SEPARATE MINUTES
Executive Board, No. 9

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DATE: 24 April 2003

TIME: 1 p.m.

PRESENT: Lars Heikensten, Chairman
Eva Srejber
Villy Bergström
Lars Nyberg
Kristina Persson
Irma Rosenberg

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

Kerstin Alm
Claes Berg
Robert Boije (§ 1)
Jörgen Eklund
Anders Eklöf (§ 1)
Victoria Ericsson
Kurt Gustavsson (§ 1)
Kerstin Hallsten
Björn Hasselgren
Per Håkansson
Leif Jacobsson
Jesper Johansson (§ 1)
Hans Lindblad
Tomas Lundberg
Sara Tägtström (§ 1)
Eva Uddén Sonnegård
Staffan Viotti
Anders Vredin
Fredrik Östbom (§ 1)

§ 1. Monetary policy discussion

It was noted that Jörgen Eklund and Victoria Ericsson would prepare draft minutes of paragraphs 1 and 2 on the agenda for the meeting.

The meeting began with a discussion of the factors in the Swedish and international economic trend that are currently of greatest significance for inflation prospects and the formulation of monetary policy (section 1).

The discussions of each area were based on analyses and assessments compiled by the Monetary Policy Department. These analyses and assessments were based in turn on the technical assumption that the Riksbank's repo rate would remain unchanged at 3.50 per cent during the forecast period. Finally, the Executive Board members summarised their view of inflation prospects (section 2) and presented their conclusions on the monetary policy situation (section 3).

1. Economic developments in Sweden and abroad

1.1. 1.1 International developments

The Executive Board noted that the armed conflict in Iraq that began on 20 March now appears to be at an end. In the most recent Inflation Report that was presented on 18 March, one of the starting points in the assessment of the inflation picture was that the war would be short. Based on this, the Executive Board concluded that the probability of a development in line with the main scenario had thereby increased.

According to the main scenario of the Inflation Report, international demand was expected to recover gradually in 2003. Growth in the OECD area was estimated to be 2.0 per cent in 2003, 2.7 per cent in 2004 and 2.6 per cent in 2005. Together with unutilised resources in the initial position, this entailed that resource utilisation was expected to remain relatively moderate during the forecast period and that international price developments would be subdued.

The Executive Board noted that the information that had been received since its most recent meeting indicated that growth may be somewhat weaker than was anticipated in the main scenario of the Inflation Report. This information may have been marked, however, by the war in Iraq. Several surveys, including those of household and corporate confidence, were carried out while the war was in progress, and this may have influenced the results. In light of this, the Executive Board members were in agreement that it was perhaps not appropriate to draw overly far-reaching conclusions from the latest information.

Recent statistics suggest that US household consumption during the first quarter of this year developed in line with the assumptions of the Inflation Report. However, generally weaker employment growth during the first three months of the year and poorer development of household disposable income indicate that future consumption may be somewhat lower than expected. All in all, this implies that future growth in the United States may be slightly weaker than anticipated in the main scenario of the Inflation Report.

In the Inflation Report, a recovery in economic activity was forecast for the euro area. The factors that were considered to be in favour of an economic upswing are still in evidence. Productivity has begun to rise, which is expected to stimulate earnings and investment and to also gradually boost employment and consumption. Gradually lower inflation is also anticipated to support this trend. Stable wage increases and a stabilisation of the labour market towards the end of 2003 are expected to contribute to an improvement in households' disposable income. However, the recovery is expected to be somewhat slower than was assumed in December.

Since the March Inflation Report, the confidence of both households and firms in the euro area has been dampened somewhat. Labour market growth has been weak, and this has most likely also affected household confidence negatively. In the short term, this may have a negative impact on household consumption. Furthermore, international conditions are slightly less favourable, which could also affect the growth forecast for the euro area.

Considerable budgetary problems in several EU Member States will require cutbacks to be made within the scope of the Excessive Deficit Procedure. This may have a negative impact on demand.

In Asia, a continued strengthening of exports and manufacturing activity is foreseen. The spread of SARS (Severe Acute Respiratory Syndrome) as well as the concern caused by the disease in recent months may hamper this trend, however.

Since the most recent Executive Board meeting, oil prices have fallen by approximately 20 per cent, which is more than was anticipated in the Inflation Report.

The Executive Board's overall assessment was that the information that has been received since its most recent meeting gives cause to expect somewhat weaker world market growth this year than was forecast in the Riksbank's March Inflation Report. At the same time, it was noted that the economic indicators that have been available thus far were compiled while the war in Iraq was in progress, thus making them difficult to interpret. It is therefore difficult to ascertain whether the tendencies towards weaker development will remain.

1.2. The financial markets

In the Inflation Report, it was concluded that pricing on the financial markets reflected expectations that the geopolitical situation would lead to a continued high oil price and a cautious investment climate. The consequences of the war proved less serious, however, as was indicated in market prices. For example, the Iraqi oil fields were secured at an early stage. In addition, various measures of risk indicate that overall uncertainty has diminished somewhat, although it continues to remain at a high level.

One member concluded that the "wet blanket" that had been lying over the world economy and impeding growth had largely disappeared now that the war appears to be at an end. The same member said, however, that it was not really possible to discern any clear reactions from the financial markets that this burden had been lifted. Instead, the markets have continued to be characterised by uncertainty over the future. According to the member, this suggests that we are facing more fundamental problems in the world's leading economies.

Another member agreed with this assessment and pointed to the fact that the dollar has continued to fall despite favourable development for the United States in the war with Iraq. According to the same member, this could indicate that the trend in the dollar may be due to other more fundamental problems in the US economy rather than to uncertainty over the Iraq war.

A third member pointed out that many factors can influence the value of a currency, e.g. expectations of differences in growth and interest rates. The member drew attention to the fact that investors still see the United States as a country with greater growth potential than Europe and Japan, for example, which is positive for the dollar. As things stand at present, with the current uncertainty surrounding stock market development, greater importance is being attached, however, to investing in fixed-income instruments, making interest rate differentials more important for exchange rates than they were a couple of years ago. These two counteractive forces as well as the fact that exchange rates have been undergoing a process of adjustment for a considerable time, indicate that the risk of an abrupt adjustment has diminished.

A fourth member disagreed with this assessment, saying instead that an increasing number of investors were engaging in portfolio investment. Previously, the flow of capital largely consisted of direct investment. This has made the capital more volatile, as it is easier to leave portfolio investments should there be a change in outlook.

The same member pointed to the differences in growth between the euro area and the United Kingdom/United States and underlined the possibility that these could explain the surpluses and deficits in the current accounts of these regions. How to get the better of these is a delicate issue. The deficits could be adjusted through a crisis scenario in which the US economy enters a recession and the dollar falls in value. A smoother adjustment could also take place whereby the dollar continues to weaken at the same time as productivity remains favourable and international growth gathers pace. It is the latter scenario that we are now witnessing. According to the same member, the recent increase seen in the deficits can partly be explained by the weaker dollar leading initially to a rise in import prices at the same time as import volumes have remained unchanged. The result is a deterioration of net trade which increases the current account deficit before import volumes fall and exports gain momentum.

1.3. Supply and demand

In the March Inflation Report, economic growth in Sweden was forecast at 1.7 per cent in 2003 and 2.4 per cent in 2004 and 2005. Actual data on foreign trade and industrial production received since the Inflation Report has largely been in line with this forecast. Indicators of expectations such as ICI and HIP have moved in a negative direction, however, since the beginning of the Iraq war. The monthly business tendency survey of the National Institute of Economic Research, which was conducted before the war broke out, showed that the expectations of firms were optimistic. Households were also more optimistic about their personal finances than in the previous survey. Consequently, the signals regarding future domestic economic activity can be said to be mixed.

The Government has presented its Spring Fiscal Policy Bill for 2003. The budget included proposals for measures equivalent to savings of just over SEK 8 billion in 2003 and an additional SEK 6 billion in 2004 so as not to exceed the expenditure ceiling. The size of the proposed savings is largely the same as in the Inflation Report.

It was also announced in the budget that municipalities and county councils will be allocated funds in 2004. It is therefore likely that public sector consumption will be somewhat higher next year. As the public sector is more employment-intensive than the private sector, the number of hours worked in the economy as a whole may increase slightly in 2004.

Corporate sector investment rose less than expected towards the end of 2002, which indicates that investment in this sector may exhibit weaker growth than was previously assumed. At the same time, national account statistics showed higher-than-expected public sector investment. As the financial situation of the public sector is expected to be strained in coming years, it is not anticipated that this sector will be able to make any large investments this year.

One member observed that the weaker recovery now foreseen in Sweden this year is largely due to a forecast delay in the rise in investment in trade and industry. Investment is difficult to predict, which makes growth estimates particularly uncertain.

All in all, the Executive Board judged the most likely scenario to be a continued recovery of the Swedish economy. However, somewhat weaker growth in export markets and the sluggish growth in investment seen at the end of last year suggest that the economic recovery will be somewhat slower compared with the assumptions of the March Inflation Report, despite the Riksbank's rate cut in March. Somewhat tighter fiscal policy will also contribute in this regard. Thus, it is anticipated that economic growth in Sweden will be slightly lower in 2003, which implies that resource utilisation is also expected to be lower during the forecast period.

One member warned of the inflation risks associated with the wage demands of the Swedish Municipal Workers' Union. At the same time, the member pointed out that the risk of relative wage movements being passed on to other labour market groups could have been greater had the demands from the Union been made when the wage bargaining round had began in earnest.

Another member disagreed with the assessment that the labour market at present constitutes an inflation risk. The member pointed to the weakening of the labour market over the past six months and added that there is a risk of this weakness increasing over the rest of the year.

2. The Executive Board's assessment of inflation prospects

In the main scenario of the March Inflation Report, CPI inflation was forecast at 1.0 per cent in March 2004 and 2.0 per cent in March 2005. The corresponding forecasts for UND1X inflation were 0.8 and 1.8 per cent, respectively.

The March Inflation Report emphasised the uncertainty that had arisen from the geopolitical situation. This posed threats to the world economy that were difficult to assess and entailed both upside and downside risks. Apart from this, the Inflation Report depicted a balanced risk spectrum. The principal downside risk for Swedish inflation was judged to be the uncertainty surrounding international economic developments, totally irrespective of the Iraq crisis.

The Executive Board concluded that the uncertainty stemming from the Iraq crisis has now diminished somewhat as the armed conflict appears to be at an end. This in turn entails less risk of higher oil prices. At the same time, it was concluded that upside risk for inflation remains from larger-than-expected contagion effects from high electricity prices and the wage bargaining round. A continuation of the high electricity prices could contribute to higher wage demands, as large sections of the labour market will be entering wage negotiations in the autumn. All in all, it was assessed that inflation would exceed the inflation target in 2003 and fall short of the target in 2004. Compared with the forecast in the Inflation Report, inflation is expected to be marginally lower one to two years ahead. This also applies to inflation adjusted for the effects of energy prices, although this is expected to develop in line with the inflation target.

2.1. The Executive Board discussion

Three members considered the risk spectrum to be balanced. One member concluded that the end of the Iraq war has reduced the downside risk for inflation, while it has also entailed that the upside risk associated with a high oil price has disappeared.

Another member agreed with this assessment and said that the risk level therefore remains balanced while the uncertainty in the assessment has diminished. The same member observed that the process of balance sheet adjustment had reached different stages in the United States and Europe, but that it had proceeded smoothly thus far. According to studies performed at the IMF, growth is subdued approximately 2.5 years on average following a substantial decline in share prices. According to the member, this perspective could entail that the worst is now behind us. At the same time, the member pointed out that a number of countries are contending with specific problems: the German banks are having problems with profitability, which could lead to lower growth in Germany. The growth in property prices in the United Kingdom also constitutes a risk, while the spread of SARS in a number of Asian countries and Canada could dampen demand in these countries. The member pointed out, however, that the threat posed by SARS may prompt people to change the focus of their consumption, thus making the overall effect on demand uncertain. In light of this, the member held the same view of future developments as before and considered it reasonable to believe in a continued recovery due to cyclical factors and the expansionary fiscal policy.

Three other members concluded that the risk of weaker economic activity had become greater and that the downside risk for inflation had thereby increased as well. One of these members emphasised that as the Iraq war had not been as dramatic as many had expected, this should have given rise to a more robust upswing on stock markets by this stage. A short war had been expected to produce a fast, powerful reaction on the markets. According to the member, the fact that this reaction has not been forthcoming may be due to the underlying trend being relatively weak, partly as a result of the fact that the adjustment of savings in the wake of the stock market decline is still in progress. The member was therefore less optimistic than before about developments one year ahead. The member also pointed out that inflation prospects now appear somewhat weaker in spite of the repo rate cut, thus reflecting a more potent underlying weakness.

Another member concluded that since the “wet blanket” that had been having a dampening effect during the Iraq crisis had been lifted, the other subduing factors - such as savings imbalances in the United States and structural problems in Japan and Europe - now appear more evident. Furthermore, another factor weighing on developments has appeared in the form of SARS. With that, there is a risk that the only growth machine seen thus far – China and South-East Asia – will also slow and that demand in the world economy will slacken further. Recent unemployment figures in the United States have been surprisingly high, and unemployment is now close to a level often associated with a recession. In addition, there is a clear risk of a property crisis in both the United States and the United Kingdom. Prices have begun to fall, and if interest rates should begin to rise as a result of high public borrowing and the need to attract capital inflows from abroad, this could trigger a crisis. In the United Kingdom, the situation in the property market today is similar to the one that preceded the property crisis that broke out in 1988. In light of this, the member questioned whether the risk spectrum could be viewed as being balanced.

One member said that a particular risk for the property market at present is that interest rates are already very low. This means that the ability to use monetary policy to counteract the effects on the economy of a sharp fall in property prices is greatly limited.

Another member pointed out that the Monetary Policy Department had analysed particularly household indebtedness in the United States and the developments in property prices, and had come to the conclusion that there were no signs of a property price bubble. This was also the assessment in the main scenario of the Inflation Report. The same member also added that it is of course possible for unexpected events to occur even if there does not appear to be any immediate threats in the United States at present. A heavy decline is part of the risk spectrum, according to the member.

One member drew attention to the fact that new statistics had only recently shown that the number of houses sold in the United Kingdom during the first quarter had fallen by 21 per cent compared with the corresponding period last year.

Yet another member pointed to the IMF's latest report in which a study of property prices indicates that the developments of recent years have resulted in a price level in many countries that is not unproblematic. Furthermore, declines in property prices tend to occur simultaneously in several countries or spread between countries.

One member observed that the same IMF study had shown that the contagion effects of the post-war property price crashes were a consequence of monetary policy tightening aimed at subduing inflation. The member concluded therefore that the current situation makes contagion via the interest rate channel appear less likely, as inflation is low and there is thus no need to raise interest rates.

Another member agreed with this assessment and added that it is not peculiar for crises to spread in the wake of share price bubbles as the stocks of leading companies are traded on several exchanges, but that such contagion is less likely to occur via monetary policy.

One member observed that even if property prices fall, it does not necessarily represent a property crisis. A certain, smooth decline does not in itself constitute a risk of a crisis. The same member was of the opinion that the price of property in the United States does not give cause for concern at present, while also pointing out that the trend could become risky in the event of a sharp rise in unemployment there. This member also agreed with the member who had observed that the alleviation in uncertainty ought to have given a considerable boost to the financial markets and that underlying economic factors are probably the reason this reaction has not been forthcoming. In light of this and the additional negative information that has been received about developments both in Sweden and abroad, the member was of the opinion that the downside risk for inflation now outweighs the upside risk.

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

3.1. Account of the monetary policy group's view of the monetary policy situation

Deputy Governor Irma Rosenberg presented the monetary policy group's view of the monetary policy situation.1 The group concluded that it appears economic activity will be somewhat weaker than forecast in the March Inflation Report, while the fundamental picture of gradually increasing economic growth during the forecast period has not changed. The group noted that various economic indicators suggest that household and corporate optimism has been dampened further. However, even if the uncertainty surrounding the Iraq crisis has diminished, the problems involved in interpreting different economic indicators have remained, as the data was collected during the period of uncertainty. The monetary policy group concluded that a strict application of the rule of action would imply a rate cut, as inflation prospects measured by both CPI and UND1X one to two years ahead fell slightly short of the inflation target. However, adjusted for the effects of energy prices, which are judged to be transitory, inflation is expected to be in line with the target. In light of this and taking into account both the March rate cut and the lack of information gathered after the Iraq war, the majority of the group advocated leaving the repo rate unchanged at present.

3.2. The Executive Board discussion

The Executive Board concluded that monetary policy in general over recent years has been based on forecasts of UND1X inflation. This index was chosen because, unlike CPI, it is not sensitive to temporary effects on inflation of changes in indirect taxes, subsidies and interest costs for home owners. In addition, developments in the prices of oil and electricity should be taken into account, as the Executive Board did prior to the most recent interest rate decision. The rise in the prices of these products is essentially judged to be a result of transitory supply shocks and is thereby irrelevant for the formulation of monetary policy, as clarified by the Riksbank in 1999.

Four members shared the opinion of the monetary policy group to wait before making any changes to monetary policy.

One of these members pointed out that cutting interest rates in the midst of a strike would send out the wrong signal. The member observed, however, that it was a source of concern that the next meeting would not take place until 4 June, which was somewhat far-off. The member was also of the opinion that UND1X inflation excluding energy prices is the most relevant variable to study at present. Inflation prospects measured in this way are in line with the inflation target, and the member deemed that a potential interest rate change should be deferred until the June meeting.

Another of the four members said that there were several factors advocating a rate cut. One was that intellectual reasoning suggests such a move. Another was that the output gap is now judged to be larger, and demand is expected to be slacker this year than previously

[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 ex-pressed in the minutes are not necessarily shared by all the members of the group, including the chairperson.

assumed, mainly due to lower investment. Consumption will also be affected by the fiscal tightening and the rises in municipal taxes. The member also pointed to the possibility that the steps being taken in the fiscal plan towards creating better incentives to work would imply marginally higher potential growth in the future, but that this would take time. An additional reason for cutting interest rates is the fall in oil prices, which has reduced the risk of persistent inflation. The member continued, however, by noting a number of reasons against a rate cut. These were partly the difficulty in interpreting incoming data and partly the fact that the larger output gap is largely due to weaker demand caused by lower investment. As investment is a difficult variable to estimate and forecasts of investment often prove incorrect, the member did not consider it reasonable to base a rate change on this variable alone. In addition, the member observed that electricity prices may not come down as forecast, which increases the risk of contagion effects. Inflation has also been slightly higher than expected at the same time as inflation expectations have remained above the target. One interpretation of the krona's weakness and the high long-term interest rate differential in relation to the euro area could be that there are inflation expectations in the market. These expectations may contribute to a lingering risk of persistent inflation. The member also agreed with the previous observation that it would be peculiar to change interest rates in the midst of a strike over higher wages and during a conflict where the outcome is still uncertain. The member continued by stating that another reason against a rate cut is that the market would be surprised by such a move and that it is not good for it to happen too often. On the whole, the member proposed leaving interest rates unchanged.

A third member observed that recent statistics have been weaker and that the recovery therefore may be delayed until further into the future. At the same time, the member pointed out that inflation has not fallen as quickly as the Riksbank assumed in March. The member shared the opinion of the monetary policy group that it is difficult to evaluate the statistics from the first quarter this year and that there is reason on the whole to wait with any rate cuts. The member said that additional rate cuts may be necessary in the future, however. The coming months' data of economic activity will play a significant part in this regard.

Two members questioned the monetary policy group's conclusion to leave the repo rate unchanged. One of these members observed that the Riksbank's rule of action advocated a rate cut in spite of the fact that the repo rate was lowered by 0.25 percentage points at the previous meeting. The member pointed out that the Government had begun in its Spring Fiscal Policy Bill to tackle the problems of both the supply of labour and sick leave, which is a positive development that can enable the Riksbank to conduct somewhat less restrictive monetary policy. The same member agreed with the member who had questioned whether the risk spectrum is balanced and who deemed that the downside risk stemming from international developments was the more important factor for Swedish inflation. The member also observed that while the Swedish Municipal Workers' Union's strike entailed an upside risk for inflation, this should only be dealt with if it eventually proves necessary and not as a preventive measure. In light of this, the member proposed a rate cut of 0.25 percentage points.

The other of the two members pointed out that even if the demands of the Swedish Municipal Workers' Union should be met, inflation would not be affected provided there were no contagion effects on coming wage bargaining rounds. A weaker labour market in Sweden together with lower resource utilisation would reduce the risk of such a development. The member shared the view that the repo rate should be lowered by 0.25 percentage points. The member pointed out that inflation in the main scenario is forecast to fall short of the target over the entire forecast period, even when taking account of energy prices. For this reason, the member believed that leaving the repo rate unchanged would not be a symmetrical action. The member pointed out that investment, which is now judged to be appreciably weaker than indicated by previous estimates, would require such stimulus. If the assumption in the main scenario of a gradual rise beginning this year holds true, it is now that the repo rate should be lowered, particularly given the fact that the next monetary policy meeting will not be held until June.

§ 2. Monetary policy decision[2]

The Chairman summarised the monetary policy decision under § 1 and found that there were two proposals at hand: to leave the repo rate unchanged or to lower the repo rate by 0.25 percentage points. A vote was held and this resulted in four votes in favour of unchanged instrumental rates and two votes in favour of lowering rates by 0.25 percentage points.

The Executive Board decided to leave the repo rate unchanged and thereby also to leave the lending and deposit rates unchanged with effect from 30 April. It was also decided to announce the decision at 9.30 a.m. on 25 April with the motivation and wording contained in Press Release no. 28, 2003 (Annex to the minutes).

Deputy Governors Kristina Persson and Lars Nyberg entered a reservation against the decision to leave the repo rate unchanged. According to both Deputy Governors, the repo rate should be lowered by 0.25 percentage points for which they cited a number of reasons including the fact that the Riksbank's rule of action advocated such a move. The two Deputy Governors continued by observing that demand both in Sweden and abroad is expected to be somewhat lower this year and next year. Resource utilisation during the entire forecast period is therefore also expected to be slightly lower than foreseen in the March Inflation Report, despite the repo rate cut in the same month. Inflation one to two years ahead is judged to be somewhat lower than anticipated in the Inflation Report and to fall short of the target measured by CPI and UND1X. Even if inflation adjusted for energy prices is expected to be close to the inflation target one to two years ahead, there is reason at present to lower the repo rate. A rate cut now could help boost investment during the forecast period. A lowering of the repo rate would stimulate both demand and potential growth without threatening the inflation target. Furthermore, the international downside risks for inflation can be assumed to be somewhat greater than the domestic upside risks.

This paragraph was confirmed immediately.

Minutes by:

Kerstin Alm

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

Checked by:

Lars Heikensten	Eva Srejber	Irma Rosenberg
Villy Bergström	Lars Nyberg	Kristina Persson