

No 8

Separate minutes of the Executive Board meeting on 14 June 2001

Present: Urban Bäckström, Chairman
Lars Heikensten
Eva Srejber
Villy Bergström
Lars Nyberg
Kristina Persson
-
Kerstin Alm
Claes Berg
Anders Borg
Eva Cory
Jörgen Eklund
Mats Galvenius
-
Leif Jacobson
-
-
-
Hans Lindblad
Christina Lindenius
Javiera Ragnartz
Robert Sparve
Åsa Sydén
Tomas Thyblad
-
Staffan Viotti
Anders Vredin
-

§ 1. Developments on the financial markets, etc.

First Deputy Governor Lars Heikensten stated the following.

The assessment in the previous Inflation Report, published on 31 May, was that the inflation rate 1-2 years ahead would develop roughly in line with the Riksbank's inflation target. The risk spectrum was then well balanced, although the uncertainty of the situation was deemed unusually great. Given these facts, the repo rate was left unchanged.

Since the Inflation Report was published, the international picture has not changed in a particularly tangible way. There are signs of slightly weaker growth rates for the current year, but at the same time inflation is expected to be higher. However, there is no reason to change the assessment made a few weeks ago with regard to prospects a year or so ahead. This assumed a gradual recovery in the USA, which will spread to other countries. It is also this scenario that is being priced to an increasing extent by the financial markets. However, there is still an unusually large element of uncertainty in the picture of international economic activity.

There are also some indications in Sweden that growth for the current year will slow down slightly more than the Riksbank assumed in the May Inflation Report, while import prices have continued to rise at a slightly more rapid rate. The inflation figures received today do not, as far as I can see, provide any reason to change the basic view communicated in the Riksbank's Inflation Report. All in all, there is no reason to revise the main scenario for economic activity and inflation in the years 2002 and 2003 that was presented in this report.

Nevertheless, the inflation risks have increased. This is connected with the fact that the krona has continued to depreciate from an already very low level. Given this, it is natural today to have a slightly more pessimistic view of the krona's ability to make a rapid recovery. Since the final date for data to be included in the previous Inflation Report (17 May), the krona has depreciated by approximately 4 per cent on the TCW index. On average, the TCW index has amounted to 135.6, which is 2.7 per cent weaker than the forecast path.

The Riksbank has no expressed target for the exchange rate. Monetary policy is aimed at achieving an inflation rate of 2 per cent one to two years ahead. However, the exchange rate is an important factor in the assessment of inflation. It has a direct effect on import prices for input goods and consumer goods, as well as an indirect effect via inflation expectations and the total demand for Swedish goods.

The impact of the low krona rate on domestic prices has been less than expected for a number of years. This is also the picture that has prevailed in other countries. However, this does not mean that the krona has no effect at all on inflation. Nor are there any guarantees that the pattern which has prevailed during the latter part of the 1990s will remain unchanged over the next few years. The rise in inflation that has occurred recently, although mainly due to disruptions in supply, means that the low exchange rate probably comprises a greater risk now than before. The relatively high demand pressure has a similar effect. If the current krona exchange rate were to remain for a longer period of time, there is thus a clear risk that UNDEX inflation one to two years ahead would exceed 2 per cent. The other information received regarding both international developments and developments in Sweden does not indicate downside risks to a corresponding size.

To summarise, a continued weak krona is the most important individual factor that could comprise a threat to the inflation target one to two years ahead. There is reason to review these problems again in future monetary policy discussions. The question here is whether there could be reason to raise the repo rate. This is an assessment that must be made in the light of the total inflation assessment to be made then.

In addition to the repo rate, which is the Riksbank's normal monetary policy tool, the Riksbank is also able to make interventions on the foreign exchange market. Both academic research and the Riksbank's own analyses indicate that the result of interventions is uncertain. Nevertheless, there can be good reason to use the intervention tool in certain circumstances. This applies in particular if the foreign exchange market deviates considerably in its pricing from what is considered a fundamentally motivated price and if the price deviation appears to enter a cycle of self-reinforcement. There is normally a greater risk of the latter occurring when unrest on the market is high and liquidity is low. Interventions in this type of situation can contribute to a slowing down of the self-reinforcement cycle and to stabilising the price situation.

Interventions in the current situation could also be a signal that the weak exchange rate motivates a tightening up of the total monetary conditions.

During the ensuing discussion it became clear that the members of the Executive Board held differing opinions. Some members felt that the effects of interventions on the foreign exchange market were uncertain. Two members pointed out that assessments of earlier interventions with regard to the krona and other currencies show that it is difficult to achieve a durable reinforcement of the exchange rate. Interventions can only have a lasting effect on the exchange rate and thereby inflation if the market participants see the intervention as the beginning of an appreciation process. It was considered doubtful whether the situation could be described as such. At the same time, the members felt that there was a risk that the sudden use of the intervention weapon could create uncertainty over the Riksbank's monetary policy intentions. From this perspective, it appeared reasonable to use the interest rate rather than interventions on the foreign exchange market if the inflation target appeared under threat.

Some members said during the discussion that the use of interventions should not be dramatised. There was easily scope for such use in the normal monetary policy philosophy. One member felt that interventions could be motivated in the monetary policy philosophy, but that the Riksbank would benefit from refraining to intervene on the foreign exchange markets, because of the unclear effects of such interventions.

Several members maintained that the Riksbank had a formal responsibility for the krona, which could motivate interventions. One member was opposed to this view. In addition, two members considered

that the need for measures to preserve market functionality could motivate interventions. Furthermore, an opinion was expressed that in a situation with a high level of resource utilisation and rising prices there could be a risk that inflation expectations would be affected by the weak exchange rate. One member of the Executive Board alleged that if interventions were used as a signal of monetary policy restraint in a situation where the exchange rate had weakened without any marked change in the underlying economic conditions, and more due to the market situation, the interventions had a good chance of success.

There was also some criticism during the discussion of the preparatory work done as background to making a decision, and two of the members recommended that this agenda item should be postponed to provide more time for consideration.

The question as to how decisions on interventions should be handled in future shall be discussed on a later occasion, following a proposal from the board member responsible for preparing matters concerning monetary policy, i.e. Lars Heikensten.

The Executive Board agreed to the proposal by Lars Heikensten that

- they should delegate to the Governor of the Riksbank the right to decide, in consultation with the First Deputy Governor, on interventions in the foreign exchange market to a maximum total of SEK XX billion¹,
- the right to decide on interventions in the foreign exchange market would apply with effect from Friday, 15 June 2001, and until no later than the next monetary policy meeting on 5 July 2001, and
- the motives for the interventions should be those described by Lars Heikensten above and that these should be communicated outside the Riksbank through a press release in accordance with Appendix to the minutes A on the same day that a first intervention is implemented.

Villy Bergström entered a reservation against the decision and stated the following: "I believe that this matter should be tabled at today's meeting and taken up for discussion again at an extraordinary meeting to be called next week. This matter is an issue of great importance and a matter of principle that should be considered carefully before making a final decision. In my opinion, we do not have sufficient reason to take a stand on this issue at today's meeting."

This paragraph was immediately confirmed.

¹ Not disclosed.

Minutes by:

Kerstin Alm

Checked by:

Urban Bäckström

Lars Nyberg