No. 8:2

SEPARATE
MINUTES of the Executive Board meeting on 4 May 2000

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

---

Sven Hulterström, Chairman of the Governing Council

---

Kerstin Alm
Claes Berg
Mårten Blix (§1)
Hans Dillén (§1)
Anders Eklöf
Björn Hasselgren
Leif Jacobsson
Per Jansson
Hans Lindblad (§1)
Christina Lindenius (§1)
Fredrika Lindsjö
Robert Sparve
Annica Svensson
Åsa Sydén
Eva Uddén-Jondal (§1)
Staffan Viotti
Anders Vredin (§1)
Helena Öström (§1)

## §1. Monetary policy discussion

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

The meeting began with a discussion of the factors in economic developments in Sweden and the rest of the world that are of importance for inflation prospects and the formation of monetary policy (section 1 below). The discussion of each aspect started from the analyses and assessments that had been made in the Economics Department and the Monetary & Exchange Rate Policy Department. These analyses and assessments were based on the technical assumption that the Riksbank's repo rate would be unchanged at 3.75 per cent up to the end of March 2002. The members of the Executive Board then summarised their views of inflation prospects (section 2) and presented their conclusions about the monetary policy situation (section 3).

## 1. Economic developments in Sweden and elsewhere

### 1.1 Prices in Sweden

The Board first noted that in the past month the rate of inflation, measured as the 12-month changes in UND1X and the CPI, had been marginally lower than foreseen in the March Inflation Report. Underlying inflation in March, measured by UND1X, had been 1.6 per cent, which is 0.2 percentage points less than had been assumed in the forecast; CPI inflation had been 0.1 percentage point less than forecast or 1.4 per cent.

The deviations were mainly due to a somewhat more marked price fall than expected for electricity and telecom products. Import prices to producers had also been weaker than assumed in the forecast.

The producer price tendency in recent months had been weak, mainly as regards consumer and investment goods. Input prices, on the other hand, have recently been rising faster, which indicates that prices in later stages of production may move up in the future. The latest business tendency survey points in the same direction, in that a growing proportion of manufacturers are planning to raise producer prices.

### 1.2 International activity and inflation

In the March Inflation Report it had been judged that GDP growth in the OECD area would be just over 3 per cent this year, almost 3 per cent in 2001 and 2.5 per cent in 2002. The rate of inflation had been judged to move up in this period to 2 per cent in 2002.

The Board noted that the upswing in the global economy is continuing on a broad front. Growth in the United States remains good. In recent months there have been signs of some increase in inflationary pressure; the oil price rise has contributed to this but even excluding its effects, the inflation tendency is somewhat upward.

The increased inflationary pressure has led to market expectations that the Federal Reserve will adjust the fed funds rate upwards by more than expected earlier. This has probably contributed to the more nervous mood on the U.S. stock exchanges. A number of Board Members noted that these factors have probably tended to heighten the risks in the U.S. economy. One of these members underscored that the imbalances in the United States have gone on growing and that the recent share price movements could presage a more pronounced stock market fall, with possible repercussions on growth in the United States as well as elsewhere. Another of these members emphasised that the stronger price pressure will probably call for large interest rate adjustments and this may lead to larger economic fluctuations. One member considered, however, that the new features — some accentuation of price pressure and expectations of a tighter monetary stance — may lead on the contrary to more reasonable stock market valuations and thereby a more moderate economic adjustment.

In the euro area, the recent statistics confirm the March Inflation Report's picture of an increasingly firm economic upswing with a moderate inflation trend excluding energy prices. But in view of the high oil price and a weak euro, HICP inflation in the euro area this year may be somewhat higher than assumed in the March Report.

In the Nordic area the Board judged that growth appears to be somewhat stronger than assumed in the Inflation Report. One member considered that the labour market problems in Norway and Finland may render the future trend in those countries more uncertain.

All in all, the Board found that the international economic upswing that had been foreseen in the Inflation Report has been confirmed and, if anything, become somewhat more pronounced. One member considered that the international trend would probably be stronger than assumed in the Inflation Report, mainly due to the robust development of the U.S. economy and reciprocal reinforcements from concurrent upswings elsewhere.

### 1.3 Financial markets

The Board noted that in the interval since the Inflation Report was compiled in March, international bond rates have fallen. Bond rates in Sweden have broadly followed the trend abroad. Since the forecast in March, the Swedish ten-year rate has moved down around 0.4 percentage points and this has narrowed the differential with the German rate to around 0.2 percentage points. The downward movement in Sweden as well as abroad has been somewhat more marked that had been assumed in the Inflation Report. The Board accordingly concluded that in the near future bond rates will be lower than assumed in the March forecast.

The Board noted that market pricing indicates expectations of further interest rate hikes by the Federal Reserve as well as by the Bank of England and the ECB. As regards Swedish monetary policy, both survey data and market pricing point to expectations of a repo rate increase of 0.25 percentage points before the summer. In the longer run, survey data represent expectations that the repo rate will have been raised to 4.4 per cent six months ahead and to almost 5 per cent after twelve months. One member stated in this context that inflation prospects in Sweden are currently more favourable compared with the euro area. It is not unreasonable to believe that this will have an effect on the relative level of short-term interest rates.

The Board noted that the krona's TCW exchange rate is currently around 121 and has accordingly appreciated somewhat more than had been assumed in the Inflation Report. The krona has appreciated mainly against the euro, whereas it has weakened against both the U.S. dollar and sterling. The recent appreciation may mean that, compared with the assumption in the Inflation Report, the krona will be stronger in the short run but the Board did not find grounds for revising the earlier assessment of the longer run.

Share prices in the rest of the world have fallen and also fluctuated markedly in recent weeks. The price corrections have been greatest for shares in the information technology sector in that investors have adjusted portfolios away from IT and telecom shares in favour of more traditional sectors. Swedish IT shares have broadly followed the trend abroad. Option prices suggest that the degree of uncertainty on the Swedish stock exchange remains high and that the probability of falling prices is somewhat greater than the opposite.

### 1.4 Import prices

In respect of import prices for commodities and intermediate goods, the Board noted that since the Inflation Report the price of oil has come down in connection with the decision by the oil-producing countries to expand output. But the future development of oil prices is highly uncertain; it will depend to a high degree on the extent to which the commitments to increased production quotas are met, as well as on how great the need is to replenish stocks, which are currently low. Two Board members underscored that, partly on account of this uncertainty, there are no grounds at present for revising the earlier oil price forecast. Another reason for keeping the forecast unchanged is that both spot and forward oil prices have recently tended to rise again. The Board supported this view.

Other commodity prices have broadly followed the forecast. One member pointed out that the price trend for non-oil commodities and intermediate goods has probably been underestimated and that the increase in these prices may be greater than assumed in the Inflation Report.

Together with the krona's recent appreciation, the weaker import price tendency for manufactured goods suggests that the import price forecast for 2000 may need to be revised downwards.

### 1.5 Demand and supply

GDP growth in Sweden was judged in the Inflation Report to be 4.0 per cent this year, 3.5 per cent in 2001 and 2.6 per cent in 2002. The rapid growth was assumed to bring the unutilised resources successively into production during the forecast period but the risks of widespread capacity restrictions were still judged to be relatively limited.

Household consumption in the coming years was assumed in the Inflation Report to be strong and this has been confirmed by the new statistics. The retail turnover figures show a growth rate that remains strong and is tending to accelerate. As previously, the increase is most pronounced for durable goods. New car registrations in the first three months of this year were 7 per cent up on the same period last year, which is in line with expectations.

Persistently high rates for growth of the money supply and lending to households likewise confirm a continuation of strongly rising consumption. A matter that has to be taken into account in this context is the recent stock market unrest. Since the Inflation Report the Stockholm Exchange has fallen around 12 per cent as measured by Affärsvärlden's general index. The Board noted, however, that the level after this fall is the same as at the end of January 2000, when the 12-month increase in share prices amounted to 60 per cent.

The Board therefore concluded that to date the stock exchange has gone through a moderate correction with direct effects on consumption that should be relatively small. To this should be added the opposite indications from strong retail turnover and somewhat lower long-term interest rates. One Board member pointed out that some share price correction had already been incorporated in the forecast. The Board also noted that the consequences of any effects of the share price fall on household expectations are difficult to gauge.

One Board member outlined two conceivable scenarios for private consumption. In one of them, a strong trend for household income can lead to rising consumption over a period when durable goods need to be replaced, followed by a return to a more normal level. This mirrors the assumptions in the Inflation Report. In the other scenario, expectations of increased lifetime incomes as a consequence of altered conditions in the economy may point to new patterns in the upswing for private consumption, so that this continues over a longer period than used to be normal. The member concluded that the recent share price movements have possibly reduced the probability of the latter alternative.

The Government's Spring Bill shows that the general direction of fiscal policy is broadly unchanged. The earlier budget targets still apply, notwithstanding some shift from tax cuts to increased spending. Proposals in the Bill aim to improve local government finances this year, which may call for some upward revision of the forecast for public consumption.

Recent statistics support the Inflation Report's assessment of investment and could even point to a somewhat stronger trend. A continuation of strongly rising activity in manufacturing is indicated by the Purchasing Managers Index for March, the latest quarterly business tendency survey from the National Institute of Economic Research and the inflow statistics for both domestic and export orders. Other factors that should be considered are the lower bond rates and the development of share prices.

The picture of the labour market broadly agrees with what was foreseen in the Inflation Report's main scenario. Although labour demand remains strong, however, the statistics suggest that the increase in employment may have slackened; this could be a reason for some downward revision of the employment forecast but the Board underscored that at present the assessment is uncertain.

The strong demand for labour does not seem to have affected the development of wages to date and the statistics show that, on the contrary, the forecast for this year may need a further downward revision.

The Board noted that the members of the teachers unions have voted to reject the wage settlement that was presented recently. Some Board members considered that this will not necessarily exert a negative influence on the coming round of wage negotiations; perhaps the effects could even be positive. The institutional changes in the labour market in connection with new negotiating procedures and settlement structures herald an outcome of the round that is favourable in a historical perspective. There also seems to be a broad awareness in the trade union movement of the degree to which wages can be increased so that the inflation target is not threatened. Other Board members, on the other hand, were somewhat less optimistic about the coming round of wage negotiations and expressed certain fears about union representatives' support from their members in a situation where the labour market is expected to become increasingly tight.

The Board also noted that the number of unfilled job vacancies is still rising, which may be an indication of certain labour market problems with matching. One Board member mentioned in particular that the strong upswing does not yet seem to have led to any bottleneck problems. One conceivable explanation for this might be a rapid increase in labour supply. However, some Board members underscored that the labour market statistics are difficult to interpret. One of them emphasised the importance of the Riksbank making a closer study of, for example, the shortage figures for different segments of the labour market in order to form a good picture of labour market tendencies and their implications for wage developments.

All in all, however, there were considered to be no grounds at present for revising the wage forecast for 2001 and 2002 that had been adopted in March. One Board member did consider that the state of labour market supply and demand would generate stronger upward pressure on wages than had been forecast in the Inflation Report.

A number of Board members found it important, in connection with future assessments of inflation, to study effects of alternative scenarios for activity in 2001 and 2002. At the same time, one of them pointed out that the inflationary effects of stronger activity could be countered, at least in part, by a development of productivity that is better than assumed earlier.

The assumptions behind the latest forecast of an economic slowdown in 2001 and 2002 included a cyclical consumption of durables that resembles the earlier pattern, an appreciation of the krona and some slackening of growth in the rest of the world towards the end of the period. Several Board members considered these arguments are good but that there is always a possibility of the historical pattern in the consumption of durables changing as a result of growing demand for new products for telecom technology, for example. One Board member cited the recent trend in the U.S. economy as an example that growth, instead of slackening, can remain high over a long period. Another member argued, however, that long business cycles are a normal feature of the U.S. economy and should therefore not be seen as a characteristic of the past decade.

All in all, the Board found that the recent statistics support the picture of strongly rising activity. One member considered that growth may become even higher than assumed in the Inflation Report, mainly on account of stronger private and public consumption.

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

In the March Inflation Report it was judged that deregulations and trade liberalisation would have downward effects on CPI inflation of 0.3 percentage points this year and 0.1 percentage point in each of the next two years. In view of the comparatively large price reductions for telecom products in March, this year's retardation of inflation from these prices may be somewhat greater than assumed in the Inflation Report.

In the Inflation Report, the effect on inflation from changes in indirect taxes and subsidies was judged to be small. No new changes in indirect taxes were proposed in the Spring Bill but there were indications that price effects from the property tax may be somewhat greater than assumed in the Inflation Report. At present, however, there are no grounds for altering the assessment in the Report.

Assumptions were also made in the Inflation Report concerning political decisions about a maximum day nursery charge, which affects the underlying rate of inflation as measured by UND1X. In the Spring Bill the Government stated that the gradual introduction of a maximum charge is to be postponed until 2002; this shifts the price effect one year ahead at the same time as the total effect on CPI inflation may be greater.[1]

## 1.7 Inflation expectations

Three surveys of inflation expectations have been published since the time of the March Inflation Report.

According to Statistics Sweden, households revised their expectations of inflation one year ahead upwards by 0.3 percentage points in March to 2.1 per cent. In April, however, these expectations were revised downwards again by 0.5 percentage points to 1.6 per cent.

Firms in the manufacturing and services sectors revised their one-year expectations marginally downwards in March to 1.6 and 1.4 per cent, respectively, according to the business tendency survey by the National Institute of Economic Research.

[1] Day nursery charges are not included in the CPI at present but the Riksbank has assumed that they will be included as of 2001.

Prospera' survey shows that inflation expectations were revised upwards in general from January to April this year but some revisions were downwards. Purchasing managers in manufacturing were the only category whose inflation expectations were consistently revised upwards, by 0.2 percentage points, for all time horizons.

The Board accordingly concluded that expectations of inflation one to two years ahead are broadly around the inflation target.

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

The 12-month rate of CPI inflation was judged in the Inflation Report's main scenario to be 1.3 per cent in March 2001 and 2.1 per cent in March 2002. The underlying rates of inflation, measured as UND1X, were judged to be 1.6 and 2.1 per cent, respectively. As the risk spectrum was considered to be balanced, the inflation forecast in the main scenario coincided with the inflation forecast adjusted for risks.

### 2.1 The monetary policy group's view

The Board's discussion of inflation prospects was preceded by a presentation of a corresponding discussion in the Bank's monetary policy group.[2]

The monetary policy group had considered that the incoming information did not decisively alter the picture of inflation that had been presented in the March Inflation Report. Mainly as a consequence of lower prices for telecom products and a weaker import price tendency, however, it was foreseen that in the rest of this year UND1X inflation would be somewhat lower than expected earlier.

### 2.2 The Board's discussion

The Board noted to begin with that in the ensuing discussion of inflation prospects and the formation of monetary policy, it is reasonable in the current situation to disregard the calculated effects from indirect taxes, subsidies and interest expenditure because these factors are not judged to exert a permanent effect on either inflation or inflation expectations.

Five Board members concluded that in the light of the information received since the publication of the March Inflation Report, there were no grounds for an appreciable revision of the forecast for UND1X inflation one to two years ahead. The picture of a strong and stable economic upswing in Sweden still holds. The unutilised resources will no doubt be brought into production by degrees but at present there are no signs of risks that serious capacity restrictions will occur.

---

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

All the Board members judged, however, that UND1X inflation this year will be somewhat lower than expected earlier, mainly because the import price tendency is likely to be somewhat weaker and the price fall for telecom products more pronounced than had been assumed in the Inflation Report.

One Board member adhered to a previous divergent opinion that towards the end of the forecast period UND1X inflation will be higher than forecast in the Inflation Report. This member foresaw stronger growth, in the Swedish economy as well as in many other economies, than had been allowed for in the Inflation Report. The combination of low flexibility in the Swedish labour market, a lack of competitive conditions and a higher rate of domestic growth was considered to indicate that, with an unchanged repo rate, inflation will exceed the targeted rate.

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

### 3.1 The monetary policy group's view

The monetary policy group had considered that the information received since the March Inflation Report favoured an unchanged repo rate. In the discussion it had been pointed out that, strictly speaking, the fact that UND1X inflation was expected to be below the inflation target for a large part of the forecast period could even indicate that the repo rate should be lowered. The policy group had agreed, however, that the prospect of strong economic activity and rising inflation beyond the end of the forecast period implied that the interest rate should not be altered at present. This was also the outcome expected by market players.

### 3.2 The Board's discussion

Five Board members shared the view of the monetary policy group that the information received since the March Inflation Report had not altered the picture of inflation prospects at all substantially, which favoured leaving the repo rate unchanged. At the same time, these members underscored that the picture of a stable and strong economic upswing in Sweden still holds.

One Board member with a different view of inflation prospects pointed out that this also implies a view of the formation of monetary policy that differs from that expressed by the majority. This member underscored that the monetary stance is currently expansionary, as is evident for example from the growth of credit and the money supply, at the same time as fiscal policy has become less restrictive. In a situation with strong economic growth, more or less full resource utilisation and the probability of inflation above the target towards the end of the forecast period, this member considered that the overall impact of economic policy should at least be neutral. Against this background the member advocated a repo rate increase.

This member pointed out, moreover, that the function of monetary policy is to be forward-looking and ensure price stability over time. Monetary policy should strive to contribute to a favourable environment for stable economic growth and not tend to generate imbalances that, while they do not perhaps affect the rate of inflation initially, may threaten stability in the longer run. Other Board members underscored that they fully support these statements about monetary policy principles but pointed out that for them, the premises led to the conclusion that the repo rate should be left unchanged at present.

## §2. The monetary policy decision

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

The Chairman then proposed that the Executive Board decides

– that the rate repo is to be held unchanged at 3.75 per cent and that this decision shall apply from Wednesday, May 10th, 2000, and

–that the decision be announced at 9.30 a.m. on May 5th, 2000 with the motivation and wording contained in the draft of Press Release no. 26 2000, Annex to the minutes.

The Executive Board decided in accordance with the proposal.

Deputy Governor Eva Srejber entered a reservation against the decision and stated that the repo rate should be raised 0.5 percentage points. Eva Srejber broadly adhered to the view of the Swedish economy and price developments that had been presented in her reservation against the Inflation Report at the Executive Board's monetary policy meeting in March.

This paragraph was immediately confirmed.