Minutes of monetary policy meeting

JULY 2014

Summary

At the monetary policy meeting on 2 July, the Executive Board of the Riksbank decided to cut the repo rate to 0.25 per cent and to adjust the repo-rate path downwards.

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

A gradual improvement in international economic activity in general is expected over the coming years. At the same time, global inflationary pressures are still low and the forecast for international policy rates has been revised downwards. Economic activity is strengthening in Sweden and household indebtedness as a share of disposable income is expected to increase more than was previously forecast. However, inflation has been lower than expected and the assessment is that inflationary pressures are clearly lower. With the adopted monetary policy, CPIF inflation is expected to rise towards the end of the year and to reach 2 per cent in early 2016.

The Executive Board agreed that an even more expansionary monetary policy is now needed given that inflation has been lower than expected, inflationary pressures are now assessed to be lower and the forecast for international policy rates has been revised downwards.

A lower repo rate and a lower repo-rate path than assessed in April are needed so that inflation will rise towards the target quickly enough to ensure that inflation expectations remain anchored at 2 per cent. However, the low level of interest rates increases the risk that the economy will develop in a way that is not sustainable in the long run. The Executive Board therefore agreed that it is now even more important for other policy areas to take measures to manage the risks associated with household indebtedness and the development of the housing market.

However, different members of the Executive Board had different assessments of how much the repo rate needed to be cut at this monetary policy meeting. A majority considered it appropriate to cut the repo rate by 0.5 percentage points to 0.25 per cent. They also considered it appropriate to postpone a first increase to the end of 2015. Their assessment was that the repo rate will then gradually begin to be raised to reach just over 2 per cent during the latter part of 2017. The purpose of the large cut in the repo rate and the revision of the repo-rate path is to send a clear signal that rising inflation is now the most important task for monetary policy.

Two members advocated cutting the repo rate by 0.25 percentage points, to 0.5 per cent. They also considered it appropriate to postpone a first increase, but to 2016, and that the repo rate should be raised slowly thereafter. These members shared the view that it is important that inflation approaches the target in the near future, but felt that this proposal entailed a better balance for attaining the inflation target at the same time as giving some consideration to the high level of household indebtedness.

Monetary policy in a small open economy was discussed at the meeting as well as the position of Sweden in an international context given that the recovery in different parts of the world is uneven with regard to growth, and given that monetary policy also differs. The Executive Board also discussed the need for measures to be taken to manage the risks associated with household indebtedness.

MINUTES OF MONETARY POLICY MEETING
Executive Board, No. 3

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DATE: 2 July 2014

TIME: 09.00

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

Johan Gernandt, Chairman of the General Council

Hanna Armelius
Meredith Beechey Österholm
Claes Berg
Charlotta Edler
Mattias Erlandsson
Eric Frieberg
Christoffer Grände (§ 1)
Tobias Helmersson (§ 1)
Ann-Christine Högberg
Martin W Johansson
Ann-Leena Mikiver
Marianne Nessén
Christina Nyman
Henrik Siverbo
Maria Sjödin
Ulf Söderström
Anders Vredin

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

§1. Economic developments

Tobias Helmersson of the Markets Department began by presenting the latest developments on the financial markets. Since the Monetary Policy Update was published in April, interest rate differentials have widened between the United States and the United Kingdom on the one hand and the euro area on the other. The krona has weakened by a couple of per cent in trade-weighted terms. The financial markets have been relatively calm with low volatility and rising prices for high-risk assets. The causes for concern that do exist, for example the political situation in the Ukraine and Iraq, have not made any great impact on the markets. There is broad agreement on the markets that the Riksbank will cut the repo rate at today's meeting. However, opinion is divided on the future form of the repo-rate path.

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 17, 23 and 24 June. The draft Monetary Policy Report was tabled at a meeting of the Executive Board on 26 June.

The international recovery is continuing, although the rate of development differs from country to country. In the United States the prospects are now good after a period of cold weather contributed to an unexpectedly weak GDP outcome in the first quarter. The recovery is proceeding more slowly in the euro area. GDP is expected to grow in the countries in the trade-weighted KIX index during the forecast period and to reach almost three per cent in 2016. Since the monetary policy meeting in April, the ECB has cut its policy rate to 0.15 per cent and signalled that the policy rate will remain low for some time to come. The ECB's communication has led to a downward revision of the forecast for international policy rates.

In Sweden, GDP fell slightly more than expected during the first quarter of 2014 and the forecast for the year as a whole has consequently been revised downwards by half a percentage point. However, the picture of a continuing economic recovery remains and growth is expected to be good in the forecast years ahead. The forecast for the slightly longer term has been revised upwards somewhat due to the more expansionary monetary policy.

Inflation is still low. Since the monetary policy meeting in April, three outcomes have been presented that have all been lower than forecast. The fact that inflation has now been surprisingly low for several months, that the fall covers a broad range of components and that inflation abroad is also unexpectedly low has led to a downward revision of for the forecast for underlying inflationary pressures in Sweden. This is also in line with the Riksbank's model forecasts, which have proved to be very accurate according to forecast evaluations carried out at the Monetary Policy Department. The forecast for inflation would have been revised downwards much more compared to the Monetary Policy Update in April if not for the substantial downward revision of the repo-rate path in the current forecast. It may be worth mentioning that this is the case despite the fact that the krona has weakened by a couple of per cent in trade-weighted terms.

The forecasts in the draft Monetary Policy Report are conditional on the repo rate being cut by half a percentage point at today's meeting and on the repo-rate path being revised downwards so that it reaches just over two per cent at the end of the forecast horizon. The repo-rate path also entails a greater likelihood of a cut than of an increase in the autumn. The more expansionary monetary policy will lead to higher GDP growth and lower unemployment in the long term. The forecast for household debt as a percentage of disposable income has been revised upwards in the long term.

§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 trade-offs presented in the draft Monetary Policy Report. She wished to begin by repeating her view of the preconditions for monetary policy that prevailed at the time of the monetary policy meeting in April. What she said then was that providing measures were gradually taken to strengthen the resilience of both households and banks, only moderate downward revisions in the inflation assessment would be required for her to support additional stimulus in monetary policy. Since then, inflation has continued to be lower than expected. The Riksbank's forecasts for the development of interest rates abroad have also been lowered. Furthermore, the internal analysis work conducted at the Riksbank has led to a significant lowering of the forecast for inflationary pressures. These three circumstances are the main reasons for the substantial cut in the repo rate and the repo-rate path proposed today.

Given the current forecast for CPIF inflation, in which the target of two percent will be reached in early 2016, we will have undershot the target for roughly five years. Ms Skingsley said it should be remembered that there is no specific time requirement for how quickly inflation should be returned to the target. If the Riksbank had retained the so-called tolerance interval of 1-3 per cent, this period of undershooting the target would have been perceived as being much shorter. But the fact remains that a long period without attaining the target can lead to movements in inflation expectations. As well-anchored inflation expectations are a central element in price setting and wage formation in the economy, it is therefore justifiable today to support an additional clear easing of monetary policy.

In most cases the Riksbank adjusts the repo rate in stages of 25 basis points, and Ms Skingsley said that supporting a cut as large as 50 basis points today was a difficult decision. It entailed balancing the risk of continued surprises in the form of lower inflation against the risks associated with growing household indebtedness as a consequence of a low repo rate. The substantial cut will come as a surprise to most people, which Ms Skingsley would normally want to avoid as it is important that market participants and other economic agents have confidence in the predictability of monetary policy. At the same time, current pricing on the fixed-income market ahead of today's meeting shows that the participants are open to the possibility of a cut higher than 25 basis points, while several forecasters have forecast a further cut in the near future already before the meeting. She said that the most important thing in this situation, after a long period of low inflation, is to bring inflation back to the target. Her overall assessment was therefore that taking forceful action in the form of a larger cut than normal was now justified.

Going forward, there is clear potential for rising inflation. Gradually increasing demand in Sweden and abroad is a central contributory factor to this. The need to increase prices is also clear as unit labour costs in the business sector have been around two per cent in recent years. It is therefore natural that the percentage of companies planning to raise their prices is increasing.[1] A number of factors that have dampened inflation in recent years have also weakened or reversed direction in recent months. In this context, Ms Skingsley wished to emphasise factors such as the exchange rate, producer prices and global food prices. The rate of increase in service prices, which has slowed down since the beginning of 2013 and which has been a subject of discussion by the Executive Board at its latest meetings, has also begun to rise again and the service companies' price expectations have increased continuously since the end of 2013 according to Almega's latest service indicator.

Given today's monetary policy decision, the forecast is that household indebtedness will continue to increase. Several international bodies have drawn Sweden's attention to this over the last few years and the Riksbank has also drawn attention to, and warned about the possible consequences of, this situation in various ways.[2] The data available in this field has long been unsatisfactory, but a recently-published analysis shows that indebtedness is high as a percentage of disposable income irrespective if one examines the statistics per individual adult, household, income group, domicile or age.[3]

Ms Skingsley said that the present and planned measures announced so far to safeguard the financial system are positive, but they also need to be complemented by the gradual

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[1] See the Riksbank's Business Survey, 16 June 2014.

[2] See, for example, the IMF Article IV consultations on Sweden and the European Commission's reports on the member states' macroeconomic imbalances.

[3] See, for example, "How indebted are the Swedish households?", Economic Commentary 1/2014, Sveriges Riksbank and Skingsley (2014) "Household debt under the microscope", speech at a financial forum arranged by the Swedish Association of Public Housing Companies (SABO).

introduction of measures directed at the households to subdue the impulse to increase indebtedness that arises during a long period of low interest rates. She welcomed the fact that amortisation requirements and tighter restrictions are now being considered. The current loan-to-value ratio of 85 per cent should also be reviewed in relation to the situation in other, comparable countries. However, there are also other measures that may be effective in dampening the impulse for the households' to increase their indebtedness that lower interest rates entail. Ms Skingsley welcomed the fact that government representatives have expressed a clear willingness to take responsibility for this situation and a readiness to take measures to counteract this impulse.

Deputy Governor **Karolina Ekholm** supported the draft Monetary Policy Report in terms of both the economic outlook and the proposed monetary policy, that is, a repo-rate cut of 0.5 percentage points and the proposed repo-rate path. This indicates that it is possible that the repo rate will be lowered further and that it is not expected to be raised until the end of 2015. Thereafter, the repo rate is expected to gradually be raised to just over 2 per cent at the end of the forecast horizon.

The monetary policy proposed now is much more expansionary than the policy adopted in April. There are two main reasons for this. The first is that the development of inflation in Sweden indicates that inflationary pressures are lower than previously forecast. The second is that monetary policy abroad is expected to be more expansionary than previously with lower interest rates in the period ahead, as shown in Figure 1:33 of the draft Monetary Policy Report. This is primarily because the ECB has clearly stated that it sees a period of more expansionary monetary policy ahead. If interest rates are lower abroad, then interest rates in Sweden will also need to be lower to avoid the krona strengthening in a way that makes inflation move further from the target.

According to Ms Ekholm the development of the real economy in Sweden hardly justifies making monetary policy considerably more expansionary now, even though, more than five years after Sweden was hit by the effects of the global financial crisis the level of resource utilisation is lower than normal. The Riksbank's assessment of the economic outlook is, after all, rather positive, with an increase in export demand and higher growth than in recent years. The need for a much more expansionary monetary policy is instead due to the fact that inflation, which has been below the target for several years, has unexpectedly become even lower recently. This is shown rather clearly in Figure 1:27 in the draft Monetary Policy Report. Such a course of development requires a strong response from the Riksbank in order to maintain confidence in the inflation target. Ms Ekholm considered that maintaining this confidence requires the Riksbank to actively demonstrate that it does not intend to allow inflation to remain below the target for a long time but is focusing on quickly bringing inflation back up to the target.

In this context, she said that it was less important to determine exactly why inflation has fallen recently. The point is that, whatever the reason, the Riksbank must act to counteract this trend. The Riksbank's main task is to provide a nominal anchor for the economy, which is the inflation target of two per cent. The Riksbank has been given this task because it is considered that the economy functions less efficiently without such an anchor. A nominal anchor is needed for wage formation to work well, for companies and households to be able to make well-founded investment decisions and for changes in relative wages and prices to take place smoothly. To this we should add that a situation in which inflation is down to levels close to zero entails a risk of outright deflation. In such a situation, a setback in the expected recovery could push inflation below zero and this could lead to major problems. The Riksbank should take action to avoid this risk.

As there is still spare capacity in the economy, a more expansionary monetary policy will not conflict with the ambition to stabilise the development of the real economy around long-run, sustainable levels, even though the repo-rate cut of 0.5 percentage points proposed in the draft Monetary Policy Report comes markedly late in the business cycle. The Riksbank's estimate of the GDP and hours gaps is that they will be positive towards the end of the forecast period. However, Ms Ekholm was more inclined to look at unemployment and her assessment was that the Riksbank's unemployment forecast entailed a higher rate than the long-run equilibrium rate of unemployment more or less throughout the forecast period.

The trend that a much more expansionary monetary policy may conflict with is the tendency towards increased credit growth in the household sector that has been noted recently. Lower interest rates are expected to increase the demand for credit. To the extent that this leads to a higher level of indebtedness for already highly-indebted households, it would increase the risk of a weakening of economic activity in the future being made worse by these households reducing their consumption.

Ms Ekholm said that she considered this risk to weigh lightly compared to the risks she sees with regard to confidence in the inflation target. To begin with, it is unclear just how acute this risk is in Sweden. Household indebtedness for housing purposes continues to increase, and this seems to be particularly the case with regard to tenant-owned apartments. At the same time, the household saving ratio is at a record-high level, as can be seen in Figure 1:16 in the draft Monetary Policy Report. It is thus apparently not a question of a general increase in the degree of loan financing of household assets. However, the tendency towards increased credit growth in a situation where debt levels are already high for many households is of course worrying. Experience also shows that housing prices can fall significantly if expectations regarding the development of the housing market change.

But the question is, what can the Riksbank do to contribute most effectively to a less risky course of development? Ms Ekholm does not believe that marginal differences in the repo rate play any great role in this context. On the other hand, conducting a much tighter monetary policy so that interest rates become significantly higher would, in the current situation, be directly irresponsible as it would pose a tangible risk of deflation. The risks associated with household indebtedness must therefore be managed elsewhere; by Finansinspektionen using macroprudential policy, or by the government using other measures that affect the households' credit demand. Finansinspektionen has already taken several measures, but if mortgage rates are cut to even lower levels following today's decision it may need to counteract the build-up of debt in the household sector with additional measures.

In this context, Ms Ekholm also wanted to say something about the current international discussion on the role of monetary policy with regard to the risk of financial imbalances. It was recently reported, for example, that the Bank for International Settlements (BIS) warned in its Annual Report that central banks are not using monetary policy to a sufficient extent to dampen credit growth. They thereby tend to act asymmetrically with a highly-expansionary monetary policy in situations with weak credit growth but with a not particularly tight monetary policy in situations with strong credit growth. All in all, this gives a bias in favour of the build-up of debt in the economy. Similar thinking may lie behind the statement of the International Monetary Fund (IMF) in mid-June in connection with their Article IV consultation on the Swedish economy, where they claimed that increased risks to financial stability could lead to the need to raise the repo rate earlier than indicated by the repo-rate path. Ms Ekholm does not agree with this view of monetary policy and believes that to some extent it is symptomatic that it is represented by organisations that do not make monetary policy decisions themselves. In a democracy, the monetary policy decisions must be based on the mandate that the central bank has been given through the democratic process. If a central bank has an inflation target, it is inflation that must be the starting point for the monetary policy decisions, not something else.

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 Report. She did not, on the other hand, support the proposal to cut the repo rate to 0.25 per cent, or the proposed repo-rate path. Ms af Jochnick instead advocated cutting the repo rate by 0.25 percentage points to 0.5 per cent and a repo-rate path in which the repo-rate remains at 0.5 per cent until 2016 and is slowly raised thereafter. This will lead to the attainment of the inflation target while at the same time taking into account the risks associated with household indebtedness to some extent.

The repo rate has been very low over the last 12 months with the aim of supporting companies and households so that demand increases and inflation rises towards the target of two per cent. An increasingly worrying factor has been that the inflation outcomes have been lower than the Riksbank's forecasts. This is why the repo rate was cut in April and the Executive Board communicated that there was quite a high probability of a further cut at today's meeting.

Since April, inflation has been lower than expected. The inflation forecast has now been revised downwards for most of the forecast period. Several factors have contributed to this. Global inflationary pressures are low. The forecast for international policy rates has been revised downwards and lower rates will dampen prices in Sweden through the exchange-rate channel. In addition, Swedish companies' margins have been squeezed, energy prices have risen slowly and the development of food prices has been weak. It is important to continue analysing the causes of the weak inflationary pressures in Sweden and abroad and how other central banks will act in the period ahead.

Ms af Jochnick's assessment was that the prospects for a global recovery are good. This applies in particular to the United States and the United Kingdom, while the recovery in the euro area is dampened by the fact that several euro countries still have problems with a high level of indebtedness. The ECB's decision in June to cut the policy rate and the market's assessment that the rate will remain at this low level until 2016 indicates that a somewhat slower recovery is expected in the euro area. However, the real economy in Sweden is developing relatively well and much better than many of the other economies in Europe. This is primarily due to a strong household sector and to increased consumption in Sweden. The Riksbank expects GDP to increase by over 2 per cent this year and by more than 3 per cent next year, which must be considered healthy in an international perspective. Sweden has a somewhat better development of GDP compared to the countries that it trades most with (KIX-weighted). Unemployment is still high but the employment rate is also high. One possibility to reduce unemployment would be to increase labour-market policy measures to make it easier for vulnerable groups to gain a foothold on the labour market.

Ms af Jochnick wanted to summarise developments as follows. The factors in favour of a lower repo rate are that inflation has been lower than expected and that the inflation forecast has been revised downwards for the years ahead. The ECB has also revised its policy rate downwards and expects to keep it low for some time to come. On the other hand, global growth has developed well and the forecasts for Swedish growth look good, partly due to good development in the household sector. In this situation, with a lower level of inflation than expected, she considered it reasonable for the Executive board to cut the repo rate to 0.5 per cent. One reason for not cutting the repo rate more is that the Swedish economy is strengthening. Another reason is that when it is difficult to assess the situation monetary policy should be as far as possible in line with what has been communicated previously, while also taking new information into account.

It will take time for inflation to rise to two per cent, irrespective of whether the repo rate is now lowered by 0.25 or 0.5 percentage points. This is partly because it is uncertain how rapid the recovery will be in Europe. It is also because it is uncertain what effect a repo-rate cut will have on the exchange rate. The krona has already weakened during the year, which indicates that a repo-rate cut of 0.25 percentage points is expected. It is difficult to assess how the market will react to an unexpectedly large cut to 0.25 per cent. It is also difficult to assess how the households will react to a cut to 0.25 per cent in combination with information that interest rates will remain low for some time to come. This may further boost developments on the housing market and lead to rising prices. It may also create false expectations of future interest rates, and increase risk taking in the economy, for example by increasing the households' interest in lending at variable interest rates.

Ms af Jochnick considered that a repo-rate cut of 0.25 percentage points to 0.5 per cent was well balanced and in line with new information and the assessments that the Executive Board had communicated to the market earlier. She said that the actions of the Riksbank should as far as possible be predictable and long term.

Sweden and the Swedish economy have been examined by several international organisations during the spring of 2014.[4] In recent months, both the European Commission and the IMF have presented their views on Sweden and have recommended measures that should be taken. The European Commission repeated for the third consecutive year that Sweden continues to have macroeconomic imbalances that require monitoring and political measures. The Commission particularly pointed out that attention must continue to be paid to household indebtedness and to inefficiencies on the housing market.

The IMF reported that the Swedish economy is developing relatively well but that financial imbalances are causing increasing concern. The IMF mentions imbalances on the housing market and a high level of indebtedness in the household sector. In its report, the IMF says that Sweden faces acute challenges in managing systemic risks and structural issues in the financial system with the aim of directly affecting household demand for loans.

Ms af Jochnick noted that both the European Commission and the IMF point to the link between monetary policy and financial stability and consider it important that measures are taken in the right order. This means that monetary policy must be relieved of some of the burden and that measures must be taken in small steps so as not to create unnecessary problems for the households and perhaps negative effects on private consumption and demand in the economy.

She said that it was not good that Sweden was repeatedly subject to critical comments of this kind. The financial imbalances that have been built up must be dealt with. Sweden is far too dependent on international confidence due to the extensive borrowing that Swedish banks have to fund Swedish mortgages. In Sweden and several other countries, the central banks have deemed it necessary to "lean against the wind" by taking financial imbalances into account in the monetary policy deliberations. The Riksbank has been

[4] See, for example, the IMF Article IV consultations on Sweden and the European Commission's reports on the member states' macroeconomic imbalances.

doing this for some time in that the Executive Board has tried to find a trade-off that aims to stabilise inflation and the real economy during the forecast horizon and at the same time takes into account more long-term risks associated with the households' high debts. The high level of household indebtedness is one of the factors considered when making monetary-policy decisions as there is a risk of major disruptions to the real economy in the longer term if households experience problems due to falling housing prices, or a loss of income, or when interest rates gradually rise. This risk is increased by the fact that the households have a large proportion of mortgages at variable interest rates.

Ms af Jochnick said that it was good that Finansinspektionen is now implementing a number of measures to further strengthen the capital and liquidity situation of the banks. This makes the banking system more robust and increases the chances of being able to manage future crises. However, the measures announced so far have not been sufficient to influence the incentives for households. Measures in addition to a mortgage ceiling and an amortisation recommendation are needed. Her assessment is that the measures proposed by the IMF should also be considered. One should also assess the possibility of limiting how large a percentage of a mortgage can be taken at a variable interest rate. Finally, she feels no stone should be left unturned and it would thus be desirable to reach an agreement across party-political lines to limit tax relief for mortgages.

Given the financial imbalances in the household sector that could contribute to problems in the real economy in the longer term, measures should therefore be coordinated between the government and its authorities. Irrespective of whether this relates to tax changes or other regulatory proposals that affect lending, a long-term plan is needed and implementation should take place over a long period of time. Changes in regulations for households should be implemented gradually to make it easier for them to make decisions and to contribute to stable regulatory frameworks that slow down the build-up of debt.

The effect on monetary policy will depend on what measures the government and its authorities decide to adopt to limit household indebtedness. The Riksbank's calculations show, for example, that abolishing tax relief for mortgages would correspond to an interest-rate increase of two percentage points for the households. This means that measures other than monetary policy can play a major role in counteracting imbalances. The Riksbank will take any adopted measures that affect household indebtedness into account as far as possible, but at present we do not know how these measures will affect the repo rate going forward.

Ms af Jochnick considered that cutting the repo rate to 0.5 per cent at today's meeting would provide a better trade-off than the proposed main scenario, given that there is some likelihood of a further cut later this year. It was also her assessment that a first increase should not be made until 2016. Household indebtedness remains a risk to a sustainable long-run development.

Deputy Governor **Per Jansson** began by noting that inflation remains low. Since the Monetary Policy Update was published in April, there have been three new inflation outcomes that have all been lower than expected. The latest outcome for May was almost 0.2 percentage points below the assessment in the Monetary Policy Update.

Mr Jansson recalled that at the monetary policy meeting in April he declared that his tolerance of further downward revisions of the inflation outlook in the near term had reached its lower limit. As the inflation outcomes since then are once again forcing the Riksbank to revise its inflation forecasts downwards he will now consequently vote for a repo-rate cut. The only question is by how much, 0.25 percentage points or 0.5 percentage points.

He said that there were, above all, two aspects in favour of settling for the smaller cut. Both aspects relate to the risks associated with household debt. First, a larger repo-rate cut will of course, all else being equal, contribute to a more rapid build-up of debt than a smaller cut. A significant factor in this context is that the larger cut is likely to have a more tangible effect on the risk of households forming unrealistic interest-rate expectations, in the sense that these are to a too high degree driven by the currently very low level of interest rates. If this is the case, the households will underestimate the size of their future interest expenditure and this may eventually have serious negative consequences for consumption and the macroeconomy at large. Second, and perhaps even more important, the Financial Stability Council and Finansinspektionen have not yet taken sufficient measures to manage the risks associated with household debt. As Mr Jansson has pointed out previously, measures that tighten the banks' capital requirements in various ways have too small and only indirect effects on the build-up of household debt. This is also now clearly illustrated in an article in the draft Monetary Policy Report.[5] Higher capital requirements are good as they help to increase the resilience of the financial system. However, reducing the risks linked to household debt also requires measures that more directly aim to affect the supply of, and perhaps above all the demand for, loans.

Mr Jansson went on to point out that both the Minister for Finance, Anders Borg, and the Minister for Financial Markets, Peter Norman, have recently communicated that the Financial Stability Council will present concrete proposals on different alternatives for amortisation requirements at its meeting in November. This is of course good. Nevertheless, one cannot escape the fact that the results of the Council's meeting in May were meagre and disappointing. Previously announced capital requirements, and a few new capital requirements, will be implemented. But no measures that aim more directly

[5] See the article "Stricter capital requirements for Swedish banks – effects on the macroeconomy", Monetary Policy Report July 2014, page 45.

to reduce the risks associated with household indebtedness were presented.[6] This is worrying, not least because the improvement in the state of the economy and the rapid rise in housing prices mean that lending may very well increase even further already this year. This in turn means that we risk lagging behind, which of course will not make things easier.

So, what are the aspects in favour of the larger repo-rate cut? In Mr Jansson's view, there are above all two weighty arguments in this case too. First, inflation outcomes have continued to surprise on the downside. Since the October outcome last year, seven of the total of eight inflation outcomes have been below the Riksbank's forecasts. It is important to note that this relates to short-term forecasts, which are normally fairly accurate. In addition, the outcomes have not only surprised the Riksbank but other forecaster too. This makes it increasingly likely that underlying inflationary pressures are clearly lower than the Riksbank previously believed. That this is actually the case is also supported by the fact that the fall in inflation is broadly based, which becomes apparent when one studies the different components of the CPI.[7]

Given this background, Mr Jansson noted that the draft Monetary Policy Report proposes an extensive revision of the forecast for CPIF inflation in the years to come. A comparison of the new forecast with the assessment in the Monetary Policy Update in April makes it clear that the figure for CPIF inflation, measured as a quarterly average, has been revised downwards by 0.1-0.2 percentage points for all of the forecast quarters up to the end of 2015. However, the extent of the forecast revisions is not effectively captured simply by comparing the new and the old inflation forecasts. We must in this context also consider that the new forecast is conditional on a much more expansionary monetary policy. Compared with the repo-rate path in April, this is an easing of monetary policy that amounts to a good 80 basis points on average per quarter over the coming three years. This makes it clear that the underlying inflationary pressures are now assessed as much lower than was previously expected, which of course points to the need for monetary policy to react decisively.

Mr Jansson said that the other weighty argument in favour of the larger repo-rate cut was linked to the role played by the inflation target as a nominal anchor. When inflation is well below the target for a fairly long period of time, it is important that the Riksbank makes clear its ambitions to bring inflation back towards the target within a reasonable time horizon. Moreover, the deviation from the target has recently increased further from an already rather poor starting point. This makes it even more urgent that the Riksbank should give clear signals that rising inflation is now its top priority.

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[6] Measures of this kind are also called for in the IMF's Article IV consultation for Sweden. See http://www.imf.org/external/np/ms/2014/061314.htm.

[7] See the articles "Why is inflation low?", Monetary Policy Report July 2014, page 35 and "Perspectives on the low rate of inflation", Monetary Policy Report February 2014, page 40.

Mr Jansson went on to say that if the Riksbank is not sufficiently clear on this point, it could in the worst case mean that the inflation target no longer fulfilled its role as a nominal anchor. This could have negative consequences for, among other things, wage formation, which has functioned much better since the inflation target has been used as a benchmark in the wage bargaining rounds.[8] In this context, a larger repo-rate cut would of course give a clearer signal of the Riksbank's intentions than a smaller repo-rate cut.

Mr Jansson felt that the arguments he had put forward show that there is currently no monetary policy decision that is completely clear cut and without any disadvantages. The situation is, quite simply, very complicated. For his part, Mr Jansson had finally decided to vote in favour of the larger repo-rate cut, that is that the repo rate should now be cut from 0.75 to 0.25 per cent. This is because he quite simply believes that a forceful monetary policy intervention is the right thing to do at this point, where inflation has been far below the target level for a fairly long time and where the status of the inflation target has been questioned repeatedly and by many people in the monetary policy debate. He thus supported both the macro forecast and the monetary policy presented in the draft Monetary Policy Report.

In conclusion, Mr Jansson wished to comment briefly on his stance with regard to today's repo-rate decision in the light of what he had said earlier about the need for monetary policy to take into account the risks linked to household debt.[9] At first glance, today's decisive monetary policy shift in a more expansionary direction may appear to be quite incompatible with such ideas. And, as Mr Jansson has mentioned earlier, this change does not, of course, reduce the risks linked to household debt; on the contrary it contributes to increasing them. But he has always been clear in his discussions of these matters that taking into account the risks linked to household debt does not mean that monetary policy is freed of difficult considerations and that the repo-rate decisions become self-evident. As inflation has continued to fall since the end of last year, he has also indicated clearly and on several occasions that his monetary policy considerations were shifting towards giving the more short-term development of inflation greater significance in the repo-rate decisions. And he has above all emphasised that the consequence must never be that the nominal anchor is put at risk.

So, what will happen in the coming period: are the risks linked to household debt now once and for all dismissed from the monetary policy deliberations? Mr Jansson pointed out that his answer to this question was a resounding no. But under the current circumstances, the Riksbank must give priority to ensuring that inflation rises. To make

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[8] See the article "The interplay between wage formation, monetary policy and inflation", Monetary Policy Report July 2014, page 41.

[9] See, for example, Per Jansson (2013), "How do we stop the trend in household debt? Work on several fronts", speech at SvD Bank Summit, Stockholm, and Per Jansson (2014), "The Riksbank's monetary policy strategy - in tune or out of tune with the rest of the world?" speech at SEB, Stockholm.

this priority clear, Mr Jansson emphasised that he also holds on to his earlier promise not to vote in favour of an increase in the repo rate until CPIF inflation accelerates and exceeds 1.5 per cent.

Governor **Stefan Ingves** began by saying that he largely shared the view of developments abroad and the Swedish economy described in the draft Monetary Policy Report. However, he did not support the proposal to cut the repo rate by 0.5 percentage points to 0.25 per cent. Mr Ingves' conclusions regarding monetary policy are somewhat different than those proposed. He advocated cutting the repo rate by 0.25 percentage points to 0.5 per cent, and a repo-rate path in which the repo rate remains at 0.5 per cent until 2016 and is slowly raised thereafter. This would contribute to bringing up inflation towards the target and at the same time in the near term better take into account the long-term risks linked to household indebtedness. Such a policy could lead to inflation overshooting the target towards the end of the forecast horizon, but Mr Ingves did not regard this as any cause for concern at present. Nor did he see any reason to surprise in the way being proposed.

Mr Ingves noted that inflation in Sweden is low and that it has been lower than the Riksbank assumed on a number of earlier occasions. It is worrying that the Riksbank's forecasts have been wrong, and this requires further analysis. Companies' profit margins have shown weak development, which is also supported by the responses to the questionnaire survey the Riksbank makes together with the National Institute of Economic Research. In addition, energy prices have risen slowly and food prices have developed weakly. A stronger krona has also contributed to slowing down inflation during certain periods but to a lesser degree recently. All in all, the inflation forecast has been revised down for most of the forecast period. This is the main reason why monetary policy needs to become more expansionary. The situation in Sweden is fairly unusual, with reasonable and rising growth at the same time as inflation is low.

At the same time, Mr Ingves considered it important to note that inflation is also low in many other parts of the world. Others have also been surprised by lower inflation than expected and have revised down their forecasts in recent years. Low global inflation also affects what monetary policy can achieve in Sweden. The monetary policy deliberations in Sweden are also affected by how other central banks react to the inflationary pressures and how this in turn affects the krona exchange rate and the Swedish inflation rate. In a small, open economy with free capital flows, the degree of freedom is limited. This is one reason why repo-rate increases in Sweden may not need to begin until after policy rate increases have begun in larger countries like the United Kingdom and the United States. At the same time, it is important to have firmly-anchored inflation expectations, which also imply postponing repo-rate increases until 2016. The weak inflationary pressures are to some extent explained by resource utilisation being lower than normal. In Sweden, however, it can be noted that the recovery in the real economy has been better, in terms of GDP, than in most other countries following the crisis.

Mr Ingves noted that monetary policy in Sweden has also been expansionary over a long period of time. It is worth noting, for instance, that the final interest rates households have to pay are lower in Sweden than in Germany, which acts as an engine for the euro area. The financial conditions are not causing difficulties for monetary policy in Sweden. There are no disruptions to the monetary transmission mechanism. This means that an interest-rate cut in Sweden will most probably have a greater effect than it would in an economy with a disrupted transmission mechanism. And this is one reason why Mr Ingves considers that a cut of 25 basis points would suffice today.

Moreover, the monetary policy now being discussed entails a further sharpening of the risks linked to household indebtedness. The forecast in the main scenario is for household debt to increase throughout the forecast period. Mr Ingves noted that the same applies to the monetary policy he advocates. The lack of an efficiently-functioning housing market constitutes a growing problem for the Swedish economy. This is partly because the housing market contributed to systemic risk in the financial sector. If monetary policy is very expansionary for a long period of time, it can contribute to creating incorrect expectations of future interest rates, and to increased risk-taking and growing imbalances, considered Mr Ingves.

A lower interest rate than the Riksbank has previously assumed therefore further increases the need to manage households' high and increasing debt by other means than monetary policy. The growth in debt is currently unsustainable and Mr Ingves pointed out that it is now urgent that measures are taken in other policy areas with regard to counteracting the development of financial imbalances.

He noted that introducing countercyclical capital buffers provides one contribution, albeit relatively small. A much greater effect could be obtained by abolishing the right to tax deductions on households' mortgages. Cutting the mortgage ceiling by 10 percentage points or an amortisation requirement of, for instance, 50 years would also have greater effects with regard to reducing indebtedness. Mr Ingves pointed out that measures that affect household indebtedness are needed in Sweden. The challenge of attaining a controlled adjustment has increased and it is important to act as soon as possible. A continued rise in indebtedness entails increased risks of shocks to the Swedish economy. If this is not managed with the tools available, there is a greater risk of setbacks that could make monetary policy more difficult further ahead. This could potentially have large and lasting consequences for both inflation and growth.

Deputy Governor **Martin Flodén** began by saying that he supports the proposal for the repo-rate decision and repo-rate path described in the draft Monetary Policy Report, and also the picture of economic developments in Sweden and abroad presented there.

Since the monetary policy meeting in April, inflation outcomes have continued to be surprisingly low, and the Riksbank has substantially revised down its forecast for underlying inflationary pressures. In addition, the ECB has cut its policy rate and signalled that they will conduct a very expansionary monetary policy for a long time to come. Market expectations of future short-term interest rates in Europe have therefore fallen, and the Riksbank has revised down its forecast for future international policy rates quite substantially (see Figure 1:33 in the draft Monetary Policy Report). Both the assessment that inflationary pressures in Sweden will be low over a long period of time and the forecast for low international policy rates over a long period of time imply that lower interest rates are required in Sweden to ensure that inflation approaches two per cent during the forecast period.

As a result of the proposal to cut the repo rate and repo-rate path substantially, the forecast for household debt in relation to income has been revised up. The high level of household indebtedness comprises a risk to the stability of the economy, and this risk needs to be dealt with. However, Mr Flodén does not consider this risk to be influenced to any great extent by the various monetary policy options compatible with the Riksbank's new forecast for inflationary pressures and international policy rates. For instance, Figure 2:15 in the draft Monetary Policy Report shows that according to the Riksbank's estimates, household debt would have increased by about as much even if the Executive Board had cut the repo rate by 25 instead of 50 basis points. The substantial repo-rate cut in the near term is thus not the main reason why the forecast for households' debt ratios has been revised up. More important is that the forecast for interest rates in general has been revised down and that it is now expected to take longer before the repo rate can be raised.

Mr Flodén regards it as unavoidable that the Executive Board now cuts the repo rate and presents a forecast in which the repo rate remains low for a long time. With this as a starting point, one can then consider different time profiles for the repo-rate path. Mr Flodén argued that a large repo-rate cut today is the most appropriate decision, for several reasons. A smaller repo-rate cut today would mean, all else equal, that it would take even longer before inflation rises and the repo rate can be raised. The risks with a low repo rate over a long time could then increase.

A more important argument for cutting the repo rate today is that inflation has been low and falling over a long time, and the outcomes have been repeatedly lower than expected. To maintain credibility for monetary policy and the inflation target, it is necessary now to give priority to the development of inflation in the short and medium term and to take measures to bring inflation towards the inflation target reasonably quickly. It is therefore particularly important that monetary policy becomes more expansionary in the near time. The long period with too low inflation also means that there is increasingly limited scope for inflation to be lower than expected. Mr Flodén would therefore rather that the Executive Board looks back a quarter or so from now at the current monetary policy decision as being unnecessarily forceful than that a continuing low inflation rate forces further cuts to be made in the autumn.

Mr Flodén's assessment is that the expansionary monetary policy now being proposed is sufficient for CPIF inflation with a high probability to be close to or over 2 per cent at the beginning of 2016. The Riksbank's inflation forecast for 2016 is higher than those of most other analysts, but it is also based on a monetary policy that is much more expansionary than the other analysts are expecting. Mr Flodén sees good prospects for inflation to rise faster now than the Riksbank had forecast. This could occur even in the short term if import prices rise as a result of the krona depreciating more than forecast after the monetary policy decision is published.

Even if inflation would become surprisingly high in the near term, it will be appropriate to hold the repo rate at a low level for a long time to come. Because inflation has been low and falling for a long period of time, and the repo rate is now approaching its lower bound, Mr Flodén would like to see clear signs that inflation attains persistently higher levels before the repo rate is raised. Such signs will consist of CPIF inflation and other measures of underlying inflation approaching 2 per cent, and inflation expectations rising.

If inflation nevertheless remains surprisingly low and monetary policy thus needs to become even more expansionary, Mr Flodén will primarily advocate a further cut in the repo rate and an adjustment of the repo-rate path, in accordance with the text in the draft Monetary Policy Report.

In conclusion, Mr Flodén wanted to comment on how he expects that today's repo-rate cut will contribute to higher inflation. He had developed this reasoning in a speech held at Saco earlier this year.[10] The prospects for an economic upturn already look good, but the Riksbank is nevertheless expecting inflationary pressures to remain weak. And it is not primarily through further strengthening of economic activity that Mr Flodén expects more expansionary monetary policy to contribute to higher inflation, at least not in the near term. Two factors that can become more important are the exchange rate and inflation expectations. Market expectations of a more expansionary monetary policy have already led to the krona weakening prior to today's monetary policy meeting. Now an even more expansionary monetary policy than these expectations is being proposed. This should contribute to holding the krona at a clearly weaker level than the forecast in the April Monetary Policy Update. Even in the short term, the weaker krona can lead to an increase in import prices, which directly results in higher inflation. And higher inflation usually means that inflation expectations rise, which in turn leads to higher future inflation. In addition, today's monetary policy decision will hopefully be perceived as a clear signal

[10] See Martin Flodén (2014) "The low rate of inflation – should we be worried and can we do anything about it?" speech at Saco on 14 May 2014.

that monetary policy will ensure that inflation rises to 2 per cent within a year or two. This should also contribute to a rise in inflation expectations.

Mr Flodén's conclusion from this reasoning is thus that the assessment of the economic situation and future inflationary pressures means that the Riksbank must conduct a more expansionary monetary policy and revise down the forecast for interest rates in Sweden. The low interest rates mean that the risks linked to the high household indebtedness increase. However, other policymakers must manage these risks. And even if this is done, for example with measures that limit household demand for credit, Mr Flodén expects that today's repo-rate cut will lead to inflation rising faster towards or even beyond 2 per cent.

§3. Discussion

Deputy Governor **Karolina Ekholm** began the discussion by referring to Mr Ingves' and Mr Flodén's earlier contributions, where they made it clear that the upward revision in the forecast for the household debt ratio was not primarily linked to the proposal to cut the repo rate by 0.5 percentage points rather than 0.25 percentage points, but was mainly due to the assessment that interest rates abroad will be lower, which means that interest rates in Sweden will also be lower in the slightly longer run. According to Ms Ekholm, one could say that it is the more expansionary monetary policy in the euro area that leads to increased indebtedness among Swedish households – an example of when the monetary policy conducted by large economies has spillover effects on small, open economies. These spillover effects are sometimes discussed in negative terms, with demands that the central banks in the large economies should take into account the effects on other countries' economies when they make their decisions. Ms Ekholm's view is that what will benefit the Swedish economy most is a rapid recovery in the euro area and if this requires an ultralight monetary policy, then it is a good idea to pursue such a policy. At the same time, it will have negative spillover effects on the Swedish economy that need to be managed and this entails challenges for economic policy. As Ms Ekholm mentioned earlier, however, she considers that this is a question of challenges for macroprudential policy and for the economic policy that is under the control of the government, rather than for monetary policy.

First Deputy Governor **Kerstin af Jochnick** began her contribution to the discussion by noting that the decision the Executive Board intends to make today, and which she intends to enter a reservation against, will mean that the repo rate is very low and very close to zero. The last time the repo rate was so low was in 2009, when economic developments were very different. Then the Monetary Policy Report described a deep recession and stated that a low repo rate was needed over a long period of time to counteract a fall in production and employment. The economic situation was thus quite different then from today. The Riksbank's assessment in 2009 was that 0.25 per cent was in practice the lower bound for the repo rate.

It has now been shown that it is possible to have a lower repo rate than 0.25 per cent. Regardless of what is the lower bound for the repo rate, her assessment is that the Executive Board's ability to influence rate-setting with regard to households and companies will decline and that monetary policy's capacity to further stimulate the economy is now limited. This means that the Riksbank must now to a greater extent work on its communication and on other measures that can influence rate-setting in Sweden.

When one follows the discussion on monetary policy in Sweden, one may get the feeling that the Riksbank is the only central bank in the world to find it difficult to attain the inflation target of 2 per cent. Ms af Jochnick pointed out that the annual report of the BIS contains a good analysis, which shows that a large number of countries have experienced problems in bringing inflation up to the target level in recent years. The BIS analysis shows that in several cases it is not weak domestic resource utilisation that is the main reason for the low inflation. They claim that domestic inflation is increasingly dependent on developments in the global economy, as a result of the increased integration of trade, financing and production. Low global inflation will thus not merely slow down one country's import prices. Domestic inflation is also affected more generally by increased global competition, reduced trade barriers and transport costs, higher mobility for goods and labour and technological advances. According to the BIS, this development entails a major challenge for many central banks. The effectiveness of monetary policy when inflation is very low is limited. For one thing, they point to the well-known zero-interest rate dilemma. For another thing, they point to the risk that low policy rate over a long period of time build up unsustainable financial imbalances, increase risk taking and contribute to misallocation of both capital and labour. Ms af Jochnick's conclusion from this report with regard to Sweden is that it is important that the Riksbank continues to develop its research, analysis and models so that we can better understand and predict how globalisation in all its different aspects will affect developments in inflation in Sweden.

Deputy Governor **Cecilia Skingsley** wanted to say a few words about a factor in the repo-rate path, namely that it will be at 0.22 per cent for the coming quarter, which is lower than it was the last time the Riksbank held the repo rate at 0.25 per cent, between July 2009 and July 2010. The question of what constitutes a policy rate's lower bound has been discussed at length since a number of central banks have had reason to test it. Two related factors are of central importance when considering this level; safeguarding the monetary policy transmission mechanism and the functioning of the financial markets. The circumstances prevailing in 2009 were marked by fairly limited and largely theoretical knowledge. One conclusion the Riksbank drew then was that 0.25 per cent was not a problem, but that most of the Executive Board members at that time were sceptical towards the possibility of cutting the repo rate further.

Since then, much more experience in this field has been obtained in various parts of the world. One conclusion is that the policy rate can come close to zero and remain there for a long period without appearing to disturb the monetary policy transmission mechanism. Another conclusion is that the monetary policy toolbox is not empty because the policy rate is close to the zero lower bound. It has been supplemented with various types of extraordinary measures, the contents and duration of which have differed from country to country depending on the particular national challenges the central bank has faced.

Ms Skingsley felt that today's forecasts and decisions by the Riksbank will lead to a sufficiently rapid attainment of the target. However, if monetary policy needed to become even more expansionary, she felt that there was further marginal scope to cut the repo rate, apart from the possibility of delaying and changing the timing of future increases.

She also wanted to take up something that Ms Ekholm had mentioned, namely that several international organisation, most recently the IMF and the BIS, had expressed some warnings regarding the low interest rate policy being conducted internationally. Ms Skingsley can respect that someone might not agree with their conclusions, but she finds it difficult to believe that the reason for these organisations' warnings would be based on their representatives not being policymakers themselves. The IMF, in particular, is ultimately governed by, and financed by, national policymakers in its member countries. In addition, Ms Skingsley felt that the warnings were not unjustified. It is probably fairly uncontroversial to claim that rapidly-growing debt caused the global financial crisis and that interest rates and credit granting have significance for decisions on indebtedness. One lesson from the financial crisis was that price stability is not sufficient to avoid financial imbalances in an economy; other economic policy measures may also be needed. Conducting monetary policy within an inflation-targeting regime, but in such a way that one tries to avoid the policy contributing to financial crises is not undemocratic, said Ms Skingsley, it is entirely compatible with the task the Riksdag (the Swedish parliament) has delegated to the Riksbank.

Governor **Stefan Ingves** began his contribution to the discussion by saying that there are several reasons why monetary policy may need to lean against the wind, and this is also being discussed internationally. This question has been long discussed at the Riksbank, not just during his time here on the Executive Board. The risk that asset prices and indebtedness will develop in manner that is not sustainable in the longer run may need to be considered in the monetary policy decisions. The analysis apparatus also needs to be improved to manage this way of thinking.

New macroprudential policy measures are now about to be introduced, but they are as yet untested, so far they have been too weak and it is difficult to know how effective they will be in practice. A very expansionary monetary policy for far too long may moreover increase risk taking and cause difficulties for macroprudential policy. In addition, there is the difficulty of now making unpopular political decisions that will slow down the future build-up of household debt. Mr Ingves pointed out that if lending to households were to begin to accelerate, the economy would be in a very difficult situation, which would make the monetary policy trade-off more complicated.

Mr Ingves also wanted to point to some other problems that affect the monetary policy trade-off. The relationship between real economic variables and inflation does not appear to be very stable, particularly after the crisis. Mr Ingves therefore expressed increasing doubts that the neat correlations of the model world still apply. It is also generally accepted that exchange rate assessments are very difficult. Nor are they made easier by the fact that since the crisis there has been considerable uncertainty over the long-term level of the interest rate, both in Sweden and abroad, and over the measures other central banks will take. The recovery is also uneven, both with regard to growth and interest rate policy in different parts of the world. This means it is not so easy to position Swedish monetary policy. Given this, he pointed out that one must be prepared for volatility and major fluctuations further ahead.

Moreover, there will be continued uncertainty over the effects of globalisation on the economy. Increased competition from companies abroad is a factor that can put pressure on companies' margins and hold down inflationary pressures more than expected in the coming period. On the other hand, the uncertain geopolitical situation can affect energy prices, push up inflation in the coming period and influence exchange rates, even though it is difficult to quantify this at present.

Finally, Mr Ingves concluded that there are thus both downside and upside risks for inflation. One should always be prepared for monetary policy to be different than the policy now being proposed. If it were the case that monetary policy needed to be even more expansionary, the Executive Board of the Riksbank may decide to cut the repo rate down to the zero lower bound. And if this were not sufficient, there is a catalogue of possible supplementary measures we could take. However, Mr Ingves does not consider this to be appropriate at present, given the forecast now being made. However, he hopes that everyone agrees that other measures than monetary policy are needed urgently to slow down household indebtedness. If this does not happen, the repo rate may need to be raised faster than is currently being assumed.

Deputy Governor **Karolina Ekholm** felt that she needed to clarify a point, given that Ms Skingsley took up her comments on the IMF. What Ms Ekholm said specifically concerned the IMF's statement in connection with their Article IV consultation in Sweden. Ms Ekholm felt it was strange to recommend that a central bank with an inflation target should tighten its monetary policy if the risks to financial stability increased. A tighter monetary policy in a situation with already very low inflation could be expected to lead to real deflation risks arising. Now this recommendation may not be representative for the way the IMF views the role of monetary policy. IMF head Christine Lagarde, for instance, has previously stated a clear recommendation of more expansionary monetary policy in the euro area to counteract the risk of deflation. It also appears as though the IMF's recommendations to other countries with similar situations regarding inflation and indebtedness differ somewhat from those given to Sweden in the middle of June.

Furthermore, Ms Ekholm wished to say something about the assessment of what constitutes the lower bound for the repo rate, as both Ms af Jochnick and Ms Skingsley had taken this up in their contributions. At the time the repo rate's lower bound was judged to be 0.25 per cent, Ms Ekholm was one of the Board members who did not wish to cut the repo rate further than this as there was such uncertainty over what the effects might be on the financial markets. The Riksbank was then fairly uncertain as to whether the repo rate could be cut to a level below 0.25 per cent and made a number of analyses with regard to what consequences an even lower repo rate might have. Ms Ekholm remembers that it was eventually decided that the repo rate could be cut to an even lower level, but at that time Ms Ekholm herself and several other Executive Board members felt there was no longer any need to make monetary policy more expansionary.

Deputy Governor **Cecilia Skingsley** thanked Ms Ekholm for her clarification. But she said that she wanted to emphasise that the IMF's section on current monetary policy also concluded that a significant deviation in inflation expectations could justify more expansionary monetary policy. On the whole, she felt that the Article IV report on Sweden captured the difficult deliberations the Riksbank has to make fairly well, and that the IMF's recommendations to slow down the demand for credit were well worth considering.

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

A gradual improvement in international economic activity in general is expected over the coming years. At the same time, global inflationary pressures are still low and the forecast for international policy rates has been revised downwards. Economic activity is strengthening in Sweden and household indebtedness as a share of disposable income is expected to increase more than was previously forecast. However, inflation has been lower than expected and the assessment is that inflationary pressures are clearly lower. With the adopted monetary policy, CPIF inflation is expected to rise towards the end of the year and to reach 2 per cent in early 2016.

The Executive Board agreed that an even more expansionary monetary policy is now needed given that inflation has been lower than expected, inflationary pressures are now assessed to be lower and the forecast for international policy rates has been revised downwards.

A lower repo rate and a lower repo-rate path than assessed in April are needed so that inflation will rise towards the target quickly enough to ensure that inflation expectations remain anchored at 2 per cent. However, the low level of interest rates increases the risk that the economy will develop in a way that is not sustainable in the long run. The Executive Board therefore agreed that it is now even more important for other policy areas to take measures to manage the risks associated with household indebtedness and the development of the housing market.

However, different members of the Executive Board had different assessments of how much the repo rate needed to be cut at this monetary policy meeting. A majority considered it appropriate to cut the repo rate by 0.5 percentage points to 0.25 per cent. They also considered it appropriate to postpone a first increase to the end of 2015. Their assessment was that the repo rate will then gradually begin to be raised to reach just over 2 per cent during the latter part of 2017. The purpose of the large cut in the repo rate and the revision of the repo-rate path is to send a clear signal that rising inflation is now the most important task for monetary policy.

Two members advocated cutting the repo rate by 0.25 percentage points, to 0.5 per cent. They also considered it appropriate to postpone a first increase, but to 2016, and that the repo rate should be raised slowly thereafter. These members shared the view that it is important that inflation approaches the target in the near future, but felt that this proposal entailed a better balance for attaining the inflation target at the same time as giving some consideration to the high level of household indebtedness.

Monetary policy in a small open economy was discussed at the meeting as well as the position of Sweden in an international context given that the recovery in different parts of the world is uneven with regard to growth, and given that monetary policy also differs. The Executive Board also discussed the need for measures to be taken to manage the risks associated with household indebtedness.

Mr Ingves observed that the proposal to cut the repo rate advocated by the majority would mean that the deposit rate would be –0.5 per cent.

§4. Monetary policy decision

The Executive Board decided after voting

- to adopt the Monetary Policy Report according to the proposal, Annex A to the minutes,
- to publish the Monetary Policy Report on 3 July 2014, at 9.30 a.m.,
- that the repo rate would be lowered to 0.25 per cent and that this decision would apply from Wednesday 9 July 2014,

- to publish the decision above at 9.30 a.m. on Thursday 3 July 2014 with the motivation and wording contained in a press release, and
- to publish the minutes of today's meeting on Wednesday 16 July 2014 at 9.30 a.m.

Governor Stefan Ingves and First Deputy Governor Kerstin af Jochnick entered a reservation against the decision to cut the repo rate to 0.25 and against the repo-rate path in the Monetary Policy Report.

They advocated cutting the repo rate by 0.25 percentage points to 0.5 per cent and a repo-rate path in which the repo rate remains at 0.5 per cent until 2016 and is slowly raised thereafter. This will lead to the attainment of the inflation target while at the same time taking into account the risks associated with household indebtedness to some extent. Nor did they see any reason to surprise in the way that would now occur.

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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