Minutes of Monetary Policy Meeting

DECEMBER 2014

Summary

At the monetary policy meeting on 15 December, the Executive Board of the Riksbank decided to hold the repo rate unchanged at zero per cent and concluded that the repo rate needs to remain at zero for a somewhat longer period of time, compared with the forecast in October.

The recovery in economic activity abroad is continuing, but there are significant differences in growth between countries. In the United States and the United Kingdom, growth is solid while the economic outlook for the euro area remains subdued. The oil price has fallen heavily. The lower oil price is expected to give some positive stimulation to growth in many countries. At the same time, the price fall means that the forecast for inflation abroad is lower.

Economic activity in Sweden continues to improve. Since October, economic developments have been in line with the Riksbank's forecasts. GDP and employment are expected to continue rising.

However, inflation is too low and is expected to be somewhat lower for a period of time, primarily due to the falling oil price. In addition, inflation expectations in the longer run have fallen slightly further and are below the inflation target of 2 per cent. For inflation to rise towards the target sufficiently quickly and to reduce the risk of longer-run inflation expectations continuing to fall, monetary policy needs to become more expansionary.

The Executive Board of the Riksbank has therefore decided to hold the repo rate unchanged at zero per cent and assesses that the repo rate needs to remain at zero for a longer period of time, compared with the forecast in October. The expansionary monetary policy underlines the Riksbank's aim to safeguard the role of the inflation target as nominal anchor for price-setting and wage-formation.

The low repo rate, together with rising demand from abroad, is expected to lead to an increase in economic activity in Sweden in the years immediately ahead. Companies will then be able to raise their prices and in this way pass on their cost increases to consumers to a greater extent. This should mean that inflation rises. The new repo-rate path means that the repo rate will remain at zero per cent until CPIF inflation is close to 2 per cent. The assessment is that it will be appropriate to begin increasing the repo rate in the second half of 2016.

If monetary policy needed to become even more expansionary, this would primarily entail continuing to postpone a first increase of the repo-rate. The Riksbank is also preparing further measures that can be used to make monetary policy even more expansionary. Such measures, were they necessary, could be presented with effect from the next monetary policy meeting.

MINUTES OF MONETARY POLICY MEETING
Executive Board, No. 6

SVERIGES RIKSBANK
SE-103 37 Stockholm
(Brunkebergstorg 11)

Tel +46 8 787 00 00
Fax +46 8 21 05 31
registratorn@riksbank.se
www.riksbank.se

DATE: 15 December 2014

TIME: 09.00

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

Michael Lundholm, Vice Chair of the General Council

Claes Berg
Charlotta Edler
Heidi Elmér
Lina Fransson
Eric Frieberg
Christoffer Grände (§ 1)
Ann-Christine Högberg
Martin W Johansson
Anna Lidberg
Henrik Lundvall
Mårten Löf
Ann-Leena Mikiver
Christina Nyman
Carl-Fredrik Pettersson (§ 1)
Maria Sjödin
Ulf Söderström
Sara Tägtström
David Vestin
Anders Vredin

It was noted that Anna Lidberg and Sara Tägtström would prepare draft minutes of § 1, and 2 of the Executive Board’s monetary policy meeting.

§1. Economic developments

Carl-Fredrik Pettersson of the Markets Department began by presenting the latest developments on the financial markets. Since the Monetary Policy Report was published in October, attention on the financial markets has been highly focused on the falling oil price, which in US dollars has fallen by a further 30 per cent since the monetary policy meeting held in October. There are signs that financial market unease has increased in recent days. The stock markets have noted downturns in December, while the reluctance to take risk is reflected by an increase in various measures of uncertainty on the financial markets.

Government bond yields have fallen in Sweden and abroad as a result of continued uncertainty about growth in several parts of the world. Central banks around the world are also expected to continue to be out of step: the ECB is expected to conduct an even more expansionary monetary policy in the years ahead, while the Federal Reserve and the Bank of England are expected to begin raising their policy rates in 2015. One cause for concern on the markets is the approaching presidential election in Greece, which has led to rising Greek government bond yields. This has had spill-over effects to government bond yields in Spain and Italy. However, both Swedish and German ten-year yields have been noted at record-low levels.

Inflation expectations have fallen in Sweden and abroad. According to the Prospera survey, there has been a falling trend in long-term inflation expectations since the latter part of 2011.

Ulf Söderström, Deputy Head of the Monetary Policy Department, presented the draft Monetary Policy Update 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 Update were discussed by the Executive Board at the meetings held on 9 and 10 December. The draft Monetary Policy Update was tabled at a meeting of the Executive Board on 12 December.

Since the Monetary Policy Report was published in October, inflation has developed in line with the Riksbank's forecasts. Compared with the October Report, the forecast for inflation measured in terms of the CPI with a fixed mortgage rate (the CPIF) has now been revised downwards somewhat in the near term as a result of lower oil prices and a somewhat slower rate of rent increases. However, this revision is partly countered by a somewhat weaker krona and a higher rate of electricity-price increases in the period ahead. CPIF inflation is expected to reach 2 per cent in mid-2016. In the slightly longer term, the inflation forecast has been revised upwards as the krona is now expected to strengthen somewhat later than forecast in October. There has been a further slight fall in long-term inflation expectations since the meeting in October and expectations are below the inflation target of 2 per cent. Given the low inflation outcomes the downturn in expectations is more or less as expected, but it will be problematic if this trend continues.

Economic activity abroad has largely been in line with the assessment made in October. It is assumed that the international recovery will continue, but sluggishly and at a different pace across countries. The substantial fall in oil prices since October is mainly interpreted as supply-driven and is expected to provide some positive stimulus to growth in the United States and the euro area. However, this is largely counteracted by weaker development in commodity-producing countries, China and Japan. The forecast for KIX-weighted GDP is largely unchanged throughout the forecast period compared to the forecast in October. The KIX-weighted inflation forecast for 2015 has been revised downwards substantially due to the fall in oil prices.

Economic development in Sweden has also been in line with the October forecast. Only marginal changes have been made to the forecast for Swedish GDP. Lower oil prices and a somewhat weaker exchange rate will contribute to slightly higher growth, while the introduction of an amortisation requirement will subdue growth marginally. The labour market is expected to be somewhat weaker at the end of 2014 and the start of 2015, compared with the assessment in October. Household debt in relation to disposable income increases in the forecast and has been revised upwards somewhat compared to the October Monetary Policy Report.

In order for inflation to rise towards the target sufficiently rapidly and to reduce the risk of a continued fall in long-term inflation expectations, the assessment is that the repo rate needs to remain at zero per cent for a somewhat longer period than was assessed in October. The forecasts in the Monetary Policy Update are based on the repo rate remaining at zero per cent until the second half of 2016 and then gradually rising to 1.45 per cent at the end of 2017.

§2. The economic situation and monetary policy

Governor **Stefan Ingves** began by saying that he shared the view of developments abroad and the Swedish economy presented in the draft Monetary Policy Update. He supported the proposal to keep the repo rate at zero per cent and the revised repo-rate path that makes monetary policy somewhat more expansionary.

The international recovery is continuing, partly because the monetary policy conducted by the central banks is highly expansionary. But development is still uneven. In the United States, the economy continues to improve. Corporate profits are good. The labour market is developing well, which is benefiting household incomes and consumption. The recovery in the euro area has been more sluggish, partly because, in his view, the debt adjustment process has been far too slow. However, the asset quality review (AQR) of the European banks has now been completed and there are signs of some stabilisation of the credit markets. The forecast for GDP growth in the euro area has been revised upwards marginally. Mr Ingves emphasised that there is still great uncertainty in several euro countries about remaining imbalances, competitiveness, the sustainability of public finances and reform processes. It therefore seems that the euro area still has a long way to go to achieve long-term equilibrium and stable growth. In other words, the economic outlook is just as disjointed as the Riksbank has previously pointed out.

Mr Ingves went on to discuss the fall in oil prices and its effects on inflation and growth. He began by noting that oil prices have fallen substantially during the autumn. Since the summer, the USD oil price has fallen by more than 40 per cent. The fall in prices is probably due to both supply-side effects, such as increased supplies from the United States' shale oil assets and from several traditional oil producers, and subdued demand from, for example, China and the euro area.

Mr Ingves said that the conclusions to be drawn regarding the effects of oil prices in the current economic juncture are not self-evident. On the one hand, the fall in oil prices has dampened global inflationary pressures. The Riksbank has therefore revised its forecast for KIX-weighted inflation downwards by 0.5 percentage points to 1.5 per cent next year. One the other hand, lower oil prices will help to increase the scope for consumption somewhat, which will provide a positive stimulus to growth in the United States and the euro area. In earlier periods with major falls in oil prices, for example 1986 and 1997-1998, this has helped to stimulate GDP growth in developed countries. However, monetary policy also provided more stimulus in these periods as the central banks responded by lowering their policy rates. Policy rates in several countries are now zero or close to zero, which limits the scope for conventional monetary policy.

Low oil prices and their effects may influence how long monetary policy continues to be expansionary abroad, according to Mr Ingves. They may also influence the extent and design of complementary monetary policy measures. The forecasts regarding the real economy and inflation differ across regions. Market expectations are that policy-rate increases will begin in the United States and the United Kingdom at the end of next year, but that the increases will be gradual, while it is assumed that the policy rate in the euro area will remain unchanged over the next three years. The ECB has announced its intention to expand its balance sheet by EUR 1 billion with the aim of boosting inflation. If this picture changes, it is likely that Swedish monetary policy will also be affected.

Mr Ingves noted that the forecast revisions regarding the Swedish economy are small compared to October. The fall in oil prices will also benefit GDP growth in Sweden, but not as much as in the United States, for example. It is also expected that the krona will strengthen somewhat later than was assumed in October, which is also positive for growth. However, Finansinspektionen's proposed amortisation requirement will dampen household consumption somewhat. This should be regarded as something of an investment for the future as in the long term it will reduce household debt.

The driving force for growth in Sweden is increasing international growth, which will benefit Swedish exports and investment. The general uncertainty about the future will abate when growth normalises, which will also lead to a realisation of postponed investments.

Inflation is still low. Mr Ingves noted that the companies are obviously finding it difficult to pass on their cost increases to consumer prices. The rates of price increases for food and services are lower than their historical averages. In addition we have the falling oil prices. Inflation expectations five years ahead have also exhibited a falling trend and this is a trend that must be broken.

He pointed out that the inflation forecasts for the short and medium term have been revised downwards due to the lower oil prices and expectations of somewhat lower rent increases. However, this is counteracted to some extent by a weaker krona. In the longer term, the inflation forecast has been revised upwards somewhat against the background of more expansionary monetary policy. Employment is increasing on the labour market. The number of new job vacancies has increased significantly during the year, while redundancy notices remain at a low level.

Mr Ingves said that there is currently a rather odd combination of a reasonable level of activity in the real economy at the same time as inflation has been low and/or lower than expected. This is not a normal situation. He said that we seem to be a rather long way from a state of long term equilibrium, and gave three examples of this:

First, he noted that unemployment is gradually falling but is still higher than in, for example, Germany. There are signs that matching on the Swedish labour market has deteriorated after the crisis.[1] A large part of the deterioration in matching efficiency after the crisis can be explained in terms of the composition of the unemployed.

A process of structural transformation is also underway in the Swedish economy with a shrinking industrial sector and a growing service sector. It appears that sector imbalances have increased. Since 2009, personnel shortages in some service sectors and shortages of white-collar technicians in the manufacturing sector have increased, while shortages of skilled blue-collar workers have been limited.

Mr Ingves said that the ongoing structural transformation and the risk of poorer matching on the labour market make it more difficult to assess the output gap and resource utilisation. The National Institute of Economic Research has, for example, revised its assessment of the equilibrium unemployment rate (2013-2015) upwards, partly as a result of changes in the composition of the labour force.

---

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

Another central problem is that housing prices and household indebtedness are increasing rapidly. Mr Ingves pointed out, as he has done on many previous occasions, that we really would need two policy rates – one for companies and another, higher rate for households. The Riksbank expects household debt to increase more rapidly than household income in the period ahead, which also increases the need for decisions on measures in policy areas other than monetary policy. There is a list of conceivable measures, including lowering the mortgage ceiling, reducing the households' tax deductions for mortgage payments and improving the functioning of the housing market.

Mr Ingves concluded by discussing monetary policy. Inflation is still low and the fall in oil prices is contributing to a slight downward revision of the forecast for inflationary pressures. Inflation expectations in the longer term have also fallen somewhat. This suggests that monetary policy needs to become somewhat more expansionary than the Riksbank estimated at the previous monetary policy meeting. The proposal is to retain the zero repo rate for a slightly longer period. This means that the Riksbank now expects that the first repo-rate increase will not occur until the second half of 2016. The assessment is that CPIF inflation will then be close to 2 per cent. Thereafter, the repo rate will be gradually raised and end up at a slightly lower level than in the previous forecast. Monetary policy will then help to increase demand and resource utilisation so that inflation rises towards the target.

However, there are many uncertain factors that may affect developments in the period ahead. Mr Ingves said that upside risks in the form of higher growth and inflation than expected are easy to manage at present, and he therefore refrained from commenting on these and focused instead on the downside risks.

He noted that the price of oil is obviously an important uncertainty factor at the moment and that there is a need to carefully analyse how this is affecting inflation and growth in Sweden and abroad. Another uncertainty factor is the recovery in the euro area and what additional measures the ECB may take.

Mr Ingves also pointed out that it is not possible to say in advance what effects the monetary-policy measures taken by other central banks will have on the Swedish exchange rate and on monetary conditions in Sweden.

Although there are no problems with the transmission mechanism in Sweden, the Riksbank needs to be prepared to take further measures to increase the monetary policy stimulus if development proves to be weaker than expected. As the price of Riksbank money is already zero, the Riksbank will have to work with quantities in various ways instead, that is to make sure that the Riksbank's balance sheet grows.

In the first instance, it is a question of continuing to postpone a first repo-rate increase, said Mr Ingves. In addition to this, it may also involve measures to push down long-term market rates in order to strengthen and improve the impact of monetary policy. This can be done either directly on the markets or through the banking system. The Riksbank has also previously demonstrated that it is fully possible to substantially expand the balance sheet. Other central banks have taken such measures and the Riksbank has the know-how. It is now time to prepare potential non-conventional measures which, if the need arises, could be presented at the next monetary policy meeting. Mr Ingves said that among such measures he did not wish to exclude a negative repo rate or foreign-exchange interventions, although the latter would in no way be his first choice.

Deputy Governor **Per Jansson** began by noting that two new inflation outcomes have been published since the October Monetary Policy Report. The outcome for CPIF inflation in November was approximately 0.6 per cent, which was marginally higher than expected. Given the recent experience to systematically over-estimate the development of inflation this was of course encouraging, he said. It was also positive that CPIF inflation adjusted for the volatile energy prices increased to almost 1 per cent. This was almost 0.1 percentage points higher than expected and the most rapid rate of increase for this measure of underlying inflation in 2014 so far.

Mr Jansson thus concluded that the outcomes for the current rate of inflation are good news. Unfortunately, the same cannot be said about the outcomes for various groups' inflation expectations. According to the latest Prospera survey, expectations of inflation five years ahead fell for all of the groups interviewed in December compared to the preceding survey in September. He observed that the fall was largest in the case of the employer and employee organisations, where inflation is now expected to be around 1.7 per cent in five years' time rather than close to 2 per cent as expected earlier. The lowest expectations are to be found among purchasing managers in the manufacturing industry, where the rate of inflation five years ahead is predicted to be 1.64 per cent. Aggregate expectations for all interviewees fell by just over 0.1 percentage points, from 1.85 per cent in September to 1.72 percent now in December.

Although the deviation from the inflation target is still rather small for most of the groups interviewed, and although the responses are perhaps too highly affected by the current low rate of inflation, we cannot escape the conclusion that the development of the more long-term inflation expectations is a cause for concern, Mr Jansson continued. There has now been a falling trend in these expectations since the autumn of 2011. The aggregate figure for all interviewees has not been as low as this since the summer of 1999 and is the fourth lowest figure to date.

In order to reduce the risk of long-term inflation expectations continuing to fall, Mr Jansson said that he shares the assessment in the draft Monetary Policy Update that it is now appropriate to make monetary policy somewhat more expansionary by postponing the first repo-rate increase. This will send a clear signal that the Riksbank safeguards the role of the inflation target as a nominal anchor for price setting and wage formation. At the same time, a postponement of the first repo-rate increase will to some extent counteract the somewhat lower inflation that is forecast in the shorter term. This is particularly important if it is the case that the more long-term inflation expectations are influenced to a too high degree by the current low rate of inflation. Given this background, he supported both the macro forecast and the monetary policy presented in the draft Monetary Policy Update.

Although the development of various groups' more long-term inflation expectations is worrying, Mr Jansson's view was that the potential for a rising rate of inflation in the period ahead continues to be good. The sizeable monetary policy stimulus now spreading throughout the Swedish economy is, not least, contributing to this. Since December 2011, the repo rate has been cut by 200 basis points, from 2 per cent to zero per cent. At the same time, the date for the first repo-rate increase has been postponed by approximately four years. Moreover, the rate at the end of the forecast period has been lowered by approximately 200 basis points, from around 3.5 per cent to 1.45 per cent. It is of course difficult to say precisely how long it will take before all these easing measures have their full effect. But the effects will increase as time passes and the likelihood of inflation rising will thereby also increase.

Another circumstance that Mr Jansson saw as significant in this context is that unit labour costs have increased faster than consumer prices for several years now. Such a situation is not sustainable in the long term, at least not if Sweden's companies are to avoid closures. Sooner or later, the companies must raise their prices. If it is also the case that the companies profit shares are initially low, which he said there are signs of, then the price increases should even be higher than the cost increases for a while. The alternative is for the companies to increase their productivity growth or for wage increases to be very low. However, in a situation in which inflation has been low for a long time and economic activity is improving, the most natural thing is for the companies' prices increases to be higher. And exactly as in the case of the monetary policy stimulus, the likelihood of more rapid price increases will also increase as time passes. This is simply because the need for a better development of corporate profits will increase the longer costs rise faster than prices.

Mr Jansson considered these to be very strong arguments for inflation rising in the period ahead. However, there is of course uncertainty about how quickly this will happen. Nor can it be ruled out that new shocks will occur that have a negative impact on inflation, for example that the recovery in the euro area takes longer than now assumed in the Riksbank's forecast or that oil prices continue to fall surprisingly.

Mr Jansson stated that several factors must be taken into account when considering the consequences that ongoing unexpected falls in oil prices may have for monetary policy. How lasting is the effect on inflation expected to be? Is there a risk that the more long-term inflation expectations will be pushed down further, even though it is estimated that the price falls will only affect inflation in the short term? How should negative inflation effects be weighed against positive effects on the real economy? He pointed out that there are no obvious answers to these questions and thus there are no obvious conclusions for monetary policy either. Nevertheless, it cannot be ruled out that further monetary policy stimulus measures may be needed in the period ahead.

If the need to make monetary policy more expansionary does arise, Mr Jansson considered that a natural first step, as pointed out in the draft Monetary Policy Update, would be to continue to postpone the first repo-rate increase. However, as the first repo-rate increase already lies well in the future, that is in the second half of 2016, it is not likely that this can be considered a particularly forceful measure, at least not to counteract significant downturns in inflation. This suggests that a further postponement of the first repo-rate increase probably needs to be combined with other measures.

Mr Jansson said that one such measure could be for all of the members of the Executive Board to commit to some form of rate-setting rule, for example the rule that he himself has promised to follow: not to vote to raise the repo rate until CPIF inflation picks up and exceeds 1.5 per cent. However, other measures are of course conceivable. The list of possible measures includes negative interest rates, purchases of various securities, targeted loan facilities for companies and loans to banks. In addition, the Riksbank can intervene on the foreign-exchange markets with the aim of weakening the krona exchange rate. This final measure is not really on the cards, however, as long as the krona exchange rate is relatively weak and the development of the real economy in Sweden is reasonably solid.

According to Mr Jansson, the important thing now is for the Executive Board to jointly analyse and agree on the measures that could be included in a stimulus package of this type. He personally intends to address this task with an open mind and a readiness to compromise. The aim of this package must of course be to increase the likelihood of inflation rising towards the target. As the need for further monetary policy stimulus can arise quickly in a negative scenario, he emphasised that he shares the view in the draft Monetary Policy Update that work on this should be conducted in such a way that the measures concerned can be implemented as of the next monetary policy meeting in February.

Deputy Governor **Cecilia Skingsley** supported the picture of economic developments, the forecasts and the proposed repo-rate path contained in the draft Monetary Policy Update.

With regard to changes in the view of the course of economic activity and inflation since the previous decision in October, she wished to make two comments, one about the oil price and the other about inflation expectations.

The main international change that has occurred since October concerns the continuing fall in the oil price. This has fallen by more than 40 per cent, in dollar terms, since the peak price in the summer, which makes it one of the three largest oil price falls in the past 50 years. This price drop, which the Riksbank assesses is largely supply-driven, has positive effects on growth. She noted that this applies in particular to the United States and other countries with large oil consumption. The US recovery, which has been surprising for some time now in relation to the Consensus forecasts, thus has the scope to continue, she said. This is also reflected in the Riksbank's upward revision to the growth forecast for the United States.

The fall in the oil price also means that international price pressures will fall further next year and it justifies the downward revision in the KIX-weighted inflation forecast.

With regard to the Riksbank's inflation forecast for Sweden, the fall in the oil price entails some downward adjustment in inflation in the coming year. Ms Skingsley felt it was important to note that inflation excluding energy prices remains largely unchanged for the whole of the forecast period. As in the previous forecast, CPIF inflation is expected to attain 2 per cent in the middle of 2016. This is based on the repo-rate path being adjusted somewhat compared with the October decision, with a delayed first increase and a slower rate of increase.

She considered that the fact that international price pressures remain low explains why inflation expectations are still declining. It is reasonable that the more short-term expectations are closely linked to actual inflation, and this is not particularly worrying. However, there is reason for continued vigilance with regard to the more long-term expectations, which are showing a continuing downward trend.

Ms Skingsley considered the most recently measured levels for inflation expectations to still be reasonable, given the recent inflation outcomes. She said that one should remember that long-term inflation expectations have been as far as 0.6 percentage points above the target when inflation has been higher. Strong monetary-policy stimulation has also been added over the past year, with a total repo-rate cut of 100 basis points and several adjustments to the repo-rate path. Ms Skingsley reminded the meeting that one had probably not yet seen the full stimulation effects of this. However, low inflation and lower inflation expectations mean that there is nevertheless reason to hold a high level of preparedness to be able to take action and provide further monetary policy stimulation to ensure target attainment within a reasonable period of time.

The Executive Board notes in the draft Monetary Policy Update, that if monetary policy needs to become more expansionary, this would primarily entail a further postponing of the first increase of the repo-rate.

Ms Skingsley also supported the statement that the Riksbank is preparing further measures that could be taken if necessary. According to her, this refers to several things the Riksbank can influence if it is considered appropriate, namely interest rate levels, better funding terms and the exchange rate.

The Monetary Policy Report published in October contained a list of possible measures, which are largely the same as those used by other central banks. Ms Skingsley did not wish to express any personal preference for which of these measures might be the most appropriate to support if there was a situation where the Board found it reasonable to add further stimulation. Nor did she wish to rule out any of these measures.

The important thing is that the Riksbank is prepared to take action, if deemed necessary, with effect from the next monetary policy meeting in February.

Since the previous monetary policy meeting, the Financial Stability Council has met to discuss financial stability. Ms Skingsley welcomes the fact that there is now more joint concern over household debt, although the authorities have differing opinions on the importance of measures to alleviate this concern. The proposal to introduce amortisation on new loans to bring the loan-to-value ratio down to 50 per cent is a welcome step, in her opinion.

However, given the broader consensus that prevails regarding the risks to the economy as a whole from this debt, Ms Skingsley assesses that the amortisation proposal should only have a slightly dampening effect on the developments in debt. The proposal refers to loans that have not yet been taken and the amortisation rate will in general be much slower than those in several other comparable countries.

So far, it has not been possible to see any signs that developments in housing prices and credit-granting have entered a calmer phase. She therefore wished to point out the importance of continuing the work by investigating further measures that could be introduced gradually. Examples of such measures can be found in the Monetary Policy Update.

At the monetary policy meeting in October, the Executive Board discussed the importance of better understanding the mechanisms behind the low inflation, and why it has been lower than expected, not just in Sweden but also in large parts of Europe. Low and uncertain demand are usually stated as the main explanation for the low price increases. However, it is also important to understand the structural transformation in the economy, beyond the weak growth that has prevailed since the global financial crisis.

Ms Skingsley felt that the difficult question to answer was whether we will now have a new, better functioning economy with higher productivity or whether we are instead heading towards a worse one. She sees two main, opposing, lines in the debate:[2]

The first can be described as fairly pessimistic. Here, she is thinking about the concept of secular stagnation, which can briefly be described as a prolonged period of weak growth.

---

[2] An overview can be found in Charles Plosser, "Economic Growth and monetary policy – is there a new normal?" Federal Reserve Bank of Philadelphia, 13 November 2014.

Either the secular stagnation is due to supply problems, where mature economies have entered a long phase where there are no particularly large technological advances to be transformed into greater production capacity. If growth is held back by supply side problems, a structural policy is needed that improves productivity and labour force participation in the economy. Monetary policy can also be used in the near term, if this is compatible with the current inflation-targeting regime.

Ms Skingsley observed that secular stagnation can alternatively be a question of a sustained lack of aggregate demand, due to demographic reasons, for instance. The policy conclusion here is that monetary-policy stimulation is needed over and above a zero interest rate to bring growth back to the long-term level.

The second line in the debate says, on the contrary, that the current technological developments will entail a leap forward for the economies, with ensuing major improvements in the structural growth potential. At least, for those countries with economies that can have the capacity to make use of this new potential. An economy that is in this situation probably needs stimulation policy in the near term to facilitate the transformation of the economy. However, ultimately such a development also means higher production potential and, all else being equal, a higher neutral interest rate, that is, the interest rate that has neither an expansionary nor a contractionary effect on the economy.

She felt that the monetary policy conclusions of these two contradicting paradigms would be difficult for monetary policy-makers to respond to, as it is difficult to determine the long-term growth potential of an economy. The effects of the global financial and debt crisis are also casting large shadows over the assessments of the economies' growth potential. And it is probably mainly by observing the effects that one can determine what direction they are taking.

Ms Skingsley concluded by saying that these questions are difficult, not only for monetary policy and the Riksbank, but also for the aim of the overall economic policy in the coming period, both in Sweden and abroad.

First Deputy Governor **Kerstin af Jochnick** began by saying that she supports the proposal in the draft Monetary Policy Update to hold the repo rate unchanged at zero per cent, and to postpone the first repo-rate increase until the second half of 2016, after which it will be gradually increased to a somewhat lower level than previously forecast.

Ms af Jochnick's assessment is that economic developments abroad have been largely in line with the forecast made by the Riksbank in October. As she has mentioned earlier, however, developments in Europe remain weak and there is a risk of a more protracted recovery there. The oil price has been significantly lower than was previously assessed and inflation expectations are somewhat lower. She noted that the lower oil prices would reduce global inflationary pressures. At the same time, the lower oil prices should also have a positive effect on demand and thereby give some positive contribution to growth.

The uncertainty that marked the financial markets at the beginning of October has declined. Ms af Jochnick noted that they have once again entered a calmer phase. However, in recent days some measures of uncertainty have increased rapidly, which shows that developments can change fast, particularly in certain euro-area countries where the reform process is slow. Rebuilding confidence in Europe takes time.

Ms af Jochnick said that inflation has been lower over the past year than the Riksbank had previously forecast. The Riksbank has reacted decisively to the lower inflation by adjusting its inflation forecasts downwards and by cutting the repo rate. The repo rate has been cut by one percentage point, down to zero, over the past year and the repo-rate path has been adjusted downwards at each monetary policy meeting from April onwards.

There are several factors that explain the low inflation, according to Ms af Jochnick. The difficulties companies have experienced in passing on their cost increases to higher prices can be due to increased competition, among other things. Price increases on services and food are below their historical averages. In addition, the oil price has fallen to much lower levels than have been previously forecast by the Riksbank.

All in all, this means that inflationary pressures in the Swedish economy are even lower than was assessed in October, said Ms af Jochnick. Developments during the autumn have evidently also affected inflation expectations in the slightly longer term, too. In Prospera's latest survey it was possible to note somewhat lower inflation expectations among a broad number of respondents. The Riksbank therefore still has an important task of communicating and showing by its actions that it is ready to do what it can to bring inflation up to 2 per cent, so that long-term inflation expectations do not fall further. Ms af Jochnick therefore felt that there could be reason for a further shift in the repo-rate path so the first repo-rate increase would come during the second half of 2016.

This measure may appear to be of minor significance in the short-term perspective and with the relatively uncertain situation for the global economy, but it acts as a signal for underlining the Riksbank's aim to attain the inflation target and safeguard its significance as a nominal anchor for price-setting and wage-formation in the Swedish economy, said Ms af Jochnick. The Riksbank's very expansionary monetary policy provides support to the Swedish economy and creates confidence in the inflation target. When growth picks up, demand for goods and services will increase, which will contribute to improving the capacity for companies to raise their prices. A repo rate at zero per cent until the second half of 2016 ought to enable us to attain an inflation rate of 2 per cent in 2016.

Ms af Jochnick considers it good that the Riksbank is continuing to analyse why inflation has been unexpectedly low since the end of 2013. There are probably several interacting factors that explain the low inflation. She said it is interesting to note that it appears that a larger share of products in the CPI have fallen in price than have increased more than 2 per cent over the past year. She also considers it interesting to note that Sweden stands out, compared with other countries. This shows that Sweden has a higher share of products with falling prices than Norway, the United Kingdom and the euro area. She asks the question of whether a contributing factor could be that Sweden has a large percentage of Internet use in the household sector, and that Swedish households buy products over the Internet to a greater extent, which increases competition and puts pressure on prices in the more traditional channels.

She also sees that it is very important to continue analysing the oil price and its significance for both global and Swedish inflation. An important question for coming years is how supply and demand for oil will develop and how persistent the current changes will prove to be.

Ms af Jochnick said that if developments abroad were to be worse than is now assessed, and here she mainly referred to the uncertainty in the euro area, or if inflationary pressures in Sweden were to be even lower for other reasons, there must be a readiness to take further measures. First of all, the initial repo-rate increase could be postponed and the repo-rate path could be cut further. In February, it is important that we return to the discussion of whether unconventional measures are necessary, and the preparations for them.

Ms af Jochnick said that the Riksbank can offer loans at longer maturities and can also influence the price of money in the market. It is also possible to influence the value of the krona. However, she agreed with Mr Ingves that she did not consider currency interventions to be a first-hand alternative. She emphasised that it is important, if measures are to be taken, that they are targeted towards areas that stimulate and support demand in the relevant sectors of the economy.

Households are now increasing their debts. Low interest rates over a long period of time, combined with generous tax deductions and shortcomings in the functioning of the housing market risk creating incentives for households that will reinforce the imbalances in the economy. As Ms af Jochnick has said earlier, her assessment is that the amortisation requirement will not resolve the problems with household debts. Households' higher indebtedness risk creating vulnerabilities in the Swedish economy further ahead. She emphasised that it is therefore still important that the Government and its authorities work actively on these issues.

Correspondingly, Ms af Jochnick wanted to point out, as at earlier meetings, the need to bring so-called vulnerable groups into the labour market. Monetary policy has limited capacity to influence the labour market for these groups. Both the social partners and the Government have a responsibility here to actively contribute to a better functioning labour market, she concluded.

Deputy Governor **Martin Flodén** began by saying that he supports the forecast in the draft Monetary Policy Update, the proposal to lower the repo-rate path and the proposal to hold the repo rate unchanged.

As all of the other Board members have already mentioned, the oil price has continued to fall rapidly since the previous monetary policy meeting, said Mr Flodén. This is a development which will on the whole have positive consequences for economic activity and growth prospects in many countries. His hope, although perhaps a pious one, is that the oil price fall will be the factor that finally boosts the recovery in economic activity in the euro area. But in the short term, the fall in the oil price means that inflation will be lower. This is problematic in countries like Sweden, where inflation is already worryingly low, long-term inflation expectations have fallen and monetary policy is limited by the policy rate's zero lower bound.

Mr Flodén said that there is a risk that the lower inflation will push down inflation expectations further and that it will then be even more difficult to get inflation to rise. If inflation is low for a prolonged period of time, people may question the credibility of monetary policy and the role of the inflation target as nominal anchor. To prevent this from happening as far as possible, monetary policy now needs to also react to factors that are temporarily pushing down inflation.

Mr Flodén noted that this is why the planned timing of the first repo-rate increase has been postponed. But the fact that the first increase has now been postponed probably will not have any major effects on developments in inflation over the coming year. This is because market expectations of the repo rate in 2016 and 2017 are already below the repo-rate path proposed in the draft Monetary Policy Update. He felt that confidence in monetary policy would hopefully be strengthened by postponing the first repo-rate increase, and by the Riksbank continuing to focus on inflation and emphasising that the repo rate will not be raised until inflation has risen significantly and lastingly. According to the forecast, the repo rate will be raised in the second half of 2016, in a situation where both CPIF inflation and CPIF inflation excluding energy are just over 2 per cent. Inflation according to these measures have then been close to 2 per cent for around six months.

Although the inflation forecast is now revised down somewhat for the coming year, Mr Flodén sees rays of hope in the developments since the previous monetary policy meeting. The inflation outcomes for October and November were marginally higher than was forecast in October, despite the falling oil price leading to a surprisingly large decline in fuel prices in November. He thought that import prices now appeared to have begun to rise faster, particularly for consumer goods. This indicates that the recently more expansionary monetary policy is beginning to have the intended effects on inflation. The fact that the krona has weakened is a part of this development. The krona has also weakened more than the Riksbank was expecting in October, which is reflected in a weaker forecast for the krona going forward.

The conditions for a continued recovering in economic activity in Sweden thus still look good, Mr Flodén thought. Finansinspektionen's proposal regarding an amortisation requirement is expected to have a dampening effect on household consumption. But he argued that this effect would probably be minor and that growth in household consumption still looked strong. Developments on the labour market look relatively bright, with strong employment, low levels of redundancy and an upturn in job vacancies.

Despite these rays of hope, Mr Flodén would in principle like to see an even more expansionary monetary policy in the near term. This would be motivated both for getting inflation to rise more quickly towards or beyond the inflation target and for creating safety margins so that inflation rises reasonably quickly even if developments are worse than in the main scenario. According to the forecast in the draft Monetary Policy Update, the wage bargaining rounds in 2016 will look back at a CPIF inflation rate that is still below the target and has on average been 0.9 per cent during the five-year period 2011-2015. He emphasised that this development, together with the falling inflation expectations, makes it clear that it is becoming increasingly urgent to get inflation to rise.

However, Mr Flodén pointed out that the problem now is that the repo rate is so close to its lower bound. Making monetary policy even more expansionary in the near term, either by cutting the repo rate to negative levels or by using some form of quantitative measure entails risks and costs. These risks and costs must of course be weighed against the positive inflation effects the measures could entail.

The reasons Mr Flodén has put forward for in principle calling for an even more expansionary monetary policy do not weigh heavier than these risks and costs. He therefore considers the monetary policy proposed in the draft Monetary Policy Update to be well balanced at present. However, conditions may of course change, and it is therefore important that measures are prepared and analysed, so there is a readiness to take action if inflation prospects deteriorate further.

This primarily concerns continuing to postpone the first increase in the repo rate. However, Mr Flodén agrees that readiness is needed to be able to make decisions on other measures and that these could mainly concern stronger communication regarding the future repo rate, a negative repo rate, supplying liquidity or purchasing domestic assets.

Mr Flodén would not put currency interventions very high up on this list. Currency interventions could probably entail a clear and fairly rapid upturn in inflation. However, when monetary policy abroad is also limited by the policy rate's lower bound, the positive effects of currency interventions on inflation in Sweden would probably fully come from negative effects on inflation abroad. He therefore hardly sees currency interventions as appropriate in a situation where other countries are also struggling with low inflation and have problems in making their monetary policy more expansionary, and where the Swedish krona is also relatively weak.

Governor **Stefan Ingves** then summarised the meeting by noting that the Executive Board agreed on the picture of economic prospects and the inflation outlook described in the draft Monetary Policy Update.

The outlook for the United States and the United Kingdom is still good, while the recovery in the euro area is expected to be sluggish. Several members have pointed to the potential downside risks in the euro area. The oil price has continued to fall since October and is expected to give some positive stimulation to growth in several parts of the world. At the same time, the lower oil price has contributed to the forecast for global inflationary pressures being revised down.

In Sweden, economic activity is strengthening, but inflation is too low and the long-term inflation expectations have shown a falling trend over a longer period of time. GDP and employment are expected to continue rising in line with the earlier assessment, while inflation is expected to be somewhat lower for a period of time. The members of the Executive Board have pointed out in different ways that it is important that inflation rises towards the target.

The Board was unanimous that monetary policy needs to be even more expansionary for inflation to rise towards the target sufficiently quickly and to reduce the risk that long-term inflation expectations will continue falling.

All of the Board members therefore advocated that the repo rate should remain at zero per cent for a slightly longer period. They considered it would be appropriate to begin raising the repo rate in the second half of 2016. The low repo rate will increase demand in the economy, which will contribute to a rise in inflation. CPIF inflation is expected to attain 2 per cent in the middle of 2016.

The Executive Board discussed monetary policy when the policy rate is zero and noted that the current very low policy rate is considered sufficient for inflation to rise towards the target. However, there is uncertainty over how quickly this will happen and the Executive Board pointed to the importance of preparing additional measures that could be used if the need arises to make monetary policy even more expansionary. It should be possible to take measures at short notice and it is important to work further to be able to present this at the monetary policy meeting in February.

§3. Monetary policy decision

The Executive Board decided

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

• to publish the Monetary Policy Update on Tuesday 16 December 2014, at 9.30 a.m.,

• to hold the repo rate at zero per cent and that this decision would apply from Wednesday, 17 December 2014,

• to publish the decision above at 9.30 a.m. on Tuesday 16 December 2014 with the motivation and wording contained in a press release, and

• to publish the minutes of today’s meeting on Thursday, 8 January 2015 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

Sveriges Riksbank
Address: Brunkebergs torg 11
Postal address: SE-103 37 Stockholm

www.riksbank.se
Telephone: 08 787 00 00, Fax: 08 21 05 31
E-mail: registratorn@riksbank.se