Minutes of monetary policy meeting

APRIL 2014

Summary

At the monetary policy meeting on 8 April, the Executive Board of the Riksbank decided to hold the repo rate unchanged at 0.75 per cent and to adjust the repo-rate path downwards.

It was noted at the meeting that the Executive Board largely agreed on the picture of economic prospects and the inflation outlook described in the draft Monetary Policy Update.

Economic developments abroad continue to improve, well in line with the Riksbank's earlier assessments. In Sweden, GDP growth was higher than expected in the fourth quarter of last year. This was partly due to temporary factors, but the broad upturn in demand implies that an economic upturn has begun. The prospects for the Swedish economy remain bright and a clear improvement in the labour market is expected during the second half of this year.

Economic activity is strengthening and household indebtedness as a share of disposable income is expected to increase more than was previously forecast. Inflation has been somewhat lower than expected, but only a minor revision has been made to the inflation forecast. CPIF inflation is expected to rise towards the end of the year and to be close to 2 per cent during the latter part of 2015.

Given that economic activity has strengthened and that the revisions to the inflation forecast are minor, a majority of four Board members considered it appropriate to hold the repo rate unchanged at the current low level of 0.75 per cent. They also assessed that it is appropriate to wait around one year before beginning to raise the repo rate, when inflation picks up.

Given the low rate of inflation, a majority of Board members also considered it appropriate to adjust the repo-rate path downwards so that it reflects a greater probability of a repo-rate cut in the near term compared with the assessment made in February.

Two members advocated cutting the repo rate to 0.50 per cent, as inflation has been lower than expected over a long period of time and to ensure that inflation rises towards the target. They both advocated a first repo-rate increase roughly in line with the forecast in the draft Monetary Policy Update, but had slightly differing views on the repo-rate path after this. One member considered it appropriate that at the end of the forecast horizon, the repo rate should coincide with the rate in the draft Monetary Policy Update, while the other member preferred a lower repo-rate path.

The members discussed the low inflation rate and some of them pointed out that now even minor revisions to the inflation forecast could affect their view of monetary policy. They also discussed the repo-rate path slightly further ahead, the long-run level for the repo rate and the significance of the exchange rate for the development of inflation. The need to implement macroprudential policy measures was emphasised, as were other measures that affect household demand for loans and the functioning of the housing market. There was also a discussion of to what extent household debt should influence monetary policy. Moreover, there

was discussion of global risks to economic developments and potential consequences for developments in Sweden.

MINUTES OF MONETARY POLICY MEETING
Executive Board, No. 2

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DATE: 8 April 2014

TIME: 09.00

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

Meredith Beechey Österholm
Claes Berg
Charlotta Edler
Mattias Erlandsson
Eric Frieberg
Christoffer Grände (§ 1)
Kerstin Hallsten
Ann-Christine Högberg
Ann-Leena Mikiver
Marianne Nessén
Christina Nyman
Bengt Pettersson
Carl-Fredrik Pettersson (§ 1)
Kasper Roszbach
Henrik Siverbo
Maria Sjödin
Ulf Söderström
David Vestin
Anders Vredin
Fredrik Wallin (§ 1)

It was noted that Bengt Pettersson and Henrik Siverbo would prepare draft minutes of § 3 and 4 of the Executive Board's monetary policy meeting.

§1. Economic developments

Fredrik Wallin of the Markets Department began by presenting the latest developments on the financial markets. Since the Monetary Policy Report in February, developments have been marked by the conflict between Russia and Ukraine, as well as some uncertainty over economic developments in China. On the whole, however, market developments have been positive. Government bond rates have fallen, partly because of unexpectedly expansionary monetary policy signals from the European Central Bank (ECB). Risky assets have benefited, long-term interest rates in Portugal and Greece have fallen and the stock exchange has risen. The Swedish krona has weakened somewhat in trade-weighted terms since the monetary policy meeting in February. Analysts believe that the repo rate will be held unchanged at today's monetary policy meeting, although one or two believe in a cut. Expectations in terms of market pricing are that the repo-rate path will be revised down.

Marianne Nessén, Head of the Monetary Policy Department, presented the draft Monetary Policy Update 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 were discussed by the Executive Board at meetings held on 25, 26 and 28 March. The draft Monetary Policy Update was tabled at a meeting of the Executive Board on 2 April.

Economic developments abroad have been roughly in line with the forecasts made by the Riksbank in connection with the previous monetary policy decision in February. New statistics received since the February meeting support the picture of a continued gradual recovery in the global economy. The United States and the countries in the trade-weighted, so-called KIX index are expected to show GDP growth of almost 3 per cent a year at the end of the forecast horizon, while GDP in the euro area is expected to grow by almost 2 per cent.

In Sweden, GDP in the fourth quarter rose by 1.7 per cent in the fourth quarter of last year, compared with the third quarter. There was a broad upturn in demand, although both inventories and defence expenditure probably contributed temporarily to the high GDP growth. The forecast for the first quarter of this year therefore assumes some downward rebound and a GDP growth of 0.2 per cent. After that, GDP growth is expected to begin growing faster than normal again. The forecast for the coming years has been revised down somewhat, as disposable incomes are expected to show weaker development than was previously forecast. However, the revision is fairly minor.

Inflation is still low. The outcomes for CPI and CPIF inflation in January and February were somewhat lower than forecast in the February Monetary Policy Report, although the outcome for the CPIF excluding energy was in line with the February forecast. But service prices are continuing to show weak development and this has meant that the forecast for the CPIF has been revised down slightly for the coming months. The strong growth in productivity in the fourth quarter is expected to lead to temporarily lower cost pressures that are consistent with slightly lower inflation in the near term. In the coming period, cost pressures will rise as economic activity abroad and in Sweden continues to improve. Companies' capacity to pass on cost increases to consumers will then increase and inflation is thus expected to rise. The increased resource utilisation will contribute to inflation, measured in terms of the CPIF, thus increasing and being close to 2 per cent towards the end of 2015. The labour market has shown somewhat weaker development than forecast in the February Monetary Policy Report, but indicators point to companies having a more optimistic view of the future. The number of redundancies has continued to decline and companies' employment plans are higher than normal, according to the National Institute of Economic Research’s (NIER) Business Tendency Survey. The labour market is expected to strengthen in the coming period and wages are expected to rise faster. Unemployment is expected to fall to around 6.5 per cent at the end of the forecast horizon.

The forecast for household debt as a share of disposable income has been revised up, mainly due to the downward revision in the forecast for disposable incomes.

Given the low inflationary pressures, monetary policy needs to remain expansionary for CPIF inflation to rise to 2 per cent, according to the draft Monetary Policy Update. The repo rate is expected to remain at 0.75 per cent for around one year and after that it is expected to be raised slowly. Inflation will then have picked up and the recovery will be on firmer ground. However, there is uncertainty over how quickly inflation will rise, particularly given that outcomes have recently been lower than expected. The forecast for the repo-rate path is therefore somewhat lower, and reflects the greater probability of a repo-rate cut in the near term compared with the assessment made in February.

§2. The economic situation and monetary policy

Deputy Governor **Cecilia Skingsley** began by saying that she supported the picture of economic developments and the monetary policy described in the draft Monetary Policy Update.

Since the monetary policy meeting in February, incoming data have confirmed an economic recovery in line with the forecast the Riksbank made then. With regard to the economic cycle in Sweden, the overall data received since the start of the year have been in line with or stronger than an average of the assessments made by other forecasters.

The GDP outcome for the fourth quarter of last year was stronger than expected, but difficult to interpret. It was partly driven by factors that are probably temporary, such as defence materiel purchases and stock building. One uncertainty factor is that GDP is less strong when measured from the production side than when measured from the expenditure side, and the discrepancy in data sources this time was the highest for many years. This time, Statistics Sweden chose to lean on the data sources from the expenditure side, which Ms Skingsley felt was reasonable, given that the expenditure side tends to be more reliable in the upturn phases of the economy. She nevertheless considered it probable that the underlying force in the recovery is not quite as strong as the data imply at first glance.

Productivity growth was strong, as production rose more than the number of hours worked. This could indicate that cost pressures have been subdued and that the difficulties for the Riksbank to attain the inflation target have increased. However, Ms Skingsley felt that the volatility in this type of data means that one cannot yet draw such far-reaching conclusions.

Despite the picture of a gradual recovery in the economy still holding good, inflation remains low and has been lower than expected since the monetary policy meeting in February. CPIF inflation excluding energy, however, has developed as expected, within a tenth of a percentage point.

The forecast in the draft Monetary Policy Update means that the assessment of inflation, excluding energy prices, is largely unchanged in relation to the forecast made in February. The downward revision made to the forecast concerns a new assessment of electricity prices, a factor that can vary substantially from one month to another.

The slower rate of increase in service prices is something that had been discussed by the Executive Board earlier. Pricing in this area is difficult to assess, particularly as it encompasses everything from sticky prices such as rents to more volatile travel prices with strong seasonal patterns.

However, Ms Skingsley pointed out that survey-based information indicates that service companies' pricing plans have bottomed out and that at the start of the year they have taken an upward turn for the first time since 2011. This is what can be seen in the service companies' organisation, Almega's so-called service indicator. Although these service companies are largely active in the producer channel, they usually have an impact on consumer prices later on.

All in all, inflation is low and the greater probability of a cut indicated by the repo-rate path is necessary, according to Ms Skingsley, to mark the most likely action for monetary policy in the coming period. On the other hand, she felt that the revisions to the inflation forecast were not sufficiently large and the new indicators of cost developments were not sufficiently convincing for her to vote in favour of a cut at this meeting.

The forecast in the draft Monetary Policy Update also contains a revised forecast for household debt as a percentage of disposable income. According to the new forecast, the ratio will now rise somewhat faster than was forecast earlier. The combination of a growing debt ratio and a large banking system with a high degree of market dependency remains a risk for the Riksbank and other authorities conducting economic policy.

Ms Skingsley emphasised, as on previous occasions, the importance of working with gradual measures to avoid the risks that have arisen. Ensuring high levels of capital and a resilient supply of liquidity in the banks is an important ingredient, but she also considers that gradual measures are needed to reduce the risk that households may be forced to make undesirable balance sheet adjustments. She noted that the managing director of the Swedish Bankers' Association had commented that housing prices and household debt had increased in a way that is not sustainable in the long run. The Swedish Bankers' Association's initiative in reducing its amortisation recommendation from 75 to 70 per cent of the loan-to-value ratio is a welcome step in the right direction. Depending on the effects of this, it is possible that a further cut is desirable in the coming period, but she felt that it was as yet too early to say.

Ms Skingsley then summarised her views of monetary policy conditions. On the condition that gradual measures are taken to strengthen the resilience of both households and banks, she felt that only modest revisions were needed to the assessment of inflation for her to support increased monetary policy stimulus in the coming period.

First Deputy Governor **Kerstin af Jochnick** began by saying that she shared the assessment of developments in Sweden and abroad presented in the draft Monetary Policy Update.

She supports the proposal for the repo rate to remain at 0.75 per cent to stimulate the Swedish economy and to bring CPIF inflation back to 2 per cent.

She also supports the proposal to amend the repo-rate path. The low inflation rate also justifies some increase in the probability of a further repo-rate cut this year and of postponing the forecast point for the first increase to the second quarter of 2015.

Economic developments abroad have largely developed in line with the forecasts in the February Monetary Policy Report. All in all, the growth forecast for international GDP in the countries with the greatest significance for the Swedish economy (KIX-weighted) in the coming period remains unchanged. The assessment is based on a continued recovery, with good growth in the United States and a continued recovery in the euro area, which moves relatively slowly as a result of the adjustment needs that still remain.

The recovery abroad means that demand for Swedish goods will increase gradually and GDP growth will therefore rise in Sweden.

The assessment in the draft Monetary Policy Update is that the uncertainty over events resulting from the conflict between Russia and Ukraine will not spread to the financial markets and slow down the European recovery. However, the Riksbank must continue to analyse and assess the effects on global economic developments of, for instance, sanctions and a possible rise in energy prices.

With regard to developments in Sweden, an unexpectedly high growth in GDP was noted during the fourth quarter of last year. However, there is a considerable probability that there will be a short-term rebound, with a slowdown in GDP growth during the first quarter of 2014. After this, however, most indicators point to GDP increasing at a faster rate than normal once again, according to Ms af Jochnick.

The most recent figures for the purchasing managers' index in March are one example that a stronger level of activity is on its way. The indexes for both orders and employment strengthened.

The picture emerging is thus of an economic upturn with gradually stronger demand, rising growth and lower unemployment.

Household consumption is developing strongly, which is based on good growth in incomes and an increasingly optimistic outlook. At the same time, the housing market is strengthening, particularly in metropolitan areas. Prices of tenant-owned apartments in particular are rising at a worryingly rapid pace. The time it takes to sell housing has shortened. Mortgage lending is now increasing at an annual rate of around 5 per cent. One can expect that the lending rate will increase in 2014, as the economic conditions for households will improve.

Despite the stronger real economic development, inflation has remained low and even been lower than expected. One explanation for the low inflation is assessed to be that companies are finding it difficult to pass on their cost increases to the consumers, which we also saw last year. The outcomes for January and February entailed price increases that were lower than expected, particularly for services. Compared with the assessment in the February Monetary Policy Report, the forecast for the rate of price increase in electricity has been revised down for the coming months. Developments in inflation at the beginning of the year further reinforce the need to look into the relationship between inflation and various macroeconomic variables, what is known as the inflation propensity, and what impact the repo rate has.

Ms af Jochnick felt, as she had pointed out at earlier monetary policy meetings, that it is important that the Riksbank analyses this in greater depth, to better understand the reasons for the low inflation and why Swedish companies are still finding it difficult to pass on their cost increases in the form of higher prices. Developments so far are relatively well in line with what companies stated in the Riksbank's business survey at the beginning of the year. A majority of the companies stated that they were aiming for very small price increases during the first half of 2014, which was justified by the uncertainty over the strength of the recovery in the economy.

Ms af Jochnick's hope is that prior to the next repo-rate decision in July, the Riksbank will have a broader analysis of the development of inflation. For one thing, more data should have been received then as a basis for the assessment of the inflation forecast, and for another thing it should be clearer how companies are thinking with regard to passing on their higher costs in the form of price increases.

Ms af Jochnick felt that given the fact that growth now seems to have taken root, her assessment is that the repo rate should not be changed at the monetary policy meeting. Global developments are looking increasingly good and the Swedish economy is developing more strongly.

The forecast in the draft Monetary Policy Update is that inflation will remain low for some time to come. She thought that it was reasonable to assume that companies' possibilities to transfer their cost increases into higher prices would increase as demand gradually increases. At the same time, she felt that there were phenomena in the development of inflation that she felt were cause for concern.

The Riksbank needs to better understand developments in service prices. The internal analysis work, both with regard to service prices and the in-depth analysis of companies' behaviour regarding price increases, is of vital importance to future monetary policy discussions.

With regard to developments in household indebtedness, there is still a need for measures as the Executive Board has discussed before. Ms af Jochnick pointed out in particular the report published by the European Commission in March.[1] This was the second report about macroeconomic imbalances in Sweden. The report shows that household indebtedness remains a macroeconomic risk that monetary policy has not managed to deal with.

The European Commission notes that some measures have been taken by Swedish authorities, but that it is difficult to take things further. There is a clear risk of what is known as an "inaction bias"; many people are aware of the problems, but no one does anything until it is too late. The Commission also points to the risk that it will become more difficult to implement suitable measures the greater the imbalances are. Sweden has already reached a level where it is important not to take measures that would have such radical and immediate effects that macroeconomic developments would be affected too negatively.

The measures should be announced clearly and implemented in stages and over a longer period of time. This includes measures to limit the build-up of debt in the household sector, to reduce tax deductions for interest paid, to review property tax, rent regulation and the regulatory framework curbing residential construction.

[1] Macroeconomic imbalances Sweden 2014, Occasional papers 186, March 2014, European Commission.

As Ms af Jochnick has mentioned earlier, it is still important that the Riksbank, the government, Finansinspektionen (the Swedish Financial Supervisory Authority) and that the banks take a broad perspective with regard to measures to limit the risks linked to high household indebtedness. Some measures have been taken, but her assessment is that they are not sufficient.

In addition to higher risk weights on mortgages, a better balance is required between supply and demand for housing. It is a question of better efficiency on the housing market and of creating sound incentives with regard to taxes and credit terms, as the European Commission has pointed out.

A clear roadmap for managing household indebtedness would be desirable. It would also create better conditions for the Riksbank to conduct a monetary policy with a clearer focus on price stability and normal resource utilisation.

Deputy Governor **Karolina Ekholm** began by saying that she shared the picture of economic prospects presented in the draft Monetary Policy Update, which have not changed very much since the February Monetary Policy Report, despite the fact that some of the data received since then was unexpected.

Inflation has been even lower than was forecast in February, but this is primarily as a result of lower energy prices and does not necessarily lead to a revised view of underlying inflationary pressures. However, it is a little worrying that inflation in service prices continues to be lower than expected, said Ms Ekholm. This was counteracted by goods price inflation being slightly higher than expected, but as the domestic cost component can be expected to be greater in service prices, the low service prices may indicate lower cost pressures than were forecast in February.

The GDP figure for the final quarter of last year was much higher than expected, which is positive and indicates that the recovery expected in February has started. At the same time, developments on the labour market have been weaker than expected, with a lower figure for the number of hours worked than was forecast in February, and also higher unemployment. The relatively large upturn in GDP does not appear to have been linked to greater resource utilisation and thus to increased inflationary pressures. Al in all, the information we have received since the monetary policy meeting in February indicates lower cost pressures than we were expecting.

So even if economic prospects have not changed very much, there may nevertheless be reason to revise the monetary policy assessment, according to Ms Ekholm. If cost pressures are lower than the forecast in February, more monetary policy stimulus may be needed to bring up inflation to 2 per cent within a reasonable period of time.

The very recent weakening of the exchange rate is a factor that in itself helps inflation rise towards the target. But this weakening, which mainly took place in connection with the

NIER's Economic Tendency Survey for March being lower than in February, is probably connected to expectations of a more expansionary monetary policy. The exchange rate could very well strengthen again if expectations shift towards a tighter monetary policy. Moreover, inflation has fallen in the euro area, so some weakening of the krona against the euro merely counteracts the downward pressure on inflation coming from lower inflation in the euro area.

All in all, Ms Ekholm therefore felt that the argument in favour of a repo-rate cut had strengthened since the monetary policy meeting in February. She said that one factor against a repo-rate cut in February was that a clear economic recovery was expected and that it would be bad timing to cut the repo rate in an economic upturn. This argument is even more valid now, as the strong GDP growth at the end of last year indicates that we really are in an upturn phase. But this must be viewed against the increased risk of low inflation becoming entrenched and finding ourselves in a situation where negative shocks lead to actual deflation. For Ms Ekholm, the latter weighs heavier and she therefore feels that there is now justification for cutting the repo rate to 0.5 per cent.

It is also worth noting that the forecast for inflation in the draft Monetary Policy Update is higher than those of other forecasters a year or so ahead. For example, in the NIER's forecast, CPIF inflation is just over 1.5 per cent in 2016, despite their assumption of a lower repo rate than shown in the proposed repo-rate path. The forecast in the draft Monetary Policy Update is close to 2 per cent. The inflation forecast in the draft Monetary Policy Update thus appears more optimistic than those of other forecasters. The proposed repo-rate path is scarcely compatible with a view of inflation that is more in line with those of other forecasters. With a view that is more in line with those of other forecasters, the repo-rate path becomes too high and monetary policy too tight for inflation to be able to reach 2 per cent during the forecast horizon.

Ms Ekholm felt that such a repo-rate path did not appear very robust. It would not survive any shocks on the downside, at the same time as upside shocks would probably only make the repo-rate path more reasonable. If there were shocks on the downside, the repo-rate path would almost unavoidably need to be revised in a more expansionary direction, as it would otherwise probably not be consistent with inflation rising to 2 per cent during the forecast horizon. If there were shocks on the upside, so that inflation appeared to rise more quickly than in the current forecast, there is on the other hand no clear reason for revising the repo-rate path. From this point of view, the repo-rate path does not appear to be unbiased. Ms Ekholm felt that one should make a principle of avoiding forecasts of repo-rate paths that could not survive any shocks in a particular direction, either up or down. Such repo-rate paths invite speculation that they will need to be revised further ahead.

The interpretation that she believes will be made with a repo-rate path like the one proposed in the draft Monetary Policy Update is that 0.75 per cent is a new floor for the repo rate. It may then affect market rates and the exchange rate so that it becomes increasingly difficult not to break through this floor. As a monetary policy strategy, Ms Ekholm feels it would be better to forecast a repo-rate path that can manage a number of shocks in both directions. Putting in greater and greater probabilities that the repo rate will be cut in the future only contributes to the impression that the current interest rate is a floor for the policy-makers, she said. If one believes that it is highly probable that an even lower repo rate will be needed than we have now, it would be just as well to cut it now. Waiting until July only means that the repo-rate cut will come further into the economic recovery and thus with even worse timing than if the cut were made now.

Ms Ekholm therefore advocated cutting the repo rate to 0.5 per cent. She advocated a repo-rate path that follows roughly the same sequence as that proposed in the draft Monetary Policy Update, that is, where the first increase occurs some way into 2015, and where the repo rate is then gradually raised. However, she did not consider it realistic to expect a repo rate of 2.7 per cent at the beginning of 2017, when policy rates abroad were expected to be much lower. She assesses it to be more realistic to have a path that ends around half a percentage point lower, that is, somewhere around 2.2 per cent. This would mean that the positive interest rate differential with regard to the rest of the world that we have now, would not increase quite as much as it is expected to do in the draft Monetary Policy Update.

Deputy Governor **Per Jansson** began by observing that inflation continues to be low. In February, CPIF inflation was 0.4 per cent. Since the February Monetary Policy Report, two new inflation outcomes have been published, both of which were lower than the forecasts in the Report. Following a relatively large forecasting error for January, of almost 0.3 percentage points, the error for February was halved and amounted to just over 0.1 percentage points. The forecasting error was primarily related to developments in energy prices, which is illustrated by the fact that inflation excluding energy prices was largely as expected. The assessment in the draft Monetary Policy Update is that inflation will be somewhat more subdued, mainly in the short run, than was assumed in the February Monetary Policy Report. In the slightly longer run, the forecast has been revised down marginally, and the adjustments in this time perspective mainly concern a new assumption for developments in energy prices.

For Mr Jansson, the decision on this occasion was to a large degree about whether the revisions to the inflation forecast were sufficient to justify an immediate cut in the repo rate. After much consideration, he had decided that they were not. He thus supported both the macro forecast and the monetary policy presented in the draft Monetary Policy Update.

The most important reason for his stance with regard to the repo-rate decision is that the changes in the inflation assessment are minor and mainly refer to developments in the near term. The forecast adjustments slightly further ahead concern the fact that energy price developments, which are in general very volatile and difficult to assess, now look to be more subdued. Mr Jansson observed that the view of the more underlying inflationary pressure has thus not changed.

He went on to say that nor was it possible to turn a blind eye to the fact that the Swedish economy has now picked up substantially. GDP growth for the fourth quarter, which amounted to more than 7 per cent when calculated as an annual rate and was thus one of the fastest in the entire EU, shows a broad upturn in demand, even when certain factors of a more temporary nature are excluded. In addition, developments in the housing market and in household debt continue to give cause for concern. There is a risk that the increasingly strong development in prices will once again cause credit provision to run away, especially as households' expectations of housing prices in the coming period are clearly optimistic. This has also contributed to the Riksbank now revising up to some extent its forecast for the debt ratio of households in coming years.

In a normal situation, Mr Jansson said, the changes that have taken place since the previous monetary policy meeting would probably not have led to a need to seriously discuss cutting the repo rate. But he went on to emphasise that the current situation was not normal. Inflation has been well below 2 per cent for a fairly long time and the deviation from target has worsened rather than improved since the autumn. This starting point means that even minor adjustments to the inflation assessment in the near term create a need to consider repo rate cuts. He himself felt that this meeting was the closest he had come to a repo-rate cut without actually voting for one. Another way of expressing it, Mr Jansson said, is that his own tolerance for further downward revisions of inflation prospects in the near term has now reached its lower bound. This view is also expressed in the repo-rate path in the draft Monetary Policy Update, which now contains a significant probability of a repo-rate cut in the short term.

With regard to the time when it might be appropriate to begin cautiously raising the repo rate, Mr Jansson stood by his earlier view that he would not vote for a repo-rate increase until CPIF inflation picks up and rises above 1.5 per cent. He also reaffirmed his earlier comment that he would consider voting to hold the repo rate unchanged at today's low level even if CPIF inflation was well over 1.5 per cent, on condition that further progress was made in managing the risks associated with household debt. He hoped that this forward guidance would clarify his firm ambition to return inflation to the target.

As Mr Jansson has pointed out on several occasions, and as is also emphasised in the draft Monetary Policy Update, greater responsibility is now being put on other policy areas with regard to managing the risks associated with the high and rising indebtedness of households. One factor that has to be taken into account here is that the Riksbank's need to prioritise short-term stimulus to an increasing extent will in itself lead to larger household indebtedness. And it is important to pay particular attention to how the currently very low interest rates affect the interest-rate expectations of households in the longer run.[2]

But it is not only changes in monetary policy that lead to a greater need for measures in other policy areas. As he mentioned earlier, the economic situation was now clearly improving and housing prices were increasing at a faster pace. Such changes usually lead to an acceleration in credit granting. It is a question of implementing measures before this happens, so one does not lag behind. Given this, it is extremely important that the new Financial Stability Council and Finansinspektionen clarify as soon as possible what further measures can be taken to dampen the risks associated with household debt. This clarification should of course include measures for 2014, but the perspective should cover several years and also entail a longer-term plan.

With regard to the specific measures that should be implemented, there are several possible combinations. Mr Jansson emphasised that he himself had chosen to keep a fairly low profile with regard to expressing views on this. However, two aspects deserve emphasis. Firstly, as he sees it, only implementing measures that tighten capital requirements for the banks is not sufficient. While such measures are generally welcome, as they contribute to increasing the resilience of the financial system, they probably have too little and too indirect an effect with regard to dampening the risks associated with household debt. Achieving this instead requires measures that are more directly aimed at influencing the supply of, or demand for, credit.

Secondly, Mr Jansson felt that it is fully possible, as many who are active in the debate have claimed, that it is primarily measures in the field of taxation and construction that are most important here. But if such measures cannot be implemented, for various reasons – perhaps because they are perceived as too politically expensive or because they require structural changes that take a long time to implement – then the conclusion should not be that nothing else should be done. Sometimes one must simply accept that it is not possible to do the best thing, and one must instead content oneself with something that is not quite as good.

The important thing for Sweden now is to show an ability to take decisions so that debt ratio of households does not continue a rising and uncontrolled trend. If one cannot manage this, it is really only a question of time before a negative shock triggers a need for households to reduce their debt. And the higher the debt ratio has become, the less the shock triggering the negative adjustment needs to be and the greater the necessary debt consolidation threatens to be. The significance of such a sequence of events is unfortunately all too clear in several countries in connection with the financial crisis, namely macroeconomic instability in the form of a very deep and prolonged recession.

[2] See the article "The effects of monetary policy on household debt", Monetary Policy Report February 2014, for a discussion of how changes in the repo rate can affect household debt.

Governor **Stefan Ingves** began by saying that he shared the view of developments abroad and the Swedish economy described in the draft Monetary Policy Update. He also supported the proposal to hold the repo rate unchanged, and the repo-rate path that forms the basis for the forecast. He said that there have been no dramatic changes since the Monetary Policy Report was published in February.

Mr Ingves went on to say that the international economic recovery is continuing more or less as expected. The assessment in the draft Monetary Policy Update is that GDP in Sweden's largest trading partners (KIX) will grow by 2.3 per cent this year, 2.7 per cent in 2015 and 2.8 per cent in 2016. There is some uncertainty with regard to the events in Ukraine, but so far this has had very limited economic contagion effects and Mr Ingves assessment was that it will not undermine the economic recovery. However, the picture is not entirely clear-cut. If, on the one hand, the economies in Europe and in the United States grow at an even rate, the direction is clear. If, on the other hand, they are out of step, for example because quantitative easing and interest rates move in different directions, then it will become more difficult to formulate Swedish monetary policy. This will probably affect both interest rates and the exchange rate.

In Sweden, a broad upturn in demand contributed to an unexpectedly high increase in GDP in the fourth quarter of 2013. Export prospects have improved, as testified by the figures for export orders. The prospects for household consumption are also bright, and investment is expected to recover after the weak growth of last year. Although the forecast for unemployment has been revised upwards, the figures on vacancies and redundancy notices indicate that economic activity will strengthen. Mr Ingves said that, all things considered, he expected to see relatively strong GDP growth in Sweden over the next three years.

He pointed out that although economic activity has strengthened, inflation has been somewhat lower than expected. The Riksbank has previously revised down its forecast for inflation and assessed that it will take longer for inflation to rise. The downward revision is now more limited. At the monetary policy meeting in February, it was noted that the Riksbank needs to conduct an in-depth study of inflation, particularly with regard to services prices, which are a large component of the CPI. This task may be facilitated when more information becomes available in the form of outcome data.

The expansionary monetary policy and the strengthening of economic activity indicate that inflation measured in terms of the CPIF will begin to rise towards the end of 2014 and be close to two per cent during the latter part of 2015. Gradually rising inflation abroad should also affect the development of prices in Sweden and cost increases have been higher than increases in consumer prices for some time, which indicates that prices should begin to rise. Mr Ingves noted that if this scenario fails to materialise the Riksbank will have to address a new and rather different situation when the picture has cleared in the period ahead. He said that the improvement in economic activity and the bright prospects for households and companies are among the factors that should now cause the Riksbank to adopt a "wait-and-see" approach.

Mr Ingves pointed out the monetary policy is highly expansionary at present. The household debt ratio is high and households should not be encouraged to further increase their borrowing. We are seeing a moderate increase in the banks' lending to companies, but a more substantial increase in the companies' borrowing on the bond markets. The companies' are not restricted by their access to funding. A comparison with the euro area in terms of the increase in lending or the interest rates offered to end customers reveals that financial conditions in Sweden are not at all restrained. There do not appear to be any restrictions on the supply of credit, according to Mr Ingves.

Given this, he said that he saw no strong reasons for cutting the repo rate at the monetary policy meeting. The Riksbank assumes that the current level of the repo rate will be retained somewhat longer than assessed previously. According to Mr Ingves, this underlines the fact that the Riksbank need to "wait and see". He said that it is of course difficult to assess exactly in which quarter of 2015 the Riksbank may begin to raise the repo rate. He added that he could also consider other repo-rate paths than the proposed path, but that the proposed path is good enough and can be revised as the situation develops.

Finally, he noted that a contributing factor in this context is that the Riksbank does not yet have a complete picture of the measures being taken in other policy areas to manage the risks associated with household indebtedness. The European Commission has pointed out in a new report on the Swedish economy that indebtedness in the private sector, particularly household indebtedness, continues to constitute a macroeconomic risk. The Commission notes that some steps have been taken, but that it is important to proceed and gradually implement reforms that restrain the build-up of debt.

Deputy Governor **Martin Flodén** began by saying that he supported the picture of economic developments in Sweden and abroad presented in the draft Monetary Policy Update. However, he said that the repo rate should now be lowered by 25 basis points to 0.50 per cent and then remain at this level for approximately one year before being raised towards the repo-rate path proposed in the draft Monetary Policy Update.

The economic outcomes and indicators observed since the monetary policy meeting in February have given mixed signals. The development of the labour market has been somewhat weaker than expected, but GDP increased unexpectedly rapidly at the end of last year, and there are still good reasons to hope that economic activity will pick up speed during the course of the year. There are, however, still signs that inflation is and will remain low.

When the Executive Board last lowered the repo rate, at the monetary policy meeting in December, Mr Flodén said that not much more negative information about the future development of inflation would be required for him to advocate a further cut of the repo rate. Since the meeting in December, the CPIF forecast for 2014 has been revised downwards by almost 0.3 percentage points and for 2015 by over 0.1 percentage points. In light of the lower inflation forecasts, Mr Flodén argued that monetary policy should react by cutting the repo rate.

He also said that the figures for inflation and GDP in recent months have been divergent and difficult to interpret, but that, in his opinion, waiting for new information was not the right strategy for dealing with such uncertainty, at least not in the present situation. Inflation has been well below the inflation target of two per cent over the last three years. In order to retain the credibility of monetary policy and the inflation target, the Riksbank must make sure that inflation now rises quickly enough to two per cent, even if outcomes do not turn out entirely in line with forecasts. Mr Flodén reminded the meeting that it is three months to the next ordinary monetary policy meeting and said that during that period of time he would rather see the Riksbank err on the side of excess rather than on the side of caution when conducting monetary policy.

He continued by saying that one could perhaps argue that the recent downward revision of the inflation forecast is less problematic because it is mainly explained by a downward adjustment of the forecast for energy prices. The Riksbank's current forecast for CPIF inflation adjusted for energy prices in 2014 is almost unchanged compared to the forecast in December, and has been revised downwards only marginally for 2015.

However, Mr Flodén said that he could see several objections to this line of thinking. First, energy prices are among the consumer prices covered by the Riksbank's inflation target and, furthermore, energy prices ultimately have an impact on other consumer prices. As energy prices are volatile and difficult to forecast, it is reasonable to say that less importance should be attached to the forecasts of these prices in the monetary policy decisions. However, monetary policy cannot completely ignore changes in the medium- and long-term forecasts of the development of energy prices.

Second, and more important, how economic developments in recent months have affected the assessment of underlying inflationary pressures depends to a large extent on difficult judgemental decisions. Mr Flodén said that this primarily related to the interpretation of the very strong figures for GDP and productivity growth in the fourth quarter of 2013, but also to the surprisingly low level of inflation for services prices, which has been partly counteracted by the surprisingly high level of inflation for goods prices.

The Riksbank's interpretation is that the GDP outcome is largely the result of a temporary increase in productivity growth. However, the draft Monetary Policy Update mentions that underlying inflation is expected to be lower than forecast in the period ahead if we have now witnessed the beginning of a prolonged period of more rapid productivity growth, roughly as described in one of the alternative scenarios in the February Monetary Policy

Report. In this alternative scenario, the higher level of GDP and productivity growth would result in a more expansionary monetary policy with lower repo rates.

Like Ms Ekholm, Mr Flodén noted that the medium-term inflation forecast is now higher than that of other forecasters. This applies in particular to the forecast of CPIF inflation excluding energy. The Riksbank's forecast for 2015 is 1.9 per cent, while the forecast of the NIER is 1.4 per cent. He also noted that the NIER has interpreted the new information received in recent months differently to the Riksbank. The NIER's forecast for the CPIF excluding energy has been revised downwards by approximately 0.2 percentage points for both 2014 and 2015 compared with the forecast they presented in December.

Mr Flodén's overall assessment of these interpretations was that the inflation forecasts have greater risks on the downside than on the upside. He considered this as another reason for cutting the repo rate at the meeting.

Mr Flodén concluded by commenting on the repo-rate path in the longer term. He advocated a repo-rate path that is 25 basis points below the path in the draft Monetary Policy Update for four quarters and then gradually returns to the repo-rate path in the draft Update. He noted that this meant that the repo-rate path he advocates for a year or two from now is well above market expectations. He saw this as a reasonable forecast for the future development of interest rates, but such long-term forecasts are of course associated with great uncertainty. Finally, Mr Flodén said that there are also arguments in favour of the repo-rate path that Ms Ekholm advocated for the longer term. Decisive factors for the long-term development of the repo rate will be how high a normal real interest rate is and how quickly the Swedish economy and the economies of other countries move towards normal levels for the real interest rate. If the propensity to save remains high abroad and the willingness to invest remains low even after resource utilisation has risen to more normal levels in the developed economies, it will probably not be necessary to raise the repo rate as quickly as indicated by the repo-rate path in the draft Monetary Policy Update.

§3. Discussion

Deputy Governor **Per Jansson** began the discussion by commenting on two aspects taken up by Ms Ekholm and Mr Flodén. The first was Ms Ekholm's statement that the current level of the repo rate can be perceived as a floor. Mr Jansson noted that several members of the Executive Board have made it very clear that 0.75 per cent is not a floor and have explicitly emphasised that very little is now required for the balance to turn in favour of a new repo-rate cut. With this in mind, he said that he could not understand why anyone would perceive the current level of the repo rate as a floor and that it was particularly strange that this issue had been raised here and now given the comments made earlier. The risk with this, he said, was that it could contribute to making monetary-policy signalling unnecessarily tight.

The second issue was how one should view the circumstance that the Riksbank's forecasts for CPIF inflation are slightly above the assessments made by other forecasters, an issue that both Ms Ekholm and Mr Flodén had taken up. Mr Jansson emphasised that although this appears to be the case in general, it was unclear to him what conclusions should be drawn from this. He stated that the Riksbank does not on average produce poorer forecasts of CPIF inflation than other forecasters and it is thus not necessarily the case that other forecasts provide a better guide than the Riksbank's own forecasts.[3] He also pointed out that analyses of the relation between inflation on the one hand and import prices and unit labour costs on the other have shown that inflation has been unexpectedly low for some time now.[4] It is therefore not unreasonable to believe that companies have accumulated a relatively substantial need to increase their prices in the period ahead, which may indicate a rather rapid upturn in inflation over the next few years. All-in-all, Mr Jansson did not consider that the argument that other forecasters make lower inflation forecasts than the Riksbank is a particularly strong reason for a further downward revision of the inflation assessment.

Deputy Governor **Karolina Ekholm** began by responding to Mr Jansson's comments. With regard to her view that there is a risk that 0.75 per cent may be perceived as a floor for the repo rate she said that when the minutes are published everyone will be able to read about the stance adopted by the different members of the Executive Board on a possible repo-rate cut in the period ahead. The proposed repo-rate path nevertheless signals something of an unwillingness to lower the repo rate which may affect the views of external stakeholders. She said that in order to retain confidence in the inflation target it is important to demonstrate in action that the inflation target is the focus of monetary policy decisions.

Turning to the fact that the Riksbank's inflation forecast is higher than that of other forecasters, Ms Ekholm said that her starting point was that the monetary-policy assessment should be relatively robust in relation to different assumptions about underlying inflationary pressures. The Riksbank's inflation forecast is partly based on the assumption that the high rate of productivity growth during the fourth quarter of last year will have only a temporary negative effect on cost pressures. An alternative assumption is that higher productivity growth leads to a more persistent downward pressure on cost pressures. Other forecasters have made different assessments regarding uncertain preconditions of this type. Ms Ekholm said that an important element of her own assessment of what is an appropriate repo-rate path was that it should provide a

[3] See for example chapter 4 and the appendix of Account of monetary policy 2013.

[4] See the article "Perspectives on the low rate of inflation" in Monetary Policy Report, February 2014.

relatively well-balanced monetary policy under different assumptions about uncertain preconditions. Given the assessment of underlying inflationary pressures presented in the draft Monetary Policy Update, her repo-rate path would entail a forecast for CPIF inflation that overshoots 2 per cent by approximately half a percentage point. With an assessment of underlying inflationary pressures closer to that of other forecasters, for example the NIER, the forecast would probably end up fairly close to 2 per cent. Ms Ekholm said that her repo-rate path is more robust than a path that with other forecasters assessments of underlying inflationary pressures is not compatible with CPIF inflation reaching 2 per cent any time during the forecast horizon.

Ms Ekholm went on to comment on household indebtedness as several Executive Board members had spoken at length about how they see the risk associated with indebtedness and the need for measures to manage these risks. She said that like many others she thinks that it is important for the Riksbank to present its views on the measures needed to manage these risks within the framework of the Financial Stability Council. Like Mr Jansson, however, she believed that measures such as increased capital requirements for banks have a limited effect when it comes to dampening the risks associated with household debts. On the other hand, she believed that the argument that the effect can be expected to be too limited and indirect is a little strange given that the repo rate, which as far as can be judged also has a limited and indirect effect, is apparently seen as an appropriate instrument for this purpose. As Mr Jansson suggested earlier, the really potent measures probably lie in other policy areas, not least in the field of tax policy. Ms Ekholm's view was that it is unrealistic to believe that any proposals for measures in this area will be presented before the general election in the autumn, as it is unlikely that any political party will want to discuss interest deductions and property taxes during the election campaign. On the other hand, she said that it may be a good time to advocate a review of taxation in the housing area after the election. Such a review should preferably be conducted on the basis of broad political representation, so that the issue of potential reforms of taxation in the housing area does not get caught up in party politics.

In response to the discussion above, First Deputy Governor **Kerstin af Jochnick** wished to underline what Mr Jansson also said about the Riksbank's self-evident focus on attaining the inflation target of two per cent. She pointed out that she, too, had not in any way suggested that the current repo-rate level of 0.75 per cent was some kind of floor. On the contrary, the repo rate path in the draft Monetary Policy Update indicates an increased probability of a repo-rate cut in the near term, compared to the Monetary Policy Report in February.

Like several other board members, Ms af Jochnick then commented on the need for measures to reduce the risks associated with household indebtedness and said that the focus should not be on individual measures but on a broader palette of measures to achieve a healthier development of the household debt ratio.

Her assessment is that in recent years the Riksbank has helped to create a greater awareness on the part of banks, households and the media of the risks relating to high household indebtedness. As Ms Skingsley mentioned earlier, the Swedish Bankers' Association's recently-adopted recommendation that amortisation should be required for mortgages amounting to more than 70 per cent of the value of the property is a further example of a healthier attitude to indebtedness. However, the Association's amended recommendation only applies to new loans, which means that it will take a long time before we see any significant effects on the household debt ratio. It is positive that an increasing number of observers share the analysis of the risks associated with household debt. Ms af Jochnick considered that a joint plan for how to reduce the level of risk without having too negative effects on the economy was now needed.

Deputy Governor **Martin Flodén** began by responding to Mr Jansson's comment that the inflation forecast in the draft Monetary Policy Update was higher than that of other analysts. To start with, Mr Flodén wished to point out that he did not believe that the other assessments are better than the Riksbank's, as he supports the inflation forecast in the draft Monetary Policy Update. However, he saw two reasons to be concerned about the fact that the Riksbank's inflation forecast is higher than that of others.

The first reason is that inflation has been well below the target over the last three years, and the Riksbank has been surprised several times recently to see that inflation has been lower than the forecast. In this situation it is more problematic if the Riksbank continues to be surprised by too low inflation than vice versa. The combination of an inflation forecast that is optimistic in relation to that of other analysts and a repo-rate path that, if anything, entails a more restrictive monetary policy than expected by other analysts then seems problematic. Mr Flodén suggested that the Riksbank handles these problems by conducting a more expansionary monetary policy, that is, by lowering the repo rate at the meeting.

The second reason was linked to the credibility of monetary policy. Mr Flodén stated that the Riksbank often discusses the importance of long-term inflation expectations. It is important for the credibility of the inflation target that the long-term inflation expectations remain anchored around two per cent. However, expectations in the shorter term are probably more important for firms’ wage and price decisions. Inflation expectations one year ahead are now around one per cent in various surveys of firms, households and financial-market participants. In an environment with low resource utilisation, low inflation and low expectations regarding the development of other firms’ prices and wages in the year ahead, it is perhaps not surprising that firms are not raising their prices. Short and medium-term inflation expectations may thus have a significant impact on the development of inflation, according to Mr Flodén. If inflation is to rise towards the inflation target it is desirable that these inflation expectations rise, or at least stop falling.

He went on to say that as it appears that short-term inflation expectations are highly coloured by the recent actual inflation rates, monetary policy can affect expectations by keeping inflation up. For example, monetary policy's temporary effects on the development of inflation through the exchange rate are strengthened when inflation expectations rise. However, monetary policy can probably affect expectations even more directly, partly by clearly communicating that the inflation target has the highest priority and partly by the Riksbank demonstrating by the action it takes that it means what it says. Mr Flodén said that how effective such direct mechanisms are probably depends to some extent on how reasonable the Riksbank's combination of inflation forecast and proposed monetary policy appears to be in relation to forecasts and assessments made by other analysts.

Governor **Stefan Ingves** began by saying that in the draft Monetary Policy Update it is assumed that inflation will rise when economic activity strengthens. The assessment in the draft Update is that companies will then pass on their cost increases to the consumers to a greater extent.

Mr Ingves also said that developments indicate that there are several uncertain factors that can affect the monetary policy puzzle in the period ahead, and he discussed some of the problems associated with this. He began by asking how economic activity is developing abroad and how the monetary policies of the major central banks are affecting financial conditions in Sweden. He said that the exchange rate is an important variable in this context as it affects inflation through total demand and directly through import prices. On the one hand, a weaker exchange rate would perhaps increase inflation, but on the other hand the current account surplus rather points in the opposite direction, that is towards a stronger exchange rate. Given that the situation is difficult to assess, Mr Ingves believed that the exchange-rate forecast in the draft Monetary Policy Update is well balanced.

He said that another central issue is whether globalisation and the pressure for change have increased again after the crisis and whether this is affecting the possibility of the Swedish companies' to increase their prices.

A third, related issue that Mr Ingves took up is whether GDP growth in the period ahead may be driven by stronger or weaker productivity growth than expected by the Riksbank. If so, cost pressures may be higher or lower than expected when economic activity strengthens.

Some of these issues have come up previously in periods with floating exchange rates and inflation targets. Mr Ingves said that experience has taught us that the links between macroeconomic variables and inflation are not always stable over time. They can be affected by changes on both the supply side and the demand side of the economy, which in turn affects the conclusions that should be drawn for monetary policy.

He pointed out that it is important to bear this in mind when the Riksbank conducts and in-depth study of inflation and the relation between inflation and various macroeconomic variables in the period ahead.

In conclusion, Mr Ingves returned to the issue of how well the monetary policy framework can manage a situation with low inflation and growing financial imbalances when the monetary policy trade-off between inflation and household debt becomes more acute. He believed that it was not possible to fully deal with both problems at the same time by making minor adjustments to the repo rate. Essentially, two different interest rates would be needed: a higher rate for households and a lower rate for companies, particularly in a situation where there is an upward trend in lending to households. However, this is of course not possible. It is therefore extremely important to take strong action to manage household indebtedness by other means, in addition to monetary policy. The Riksbank estimates that consumption will increase by 2.5 to 3 per cent in the years ahead. Mr Ingves said that it is reasonable that part of this scope for consumption should be claimed by macroprudential policy measures. Otherwise, the same measures may become necessary at a later stage when the economy is weaker or when interest rates are at an entirely different level than the low level of today. He said that it is high time to give concrete form to the measures that need to be taken in other policy areas in 2014 and thereafter to counteract the development of financial imbalances.

Deputy Governor **Cecilia Skingsley** responded to Ms Ekholm's statement that the proposed repo-rate path could be perceived as a floor and that it signals an unwillingness to lower the repo rate on the part of the majority of the members of the Executive Board. Ms Skingsley considered this to be the type of argumentation that could give the outside world the impression of an undesirable uncertainty, and said that this had happened before. These include claims that have questioned the willingness of others to attain the inflation target, claims that the inflation target has deliberately been set aside and claims that the mission of the Riksbank has been misunderstood.

Ms Skingsley emphasised that as far as she was concerned there is no floor in monetary policy and that she supports the policy that in her assessment leads to the attainment of the inflation target within a reasonable period of time.

With regard to the issue of indebtedness and measures in different policy areas, Ms Skingsley believed that there was broad agreement that central banks have a responsibility for financial stability in an economy. It is rather the case that the controversy surrounding central banks and indebtedness relates to whether the course of development and the level of debt are sustainable, and to whether this is an issue for monetary policy or not.

It is sometimes claimed that monetary policy can be used to steer growth, unemployment and inflation in a significant and detailed way, but that it has no affect on the development of debt. This is not a claim that is clearly verified in empirical research on the effects of monetary policy. It is possible that the claim is based on the Riksbank's own analysis in the Monetary Policy Report published in February, where the question of the effects of monetary policy on indebtedness is discussed in an article. Ms Skingsley said that what has been overlooked is that this analysis is associated with several uncertainties: The impact on debts is based on interest-rate changes being temporary, and that they only reflect average relations, and so on.

Ms Skingsley went on to say that while one may have objections to using monetary policy as an instrument to limit the risks associated with indebtedness, one should then also present one's own risk analysis and the alternative measures that should be implemented. She did not believe it was enough to make general references to macroprudential policy measures.

She added, in conclusion, that there is also an international dimension to macroprudential policy measures. There are strong ambitions at the EU level to maintain a single market and to avoid distinct national solutions, and individual countries may therefore be deterred from implementing national measures. There will thus be international restrictions on what Sweden can do to secure the situation with financial imbalances.

Deputy Governor **Karolina Ekholm** then responded to Ms Skingsley's comments. She said that to begin with she did not believe she had attributed any particular points of view to other members of the Executive Board. What she said was that she believes the proposed repo-rate path will be interpreted in such a way that 0.75 per cent is seen as a new floor for the repo rate. She said that this was a statement of how she believes external stakeholders will react to the proposed monetary policy decision, not a statement of what she believes the stances of the different board members to be.

She also said that she found it difficult to understand Ms Skingsley's argument that it is important that those members who do not want to use the repo rate to manage the risks associated with household indebtedness clarify what measures they think should be used instead to manage these risks.

Ms Ekholm said that she had been clear about her assessment that the effects of marginal changes to the repo rate on the household debt ratio were so limited that they do not affect the risks associated with household indebtedness in any significant way. She emphasised that her view of the repo rate's effect on inflation and the development of the real economy is the one that the Riksbank's forecast is based on, and no other. Thus, her view is that marginal changes to the repo rate affect inflation and the development of the real economy, but have negligible effects on the risks associated with household debt.

Ms Ekholm went on to say that, as she understood it, Ms Skingsley does not believe in the estimate of the repo rate's effect on the debt ratio presented in the Monetary Policy Report in February but believes instead that the effect is greater. Ms Ekholm said that it seemed important to her that those who do not believe in the estimate presented by the Riksbank should clarify just how great an effect on indebtedness they believe the repo rate actually does have, and thus how they view the trade-off between poorer target attainment during the forecast period and the potential risk of a deep recession further ahead. To her, this seemed to be at least as important as those who believe that the repo rate's effect on the debt ratio is in fact in line with the estimate presented clarifying what measures other than monetary policy they believe should be used to manage the risks relating to household indebtedness.

Ms Ekholm concluded by commenting on Mr Ingves remarks on the exchange rate and the current account and said that in this context it may be important to distinguish between the nominal and the real exchange rate, even though changes in the real exchange rate largely follow the nominal rate in the short term. She said that it is the real exchange rate that is important to the current account. She did not believe that a weakened nominal exchange rate would necessarily lead to an even greater surplus in the current account. In the prevailing situation, a weaker exchange rate can create scope for price increases, which in turn create scope for wage increases and for a greater propensity to invest. Higher investment increases domestic absorption and reduces the savings surplus – the difference between domestic financial saving and domestic investment – which is reflected in the present current account surplus. With higher wage and price increases, such a course of development can go hand in hand with a strengthened real exchange rate in the long term. A weaker nominal exchange rate in the short term could thus be compatible with a stronger real exchange rate and a smaller current account surplus in the longer term.

Deputy Governor **Martin Flodén** then responded to Ms Skingsley's comments. He referred to the fact that Ms Skingsley had mentioned the article on the effects of the repo rate on household indebtedness in the Monetary Policy Report published in February. Ms Skingsley said, among other things, that the article can be criticised because it is based on the assumption that the repo rate is only lowered temporarily – for four quarters – before returning to the path in the main scenario. Mr Flodén made it clear that he did not advocate a repo-repo-rate path that deviates from the main scenario permanently, or even for a long period of time. He actually meant that there may be good reasons to be concerned about the possibility that a low repo rate for a prolonged period of time can lead the households to have too optimistic expectations of the future level of interest rates. He said that one of the conclusions of such a concern may well be that monetary policy should be made even more expansionary in the near term. All else being equal, a lower repo rate today will entail inflation moving towards the target and resource utilisation becoming balanced more quickly, and this will also make it possible to raise the repo rate from today's abnormally low levels more quickly. He pointed out that he has presented these arguments at several previous monetary policy meetings and in a speech he made in the autumn.

Mr Flodén returned to Ms Skingsley's claim that those who do not see the repo rate as a useful instrument for limiting the risks associated with household indebtedness must specify what other macroprudential policy measures should now be introduced. He said that he did not believe that the monetary policy meeting was the right forum for making specific recommendations on how various macroprudential policy instruments should be used. He has expressed his views on these issues on previous occasions, mainly in connection with several of his speeches. In conclusion, Mr Flodén pointed that the Riksbank will publish its Financial Stability Report later this spring and it will be more natural to present further recommendations and views on macroprudential policy at that time.

Governor **Stefan Ingves** then summarised the discussion. It was noted at the meeting that the Executive Board largely agreed on the picture of economic prospects and the inflation outlook described in the draft Monetary Policy Update.

Economic developments abroad continue to improve, well in line with the Riksbank's earlier assessments. In Sweden, GDP growth was higher than expected in the fourth quarter of last year. This was partly due to temporary factors, but the broad upturn in demand implies that an economic upturn has begun. The prospects for the Swedish economy remain bright and a clear improvement in the labour market is expected during the second half of this year.

Economic activity is strengthening and household indebtedness as a share of disposable income is expected to increase more than was previously forecast. Inflation has been somewhat lower than expected, but only a minor revision has been made to the inflation forecast. CPIF inflation is expected to rise towards the end of the year and to be close to 2 per cent during the latter part of 2015.

Given that economic activity has strengthened and that the revisions to the inflation forecast are minor, a majority of four Board members considered it appropriate to hold the repo rate unchanged at the current low level of 0.75 per cent. They also assessed that it is appropriate to wait around one year before beginning to raise the repo rate, when inflation picks up.

Given the low rate of inflation, a majority of Board members also considered it appropriate to adjust the repo-rate path downwards so that it reflects a greater probability of a repo-rate cut in the near term compared with the assessment made in February.

Two members advocated cutting the repo rate to 0.50 per cent, as inflation has been lower than expected over a long period of time and to ensure that inflation rises towards the target. They both advocated a first repo-rate increase roughly in line with the forecast in the draft Monetary Policy Update, but had slightly differing views on the repo-rate path after this. One member considered it appropriate that at the end of the forecast horizon, the repo rate should coincide with the rate in the draft Monetary Policy Update, while the other member preferred a lower repo-rate path.

The members discussed the low inflation rate and some of them pointed out that now even minor revisions to the inflation forecast could affect their view of monetary policy. They also discussed the repo-rate path slightly further ahead, the long-run level for the repo rate and the significance of the exchange rate for the development of inflation. The need to implement macroprudential policy measures was emphasised, as were other measures that affect household demand for loans and the functioning of the housing market. There was also a discussion of to what extent household debt should influence monetary policy. Moreover, there was discussion of global risks to economic developments and potential consequences for developments in Sweden.

§4. Monetary policy decision

The Executive Board decided after voting

- to adopt the Monetary Policy Update according to the proposal, Annex A to the minutes,
- to publish the Monetary Policy Update on 9 April 2014, at 9.30 a.m.,
- to hold the repo rate at 0.75 per cent and that this decision would apply from 16 April 2014,
- to publish the decision above at 9.30 a.m. on Wednesday 9 April 2014 with the motivation and wording contained in a press release, and
- to publish the minutes of today's meeting on Thursday 24 April 2014 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 Update. She advocated cutting the repo rate to 0.50 per cent and preferred a repo rate that remains on this level for about one year and is then gradually raised to around 2.2 per cent at 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 Update. He advocated cutting the repo rate to 0.50 per cent and that the repo rate should remain at this level for around one year, before being raised towards the repo-rate path proposed in the draft Monetary Policy Update. This is justified by his assessment that this repo-rate path would entail a forecast where CPIF inflation returns to 2 per cent more quickly.

This paragraph was verified immediately.

Minutes by

Ann-Christine Högberg

Verified:

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

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