Minutes of Monetary Policy Meeting

December 2015

Summary

At the Monetary Policy Meeting on 14 December, the Executive Board of the Riksbank decided to leave the repo rate unchanged at –0.35 per cent. Purchases of government bonds will continue for the first six months of 2016, as was decided in October. The Board is also highly prepared to make monetary policy even more expansionary, even between the ordinary monetary policy meetings. 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.

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

The very expansionary monetary policy pursued by the Riksbank is contributing to strengthening economic activity, falling unemployment and an upward trend in inflation. GDP growth is expected to remain high and CPIF inflation will stabilise around 2 per cent in 2017. There is still considerable uncertainty regarding the strength of the global economy however, and central banks abroad are expected to pursue an expansionary monetary policy for a long time, which also affects Swedish monetary policy.

Overall, growth in the Swedish economy has been slightly stronger than expected since the October Monetary Policy Meeting. However, the latest inflation outcome shows that the upturn in inflation is volatile and not yet on a firm footing. To safeguard the resilience of the upturn in inflation, monetary policy therefore still needs to be very expansionary.

The Executive Board unanimously agreed to leave the repo rate unchanged at –0.35 per cent and to continue to purchase government bonds for the first six months of 2016 in line with the decision in October.

The Riksbank remains highly prepared to make monetary policy even more expansionary, even between the ordinary monetary policy meetings. Several members also noted that if the exchange rate appreciated too rapidly, currency interventions could be necessary. The monetary policy being pursued aims to limit the risks of continued low inflation and to contribute to inflation expectations which are compatible with the inflation target.

Several members of the Executive Board once again underlined the importance of promptly tackling the risks linked to the housing market and households' debts. Finally, several members also commented on the monetary policy framework and welcomed a broad and public discussion about potential improvements to the framework.

MINUTES OF MONETARY POLICY MEETING
Executive Board, No. 6

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DATE: 14 December 2015

TIME: 09.00

PRESENT: Stefan Ingves, Chairman
Martin Flodén
Per Jansson
Kerstin af Jochnick
Henry Ohlsson
Cecilia Skingsley

Susanne Eberstein, Chair of the General Council
Michael Lundholm, Vice Chair of the General Council

Mattias Ankarhem
Claes Berg
Sophie Brauner
Charlotta Edler
Paul Elger
Heidi Elmér
Mattias Erlandsson
Lina Fransson
Jens Iversen
Pernilla Meyersson
Ann-Leena Mikiver
Marianne Nessén
Christina Nyman
Carl-Fredrik Pettersson (§ 1-3)
Kasper Roszbach
Maria Sjödin
Ulf Söderström
Anders Vredin

It was noted that Paul Elger and Mattias Ankarhem would prepare draft minutes of the monetary policy meeting under Sections 2 and 3.

§1. Economic developments

Carl-Fredrik Pettersson of the Markets Department began by presenting the latest developments on the financial markets. Since the October Monetary Policy Meeting, many analysts have focused on the expectations of divergent monetary policy between the Federal Reserve and the ECB. The US labour market has developed strongly, the risks outside the United States have been played down in the Federal Reserve's communication and market expectations now indicate a rise in the federal funds rate in December. The ECB's decision on 3 December to cut the deposit rate and continue asset purchases was seen by the financial market as less expansionary than expected, which led to the euro appreciating against other currencies after a period of depreciation. It also contributed to lower expectations of further rate cuts from central banks in other countries such as Switzerland and Sweden. At its meeting in December, the Bank of England decided to keep its policy rate unchanged.

The value of riskier equity assets has fallen recently. Commodity prices have also fallen, which can in part be linked to lower demand from China and a stronger US dollar. The fall in oil prices is also linked to a continued high level of oil production.

Expectations concerning the Riksbank have been relatively stable for most of the period since the October meeting. The ECB's announcement contributed to lower expectations of a Swedish rate cut in December. The Swedish krona has appreciated for most of the period since October, primarily because of a generally weaker euro, but weakened after the ECB's announcement and the most recent Swedish inflation figures. In trade-weighted terms, however, the krona is still stronger than after the Monetary Policy Meeting in October.

Marianne Nessén, Head of the Monetary Policy Department, presented the draft Monetary Policy Report which, in the assessment of the Monetary Policy Department, would gain the support of the majority of the members of the Executive Board. She began by noting that the forecasts in the draft had been previously discussed by the Executive Board at the meetings held on 7 and 9 December. The draft monetary policy report was discussed and tabled at a meeting with the Executive Board on 11 December.

The market's expectations of an increase in the US policy rate and the continued expansionary monetary policy of the ECB have been important features of the landscape the Riksbank is navigating this year. This will also be the case in the future.

The Swedish economy has grown more strongly than expected. In the third quarter, Swedish GDP grew by 3.4 per cent compared with the second quarter and calculated as an annual rate. Furthermore, GDP was revised retrospectively, which gave a slightly different picture of growth in 2015. From previously being mainly driven by household consumption and housing investment, it is now indicated that exports and business sector investment have also made a more positive contribution.

The Swedish economy is also deemed to continue to grow at a healthy rate. GDP is expected to grow by 3.6 per cent in 2016, 2.9 per cent in 2017 and 2.6 per cent in 2018, which is above its historical average. The growth forecast has been revised upwards, partly because of the strong figures, and partly due to increased public expenditure in connection with the reception of asylum seekers. For the first time, the report contains quantified effects of the dramatically increased asylum immigration during 2015. In the short term, the arrival of asylum seekers will result in greater public expenditure, which in turn will lead to increased domestic demand, higher growth and slightly higher inflation. In the longer term, the rise in immigration will increase the supply of labour. How this will affect employment, unemployment and the rest of the economy is very difficult to assess. The report assumes that unemployment will rise towards the end of the forecast period since the employment rate among new arrivals who enter the labour market is assumed to be lower than among the rest of the labour force. However, there is considerable uncertainty regarding the calculations.

The outcome for inflation in November was lower than the Riksbank's assessment. The assessment is that this fall was driven by temporary factors such as unexpectedly weak growth in the price of foreign travel. The forecasts for CPI and CPIF inflation have been revised downwards slightly for 2016 – despite the effects of increased public expenditure – compared with the forecast in October, partly as a result of the lower outcome in November but also due to lower forecasts for energy prices and rental expenses.

The forecasts in the draft monetary policy report are based on the assumption that monetary policy will adhere to the plan adopted at the Monetary Policy Meeting in October. This means that the repo rate remains unchanged at –0.35 per cent, and that the repo rate path continues to indicate some likelihood of a further cut. Government bond purchases are also continuing so that total purchases will amount to SEK 200 billion at the end of June 2016.

§2. The economic situation and monetary policy

Deputy Governor **Cecilia Skingsley** began by saying that she supports the analysis, forecasts and proposals for the monetary policy decision presented in the Monetary Policy Report. She noted that in 2015, monetary policy has been characterised by a number of stimulus decisions and a high level of preparedness on the part of the Executive Board to take additional decisions should the outlook for inflation deteriorate again. She pointed out that the trend in inflation has begun to rise, but she sees the unexpectedly weak outcome in November, as it is described in the report, as a sign of inflation continuing to be difficult to assess.

Looking at the real economy, growth has strengthened and broadened during the year and the forecasts for the coming years have been revised upwards, largely as a result of the extensive refugee immigration. As has already been said, however, inflation is difficult to assess and domestic prices, including service prices, need to take over as the main driver of price growth from import prices, which have been pushed up by the earlier depreciation of the Swedish krona.

Prior to the meeting, Ms Skingsley had considered proposing a further loosening of monetary policy. There are three reasons, however, why she nevertheless decided to support an unchanged policy: firstly, the strong outcome in the real economy; secondly, the fact that the Riksbank is already pursuing a very expansionary monetary policy and forecasting a negative policy rate for a further two years; and thirdly, the fact that it is difficult to assess the causes of the weak CPI figures for November, the current assessment being that the fall was driven by temporary effects. She had therefore decided to adhere to the strategy established by the Executive Board 12 months ago to maintain a high level of preparedness for further stimuli if the outlook for inflation were to deteriorate.

On the positive side, she noted that inflation expectations are no longer falling, but are instead rising broadly, even among employers and the industrial sector, who have previously had lower expectations than other groups in society.

She referred to the Monetary Policy Report in which the Riksbank describes its approach to how monetary policy should deal with the population increase expected in Sweden over a number of years. Refugee immigration and its consequences for public consumption will contribute to strong demand in Sweden for some time to come. In this context, Ms Skingsley wished to point out that the housing market is fraught with major structural problems. The population increase and current economic assessments indicate a continued rise in housing prices. She emphasised that present building plans will not be enough to compensate for this. And rising prices lead to rising debts. This continues to provide justification for macroprudential policy to compensate for low interest expenses, in order to counteract the vulnerabilities emanating from rising household indebtedness. It is important therefore than a mandatory amortisation requirement is put in place. She also pointed out that it is important for Finansinspektionen to analyse and eventually implement a debt-to-income limit in relation to disposable income as a complement to the loan-to-value limit of 85 per cent of the value of the home.

Even though Ms Skingsley, after some hesitation, supported the unchanged monetary policy, she wished to underline the importance of a continued high level of preparedness. As is explained in the report, she emphasised the existing scope for doing more by using the repo rate, purchasing securities, intervening on the foreign exchange market and lending to companies via the banks. Which of these stimuli to use will be determined by which part of the transmission mechanism is in need of support. Ms Skingsley pointed out that she had made it clear at the last meeting in October that she sees interventions on the foreign exchange market as a possible option, in the event of the exchange rate strengthening in such a way as to jeopardise the inflation forecast.

One factor she highlighted as important is the circumstances under which foreign exchange interventions may come into question. The appreciation of the krona following an unexpectedly strong development of the Swedish economy need not signify that interventions are of immediate interest, since it is just such strong economic growth that current monetary policy is aiming for. Appreciations of the krona as a result of slowdowns in economies abroad will, however, pose a greater threat to Sweden's growth and may therefore need to be addressed using interventions.

Ms Skingsley also observed that the International Monetary Fund, in its new Review of Sweden,[1] has explicitly stated that interventions are a possible tool for Sweden insofar as further stimulus is needed to safeguard confidence in the inflation target.

First Deputy Governor **Kerstin af Jochnick** began by saying that she agreed with the assessment in the Monetary Policy Report regarding developments in Sweden and the rest of the world and she also agreed with the assessment that current monetary policy is still well balanced in order to stimulate demand in the Swedish economy and underpin the upturn in inflation. As regards the Riksbank's assessments of developments abroad, she observed that they were mostly in line with the assessments made in the October Monetary Policy Report.

She highlighted the fact that, over the past 12 months, the Riksbank has discussed a number of risks that are creating uncertainty regarding the expected strength of the Swedish economy in the coming years. It is a question of central banks out of step with each other, the commodity price trend, weak growth in the euro area and geopolitical unease in various parts of the world. Ms af Jochnick's assessment was that the risk level is basically comparable with the assessment made in October, and that the Riksbank must continue to be observant with regard to how these risks develop.

According to her, an important part of the Riksbank’s new forecast was an assessment of how the increase in refugee immigration into Sweden is expected to affect GDP growth and inflation over the coming years. To this should be added both an analysis of how demand is broadening in the Swedish economy, based on stronger-than-expected GDP figures according to the National Accounts, and a new assessment of the outlook for inflation. She observed that it is difficult to assess how refugee immigration will affect the Swedish economy since there is considerable uncertainty regarding the number of refugees and what their arrival involves in terms of costs and revenues. She nevertheless emphasised that it is important for the Riksbank to constantly monitor developments and

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[1] See Article IV Consultation Sweden No. 15/329, IMF, 2015.

continue with its analysis of the effects. She also thought that the Riksbank must be prepared for the possibility that the analysis will need to be revised going forward. In the short term, public consumption will rise as a consequence of the initial costs for refugees coming to Sweden. In addition, many municipalities will probably have to expand their childcare and school activities. The county councils' costs for medical care and public transport are increasing and housing construction should be stimulated. All in all, it is her assessment that the Riksbank is making a relatively cautious assessment of the effects of the refugee immigration on demand in the Swedish economy in the draft monetary policy report.

She also observed that the Riksbank's forecast indicated healthy growth in the Swedish economy. The recovery abroad is continuing and demand in Sweden is broadening. Exports and business sector investment are also starting to contribute to growth, in addition to household consumption and housing investment.

As regards inflation, she found it satisfying that inflation expectations had taken an upward turn in both the short and the long term. She interpreted this as the inflation target being well anchored in households and companies and constituting a firm basis for economic development. She highlighted the fact that the very expansionary monetary policy and a weaker krona have probably strengthened confidence in the Riksbank reaching the inflation target.

Inflation has been on the up for some time. Its rather fitful progress, however, is indicated by the most recent outcome in November, when inflation was slightly lower than forecast. Part of the explanation was that travel prices were lower than expected, a component that in the past has also been volatile and difficult to predict. She expected the inflation trend to continue to rise, even if inflation will be a little lower for a time, compared to the assessment in October.

The Riksbank estimates a rise in CPIF inflation over the coming months when the contributions of previously falling energy prices and interest expenses fall away. The depreciation of the krona seen in recent years remains an important explanation for the rising rate of inflation. The krona will appreciate slowly according to the forecast. The positive contribution of the exchange rate to inflation will hence gradually subside. Other factors will then contribute to rising inflation. A gradually stronger global economy will lead to both higher international prices and a higher demand for Swedish goods and services. Continued strong domestic demand is also helping to strengthen the economy and increase resource utilisation. This should lead to companies having more scope for raising their prices. The stronger demand as a result of the increase in refugee immigration is also expected to lead to positive inflation impulses.

At the same time, however, she also observed that there were other factors pulling in the opposite direction. The most recent inflation figures were lower than expected. She also pointed out that the Riksbank was now forecasting lower rents and energy prices than in October. This means that the forecast for inflation is revised downwards for a time but revised upwards in 2017. All in all, CPIF inflation is expected to rise gradually and then stabilise around the two-percent mark in 2017. She thought, however, that it was still not possible to be absolutely certain about developments going forward and that it was therefore important for monetary policy to remain expansionary and that the Riksbank continues to be prepared to take additional measures.

While Ms af Jochnick deemed the Swedish economy to be developing well and inflation to be stabilising around two per cent in 2017, she also wished to emphasise that the structural imbalances in the Swedish economy may lead to problems later on. A large number of immigrants are now arriving in Sweden, in need of a home and a job. Not modifying the regulatory frameworks on the labour and housing markets will risk reinforcing the existing major structural imbalances. She pointed to integration into Swedish society being crucial to how quickly new arrivals will be able to establish themselves in Sweden. There are major challenges in both these areas. The problems on the housing market are well known and several different measures are needed to make it more efficient and create greater supply. There are also structural problems on the labour market with rather high unemployment among those groups defined as vulnerable. She therefore found it important for measures to be taken aimed at speeding up the integration of new arrivals. A long wait for a home and a job may also lead to other problems for society.

In addition, she also highlighted the problems associated with household indebtedness. If housing prices continue to rise at the current rate, indebtedness is very likely to create problems for the Swedish economy later on in the form of lower demand. She pointed out the timeliness of the Riksbank's recommendations in the Financial Stability Report[2] and the fact that the Riksbank should once again discuss the need for measures in the Financial Stability Council during the same week as the monetary policy meeting.

Deputy Governor of the Riksbank **Martin Flodén** began by saying that he backs the proposal to leave the repo rate unchanged and to stick to the previous plan regarding government bond purchases. He also backed the draft of the monetary policy report and the forecast contained within it.

Following the monetary policy meeting in October, Flodén noted that the real side of the Swedish economy had strengthened more than in the Riksbank's October forecast. The most recent GDP outcome was higher than expected, and developments on the labour market have been surprisingly strong. Recent developments also indicate that the economic recovery has now broadened to include the manufacturing industry and export sector after previously having been focused on household consumption, the private

[2] See Financial Stability Report 2015:2, Sveriges Riksbank.

services sector and housing investment. In addition to this, refugee immigration is expected to contribute to a continued high level of growth and higher resource utilisation over the coming years. There is therefore strong reason to believe that the real side of the Swedish economy will contribute to a higher rate of inflation in the future.

Another positive sign he highlighted is that inflation expectations have risen slightly following the Riksbank's meeting in October. However, he thought that long and medium-term expectations are still worryingly low. Both Prospera's survey and the pricing of inflation-indexed bonds are based on CPI inflation. Flodén said that CPI inflation expectations two to five years from now would need to be close to three per cent in order to be consistent with a CPIF inflation which at that point is near two per cent while the repo rate is gradually raised towards a long term normal level.

A greater cause for concern pinpointed by Flodén is that inflation outcomes, particularly the one in November, have been low. The low November figures were caused mainly by temporary factors which do not seem to indicate that inflationary pressures are lower than we have previously assessed. But even such temporary effects are expected to have some impact on the inflation figures over the coming year. The fact that inflation will be subdued for a while to come is problematic because inflation is already low and has also been low for a long time. The risk is that continued low inflation will contribute to lower inflation expectations and weaker credibility for the inflation target, and will thereby make it harder to bring inflation up in the long term.

Another problem with recent inflation developments is that it still mainly appears to be prices for products and services with a large import content that are rising, while prices for domestically-produced products and services have not yet picked up speed.

He then wondered what this implies for the monetary policy decision. The fact that inflation will be subdued for a while to come is, as stated above, problematic in this situation, but it is also not something the Riksbank can do much about. It will take some time before monetary policy has an effect on inflation, and in the slightly longer term, everything indicates that the strong and broad growth seen in the Swedish economy will lead to higher domestic price pressure. Inflation is therefore expected to be somewhat higher from the end of next year than was stated in our October forecast. Flodén's assessment was therefore that it is appropriate to stick to the same monetary policy plan as at the October meeting and thus to leave the repo rate unchanged at this meeting.

He wanted to point out, however, that the long period with inflation at too low a level means the Riksbank must remain especially ready to quickly make monetary policy more expansionary if the conditions for the inflation upturn deteriorate. Of course, the clearest example of a development which could justify a change in monetary policy in the near future is if the krona rapidly appreciates more than in our forecast, without this being caused by news also indicating higher Swedish inflationary pressures. This would of course mean that import prices would contribute less to the inflation upturn, as well as subdue the economic upturn and thereby the contribution of domestic prices to the inflation upturn. Finally, he noted that it was his assessment, as previously, that the repo rate has not hit its lower bound and that an interest rate cut would therefore be a reasonable option if monetary policy needs to be more expansionary.

Deputy Governor **Per Jansson** began by noting that two new inflation outcomes have been published since the October monetary policy meeting. The latest outcome for November shows that price developments are weaker than expected regardless of whether energy prices are taken into account or not. The outcome for CPIF inflation was 0.98 per cent, which can be compared to a forecast of 1.23 per cent. Excluding volatile energy prices, the outcome was 1.39 per cent. In the Riksbank's forecast, the outcome was assumed to be 1.67 per cent.

Mr Jansson said that one cannot be anything other than extremely disappointed about these figures. It is true that the Riksbank has been clear that it is not possible to count on a dead straight increase in inflation, but after a few months of highly accurate forecasts such a sizeable forecast error is nevertheless quite a disappointment. Naturally, the question is now whether this should immediately lead to further easing of monetary policy or whether we should keep a cool head and wait to see whether the need for such easing increases or rather declines, he said.

Mr Jansson pointed out that a fundamental factor needing to be sorted out from the outset is whether the poor inflation outcome could even be a sign that the entire inflation upturn, which has been under way since the spring of 2014, is now in danger. It is indeed the case that we could have hoped for a successively slightly stronger development in terms of service prices during the autumn, rather than the opposite. It is also certainly the case that much of the improvement in the inflationary situation has so far been a result of a weakening of the krona exchange rate. Although energy prices did not contribute to the forecast error on this occasion, recent new falls in the oil price mean that energy prices will also be a factor which continues to make it difficult to bring inflation up. Mr Jansson reasoned that it is not strange that all of this is leading to questions about how robust the inflation upturn actually is.

On the other hand, the conditions in Sweden for achieving a sustainable upturn in inflation have been good for a long time, he continued. An essentially strong real economy has resulted in cost developments, measured by unit labour costs, which under normal conditions should already have led to a rate of inflation relatively close to 2 per cent. Although the Riksbank has invested major resources and a lot of time into understanding why this has not been the case, the unusually low rate of inflation in recent years has proved difficult to explain fully. Mr Jansson emphasised that this in itself is contributing to creating uncertainty about how quickly inflation can rise in the future. This of course is something the Riksbank has pointed out on several previous occasions and also mentioned as an important reason behind the very expansionary monetary policy being pursued.

However, if the conditions for a sustainable inflation upturn have been good so far, then they are, if anything, even better now, thought Mr Jansson. This is due to a number of factors. Firstly, inflation expectations are continuing to develop favourably. Prospera has carried out two new surveys since the October meeting; one monthly survey among money market participants and one quarterly survey where labour market parties and purchasing managers are included alongside money market participants. The new surveys show that inflation expectations are rising among all respondents for all time horizons, without exception.[3] In terms of inflation expectations 5 years ahead, which can be seen as a measure of the inflation target's credibility, the deviation from 2 per cent is now minor.

Secondly, the current situation in the Swedish economy has strengthened in a number of regards. GDP growth for the third quarter was a considerable upside surprise, and Statistics Sweden has revised the outcome for the first six months upwards. Mr Jansson noted it was particularly pleasing that the composition of growth has broadened, thanks to both greater exports and greater business sector investments. The stronger current situation can also be seen in figures for the labour market. Both employment and unemployment have developed better than expected here.

Thirdly, the increased refugee immigration means that both public and private consumption will grow faster than previously forecast. It is also reasonable to expect employment to be higher and unemployment to be lower, at least over the next few years, Mr Jansson believed. The effects are hard to assess, but it cannot be ruled out that they will be quite a lot greater than is currently indicated in many available calculations. Such aspects are discussed in an article contained in the draft Monetary Policy Report, where it is also noted that inflation could be pushed up more than is currently expected, but that this nevertheless does not need to affect monetary policy.[4]

Given this background, Mr Jansson supported both the forecast and the monetary policy presented in the draft Monetary Policy Report. However, he wanted to emphasise that he does so with a certain amount of hesitation. As he explained to begin with, there are arguments which support making a decision about further easing in monetary policy today, for example in the form of another repo rate cut.

Mr Jansson also stated that if the Riksbank now chooses not to act in terms of monetary policy at today's meeting, then it will only be even more important to stress that it is fully prepared to do so quickly and decidedly in the future. The components contained in the monetary policy toolbox are very familiar by this point and do not need repeating again.

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[3] According to TNS Sifo Prospera, see http://www.prospera.se/inflation-expectations/.

[4] See the article, "Scenario: Refugee immigration is deemed to have only minor effects on monetary policy in the near future", Monetary Policy Report, December 2015, pp. 12-13.

It is positive that the market considers currency interventions as a more viable option for policy, following the discussion at the meeting in October, he said.

Mr Jansson thought it was important for the market to understand the Riksbank's thinking in terms of the exchange rate, because it will be crucial to avoid the krona appreciating too quickly and too much for still some time to come. The best scenario would of course be if it weakened somewhat further from today's level. But here, there are reasons to be concerned when considering developments since April. There has namely been a tendency since then towards a greater strengthening of the krona than the Riksbank had assumed in its assessments. This is obviously not a desirable development, and we have to hope that the weakening seen over the past few days is not related to the market already having assumed that the Riksbank will undertake some further policy easing. Rather, it should be mirroring an understanding between the market and the Riksbank that a weaker development of the exchange rate is appropriate at this time without further monetary policy measures.

To conclude, Mr Jansson wanted to comment on an aspect linked to the speech he gave at Handelsbanken just over a week ago.[5] In this speech he discussed a couple of changes he believes would improve the inflation target. The first improvement would be to switch to a target variable which is influenced to a much lesser extent by the Riksbank's own interest rate changes than CPI inflation. The closest alternative inflation measures to hand are CPIF and HICP inflation. The other improvement would be to reintroduce a well-calibrated tolerance band surrounding the inflation target. The main reason for reintroducing this kind of interval is the need to continuously remind people that monetary policy is pursued amidst significant uncertainty, and that the Riksbank is unable to fine-tune the economy and inflation.

Mr Jansson feels that the proposals in the speech were generally positively received and that most people appreciate the arguments he put forward. However, some people have also interpreted his comments to mean that he is attempting to paint monetary policy as being more successful than it actually is, and to pave the way for a tightening of monetary policy faster than the Riksbank has so far communicated.

But as CPIF inflation has been the Riksbank's most important inflation measure when taking monetary policy decisions for several years now, and as a tolerance band does not change the fact that the target level for inflation is 2 per cent, neither the de facto achievement of the target nor the direction of future policy would be affected by the changes, he stressed. Even if these changes thus only have a minor practical and concrete significance, Mr Jansson considers them important and worth careful consideration. Experiences of monetary policy since the financial crisis have been a clear reminder that

[5] Jansson, Per. "Time to improve the inflation target?" speech at Handelsbanken, 3 December 2015.

monetary policy is not a highly precise tool, and that there are good reasons for excluding interest expenditure from the targeted inflation measure once and for all.

Deputy Governor **Henry Ohlsson** began by saying that he supported the proposal to leave the repo rate unchanged.

He then noted that the rate of inflation is continuing to rise. Monthly measurements vary irregularly, but the rising trend remains clear. However, there are threats to the rise towards the inflation target. A strengthening of the Swedish krona is one such major threat. International concern and the weak development of global trade in products could also threaten the upturn, Mr Ohlsson said.

He then noted that the expected annual rate of inflation among money market participants looking five years ahead in December is 1.8 per cent. Five-year expectations among these participants have been at this level in the most recent measurements; near but below the inflation target, in other words. It is important in terms of the monetary policy's credibility for expectations to rise towards the inflation target.

Mr Ohlsson also noted that consumption of durable and partially durable goods has risen as a proportion of total private consumption over the four most recent quarters, according to the National Accounts. The most recent measurement refers to the third quarter of 2015. He interprets this to mean that households are expecting positive economic developments in the coming years, and that they are reacting to the expansionary monetary policy by investing in durable goods.

He also noted that GDP is currently growing rapidly. According to the forecast in the Monetary Policy Report, the growth level next year will be at around the same level as during the current year. Population growth is also considerably faster than before. This means that GDP growth per capita is more modest than total GDP growth. This population growth can be expected to strengthen as people currently seeking asylum in Sweden will eventually be included in the population. This means the difference between GDP growth and per capita growth may increase over the coming years.

Mr Ohlsson wondered whether we are beginning to approach full resource utilisation in the Swedish economy when considering the rapid growth rate. The number of job vacancies as a share of the labour force is currently on the same level as before the financial crisis, according to Statistics Sweden's short-term job vacancy statistics. Swedish Public Employment Service statistics show that the number of unfilled job vacancies is also currently higher than before the financial crisis. Furthermore, the National Institute of Economic Research's Economic Tendency Survey shows an increasing shortage of labour. There are also signs of spare capacity, however. The labour force surveys (LFS) for

October 2015 report an unemployment rate of 6.7 per cent (not seasonally adjusted). This represents a fall of 0.8 percentage points compared to the corresponding month last year. Even though unemployment has declined during 2015, it still remains at a level that is too high in Mr Ohlsson's opinion.

The Swedish labour market is severely divided, however, he thinks. There are major differences between vulnerable and non-vulnerable groups. Those who are well established on the labour market can for example benefit from unemployment insurance to a completely different extent compared to new entrants. The proportion of unemployed members in the unemployment insurance fund was 2.6 per cent in November compared to 2.7 per cent in the same month one year earlier. This shows that unemployment is significantly lower for members in the unemployment insurance fund. At the same time, unemployment among these people has only reduced marginally compared to the reduction in LFS unemployment.

When Mr Ohlsson weighed the available facts against each other, he could not come to any other conclusion than that a continued expansionary monetary policy is needed. His assessment is that the low repo rate and the previously determined programme for purchasing government bonds will contribute to steering inflation towards the target and raising inflation expectations.

Monetary policy has an inflation target, not an exchange rate target. However, situations could potentially arise where a too-rapid appreciation of the krona could end up threatening the chances of reaching the inflation target. Mr Ohlsson felt that the Riksbank must act in such a situation and select the most appropriate monetary policy tool for the situation in question. It is his assessment that interventions on the foreign exchange market could in many cases be the best option in such a situation.

He therefore thought that it was a well-balanced monetary policy to leave the repo rate unchanged at a low level in the situation the Swedish economy is currently in. He also backed the Monetary Policy Report.

Governor **Stefan Ingves** began by saying that he also shared the view of developments abroad and the Swedish economy presented in the draft Monetary Policy Report. He supported the proposal to hold the repo rate at –0.35 per cent and to continue the purchases of government bonds according to the plan adopted at the last meeting and the Riksbank estimates an initial increase in the repo rate during the first half of 2017. Mr Ingves thought that the report was very much in line with his view of economic development.

He noted that the recovery abroad is continuing in the major, developed economies. Strong domestic demand had countered the indications of a slowdown from China and other emerging economies. In the euro area, the recovery is being supported by low oil prices, weaker exchange rates and expansionary monetary policy. The increase in asylum immigration is also expected to contribute to slightly stronger GDP growth in the short term. Inflation is still low in the euro area and is expected to increase slowly during the forecast period. The economic upturn in the United States since the crisis has been slower than normal but on the other hand has continued for much longer than usual, he noted. GDP growth is expected to be good for a few more years but will slow down somewhat towards the end of the forecast period. The labour market is developing strongly. Inflation is expected to rise significantly over the coming years. The economy in China has slowed, partly as a result of a desirable rebalancing of the economy. The Riksbank still expects a gradual slowdown in GDP growth, partly as a result of the measures taken by the authorities.

From a Swedish perspective, the economy abroad is developing quite well, Mr Ingves observed. A recovery or stabilisation of GDP growth is expected next year in the emerging economies that are most important for Swedish exports. A deterioration in growth in, say, one of the emerging economies would hardly have any palpable effect on the Swedish economy.

According to him, the unease regarding the economic development abroad has lessened slightly overall since the previous meeting. Geopolitical unease abroad has grown, on the other hand. There are also tendencies towards greater political uncertainty in several European countries. But it is difficult to put a figure on how such uncertainty may affect the economy, he said.

Inflation is still low in many other countries that are important for our trade. It is expected to rise in the near future, however, once the effects of last year's fall in oil prices subside. Overall, the Riksbank expects inflation abroad (KIX-weighted) to rise from 1.1 per cent this year to 1.8 per cent in 2016. Towards the end of the forecast period, it is expected to be 2.3 per cent, which is of considerable significance for us.

Regarding the Swedish economy, demand has broadened during the year. In addition to household consumption and housing investment, exports and business sector investment are also contributing to the growth.

The increase in refugee immigration is expected to boost demand over the next few years. Increased public expenditure in connection with the arrival of asylum seekers will primarily lead to greater public consumption but also to higher private consumption. GDP is expected to grow by 3 per cent on average during the forecast period.

Inflation expectations among all participants have taken an upward turn in both the short and the long term. The underlying inflation trend in Sweden has been rising for a while. Certain indicators took a step downwards in November, however, something which Mr Ingves believed can be seen as a temporary setback. Inflation is expected to be slightly lower for a time compared with the assessment in October and that was naturally a disappointment, but as Mr Ingves saw it, the stronger economic situation abroad and in Sweden points to the rising trend in inflation continuing.

The Riksbank anticipates a rapid increase in CPI and CPIF inflation over the coming months. The contributions from previously falling energy prices and interest expenditure are subsiding. Higher resource utilisation and rising cost pressures mean that it will be easier for companies to increase prices during the forecast period. The picture for inflation is rather similar to the one we discussed in October.

As regards monetary policy, some of the uncertainty abroad that began to surface just over 12 months ago is still there. The ECB extended its bond purchasing and cut the deposit rate at the beginning of December while it is not entirely clear how the Federal Reserve will act going forward. But even against this background, Mr Ingves thought that the Riksbank's monetary policy is now well-balanced. The Riksbank's purchases of government bonds, which began in early 2015, will correspond to around a third of nominal Swedish government bonds at the end of June 2016. He noted that the purchases have already had an effect by reducing the rates on long-term government bonds and the yield differential in relation to other countries and an exchange rate appreciation has been suppressed.

Swedish inflation is on the way up but still below the target. This means that the Riksbank needs to stick to its current course with a very expansionary monetary policy and be ready to implement further measures for a while longer.

There is still a risk of the exchange rate appreciating earlier and more rapidly than forecast. In that case, there is a risk that it will be more difficult to push up inflation towards the target. The Riksbank therefore needs to be ready to intervene on the exchange market whenever we deem it necessary, he said.

Mr Ingves also reminded the meeting of the fact that household indebtedness as a share of disposable income has risen dramatically in recent years and is expected to continue to increase rapidly going forward. Swedish households are taking on more and more debt in order to buy homes on a malfunctioning market. This is not a sustainable development, according to him. Without reforms of the Swedish housing market and without the relevant macroprudential policy measures, the risks increase of a very substantial shock to the economy in the period ahead. Such a development may also hamper normal monetary policy later on. In other words, there are a number of good reasons to, while there is still time, solve both the problems of households' excessively high loan growth and several other problems on the housing market, he concluded.

§3. Discussion

First Deputy Governor **Kerstin af Jochnick** referred to Mr Jansson's speech and pointed out that he brought up two important issues, both of which concern the monetary policy framework.

It was her opinion that it may be appropriate next year to develop the analysis of and discussion on the monetary policy framework. She pointed out that the Riksbank not only has its own recent experiences to fall back on with very low inflation and very expansionary monetary policy but will also benefit from the evaluation of monetary policy commissioned by the Riksdag Committee on Finance.

She referred to the two issues raised by Mr Jansson, namely i) which target variables should be used and ii) whether it is appropriate to use a tolerance band. She thought that both these issues should be included in a broader analysis and found it important that an overview of the framework take place in the light of recent experiences in both Sweden and other countries. If any changes are to be made to the framework, they should not be made because it has proved difficult to attain the inflation target in recent years but instead because analyses indicate that monetary policy can be even better and clearer.

Deputy Governor **Cecilia Skingsley** pointed out that although the inflation targeting regime generally works well, it should still be possible to discuss and potentially make adjustments to it.

The CPI measure was launched in 1993 as a target for monetary policy, and the measure was selected on the basis that it was commonly known. It was also the Riksbank's only realistic choice of inflation targeting policy measure at the time. After the demise of the fixed exchange rate regime in 1992, it would have been difficult for reasons of credibility for the Riksbank to create an inflation measure itself.

Consequently, according to Ms Skingsley, the Riksbank had little choice in the matter. The difficulty with the CPI measure is that it includes the effects of monetary policy via the fact that mortgage rates change when monetary policy changes. This circumstance has been known since the 1990s, but the Riksbank still has to devote a substantial amount of time explaining it to the rest of the world. In periods of major changes to the repo rate, the CPI measure becomes misleading, thereby impairing people's understanding of and confidence in the inflation targeting policy.

Ms Skingsley then pointed out that the IMF makes a similar assessment in its most recent report on Sweden[6] and in it suggests the HICP as an alternative measure to the CPI. This would facilitate international comparisons and communication, as well as increase confidence. She pointed to this as an interesting proposal, but also wished to mention

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[6] See Article IV Consultation Sweden No. 15/329, IMF, 2015.

that the drawback with the HICP is that the measure is comparatively unknown to Swedish households and price- and salary-setters. In conclusion, she saw the entire issue of possible adjustments to the current inflation target regime as feasible for the Riksbank to continue working on in 2016.

Deputy Governor **Martin Flodén** also wished to follow up on what Mr Jansson said about the framework and the issues he raised in his speech. He stated that Mr Jansson had raised several important issues, and he agreed with much of what Mr Jansson said, but he did not want to enter into a discussion about the design of the framework at this point. He then agreed with Ms af Jochnick's view that it may be appropriate for the Riksbank and others to develop the analysis and discussion of the monetary policy framework in the coming years.

He also wished to clarify something which he thought was important. As Mr Jansson mentioned, CPIF inflation is already an important part of the monetary policy decision process. The fact that it is already important during periods when the rate is being drastically raised or cut is also made clear in Monetary Policy in Sweden[7] which describes the Riksbank's strategy and was formulated by the Executive Board in 2010. In every monetary policy process that Mr Flodén has participated in, that is, prior to the 16 most recent scheduled monetary policy meetings, monetary policy has been designed so that the forecast for CPIF inflation including and excluding energy shall get close to the inflation target of 2 per cent at the end of the forecast period. But in all these processes, it has led to CPI inflation getting close to 3 per cent. Even if it is CPI inflation that is the target variable, Mr Flodén found it completely natural for monetary policy to be planned based on inflation measures that purge the impact of mortgage rates on inflation, at least when the repo rate is changed quickly or when it deviates a lot from its long-term average level. It is quite simply the most effective strategy to get CPI inflation to be around the two-percent mark in the long term, and it is furthermore consistent with the actions formulated by the Executive Board in its strategy publication "Monetary policy in Sweden".

In conclusion, Mr Flodén commented that his clarification is therefore that monetary policy would not be designed any differently today even if CPIF or HICP was the explicit target variable. Neither had monetary policy in recent years been designed in any other way.

Deputy Governor of the Riksbank **Henry Ohlsson** welcomed the fact that Mr Jansson raised questions about the monetary policy framework in his speech. He also welcomed a continued public, broad and deep debate about the subject and pointed out that he himself intended to participate actively in such a debate. As a personal reflection, Mr Ohlsson highlighted however that his assessment is that it would be easier to conduct a

[7] See "Monetary policy in Sweden", Sveriges Riksbank, 2010.

good discussion about the framework once actual inflation has stabilised near the two per cent inflation target.

The Governor of the Riksbank **Stefan Ingves** also commented on Mr Jansson's comments on the framework. He felt that the issue is not urgent in the current situation, but thought it was good that it had been raised and agreed about the importance of a broad and public discussion of the issue.

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

The very expansionary monetary policy pursued by the Riksbank is contributing to strengthening economic activity, falling unemployment and an upward trend in inflation. GDP growth is expected to remain high and CPIF inflation will stabilise around 2 per cent in 2017. There is still considerable uncertainty regarding the strength of the global economy however, and central banks abroad are expected to pursue an expansionary monetary policy for a long time, which also affects Swedish monetary policy.

Overall, growth in the Swedish economy has been slightly stronger than expected since the October Monetary Policy Meeting. However, the latest inflation outcome shows that the upturn in inflation is volatile and not yet on a firm footing. To safeguard the resilience of the upturn in inflation, monetary policy therefore still needs to be very expansionary.

The Executive Board unanimously agreed to leave the repo rate unchanged at –0.35 per cent and to continue to purchase government bonds for the first six months of 2016 in line with the decision in October.

The Riksbank remains highly prepared to make monetary policy even more expansionary, even between the ordinary monetary policy meetings. Several members also noted that a too-rapid strengthening of the exchange rate could make currency interventions necessary. The monetary policy being pursued aims to limit the risks of continued low inflation and to contribute to inflation expectations which are compatible with the inflation target.

Several members of the Executive Board once again underlined the importance of promptly tackling the risks linked to the housing market and households' debts. Finally, several members also commented on the monetary policy framework and welcomed a broad and public discussion about potential improvements to the framework.

§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 publish the Monetary Policy Report on Tuesday 15 December 2015, at 9.30 a.m.,

• to hold the repo rate at –0.35 per cent,

• to publish the interest rate decision above with the motivation contained in a press release on Tuesday 15 December 2015, 09.30, and

• to publish the minutes from today's meeting at 09.30 on Friday 8 January 2016.

This paragraph was verified immediately.

Minutes by

Sophie Brauner

Verified by:

Stefan Ingves	Martin Flodén	Per Jansson
Kerstin af Jochnick	Henry Ohlsson	Cecilia Skingsley

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