

No. 14

SEPARATE

MINUTES of the Executive Board meeting on 2 June 1999

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

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Sven Hultström, Chairman of the Governing Council  
Johan Gernandt, Vice Chairman of the Governing Council

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Javiera Aguilar  
Kerstin Alm  
Claes Berg  
Richard Gröttheim  
Hans Lindberg  
Hans Lindblad  
Christina Lindenius  
Björn Hasselgren  
Robert Sparve  
Åsa Sydén

### **§1. Monetary policy discussion and decision**

It was noted that Christina Lindenius and Hans Lindberg would prepare draft minutes of item §1 on the agenda for the meeting.

The monetary policy discussion was preceded by Lars Heikensten presenting a draft Inflation Report and proposing that the Report be published on 3 June at 9 a.m. The Inflation Report reproduces the main features of the presentations and discussions of inflation prospects at the Executive Board meetings on 20 and 27 May 1999.

The Board decided to adopt the Inflation Report in accordance with the draft and that the Report be published at the proposed time.

The monetary policy discussion opened with accounts of the information about economic developments in Sweden and the rest of the world that had been obtained since the previous Board meeting (section 1 below). This was followed by a discussion of whether and to what extent the information affected the Board's assessment of inflation prospects as presented in the Inflation Report (section 2). The Board's assessment of the monetary policy situation (section 3) started from an account of the conclusions that had been reached in a corresponding discussion in the Bank's monetary policy group.

## 1. Economic developments in Sweden and elsewhere

### 1.1 International activity and inflation

The Board briefly discussed the development of international economic activity and inflation. It was noted that the latest statistics did not alter the earlier assessment as expressed in the Inflation Report.

The statistics point to a continuation of strong activity in the United States, which supports the assessment in the Inflation Report. US manufacturing output is still rising rapidly and export demand also seems to be growing. Indications of mounting price pressure and incipient bottlenecks may be discernible in certain sectors. For the euro area, the latest statistics appear to confirm the picture of weak activity that has now probably reached a low.

### 1.2 Developments in Sweden

The Board noted that, as expected, producer prices had risen fairly sharply from March to April, mainly due to rising oil prices and a somewhat weaker exchange rate. The increase in import prices was, however, somewhat smaller than envisaged in the Inflation Report.

The inflow of manufacturing orders, as measured by Förenings sparbanken's Purchasing Managers' Index, has tended to weaken. But a survey from Statistics Sweden shows that households are optimistic about their own as well as the national economy and expect a continued reduction of unemployment. There has also been some upward shift in households' expectations of inflation one year ahead. The statistics on private sector wages show that the rate of wage increases remains moderate.

All in all, the Board concluded that the new statistics point to prospects that are well in line with the picture presented in the Inflation Report.

### 1.3 Financial markets

The Board noted that in recent weeks international long-term interest rates had risen, not least in the United States. The background to this included new statistical evidence

of a continuation of the high activity in the US economy; there also seemed to be increased market expectations that the Federal Reserve would raise the interest rate relatively soon. The euro, moreover, has continued to weaken, above all against the US dollar. The Board also observed that the financial unrest in Argentina has moderated.

In Sweden, too, long-term interest rates has moved up, above all as a consequence of the international tendency, though there has been some increase in the differential with euro area rates. The krona has remained stable against the euro but the effective exchange rate has tended to weaken, mainly due to the general appreciation of the US dollar. Finally, the Board noted that a further reduction of the Swedish repo rate is not allowed for in market pricing. The expectations derived from recent survey data give the same picture.

## 2. The Board's assessment of inflation prospects

The Board concluded that the new information about Swedish and international tendencies did not call for any change in the appraisal of Swedish inflation prospects compared with the assessment the Board had expressed in the Inflation Report. The Board accordingly noted that the Report's assessment of inflation prospects was the relevant starting point for the monetary policy discussion. In this context it was observed that the Board's assessment in the Report is based on the technical assumption that the Riksbank's repo rate is kept unchanged at 2.90 per cent up to the end of June 2001.

The Report's main scenario envisages that changes in indirect taxes, subsidies and house mortgage interest expenditure will have downward effects on the consumer price index of 0.8 percentage points twelve months ahead and 0.3 percentage points in twenty-four months time. The Board considered that in the current situation these transitory factors would be disregarded in the formation of monetary policy because they are not expected to exert a permanent effect on inflation or inflation expectations. This means that at present the direction of monetary policy is based in practice on an assessment of inflation measured by UNDI<sub>X</sub>.

In the Report's main scenario, the rate of UNDI<sub>X</sub> inflation is expected to be 1.9 per cent twelve months ahead and 2.0 per cent in twenty-four months time. The risk of a more prolonged international economic slowdown is judged to have decreased and the risk spectrum is balanced around the main scenario.

The conclusion from the Board's assessments, presented in the Inflation Report, was, briefly, that in twelve to twenty-four months time the rate of inflation, excluding transitory effects from indirect taxes, subsidies and interest rates, would be marginally below the Riksbank's target. The Board considered, however, that the deviation is slight, particularly when the altered risk spectrum is taken into account.

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

The Board meeting had been preceded by a discussion in the Bank's monetary policy group. The main conclusions from the group's meeting were presented to the Executive Board.

The discussion in the policy group had started from the Board's assessment of inflation prospects at its meetings on 20 and 27 May 1999 prior to the drafting of the Inflation Report.

The policy group had noted that in view of the improved prospects for the Swedish economy, the underlying rate of inflation was expected to be somewhat above the assessment at the time of the Board's monetary policy discussion on 22 April 1999. Moreover, the time perspective for the inflation assessment has shifted one quarter into the future, to the end of June 2001. UNDI<sub>X</sub> inflation in the main scenario is now judged to be only marginally below two per cent in twelve to twenty-four months time and the risk spectrum is symmetrical. Against this background, the policy group had concluded that the repo rate should be left unchanged at 2.90 per cent.

Those members of the policy group who had been of the opinion, prior to the Board's monetary policy discussion on 22 April, that the repo rate would be reduced, considered that the deviation from the inflation target was now too small to motivate a repo rate cut, particularly in an upward cyclical phase. In this context it was noted, however, that inflation was judged to be below the Riksbank's target during the greater part of the forecast period, not reaching the target until twenty-four months ahead.

All the Board members expressed the opinion that, in the light of the inflation prospects, it now seemed natural to keep the repo rate unchanged. Two members underscored, however, that it was still too early to hold an opinion about monetary policy's future course, particularly in that the trade-off between growth and inflation in the Swedish economy may have changed. One of these members emphasised that in an upward cyclical phase the picture of expectations is strongly influenced by the Riksbank. In external communications it should therefore be pointed out that the Riksbank continuously monitors indications of capacity shortages and price formation in order to appraise the validity of the historical relationships between growth and inflation.

A third Board member considered that while the possibility of inflationary pressure being subdued by deregulations, increased international competition, technical innovations and so on cannot be ruled out, no clear conclusions can be drawn at present. Moreover, the Swedish economy still has major structural problems, as well as a lack of competition in many sectors, which can work in the opposite direction.

A fourth member pointed out that the Board has agreed on an Inflation Report that gives a picture of the Swedish economy which is basically very positive. It points to a future path characterised by good growth combined with price stability—in marked contrast to experience from the 1980s. The member warned against being caught up in the recent positive mood shift and considered it was important to emphasise that the risk spectrum is symmetrical around the main scenario. Downside risks still exist in

the form of a sharp fall in US stock markets and a situation in Latin America that has not yet become entirely stable. The member also raised the issue of Statistics Sweden's publication of the national accounts and considered that the time lag is unduly long; it is unfortunate that the national accounts for 1999 Q1 were not available in time for the monetary policy decision the Board has to make today.

The Board then discussed matters relating to the path of productivity and the possibility of the Swedish economy being capable of growing at a rate that is more permanently above the historical trend. Experience from the United States and the United Kingdom was cited in this context; in those countries consumption has risen rapidly and growth has been comparatively high in recent years without an acceleration of inflation. Looking ahead, it was therefore considered to be important that the Riksbank closely monitors and analyses the economy's supply side and also studies how the labour market functions, with particular reference to wage formation and the possibilities of recruiting labour in the economic sectors that are expanding rapidly. Special studies should also be made of the development of productivity and factors behind this.

#### 4. The Board's decision

The Chairman noted that all the Board's members were of the opinion that the repo rate should be left unchanged at 2.90 per cent.

The Chairman then proposed that the Executive Board decides

– to announce a fixed rate repo with a duration from the 9th to the 16th of June 1999 at an unchanged rate of 2.90 per cent and a fixed rate repo with a duration from the 16th to the 23rd of June 1999 at an unchanged rate of 2.90 per cent, and

– to announce the decision to keep the repo rate unchanged with the motivation and wording contained in the draft before the meeting of Press Release no. 41 1999, Annex A to the minutes.

The Executive Board decided in accordance with the proposal.