No. 12

SEPARATE
MINUTES of the Executive Board meeting on 6 July 2000

Present: Urban Bäckström, Chairman
Lars Heikensten
Eva Srejber
Villy Bergström
Kerstin Hessius
Lars Nyberg

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Malin Andersson (§1)
Hans Dellmo
Anders Eklöf
Kerstin Hallsten (§1)
Björn Hasselgren
Olle Holmgren (§1)
Leif Jacobsson
Per Jansson
Ann-Kristin Johnsson
Tomas Lundberg
Thomas Thyblad (§1)
Staffan Viotti
Göran Zettergren (§1)

§1. Monetary policy discussion

It was noted that Hans Dellmo and Anders Eklöf would prepare draft minutes of §§1 and 2 on the agenda for the meeting.

The meeting began with discussions of the factors in economic developments in Sweden and the rest of the world that are of importance for inflation prospects and the formation of monetary policy (section 1). The discussion of each aspect started from the analyses and assessments that had been compiled by the Monetary Policy Department on the basis of the technical assumption that the repo rate would remain unchanged at 3.75 per cent until mid 2002. In conclusion the members of the Executive Board summarised their views of inflation prospects (section 2) and presented their conclusions about the monetary policy situation (section 3).

1. Economic developments in Sweden and elsewhere

1.1 Price tendencies in Sweden

The Board noted that in May the 12-month changes in UND1X and CPI inflation were marginally higher than had been assumed in the Inflation Report. The underlying rate of inflation, as measured with UND1X, was 1.5 per cent in May, while CPI inflation was 1.4 per cent. This represented an acceleration of 0.3 percentage points from April. Both CPI and UND1X inflation were 0.1 percentage point higher than had been forecast.

The increase in the rate of inflation and the deviation from the forecast were mainly a consequence of high prices for domestic heating oil and petrol.

Producer prices rose 0.6 per cent from April to May, which gave a 12-month change figure of 3.7 per cent. Rising prices for energy-related goods were the main cause of the increase but prices of intermediate goods also moved up. Consumer goods prices rose in the domestic market but fell for exports. The opposite was the case for investment goods. According to the latest business tendency survey, producers of intermediate goods foresee further price increases in domestic as well as export markets, while price expectations in other sectors of manufacturing are more restrained.

1.2 International activity and inflation

In the June Inflation Report it was judged that GDP growth in the OECD area would average just over 3 per cent this year, just under 3 per cent in 2001 and 2.5 per cent in 2002. During this period inflation was judged to accelerate gradually to an average in 2002 of 2 per cent.

In the United States a number of indictors have pointed to an incipient slowdown, which is in line with the assessment in the Inflation Report. Among other things, the growth in employment has slackened. To some extent it therefore seems that the Federal Reserve's interest rate increases have had the intended effect. One Board member pointed out that the beginnings of a slowdown in the United States may have reduced the risk of an abrupt adjustment of the U.S. economy via steeply falling share prices. Despite the slowdown, however, price pressure this year looks like being marginally stronger than forecast in the Report. This is due in part to the higher oil prices recently and in part to increased wage costs.

In the United Kingdom the development of house prices and retail turnover indicate weaker domestic demand. Notwithstanding the high level of activity to date, during 2000 the rate of wage increases has decreased and inflation has remained low.

In the euro area the economic upswing looks like being marginally stronger than assumed in the Inflation Report, due to stronger tendencies for both exports and private consumption. As regards price tendencies, it can be noted that the upward pressure from the price of oil is partly countered by a dampening effect from a stronger euro. But the rapidly rising activity and increased resource utilisation do suggest that inflation may be somewhat higher than assumed earlier.

Stronger growth is also expected in the Nordic area; an upward revision of the growth forecast seems to be warranted for Norway in particular. In all the Nordic countries, the path of the oil price and rising labour costs point to price pressure being marginally higher than expected.

All in all, the Board found that the Inflation Report's picture of an international economic upswing that remains strong still holds. The Board considered, however, that minor shifts which have occurred in the picture may point to international GDP growth being somewhat higher this year. This has to do with the slowing tendencies in the United States and the United Kingdom being countered by an upswing in the euro area and the Nordic countries that looks like being slightly stronger than assumed earlier. One Board member added that since activity in the U.S. economy in recent years has tended to weaken in the second quarter, there were grounds for a cautious interpretation of the latest American statistics; the member foresaw a continuation of strong international activity, particularly as even the Japanese economy is now becoming stronger. Another member argued on the contrary that a combination of an economic slowdown in the United States and a stronger trend in the euro area would no doubt contribute to future international inflationary pressure that is relatively restrained.

1.3 Financial markets

The Board noted that in the interval since the Inflation Report was compiled in June, the average level of international bond rates has tended to fall. The Swedish ten-year rate has broadly followed its German counterpart and declined about 0.1 percentage point to 5.2 per cent. This means that the levels of the Swedish and German long-term interest rates are still more or less the same. Meanwhile, the American and British long-term rates have fallen somewhat more, by approximately 0.3–0.4 percentage points. Partly against this background, the Board considered that in the near future the long-term interest rates will be somewhat lower than was assumed in the Inflation Report.

Market prices indicate that players are counting on further interest rate increases by the Federal Reserve and the ECB. After the signs of decreased economic activity, however, the expectations of higher US rates have become somewhat less pronounced. Players expect that in the United Kingdom there will be only one further increase in the instrumental rate or that this may even be kept unchanged. As regards Swedish monetary policy, survey data as well as market prices indicate expectations of a repo rate increase of 0.25 percentage points after the summer. In the longer run, surveys show expectations of the repo rate being increased to 4.4 per cent six months ahead and to almost 5 per cent after twelve months.

The Swedish krona's TCW index has fluctuated between 119 and 124 and is currently around 123. The appreciation has accordingly been somewhat more marked than was assumed in the Inflation Report. But the Board judged that in the present situation there is no need to adjust the earlier forecast.

Share prices in Sweden and other countries have continued to fluctuate relatively widely, though the movements have subsided somewhat in the period since the Inflation Report. Still, option pricing indicates expectations that price movements will continue to be relatively large. It was noted that the Swedish stock market has been comparatively strong to date this year, in large measure as a result of a strong price trend in the telecom sector.

1.4 Import prices

The barrel price of crude oil was forecast in the Inflation Report to average USD 25.8 this year and then fall back to averages of USD 22.1 in 2001 and USD 20.6 in 2002.

Since the Report's publication, the oil price has risen more than expected; the average for June was about USD 29 as against the forecast of USD 27. One factor behind the recent price increase is presumably this summer's petrol shortage in the United States. In the opinion of two Board members, however, Saudi Arabia's unilateral decision to increase oil production could lead to lower prices in the future. Another member considered that in the present situation there was no reason to revise the oil price forecast. Given the earlier perception of the long-term equilibrium price, a higher price today implies more room for future price reductions. On the other hand, it might perhaps be argued that the strong international growth suggests that the price fall may be less pronounced than assumed earlier. All in all, the Board judged that in the present situation there is no reason to adjust the earlier oil price forecast.

The consumption-weighted level of import prices to producers rose 0.9 per cent from April to May, mainly on account of sharp price increases for petroleum products. But although the outcome was high, it was less than had been expected. In view of the difficulty in evaluating single monthly outcomes, the Board saw no reason at present to alter the earlier assessment of import prices. But the Board did note that a somewhat higher oil price may entail some upside risk in the import price forecast for 2000.

1.5 Demand and supply

GDP growth in Sweden was judged in the Inflation Report to be 4.3 per cent this year, 3.5 per cent in 2001 and 2.9 per cent in 2002. The comparatively high growth was assumed to mean that the unutilised resources would be brought into production successively during the forecast period; but the risks of more extensive capacity restrictions were still expected to be relatively limited.

Household consumption growth was calculated in the Inflation Report to be 4.3 per cent this year, 3.8 per cent in 2001 and 3.6 per cent in 2002. The Board noted that new statistics on retail turnover, households' purchasing plans and growth of the money supply confirmed the picture of persistently high growth of private consumption and strong household confidence in the future. Moreover, asset prices and household disposable income have followed their forecast paths.

In the light of this, the Board noted that the national accounts' Q1 outcome for private consumption was remarkably low; the growth rate of 3.7 per cent was considerably below the forecast. A number of Board members pointed out, however, that other statistics indicated a stronger growth of consumption and that the quarterly statistics for the national accounts are frequently revised appreciably. These members accordingly did not attach all that much importance to the unexpectedly weak Q1 outcome for consumption according to the national accounts.

For public consumption, the national accounts' Q1 fall of 1.4 per cent from the same quarter a year earlier was considerably more pronounced than expected.[1] Factors behind the decline include lower disbursements for labour market training (AMS courses), changes of a technical nature and lower defence expenditure. Local government consumption rose 0.3 per cent, which was also weaker than expected.[2] One explanation may be that local governments were cautious in the early part of the year because as of 2000 they are required to show a balanced economy. The low Q1 outcome for public consumption means that in order to match the Inflation Report's forecast for 2000, the increase in the rest of the year needs to be comparatively substantial. The Board judged that such a development cannot be ruled out but considered that the path of public consumption does entail some downside risk for GDP growth this year.

As regards investment, the Board considered that the recent statistics did not alter the earlier assessment. The picture of gross capital formation in the national accounts does admittedly point to a weaker tendency but business tendency data and the May investment survey by Statistics Sweden imply a continuation of the strong trend.

The Board noted that both the national accounts and the trade statistics point to the growth of goods exports to date this year being higher than expected. To some extent the stronger tendency can presumably be explained by the somewhat higher international growth and thereby a stronger expansion of markets for Swedish exports. It is judged, however, that the growth of goods exports will slacken during the year. This impression is supported by the latest business tendency survey from the National Institute of Economic Research and the purchasing managers index (ICI), which show some slowdown in the inflow of export orders. But all in all, the Board found that some upward revision of exports this year may be called for.

The positive labour market development is continuing, in accordance with the assessment in the Inflation Report. Still, the statistics show that at 66,000 persons, the average increase in employment in the first five months of this year was somewhat below expectations. This could lead to a marginal downward revision of employment this year. One Board member noted, however, that the national accounts show a sharp

[1] Including the effect of the reclassification of the Church of Sweden's consumption, the level fell 3.3 per cent.
[2] Including the effect of the reclassification of the Church of Sweden's consumption, the level fell 2.3 per cent.

Q1 increase in hours worked, while the number of persons in employment does not seem to have risen correspondingly. This suggests that labour demand remains high.

The member also underscored that the lack of agreement between the national accounts and the labour market statistics can be seen as a sign that for various reasons firms regard an increase in average working hours as preferable to recruitment. Another Board member commented that a conceivable increase in average working hours can also be interpreted as a sign of labour market flexibility; more overtime can be arranged when it is needed. In the opinion of a number of Board members there are signs of labour market problems with matching; the number of unfilled job vacancies is rising more rapidly than the number of new vacancies, for example. These statistics and those on labour shortages should therefore be followed attentively. One of these members pointed out that a weighted combination of statistics on capacity utilisation and shortages of key personnel in engineering suggests that resource utilisation in manufacturing is relatively high. All in all, however, the Board judged that at present there is no reason to alter the earlier assessment of resource utilisation.

The preliminary rate of wage increases in the total economy in 1999 was 3.3 per cent. This is in line with the assessment in the Inflation Report. The Board noted that the continuation of strong labour demand does not yet seem to have affected wage developments at all substantially, though the preliminary figures for April do show some acceleration of the wage rise in the private sector. At present, however, it was considered that there were no grounds for altering the June forecast for wages in 2001 and 2002.

All in all, the Board found that the new statistics since the Inflation Report support the picture of strongly rising activity that is in the process of bringing the unutilised resources into production. The Board found no reasons for appreciably altering the June assessment of growth prospects.

1.6 Price effects of deregulations, trade liberalisation, political decisions and interest expenditure

The downward CPI effect of deregulations and trade liberalisation was judged in the Inflation Report to be –0.4 percentage points in 2000 and –0.1 percentage point in 2001 as well as 2002. The Board noted that there was no new information that warranted a change in this assessment. Neither have any new proposals to change indirect taxes been presented.

The contribution to CPI inflation from interest expenditure has been marginally higher than forecast. This is largely a consequence of bank interest rates and the house mortgage institutions' flexible interest rate being higher than anticipated. The interest rate tendency in the past month suggests, however, that house mortgage interest expenditure may be somewhat lower in the remainder of the forecast period. It is worth underscoring, however, that the discrepancies are slight.

1.7 Inflation expectations

One survey of inflation expectations has been published since the time of the June Inflation Report.

According to Statistics Sweden, the inflation expectations of households moved up from 1.6 per cent in April to 1.9 per cent in May. From March to April, however, the level had fallen 0.5 percentage points. The Board noted that inflation expectations continue to be well in line with the inflation target.

2. The Board's assessment of inflation prospects

In the Inflation Report's main scenario it was judged that the 12-month rate of CPI inflation would be 1.3 in June 2001 and 1.9 per cent in June 2002. The corresponding underlying inflation rates, measured as UND1X, were judged to be 1.5 and 1.9 per cent. The risk spectrum was judged to be balanced one year ahead, while after two years there was considered to be some upside risk, mainly in view of the greater probability of strong total demand. Including the risk spectrum, UND1X inflation two years ahead was judged to be 2.0 per cent.

2.1 The monetary policy group's appraisal

The Board's discussion of inflation prospects was preceded by a presentation of a corresponding discussion in the Bank's monetary policy group.[3]

In the opinion of the policy group, the subsequent information has not decisively altered the picture that was presented in the June Inflation Report. As a consequence of higher oil and petrol prices, however, it is foreseen that in the short run, UND1X inflation will be somewhat stronger than expected. But as long as it does not affect inflation expectations, this was not judged to have any sizeable effect on inflation in the longer run. The group considered that this has not happened to date.

2.2 The Board's discussion

The Board noted to begin with that under present circumstances, in the further discussion of inflation prospects and the formation of monetary policy it was reasonable to disregard the estimated effects of indirect taxes, subsidies and interest expenditure because they are judged to have no permanent effect on either inflation or inflation expectations.

Five Board members concluded that in the light of the information that had been obtained since the publication of the June Inflation report there were no grounds for appreciably revising the forecast rate of UND1X inflation one to two years ahead. One of these members noted, however, that most of the new information pointed to the

[3] The group is made up of Riksbank staff and is headed by one of the deputy governors. The main features of the group's discussion are presented at the Board meeting. The opinions expressed in the minutes are not necessarily shared by all the members of the group, including the chairperson.

future domestic demand tendency being weaker. All in all, the members judged that the picture of a strong and stable economic upswing in Sweden still holds. The unutilised resources are likely to be brought into production by degrees and in this context several members pointed out that there are signs of increased labour shortages and underscored the future importance of analysing new information about such shortages.

A sixth Board member judged that towards the end of the forecast period UND1X inflation will be higher than assessed in the latest Inflation Report's main scenario but well inside the uncertainty interval as stated in the Report. This member foresaw strong economic growth in Sweden as well as in the rest of the world. The combination of low labour market flexibility in Sweden, signs of incipient matching problems, a lack of competition in a number of markets and rapidly rising domestic demand was considered to suggest that, with an unchanged repo rate, at the end of the forecast period inflation will be somewhat above the targeted rate. The expansion of total corporate borrowing and of household credits points in the same direction, in that in both cases the growth rate continues to be around 10 per cent. This is accompanied by rising levels of liabilities. Moreover, growth of the money supply is continuing at a rate that is not ultimately compatible with price stability. The member also pointed out that in the 1990s inflation in Sweden was subdued by the global disinflation process and the Asian crisis' tendency to restrain prices abroad. Today the situation is different, with strong growth in virtually the whole of the global economy. The aggregate effects of this simultaneous growth are probably underestimated. The member noted, moreover, that since prices tend to be more rigid in a low-inflation regime, price increases can be expected to occur relatively late in an expansionary phase.

All the Board members considered that in the short run UND1X inflation will be somewhat stronger than expected earlier on account of oil and petrol prices that are higher than assumed in the Inflation Report. But provided inflation expectations are not affected, this was not judged to have any sizeable effect on inflation in the longer run. There are considered to be no signs that this has happened to date. Neither did the Board members see any reason to revise the oil price forecast for the longer term, partly in view of Saudi Arabia's decision to step up production.

3. The Board's assessment of the monetary policy situation

3.1 The monetary policy group's appraisal

In the opinion of the policy group, the new information since the Inflation Report did not speak in favour of a repo rate adjustment at today's meeting. In the discussion at the previous meeting it had been stated that the forecast presented on that occasion could warrant both an unchanged and a higher repo rate. The motivation for a repo rate increase called, however, for a fairly wide interpretation of monetary policy's intellectual framework. Examples of factors that could have already motivated raising the repo rate at the previous meeting are a changed perception of the monetary policy horizon, effects of asset prices and/or what is meant by transitory factors. All in all, however, it had been judged that the arguments for adopting a wider interpretation of the intellectual framework were not sufficiently strong. There are no grounds for changing this opinion today. A deviation from the intellectual framework by the Riksbank should require a more stringent motivation. The Riksbank's experiences in the 1990s clearly demonstrate the value of working with a distinct framework. There is then less risk of being misunderstood.

The policy group pointed out that the picture of a strong economic upswing continues to apply and that this can be expected to lead to rising capacity utilisation and increased underlying price pressure. This speaks in favour of a future need to raise the repo rate. An unchanged repo rate at present and an increase in late summer/early autumn are also what market players expected.

3.2 The Board's discussion

Five Board members shared the policy group's view that the new information since the Inflation Report has not substantially altered the picture of inflation prospects. These members declared that the repo rate would be left unchanged for some further time. At the same time they underscored that the picture of a stable and strong economic upswing still holds. One of these members attached greater weight than the others to the indication in the latest national accounts figures that domestic demand in Q1 this year was somewhat weaker than expected. This member was therefore somewhat more uncertain than the others about the future strength of the Swedish economy. But all five members judged that in the coming two years the rate of inflation will become successively higher. As the assessment's time horizon shifts into the future, the more cyclically-dependent inflationary pressure is likely to show up more clearly. A number of the factors that will subdue inflation in the coming two years (the exchange rate and oil prices, for example) can then no longer be expected to act as forcefully. This suggests that a repo rate increase may be needed in the future.

A sixth Board member with a somewhat different appraisal of inflation prospects pointed out that this also implies a view of the formation of monetary policy that differs from that expressed by the majority. This member considered that transitory effects on inflation from administrative decisions, such as, for example, the introduction of a maximum day nursery charge in 2002, ought not to affect monetary policy because they do not stem from the cyclically-dependent price pressure in the economy. This member considered, moreover, that monetary policy is currently expansionary. At a time of strong economic growth with virtually full resource utilisation, with the prospect of inflation probably being above the target towards the end of the forecast period, the member considered that aggregate economic policy should at least be neutral.

Furthermore, this Board member considered that the burden of proof in the discussion rests on those who advocate the continuation of an expansionary monetary stance when the economy is growing at almost twice its potential rate and restrictions in supply are beginning to make themselves felt. Continuing in such a situation with what this member regarded as an expansionary monetary stance would be liable to lead to financial and real imbalances that ultimately threaten price stability, accentuate fluctuations in growth and entail a risk of lower average growth. The member considered that the Riksbank's intellectual framework should not be interpreted unduly strictly and underscored the importance both of basing monetary policy decisions not only on the inflation assessment but also on the risk of a build-up of financial imbalances and of also taking developments beyond the forecast horizon into account. This is particularly the case in that price rigidity in a low-inflation economy is such that if inflation is left unchecked, bringing it down again takes longer than if the interest rate is raised in good time. Against this background the Board member advocated a continued realignment of monetary policy towards a neutral level and stated that the repo rate ought now to be raised 0.5 percentage points.

Other Board members underscored that they shared the opinion that monetary policy should be pre-emptive and that the repo rate should be raised in good time so as to avoid a build-up of financial imbalances. In their case, this led to the conclusion that at present the repo rate should be left unchanged.

§2. The monetary policy decision

The Chairman summarised the monetary policy discussion under §1 and noted that a majority of the Board members considered that the repo rate should be left unchanged.

The Chairman then proposed that the Executive Board decides

- that the rate repo is to be held unchanged at 3.75 per cent and that this decision shall apply from Wednesday, July 12th, 2000, and
- that the decision be announced at 9.30 a.m. on July 7th, 2000 with the motivation and wording contained in Press Release no. 43 2000 (Annex A to the minutes).

The Executive Board decided in accordance with the proposal.

Deputy Governor Eva Srejber entered a reservation against the decision and stated that the repo rate should be raised 0.5 percentage points.

This paragraph was immediately confirmed.