No. 1

SEPARATE MINUTES of the Executive Board meeting on 1 February 2001

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

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Sven Hulterström, Chairman of the General Council
Johan Gernandt, Vice-Chairman of the General Council

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Kerstin Alm
Malin Andersson (§ 1)
Claes Berg
Hans Dellmo
Jörgen Eklund
Kerstin Hallsten (§ 1)
Björn Hasselgren
Hans Lindblad
Christina Lindenius
Tomas Lundberg
Staffan Viotti
Åsa Sydén
Hanna Widell (§ 1)

§ 1. Monetary policy discussion

It was noted that Hans Dellmo and Jörgen Eklund would prepare draft minutes of §§ 1 and 2 on the agenda for the meeting.

The meeting began with discussions of the factors in economic developments in Sweden and the rest of the world that are presently most important for inflation prospects and the formation of monetary policy (section 1). The discussion of each aspect started from analyses and assessments compiled by the Monetary Policy Department on the basis of the technical assumption that the repo rate would remain unchanged at 4.0 per cent until December 2002. In conclusion, the members of the Executive Board 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 Price tendencies in Sweden

The Board noted that in December 2000 the 12-month rates of CPI and UND1X inflation were 1.4 and 1.3 per cent, respectively. CPI inflation was accordingly in line with the assessment in the Inflation Report, while UND1X inflation was 0.1 percentage point lower than expected.

For some components of the CPI and UND1X, however, the discrepancies between forecast and outcome were larger. The underlying rate of domestic inflation (UNDINHX) in December was somewhat higher (0.2 percentage points) than expected, while imported inflation was 0.8 percentage points below the forecast.

1.2 International activity and inflation

In the December Inflation Report it was judged that GDP growth in the OECD area would average 3 per cent this year and just under 3 per cent in 2002. The rate of consumer price inflation was judged to be about 2 per cent in both 2001 and 2002.

The Board noted that in the United States the latest statistics have shown weak tendencies for manufacturing activity as well as household consumption. Q4 GDP growth was 3.5 per cent in annual terms as against 5.2 per cent for Q3. Inflation has recently been stable around 3.4 per cent but the rate of producer price increases has slackened markedly. Bond rates have fallen from the level when the December Report was compiled. Leading indicators suggest that the economic slowdown has become both broad and deep. Applications for unemployment support have risen and the level of the NAPM index in December was the lowest since April 1991. Households have become less optimistic about the future, which is partly explained by falling stock markets. This has been accompanied by increased costs for corporate financing, as mirrored for example in the wider spread between corporate borrowing rates and the federal bond rate. Moreover, new bond and share issues among firms with low credit ratings have decreased sharply and this may accentuate the economic downturn. In order to counter the negative economic tendencies, during January the Federal Reserve’s instrumental rate was lowered twice, by a total of 1 percentage point.

In this context the Board discussed whether the slowdown in the United States would be brief or more protracted. All the members considered that, in view of the imbalances in the American economy, a risk of the slowdown being more protracted does exist. With reference to this, one member noted that adjusting economic imbalances of the type that are now present in the United States often takes a relatively long time. Another member considered that the current discussion about the U.S. economy cannot be confined to whether a quick upturn is feasible; an equally important question is how the imbalances will develop if the economy returns to full capacity utilisation. Due to low structural private saving in the United States, the deficit on current account is at a record level; what will happen to this, for instance in the longer run, if there is a sizeable structural weakening of the federal finances? In the opinion of a third member, there are no strong grounds for supposing that saving in the U.S. economy would automatically return to the previously low levels after a recovery. The low private saving is connected with special circumstances, such as optimism in the IT sector and greatly elevated share prices. At the same time, this member continued, when expectations change substantially, monetary policy may be relatively ineffective as a way of stimulating demand and this also speaks against a quick recovery. Moreover, the weaker economic prospects could lead to a depreciation of the dollar, which would narrow the scope for further interest rate cuts by the Federal Reserve. A member underscored the importance of trying to quantify how a marked economic downturn in the United States would affect the Swedish economy.

The Board noted that this year's growth in Japan also looks like being somewhat worse than foreseen in the Inflation Report, with weak tendencies for household consumption, investment, manufacturing output and exports. The weaker outlook in the United States may also affect future growth in Japan, in that about 30 per cent of Japanese exports goes to the United States and more than another 40 per cent to Asian markets from which about a third of exports go in turn to America.

All the Board members considered there are grounds for assuming that the economic slowdown in Europe will not be as marked as in the United States. The macroeconomic situation looks stable in many of the major countries in the euro area. Households, for example, are still optimistic, partly in view of expected tax cuts and a favourable labour market trend. One member observed that the expected tax cuts are occurring at the right time for a positive effect on household expectations. Another reason why the European slowdown will probably be milder than the American is that wealth effects of falling share prices will be smaller than in the United States. Moreover, as the IT sector is considerably smaller in Europe, the problems there are likely to be less than in the United States. Another factor is that debt levels among households and firms are lower than in the United States. Furthermore, interest rate expectations in the euro area have been adjusted downwards in the light of falling consumer and producer price inflation, the economic slowdown and the interest rate cuts in the United States.

All in all, the Executive Board found that most of the evidence now points to international economic activity being somewhat weaker than foreseen in the Inflation Report's main scenario. A weaker tendency was included as a factor in the Report's risk spectrum. Just how much weaker international growth will be depends on the duration and depth of the slowdown in the United States as well as on the effects of this in other parts of the world. The international economic slowdown and falling oil prices are judged to result in future price tendencies being more subdued than foreseen earlier.

1.3 Financial markets

The Board noted that in the interval since the forecast in the December Inflation Report was completed, the Swedish ten-year bond rate has followed the international path and fallen about 0.2 percentage points, to about 4.9 per cent. Contributory factors have been the international slowdown and the increased bond demand in connection with volatile stock markets. The level of share prices, as measured by Affärsvärlden's general index, is now about 4 per cent lower than when the December Report was completed. The differential with German interest rates has been stable in recent months at around 0.1 percentage point. The average Q4 level of the 10-year bond rate turned out to be about 0.1 percentage point lower than assumed in the Inflation Report. Against this background and the economic slowdown, the Board considered that in the forecast period the long-term interest rates will be somewhat lower than was assumed in the Inflation Report.

Market prices indicate that players expect further interest rate cuts by the Federal Reserve. Instrumental rate expectations in the euro area have also been adjusted downwards. Implied forward interest rates indicate that this year the ECB and the Federal Reserve will lower their instrumental rates by 0.5 and 1.5 percentage points, respectively. Expectations in the United Kingdom have also been revised downwards, though not as much. As regards Swedish monetary policy, survey data as well as market prices show a downward adjustment of expectations, so that players now believe the repo rate will be largely unchanged in the coming twelve months.

The Swedish krona's TCW index has fluctuated between 127 and 130 in recent months and is currently about 1 per cent weaker than at the time of the December Inflation Report. In December the Board had attributed the weak rate primarily to a combination of falling share prices, capital outflows in connection with more liberal investment rules for insurance companies from the turn of the year and a general financial unrest that is detrimental for the Swedish krona. The exchange rate fluctuations have increased since the December Report but market players count on them diminishing in the future. Partly against this background the Board found no strong reasons for altering the assessment in the December Report's main scenario.

1.4 Import prices

The price of oil has fallen faster than expected, partly due to the international economic slowdown and increased stocks of heating oil; an explanation for the latter may be that problems with shortages in shipping and refinery capacity seem to have diminished. Although oil prices tended to move up in January — in connection with colder weather in the United States and Europe, accompanied by expectations that OPEC would cut production — at about USD 25 the average barrel price of oil in January (up to the 23rd of January) was over USD 8 lower than assumed in the December Report. The Board noted that the expected economic slowdown points to lower demand for oil. Oil option prices as well as forecasts by other observers also indicate that the upside risk from the oil price has decreased. All in all, the Board considered that the forecast in the December Report's main scenario should be revised downwards.

The Board found that an unchanged forecast for the exchange rate, a downward revision of the oil price and weaker international price pressure lead to some downward adjustment of the predicted development of import prices in the forecast period.

1.5 Demand and supply

GDP growth in Sweden was judged in the December Inflation Report to be 3.9 per cent in 2000, 3.4 per cent in 2001 and 2.9 per cent in 2002. The comparatively high growth was assumed to mean that the unutilised resources would be brought into production successively during the forecast period.

The Board noted that GDP growth in 2000 Q1–3 from the corresponding period the year before was 3.9 per cent. However, the composition of growth differed somewhat from the assessment in the December Report. Public consumption and gross fixed investment were weaker than had been expected, while import growth exceeded the forecast. Moreover, stockbuilding's contribution to GDP growth was larger than expected.

Household consumption expenditure rose 4.9 per cent between the first three quarters of 1999 and 2000, which is in line with the December assessment. However, a number of factors suggest that future growth will be weaker. In Statistics Sweden's December survey of household purchasing plans, for example, households had become appreciably less optimistic about the national economy and unemployment. Moreover, the growth of retail turnover has slackened and growth of the money supply aggregates M0 and M3 has gone on falling since the December Report (some of the slowdown in growth of the money supply may, however, reflect effects from the turn of the millennium). One member noted that the timing of the tax cuts in Sweden is now turning out to be more suitable than there was reason to believe when they were decided.

Lending to the Swedish non-bank public has continued at a stable rate. One member pointed out that the signs of an economic slowdown in Sweden mainly refer to manufacturing, where they are primarily a consequence of weaker activity in the rest of the world. In the services sector, on the other hand, the trend is still strong. The January statistics on retail turnover, growth of the money supply (adjusted for effects of the millennium transition) and the continued expansion of credit all indicate that the international slowdown has not yet had sizeable effects on domestic demand. House prices have not changed appreciably since the December Report, while Affärsvärlden's general index has fallen about 4 per cent. All in all, the Board found that the latest statistics point to household consumption being somewhat weaker than assumed in the December Report.

No new information about public consumption had been obtained since the December report. The Board therefore saw no strong reason to revise the public consumption forecast.

Gross fixed capital formation rose 4.9 per cent in annual terms in 2000 Q1–3. In the December Report the increase in 2000 from the year before was judged to be 6.6 per cent. Although the business tendency survey shows that a large proportion of manufacturing firms did enlarge their production capacity in Q4, it seems probable — partly because the purchasing managers index shows an appreciable weakening of

demand for manufactured products — that the December assessment of industrial investment was rather too optimistic.
In construction, on the other hand, there are no signs of an imminent break in the positive trend and therefore no strong grounds for revising the forecast for residential investment. Investment in the non-industrial corporate sector may be slacker than expected, however, as a consequence of the weaker outlook in manufacturing. While the construction of networks for the third generation of mobile telephony will probably entail sizeable investments, their magnitude is still uncertain. One member noted that the timing of increased residential construction as well as planned investment in broadband facilities was appropriate for combating fixed investment's cyclical decline. All in all, the Board considered that the development of investment in 2000 and 2001 is probably weaker than expected earlier, while the outlook for 2002 is more uncertain.

The Board noted that stockbuilding's contribution to GDP growth in 2000 Q1–3 was 0.8 percentage points. Moreover, the National Institute's business tendency survey suggests a Q4 increase in manufacturers' stocks of finished goods, which may be an indication that the accumulation of stocks is partly due to decreased demand. All in all, the Board considered that stockbuilding constitutes some upside risk for last year's GDP growth and this has increased the probability of firms reducing stocks during 2001.

The development of net exports in 2000 Q1–3 was somewhat poorer than expected in that import growth was stronger than had been foreseen. In the light of weaker international prospects, reflected for example in falling net figures for export orders, and somewhat slacker domestic demand, the Board considered that some downward revision of both exports and imports in the coming years may be called for.

The Board noted that labour market developments were still favourable in the latter part of 2000 and that, at 2.2 per cent, the increase in the annual level of employment from 1999 was somewhat higher than had been expected. Even with a large inflow to the labour force during the year, open unemployment fell to an average level of 4.7 per cent, which is in line with the latest forecast. The average number of new job vacancies rose 17 per cent during 2000 and although the increase has slackened recently, most things suggest that employment will go on rising in the near future. The Board judged that the poorer economic prospects will probably lead to the employment trend being somewhat weaker than assessed in the December Report.

Total labour productivity rose about 2 per cent in annual terms in 2000 Q1–3, which is in line with the forecast for the whole year. There are signs, however, that late last year the employment trend was somewhat stronger than envisaged earlier, which may mean that the registered annual increase in productivity was marginally below the forecast. An economic trend that is weaker than expected earlier is likely to have some effect on productivity primarily during 2001 and perhaps also in 2002.

New statistics indicate that resource utilisation in the economy is still high but has fallen more than expected. In manufacturing, capacity utilisation dropped 3 percentage points in Q4, to 84 per cent. The proportion of firms reporting shortages of skilled workers and salaried technicians also tended to fall in Q4. The lower number of unfilled job vacancies indicates that labour shortages in the economy as a whole have decreased. Moreover, a decreased proportion of firms report that output is restricted mainly by supply factors such as machinery and plant capacity, labour supply and a shortage of other inputs. Delivery times shortened as well in Q4. In construction, on the other hand, resource utilisation shows no sign of declining; if anything, some increase is indicated by the proportion of firms reporting labour shortages. The picture in service industries varies somewhat but labour shortages there did not grow on the whole from Q3 to Q4. All in all, the Board considered that resource utilisation in the economy is still high but has fallen more than expected. The poorer economic prospects are judged to mean that future resource utilisation may also be less strained than was assumed in the December Report.

In the December Inflation Report wage increases were judged to average 3.5 per cent last year, 4.0 per cent in 2001 and 4.3 per cent in 2002. The Board noted that the statistics on wage outcomes in the first ten months of 2000, together with expectations of retroactive wage payments for local government employees, suggest that the rate of wage increases last year somewhat exceeded the forecast. Since the December Report was compiled, wage agreements have been completed for teachers as well as for three manufacturing sectors. The settlements are broadly in line with the development of wages in the December Report's main scenario. The three manufacturing agreements can set a standard for the remaining settlements in manufacturing and perhaps to some extent also for other sectors. The Board accordingly considered that the risk of a wage rise that is appreciably higher than in the main scenario has diminished. The risk of wage drift being higher than expected was also judged to have become somewhat smaller in view of a decreased labour shortage and the prospect of future resource utilisation being less strained than assumed earlier. It is important to note, however, that wage agreements have still to be concluded in large segments of the labour market, for example in economic sectors that are less exposed to competition, and that the wage demands there are comparatively high. This implies a risk for the overall development of wages.

All in all, the Board found that the new statistics since the December Inflation Report suggest that GDP growth in Sweden is probably slackening somewhat faster than foreseen in the main scenario. Although the tendency has not been dramatic, the weaker development of demand can lead to future resource utilisation being less strained than was foreseen in the latest forecast. The risk of inflation being higher than in the main scenario was therefore also judged to have decreased.

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

The downward CPI effect of deregulations and trade liberalisation was judged in the December Inflation Report to be –0.1 percentage point in both 2001 and 2002. The Board noted that the price ceiling on subscription charges for fixed telephony was abolished at the turn of 2000 and that in this context Telia has announced a price increase of about 20 per cent in March. The contribution from this to CPI and UND1X inflation amounts to just over 0.1 percentage point. To enhance competition, there have also been some legislative amendments as regards competition between firms in certain sectors but their effects on competition and price pressure are uncertain and largely depend on how the Competition Authority acts.

In recent Inflation Reports it has been assumed that the introduction of a maximum day nursery charge will have a downward effect on CPI and UND1X inflation of –0.3 percentage points in 2002. The charge is not included in the CPI at present, so the forecast presupposes that it is incorporated before January 2002. The CPI Inquiry's proposal that the charge be included in the CPI supports this presumption. But as the choice of method for measuring day nursery charges is both complex and controversial, the matter may take time to handle by the CPI Board. The Executive Board noted the uncertainty as to whether the inclusion of the charge can be arranged by January 2002; if it cannot, the introduction of a maximum day nursery charge will never show up in either the CPI or UND1X. This can result in registered inflation being higher than assessed earlier.

No new proposals involving changes to indirect taxes or subsidies have been presented since the December Report. The December contribution to CPI inflation from house mortgage interest expenditure somewhat exceeded the forecast, partly due to the repo rate increase early in the month. In view of falling bond rates recently and the downward revision of the future level of interest rates, however, the Board found grounds for adjusting the contribution to CPI inflation downwards by 0.1 percentage point in both 2001 and 2002.

1.7 Inflation expectations

According to Statistics Sweden, the one-year inflation expectations of households fell slightly in December, to 1.6 per cent from 1.7 per cent in November. At the time of the October Inflation Report the level was 1.8 per cent. On the other hand, the corresponding expectations among both manufacturing and services companies have risen somewhat since the October report, in both cases by 0.1 percentage point from 1.7 per cent to 1.8 per cent in December. The Board noted that inflation expectations continue to be well in line with the inflation target.

2. The Board's assessment of inflation prospects

In the December Inflation Report's main scenario it was judged that the 12-month rate of CPI inflation would be 1.8 per cent one year ahead and 2.1 per cent after two years, while the corresponding rates of UND1X inflation would be 1.8 and 1.9 per cent. When the risk spectrum was taken into account, it was judged that both CPI and UND1X inflation would be in line with the inflation target after one year and above the target after two years.

2.1 The monetary policy group's appraisal

The Board's discussion of inflation prospects was preceded by an account of a corresponding discussion in the Bank's monetary policy group.[1]

In the opinion of the policy group, the Riksbank's repo rate increase of 0.25 percentage points, to 4 per cent, in December, together with weaker international activity, is helping to subdue future price pressure in the Swedish economy. It is developments in the United States that will largely determine the future course of both the global and the Swedish economy. Conditions for a quick economic recovery exist in the United States but it is difficult to determine whether the considerable imbalances there render this feasible.

Oil prices have been somewhat weaker than expected earlier and the present picture of international economic prospects reduces the risk of the oil price exceeding the forecast. As regards the exchange rate, on the other hand, the policy group saw no reason to revise the earlier assessment. The main scenario's appreciation still seems reasonable in relation to economic fundamentals. But a weaker exchange rate continues to be a risk. Expectations of decreased short-term interest rate differentials, for instance between the United States and Sweden, speak for an appreciation of the krona. In the past, however, the krona has weakened during periods of international unrest; the krona's path against the euro since the December Report was considered to point in this direction. The policy group also noted that the wage agreements which have been concluded to date are not a substantial threat for inflation, though the end result for wage increases remains uncertain, partly because settlements have not yet been reached for large sectors of the labour market. All in all, the policy group judged that compared with the December assessment, inflation prospects have become somewhat more favourable.

2.2 The Board's discussion

Monetary policy's target is to keep CPI inflation at 2 per cent. However, if CPI inflation is affected by factors that are judged to have no permanent effect on inflation, there may be reasons for deviations from the target. Examples of such factors are changes in interest expenditure, indirect taxes and subsidies. Thus, there may be situations in which there are grounds for basing monetary policy on an assessment of UND1X instead of the CPI. Monetary policy was formulated on the basis of UND1X in December and the Board saw no reason to change this.

The Board noted that international economic activity appears to be developing somewhat more weakly than expected earlier and there may be cause for a downward revision of the assessment of export markets of importance for Sweden. Together with

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[1] 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.

a lower oil price, this means that the aggregate inflationary impulses from abroad will probably be lower than assumed in December.

Since the December Inflation Report was published, the price of oil has fallen sooner than expected and in view of the poorer economic prospects, it was assumed that throughout the forecast period the oil price will be lower than foreseen at that time. It was accordingly considered that the oil price no longer poses the same threat for price developments as before. As regards wage developments, it was judged to be too early to draw any definite conclusions from the wage agreements that had been completed since the previous forecast. The risk of a significantly higher wage trend than in the main scenario in the December Report was thought to have decreased.

In the main scenario in the December Report the Riksbank had judged that the krona would continue to be relatively weak. The exchange rate was included in the risk spectrum as a factor that could be worse than forecast in the main scenario and thereby contribute to higher inflation.

All the Board members considered there was no reason to revise the exchange rate forecast. Their opinions differed, however, about the risk of the krona deviating from the path in the main scenario. Three members adhered to the December assessment that there is still a clear risk of the krona not appreciating along the lines assumed in the main scenario. One of them considered the krona had previously had difficulty in holding its own in periods of turbulence and concern about the international economy; neither had the krona appreciated against the euro in the way that would be natural when the euro recovers against the U.S. dollar. The fourth and fifth members considered, on the other hand, that expectations of lower exchange rate volatility for the krona, a more stable stock-market trend and expectations of a decreased instrumental rate differential with the rest of the world, implied that the risk of a weaker krona had diminished.

One member pointed out that the Swedish economy is still developing fairly well. The continuation of strong credit growth and a favourable development of retail trade were cited as examples. This member underscored that some slowing of international activity can contribute to a quicker adjustment of demand to the long-term growth rate and thereby reduce the risk of tensions in the economy. In the light of this, the member wondered whether the Swedish economy might not achieve a soft landing. Another member pointed out that increased residential construction, expected investments in broadband facilities and conceivable tax cuts can secure the continuation of a positive trend and lessen the risk of a more substantial downturn. In the opinion of a third member, however, talk of a soft landing is premature. But all three members noted that future resource utilisation may be less strained than foreseen earlier. On this point the remaining Board members concurred.

3 The Board’s assessment of the monetary policy situation

3.1 The monetary policy group’s appraisal

The policy group noted that the overall inflation assessment in the December Report had pointed to the rate of UND1X inflation at the end of the twenty-four month period being 2.3 per cent and that this could have motivated a somewhat larger repo rate increase than was actually made at that time. The information that had become available since then showed that activity was slowing somewhat faster, accompanied by a decreased risk of appreciable upward deviations from the Report's main scenario. In view of the inflation assessment in the December Report, the December repo rate increase and the assessment of subsequent economic developments, the policy group judged that the repo rate should be left unchanged at 4.0 per cent.

3.2 The Board's discussion

All the Board members shared the policy group's assessment. There has been some change in the risk spectrum. The oil price has fallen faster than expected and to date the round of wage negotiations does not seem to have led to wage levels that risk threatening price stability. A member who had not concurred with the assessment in the Inflation Report noted that as the recent statistics speak in favour of a downward revision of inflation, this could motivate a repo rate cut. However, in view of the uncertainty in the assessment and the perception that frequent upward and downward repo rate adjustments should be avoided, this member saw no cause to alter the repo rate.

§ 2. The monetary policy decision

The Chairman summarised the monetary policy discussion under §1 and noted that an unchanged repo rate had been proposed.

A vote was taken and the Executive Board decided that the repo rate is to be held unchanged at 4.0 per cent, that this decision shall apply from Wednesday, 7 February, and that the decision be announced at 11.00 a.m. on 15 February with the motivation and wording contained in Press Release no. 7 2001 (Annex A to the minutes).

This paragraph was immediately confirmed.