No. 9

SEPARATE MINUTES of the Executive Board meeting on 5 July 2001

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

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Johan Gernandt, Vice-Chairman of the General Council

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Claes Berg
Mårten Blix (§ 1)
Hans Dellmo
Jörgen Eklund
Mats Galvenius
Kerstin Hallsten
Björn Hasselgren
Leif Jacobsson
Ann-Kristin Johnsson
Javiera Ragnartz (§ 1)
Annika Svensson (§ 1)
Åsa Sydén
Anders Vredin
Martin Ådahl

§ 1. Monetary policy discussion

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

The meeting began with a discussion of the economic factors in Sweden and the rest of the world that are currently 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 the end of June 2003. 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 May the 12-month rates of CPI and UND1X inflation were 3.0 and 3.1 per cent, respectively, which in both cases is 0.1 percentage point higher than the assessment in the Inflation Report in May. The outcomes differed from the forecasts primarily due to domestic price pressure being stronger than expected, at the same time as this was only partly offset by imported inflation being somewhat lower than anticipated.

Domestic underlying inflation (UNDINHX) in May was 3.8 per cent or 0.5 percentage points higher than the forecast rate. Just as earlier in the spring, price increases exceeded expectations for a number of items, for example petroleum products and food, that were subject to specific supply factors. The outcome excluding these items was in line with the forecast.

1.2 International economic activity and inflation

In the Inflation Report in May it had been considered that GDP growth in the OECD area would average 2 per cent in 2001, 2.5 per cent in 2002 and almost 3 per cent in 2003. Consumer price inflation was judged to be 1.9 per cent in 2001 and 1.7 per cent in 2002.

The Board noted that recent statistics on the euro area point to growth being somewhat lower than assumed in the Inflation Report's main scenario. Manufacturing output, for example, had slackened in recent months. Retail turnover had also been weaker than expected and consumer confidence had declined. Although confidence is still relatively high, this suggests that the future development of household demand may be more subdued than expected earlier. One explanation for the restrained propensity to consume could be the increase in inflation.

In Japan, the recent development of manufacturing output and exports points to a continuation of falling activity. GDP growth in Q1 was 0.1 per cent lower than a year earlier and consumer prices went on falling. Structural reforms are expected to act as a temporary damper on growth in the coming year.

In the United States, the latest statistics suggest that developments will be approximately in line with the forecast in the Inflation Report. The slowdown in manufacturing seems to be continuing and in spite of rapid stock adjustments there are still no clear signs of a recovery in the production of industrial goods. Moreover, the poorer international economic prospects and a persistently strong dollar are judged to have a negative effect on future investment as well as net exports. Some forward indicators do, however, point to manufacturing becoming more stable or reaching a turning-point. Household consumption has remained comparatively strong and household optimism is still high. Revised figures show that Q1 GDP growth was weaker than expected but the downward revision mainly concerned the contribution from stockbuilding.
The poorer international economic prospects have been mirrored in the financial markets. In the period since the Inflation Report was compiled, stock markets have fluctuated widely and the tendency in most countries has been downwards. Credit spreads (between corporate bonds with low ratings and federal bonds) have been broadly unchanged in recent months in the United States but have widened in Europe. This indicates expectations of weaker activity in Europe. Long bond rates, finally, have tended to fall in the United States, the euro area and Japan.

Inflation has increased in recent months in the United States as well as the euro area; in May the CPI and HICP rates were 3.6 and 3.4 per cent, respectively. Price increases for energy and food, for example, contributed to the upward movement. But even underlying inflation rose somewhat in May in the euro area, whereas there was some fall in the United States. Prices in Japan have continued to fall at an increasing rate.

All in all, the Board considered that international growth prospects have become somewhat worse. There are signs of lower growth in Japan as well as the euro area. The outlook in the United States is still judged to lead to a gradual recovery there that spreads successively to other countries. But the uncertainty about international economic activity continues to be very large. The poorer outlook for growth is accompanied by the prospect of inflation this year being somewhat higher than expected in both the United States and the euro area, followed by a path in 2002 and 2003 that is approximately in line with the Inflation Report's main scenario.

1.3 Financial markets

The Board noted that since the time of the Inflation Report in May, the Swedish 10-year bond rate has been broadly unchanged. This has been accompanied by some fall in the German long bond rate and the interest rate differential has accordingly widened to between 0.3 and 0.4 percentage points. In the past month the nominal 2-year and 5-year rates have risen sharply and are higher than foreseen in the Inflation Report. This favours an upward revision of the paths of interest rates, at least in the short term. A Board member noted that during the winter the long bond rate in Sweden had been lower than in Germany, whereas now the opposite applies. The change can be attributed in part to the higher rates of inflation in Sweden during the late spring, so that inflation here has ceased to be so markedly below the European level. The short bond rates rose somewhat later in connection with expectations of a repo rate increase. This in turn seems to have been occasioned by, among other things, the appreciable weakening of the Swedish krona.

The picture of monetary policy expectations has changed in the past month; according to the June survey from Reuters, market players now expect a repo rate increase of about 0.25 percentage months in the coming three months and an increase of about 0.5 percentage points one year ahead. Two factors have contributed to this: the higher inflation figures and the weakening of the krona. In addition, there was the monetary policy signalling by Board members in the middle of June. Market pricing pointed unequivocally to a repo rate increase of 0.25 percentage points at the monetary policy meeting on 5 July; market analysts differed, on the other hand, with about half of them counting on an increase.
The Swedish krona's TCW index weakened markedly in late May and early June, to a low of 138.9. This was followed by some appreciation that seemed to be accentuated by the Riksbank's currency market intervention. Since the middle of June, however, the krona has fallen again and is currently about 2.5 per cent weaker than when the Inflation Report was compiled in May. This means that its path has been weaker than foreseen in the main scenario. There are a number of reasons for this: the weakening of the euro against the dollar, outflows connected with portfolio adjustments by Swedish investors, sales of Swedish shares by foreign funds and generally weak stock-markets. Other factors may have included weaker export activity and a deterioration in terms of trade on account of falling prices for major export items such as telecom products, motor vehicles, paper and steel. All in all, the Board considered that there are still grounds for counting on a future appreciation of the krona but that the weaker initial position makes it more difficult to presuppose a rapid improvement to the level in the Riksbank's earlier assessment. This means that there is now a larger risk of the krona's path being weaker than in the Inflation Report's main scenario, above all this year but to some extent also in the period twelve to twenty-four months ahead.

1.4 Import prices

The barrel price of oil rose strongly in May to a high of almost USD 30. Since then it has fallen successively as a result of a continued accumulation of stocks and weakening demand. Developments to date and oil option prices are judged to indicate that the oil price this year may be somewhat higher than expected but in the longer run there do not seem to be any strong grounds for revising the forecast. The world market price of petrol has been weaker than expected in the past month, partly due to rising stocks of petrol in the United States. The Board noted that the prices of other commodities and international export prices have broadly followed the assessment in the Inflation Report.

All in all, the Board considered that the weak import price tendency in May, together with the lower price of petrol, could mean that imported inflation in the coming months would be somewhat weaker than expected earlier. Some upward revision of the path one to two years ahead might be called for, on the other hand, partly due to the prospect of a weaker exchange rate and possibly also a somewhat larger pass-through from the exchange rate.

1.5 Demand and supply

In the Inflation Report it was judged that GDP growth in Sweden would slacken to 2.2 per cent this year and then pick up to 2.5 per cent in 2002 and 2.9 per cent in 2003. It was considered that this path would lead to total resource utilisation remaining high and broadly unchanged during the forecast period.

The Board noted that, notwithstanding Sweden's weak exchange rate, international prospects suggest that exports and, to some extent, even imports may be lower than expected, in the first place during 2001. This will probably lead to net exports being be more subdued than expected. The increase in household consumption expenditure has slowed; the Q1 rate of 1.2 per cent was lower than expected. Some factors that influence household consumption, for example share prices and house prices, have also developed less favourably than anticipated. At the same time, however, households' expectations of their own economy were broadly unchanged in June, accompanied by increased optimism about the prospects for unemployment and the national economy. Lending to households has gone on rising at a rapid rate.

The Board noted that manufacturing activity has continued to slacken, though there are signs that order inflows may have begun to stabilise. Construction activity is still good and orderbooks have become even stronger since the publication of the Inflation Report. Developments in retail trade vary; the rate of infrequent purchases has been weak, whereas the turnover of everyday goods has been comparatively good.

Gross fixed investment in Q1 this year was 5.7 per cent higher than a year earlier, which is broadly in line with the assessment in the Inflation Report. Survey data from Statistics Sweden also indicate that investment this year is in line with the forecast. The slackening of demand this year is an indication that investment next year may be somewhat weaker than foreseen in the main scenario. The Q1 figures for industrial stocks show an appreciable accumulation of stocks during the past year. The Q1 national accounts likewise show that stocks rose in annual terms, which may indicate that future stock reductions may be more marked than expected.

Employment has been developing strongly this year, although the growth rate has fallen back in recent months. Seasonally-adjusted data show a drop in employment from April to May. The number of new job vacancies went on falling in May and the number affected by dismissal notices has risen. The Board considered, however, that the strong employment trend to date this year may lead to an upward revision of the forecasts for the number in employment and the number of hours worked, in which case productivity growth would be somewhat lower than expected.

Preliminary data indicate that the total wage level in the first three months of this year was 3.1 per cent higher than in the corresponding period in 2000, which is less than expected. Since the publication of the Inflation Report a number of new wage agreements have been concluded and they are all in line with the forecast. The Board considered that although the low outcome to date this year could motivate some downward revision, the recent statistics are highly uncertain because they do not yet include retroactive wage payments. It is difficult to determine whether wages in 2002 will be in line with the forecast or somewhat weaker on account of lower labour demand. Weaker productivity, however, is judged to lead to somewhat higher unit labour costs. A Board member pointed out that the expected weakening of productivity rests on an uncertain assumption about the volume of hours worked.

All in all, the Board considered that the recent statistics suggest that growth this year will be somewhat weaker than envisaged in the Inflation Report. The picture of the coming years is not clear-cut. Domestic demand is still comparatively strong and there are signs that the slowdown in industrial activity is on the way to being checked. The effect that possibly somewhat lower resource utilisation might have on inflation could be countered by higher unit labour costs next year.

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

The National Post & Telecom Agency has required Telia to reduce the interconnection charge by about 17 per cent. Telia has appealed, however, and pending a final decision, the earlier price applies. Since the publication of the Inflation Report the Government has proposed a reduction of the tax on wine of SEK 5 per bottle as of 2002. The downward effect of this on CPI inflation next year would amount to almost 0.1 percentage point. The contribution to the CPI from house mortgage interest expenditure in May was more or less as expected.

1.7 Inflation expectations

Households' expectations of inflation one year ahead moved up in June from 1.9 to 2.4 per cent. Inflation expectations derived implicitly from market interest rates have also risen since the publication of the Inflation Report, from 2.2 to 2.7 per cent. A Board member noted that long bond rates in the industrialised countries have recently been around 5 per cent, which is 1–1.5 percentage points higher than during the economic slowdown in 1997–98. The member considered that today's higher level of interest rates is no doubt partly a result of higher inflation expectations. Another member remarked that in a situation with falling output and an increase in inflation generated from the supply side it is not surprising that long bond rates move up. Even if market players believe that the authorities in the West will remain committed to the low-inflation policy, under the prevailing circumstances it is reasonable to suppose that they see a somewhat higher probability of the authorities focusing more on prospects for growth than on inflation.

2. The Board's assessment of inflation prospects

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]

Deputy Governor Lars Heikensten commented initially on the currency market interventions. There is reason to come back to this matter with material for an evaluation and discussion in the autumn. He also intended to propose, in September at the latest, a process for the future preparation of interventions. A Board member welcomed this and agreed that it was still too early for a final evaluation of the interventions' effect. This member noted, however, that there had not been any "snowball effect" in the sense that other buyers of Swedish krona had been enticed into the market and reinforced the Riksbank's operations.

The subsequent discussion started from the Inflation Report that the Riksbank had presented in May. In the main scenario it had been judged that total resource utilisation was high and would be broadly unchanged during the forecast period. It was worth underscoring that this means that, once the transitory effects of price increases for petroleum products and food, for example, had disappeared, inflation would again gradually move up to and somewhat above the targeted level. In the public discussion that followed the publication of the Report this may not have attracted the attention it warranted.

The policy group considered that in the interval since the Inflation Report was published May, the international picture had not changed appreciably. Despite a weakening of activity in Japan and the euro area, a gradual recovery in the United States is still expected to boost global activity, a perception that is also evident in financial market prices. At the same time, inflation has risen internationally somewhat more than anticipated.

In Sweden, the recent statistics suggest that growth this year is slackening more than expected, while the picture of the coming years is not clear-cut. Manufacturing activity has admittedly weakened during the spring but there are signs that, for example, order inflows are beginning to stabilise. Meanwhile, domestic demand remains comparatively strong, supported by, among other things, a series of years with low interest rates and a slightly expansionary fiscal policy. Before the ongoing slowdown, the initial position in Sweden differed somewhat from other countries. Sweden has, for example, had a long period of very low inflation and low interest rates. This applies in particular in a comparison with the United States but to some extent also with the euro area. The effects of a monetary stance that has been expansionary for a considerable time are influencing developments at present and tending to counter the slowdown.

The spectrum of risks for inflation has changed to some extent since the latest Inflation Report, above all in that the Swedish krona has weakened from a level that was already low. Still, it is not the present value of the krona that determines monetary policy but a more long-term assessment of its impact on inflation. There is still reason to count on a future appreciation of the krona; this has to do with long-term factors

[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.

such as the current account as well as with cyclical factors such as the stock market trend and problems in certain export-dependent sectors that are depressing the exchange rate for the time being. However, the krona's weaker initial position does make it difficult to argue in favour of an appreciation of the magnitude that featured in the Riksbank's earlier assessment. An exchange rate that remains weak for a longer period would have consequences for inflation.

It is worth underscoring that one reason why the exchange rate has not had a larger impact on prices is that the public and firms have counted on an appreciation. If that does not happen, there is a risk that the expected real appreciation takes the form of higher inflation instead of a strengthening of the nominal exchange rate. That applies in particular when resource utilisation is comparatively high. There is also a notable connection with the temporary price increases. It is important that the supply-related, more transitory price increases are not allowed to affect the formation of other prices, too, and that expected inflation in the years ahead remains low. A persistently weak exchange rate can add to the difficulties here.

In the other scale there is somewhat greater uncertainty about economic activity as a result of a weak outcome and a somewhat larger downside risk. But this does not fully balance the effects of the krona's weakening in the current situation with relatively high resource utilisation and sizeable transitory price increases. A marked worsening of activity would be needed to offset the effects on inflation from an exchange rate that remains as weak as at present.

All in all, the policy group judged that with the risk spectrum taken into account, inflation prospects one to two years ahead point to a risk of the inflation target being exceeded.

2.2 The Board's discussion

In recent years the formation of monetary policy has been based on UND1X because the CPI has been affected by factors that are not considered to have a permanent effect on inflation. The Board found no reason to alter the formation of monetary policy in this respect. Monetary policy is therefore to be based on an assessment of UND1X inflation.

Three Board members expressed strong concern about the weak international economic tendency and the highly uncertain state of global activity at present. During the spring, growth forecasts have been adjusted downwards successively. These members noted that there will now clearly not be a rapid recovery in the United States and that, despite the interest rate cuts, financial markets are reflecting continued uncertainty. They were looking above all for a clear signal that activity in the United States will turn upwards. According to one of them, if the labour market in the United States does not improve in the near future, there is a risk of effects on private consumption and residential construction, which have restrained the decline to date.

These three members also noted that activity in the euro area, which absorbs more than half of Swedish exports, has clearly weakened and that this is particularly true of

Sweden's largest trading partner, Germany. They also pointed out that Japan is again threatened by recession. The growth forecasts, which had already been adjusted downwards for all three areas during the spring, have now been revised downwards again. They mentioned that it is very unusual for a slowdown to hit all the three leading economic areas simultaneously and that this conjunction is liable to have a marked impact on the Swedish economy. According to one of these members, an indication of the slowdown's force can be seen in the fact that in modern times the past year's fall in international industrial output has no parallel in a single year. According to these three members, this means that, until there are some signs of a clear upturn, in the coming years there is a risk of lower inflationary pressure from abroad. One of the members warned that numerous marginal adjustments to the assessments of particular factors during the forecasting work may lead to a conclusion that no major changes have occurred in economic activity at the same time as the forecast fails to catch the overall picture, which is dominated instead by a weakening of international activity.

Another Board member did not share the view that international economic prospects have deteriorated markedly since the Inflation Report and considered instead that developments have been broadly in line with what the Riksbank anticipated in the main scenario. The slowdown in the United States is continuing but the fall in manufacturing seems to be approaching a low. Order inflows are improving and activity in sectors, such as the automobile industry, that led the slowdown now appears to have stabilised or turned upwards. An exception is the IT sector, which will take some time to do away with the over-investment. Meanwhile, the development of private consumption, construction and house sales is stable. The assessment therefore continues to be that the slowdown in the United States will be relatively moderate and not particularly long. In Japan, the indicators point to further setbacks for a recovery and falling prices. An upturn is not to be expected until the structural problems have been tackled but there are some grounds for hoping that a thorough programme of Japanese reforms will be implemented. In the euro area it seems that the effects of the global slowdown have been accentuated, particularly in certain countries, by a fall-off in domestic demand, even though consumer confidence continues to be historically high. Still, the time lag between a slowdown in the United States and effects in Europe seems to be following the normal pattern. It is worth noting that despite the slowdown, growth is not expected to be particularly far from the euro area's potential rate.

If the slowdown in international activity does begin to level out, Swedish exports will be affected. The situation in manufacturing has weakened markedly from the highest level last year but there are now signs that the deterioration of order inflows has come to an end. Taken together, the manufacturing indicators do not signal a dramatic fall in the future; they point rather to a stabilisation of order inflows and output at levels that are rather good.

In the opinion of this Board member, however, the risk lies in the recovery being affected by weaknesses in the financial markets. If the return to high productivity growth in the United States that financial markets seem to count does not materialise, credit terms may be tightened. The stock-market fall could then spill over to other markets and sectors, capital flows to the United States could dry up and the relative prices of the world's major currencies could be corrected abruptly. According to this member, such a development would, however, create a completely new decision-making situation that would have to be handled if it arises.

A Board member considered that the discussion pointed to a dilemma. While some depict a gradual improvement in future international activity, others are very uneasy about a marked downturn in the United States. This member had for a long time shared the concern about activity being hit by a major shock occasioned by a rapid correction of the saving imbalances in the United States but now seemed to see that a more gradual correction is under way. At the same time, the exchange rate is a growing problem. While the possibility that international activity will be worse than forecast does constitute a risk, the krona's depreciation is already a fact. It is a fact that, in spite of stronger public finances and a more stable macro policy, the level of the exchange rate is the lowest since Sweden changed to a floating rate. It is currently 2.5 per cent weaker than foreseen in the forecast and that means that its expected path needs to be adjusted. The longer this situation lasts, the greater the risk that inflationary pressure rises and that inflation expectations and wages do the same. If reasonable allowance is made for the weakening of the krona and the future path of the exchange rate is adjusted so that it is weaker than in the Inflation Report, the weaker rate's impact on inflation would probably outweigh the effects of somewhat poorer international activity.

If the saving imbalances in the United States were still to begin a rapid and pronounced correction, there would then be a new situation in the global economy and the Riksbank would have to handle it. The risks of inflation have already increased and the single most important factor here is the weakening of the krona.

A Board member observed that the krona's expected appreciation has again come to the fore and considered that the part played by flows of portfolio investments has presumably been greater than expected. Foreign investors have had sizeable holdings of Swedish shares that they have disposed of at the same time as Swedish institutional investors have increased their holdings of foreign securities. The flow effects will diminish or be reversed when these portfolio rearrangements have been completed. This member also wondered what it is that would cause the exchange rate, which has been weak for so long, to have a larger impact on inflation in this particular cyclical situation and wanted to see a more thorough analysis of this.

Another Board member agreed that economic fundamentals really do indicate a stronger exchange rate and that an appreciation will occur, even though it may take somewhat longer. Yet another member considered that there is still a risk of a hard landing in the United States and this would entail a depreciation of the dollar and thereby an appreciation of both the euro and the Swedish krona.

Another member rejoined that the problem does not necessarily have to do with the krona's fundamental value. There are good arguments for a major appreciation; the question is when. There would now have to be a very marked appreciation in order to reach the average levels on which Riksbank is counting for 2001 and 2002; there is no direct evidence of that in the recent development.

A Board member asked which calculations there were to show where inflation would land, given an adjusted path for the exchange rate and a somewhat weaker development of international activity. It transpired that alternative risk assessments in connection with the previous forecast had pointed for that scenario to inflation being clearly above the target. According to those calculations, if the krona were to remain as weak as it is at present, the effects on inflation would be considerably greater than those from a further limited international slowdown.

A majority of the Board members expressed concern that, according to recent statistics, both observed inflation and households' expectations of inflation one year ahead had moved up. Opinions differed, however, about the risks of inflation expectations remaining permanently high and the extent to which they have been influenced by transitory price increases. The members' assessments of future resource utilisation in the Swedish economy also differed to some extent.
According to one member, resource utilisation may remain relatively high in that the decline in export markets is coming to an end and domestic demand continues to be good. Employment is still rising, albeit at a slower rate. As regards assets, share prices have admittedly fallen markedly but real estate prices have stabilised at a high level after prices increases in recent years, for both residential and commercial properties, that have been faster than in most other industrialised countries. This has been accompanied by a rapid expansion of credit, whereby the ratio of credit to GDP has risen above the average for industrialised countries. This year's growth of lending to the non-bank public is actually higher than in 2000. Notwithstanding the growth of credit and falling share prices, private sector balance sheets seem to be robust. All in all, this member found it most probable that a dramatic slowdown was not imminent, rather a growth rate in the vicinity of the Swedish economy's potential. The price increases indicate, moreover, that firms judge demand to be so good that there is a possibility of passing on increased costs to customers.

Another member rejoined that the weakening of the krona is the only factor that points to higher inflation. Other assumptions to that effect in the forecast are uncertain. The stock-market fall is likely to affect prices of other assets, which together would subdue demand. All in all, the spectrum of risks for inflation is balanced, as it was in the assessment at the previous monetary policy meeting. The economic slowdown can be expected to exert downward price pressure that should counter price increases connected with a weaker exchange rate.

Another member pointed out that in the course of this year the Riksbank has now revised growth downwards three times, from 3 per cent in December last year to 2.4 per cent in the March Inflation Report, 2 per cent in the Inflation Report in May and a current figure that is possibly around 2 per cent. The member considered that this ought to lead to lower capacity utilisation and ease resource utilisation in the Swedish economy. Pending signs of a recovery, there is no reason to alter the inflation forecast, this member said.

To sum up, a majority of the Board members considered that even though there has possibly been some fall in resource utilisation, the level will continue to be relatively high. A majority also found reason to count on a somewhat higher risk of inflation from import prices in that the krona would probably not appreciate as much as assumed earlier. Opinions differed, however, about the risks of a further deterioration in international economic activity. All in all, a number of members considered that with the risk spectrum taken into account, inflation prospects one to two years ahead indicated a risk of inflation exceeding the target, whereas other members saw an indication of inflation developing in line with the target.

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

3.1 The monetary policy group's appraisal

Altogether, the policy group saw a minor shift in the appraisal of inflation; including the risk spectrum, it now considered that inflation one to two years ahead would exceed 2 per cent by somewhat more than envisaged earlier. The upward revision of inflation stemmed from a combination of factors: high resource utilisation, albeit falling somewhat in the short term; a continued increase in inflation after transitory effects have ended; and a weak exchange rate. Together, these factors can lead to the spread of some uncertainty that inflation will not be 2 per cent in the future. At the same time, there is unquestionably considerable uncertainty about global economic activity and risks of a deeper slowdown are not lacking. Against this background, monetary policy faces unusually difficult choices. All in all, there was considered to be a predominance of reasons for raising the repo rate, which in Sweden is still low, by 0.25 percentage points.

It was underscored that in the event of a repo rate increase today, this should not imply further increases in the future. Neither is it a signal that the current picture of underlying inflation relative to growth in Sweden is worse than in the other countries. Just as in other countries, the increase in inflation is mainly a consequence of transitory factors. But monetary conditions in Sweden are more expansionary than in other comparable countries, primarily on account of the krona's low value.

3.2 The Board's discussion

The Board members agreed that the weakening of the krona affects the risk spectrum but opinions differed as to whether the significance of this should be accorded more as opposed to less weight than the downside risks associated with international economic activity.

Three members supported the proposal to raise the repo rate 0.25 percentage points. In view of the present situation — with inflation at around 3 per cent and some, albeit limited, indications of higher inflation expectations — they considered it important to send a clear signal that the inflation target is taken very seriously. They warned of the risk that inflation expectations might otherwise creep up more generally and found it significant in this context that inflation is currently closer to 3 than to 2 per cent. At the same time, with expansionary effects from the exchange rate and fiscal policy, an increase of 25 basis points was not judged to be an appreciable obstacle to continued economic growth in Sweden.

A number of Board members observed that the currency interventions had not been undertaken with an exchange rate target in mind. There is no particular value of the krona that is decisive for the interest rate; as always, the formation of monetary policy is determined by the overall assessment of inflation prospects one to two years ahead. Thus, the purpose of the interest rate increase is not to direct the exchange rate but to maintain price stability.

Three other Board members considered that at present there are not sufficient grounds for raising the interest rate and advocated an unchanged rate. The main reason for this is are the international risks, with great uncertainty and a considerable risk of a simultaneous decline in all the major economic blocs. If a clear turning-point is observed in the American economy, it will always be possible to return to this matter during the summer or autumn and tighten the monetary stance. In the opinion of these members, there are still no indications of such a turning-point and the uncertainty has, if anything, increased.

A Board member found it highly uncertain that a repo rate increase would affect the exchange rate and thereby import prices in the desired direction. The effect of an interest rate increase on inflation was accordingly uncertain. The tendency for an interest rate increase to subdue demand could well be countered by a negative exchange rate effect in connection with poorer economic prospects in Sweden.

Another member criticised the signalling of an interest rate increase in the event of the exchange rate not being strengthened; there was a risk of this restricting the Riksbank's room to manoeuvre. This member agreed with the preceding member about the great uncertainty that a repo rate increase would affect the exchange rate. The notion behind an interest rate increase would then be that reduced growth is needed to fulfil the inflation target, which the member found questionable in the present weak phase.

A third member observed that other central banks, for example in the United States and the euro area, also confront forecasts of slowing growth, rising inflation and, in the euro area, a declining exchange rate against the dollar. Yet no interest rate increase seems to be expected in those countries, rather the opposite.

Another member underscored that such direct comparisons are not valid. The difference, according to this member, is that for a long time monetary conditions (in the sense of the combination of interest rates and the exchange rate) in Sweden have been more expansionary than in other countries. The member also emphasised that in the event of a decision to raise the interest rate, the motivation has to be, not the current exchange rate but an assessment of the krona's path during the forecast period. The depreciation since the Inflation Report means that a stronger appreciation than before is now needed to achieve the same average forecast path. This member stressed that in the face of difficult decisions, arguments for not adjusting the interest rate can often be found. It may be prudent, however, to ponder not just the risks of acting but also those of refraining from action. What will happen, for example, if the Riksbank does not act at present and the krona continues to be weak at the same time as inflation expectations creep upwards? Would there not then be a risk that in August the Riksbank will be too late?

§ 2 The monetary policy decision

The Chairman summarised the monetary policy discussion under § 1 and found there were proposals to raise the repo rate 0.25 percentage points and to leave the repo rate unchanged.

A vote was taken and resulted in three votes for each of the two proposals. When the Executive Board votes, the Chairman has the casting vote. The proposal supported by the Chairman was therefore found to have obtained a majority. The Board decided to raise the repo rate 0.25 percentage points to 4.25 per cent with effect from 11 July 2001 and that the decision be announced at 9.30 a.m. on 6 July 2001 with the motivation and wording contained in Press Release no. 47 2001 (Annex A to the minutes).

Deputy Governors Villy Bergström, Lars Nyberg and Kristina Persson entered reservations against the decision. They considered that the trend is weak in the three major economic areas — United States, EU and Japan — as well as in Southeast Asia and South America, with a risk of a widespread recession if developments in the United States do not turn upwards. The signs of such an upturn are still indistinct. Activity in Sweden has also weakened during the spring and no longer seems to constitute a risk of capacity utilisation being generally strained.

The risk of inflation as a result of the weak krona has to be set against this weak real trend but these three members considered that this risk is balanced by the risk of weaker activity. Against this background, the monetary stance should remain unchanged.

This paragraph was immediately confirmed.