



Minutes of monetary policy meeting

JULY 2013

Summary

At the monetary policy meeting on 2 July, the Executive Board of the Riksbank decided to hold the repo rate unchanged at 1.0 per cent and to leave the repo-rate path largely unchanged.

It was observed at the meeting that economic developments both in Sweden and abroad have been largely in line with the forecast made by the Riksbank in the April Monetary Policy Update. The Executive Board noted that economic prospects abroad were different in different parts of the world, but the general assessment for the world as a whole was a gradual improvement in the coming years. GDP growth in Sweden is expected to be lower than normal in 2013, and then to rise in 2014 as demand abroad picks up. An improvement in the labour market is also expected then. There was also discussion of the division in the Swedish economy, with weak investment and exports, but stronger households. Households have had a good development in income, which has led to increased consumption and rising house prices. Finally, the discussion turned to the high level of debt among Swedish households, both from an international and a historical perspective, which was considered to make the economy more vulnerable to shocks.

The Executive Board was unanimous that monetary policy needed to continue to be expansionary, given the low rate of inflation. A majority of four members thus assessed that it was appropriate to hold the repo rate at 1 per cent until the second half of 2014, to support the economy and contribute to inflation rising towards the target. They also considered a largely unchanged repo-rate path in relation to the April Monetary Policy Update to be reasonable, as new information received since then had been largely as expected. The forecast for unemployment has been revised up, but the view of resource utilisation remains in principle unchanged as it is believed that much of the increase in unemployment is because the labour force will to a greater extent consist of groups thought to be on the periphery of the labour market.

It was noted that although a lower repo-rate path could lead to inflation attaining the target slightly sooner, it would also increase debt and thus the risks to economic developments in the longer term. The majority therefore considered that the current repo-rate path was a reasonable balance as it entails inflation and the real economy stabilising more in the short run, at the same time as taking into account more long-term risks linked to household debt.

Two members considered that there was scope to cut the repo rate to 0.75 per cent and to let it remain at this level until the second quarter of 2014. After that the two members advocated slightly different rates of increase. They assessed that this monetary policy would bring inflation back on target sooner, while resource utilisation would be better balanced. It could thus improve the conditions for the economy to manage future shocks and also potential risks linked to household debt.

The future development of the repo rate was also discussed at the meeting. There were different opinions regarding the probability of increases or cuts in the near term, even within the majority.



MINUTES OF MONETARY POLICY MEETING

Executive Board, No. 3

DATE: 02/07/2013
TIME 09.00

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■ PRESENT:

Stefan Ingves, Chairman
Karolina Ekholm
Martin Flodén
Per Jansson
Kerstin af Jochnick
Cecilia Skingsley

Hanna Armelius
Claes Berg
Charlotta Edler
Mattias Erlandsson
Eric Frieberg
Kerstin Hallsten
Mia Holmfeldt (§ 1)
Ann-Christine Högberg
Johanna Jeansson
Tor Johansson (§ 1)
Martin W Johansson
David Kjellberg
Tomas Lundberg
Ann-Leena Mikiver
Marianne Nessén
Christina Nyman
Maria Sjödin
Ulf Söderström
David Vestin
Staffan Viotti
Fredrik Wallin (§ 1)

It was noted that Hanna Armelius and Johanna Jeansson would prepare draft minutes of § 1, 2 and 3 of the Executive Board's monetary policy meeting.

§1. Economic developments

Fredrik Wallin of the Monetary Policy Department began by presenting the latest developments on the financial markets. Volatility has increased as a result of uncertainty over the monetary policy that central banks will conduct in the coming period. This concerns in particular the point at which the Federal Reserve will reduce its monthly bond purchases. Since the monetary policy meeting in April, government bond yields in Sweden, Germany and the United States have risen. The movements were largest directly after the Federal Reserve's most recent meeting, since when bond yields have fallen slightly. Since the monetary policy meeting in April, the stock market has shown relatively large movements and share prices are now at a somewhat higher level in Sweden, the euro area and the United States. The Swedish krona, measured in terms of the KIX, has weakened since April. According to market prices and survey responses, as well as market analyses, the repo rate is expected to be held unchanged at today's meeting. The first increase from the current level is not expected to come until around one year from now.

Tor Johansson of the Financial Stability Department gave an account of the price of credit risk for banks and governments in the euro area. Volatility in the Swedish stock market, foreign exchange market and fixed-income market has risen somewhat, but is still at a low level.

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 11, 17 and 25 June. The text of the draft Monetary Policy Report was discussed at a meeting of the Executive Board on 27 June.

All in all, the new information received since the monetary policy meeting in April has been largely in line with the assessment made then. With regard to international developments, both growth and inflation were slightly lower than expected during the first quarter and the forecasts for 2013 have been revised down somewhat. The prospects for a continued recovery in the United States are good, however, and the euro area is improving from low levels. All in all, international growth is expected to improve gradually, although the conditions for various regions differ.

In Sweden, growth was higher than expected during the first quarter, although this was partly due to temporary changes in inventories. According to the forecasts in the draft Monetary Policy Report, however, growth is expected to be lower in the coming quarters. After that, growth is expected to gradually pick up when international demand strengthens.

Employment continues to rise. However, the forecast for unemployment has been affected by a new population forecast from Statistics Sweden that shows the population growing at a faster pace than before. This means that the forecasts for both the workforce and unemployment are revised upwards. The upward revision for unemployment is because the workforce will to a greater degree consist of groups that are considered to be on the periphery of the labour market.

Inflation in Sweden has been low for a long time, and was lower than forecast in April and May. As economic activity improves, companies are expected to be able to raise their price mark-ups at the same time as import prices and labour costs increase. At the same time, the effects of the earlier krona appreciation are expected to subside. CPIF inflation is thus expected to rise and reach 2 per cent in 2015. CPI inflation is expected to rise faster and the rate of increase in the CPI is expected to be around 2 per cent at the end of 2014, and close to 3 per cent at the end of the forecast period.

Household debt as a percentage of disposable income is at a high level. However, compared with the assessment in April, the debt ratio is somewhat lower. This is due to new outcomes for both debts and disposable incomes. Debts were slightly lower than expected in the first quarter of this year, while households' disposable incomes were higher. At the end of the forecast period, the household debt ratio is expected to be almost 176 per cent.

The repo-rate path remains largely unchanged, compared with the assessment in April. The repo rate is expected to remain unchanged at 1 per cent until the second half of 2014, and then to rise gradually to 2.8 per cent in the third quarter of 2016. This repo-rate path is expected to stimulate economic developments so that CPIF inflation attains 2 per cent, and at the same time take into account the risks linked to households' high indebtedness. If the repo rate needs to be adjusted in the near term, it is slightly more likely that it will be cut than that it will be raised, which is due to the low inflationary pressures and continuing uncertainty over developments in the euro area.

§2. The economic situation and monetary policy

Deputy Governor **Karolina Ekholm** began by saying that she supported the description of the prospects for the Swedish economy and developments abroad presented in the draft Monetary Policy Report. Developments abroad are still uncertain, but Ms Ekholm considered that a gradual recovery, albeit a slow one, appeared to be the most reasonable forecast. The Swedish economy appears to have developed positively recently, although growth is expected to be weak this year. This is in line with the developments described in the April Monetary Policy Update.

However, Ms Ekholm did not support the proposed repo-rate path in the draft Monetary Policy Report. As in April, she preferred a lower repo rate and she advocated now, as

then, cutting the rate to 0.75 per cent. The reasons were the same as in April; with inflation far below the target and unemployment higher than can be considered sustainable in the long run, she considered stronger monetary policy stimulation to be justified. A lower repo rate would bring inflation up to 2 per cent sooner and lead to lower unemployment, as shown in the analysis of alternative scenarios for the repo rate at the end of Chapter 2 in the draft Monetary Policy Report.

Ms Ekholm felt that the draft Monetary Policy report was clearer than before that the motive for not cutting the policy rate was that a cut was believed to increase the risks linked to household debt so much that it is considered worth holding the policy rate unchanged. She thought it was good that this trade-off was made clearer, although it was still not fully explained. The reasoning put forward in an article on the principles of how monetary policy can take household debt into account within the scope of flexible inflation targeting is an important first step on the way to clarifying the trade-off. This means that it is also an important step in making monetary policy clearer and more predictable.

Ms Ekholm emphasised that there are other risks than those linked to household debt which need to be taken into account by the Executive Board. One important reason why she felt that it was important to cut the repo rate despite a relatively low initial level and despite being in a phase of the business cycle where one doesn't usually expect policy rate cuts, is that there are risks with inflation being too low. CPIF inflation has been below 2 per cent essentially since the beginning of 2011, that is, for 2½ years. During this time the Riksbank's forecasts have always been that CPIF inflation would reach 2 per cent during the forecast horizon. But instead of rising and approaching 2 per cent, it has slid downwards and is now a few tenths below 1 per cent. Ms Ekholm pointed out that one reason for this was that economic activity had unexpectedly weakened during 2011. But unforeseen fluctuations in economic activity could also occur during the coming three years that form the Riksbank's forecast horizon. It was possible that there could be a new period with an appreciating krona or a period with low inflation abroad. All of these are factors that dampen Swedish inflation. The question is what would happen in this case, when inflation is so low to start with. Ms Ekholm considered it important to keep a respectful distance to the situation when prices are not increasing at all, so that one can be sure to avoid the risk of out and out deflation. Now the krona has weakened somewhat in connection with the recent increased turbulence on the financial markets, which means that the downward pressure on inflation is dampened somewhat. However, it is difficult to know how long this will last.

Ms Ekholm also pointed out that expectations are important to the development of inflation. The message in the draft Monetary Policy Report is that inflation expectations in the long run are firmly anchored. According to the Prospera survey, expectations 5 years ahead are anchored at or around 2 per cent. However, there are signs that inflation

expectations have fallen in the shorter run. Moreover, the compensation for inflation in government bonds, as indicated by yields on nominal and real bonds, points to expectations falling somewhat in the long run. She therefore felt that it was not entirely clear what conclusions should be drawn regarding inflation expectations.

In addition, low inflation could be a problem, regardless of whether inflation expectations slide downwards or remain anchored, in a situation where inflation is expected to remain below the target for a long period of time. If inflation expectations slide downwards, it will be difficult to bring inflation back up to the target. If they remain anchored at 2 per cent, the cost of not attaining an inflation rate of 2 per cent could be high in terms of unemployment, as has been pointed out by Lars E.O. Svensson in his analyses of the long-run inflation rate.

Ms Ekholm felt that the reasoning in the article about how monetary policy can take into consideration risks linked to household debt made it clear that one must react to both how one believes the repo rate affects household debt and how this debt affects the risk of a situation where house prices fall heavily and households react by increasing their saving in a way that leads to a low consumption growth over a long period of time. Her impression, based on what the Riksbank has so far succeeded in investigating with regard to these various sub-issues, was that changes in the repo rate in the magnitude of a quarter or half percentage point could hardly have a sufficiently large effect on debt to significantly influence the risk of a fall in house prices at any point in the future leading to a prolonged recession.

Ms Ekholm agreed that it might be the case that a generally low interest-rate level for a long period of time contributes to the risk of this happening. In many of the countries that now have very low interest rates, and which have had low interest rates during the last few years, there were drastic falls in house prices and households reacted to them by reducing their debt. Low interest rates in this type of situation would hardly risk encouraging excessive debt; they would help households to consolidate their balance sheets. In Sweden, however, the situation is different as house prices here have been relatively stable in recent years. There may be some cause for concern that low interest rates for a long period of time - justified by the stressful situation in the corporate sector and low propensity to invest - may contribute to a build-up of debt that creates problems in the future.

But Ms Ekholm felt that this problem could not be resolved by holding the repo rate fairly low, rather than very low, over a long period of time. There is then a risk that debts will nevertheless be high at the same time as the economy experiences fundamental imbalances because both inflation and resource utilisation are too low. In this situation, she believed that it was less risky to do what one can to bring the macro economy into balance relatively quickly. This creates the right conditions to be able to raise the repo rate within the relatively near future, which could be important in dampening the build-

up of debt. Moreover, she felt that a fall in house prices risks causing much greater problems if unemployment is already high and inflation is close to zero, compared with if the economy is largely balanced.

Ms Ekholm felt that one must also address the question of how changes in debt might affect the risk of a negative macroeconomic scenario, triggered by falling house prices. The forecast for households' debt ratio has been revised down by a percentage point or so compared with the April Monetary Policy Update, on the basis of outcomes since then. Now the debt ratio is expected to grow to almost 176 per cent at the end of 2015/beginning of 2016, compared with 177 per cent in the April forecast. Ms Ekholm's assessment, on the basis of the short-run relationships between the repo rate and the debt ratio described in the article in the Monetary Policy Report she mentioned earlier, was that a cut of 0.25 percentage points, with the rate remaining at this level for a year, would entail a debt ratio that was only around one percentage point higher, that is, the same level as in the April Monetary Policy Update. This would entail the same risk of a negative macroeconomic scenario as in the forecast made in April. As the downward revision of the debt ratio has not led to a downward revision of the repo-rate path, Ms Ekholm thought it was reasonable to draw the conclusion that the relationship between debt and the risk of a negative macroeconomic scenario was assessed to be more complex than one in which marginal changes in one lead to marginal changes in the other. But for monetary policy to be properly predictable, a clarification of this relationship is required. She considered it important that the Riksbank publishes such a clarification in the future.

Instead of the repo-rate path in the main scenario, Ms Ekholm advocated cutting the rate by 0.25 percentage points and leaving it at this level until the end of the second quarter of 2014, after which it could be gradually raised. She felt that to assess how quickly the repo rate can be expected to rise and what level it can be expected to reach at the end of the forecast horizon, one must address the question of how policy rates abroad will develop, as the repo rate can hardly deviate too far from policy rates abroad without this having substantial effects on the exchange rate. The forecasts for policy rates abroad and monetary policy expectations based on implied forward rates are fairly close to one another - in the short term monetary policy expectations, measured in terms of implied forward rates, have recently and unusually been higher than the forecast in the draft Monetary Policy Report. However, in the forecast policy rates abroad rise faster than expectations according to forward pricing, which implies that the forecast may overestimate how quickly these interest rates will rise. The profile of the Riksbank's own repo-rate path is important to the Riksbank's forecast of CPI inflation. Ms Ekholm pointed out that it is precisely with regard to the forecasts of the repo rate and CPI inflation (which includes households' mortgage rates) that the Riksbank receives such poor ratings in various evaluations of forecasting performance compared with other forecasters. It is

thus important for the Riksbank's reputation as forecaster that the tail of the repo-rate path should also be correct. Her assessment was that it is rising too quickly in the light of what can be expected with regard to monetary policy abroad, despite the downward revision to the repo-rate path made last time and despite the increase in implied forward rates abroad recently. She therefore preferred a path that rises to a slightly lower level than the repo-rate path in the main scenario, namely to around 2.25 per cent at the end of the forecast period. According to simulations using the Ramses macro model, this path gives a better target attainment for inflation and unemployment than the one in the main scenario of the draft Monetary Policy Report.

First Deputy Governor **Kerstin af Jochnick** began by saying that she shared the assessments in the draft Monetary Policy Report with regard to developments abroad and in Sweden. Developments since the monetary policy meeting in April have largely followed the forecasts made then, although there have been some deviations. Her assessment was that monetary policy needs to continue to be expansionary to support the Swedish economy and to attain the inflation target of 2 per cent. She therefore supported the proposal to hold the repo rate at 1 per cent as well as the proposed repo-rate path.

Ms af Jochnick noted that GDP growth abroad measured in the way most relevant to the Swedish economy, that is, KIX-weighted, is expected to be fairly weak this year and she supported the assessment that it would improve gradually in the coming period. She pointed out that during 2012 the Executive Board had been concerned over the recovery in the United States and the effects of the fiscal cliff on the US economy. These concerns have now been appeased as growth is recovering and the effects of the fiscal cliff were manageable.

Ms af Jochnick said that there were, however, some uncertainty factors in the global economy that deserved attention. There have been relatively large movements in the financial markets recently. Market participants' unease has been affected by uncertainty over when and to what extent the United States will begin its "exit" from the very stimulative monetary policy. In addition, it is difficult to assess the effects of the problems in the Chinese banking sector on its economy. At present it is difficult to determine what the long-run consequences of these uncertainty factors might be, which means that there is a high level of uncertainty in the forecasts.

As Sweden is dependent on growth in the euro area picking up, it is particularly interesting to follow the measures now being taken there. Compared with the situation a year ago, a number of measures have been taken, which has contributed not least to the financial markets functioning better and to interest rates in the problem countries falling to lower levels. However, the recovery in the euro area is progressing slowly and much remains to be done before developments can be regarded as sustainable in the long term. Ms af Jochnick said there remained downside risks in the euro area. These are

primarily related to the euro area countries not implementing the necessary reforms sufficiently quickly and adequately and to growth therefore failing to pick up.

She pointed out that her assessment was that future developments would differ considerably for the different euro-area countries. When assessing developments in the euro area, she therefore considered it important to closely monitor the countries that have most significance for Swedish exports. She felt that, for instance, it was positive from a Swedish point of view that things are going better for Germany than other euro-area countries less important to Swedish trade. German exports also seem to be slowly recovering as a result of the global recovery and of a good ability to adapt to demand from emerging markets, for instance. All in all, her assessment was that there are downside risks for the euro area, but that there is also positive information that supports the assessment that growth in the euro area will show an upswing in 2014.

Ms af Jochnick observed that developments in Sweden since the monetary policy decision in April had largely followed the forecast the Riksbank made then. The economy is divided, as described in the draft Monetary Policy Report, with exports and investment remaining at low levels. However, there are signs of a turnaround in industrial activity, which was indicated recently in the purchasing managers' index for June.

Households on the other hand are increasing their consumption. This increase is because households now have a positive outlook on both their own finances and the Swedish economy, and at the same time their incomes are rising. Households' optimism has also affected developments in the housing market. House prices are rising and indebtedness is increasing. The low interest rates have also contributed to this development. Ms af Jochnick pointed out that it was possible to discern some increase in the mortgage rates charged to households, which could dampen the demand for loans. She intended to return to her views on household indebtedness later in the discussion.

Ms af Jochnick pointed out that Sweden has had low inflation for a long period of time. This has been due to weak imported inflation resulting from low international prices and a strong krona, as well as to weak domestic demand and low resource utilisation. Ms af Jochnick said that it was therefore reasonable to hold the repo rate at the current low level for around one year. She shared the view that growth in Sweden would gradually pick up as international demand strengthens. She also felt that domestic demand would increase when the labour market recovers, employment increases at a faster pace and unemployment declines. When economic activity begins to improve, import prices are expected to increase and labour costs to rise faster. Moreover, companies' price mark-ups are expected to be higher. CPIF inflation will then rise and reach the target of 2 per cent in 2015.

Deputy Governor **Per Jansson** supported both the macroeconomic forecast and the monetary policy presented in the draft Monetary Policy Report. He said that the decisive

factor for his view of monetary policy, as before, had been the trade-off between the need on the one hand for more stimulation of the economy to contribute to inflation rising in the shorter term, and on the other hand for consideration of the risks linked to high household indebtedness in the longer term. He said that it was a question of stepping on the accelerator just enough to ensure that macroeconomic developments not only look decent in the short run but are also sustainable in the longer run. Mr Jansson felt that these principles for monetary policy were described very well in an article in the draft Monetary Policy Report, and he hoped that many people would read it.¹

Mr Jansson noted that it became more complicated to reason about monetary policy in this way, compared with endeavouring to rapidly push up inflation towards the target. To ensure that monetary policy is predictable and comprehensible, it is therefore important to explain as clearly as possible in what way the policy conducted is considered reasonable in the light of the factors that affect the trade-off. He therefore intended to clarify, in his contribution to the debate, his views on both the more short-term economic developments and the more long-term risks linked to household debt compared with the assessment made in April.

GDP growth for the first quarter had a much better outcome than the Riksbank and almost all other analysts had been expecting. The seasonally-adjusted growth figure was 0.6 per cent when compared with the fourth quarter of last year, which is almost twice as high as assumed in the April Monetary Policy Update. If one studies the different components of GDP, however, developments are not wholly positive. Both exports and investment were weaker than expected. However, household consumption increased rapidly and some indicators give hope that exports may also pick up speed in the coming period. This is illustrated, for example, by yesterday's purchasing managers' index for June, which rose by around 1.5 units to 53.5. This is the highest level since May 2011. Mr Jansson pointed out that a stronger export market lays the foundation for a gradual increase in investment activity too.

He went on to say that the Swedish labour market is continuing to show resilience. Unemployment has developed largely as expected since the Monetary Policy Update was published in April. The stable aggregate unemployment figure conceals positive trends in both the number of persons in the workforce and the number of employed. The positive trend for employment has actually accelerated somewhat recently. He also felt that it was worth highlighting the fact that the most recent outcome for unemployment exceeded expectations quite significantly; when seasonally adjusted, unemployment in May fell by 0.4 percentage points to 7.9 per cent, which was 0.5 percentage points lower than the

¹ See the article "Financial imbalances in the monetary policy assessment", Monetary Policy Report July 2013, Sveriges Riksbank, p. 42. These questions are also discussed in Per Jansson (2013), "Perspectives on the Riksbank's monetary policy", speech at the Centre for Business and Policy Studies, Stockholm June 2013.

market had expected.² At the same time, he emphasised that the unemployment outcomes in individual months are erratic and must therefore be interpreted with caution.

Mr Jansson noted that CPIF inflation in May amounted to 0.7 per cent, which was one tenth of a percentage point lower than the assessment in the April Monetary Policy Update. As the outcome for April was almost 0.3 percentage points below the April forecast, the May outcome means that around 2/3 of the forecasting error was recovered. Mr Jansson said that he could not rule out the possibility that the recent relatively sizeable depreciation in the krona will mean that the inflation rate rises somewhat faster in the coming period than is assumed in the draft Monetary Policy Report. Since the work on compiling the forecasts in April, the krona has weakened by around 5 per cent against both the euro and the US dollar. The way that the exchange rate ultimately affects inflation is largely dependent on how lasting the depreciation is perceived to be.³

All in all, the picture of economic developments remains roughly the same as in April. As in April, it is expected to take around two years before CPIF inflation is close to 2 per cent. Mr Jansson considered this to be a slow, but not unacceptably slow, adjustment of inflation. Nor are there any tendencies towards inflation expectations in the longer run beginning to deviate significantly from 2 per cent. Economic prospects indicate a gradual recovery that should eventually also impact clearly on the labour market. Mr Jansson stressed that although he has pointed to some factors that may make him slightly more optimistic than the proposed forecast in the draft Monetary Policy Report, he felt that the differences were after all fairly marginal, and not sufficient to justify entering a reservation.

Nor have there been any dramatic changes with regard to the risks linked to household debt and on the housing market since April. The fact that housing prices are showing a tendency to accelerate at present illustrates both that interest rates are significant to price developments and that there are structural problems on the Swedish housing market. Mr Jansson stressed that it was important to avoid an overly rapid increase in housing prices and that such a development, as in earlier years, spurs an excessive credit boom in the household sector. As pointed out in the draft Monetary Policy Report, this type of development could be particularly problematic if it entailed unrealistically-low interest rate expectations among households. To summarise, Mr Jansson said that the situation on the Swedish housing market continues to be risky, and he did not at present see any potential for this picture to change significantly unless authorities and other agents take further measures. And, as he has emphasised on previous occasions, it was important to act while there was still time.

² According to SME Direkt's forecast survey.

³ The krona and the significance of exchange-rate expectations are discussed in the alternative scenario "Cost developments and inflation", Monetary Policy Report July 2013, Sveriges Riksbank, p. 26.

With this, Mr Jansson concluded that the repo-rate path in the draft Monetary Policy Report comprises a well-balanced compromise. By not stepping too hard on the accelerator to try to quickly push up inflation towards the target, the Riksbank can, at least to some extent, continue to contribute to subduing the risks linked to household debt. As he saw it, this improves the prospects for ensuring that macroeconomic developments are sustainable in the long run, although it is probably not sufficient.

Mr Jansson considered the low inflation rate and the uncertainty surrounding international developments to mean that it may be reasonable to indicate a somewhat greater probability of a cut than an increase in the repo rate in September. Given the fact that he was slightly more optimistic than the proposed forecast in the draft Monetary Policy Report, however, he felt that a uniform probability distribution was an equally reasonable alternative.

Governor **Stefan Ingves** stated that he shared the views on international developments and the Swedish economy described in the draft Monetary Policy Report and noted at the same time that the changes were not so great compared with the forecasts made in April. He also supported the proposal to hold the repo rate unchanged, and the repo-rate path used as a base for the forecasts.

Mr Ingves pointed out that the recovery abroad was continuing step by step. But when balance sheets need to be repaired, the economic downturn is often deeper and more prolonged than would otherwise be the case, and this is what is happening now. There are signs of stabilisation in the euro area. However, several countries have missed their deadlines for correcting excessive budget deficits and the continued high indebtedness means that several countries are vulnerable. Mr Ingves drew attention to the fact that the Riksbank's forecasts are based on credible measures being implemented in the euro area to gradually strengthen balance sheets in the financial and public sectors and that competitiveness is improving in southern Europe. This will contribute to some recovery in 2014 and 2015. However, Mr Ingves felt that there is a risk that the countries concerned will suffer consolidation fatigue.

In the United States, the adjustment of household balance sheets has made more progress. The housing market is continuing to recover. This, together with a reduction in unemployment, will contribute to a recovery in household consumption. The adjustment of balance sheets in the financial system has also come further in the United States, which will support the recovery there. However, Mr Ingves wondered whether perhaps the financial markets had assumed the recovery in advance to some extent. He went on to note that KIX-weighted GDP growth abroad would be weak this year as a result of the euro area having relatively large weights in KIX, but that international developments would gradually improve during the forecast period. A global recovery is thus occurring, although it is an uneven and unsynchronised recovery.

The Swedish economy is still divided. On the one hand, the weak demand in the euro area has subdued exports and investment. But on the other hand, households' incomes have risen, confidence has strengthened and house prices and lending have continued to increase. Mr Ingves noted that the Riksbank's forecast is that GDP growth in Sweden will gradually increase as demand abroad improves. According to the forecast, the labour market will then also recover.

Mr Ingves went on to note that inflation has been low for a long period of time. Weak international price developments and the krona appreciation in recent years have contributed to this, as have weak domestic demand and low resource utilisation. He therefore thought it was reasonable to hold the repo rate at a low level.

Recent developments on the international financial markets have been volatile, and have for instance been affected by the market participants' uncertainty over when the Federal Reserve will begin to exit the monetary policy stimulation in the United States and by the liquidity situation in the Chinese financial sector. Mr Ingves pointed out that although it is too early to say that the world is in a new situation, it is still possible that exchange rate fluctuations will become more pronounced in the future. However, from an inflation perspective, it is no disadvantage if the krona weakens somewhat in the coming period, as inflation is currently below the target. When economic activity recovers, and various central banks begin to reduce their stimulation policy, one can expect further exchange rate adjustments that are difficult to predict. He said it was difficult to know what this might mean for the krona. At the same time, Mr Ingves felt that the volatile developments on the financial markets show the difficulty of "fine tuning" monetary policy, which he also felt was an argument in favour of holding the repo rate unchanged at today's meeting. He said that monetary policy can then contribute to economic activity strengthening and resource utilisation increasing, which raises domestic inflationary pressures. The higher growth abroad will at the same time contribute to higher global export prices and higher prices for import goods. CPIX inflation is expected to rise and reach the target of 2 per cent in 2015.

At the same time, Mr Ingves pointed out that growth abroad could of course be either better or poorer than expected. There is also a risk that the reform work in Europe will proceed unevenly. If things go better in northern Europe and not so good in southern Europe, there may not be much impact on Sweden, which is mainly affected by the countries in the northern part of Europe.

In conclusion, Mr Ingves noted that the Riksbank's repo-rate forecast entails the repo rate remaining at the current very low level for around one year and then being raised to 2.8 per cent at the end of the forecast period. He considered that as the forecast revisions were slight and the forecasts were very uncertain, it was best to conduct monetary policy according to the principle of "safety first", which means that the policy rate should be left unchanged.

Deputy Governor **Cecilia Skingsley** began by saying that she supported the picture of economic developments presented in the draft Monetary Policy Report. A recovery is underway globally, although it is unsynchronised and still fragile. Ms Skingsley also agreed with the description in the main scenario that there are some positive signs even in the harder-hit euro countries, although risks still remain. She pointed out that this particularly applies to the countries' competitiveness and public finances. According to Ms Skingsley, Sweden's experience of the crisis of the 1990s indicates that confidence can increase when households and companies begin to see that the worst problems are over. This is despite the fact that the current levels of unemployment and economic activity still represent a severe strain on the economy.

Ms Skingsley noted that the current global situation is marked by an unsynchronised recovery. Consequently, several leading central banks will reduce their stimulation measures at different times and at different rates. This will probably lead to recurring periods of uncertainty and volatile markets. She pointed out that the financial markets have been marked by increasing volatility recently as a result of altered expectations regarding the monetary policy the Federal Reserve will conduct in the period ahead. As the US economy is recovering, she believed that it was natural to start discussing when and how to begin reducing the monthly purchases of bonds. She also noted that although volatility is rising it is doing so from low levels. She said that the market movements were reasonable so far and did not pose a threat to the recovery.

Ms Skingsley continued by commenting on the recovery of the Swedish economy, and particularly developments in the business sector. She said that it is clear in terms of export and investment statistics that the companies are struggling with the consequences of weak economic activity. However, there are several positive factors to take note of that she also believed supported the main scenario in the Report. These include expectations of a recovery, as shown for example in the Riksbank's own business survey. Activity in the service sector is also resilient, as shown by the Business Tendency Survey of the National Institute of Economic Research. Ms Skingsley wished to add to this the increasing confidence of the small companies in Sweden, as revealed by Swedbank's Small Business Outlook Survey, despite setbacks earlier in the year. She said that confidence in this part of the business sector is important, as small companies often lack the possibility of large companies to diversify in terms of both products and geographical markets.

Ms Skingsley's assessment was that the economic recovery in Sweden is relatively stable. One argument for this was that the risk of negative events occurring within the framework of the euro crisis, for example government crises in Greece or Italy, was no longer generating the same degree of unease as previously. One explanation of the calmer situation on the markets was, in her opinion, that several of the problem countries have made progress in making the required adjustments, but also that the other euro countries, and particularly the ECB, have established clearer strategies for the action to

take if negative events do occur. This has contributed to a certain degree of stability in market pricing. She therefore believed that setbacks in the euro area, such as difficulties in forming a government in Italy or new government problems in Greece, should not be as troublesome for confidence indicators in Sweden as they were in 2011 and 2012.

Ms Skingsley continued by posing the question of what represents a well-balanced monetary policy in this situation. Given the Riksbank's own assessments, a repo-rate cut at today's meeting could lead to a more rapid attainment of the inflation target and a more rapid increase in resource utilisation. In connection with this she also wished to comment on the risk outlook in relation to monetary policy. The first risk factor, which could support making a repo-rate cut, is inflation expectations. If there is a significant fall in the more long-term inflation expectations, this would be an expression of a loss of confidence in price stability. If so, this would need to be addressed by a more expansionary monetary policy, all else being equal. The second risk factor relating to monetary policy, and which Ms Skingsley found more important, is indebtedness in the household sector. The global financial crisis demonstrated that it takes many years of unemployment and cutbacks for households, and in many cases also governments, to adjust from a high level of debt, even if an expansionary monetary policy is conducted throughout these years. The countries that have experienced problems have had different levels of debt, in both the private and public sectors, different exchange-rate regimes, different growth models and different banking structures. It is therefore not possible to predict when indebtedness will become a problem with any degree of certainty. She therefore believed that there was every reason to be highly vigilant and cautious in the face of the forecasting and decision-making trade-offs that indebtedness entailed.

Ms Skingsley added that it is also extremely important to monitor the workings of the transmission mechanism. This is always the case, but not least the financial crisis demonstrated that the effects of monetary policy on different parts of the economy are not static. A more expansionary monetary policy may be needed when the transmission mechanism works badly, and a tighter monetary policy may be needed when it works well.

After several years' work, the Swedish banks have come a long way in their efforts to adjust to new and stricter capital and liquidity requirements. It also appears that the margins on mortgages have stopped increasing. The limited opportunities for volume growth mean therefore that there is now potential for fiercer price competition. This would risk driving up indebtedness, irrespective of what the Riksbank does with the repo rate. Ms Skingsley therefore concluded that the repo rate should be left unchanged and that the repo-rate path was well balanced given her view of the macro situation and the risk outlook.

Finally, she welcomed the preparatory work and the approaching decision on tools and the distribution of tasks for macroprudential policy in Sweden. In her view, these new

tools will enable a better control of systemic risks and lead to a more precise management of risk-taking in various sectors. Once the macroprudential-policy tools are in place, there will be less need than at present to take household indebtedness into account in the monetary policy decisions.

Deputy Governor **Martin Flodén** said that he supported the picture of economic developments in Sweden and abroad presented in the draft Monetary Policy Report. However, he advocated a lower repo rate in the year immediately ahead than the rate proposed in the main scenario. He said that the factors that had determined his stance were the low rate of inflation in combination with low inflation expectations in the short and medium terms, and signs of falling inflation expectations in the longer term. A lower repo rate now would provide a quicker and more certain return to the inflation target and also the opportunity to raise the repo rate from its current low level somewhat more rapidly. He agreed with the description of the build-up of household debt as a possible risk factor, but wished to return to his thoughts on this subject a little later in the discussion.

Mr Flodén noted that CPIF inflation was 0.7 per cent in May and had thus been around 1 per cent for the last two years. According to the forecast in the draft Monetary Policy Report, CPIF inflation will reach the target of 2 per cent at some point in mid-2015 if the proposed repo-rate path is followed. Inflation will then have been well below the target for four years. According to this inflation forecast, inflation will also return to the target much sooner than predicted by other forecasters. For example, the National Institute of Economic Research expects CPIF inflation to reach the target more than a year later, around the end of 2016, although the Institute expects monetary policy to be more expansionary than proposed in the draft Monetary Policy Report.

There are also some signs that the credibility of the inflation target and monetary policy is beginning to be questioned. Inflation expectations in the Prospera surveys and the surveys of the National Institute of Economic Research have fallen significantly in recent years, as shown in Figures 3:29 and 3:30 of the draft Monetary Policy Report. Mr Flodén noted that in the Prospera survey of the inflation expectations of money-market players, the social partners and purchasing managers two years ahead, which was conducted in March this year, only 8 per cent of the over 200 respondents believed that the rate of inflation would be as high or higher than the level in the Riksbank's forecast. The average expectation was one percentage point below the Riksbank's forecast. The survey showed that inflation expectations five years ahead have also fallen, but are only marginally below the inflation target. Implied expectations of inflation in five years' time based on the pricing of real and nominal bonds have fallen and are now around 1.5 per cent.

Mr Flodén emphasised that he did not mean that the credibility of the inflation target has been lost. However, he argued that even small signs of weakening credibility should call for extra caution. He therefore considered that it was problematic to present forecasts

and repo-rate paths in which inflation returns to the target more rapidly than in the forecasts of other analysts, at the same time as the repo-rate path entails a stricter monetary policy than according to other analysts. He pointed out that the Executive Board's earlier repo-rate paths have not been particularly accurate but have often had to be revised downwards. In his assessment, it was more likely that the now proposed repo-rate path will once again need to be revised down than that it will need to be revised up. He said that in this situation it would be better to immediately cut the repo rate, rather than to present a repo-rate path that will not be seen as entirely credible in the eyes of external observers, or seen as not contributing to a reasonably rapid return to the inflation target. According to Mr Flodén, this reasoning strengthened the argument for a repo-rate cut at today's meeting.

He noted that this argument could be countered by risks associated with household indebtedness. He agreed with the draft Monetary Policy Report's description of the Swedish economy as divided. He pointed out that this was a picture that has been evident for some time. Overall resource utilisation is low; GDP growth is lower than normal, unemployment is higher than a long-term equilibrium rate, wage pressures are moderate and capacity utilisation and investment levels in the manufacturing industry are low. However, development in large parts of the household sector is strong; the households' disposable incomes are continuing to increase relatively quickly and, despite high unemployment, the employment rate is relatively high and the risk of unemployment low in many occupational groups.

In addition, households with large mortgages have benefited from an expansionary monetary policy that has led to low mortgage rates. Mr Flodén said that the strong development of disposable incomes, in combination with low interest rates and a low risk of unemployment in many occupational groups, likely had contributed to raising housing prices and household debt. Further repo-rate cuts would probably widen the divide in the economy and contribute to an on-going increase in household indebtedness.

He noted, however, that it is difficult to determine whether housing prices and household indebtedness have increased more than is justified by fundamental factors. Nevertheless, it cannot be ruled out that the increase in household indebtedness has, at least to a certain extent, been generated by non-fundamental factors such as unrealistically-low expectations of future mortgage rates. In his opinion, it was therefore in principle justified for monetary policy to now take into account the rapid increase in household indebtedness.

Mr Flodén said that the ideal would be if the effects of repo-rate cuts on the households were now counteracted by other measures, such as significantly higher mortgage risk weights. Given the lack of sufficient measures of this type, the question now is how concerns about high household debt should affect the Riksbank's repo-rate decision. He said that there was no obvious answer to this question, but he argued that it was

problematic to take such concerns into account in any meaningful way if the aim was to attain the inflation target.

Inflation could quickly move towards the inflation target if the Riksbank were to further cut the repo rate in the short term. Alternatively, the Executive Board can choose to retain the current level of the repo rate. It will then take longer to raise inflation towards the target and the repo rate will have to be low for a longer period of time. The choice is thus not necessarily between a high and a low repo-rate path as in Figure A1 in the article on financial imbalances in the draft Monetary Policy Report. Lowering the repo rate now would instead entail a more rapid attainment of the inflation target and also mean that the repo rate could be more quickly raised towards normal levels. If the repo rate is left unchanged now it will take longer before inflation begins to rise, and it may then take a long time before the repo rate can be raised.

Mr Flodén said that the first alternative, with a lower repo rate now, would probably contribute to a somewhat higher build-up of household debt in the short term, but possibly to a somewhat lower build-up of debt in the medium term. His assessment was that the two alternative repo-rate paths would have similar implications for the potential problems with a high build-up of debt in the household sector. A lower repo rate now would contribute to a better attainment of the inflation target and a more rapid stabilisation of economic activity, and at the same time reduce the risk of having to hold the repo rate at a low level for a longer period of time than follows from the proposed repo-rate path in the draft Monetary Policy Report.

Moreover, if the problems relating to a build-up of household debt are completely ignored, the low level of inflation in combination with weak resource utilisation would justify a substantial repo-rate cut in the present situation. On the basis of his reasoning thus far, a substantial repo-rate cut could also be justified even if the build-up of household debt is taken into account, but then in combination with a repo-rate path that returns to normal levels more rapidly than in the main scenario in the draft Monetary Policy Report. However, it is usually desirable not to change the monetary policy message too much from one monetary-policy meeting to another. He therefore advocated cutting the repo rate to 0.75 per cent at today's meeting and keeping the repo rate at this level for a year before returning to the repo-rate path proposed in the draft Monetary Policy Report.

Consequently, he entered a reservation against the repo-rate path proposed in the draft Monetary Policy Report. He instead advocated the lower repo-rate path shown in Figure 2:18 in the section "Alternative scenarios for the repo-rate path" in the draft Monetary Policy Report. The model calculations presented there indicate that the differences in the development of inflation and GDP would be limited with this repo-rate path compared with the path in the main scenario. Mr Flodén said that this was quite possible, but he wished to conclude by commenting on two aspects relating to this. First, he pointed out

that the model-based calculations in this section assume that the lower repo rate (compared with the main scenario's repo rate) comes as a surprise to the agents in the model in each quarter. If the model calculations had instead been performed under the assumption that the market would revise its repo-rate expectations directly when the new repo-rate path was presented – an assumption he regarded as more reasonable – the effects on inflation and GDP would have been doubled, according to model simulations. The second, and for Mr Flodén more important aspect, was that in his opinion the Riksbank should clearly signal that the inflation target will be attained in the near future, and also demonstrate that action was being taken in line with such signalling.

§3. Discussion

Deputy Governor **Per Jansson** began the discussion by pointing out that a number of the members of the Executive Board had noted that the risks associated with household indebtedness may become particularly serious if the households have unrealistically-low expectations of the repo rate. He said that this was not a simple issue, but a very important one. One of the reasons why Mr Jansson thought it was important to think about how the Riksbank can deepen its analysis in this area is that, although there is a lot of talk about the risks posed by household indebtedness, when it comes to making concrete monetary-policy decisions the Executive Board ultimately chooses, for the most part, to prioritise the short-term outlook for economic activity and inflation. He noted that since becoming a member of the Executive Board he had participated in eight monetary-policy meetings. The Executive Board had decided to lower the repo-rate path at seven of these meetings, and at three of them to also cut the repo rate. He said that this underlined the fact that in its concrete decision-making the Executive Board clearly prioritised the development of the economy in the short term. Mr Jansson continued by wondering how households would react to a monetary policy that does not translate its words into deeds. If households begin to take it into their heads that the Riksbank is "all talk and no action", then perhaps credit growth will accelerate once again. He speculated that if things go badly "all-at-once" effects can arise that lead to rather rapid and dramatic changes in credit growth.

The Riksbank therefore needs to carefully monitor the development of credit growth and to consider how reasonable the households' repo-rate expectations are. He noted that the Riksbank has difficulties in analysing this question in its models as these assume that the formation of expectations is rational. Accepting such an assumption means that we have already from the start excluded the possibility that there may be unrealistic expectations. But if we cannot use formal models, how can we otherwise get to grips with this question? Mr Jansson proposed that it would perhaps be possible to put additional questions to the households in surveys that examine in more detail the formation of expectations in the household sector. He emphasised that he did not have a ready-made

solution as to the best approach to this, but he thought that the issue was a very important one and therefore wished to raise it.

Mr Jansson concluded by pointing out that the issue was not really only about repo-rate expectations but also about expectations of movements in housing prices. He referred to a study by Karl Case and Robert Shiller which argues that rising housing prices today can in themselves lead the households to begin to expect rising prices tomorrow too.⁴ The combination of unrealistic repo-rate and housing-price expectations can create powerful processes in which there is a rapid and trendwise increase in housing prices and indebtedness. It is very difficult to halt such processes once they have begun and it is therefore important to prevent them from arising at all.

Deputy Governor **Karolina Ekholm** said that Mr Jansson's fears that the Executive Board's consideration of indebtedness would be perceived as "just talk" was related to the problem that she and Mr Flodén had taken up for discussion earlier; that is that it can be difficult to find scope to raise the repo rate when the macroeconomy is weak. She noted that there seemed to be two contrasting points of view among the members of the Executive Board. The choice seemed to be to either hold the repo rate a little higher for a long period of time in order to dampen the growth of debt, or to focus on an attempt to improve the macroeconomic situation more quickly so that the repo rate can be raised towards a historically more normal level. She said that the difference between these strategies was not obvious when it comes to influencing household indebtedness, which made this an issue that could be worth analysing in more detail at the Riksbank.

Ms Ekholm also wished to respond to Mr Flodén's comment that larger repo-rate cuts than that she advocated at this meeting could be justified in order to bring inflation up to the target more quickly. She agreed with Mr Flodén that larger repo-rate cuts could be justified for this reason, but noted that she also attached a certain degree of importance to not making unexpectedly substantial repo-rate changes. She said that there could be something in Mr Flodén's view that a larger cut now and then a more rapid increase of the repo rate than would otherwise prove possible could also be justified on the basis of concern about a high level of indebtedness.

First Deputy Governor **Kerstin af Jochnick** pointed out that as at previous meetings she believed that the on-going development of household indebtedness is probably not sustainable in the long term. There are many international examples of countries that have experienced a similar situation and then had problems. These problems have not primarily concerned mortgage losses but have been effects that have arisen after a fall in housing prices with dramatic falls in consumption and GDP and rising unemployment. The risk of potential problems with household indebtedness has also been pointed out by

⁴ See Karl E. Case and Robert J. Shiller, "Is there a bubble in the housing market?", *Cowles Foundation Paper* No 1089, 2004.

several international organisations, including the OECD, the European Commission and the IMF, in connection with assessments of the Swedish economy. These international organisations have also said that the problems on the Swedish housing market are aggravating the financial imbalances in the household sector. This means that the housing shortage is a factor that is pushing up housing prices and thus the level of indebtedness.

It was therefore important to take a holistic view of these issues as a dramatic increase in housing prices that is then followed by a fall in housing prices risks impacting the banking sector and affecting the ability of the banks to fund their operations and the price of the banks' funding. Ms af Jochnick said that it was thus a matter of urgency for Sweden to draw up a plan for how to eventually reduce household indebtedness to more reasonable levels. The regulations should aim to gradually achieve long-term balance on the housing market as well as in household indebtedness.

She said that as far as household indebtedness was concerned it was a widely-held view among most analysts that the debt ratio, at least in the metropolitan regions, had reached levels that create unnecessary risks to the economy. Monetary policy can only marginally affect this process. Given the expansionary monetary policy that the Executive Board is conducting to support the Swedish economy, it is nevertheless reasonable to pay some attention to indebtedness. If household indebtedness increases, then the probability of a financial crisis beyond the forecast horizon will also increase, according to the analysis presented in an article in the draft Monetary Policy Report. There is also a risk that there will be major negative effects on the economy. A fall in housing prices could lead the households to increase their saving and reduce their consumption, which would dampen demand and push up unemployment. Ms af Jochnick therefore thought it was important to take a long-term view and look beyond the three-year perspective that is the Riksbank's normal forecast horizon. She pointed out that this does not entail deprioritising the inflation target. The overall objective is to stabilise inflation around the target of 2 per cent and to ensure that resource utilisation in the economy is at a normal level. But she thought it was worth emphasising that monetary policy cannot deal with structural problems on the housing market.

Nor can monetary policy deal with structural problems on the labour market. Matching on the Swedish labour market seems to have become more problematic in recent years. A large part of the increase in unemployment relates to those that are defined as vulnerable groups. Ms af Jochnick said that the problems the Swedish labour market has today are largely structural in nature and therefore cannot in the first instance be affected by changing the repo rate.

All in all, she thought that it was unfortunate that there is such a great focus on what monetary policy can achieve in the present situation with regard to household indebtedness and unemployment. Conducting monetary policy in a low interest-rate

environment with tendencies towards the build-up of bubbles and weak growth is a challenge. However, monetary policy cannot solve the basic structural problems on the housing market or on the labour market. Monetary policy can stabilise inflation around the target and stabilise resource utilisation around a normal level. If monetary policy is conducted with a long-term perspective, it can also weigh in the risks associated with financial imbalances.

Governor **Stefan Ingves** said that the deliberations at today's monetary policy meeting were similar to those at several previous meetings as the current rate of inflation is low and the Swedish households are still more indebted than households in several of the countries that have been hit by crises.

He said that the draft Monetary Policy Report contains an article that presents a sound analysis on which to base one's thinking on financial imbalances in the monetary policy assessment. A lower repo rate would bring inflation up to the target more quickly, but would risk increasing household indebtedness. An increase in household indebtedness would in turn increase the likelihood of all kinds of problems arising in the longer term. The stylised examples in the article assume that economic difficulties will arise beyond the forecast horizon. However, Mr Ingves noted that in reality such events may arise sooner. The conclusion was clear. If it is considered that monetary policy is conducted in a long-term perspective, then the level of the repo rate is affected by risks associated with financial imbalances.

He also said that this conclusion is strengthened by the fact there is still a lack of tools to manage systemic risks. International authorities such as the IMF, the European Commission and the OECD have argued that Sweden needs to add tools such as amortisation requirements, higher risk weights for mortgages and lower tax deductions for interest-rate payments to its toolbox. Mr Ingves agreed with Ms Ekholm's earlier comment that additional work is needed on how the Riksbank should take financial imbalances into account when determining monetary policy and on attempting as far as possible to quantify the relationship between different measures of imbalances and the repo-rate path, while also taking into account the overriding role of the inflation target in monetary policy. Mr Ingves said that this was in line with the fact that an increasing number of central banks are focusing on the role that financial stability has as one of the main objectives.

He continued by saying that there are other factors that affect the housing market that neither monetary policy nor other macroprudential policy tools can influence. There is a need, for example, for structural reforms to increase the supply of housing, more efficient planning processes for the issue of municipal building permits and a better functioning rental market, which has also been pointed out by the international organisations.

Mr Ingves said that there are also other considerations with regard to monetary policy that support leaving the repo rate unchanged. Although he would really like to see more investment in the housing and business sectors, he did not wish to further fuel household indebtedness. He said that with only one interest-rate level it is difficult for monetary policy to manage this type of fine tuning. He agreed with Ms af Jochnick that it is important to remember that monetary policy cannot solve structural problems on the labour market. This applies, for example, to the fact that the labour force will to an increasing extent consist of groups considered to be on the periphery of the labour market according to Statistics Sweden's new population forecast. Given economic developments abroad, the prevailing uncertainty and what monetary policy can and cannot do, he thought that monetary policy was now well balanced.

Deputy Governor **Martin Flodén** said that he agreed with many of the points made in Ms af Jochnick's and Mr Ingves' discussion of household indebtedness and housing prices. He also thought that the build-up of debt was a risk factor and that effective macroprudential tools were needed to manage this risk. This was, as mentioned previously, an issue that the OECD, the European Commission and the IMF had also raised. However, he said that it should be pointed out that these international organisations have called attention to risks and the need to manage them within the scope of macroprudential policy and with structural measures. The problems have thus not been presented as being central to monetary policy, although the IMF does mention that monetary policy might need to take these risks into account.

He also wished to emphasise that although he saw the build-up of household debt as a risk factor, he did not share Ms af Jochnick's view that household indebtedness is now definitely at an unsustainable level. He said that after all there are several factors that indicate the opposite. For example, household saving is high and investment is low, particularly in housing. Structural problems on the housing market in combination with a low level of construction are pushing up housing prices, and a build-up of debt may thus be justified. Perhaps an adjustment of the debt ratio will take place in the longer term if the structural problems are dealt with and construction picks up, but Mr Flodén said that it was not obvious that such an adjustment would entail an economic crisis.

Deputy Governor **Cecilia Skingsley** wished to comment on the issue of how actively monetary policy should be used. She said that the advantages of a marginal change in the repo rate must be set against the risks associated with such a change. She agreed with the picture of a divided Swedish economy in which the households are in a position of strength while development in the corporate sector is weaker. However, she was not certain that it would boost corporate investment to adjust the repo rate when the willingness to invest is weak and balance sheets are generally strong while the willingness to borrow is nevertheless weak.

Ms Skingsley referred to Ms Ekholm's earlier comments about the problems concerning household indebtedness. She said that there is too much focus on the debt ratio as a measure and that a broader approach to household indebtedness is needed. If the households expect to see housing prices rise at the same time as lending rates fall then this is a recipe for rising prices and debts. This was one of the reasons why she believed the repo rate should be left unchanged at today's meeting.

She concluded by saying that she thought it was important to look at the households' balance sheets in the analysis. In this context she said that it was good that the Riksbank has asked for more data on the households' debts.

Deputy Governor **Karolina Ekholm** said that it was not justifiable to tone down the role of monetary policy when it comes to affecting variables such as unemployment. She said that current unemployment obviously has a cyclical component that monetary policy can affect. Cyclical unemployment can also become structural unemployment due to persistence effects on the labour market and it is therefore important that monetary policy is used to avoid unemployment becoming entrenched above a long-run sustainable rate for a long period of time. Ms Ekholm was also sceptical of the argument that nothing can be done about unemployment for groups with little chance of finding a job. She said that higher aggregate demand was particularly important for these groups in order to increase their chances of finding employment.

In the case of household indebtedness, Ms Ekholm said that there seemed to be agreement that tools other than the repo rate are better suited to managing potential problems. As Mr Flodén had pointed out, the international organisations that have highlighted the risks associated with indebtedness in Sweden have not in the first instance argued that monetary policy should be used to subdue the increase in debt. If household indebtedness is made a more explicit part of the basis for monetary policy, then the forecast must also comprise an assessment of the measures taken in other policy areas by, for example, the government and Finansinspektionen, and how these are expected to affect indebtedness in the period ahead.

Ms Ekholm agreed with Ms Skingsley that there is too much focus on the debt-ratio and that it is important to also consider other aspects of the households' financial situation in the analysis. Like Mr Flodén, she saw the relatively high level of household saving as an important factor that should reduce the vulnerability of the households in the event of a fall in housing prices and incomes.

Governor **Stefan Ingves** summarised the discussion. It was observed at the meeting that economic developments both in Sweden and abroad have been largely in line with the forecast made by the Riksbank in the April Monetary Policy Update. The Executive Board noted that economic prospects abroad were different in different parts of the world, but the general assessment for the world as a whole was a gradual improvement in the

coming years. GDP growth in Sweden is expected to be lower than normal in 2013, and then to rise in 2014 as demand abroad picks up. An improvement in the labour market is also expected then. There was also discussion of the division in the Swedish economy, with weak investment and exports, but stronger households. Households have had a good development in income, which has led to increased consumption and rising house prices. Finally, the discussion turned to the high level of debt among Swedish households, both from an international and a historical perspective, which was considered to make the economy more vulnerable to shocks.

The Executive Board was unanimous that monetary policy needed to continue to be expansionary, given the low rate of inflation. A majority of four members thus assessed that it was appropriate to hold the repo rate at 1 per cent until the second half of 2014, to support the economy and contribute to inflation rising towards the target. They also considered a largely unchanged repo-rate path in relation to the April Monetary Policy Update to be reasonable, as new information received since then had been largely as expected. Although the forecast for unemployment has been revised up, the view of resource utilisation remains in principle unchanged in that a large percentage of the increased workforce is expected to be on the periphery of the labour market.

It was noted that although a lower repo-rate path could lead to inflation attaining the target slightly sooner, it would also increase debt and thus the risks to economic developments in the longer run. The majority therefore considered that the current repo-rate path was a reasonable balance as it entailed inflation and the real economy stabilising more in the short run, at the same time as taking into account more long-term risks linked to household debt.

Two members considered that there was scope to cut the repo rate to 0.75 per cent and to let it remain at this level until the second quarter of 2014. One of the members thereafter advocated a repo-rate path that coincided with that in the main scenario, while the repo-rate path advocated by the second member ends at approximately 2.25 per cent. They assessed that this monetary policy would bring inflation back on target sooner, while resource utilisation would be better balanced. It could thus improve the conditions for the economy to manage future shocks and also potential risks linked to household debt.

The future development of the repo rate was also discussed at the meeting. If the repo rate needed to be changed in the near term, it is more likely that it would be cut than that it would be raised. There were however different opinions regarding the probability of increases or cuts in the near term, even within the majority.

§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 Wednesday 3 July 2013, at 9.30 a.m.,
- to hold the repo rate unchanged at 1.00 per cent and that this decision would apply with effect from Wednesday 10 July 2013,
- to publish the decision above at 9.30 a.m. on Wednesday 3 July 2013 with the motivation and wording contained in a press release, and
- to publish the minutes of today's meeting on Tuesday, 16 July at 9.30 a.m.

Deputy Governor Karolina Ekholm entered a reservation against the decision to maintain the repo rate at its current level and against the repo-rate path in the Monetary Policy Report. She advocated a lowering of the repo rate to 0.75 per cent and a repo-rate path that stays at 0.75 per cent through the second quarter of 2014, and then rises to about 2.25 per cent by the end of the forecast period. This was justified by her assessment that a repo-rate path that is associated with a higher forecast of CPIF inflation and a lower forecast of unemployment constitutes a better-balanced monetary policy.

Deputy Governor Martin Flodén entered a reservation against the decision to hold the repo rate unchanged and against the repo-rate path in the Monetary Policy Report. He advocated cutting the repo rate to 0.75 per cent and a path where the repo rate remains at this level until the end of the second quarter of 2014, after which it follows the repo-rate path in the Monetary Policy Report. This was justified by his assessment that this repo-rate path would entail a forecast where CPIF inflation returns to 2 per cent sooner and resource utilisation is better balanced. Moreover, it would reduce the risk that the repo rate might need to be revised down in the future and that it would take a long time before the repo rate can be raised from the current low levels.

This paragraph was verified immediately.

Minutes by

Ann-Christine Högberg

Verified by:

Karolina Ekholm

Martin Flodén

Stefan Ingves

Per Jansson

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