

# Minutes of the Executive Board's monetary policy meeting, No. 6

DATE: 14 December 2010

TIME: 9 a.m.

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

Johan Gernandt, Chairman of the  
General Council  
Leif Pagrotsky, Vice Chairman of the  
General Council

Sigvard Ahlzén  
Carl-Johan Belfrage  
Carl Andreas Claussen  
Heidi Elmér  
David Forsman (§ 1)  
Eric Frieberg  
Jesper Hansson  
Ann-Christine Högberg  
Per Jansson  
Anna Lidberg (§1)  
Pernilla Meyersson  
Christina Nyman  
Cecilia Roos-Isaksson  
Mattias Persson (§ 1)  
Britta von Schoultz  
Ulf Söderström  
David Vestin  
Staffan Viotti

## § 1. Economic developments

It was noted that Carl-Johan Belfrage and Carl Andreas Claussen would prepare draft minutes of § 1, 2 and 3 of the Executive Board's monetary policy meeting.

David Forsman of the Financial Stability Department began by presenting recent developments regarding financial stability. Despite the prevailing uncertainty about public finances, he noted that at present the Swedish banks have good access to both

short-term and long-term funding. If this uncertainty increases, however, access to market funding may deteriorate.

Anna Lidberg of the Monetary Policy Department presented the most recent developments on the financial markets. Pricing on the market indicates that an increase in the repo rate of 0.25 percentage points is expected at today's monetary policy meeting. The prices also reflect expectations of increases of 0.25 percentage points at two of the three subsequent meetings. Most analysts believe that the repo rate will be increased by 25 basis points at today's meeting and by a further 25 basis points in February. Thereafter, expectations diverge. Forward pricing indicates that monetary policy expectations are somewhat higher now than they were at the time of the monetary policy meeting in October. In the period ahead, further repo-rate increases are expected in Sweden. In the United States, the UK and the eurozone it is expected that the first policy-rate increases will come approximately one year ahead, according to market pricing. 10-year government rates have increased since the monetary policy meeting in October, and the TCW-weighted exchange rate for the krona is now marginally stronger.

Per Jansson, Head of the Monetary Policy Department, presented the draft Monetary Policy Update which, in the assessment of the Monetary Policy Department, would gain the support of the majority of the members of the Executive Board. He began by noting that the forecasts in the Update were discussed by the Executive Board at the meetings held on 9 and 10 December. Since then, new statistics for industrial production and new orders in Sweden have become available. These statistics have not led to any revisions of the forecasts.

Important new international information received since the October Monetary Policy Report includes the agreement on fiscal policy in the United States between the Obama administration and leading republicans in Congress in early December. This means that it is highly likely that fiscal policy in the United States will be somewhat expansionary in the period ahead, and not contractionary as previously expected. Uncertainty regarding the development of public finances in the eurozone remains despite the EU's and the IMF's support programmes for Ireland. In Sweden, GDP growth in the third quarter of 2010 was much stronger than forecast in the latest Monetary Policy Report. This has largely comprised growth in productivity rather than growth in employment, but developments on the labour market have also been somewhat better than expected. Inflation in October and November was higher than forecast due to unexpectedly rapid increases in energy and food prices.

Outcomes and indicators in Sweden are strong, but uncertainty about the situation abroad remains. The forecast in the draft Monetary Policy Update is that GDP growth will be 5.5 per cent in 2010 and 4.4 per cent in 2011. Resource utilisation will therefore increase and is expected to be normal or slightly above normal at the end of the forecast period. CPI inflation will fall to just over 1 per cent at the end of 2011, and will then gradually rise towards 2 per cent. CPI inflation will rise more rapidly and will be just over 2.5 per cent at the end of 2013. According to the forecast, the repo rate will be gradually increased and will reach approximately 3.5 per cent at the end of 2013.

The forecasts for GDP abroad are somewhat higher than those presented in the Monetary Policy Report in October. The revisions are primarily due to the agreement on fiscal policy

in the United States, but also to strong short-term indicators. The figures for the development of the real economy in Sweden have also been revised upwards. The inflation forecast for 2011 is higher, mainly due to higher electricity prices. However, only a marginal change has been made to the overall forecast for inflation in the longer term. It is expected that the repo rate will be increased at the same pace as that indicated in the October Monetary Policy Report.

## § 2. Economic outlook abroad

First Deputy Governor **Svante Öberg** began by saying that he supports the forecasts of economic developments abroad presented in the draft Monetary Policy Update. Growth in the world as a whole is high, but there are considerable differences between different regions. He still expects to see a recovery in the United States and in Europe, but at a slower pace than after a normal downturn. This is because there has been a financial crisis, which is normally followed by problems at the banks and with public finances. Since the Monetary Policy Report was published in October, the growth figures in the Monetary Policy Update have been revised upwards somewhat for both the United States and Europe.

Mr Öberg continued by discussing the problems in Europe. No one knows how things will eventually develop, but he nevertheless wished to present his assessment as it affects his view of economic developments in Sweden, and thus monetary policy too.

Mr Öberg said that two things are worth noting. First, there are major differences between the different European countries. The countries experiencing the greatest problems are Greece; Ireland, Portugal and Spain. The competitiveness of all of these countries has deteriorated over the last 10 years compared to the average for the eurozone, and they have considerable deficits in their public finances. This applies particularly to Greece and Ireland, which had the largest deficits in the EU in 2009 at approximately 15 per cent of GDP. Nevertheless, these four countries constitute a relatively small part of the eurozone. The three smaller countries together account for approximately 6 percent of the eurozone's GDP, while Spain accounts for around 12 per cent.

Second, it has so far been possible to manage these problems, even though this has been a prolonged process. At the EU level, there are now two loan facilities which, together with the IMF and individual countries, can provide support to countries if the need arises. These resources are also more or less large enough to provide support to Portugal and Spain should they need it, and it will probably be possible to increase the facilities if required. The ECB is also able to influence developments by lending to banks in the countries concerned and by purchasing government bonds.

Mr Öberg therefore believed that it is most likely that the eurozone will continue to recover at approximately the rate predicted in the Monetary Policy Update. He believed that the probability of more dramatic scenarios, such as the collapse of the eurozone, was highly unlikely. However, there is a risk that the public finance problems in Portugal, Spain and possibly several other countries may lead to new periods of unease on the financial markets and an even slower recovery. But it is also possible that the recovery will

be stronger than forecast if Portugal, or at least Spain, are able to handle their problems themselves without having to rely on external support.

Deputy Governor **Lars Nyberg** said that he essentially supported the analyses and conclusions in the draft Monetary Policy Update and only wished to comment on financial developments in Europe.

Uncertainty on the financial markets has increased and spread since the previous monetary policy meeting. Ireland was finally granted a support package, but all of the discussions concerning this led to an even sharper focus on Portugal and Spain. Investors on the market have a lot of what appear to be justified questions: Will the governments of Portugal and Spain be able to implement structural reforms that can create sustainable growth? What will happen if such reforms are not implemented? Is there a willingness to add to the European support fund, or will a debt restructuring process entailing major losses for the investors be enforced? It is important to remember that credibility problems will not arise when, if at all, the European support fund runs dry, but when it becomes apparent that it will run dry. This issue of increased guarantees may become acute very quickly. It is therefore not surprising that many pension-fund managers are withdrawing from the market while waiting for all these questions to be resolved. It could take a long time to restore market confidence. The situation can get worse before it gets better.

It is reasonable to expect that a debt restructuring process in one of the problem countries would lead investors to suspect that more countries could be affected, and this would thereby have a negative impact on the supply of capital to these countries as well. In addition, debt restructuring is seldom a smooth and orderly process, and it is easy to foresee scenarios in which such a process would have major impacts on the real economy, not only in the country concerned but in the eurozone as a whole. This would of course also have indirect effects on Sweden. However, Mr Nyberg said that, like Mr Öberg, he believes that the incentives are ultimately strong enough for the eurozone countries to take action to avoid the development of such a situation, although all experience shows that such action will come late, that is not until considerable unease has arisen on the market.

The individual countries must further strengthen their budgets in the short term in order to avoid an escalation of these problems. This will have a negative impact on growth. Structural reforms designed to improve competitiveness would improve market confidence without having negative effects on budgets, but it appears difficult to implement such reforms. However, most important for investor confidence is probably the signals sent from the countries that are likely to be at the centre of things when problems have to be solved, first of all Germany.

In conclusion, Mr Nyberg noted that the Swedish banks have not been affected by the unease on the markets so far as they are well capitalised and Sweden does not have any problems with its public finances. The banks' borrowing may become more expensive, however, if there is an overall increase in risk premiums.

Deputy Governor **Karolina Ekholm** said that she had no objections to the forecasts for international inflation and GDP in the draft Monetary Policy Update but that she, as at the

meeting in October, is sceptical about the forecast for policy rates abroad. This forecast is marginally higher than in October.

Ms Ekholm said that a certain increase in the forecast for international policy rates is well warranted, above all due to the somewhat improved outlook for the US economy. The agreement on tax reductions announced last week entails a fiscal policy stimulus that should relieve the pressure on an expansionary monetary policy in the period ahead. In the eurozone, it appears that short-term growth will be slightly higher than previously expected. However, there is still concern about the development of public finances in a number of eurozone countries. It is even possible that this concern has increased, as mentioned by Lars Nyberg, and this means that the outlook in the slightly longer term is particularly uncertain.

Although a certain increase in the forecast for policy rates abroad is justified, Ms Ekholm's current assessment is, as it was at the previous monetary policy meeting in October, that the level is too high, especially for 2012 and 2013. One reason for this assessment is that her interpretation of signals communicated by the Federal Reserve, the ECB and the Bank of England is that they intend to keep their policy rates at a very low level for longer than in the forecast. Another reason is that no information has yet become available that would contradict the fact that there is a need to keep policy rates very low for a long period of time in these economies. This is because, in spite of everything, the recovery in the United States still appears to be rather sluggish. Unemployment is still very high and it may take many years before it returns to normal levels. In addition, the situation regarding public finances in Europe is still very problematic.

Deputy Governor **Lars E.O. Svensson** declared that he largely shares the view of developments abroad presented in the draft Monetary Policy Update with regard to inflation and GDP. However, like Ms Ekholm, his opinion differs concerning the development of foreign interest rates in relation to prevailing foreign market rates and implied forward rates. The main scenario assumes a forecast for TCW-weighted foreign policy rates that a couple of years ahead is significantly above the level of TCW-weighted foreign forward rates. For the same reasons as at the previous monetary policy meeting, Mr Svensson believes that it would be better to instead assume a forecast for foreign policy rates that is in line with foreign forward rates.

Mr Svensson's interpretation of the communication and the signals from the Bank of England, the ECB and the Federal Reserve is that they hardly intend to conduct a monetary policy that entails interest-rate paths that significantly exceed market expectations as expressed in the forward rates.

Mr Svensson also pointed out that if the forecast for policy rates abroad is in line with the forward rates, then no contradiction arises between the forecast and the prevailing foreign long-term market rates. As it is the prevailing long-term market rates that affect the exchange rate, no contradiction thus arises between the forecast for foreign policy rates and how the exchange rate is determined either. Mr Svensson referred to his detailed discussion of these issues in the minutes of the monetary policy meeting in October and in a speech he made on 24 November.

Like Mr Nyberg and Mr Öberg, Deputy Governor **Barbro Wickman-Parak** believed that the unease on the financial markets has increased since the previous monetary policy

meeting. A lot of attention is now being paid to the public finance problems in Europe. There has long been unease on the financial markets, but the focus has shifted and the intensity has varied. At the time of the previous monetary policy meeting there was much more focus on the uncertainty in the US economy. At that meeting, as several times previously, she presented a number of reasons why the upturn could nevertheless continue. The statistics that have become available since then confirm that the prospects for growth have improved. In addition, new stimulative fiscal policy measures have been introduced which explain a large part of the upward adjustment of the growth forecasts for next year and 2012 in the draft Monetary Policy Update. At the same time, the housing market continues to be a cause for concern and employment has not really picked up. However, Ms Wickman-Parak shares the view in the draft Monetary Policy Update that other indicators point to somewhat better progress on the labour market in the period ahead.

Ms Wickman-Parak said that the current uncertainty concerning public finance problems in the eurozone has so far not had an impact on confidence in those parts of the eurozone that have not suffered any acute problems. Various confidence indicators have continued to improve. She also noted that domestic demand in the form of investment and private consumption is now contributing to growth. It appears that there is an underlying driving force in the economy that has not been curbed by the uncertainty that exists on other levels. However, uncertainty on the financial markets remains and this uncertainty is not likely to fade quickly. There is constant uncertainty about whether certain highly-indebted countries will be able to meet their commitments or be forced into a debt restructuring process. However, as long as this does not have any profound effects on the financial markets that disrupt the supply of credit, there is every chance that the core countries in the eurozone will be able to continue to grow. It is reasonable to believe that growth can attain the rather modest levels forecast in the draft Monetary Policy Update.

According to Ms Wickman-Parak, the countries in southern Europe have a long way to go before they come to terms with their problems. There is a need for extensive budget measures as well as measures to strengthen competitiveness. However, the adjustments required in these countries are also being supported by improved international growth. The concern associated with the ability of countries to meet their commitments is closely linked to the broader concern relating to the risk that the eurozone will break up into its component parts. Both of these concerns are basically political in nature. Ms Wickman-Parak believes, in common with Mr Nyberg and Mr Öberg, that the most likely outcome is that these problems will be resolved. However, these issues, together with other large-scale problems such as how global imbalances should be resolved, are issues that will be with us for some time to come.

Irrespective of the degree of uncertainty, the Executive Board must make a forecast. Ms Wickman-Parak's assessment of the international forecast presented in the draft Monetary Policy Update was that it is highly reasonable and she supports it. Overall, the forecasts indicate that the market for Swedish exports will increase by 7-8 per cent over the next two years. The prospects for Swedish exports in the period ahead are therefore sound.

Governor **Stefan Ingves** said that he shares the view of international developments presented in the draft Monetary Policy Update. Global trade is largely back to the level it was at before the crisis. This recovery is of course important when assessing the prospects for the export-dependent Swedish economy. Global growth is at just over 4 per cent, but is unevenly distributed. There have been limited changes since the October Monetary Policy Report was published, but there is now no longer any reason to speak of a major risk of a double dip, particularly as the figures for growth have been revised upwards somewhat for the years ahead. In the United States, there is still uncertainty about the labour market and the housing market, and in the longer term about public finances, while at the same time growth is picking up, as Ms Wickman-Parak has already pointed out.

In Europe, growth is good in the north while the problems surrounding sovereign debt are creating uncertainty in the south. However, the forecast for the eurozone is based on the assumption that the public finance problems will be resolved in an orderly way.

When growth and saving are unequally distributed between different parts of the world imbalances arise, as does the need for different types of monetary policy and tensions between different currencies. The global imbalances have not yet been corrected and this creates uncertainty for everyone, not least for countries like Sweden that depend on exports. In terms of the real economy, Sweden is benefiting greatly from the global recovery. At the same time, the two large currency areas, those for the US dollar and the euro, need low interest rates. All in all, this means that different external forces are pulling in different directions with regard to Swedish monetary policy and one needs to strike an appropriate balance adapted to Swedish conditions.

Mr Ingves then summed up the discussion of the international economic outlook by saying that there is a great deal of agreement between the members of the Executive Board about economic developments abroad and about the sources of uncertainty regarding these developments. There are, on the other hand, some differences of opinion regarding the development of policy rates in the large currency areas.

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

First Deputy Governor **Svante Öberg** declared that he supports the forecasts for the Swedish economy presented in the draft Monetary Policy Update. The Swedish economy is growing rapidly, unemployment is falling and inflation is close to the target of 2 per cent. The revisions since October entail higher GDP growth, higher resource utilisation, higher inflation and lower unemployment. He also supports the proposal to increase the repo rate by 0.25 percentage points to 1.25 per cent and the repo-rate path presented in the Update.

Resource utilisation is now increasing rapidly and is higher than predicted in the October Monetary policy Report. This is partly due to the unexpectedly rapid growth of GDP during the third quarter. Several measures of resource utilisation, for example the RU

indicator,<sup>1</sup> capacity utilisation and the shortage of labour are now more or less back to normal levels. Mr Öberg's own assessment is that the GDP gap is closed now.

Inflation has risen in the past few months. In November, both CPI and CPIF inflation were just under 2 per cent. Inflation expectations have also risen. According to Prospera these are now around 2 per cent. According to the forecasts in the draft Monetary Policy update, inflation will fall slightly over the next 12 months but then begin to increase towards 2 per cent again. However, the high level of resource utilisation means that there is a risk that inflation may be higher than forecast in a couple of years' time.

With GDP growth of over 5 per cent, more or less normal resource utilisation, and inflation and inflation expectations at around 2 per cent, it feels slightly uncomfortable to have a repo rate of 1.25 per cent. A traditional Taylor rule would in the present situation result in a repo rate of 3 to 4 per cent. Mr Öberg feared that something important may be being missed if, directly after the most severe downturn since the early 1990s, an attempt is made to immediately bring underlying inflation up to 2 per cent. Bringing inflation back to target may be allowed to take a little longer in such a situation. This also lies within the framework outlined by the principles for monetary policy presented in "the green book".<sup>2</sup>

Mr Öberg also believes that problems will arise in other parts of the economy if a very low interest rate is maintained over a long period of time. That would affect credit expansion and asset prices, and may lead to misguided investments and asset bubbles, which when they burst cause major problems in the real economy.

He therefore expects the repo rate to be increased by 0.25 percentage points at the next two monetary policy meetings too, which is in line with the repo-rate path in the draft Monetary Policy Update and with market expectations.

If the economy continues to recover in line with the forecast, Mr Öberg's assessment is that it will be necessary to raise the repo rate at each of the remaining monetary policy meetings in 2011. This would entail a somewhat steeper upward path in the second half of 2011 than the repo-rate path presented in the draft Update. However, given the uncertainty regarding the development of interest rates in the longer term he did not want to enter a reservation against the repo-rate path but felt it was enough to make this point. If, on the other hand, the recovery in the United States comes to a halt, or if the public finance problems in Europe result in renewed concern on the financial markets, there may be a need to increase the repo rate more slowly. There is a high degree of uncertainty regarding the repo rate in three years' time.

He reminded the meeting that it only took nine months for the Riksbank to cut the repo rate by 4.5 percentage points. If the repo rate is raised by 0.25 percentage points at every monetary policy meeting, it will take three years to reach the pre-crisis repo-rate level. A

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<sup>1</sup> See C. Nyman, "An indicator of resource utilisation", *Economic Commentary* No 4, 2010, Sveriges Riksbank.

<sup>2</sup> Sveriges Riksbank, *Monetary Policy in Sweden*, 2010.

lot can happen in the course of three years that may lead to different assessments, and it cannot be ruled out that it may be necessary to increase the repo rate faster than this.

Deputy Governor **Barbro Wickman-Parak** pointed out that the Riksbank's earlier message that the Swedish economy is developing strongly now has further weight behind it following the growth figures for the third quarter, which were much stronger than expected, as well as a range of different indicators that signal good growth also in the period ahead. The figure for growth this year has been revised upwards substantially, due to what has already happened plus a small upward adjustment for the fourth quarter. The strong end to the year will have an impact on growth for 2011 as a whole, despite the fact that the figures for development during the year have been reduced slightly compared to those presented in October.

The Riksbank has been surprised for quite some time now by the strength of the economic recovery and, as pointed out in the draft Monetary Policy Update, production volumes are now roughly back to pre-crisis levels. This is approximately one year earlier than predicted in the assessments made last autumn. The recovery of the labour market has also been a positive surprise. In December last year, it appeared that employment this year would fall by more than two per cent while, happily, it now appears that it will instead increase by one per cent. This is a more rapid development than indicated by historical links between GDP and employment.

The growth forecast in the draft Monetary Policy Update is rather cautious for the period ahead. There may be good reasons for this following the very strong and rapid growth rebound we have now experienced. The companies have, for example, built up their stocks due to a positive development of production. This provides a strong contribution to growth, but is not something that will be repeated. And even if our export market is growing strongly, the forecast is that the rate of increase will nevertheless slow down compared with this year.

The comparison between the Riksbank's forecast one year ago and what has actually happened since then aimed to illustrate how quickly the economy can develop in directions different to those that were predicted. The strength of the upturn has surprised us several times and it may do so again. Perhaps the slowdown in GDP growth will not be as rapid as the forecast suggests? Ms Wickman-Parak said that only time will tell and that she herself had no better forecast to offer.

Underlying inflationary pressures are now low and this is normal when emerging from a deep recession with low resource utilisation. However, monetary policy should be forward looking and the forecasts in the draft Monetary Policy Update indicate that underlying inflation will reach the target at the end of the forecast period at the same time as resource utilization, according to the various measures usually used, will reach a more or less normal level. In order to achieve this balanced development we need to raise the repo rate. Otherwise there is a risk that resource utilisation will continue to move upwards at a rate that can initiate increased cost pressures. Ms Wickman-Parak said that she supported increasing the repo-rate at today's meeting and the proposed repo-rate path presented in the draft Update.

Ms Wickman-Parak repeated what she has said on previous occasions, namely that she sees risks on the labour market that should be taken into consideration. These risks reinforce her view that the Riksbank should now continue to raise the repo rate. She believed that the repo-rate path in the draft Monetary Policy Update is compatible with a balanced development and reduces the risk of having to take action reactively in the form of more drastic increases further ahead.

Ms Wickman-Parak pointed out that she is well aware that there are also risks on the downside as developments abroad may move in a different direction than indicated in the forecast. If this turns out to be the case, then the repo-rate path will of course have to be reconsidered.

Ms Wickman-Parak concluded by saying a few words about household borrowing and house prices but first wanted to make it clear that, irrespective of these variables, her assessment of the forecasts for resource utilization and inflation supports the proposed interest-rate policy. Nevertheless, it is satisfying that the repo-rate increases may contribute to a calmer development of household borrowing. It may mean that we can avoid problems beyond the forecast horizon. Ms Wickman-Parak underlined the view that she has expressed several times previously that considerations of this type should be taken into account when determining monetary policy. Sometimes, they may even justify increasing the repo rate a little earlier than would otherwise have been the case.

Deputy Governor **Karolina Ekholm** noted that development in Sweden appears to be even stronger than in was at the time of the monetary policy meeting in October and that it is undeniable that the Swedish economy is recovering rapidly at the moment. One question that it is important to address but difficult to answer is how high resource utilisation really is. Are we now rather close to a normal level of resource utilisation, and if so is there a risk that the economy will become overheated if monetary policy is not tightened?

If we examine inflation we can see that it is currently close to the target of 2 per cent but, as stated in the draft Monetary Policy Update, it is largely temporary factors such as increased food and energy prices that are keeping up inflation and it is expected to fall as the impact of these factors fades. It appears, therefore, that underlying inflationary pressures are low, which indicates that the level of resource utilisation is still relatively low. This is also supported by the unemployment figures, which are still relatively high. The picture that there is still an ample supply of labour is supported by the fact that the recent high level of growth is largely due to increases in productivity rather than increases in employment.

As a result of the continued low level of resource utilisation and the low underlying inflationary pressures, Ms Ekholm saw no strong reasons to change the assessment she made at the meeting in October. At that meeting she voted to leave the repo rate unchanged at 0.75 per cent, but in the light of the continued recovery of the Swedish economy the current level of 1 per cent is well justified. However, she did not support an increase to 1.25 per cent and she still believed that a flatter repo-rate path was preferable.

As at the previous meeting, Ms Ekholm feared that the proposed repo-rate path entails a tighter monetary policy than assumed in the forecast. If the market participants expect policy rates abroad to be lower than assumed in the forecast, which they appear to do, at the same time as they believe that the Swedish repo rate will increase as assumed in the proposed repo-rate path, then the interest rate differentials between Sweden and abroad will be larger than forecast. All else being equal, this would entail a stronger appreciation of the krona than in the forecast, which in turn would exert greater downward pressure on inflation and have a dampening effect on growth and employment.

According to Ms Ekholm, it seems that the forecast in the draft Monetary Policy Update is based on the assessment that market expectations regarding policy rates abroad will shift upwards as they shift upwards for the Swedish repo rate. And, to a certain extent, this is what has happened since the previous monetary policy meeting: monetary policy expectations in Sweden have shifted upwards somewhat at the same time as they have shifted upwards in countries such as the United States and the UK. In the eurozone, on the other hand, they seem, if anything, to have shifted downwards. In any case, the shifts have been rather modest. In order for market pricing to reflect the repo-rate path proposed in the draft monetary Policy Update, rather substantial shifts would be required. Larger shifts than can realistically be expected at the moment would be needed.

Ms Ekholm wished to once again emphasise that her position was not about avoiding a strengthening of the krona exchange rate. Considering the strong development of the Swedish economy and the high current account surplus that we have had for a long period of time, she believed that a strengthening of the real krona exchange rate was well justified. She also wished to emphasise that she sees a rising repo rate in the period ahead. A rising repo rate is necessary to achieve a balanced development of the Swedish economy. She said that the difference between her position and the repo-rate path presented in the draft Update can be explained by the fact that she attaches relatively great importance to the need to adapt Swedish monetary policy to the policy conducted abroad. She does this on the basis of the view that the Swedish economy is a highly integrated part of the global economy and that there are rather high risks associated with deviating too much from the policy conducted outside Sweden.

Ms Ekholm advocated allowing the repo rate to remain unchanged at 1 per cent and a repo rate path that would reach approximately 2.7 per cent at the end of the forecast period. Her main reason for taking this position was that she considered that the repo-rate path proposed in the draft Update risked becoming overly restrictive by way of a greater strengthening of the krona exchange rate than in the forecast.

Like Ms Ekholm, Deputy Governor **Lars E.O. Svensson** said that he prefers an unchanged repo rate of 1 per cent at this meeting and a repo-rate path that increases at a steady rate to a level of 2.7 per cent by the end of the forecast period. This is because he sees several problems with the monetary policy proposed in the draft Monetary Policy Update.

One problem is that the repo-rate in the main scenario entails an intended monetary policy that according to Mr Svensson is not well balanced, even if all the assumptions and the entire analysis in the draft Update are accepted. This is because the main scenario

includes a CPIF forecast under the target and an unemployment forecast higher than a normal level throughout almost the entire forecast period. An unchanged repo rate now followed by a lower repo-rate path will, all else being equal, provide a better attainment of the targets for inflation and unemployment.

In other words, the main scenario does not fulfil Jan Qvigstad's necessary but not sufficient conditions for a well-balanced monetary policy.<sup>3</sup> Applied to inflation and unemployment this condition states that the inflation gap (the difference between inflation and target) and the unemployment gap (the difference between unemployment and its normal level) must have the same sign. Since the inflation gap is negative and the unemployment gap is positive for the main scenario, the condition is not fulfilled. Instead the gap for both can be reduced with another repo-rate path. In the present case a lower repo rate path will lead to a reduction in the gap for both and hence an increase in target fulfilment for both.

Another problem has to do with whether it is desirable for the main scenario repo rate path to be credible or not. Here "credible", as used in the international literature, means that market participants' expectations are compatible with the repo rate path and incorporated into market pricing. According to Mr Svensson it should always be desirable that the repo rate path of the main scenario becomes credible immediately or as soon as possible, and hence immediately or as soon as possible leads to the equivalent yield curve for market rates. According to the now accepted view in the international literature, the monetary policy transmission mechanism is such that monetary policy affects inflation and the real economy by affecting market participants' expectations of future interest rates and hence the actual yield curve. It is after all the actual yield curve that determines the return on saving and the cost of financing investments, output and trade, thus affecting the real economy. Consequently, the aim of monetary policy communication in general and of publishing a repo rate path in particular is to affect expectations so that the actual yield curve is compatible with the repo rate path. That is, so that actual monetary policy (the actual yield curve) will be the same as intended monetary policy (the yield curve that is compatible with the repo rate path). It is also in line with what Irma Rosenberg said in the speech in January 2007, announcing that the Riksbank would start publishing its own repo rate path: "the primary reason for publishing one's own interest rate forecast is that it makes it easier for the central bank to steer expectations".<sup>4</sup>

But if the main scenario's repo rate path were to become credible, all else being equal, Swedish long-term rates would increase by about 70 points for a 5-year rate (zero coupon rate). This can be shown by means of the same figure as Mr Svensson presented at the October monetary policy meeting. This would mean a considerable tightening of actual monetary policy. The difference between Swedish and foreign (TCW-weighted) 5-year rates (zero coupon rates) would also, all else being equal, increase by about 70 points, from about 60 points to about 130 points. This would mean a strengthening of the krona that would entail a further tightening in addition to the increase in long-term

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<sup>3</sup> J. Qvigstad, "When does an interest path look good? Criteria for an appropriate future interest rate path - A practitioner's approach", *Staff Memo 2005/6*, Norges Bank.

<sup>4</sup> I. Rosenberg, "Monetary policy with own repo rate path", speech on 8 June 2007.

interest rates. The overall tightening would lead to even lower inflation and even higher unemployment than in the main scenario.

A third problem, according to Mr Svensson, is that the main scenario builds on a forecast of foreign policy rates considerably in excess of the current low foreign forward rates. Instead, as Mr Svensson and Ms Ekholm already pointed out, it can be maintained that an assessment of monetary policy in the eurozone, the UK and the United States, on the basis of signals, statements and other communication from these central banks, yields a forecast in line with the foreign forward rates. It is also prevailing foreign long-term market rates that affect the prevailing exchange rate.

This means that the main scenario according to Mr Svensson underestimates the difference between Swedish and foreign interest rates and the strengthening of the exchange rate that would result, all else being equal. With an assumption of foreign policy rates being in line with foreign forward rates, the main scenario repo rate path leads to even lower inflation and even higher unemployment. Using a four-panel diagram similar to those he presented at the October monetary policy meeting one can then show, according to Mr Svensson, that the repo rate path that he and Ms Ekholm advocate, that is, an unchanged interest rate now and then a steady increase to 2.7 per cent at the close of the forecast period, leads to a higher rate of inflation considerably closer to the target and considerably lower unemployment. Unemployment falls faster and reaches a level of about 6 per cent at the close of the forecast period. The more rapid fall in unemployment reduces unemployment periods for the unemployed and reduces the risk of exclusion from the labour market.

Mr Svensson summarised his standpoint by saying that he advocates a repo rate of 1 per cent and a repo rate path that then gradually rises to 2.7 per cent at the close of the forecast period. That repo rate path would lead to CPIF inflation closer to target and unemployment closer to a normal level. The repo-rate path in the draft Monetary Policy Update implies a tighter monetary policy than is presented in the draft Monetary Policy Update. This could lead to a further strengthening of the krona than in the Update's forecast, and higher long-term interest rates than at present. This would reduce inflation and raise unemployment. Mr Svensson's expectation that the repo rate path will lead to a greater krona appreciation than forecast is based on the view that foreign policy rates will rise more slowly, and that the exchange rate is being affected by the current low foreign long-term market rates.

Deputy Governor **Lars Nyberg** said that this time he had little to add to the analysis in the Monetary Policy Update and consequently he would turn directly to the monetary policy conclusions. He shares the view that the interest rate should be raised by a quarter of a percentage point at today's meeting and that the repo rate path should remain unchanged. Sweden has, in his view not entirely unexpectedly, continued to grow slightly faster than in the Riksbank's forecast. The output gap is closing and there are tendencies towards labour shortages in the construction industry and parts of the service sector. It is true that the improved growth prospects could justify a somewhat faster return to a normal interest rate level, that is an upward adjustment of the repo rate path. But underlying inflation is still low and unemployment is higher than normal. Even if real

uncertainty in the rest of the world has decreased and the "double-dip" discussion has waned, financial uncertainty has increased, above all in Europe. All in all, according to Mr Nyberg, it appears reasonable to allow the repo rate path to stay where it is for the time being.

Monetary policy expectations, as reflected in market prices, have risen slightly since October, but are still low for maturities of more than one year. He shares the view in the draft Monetary Policy Update that the longer end of the forward rate curve is currently being held down artificially for a number of reasons discussed at the previous monetary policy meeting and that the expectations shown by various surveys are a better reflection of a reasonable future development of market rates. The credibility of the Riksbank's interest rate path at present can be judged in relation to these expectations rather than in relation to those of the market. The information currently communicated by the forward rate curves as regards monetary policy expectations is now the subject of lively discussions throughout the world. Many analysts, both in the market and in various central banks, are doubtful about using them in today's situation in a traditional way as regards measuring monetary policy expectations.

As regards the exchange rate, Mr Nyberg stated that there are better arguments now than for a long time for a stronger krona. Sweden has good public finances, a stable banking system, a continued current account surplus and now progressively higher interest rates than in the rest of the world. But experience has shown that it is wise to be prudent when forecasting the exchange rate. Sweden has had a current account surplus for more than a decade without any appreciation in the krona. However, if the krona appreciates, this will be immediately apparent. Then it will be possible to adapt monetary policy and adjust the interest rate path downwards if deemed reasonable.

Housing prices and household borrowing have been a focus of media interest recently. This is a good thing, according to Mr Nyberg. Even if current housing prices can be explained by increasing real incomes, low interest rates and limited construction, there is every reason for concern about households' increasing debt, which the Riksbank has been pointing out for a long time. It remains to be seen if increased interest rates and Finansinspektionen's loan ceiling will slow down growth in household borrowing. The developments must be followed closely. But it is interesting and positive to note that the majority of those taking part in the debate now seem to hold the view that the repo rate is not the best instrument for dampening growth in household borrowing. Voluntary amortisation requirements from the banks or increased capital adequacy requirements for lending against collateral in housing for example may be better measures.

Mr Nyberg believes that this, to the extent the Riksbank's interest rate increases can contribute to dampening the rate of increase in household borrowing, is a positive side-effect in the present situation. But even if the risks of a rapid build-up of credit should, in his opinion, always be taken into account in interest rate decisions, the interest rate increases made since the summer were primarily motivated by traditional monetary policy considerations. The endeavour to keep inflation around 2 per cent while maintaining a balanced resource utilisation is sufficient, as Mr Nyberg sees it, given the rapid development we have seen in Sweden in 2010.

Governor **Stefan Ingves** stated that he shares the view of economic development in Sweden as described in the draft Monetary Policy Update and consequently he supports an increase in the interest rate of 0.25 percentage points and an unchanged interest rate path.

The data that has come in shows that growth is higher and unemployment lower than in earlier forecasts, and that the current account surplus remains. GDP will shortly have reached the same level as before the crisis and resource utilisation will normalise during the forecast period. Business tendency data indicate continued strength in the economy. Inflationary expectations are rising even though the forecast inflation will be quite close to the two per cent target. All in all, according to Mr Ingves this means that it is now appropriate to raise the interest rate and continue to do so in the future.

According to Mr Ingves, Sweden needs less expansionary monetary conditions. This can be achieved via two channels; via interest rate increases and/or via the exchange rate. Exchange rate assessments are genuinely difficult and it is hard to base monetary policy on an assumption that the low interest rate in the rest of the world will contribute to a strengthening of the exchange rate. The discussion of the role of the exchange rate in monetary policy is reminiscent of the discussion of a "monetary conditions index" in the 1990s, which did not lead to any clear conclusions, but on the contrary led to the abandonment of this kind of index.

The repo-rate path proposed in the Monetary Policy Update is a reasonable compromise, according to Mr Ingves. By gradually raising the interest rate monetary policy will be less expansive. If developments in the exchange rate should differ dramatically from those forecast this must be dealt with when it happens.

Household debt continues to increase and it is too early to judge what effect Finansinspektionen's loan ceiling will have. To avoid problems in the future it is also appropriate in view of this to raise the interest rate and indicate interest rate increases in the future as specified by the repo-rate path. The monetary policy transmission works via expectations and the repo-rate path steers expectations.

First Deputy Governor **Svante Öberg** commented on what Mr Svensson said about the repo-rate path. According to Mr Öberg, the presented repo-rate path neither means that the majority of the Executive Board believe nor that they wish that longer rates will jump to another level overnight. It means rather that longer rates will gradually adapt to what is implied by the repo-rate path. Consequently, the adopted repo-rate path will not have any immediate or tangible effect on the exchange rate. However, it is reasonable for the krona to continue to be strengthened for other reasons. Sweden has stronger growth than other countries and a very large current account surplus. These are two factors that usually lead to a stronger currency.

Mr Öberg also had views on Mr Svensson's use of the term "credible repo-rate path". According to Mr Öberg, it has never since the Riksbank introduced the repo-rate path in February 2007 been the intention that the repo-rate path should be interpreted in such a way that it is assumed that the longer interest rates will change overnight to the level compatible with the repo-rate path. The Riksbank only decides on the short-term interest

rate and has limited possibilities to steer the longer interest rates instantaneously. However, it is reasonable that the Riksbank, through the repo-rate path, presents the assumptions about the development of the repo rate on which the forecasts are based. By presenting the repo-rate path, one can also state what one assesses to be a reasonable development of the repo rate. This is also compatible with Irma Rosenberg's statement that the aim of publishing our own repo-rate path is to influence future interest rates.

Deputy Governor **Lars E.O. Svensson** began his reply to Mr Öberg by noting that, according to the international literature in the field, the repo-rate path is credible when the market participants' expectations are compatible with the repo-rate path and incorporated into market pricing. As Mr Svensson has shown in a couple of essays published in the Riksbank's quarterly journal *Economic Review*, the repo-rate path has by and large had good credibility up to and including February 2009.<sup>5</sup> The market has often predicted the repo-rate path fairly well, in the sense that forward rates on the day before publication of the repo-rate path have been quite close to the repo-rate path. When the repo-rate path is published the forward rates have often shifted closer to the repo-rate path. In some cases there is perfect agreement between forward rates and the repo-rate path. From April 2009 the forward rates were higher than the repo-rate path, which means that actual monetary policy was tighter than intended. This was a problem since the crisis motivated as expansionary a monetary policy as possible. The Riksbank gradually succeeded in pushing down forward rates, for example with the help of the fixed rate loans at longer maturities. From February 2010 the opposite situation started to arise, with forward rates that were lower than the repo-rate path. Mr Svensson thinks that this was a good thing in itself, since it contributed to faster recovery. All in all, the repo-rate path had relatively good credibility up to February 2009, while after that date its credibility was poorer. Mr Svensson hopes that the credibility will improve when the situation is back to normal.

According to Mr Svensson the view of the transmission mechanism that is now generally espoused in the international literature in the field is that it mainly consists of the central bank influencing expectations of future interest rates and thereby the yield curve. Behind this lies the view that the short interest rate in the next two to three months has little impact on the economy, while market rates at longer maturities and expectations of short rates during the corresponding longer period that mainly affect economic decisions and hence the economy. It is a matter of whether it is desirable for actual monetary policy, represented by the actual yield curve, to be the same as intended monetary policy, represented by the repo-rate path and the yield curve that is compatible with the repo-rate path. According to Mr Svensson it should not be particularly controversial that it is desirable that actual monetary policy is in line with intended monetary policy as soon as possible. According to Mr Svensson, the main scenario's inflation and real economy forecasts are contingent on the credibility of the repo-rate path, that is, that the market participants believe in the repo-rate path in the sense that their expectations of future policy rates are in line with the repo-rate path.

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<sup>5</sup> See L.E.O. Svensson, "Transparency under Flexible Inflation Targeting: Experiences and Challenges", *Economic Review*, 2009:1, Sveriges Riksbank and L.E.O. Svensson, "Policy Expectations and Policy Evaluations: The Role of Transparency and Communication", *Economic Review*, 2010:1, Sveriges Riksbank.

Mr Svensson further commented on Mr Nyberg's discussion of whether surveys or forward rates are better indicators of the market interest rate expectations. Mr Svensson attaches greater weight to people who trade on the market and back their expectations with money than to those who just reply to surveys. There are well-known problems with surveys and reason to be sceptical towards them. For example, it is not clear that the respondents have any incentive to reply correctly or that the respondents state an expected value and not the most probable outcome, the mode, which differs from the expected value for asymmetrical distributions.

Mr Svensson noted that in this context there has been quite a bit of discussion of term premiums, in other words the difference between forward rates and expected future short-term interest rates.<sup>6</sup> The term premium is a risk premium, and like all risk premiums it depends on such things as risk aversion among investors and the uncertainty experienced by investors. The term premiums for long maturities may be greater than normal due to increased risk aversion after the crisis and greater uncertainty in general in the current economic situation. Large-scale bond purchases (quantitative easing, QE) in the United States and the UK work in the opposite direction and via the portfolio balance effect can result in term premiums being smaller than usual in these countries. The net result can be fairly small changes in relation to normal premiums. Since the ECB's bond purchases were small in comparison with those of the United States and the UK, term premiums for bonds in the eurozone have not necessarily decreased for this reason. The spillover effects of QE in the United States and the UK to term premiums for other assets depend on the degree of substitutability between assets. Government bonds in different currencies are likely to be less good substitutes, and therefore the spillover effect on assets denominated in other currencies is probably limited. Large positive term premiums mean that unadjusted forward rates overstate market expectations of future interest rates, while large negative premiums mean that unadjusted forward rates understate market expectations. All in all and in the absence of a closer analysis, Mr Svensson believes for the time being that there is hardly reason to believe that forward premiums have become so small or even so negative that implied forward rates with normal adjustments for term premiums can no longer provide a fairly good picture of market expectations.

It is important to remember that the effect on the exchange rate of the difference between market rates in Sweden and abroad are independent of whether term premiums are small or large.

Mr Svensson then discussed what is a good measure of resource utilisation. He said that measures such as the output gap and the hours gap are problematic due to the difficulty of estimating potential output and potential hours, particularly under the current abnormal conditions. The following argument can act as an illustration. Swedish GDP fell almost 8 per cent from the top level in the fourth quarter of 2007. Now GDP has more or less recouped this fall and has accordingly recouped these 8 per cent. If the crisis had not happened and if export demand had not collapsed GDP may perhaps have continued to grow by 2 per cent per year from the fourth quarter of 2007. In that case it would be 6 per cent higher than now. Since Sweden was exposed to a pure demand shock and does not

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<sup>6</sup> The term premium is the expected return on a forward contract with a given forward rate that is funded with borrowing at a future uncertain rate.

have any structural problems or problems with the financial sector it can perhaps not be ruled out that potential output continued to grow at a rate of 2 per cent per year from the fourth quarter of 2007. In that case the output gap is now minus 6 per cent, a much greater negative gap than indicated by other measurements.

Given the problems relating to measures such as the output gap and the hours gap, he believes that the unemployment gap has great advantages. Unemployment is measured often and fairly accurately and is not revised. The problem is how the normal level, equilibrium unemployment, should be determined. Mr Svensson has made a preliminary estimate of 5.5 per cent after having read some papers on the subject and discussed it with some specialists on labour market economics. In the minutes of the October monetary policy meeting he discussed in more detail how one arrives at precisely 5.5 per cent. If there are new better estimates he is prepared to revise the level. A great advantage of the unemployment gap is that there can be an open debate on equilibrium unemployment within the Riksbank and with economists outside the bank. Everyone can make their own assessment. It is also easy to conduct sensitivity tests, for example, by assuming that equilibrium unemployment is 6 or 6.5 per cent instead of 5.5 per cent. According to Mr Svensson, his and Ms Ekholm's conclusion, that their lower repo rate path gives a better outcome, applies also for these higher levels of equilibrium unemployment. All in all, he therefore sees the unemployment gap as a more robust and reliable and less easily manipulated indicator of resource utilisation than other measures.

As regards the question of monetary policy, housing prices and household debt, Mr Svensson's understanding is that the mandate for monetary policy under the Sveriges Riksbank Act and its preparatory work does not provide scope to attempt to influence housing prices or household debt at the expense of target fulfilment for inflation and resource utilisation. As he sees it the Executive Board should take housing prices, debt and similar variables into consideration only to the extent they can be proved to affect the forecast for inflation and resource utilisation in a short-term or long-term horizon.

If housing prices and debt were to be assessed as problematical, according to Mr Svensson there are effective instruments (caps on mortgage borrowing, amortisation requirements, specific taxes, and so on) that have a greater effect on housing prices and debt than the policy rate without negative effects on inflation and resource utilisation. According to Mr Svensson existing research shows that the policy rate has little effect on housing prices but considerable effects on inflation and resource utilisation.

Deputy Governor **Barbro Wickman-Parak** referred to Mr Svensson's earlier contribution and said that it is not her opinion either that it should be a separate objective for monetary policy to limit growth in housing prices and household debt. This should be perfectly clear by now. It is also evident if one reads what she and other members of the Executive Board have said on several occasions. The minutes of previous monetary policy meetings, for example, show that she has pointed out that the rate of increase in household borrowing is not sustainable in the long term. Sooner or later an adjustment could come and that could mean that households start to rapidly reduce their debt with consequences for consumption. Such a situation, which can occur after the end of the current forecast horizon, would be made worse if house prices fell at the same time. The American case clearly illustrates that it is difficult to overcome such a situation by means of interest rate policy.

Ms Wickman-Parak then commented on forward rates as a measure of monetary policy expectations. She said that while preparing the day's decision, the Executive Board had discussed the market interest rates and the problems associated with deriving monetary policy expectations from them, both in Sweden and the rest of the world. It is also mentioned in the Monetary Policy Update. She is not sure how the market interest rates should be interpreted. Looking back, it can be noted that market rates have not been good at predicting the future repo rate, particularly not in the long term. This is reflected in the large uncertainty bands around the repo rate path that are based on historical "forecasting errors" in forward rates.

As regards the credibility of the repo rate path she agreed with Mr Nyberg and noted that many analysts and experts hold approximately the same view as the Executive Board majority. She also said that if we are to discuss the Riksbank's credibility then, as she sees it, this basically concerns the credibility of the inflation target. As long as inflation expectations are anchored around the target then monetary policy is credible, and this is the important thing.

Ms Wickman-Parak noted that Mr Svensson has now changed his view on how to measure resource utilisation. She and many with her have been sceptical towards the one-sided use of hours gaps and output gaps. In the same way, she is sceptical to now using an unemployment gap based on equilibrium unemployment being 5.5 per cent. In her opinion, this is far too much of a one-sided measurement to rely on when deciding on the interest rate. The Riksbank needs to continue using several different measures to get an indication of resource utilisation.

As regards the forecast in the Monetary Policy Update that CPIF inflation will be below the target for the forecast period, Ms Wickman-Parak was of the opinion that the deviation can be accepted. The Swedish economy is coming from a period of very low resource utilisation. The main thing is that inflation returns to the target within a reasonable time horizon.

Deputy Governor **Karolina Ekholm** commented on what Mr Nyberg and Mr Ingves said about the exchange rate. It is well known that it is difficult, if not impossible, to forecast exchange rate developments in the short term. There is an extensive research literature which attempts to explain exchange rate developments and in this literature one finds that changes in interest rate differentials do not have much explanatory power. On this basis it could be asked if it is justified to worry about how monetary policy affects the Swedish krona exchange rate. However, it is difficult not to believe that increased interest rate differentials in relation to the rest of the world, all else equal, have an appreciating effect on the exchange rate. Then there are a lot of other things happening constantly that affect the exchange rate and that are difficult to predict.

There are several factors that suggest a real appreciation of the krona in the long term. It may not be the first time that this type of assessment of the real krona exchange rate developments has been made at the Riksbank, only to then see the krona in real terms weakened or remaining unchanged. The factors that indicate a real appreciation are that growth is considerably higher in Sweden than in many other countries, that inflation in Sweden in relative terms is nevertheless quite high, that Sweden has a very large current

account surplus and sound government finances, and that the banks appear to be relatively well capitalised.

For the nominal krona exchange rate this means that there is some kind of underlying appreciation pressure. Ms Ekholm is concerned that a strengthening of the nominal krona exchange rate will be so rapid and extensive that inflation will fall considerably short of the target.

As regards Mr Nyberg's and Mr Ingves view that it is easy to change the direction of monetary policy if the krona is seen to be developing in a way that makes it difficult to achieve a balanced economy, Ms Ekholm thinks this is something that could be said about several variables in a forecast. However, she wished to clarify that her position is ultimately based on the fact that she makes a different assessment of the development of policy rates abroad than the assessment in the draft Update. With her assessment of the development of international policy rates the proposed repo rate path would lead to a clearly poorer outcome for the Swedish economy than that in the proposed forecast. It is not that she advocates a lower repo rate path to achieve development of Swedish inflation and GDP that is different from the forecast, but that she advocates a lower repo rate path to achieve approximately the development of the Swedish economy that is described in the draft Monetary Policy Update.

Deputy Governor **Lars E.O. Svensson** said in reference to Ms Wickman-Parak's comment on his view of resource utilisation measurement that it is correct that he previously considered output gaps and hours gaps as suitable measures. However, he has gradually come to a better understanding of the difficulties associated with determining potential output and potential hours worked. For that reason he has come to regard these measurements as somewhat less reliable and very sensitive to different assumptions that may be fairly arbitrary. This is particularly true in the present abnormal times. It would be very difficult to check exactly how potential output and potential working hours have been calculated, and difficult to conduct sensitivity tests. In comparison, the unemployment gap has several advantages, as he said earlier.

Governor **Stefan Ingves** said that the Executive Board in different contexts has stated that credit growth cannot be ignored. It is difficult to take account of credit growth in standard models, but it is nevertheless very important. Even if it is difficult to model, he has no problems in taking credit growth into account in his monetary policy positions.

Mr Ingves commented further on the market rates' lack of adjustment to the repo rate path. Like other central banks, the Riksbank has decided to keep to operations that influence the short end of the yield curve. According to Mr Ingves it is unreasonable to expect an immediate adjustment of market rates unless the Riksbank starts to buy and sell fixed income instruments with long maturities.

First Deputy Governor **Svante Öberg** said that he sees monetary policy in exactly the same way as Mr Ingves. He then raised a further issue on which he does not agree with Mr Svensson, namely the use of the expression "actual monetary policy". Actual monetary policy is not the same as the forward rate curve. The forward-rate curve is affected by many other things, such as portfolio changes and forward premiums. Actual monetary policy is the Riksbank's repo rate decision, the presented repo rate path, any lending to banks and so on.

The chairman, Governor **Stefan Ingves**, summed up by saying that there seems to be a majority for raising the interest rate at today's monetary policy meeting and that the interest rate increases going forward should continue at about the same rate as was deemed reasonable already in October. Among the members who today advocate an increase and continued interest rate increases in accordance with the forecast in the Monetary Policy Update there are, however, some nuances that may be worth emphasising. Some have stressed the risks on the upside. The Swedish economy may grow even faster than forecast. There are signs of labour shortages in some sectors and overall the indicators point to strong growth going forward. Some have mentioned the risks associated with developments in central government finances in Europe and even if the American economy is showing signs of strength the housing and labour markets are both sluggish. But these are nuances and by and large the Executive Board has a common view of how monetary policy should be conducted going forward. Two of the members today want to keep the repo rate unchanged and have a repo rate path that is subsequently increased at a slower rate on the grounds that this gives better target fulfilment both for inflation and resource utilisation.

Mr Ingves said that the Executive Board in other respects had reflected on the premises for how monetary policy is conducted in a small open economy where far-reaching integration with the rest of the world includes both real links via trade and financial links via interest rates and exchange rates. The members arrive at different conclusions. One question concerns which monetary policy expectations can be read from interest rates in Sweden and abroad. Some members believe that lower interest rates are expected in the rest of the world than those forecast in the Monetary Policy Update. These members fear that a higher repo rate in Sweden will strengthen the krona more than in the forecast and consequently give weaker development in the real economy and lower inflation. Besides this the Executive Board again discussed the role that housing prices and household debt should play in formulating monetary policy. Just as before it can be noted that this is a question on which different members have different opinions.

### § 3. Monetary policy decision

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 Wednesday, 15 December at 9.30 a.m.,
- to raise the repo rate by 0.25 percentage points to 1.25 per cent and that this decision would apply from 22 December 2010,
- to publish the decision above at 9.30 a.m. on 15 December 2010 with the motivation and wording contained in a press release, and
- to publish the minutes of today's meeting on 3 January 2011, at 9.30 a.m.

Deputy Governor Karolina Ekholm and Deputy Governor Lars E.O. Svensson entered a reservation against the decision to raise the repo rate by 0.25 of a percentage point to

1.25 per cent and against the repo rate path in the Monetary Policy Update. They advocated a repo rate of 1.0 per cent and a repo rate path that then gradually rises to 2.7 per cent at the end of the forecast period. They considered that the proposed interest rate path entails a tighter monetary policy than presented in the Monetary Policy Update. This could lead to a further strengthening of the krona than in the Update's forecast and considerably higher long-term interest rates than at present. This would reduce inflation and raise unemployment. Their expectation that the repo rate path will lead to a greater krona appreciation than forecast is based on the perception that foreign policy rates will rise more slowly, and that the exchange rate is being affected by the current low foreign long-term market rates.

This paragraph was verified immediately.

Minutes by

Ann-Christine Högberg

Verified by:

Stefan Ingves

Karolina Ekholm

Lars Nyberg

Lars E.O. Svensson

Barbro Wickman-Parak

Svante Öberg