No. 2

SEPARATE MINUTES of the Executive Board meeting on 7 February 2002

Present: Urban Bäckström, Chairman
Lars Heikensten
Eva Srejber
Villy Bergström
Lars Nyberg
Kristina Persson
–
Sven Hulterström, Chairman of the General Council
–
Kerstin Alm
Malin Andersson (§ 1)
Claes Berg
Mårten Blix
Anders Borg
Jörgen Eklund
Kerstin Hallsten (§ 1)
Björn Hasselgren
Cecilia Roos Isaksson (§ 1)
Leif Jacobsson
Hans Lindblad
Christina Lindenius
Tomas Lundberg
Pernilla Meyersson (§ 1)
Javiera Ragnartz (§ 1)
Robert Sparve
Staffan Viotti

§ 1. The monetary policy discussion

It was noted that Mårten Blix and Anders Borg 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 relevant 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 3.75 per cent until the end of December 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 internationally and in Sweden

1.1 The international scene

The Board noted that much of the information since the previous meeting on 4 December 2001 suggests that the global economic slowdown may be on the way to ending. One sign of this is that household Q4 consumption in the United States was stronger than foreseen in the Inflation Report. This may partly have to do with bargain sales of cars and other capital goods, so that purchases of these items may have been brought forward, but also with lower dwelling costs. Moreover, tax relief and lower petrol prices have helped to raise household disposable income. The Board noted that inventories in the United States have been reduced more quickly than expected; there are now certain signs of a better balance between inventories and sales.

Against this, US statistics show lower employment growth as well as some saturation for purchases of capital goods and residential investment; together with high indebtedness, this is expected to restrain consumption and promote increased household saving. All in all, the Board considered that developments were broadly in line with the forecast path, while the risk of a deeper decline had decreased.

One Board member pointed out that the past year’s signals from the US economy have been mixed but that more and more indicators now point to an imminent turning-point. So it looks as though the contractionary phase will not necessarily be so deep and can even be described as a recession.

A recovery in the US economy presupposes an end to the restrictive effects from stock adjustments and a strengthening of domestic demand. It seems clear that the stocks cycle has followed the historical pattern to date but it is too early to count on an increased contribution to demand from consumption and investment. That means, according to this member, that demand may weaken again when the effects from stock movements have ebbed.

Another threat is that the imbalances in the US economy are subduing GDP growth both this year and next. Relative to disposable income, American households have an appreciably higher stock of debt and a higher debt servicing ratio than households in Sweden, for example. It is a good thing, not least in view of the low household saving and persistent current-account deficits, that productivity to date in the United States has not disappointed expectations, because a continuation of strong productivity growth makes rectifying these imbalances less difficult.

In the event of a synchronous industrial upswing in a majority of OECD countries, the member continued, it is conceivable today that the restraining factors would have a stabilising effect. Moreover, there are grounds for believing that the additional package of tax cuts that has been discussed in the United States after the events in September will not materialise; considering that the risk of a deeper recession is diminishing, this might be a good thing.

In the subsequent discussion, other members agreed that the slowdown in the United States presumably need not be all that protracted and that the path of productivity to date is a sign of strength. But one member did perceive a considerable risk of the imbalances remaining when activity picks up. This is also suggested by share prices still being high in relation to economic fundamentals.

Another member shared the view that the industrial sectors in many OECD countries are moving towards a synchronous recovery. Last autumn's major uncertainty about the global economy, partly in view of the terrorist attacks on 11 September and the war in Afghanistan, has decreased considerably. The tendency has been weak in the United States, as expected, and the decline more marked than anticipated in certain Asian countries. But all in all, the countries with a more marked slowdown than had been feared are relatively few, while development has been comparatively favourable in other countries in Asia, Central and Eastern Europe, as well as in Russia and the United Kingdom.

This member was concerned about the danger of economic policy being unduly expansionary, above all in the United States and Europe. The combination of low real interest rates and fiscal stimuli in several parts of the world entailed risks for the future development of asset prices, share prices in particular. Moreover, property markets in a good many countries remained buoyant during 2001. Furthermore, household and corporate indebtedness are already high in some countries. While these risks may not be impending today, by the end of and after the forecast period the problems could be appreciable. There is accordingly a risk that economic policy is too expansionary, in much the same way as after the crisis in 1987 when a financial bubble reappeared. The economic upturn is therefore liable to be dependent on assessments of asset prices that remain excessively optimistic and on credit growth that is high relative to fundamentals, so that it is followed by another cyclical setback.

Yet another member underscored that the upturn is not yet stable. There is considerable uncertainty about its strength and durability in the United States. The recovery there may be weakened by a poorer labour market trend as well as by less of a pull, at least initially, from the rest of the world. While the strength of US productivity, despite the slowdown, is impressive and prompts hopes of an imminent upturn, it could also contribute to a strong dollar and thereby delay the necessary correction of saving imbalances. There is an evident risk of the US economy doing a double dip.

Another member agreed that the chief question about the US economy at present is whether domestic demand will pick up. The conceivable scenarios here include two distinct alternatives. One assumes a paradigmatic shift, so that the longest upward phase is being followed by the shortest downturn. If productivity growth has in fact bottomed at levels around 1.5 per cent during a recession, this may be a sign that the US economy's sustainable growth rate has moved up. The other alternative is that the situation is characterised by an asset price bubble that burst last year. As a result of fiscal and monetary measures, that bubble has now been pumped up again. That means that the adjustment of imbalances in saving and investment will not occur. It is worth noting that share prices are high for the current cyclical phase. The comparison should not be taken too far but there are certain similarities with Japan in the second half of the 1980s, when an expansionary economic policy contributed to a necessary adjustment being postponed for 2–3 years. There is then a risk of the asset price bubble giving way to debt deflation in the United States as well.

This member found it reasonable to base monetary policy on a scenario similar to the main scenario in the Inflation Report, that is, on a stabilisation of economic activity and a successive adjustment of the imbalances, but that there are grounds for being prepared to revise the assessment.

The Board then proceeded to discuss developments in Europe and noted that various corporate sector and purchasing manager indexes suggest that industrial activity is also moving towards a stabilisation in the euro area. But retail turnover has been slack and labour markets have shown signs of a further weakening. In Finland – one of Sweden's principal trading partners – the slowdown in manufacturing is having clearer effects, for example lower-than-expected growth of exports and investment. In Germany, too, the tendency has been weaker than foreseen, including a marked drop in construction. The scope for an expansionary fiscal policy is restricted by, for example, a large budget deficit and high debt. Still, the economic outlook for the euro area, as well as for the EU as a whole, is mainly the same as in the December Inflation Report.

A Board member noted that many had been caught unawares by the rapid downturn in Europe. The more synchronous path with the United States may mean that other links besides traditional channels for trade have played a part. Multinational companies and financial markets, for instance, may have strengthened the channels between countries. This member observed that if it turns out that the links have been stronger in the downward phase, the same may apply during the forthcoming recovery.

In Germany, the member continued, the tendency is weak. Problems may arise from the inability to reform the pension system and the high wage demands from IG-Metall.

In Japan, the GDP figures towards the end of last year were worse than expected. Japanese treasury paper is still being down-rated, which is making many banks more vulnerable, for instance. Yet another major regional bank has been declared bankrupt. A Board member considered that there are still certain signs that the decline in manufacturing is on the way to being broken. Another member pointed out that even if there are some indications of an improvement for Japanese industry, the uncertainty about the financial sector remains considerable.

The Board noted that the price of oil has recently been comparatively stable. The average barrel price to date in January has been USD 19.5, which about one dollar higher than forecast. For the longer run, there has been no new information that calls for a change to the assessment in the Inflation Report. Other commodity prices rose somewhat more than expected in December but have now fallen back and are broadly in line with the forecasts. As in the December Report, a price rise is foreseen as international activity recovers.

A member observed that while oil prices have broadly followed the forecast in the Inflation Report and there has been no marked drop, there is a risk, partly in view of the large Russian oil surplus, of a steeper price fall in 2002 Q2.

The Board's overall assessment was that international export prices will approximately match the picture in the Inflation Report.

New statistics from a number of countries suggest that import prices slackened more markedly than expected towards the end of last year, particularly among countries in Asia and several of the smaller economies in Europe. World market growth for Swedish exports this year is therefore judged to be somewhat lower than allowed for in the Inflation Report.

The Board's overall assessment of the international picture was that this largely matches the presentation in the December Report, with an international recovery in the second half of this year. The signs of a damping of demand are receding and it has become clearer that activity in the US economy is stabilising. However, the forecast still contains risks in the form of uncertainty about labour market developments, continued saving imbalances and volatile stock markets. The tendency in Europe is weak but here, too, there seems to have been some stabilisation. In Japan, on the other hand, the economy has continued to weaken in recent months.

1.2 Financial markets

The Board noted that international and Swedish bond rates have risen marginally since the December Report. At that time, interest rates were being driven mainly by stronger economic statistics for the United States. In January, however, the optimism was subdued, partly by increased uncertainty about the cyclical path and some doubts about quarterly corporate reports. In the latter part of January, it seems that Swedish interest rates also tended to move up in response to the unexpectedly high CPI outcome for December.

The long-term interest rate differential with Germany has been around 0.4 percentage points since the December Report. The differential narrowed to about 0.35 percentage points at the turn of the year, which could have to do with increasingly clear signals considering a potential Swedish entry into EMU from political representatives.

Unlike their international counterparts, the shorter Swedish interest rates have risen relatively rapidly in recent months. Part of the reason is presumably that the high inflation outcomes have caused market players to alter their view of monetary policy so that they now count on the repo rate being somewhat higher than foreseen earlier.

The effective trade-weighted (TCW index) exchange rate has appreciated marginally more than forecast in the December Report. The low value of the krona had basically pointed to an appreciation. The tendency is probably attributable to recent political signals about the question of Sweden's adoption of the euro. Another factor could be the rising short-term interest rate differential with the rest of the world. The euro became somewhat stronger against the dollar in the run up to the new currency's physical introduction at the turn of the year but since then it has depreciated after statistical outcomes presented during January were generally weaker for Europe and stronger for the United States.

The Board noted that after the terrorist attacks, stock markets abroad recovered during October and November. Since the time of the December Report, however, this trend has been broken and share prices abroad as well as in Sweden have fallen back, particularly for technology and telecom companies. The Swedish stock exchange has fallen more than other bourses, partly on account of Ericsson's weak result, published at the end of January. Since the December Report, the Stockholm Exchange's OMX index has fallen about 7 per cent. The Board also noted that developments to date in Argentina have not had any serious contagious effects on the financial system.

One Board member considered that the collapse of the Enron energy company has heightened concern about the financial markets in that it has become clear that the principles for corporate accounting in the United States have not kept up with the development of financial instruments. If investors are uncertain about what corporate balance sheets actually contain, risk premiums will be higher, with negative effects on share prices. High and lasting uncertainty can lead to a major and lasting price effect.

Another member agreed that this risk exists and should not be underestimated. The possibility of contagious effects from the Enron collapse, a weaker stock market trend and the disturbing developments in Japan are seen as downside risks for international economic activity. There is also a risk of new terrorist attacks. This member saw some remaining risk of renewed financial market unrest.

All in all, the Board judged that, as a consequence of higher short and long market interest rates, a stronger exchange rate and lower share prices, monetary conditions in Sweden have become somewhat less expansionary than at the time of the December Inflation Report.

1.3 Demand and supply

The GDP growth rate for Sweden was judged in the December Inflation Report to be 1.2 per cent last year, 1.8 per cent this year and 2.4 per cent in 2003. The acceleration was grounded in a recovery of international activity, a comparatively weak exchange rate, low real interest rates and an expansionary fiscal policy.

Last year's growth of consumption has turned out to have been more subdued that assumed in the December Report. The national accounts show that the Q1 level was unchanged from the corresponding period in 2000. Surveys of households' purchasing plans suggest that households' expectations are broadly unchanged. The path of asset prices has been somewhat worse than assumed in December but statistics on retail turnover show a stabilisation. Still, the Board found no reason to revise its assessment of the growth of consumption this year and next.

The Board noted that foreign trade in goods has fallen more than had been expected in the December Report. Imports have declined more than exports and the contribution from net exports exceeded the forecast. The decreased exports are partly explained by an unfavourable product mix (telecom products and vehicles) and it seems that world market growth was overestimated. Export growth for services was remarkably strong in the first three quarters of 2001, but balance of payments statistics point to a slowdown towards the end of 2001.

The Board observed that new output gap estimates, based on additional information in Statistics Sweden's national accounts, show that resource utilisation last year was somewhat higher than allowed for earlier.

Signals from the labour market are mixed. Open unemployment fell to 3.6 per cent in December. Employment levelled out during the second half of 2001 but the annual level still rose from 2000 by about 80,000 persons or 1.9 per cent. However, hours worked followed a weaker path, which means that average hours worked fell, probably as a combined result of decreased overtime and a rising number of sick-days. Employment declined in manufacturing but rose in other sectors of the economy.

The number of new job vacancies has gone on falling. The number of discharge notices rose sharply from the beginning of last year and although the pattern is uncertain, there are no signs of a decrease. Developments in the labour market are judged to be broadly in line with the assessment in the December Report.

Wage increases have been somewhat higher than expected despite last year's weaker economic activity. There is a risk that this tendency is not temporary and there may be grounds for some upward revision of the wage forecast for 2002 as well.

A Board member considered that manufacturing output in Sweden is beginning to bottom out and that consumption has weathered the slowdown comparatively well. Labour market developments to date have countered the economic fall-off. It is historically unique that the latter has not had a clear effect on unemployment. If growth matches the Riksbank's forecast in December, the average annual rate from 2001 to 2003 will be well on a par with the 1970s and '80s; given that the global economy is going through a downward phase, that level cannot be said to be low.

A second member reflected that economic tendencies in different parts of the economy have not been synchronous. Falling industrial capacity utilisation, with a rising number of discharge notices and declining employment, has been accompanied by a comparatively strong domestic market. This raises questions about the extent to which measurements of total resource utilisation and the output gap are relevant for the development of consumer prices. Unutilised industrial resources may not have the same implications for these prices as resource utilisation in the domestic economy. Support for this view is also provided by what happened in the second half of the 1990s, when price pressure was remarkably low even though the economy was expanding rapidly, albeit at that time mainly as regards the sectors exposed to foreign competition.

A third member noted than in the December Inflation Report the Riksbank had overestimated world market growth, which must now be revised downwards. Rising discharge notices in addition indicate that unemployment may move up, with negative effects on private consumption. Moreover, the stock market recovery may slacken and subdue the propensity to consume.

A fourth member saw signs that the preliminary figures from Statistics Sweden may underestimate last year's GDP growth. The weak picture of demand does not agree with other indicators such as consumer prices, employment, the money supply, credit growth and tax receipts. One explanation may lie in the effects on insurance services from flood damage payments, for example. This would not be the first time that revisions to the national account have changed the picture of outcomes.

All in all, the Board found no reason at present to alter its appraisal of economic activity in Sweden, though the risk of a weaker development was judged to have become somewhat smaller.

2. The Board's assessment of inflation prospects

The rate of CPI inflation was judged in the December Inflation Report to be 2.0 per cent in December 2002 and 2.1 per cent in December 2003. The corresponding rates of UND1X inflation were forecast to be 2.0 and 1.9 per cent, respectively. A part of last year's price rise was judged to be transitory and to disappear during 2002.

The Board noted that since the time of the Report, inflation has risen somewhat more than expected. In December, the annual rate of underlying inflation (UND1X) was 3.4 per cent, which is 0.3 percentage points more than forecast. This is partly explained by unexpectedly high price increases for fruit and vegetables. There is also information that these prices may continue to rise somewhat in the short run.

But other prices have risen more than expected, too. Of the upward shift of 1.5 percentage points in the rate of inflation since March 2001, half has come from items that have been hit by supply shocks, that is, electricity, meat, fruit and vegetables. The other price increases that exceed expectations are probably due in part to unforeseen increases in costs. The exchange rate pass-through may have been somewhat larger than expected; one indication of this is the unexpected extent to which imported inflation has moved up in both producer and consumer prices.

The Board noted that new survey data since the December Report show a fall in inflation expectations. According to Statistics Sweden's monthly survey of households, in the coming twelve months prices were expected to rise about 1.8 per cent last December as against 2.0 per cent in November and 2.9 per cent in October. In the latest business tendency survey from the National Institute of Economic Research, inflation expectations in manufacturing had likewise fallen, to 1.7 per cent from 1.9 per cent in October. The Institute has altered the construction of its household survey and it is not entirely clear how the latest measurements should be interpreted.

A Board member mentioned that trade union representatives are expressing concern about the high rate of inflation. This can be interpreted in part as some irritation because the actual development of relative wages for workers in export production deviates from what these organisations consider desirable. Wage increases for white-collar employees in manufacturing have been in the interval 5–6 per cent, while for blue-collar workers they have been somewhat lower. It could be that the discussion about real wages being eroded is to be seen as an argument for compensation in future wage negotiations. But that does not imply that the statements should be made light of; they may have implications for the future development of costs. Three more members referred to the concern expressed by union representatives.

A member judged that the inflation comes in part from effects of high resource utilisation. The high outcomes show that demand pressure is still strong and the member found it troublesome that inflation still shows no tendency fall.

It would be worrying, this member continued, if economic agents start altering their assessments of the long-term price trend. Pricing in the fixed-income market suggests that this may be the case in that the implied expectations of inflation two years ahead have moved up since the autumn. Another indication is the low exchange rate, which could possibly reflect expectations of higher inflation than in the rest of the world. The member also pointed out that employment is favourable, unemployment will probably rise only marginally and the business cycle appears to be turning upwards, which may mean that demand is not going to slacken sufficiently for price pressure to have time to ease. It seems, moreover, that employees are also concerned about this.

This member concluded that there is some risk of people's confidence in the Riksbank's target being affected adversely if the Board does not demonstrate a readiness to take timely measures to ensure that prospects of inflation 1–2 years ahead lie around 2 per cent.

Another member pointed out that so far, the price increases for certain goods and services that were attributed earlier to temporary supply shocks have essentially turned out to be transient. The prices of these items have largely followed the path that was forecast in May last year. The deviation from the price forecasts at that time has come from other goods and services. Underlying, trend inflation has tended to rise more than expected. The member also noted that ever since price increases accelerated last spring, the Riksbank has acknowledged that this raises questions about the relationship between demand and inflation. As an example, the member cited a passage from the Inflation Report in May 2001:

> *The risks for inflation connected with domestic demand and the relationship between growth and inflation in Sweden are somewhat more on the upside than foreseen in the March Report. The inflation forecast in the main scenario has admittedly been revised upwards in view of the unexpectedly high domestic inflation but this has been done mainly for the coming year. It is conceivable that the higher registered inflation is partly a sign that resource utilisation is more strained than assumed in the main scenario. (pp. 24–25)*

During the autumn there have been further warnings that the rising rate of price increases may be partly attributable to resource utilisation and the inflation propensity in a wide sense.

The same member also found reason to be cautious about interpreting movements in inflation expectations. The picture is not clear-cut. Business tendency surveys for manufacturing, for example, show falling price expectations; moreover, the increase in long-term interest rates is limited. And while the rising short interest rates may partly reflect greater concern about inflation, to a high degree they mirror expectations of how the central bank will react. The member also objected to the argument that statements by individual union representatives are taken to mean that confidence in the inflation target has weakened and that inflation expectations will get stuck at a higher level. Such statements can be connected with many things that do not have all that much to do with monetary policy. There may possibly be a slight upward tendency in inflation expectations in a wide sense but the situation should not be regarded as dramatic.

Another member agreed that inflation is unduly high but considered it will probably be subdued in the course of this year. The effects of the transient price increases will drop out of the statistics this spring and effects of the economic slowdown should become increasingly clear in the rest of the year. In this member's opinion, a further appreciation of the krona can be assumed as the possibility of adherence to the ERM and EMU approaches. An appreciation by more than was assumed in the December Report also provides support at the margin for lower inflation.

The Board's conclusion, as regards inflation prospects, was that as previously, inflation is judged to fall back during the forecast period, though there are arguments for placing the decline somewhat further ahead. Compared with the assessment in the December Report, inflation in 2002 is now judged to be somewhat higher. This has to do, for example, with the higher inflation outcomes, rising unit labour costs and the prospect of rent increases being higher than expected. The Board found no grounds at present for revising the inflation forecast for 2003.

In the December Report the spectrum of risks both one and two years ahead had been judged to be balanced. The downside risks from weaker economic activity, internationally as well as in Sweden, were balanced by the upside risk from domestic inflationary pressure.

Starting from the balanced risk spectrum in the December Report, a Board member noted that inflation since then has been somewhat higher, which adds something to the risk of higher domestic inflation. As regards the international picture, the signs of an upturn have become clearer, as noted.

This member concluded that the spectrum of risks is beginning to shift upwards. It is too early to conclude that the upside risks clearly predominate but it will be hard to avoid such a conclusion in the event of further signs in this direction. An example would be if inflation were to go on exceeding the forecast. So there is a tendency for the risk spectrum to move upwards.

Another member considered that the risk spectrum is still balanced; the upward tendency is weak and there is still some risk of economic activity remaining subdued. In the opinion of another member, the balance of risks is already on the upside.

All in all, the Board considered that to some extent, the risk of weaker international activity has decreased and that means that the same applies to the risk of a weaker exchange rate in connection with a more marked international slowdown. Moreover, the risk of a less favourable relationship between growth and inflation is judged to be greater than allowed for earlier. The Board concluded that some shift has occurred in the risk spectrum and that there is now an overall tendency towards an upside risk for inflation one to two years ahead.

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

3.1 The monetary policy group's view[1]

The policy group's discussion had started from the opinion that there is currently no reason to revise the main features of the December forecast. The discussion had been shaped by the group's view that the economic slowdown shows signs of coming to an end but that an upturn is not yet assured. Reference was made, for example, to the US Federal Reserve's statement in connection with the monetary policy decision in February, to the effect that it is the signs of a slowdown that have receded rather than a recovery being indicated by new statistics. The group had considered that the risk of economic activity becoming weaker has decreased but still exists.

A majority of the group had held that inflation could turn out to be somewhat higher than allowed for earlier. The fact that pressure from costs has been stronger than envisaged earlier and the pass-through from this to consumer prices may be indications that resource utilisation has been somewhat higher than assumed.

Although this turn of events was not a decisive consideration for the main scenarios in last year's Inflation Reports, it was still taken into account in the overall assessments on those occasions. The risk of higher inflation on account of an unfavourable development of the domestic component was weighted into the repo rate decisions. The interest rate increase in December 2000 came comparatively late in the business cycle in view of certain signs that demand was tending to slacken. There were interventions in June last year and the interest rate was raised again in July, partly because the overall picture caused concern that inflation might exceed the targeted rate even though demand was clearly weakening. The interest rate was cut in September partly to safeguard against a dramatic slump in activity that would also lower inflation. Since then the instrumental rates have not been changed. In the same period since December 2000, interest rates have been lowered 4.75 percentage points in the United States and 1.5 percentage points in the euro area, as against the net

[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.

figure of 0.25 percentage points for Sweden. So the relative level of interest rates has changed appreciably.

Quantifying the exact degree of resource utilisation is always difficult, partly because the assessment is based on both the demand and the supply side of the economy as well as on the interaction of prices and wages. The Riksbank's assessment assumes that resource utilisation falls during most of this year in that actual GDP growth is expected to be weaker than the sustainable long-term expansion of productive resources. Towards the end of this year, resource utilisation is judged to start rising again.

The probability of demand expanding more rapidly than potential output will grow as economic activity picks up. The policy group had accordingly considered that the next instrumental rate adjustment would presumably be upward. As regards the Board meeting in February, however, the arguments were predominantly against a change in the instrument rate. A major argument was that the signs of the slowdown coming to an end must still be said to be preliminary and the effect on demand remains uncertain. Although there are conceivable signs of some upward shift in inflation expectations, these are not so alarming as to warrant an immediate policy realignment in a situation where both resource utilisation and the rate of price increases are expected to fall.

In conclusion, the policy group had noted that under these circumstances, incoming information about economic developments as well as inflation is to be seen as particularly relevant for future interest rate decisions.

3.2 The Board's discussion

The Board unanimously considered that monetary policy should be based on UND1X inflation. All but one of the members shared the policy group's opinion that the repo rate should be left unchanged.

The member who opened the discussion stated that taking action today would be premature. However, the problems with inflation are not confined to transient factors. The margin for further unexpected upside developments is limited. When an economic recovery has gained a firmer footing, we shall be approaching a point at which economic policy ought not to be as expansionary as at present. The interest rate cut after the terrorist attacks in the United States was a precautionary measure to counter a deeper and more prolonged slowdown. Developments since then have shown that the detrimental effects, for example on household and business confidence as well as on financial markets, have not been as serious as was feared. The concern about inflation that union representatives have expressed does constitute a problem, this member said. We are gradually moving towards a situation in which it will be necessary to tighten monetary policy but it is still too early to indicate the timing of such a measure.

Two Board members agreed with this assessment of the monetary policy situation. One of them underscored that the signs of an imminent upturn are not yet distinct. The other agreed with this but considered that the time for an interest rate increase has come nearer.

Another member noted that the occasion for interest rate cuts seems to have passed. The high inflation is a problem that has to be followed closely. If the rate does not fall at the same time as economic activity improves sooner than expected, the inflation target will be threatened. This member considered, however, that it is still feasible to wait for new, more definite indicators of both economic activity and price developments. Risks are also associated with raising the repo rate too early because that could harm the economic recovery.

Other members objected that when inflation persists in exceeding the target, one cannot wait for the economy to become appreciably stronger. One of them noted that when forward indicators signal more clearly that an upturn has begun, it may be necessary to act rather quickly.

Yet another member stated that at the time of this member's objections to interest rate increases in December 2000 and July 2001, activity had been falling. The situation today is different, with prospects of a recovery. An increase of 0.25 percentage points would underscore that the Riksbank does not accept the target being exceeded. Although there are arguments for raising the interest rate at today's meeting, the reasons for waiting predominate.

One Board member considered, however, that an increase of 0.25 percentage points at today's meeting is called for. One reason for the September cut of 0.5 percentage points had been to generate confidence in the future at a time of uncertainty. This uncertainty no longer exists. It is therefore time to start moving back to a less expansionary policy. Together with the tendency for demand to stabilise and the fact that inflation is above the Riksbank's target, this speaks for an immediate increase. This member did not feel sufficiently assured that inflation expectations would remain anchored around the 2 per cent target. It is important that interest policy reacts promptly when faced with downside risks, as the Riksbank was ready to do last autumn, but acting on upside risks is equally important. This member pointed out that it was a matter, not of adjusting monetary policy in a restrictive direction, but of responding like a driver who takes a big toe off the accelerator.

The Board's overall assessment was that today, the interest rates should be left unchanged. The time for an interest rate increase is probably not far off if economic statistics continue to confirm an upturn and if inflation remains high.

§ 2 Monetary policy decision

The Chairman summarised the monetary policy discussion under § 1 and found there was a proposal to raise the repo rate 0.25 percentage points and a proposal to leave the repo rate unchanged. A vote was taken and resulted in five votes in favour of unchanged instrumental rates and one vote for an increase of 0.25 percentage points.

The Executive Board decided to leave the repo rate, and thereby the deposit and lending rates, unchanged with effect from 13 February and to announce the decision at 9.00 a.m. on 8 February with the motivation and wording contained in Press Release no. 8, 2002 (annex A to the minutes).

Deputy Governor Eva Srejber entered a reservation against leaving the repo rate unchanged and stated that the repo rate ought to be raised 25 basis points. Ms Srejber noted that the uncertainty about developments in the rest of the world that had motivated the interest rate reduction in September no longer existed and that there are now reasons for directing monetary policy in a less expansionary direction to ensure that inflation expectations continue to be in line with the Riksbank's target in the future.

This paragraph was immediately confirmed.