Minutes of the Executive Board's Monetary Policy Meeting, No. 4

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Lars Nyberg
Lars E.O. Svensson
Barbro Wickman-Parak
Svante Öberg

Johan Gernandt, Chairman of the General Council (§ 1-3)
Leif Pagrotsky, Vice Chairman of the General Council

Sigvard Ahlzén
Claes Berg
Heidi Elmér
Eric Frieberg
Jesper Hansson
Mia Holmfeldt (§1-3)
Ann-Christine Högberg
Andreas Johnson
Anna Lidberg (§1-3)
Tomas Lundberg
Pernilla Meyersson
Marianne Nessén
Christina Nyman
Bengt Pettersson
Olof Sandstedt (§1-3)
Anders Vredin

§ 1. Economic developments

It was noted that Andreas Johnson and Bengt Pettersson would prepare the necessary draft for monetary policy meeting minutes with regard to paragraphs 1, 2 and 3 on the agenda for the meeting.

Mia Holmfeldt of the Financial Stability Department began by presenting recent developments regarding financial stability. There are signs of continued improvement in the situation on the financial markets. Investors' risk appetite has increased and the demand for government securities has declined. The assessment of risks for high-yield companies has been revised down. The so-called three-month basis spread, which is a commonly-used measure of the market's valuation of credit and liquidity risks, has continued to fall internationally and is now back below the levels prevailing prior to the start of the most acute phase of the crisis in September last year. The opportunities for companies to find funding in the capital market have improved. However, the financial system is still dependent on the liquidity offered by central banks. In Sweden, the Swedish banks believe that borrowing by issuing covered bonds is working well but that this is still more expensive than prior to the crisis. The so-called CDS premiums have fallen substantially for Swedish banks, compared with the situation in July.

Anna Lidberg of the Monetary Policy Department reported on developments in the financial markets since the internal monetary policy group meeting on 25 August. The Swedish krona has weakened slightly and stock exchanges have fallen globally, partly as a result of uncertainty regarding the recovery in Asia. Both government bond rates and interbank rates have fallen. Both the pricing of financial instruments and surveys of the views of market participants indicate that the repo rate is expected to remain at 0.25 per cent after today's meeting. Opinions differ with regard to the repo rate path. Some analysts believe the path will remain unchanged, while some expect increases to come earlier than was forecast in July, and others expect the increases to come later. The pricing implies that the expectations of earlier increases are predominant. The market assessment is that it is probable that the Riksbank will offer new loans at a fixed interest rate.

Jesper Hansson of the Monetary Policy Department presented a summary of the background material for the Executive Board’s discussion. He noted that there are clearer signs of an upward turn in the world economy and in Sweden than could be seen at the time of the monetary policy meeting in July. GDP outcomes for the second quarter of this year were one indication of this. Confidence indicators have risen quickly and optimism has returned to the financial markets. However, one must remember that the recovery will be from a low level and that an increase in confidence does not automatically mean that unemployment will fall rapidly and resource utilisation increase. Production is not expected to reach the levels prevailing before the crisis until 2012. The Swedish krona has strengthened faster than expected. This has led to the forecast for underlying inflation in terms of the CPIF being revised down slightly for 2010 and 2011. All in all, the conditions for growth are the same as they were in connection with the meeting of the internal monetary policy group on 25 August, although some further information has been received since then. The National Institute of Economic Research’s Economic Tendency Survey rose in August, while the purchasing managers’ index fell slightly. Retail trade sales rose in July and exports have ceased falling in recent months. House prices rose in the United States in June. With regard to the euro area, the purchasing managers’ index and the European Commission’s economic tendency survey rose in August. Finally, Jesper Hansson pointed out that the forecasts in the draft Monetary Policy Update were based on the assumption that the Riksbank will lend a further SEK 100 billion at a fixed interest rate and with a maturity of twelve months. This should contribute to continued low interest rates on loans to companies and households.

§ 2. Economic outlook abroad

Deputy Governor **Lars Nyberg** began by pointing out that since the most recent monetary policy meeting at the beginning of July the situation on the international credit markets has continued to improve at a rapid rate. Investors' willingness to take slightly higher credit risks, on condition that they receive reasonable compensation for this, has increased substantially. More and more borrowers have been able to access funding in the credit markets in the United States and Europe, even those with slightly poorer credit ratings. The markets for subordinated loans have opened again, as has the market for municipal loans in the United States. At the same time, it has been possible to extend maturities and the cost to borrowers has fallen, that is, credit spreads have fallen. This is not a return to normal conditions, but it is a good step in the right direction.

Although the credit markets are functioning better, large loan losses remain in many banks' balance sheets. And new ones will be added as an increasing number of clients are hit by the recession and experience debt-servicing problems. Confidence in the banks has still not been restored. The banks sometimes have to pay more for their borrowing in the credit markets than the larger non-financial companies that are usually their customers. Mr Nyberg pointed out that many banks have been able to obtain new risk capital, either privately or with government aid. But this does not apply to all of them. In some countries the banks still have a shortage of equity.

Mr Nyberg thought that the news regarding real economic developments in the world during the summer had largely been positive. The large fiscal and monetary policy stimulation packages appear to have fulfilled their functions. GDP in Asia has recovered much more quickly than expected. GDP figures for the euro area in the second quarter were also a positive surprise. In the United States, the property market finally appears to be showing an upturn. Confidence among companies in terms of the purchasing managers' index has improved substantially. The stock markets have risen. Mr Nyberg claimed that most analysts appear to be agreed that the recession has bottomed out, although there is disagreement over the speed of the upturn.

We can never rule out the possibility that developments will change again and we will experience a new downturn before the real upturn comes. All optimism may be too hasty, not least on the stock market. The upturn may take longer than expected, particularly as there are many holes in the bank system that need filling. Several countries, not least the Baltic and eastern European countries, also have various structural problems to deal with in their public and financial sectors. And the crisis is not over just because an upturn has begun.

However, Mr Nyberg commented that there are also arguments in favour of the upturn actually coming slightly sooner than was believed earlier. The world has never before in modern times experienced that the liquidity in the bank market and the capacity to supply credit has disappeared as quickly as it did after the Lehman Brothers bankruptcy in September last year. During the last quarter of 2008 and the first quarter of 2009 world trade fell by around 20 per cent. It is not unreasonable to assume that access to credit may have had considerable influence here. There is a box in the latest OECD "Economic Outlook" report published in June this year that argues along these lines. Mr Nyberg said that as far as he knew access to credit was not adequately captured by any of the macro models currently used by economists. The financial collapse and the ensuing strong reluctance to take financial risks could thus have contributed more to the speed and depth of the recession than we and others have previously realised.

If this is true, the mechanism could of course also work in the other direction. The credit markets, and in some places also the banks, appear to be recovering at a slightly faster rate than expected. This is largely due to the unique efforts made by central banks around the world. The improved situation in the financial markets and the rapidly-growing access to credit may also contribute to a slightly faster growth in the real economy than we had previously assumed. Once trade credits and operating credits to companies become available again, trade and production will pick up. The unexpectedly rapid upturn in Asia may be partly due to this. Mr Nyberg pointed out that the Riksbank's forecasts may have underestimated future growth in both world trade and the real economy.

Deputy Governor **Karolina Ekholm** emphasised two things. The first is the clear signs that the economic downturn has slowed down. The prospects for the western European economies important to Sweden and for the United States beginning to grow again towards the end of the year now look much brighter than they did at the previous meeting. The second thing is the great uncertainty over how strong and stable the recovery will be. It is positive that there has been a clear improvement in the situation on the financial markets and it reduces the risk of a serious setback. On the other hand, the situation in these markets has not completely normalised. Central banks around the world will continue to use various measures to help the banks find funding. The powerful fiscal policy stimulation in all of the large economies has probably played a major role in the recent slowdown in the fall in GDP. But the rapid increase in national debts which often arises from such measures may at the same time create unease among households, which could lead to the recovery faltering. One can thus summarise economic prospects by saying that they are brighter now, but that there is still considerable uncertainty.

Ms Ekholm also referred to discussions at earlier meetings of a comparison between the developments during the current crisis and the great depression of the 1930s. Researchers Barry Eichengreen and Kevin O'Rourke have earlier shown in a much-publicised article that industrial output, stock market rates, trade and so on have during this crisis shown a frighteningly similar development to the time of the great depression. But at the beginning of September they showed in an update that industrial output for the world in total has actually turned upwards, which thus demonstrates a clearly different development to the 1930s depression, when it continued to fall for three years. Ms Ekholm pointed out that this strengthens the picture of a decline in the risk of the recession being very prolonged.

Deputy Governor **Lars E.O. Svensson** explained that he shares the view of developments abroad contained in the draft Monetary Policy Update. Although the situation in the world economy has improved somewhat since July, it is important not to count too much on the positive signs. It is important that monetary and fiscal policy continue to be expansionary. The risks of breaking off the expansionary policy too early are much greater than the risks of continuing too long with it. It is a question of avoiding the classical policy mistakes considered to have been made by the United States in 1936 and Japan in 1996.

Governor **Stefan Ingves** commented that since the previous monetary policy meeting there have been further signs indicating that the severe downturn in international economic activity had bottomed out. The financial crisis is not over, but the measures taken have begun to show results. Very low policy rates and fiscal policy stimulation have laid the foundation for a recovery in several countries. Lower interest rate spreads and risk premiums on financial instruments point to less uncertainty in the financial sector, which is also a necessary condition for the beginning of a recovery in the real economy. Companies' and households' funding opportunities have improved. Equity prices have risen substantially since last spring, which has contributed to a recovery in property values, which had been under severe strain.

Moreover, the dramatic fall in world trade now appears to have bottomed out. This is partly because monetary and fiscal policy stimulation in many countries has contributed to stimulating imports from other countries, and partly because the central banks' dollar loans have reduced the funding problems holding back trade during the crisis. On the other hand, not all of the problems have been solved yet, neither with regard to economic activity nor the situation in the financial market. Mr Ingves said that we are now going from a situation of acute crisis management to managing bad loans and rebuilding balance sheets. This is a process that takes time, although it will probably not entail the same drama as experienced over the past year. This means that even if the markets are functioning better, the financial sector will in future find it difficult to contribute significantly to restoring growth. Nor can we sound the all clear for the economic situation in the Baltic with the risk of negative contagion effects on the Swedish financial sector.

The clearest recovery is in Asia. In the euro area production looks to be slightly higher than we assumed in July, although the fall in GDP this year will be substantial and growth next year will be relatively weak.

In the United States household saving was at a very low level when the crisis began. An adjustment has begun and saving as a share of disposable income has increased. Mr Ingves said that although the forecast for GDP growth has been revised up since the previous monetary policy meeting, the need to adjust will contribute to a slower recovery. Everything cannot and should not return to its earlier status. What is happening in the United States is a part of the correction of international imbalances with a redistribution of world demand. This is an important factor for the open Swedish economy which is greatly affected by global trade flows.

Mr Ingves expressed support for the main scenario in the draft Monetary Policy Update. However, there is both a possibility that developments will be better than expected and a risk that they will be worse.

In connection with the financial crisis a number of financial and real economic supplementary mechanisms have contributed to a deep, globally-synchronised real economic recession. But since the previous monetary policy meeting there have instead been tendencies towards a positive feedback loop, between better financial data, confidence in the future and real economic indicators. Mr Ingves said that this could indicate a faster recovery. But on the other hand, recovering from large imbalances and financial crises usually takes longer than from a normal economic downturn. Equity prices are volatile and upturns can sometimes send the wrong signals, as they are not always sustainable. Moreover, house prices usually remain subdued longer than equity prices. Unemployment usually remains at high levels for longer than the GDP slowdown. In addition, there are risks connected with the fact that the fiscal policy stimulation package is not and cannot be permanent. When these are phased out there is a risk that the recovery will lose momentum. And if the stimulation package goes on too long there is a risk that unsustainably large budget deficits and debts in the public sector will hold back development in the rest of the economy. If households perceive the budget deficit to be unsustainable, they may expect rising taxes in the future to correct this, which could dampen their current consumption.

It looks as though there will now be a favourable, v-shaped recovery in the world economy. However, there is a risk that growth will nevertheless be relatively weak, which will of course affect the conditions for monetary policy.

Deputy Governor **Barbro Wickman-Parak** began by referring to earlier contributions to the debate by Karolina Ekholm and Stefan Ingves regarding economic policy stimulation and global imbalances. At earlier monetary policy meetings the Executive Board has discussed the effects of the fiscal policy measures taken abroad. There was great uncertainty over the effects of these measures. We can now feel more certain that they appear to have had a positive effect and we should be pleased with this. With regard to the global imbalances, the necessary correction has already begun. Imports in the United States, which have shown a significant current account deficit, have in recent years fallen more than exports. At the same time, we see signs that the current account surplus has declined in important countries. In China, growth appears to be increasingly driven by domestic demand. These factors contribute to the global imbalances declining and this process needs to continue.

Ms Wickman-Parak went on to comment more specifically on the current economic situation. Characteristic for this crisis has been a significant collapse in confidence, and her view is and has been that one should not underestimate the effects of this confidence returning. As Lars Nyberg has described, the situation in the financial markets has continued to improve and no one can have failed to notice that confidence among economic agents has increased considerably.

Ms Wickman-Parak reminded that she had provided fairly detailed information at recent monetary policy meetings as to which statistics and indicators she considered most significant on an international level, and why. These have included the source of the crisis, namely the US housing market, and it is important to point out that a turnaround is on the way there. Ms Wickman-Parak's assessment is that housing investment will improve within a quarter or so and begin to provide a positive contribution to growth after earlier having provided a strongly negative contribution. She pointed out that she has also emphasised earlier the importance of the cyclical upturn in production that follows when stocks adjustments are concluded. Ms Wickman-Parak noted that the positive signs visible last summer were even clearer now. With regard to the fiscal policy stimulation measures, she once again repeated what she had stated in July, that these measures in the United States will be larger next year than they are this year, while in the euro area they are expected to be around the same size next year as this year. This is important in the forecast perspective covered by today's monetary policy decision. But in a slightly longer perspective it is, as colleagues have already pointed out, a different matter when governments are to correct large budget deficits.

Sometimes the view is put forward that not very much has happened in the economy, that it is only the confidence indicators that are pointing upwards and that little can be seen in terms of "hard facts". This is correct, but it is also the case that a coming upturn in the hard facts will first be visible in the confidence indicators, pointed out Ms Wickman-Parak. Moreover, the indicators are particularly important to follow this time, as the crisis has just been characterised by a collapse in confidence. But we are also starting to see signs of positive changes in some outcome data. In some important countries such as Germany and France GDP rose slightly during the second quarter and in some Asian countries there was a substantial rise. Another important example of hard facts that have shown an upturn is that world trade has ceased falling and shown a cautious upturn. Ms Wickman-Parak pointed out that she could mention more examples but chose not to spend more time on this now.

While there are an increasing number of positive signals in the global economy, it should be mentioned that there are forces having a restraining effect on the upturn. When credit granting slowed down this had substantially negative effects on demand, which resulted in large falls in production. This has left behind a starting point with very low resource utilisation. This means that it will take longer than is usual in an upturn phase for investment to really accelerate. There is also another factor that means we cannot expect a rapid return to the strong growth rate prior to the crisis. It is hardly likely that a strong credit-lead growth in demand will arise. The banks' willingness and ability to grant credit will not be the same, and the willingness to take loans among, for instance, households in countries with large indebtedness will probably be more restrained.

Ms Wickman-Parak pointed out that her overall assessment at the previous monetary policy meeting was that the international growth forecast in the main scenario was on the low side. Although the international forecast has been revised upwards, her assessment is that international growth will nevertheless be slightly stronger than the forecast in the draft Monetary Policy Update. Ms Wickman-Parak concluded her contribution to the debate by noting that all analysts, regardless of how sophisticated the models and other analysis tools they had at their disposal, have experienced difficulty during the crisis in capturing its effects on the real economy. Now that the crisis is loosening its grip, it is all too easy to underestimate the effects on the real economy once again.

First Deputy Governor **Svante Öberg** agreed with the picture of international economic developments presented in the draft Monetary Policy Update. It is reasonable to revise up the forecasts for GDP growth in the world. Developments in both the United States and Europe were slightly stronger in the second quarter of this year than we anticipated at the previous monetary policy meeting and developments in Asia have been surprisingly strong.

Mr Öberg agreed with earlier contributions to the debate by Barbro Wickman-Parak and Lars Nyberg that it is possible that the upturn will be faster than is predicted in the draft Monetary Policy Update. But there are also downside risks.

Historical experiences show that the upturn after a financial crisis is usually slow and prolonged. There are several reasons for this. The banks usually reduce their balance sheets and strengthen their capital bases after a financial crisis. This can subdue lending to a greater extent than the demand for loans, despite the measures taken by central banks and governments. This process is reinforced by bankruptcies and loan losses.

The public sector's tax income falls in connection with the economic downturn. Deficits in public finances and national deficits will increase significantly in the United States, Europe and other parts of the world. This development is reinforced partly by the fact that both the level of, and growth in, potential GDP fall, which has a negative effect on tax income, partly because the fiscal policy conducted is expansionary to deal with the economic downturn.

Sooner or later this will lead to tax increases and cutbacks in expenditure, which will also occur more or less simultaneously in several countries.

The central banks are now supporting both economic activity and the bank sector with low interest rates and measures to preserve financial stability. Sooner or later interest rates will be raised and the support measures will be phased out.

Households, particularly those in the United States, but also those in a number of other countries, have consumed above their long-term capacity in connection with the low interest rates and the rising property prices. They now need to increase their saving, which will subdue private consumption. This development is reinforced by the fact that employment is declining and unemployment is rising, and also by the fact that interest rates will rise and fiscal policy will be tightened. Investment is being held back by low demand and by very low capacity utilisation.

There is a risk that we have not fully taken these mechanisms into account, that there will be a setback as there was in the 1990s and that developments will be weaker than we are assuming. All in all, however, Mr Öberg considered the risks to be balanced.

§ 3. Economic developments in Sweden and the monetary policy discussion

First Deputy Governor **Svante Öberg** began the discussion and stated that his assessment was that the repo rate needs to be low for a long period of time, and that he therefore supports the proposal to hold the repo rate at the current low level and the proposed repo rate path in the draft Monetary Policy Update. Mr Öberg went on to put forward four comments on monetary policy.

Compared with the forecasts made in the July Monetary Policy Report, the forecast for GDP growth in Sweden has now been revised up slightly. But at the same time, the forecast for inflation has been revised down slightly. Mr Öberg considered that these two changes largely offset one another with regard to the consequences for monetary policy, and that this indicates that the repo rate path should be held unchanged.

The repo rate needs to be low for a long period of time because resource utilisation is very low and inflationary pressures are expected to be low. There are different ways of measuring resource utilisation, but however one measures, one must conclude that it is at present very low and that it will probably remain low for a long time to come. The labour market will probably not reach bottom until the end of 2010/beginning of 2011. Inflationary pressures are also expected to be low over the coming years. The underlying inflation rate measured as the CPIF excluding energy is now above 2 per cent, despite the weak real economic developments. This is mainly because unit labour costs have increased rapidly three years in a row, and the krona has weakened compared to one year ago. These factors will probably be reversed over the coming years and will hold back inflation.

Mr Öberg also claimed that the important question in the future would be when the Riksbank needs to begin raising the repo rate and phasing out the support measures. In the long term the repo rate must be raised. It is important not to begin raising it too early, but neither too late. Mr Öberg considered that the question of an exit strategy should be taken up in the October Monetary Policy Report. This was not immediately imminent, but it is desirable that the Riksbank should be clear about how it views this question before it becomes immediate.

Mr Öberg also thought there was good reason for lending a further SEK 100 billion with maturity of twelve months and at a fixed interest rate. Although the experiences of the loans offered in July indicate there were only small effects on the market's expected repo rate path, the loans have contributed to lower funding costs for the banks and probably also to slightly lower interest rates for companies and households.

Deputy Governor **Lars E.O. Svensson** pointed out that monetary policy aims at stabilising both inflation around the target level and resource utilisation around a normal level. It is necessary to find a repo rate path that gives a well-balanced monetary policy. If there is a conflict between stabilising inflation and stabilising resource utilisation, then a well-balanced monetary policy involves a reasonable compromise between the stability of inflation and stability of resource utilisation. If there is no such conflict, things are much simpler. Then it is merely a question of finding the repo rate path that will best stabilise inflation and resource utilisation. Mr Svensson considered that in the current situation one can actually claim that there is no conflict; that inflation stability is not a problem and that monetary policy should therefore now focus on stabilising resource utilisation in the best way. Mr Svensson emphasised that resource utilisation is best stabilised by a repo rate path that is lower than the one in the main scenario of the draft Monetary Policy Update.

In this case we have a main scenario in the draft Monetary Policy Update with a repo rate path that agrees with the main scenario in the July Monetary Policy Report, that is, with a repo rate of 0.25 per cent until autumn 2010. This gives a forecast for CPIF inflation that is slightly low during the forecast period, and a forecast for resource utilisation that is very low and will remain low throughout the forecast period. Unemployment will rise to around 11 per cent. As the CPI is fluctuating so much due to the large repo rate cuts in the spring, it is more relevant to use the CPIF as a basis than the CPI.

One possible alternative repo rate path is the lower interest rate path presented as an alternative in the July Monetary Policy Report, that is a repo rate path with the interest rate at zero per cent from now until the end of the first half of 2010 and which agrees with the main scenario's repo rate path with effect from the first quarter of 2011.

Mr Svensson said that the lower repo rate path in July then pushed up the forecast for inflation and resource utilisation somewhat compared with the main scenario. In the same way, the lower repo rate path now in September pushes up the forecasts for inflation and resource utilisation somewhat compared with the main scenario.

Mr Svensson pointed out that when one looks more closely at the inflation forecast for this low interest-rate path one can see that it actually stabilises CPIF inflation slightly better around the inflation target than the repo rate path in the main scenario. However, the difference is slight.

With regard to the forecast for resource utilisation, however, one can see that the low interest-rate path, in the same way as in July, stabilises resource utilisation much better than the repo rate path in the main scenario. Mr Svensson said that this was really self-evident. Resource utilisation is very low and well below normal with the repo rate path in the main scenario. It becomes better and is closer to a normal level with the low interest-rate path. As monetary policy aims to stabilise inflation around the inflation target and resource utilisation around a normal level, the low repo rate path is therefore preferable. Mr Svensson therefore wanted to advocate the low interest-rate path over the path contained in the main scenario.

Mr Svensson went on to point out that monetary policy is sometimes fairly abstract. One talks about abstract concepts such as resource utilisation, output gaps and potential output. But monetary policy has very concrete effects. Mr Svensson claimed that people can lose their jobs unnecessarily if monetary policy is tighter than necessary. The number of jobs that could be expected to be saved with the lower repo rate path could be as high as 10,000 to 20,000, depending on what assumptions one makes, possibly even higher. When unemployment is high, 10,000 to 20,000 saved jobs may have an even greater effect on welfare than when unemployment is at a normal level. It becomes more difficult for every unemployed person to find a new job, the period of unemployment is longer and there is a greater risk of exclusion of employees from the labour market and closing down of companies when unemployment is already high.

Mr Svensson claimed that the low interest-rate path would better stabilise both inflation and resource utilisation than the repo rate path in the main scenario. He therefore considered that the low interest-rate path should be the natural choice. Mr Svensson wondered, however, whether there might be some argument against this choice?

One possible argument would be that it would be inappropriate to have a zero interest rate (or an interest rate of a few couple of points) because such a low interest rate would entail problems for the financial markets. Mr Svensson said that one might possibly have been able to claim this last spring, but that there were now no signs that it would be a problem for the financial markets to have a repo rate at zero. It has been evident since July that there have been no disruptions whatsoever in the financial markets from having a repo rate path of 0.25 per cent, and Mr Svensson considered there was no reason to believe that there would be any disruptions from having zero per cent. Furthermore, the Riksbank's official deposit rate is now minus 0.25 per cent, and every day there are some deposits made in the Riksbank at this negative rate, even if the major volumes are deposited under the terms of fine-tuning operations at an interest rate of plus 0.15 per cent. There have also been private repo transactions at negative interest rates. Mr Svensson also noted that articles in Friday's and Monday's Financial Times newspapers had emphasised that it was no longer a problem for financial markets to cope with interest rates as low as zero or even negative. He therefore considered that it is time to completely abolish the zero interest rate mystique that has existed.

Mr Svensson pointed out that the Riksbank had actually received praise from the Financial Times and from the eminent professor Charles Goodhart in the latter's presentation at the recent Jackson Hole conference because the Riksbank had stood up for a negative deposit rate of minus 0.25 per cent. However, Mr Svensson thought this praise was somewhat undeserved, as the greater part of the deposits was in the form of Riksbank Certificates and so-called fine-tuning deposits at positive interest rates of 0.25 and 0.15 per cent respectively. Only a small part was at a negative interest rate of minus 0.25 per cent. But it is nevertheless interesting that discerning analysts do not consider a negative interest rate to be a problem, and even to be praiseworthy.

As Mr Svensson pointed out at the monetary policy meeting in July, the only reason why there has been such focus on the zero interest rate is that households, companies and investor might decide to withdraw cash from their accounts and store banknotes in their mattresses, in safes or in suitcases. Banknotes yield zero interest. However, Mr Svensson said that taking the handling costs into account, including crime-prevention measures, storage costs and so on, banknotes do provide an actual yield that corresponds to a negative interest rate. The lower bound for the interest rate depends on the level of the interest rate at which households, companies and investors would begin to hold really large volumes of banknotes. It is probably a negative interest rate that is needed for this, but it is not possible to know exactly how negative. The critical level ought reasonably to vary between different categories and the withdrawals would probably increase with more negative interest rates. Mr Svensson therefore claimed that the lower bound is soft and not hard. Moreover, even if there were large withdrawals, it is not clear how much of a problem this would be for the financial markets, and especially for the real economy.

Mr Svensson considered that, based on the experiences of low interest rates in Japan, Switzerland, the United States and now in Sweden, where a repo rate of 0.25 per cent had not caused any problems, one could draw the conclusion that there are no obstacles to setting the repo rate at zero per cent.

Moreover, as emphasised in Monday's article in the Financial Times, if there were nevertheless problems in some financial sub-market, this problem for a few market agents, traders and portfolio managers should be weighed against the 10,000 to 20,000 jobs that could be expected to be saved with a lower repo rate path.

Mr Svensson pointed out that one could of course ask oneself what the more general effect on financial stability would be with a lower repo rate path. Mr Svensson claimed that as far as he could understand, it should be good for financial stability. Higher liquidity, better developments in the real economy and a weaker krona should entail lower credit risk and thus make the banks' loan portfolios less risky. Mr Svensson pointed out that bank shares normally rise when interest rates are low.

Mr Svensson said that another argument he had heard is that the stimulating effect on the real economy of cutting by 0.25 percentage points, from 0.25 per cent to zero, would perhaps be less than the stimulating effect of cutting from 0.50 per cent to 0.25 per cent. Even if this were the case, however, it is not an argument against lowering the repo rate path as the effect would nevertheless be in the right direction and mean that inflation and resource utilisation were stabilised better. But there is also hardly any reason to believe that the effect would be less. Mr Svensson emphasised that interest rates are only one method of expressing relative prices of assets. Cutting the repo rate from 0.50 per cent to 0.25 per cent and then to 0 per cent for a 12-month treasury bill with a nominal value of SEK 100 million means that the price will change from SEK 99.5 million to SEK 99.75 million and then to SEK 100 million. There is no reason to believe that there is any difference in the effects of these price changes. Mr Svensson claimed that it was moreover the case that both interbank rates and mortgage rates were above the expected repo rates because of positive spreads and they have a margin to fall before they reach zero, if there is anyone who still thinks there is something magical about zero. Expected future repo rates are much higher than the repo rate path in the main scenario and it is reasonable that they will fall as much as the repo rate path is moved down.

Mr Svensson said that this applied in particular if a lower repo rate path was followed by a fixed interest rate loan. He considered it desirable to support the repo rate path with continued fixed interest rate loans. This is particularly important as the repo rate path still has low credibility, in that expected repo rates in 2010 and 2011 are much higher than the Riksbank's repo rate path and thus, all else being equal, this makes actual monetary policy more restrictive than intended. One could claim that to have the greatest effect, a fixed interest rate loan should preferably be unlimited, like the ECB's fixed interest rate loans. In practice, the requirement for good collateral is nevertheless a limitation, albeit a fairly generous one.

Mr Svensson claimed that a third argument against a lower repo rate path that he had heard was that the real economy might improve more quickly than was forecast by the Riksbank. However, this was not an argument against a lower repo rate path, as a better development in the real economy would only mean that resource utilisation was not so low during the forecast period. Resource utilisation will still be lower than normal and unemployment will still be higher than normal. Mr Svensson considered it quite improbable that the real economy could improve so quickly that the Swedish economy would become overheated or that CPIF inflation would greatly overshoot the target. If such tendencies were nevertheless to arise, it would be possible to detect them in time and there would then be no limit to how quickly the repo rate path could be raised to counteract an overheating.

Mr Svensson said that this brought him in to a risk management perspective; the risks were currently asymmetrical. The risks of being too contractionary were much higher than the risks of being too expansionary. If monetary policy were too expansionary it would be easy to adjust this later by raising the repo rate path. If monetary policy was too contractionary, however, it would be difficult to adjust this later, as one cannot cut the repo rate much more. Mr Svensson therefore felt that if mistakes were to be made, it would be better to err on the expansionary side rather than on the contractionary side.

Mr Svensson summed up by claiming that a lower repo rate path is a feasible alternative. It stabilises resource utilisation much better and stabilises inflation slightly better than the repo rate path presented in the draft Monetary Policy Update. This is so even if the effect on the economy of a lower repo rate path were less than normal. This is also so if the real economy develops better than expected. Mr Svensson therefore proposed cutting the repo rate to zero per cent and a repo rate path that enables the repo rate to be held at this level one year ahead, and that the forecasts in the draft Monetary Policy Update should be adjusted in accordance with this. This was unless his colleagues on the Executive Board had any important arguments against the cut that Mr Svensson had not thought of.

Deputy Governor **Karolina Ekholm** supported the proposal in the draft Monetary Policy Update, that is, an unchanged repo rate of 0.25 per cent which was expected to remain at this level during the coming year. Mr Ekholm said that her reasons for this decision were to some extent the same as those put forward by Svante Öberg.

The brighter economic prospects abroad will of course affect economic prospects for Sweden. It is particularly important that there are signs of a recovery in Germany, which is Sweden’s most important trade partner.

However, resource utilisation in Sweden is still very low and employment can be expected to be weak over the coming year. Ms Ekholm also emphasised that there is great uncertainty, not just concerning growth abroad, but also with regard to developments in Sweden. We still do not know whether the recovery will be fast or slow or if it risks coming to a halt as soon as the monetary policy and fiscal policy stimulation is phased out.

Ms Ekholm nevertheless considered that the situation looked brighter today than it did a couple of months ago. This in itself motives a slightly tighter monetary policy than the Riksbank has previously considered justified.

However, Ms Ekholm noted that, as Svante Öberg pointed out, there were factors operating in the opposite direction and thus in favour of more expansionary monetary policy. This applies in particular to the development of the krona exchange rate, where the krona has been stronger than the Riksbank had expected. The forecast in the draft Monetary Policy Update is now for a faster appreciation of the krona than was assumed in the July Monetary Policy Report.

Just as it is difficult to explain the earlier weakening of the krona by developments in the Swedish economy, it is difficult to explain the recent appreciation in the krona. Ms Ekholm said that the best explanation might be that it involved an adjustment towards more normal levels after the exchange rate had strongly deviated from its long-term sustainable rate.

Ms Ekholm pointed out that a strengthening of the krona is a factor that pushes down inflation and the inflation forecast. As inflation adjusted for the effect of interest changes on housing costs, the CPIF, is expected to be slightly below the target over the coming years, this is something that in itself could indicate more expansionary monetary policy.

Ms Ekholm said that she, like Svante Öberg, could see change tendencies pointing in different directions with regard to the implications for monetary policy. The brighter economic prospects pointed towards tighter monetary policy, while the stronger krona pointed towards more expansionary monetary policy.

However, Ms Ekholm considered that the future development of the krona was even more uncertain than economic developments. She therefore wished to put relatively little emphasis on this particular factor with regard to assessing what would be well-balanced monetary policy. This means that Ms Ekholm instead places greater importance on the improved economic prospects.

She said that with regard to the economic outlook, resource utilisation was still expected to be well below normal over the coming years. This means that there is still a need for monetary policy stimulation to stabilise the real economy. It would therefore be unwise in this situation to tighten monetary policy. The fact that CPIF inflation is expected to slightly undershoot the target of two per cent over the coming years also means that a continued expansionary monetary policy does not risk conflicting with the inflation target.

Thus, the expectation that resource utilisation will be so low in the future is a strong argument in favour of continued expansionary monetary policy. Ms Ekholm therefore said that the policy rate would need to be held at a low level for a relatively long period of time. This was also an argument in favour of once again offering the monetary policy counterparties loans at a fixed interest rate. Apart from the fact that this can make the forecast of a retained repo rate over the coming year more credible, it should also be able to push down some interest rates with longer maturities. This means the measure should contribute to bringing down the interest rates met by households and companies and in this way increase the impact of the low policy rate on interest rates that are important to the development of the economy.

Ms Ekholm pointed out that with reference to Lars E.O. Svensson's contribution to the debate, there may be justification for commenting on her own views on the repo rate's actual lower bound. At the July meeting, as at the April meeting, Ms Ekholm's opinion was that the economic situation in principle justified even greater repo rate cuts, but that it was too risky to cut the policy rate even further when one did not really know how the financial markets would react to such low interest rates. One can note that cutting the repo rate to 0.25 per cent was carried out without any apparent problems. Ms Ekholm said that from this perspective it would appear with hindsight that her fears were slightly exaggerated. On the other hand, she said that it is worthwhile for a central bank to act with some caution in areas where it does not have any previous experience to lean on.

Ms Ekholm did not consider there was justification for cutting the repo rate today. The development Ms Ekholm saw ahead was one where economic activity recovered on the whole, although it may take some time and there may even be setbacks along the way. She therefore saw no need for further stimulation in the form of cutting the repo rate.

Deputy Governor **Lars Nyberg** began by pointing out that the Swedish banks have been able to benefit from the improved situation in the financial markets. Swedbank has announced a large new issue, which would hardly have been possible in the spring, and SEB has chosen not to make use of the government guarantee programme. All of the banks are able to borrow abroad at longer maturities and at lower costs than was possible in June. Many large companies are now also able to borrow in the international credit markets, which means that they do not need to compete with smaller companies for the banks' lending. Mr Nyberg also said that the signs of credit shortages detected at the beginning of this year appeared to have disappeared entirely. Although the banks' lending to companies has declined in recent months, this is no more than can be explained by the decline in economic activity. Despite the rapid decline in economic activity, lending to households has continued to increase, which has contributed to keeping up prices in the housing market.

Within the manufacturing sector orders have begun to increase slightly, particularly in the companies that export to Asia. Confidence in the future has increased substantially, which can be seen in the purchasing managers' and households' expectations, as well as in developments in retail trade. Car sales, which fell substantially during the winter, have picked up again. At the same time, many manufacturing companies are still experiencing problems and unemployment is rising. Mr Nyberg said that the turnaround he envisages will come at different points in time in different sectors.

Mr Nyberg considered that the situation was interesting from a monetary policy point of view, as always when the economy approaches a turning point. Inflation is currently no problem. The forecast for underlying inflation is close to the target of two per cent and inflation expectations are low. At the same time, resource utilisation is low for the whole forecast period. This indicates that the interest rate could be cut slightly further; the experiences of an interest rate close to zero have been good and the fears that market functioning would be damaged have proved unfounded. Mr Nyberg said that Lars E.O. Svensson was right about this.

However, Mr Nyberg stated that on this occasion he felt there was unusually great uncertainty regarding the forecasts. None of the models used by the Riksbank and other central banks adequately takes into account events in the financial sector. Mr Nyberg felt that this could lead to an underestimation of the force behind the upturn expected over the coming months, just as the force of the downturn last autumn and winter was underestimated. This applies to growth abroad and in Sweden. He said that his assessment is that resource utilisation will rise slightly more than in the forecast and that this in turn will affect inflation expectations and the assessment of inflation. Although there has been some tightening through the exchange rate, he nevertheless said that his view was that the repo rate should be held at 0.25 per cent rather than cut. Mr Nyberg further pointed out that in his view it would be necessary to begin raising the interest rate slightly sooner than the Riksbank has so far estimated; at the end of the spring or early summer 2010 rather than in autumn 2010.

However, Mr Nyberg wanted to emphasise that his own assessment was nevertheless a deviation from the margin with regard to the forecast. There is still a long way to go before the economic downturn is behind us and the repo rate needs to be kept low for a long period to come. However, Mr Nyberg felt that this period may not be quite as long as the Riksbank had previously assessed.

With regard to long-term loans to the banks at a fixed interest rate, Mr Nyberg considered that this was in principle a good method to use in Sweden if one wishes to further increase the downward pressure on interest rates further along the yield curve. The Swedish financial system is primarily bank-based. When the banks gain access to more kronor they want to invest them in other assets, such as government or corporate bonds. The price of these securities will then be pushed up and the interest rate will be pushed down. Mr Nyberg felt that it was this effect that was desirable, not affecting various credit spreads in relation to government security rates. Influencing the banks' assessment of credit risk among various borrower categories is not a task for the Riksbank, says Mr Nyberg. However, he considered that this would be an entirely different question if the method functioned in realty - although it would nevertheless be difficult to ensure it did not go in the wrong direction.

Mr Nyberg felt, however, that the economy did not require further stimulus at present and he therefore considered that the Riksbank should not lend any more money at a fixed interest rate at this time. The loans will increase the liquidity in the bank system throughout the 12-month maturity of the loan, over which he expressed doubts. He said that a lot could happen during the course of a year with regard to the banks' need for liquid funds. If the economy grows more quickly than is forecast in the draft Monetary Policy Update, which Mr Nyberg believes it will, the Riksbank may have reason to withdraw liquidity to avoid inflationary pressures. On the other hand, this is easily done by issuing Riksbank Certificates or other securities.

Deputy Governor **Barbro Wickman-Parak** began by referring to Lars E.O. Svensson's contribution to the debate, stating that the arguments he puts forward are interesting in principle and that it may well be the case that the repo rate can be cut to zero without causing any disruptions to the financial system. However, this discussion should be kept separate from the discussion of whether there is a need to cut the repo rate further today. Ms Wickman-Parak's own assessment was that it was not necessary to cut the interest rate further.

GDP was unchanged in the second quarter of this year in relation to the first; the large fall in production had thus passed. The outcome was slightly stronger than the Riksbank had forecast in July. The current forecasts for growth in the final two quarters of the year have been revised upwards and Ms Wickman-Parak considered this to be a reasonable assessment. However, she pointed out that it is the developments after this that are the most interesting.

The confidence indicators have continued to point upwards since last summer. The purchasing managers' index, for example, is now a bit above 50. The sub-index for export orders has passed 60 and the upturn has been rapid. The National Institute of Economic Research's Economic Tendency Survey also points to stronger export prospects. According to Statistics Sweden, actual orders have so far only shown a marginal rise. Ms Wickman-Parak's assessment was that export orders will rise during the autumn and during the course of next year. She said that one should not underestimate the assessments of those who are closer to operations and respond to the surveys she just mentioned. Even if the export indicators were to fall back somewhat, the tendency is nevertheless clear; the Swedish economy will receive much-needed support for growth through exports.

The growth forecast for 2010 now being presented has been revised upwards by 0.5 percentage points and GDP is expected to increase by 1.9 per cent. The larger part of the upward revision is due to a positive overhang from 2009, as the forecast for the second half of 2009 is being revised upwards. The forecast for the growth rate for the first quarter of next year has been revised marginally upwards, while the quarterly forecasts thereafter remain roughly the same as those made in July. Ms Wickman-Parak's own assessment was that the growth path in 2010 would be slightly steeper than indicated in the current forecast.

Ms Wickman-Parak emphasised that, as already demonstrated, she holds a more positive view of international economic activity than that presented in the draft Monetary Policy Report. This entails stronger exports, even if the krona appreciates. Her assessment was also that private consumption would increase more quickly over the course of next year than is currently forecast, despite an increase in unemployment. Income growth for those in work is good, saving is high and household confidence has continued to increase. It is worth noting that households' views of the Swedish economy have brightened significantly. It can be observed that the percentage of household who believe that employment will increase over the coming 12 months is 56 per cent. When the redundancy notices were pouring in last autumn and at the beginning of the year, the corresponding figure was 80-85 per cent. Ms Wickman-Parak considered that this provides support for the theory that households may be less cautious in their expenditure, despite earlier redundancy notices now having an impact in the form of increased unemployment. In addition, Ms Wickman-Parak felt that the high and rising unemployment was a substantial cause for concern. It lags behind in the economic cycle and other measures than monetary policy may have a larger and faster impact on employment.

Ms Wickman-Parak said that over the past year the Executive Board has held similar views regarding the seriousness and depth of the economic crisis and been unanimous regarding the measures needed. However, she pointed out that there have of course been nuances, and that she had a more positive view of events at the monetary policy meeting in July than the other members of the Executive Board. On the other hand, her views did not differ with regard to the starting situation and developments in the immediate future. At the July meeting Ms Wickman-Parak supported the decision to cut the repo rate to 0.25 per cent, but entered a reservation against the repo rate path.

Ms Wickman-Parak claimed that on this occasion, too, she supported the proposal to hold the repo rate unchanged. Although her view on economic activity in the future is more positive than that in the forecast contained in the draft Monetary Policy Update, she considered that an extremely low repo rate could be held a little longer. However, Ms Wickman-Parak entered a reservation against the repo rate path now, too. Her assessment was that the repo rate might need to be raised during the late spring or summer 2010. Growth would then be higher and above all growth prospects then would be better than indicated by the forecast in the draft Update. It would then be possible to see the beginning of a normalisation in resource utilisation on the forecast horizon. And monetary policy is of course forward-looking.

Ms Wickman-Parak considered that inflation was not a problem at present, but as she had pointed out at the monetary policy meeting in July, it might be necessary further ahead to deal with an inflation outlook that was rather different from now. According to the forecasts in the draft Monetary Policy Update, inflation is already around two per cent during the forecast period, when one excludes the effects of the Riksbank's interest rate changes. Even if one envisages a fall in cost pressures in future, three years or strongly rising unit labour costs may trickle through into consumer prices as demand increases. Commodity prices have also risen and they may continue rising as demand strengthens. The krona rate and productivity are also uncertain factors with regard to the inflation forecast.

Ms Wickman-Parak said that she considered it worthwhile that the process of normalising the interest rate should occur gradually. This gives companies and households better opportunities to adjust to a situation with higher interest rates. We also know that it takes time before an interest rate change has an impact. Even if the interest rate is raised in several small stages over the course of next year, it will still be at a level that has a stimulating effect on the economy.

Ms Wickman-Parak also wanted to provide a brief and more general comment on future monetary policy. At present the interest rate is extremely low. The global financial crisis has to some extent originated in a low interest rate over a long period of time. There is therefore cause to be observant of possible imbalances that may build up over time.

Ms Wickman-Parak did not support the proposed loans at a fixed interest rate. She thought that this might have been a good method to try to bring down interest rates, but more generally she did not consider this type of measure to be necessary. Ms Wickman-Parak pointed out that she has a different picture of developments in the real economy and that she sees a need to raise the repo rate before the fixed interest loans have expired.

Governor **Stefan Ingves** pointed out that the indicators showed a somewhat faster recovery in Sweden than was anticipated in July. But the fall in GDP this year would be greater in Sweden than in the euro area, and the largest in our economic history since the Second World War. Sine the beginning of the 20th century we have rarely seen a fall in production of the current size during the course of one year. This means it is not easy to learn from earlier experiences. With the current economic structures we quite simply have not experiences anything similar before, and this of course makes it more difficult to assess economic developments. Next year the Riksbank is expecting slightly better growth than was forecast in the July Monetary Policy Report. All in all, output is expected to grow slightly faster during the forecast period than in July, but resource utilisation is low and will remain lower than normal during the period.

CPI inflation will be very volatile during this period, as a result of large fluctuations in the mortgage rate component. CPIF inflation is expected to be slightly below 2 per cent 1 to 2 years ahead, which is slightly lower than anticipated at the previous meeting, as the krona has strengthened more and is expected to be stronger in the future.

The Riksbank has met the deep economic recession with substantial monetary policy stimulus and there is reason to hold on to the repo rate path decided on at the previous meeting. The repo rate should remain at 0.25 per cent until the second half of 2010 and then be raised. This enables us to manage the inflation target at the same time as contributing to the stabilisation of resource utilisation. Mr Ingves said that it is important to hold on to the low policy rate for a sufficiently long period of time to allow the economy to continue growing at a suitable pace. Inflation expectations do not present any obstacle to this policy. There are still downside risks as a result of the global financial crisis and the generally low resource utilisation. It is therefore better that the repo rate remains at a low level for a long time until one can be sure that the recovery is self-supporting. Raising the repo rate too soon is more risky than waiting to see what happens. The staff's proposal for a repo rate path in the draft Monetary Policy Update provides a suitable balance when one considers the advantages and disadvantages.

In conclusion, Mr Ingves noted that the Riksbank has contributed during the crisis to restoring the monetary policy transmission mechanism through a long series of measures. New types of lending to the banks have contributed to reducing basis spreads and risk premiums in the markets. The situation in the financial sector has stabilised. Mr Ingves said that one can see already that the policy pursued has shown results, but also that it is evident that non-conventional measures should be kept in place as long as they are needed. This also means that one should not at present merely assess monetary policy on the basis of the repo rate path and a very technical discussion of the same. This is an overly narrow approach. It is the aggregate effect of both special loans and low interest rates in general that mean that monetary policy is expansionary and that restore the transmission mechanism so that this expansionary monetary policy can have the desired impact. Using this approach, the conclusion is that it is appropriate to continue with the extraordinary loans. It is too early to reason over exit measures and normalisation.

With regard to the discussion on cutting the repo rate to zero per cent, Mr Ingves said that one should exercise caution when approaching these complex problems, and that there are many questions regarding the lower bound that we cannot answer. He said that at present it is not desirable to cut the repo rate further.

In conclusion, Mr Ingves said that he supported the proposal to hold the repo rate at 0.25 per cent and the proposal to retain the repo rate path presented in the draft Monetary Policy Update. He also supported the proposal regarding loans at a fixed interest rate.

First Deputy Governor **Svante Öberg** also wished to put forward three more technical comments. The first concerns resource utilisation. The figures regarding resource utilisation shown in the Monetary Policy Update – deviation from HP trend for GDP, employment and number of hours worked – are based on potential GDP declining gradually over a long period of time prior to and after the deep recession. This results in a large positive GDP gap prior to 2009 and a large negative GDP gap after 2009. Mr Öberg considered that it was more reasonable to assume that potential GDP will fall more abruptly in connection with the fall in actual GDP. If this is the case, the figure exaggerates the positive GDP gap prior to 2009 and the fall in the GDP gap in 2009 and perhaps also the negative GDP gap after 2009. Mr Öberg considered that this question should be analysed more over the coming period.

His second comment concerns the three standard figures reported first in the Monetary Policy Update. Mr Öberg said that all three of these have deficiencies. The first figure with the repo rate and the uncertainty band does not take into account the fact that the uncertainty band is not symmetrical when one comes down to very low interest rate levels. The second figure showing CPI inflation is interesting, but what the Executive Board of the Riksbank primarily focuses on in the monetary policy discussion now is underlying inflation measured in terms of the CPIF or the CPIF excluding energy. Further, Mr Öberg said that the third figure showing GDP growth is interesting, but so is resource utilisation measured in terms of a GDP gap and unemployment. Mr Öberg thought that today's discussion has shown that the members of the Executive Board attach different degrees of importance to GDP growth and GDP level or resource utilisation when assessing monetary policy. He felt that one should reconsider which figures need to be highlighted as the most important prior to the publication of the Monetary Policy Report in October.

Mr Öberg’s third comment concerned the Riksbank’s deposit rate. As Lars E.O. Svensson pointed out, there have been comments in the international press regarding the Riksbank having a negative deposit rate for the banks’ deposits. This is a misconception. Although the Riksbank formally has a deposit rate of -0.25 per cent, this is of marginal significance. Approximately SEK 100 billion of the banks’ total deposits of around SEK 300 billion are deposited over night at 0.15 per cent interest, and approximately SEK 200 billion are deposited in a one week Riksbank Certificate at an interest rate of 0.25 per cent. Only a very small percentage is deposited at the advertised deposit rate.

Deputy Governor **Lars E.O. Svensson** said that he supported Svante Öberg’s views regarding the figures, that it was desirable to look into this question and he called attention to the figures at the beginning of Norges Bank's monetary policy report as examples of figures that are more central to the monetary policy decision. Mr Svensson went on to point out that he had not heard any important arguments from his colleagues against cutting the interest rate. He perceived this to mean that the other members considered it was fully possible to cut the repo rate to zero, which would result in higher resource utilisation. Mr Svensson wondered whether this meant that the other members did not see a need for higher resource utilisation.

Governor **Stefan Ingves** pointed out that the other members had already presented their arguments for retaining the repo rate at 0.25 per cent.

First Deputy Governor **Svante Öberg** pointed out that he does not agree with Lars E.O. Svensson that the repo rate should be cut to zero per cent. Monetary policy is already very expansionary. A further cut in the repo rate from the current low level is a question of fine tuning, which would probably have minor effects on inflation and resource utilisation, which lie within the error margins. Mr Öberg felt that there were already difficulties in engendering credibility for the low repo rate path the Riksbank is forecasting. Mr Öberg agreed with Karolina Ekholm that a central bank should exercise caution with regard to cutting the repo rate to very low levels. It is not possible to know very much about the effects it might have on the financial markets, as the repo rate has never been so low before.

Governor **Stefan Ingves** then summarised the monetary policy discussion. There have been increasing signs of a recovery in the economy. For example, GDP growth during the second quarter was slightly stronger than expected both in Sweden and abroad. At the same time, the situation in the financial markets has continued to improve. But future developments are still uncertain. Sweden has been hard hit by the deep recession abroad and the recovery in economic activity is from a low level.

The repo rate needs to be low over a long period of time to come to enable a stable recovery in the economy and to attain the inflation target of 2 per cent. The interest rate therefore needs to remain at the present low level of 0.25 per cent up to autumn 2010.

Although the situation in the financial markets has improved, it is still not normal. Supplementary measures are necessary to ensure that monetary policy has the intended effect. The Riksbank should therefore offer further loans totalling SEK 100 billion to the banks at a fixed interest rate and with a maturity of 12 months. This should contribute to continued lower interest rates on loans to companies and households.

The low repo rate, together with the economic upturn abroad, will contribute to positive GDP growth in Sweden towards the end of the year. However, the labour market will lag behind and employment will not begin to rise until 2011. As economic activity recovers, the repo rate will be raised to more normal levels to attain a balanced development of the economy and an inflation rate in line with the target.

Changes in the repo rate affect mortgage rates, which are included in the consumer price index (CPI). There will thus be large fluctuations in the CPI in the future. The CPIF underlying inflation rate (the CPI with a fixed mortgage rate) will on the other hand remain stable close to 2 per cent during the forecast period.

The situation on the financial markets has not yet normalised and the foundation for the recovery is still fragile. However, it could also be the case that the recovery comes sooner than expected. There is thus still a considerable amount of uncertainty. The future direction for monetary policy will depend, as always, on how new information on economic developments abroad and in Sweden will affect the prospects for inflation and economic activity in Sweden.

§ 4. Monetary policy decision

The Chairman observed that there was a proposal to hold the repo rate unchanged at 0.25 per cent and a proposal to cut the repo rate by 0.25 percentage points.

The Executive Board decided after voting

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

- to publish the Monetary Policy Update on Thursday 3 September at 09.30 a.m.,
- to hold the repo rate unchanged at 0.25 per cent and that this decision would apply from 9 September 2009,
- to hold the lending rate unchanged at 0.75 per cent, and the deposit rate unchanged at -0.25 per cent, with effect from 9 September 2009,
- to announce the decision at 9.30 a.m. on Thursday 3 September 2009 with the motivation and wording contained in Press Release no. 81 2009 (Annex B to the minutes), and
- to publish the minutes of today's meeting at 9.30 a.m. on Wednesday, 16 September at 9.30 a.m.

Deputy Governors Lars Nyberg and Barbro Wickman-Parak supported the decision to hold the repo rate unchanged at 0.25 per cent, but entered reservations against the growth forecasts in the Monetary Policy Update and thereby the repo rate path. They motivated their stance by stating, for instance, a more positive view of how developments in the financial markets could affect economic activity both in Sweden and abroad. This would mean that the interest rate needed to be raised slightly earlier than is forecast in the Monetary Policy Update. Nor did they consider that the economy needed to be stimulated by further loans to the banks at a fixed interest rate.

Deputy Governor Lars E.O. Svensson entered a reservation against the decision and advocated cutting the repo rate to 0 per cent and a repo rate path that meant the repo rate would be kept at this level for one year ahead. He considered that such a repo rate path entailed a better-balanced monetary policy, with lower unemployment, higher resource utilisation and a CPIF inflation rate closer to the target.

This paragraph was confirmed immediately.

Minutes by

Ann-Christine Högberg

Checked by:

Karolina Ekholm	Stefan Ingves	Lars Nyberg
Lars E.O. Svensson	Barbro Wickman-Parak	Svante Öberg