Nr 18

SEPARATE MINUTES
of the Executive Board meeting on 14 November 2002

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

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Jan Bergqvist, Chairman, General Council
Johan Gernandt, Vice Chairman, General Council

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Kerstin Alm
Claes Berg
Mårten Blix
Anders Borg
Hans Dellmo (§ 1)
Jörgen Eklund
Anders Eklöf (§ 1)
Kerstin Hallsten (§ 1)
Jyry Hokkanen (§ 1)
Per Håkansson
Jesper Johansson (§ 1)
Hans Lindblad
Tomas Lundberg
Stefan Palmqvist
Sara Tägtström (§ 1)
Staffan Viotti

§ 1. Monetary policy discussion

It was noted that Mårten Blix and Anders Borg would prepare draft minutes of §§ 1-2 on the agenda for the meeting.

The discussions were based on the analyses and assessments compiled by the Monetary Policy Department. These were in turn based on the technical assumption that the Riksbank's repo rate will remain unchanged at 4.25 per cent until the end of Q4, 2004.

1. The Board’s assessment of inflation prospects

The Executive Board observed that there had been some stabilisation in the financial markets, although it was too early to assess whether this would become more permanent. Both the global stock markets and the Stockholm Stock Exchange had risen over the past month. One explanation could be that the stock market had priced the risk of even weaker economic prospects and of interim reports being more negative than expected.

The US central bank has lowered its policy rate by 0.5 percentage points to 1.25 per cent. The ECB chose to retain its refi rate unchanged at its most recent meeting. Developments in the stock markets have contributed to rising long interest rates, particularly in the USA, but also in Europe. Swedish bond rates have largely followed developments in the euro area. The US dollar has weakened since the publication of the Inflation Report.

The main scenario of the October Inflation Report anticipated a tentative recovery in global market growth over the year and subdued price pressure on goods traded internationally. GDP growth in the 19 OECD countries that comprise Sweden’s main trading partners was expected to amount to 1.5 per cent this year, 2.4 per cent in 2003 and 2.8 per cent in 2004. The total international CPI inflation was calculated in the October report to be 1.4 per cent this year, 1.6 per cent in 2003 and 1.8 per cent in 2004.

Information received since then indicates that industrial activity is still weak in both the USA and Europe. Confidence indicators for households and companies show the same picture. There is also a risk that the pronounced fall on the stock market since the beginning of 2000 will have a greater impact on households' and companies’ behaviour than was assumed in the main scenario. Nevertheless, there is reason to adhere to the assessment that global economic activity will gradually turn upwards over the coming years. This assessment is essentially based on normal cycles for investment and stocks making a gradual impact, even if the recovery is burdened this time by large debts among households and companies. In the USA, economic activity is supported by the continuing positive development in productivity, higher profits and the total economic policy pursued.

However, there are a number of signs that developments in Europe may be weaker than was previously anticipated. Several countries in the euro area are showing a more subdued development than was forecast in the previous Inflation Report. The already weak development in Germany appears to have deteriorated even further, partly as a result of proposed tax cuts being withdrawn and, cutbacks in expenditure and planned increases in taxes. The effect of the total economic policy, including the exchange rate effects, cannot be expected to provide any great stimulation to demand in the euro area as a whole. In addition, developments in the financial markets and the potential war in the Middle East appear to be having a restraining effect on the real economy in the euro area.

The more subdued growth in demand means that international export prices on processed goods are expected to develop more weakly in future than was previously anticipated. Oil prices have fallen since the previous Inflation Report, following a large rise earlier in the year. Raw materials prices are expected to rise, albeit at a slower rate than was previously assumed. The krona has strengthened somewhat in terms of the TCW index since the previous report and the assumption is, as before, that the exchange rate will strengthen further during the forecast period. All in all, Swedish import prices in the consumer segment are expected to rise slightly more slowly than previously anticipated during the forecast period.

The October Inflation Report estimated that growth in the Swedish economy would amount to 1.7 per cent this year, 2.3 per cent in 2003 and 2.1 per cent in 2004. This assessment was based on an international recovery, a relatively weak initial exchange rate, low real interest rates and an expansionary fiscal policy.

Despite a more subdued level of economic activity abroad this year, demand in Sweden has remained relatively high. This is also, on the whole, the picture painted by incoming data. However, there are clear signs of a weaker level of industrial activity; exports have slackened and industrial production has been more subdued than was anticipated in the previous Inflation Report. In addition, there is a risk that domestic inflation may be more affected by the stock market fall than was assumed earlier. Since the October report was published it has become clearer that fiscal policy will become less expansionary.

Employment has held up relatively well so far, although it has been possible to note a number of weakening tendencies over the past six months, for instance, within manufacturing. Demand for labour is particularly strong in the public sector. Since the October Inflation Report, the Swedish Municipal Workers' Union has demanded renegotiation of the wages for 2003. However, within trade and industry the weaker demand for labour is expected to have a subduing effect on wage trends. Although the union's decision has not led to corresponding demands from other unions to re-negotiate their collective wage agreements, it is worrying with regard to what effects this might have on the wage bargaining rounds in 2004. Even before the union announced its decision, the Riksbank was anticipating wage increases over the coming years that are estimated to be too high in a long-term perspective.

According to the most recent Inflation Report, CPI inflation was forecast, taking into account the risk spectrum, to be 2.0 per cent in September 2003 and 2.2 per cent in September 2004. The corresponding forecasts for UND1X inflation were 1.7 per cent and 1.8 per cent respectively.

There is reason to assume a slightly lower rate for economic growth. Resource utilisation in the Swedish economy is thus expected to be less strained. This reduces domestic inflationary pressure over the coming two years.

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

2.1 The monetary policy group's view[1]

First Deputy Governor Lars Heikensten presented the monetary policy group's views on the development of inflation and the monetary policy situation.

The group agreed that the arguments for conducting a more expansionary monetary policy were stronger than for an unchanged policy. The group considered that the repo rate should be lowered by 0.25 percentage points, from 4.25 to 4.0 per cent. As the forecast for future inflation both one and two years ahead was below the Riksbank's inflation target, it would be natural to adjust the repo rate. The monetary policy group felt that there had been no dramatic changes to the assessment presented in the Inflation Report. It could rather be said that the economic statistics presented confirmed the earlier view. Signs of weaker economic activity were clearer. In addition, a majority of analysts was expecting the meeting to result in a reduction of 0.25 percentage points.

At its previous meeting, the Executive Board highlighted developments in the financial markets and the risk that Swedish Municipal Workers' Union would terminate its collective wage agreements as two factors that could influence future assessments of inflation. The group now noted that the stock market fall had turned around into a rise, but that it was too early to determine whether developments had really stabilised. The demand for renegotiations is worrying, but other unions with collective wage agreements have not, as yet, elected to follow suit. At the same time, the next wage agreement period lies within the horizon that normally guides monetary policy. However, even taking into account these factors, the forecast for inflation did not fall below the 2 per cent target level in the relevant time perspective.

The group considered that there were reasons in favour of signalling that the future direction for monetary policy should be an open issue. There was no reason now for commitment to further reductions in steering interest rates, although a majority in the group felt it was probable that the next change made would be a reduction.

2.2 The Board's discussion

All of the Board members were of the opinion that monetary policy should be based on UND1X inflation. In addition, they all shared the opinion of the monetary policy group that the repo rate should be lowered by 0.25 percentage points, from 4.25 to 4.0 per cent.

The members of the Executive Board also shared the basic view of the economy presented and the discussion therefore centred mostly on how the risk spectrum should be assessed. One member questioned whether the European economy had really passed its lowest point and pointed to the effects of a

[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.

stronger euro, rising oil prices and tighter fiscal policy. In addition, it was far from certain that the US demand would really provide the stimulation to Europe assumed in the forecasts. The possibility of a more serious risk spectrum than that presented in the October Inflation Report could not be ruled out, particularly in the light of the threat of war in the Middle East. A prolonged war scenario could lead to a serious downturn in the global economy. The member felt that the situation for the US economy, with a large current account deficit, a high level of indebtedness among the general public and a growing budget deficit, constituted serious uncertainty factors regardless of the risk of war and these factors could lead to a continued fall for the US dollar and higher interest rates. There was still a risk that a fall in share prices could lead to falling property prices and trigger a recession. This Board member felt that, given this background, there was reason to signal that further adjustments of the repo rate might be necessary.

Another member also assessed the imbalances in the US economy to be a risk. Although there had been reasonable growth this year, developments in the labour market continued to be weak. At the same time, there were strongly expansionary charges in the economy. Both fiscal policy and monetary policy have had an expansionary orientation. Productivity development is good and indicates that potential growth may be as high as 3.5 per cent. The member felt that the rapid increase in potential growth could be problematic, as the development of demand would be weak following on from the budget consolidation process and could not easily develop as favourably as the supply side of the economy. This member also felt that the reduction in indebtedness that had taken place in that households have increased their savings was matched by an increased level of indebtedness within the public sector.

A third member considered that developments in the global economy in general and in the USA in particular were affected by a large downward adjustment in capital value that has been under way since 2001. Share capital has been eroding and real capital has become obsolete. This development was clear in several sectors, for instance certain manufacturing companies and insurance companies. It has been difficult to adapt supply and demand during this large downward adjustment. The Riksbank may have underestimated how much the lower capital values had subdued demand. The forward-looking indicators now published could be an expression of this. It might be difficult to correctly assess this risk of a weaker development. If the downward adjustment in capital values turns into asset price deflation, it will require a much more distinct shift in monetary policy, but the member emphasized that we were not yet at that point. It would therefore be reasonable to adjust the interest rate in tentative stages and assess developments. The member was of the opinion that the risks of a lower inflation rate associated with a weaker international development had not diminished.

A fourth member did not completely agree with the first two members' view of the global economy and the situation in the USA, considering that conditions for continued consolidation of companies' and households' balance sheets were good, given the changeover in economic policy that had taken place. Low interest rates provide the right conditions for continued consolidation, which supports a recovery. Increased real wages and rising disposable incomes for households also support this development. The conditions are right for a continued recovery. So far the adaptation resulting from the heavy fall in stock market prices has been relatively orderly. The member agreed with the previous member, who had highlighted the importance of the current account deficit in the USA and said that this would constitute a downside risk if the exchange rate adaptation occurred abruptly. So far, however, the exchange rate adaptation has been smooth.

The member also reflected that there may have arisen a failure to adjust to a lower speed following the overheating, as growth in some countries has been reasonable so far and yet it is being described as hard times. Another reflection was that the cost reductions that had improved prospects for profits could be a sign that competition had improved, which is essentially positive. The increased competition forces companies to reduce costs, which increases productivity and provides the right conditions for higher real wages.

A fifth member agreed with the previous speaker's description of the situation in the USA. The member pointed out that if one had imagined a few quarters ago that the stock market and the dollar would fall so heavily as they did, one would probably have imagined the consequences to be much more dramatic than they actually turned out. The air has gone out of the stock market bubble slowly and in a relatively orderly manner, while households' balance sheets have so far been adapted fairly smoothly. The Riksbank and other analysts have been concerned that private consumption would be subdued in a more dramatic manner when household savings increased. The member felt that the risk of a severe decline in domestic demand in the USA had probably declined over the past quarters as a result of the adaptation of the private sector's balance sheets. The member expressed greater concern for developments in Germany, which appeared much more negative than was anticipated earlier.

This member considered that the forecast in the October Inflation Report was sufficient argument for lowering the interest rate and that the data received since then further reinforce this. Currently both the expectation variables and the real variables indicate a weaker development in the economy. The member therefore agreed with those who recommended lowering the repo rate by 0.25 percentage points.

The Executive Board then went on to discuss the risks connected with domestic developments. One member made the assessment that the Swedish Municipal Workers' Union's termination of its collective agreement did not constitute a threat that would inflate wage demands this year and that the risk of a wage drift in 2003 was limited. On the other hand, the member felt that the collective bargaining rounds in 2004 could become problematic; it might be difficult to bring about the relative wage changes that have been proposed. There is a risk of demands for compensation from other parts of the labour market. However, this can be counteracted by a subdued demand ensuing from tighter fiscal policy and an appreciating krona. In addition, global market growth will decline and Swedish will lose market shares, which will lead to a weaker export growth.

Another member observed that the forecast growth for Sweden was close to the potential growth level and that the inflation forecast was fairly close to the target level, while monetary policy was not contractionary at present. However, the total economic policy would become tighter during the forecast period because of tighter fiscal policy and municipal tax increases, as well as an appreciating krona. The member's overall assessment was that the repo rate should be lowered by 0.25 percentage points. With regard to the risk spectrum, this member felt that it was now balanced. However, the member pointed out that there were questions regarding, for instance, the development of the labour supply and the functioning of the labour market. Despite the total level of unemployment of just over 6 per cent, wages in the economy are increasing by 4 per cent. In addition, there are many unfilled vacancies, particularly in the public sector. Moreover, this is in a situation in which labour costs are increasing as a result of rising pension charges and sick leave costs. The member emphasized that there is a risk that the situation on the labour market will lead to a labour shortage and higher wage increases.

Another member objected that the downside risks resulting from weak economic activity were dominant. The weak development in the USA and Europe showed perhaps that there were no shortcuts to growth when there are profound structural problems in the economy. In the USA there are large, growing imbalances in savings and in Europe there is a lack of dynamism and competition. Interest rate adjustments are not sufficient to attain a sustainable economic development.

One member observed that even if there were some disagreement on the risks of a weaker development, there was agreement that the repo rate should be lowered by 0.25 percentage points to 4.0 per cent. This member noted that there should be possibilities for a more in-depth assessment of the situation in the coming Inflation Report.

§ 2. Monetary policy decision[2]

The Chairman summarised the monetary policy decision under § 1 and found that there was a proposal to lower the repo rate from 4.25 to 4.0 per cent.

A vote was taken and the Board decided unanimously to lower the repo rate to 4.0 per cent and accordingly to lower the deposit and lending rates to 3.25 per cent and 4.75 per cent respectively and to announce the decision at 9.30 a.m. on Friday, 15 November 2002 with the motivation and wording contained in press release no. 70, (annex to the minutes).

[2] Board members who are present and do not enter a reservation have participated in and agreed to the Board's decision.

The Executive Board also decided to publish the minutes of today's meeting on Friday, 29 November 2002.

This paragraph was immediately confirmed.

Minutes taken by:

Kerstin Alm

Checked by:

Urban Bäckström	Lars Heikensten	Eva Srejber
Villy Bergström	Lars Nyberg	Kristina Persson