Minutes of Monetary Policy Meeting

OCTOBER 2014

Summary

At the monetary policy meeting on 27 October, the Executive Board of the Riksbank decided to cut the repo rate to zero 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.

The prospects for the United States and the United Kingdom remain good. However, inflation abroad is expected to become lower and the recovery in the euro area is expected to proceed more slowly than was previously assessed.

In Sweden, economic activity is strengthening and the labour market is continuing to improve. Nevertheless, inflation is low and inflationary pressures are expected to be lower than was previously forecast.

The Executive Board was therefore unanimous in the view that monetary policy needs to be even more expansionary for inflation to rise and attain the target and for inflation expectations to remain anchored at 2 per cent.

All of the Board members advocated that the repo rate be cut to zero and that the repo-rate path should be lowered substantially. The low repo rate will increase demand in the economy, which will contribute to a rise in inflation. CPIF inflation is expected to reach 2 per cent during the first half of 2016. As noted in the draft Monetary Policy Report, monetary policy may need to be adjusted if conditions change. Moreover, the Riksbank will have the same possibilities as other central banks to take further measures to increase the monetary policy stimulus.

But the low repo rate will also contribute to reinforcing the trend of rising house prices and household indebtedness. This risks leading to problems for both individual households and the economy as a whole. When interest rates are this low, several Board members emphasised that it is even more important that other policy areas now handle these risks.

During the meeting the Board also discussed the role of supply factors when analysing the development of inflation, as well as the role of the repo-rate path in the light of the current uncertainty over economic and monetary policy developments around the world.

MINUTES OF MONETARY POLICY MEETING
Executive Board, No. 5

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DATE: 27 October 2014

TIME: 09.00

PRESENT:

Stefan Ingves, Chair
Martin Flodén
Per Jansson
Kerstin af Jochnick
Cecilia Skingsley

Susanne Eberstein, Chair of the General Council

Carl-Johan Belfrage
Claes Berg
Charlotta Edler
Heidi Elmér
Mattias Erlandsson
Eric Frieberg
Christoffer Grände (§ 1)
Tobias Helmersson (§ 1)
Ann-Christine Högberg
Martin W Johansson
Eva Julin
David Kjellberg
Anna Lidberg
Henrik Lundvall
Ann-Leena Mikiver
Christina Nyman
Maria Sjödin
Ulf Söderström
David Vestin

It was noted that Carl-Johan Belfrage and Anna Lidberg would prepare draft minutes of § 1, 2 and 3 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 September, weaker growth prospects have led to greater uncertainty on the financial markets and to a fall in demand for risky assets. All-in-all, however, the effects have been limited. The stock markets have recovered to varying extents and, with the exception of Greece, changes in the yields on the government bonds of the crisis-hit euro countries have been small.

Given the economic outlook, it is expected that the major central banks will continue to be out of step with regard to the development of policy rates. The Federal Reserve and the Bank of England are moving towards a less expansionary monetary policy and according to market pricing are expected to raise their policy rates during the second half of 2015, while the ECB has recently cut its policy rate and launched asset-purchase programmes.

The krona has continued to weaken against the US dollar but has strengthened somewhat against the euro and sterling. All-in-all, this means that the krona exchange rate has remained largely unchanged in trade-weighted terms since the Monetary Policy Update in September. There is consensus among analysts and market participants that the repo rate will be cut at today's meeting and that the date for the Riksbank's first rate increase will be moved forward.

Ulf Söderström, Acting Deputy Head of the Monetary Policy Department, presented the draft Monetary Policy Report which, in the assessment of the Monetary Policy Department, should gain the support of the majority of the Executive Board members. He began by noting that the forecasts in the draft were discussed by the Executive Board at meetings held on 16, 17 and 20 October. The draft Monetary Policy Report was tabled at a meeting of the Executive Board on 22 October.

The inflation outcome was unexpectedly low in September. As it is assessed that inflationary pressures will also be lower than previously forecast, the inflation forecast has been revised downwards compared with the assessment in the Monetary Policy Update in September. CPIF inflation is now expected to reach 2 per cent in the first half of 2016. The point in time at which inflation is expected to reach the target has been moved forward compared to the assessment in September.

A recovery is expected abroad. However, the recovery is expected to proceed slowly and at a different pace in different regions; the economic indicators from the United States and the United Kingdom remain strong while the already weak forecast for the euro area has been revised further downwards. The overall forecast for GDP growth abroad is therefore somewhat lower compared with the assessment in September.

All-in-all, the forecast for GDP growth in Sweden this year has been revised upwards somewhat, but is slightly lower for 2015 as a result of the weak international outlook. The figures for both CPI and CPIF inflation have been revised downwards compared with September. Unemployment is expected to fall going forward, but more slowly than was previously forecast. The debt ratio has been revised downwards retroactively due to new calculations of the households' disposable incomes. However, the lower repo-rate path and somewhat higher outcomes for debts and housing prices than expected mean that the debt ratio will reach the level forecast in the September Monetary Policy Update at the end of the forecast period.

The repo rate needs to be cut and to remain low for a long period of time for inflation to rise towards the target. The forecasts in the draft Monetary Policy Report are conditional on the repo rate being cut to zero per cent at today's meeting and on repo-rate increases beginning no sooner than in 2016 when inflation has clearly picked up.

§2. The economic situation and monetary policy

Deputy Governor **Martin Flodén** began by saying that he supported the forecast in the draft Monetary Policy Report, the proposed repo-rate path and the proposal to cut the repo rate by 0.25 percentage points.

The Riksbank presented a rather pessimistic view of developments in the euro area already in the forecast in September, but economic outcomes and indicators have nevertheless been a surprise on the downside in recent months. Uncertainty has also increased on the global financial markets. In addition, there has been a rapid fall in oil prices, inflation has surprised negatively in several countries and indicators of long-term inflation expectations have continued to fall in both the euro area and the United States. Given this, the forecasts for inflationary pressures and policy rates abroad have been revised downwards. Both the lower inflationary pressures and the lower policy rates abroad have spillover effects resulting in lower inflationary pressures in Sweden.

Mr Flodén noted that developments in Sweden have been more mixed in relation to the earlier forecast. However, for monetary policy the major event was that the inflation outcome for September was significantly lower than the Riksbank's forecast, and the low outcome cannot be simply explained in terms of any single, temporary factor. In combination with the fact that inflation has repeatedly been lower than expected, Mr Flodén believed that the weak inflation outcome justified lowering the forecast for inflationary pressures in the period ahead in line with the proposal in the draft Monetary Policy Report.

Inflation is well below the target and has been for some time. He pointed out that in order to maintain the inflation target’s credibility it is of the utmost importance that monetary policy focuses on bringing inflation up to or over two per cent. At earlier monetary policy meetings, he had therefore declared that monetary policy must react to new information that entails a lower forecast for future inflationary pressures. The fact that he was now advocating a repo-rate cut and a downward revision of the repo-rate path was therefore a consequence of his view that weaker economic development abroad and the low outcome for domestic inflation were contributing to lower inflationary pressures in Sweden.

Changing the repo rate and the repo-rate path was thus not due to a change in monetary policy strategy but to a change in the economic forecast. As at the monetary policy meeting in September, Mr Flodén believed that the combination of the economic forecast and the repo-rate path in the draft Monetary Policy Report means that the repo rate will remain at zero even when inflation rises rapidly towards the target, growth is good and unemployment falls. When, according to the forecast, the repo rate is raised in mid-2016, CPIF inflation will be 2 per cent, both including and excluding energy prices. CPIF inflation will then have been over 1.5 per cent for more than six months, at the same time as CPIF inflation excluding energy will have been close to 2 per cent during the same period.

As at earlier meetings, Mr Flodén did not wish to commit himself to needing to see precisely this course of developments before accepting that the repo rate can be raised. Decisive factors for his decision on this issue would still be what the inflation forecast looks like at the time and how certain one can be that inflation is and will remain at a level that preserves the inflation target’s credibility.

In conclusion Mr Flodén wished to say something about his view of the monetary policy reaction function now that the repo rate will be set at zero. According to the proposed repo-rate path, the expected future level of the repo rate will be zero throughout the first quarter of 2016. As the scope for cutting the repo rate to negative levels is limited, or perhaps non-existent, he pointed out that the likelihood of the repo rate being lowered from its current level is small. For the expected future repo rate to be zero, the likelihood that the repo rate will be raised must also be small during the period in which the repo-rate path has been set at zero. This reasoning can be relaxed somewhat if one considers the possibility of making monetary policy more expansionary by using methods other than cutting the repo rate. Mr Flodén's conclusion was nevertheless that significant upward revisions of the inflation outlook would be required before a repo-rate increase could be considered during this period.

Another way to express this is to say that positive inflation surprises are welcome now that inflation has been low for a long time. He found it difficult to see reasons for raising the repo rate to counteract higher inflationary pressures in the year ahead, even if the inflation forecast were to be revised upwards so that inflation clearly overshoots the target in the medium term.

First Deputy Governor **Kerstin af Jochnick** began by saying that she largely supported the assessment of developments in Sweden and abroad presented in the draft Monetary Policy Report, as well as the proposal to cut the repo rate to zero and adjust the repo-rate path so that the first repo-rate increase will not come until mid-2016.

Her assessment was that global developments are somewhat weaker than previously assessed, but that the situation still looks relatively positive in, for example, the United States and the United Kingdom. However, she found it a little worrying that growth does not really seem to be picking up in many of the developed economies. The recovery is slow despite historically-low interest rates and an expansionary monetary policy, at the same time as inflation has been lower than expected and inflation expectations have fallen in several countries.

Ms af Jochnick pointed out a number of downside risks during the forecast period at the previous meeting in September. As less than two months have passed since that meeting, her assessment of the future remains largely unchanged. However, she believes that there is now somewhat greater uncertainty about developments in, above all, the euro area, which also generates uncertainty about growth prospects in Sweden. It is primarily the somewhat weaker development of the German economy, which has been the driving force in the euro area, that worries her.

It is not only in Sweden that inflation is low, inflation is lower than expected in many countries as a result of low demand and lower oil and food prices.

Ms af Jochnick shares the assessment that the recovery is continuing in Sweden, although it is marked by a slow increase in demand, and she expects GDP growth to be almost 2 per cent this year and almost 3 per cent next year. The households' and companies' positive view of the future just before the summer has once again changed to uncertainty about the development of the economy. She said that it is important that this uncertainty does not take root in the households' and companies' consumption and investment plans.

Compared with the assessment made in September, the actual inflation outcome for September was significantly lower than expected. According to Ms af Jochnick this is partly due to international factors. Weak demand and weak inflation in the euro area, as well as very subdued international commodity prices, have contributed to unexpectedly low inflation in Sweden and several other countries. However, as the fall in inflation in Sweden has been broadly based in that it covers the prices of both goods and services, she said that it is important to continue to analyse the factors underlying the lower inflationary pressures in the Swedish economy. She noted that the companies have obviously found it difficult to pass on their cost increases to the consumers by increasing prices. In the Riksbank's Business Survey, the companies also say that the level of uncertainty is higher than normal. There are also signs that increasing competition has held back price increases. Despite the fact that it is not completely clear why inflationary pressures are so low, Ms af Jochnick said that the repo rate should be cut to zero and thus further emphasise the Riksbank's ambition and willingness to support the Swedish economy so that demand can gain a foothold and inflation can eventually rise to 2 per cent. Hopefully, this will also have a positive impact on inflation expectations so that they remain anchored around 2 per cent in the longer term.

With a repo rate at zero per cent and a repo-rate path in which the repo rate will remain unchanged until mid-2016 the focus of monetary policy is clear: to support the Swedish economy and to get inflation to rise to 2 per cent.

Low interest rates for a long period of time will enable the companies to fund investments in order to meet increased demand. Ms af Jochnick pointed out that compared to many countries in the euro area bank lending to companies is increasing, and that the corporate bond market has also increased in importance in Sweden. However, Sweden's dependence on exports means that low interest rates and access to funding are not on their own enough to increase demand in the economy. The demand for Swedish goods and services must also come from abroad. Increased demand will also lead to lower unemployment and higher growth. All-in-all, she expects a continued recovery abroad and a highly-expansionary monetary policy to contribute to resource utilisation increasing and inflation reaching the target.

Ms af Jochnick said that recent outcomes indicate that the labour market is continuing to strengthen. In September, unemployment in Sweden fell to 7.7 per cent in seasonally-adjusted terms and the assessment is that the cyclical component of unemployment will continue to gradually decrease as demand increases. However, there are also structural problems on the labour market that cannot be reduced by monetary-policy means but that require measures in other policy areas. The latest issue of Sveriges Riksbank Economic Review contains an interesting article that analyses how the composition of unemployment has developed and how matching on the labour market works.[1] Ms af Jochnick noted that the results of the analysis indicate that matching problems remain. The analysis also shows that a large part of the deterioration in matching after the crisis can be explained by changes in the composition of the unemployed, an increasing proportion of which at present are people with a weaker connection to the labour market. The unemployed that the Swedish Public Employment Service define as belonging to vulnerable groups is growing and now accounts for 60 per cent of those registered as unemployed. It is important to focus measures on these vulnerable groups to achieve a more tangible fall in unemployment. She noted that monetary policy will not be able to affect structural problems on the labour market relating to composition and matching.

[1] See Christina Håkanson (2014): "A divided labour market – on matching on the Swedish labour market after the economic crisis", Sveriges Riksbank Economic Review 2014:2, Sveriges Riksbank.

Ms af Jochnick went on to point out that the euro area is suffering from the failure to implement structural reforms to the extent needed following the financial crisis. A central dilemma is the need to reduce indebtedness in both the public and private sectors. The low interest rates have probably contributed to the failure to carry out debt consolidation. She was concerned that very low interest rates over a long period of time will create the wrong incentives in the economy and that this may lead to problems for both growth and financial stability in the slightly longer term.

Ms af Jochnick referred to a recently-published report[2] which points out that the euro area, Sweden and many other countries have not reduced their total (domestic and external) indebtedness but have, on the contrary, increased their debts in relation to GDP since the financial crisis. The authors say that the increasing debt burden will act as a major constraint for many countries and hamper growth. This is a problem despite the low interest rates. The report's conclusions underline how important it is for Sweden to take responsible measures that limit household indebtedness so we do not end up in a situation where indebtedness leads to lower growth and higher unemployment.

In Ms af Jochnick's view, a heavy responsibility therefore lies with the government and its authorities to urgently assess how the indebtedness of Swedish households should be managed so that it develops in a more sustainable way. Her assessment is that the longer measures are postponed the more difficult it will be, as the sensitivity of the households to shocks will increase as the debt stock increases. Adopting a wait-and-see attitude and hoping that the problem of indebtedness will be resolved in some other way would be tantamount to building up problems for the future and would probably lead to very negative effects for the Swedish economy.

To sum up, Ms af Jochnick expressed her support for the proposed monetary policy decision but pointed out two areas of importance to monetary policy in the period further ahead. These areas relate to improving the workings of the labour market and limiting household indebtedness.

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

Since the Monetary Policy Update was published in September, global developments have led to a number of downward revisions which are now presented in the draft Monetary Policy Report. The recovery in the euro area is now expected to be even slower than previously assessed and the figures for global inflationary pressures need to be revised downwards due, in part, to lower oil prices. At the same time, negative inflation surprises in many countries are expected to lead several of the world's central banks to

[2] See Buttliglione et al. (2014):"Deleveraging? What deleveraging? The 16th Geneva Report on the World Economy", http://www.cepr.org/content/deleveraging-what-deleveraging-16th-geneva-report-world-economy.

continue to conduct an expansionary monetary policy and, moreover, to make monetary policy even more expansionary, which has resulted in a downward revision of the forecast for policy rates abroad.

Growth in the Swedish economy has been better than expected and continues to be driven by domestic factors. However, as Sweden is a small, industry-oriented economy that is dependent on foreign trade, the ongoing difficulties abroad mean that the prospects for the years ahead need to be revised downwards somewhat for Sweden too.

Ms Skingsley noted that inflation has been undesirably low for a long time, but already ahead of today's decision on the repo rate she wished to remind the meeting that it can be said that the impact of monetary policy on the Swedish economy is strong in an international comparison.

She was referring here to the fact that Swedish lending rates to companies are generally lower than the average for the euro countries and that lending to companies is also expanding more in Sweden. Swedish mortgage rates are also lower than the average in the euro area.

However, as inflation is still weaker than expected, as a result of the factors mentioned above, and as expectations regarding how to reach the inflation target are an important component of price and wage formation, there are good reasons for cutting the repo rate further. Today's revised repo-rate path also means that it is now forecast that the first increase will come later than assessed in September, and not until inflation really picks up.

Monetary policy may need to be adjusted if the underlying conditions change. If monetary policy needs to become more expansionary, this would primarily entail postponing a repo-rate increase. Ms Skingsley pointed out that like other central banks that have reached the zero-rate level for monetary policy, the Riksbank also has the opportunity to use further measures.

With an even lower repo rate for an even longer period of time, she felt that that it was once again justified to raise the question of what this means to the households' willingness to take new loans. Prices are still rising on the housing market and expectations regarding price increases are close to historically-high levels. It thus appears that the current rate of credit expansion of over 5 per cent will continue, with a risk that it will increase further. She underlined the fact that the Riksbank has long called for economic-policy measures that limit the further build-up of debt and it is urgent that such measures are implemented.

Proposals for various forms of higher and more compulsory amortisation requirements are now being discussed, which Ms Skingsley welcomed. It is important to bear in mind that there are objections to each individual measure, but she does not see this as a reason to remain passive and to allow the ongoing expansion of credit to increase vulnerability in the household sector.

She said that, strangely enough, the Swedish debate on the households' increasing debts has been dominated by the view that Sweden differs from all other countries in that it should be able to have increasing debts without increasing the risks. The view was long put forward that no measures should be taken because household indebtedness is not a problem. Recently, we have instead heard the view that no measures should be taken because household indebtedness has become such a major problem that measures to address it risk damaging economic activity.

Of course it is difficult to know for certain where the critical levels lie, partly because experience varies from country to country. However, the growth of debt should be limited as a first step, and it is important to start doing this now when interest rates are so low. At a later stage, with higher interest rates and, to all appearances, higher debts, these changes will present a greater challenge to the economy.

Ms Skingsley wished to conclude by saying something about possible courses of development for the inflation analysis going forward. Low inflation has become an increasingly international phenomenon and an overwhelming majority of analysts have been surprised by this. The period of low inflation that we are now experiencing in Sweden and abroad, in the wake of the financial crisis, is usually explained by saying that demand is too low for price increases to take place as normal.

However, in a longer perspective, and looking back to the years before the global financial crisis, the general picture was that there was a global downward trend in inflation, particularly during the 1990s. In other words, this happened also during periods of strong growth. In that phase, low inflation was discussed on the basis of a broader analytical approach than central banks are adopting today, according to Ms Skingsley.

In short and simple terms one can view low inflation on the basis of both a supply and demand perspective, and the monetary-policy response may shift depending on the underlying analysis. Supply-driven low inflation or even falling prices as a result, for example, of increasing production capacity in various sectors, are circumstances that would not necessarily entail a more expansionary monetary policy.

The Riksbank's own survey of companies' pricing behaviour confirms the picture that low demand is an important reason for low price increases.[3] However, an even larger proportion of the responding companies said that stronger competition was the main reason for low price increases. For example, the possibilities offered by IT tools mean that the costs of finding suitable goods or services at a price one is prepared to pay are

[3] See Apel, Mikael, Frohm, Eric, Hokkanen, Jyry, Nyman, Christina and Palmqvist, Stefan (2014), Results of a survey on the companies' pricing. *Economic Commentary* no. 4, 2014. Sveriges Riksbank.

now extremely low for more or less all participants, irrespective of their place in the processing chain.

This is just one example of evolutions in the economy that central banks in general must be better at understanding, said Ms Skingsley. It is possible that this is just a question of the gradual technological changes that always take place in an economy. But Ms Skingsley said that a deeper analysis of the supply side of the economy would be desirable before we can claim this with any degree of certainty.

Governor **Stefan Ingves** began by saying that he shares the view of international developments and the Swedish economy presented in the draft Monetary Policy Report. He supported the proposal to cut the repo rate to zero per cent and the new forecast for the repo-rate path, although he wished to point out that it is of course highly uncertain in the longer term.

Mr Ingves noted that the international recovery is progressing more sluggishly than expected. It is mainly in the euro area that growth is weak. One explanation of this is that debt adjustment in the public and private sectors has been far too slow, at the same time as under-capitalised banks are finding it difficult to increase their lending even though they can borrow on extremely favourable terms from the central bank. Added to this is the weak confidence in the future, in part as a result of geopolitical unrest but also due to generally lower global demand. The figure for GDP growth during the forecast period has therefore been revised downwards.

Inflation in the euro area is still low. Mr Ingves said that this is partly due to falls in energy and food prices. Weak resource utilisation and ongoing debt adjustment in several crisis countries are contributing to holding down inflationary pressures. He also noted that the inflation forecast for the euro area has been revised downwards.

The recovery abroad is still rather uneven between different regions. In the case of several countries there are no significant forecast revisions compared with the forecasts in September. In the United States and the United Kingdom, growth is continuing in line with the earlier assessment. In China we are seeing an expected slowdown from very high growth figures. Mr Ingves noted, in other words, that the picture is just as disjointed as previously. Europe is moving in one direction and the rest of the world in another.

The general increase in uncertainty may affect the strength of the global recovery. The geopolitical unrest relating to Ukraine and Russia and the situation in the Middle East, as well as declining confidence in the future, may have contributed to this increased uncertainty. He pointed out that the oil price usually increases in connection with geopolitical unrest, but the oil price has now fallen instead. This is probably due to subdued international demand for oil and to an increase in the supply from the United States' shale-oil assets and from several traditional oil producers, and the fall in oil prices has had a dampening effect on inflation internationally.

Low inflation and subdued inflation expectations have contributed to lower government bond yields in several countries. Mr Ingves noted that the ECB has cut its policy rate to what it regards as the rate's lower bound, 0.05 per cent, and announced further measures to restore the transmission mechanism in the euro area and stimulate lending to households and companies. The ECB's Asset Quality Review and stress test form an integrated part of this strategy and Mr Ingves hoped that this will help bank lending to pick up again and to reduce the final interest rates charged to households and companies. He said that the publication of the review may in fact turn out to be more important than the purchases of asset-backed securities, as the market for such securities is rather limited in the euro area. He emphasised that it is very difficult to forecast the effects the ECB's measures will have on GDP and inflation in the euro area, but it is reasonable to assume that the effects will be positive.

Mr Ingves also noted that the weak economic development in the euro area has already had a great impact on the economy in Sweden. Exports have been weak and investment has been held back, especially in the early part of the year. However, consumption growth is expected to be good and housing investment to remain high. Exports and corporate investment are expected to make increased contributions to GDP growth from the start of next year when growth gradually strengthens abroad. This is a cyclical pattern that he recognises.

On the labour market, employment increased somewhat more than expected in the third quarter of this year. However, labour-force participation also increased, so that unemployment fell to a lesser extent. Mr Ingves expects to see a more marked fall in unemployment in the period ahead as economic activity strengthens. Going forward, the labour force will also to a greater degree be composed of groups on the periphery of the labour market. All-in-all, together with the new forecast for economic activity, this will contribute to unemployment falling somewhat more slowly than in the previous assessment.

Mr Ingves noted that inflation has once again been lower than expected. Over the last two months, prices for food, goods and services have overall been lower than forecast. The low food prices are a global phenomenon that has held back inflation not only in Sweden. International food commodity prices were almost 7 per cent lower in September than they were a year ago. Goods prices, excluding food, fell in September somewhat more than they usually do on average. Service prices, which weigh heavily in the CPI,[4] increased much less than they do on average. He also pointed out that the prices of oil, electricity and other commodities have not contributed to rising inflation.

Mr Ingves observed that this means that inflation has been misjudged once again. Given the development of the real economy, inflation should be higher than it is. This means

[4] 44 per cent

that the uncertainty that has to be managed in connection with monetary policy decisions is now unusually high. This is partly a question of issues that need to be analysed more closely; for example, uncertainty about the future, technical developments, particularly in the service sector, and increasing global competition may help to explain the development of inflation. But it is also a question of acquiring more knowledge about the supply side. To the extent that low inflation in Sweden and other countries is due to supply effects of various kinds, this can in itself contribute to a positive stimulus for companies and households going forward. If one compares the CPIF and the CPI measured with KIX weights they look rather similar, according to Mr Ingves, and this raises the question of how much domestic monetary policy can manage irrespective of what happens in the rest of the world.

Nevertheless, he believed that it was a natural monetary policy reaction to cut the repo rate to zero at today's meeting and to assume that it will remain at this level until mid-2016. He noted that inflation is unexpectedly low. Together with lower international price pressures, this means that inflation is also expected to be lower during the next two years. Wages and prices should rise faster as resource utilisation increases. Rising import prices are also expected to contribute to rising inflation. Mr Ingves pointed out that with the current monetary policy, Sweden now has interest rates that are among the lowest in Europe and a significantly more rapid credit expansion, and there are no obvious disruptions to the transmission mechanism. The money supply, M1, is growing by 10 per cent. In other words, monetary policy is highly expansionary from a financial perspective and should lead to rising inflation, according to Mr Ingves. If the economy develops as expected there should be no need for other monetary-policy measures.

At the same time it is important to carefully monitor the growing indebtedness of the households. On the one hand, inflation is low and demand needs to be kept up. On the other hand, households are borrowing too much and this is an equation that does not add up. Debts are expected to increase more quickly than incomes during the forecast period, which means that the debt ratio will increase. In Mr Ingves' view this situation is untenable. In his view this is basically a case of the economy really needing two different policy rates: one for the households and one for the companies. It is of course not possible to achieve this by monetary-policy means. It must instead be achieved in some other way, for example with clear amortisation requirements or reduced interest-rate deductions for mortgages. A failure to make decisions in this area threatens economic development and ultimately also monetary policy, said Mr Ingves.

There is also uncertainty regarding the direction that other central banks' monetary policies will take in the period ahead. He pointed out that it is not possible to know for certain when other central banks will begin to raise their policy rates, or to say anything about what the effects of complementary monetary-policy measures will be in the euro area.

When the international situation is so messy, it is difficult to use conventional analytical tools to make forecasts. Models cannot capture everything, although models are good at calculating a future mean value for production and inflation. However, models are not good at capturing the risk of very negative scenarios. He could, for example, not rule out a risk scenario in which macroprudential policy or housing policy fails to manage all the risks associated with household indebtedness. Retaining a zero interest rate for too long would then increase the likelihood of a domestic crisis caused by household indebtedness.

Another risk scenario that Mr Ingves feared may become a reality is that the monetary policies of other central banks continue to be expansionary longer than in the Riksbank's assessment. Low policy rates and complementary measures in other countries would then risk leading to capital flows and exchange rate appreciation that hold inflation in Sweden down longer than is desirable.

In his view, monetary policy in the present situation is therefore a question of risk management, not a question of fine tuning to the last decimal over a three-year horizon. He said that an open-minded attitude was needed and emphasised that it is difficult to compensate for very weak economic developments abroad solely with the help of monetary policy. He noted that inflation is very low in the initial position in the main scenario. The international outlook is uncertain and the assessment is that the repo rate will remain at zero until it is clear that inflation will reach the target. Mr Ingves concluded by saying that if some unforeseen event occurs that upsets this assessment, then it will be a question of adapting to the situation further ahead.

Deputy Governor **Per Jansson** began by observing that inflation was still very low. Two new inflation outcomes have been published since the Monetary Policy Update in September. The latest outcome for September was almost 0.4 percentage points lower than the forecast in the Monetary Policy Update. Mr Jansson said that this was a real setback given that the outcome for September was supposed to represent the starting point of a trend towards a higher rate of inflation. However, this proved not to be the case.

Mr Jansson pointed out that the main question in connection with this monetary policy meeting, as on a number of previous occasions over the last 12 months, was whether the unexpectedly low inflation outcome would lead to a revision of inflationary pressures in the period ahead, or whether it should rather be seen as a temporary deviation from the previous assessment. The draft Monetary Policy Report proposes that it is the former that applies. The proposed forecast represents a significant downward revision of inflationary pressures in the coming years, especially when one considers that the new inflation assessment is conditional on a much more expansionary monetary policy. The reasons put forward in the draft Monetary Policy Report are that inflation has repeatedly been lower than expected in the recent past, that international price pressures are now expected to be lower and that it is predicted that the development of oil and fuel prices will be weaker. Moreover, the draft Monetary Policy Report also proposes a rather substantial downward revision of the growth forecast for the euro area and the weaker economic outlook now applies to the German economy too.

According to Mr Jansson, it is no exaggeration to say that it has been unusually difficult to make reasonably accurate inflation forecasts recently. Since the outcome for October last year, which can be said to mark the beginning of this period with particularly substantial negative inflation surprises, eight out of twelve monthly outcomes have been below the Riksbank's forecast. The results are no better for other forecasters. For them too, on average eight out of twelve outcomes have been lower than expected. This is particularly disheartening given that we are talking about forecasts for the short term. Mr Jansson declared that against this background, and against the background of other arguments put forward in the draft Monetary Policy Report, he shares the assessment that it is most probable that the trend with unexpectedly low inflationary pressures has not yet come to a halt. He thus supported both the macro forecast and the monetary policy presented in the draft Monetary Policy Report.

So, how probable is it that this forecast will hold water and that it will not be necessary to once again revise the inflation assessment downwards at some point in the future? Mr Jansson said that forecasts are uncertain, as we all know, so we cannot rule out that further downward revisions will be required. However, it is nevertheless worth pointing out that the new assessment entails substantially lower inflationary pressures in the years ahead. If we only compare the forecast paths for CPIF inflation we are talking about a downward adjustment of at most 0.6-0.7 percentage points during the second and third quarters of 2015. However, in addition to this the repo-rate path has also been significantly lowered. On average the repo rate is now approximately 0.6 percentage points lower in each quarter during the forecast period. At most, the downward adjustment amounts to 1 percentage point in the second quarter of 2016. Mr Jansson said that it would not surprise him if this was the largest downward revision of inflationary pressures that the Riksbank has ever made since it began publishing both a repo-rate path and an accompanying inflation forecast.

He said that taking all this into account it is now reasonable to assume that, compared with the assessment in September, it is less likely that inflation outcomes in the period ahead will be lower than the Riksbank's forecast. At the same time, he emphasised that he stands by his earlier analysis that the general preconditions for a rising rate of inflation look good. Monetary policy of course contributes to this. In addition economic activity is expected to improve both in Sweden and abroad. This will strengthen the labour market and push up the rate of growth in unit labour costs, which has already been significantly higher than the rate of inflation for a number of years now. Sooner or later, it will become necessary for companies to raise their prices more markedly. The alternative is for companies to make staff cuts. Fortunately, staff cuts are not at all on the cards at present.

As pointed out in the draft Monetary Policy Report, the more expansionary monetary policy makes it increasingly urgent for other policy areas to manage the risks relating to household indebtedness and developments on the housing market. As has been said many times before, it is measures that are directly targeted at the households' demand for credit that are needed. Mr Jansson said that the exact combination of measures taken is less important. The important thing is instead to avoid a situation in which no measures are taken at all. This is of course not a question of cutting the Gordian knot. It is instead about implementing well-balanced and gradual changes. And there is broad agreement on this, observed Mr Jansson.

He noted that the measure that has perhaps been discussed most in recent months is to introduce some form of amortisation requirement. In this context, the Swedish Bankers' Association has said that it wishes to tighten up its previous amortisation recommendation that new mortgages with a loan-to-value ratio of over 70 per cent should be amortised within 10 to 15 years. The tighter proposal is that amortisation payments should now be made on new mortgages with a loan-to-value ratio of over 50 per cent.

Striving to establish a self-regulating system that provides scope for flexibility is in general a good idea, said Mr Jansson. However, it is not yet possible to take a stance on the Swedish Bankers' Association's proposal as it is too general. It is important that the rate of amortisation is rapid enough so that indebtedness is affected to a reasonable extent. Moreover, it must be possible to continually monitor a solution based on self-regulation and it must be backed up by a plan for regulation by Finansinspektionen if the desirable results are not achieved. It is also important that the drafting of the Swedish Bankers' Association's proposal does not drag on. He emphasised that the situation is acute, and that in this case Finansinspektionen should instead adopt a binding regulation, or possibly a general guideline.

Mr Jansson said that the discussions on further measures must continue even if an amortisation requirement is introduced. An important task for the Financial Stability Council, which will meet under the leadership of the new government on 11 November, will be to establish the framework for this ongoing work so that a plan with further concrete measures is drawn up. In parallel with this, the structural problems on the housing market must also be addressed, and primarily the fact that the supply of housing is insufficient and not rich enough.

But isn't there a contradiction between conducting an extremely expansionary monetary policy on the one hand and calling for measures to slow down the households' demand for credit on the other? Mr Jansson pointed out that it is obviously the case that the monetary policy transmission mechanism will be missing a link if macroprudential policy is successful in limiting household lending. On the other hand, however, it is not desirable to attain the inflation target at the cost of an unsustainable development of household debt. This would sooner or later simply lead to the risk of repercussion in the form of macro instability and possibly also new difficulties in reaching the inflation target. So, in this perspective there is no contradiction here, indeed the opposite is true, argued Mr Jansson.

He emphasised that the situation is of course not simple, but this is the reality we are in and nothing will be improved by hiding one's head in the sand. All of the policy areas concerned must now shoulder their part of responsibility. And this must be done with the knowledge that monetary policy has no scope to help in this context, at least not by adjusting the repo rate. On the contrary, monetary policy will contribute towards increasing the risks, but this is unavoidable in a situation where the Riksbank must give priority to achieving rising inflation. To make this priority clear, Mr Jansson said that he also holds to his earlier promise not to vote in favour of an increase in the repo rate until CPIF inflation picks up and exceeds 1.5 per cent. The forecast in the draft Monetary Policy Report entails the Riksbank observing outcomes for CPIF inflation exceeding 1.5 per cent for just over six months before initiating cautious increases in the repo rate. On this point, the relation between the inflation forecast and the repo-rate path is thus largely unchanged compared to the assessment in September. And it is still also roughly such a relation that Mr Jansson considers to be compatible with his promise. As previously, he wished to underline that this promise is unconditional, that is it applies irrespective of the development of other variables that are normally considered to be relevant to monetary policy.

§3. Discussion

Deputy Governor **Per Jansson** began the discussion by expressing his support for what Ms Skingsley said about the need to take a broader approach when analysing the reasons for the low rate of inflation. He felt that it was important to take into account both demand and supply factors here.

It might be understandable for countries that have been at the epicentre of the crisis to have a one-sided focus, continued Mr Jansson. There, the considerable negative effects on production, employment and unemployment have entirely dominated both the debate and actions in economic policy. One might think that countries that had fared better, such as Sweden, ought perhaps to have scope to conduct a more nuanced discussion. However, even in these countries the discussion has focused rather one-sidedly on the development of demand, said Mr Jansson.

This is something that needs to be rectified now. Such analyses are also important for those who may consider whether the Riksbank's tasks are to be changed, for instance, by introducing an explicit target for employment or unemployment. One might reasonably believe that the conclusions on this point will not be the same if shortages on the supply side of the economy play a more important role than the debate has so far implied. In this case, argued Mr Jansson, it is more an issue of resolving structural problems in the labour market than making changes to the Riksbank's objectives.

Monetary policy's capacity to counteract shocks should be examined in this context as well. Mr Jansson felt that the question here was why the major stimulus measures in recent years have not had greater effects on economic activity and inflation. Structural problems may of course be an explanation in some countries, but it is more difficult to understand why this has been the case in countries with a monetary policy transmission mechanism that works, a relatively robust financial sector, and stable public finances.

First Deputy Governor **Kerstin af Jochnick** wanted to comment on the views expressed by Ms Skingsley and Mr Jansson regarding the importance of taking measures now to limit household indebtedness. As she sees it, there are two parts to this question. One is that measures need to be taken to create greater efficiency in the housing market. The other is that the measures taken should more directly influence household indebtedness.

She shares the assessment that there is now a risk that it will be increasingly difficult to take measures, as many households are heavily indebted and measures may have a negative effect both on individual households and the macroeconomy.

Ms af Jochnick pointed out that amortisation requirements will be discussed at the next meeting of the Financial Stability Council. Given the very low interest rates and continuing rise in housing prices, it will be even more important to quickly introduce an amortisation requirement, regardless of whether this comes via regulations or self-regulation.

Deputy Governor **Martin Flodén** also wanted to comment on the broader and more developed analysis of explanatory factors behind inflation, and in particular a more thorough analysis of supply factors that might have contributed to the low inflation rate, which was requested by Ms Skingsley and Mr Jansson. Mr Flodén agreed that it is important to understand the development of inflation, and also he would welcome such an analysis. At the same time, he felt that it is not evident that the results of such an analysis would have implications for the monetary policy decisions, particularly in Sweden at the present time. One reason why it is important to understand which factors have influenced inflation is that this type of analysis is necessary to assess whether developments have a temporary or lasting influence on future inflationary pressures. In the latter case there is of course a greater need to let monetary policy react.

The distinction between supply and demand factors behind the development of inflation is probably more relevant to make an assessment of how the real economy develops, which in turn may also have implications for monetary policy. After all, monetary policy involves both stabilising the real economy and keeping inflation close to the target, Mr Flodén pointed out, but noted that in Sweden at present it is the low inflation that is in focus. The fact that inflation has been low for a long time and inflationary pressures are expected to remain low justifies the Riksbank conducting a very expansionary monetary policy to safeguard the credibility of the inflation target. And according to Mr Flodén, it is reasonable to draw this conclusion regardless of which explanatory factors are identified behind the low inflation.

Mr Flodén pointed out that he was not trying to dismiss Ms Skingsley's wishes, but was only discussing the implications he expected that such an analysis might have for current monetary policy. It is, of course, important that central banks have a broad and well-developed analysis of the development of inflation.

Deputy Governor **Cecilia Skingsley** declared that she shares the view of Mr Jansson regarding the Swedish Bankers' Association's proposal on amortisation. Self-regulation is of course preferable to government regulation, but the Swedish Bankers' Association's proposal has so far been worded in too general a manner for its consequences to be analysed. She also agreed that it should be possible to measure the effects of self-regulation and that Finansinspektionen needs to be prepared to supplement this self-regulation with a more coercive measure if things do not develop in a satisfactory manner.

With regard to Mr Flodén's comments on her contribution to the debate on supply aspects in the inflation analysis, Ms Skingsley said that she believes there is reason to take one thing at a time and not to determine anything in advance. She sees continuing to develop the analysis of price mechanisms in the economy as a natural part of the monetary policy framework and this does not entail a departure from the inflation targeting regime. It could also be an important part of increasing the general public's understanding that monetary policy is not always able to make inflation stick to the target level of 2 per cent, said Ms Skingsley.

Governor **Stefan Ingves** wanted to comment on a few aspects of inflation, which had been discussed by all of the Board members during the meeting. Why has inflation turned out the way it has? He felt that it is reasonable to study this question in more depth, and not just in Sweden but internationally. What is demand driven and what is driven by supply factors? Regardless of how inflation develops in the future, there is always something to be learnt from this, said Mr Ingves. In a small open economy, particularly one as open as the Swedish economy, with large exports, imports and no limits on capital flows – and this is how it should be, he emphasised – what possibility is there to fine tune monetary policy? For his part, he considers it probable that inflation will continue to deviate periodically from the target.

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

The prospects for the United States and the United Kingdom remain good. However, inflation abroad is expected to become lower and the recovery in the euro area is expected to proceed more slowly than was previously assessed.

In Sweden, economic activity is strengthening and the labour market is continuing to improve. Nevertheless, inflation is low and inflationary pressures are expected to be lower than was previously forecast.

The Executive Board was therefore unanimous in the view that monetary policy needs to be even more expansionary for inflation to rise and attain the target and for inflation expectations to remain anchored at 2 per cent.

All of the Board members advocated that the repo rate be cut to zero and that the repo-rate path should be lowered substantially. The low repo rate will increase demand in the economy, which will contribute to a rise in inflation. CPIF inflation is expected to reach 2 per cent during the first half of 2016. As noted in the draft Monetary Policy Report, monetary policy may need to be adjusted if conditions change. Moreover, the Riksbank will have the same possibilities as other central banks to take further measures to increase the monetary policy stimulus.

But the low repo rate will also contribute to reinforcing the trend of rising house prices and household indebtedness. This risks leading to problems for both individual households and the economy as a whole. When interest rates are this low, several Board members emphasised that it is even more important that other policy areas now handle these risks.

During the meeting the Board also discussed the role of supply factors when analysing the development of inflation, as well as the role of the repo-rate path in the light of the current uncertainty over economic and monetary policy developments around the world.

§4. Decision on the Monetary Policy Report and the repo rate

The Executive Board decided

• to adopt the Monetary Policy Report according to the proposal, Annex A to the minutes,

• to cut the repo rate to zero per cent and that this decision would apply from Wednesday 29 October 2014,

§5. Decision on fine-tuning transactions and standing facilities

Heidi Elmér presented this agenda item.

The Executive Board decided in accordance with the proposal, Annex B to the minutes.

§6. Other decisions

The Executive Board decided

• to publish the decision under §4 and §5 at 9.30 a.m. on Tuesday 28 October 2014 with the motivation and wording contained in a press release, and

• to publish the minutes of today's meeting on Tuesday, 11 November 2014, at 9.30 a.m.

This paragraph was verified immediately.

Minutes by

Ann-Christine Högberg

Verified:

Stefan Ingves	Per Jansson	Kerstin af Jochnick
Martin Flodén	Cecilia Skingsley	

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