foreign policy rates rise much more rapidly than the TCW-weighted implied forward rates.

Also as previously, Ms Ekholm's view was that it should be possible to present a forecast that deviates from market expectations, but that if such a forecast is presented it should be clearly justified. One possible justification is to say that the Riksbank is more optimistic in its assessment of the economic outlook, but Ms Ekholm was doubtful about this assessment. She believed, as previously, that the strained fiscal-policy situation means that monetary policy in the United States and Europe will need to be highly expansionary more or less across the entire forecast horizon. The forecast for foreign policy rates is of great significance to the forecast for the krona exchange rate, and this in turn is of great significance to the forecasts for inflation and resource utilisation in Sweden. The forecast for foreign policy rates is therefore a very important component of the international economic outlook and Ms Ekholm said that it is too high during the latter part of the forecast horizon.

She then pointed out that the forecasts made in 2010 for the TCW-weighted policy rate at the turn of the year 2011/2012 were between 1 and just over 3 per cent, depending on which particular forecast from 2010 one looks at. This can be seen in Figure 1 in the minutes of the monetary policy meeting held in July 2011. The actual TCW-weighted policy rate never reached 1 per cent in 2011 and appeared instead to be around 0.5 per cent at the turn of the year. This is not a very large difference compared to a forecast of 1 per cent, but quite a large difference compared to 3 per cent. It can also be noted that inflation in both the euro area and the United States, which carries a heavy weight in the TCW-index, was significantly higher in 2011 than was forecast in 2010. Ms Ekholm said that, in her opinion, this indicates either that the relationships on which the Riksbank bases its forecasts for foreign policy rates are misspecified, or that the Riksbank has misjudged the tolerance of the rest of Europe and the United States to higher inflation, given a very weak outlook for the real economy. Ms Ekholm said that the Riksbank should examine how accurate the forecasts for foreign policy rates have been in recent years and whether there are reasons to change the forecasting methods in any way.

Deputy Governor **Barbro Wickman-Parak** began by pointing out that the difference between forward rates and the forecasts for policy rates abroad does not arise until after 2014 and that this is not of any decisive importance to her decision on the repo rate today.

She then said that her assessment of the situation abroad in December was not uniformly bleak. This assessment still holds and, in her opinion, can now be expressed with greater emphasis. It is true that growth in the euro area appears to have slowed down more than expected at the end of last year, and the forecast in the draft Monetary Policy Report for growth over the next few years has also been revised downwards somewhat compared to the forecast in December. The confidence crisis that grew steadily worse during the summer and autumn has had a significant impact on both production and new orders in the euro area. However, the companies appear to have reacted quickly to the heightened crisis situation, which is perhaps to be expected. Following the collapse of Lehman Brothers, there is greater awareness of the fact that economic conditions can change very abruptly.

Ms Wickman-Parak said that she supported the adjustments of the growth forecast for the euro area. Of course, it cannot be ruled out that things may get worse. But already in December there were tentative signs of a stabilisation in various indicators and these indicators have now strengthened for households and companies, although from low levels. One should not draw too far-reaching conclusions from a month or two of better indicators, but it is nevertheless worth noting this improvement. When so much of the focus is on developments in individual crisis countries it is easy to lose sight of the overall picture. There are countries in the euro area where the potential for a recovery in growth is good. Germany, which also did not manage to escape a significant weakening in economic activity at the end of last year, is perhaps the foremost example and it is reasonable to expect an eventual recovery in domestic demand there.

As Ms Wickman-Parak pointed out already in December, the risk of severe credit tightening in the euro area is a serious threat to the potential for growth. There were already signs of credit tightening in December, and the ECB survey that was published about a week ago indicates that this is continuing. The ECB survey covers the banks, but it can also be noted that issues of corporate bonds have increased and that various credit spreads have decreased. Declining risk aversion is also reflected by developments on the stock markets. Government rates in the debt-ridden countries have fallen back from extremely high levels.

Ms Wickman-Parak's assessment was that the ECB's offer of three-year loans to the banks, which led to the lending of considerable sums just before Christmas, was an important factor. Although these loans are of course not a solution to the long-term problems, they have played a role in the situation that has arisen in helping to fend off a serious liquidity crisis.

As described in an article in the draft Monetary Policy Report, the euro countries have managed to agree on a range of measures to strengthen the budget policy framework. The political will this demonstrates will not affect the problems in the short term but nevertheless leads Ms Wickman-Parak to be slightly more optimistic about the chances of confidence returning and growth eventually picking up.

Signs that the US economy is not in such bad shape as many observers predicted six months ago were already evident in December. New statistics reinforce this picture and this is described in detail in the draft Monetary Policy Report. The assessment in the draft Report is also that earlier stimulation measures, such as tax cuts, will be withdrawn after the extension that was previously decided to apply until the end of February. This subdues the growth forecast. Although consolidation measures are necessary, they can be carried out in different ways and at different times. The political system has not demonstrated any great ability to solve problems like this. However, if the politicians do manage to pull this off then our growth forecasts may be slightly too low.

Ms Wickman-Parak had no desire to belittle the problems faced by the euro area. The problems in Greece will be difficult to manage even if a new support package is implemented. Several other countries, with or without support packages, also have a long way to go to achieve stability in their public finances and to strengthen the potential for long-term growth. The assessment in the forecast is that the euro area as a whole is facing a few years of meagre growth. However, this is counterbalanced by the fact that other parts of the world will still growing at a fairly good rate. The downward revision for global growth is marginal. Ms Wickman-Parak concluded by saying that she supports the forecast for the economic outlook abroad in the draft Monetary Policy Report.

Deputy Governor **Per Jansson** began by saying that he supported the forecast for the economic outlook abroad presented in the draft Monetary Policy Report. Mr Jansson said that there are no significant differences between the view of the situation abroad presented in the report and that given by other forecasters, with the possible exception of the United States, which is natural as there is a time lag to the other forecasts. Mr Jansson pointed out in this context that he thus agreed with Ms Wickman-Parak that new statistics for the US economy have outperformed expectations.

With regard to developments abroad, Mr Jansson said that attention is still highly focused on the euro-area countries that have public-finance problems. He then said that as he supports the international forecast in the draft Monetary Policy Report in its entirety, it also follows that he supports the key assumption that it will be possible to deal with the public-finance problems and that there will be no escalation in the large, debt-ridden euro-area countries. Mr Jansson pointed out that he agrees with Ms Ekholm that recent developments suggest that the key assumption is reasonable..

Nevertheless, he wished to express some concern about the fact that it is going so slowly for the countries with weak public finances to improve their budgets and about the arrangements in place to manage these countries' problems. Mr Jansson then discussed these two concerns in turn.

Examining the IMF's latest "Fiscal Monitor Update", it can be seen that the group designated "advanced countries"[2] is estimated to have reduced its budget deficits from

-7.6 per cent in 2010 to -6.6 per cent in 2011. For the euro area alone, the improvement is slightly larger, from -6.3 per cent to -4.3 per cent, but it should be noted that a rather large part of this improvement comes from the German budget, which has moved from

-4.3 per cent to -1.1 per cent. What is worse is that, according to the IMF, the same depressing figures apply to so-called structural balances, that is, budget balances adjusted for cyclical effects. Here there has been an improvement for "advanced countries" from -5.9 per cent to -5.1 per cent, that is by a meagre 0.8 percentage points. The figures for the euro area imply an improvement from -4.8 per cent to -3.5 per cent, that is, by 1.3 percentage points, but once again Germany accounts for a large part of the improvement, from -3.5 per cent to -1.2 per cent.

Of course, identifying an appropriate speed for budget consolidation is no easy task in a situation in which growth is weak and the deficit very large. Even so, these figures are a little worrying. At the rate at which the budget is improving just now, it will take a very long time before balance is restored and the debt ratio can start falling. The meagre improvement of the budget is an important reason for why many countries are now being forced to live with high risk premiums and borrowing rates. This makes it more difficult to manage fiscal problems.

Mr Jansson went on to discuss the other aspect, the arrangements in place to manage these countries' problems. Here, the significant difficulties faced by these countries in sorting out their problems on their own are creating unease. The budget restraints are just one example, he said. There is also a need to undertake structural reforms for growth,

[2] The group "advanced countries" includes the United States, the euro area, Japan, the United Kingdom, Canada, South Korea, Australia, Taiwan, Sweden, Switzerland, Hong Kong, Singapore, the Czech Republic, Norway, Israel, Denmark, New Zealand and Iceland.

reforms of the framework for economic policy and, in some areas, fundamental institutional reforms. Unfortunately, no great progress has been made in any of these areas, as yet.

Mr Jansson emphasised that he is, of course, aware that some countries will not be able to sort out their problems unless they are supported by other countries, the IMF and various EU facilities. But placing too much emphasis on these support measures will undermine the incentive for these countries to adopt measures themselves, thereby weakening the conditions for identifying sustainable solutions to their problems. Support measures are needed, but are not enough to reach sustainable solutions. Mr Jansson feared that at least one reason for the comparatively weak results achieved so far, in terms of matters such as budget consolidation and structural reforms, is that altogether too much focus has been placed on support facilities and too little on the need for national responsibility.

However, Mr Jansson concluded by observing that the recent agreement on a fiscal compact is encouraging, as is the progress that seems to have been made in the management of the problems in Greece. We just have to hope that more progress can be made in the period ahead, he said.

First Deputy Governor **Kerstin af Jochnick** noted that the draft Monetary Policy Report reflects her view of economic activity abroad on the basis of the information available at present. Since December, development in Europe has weakened slightly, while development in the United States has been slightly stronger. It is difficult to assess development in Europe due to the interplay of many factors. The combination of fiscal problems and fiscal policy measures in several countries will probably lead to very weak growth in the area. The need to capitalise banks and strengthen competitiveness in the crisis countries can be added to this. However, it is important to note that several countries that are important for Swedish exports still have strong growth.

Ms af Jochnick went on to point out that international economic activity depends on Europe being able to manage these fiscal problems and, ultimately, the problems in the banking sector. It is clear that Europe is on the right path and that a number of decisions have been taken in the right direction. Several steps have been taken to reinforce fiscal policy cooperation in the euro area, but the decisions taken at both the national and EU levels remain to be implemented in a credible manner. Once long-term sustainable solutions have been introduced, confidence in the euro area should return. Europe will be walking a precarious tightrope for a long period to come, and so great uncertainty remains over how quickly growth can recover. On one hand, there may be reason to believe that a recovery may arrive relatively rapidly. This assumes that the crisis countries will consolidate their public finances, strengthen competitiveness and capitalise their banks. On the other hand, there is unease that the accumulated effects of fiscal policy measures in several countries will have too many dampening effects over the short term.

In this context, it is important to note that the European Central Bank's measures, with loans to the banking sector, have acted as a lubricant, pushing down interest rates, observed Ms af Jochnick. This has contributed to the positive performance of the financial markets at the start of the year. However, there are risks linked with the European Central Bank's lending, and attention should be paid to these. A large number of banks have borrowed at low interest rates, which itself could force behaviour in the market to create imbalances beyond our forecast horizon.

Furthermore, Ms af Jochnick explained that the capital requirement of 9 per cent set by the European Banking Authority for larger banks in the EU should strengthen confidence in the European banking sector and thus have a stabilising effect on the financial market. The supply of credit in Europe seems to function, but demand is weak, particularly in the crisis countries.

The issue of using implied forward rates instead of making our own forecasts of overseas policy rates is interesting and deserves a careful analysis, considered Ms af Jochnick. The Riksbank's forecast of overseas policy rates and how these are used in the models should probably be developed. The opinion that this forecast should consider the development of implied forward rates is reasonable. At the same time, forward rates occasionally display great volatility, which suggests that the central banks' own communication and the Riksbank's own model analysis should also be considered.

Governor **Stefan Ingves** said that he shares the view of international developments presented in the draft Monetary Policy Report. It has largely followed the assessment from December. As expected, development is continuing to be weak in the euro area. However, there is still a difference between the countries in the north, for example Germany which are experiencing significantly stronger development, and the crisis countries of the south. The same applies among Sweden's neighbours, if Norway, which is faring better, is compared with Denmark, which is not doing as well. The development of the real economy indicates a smaller downward revision of growth in the euro area this year and next year.

Mr Ingves then noted that there have not been any major surprises in the real economy of the United States either. Growth was revised upwards in December's Monetary Policy Update. Since this, even more bright spots have been noted: the labour market has developed in a more positive direction than expected and there are stronger confidence indicators in the industrial sector and among households. The upward revision of growth in the United States is counteracting the downward revision of the euro area, to a certain extent.

Mr Ingves went on to observe that the emerging markets have become increasingly important for Swedish exports, as illustrated by an article in the Monetary Policy Report. Since 2007, the increase of exports to the emerging markets has been greater than the decrease to the EU and United States. But the emerging markets are not immune to the weak development of Europe either. Nevertheless, the forecast is that these countries can expect continued good growth. As Europe continues to be a very important trading partner, economic activity will be facing an uphill struggle compared with previous years. This can also be seen clearly in the weak export forecast.

As regards financial indicators, a certain degree of stabilisation has been noticed recently, said Mr Ingves. The European Central Bank's decision to issue loans to the banks at a maturity of three years has increased access to liquidity and contributed to lower interest rates. At the same time, no acute banking crisis is expected. Since the start of the year, CDS premiums for banks have fallen in the United States and Europe and share prices have increased. The 10-year government bond rate has fallen in most of the crisis countries of the euro area.

One question that may arise in the period ahead is how access to liquidity and the low interest rate level will influence countries other than the crisis countries. In the euro area, excluding Germany, France, the Netherlands and Finland, M3 and bank lending at an annual rate fell by about 0.5 per cent at the end of last year. In the euro area as a whole, the money supply and bank lending instead increased by a couple of per cent. This means that the rate of increase was higher in the non-crisis countries than in the crisis countries. For example, in Germany, the money supply increased by 6 per cent in December 2011, Mr Ingves pointed out. In terms of the European credit crunch, this means that the circumstances are very different in countries with and without problems. This benefits Sweden, as our neighbouring countries have less serious problems than in southern Europe.

Mr Ingves went on to observe that there are two different perspectives on how Europe's crisis countries should be dealt with. The first perspective revolves around what needs to be implemented now in separate countries. This is a matter of consolidating public finances, capitalising banks and strengthening competitiveness. The capital requirements set by the European Banking Authority are reasonable. Waiting to capitalise the banks may delay the recovery, which would create even greater problems in the long term. In addition, wages and prices must increase more slowly than the average rate for the euro countries in order to improve competitiveness.

The second perspective deals with measures acting over a slightly longer term without delaying the resolution of short-term problems. The fiscal compact is a step on the way to improving fiscal policy coordination, the monitoring of individual countries and the possibility of imposing sanctions, but it will not take effect until after the forecast horizon. The EFSF/ESM support facilities need sufficient capacity to reduce contagion risks between countries. But they also need to be balanced so as not to incite any delay to the consolidation of public finances.

The IMF will play a central role by lending money at the same time as it places requirements for binding commitments. As a small, export-dependent country, it is in Sweden's interest to contribute to this lending. There is no difference between participating now and when Sweden lent money to Iceland, Latvia and Estonia, Mr Ingves pointed out.

Referring to Ms Ekholm's observation that the accuracy of forecasts of overseas policy rates in recent years should be investigated, Mr Ingves said that this is something that should be investigated further, even if the difference between forward rates and forecasts of overseas policy rates after 2014 is not the most urgent issue on the agenda. The models must have a system in which exchange rates and interest rates are connected – but reality does not always behave like the models. It is genuinely difficult to reconcile the models' demands for precision with the developments then observed. But this divergence of theory and reality is well worth continued analysis, concluded Mr Ingves.

Deputy Governor **Lars E.O. Svensson** then commented on what had been said so far. Mr Svensson started by addressing Mr Ingves and Ms Wickman-Parak's comments on how the difference between forward rates and forecasts of overseas policy rates after 2014 are not particularly important at present. The important thing, asserted Mr Svensson, is that the repo-rate path is highly sensitive to assumptions of the forecast of foreign policy rates beyond 2014. It is very important for the monetary policy analysis and has major effects on the repo-rate path if the forecast is assumed to follow the yellow, solid grey or dashed grey curve in Figure 1. So the question of forecasts of foreign policy rates is important, said Mr Svensson.

A look at Figure 1 also gives the impression that the Riksbank's policy-rate forecasts have lost contact with reality, maintained Mr Svensson. The low grey forward rate curve with its dashed extension in Figure 1 – and the low grey yield curve in Figure 2 – represent the actual financial circumstances abroad, while the much higher yellow curve in Figure 1 – and the higher yellow yield curve in Figure 2 – can be seen as the Riksbank's assumption of financial circumstances abroad. It becomes even more apparent when it comes to Swedish financial conditions. The low blue curve for Swedish forward rates, with its dashed extension in Figure 1 – and the low blue yield curve in Figure 2 – represent the actual Swedish financial conditions, while the high red repo-rate path in Figure 1 – and the high red yield curve in Figure 2 – show the much tighter financial conditions corresponding with the high repo-rate path. There are very great differences between the Riksbank's view and reality, particularly between the Riksbank's perception of Swedish and foreign five-year interest rates and actual Swedish and foreign five-year interest rates.

Mr Svensson agreed with Ms Wickman-Parak that the crisis in the euro area is a crisis of confidence, but considered that it is primarily a crisis of confidence over a short-term perspective. Over a longer perspective, there are major long-term structural problems in the euro area. Major countries like Italy and Spain have lost competitiveness and it will take a very painful internal devaluation with a very tight fiscal policy for a long time to improve competitiveness. There are major structural problems in the financial sector. If the fiscal policy agreement between the euro area countries is put into place, this will mean that fiscal policy will become strongly procyclical and it will then create instability rather than stability and lead to deeper recessions. Mr Svensson agreed with Ms Wickman-Parak that the European Central Banks' three-year liquidity support would not solve any structural problems.

Mr Svensson also considered that there is a tendency to overvalue the signs of improved development for the United States. Ben Bernanke, the Chairman of the US Federal Reserve recently seemed to wish to warn Congress not to make too much of these signs. Fiscal policy is paralysed and a divided Congress is facing overwhelming problems. There are great risks for new major cutbacks with concomitant negative consequences for the economy.

Mr Svensson went on to refer to Mr Ingves and Ms Wickman-Parak's hopes that the rest of the world, apart from Europe and the United States, would experience better development and create demand for Swedish exports that could compensate for the deteriorated development of demand from Europe and the United States. But Europe and the United States are China's largest trading partners, with Europe being marginally larger than the United States, and China is highly dependent on the development of Europe and the United States. This was emphasised in the IMF's "China Economic Outlook", published on 6 February, which noted that China's growth would fall far and rapidly if the euro area would experience a deep recession.

Mr Svensson then commented on Mr Ingves' remark that a few countries in northern Europe, such as Germany, are developing quite well. Germany resembles Sweden in several respects – with a composition of exports like Sweden's –, but an Eonia rate of 0.35 percentage points is considered to be quite right and proper for Germany, while the Swedish economy is being subjected to a much higher repo rate.

Deputy Governor **Karolina Ekholm** said that she agreed with Mr Ingves that the deviation between exchange rate theory and reality is well worth a continued analysis. This deviation can possibly be explained by the effects of the interest rate differentials being dwarfed by the effects of other shocks. This would make it difficult to empirically identify the true relationship between interest rates and exchange rates. Ms Ekholm remarked that this is more or less how she herself thinks of the relationship. However, it is important to determine what the relationship is here, and how the fact that the exchange rate may be primarily governed by other shocks should be handled in the forecast.

Deputy Governor **Per Jansson** pointed out that his impression was that there have seldom been such reliable exchange rate forecasts as recently, when interest rate differentials have been allowed to influence the forecasts to a lesser degree. It would be interesting to see whether a formal analysis of forecast errors could confirm this. Mr Jansson went on to agree with Mr Ingves that there are more important issues than the difference between forward rates and forecasts for foreign policy rates after 2014. Mr Jansson said that if the work on exchange rate and interest rate forecasts is to be deepened, this should proceed on the basis of an uncertainty band around the forward rates so that the discussion does not short-sightedly get stuck on insignificant details.

As a comment on Mr Svensson's contribution about the major long-term structural problems existing in the euro area over a longer perspective, Deputy Governor **Barbro Wickman-Parak** agreed about these problems, and mentioned that she had also emphasised them in her contribution. As Mr Svensson adduced, there are also other risks and problems. She pointed out that, in her contribution, she had selected the problem areas that she identifies as being most relevant to the repo-rate decision. This is not the same as being unaware of other types of problem.

To sum up, Governor **Stefan Ingves** observed that the economic development of the euro area was weak. Assessments within the Executive Board differ in their degree of pessimism. There are certain bright spots in the US economy and the development of the financial markets has stabilised somewhat since the December Monetary Policy Update. The analysis of overseas interest rates and the analysis of the link between foreign and Swedish interest rates and exchange rates should continue and be deepened, observed Mr Ingves.

§3. Economic developments in Sweden and the monetary policy discussion

Deputy Governor **Lars E.O. Svensson** explained that he thinks it good to lower the repo rate and the repo-rate path at this time. However, the main scenario's CPIF forecast is still too low in relation to the inflation target and the forecast for unemployment is still too high in relation to a sustainable rate of unemployment. According to Mr Svensson, it is clear that an even lower repo-rate path would give a better outcome for both CPIF inflation and unemployment.

Mr Svensson entered reservations against considerable parts of the draft Monetary Policy Report, namely the forecasts for foreign policy rates, euro area growth and Swedish resource utilisation, which he considers are too high. He prefers that the repo rate be cut by 0.50 percentage points to 1.25 per cent at this meeting, and then prefers a longer repo-rate path which is at 0.75 per cent from the third quarter of 2012 until the third quarter of 2013, and which then rises at an even pace to 2 per cent at the end of the forecast period. This repo-rate path strongly resembles the one published by the National Institute of Economic Research in December 2011.

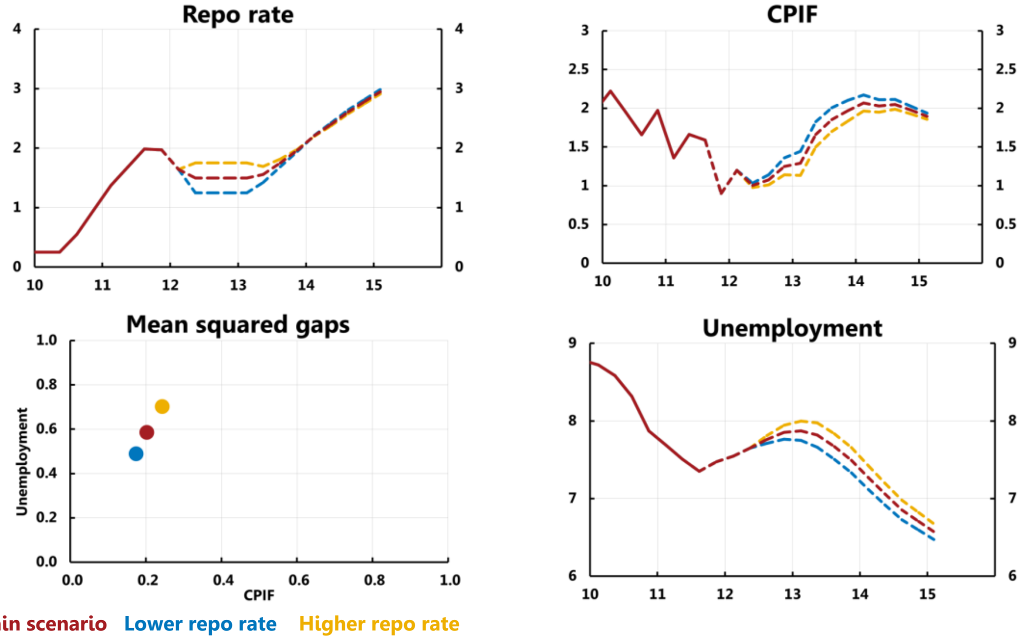
Mr Svensson considered the repo-rate path in the main scenario to be too high for several reasons. First, an according to Svensson unjustified high forecast for foreign policy rates gives a bias towards a too high repo-rate path. Second, as the forecasts for the euro area and thus demand for Swedish exports are too optimistic, the forecast for Sweden is also too optimistic. Third, there is a general bias towards overestimating resource utilisation due to the assumption by the Riksbank of a higher sustainable unemployment level than other major analysts. Moreover, as Ms Ekholm and Mr Svensson have pointed out at previous meetings, the Riksbank's analysis and measure of resource utilisation are unclear. The analysis suffers from considerable confusion and makes no distinction between measures of resource utilisation as a target variable and measures of resource utilisation as an indicator of inflation. These are different things, but the Riksbank's analysis mixes them together.

Fourth, even if one accepts the high forecast for foreign policy rates and the high estimate of 6.5 per cent for the sustainable unemployment rate, it can still be shown that a lower repo-rate path stabilises CPIF inflation better around 2 per cent and unemployment better around a level of 6.5 per cent. Regardless of how it is viewed, the main scenario thus entails a monetary policy that is not well balanced, according to Mr Svensson.

To explain his fourth reason for monetary policy not being well balanced, Mr Svensson referred to Figure 4 in the graph data he handed out. This figure shows the forecasts for CPIF inflation and unemployment for different repo-rate paths under the assumption in the main scenario of a high forecast for foreign policy rates and a high sustainable level of unemployment of 6.5 per cent. These are the same diagrams as in Figures 2.14, 2:15 and 2.19 in Chapter 2 of the draft Monetary Policy Report. The diagram with the mean squared gap at the lower left has been added.

Figure 4. Monetary policy alternatives, February 2012

Foreign interest rates according to the main scenario. Sustainable unemployment 6.5%



Sources: Statistics Sweden and the Riksbank

In the upper left-hand diagram, the red path shows the repo-rate path in the main scenario, and the blue path is a lower repo-rate path. The right-hand diagrams show that the lower repo-rate path gives a forecast for CPIF inflation that is better stabilised around 2 per cent and a forecast for unemployment that is better stabilised around 6.5 per cent. According to Mr Svensson, it can thus directly be seen that a lower repo-rate path leads to better target fulfilment for both inflation and unemployment. The lower left-hand diagram also shows that the mean squared gap is lower for both inflation and unemployment with the lower repo-rate path.

The repo-rate path in the main scenario has been lowered compared with December, but according to these diagrams it has not been lowered enough to best stabilise inflation and resource utilisation. With the new repo-rate path, the forecast for CPIF inflation is still too low and the forecast for unemployment is still too high. Lowering the repo-rate path further would improve target fulfilment for both inflation and unemployment. Monetary policy is therefore not well balanced in the main scenario, according to Mr Svensson. He does not think that it is necessary to be an expert on monetary policy to realise this.

So why isn't the repo-rate path being lowered further? In the draft Monetary Policy Report, the main scenario's repo-rate path is justified by the claim that a "more expansionary monetary policy will contribute to CPIF inflation stabilising around 2 per cent and to resource utilisation stabilising around a normal level towards the end of the forecast period". According to Mr Svensson, this is no reason for suggesting that the red repo-rate path should be better than the lower blue one. The lower blue path stabilises inflation and resource utilisation as well or better at the end of the forecast period. In addition, it stabilises inflation and resource utilisation better over the entire forecast period.

Mr Svensson then gave three reasons for why it would be misleading to only consider target fulfilment at the end of the forecast period. First, there are many alternative repo-rate paths that stabilise inflation and resource utilisation at the end of the forecast period. So this criterion is not enough to select a repo-rate path. Secondly, in practice, there is not much information available on forecasts three years ahead. Forecasts at such a long horizon are, in practice, instead close to the unconditional mean of 2 per cent for inflation and a sustainable level for resource utilisation. Third, it is well known in the scientific literature that monetary policy is not time consistent if the focus is on target fulfilment at a fixed. A monetary policy alternative that fulfils this criterion in one quarter often no longer fulfils the criterion in the next quarter, even if the economy has developed completely in accordance with the forecasts and there have been no surprises. This has been demonstrated in a classic paper on intertemporal decision-making by Strotz from the mid-1950s and, more recently, in well-known papers on monetary policy by Kai Leitemo and Michael Woodford.[3] For monetary policy to be time consistent, target fulfilment over the entire forecast period must instead be considered. According to Mr Svensson, this should be self-evident from a more general perspective: for households and firms, what matters is what inflation and resource utilisation is in each quarter, not in 12 quarters.

The section "Alternative scenarios for the repo rate" in Chapter 2 of the draft Monetary Policy Report includes several lines of argument for why the red repo-rate path should be better than the blue one. Mr Svensson said he found these lines of agument strange. One argument drifts back and forth between CPI and CPIF inflation. Having several targets and switching emphasis between these different targets from time to time is a well-known way of justifying a specific policy that is desired for other, unstated reasons, Mr Svensson pointed out. But it is no way to conduct a transparent and consistent policy. Another argument is that the blue path is not a feasible alternative, but that the real alternative is instead a path characterised as being "uneven". Mr Svensson did not understand what this meant and wondered if some strange discontinuity had arisen between the blue and red paths.

[3] Strotz, Robert. H. (1956), Myopia and inconsistency in dynamic utility maximization. *Review of Economic Studies* 23 (2), p 165-180.
Leitemo, Kai (2003), Targeting Inflation by Constant-Interest-Rate Forecasts. *Journal of Money, Credit and Banking* 35 (4), p 609-626.
Woodford, Michael (2005), Central Bank Communication and Policy Effectiveness. In *The Greenspan Era: Lessons for the Future, A Symposium Sponsored by the Federal Reserve Bank of Kansas City, Jackson Hole*, p 399-474.

According to Mr Svensson, a large and serious problem in the decision-making process is that, in practice, there is no scope for a serious, in-depth discussion of different policy alternatives. There should be at least two alternative repo-rate paths with attendant carefully-analysed forecasts for inflation and resource utilisation, together with discussions of target fulfilment for the various alternatives. Without this, the decision-making material is insufficient. How can the members of the Executive Board take reasonable decisions if the consequences of the alternative repo-rate paths have not been properly examined?

Mr Svensson then explained his third reason for arguing that the repo-rate path in the draft Monetary Policy Report is too high, namely that the Riksbank overestimates resource utilisation. In the spring of 2011, the Ministry of Finance, together with some of Sweden's leading labour market economists and macroeconomists, estimated the sustainable level of unemployment, the unemployment level in steady state, at 5 per cent. In December 2011, just after the monetary policy meeting, the National Institute of Economic Research published an analysis with an estimate of 5.8 per cent. The average of the estimates of these two main authorities is 5.4 per cent, close to Mr Svensson's own preliminary estimate of 5.5 per cent from the autumn of 2010.

The Riksbank remains at an earlier estimate of 6.5 per cent, without the same careful review of the possible consequences of reforms and other changes to the labour market that the Ministry of Finance and the National Institute of Economic Research include in their analyses. Mr Svensson sees this as problematic. If the Riksbank's estimate is too high and the Riksbank is contributing to holding unemployment above a sustainable level, Mr Svensson believes that this may have major negative effects for the Swedish economy. High unemployment over a longer period contributes towards higher long-term unemployment by allowing unemployment to become entrenched and harder to reduce to a sustainable level. Unlike steady-state unemployment, the short-term NAIRU and short-term equilibrium unemployment are problematic and model-dependent terms.[4] Richard Rogerson highlights steady-state unemployment as largely being the only unequivocal and usable equilibrium measure.[5] However, to the extent that it is possible to talk about a short-term NAIRU, it is clear that high unemployment via persistence phenomena contributes towards pushing up the short-term NAIRU and makes the relation between inflation and unemployment more unfavourable, meaning that it costs more in terms of high inflation to bring unemployment down to a long-term sustainable level. In addition, according to the preparatory works for the Sveriges Riksbank Act, the Riksbank, without prejudice to the objective of price stability, shall support the objectives

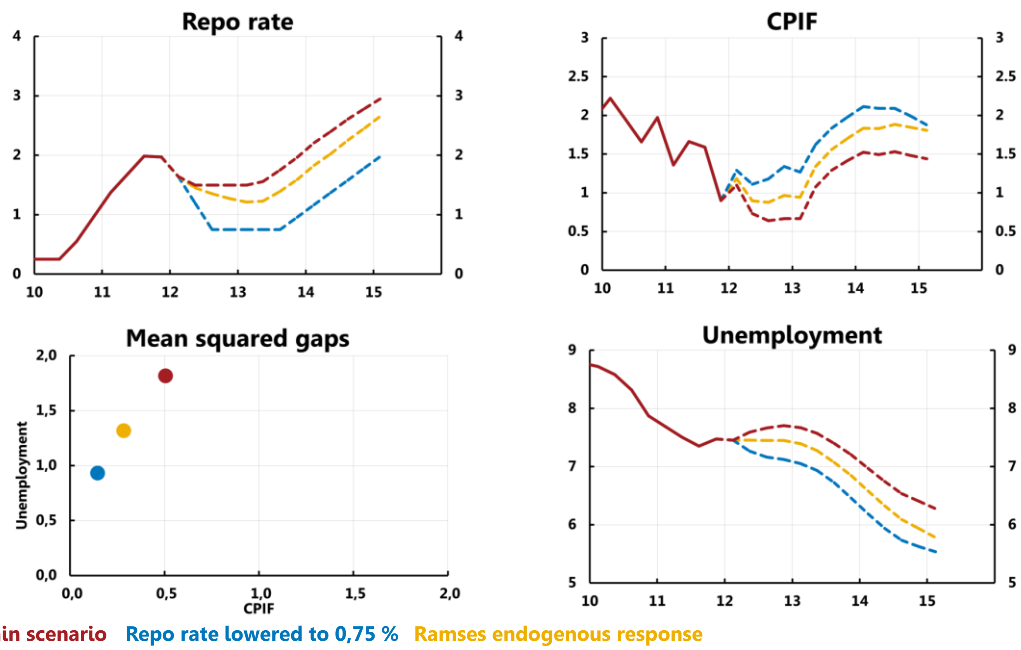
[4] NAIRU stands for Non-Accelerating Inflation Rate of Unemployment.

[5] Rogerson, Richard (1997), Theory Ahead of Language in the Economics of Unemployment. *Journal of Economic Perspectives* 11 (1), p 73-92.

of general economic policy with a view to achieving sustainable growth and high employment. The general economic policy of the government and Riksdag is strongly focused on achieving high employment and reducing unemployment to a long-term sustainable level.

Mr Svensson then explained why he wants to have an even lower repo-rate path than the alternative scenario with lower repo rate in Figure 3. He referred to Figure 5 of the figure supplement he handed out, where his preferred low repo-rate path is shown in blue in the upper left-hand diagram. The main scenario's repo-rate path is red. Corresponding forecasts for the CPIF and unemployment, assuming foreign interest rates in accordance with forward rates and Mr Svensson's assessment of a sustainable level of unemployment of 5.5 per cent, are shown in the right-hand diagrams in the figure.

Figure 5. Monetary policy alternatives, February 2012
Foreign interest rates according to implied forward rates. Sustainable unemployment 5.5 %



Sources: Statistics Sweden and the Riksbank

The repo-rate path of the main scenario gives a CPIF forecast well below 2 per cent. A lower foreign interest-rate path together with the repo-rate path in the main scenario gives a greater interest rate differential and a stronger krona that brings down inflation. Mr Svensson's preferred repo-rate path gives higher CPIF inflation closer to the target and a much lower forecast for unemployment, closer to 5.5 per cent. The repo-rate path takes into account that the forecast for the euro area in the main scenario and thereby Sweden is too positive, all other things being equal. It also takes inte account that the forecast for the forward rates abroad according to forward rates and the dashed grey curve in Figure 1 will in practice be implemented with the higher solid grey curve. Mr Svensson's view is that this figure shows that target fulfilment for both inflation and unemployment will be much better with the lower repo-rate path.

Finally, Mr Svensson pointed out that the conclusion that the lower repo-rate path is better than the repo-rate path in the main scenario is not currently sensitive to the assumption of a sustainable unemployment rate of 5.5 per cent. The lower repo-rate path also gives better target fulfilment if the sustainable unemployment rate is assumed to be 6 or 6.5 per cent.

Deputy Governor **Barbro Wickman-Parak** began by pointing out that the Executive Board has long assumed that 2012 would be a significantly weaker year for growth than 2010 and 2011. But the extent of the slowdown and the speed of the process have been hard to assess. The unexpectedly swift slowdown in the euro area during the autumn had a powerful impact on Swedish exports. Even if developments cannot in any way be compared with the drama following Lehman Brothers' bankruptcy, there are certain similarities in the dynamics, as Ms Wickman-Parak sees it. A heightened crisis, with its epicentre in the euro area, has quite abruptly dammed up demand. In situations like these, investments are postponed, which has a major impact due to the composition of Sweden's exports.

Ms Wickman-Parak's view is that the decisive change in the forecast for 2012 comes from net exports. As regards domestic demand, forecasts have already been cautious and, taken as a whole no adjustment has been made for the full year 2012 on this point.

When Ms Wickman-Parak looks ahead over the next couple of quarters, there is undoubtedly reason to expect weak outcome data. The decline in the flow of orders and stocks in relation to demand suggest this. However, early indicators have recently improved, both in Sweden and abroad. Wickman-Parak added that, in the forecast for Sweden's GDP, a downwards correction is expected in the contribution from inventories growth to GDP growth. However, as always, the contribution from inventories is difficult to apportion to quarters with any degree of precision. This is important to bear in mind when subsequently analysing new GDP outcome.

It is more interesting to consider whether the recovery expected towards the end of 2012 and in 2013 is realistic. If the Executive Board's overseas forecast holds true, Ms Wickman-Parak sees it as a highly realistic forecast and supports it and the analysis it is based on. The downward adjustments in growth made in the draft Monetary Policy Report will lead to lower resource utilisation that the Executive Board previously predicted. This is true regardless of which measure is observed. At the same time, it is difficult to see any inflation risks over a medium-term perspective. So lowering the repo rate and adjusting the repo-rate path downwards in the way suggested by the Report was not a hard decision for Ms Wickman-Parak.

As usual, there are a number of other possible development paths than those in the main scenario. This time, the draft Monetary Policy Report includes alternative scenarios that capture, in an illustrative manner, the effects of various assumptions on such notoriously unpredictable variables as the exchange rate. These assumptions are also combined with a couple of scenarios depicting both weaker and stronger developments overseas. This model experiment has resulted in a wide spectrum of repo-rate paths with fairly large upward and downward deviations from the main scenario's repo-rate path.

When Ms Wickman-Parak listens to the economic debate, she feels that it is easy to form the opinion that growth risks only exist on the downside. Such risks certainly exist, but there are also possibilities for a more positive development. As she sees it, not much would be needed to get better growth in Sweden than in the main scenario of the draft Monetary Policy Report, even if it is not likely that this will happen in the immediate future.

Ms Wickman-Parak noted that it is important to remember that Sweden's exports to the problem countries in the euro area, including Italy and Spain, which are expected to continue to have very low or negative growth next year are only equivalent to 5.5 per cent of Sweden's total exports of goods. Other countries such as Germany, Finland and the Netherlands, for example, are expected to grow by about 1.5 per cent next year. Sweden's goods exports to these countries are equivalent to 20 per cent of Sweden's total exports of goods. More than 9 per cent of Sweden's exports of goods go to Norway. Growth in these countries could very well be slightly faster than is assumed in the draft Monetary Policy Report. To this can be added that the US economy could actually develop more positively than we have forecast.

In such a situation, Sweden would again benefit from the composition of its exports. According to Ms Wickman-Parak, increased exports could have relatively rapid effects on investments, given that these are now postponed from already low levels. It would also mean a stronger response from households further ahead, when disposable incomes start to increase more rapidly at the same time as saving lies on a high level. Furthermore, according to Ms Wickman-Parak, the restraining effect on consumption of declining wealth would also be reversed.

These are the kinds of considerations Ms Wickman-Parak bears in mind when taking monetary policy decisions. She cannot see any reason to announce any rapid repo-rate cuts via the repo-rate path, even if she now expects a few weak growth quarters. When economic activity, as she assesses it, is in the balance, it is appropriate for the repo-rate path to imply the same probability of a decrease as for an increase of the repo rate.

The repo rate is very low and, in real terms, it will be negative for at least two years to come. For Ms Wickman-Parak, the proposed repo-rate path entails a good balance of price stability and real economic stability.

Ms Wickman-Parak wished to conclude by making a more general reflection. In the Executive Board's discussions, it has occasionally been pointed out that no target should be set for the repo-rate level. This is something she agrees with, but nevertheless she feels that there is a value to not creating unnecessarily severe unevenness in monetary policy. High volatility in the repo rate could create unpredictability and problems for the participants in the real economy. Consequently, her view is that a certain emphasis must be placed on the stable development of the repo rate when taking monetary policy decisions.

Deputy Governor **Karolina Ekholm** said that the less favourable development of the euro area would, of course, have a negative effect on the Swedish economy. It is thus reasonable to revise the growth prospects for Sweden down again. As Ms Wickman-Parak pointed out, the slowdown of the Swedish economy has now also become clear in outcome data, at least as regards exports.

Since the prospects for the Swedish economy have deteriorated further, Ms Ekholm thought that monetary policy should be adjusted in an expansionary direction. She explained that she is thus in favour of a repo-rate cut and a downward adjustment of the repo-rate path. However, as last time, the question for Ms Ekholm is by how much.

Ms Ekholm's starting point is that, last time, she voted for a decrease of the repo rate to 1.5 per cent and a lowering of the repo-rate path to bottom out at 1.25 per cent. A lowering of the repo rate and repo-rate path on this basis would result in a repo rate below the level of 1.5 per cent proposed in the draft Monetary Policy Report, and a repo-rate path bottoming out at a significantly lower level than the repo-rate path in the main scenario.

As the view of the economic outlook is not completely different from the one held by the Executive Board in December, Ms Ekholm considered it appropriate to lower the repo rate by 0.25 per cent, but from the level of 1.5 per cent that she wished to see at the previous monetary policy meeting. She thereby preferred a lowering of the repo rate by 0.50 percentage points from its present level to 1.25 per cent.

Ms Ekholm thought that the section "Alternative scenarios for the repo rate" in Chapter 2 of the draft Monetary Policy Report explained clearly why a decrease to 1.25 per cent is well-justified. The section shows that a lowering to 1.25 per cent over four quarters followed by a successive increase to the main scenario's repo-rate path in Ramses is associated with higher underlying inflation, which is presently very low, and lower unemployment. Possibly one might be concerned that model simulations do not capture all relevant aspects of what could happen in reality. However, here the model is used to study the expected consequences for inflation and resource utilisation of marginal deviations from the main scenario's path. As this is still an estimated model, Ms Ekholm finds it hard to believe that it would not capture the direction in which these variables are likely to be changed by a marginally different repo rate. At present, higher underlying inflation and lower unemployment would be positive, as underlying inflation is low and unemployment is higher than any sensible estimate of long-term sustainable unemployment.

The draft Monetary Policy Report states that the lower repo rate is associated with a rate of CPI inflation that would be further from target over most of the forecast period and a rate of CPIF inflation just above 2 per cent in 2014. This might argue against this path, if it is believed that it entails a risk of inflation expectations drifting away from the 2 percent target. However, in Ms Ekholm's opinion this risk is presently very low.

Another potential objection to the lower repo rate given in the draft Monetary Policy Report is that the effects of a lower repo rate may be delayed, only stimulating the economy when this is no longer needed. Ms Ekholm sees this as an argument for why the repo rate should have been lower today than it actually is, an argumentthat, for natural reasons, she feels is quite reasonable. But she does not consider this a strong argument against the lower repo-rate path. We do not know if the effect of monetary policy arrives with a greater delay today than it usually does. Repo rate decisions should be based on the current analysis of the effects of the repo rate. This analysis can then be updated when it becomes possible to observe the effects of the repo-rate cuts.

Ms Ekholm then went on to explain that she thought it was significantly more difficult to determine a suitable level for the repo rate path than what the repo rate should be today. As she had previously stated, Ms Ekholm believes that the forecast of foreign policy rates is too high towards the end of the forecast period. This suggests that the main scenario's repo-rate path is also too high. With a lower forecast for foreign policy rates, a rapid increase in the repo rate would be expected to lead to a greater appreciation of the krona than is currently included in the forecast. This is something that would tend to further dampen inflation and resource utilisation. Ms Ekholm believes that a lower repo-rate path is needed for a well-balanced monetary policy.

But how much lower? It is harder to use the results of model simulations as a basis for the analysis of the expected consequences of completely different repo-rate paths than the one in the main scenario. This is because factors not captured by the model can play a decisive role for the outcome.

Despite this, during the drafting process, the Executive Board looked at a number of different simulations. Ms Ekholm's assessment is that it would be reasonable to let the repo rate go down to 1 per cent and stay there until the end of the third quarter 2013, before successively raising it to just above 2 per cent. This is a slightly lower path compared with the one she preferred in December. Even with a lower forecast for foreign policy rates, which is to say a path based on implied forward rates, such a path would seem to be associated with a forecast for CPIF inflation lying above and a forecast for unemployment lying below the main scenario's path.

Ms Ekholm is open to the idea that a thorough analysis of various alternative repo-rate paths may show that there is reason to let the repo-rate path bottom out below the repo-rate path she prefers, as in the repo-rate path advocated by Mr Svensson, or above it, as in the main scenario of the draft Monetary Policy Report. She sees it as important that the Executive Board analyses this thoroughly in the future, preferably before the next decision, in a context in which the entire Executive Board is involved and discusses the reasonability of the analysis. Like Mr Svensson, she thinks that an important element in the preparation of the monetary policy decision is the analysis of the expected consequences of various policy alternatives.

In summary, Ms Ekholm preferred a lowering of the repo rate by 0.50 percentage points to 1.25 and a lowering of the repo-rate path to 1 per cent until the end of the third quarter of 2013, before successively rising to just over 2 per cent at the end of the forecast horizon.

Deputy Governor **Per Jansson** said that he supports the assessment of the Swedish economy presented in the draft Monetary Policy Report.

Inflationary pressures are presently low in Sweden, and growth is slow. The Riksbank previously also expected a slowdown in economic activity, but the slowdown has been more abrupt than forecasted. However, it is important to emphasise that this was not a matter of a free fall, but entailed a downward adjustment of the forecast by a number of tenths of a percentage point against December. The downward adjustment is primarily due to weaker foreign trade statistics and industrial output.

According to Mr Jansson, against this background, it seems reasonable to now implement the repo-rate cut of 0.25 percentage points that to a certain degree was already expected in December. To ensure that the more abrupt slowdown will mostly have temporary effects in 2012, it also seems reasonable to allow the repo-rate path to remain at 1.5 per cent for approximately one year, before rising in parallel with the repo-rate path from December.

Mr Jansson emphasised that the Riksbank's forecast for GDP development in the fourth quarter of 2011 is a good bit below the forecast obtained from different indicator models. Even so, he feels that it is a wise strategy to adopt such a low forecast, as linear indicator models often show an excessive degree of sluggishness when the economy turns rapidly.

Even though Mr Jansson supports the analyses and forecasts in the draft Monetary Policy Report, he notes that the present plan for monetary policy will mean an exceptionally low repo rate over the years to come. This is clearly shown in Figure 1:27 of the draft

Monetary Policy Report, which shows that the real repo rate is expected to be negative for a significant part of the forecast period.

Given the highly expansionary monetary policy plans, is there not, then, a risk that the Swedish economy will develop too strongly and that inflation will be too high? According to Mr Jansson, this is, naturally, not impossible, but the risks of such a development nonetheless seem at present to be under control.

As regards the development of the real economy, a number of indicators in the autumn suggested that resource utilisation was becoming quite strained and that certain overheating tendencies could eventually arise. These indicators have now fallen as a result of the slowdown in the economy, and the risk of excessively rapid growth in the Swedish economy must now be assessed as being very low.

Furthermore, last year, there was concern that a transitionally high level of CPI inflation would lead to rising underlying inflation. This could have occurred through an effect on more long-term inflation expectations and/or wage formation generating excessive wage increases. According to Mr Jansson, this risk has also decreased. The more long-term inflation expectations 2 and 5 years ahead are now close to the inflation target, both according to Prospera's quarterly and monthly surveys.

The wage agreements for large parts of the industrial sector that were concluded at the end of last year resulted in agreed wage increases of 2.6 per cent per year. Assuming that the new wage agreements for other sectors follow the industrial sector's standard, a total wage increase, including wage drift, of about 3.5 per cent can be expected to be possible. Considering that unemployment is relatively high, this is assuredly a comparatively high rate of wage increase and, according to Mr Jansson, it does not support the view that equilibrium unemployment is very low. But neither is it a wage increase liable to create any more serious inflation risks.

In addition, CPI inflation, as such, has also retreated. At its peak, CPI inflation amounted to 3.4 per cent in August 2011. In December, the outcome was 2.3 per cent. When Mr Jansson considers all of this together, he finds it difficult to reach any other conclusion than that the risks for excessively rapid economic development and excessively high inflation are small at present. He therefore supports the conclusion that the repo rate can now be lowered by 0.25 percentage points to 1.5 per cent, and can then remain on this low level for about 1 year.

Governor **Stefan Ingves** said that he agreed with the assessment of the Swedish economy in the draft Monetary Policy Report and supported the proposal to cut the repo rate by 0.25 percentage points to 1.50 per cent and to adopt the repo-rate path shown.

The weakening of the euro area has dampened Sweden's exports. There are also signs of lower resource utilisation in other indicators. Unemployment is rising gently. This means that the present situation in Sweden is slightly weaker than forecast in the Monetary Policy Update in December 2011. Sweden has clearly passed an economic peak and will notice a slowdown in growth.

A significant portion of last year's discussions dealt with how quickly and how seriously economic activity would deteriorate, particularly in the second half of 2011. The discussion now deals instead with the level at which growth will bottom out and when it will normalise again. The krona has been stronger than it usually is in times of financial unease and is expected to appreciate somewhat in the period ahead. Lending to households is increasing more slowly than previously, which Mr Ingves sees as welcome. But, at the same time, financial indicators have been slightly more stable since the start of the year. If lending to households picks up again, the Executive Board should be vigilant, said Mr Ingves. If this were to happen, it would also be good if other tools, focused on handling systemic risks, could be in place.

Another issue that is discussed intensively is that the gap between mortgage rates and the repo rate is now wider than it was before the crisis. The banks' financing costs have increased. After the crisis, the price of credit and liquidity risks increased. The banks' margins, which decreased before the crisis, have also increased. The Riksbank now expects the gap between mortgage rates and the repo rate to decrease slightly in the period ahead, but not to the levels prevailing before the crisis. One explanation for this is that the funding costs that reflect the risks are not deemed to become as low. But in the long term, better regulation should contribute towards more stable markets and lower risk premiums than at present.

At the same time, according to Mr Ingves, finely tuning monetary policy in accordance with the development of the mortgage rate gap would be both difficult and pointless. This is because other interest rates, including those for corporate loans, must also be considered. Companies have not experienced such a large increase in the interest rate gap against the repo rate. Furthermore, corporate lending has continued to increase at quite a strong pace over the last year.

In addition, implied forward rates have varied quite a lot since the autumn. They fell between October and December, but have since risen. This is also an example of the prevailing uncertainty.

The Executive Board has no general rule of action for how the repo rate should be adjusted to various market rates. On each occasion, the Executive Board has to make an overall assessment of how the financial conditions are influencing resource utilisation and inflation. But even in an overall assessment, the Executive Board will, of course, continue to analyse the monetary policy transmission mechanism and how it is changing.

All in all, Mr Ingves now deems that resource utilisation is slightly weaker than in December. Resource utilisation will be lower than normal in 2012 and 2013, and will be normal at the end of the period. The weak level of resource utilisation will restrain inflation at the start of the period. Mr Ingves deems that inflation this year, measured as both the CPI and the CPIF, will be below 2 per cent. But, as the economy recovers, CPIF inflation will increase to 2 per cent in 2013. CPI inflation, which is influenced by interest expenditure, will rise more and Mr Ingves deems it will be 3 per cent in 2014.

With the economic development Mr Ingves now sees ahead, there is reason to lower the interest rate by 0.25 percentage points today and to have a slightly lower repo-rate path for a period. This decrease will entail a negative real interest rate, which may be reasonable for a limited period.

Political uncertainty has decreased slightly since the last decision. But it remains difficult to capture in models. However, the models can be used to provide information on how monetary policy is influenced by various assumptions of which it is difficult to determine the probability. Chapter 2 of the draft Monetary Policy Report presents several scenarios in which developments abroad are assumed to be weaker or stronger than in the main scenario. The krona may also appreciate or depreciate, making the number of possible repo-rate paths large. If developments abroad improve and the krona depreciates, the repo-rate path will need to be significantly higher than in the main scenario. If, on the other hand, developments abroad deteriorate and the krona appreciates, it may be necessary to lower the repo rate to zero.

Both of these scenarios, included in Chapter 2 of the draft Monetary Policy Report, may occur. The scenarios entail two different paths for the repo rate, and a completely different monetary policy than in the main scenario. In an uncertain world, where political uncertainty in Europe is particularly hard to judge, the proposed monetary policy is well-balanced, said Mr Ingves. In the economic slowdown Sweden is now experiencing, Sweden is starting from a strong position. Sovereign debt is low, the government budget is under control, wage increases are moderate, the current account surplus is large and unemployment is only rising slightly. At the same time, the banks are well-capitalised. Considering this, Mr Ingves does not see any need for sudden and dramatic changes to monetary policy.

First Deputy Governor **Kerstin af Jochnick** said that she shares the assessment of the Swedish economy presented in the draft Monetary Policy Report. She supports the proposal to lower the repo rate by 0.25 percentage points to 1.5 per cent and the repo-rate path presented in the Report. A number of factors lie behind the decision to lower the repo rate. Ms af Jochnick attaches greatest importance to the reduced foreign demand and weaker growth in demand from Swedish households, which is dampening inflation.

Growth in the Swedish economy at the end of 2011 and start of 2012 was lower than expected by the Riksbank's forecast from December. This is because decreased export demand in combination with lower growth in consumption is leading to a faster slowdown in the Swedish economy.

The uncertain situation in Europe has probably led both households and companies to be more cautious with their consumption and investments than they would have been in a more normal downturn. This uncertainty will remain during a large part of the spring of 2012 and may mean that the impact of repo-rate reductions will not be as rapid as in a more normal situation.

Developments in Europe and, above all, in the euro area are of central importance to the Swedish economy. Ms af Jochnick feels that uncertainty in how the euro area's problems will be dealt with continues to be great. However, it seems reasonable to assume that the most important decisions will be taken in the spring of 2012 and that a recovery can be expected towards the end of the year. As far as Sweden is concerned, the effects of a turnaround will first be seen towards the end of 2012.

Household consumption will probably be weak in 2012. Weak economic development, uncertainty over the future and a deteriorated labour market explain households' behaviour. However, if household wealth should increase, this could affect households positively. For example, the value of shareholdings has increased as a result of the stock market upturn at the end of 2011 and start of 2012. A counteracting factor, however, is the slowdown of the housing market, which is decreasing the real wealth of households.

Demand for credit from households has also slowed down. Ms af Jochnick's assessment is that credit is available in both Sweden and Europe, but demand has decreased significantly. Swedish banks are well-capitalised and will be able to guarantee the supply of credit. The banks have possibly become more restrictive and are placing greater demands in the granting of credit.

Weak demand in the Swedish economy and lower than normal resource utilisation will lead to lower inflationary pressures, meaning that inflation will remain low in 2012. As the economy recovers, CPIF inflation will increase to 2 per cent in 2014, while CPI inflation is expected to be just over 3 per cent in the same year due to the effects of interest expenditure.

Ms af Jochnick concluded by saying that the Riksbank's repo rate assessments are based on models, statistics and forecasts. The Riksbank's task is to ensure that the repo rate changes over time so that the price stability target is fulfilled and monetary policy can be considered to be well-balanced in relation to resource utilisation in the economy. The forecast work is greatly influenced by the currently prevailing uncertainty over growth abroad. Information and indicators point in both a positive and negative direction. Perhaps the most crucial parameter is identifying credible long-term solutions to the fiscal crisis in Europe. The draft Monetary Policy Report also shows what may happen if the development of the krona deviates from the main scenario. In other words, our forecasts could change relatively rapidly if developments abroad diverge from the forecast in the draft Monetary Policy Report.

Deputy Governor **Lars E.O. Svensson** then referred to Mr Ingves and Mr Jansson's comments on the real interest rate, which will be very low in the period ahead. Mr Svensson pointed out that, while the real interest rate is very low in a historical perspective, Figure 3 of the figure supplement he handed out shows that the nominal interest rate is historically high in relation to foreign interest rates. Furthermore, it is not obvious how we can measure how expansionary monetary policy is. It could be maintained that the most relevant measure is the gap between the real policy rate and the neutral interest rate, where a practical definition of the neutral interest rate could be the real interest rate that leads to a sustainable level of resource utilisation within a certain period, for example one year. According to Mr Svensson, the neutral interest rate is apparently very low and negative in Sweden, Europe and the United States.

Mr Svensson maintained that it is important not to see the policy rate as a target, but as an instrument that should always be set so that target fulfilment for inflation and resource utilisation are as good as possible, regardless of whether this means a high a low policy rate. He also regards consistently striving for the best target fulfilment as a way of making monetary policy more predictable and minimising uncertainty over monetary policy. Mr Svensson did not believe that anybody would consider that his preferred repo-rate path in Figure 5 entails any sort of "sudden and dramatic change to monetary policy". As he had already said, the repo-rate path strongly resembles the one included by the National Institute of Economic Research in the publication *The Swedish Economy* in December 2011.

Mr Svensson then addressed something he felt was a more general and far-reaching matter. Now and previously, he has pointed out a number of circumstances indicating that the Riksbank has systematically conducted an overly contractionary monetary policy in recent years. Over a longer perspective, average inflation, for example the moving five-year average, has consistently been below the inflation target. The average for CPI inflation from 1995 to today is 1.3 per cent. For CPIX inflation until the end of March 2008 and for CPIF inflation from the start of April 2008, the average is 1.6 per cent. The Riksbank has thus systematically missed the target and, seen in retrospect, monetary policy has been overly contractionary. The Riksbank's critics have pointed this out earlier. Now, most recently, the Centre for Business and Policy Studies' Economic Policy Group and the Minister for Finance have pointed this out in conjunction with the publication of the Economic Policy Group's report. Systematically missing the inflation target is not good. But another, more important issue is whether this has also had any real costs in terms of GDP and unemployment. The Centre for Business and Policy Studies' Economic Policy Group discussed this. However, the Economic Policy Group does not note that, according to normal monetary policy theory, this depends on whether inflation has fallen below inflation expectations or not.

It is then a matter of comparing realised inflation with previous inflation expectations. The average of Prospera's two-year expectations for all participants – lagged two years – from 1998 until today is 2.07 per cent. Average CPI inflation from 1998 is 1.36 per cent. The deviation from inflation expectations is thus minus 0.71 percentage points. The average of CPIX and CPIF inflation from 1998 is 1.56 per cent. The deviation from inflation expectations is then minus 0.52 percentage points.

According to standard monetary policy theory, inflation that systematically falls below expectations indicates real costs in terms of lower employment and GDP, and higher unemployment. How much is an empirical question, and depends on the slope of the long-term Phillips curve when inflation expectations are held constant. It cannot be ruled out that the costs may be considerable, for example that unemployment has been significantly higher than necessary. This also matters for estimates of sustainable unemployment and may mean that such estimates have become too high. All in all, this is something that Mr Svensson considers deserves closer investigation and is important when monetary policy is to be evaluated..

Deputy Governor **Per Jansson** referred to what Mr Ingves said about the Executive Board having to be vigilant if lending to households should start to pick up again, and the recent statement by the European Commission about the risks linked with the high level of private sector indebtedness in Sweden. Mr Jansson wished to briefly comment on his view of the link between, on the one hand, monetary policy and, on the other hand, credit growth and indebtedness in the household sector.

Mr Jansson belongs univocally to those who consider that credit growth and indebtedness cannot be disregarded in the formulation of monetary policy. It cannot be denied that there occasionally arise situations in which it is desirable for monetary policy to take account of such aspects, in addition to the development of inflation and the real economy. Mr Jansson referred to Michael Woodford's explanation of this in a new article in the Riksbank's journal Sveriges Riksbank Economic Review.[6] How often it is appropriate to consider credit growth and indebtedness depends, among other factors, on how well macroprudential policy is functioning.[7] If macroprudential policy is functioning less efficiently, it is likely that monetary policy must take greater account of credit growth and indebtedness than otherwise. The financial crisis of 2008–2009 clearly showed how important it is to avoid a situation with excessive indebtedness. If indebtedness has

6 Woodford, Michael (2012), Inflation Targeting and Financial Stability. *Sveriges Riksbank Economic Review* 2012:1, p 7-32.

7 Macroprudential policy is aimed at detecting, analysing and mitigating risks to the financial system as a whole, unlike the traditional financial supervision, which focuses on the state of health of the individual institutions.

become too high, it is extremely costly to reduce it. Excessive indebtedness must be avoided.

Mr Jansson then wished to modulate Mr Svensson's point about average inflation being below the inflation target and this being a problem. It is correct that average inflation has fallen slightly below 2 per cent since the inflation target was introduced, but exactly how far below 2 per cent it is depends on which period is being examined and which measure of inflation is being used. For example, the average increases of the CPI and CPIF since 1995 have been 1.3 and 1.7 per cent, respectively. Since 2000, a year in which the credibility of the inflation target can be considered to be established, the average increases of the CPI and CPIF have been 1.6 and 1.8 per cent, respectively.

Mr Jansson is unable to answer whether this target fulfilment has been good enough or not. Neither does he believe that anybody else has the answer. However, Mr Jansson observed that the level of inflation has fallen by a factor of about 4 compared with the 1970s and 1980s. As regards inflation variability, the corresponding reduction factor is between 2 and 4, depending on the period and inflation measure. In addition, it deserves to be emphasised that these changes in the development of inflation have not taken place at the cost of lower growth. On the contrary, GDP growth after the introduction of the inflation target has been significantly higher than previously.

Regarding Michael Woodford's article in the latest issue of Sveriges Riksbank Economic Review, Deputy Governor **Lars E.O. Svensson** mentioned that he has a commentary on Woodford's article in the same issue.[8] Woodford illustrates a situation in which a tighter monetary policy – "leaning against the wind" – could be justified, as the leverage in the financial sector is assumed to be procyclical and the risk of a financial crisis is assumed to increase with increased leverage. In Mr Svensson's commentary, he shows that, if there are regulatory instruments that can directly influence leverage –and there are, of course, for example in the form of loan-to-value ceilings for mortgages and capital requirements for banks –, it is much better to use these to limit leverage and the risk of a financial crisis than a contractionary monetary policy. Monetary policy and financial-stability policy – macroprudential policy – can then be conducted independently. Monetary policy can unproblematically be focused on stabilising inflation and resource utilisation, while financial-stabilitypolicy can be focused on maintaining financial stability.

Mr Svensson said that the connection between financial stability and monetary policy is a very interesting and relevant issue. There has been considerable discussion of this matter recently. For Sweden, data shows that there does not seem to be any connection between the repo rate and households' and banks' leverage. If there are any remaining questions about the relationship between monetary policy and financial stability in the Swedish

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[8] Svensson, Lars E.O. (2012), "Comment on Michael Woodford, 'Inflation Targeting and Financial Stability'", *Sveriges Riksbank Economic Review* 2012:1, pp. 33-39.

economy and financial system, Mr Svensson feels that these should be addressed in the work on financial stability and in the Financial Stability Report.

Mr Svensson then returned to Mr Jansson's comment on the averages and variability of inflation and growth before and after the introduction of inflation targeting. Mr Svensson does not think that trying to find periods in which average inflation is as close to two per cent as possible is the right method. It is reminiscent of so-called data mining. It is better to look at the moving five-year average figures over the entire period and see whether these fall significantly below the inflation target. However, Mr Svensson's most important question is not whether the inflation target has been undershot, which is incontrovertible, but rather whether this is associated with any real costs in the form of lower GDP and higher unemployment. It is important to realise that, if this is the case, then this is something that would be visible in the level of GDP and unemployment, not in the average growth of GDP.

The chairman, Governor **Stefan Ingves**, observed that Sweden will now enter a period of much lower growth than has been experienced in recent years, before growth increases again. Inflationary pressures are low, but inflation will eventually return to the inflation target. There is no disagreement about these directions. On the other hand, there are differing opinions on what constitutes a well-balanced monetary policy and how strong monetary policy stimulation should be to best stabilise inflation and resource utilisation. Two members advocate cutting the repo rate by 0.50 percentage points and having lower repo-rate paths than the ones in the latest Monetary Policy Report. The majority support the proposed repo-rate path and the proposal to cut the repo rate by 0.25 percentage points, to 1.50 per cent.

§4. Monetary policy decision

The Executive Board decided after voting

- to adopt the Monetary Policy Report according to the proposal, Annex A to the minutes,
- to publish the Monetary Policy Report on Thursday 16 February 2012 at 9.30 am,
- to lower the repo rate by 0.25 percentage points to 1.5 per cent and that this decision would apply from Wednesday 22 February 2012,
- to publish the decision above at 9.30 am on Thursday 16 February 2012 with the motivation and wording contained in a press release, and
- to publish the minutes of today's meeting on Wednesday 29 February 2012 at 9.30 am.

Deputy Governors Karolina Ekholm and Lars E.O. Svensson entered reservations against the decision to lower the repo rate to 1.5 per cent and against the repo-rate path in the Monetary Policy Report. They both advocated a lowering of the repo rate to 1.25 per cent and a lower repo-rate path than in the Monetary Policy Report.

Karolina Ekholm preferred a repo-rate path that stays at 1 per cent from the third quarter of 2012 through the third quarter of 2013, and then rises to slightly above 2 per cent by the end of the forecast period. This was justified by her assessment that the Report's forecasts of foreign policy rates are too high and that a repo-rate path that is associated with a higher forecast of CPIF inflation and a lower forecast of unemployment than in the Monetary Policy Report constitutes a more well-balanced monetary policy.

Lars E.O. Svensson preferred a repo-rate path that stays at 0.75 per cent from the third quarter of 2012 through the third quarter of 2013, and then rises to 2 per cent by the end of the forecast period. This was justified by his assessment that the Report's forecasts of foreign policy rates, euro-area growth and Swedish resource utilisation were all too high. His repo-rate path then implies CPIF inflation closer to 2 per cent and a faster reduction of unemployment towards a longer-run sustainable rate.

This paragraph was verified immediately.

Minutes by

Ann-Christine Högberg

Verified by:

Karolina Ekholm	Stefan Ingves	Per Jansson
Kerstin af Jochnick	Lars E.O. Svensson	Barbro Wickman-Parak