Monetary policy Minutes

July 2016

S V E R I G E S R I K S B A N K

Summary

At its monetary policy meeting on 5 July, the Executive Board of the Riksbank decided to hold the repo rate unchanged at −0.5 per cent and to continue purchasing government bonds during the second half of the year, according to the plan decided in April. The time of a first increase in the repo rate is postponed somewhat. The rate is not expected to be raised until the second half of 2017, and then at a somewhat slower rate than was previously assessed. A majority of Executive Board members decided to extend the mandate for foreign exchange interventions introduced at the beginning of the year. There is still a high level of preparedness to make monetary policy even more expansionary if this is needed to safeguard the inflation target.

It was noted at the meeting that the Executive Board agreed on the picture of economic prospects and the inflation outlook described in the draft Monetary Policy Report. Uncertainty over economic developments abroad and in Sweden had increased after the United Kingdom EU referendum. It remains the Riksbank's assessment that the global economy is continuing to improve, but the forecasts for growth abroad and in Sweden have been revised down. International inflation is low and several central banks are expected to conduct a more expansionary monetary policy.

In Sweden, economic activity has strengthened rapidly. Activity is expected to continue to improve and that creates the conditions for inflation to keep on rising. Next year, CPIF inflation is expected to reach 2 per cent.

All in all, the Swedish economy has developed as expected since the monetary policy decision in April although uncertainty has increased. To maintain the rising trend in inflation, good economic growth in Sweden needs to continue. Several central banks abroad are, however, expected to pursue an even more expansionary monetary policy and the inflation forecast is sensitive to various international factors. Against this backdrop, the Executive Board drew the conclusion that monetary policy in Sweden needs to continue to be very expansionary.

The Executive Board agreed unanimously to hold the repo rate unchanged at −0.5 per cent and to continue to purchase government bonds in the second half of 2016 in line with the decision in April.

The increased uncertainty means that the entire Executive Board considers it appropriate to postpone the first repo rate increase somewhat. The rate is not expected to be raised until the second half of 2017, and then at a somewhat slower rate than was previously assessed. Until further notice, maturities and coupons from the portfolio of both nominal and real government bonds will be reinvested.

Against the backdrop of, not least, this increased uncertainty, the Executive Board was also unanimous as regards the importance of having a high level of preparedness to make monetary policy even more expansionary, even between ordinary monetary policy meetings, if this is needed to safeguard confidence in the inflation target. A majority of Executive Board members has therefore decided to extend the mandate for foreign exchange interventions adopted at the beginning of the year.

MINUTES OF MONETARY POLICY MEETING
Executive Board, No. 5

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DATE: 05/07/2016

TIME: 09.00

PRESENT: Stefan Ingves, Chair
Martin Flodén
Per Jansson
Kerstin af Jochnick
Henry Ohlsson
Cecilia Skingsley

Susanne Eberstein, Chair of the General Council

Mattias Ankarhem
Sophie Brauner
Charlotta Edler
Heidi Elmér
Bo Enegren
Mattias Erlandsson
Jens Iversen
Jesper Johansson
Martin W Johansson
David Kjellberg
Pernilla Meyersson
Marianne Nessén
Christoffer Nordenlöw (§ 1)
Cecilia Roos-Isaksson
Maria Sjödin
Ulf Söderström

It was noted that Mattias Ankarhem and Bo Enegren would prepare draft minutes of the monetary policy meeting.

§1. Economic developments

Christoffer Nordenlöw from the Markets Department began by presenting the latest developments on the financial markets. Since the monetary policy meeting in April, developments on the financial markets have been characterised by uncertainty linked to the referendum in the United Kingdom, in which a majority voted on 23 June to leave the EU. As a result of this, there have been major fluctuations on the world's stock exchanges and prices of safer assets, such as government bonds, have risen. In Europe, stock markets have fallen since April, while in the United States the level is more or less unchanged at present. There have been larger falls for bank shares, which is partly due to renewed unease regarding the health of the European banking sector, and partly to uncertainty over the conditions for the banks' activities in the United Kingdom going forward.

The market's expectations of when the Federal Reserve will raise the policy rate in the United States have swung back and forth since April. Following the UK referendum, expectations are now significantly lower than before. According to market pricing, the next policy rate rise in the United States is now expected in 2018. In Europe, the European Central Bank (ECB) has not launched any new measures over the period. However, following the referendum in the United Kingdom, expectations of lower policy rates in the period ahead have increased. The shift in market expectations has been greatest in the United Kingdom, where the market is now awaiting a policy rate cut from the Bank of England later in the year. This picture is reinforced by statements from the Bank of England, which have signalled that monetary policy in the United Kingdom will probably need to be made more expansionary over the coming months.

The referendum result has led to a large depreciation in sterling. At the same time, currencies that usually appreciate substantially when there is great uncertainty on the market, such as the US dollar and the Japanese yen have appreciated. The increased uncertainty has also led the krona to weaken in relation to the forecast in April. Prior to today's monetary policy meeting, a majority of analysts are expecting an unchanged repo rate but that the Riksbank will postpone the first increase in the rate.

Marianne Nessén, Head of the Monetary Policy Department, presented the draft Monetary Policy Report which, in the assessment of the Monetary Policy Department, would gain the support of the majority of the members of the Executive Board.

The global recovery is expected to continue, but uncertainty has increased due to the result of the United Kingdom referendum. Forecasts for growth have been revised down, primarily for the United Kingdom, but also for the rest of Europe. However, it is difficult to assess the effects of the outcome of the United Kingdom referendum. There is a risk of larger negative repercussions, but these are at present difficult to quantify in a forecast. At the same time, monetary policy abroad is expected to become even more expansionary than assumed in the April forecast, while inflation prospects remain largely unchanged. Following the United Kingdom referendum the krona weakened, but is expected to gradually strengthen and return to the level forecast in April in around one year.

The Swedish economy is continuing to develop strongly, and unemployment is falling. However, growth will be lower going forward, compared with 2015, and the forecast has been revised down, mainly as a result of the UK referendum. The labour market is continuing to improve, with rising employment and falling unemployment in 2016 and 2017. Resource utilisation, which is currently assessed to be normal, will thus continue to rise in the coming years. Household indebtedness is increasing, and towards the end of the forecast period debt as a percentage of disposable income is expected to be 195 per cent.

Since the monetary policy meeting in April, inflation outcomes for April and May have been reported. The upturn in inflation slowed down in relation to March, as expected, and the outcomes were slightly lower than the Riksbank's forecast. The rising trend in inflation that begin in early 2014 is expected to continue, however. The contribution to inflation from the earlier krona weakening is expected to decline as the krona slowly strengthens. Instead, the upturn in inflation is expected to be increasingly driven by higher resource utilisation. CPIF inflation is expected to increase from just under 1.5 per cent for most of 2016 to close to 2 per cent in the second half of 2017. This entails a somewhat delayed upturn in inflation in relation to the April forecast. The main reason for this is a changed forecast for energy prices, which are expected to increase more rapidly in the short term and more slowly in 2017. Another reason for the downward revision in the inflation forecast is that rents are expected to increase somewhat more slowly than was forecast in April.

The forecast in the draft Monetary Policy Report is based on the repo rate being held at –0.5 per cent, and on the first increase in the rate being postponed in relation to the earlier assessment. The bond purchases will continue during the second half of 2016, as decided in April.

Ms Nessén noted that the forecasts in the draft report were discussed by the Executive Board at meetings held on 2, 15, 17 and 20 June. The forecasts were also discussed at an extraordinary meeting on 28 June in the light of the outcome in the United Kingdom referendum on EU membership. The draft monetary policy report was discussed and tabled at a meeting of the Executive Board on 30 June.

Ms Nessén went on to describe the discussions conducted by the Executive Board at the monetary policy drafting meetings.

One question that has permeated the entire monetary policy drafting process on this occasion was the uncertainty abroad, not least the potential consequences of various outcomes of the United Kingdom referendum on EU membership. Other important discussions concerned the Swedish krona, inflation prospects and the effects of monetary policy. When the outcome of the

UK referendum was announced, the Executive Board agreed to revise down growth forecasts, primarily for the United Kingdom, but also for the euro area and Sweden. They were also agreed that the very uncertain nature of the forecasts should be emphasised. The Executive Board thought it important to gather information during the course of the work and to analyse how other analysts have dealt with this issue so far.

Ms Nessén observed that in the discussion on monetary policy abroad and how this affects monetary policy in Sweden, questions were raised regarding the level of the long-run repo rate and how one should view differences in future policy rates in different countries and regions over time. The effects of monetary policy abroad on Sweden and on the krona exchange rate are described in detail in the draft Monetary Policy Report.

Further, Ms Nessén described some of the questions raised by the Executive Board and which have been analysed in the drafting work with regard to the inflation forecast. For instance, how high resource utilisation needs to be in the economy to generate sustainably higher domestic price pressure, and how sensitive the inflation forecast is to fluctuations in the exchange rate. There are now signs that the rising resource utilisation in the Swedish economy is also contributing to a rising rate of increase in more domestically determined prices. Different members of the Executive Board highlighted on several occasions the importance of following the development of domestic price pressure and the relationship between resource utilisation and the development of inflation.

Ms Nessén noted that the monetary policy discussion in the drafting process had concerned, in addition to the UK referendum, the effects of a negative repo rate, the design of the repo-rate path, the extension of the delegation decision regarding foreign exchange interventions and how best to communicate monetary policy in a very uncertain situation. The deliberations made and conclusions drawn are reflected in the draft Monetary Policy Report.

§2. The economic situation and monetary policy

First Deputy Governor **Kerstin af Jochnick** began by saying that she agreed with the assessments in the draft Monetary Policy Report with regard to developments both abroad and in Sweden. She also supported the draft forecast for the repo rate, according to which it will now take longer before the repo rate begins to be raised. She also backed the proposal to extend the foreign exchange intervention mandate.

Ms af Jochnick pointed out that the Riksbank has for a long time been highlighting uncertainty abroad, which is making it difficult to make really good forecasts of future developments. The uncertainty in recent years has largely been caused by weaknesses in the financial system and the negative effects of excessively high public and private indebtedness in several countries. Ms af Jochnick said that she considers that the uncertainty in international developments has now increased further. This is in part due to the effects of the result of the referendum in the United Kingdom, although there were question-marks about the strength of global growth even before the vote took place. At this stage, it is difficult to assess what effect Brexit will have on the global economy. Answers are required to many difficult questions and it will probably take a long time before the picture becomes clear. However, Ms af Jochnick said that, in her opinion, most analysts agree with the Riksbank that growth in the UK will be negatively affected in the years ahead. The effect on Sweden need not necessarily be so great but this remains to be seen, and the Riksbank must be prepared to adjust its assessment.

Ms af Jochnick also noted that global developments look quite good despite only moderate growth and rather weak inflation. Nonetheless, the Riksbank expects the global recovery to continue albeit at a slower pace compared to the previous forecast in April. Different countries and regions have different problems. In the euro area, monetary policy is very expansionary. In addition, fiscal policy is deemed to be shifting from having been neutral in 2015 towards making a weak positive contribution to growth this year and next year. Despite this, GDP growth in the euro area will be rather weak during the forecast period. Ms af Jochnick also pointed out that macroeconomic developments in Europe, to a high degree, are being affected by the fragility of the banking system in several countries. A high proportion of bad loans risks damaging confidence in both banking systems and sovereign countries. Structural measures are therefore needed in several countries in order to tackle the imbalances and ensure that the banking system is adequately capitalised so that it can support households and companies in the long term.

In addition, Ms af Jochnick said that there are also financial imbalances in China, primarily a high level of indebtedness in the corporate sector, which is contributing to the uncertainty about the strength of future growth. Furthermore, several commodity-producing countries, such as Brazil and Russia, face major challenges.

She also pointed to the fact that the weak global recovery and the market's interpretation of signals from, for example, the Bank of England mean that we can expect many central banks to continue to pursue a very expansionary monetary policy. Market participants have also made the assessment that the Federal Reserve will postpone further rate rises. She also noted that as far as Sweden and the Executive Board's decisions are concerned, there is a great deal to suggest that the global risks have increased and that growth abroad will be lower than previously forecast by the Riksbank. According to Ms af Jochnick, it is therefore reasonable to revise growth down slightly for both abroad and Sweden.

In addition, she pointed out that it is difficult to judge what effects Brexit would have on the global economy and Sweden. Ms af Jochnick emphasised that the Riksbank must continue to monitor developments closely and discuss how the Swedish economy might be affected. In the long run, it is a question of ensuring that monetary policy is well balanced in order to achieve the inflation target of two per cent. Greater uncertainty abroad and weaker growth now justify a postponement in the forecast for a first rate rise.

Ms af Jochnick noted that CPIF inflation has developed more or less in line with the Riksbank's forecast in April. The adjustments now being made are relatively minor. CPIF inflation is expected to increase from just under 1.5 per cent for most of 2016 to close to 2 per cent in the second half of 2017. The upturn in inflation is slightly delayed compared with the previous forecast and is primarily due to the expectation that energy prices will increase more quickly in the short term but more slowly in 2017. The Riksbank's assessment is that economic activity will continue to improve, creating the conditions for inflation to continue to rise and stabilise close to the target in 2017.

She also pointed to the successive improvement in the labour market and the fact that in some industries, companies are starting to find it difficult to find labour with the right skills. According to Ms af Jochnick, this should lead to rising wage and salary costs for certain groups. At the same time, she noted that many consumer-related companies in the Riksbank's Business Survey say that competition is tough, not least from eCommerce, and that this will continue to dampen price growth. However, there are many indications that underlying inflation is rising albeit at a slow pace.

Ms af Jochnick asserted that one threat to the development projected by the Riksbank is that development abroad can be worse than in the forecast. According to Ms af Jochnick, a worse international scenario cannot be ruled out as a result of the downside risks identified in the draft Monetary Policy Report. On the other hand, it is positive for the development of inflation that inflation expectations in Sweden, especially over five years, seem to be stabilising just under 2 per cent. She pointed out, however, that there is naturally a concern that the heightened uncertainty seen above all in the UK may spread and also affect expectations in Sweden.

With low interest rates even longer than previously expected by the Riksbank and without further measures from other authorities, the risks on the Swedish housing market will increase, according to Ms af Jochnick. The measures previously called for by the Riksbank in order to make the housing market function more efficiently and to stem household indebtedness therefore continue to be of pressing importance. In Ms af Jochnick's view, failure to take further measures can lead to greater imbalances, which can ultimately threaten economic stability. It is her opinion that monetary policy for a long time has taken responsibility for stimulating the Swedish economy and for ensuring that inflation rises towards the target. According to Ms af Jochnick, it is now high time for other policy areas to act with the aim of ensuring that both the housing market and household indebtedness can develop in a way that will benefit the national economy.

Deputy Governor **Cecilia Skingsley** began by supporting the forecasts, deliberations and draft monetary policy in the report. She highlighted the fact that the deliberations leading up to today's Monetary Policy Report have been dominated by the effects up to now and conceivable future effects of the United Kingdom EU referendum and thought that the wording of the report mirrored these deliberations very well. However, Ms Skingsley wished to add two comments concerning the referendum that are important for her as regards the view of developments in Sweden in the period ahead: One on the economic consequences and one on the importance of institutions for long-term favourable economic development.

Regarding the economic consequences, the dramatic market reactions indicate that the outcome was a considerable surprise to most people. One positive aspect is that the financial markets continued to function, despite a large turnover and substantial price changes in many assets over a short period of time. Concerns expressed from the financial market that recent new international regulations have impaired market functions were not realised. Regardless of one's opinion of the actual result of the referendum, it is Ms Skingsley's assessment that it raises different types of risk premia not only for the UK economy but also for uncertain future political events, which will then subdue growth. Greater uncertainty will dampen both investment decisions and job creation in companies, as well as household consumption. Ms Skingsley expects more cautious future plans among both companies and households especially in the UK, but also among many neighbouring countries and as a result a weaker recovery than previously projected by the Riksbank. At the same time, we should bear in mind that the focus has thus far been on the negative risks in the form of greater uncertainty and impaired trading conditions. Ms Skingsley also highlighted the potential positive economic effects of the UK's stance in a long-term perspective, i.e. many years ahead. But this is a perspective that lies beyond the normal forecast horizon of central banks.

Regarding the institutional importance, she noted that the referendum result implies major challenges. In the short-term perspective, the Bank of England must shoulder great responsibility within its remit to safeguard financial stability and continued price stability in the British economy. Thorough preparations have been made by the authorities, in which UK banks, for example, have been instructed to take in more capital and liquidity so that the banking system can manage to absorb the downturn in economic activity, rather than the banking system exacerbating it.

For Ms Skingsley, the economic, political and central government upheavals in the UK are a reminder of the importance ofSweden also safeguarding its own well-functioning institutions which, within their various remits, are delivering on their objectives. The Riksbank's price stability objective, defined more closely as an inflation rate of 2 per cent, is for her a cornerstone of good economic development. In the same way, reassuring rules and supervision of banks act as a shock-absorber. So price stability and financial stability become even more important when many other things in the world are changing. Ms Skingsley then left the issue of the UK referendum by noting that revision tendencies for international growth were already pointing in a weaker direction even before 23 June. She then highlighted the prospects of both the euro area and the United States.

Since the April meeting, however, the Swedish economy has developed approximately as expected , with strong domestic demand, even though growth is gradually slowing compared with 2015. The Riksbank's negative policy rate and bond purchases are raising some questions and comments, but have so far had an effect, with respect to Swedish growth, the labour market and inflation, that is going in the right direction. Ms Skingsley was very keen to highlight the recent survey of money market participants, which showed that their long-term inflation expectations are back at 2 per cent and that the inflation expectations of other groups of economic agents are one tenth of a per cent below. The continued policy of low interest rates is not without risk, however. It is important that the Riksdag and the Government continue to work to improve the housing market, the financial dimension of which constitutes a major stability risk.

She also considers it reasonable at this meeting to make certain downward revisions to the economic prospects, while making it clear that there are risks and opportunities emanating from the international difficulties that cannot be quantified, at least not yet. For the monetary policy decision today, the proposal is to delay the start of forthcoming rate rises. Given the strong Swedish economy, supporting the proposed repo rate forecast was not a foregone conclusion for Ms Skingsley. But against the backdrop of the elevated uncertainty and that the forecast risks dominate on the downside, she considers the advantages of a prolonged low interest rate to be greater than the disadvantages.

Finally, Ms Skingsley was of the opinion that the krona exchange rate will continue to be an important factor to monitor going forward. Even if the Riksbank's forecast is that the krona will gradually strengthen in the coming years, it is important that the appreciation is only gradual and does not become a threat to the development of inflation. She therefore supported an extended delegation to the Governor and Deputy Governor to take action if needed at short notice.

Governor **Stefan Ingves** began by stating that, in his opinion, the Monetary Policy Report mirrored the state of the Swedish economy and the monetary policy deliberations very well. He noted that he could confine himself to supporting the report and not say anything further, but that it was also customary to make some additional comments.

To begin with, he noted that the Riksbank's inflation targeting policy is delivering on its objectives. Since the negative policy rate and government bond purchases were introduced at the beginning of 2015, inflation has risen and is now close to the target. Furthermore, long-term inflation expectations have picked up again and are now back to 2 per cent. The Riksbank now estimates that Swedish CPIF inflation will increase from 1.5 per cent in 2016 to around 2 per cent in 2017 and 2018.

Mr Ingves also highlighted the fact that it is impossible to control inflation so that it is always at exactly 2 per cent. It will be perfectly sufficient if the Riksbank can push it up to around 2 per cent. Reintroducing some kind of interval around 2 per cent would facilitate discussions, according to Mr Ingves. He also reminded the meeting that inflation is very low in several other countries. HICP inflation in the euro area was –0.1 per cent in May. Also in France, Italy and Spain, inflation was negative in May. In Germany inflation was 0.0 per cent. But several countries outside the euro area also have low inflation. In the United Kingdom it was 0.3 per cent, in Denmark –0.1 per cent and in Switzerland –0.5 per cent. In an international environment with low inflation in many developed countries, the fact that Swedish inflation is on its way up and is expected to approach the target must be seen as a success.

Mr Ingves also noted that the referendum in the United Kingdom resulted in a vote to leave the EU and that this is contributing to a high level of political uncertainty in the short term with economic consequences that are difficult to assess in the longer term. It is difficult, even in normal cases, to make assessments of political decisions and to forecast their economic effects. After the outcome of the referendum, it is particularly difficult to quantify the international forecast and an appropriate strategy is to make gradual adjustments as the picture becomes clearer. The Riksbank estimates that the United Kingdom will bear the brunt of Brexit insofar as its GDP level at the end of the forecast period will be 2 percent lower than if it had voted to remain in the EU. But one must also consider the spillover effects to other countries. Internationally, the Riksbank still predicts a recovery, albeit at a slower pace, and expects monetary policy abroad to be more expansionary in order to counteract the negative consequences.

Mr Ingves also noted that growth is being adjusted down slightly in the euro area. But the Riksbank expects the euro area to continue to expand at a moderate rate. Growth will be supported by a weaker euro and a continued highly expansionary monetary policy. But there are also clear risks in the financial sector. The decline in bank equities in several countries in the euro area after the referendum is a reminder of how great the vulnerability is. In addition, the conditions for growth in the euro area are generally weaker than in Sweden, a consequence of a remaining need to adapt in a number of areas. The US economy slowed at the end of 2015 and start of 2016. However, incoming statistics since then indicate a recovery in the second quarter of the year. Over the last two months, however, employment has slowed noticeably, although this is deemed in part to be temporary.

All in all, Mr Ingves agrees with the assessment in the draft Monetary Policy Report that the recovery in the global economy will continue in the main scenario, albeit at a slighter slower pace. Even the Swedish economy will be affected by Brexit. GDP growth in Sweden was high in 2015, underpinned by strong domestic demand and strong exports. Resource utilisation is now close to normal. The Riksbank has made a slight downward revision of GDP growth for the period ahead, but economic activity continues to strengthen and resource utilisation will increase during the forecast period. This creates good conditions for inflation to continue rising.

CPIF inflation has been rising since 2014 and covers price increases in goods, services and food. Even though the inflation forecast has been revised down by 0.1–0.2 percentage points per year for 2017 and 2018, the conditions are in place for rising inflation in the period ahead. The Swedish economy is growing at a good pace and resource utilisation is rising. With a stronger development on the labour market, wages are expected to increase more quickly. Higher demand should make it easier for companies to raise their prices. The sharp depreciation of the krona in 2014–2015 has contributed to this. In the period ahead, increased resource utilisation is expected to contribute to an ever-greater degree to rising inflation while the krona's contribution will gradually wane as the exchange rate gets stronger. It is not least important that services prices then rise to a sufficient degree.

Mr Ingves pointed out that there are various risks associated with Brexit and developments abroad as he has noted previously. Since April, the krona has been weaker than the Riksbank's forecast. The reactions are in part temporary but the krona is expected to be weaker in the year ahead compared with the previous forecast. The krona is expected to appreciate in the period ahead, but we must be prepared that it can be both stronger and weaker than in the main scenario.

An event that has an unexpected outcome, such as Brexit, leads to greater uncertainty and shows how important it is to have one's own house in order. The Riksbank is currently pursuing a very expansionary monetary policy to contribute to strong domestic demand that leads to inflation rising towards the target. The policy is now starting to work. At the same time, however, the pursued policy presupposes that the risks on the housing market are tackled by other policy areas.

Rising housing prices and ever higher household indebtedness pose ever-greater risks to economic stability. Finansinspektionen has taken certain measures such as the introduction of an amortisation requirement, a loan-to-value limit and a risk-weight floor for mortgages. Further measures are required, however, to mitigate the risks. It was therefore unfortunate that the political party discussions on housing policy were concluded without cross-party agreement, Mr Ingves noted. If no further measures are taken, the imbalances will increase. Households' loans are rising considerably faster than their incomes. If there were also to be a financial crisis in European banks, the funding options of Swedish banks may also be adversely affected. Mr Ingves asked how both the Swedish mortgage market and the share prices of Swedish banks would cope should that be the case. The fall is naturally greater than for, say, Deutsche Bank, whose share were trading at about 30 per cent of their book value a few days (28 June) after the Brexit vote, while Swedish banks were trading at about 130 per cent of their book value. But sentiment can shift very quickly, he added.

A sharply increased repo rate today would certainly slow down the build-up of debt, but with negative rates abroad, it would probably occur at the cost of a rapid appreciation of the krona, lower inflation and higher unemployment. For this reason, it is extremely important that macroprudential policy and other measures restrict the accrual of debt by households. Overall, Sweden currently has an unbalanced policy mix. The collective inability to manage the housing market may well cost us dearly later on.

Mr Ingves rounded off by presenting his conclusions regarding monetary policy. A continued highly expansionary monetary policy is needed to provide continued support to the Swedish economy and rising inflation. Mr Ingves backed the proposal to hold the repo rate unchanged at –0.5 per cent and to adjust the forecast for the repo rate so that it takes slightly longer before an initial rate rise is implemented. The Riksbank will continue its purchases of nominal and real government bonds in the second half of 2016 as decided at the previous meeting. He also supported the proposal to extend the delegation mandate for foreign exchange interventions. In an uncertain world, the Riksbank needs to be ready to use all the tools at its disposal. And, if necessary, even between the ordinary monetary policy meetings, he concluded.

Deputy Governor **Per Jansson** stated that the major event since the previous monetary policy meeting in April is of course the referendum in the United Kingdom and the result that a majority of the British population voted to leave the EU. However, Mr Jansson wanted to begin by giving his views on current inflation conditions, which are based on data gathered prior to the referendum and therefore not affected by it. Since the meeting in April, two new inflation outcomes have been reported, for April and May. Compared with the outcome in March, the inflation rate has slowed down somewhat in recent months. In May, CPIF inflation was 1.14 per cent, while CPIF inflation excluding energy prices was 1.42 per cent. The corresponding figures for March were 1.50 and 1.86 per cent respectively. That the inflation rate would decline in April and May was in line with the forecast in the April Monetary Policy Report. However, the slowdown was slightly bigger than expected, he noted.

The outcomes in April for both CPIF inflation and CPIF inflation excluding energy prices were scarcely a tenth of a percentage point lower than forecast. This still applied with regard to CPIF inflation in May, but for CPIF inflation excluding energy prices, the forecasting error had increased to almost 0.2 percentage points. The somewhat lower rate of increase for CPIF inflation excluding energy prices was due to a weaker development in both goods and services prices. The impact on the forecasts of CPI and CPIF inflation was counteracted by energy prices rising slightly faster than expected. All in all, inflation developments have thus been slightly poorer than was assumed in the April Monetary Policy Report. But Mr Jansson pointed out that the forecasting errors are fairly small and therefore do not give any great cause for alarm.

He went on to say that since the monetary policy meeting in April, two new outcomes for inflation expectations have also been published. With regard to expectations among money market participants, which are surveyed by Prospera every month, one can be satisfied with rising inflation expectations on all horizons in both May and June.[1] The important expectations of where the inflation rate will be five years from now, which can be regarded as a measure of credibility for the inflation target, were when rounded off to one decimal place, 2.0 per cent for both of these months. Mr Jansson noted that it is 30 months ago, in November 2013, that the five-year inflation expectations among money market participants were last at the inflation target.

The developments for other respondents, which are shown in Prospera's quarterly surveys, were also positive, emphasised Mr Jansson. Compared with March, expectations of inflation five years ahead rose for all groups in June. This continues to provide scope for the Riksbank to "see through" various temporary price shocks. He asserted, however, that as both inflation and longer-term inflation expectations have been lower than the inflation target for a long time, there is still a risk of even initially temporary price shocks having unusually large and sustained effects on inflation.

Given this, Mr Jansson summarised current inflation conditions as reasonably bright. Inflation developments suffer setbacks from time to time, but the Riksbank has emphasised all along that this is unavoidable. The important thing is that the trend rise in inflation, which has been under way since early 2014, continues and is broad-based. He noted that confidence in the inflation target has strengthened since the Riksbank has had a clearly stronger focus on inflation and also some success in pushing the inflation rate up. The fact that inflation has shown a rising trend for a couple of years and the inflation target is perceived as credible is of course reassuring. But this positive development needs to be sustained and to continue going forward, Mr Jansson pointed out. His assessment is that over the coming years a relatively rapid growth in the Swedish economy will be needed to ensure inflation rises as expected. From this perspective, the result in the UK referendum is of course a serious complication, he said.

Mr Jansson stated that at present, it is very difficult to assess the political and economic consequences of the outcome of the referendum. Initially, there were very strong reactions on financial markets. There were considerable fluctuations on stock exchanges, fixed-income and foreign exchange markets. But the most acute concern was short-lived and market functioning was not under any great threat. However, he underscored that a number of difficult questions remain to be dealt with and that there is always a possibility of new unease arising along the way. With regard to the effects on macroeconomic developments, the forecast in the draft Monetary Policy Report implies sizeable consequences for economic developments in the UK but more limited consequences for Sweden and other countries.[2] At the same time, the report points out

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[1] According to TNS Sifo Prospera, see http://www.prospera.se/inflation-expectations/.

[2] For a more detailed discussion, see the article "The result of the United Kingdom referendum on the EU creates uncertainty", Monetary Policy Report July 2016, pages 12-13.

that there is a risk of larger negative repercussions, but that these are at present difficult to quantify in a forecast. Mr Jansson felt that this approach, with a requirement for well-founded forecast revisions, is wise and the best route to take. In this situation, one must quite simply accept that further information is needed before one can make more definitive assessments, he said.

Mr Jansson went on to say that difficulties in assessing the consequences for the macroeconomy also mean, of course, complications when it comes to figuring out how monetary policy should react. But even if it is not possible right now to quantify the economic effects very precisely, it is clear that the result of the UK referendum is a negative event for Sweden and other countries, he reasoned. In Mr Jansson's view, it is thus also clear that the event, all else being equal, increases the probability of further monetary policy stimulus from the Riksbank. Possible measures include cutting the repo rate further, making supporting changes to the operational monetary policy framework, purchasing more securities and intervening on the foreign exchange market.

Mr Jansson emphasised that as far as the near term is concerned the Riksbank has already maximum preparedness to take further measures. This has been the case throughout 2015 and so far during 2016, and is also stated once again in the current draft Monetary Policy Report. He noted that the need to take further measures in the short term will of course be affected by how other central banks, primarily the ECB, the Federal Reserve and the Bank of England, choose to act.

With regard to the more long-term need for further monetary policy easing, the draft Monetary Policy Report draws the conclusion that it is at present appropriate to postpone the first increase in the repo rate somewhat and also to allow the repo rate to rise at a slightly slower pace than was forecast in April. According to Mr Jansson, it is possible that these changes in future monetary policy will prove insufficient to counteract the negative consequences of the result of the UK referendum. However, the Executive Board has ample opportunity to revise its policy response as the consequences for the forecast become clear. Given this background, he supported both the forecast and the monetary policy presented in the draft Monetary Policy Report.

Mr Jansson concluded with a few more specific comments on how the result of the referendum may affect the krona exchange rate and what this may mean in turn for monetary policy. Developments so far have been relatively favourable, with a weakening of the krona in competition-weighted terms. However, it is far from clear that the weakening will persist, he said. The forecast in the draft Monetary Policy Report is that the krona will strengthen gradually and in an orderly manner, and then around one year from now return to the path forecast in April. But this forecast is of course highly uncertain. If the strengthening were to be larger or faster than expected, it would worsen both growth prospects and conditions for attaining the inflation target. An important factor in this context is that the point of departure is now less favourable, as the Riksbank is assuming slightly lower growth and inflation than was forecast in April.

Given this, Mr Jansson believed it was good that the Executive Board is now taking the decision to extend the mandate that facilitates a quick intervention on the foreign exchange market. He said that this does not necessarily mean that he favours interventions on the foreign exchange market as the best means, or at least not as the only means of trying to counteract an overly large, or rapid, krona appreciation. Several of the Riksbank's empirical analyses indicate that a combination of different measures may often be mutually reinforcing. Therefore, foreign exchange interventions can have better chances of success if combined with, for instance, further cuts in the repo rate. Depending on circumstances, extended or broader purchases of securities may also be a good supplementary measure, claimed Mr Jansson.

Deputy Governor **Martin Flodén** began by supporting the proposal to hold the repo rate unchanged and to continue bond purchases during the autumn in accordance with the Riksbank's earlier plan. He also backed the draft Monetary Policy Report and the forecast contained within it. Mr Flodén pointed out that, like Mr Ingves, he had little to add to what was already in the draft report.

Mr Flodén continued by noting that the Riksbank has highlighted the referendum in the United Kingdom as an uncertainty factor prior to the most recent monetary policy meetings. He also noted that the uncertainty has unfortunately not abated despite the result of the referendum now being known. The only thing, according to Mr Flodén, that has become clearer after the vote is that there is no plan for how to deal with the result. This has since led to widespread economic, and, to an even greater degree, political uncertainty. This, off course, applies first and foremost to the UK economy, but also to the rest of Europe.

Mr Flodén also noted that monetary policy naturally cannot resolve the sources of this prevailing uncertainty. The challenges ensuing from the referendum must be dealt with politically. Before there is greater clarity, it is also natural and unavoidable, according to Mr Flodén, that fluctuations will occur on the financial markets. Central banks can, however, help to manage any acute disturbances to the functioning of the financial markets if the uncertainty causes such disturbances to occur. But so far, the markets have continued to function despite the increased uncertainty and resulting price volatility.

Furthermore, Mr Flodén pointed out that monetary policy may also need to react to the effects on economic activity and inflation resulting from the referendum, although it is, as said, uncertain what these will be. Especially in light of the situation in which Swedish monetary policy already finds itself, with the repo rate close to its effective lower bound, adjustment to the policy is presently not appropriate, according to Mr Flodén. In his view, it is probable, however, that the result of the referendum will lead to growth in Sweden and our neighbouring countries being somewhat lower in the coming years, and monetary policy abroad becoming somewhat more expansionary. It will then take a little longer before it is appropriate to raise the repo rate.

Mr Flodén also noted that the situation for banks in some euro countries is another uncertainty factor highlighted by the Riksbank for some time. He noted that the banks are not of course benefitting from recent revisions of growth prospects. That this is an impending problem is illustrated by sharply declining stock prices for many banks in the euro area. The economic recovery in the euro area is already being hampered by banking systems with structural problems and a weak capital base. If the problems deepen, the recovery may stagnate, according to Mr Flodén, and this could ultimately cause a slowdown in Swedish growth as well.

Mr Flodén also noted that, prior to the UK referendum, both the global and the Swedish economies had developed in line with the Riksbank's forecast in April. The Swedish inflation outcomes for April and May were marginally lower than in the Riksbank's forecast, but the recent trend of strong growth and rising inflation has nevertheless continued. If the spillover effects from the referendum to the euro area and Sweden are limited, as projected in the Riksbank's current assessment, Mr Flodén sees continued good conditions for Swedish inflation to rise towards the target over the next year or so.

Finally, Mr Flodén commented on the proposal for an extended mandate for interventions on the foreign exchange market. He is against the proposal and his justification is the same as when the previous delegation decisions were taken in January and February. Factors weighing on Mr Flodén's opposition to the decision are firstly that he considers the use of tools that only have an impact via the exchange rate to be dubious. This is particularly true since the Swedish economy is developing well in relation to our neighbouring countries, the krona is relatively weak and monetary policy abroad is also limited by the policy rate's lower bound. Any positive effects of a currency intervention on Swedish inflation are then probably offset by negative effects on inflation abroad. Secondly, Mr Flodén doubts the effectiveness of currency interventions. In his view, it would require extensive interventions over a long period of time to have a clear impact on the exchange rate. But this would entail considerable risks for the Riksbank's balance sheet and equity, particularly given that the krona is expected to strengthen somewhat over the coming years. Mr Flodén did not rule out a scenario where foreign exchange interventions are justified, but he does not think that the Swedish economy is close to such a scenario at this present time.

Deputy Governor **Henry Ohlsson** began by supporting the proposals to hold the repo rate unchanged at –0.5 per cent and change the repo rate path so that a first rate rise is postponed and subsequent rises take place at a slower pace. He also backed the proposal to extend the delegation of decision-making with regard to foreign exchange interventions.

Mr Ohlsson noted that the inflation rate was still showing an upward trend. The monthly outcomes are varying in an irregular manner; they are strongly affected by temporary factors. In some months, the outcomes are higher than expected, and in other months they are lower. The upward trend is still clear, however. The inflation target is a cornerstone of economic policy, but it is also important to realise that achieving it can take time, he said. The most recent outcome in June showed the expected annual rate of inflation five years ahead to be 2.0 per cent, according to money market participants. It is satisfying that inflation expectations are now back on the inflation target. The June outcome is the highest since November 2013. At the same time, he noted that inflation expectations one and two years ahead are below the inflation target, but also showing a rising trend. The June figures are 1.3 and 1.7 per cent respectively.

Mr Ohlsson also noted that GDP in Sweden is growing rapidly. Growth will be well over the historical average in the coming year according to the forecast in the draft Monetary Policy Report. Growth will also continue to be high in the following years. The labour force surveys (LFS) for May 2016 report an unemployment rate of 7.6 per cent (not seasonally adjusted). This indicates a continued declining trend in unemployment, which is a welcome development. According to Mr Ohlsson, however, unemployment is still too high. Overall resource utilisation in the Swedish economy is close to normal and expected to be even higher in the coming years. Inflation should rise as resource utilisation increases.

All these indicators taken together might suggest that monetary policy could be slightly less expansionary, Mr Ohlsson said. But then came the result of the United Kingdom referendum on membership of the European Union. The decision to leave the EU was unexpected and has therefore led to major shocks since the vote took place. His assessment is that Brexit will lead to permanently negative effects for the British economy. UK consumers' real purchasing power will decline in the long run.

The effects for other economies, however, will be more limited and temporary in the coming years, according to Mr Ohlsson. Initially, the financial markets reacted very negatively but many have since recovered.

At the same time, there are a number of weaknesses elsewhere in the global economy, weaknesses that, as a result of external shocks, can trigger economic problems. An example of such a weakness is the number of non-performing loans among many European banks. In a negative scenario, Brexit could have an indirect trigger effect and cause these weaknesses to turn into economic crises.

This, according to Mr Ohlsson, forces him to change his opinion of the direction of monetary policy in the coming years. In the current situation, he thinks that an initial repo rate rise must be postponed and that subsequent rate rises must occur at a slower pace than shown by the repo rate path adopted in April.

Too rapid an appreciation of the krona can threaten the chances of attaining the inflation target. Although monetary policy does not have a target for the exchange rate, developments in the exchange rate affect developments in inflation. Mr Ohlsson's assessment is that there are situations where interventions on the foreign exchange market are the best alternative to counteract a development where the krona appreciates too rapidly. Finally, Mr Ohlsson also supported the draft Monetary Policy Report.

Governor **Stefan Ingves** then summarised the discussion. He noted that the Executive Board agreed on the picture of economic development and the outlook for inflation described in the draft Monetary Policy Report. Uncertainty over economic developments abroad and in Sweden had increased after the United Kingdom EU referendum. It remains the Riksbank's assessment that the global economy is continuing to improve, but the forecasts for growth abroad and in Sweden have been revised down. International inflation is low and several central banks are expected to conduct a more expansionary monetary policy.

In Sweden, economic activity has strengthened rapidly. Activity is expected to continue to improve and that creates the conditions for inflation to keep on rising. Next year, CPIF inflation is expected to reach 2 per cent.

All in all, the Swedish economy has developed as expected since the monetary policy decision in April although uncertainty has increased. To maintain the rising trend in inflation, good economic growth in Sweden needs to continue. Several central banks abroad are, however, expected to pursue an even more expansionary monetary policy and the inflation forecast is sensitive to various international factors. Against this backdrop, the Executive Board drew the conclusion that monetary policy in Sweden needs to continue to be very expansionary.

The Executive Board agreed unanimously to hold the repo rate unchanged at −0.5 per cent and to continue to purchase government bonds in the second half of 2016 in line with the decision in April.

The increased uncertainty means that the entire Executive Board considers it appropriate to postpone the first repo rate increase somewhat. The rate is not expected to be raised until the second half of 2017, and then at a somewhat slower rate than was previously assessed. Until further notice, maturities and coupons from the portfolio of both nominal and real government bonds will be reinvested.

Against the backdrop of, not least, this increased uncertainty, the Executive Board was also unanimous as regards the importance of having a high level of preparedness to make monetary policy even more expansionary, even between ordinary monetary policy meetings, if this is needed to safeguard confidence in the inflation target. A majority of Executive Board members has therefore decided to extend the mandate for foreign exchange interventions adopted at the beginning of the year.

§3. Decision on the Monetary Policy Report and the repo rate

The Executive Board decided

• to adopt the Monetary Policy Report according to the proposal, Annex A to the minutes, and

• to hold the repo rate at -0.50 per cent.

§4. Decision on the mandate for foreign exchange interventions

Special minutes were taken.

§5. Other decisions

The Executive Board decided

• to publish the Monetary Policy Report and decisions under Sections 3 and 4, apart from Annex B to the special minutes, at 09.30 on Wednesday 6 July 2016 with the motivation and wording contained in a press release, and

• to publish the minutes of today's meeting on 19 July 2016, at 09.30.

Sections 3 - 5 were verified immediately.

Minutes taken by

Sophie Brauner

Verified by:

Stefan Ingves	Martin Flodén	Per Jansson
Kerstin af Jochnick	Henry Ohlsson	Cecilia Skingsley

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