

No. 25

SEPARATE

MINUTES of the Executive Board meeting on 8 December 1999

Present: Urban Bäckström, Chairman
Lars Heikensten (by telephone)
Eva Srejber
Villy Bergström
Kerstin Hessius
Lars Nyberg

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

Kerstin Alm
Anders Eklöf (§1)
Kersti Eriksen
Richard Gröttheim
Björn Hasselgren
Hans Lindberg
Hans Lindblad (§1)
Christina Lindenius
Robert Sparve
Åsa Sydén
Staffan Viotti
Michael Wallin

§1. Decision on Inflation Report 1999:4

It was noted that Christina Lindenius and Hans Lindberg would draft the minutes of §§1, 2 and 3 on the agenda.

Lars Heikensten presented a draft of Inflation Report 1999:4, Annex A to the minutes. The Inflation Report is based on the presentations and discussions of inflation prospects at the Executive Board meetings on 25 November and 1 December 1999.

The Board decided to adopt the Inflation Report as drafted and that the Report be made public at 9 a.m. on 9 December 1999.

Reservation

Deputy Governor Eva Srejber entered a reservation against the decision to adopt the Inflation Report and made the following statement.

I broadly agree with the majority's view of international and Swedish growth prospects in the Inflation Report's main scenario. In my opinion, however, the risk of a stronger economic trend in the rest of the world and in Sweden is greater than the other Board members consider. Moreover, I still count on the higher trade-off between growth and inflation that I mentioned in my reservation against the Board's decision on Inflation Report 1999:3 on 5 October 1999. I consider, for example, that labour market shortages will probably be more marked and that this will contribute to a wage trend that is stronger than foreseen in the Inflation Report's main scenario. It also seems likely, in view of the lack of competition that characterises parts of the Swedish economy, that corporate profit margins will decline more slowly than foreseen in the Inflation Report. Against this background, my current assessment is that, taking my risk spectrum into account, the rate of inflation one to two years ahead will be some tenths of a percentage point above the assessment in the Inflation Report.

This minute was immediately confirmed.

§2. Monetary policy discussion

The monetary policy discussion began with accounts of the information about economic developments in Sweden and the rest of the world that had become available since the Board's preceding meeting (section 1). This was followed by a discussion of whether and to what extent the new information affected the assessment of inflation prospects that the Board had expressed in the Inflation Report (section 2). The Board's assessment of the monetary policy situation (section 3) was preceded by an account of a corresponding discussion in the Bank's monetary policy group.¹

1. Economic developments in Sweden and elsewhere

In the short interval since the previous Board meeting on 1 December 1999 there has been little new statistical information about economic activity and inflation in Sweden and the rest of the world. The Board noted that there were no grounds for modifying the earlier assessment, expressed in the Inflation Report.

The Board then considered the tendencies in financial markets. Price setting in interest markets indicates expectations that instrumental rates in the United States, the euro area and the United Kingdom will be raised in the coming year but will be unchanged in the short term. The international level of long bond rates has moved up 0.15–0.30 percentage points in November; the improvement in international activity and the higher price of oil have probably contributed to this. But long-term interest

¹ The group is made up of Riksbank staff and is headed by one of the deputy governors.

rates in the G-3 area are still below the levels from before the outbreak of the Asian crisis in the summer of 1997. Long bond rates in Sweden have broadly followed the international tendency but the differential with German rates has narrowed to 0.4–0.5 percentage points.

The Board noted that survey data in recent weeks show that market players expect the repo rate to be left unchanged at today's Board meeting but that a majority foresees a repo rate increase in connection with the Board's monetary policy meeting in February 2000.

The krona's fluctuations against the euro in recent weeks have been in the interval EUR 8.54–8.64, which represents an appreciation of about 1 per cent since October. According to market players, factors behind this development have been the strong economic trend in Sweden, the Riksbank's repo rate increase and growing international investment in Swedish shares. In effective (TCW) terms, however, the krona's exchange rate is virtually unchanged.

2. The Board's assessment of inflation prospects

The Board concluded that no new information about Swedish and international developments has been obtained that warrants an appraisal of Swedish inflation prospects that departs from the assessment the Board had expressed in the Inflation Report. The Report's assessment of inflation prospects was accordingly the relevant starting point for the monetary policy discussion. One Board member differed, however, and considered that inflation would be somewhat higher than envisaged in the Inflation Report.

In the Report's main scenario it is considered that changes in indirect taxes, subsidies and house mortgage interest expenditure will exert a downward effect on CPI inflation of 0.2 percentage points twelve months ahead but that in twenty-four months' time the effect will be upwards and amount to 0.3 percentage points. The Board considered that in the present situation the Riksbank would disregard these transitory factors in the formulation of monetary policy because they are not expected to have a permanent effect on either inflation or inflation expectations. In practice, therefore, the formulation of monetary policy is currently based on an assessment of inflation as measured by UNDEX.

In the Inflation Report's main scenario it is judged that, given an unchanged repo rate of 3.25 per cent, the rate of UNDEX inflation will be 1.8 per cent in one year's time and 2.2 per cent two years ahead. Moreover, the balance of risks in inflation prospects is considered to be somewhat on the upside. Import prices, for instance, may follow a higher path and inflation's reaction to the strong growth of demand may be more marked than in the main scenario. Neither can a stronger wage trend be ruled out. Including the risk spectrum, the rate of UNDEX inflation is therefore judged to be approximately 0.1 percentage point higher than foreseen in the main scenario, that is, 1.9 per cent one year ahead and 2.3 per cent after two years. So all in all and given an unchanged repo rate, inflation is judged to move up slowly and be somewhat above the Riksbank's target two years ahead.

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

3.1 The monetary policy group's appraisal

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 the Board meetings on 25 November and 1 December 1999.

The policy group essentially agreed with the inflation assessment as expressed in the Inflation Report and considered that, excluding transitory effects of indirect taxes, subsidies and interest expenditure, inflation will tend to rise in the coming years and, given an unchanged repo rate, will be somewhat above the Riksbank's target two years ahead.

In its assessment of the monetary policy situation, the group also considered the Riksbank's recent monetary policy signals. A press notice in connection with the November repo rate increase of 0.35 percentage points had stated that, provided the future path of the Swedish economy was in line with the Riksbank's assessment, the repo rate hike created conditions for keeping the repo rate unchanged for the rest of the year. This picture was also conveyed later on in the minutes of the Board's monetary policy meeting on 11 November.

The analysis in the Inflation Report is in line with the assessment that was made in connection with the Board's decision to raise the repo rate 0.35 percentage points. The policy group also noted that market players and analysts expect today's Board meeting to result in an unchanged repo rate. In the light of earlier statements and the deliberations in connection with the previous decision, the group therefore considered that the repo rate shall not be changed at today's meeting.

In the Inflation Report it is judged that, taking the risk spectrum into account, the rate of UNDI_X inflation one year ahead will be 1.9 per cent and after two years 2.3 per cent. Thus, inflation is judged to be somewhat above the target two years ahead but somewhat below it in one year's time. In this context the group drew attention to the fact that monetary policy is formulated with a time horizon of 1–2 years. Where the emphasis is placed inside this interval is a matter of judgement. UNDI_X inflation will be somewhat below the target for the greater part of the forecast period. The inflation assessment in the Inflation Report is accordingly compatible with a decision to keep the repo rate unchanged.

At the same time, economic activity is becoming increasingly strong and inflationary pressure is rising successively. Against this background the policy group considered there were grounds for already underscoring that if the economy develops as currently envisaged by the Riksbank, in the future monetary policy cannot continue to be as expansionary as it is at present.

3.2 The Board's discussion

The members of the Executive Board all underscored that the decision on 11 November 1999 to raise the repo rate by 0.35 percentage points had aimed to 'clear the air' for the rest of the year. The economic picture in the current Inflation Report is broadly the same as in the October Report and well in line with the economic assessment at the monetary policy meeting on 11 November. The Swedish economy is in a strong upward phase with gradually growing price pressure. Additional features include a somewhat stronger oil price trend and the Riksbank's repo rate increase in November.

Four Board members noted that inflation is judged to be just under 2 per cent one year ahead but somewhat above 2 per cent in two years' time. These members considered that, given the precision that is reasonable to aim for, inflation one to two years ahead can be said to be approximately in line with the target. In their opinion, the air has been cleared up to the turn of the year and today's decision shall leave the repo rate unchanged at 3.25 per cent.

A fifth Board member pointed out that the October Inflation Report had shown that inflation two years ahead would be virtually on the target. On that occasion the repo rate had been left unchanged. At the November monetary policy meeting this member had considered that the forecast should not be altered. An interest rate increase was therefore not called for, particularly as a new Inflation Report with a more comprehensive assessment would be available in some weeks' time. Moreover, an increase might lead to the perception that the Riksbank does not act symmetrically. In the light of the new Inflation Report that has now been produced, the member considered that a repo rate increase could be warranted notwithstanding the earlier increase of 0.35 percentage points. The member also pointed to the danger of statements by Board members generating expectations whereby the Board is already tied to reaching a particular decision before the monetary policy meetings are held.

In the opinion of the sixth Board member, inflationary pressure is somewhat higher than the other members consider but it is important to adhere to the Riksbank's earlier signals that the repo rate would be kept unchanged for the rest of the year. Since the previous monetary policy decision, nothing remarkable has occurred to alter this picture. This member was therefore also in favour of an unchanged repo rate at present.

All the members underscored that in view of the strong and broad economic upswing and successively rising inflationary pressure, there are grounds for already emphasising in connection with today's monetary policy decision that in the future monetary policy cannot continue to be as expansionary as it is at present.

One member noted that according to survey data, expectations of inflation five years ahead have now risen somewhat above the inflation target. This member considered that the Board must keep a close eye on the future path of inflation expectations. Moreover, the inflation assessment in the Inflation Report points to a successive

acceleration of wage increases and higher domestic inflation; this is countered by a low import price trend that is, however, tending to become stronger. The restrained increase in import prices presupposes in turn that there is a gradual effective appreciation of the krona and that oil prices fall successively from current levels. The member also noted, however, that the recent wage statistics are not alarming and that this contributed to the argument for a decision today to leave the repo rate unchanged. Another member agreed about the importance of monitoring inflation expectations but saw a danger in focusing on isolated survey data. Results from surveys must be assessed continuously in the light of other indicators that can yield information about inflation expectations.

Two Board members emphasised that the significance of deviations from the inflation target of one or a few tenths of a percentage point should not to be exaggerated and that it is important to bear in mind that the forecast horizon is normally 1–2 years. They also considered that repo rate adjustments should not necessarily be made in such small steps as has previously been the case.

§3. The Board's decision

The Chairman summarised the monetary policy discussion under §2 and noted that a majority of the members of the Executive Board considered that the repo rate should be kept unchanged.

The Chairman then proposed that the Executive Board decides

- that for the time being the repo rate be kept unchanged at 3.25 per cent and that this decision be effective from Wednesday 15 December, and
- that the decision on an unchanged repo rate be announced at 9 a.m. on 9 December with the motivation and wording contained in the draft of Press Release no. 82, Annex B to the minutes.

The Executive Board decided in accordance with the proposal.

This minute was immediately confirmed.